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The FTC's Non-Compete Ban: Navigating the New Legal Landscape to Protect Your Business

Client Alert

4.24.2024

On April 23, 2024, the Federal Trade Commission (FTC) took a significant step in its nearly two-year battle against non-compete agreements by voting to ban such clauses. The rule, which passed in a 3-2 vote along party lines, not only prevents employers from entering into new non-compete agreements but also prohibits them from enforcing existing non-compete clauses against employees, independent contractors, or any individual who does work for a person.

The FTC rule defines non-compete agreements as any clause that prohibits, penalizes, or prevents 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. This definition is very broad and has limited and temporary exceptions.

Exception for "Senior Executives"

The final rule includes a narrow exception that grandfathers in existing non-compete agreements with certain high-level employees classified as "senior executives," defined as those earning over \$151,164 annually and holding positions with significant policy-making authority. This exception applies only to agreements entered into before the rule's effective date; once the rule takes effect, employers will be prohibited from entering into new non-compete agreements, even with senior executives.

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In addition to the senior executive exception, the new rule includes exceptions related to the bona fide sale of a business and existing causes of action. The bona fide sale exception allows individuals purchasing ownership of a business to prohibit the seller of the business from then competing against the entity they just sold. The FTC declined to limit the exception to situations where the seller of a business owns 25% or more of the entity. Instead, the rule imposes a good faith requirement for non-compete agreements related to the sale of the business. The good faith requirement prevents employers from using a sham transaction as an end around to the non-compete ban.

The second exception clarifies that the FTC rule does nothing to causes of action that accrued prior to the effective date of the rule. Essentially, the FTC rule cannot be used as a get out of jail free card for those that have already violated an existing non-compete agreement. Lastly, there is also an exception for situations where a person has a good faith basis to believe the ban is inapplicable, but this exception will rarely apply.

Required Notice to Workers

Not only are employers prohibited from enforcing non-compete agreements with workers, but they must also notify workers of the FTC's new rule. Specifically, the rule requires employers to notify all workers with a non-compete "that the worker's non-compete clause will not be, and cannot legally be, enforced against the worker." The FTC included a sample notice in the final rule, but employers are not required to use that form. However, any notice must:

- (i) Identify the person who entered into the non-compete clause with the worker;
- (ii) Be on paper delivered by hand to the worker, or by mail at the worker's last known personal street address, or by email at an email address belonging to the worker, including the worker's current work email address or last known personal email address, or by text message at a mobile telephone number belonging to the worker.

This notice requirement applies to all workers that are bound by an existing non-compete agreement, including former employees.

Non-Disclosure Agreements and Other Protective Measures

The final rule offers guidance on the permissibility of Non-Disclosure Agreements (NDAs) in light of the new restrictions on non-compete clauses. Employers may continue to utilize NDAs, but they must ensure that these agreements are not so expansive as to effectively prevent a former employee from working in the same industry. It is advisable for employers to carefully examine their existing NDAs to confirm that they offer the necessary protections without violating the new FTC rule.

In addition to NDAs, employers may consider implementing various other protective measures to safeguard their legitimate business interests, such as:

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- Non-solicitation agreements that prohibit former employees, for a reasonable period, from soliciting the company's clients or attempting to recruit its current employees;
- Invention assignment agreements that give employers certain rights to inventions created by employees created during the course of their employment; and
- Well-developed trade secret protection policies that establish clear processes for identifying, designating, and securing trade secrets, as well as enforcing the company's rights in the event of misappropriation.

These alternative protective measures, when properly crafted and implemented, can help mitigate the potential risks associated with the loss of non-compete agreements while still providing a level of protection for the company's valuable assets and relationships.

Effective Date and Potential Litigation

The FTC's non-compete rule is set to take effect 120 days following its publication in the Federal Register. However, the rule's implementation is not certain, as the U.S. Chamber of Commerce has announced its intention to challenge the FTC's action in court. Ryan, LLC, the global tax services company, filed a case against the FTC by the day's end. Other organizations will follow suit and seek injunctive relief from the courts. The fate of the rule likely rests in the hands of the Supreme Court and potentially the outcome of the upcoming Presidential election. Employers should closely monitor these legal developments to ensure they are prepared to adapt their policies and practices accordingly.

Key Takeaways for Employers

While the FTC's non-compete ban faces legal challenges, employers should prepare for the potential impact of the rule. Consider the following steps to protect your company's trade secrets, confidential information, customer relationships, and workforce:

1. Review your employment agreements: Employers should carefully examine their existing employment contracts and identify any non-compete clauses that may be impacted by the rule. Be prepared to cease using these clauses and notify affected employees of their unenforceability within 120 days of the rule's publication. However, refrain from taking action until absolutely necessary, as legal challenges may alter the rule's implementation.
2. Implement alternative protective measures: Employers should proactively consider implementing alternative measures to protect their legitimate business interests. These may include well-crafted non-solicitation agreements, NDAs, and robust trade secret protection policies.
3. Stay informed about legal developments: With legal challenges to the FTC's rule already starting, employers must remain vigilant and stay apprised of any litigation that could impact the rule's enforceability. Regularly monitor legal updates and adjust your company's policies and practices accordingly.

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Butzel's Non-Compete & Trade Secret Team will be diligently monitoring the new FTC rule and the associated litigation to block the new rule. If you have questions or comments about the new rule or its impact on the agreements with your workforce, please contact the authors of this article or your Butzel attorney for further guidance.

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