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BLOG

FTC Adopts Final Ban on Worker Non-Competes

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On April 23, 2024, the U.S. Federal Trade Commission promulgated a final Rule banning non-compete clauses in contracts with employees and other workers (the Rule). The final Rule is set to become effective 120 days after publication in the Federal Register, although enforcement may be delayed by significant legal challenges seeking to invalidate the Rule. If the Rule becomes effective, it will invalidate millions of existing non-compete clauses nationwide and impose a sweeping ban on new non-competes, however, employers will still have a variety of tools to protect their business interests when workers depart.

Employers should be aware of several key features of the Rule and the evolving non-compete legal landscape:

- The Rule bans all **new** non-competes with workers of any kind, with very limited exceptions for non-compete agreements between the seller of a business and the purchaser.
- The Rule invalidates all **existing** non-competes with workers, other than senior executives who have final authority to make policy decisions that control significant aspects of a business entity or common enterprise (such as the CEO or other C-suite executives). For senior executives, although existing non-competes will remain enforceable, new non-competes will not be permitted. Existing non-competes can still be challenged on a case-by-case basis.
- Employers are required to provide notice by the effective date to affected workers that the non-compete agreements are no longer enforceable. The Rule provides model language that may be used for this purpose. Formal rescission of non-compete clauses or contracts is not required.
- The Rule contains a narrow exception allowing non-compete agreements between the seller of a business entity and the purchaser.
- “Workers” are broadly defined and include employees, independent contractors, and others who provide a service. However, franchisees in the context of a franchisee-franchisor relationship are not included.
- Several states already have non-compete bans or substantial restrictions, while other states permit and enforce non-competes. The FTC’s Rule would supersede most states’ laws and impose a nationwide ban.
- The Rule is scheduled to become effective 120 days following publication – on or around August 21, 2024. However, legal challenges are certain and there is a strong chance that implementation will be enjoined pending

resolution of the challenges.

- Other forms of restrictive employment agreements, including non-disclosure agreements, non-solicitation agreements, and training-repayment agreements are not subject to the blanket ban, provided they are not functionally equivalent of a non-compete. Employers anticipating the Rule becoming effective, or concerned about the legal uncertainty of court challenges, should review their worker agreements for non-competes that may be invalidated by the Rule and consider the available alternatives to protect their significant business interests when a worker departs.

Below, we discuss the Rule and its implications in greater detail. As the FTC acknowledges, the Rule would affect tens of millions of contracts with provisions that were valid when written, and significantly impact workers and businesses across the entire spectrum of American industry.

1. THE FINAL RULE LARGELY MIRRORS THE PROPOSED RULE, BUT CREATES A NEW EXCEPTION FOR SENIOR EXECUTIVES WITH EXISTING NON-COMPETES

A rule banning worker non-compete agreements was first proposed on January 5, 2023. (See here for an earlier post about the FTC's proposal). After receiving and reviewing 26,000 comments during the public comment period, the FTC voted to finalize the Rule at its April 23, 2024, meeting. In a 3-2 vote along party lines, the FTC adopted a Rule virtually banning all non-competes for all workers.

Once effective, the final Rule bans all new non-competes for all workers—including senior executives—as of the effective date. In a shift from the proposed rule, non-competes for senior executives existing at the time of the Rule's effectiveness remain enforceable. However, pre-existing non-competes with all other workers will be deemed unenforceable. However, employers will not be required to enter into new employment agreements if they contain a non-compete clause. Rather, to comply with the Rule, employers will generally need to stop enforcing existing non-competes (except for senior executives), provide notice to workers about the non-competes, and not seek any new non-competes (including for senior executives). To assist employers with providing sufficient notice, the FTC included model notice language in the Rule.

In general, the enforceability of appropriately tailored non-disclosure and non-solicitation restrictions, as well as agreements requiring workers to repay training expenses in connection with certain terminations, will not be affected by the Rule. However, if such restrictions are overly broad or restrictive to an extent that, as a practical matter, the restrictions function to prevent a worker from accepting competitive employment or starting a competitive business, they face potential challenges under the Rule.

