Peckar & Abramson, P.C. ALERT

Federal Trade Commission Prohibits Non-Competes: What Should Employers Do Now?

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Effective September 4, 2024, non-compete agreements with all employees, including senior executives, will be prohibited by a new Federal Trade Commission (FTC) rule. However, non-compete agreements for certain senior executives entered into before September 4, 2024, and non-compete agreements connected to an individual's sale of a business, will remain enforceable.

The FTC's Non-Compete Clause Rule reflects a sentiment expressed by state legislators, federal and state judges, and researchers, disfavoring the enforceability of non-compete agreements.

There is litigation pending to invalidate the rule on the grounds that it violates the US Constitution, and that the FTC exceeded its rulemaking authority. But as of now, no injunction has been issued and the rule is enforceable effective September 4, 2024. Regardless of the outcome of the litigation, companies should review and determine whether they have appropriately crafted agreements which adequately protect their talent pool, property and intellectual assets, independent of non-compete clauses.

RULE DETAILS

The Federal Trade Commission Act ostensibly empowers the FTC to regulate unfair methods of competition. The new Non-Compete Clause Rule concludes that non-competes are an unfair method of competition – and therefore a violation of the Act.

A "non-compete clause" is defined as any term or condition of employment prohibiting an employee from seeking or accepting work in the United States with a different person (entity) where such work would begin after the conclusion of the employment; or operating a business in the United States after the conclusion of the employment. The rule prohibits non-compete agreements with direct employees as well as independent contractors.

The exceptions to the rule are limited:

- ✓ Non-competes with "senior executives" entered into before September 4, 2024. The term "senior executive" is defined as an officer or other person that has "policy making authority" who earns more than $151,164 annually. A "policy-making position" means the CEO or any other officer of a business entity or person who has "policy-making authority."
- ✓ Non-competes 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.

WHAT SHOULD EMPLOYERS DO NOW?

By September 4, 2024, employers are required to provide a written notice to workers who are subject to a prohibited non-compete advising them that the non-compete clause will not be enforced. The notice must be sent in an individualized communication (text message, hand delivery, mailed to last known address, or the like).

Whether or not litigation results in an invalidation of the new rule, in light of pre-existing challenges to the enforcement of non-competes, employers should review and determine whether they have effectively employed other tools available to adequately protected their talent pool, property and intellectual assets.

Critically, non-solicitation, non-disclosure, no-hire, and similar agreements will remain available to companies to protect their intellectual assets. Similarly, the FTC commentary explains that “garden leave agreements” (where an employee is effectively on paid leave during a non-compete period) may be permissible. However, all restrictive covenants must be carefully drafted because the new rule will bar enforcement if they have the functional effect of a non-compete.

Beyond non-solicitation and non-disclosure agreements, intellectual assets can be protected under the Uniform Trade Secrets Act (which has been adopted by 47 states), the federal Defend Trade Secrets Act, Economic Espionage Act, and various intellectual property rights laws. Whether or not the FTC rule is invalidated, employers should NOT rely upon non-compete agreements, but should review existing agreements and carefully draft future agreements to utilize other available means to properly protect their assets.