

Is This The End Of Non-Competes?

On April 23, 2024, the Federal Trade Commission (the "FTC") approved its final rule banning non-compete agreements, with some exceptions. The FTC ruled that the use of non-compete agreements is an "unfair method of competition" in violation of Section 5 of the Federal Trade Commission Act ("FTC Act"). The FTC initially proposed a rule banning the use of non-compete agreements in January 2023, receiving numerous public comments regarding the proposed rule. The final rule, which becomes effective 120 days after the date of publication in the Federal Register, effectively bans all existing and future non-compete agreements for all types of workers, with exceptions described below.

Due to the sweeping nature of the final rule, legal challenges were expected and have already begun. On the same day the FTC announced the final rule, a lawsuit was filed in the United States District Court for the Northern District of Texas asserting that the FTC does not have the authority to make such a rule and that the rule is unconstitutional. The next day, the United States Chamber of Commerce and other business groups sued the FTC in Texas federal court, echoing that the FTC does not have the authority to make this rule and that the scope of the rule is unlawful.

The FTC is highly critical of the widespread use of non-compete clauses, estimating that 30 million workers are subject to a non-compete agreement in the United States. The FTC maintains that this final rule will increase the amount of new business formations, support rises in innovation, and allow for higher earnings for workers.

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." Further, employers must be cognizant of the "functions to prevent" competition language, noting that the final rule is not limited to traditional contractual non-compete clauses.

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The final rule does not apply to existing non-compete clauses for “senior executives,” though still prohibits new non-compete clauses for senior executives. “Senior executive” is defined as an individual “in a policy-making position” with an annual compensation of at least \$151,164. A policy-making position includes “a business entity’s president, chief executive officer or the equivalent, any other officer of a business entity who has policy-making authority.” The FTC estimates that less than 1% of all workers will qualify as the excepted “senior executive.”

The final rule contains a notice provision, requiring employers to provide notice to all workers subject to non-compete clauses that they are not enforceable. The FTC provided model language that satisfies the notice requirement, as well as methods for distributing the notice.

The final rule provides the following exceptions:

- When a non-compete clause is entered into by “a person pursuant to a bona fide sale of a business entity, of the person’s ownership interest in a business entity, or of all or substantially all of a business entity’s operating assets.”
- It is not applicable if “a cause of action related to a non-compete clause accrued prior to the effective date.”
- “It is not an unfair method of competition to enforce or attempt to enforce a non-compete clause or to make representations about a non-compete clause where a person has a good-faith basis” to believe the final rule does not apply.

Given the legal challenges, the effective date of the final rule is unclear. Employers must be aware that non-competes may be banned in the future and proceed with this in mind. Phillips Nizer will provide further updates as developments occur.

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