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ALERTS

FTC Passes Final Rule Banning Worker Non-Compete Agreements

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Highlights

The FTC has voted to prohibit non-compete agreements with workers

Employers must notify all workers that existing non-compete agreements are unenforceable

The final rule will take effect at the end of August 2024, unless stayed by a court

On April 23, 2024, the Federal Trade Commission (FTC) voted to ban non-compete agreements in the employment context. The new rule forbids employers from entering into new non-compete agreements with any workers, including contractors, and requires all employers to inform any current and past workers that their non-compete agreements are unenforceable.

Employers who fail to abide by the new rule may face an adverse FTC enforcement action, prohibitive injunctions, and civil penalties up to $10,000 per individual offense. The new rule will go into effect 120 days after it is published in the Federal Register, likely at the end of August

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The compliance process involves identifying all current and past workers affected by non-compete agreements, notifying them of the unenforceability of those non-compete agreements, and removing non-compete agreements from any employment contracts looking forward.

Unenforceability of Existing Non-Compete Agreements

One key provision of the new rule is that it invalidates existing non-compete agreements. Existing employment contracts containing non-competes do not need to be re-drafted, but employers must notify current and former workers, including contractors, of the unenforceability of any non-compete provisions. This notification must explicitly state that the employer will not be enforcing any non-competes against that worker; importantly, this notification requirement applies to current and past paid workers (i.e., employees and contractors), as well as unpaid workers (i.e., volunteers or interns). The finalized rule contains model language that employers can use to ensure compliance with the notification requirements.

No New Non-Compete Agreements

The other key provision of the new rule is that employers are prohibited from entering into new non-compete agreements with their workers. Employers should be careful and review any existing template employment contracts they use with their workers routinely. Where contracts contain non-compete clauses, those clauses must be removed before hiring new workers to remain compliant with the new rule. Continuing to use a contract that contains a non-compete clause, even accidentally, would be a violation of this rule, and subject violators to civil penalties up to $10,000 per individual offense.

Limited Exceptions: Senior Executives and Business Sellers

Existing non-compete agreements covering senior executives can remain in effect, but new non-compete agreements are forbidden, even for senior executives. The FTC defines the term “senior executive” to refer to workers earning more than $151,164 who are in a “policy-making position.” The FTC estimates that less than 1 percent of workers qualify as a "senior executive" under this test.

Also, the purchaser of a business can generally still enter and enforce a non-compete against an owner, member, or partner of the seller as part of the bona fide sale of a business entity. The FTC has indicated, however, that particularly onerous non-competes, such as preventing the seller from engaging in a business for an indefinite period of time, would be invalid. Such non-compete agreements should be tailored narrowly meet the needs of a particular deal.

Other Arrangements Remain Valid

Trade secret laws and non-disclosure agreements (NDAs) remain in

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effect under this rule. Companies can continue to require workers to keep their trade secrets and other competitively sensitive information confidential and not use such information for the benefit of a competitor. The FTC estimates that roughly 95 percent of workers currently bound by a non-compete are also bound by an NDA. However, NDAs must not be so onerous that they effectively become non-competes by, for example, forbidding discussion of an entire industry. As a result, care should be taken in drafting NDAs, as well, in light of this rule.

Further, non-solicitation agreements, per FTC guidance, "are generally not non-compete clauses" because they do not "prevent a worker from seeking or accepting other work or starting a business." However, like NDAs, non-solicitation agreements can run afoul of the non-compete rule if the non-solicitation agreement is drafted so broadly that, in function, it prevents a worker from seeking or accepting other work or starting a business. Non-solicitation agreements should also be drafted with care in light of this rule.

Training repayment agreement provisions (which the FTC refers to as "TRAPs"), where a worker that fails to meet certain conditions must refund the employer certain hiring costs or bonuses, are not automatically invalid under this rule. The FTC cautions, however, that TRAPs pose a particularly serious risk of putting an employee in a position where the employee has, in effect, no option but to remain with the employer, which would amount to a non-compete and violate this rule. As a result, TRAPs should be drafted especially narrowly to prevent adverse FTC action.

Litigation Seeking to Block

Certain trade groups argue that the FTC lacks clear authorization from Congress to pass a rule that, according to the FTC, would affect the terms of employment for 18 percent of the American workforce. These trade groups have indicated that they will sue to block enforcement of this non-compete ban, and the U.S. Chamber of Commerce filed such a suit April 24. They cite Supreme Court precedent favoring what's known as the "major questions doctrine" – that is, a legal canon of statutory interpretation that bars agencies, such as the FTC, from resolving questions of "vast economic and political significance" without clear statutory authorization from Congress. Business groups will likely argue that the statutes granting authority to the FTC are too inherently vague to incidentally cover such a major question as the legality of non-compete agreements. It is therefore possible that a court orders a stay of implementation before it goes into effect.

Takeaways

The FTC's new rule is a sweeping ban on non-compete agreements, with very narrow exceptions. Employers should remain diligent and prepare to comply with the new rule in a timely manner.

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