FTC Bans Employee Non-Compete Agreements

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On April 23, 2024, the Federal Trade Commission (FTC) announced a new rule that "[i]t is an unfair method of competition—and therefore a violation of Section 5 of the FTC Act—for employers to enter into non-compete clauses with workers." As a result, the final rule generally bars most non-compete agreements. This means most existing non-compete agreements will be unenforceable, and employers will be prohibited from creating new agreements once the rule becomes effective. There are some narrow exceptions, which are discussed below. The rule also requires employers to provide notice to workers impacted by the rule. Importantly, however, the final rule is already being challenged in court, which may delay, and could potentially invalidate the rule entirely.

What does the FTC final rule say?

The final rule defines a "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: (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."

The rule states:

- With respect to a worker other than a senior executive, it is an unfair method of competition for a person (i) to enter into or attempt to enter into a non-compete clause; (ii) to enforce or attempt to enforce a non-compete clause; or (iii) to represent that the worker is subject to a non-compete clause.
- With respect to a senior executive, it is an unfair method of competition for a person (i) to enter into or attempt to enter into a non-compete clause; (ii) to enforce or attempt to enforce a non-compete clause entered into after the effective date; or (iii) to represent that the senior executive is subject to a non-compete clause, where the noncompete clause was entered into after the

effective date.

This means the rule invalidates most preexisting non-compete agreements and bans nearly all future non-compete agreements (except for the limited exceptions discussed below).

What "workers" are covered by the final rule?

The final rule broadly defines "worker" to include a natural person who is an employee, independent contractor, extern, intern, volunteer, apprentice, a sole proprietor who provides services to a person, and a natural person who works for a franchisee or franchisor (this does not include a franchisee in the context of a franchisee-franchisor relationship). Under the final rule, it does not matter whether the worker was paid or unpaid, their title, or their status under state or federal law (e.g., part-time, full-time, exempt, non-exempt, temporary, seasonal, etc.).

Who is a "senior executive" under the final rule?

Senior executives remain subject to existing non-compete agreements. However, new non-compete agreements are prohibited after the final rule's effective date.

A "senior executive" is a worker who was in a "policy-making position" and who was paid at least "total compensation" of at least (1) $151,164 in the preceding year; (2) $151,164 when annualized if the worker was employed only part of the year; or (3) $151,164 when annualized if the preceding year before the worker's departure if they left employment before the preceding year and is subject to a non-compete. Total compensation includes salary, commissions, nondiscretionary bonuses, and nondiscretionary compensation. It does not include the cost of any fringe benefits.

The final rule limits those who are deemed to be in "policy-making positions" to a business's president, chief executive officer or equivalent, and the business's officers and natural persons who have "policy-making authority." "Policy-making authority" is limited to the "final authority to make policy decisions that control significant aspects of a business entity or common enterprise." It does not include advising on policy decisions. Nor does it include having final authority over policy decisions "for only a subsidiary or affiliate of a common enterprise."

What notice must be given to workers who have non-compete agreements?

The final rule requires that the person who entered the non-compete agreement with the worker provide "clear and conspicuous notice" to the worker that the non-compete "will not be, and cannot legally be, enforced against the worker." The notice must be provided by the rule's effective date by hand delivery, mail, email, or text message.

Are there exceptions to the final rule's ban on non-compete agreements?

The final rule provides three exceptions. First, the rule does not apply to a non-compete agreement that is entered into by a person in a *bona fide* sale of a business, of the person's ownership interest in a business, or of all a business's operating assets. Second, the rule does not apply "where a cause of action related to a non-compete clause accrued prior to the effective date." This means current litigation to enforce a non-

compete is not subject to the final rule. Third, it is not a violation of the final rule to enforce or attempt to enforce a non-compete agreement or to make representations about a non-compete agreement where the person has a good faith basis to believe the final rule does not apply.

Does the final rule apply to nondisclosure agreements, non-solicitation agreements, and repayment agreements?

Generally, these sorts of agreement are outside the final rule if they otherwise comply with state law and are not so broad as to function as a non-compete the rule prohibits. The FTC's commentary explains that nondisclosure agreements, non-solicitation agreements, and training repayment agreements "do not by their terms prohibit a worker or penalize a worker for seeking or accepting other work or starting a business after they leave their job." Whether such an agreement violates the rule would require a case-by-case adjudication.

Does the final rule preempt state laws that regulate non-compete agreements?

Several states already ban or restrict non-compete agreements for all or some employees, such as those earning below a certain income level or working in certain industries. The FTC final rule generally does not preempt state statutes, regulations, or common law that apply to noncompete agreements to the extent state law (1) does not otherwise permit or authorize a person to engage in conduct that would violate the final rule; and (2) does not conflict with the final rule's notice requirement. Additionally, the FTC rule does not limit the authority of a state attorney general or the right of individual to bring a claim under state law.

What happens next?

The final rule will become effective 120 days after it is published in the Federal Register. However, the rule is already being challenged in court. Today, the U.S. Chamber of Commerce filed suit against the FTC in the U.S. District Court for the Eastern District of Texas. We expect this litigation will at least delay, and could potentially invalidate, the rule. We will report on significant developments. In the interim, contact your Vorys lawyer if you have questions about the FTC rule.