LEGAL UPDATES

FTC Approves Final Rule, Would Ban Most Employment Non-compete Agreements

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Yesterday, the Federal Trade Commission ("FTC") voted and approved the issuance of a final rule, the Non-Compete Clause Rule, that, if it goes into effect, will make future employment non-compete agreements unenforceable and will retroactively void most existing employment non-compete agreements. In announcing the Non-Compete Clause Rule, the FTC stated that the rule will protect the fundamental freedom of workers to change jobs and increase innovation and new business formation. The FTC has estimated that the new rule, which is set to be effective 120 days after its publication in the Federal Register, will lead to new business formation growth of 2.7% per year, more than 8,500 new businesses being created each year, an increase in innovation through more patent filings, and higher wages for workers.

By way of background, the FTC issued a proposed rule in January 2023 to ban most employment non-compete agreements and, during the public comment period on the proposed rule, received more than 26,000 comments. The FTC has stated that over 25,000 of these comments were supportive of the FTC's proposed ban. After its consideration of the comments, the FTC voted to approve the final Non-Compete Clause Rule.

The FTC has issued a Fact Sheet summarizing the final Non-Compete Clause Rule. In summary, the final Non-Compete Clause Rule will, if it becomes effective, provide as follows:

- The rule provides that it is an unfair method of competition, in violation of sections 5 and 6(g) of the Federal Trade Commission Act ("FTC Act"), to enter into non-compete clauses ("non-competes") with workers on or after the rule's effective date that would prohibit post-employment competition. Employers can require that employees not compete during employment.

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- The rule is retroactive as to existing non-competes (e.g. those entered into before the rule's effective date) if the non-compete is with any employee other than a senior executive. Existing agreements with a senior executive that predate the final rule's effective date remain in force, subject to the applicable state law governing the agreement. The rule defines a senior executive as a worker earning more than $151,164 annually and who is in a policy-making position. The FTC has stated that the rule allows existing non-competes with senior executives to remain in force because this subset of workers is less likely to be subject to "the kind of acute, ongoing harms currently being suffered by other workers subject to existing noncompetes and because commentators raised credible concerns about the practical impacts of extinguishing" such non-competes.

- The 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." The rule further provides that, for purposes of the rule, "term or condition of employment" includes, but is not limited to, a contractual term or workplace policy, whether written or oral. The rule defines "employment" as "work for a person." The rule defines a "worker" as "a natural person who works or who previously worked, whether paid or unpaid, without regard to the worker's title or the worker's status under any other state or federal laws, including, but not limited to, whether the worker is an employee, independent contractor, extern, intern, volunteer, apprentice, or a sole proprietor who provides a service to a person." The definition further states that the term "worker" includes a natural person who works for a franchisee or franchisor, but does not include a franchisee in the context of a franchisee-franchisor relationship. (*Lathrop GPM's franchise practice group also authored an alert providing an analysis on the effect of this new rule on franchisors and franchisees.*)

- The rule provides that employers must provide workers with unenforceable existing non-competes notice that they are no longer enforceable. To facilitate compliance, the rule includes model language to satisfy the notice requirement.

- The rule does not apply to non-competes entered into by a person pursuant to a bona fide sale of a business entity. In addition, the final rule does not apply where a cause of action related to a non-compete accrued prior to the effective date of the final rule. The rule further provides that it is not an unfair method of competition to enforce or attempt to enforce a non-compete or to make representations about a non-compete where a person has a good-faith basis to believe that the final rule is inapplicable.

- The rule does not limit or affect enforcement of state laws that restrict non-competes where the state law does not conflict with the final rule, but the rule preempts state laws that conflict with the final rule.

- The rule includes a severability clause clarifying the FTC's intent that, if a reviewing court were to hold any part of any provision or application of the final rule invalid or unenforceable—including, for example, an aspect of the terms or conditions defined as non-competes, one or more of the particular restrictions on non-competes, or the standards for or application to one or more category of workers—the remainder of the final rule shall remain in effect.

- Certain types of entities, such as non-profits, certain banks, and certain common carriers, may be exempt from the Non-Compete Clause Rule if they fall outside the FTC's jurisdiction, although the FTC has cautioned that a nuanced coverage analysis applies. More information is available in our separate client alert.

The FTC has stated that the Non-Compete Clause Rule will permit customer or employee nonsolicitation agreements and training or bonus repayment agreements so long as they are drafted not to function as a *de facto* non-compete and do not prohibit or penalize an employee for accepting employment with a competitor or starting their own business. In addition, the FTC has noted that an employer's ability to rely on trade secret laws and nondisclosure agreements to protect sensitive and confidential data is not impacted by the rule. The FTC has also stated that, rather than using non-competes, an employer wishing to retain workers can compete on the merits for the worker's labor services by improving wages and working conditions.

According to media sources, the FTC commissioners voted 3 to 2 along party lines to approve the Non-Compete Clause Rule, with dissenting commissioners arguing that the FTC was overstepping the bounds of its authority. One dissenting commissioner reportedly predicted, as have commentators, that the final rule is likely to be challenged in court. Media sources are reporting that, shortly after the FTC vote, the U.S. Chamber of Commerce said it would sue to try to block the rule. Employers should prepare to comply with the rule but should also stay tuned to see if there is litigation challenging the rule and how any litigation impacts the timing and enforceability of the rule.

If you have any questions about the application of the new rule, please contact Megan Anderson or your regular Lathrop GPM attorney.