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FTC NON-COMPETE AGREEMENTS RULE: A PRACTICAL GUIDE

On April 23, 2024, the Federal Trade Commission issued a final rule that prohibits new non-compete agreements with all workers and prohibits enforcing existing agreements except for those with "senior executives."

When does the rule go into effect?

The rule is effective September 4, 2024. After that date, all existing agreements (with the exception of those with qualifying senior executives) will cease to be effective or enforceable.

Which employers are covered?

The rule applies to all entities covered by the FTC Act. This means all private sector employers except banks, savings and loan institutions, credit unions, common carriers and non-profits.[1] Parent companies or affiliates of these same entities, however, may still be subject to the rule.

Which workers are covered?

The rule defines "worker" extremely broadly such that it would apply not only to full-time employees, but also to independent contractors, interns, or volunteers. Essentially, any individual who performs "work" for the employer is covered.

Which agreements are covered?

In addition to non-compete agreements, the rule prohibits any term or condition of employment that "prohibits...penalizes...or functions to prevent a worker from" working elsewhere.

Likely prohibited:

- Forfeiture-for-competition agreements – the rule explicitly indicates that most forfeiture agreements are likely prohibited under the rule.
- Non-solicitation, non-disclosure, and Training Repayment Agreement Provisions (TRAPs) that are so broadly written they function as non-competes.
- Severance agreements that pay out only if the worker refrains from competing.

For example, NDAs that prohibit workers from using any knowledge gained during their employment would likely be considered too broad. Similarly, TRAPs that require repayments that are disproportionally high in comparison to earned wages would be prohibited.

[1] The FTC has taken the position that the rule *would* apply to those non-profits that are "profit-making enterprises" or organized for the profit of their members. This would be a dramatic expansion of FTC coverage that would likely be subject to legal challenge.

Likely not prohibited:

- Properly constructed employment agreements or "garden leave" provisions that do not prevent workers from competing post-employment.
- "Appropriately tailored" non-disclosure agreements, non-solicitation agreements, and TRAPs.[2]
- Retention awards or other bonuses requiring repayment if the employee leaves (for any reason) within a designated time period.

Exceptions

There are two exceptions to the rule:

(1) Existing agreements with "senior executives": Existing non-compete agreements (entered into prior to the rule's effective date) with "senior executives" are allowed to remain in effect. Employers are still prohibited from entering into non-compete agreements with senior executives after the effective date.

- **"Senior executive":** The FTC used a similar but narrower version of the SEC's definition of "executive officer" for public companies. In order for an individual to qualify as a "senior executive" under the rule, they must:
  - Earn more than **$151,164** in total compensation; AND
  - Be in a "policy-making position."
    - "Policy-making position" is defined as a C-suite executive, officer, or any other person who has policy-making authority for the business entity (final authority to make policy decisions that control significant aspects of a business entity.)

The FTC sought to make this definition as narrow as possible. The rule stipulates that vice presidents, for example, aren't covered – and neither is anyone who merely influences policy rather than controls it.

(2) Business sales: Contrary to the proposal, the final rule exempts non-competes entered into by individuals pursuant to sales of business entities, a person's ownership interest in a business, or of all or most of a business's operating assets.

Notice for Existing Non-compete Agreements

The rule requires employers to provide notice to all individuals (other than qualifying senior executives) with existing non-compete agreements that such agreements are no longer effective or enforceable. This notice must be provided by the effective date of the rule.

- The notice must identify the individual who entered into the agreement and can be delivered by mail, email, or text message at the last known address or phone number of the individual.
- Notice is not required where the employer has no known record of any address, email address, or phone number of the individual.
- The rule provides model language for the notice requirement that employers can use.

Preemption

The rule supersedes all state and local non-compete laws that are less restrictive than the rule, but does not supersede laws that are more restrictive.

FREQUENTLY ASKED QUESTIONS

Q. What should I be doing right now?

1. Audit your current use of restrictive covenants.
    - HR and legal teams should work together to identify:
        - The extent and location(s) of your company's usage of non-competes and other covenants that could be "functional" non-competes under the rule.
        - All current and former employees covered by a non-compete. Although existing agreements for senior executives *may* be left in place, the company should understand who is and is not covered right now.

2. Consider alternative protections for sensitive information and talent investment.
    - Unfortunately, it appears that forfeiture agreements may be considered "functional non-compete agreements" under the rule as the FTC views them as penalizing workers for competing (in that money is forfeited). However, non-disclosure and non-solicitation agreements are still allowable if they don't reach the level of a functional non-compete.

3. Prepare notices for employees with existing non-compete agreements.
    - By the rule's effective date, employers are required to notify (non-senior executive) employees with existing agreements that they are no longer enforceable. The rule provides employers with model language to use for the notice. We do not recommend taking this step until the effective date, but preparations should be made well in advance.

