

FTC Adopts Rule Barring Virtually All Non-Competes with Workers

April 24, 2024

Update: The FTC's final non-compete rule was published in the Federal Register on May 7, 2024 ([Federal Register :: Non-Compete Clause Rule](#)). The rule becomes effective 120 days after publication, or on September 4, 2024, unless one of the pending court challenges to the rule is successful.

On April 23, 2024, the Federal Trade Commission ("FTC") adopted a sweeping rule banning virtually all future non-compete clauses with workers and invalidating existing non-compete clauses with all workers other than "senior executives." The three Democratic Commissioners voted in favor of the rule, while the two Republican Commissioners voted against the rule. The rule deems non-compete agreements illegal unfair competition in violation of Section 5 of the FTC Act.

The Rule Bans Existing and Future Non-Compete Agreements

The rule flatly bans virtually all new non-compete provisions with all workers. The rule states that "[i]t is an unfair method of competition for a person [or entity] . . . [t]o enter into or attempt to enter into a non-compete clause" with any worker. Rule §910.2(a)(1)(i) and §910.2(a)(2)(i).

The rule also invalidates virtually all existing non-competes with all workers other than "senior executives." The rule states that "[i]t is an unfair method of competition for a person [or entity] . . . [t]o enforce or attempt to enforce a non-compete clause" with any worker other than a senior executive. Rule §910.2(a)(1)(ii). Thus, non-competes entered into with senior executives prior to the effective date of the rule are not impacted by the new rule. The rule defines a "senior executive" as a worker "in a policy-making position" who receives total annual compensation of at least \$151,164. See Rule §910.1(i). The rule specifies that a business entity's president and CEO are deemed to be "policy-making positions." Other officers or employees who "have final authority to make policy decisions that control significant aspects of a business entity" are also in a policy-making position. See Rule §910.1. Similarly, partners in a business organized as a partnership (such as an independent physician practice) likely are in policy-making positions.

Definition of Non-Competes

The rule broadly defines a non-compete clause as any term of employment that "prohibits a worker from, penalizes a worker for, or function to prevent a worker from (i) seeking or accepting work in the United States . . . or (ii) operating a business in the United States after the conclusion of the employment . . ." Rule §910.1. The rule employs a functional test and treats any contract clause that has the *effect* of prohibiting a worker from accepting employment as a non-compete clause.

Agreements not to solicit clients or other employees seem to fall outside the definition of banned non-competes in the rule as long as they are not drafted so broadly as to prevent a worker from accepting employment in the same industry.

The rule does not specifically address whether provisions in long term incentive compensation agreements (in which an employee forfeits unvested or vested equity awards if they compete) fall within the rule's definition of a non-compete agreement. These types of agreements give an employee who resigns a choice between (1) abiding by a non-compete provision and keeping post-employment compensation from the former employer, or (2) working for a competitor and forfeiting that compensation. Because the employee has a choice and is not actually

precluded from competing, courts in many states have distinguished these types of provisions from traditional non-competes. The staff commentary accompanying the new FTC rule, however, posits that forfeiture-for-competition provisions “penalize” a worker for competing and thus are covered by the new rule.

The rule does not specifically address garden leave provisions in which a worker remains employed for a period of time after giving (or receiving) a notice of termination of employment, but the rule does not appear to cover garden leave arrangements. The staff commentary accompanying the new rule states that “an agreement whereby the worker is still employed and receiving the same total annual compensation and benefits on a pro rata basis would not be a non-compete clause under the definition because such an agreement is not a post-employment restriction. Instead, the worker continues to be employed, even though the worker’s job duties or access to colleagues or the workplace may be significantly or entirely curtailed.”

The Rule Applies to Employees, Independent Contractors, Interns and Others

The rule bars non-compete agreements with “workers.” The rule defines a “worker” as “a natural person who works or previously worked, whether paid or unpaid,” for a person or entity. The definition of worker specifically includes not only traditional employees, but also individuals classified as independent contractors, externs, interns, volunteers, and apprentices. Thus, the rule covers employees as well as natural persons working as independent contractors or in virtually any other capacity.

The rule does not cover workers at entities that are not within the scope of the FTC’s rulemaking authority, such as non-profit health care organizations.

Exceptions

The rule creates a narrow exception for non-competes as part of a sale of a business. The rule allows the use of a non-compete provision with “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.” See Rule §910.3(a).

The rule also provides that it does not apply to a cause of action relating to a non-compete provision “accrued prior to the effective date.”

The Rule Requires Notice to Most Workers with Existing Non-Competes

Employers must notify each worker (other than a senior executive) who was subject to a non-compete agreement in writing that the non-compete agreement is no longer in effect and is unenforceable. The notice must be provided before the effective date of the rule and must be delivered to the worker by hand, by mail at the worker’s last known personal address, by email to an email address belonging to the worker, or by text message to a mobile phone belonging to the worker. The rule provides a form of notice that can be used for this purpose. See Rule §910.2(b)(2).

Preemption of Existing State Law

The rule explicitly supersedes state statutes, regulations, orders, or interpretations that are inconsistent with the rule. See Rule §910.4(a). Many states allow the use of narrowly tailored non-competes to protect an employer’s legitimate interests in trade secrets, confidential information, and good will with clients. The FTC rule, however, seems to assert that (outside of the sale of a business), employers do not have any legitimate interests that would ever justify the use of a non-compete. Existing state non-compete law would be preempted by the FTC’s new rule.

Effective Date

The rule will go into effect 120 days after it is published in the federal register. See Rule §910.5. It is anticipated that the rule will be published in the federal register within days of the FTC vote approving the rule. Employers seeking to enforce non-competes in the interim should anticipate arguments that the non-competes are not enforceable using the reasoning adopted by the FTC even before the rule fully goes into effect.

Anticipated Legal Challenges

The FTC's rule seeks to upend an entire area of law historically regulated by the states, not the federal government. The rule is certain to be challenged, including on grounds that it is unconstitutional, and the FTC exceeded its rulemaking authority. The two FTC commissioners who voted against the rule both stated that they believed that adoption of the rule violated the FTC's constitutional authority. At least one litigation challenging the rule was filed shortly after the rule was adopted by the FTC. In addition, the U.S. Chamber of Commerce announced that it plans to challenge the rule in court before the FTC formally adopted the rule.

Please follow us for notices of subsequent action on this rule and for more details about the implications of the FTC's position on non-competes.

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