Legal Update Article

Federal Trade Commission's Sweeping Final Rule to Ban Non-Competes: What You Need to Know

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On April 23, 2024, the Federal Trade Commission (FTC) issued its final rule prohibiting all non-compete agreements for all employees at all levels, with only extremely limited exceptions.

The FTC's much-anticipated action follows its January 2023 proposed rule and its review of over 26,000 public comments. Though approved 3-2 along party lines by the FTC, the final rule is not yet effective and legal challenges already are looming.

What does the final rule say?

The final rule broadly bans all true non-compete clauses. A non-compete clause is not just a contractual term but can include any workplace policy, whether oral or written. Section 910.1 defines "non-compete clause" as "[a] term or condition of employment that *prohibits* a worker from, *penalizes* a worker for, or *functions to prevent* a worker from" either seeking or accepting work after the conclusion of employment, or operating a business after the conclusion of employment.

The confusing "functional test for whether a contractual term is a non-compete" (referred to as the "de facto" test) that appeared in the January 2023 proposed rule has been eliminated. Still, the new definition of "non-compete clause" includes a term or condition that "functions to prevent" a worker from competing. As indicated in the 560 pages of "Supplementary Information" accompanying the final rule, it is possible that non-disclosure agreements, training repayment agreement provisions, and non-solicitation agreements that are overbroad and "function to prevent" a worker from seeking or accepting other work or starting a new business after employment ends could be barred by the final rule, depending on the precise language of the agreements and the surrounding facts and circumstances. Generally, garden variety non-solicitation clauses are not covered by the final rule.

Who is affected by the final rule?

All current and former workers, regardless of which entity hired or contracted with them to work and regardless of the worker's position, title, or status, are covered by the final rule. While the final rule prohibits new non-compete clauses for "senior executives" following the effective date, non-compete clauses entered into with senior executives prior to the effective date remain enforceable.

Under §910.2(a)(2), "senior executives" are workers who are in a "policy-making position" and earned at least $151,164 annually. A "policy-making position" means the CEO or any other officer of a business entity or person who has "policy-making authority." "Policy-making authority" means "final authority to make policy decisions that control significant aspects of a business entity or common enterprise," but it does not mean a person whose role is limited to advising or influencing such decisions.

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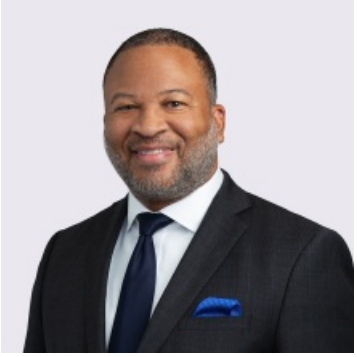

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Are there exceptions to the final rule?

The final rule expressly incorporates two limited exceptions where it does not apply. Under §910.3(a), the final rule does not apply to a non-compete clause in connection with the "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 proposed rule's requirement that the seller be an owner of 25 percent of the entity being sold has been eliminated in the final rule.

Section 910.3(b) adds a new exception, stating that the final rule does not apply "where a cause of action related to a non-compete clause accrued prior to the effective date."

Section 910.3(c) provides that it is not an unfair method of competition for a person to enforce or attempt to enforce a non-compete clause where the person has a good-faith basis to believe that the final rule is inapplicable.

Is there a notice requirement for workers?

Although the final rule does not contain a rescission requirement, employers must give notice to workers who entered into a non-compete clause that the non-compete provisions are unenforceable. The notice must identify the person who entered into the non-compete with the worker. Additionally, the notice must "be on paper," delivered by hand, by mail, by email, or by text message. Model language for the notice is provided in the final rule that employers may use.

What will happen now?

The final rule will become effective 120 days after publication in the Federal Register. If the final rule is deemed "significant" due to its economic impact or important policy implications, it undergoes a presidential-level review before being published in the Federal Register. Further, Congress and the Government Accountability Office will have an opportunity to review it before it takes effect. If both the House and Senate pass a resolution of disapproval and the president signs it, or if both houses override a presidential veto, the rule is void and cannot be reinstated in the same form without Congressional approval.

As anticipated, legal challenges to the final rule have already commenced. On the same day the rule was announced, Ryan, LLC, filed a lawsuit in the U.S. District Court for the Northern District of Texas seeking to vacate and set aside the final rule for reasons including (i) that the FTC does not have the authority to issue the rule and (ii) that the rule itself is unconstitutional. On April 24, 2024, the U.S. Chamber of Commerce filed its promised federal lawsuit in the U.S. District Court for the Eastern District of Texas, Tyler Division, seeking injunctive relief from FTC's enforcement of the final rule. An injunction would halt the enforcement of the final rule and (at a minimum) extend the effective date of enforcement.

What should employers do now?

Employers that use restrictive covenants understandably are nervous about the FTC's final rule. Importantly, it is not yet effective, and the legal challenges to it are significant.

What is important now is the same as what has always been important under the many

years of well-developed caselaw pertaining to non-compete clauses and other restrictive covenants. All restrictive covenants should be drafted narrowly to protect a legitimate business interest of the employer, such as trade secrets, confidential information, or customer goodwill. The restrictions themselves should be no broader than necessary to protect those legitimate interests, and they must be reasonable in terms of duration, geography, and scope of activities prohibited. Agreements should be drafted in a way to increase the likelihood that any provisions found to be unlawful can be severed from the agreement, leaving other restrictions intact. Finally, restrictive covenants generally should not be used with lower-level workers absent legitimate reasons to do so.

Employers should bear in mind, of course, that the final rule may ultimately become effective. If so, as noted above, all true non-competes will be barred, as well as clauses that function to prevent a worker from competing or penalize a worker for competing.

Jackson Lewis attorneys are available to discuss the rule and to assist with reviewing and revising restrictive covenant agreements.