4. Monitor legal developments.
    - The rule is currently the subject of litigation that may result in its temporary and/or permanent reversal. Make sure to stay aware of legal developments that may change your legal obligations under the rule.

Q: Will the law actually go into effect?

A: The rule is subject to multiple legal challenges from law firms and business groups. These lawsuits seek both an immediate and temporary block of the rule before it goes into effect, and its permanent recission.

The lawsuits are likely to succeed in temporarily blocking the rule for two reasons:

- *Lack of legal authority to issue the rule*. Despite its assertions to the contrary, the FTC likely lacks necessary legal authority here – it has never engaged in this type of rulemaking nor asserted the authority to do so. (In fact, the FTC has previously asserted that it *does not* have this type of rulemaking authority). [2]
- *Texas courts*. The lawsuits have been filed in the Eastern District of Texas, which has proven to be an effective firewall against Biden administration regulatory efforts. This district previously blocked the NLRB's joint employer rule and the executive order raising the minimum wage for federal contractors, for example.

Whether a subsequent appellate court will decide to permanently block the rule is less certain. Such a result will depend, in part, on the leanings of the federal circuit court of appeal in which the lawsuits end up.

Bottom line: Although a preliminary block of the rule may be likely, the outcome of full litigation will take time. As always, employers should not count on any legal result in lieu of preparing for compliance with the rule.

Q: Should we continue to enter into new non-compete agreements?

A: This is a threshold question that employers will need to address in the coming days and weeks, possibly in consultation with their Board. While some companies may decide to continue to enter into non-compete agreements until required to stop, others may prefer to hold off on new agreements until the fate of the rule is certain.

Q: Assuming the rule becomes effective, should we retain existing non-competes for senior executives (as allowed by the rule)?

A: This is another company-specific question that should be carefully considered. For some employers, it will be necessary and appropriate to keep all allowable existing non-competes in place. For others, the optics of requiring tenured executives to abide by a non-compete while new executives have no such obligation may be challenging.

[2] National Petroleum Refiners Ass'n v. Fed Trade Comm'n, 482 F.2d 672, 693 (D.C. Cir. 1973) ("[T]he agency itself did not assert the power to promulgate substantive rules until 1962 and indeed indicated intermittently before that time that it lacked such power.")

Q: What alternative arrangements should we consider to protect investments and sensitive information?

A: There are several options companies can consider in lieu of non-competes.

- **Non-disclosure agreements:** Although often not as effective as non-compete agreements, especially for trade secrets and other sensitive information, employers should consider using non-disclosure agreements instead. Such agreements, as long as they are not overly broad, are not prohibited under the rule and are additionally protected under federal trade secrets law.
- **Non-solicitation agreements:** To protect current customer or client relationships, employers should consider using non-solicitation agreements in lieu of non-compete agreements. Such agreements, provided they are not overly broad, are not prohibited by the rule.
- **Employment agreements:** The FTC clarified in its rule that agreements where the employee is still employed and receiving pay and benefits are allowable, since they don't restrict the worker post-employment. This seems to imply that an employment agreement with a required notice period would be allowable – but this is not guaranteed and must be carefully crafted with counsel.
- **Garden leave:** Similarly, some companies (especially in Europe) require employees to sign a separation agreement with garden leave attached. In this situation, the employee is not working full-time for the company but, as they are being paid, they are also not free to take on alternative employment before the end of garden leave. Again, while the FTC claimed that garden leave might be allowable under the rule, the agency's attitude when it comes to enforcement may be very different, so the viability of this option is still unclear.
- **Retention grants:** The rule noted that it is likely allowable to require employees to repay or forfeit a retention bonus or grant if they leave before the retention period is over. This means that retention grants are still a viable way to align executives with the long-term wins of the company and reduce turnover.
- **Enforce trade secret agreements**: Companies can protect trade secrets and other confidential information:
    - **Training**. Provide comprehensive training to employees about their obligations regarding confidentiality both during and after employment. This may help mitigate the risk of breaches.
    - **Security Measures**. Companies can beef up physical and digital security measures and monitoring to detect unauthorized access or use of confidential information.

Q: Should we change existing severance agreements or policies?

A: Severance packages are provided for many reasons, such as providing financial assistance to executives during their post-employment transition. However, companies typically include restrictive covenants such as non-disparagement, non-solicitation, and non-compete clauses as necessary agreements to receive severance.

It is possible that if a covenant not to compete is no longer allowable, companies may consider whether a reduction in severance is appropriate (since the severance would have to be paid even if the executive immediately joined a direct competitor and began competing).