2. LIMITED EXCEPTION FOR SALE OF A BUSINESS ENTITY

Except for existing agreements with senior executives, the Rule's ban extends to non-competition restrictions in all types of agreements with workers, including equity grant agreements, LLC/partnership agreements, and deferred compensation agreements (including so called forfeiture-for-competition provisions). The FTC retained in the final Rule an exception for a non-competition agreement "entered into by a person pursuant to a bona fide sale of a business entity, of the person's ownership interest in a business entity, or of all or substantially all of a business entity's operating assets." The FTC's commentary notes that "non-competes arising out of repurchase rights or mandatory stock redemption programs are not entered into pursuant to a bona fide sale" because "the worker has no good will that they are exchanging for the non-compete or knowledge of or ability to negotiate the terms or conditions of the sale at the time of contracting." The FTC otherwise expressly declined to delineate the types of "bona fide sales" that would qualify for the exception to the Rule's ban but did eliminate in the final Rule the 25% ownership interest threshold on such sale-of-business non-competition agreements found in the proposed rule. In its commentary, the FTC also notes that it declined to expressly exclude from the Rule "partners, shareholders, and similar groups [as they] are likely covered by the sale of business exception if they sell their share of the business upon leaving."

3. CERTAIN EMPLOYER TYPES ARE OUTSIDE THE FTC'S ENFORCEMENT JURISDICTION AND MAY NOT BE SUBJECT TO THE RULE

Certain nonprofits and federally regulated employers are also outside the FTC's enforcement authority under the FTC Act—notably banks, savings and loan institutions, common carriers, air carriers, and those subject to the Packers and Stockyards Act. *See* 15 U.S.C. §§ 44, 45(a)(2). The exclusion of nonprofits from the FTC's jurisdiction is particularly relevant for the many hospitals and healthcare systems that operate as non-profits.

However, at least some of these employers are still subject to enforcement of the FTC Act by other regulators. For example, the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Board (FRB), and the Office of the Comptroller of the Currency (OCC) can enforce Section 5 of the FTC Act and take appropriate action for violations pursuant to their authority under Section 8 of the Federal Deposit Insurance Act (FDI Act) against banks under the agencies' supervision and have historically looked to FTC policies and official interpretations for guidance. The FTC's official position in its commentary is that, "Whether other agencies enforce section 5 or apply the rule to entities under their own jurisdiction is a question for those agencies."

The FTC's commentary also addresses its nonprofit jurisdictional limitation in some detail and Commissioner Slaughter stressed this point orally at the Commission's meeting to vote on the Rule, acknowledging that many healthcare workers are not covered by the Rule. However, non-profit entities should note that the FTC's position is that an entity's corporate form and status under the Internal Revenue Code is not dispositive of whether the entity is within reach of the FTC's jurisdiction and the Rule. Rather, the FTC applies a unique test to determine whether the entity is in fact organized for a profit of the corporation or its members.

4. THE BUSINESS COMMUNITY IS ALREADY CHALLENGING THE RULE

The Rule faces immediate legal challenges. Indeed, in their respective dissents at the April 23 FTC meeting, Commissioners Holyoak and Ferguson noted several potential infirmities with the FTC's making efforts that will be challenged. Under the Administrative Procedure Act, parties challenging the Rule will file in federal district court over the next week or two. Ultimately, the cases will likely be consolidated for review by one of those courts. The parties will also request that the effective date of the rule be stayed (or delayed) while the court considers the challenges, which will likely take much longer than the 120 days currently considered for the Rule to become effective. Indeed, it may take more than a year for these initial challenges to be resolved.

