

FTC Announces Rule Banning Non-Compete Agreements

On April 23, 2024, the Federal Trade Commission (“FTC”) issued a Final Rule that constitutes a comprehensive nationwide ban on non-competes, with certain limited exceptions. Under the Final Rule, existing non-competes for most employees will no longer be enforceable after the Final Rule’s effective date. The Final Rule applies retroactively, supersedes all state laws only to the extent that they are inconsistent with the Final Rule, and it is due to become effective 120 days after publication in the Federal Register.

What is a Non-Compete Clause Under the Rule?

The Final Rule defines “non-competes clause” as a term or condition of employment that prohibits a worker from, penalizes a worker for, or functions to prevent a worker from: (i) seeking or accepting work in the United States with a different person where such work would begin after the conclusion of the employment that includes the term or condition; or (ii) operating a business in the United States after the conclusion of the employment that includes the term or condition.

Does the Definition of “Non-Compete Clause” Encompass Other Restrictive Covenants?

In its summary of the Final Rule, the FTC notes that “non-disclosure agreements” and “non-solicitation agreements” “do not by their terms prohibit a worker from or penalize a worker for seeking or accepting other work or starting a business after they leave their job.” With respect to “non-solicitation agreements” specifically, the FTC explains that they generally are “not non-competes clauses under the Final Rule because, while they restrict who a worker may contact after they leave their job, they do not by their terms or necessarily in their effect prevent a worker from seeking or accepting other work or starting a business.”

However, the FTC does not go as far as to fully sanction the use of non-solicitation agreements and non-disclosure agreements. The FTC explains that these types of agreements can fall within the definition of “non-competes clause” if they are so broad or onerous that they have “the same functional effect” as a “non-competes clause.” With respect to NDA’s, the FTC notes that they may be non-competes where they span such a large scope of information that they function to prevent workers from seeking or accepting other work or starting a business after they leave their job. As for non-solicitation agreements, the FTC explains that “[w]hether a non-solicitation agreement—or a no-hire agreement or a no-business agreement...meets this threshold is a fact-specific inquiry.”

Should the Final Rule take effect, employers should anticipate disputes and numerous litigation surrounding the question of whether a non-disclosure agreement or non-solicitation agreement falls within the definition of a “non-competes clause” based on the “fact-specific inquiry” described by the FTC.

The Senior Executive Exception

The major exception to the Final Rule involves non-competes agreements with senior executives (defined under the Rule as workers earning more than \$151,164 annually and who are in “policy-

making positions”), which can remain in force under the Final Rule, but employers are banned from entering into or attempting to enforce any new non-compete agreements, even if they involve senior executives.

The Final Rule defines “policy-making position” as an employer’s president, CEO or equivalent officer, or any other person with “policy-making authority.” The term “policy-making authority” is defined as “final authority to make policy decisions that control significant aspects of a business entity or common enterprise.” “Policy-making authority” does not include authority limited to advising or exerting influence over such policy decisions or having final authority to make policy decisions for only a subsidiary of or affiliate of a common enterprise.

The Notice Requirement

Employers will be required to provide “clear and conspicuous notice” to employees, other than senior executives, who are bound by an existing non-compete agreement that they will not be enforcing any non-compete clauses against them. The notice must adequately identify the employee who entered into the non-compete and be delivered by hand, mail, email, or text message. The Final Rule provides “model language” that should “ease the burden of compliance” and “satisfy the notice requirement.” Use of the model language will provide a “safe harbor” for employers.

How Does the Final Rule Impact Existing Claims Against Former Employees?

Significantly, the Final Rule does not apply “if a cause of action related to a non-compete provision accrued prior to the effective date. This includes, for example, where an employer alleges that a worker accepted employment in breach of a non-compete if the alleged breach occurred prior to the effective date.” In other words, already pending litigation related to the breach of restrictive covenants that may fall within the definition of “non-compete clause” should not be impacted by the Final Rule. Similarly, if a cause of action for breach of a non-compete clause accrued prior to the effective date of the Final Rule, but an employer has yet to initiate litigation on the cause of action against the former employee, the employer may still do so.

The Final Rule Will be Subject to Legal Challenge

Immediately after the Final Rule was announced, the U.S. Chamber of Commerce announced its intent to “sue the FTC to block this unnecessary and unlawful rule and put other agencies on notice that such overreach will not go unchecked.” (<https://www.uschamber.com/finance/antitrust/u-s-chamber-to-sue-ftc-over-unlawful-power-grab-on-noncompete-agreements-ban>). Indeed, the Chamber of Commerce and several other business groups have already initiated suit against the FTC in Texas federal court on April 24, 2020⁴—a day after the FTC announced the Final Rule. Accordingly, while the Final Rule is due to become effective 120 days after publication in the Federal Register, the impending legal challenge is likely to further delay the effective date.

Esbroom P.C. will continue to monitor all developments related to the Final Rule and will provide additional updates as they become available.