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Client Alert | April 24, 2024

Federal Trade Commission Issues Final Rule Prohibiting the Use of Non-Compete Clauses with Workers

On April 23, 2024, the U.S. Federal Trade Commission ("***FTC***") published a Final Rule ("***Final Rule***") that generally prohibits any entity under the jurisdiction of the FTC from using post-employment non-compete clauses with "workers," except for existing non-compete clauses with a very limited population of "senior executives." This ban on non-compete clauses will apply retroactively from the effective date of the Final Rule, which will be 120 days after the Final Rule is published in the Federal Register (the "***Effective Date***").

Specifically, the Final Rule provides that following the Effective Date, it will be considered unfair competition for an employer to (i) enter into a new non-compete clause with any worker, (ii) attempt to enforce an existing non-compete clause with any worker other than a senior executive, as defined by the FTC, and/or (iii) represent that a worker is subject to a non-compete clause (other than a senior executive with a pre-existing non-compete clause).

Key Terms of the Final Rule

Following the Effective Date:

- **Prohibition on New Non-Competes.** Employers will be prohibited from entering into any new non-compete clauses with any worker, without regard to compensation, seniority or role of the worker.
- **Prohibition on Enforcement of Current Non-Competes.** Employers will be prohibited from enforcing or attempting to enforce existing non-compete clauses with any current or former worker other than a "senior executive."
- **Existing Non-Competes with "Senior Executives" are Grandfathered.** The Final Rule does not invalidate existing non-compete clauses with "senior executives" provided they were in effect prior to the Effective Date.
    - A "***senior executive***" includes any worker in a policy making position with total annual compensation for the preceding year of at least $151,164 (including salary, commissions, and nondiscretionary bonuses and other compensation).
    - A "***policy making position***" means a business entity's president, chief executive officer or other officer (such as a vice president, secretary, treasurer or principal financial officer) to the extent they have policy making authority. Note, officers of a subsidiary are not considered senior executives for purposes of the Final Rule unless they have policy making authority for the common enterprise.
- **Broad Definition of Non-Compete Clause.** "***Non-compete clause***" includes any 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 employer; or (ii) operating a business in the United States with a different employer, in each case, following the conclusion of the worker's employment. Notably, non-compete clauses during employment are still permitted, including during paid notice periods or "garden leave" where workers are considered to still be employed.

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- **Duty to Notify Employees**. Employers will be required to affirmatively notify current and former employees that any existing non-compete clauses will no longer be enforced following the Effective Date.

- **Interaction with State Law**. The Final Rule supersedes any state laws that would allow the implementation of non-compete clauses, but will not interfere with any rights under state law that are more protective than those set forth in the Final Rule.

Effect on Other Restrictive Covenant / Post-Termination Provisions

- **Forfeiture-for-Competition / Liquidated Damages**. The expansive definition of "non-compete clause" in the Final Rule seeks to prohibit clawbacks, forfeiture for competition provisions and liquidated damages provisions (that may require workers to either forfeit certain economics or pay an employer liquidated damages if they compete).

- **Garden Leave**. The FTC noted that garden leave arrangements, i.e., where workers remain employed and continue to receive the same compensation and benefits, would not be prohibited under the Final Rule as such arrangements do not prohibit competition following the termination of a worker's employment.

- **Non-Disclosure / Non-Solicitation**. The FTC noted that non-disclosure agreements and non-solicitation agreements would generally not fall under the definition of "non-compete clause". However, the Final Rule clarified that provisions that functionally prevent a worker from, or punish a worker for seeking or accepting work with, a person or operating a business after the conclusion of the worker's employment with the employer (such as non-disclosure or non-solicitation agreements that are drafted so broadly that they may have the effect of a non-compete) are also prohibited even though they may not on their face appear to be non-compete clauses. The FTC noted that this threshold will be a fact-specific inquiry.

- **Repayment Obligations**. The FTC noted that training-repayment agreements and repayment of bonus obligations when a worker leaves their job (such as signing bonuses with a clawback in the event the worker resigns prior to some fixed period of time) would generally not fall under the definition of "non-compete" clauses, so long as such arrangements do not penalize or function to prevent a worker from seeking or accepting work with a person or operating a business after the worker leaves their job.

- **Sale of Business Exception**. The Final Rule retains the narrow exception to its prohibitions for non-compete clauses entered into by a person pursuant to a "bona fide" sale of a business (or their ownership interest in the business), or selling all or substantially all of a business' operating assets.

Applicability

- **Employers**. The Final Rule applies to any employer that is a legal entity under the jurisdiction of the FTC, which notably excludes nonprofits, banks, insurance companies, and air carriers.

- **Workers**. The Final Rule applies to any "worker," which is defined as any natural person without regard to their title or status under state or federal law, including an employee, an independent contractor, extern, intern, volunteer, apprentice, or sole proprietor who provides a service to a person. However, the definition of "worker" in the Final Rule does not include a franchisee in the context of a franchisee-franchisor relationship, which the FTC views as more analogous to the relationship between two businesses than the relationship between an employer and a worker.

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Suggested Considerations for Affected Employers

- Prior to the Effective Date, employers may still enter into new non-compete clauses with senior executives, as the FTC has defined. Accordingly, employers should consider whether to enter into non-compete clauses with any senior executives currently employed without such post-employment restrictions in place prior to the Effective Date.

- Employers should review their restrictive covenant agreement templates to ensure that when the Final Rule goes into effect, their non-solicit and non-disclosure covenants are narrowly tailored to avoid being subject to the Final Rule, as well.

Effective Date / Legal Challenges

As discussed earlier in this client alert, the Final Rule's Effective Date will be 120 days after it is published in the Federal Register. Currently, compliance with the Final Rule will be required as of the Effective Date, but it is expected that the Final Rule will face legal challenges that may delay such enforceability. For example, the Chamber of Commerce has already filed a lawsuit against the FTC, having previously asserted that the Final Rule is a "blatant power grab that will undermine American businesses' ability to remain competitive." It is very possible that the Final Rule may be enjoined pending resolution of the litigations challenging it, in which case, it may be years before the Final Rule will be enforced.

Key Contacts

We will continue to analyze the Final Rule and monitor further developments. If you have any questions regarding the foregoing, or non-competition or restrictive covenants agreements generally, or would like assistance in evaluating your existing restrictive covenant arrangements, please contact your Morrison Cohen relationship attorney or one of the following Compensation, Benefits and Labor & Employment attorneys:

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