

What Employers Need to Know About the FTC's Ban of Non-Competition Agreements



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On May 7, 2024, the Federal Trade Commission ("FTC") published its controversial final rule (the "Rule") that once effective will ban employers from entering into new non-compete agreements across the country, retroactively void a significant number of existing non-compete agreements, and supersede any state law conflicting with the Rule's prohibitions. The Rule leaves undisturbed an employer's ability to have employees enter into non-solicitation and non-disclosure agreements (so long as those agreements do not functionally serve as non-competition restrictions) or seek relief under applicable trade secret laws.

Unless enjoined by a legal challenge, the Rule will go into effect on September 4, 2024.

Background

Non-compete covenants have traditionally been regulated at the state level. Despite that, [as we alerted in January 2023](#), the FTC is now exercising regulatory authority to curb what it claims are unfair restraints on trade and

business. The FTC has stated that, through the implementation of its Rule and the elimination of most non-compete restrictions, new businesses will form, innovation will be sparked, and higher earnings for workers will ensue. To that end, the Rule is broad and encompasses nearly all forms of agreements that prohibit, or have the practical effect of prohibiting, a worker from (or penalizing a worker for) seeking or accepting work with a different employer.

The Rule's Application and Requirements

So, what are employers supposed to do? Employers should first understand who is covered by this Rule. Currently, the Rule applies to all persons and private for-profit “business entities” regardless of structure. Further, the Rule broadly applies to “workers,” which the Rule defines as including employees, independent contractors, externs, interns, volunteers, apprentices, and other paid and unpaid working persons regardless of job title. Excepted from this Rule are non-compete agreements with “senior executives” entered into before the effective date. Under the Rule, “senior executives” are those employees who (A) are in a “policy-making position” (i.e., presidents, CEOs and equivalent positions), (B) have “final authority” over policy-making decisions that control a significant aspect of business, and (C) earn more than \$151,164.00 in total annual compensation.

As of September 4, 2024, employers may not enter into new non-competes with any “worker,” even senior executives. Similarly, after the effective date, it will be an “unfair method of competition” for employers to enforce or attempt to enforce an existing non-compete against any worker who is not a “senior executive.”

The Rule also requires that employers, by the Rule’s effective date, provide written notice to each worker (other than those qualifying as a senior executive) subject to a non-compete restriction that the non-compete provision will not be (and cannot legally be) enforced against the employee. The Rule provides model notice language for use in this regard.

Exceptions to the Rule

As noted, the Rule will not apply to non-compete agreements between an employer and a senior executive existing before the Rule becomes effective (thus allowing those non-compete agreements to be enforced). Also exempt from the FTC’s Rule are non-compete clauses entered as part of a franchisor-franchisee relationship, as well as between a buyer and a seller as part of a bona fide sale of a business, regardless of an individual’s percentage of ownership. Lastly, the Rule will have no effect on lawsuits involving non-compete claims filed before the Rule’s effective date.

The Rule and State Law

The Rule’s prohibitions place it in contradiction to various state laws governing non-competes. Indeed, the Rule expressly provides that it supersedes and controls all state antitrust, consumer protection, and common laws that conflict with the Rule’s non-compete prohibitions. Thus, an employer’s reliance on the law(s) in the state where it resides may not keep it from having to comply with the Rule.

Additional Considerations

Depending on how they are drafted, “garden leave” agreements and non-competition clauses tied to severance

agreements may also be banned under the Rule. While the FTC has not provided a definitive list of arrangements where these types of agreements are permissible under the Rule, it has reasoned that “garden leave” agreements where a worker is still employed and receiving the same total annual compensation and benefits on a *pro-rata* basis would not be prohibited because such an agreement is not a post-employment restriction.

Further, while non-profit organizations have historically enjoyed a jurisdictional exemption under Section 4 of the Federal Trade Commission Act (the “Act”), the Rule indicates the Commission’s intent to apply a two-part test to determine whether an entity is organized for profit and thus within the Commission’s jurisdiction. Specifically, the Commission will consider “the source of the income, *i.e.*, ... whether the corporation is organized for and actually engaged in business for only charitable purposes, and ... the destination of the income, *i.e.*, ... whether either the corporation or its members derive a profit.” If the Commission determines that a non-profit organization does not meet this requirement, it may be subject to the Rule.

Enforcement Considerations

Per the FTC, a violation of the Rule constitutes a violation of Section 5 of the Act. As such, the FTC could seek to enforce its Rule through administrative processes under the Act or by pursuing injunctive relief in Federal court against a party that has engaged in an unfair method of competition. Importantly, neither the Rule nor the Act create a private right of action or grant the FTC authority to recover monetary relief from employers who engage in “unfair methods of competition” under the Rule.

Legal Challenges to the Rule

Several legal challenges have already been filed in various federal courts that, at a minimum, may delay enforcement of the Rule. Key among those legal challenges are *Ryan LLC v. FTC*, No. 24-cv-00986-E (N.D. Tex.) and *Chamber of Commerce of the United States of America, et al. v. FTC*, No. 24-cv-00148 (E.D. Tex.). Litigants in the *Ryan* and *Chamber of Commerce* cases both argue that the FTC lacks the authority to adopt rules banning conduct that it deems to be an “unfair method of competition” under Section 5 of the Act. Both lawsuits further argue that the Rule violates federal agency rulemaking law because the FTC failed to consider narrower limitations on non-compete. Critically, in both *Ryan* and *Chamber of Commerce*, the plaintiffs have requested the federal courts to enjoin the Rule and keep it from going into effect. While matters remain fluid, the *Ryan* court has committed to issue a decision on the merits of Ryan’s Motion for Stay of Effective Date and Preliminary Injunction by July 3, 2024. It is expected that, if the court grants Ryan’s Motion, a nationwide injunction could stay the implementation of the Rule.

Interim Considerations

For now, there is no need to panic! Employers may continue to enforce non-compete agreements and include them in contracts; nonetheless, barring a successful legal challenge, employers should be proactive and begin preparing for the Rule. Such steps include consulting with legal counsel, reviewing existing restrictive covenant agreements (including non-disclosure and non-solicitation agreements), identifying those “workers” with whom the employer is a party to a restrictive covenants/non-compete agreement, and considering how the Rule could affect those contractual arrangements. Employers should also think about existing and anticipated non-compete disputes that the employer may need to pursue and file before September 4, 2024. Finally, if not already in place, employers should assess whether entering into new non-compete agreements with their senior executives before the Rule’s

effective date might be warranted. And, of course, employers should continue to monitor the *Ryan* case and the other legal challenges to the Rule as they navigate what's ahead.

If you have any questions about the Rule, please contact one of the members of our [Employment Practice Team](#).

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