Tucker Ellis LLP

What Employers Need to Know About FTC's Final Rule Banning Non-Compete Agreements

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On April 23, 2024, the Federal Trade Commission (FTC) issued its watershed Final Rule, which purports to nullify nearly all existing post-employment non-compete agreements between employers and employees (excluding senior executives). It also bans all new post-employment non-compete agreements in employment (including those with executive level employees). The FTC plans for the Rule to take effect as early as late August 2024 (120 days from publication of the Rule in the *Federal Register*), but it already faces several legal challenges. In short, employers do not need to scrap their non-competes just yet.

Background

The FTC has rulemaking authority "to issue industry-wide regulations [] to deal with common unfair or deceptive practices and unfair methods of competition." In response to a 2021 executive order issued by the Biden Administration, the FTC announced its intent to "address conduct that harms fair competition" and took aim at the use of non-compete agreements in employment. Based on the conclusory findings of three "empirical studies," the FTC found that non-competes "harm competitive conditions in labor, product, and service markets." The Commission further noted that "the evidence of harms has increased substantially in recent years" – but it did not cite the source(s) of that evidence. Notwithstanding, the FTC estimated that banning non-compete agreements would "lead to new business formation," "result in higher earnings for workers," and "lower health care costs by up to $194 billion over the next decade." The FTC initially proposed the rule banning non-competes in January 2023.

The Final Rule

The Final Rule – which passed by a 3-2 vote along partisan lines – is nearly identical in substance to the initial version proposed last year. The Rule has two key components:

- After the Rule's "effective date" (120 days from its publication in the *Federal Register*, which has not occurred yet), all *new* post-employment non-compete agreements between employers and employees (including executive-level employees) will be banned; and
- After the "effective date," all *existing* post-employment non-compete agreements between employers and employees will be unenforceable, *except* for existing non-compete agreements with "senior executives." The Rule defines "senior executive" as "a worker who was in a policy-making position" and "received total annual compensation of more than

$151,164."

The Rule applies to independent contractors as well. Since the FTC's authority extends only to for-profit businesses, the Final Rule will *not* affect non-compete agreements between employees and non-profit organizations. The Rule also allows an exception for agreements executed in conjunction with the sale of a business, of the person's ownership interest in a business entity, or of all or substantially all of a business entity's operating assets. The Rule also excludes agreements between franchisees and franchisors. Note, however, that the ban *will* apply to employees working for a franchisee or franchisor. While employers do not need to formally rescind existing non-competes, they will need to notify workers with non-competes (excluding senior executives), on or before the effective date, that their non-competes are unenforceable. The entire Final Rule can be found on the FTC website here.

Enforceability of other employment agreements

The Final Rule does not affect agreements (or company policies) prohibiting employees from engaging in competitive activities *during* their employment. The Rule also does not prohibit so-called "garden leave agreements," which restrict competitive activities during a paid, mandatory notice period. However, post-termination paid non-compete periods are banned under the Final Rule. Finally, the Rule does not invalidate confidentiality and non-solicitation agreements, provided that they do not "prohibit, penalize, or function to prevent a worker from switching jobs or starting a new business."

What employers need to do (now)

As mentioned above, the Final Rule is already being challenged, as it reflects an unprecedented exercise of the FTC's administrative agency power. On April 24, the U.S. Chamber of Commerce filed a lawsuit against the FTC in federal court (Eastern District of Texas). The FTC can expect similar lawsuits in other jurisdictions. It is very likely that one or more federal courts will enjoin implementation of the Final Rule until courts decide its constitutionality. The issue may make its way to the U.S. Supreme Court.

The FTC's Final Rule is far from "final." Employers are not required to change or discontinue their current practices now. Employers should, however, have a plan in place if the Final Rule does take effect. Existing non-compete agreements and other restrictive covenants should always be narrowly tailored to comply with state-specific laws, and many states have revised non-compete laws in recent years. Agreements should be carefully drafted to avoid challenges to enforceability. As a matter of practice, employers should utilize comprehensive non-disclosure agreements and similar policies whenever possible to protect confidential information and trade secrets. These agreements will be crucial if the Final Rule does go into effect.

Additional Information

For more information, please contact:

- Melissa Z. Kelly | 216.696.2067 | melissa.kelly@tuckerellis.com
- Gregory P. Abrams | 312.256.9444 | gregory.abrams@tuckerellis.com
- Christine M. Snyder | 216.696.5593 | christine.snyder@tuckerellis.com
- Ndubisi (Bisi) A. Ezeolu | 213.430.3239 | ndubisi.ezeolu@tuckerellis.com
- Matthew A. Boyd | 404.678.6365 | matthew.boyd@tuckerellis.com
- Ronald G. Polly, Jr. | 404.678.6364 | ron.polly@tuckerellis.com
- Alex M. Barfield | 404.678.6366 | alex.barfield@tuckerellis.com
- Christine A. Kurke | 404.678.6367 | christine.kurke@tuckerellis.com
- Breshauna Perkins | 404.678.6368 | breshauna.perkins@tuckerellis.com