FTC Approves National Ban of Employee Non-Competition Agreements

April 26, 2024

On April 23, 2024, the Federal Trade Commission ("FTC") approved a new rule, on a 3-2 party line vote, prospectively prohibiting non-compete restrictions in any type of employment arrangement, including arrangements with independent contractors. The new Final Rule also retroactively voids preexisting non-competes for workers, other than for "senior executives," who are defined as employees earning over $151,164 who work "in a policy-making position." The Final Rule declares that imposing non-compete restrictions constitutes an "unfair method of competition" that violates Section 5 of the FTC Act. Unless an injunction is issued—or if the FTC volunteers (as it has done in similar scenarios) to delay enforcement to permit juridical review—this Final Rule will take effect in early September 2024, 120 days after publication of the Rule in the Federal Register.

WHAT CONSTITUTES A PROHIBITED NON-COMPETE?

The Final Rule applies to all individual "workers" who provide a service, regardless of title, compensation, or employment affiliation. As such the Final Rule bans non-competes for any worker who is "an employee, independent contractor, extern, intern, volunteer, apprentice, or a sole proprietor who provides a service to a person."

A "non-compete clause" is defined as a term or condition of employment that expressly prohibits or "effectively functions to prevent" a worker, post termination, from accepting a new position or opening a competing business in the United States. This includes provisions triggering oppressive financial penalties or forfeitures (*i.e.*, "pay for release") and certain training-repayment agreements ("TRAPs"), which require a worker to pay the employer or a third-party for training costs if the worker's employment terminates within a specified period. The Final Rule does not categorically bar non-disclosure agreements ("NDAs") or non-solicitation agreements, unless "they function to prevent a worker from seeking or accepting other work or starting a business after their employment ends."

CHANGES FROM THE FTC'S INITIALLY PROPOSED RULE

As discussed in a prior advisory, the FTC initially proposed a blanket non-compete ban while the Final Rule is somewhat narrower.

The major changes from the initial proposal to the Final Rule are:

- **Partial Grandfathering**: The Final Rule allows continued enforceability of pre-existing non-competes with "senior executives."
- **Exception for Sale of Business**: The originally proposed rule would have permitted the use of non-competes in the sale of a business context when the person restricted is a substantial owner of, or substantial member or substantial partner in, the business entity at the time they enter the non-compete. Under the previously proposed rule, a person was defined as a substantial owner, member, or partner if they hold at least a twenty-five (25) percent ownership interest in a business entity. The Final Rule removes the ownership threshold. The Final Rule allows a non-compete "that 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."
- **Excludes Some Non-Profits**: The Final Rule acknowledges that some employers fall outside the FTC's rulemaking jurisdiction, and therefore are not subject to the Final Rule. This includes banks, savings and loans, credit unions, common carriers, air carriers, and certain "bona fide" non-profits. The FTC contends that whether an employer is a "bona fide" non-profit is not based solely on tax-exempt status. For example, if a tax-exempt company is organized in a way that seeks to drive profit to its members, the agency may argue it is subject to the FTC's noncompete ban. If the FTC pursues such claims, there will be little precedent and many new legal issues to be resolved.
- **De Facto Restraints**: The FTC removed language barring "*de facto* non-competes" achieved using NDAs, training reimbursements, and non-solicitation agreements. However, whether such agreements function to prevent workers from seeking or accepting other work or starting a business after their employment ends remains relevant in determining whether they are prohibited non-competes.

IMPLICATIONS FOR HEALTHCARE EMPLOYERS

Although the Final Rule applies uniformly to all industries, there are two limitations particularly relevant in the healthcare sector. Notably, the FTC lacks authority to regulate "bona-fide" non-profit employers. As noted above, whether an employer is a "bona-fide" non-profit will depend on the organization and operation of the company, in addition to its tax-exempt status.

The Final Rule also does not preclude business owners from agreeing to non-competes related to the sale of a business. Thus, for example, a physician who is a partner in an independent physician practice could be subject to a non-compete if they sell their shares of the business in an acquisition.

PERVASIVE UNCERTAINTY FROM IMMINENT LEGAL CHALLENGES

Whether the FTC's Final Rule will go into effect or, if so, when, remains uncertain due to legal challenges. The US Chamber of Commerce, together with other stakeholders, has already filed a federal lawsuit in the U.S. District Court for the Eastern District of Texas challenging the FTC's authority to legislate competition rules. A Texas tax services company has also filed a legal challenge in the U.S. District Court for the Northern District of Texas. Hancock, Daniel & Johnson P.C. will continue to monitor these legal challenges.

OVERVIEW OF EMPLOYERS' COMPLIANCE OBLIGATIONS

Before the Final Rule takes effect (as early as September 2024), employers are permitted or advised to do the following:

- May continue to include non-compete provisions in new employment contracts.
- May file lawsuits to enforce the breach of a pre-existing non-compete agreement. Legal actions initiated before the Effective Date may continue, even after such non-compete provisions are no longer enforceable.
- Are advised to identify the universe of employment arrangements that remain enforceable (*e.g.*, senior executives) or are otherwise exempt from the Final Rule (*e.g.*, non-profits), and customize company policies and communications.
- Are advised to work with counsel to develop alternative strategies to safeguard business interests that do not implicate the FTC or applicable state laws bans on non-competes.

Employer notice and compliance obligations on or after the Final Rule's Effective Date:

- By the Effective Date, employers are required to remove all non-compete provisions from employment contracts, employee handbooks, and workplace policies.
- By the Effective Date, employers must notify all former and current workers subject to preexisting non-competes (other than senior executives) that such provisions are void and unenforceable. The FTC has provided suggested language in a model notice, which can be distributed by first-class mail, email, or text message.
- After the Effective Date, employers are prohibited from attempting or threatening to enforce any preexisting non-competes (other than with respect to senior executives).

CONCLUSION

Before the FTC's Final Rule takes effect, clients are advised to consult legal counsel to confirm (1) the scope of the FTC's ban and its exemptions; (2) mandatory reporting and compliance obligations; (3) applicable state laws not preempted by the FTC's Final Rule, and (4) permissible alternative strategies to protect employer interests.

If you have any questions or would like further guidance regarding non-competes, please contact a member of Hancock Daniel's Labor & Employment team.

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