One of the most vocal opponents to a potential ban of all non-competes has been the U.S. Chamber of Commerce. Shortly after the Rule was announced, the Chamber issued a statement vowing to challenge it and promptly filed suit in the Eastern District of Texas. The Chamber argues that the Rule may open the floodgates regarding making what they believe goes beyond the FTC's authority. Therefore, beyond the subject matter of the Rule itself, the Chamber is concerned with the FTC's untested power to regulate unfair methods of competition, a sentiment shared by Commissioners Holyoak and Ferguson. Officials at the Chamber of Commerce worry that a subset of commissioners can decide any business practice is an unfair method of competition, one that would ultimately be subject to a nationwide ban. The Chamber is also considering whether the U.S. Supreme Court's "major questions" doctrine addressed in *West Virginia v. EPA*, in which the Court said that broad legislative language is not enough to authorize regulations on significant national issues without clear congressional authority, can help to challenge the making. (See here for an earlier post about the major questions doctrine). Similarly, then-Commissioner Wilson had argued in her dissent to the proposed rule that the major questions doctrine would be a basis for challenging the making, as it would require the FTC to identify clear congressional authorization to impose a broad regulation banning non-compete clauses.

While the Chamber's legal suit is pending, any number of additional plaintiffs can seek legal action. Indeed, shortly after the FTC's announcement, another lawsuit was filed in the Northern District of Texas challenging the Rule. Plaintiff Ryan LLC, a global tax services firm, alleges that the FTC lacks substantive making authority and raises concerns under the major questions and nondelegation doctrines.

A court may enjoin the Rule, which would likely significantly delay when the Rule's bans on non-competes would become effective. The legal process can be long, and with a potential new administration being voted in later this year, it is uncertain whether or when the Rule will actually be enforced.

5. ALTERNATIVE MEASURES TO PROTECT CONFIDENTIAL AND TRADE SECRET INFORMATION, BUSINESS RELATIONSHIPS, AND OTHER BUSINESS INTERESTS

Regardless of the legal landscape surrounding non-compete agreements, employers may deploy other measures to safeguard their trade secrets, proprietary information, and other business interests, some of which were highlighted by the Commissioners who voted in favor of the Rule:

- **Non-Disclosure Agreements (NDAs) and Non-Solicitation Agreements:** The commentary around the Rule notes that appropriately tailored non-disclosure agreements and customer non-solicitation agreements are generally not prohibited. Employers should review their current use of such agreements and consider requiring new or amended agreements from workers to protect their trade secrets, customer relationships, and other legitimate business interests.
- **Training-Repayment Agreements**: Employers who invest in workers' training can require the worker to pay back the employer or a third-party entity for training costs if the worker's employment terminates within a specified time period, provided that the repayment is reasonably related to the costs the employer incurred to train the worker.
- **Confidentiality Policies and Training**: Employers can implement strict confidentiality policies outlining the handling of sensitive information and provide training to workers on how to properly safeguard trade secrets. This creates a culture of awareness and emphasizes the importance of confidentiality. Additionally, reinforcing restrictions in practice through employee policies and training can further solidify protection.
- **Restricted Access and Technological Safeguards**: To reduce the risk of theft of trade secret or confidential information, employers can limit access to sensitive information only to workers who need it to perform their job duties. Various technological safeguards can protect against the unauthorized access or theft of sensitive information, including passwords, data encryption, firewalls, file-tracking, and restrictions on data downloads or exports.
- **Leverage Other Laws**: The federal Defend Trade Secrets Act (DTSA) and similar state laws provide other protections for employers against trade secret misappropriate. To maximize protection under these laws, employers should ensure that their trade secrets are kept secret, engage in information protection practices that demonstrate their efforts to safeguard trade secrets, and include certain required notice provisions in agreements that govern the use of trade secret or other confidential information.
- **Effective Hiring and Exit Practices**: Having workers sign confidentiality and nondisclosure agreements, implementing proper training on trade secret policies, and conducting thorough exit interviews can bolster legal rights and create a culture where confidential information is respected and protected.

By implementing a combination of these and other strategies, employers can better safeguard their valuable information and other business interests without relying on the use of non-compete agreements. Even if the FTC's Rule is delayed or ultimately successfully barred, these alternative methods and strategies can help minimize risks of future enforcement and litigation for employers.

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