

BREAKING NEWS: The FTC's New Rule Invalidates Most Non-competition Clauses

April 24, 2024

On April 23, 2024, the Federal Trade Commission ("FTC"), in a 3-2 vote, approved a final rule that renders existing non-competition agreements for employees working in for-profit businesses unenforceable, with the exception of non-competition agreements for "senior executives" in place before the effective date of the final rule ("Final Rule"). The Final Rule upends a long-standing business practice of using non-competition agreements to protect an employer's interests. Businesses should be poised to respond immediately.

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 (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."* The Final Rule further provides, *"term or condition of employment"* includes, but is not limited to, a contractual term or workplace policy, whether written or oral. The Final Rule further defines *"employment"* as *"work for a person."*

This rule, when in effect, means the only non-competition agreements that will remain enforceable are those governing senior executives that were signed before the effective date. According to the Final Rule, senior executives refers to workers earning more than \$151,164 annually who are in policy-making positions. The effective date will be August 21, 2024. Employers are prohibited from requiring non-competition agreements from new hires even if they are senior executives.

Additionally, the Final Rule requires employers to notify employees and former-employees who have entered into non-competes that their agreements will not be enforced.

Importantly, the Final Rule does not apply to non-competes entered into by a person pursuant to a bona fide sale of a business entity. In addition, the Final Rule does not apply where a cause of action related to a non-compete accrued prior to the effective date, meaning pending enforcement actions remain unaffected.

Although the Final Rule has not been interpreted by any court yet, it is important to note:

- The definition of "worker" is broad enough that this rule applies to employees, independent contractors, externs, interns, volunteers, apprentices, and even sole proprietors providing services;
- The FTC does not normally have jurisdiction over non-profit businesses, banks, savings and loan institutions, federal credit unions, common carriers, and air carriers, meaning it is likely the Final Rule does not apply to workers in these industries;

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- The FTC's definition of "*non compete clause*" does not necessarily apply to agreements prohibiting employees from soliciting customers or other employees, unless the agreement is so broad as to prevent a worker from seeking or accepting work or operating a business;
- Agreements protecting trade secret and other confidential information, such as non-disclosure agreements, remain enforceable;
- The Final Rule applies to post-employment non-compete agreements and does not impair agreements that restrict competitive activities during the course of employment; and
- The Final Rule supersedes state laws to the extent that they are in conflict, but does not supersede state laws that are more protective (e.g., California's law banning non-competes even for senior executives).

Employers should expect hard-fought challenges to the Final Rule to make their way through the court system. This may include a stay delaying the effective date of the Final Rule. Since the FTC commissioners are nominated by the President and confirmed by the Senate, each serving a seven-year term, the outcome of the 2024 presidential election may also influence how the FTC responds to challenges and whether the Final Rule is maintained.

For now, employers should immediately work with employment counsel to develop a strategy to plan for the Final Rule, including (i) strengthening other restrictive covenants (e.g., non-solicitation prohibitions) and proactively develop an approach for addressing the potential risks that the implementation of the Final Rule may impose; (ii) weighing how this Final Rule may influence valuation for mergers or acquisitions when employees may more freely compete; and (iii) considering options to strengthen or introduce agreements for senior executives before the effective date.

ATTORNEYS MENTIONED

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