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ISSUE ALERTS

FTC ISSUES FINAL RULE BANNING NON-COMPETE AGREEMENTS

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On April 23, 2024, in a divided 3-2 decision, the Federal Trade Commission ("FTC") voted to approve a final rule to ban non-compete agreements nationwide in the name of promoting competition, "protecting the fundamental freedom of workers to change jobs, increasing innovation, and fostering new business formation." The final rule will become effective 120 days after publication in the Federal Register, toward the end of August.

Yet, less than 24 hours after the FTC voted to effectively ban non-compete agreements, the U.S. Chamber of Commerce has already filed a lawsuit in a Texas federal court arguing that the final rule exceeds the FTC's authority. If the Chamber's legal challenge and the barrage of other legal challenges expected to come are unsuccessful, here is what employers need to know:

- After the effective date, employers are prohibited from entering into new non-compete agreements.
- Non-compete agreements entered into before the effective date are unenforceable—with the exception of non-compete agreements with senior executives.
- While there are no "de facto" non-compete agreements, if the agreement functions to prevent an employee from seeking or accepting work or operating a business after the conclusion of employment, it is prohibited.
- Prior to the effective date, employers must provide notice to employees other than senior executives that their non-compete agreement is unenforceable.

WHAT DOES THE FINAL RULE SAY?

The FTC issued the rule after determining that non-compete agreements are an unfair method of competition and therefore a violation of Section 5 of the FTC Act. The final rule precludes employers from entering or trying to enter into new non-compete agreements with employees, from representing that an employee is subject to a non-compete clause, and from enforcing existing non-competes—with the exception of existing non-competes with "senior executives."

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WHAT ARE NON-COMPETE AGREEMENTS?

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 proposed rule included language about "de facto" non-compete agreements such as overly restrictive non-solicitation or non-disclosure agreements or contractual terms that require an employee to reimburse the employer for training costs if employment ends within a certain amount of time. The interpretive guidance refers to such agreements as "functional non-competes," which meet the above definition and would therefore be unenforceable.

WHAT EMPLOYEES DOES THIS APPLY TO?

The rule covers all employees and also includes independent contractors, externs, interns, volunteers, apprentices, or sole proprietors who provide a service to a client or customer.

The final rule, however, includes one major exception for senior executives. Employers are allowed to continue to enforce, attempt to enforce, and represent that a senior executive is subject to an *existing* non-compete agreement. After the effective date, however, even for senior executives, employers will not be able to enter into new non-compete agreements.

Senior executives are defined as employees in a "policy-making position" who received at least $151,164 in annual compensation over the preceding calendar, fiscal, anniversary, or 52-week year. Policy-making positions include president, chief executive officer, secretary, principal financial officer, comptroller, or the equivalent with policy-making authority. The authority must be "final authority to make policy decisions that control significant aspects" of the business, not just limited authority to advise or exert influence over policy decisions, or only having final authority on policy decisions for a subsidiary or affiliate entity.

ARE THERE OTHER EXCEPTIONS?

There are three circumstances where non-compete agreements would be allowed: (1) when they stem from the bona fide sale of an entity, a person's ownership interest, or substantially all of a business's operating assets, (2) for existing causes of actions to enforce non-compete clauses, (3) where a person has a "good-faith" basis to believe that the non-compete ban is inapplicable. The final rule also excludes franchises in a franchisee-franchisor relationship under the definition of "worker."

WHAT ARE THE NOTICE REQUIREMENTS FOR EXISTING AGREEMENTS?

For existing non-compete agreements, except with senior executives, the new rule would require employers to give "clear and conspicuous notice" in writing to employees and former employees that their non-compete agreements "will not be, and cannot legally be, enforced." The FTC has provided model language. There is no longer the requirement that employers formally "rescind" the non-compete agreements. The only exception to the notice requirement is if the employer has no record of a street address, email address, or mobile number to provide such notice.

WHAT IS NEXT FOR EMPLOYERS?

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Employers should keep an eye on the U.S. Chamber of Commerce's lawsuit filed in the U.S. District Court for the District of Texas. A court may issue an injunction preventing the FTC from enforcing the final rule, but the timeline of such a ruling is unclear.

If the courts allow the final rule to go into effect in August, existing non-compete agreements (other than those of senior executives) will be unenforceable. Between now and August, employers should take two important steps toward compliance:

1. Employers should identify those non-senior-executive employees with existing non-compete agreements and draft notice language.
2. Employers should also proactively consider alternatives to protecting their organization's legitimate business interests in the event their non-compete agreements are no longer enforceable. Employers should consider including other restrictive covenants, such as confidentiality and non-solicitation clauses. Employers should work with legal counsel to ensure they are framed in such a way as not to "function" as non-compete agreements, to provide an extra layer of protection as a fallback in the event the ban survives legal scrutiny.

Nonetheless, the future of the FTC's non-compete ban is unclear, pending the forthcoming legal challenges.

FOR MORE INFORMATION

If you have questions or want more information regarding the FTC's rule on banning non-compete agreements, contact your legal counsel. If you do not have regular counsel for such matters, Foulston Siefkin LLP would welcome the opportunity to work with you to meet your specific needs. For more information, contact Scott C. Nehrbass at 913.253.2144 or snehrbass@foulston.com or Clayton J. Kaiser at 316.291.9539 or ckaiser@foulston.com. For more information on the firm, please visit our website at www.foulston.com.

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