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ALERT

Federal Trade Commission Issues Final Rule Banning Most Non-Competes: What You Should Know

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WHAT HAPPENED: On Tuesday, April 23, 2024, the Federal Trade Commission (FTC) issued the Non-Compete Clause Rule (the "final rule" or the "rule"), which effectively bans the use and enforcement of non-compete agreements with limited exceptions.

FAST FACTS:

- In the final rule, the FTC determined that employers' entering into and enforcing certain non-competes with workers is an unfair method of competition and a violation of Section 5 of the FTC Act.
- The final rule will become effective 120 days after publication in the Federal Register. After that date, the federal non-compete ban will prohibit enforcement of non-competes in the U.S. with limited exceptions.
- Non-compete agreements that existed before the effective date of the final rule that were entered into between an employer and "senior executives" are exempt from the ban on enforcement of non-competes.
- Non-compete agreements concerning the sale of a business are also exempt from the ban on enforcing non-competes.
- The final rule requires employers to notify workers that existing non-compete agreements are no longer enforceable.

ANALYSIS:

Authors

Olaoluwaposi O. Oshinowo
Of Counsel
202.719.4275
ooshinowo@wiley.law

Duane C. Pozza
Partner
202.719.4533
dpozza@wiley.law

Practice Areas

Employment & Labor
FTC Regulation

The final rule is the culmination of years of rumblings concerning the enforceability of non-compete agreements nationwide. In 2016, then-Vice President Joe Biden urged the elimination of non-competes and then-presidential candidate Biden renewed his focus on non-compete agreements in a 2019 Time magazine article titled "Non-Compete Clauses Are Suffocating American Workers," accompanied by the following caption: "We should get rid of non-compete clauses and no-poaching agreements that do nothing but suppress wages." Biden explicitly called for federal action in the area on multiple occasions, and the FTC has targeted the area for a similarly lengthy period, including holding a public hearing on January 9, 2020, to examine whether there is a legal basis for creating a rule to restrict the use of non-compete agreements.

The FTC's January 2023 notice of proposed rulemaking announced a clear intention by the agency to use its rulemaking power to limit the use of non-compete agreements, and the final rule follows through on that announcement by prohibiting employers from entering into or enforcing a "non-compete clause" with "workers" on or after the final rule's effective date, which is 120 days from its publication in the Federal Register. The final rule would create a comprehensive ban on enforcing new non-compete agreements and certain agreements entered into before the effective date.

What does the final rule cover?

The final rule would apply to "workers," which the FTC broadly defines as "a natural person who works or who previously worked, whether paid or unpaid, without regard to the worker's title or the worker's status under any other State or Federal laws, including, but not limited to, whether the worker is an employee, independent contractor, extern, intern, volunteer, apprentice, or a sole proprietor who provides a service to a person."

The final rule defines a "noncompete clause" as "a term or condition of employment that prohibits a worker from, penalizes a worker for, or functions to prevent a worker from (1) 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 (2) operating a business in the United States after the conclusion of the employment that includes the term or condition."

Notably, the definition of a prohibited non-competition clause includes terms and conditions that might "require a worker to pay the penalty for seeking or accepting other work or starting a business after their employment ends." Accordingly, provisions in severance or other agreements that impose liquidated damages or require the forfeiture of some benefit if an individual engages in competitive activity are also prohibited under the final rule.

The final rule also generally prohibits any agreement that "functions to prevent" workers from seeking, accepting, or completing work after their employment ends. That broad language may require a close review of some non-solicitation, non-disclosure, or no-hire agreements that would not typically have been considered to function as a "non-compete clause" before issuing the final rule.

The final rule clearly demonstrates that the FTC intends to analyze all restrictive covenants on a case-by-case basis to determine whether they constitute an unfair method of competition.

A Limited Exception for Senior Executives

The final rule provides for a limited exception for non-compete agreements between an employer and a senior executive worker if the agreement is entered into before the rule's effective date. The FTC defines a "senior executive" as a worker who earns more than $151,164 annually and who is in a "policy-making position" as it relates to the entire business.

Sale of Business Exception

The final rule does not prohibit non-compete agreements entered into as part of a bona fide sale of a business, a person's ownership interest in a company, or all or substantially all of a business's operating assets.

Notice Requirement

The final rule requires employers to notify workers by the rule's effective date that their non-compete agreements with the employer will no longer be enforced. The notice must identify the employer who entered into the non-compete and must be delivered in writing by hand to the worker, by email at an email address belonging to the worker, by text message at a mobile telephone number that belongs to the worker, or by mail to the worker's last known home street address.

Legal Challenges on the Horizon

The final rule was issued after the five FTC Commissioners split along party lines in a 3-2 vote. The three Democrats on the Commission voted in favor of the final rule, while the two Republican Commissioners opposed it. The dissenting Commisioners' opposition lays a roadmap for the coming legal challenges. Republican Commissioners Andrew Ferguson and Melissa Holyoak raised multiple challenges that the final rule will likely face, including: (i) challenges to the FTC's authority to issue a binding rule concerning unfair competition based on the position that such power is reserved for Congress; (ii) challenges asserting that the final rule represents arbitrary and capricious decision-making violating the Administrative Procedure Act; and (iii) , ultimately, determining whether the "major questions" doctrine dictates that Congress, not agencies, must make significant policy decisions. *See West Virginia v. Environmental Protection Agency*, 597 US 687, 723 (2022) ("We presume that 'Congress intends to make major policy decisions itself, not leave those decisions to agencies.'").

The U.S. Chamber of Commerce has already announced its intention to oppose any rulemaking in this area by the FTC, and other trade organizations are sure to challenge this significant alteration to the business landscape. At least one challenge has already been filed in federal court. *See Ryan LLC v. Federal Trade Commission*, 3:24-cv-986 (N.D. Tex., April 23, 2024).

What Should You Do Next?

There is a significant amount of uncertainty concerning how long it may take to reach a conclusion in the various legal challenges that are pending and are to come. If the final rule is upheld, employers will need to move quickly to understand and comply with the full breadth of their notice obligations. Accordingly, now is a good time for businesses to review their existing non-compete clauses and other contractual provisions that could fit within the FTC's efforts to broadly prohibit clauses that restrict competition, including non-disclosure, confidentiality, proprietary rights, and non-solicitation agreements as well as provisions requiring employees to forfeit benefits or payments made on their behalf. Employers should also continue working with employment counsel to strategize the best methods for protecting their legitimate business interests, confidential information, and trade secrets.

Wiley is closely monitoring all relevant developments in this area and is ready to assist employers as they navigate the uncertainties created by the final rule.