

Federal Trade Commission Prohibits Nearly All Non-Compete Agreements

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On April 23, 2024, the Federal Trade Commission (FTC) voted 3-2 to approve the Final Rule that (1) prohibits employers from entering into non-compete agreements with workers and (2) requires employers to rescind nearly all existing non-compete agreements. The Final Rule is effective 120 days after its forthcoming publication in the Federal Register, which we expect will happen in the next 30 days.

The Final Rule comes more than a year after the FTC issued a Notice of Proposed Rulemaking (the "Proposed Rule") to ban practically all non-compete agreements. The FTC reasons that banning non-compete agreements will result in reduced healthcare costs, new business formations, a rise in innovation, and higher worker earnings. During its 90-day public comment period, the FTC received more than 26,000 comments with many proponents for and against the prohibition on non-compete agreements. The Final Rule is nearly identical to the Proposed Rule.

The FTC Final Rule

The Final Rule provides that it is an "unfair method of competition" – and therefore a violation of Section 5 of the Federal Trade Commission Act of 1914 ("FTC Act") – for employers to enter into non-compete agreements with workers on or after the Final Rule's effective date. Accordingly, the FTC adopted a "comprehensive ban" on new non-compete agreements with *all* workers (including employees and independent contractors).

The Final Rule also sets forth the following broad definitions:

- "Non-compete clause" is defined 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."
- "Term or condition of employment" includes, but is not limited to, "a contractual term or workplace policy, whether oral or written."
- "Employment" is "work for a person" – "person" meaning any "natural person, partnership, corporation, association, or any legal entity, including any person acting under color or authority of State law."
- "Worker" is defined 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."

Under the Final Rule, existing non-compete agreements for senior executives can remain in force, but employers cannot enter into non-compete agreements with senior executives after the Final Rule's effective date. The Final Rule defines "senior executives" as workers earning more than \$151,164 annually and who are in "policy-making positions." ^[1]

The Final Rule's Notice Requirements for Existing Agreements

With respect to *existing* non-compete agreements, *i.e.*, non-compete agreements entered into *before* the Final Rule's effective date, the majority of such agreements are unenforceable after the Final Rule's effective date. The Final Rule directs employers to provide workers with existing non-compete agreements notice that such agreement is no longer enforceable. Employers may provide notice by personal service, via mail to a last known address, email, or text message. The FTC has also provided a model notice form for employers to use.

Exceptions to the Final Rule

The Final Rule does not apply in limited instances, such as non-compete agreements entered into by a person pursuant to a *bona fide* sale of a business entity, franchisee/franchisor contracts, and where a cause of action related to a non-compete agreement accrued prior to the Final Rule's effective date.

In addition, the Final Rule does not limit or affect enforcement of state laws that restrict non-compete agreements where the state laws do not conflict with it. On the other hand, the Final Rule *preempts or supersedes* state laws that conflict with it, which would include *most* jurisdictions. Employers who need guidance as to whether existing state law may conflict with the Final Rule should consult with counsel. Thinking ahead to the anticipated legal challenges, the Final Rule also includes a "severability clause" clarifying the FTC's intent that, if a reviewing court were to hold any part of any provision or application of the Final Rule invalid or unenforceable, the remainder of the Final Rule shall remain in effect.

Challenges to the Final Rule

When the Proposed Rule was issued in January 2023, it was quickly emphasized that a ban on non-compete agreements was a "radical departure from hundreds of years of legal precedent that employs a fact specific inquiry into whether a non-compete clause is unreasonable in duration and scope, given the business justification for the restriction." Then-FTC Commission Christine S. Wilson noted that any Final Rule would "certainly" be challenged and that the Proposed Rule was "vulnerable to meritorious challenges..." Particularly, the FTC lacks authority to engage in "unfair methods competition" rulemaking, the FTC lacks clear Congressional authorization to undertake this initiative (the major questions doctrine), and, assuming it possesses the requisite authority, it is an impermissible delegation of legislative authority under the non-delegation doctrine.

The same day the Final Rule was approved by the FTC on April 23, 2024, a Complaint was filed in the Northern District of Texas seeking entry of an order and judgment, *inter alia*, vacating and setting aside the Final Rule, declaring that the FTC does not have authority to issue rules defining acts to be unfair methods of competition, and declaring that Section 5 of the FTC Act violates the Constitution's non-delegation doctrine. In their opposition, the petitioner argues that, "if ever a federal agency attempted to pull an elephant out of a mousehole, that is it."

The U.S. Chamber of Commerce also announced that it "will sue the FTC to block this unnecessary and unlawful rule and put other agencies on notice that such overreach will not go unchecked." On April 24, 2024, the U.S. Chamber of Commerce, Business Roundtable, Texas Association of Business, and the Longview Chamber of Commerce filed a Complaint for Declaratory and Injunctive Relief. The petitioners seek entry of an order and judgment, *inter alia*, declaring the Final Rule arbitrary, capricious, or otherwise contrary to the Administrative Procedure Act, vacating and setting aside the Final Rule in its entirety, permanently enjoining the FTC from enforcing the Final Rule, and issuing a delay to the effective date of the Final Rule pending the conclusion of the case.

Practical Guidance for Employers

With the outcome of the challenges to the regulation not certain, employers should consider steps to comply with the Final Rule. Specifically, by the Final Rule's effective date, employers should provide any required notice to affected current and former workers (except exempted senior executives). Employers should also consider consulting with counsel to determine whether restrictive covenants in employment contracts, such as non-solicitation or non-disclosure provisions, should be updated to protect the employer's intellectual property and goodwill, among other interests.

Members of the Labor and Employment Group at White and Williams LLP are available to assist employers with questions relating to compliance with the new Final Rule. If you have questions, please contact Nancy Conrad (conradn@whiteandwilliams.com; 610.782.4909), Scott H. Casher (cashers@whiteandwilliams.com; 475.977.9316), R. Victoria Fuller (fullerv@whiteandwilliams.com; 617.748.5223), Laura H. Corvo (corvol@whiteandwilliams.com; 201.368.7226), Joseph M. Carr (carrj@whiteandwilliams.com; 610.782.4907), or another member of the Labor and Employment Group.

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^[1] The Final Rule defines "policy-making position" as "a business entity's president, chief executive officer or the equivalent, any other officer of a business entity who has policy-making authority, or any other natural person who has policy-making authority for the business entity similar to an officer with policy-making authority." "Officer" is defined as "a president, vice president, secretary, treasurer or principal financial officer, comptroller, or principal accounting officer, or any natural person routinely performing corresponding functions with respect to any business entity incorporated or unincorporated." To account for differences in the way business entities may use and define job titles, the definition includes workers in equivalent roles. "Policy-making authority" is broadly defined as "final authority to make policy decisions that control significant aspects of a business entity or common enterprise" and does not include authority "limited to advising or exerting influence over such policy decisions or having final authority to make policy decisions for only a subsidiary of or affiliate of a common enterprise."

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