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FTC ADOPTS FINAL RULE REGARDING NON-COMPETE AGREEMENTS

On April 23, 2024, the U.S. Federal Trade Commission ("FTC") announced a final rule, Non-Compete Clause Rule, which implements a nationwide ban on non-compete agreements for the vast majority of the American workforce. The final rule is currently set to take effect 120 days after its publication in the Federal Register. However, legal challenges to the FTC's final rule have already begun, making the rule's actual effective date uncertain.

Below is a summary of the rule's primary prohibitions and requirements as currently set forth by the FTC.

What does the FTC's rule prohibit?

The FTC's final rule prohibits any person from:

- entering into or attempting to enter into a non-compete clause;
- enforcing or attempting to enforce a non-compete clause against non-senior executive workers;
- enforcing or attempting to enforce a non-compete clause entered into after the rule's effective date against senior executive workers;
- representing that a non-senior executive worker is subject to a non-compete clause; or
- representing that a senior executive is subject to a non-compete clause, where the non-compete clause was entered into after the rule's effective date.

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:

- seeking or accepting work in the United States with a different person where such work would begin after the conclusion of the employment with the worker's current employer; or
- operating a business in the United States after the conclusion of the employment.

Which employers are covered?

As issued, the FTC's rule applies to any natural person, partnership, corporation, association, or other legal entity within the FTC's jurisdiction, including any person acting under color or authority of state law.

Which workers are covered?

If it becomes effective, the FTC's final rule will apply to all natural persons who work or who previously worked for a person, whether paid or unpaid, including, but not limited to:

- employees
- independent contractors
- externs
- interns
- volunteers
- apprentices
- sole proprietors

The final rule specifies that the term "worker" also includes a natural person who works for a franchisee or a franchisor, but it does ***not*** include a franchisee in the context of a franchisee-franchisor relationship.

How does the FTC's rule impact existing non-compete clauses?

The impact of the FTC's final rule on existing non-compete clauses varies depending on whether the clause was entered into with a senior executive or non-senior executive worker.

1. Senior Executive Workers

The FTC's final rule does not impact non-compete clauses entered into with senior executive workers ***prior to*** the rule's effective date, meaning such agreements may remain in force.

For purposes of the final rule, senior executives are defined as those workers who, as of the rule's effective date:

- were employed in a policy-making position; **and**
- received for the worker's employment:
    - total annual compensation of at least $151,164 in the preceding year; or
    - total compensation of at least $151,164 when annualized, if the worker was employed during only part of the preceding year; or
    - total compensation of at least $151,164 when annualized in the preceding year prior to the worker's departure, if the worker departed from employment prior to the preceding year and the worker is subject to a non-compete clause.

The term "policy-making position" is defined to mean a business entity's president, chief executive officer or the equivalent, any other officer of a business entity who has policy-making authority, or any other natural person who has policy-making authority for the business entity similar to an officer with policy-making authority.

For purposes of the new rule, "total annual compensation" may include the employee's salary, commissions, nondiscretionary bonuses, and other nondiscretionary compensation earned during the annual period. "Total annual compensation" does ***not*** include board, lodging, and other facilities (as defined in 29 C.F.R. § 541.606). Nor does it include payments for medical insurance, payments for life insurance, contributions to retirement plans, and the cost of other similar fringe benefits.

In evaluating compensation received in the preceding year, the new rule allows an employer to choose from the following time periods:

- the most recent 52-week year;
- the most recent calendar year;
- the most recent fiscal year; or
- the most recent anniversary of hire year.

Notably, the FTC estimates that less than 1% of all workers will qualify as senior executives under the new rule.

2. Non-Senior Executive Workers

For workers who do not meet the definition of senior executives, existing non-compete clauses will no longer be enforceable as of the rule's effective date.

Must employees be notified of unenforceable non-compete clauses?

The FTC's final rule does not contain a requirement that unenforceable non-compete clauses be rescinded. However, employers will be required to provide notice to impacted workers if their non-compete clause is no longer enforceable. The notice must "be on paper" and delivered by hand, mail, email, or text message. The final rule includes model language that employers may use to satisfy this notice requirement.

Does the FTC's rule contain any exceptions?

If the FTC's final rule becomes effective, it will not apply to:

- non-compete clauses entered into by a person pursuant to a bona fide sale of a business entity, or of all or substantially all of a business entity's operating assets;
- situations where a cause of action related to a non-compete clause accrued prior to the rule's effective date; or
- situations where an employer enforces or attempts to enforce a non-compete clause or makes representations about a non-compete clause when the employer has a good-faith basis to believe that the rule would not apply.

How does the FTC's rule impact existing state laws?

The FTC's final rule would supersede existing state laws only to the extent such laws permit employers to enter into non-compete clauses otherwise prohibited by the rule.

Stated differently, existing state laws imposing more restrictive requirements for non-compete clauses, or otherwise banning such clauses in their entirety, will not be affected.

Does the rule prevent employers from entering into other types of restrictive covenant agreements with employees?

The FTC's rule does not categorically prohibit other types of restrictive covenant agreements such as nondisclosure agreements, training-repayment agreements, or non-solicitation agreements. This would include, for example, employees with existing non-solicitation agreements that are limited to non-solicitation of customers or clients with whom the employee actually did business and had personal contact, as permitted under Nebraska law. On this point, the FTC has indicated that these types of agreements do not by their terms prohibit a worker from, or penalize a worker for, seeking or accepting other work or starting a business after the leave a job, which is what the rule seeks to eliminate.

While other types of restrictive covenant agreements are not categorically banned under the new rule, the FTC has indicated that if an employer adopts a term or condition that is so broad or onerous that it has the same functional effect of restricting a worker's ability to compete, such a term will be deemed to be a non-compete clause under the rule.

What can employers expect moving forward?

As noted above, the final rule is currently set to take effect 120 days after its publication in the Federal Register, which is distinguishable from the FTC's public announcement. At this time, the precise publication date is unclear.

Unsurprisingly, legal challenges to the FTC's final rule have already begun. Notably, on April 24, 2024, the U.S. Chamber of Commerce filed a federal lawsuit in the United States District Court for the Eastern District of Texas seeking to enjoin the FTC from enforcing the final rule.

While the rule's future remains unclear, employers should take the time to review existing restrictive covenant agreements to ensure compliance with existing applicable law and to consider the impact of the FTC's final rule.

For more information about the FTC's final rule, please reach out to Tara Stingley, Sydney Huss, or another member of Cline Williams' Labor and Employment Law Section at www.clinewilliams.com.