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The End of Non-Competition Agreements? Not so Fast!

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The Federal Trade Commission (FTC) issued a final rule in a partisan 3-2 vote on April 23, 2024 prohibiting employers from binding most American workers to post-employment non-competition agreements (the "Final Rule").

The Final Rule is set to take effect 120 days following its publication in the Federal Register, which we expect to happen soon. However, two lawsuits were filed the same day the FTC issued the Final Rule – one by the Chamber of Commerce in the United States District Court for the Eastern District of Texas and the second by a global tax services and software company in the Northern District of Texas – each challenging the Final Rule and arguing that the FTC lacked the authority to issue it. Given that these are the same courts that respectively struck down the National Labor Relations Board's joint-employer standard and the Department of Labor's "persuader rule," many legal observers expect that one or both courts will issue a nationwide injunction staying enforcement of the Final Rule until the issue can be decided on the merits and, ultimately, by a higher court. In addition, concerns exist that the Final Rule violates the Major Questions Doctrine, which states that Congress presumptively does not delegate to executive agency issues of major political or economic significance. Notably, the FTC is not an executive branch agency but an independent agency set up under Congress's authority and oversight.

Common Questions: Answered

Although the Final Rule's future is uncertain, workers and businesses alike should understand the contours of the Final Rule and be prepared to navigate current and former employees' questions and challenges in the near future. Below are the top ten questions we have received from our clients about the FTC's Final Rule.

1. Does the Final Rule apply to all workers and all employers?

The Final Rule applies to all natural persons who work or have worked, whether paid or unpaid, including independent contractors, externs, interns, volunteers, and apprentices, among others.

The Final Rule also applies to most entities, including natural persons, partnerships, corporations, associations, or other legal entities within the FTC's jurisdiction, including "any person acting under color or authority of state law." Certain entities, however, fall outside the FTC's jurisdiction including:

1. Certain banks and savings and loan institutions;
2. Federal credit unions;
3. Common carriers subject to the Acts to regulate commerce;
4. Air carriers and foreign air carriers subject to the Federal Aviation Act of 1958;
5. Entities subject to the Packers and Stockyards Act of 1921, as amended;
6. Bona fide non-profit entities; and
7. Entities owned by state and local governments.

2. What is a covered non-competition clause?

The Final Rule defines a non-competition clause, whether written or oral, as a term and condition of employment that prohibits a worker from, penalizes a worker for, or functions to prevent a worker from: (i)

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 (ii) operating a business in the United States after the conclusion of the employment that includes the term or condition. The Final Rule applies to employment agreements, employment policies, garden leave agreements, and severance agreements. In fact, the FTC's commentary issued with the Final Rule suggests that severance agreements and garden leave agreements cannot, under the Final Rule, contain a non-competition clause because such a clause would "penalize" a worker from seeking competitive work and/or starting a competitive business.

3. Does the Final Rule prohibit customer non-solicitation, employee non-solicitation, and/or non-disclosure provisions?

The FTC asserts that the Final Rule does not prohibit customer non-solicitation, employee non-solicitation, and/or non-disclosure provisions so long as those provisions do not "function to prevent" a worker from accepting or seeking work with a competitor or starting a competitive business. In fact, the FTC noted that a non-disclosure provision that prevents a worker from disclosing confidential information to a competitor would not be prohibited under the Final Rule. That said, whether such provisions functionally operate as a non-compete will be made on a case-by-case basis.

4. Does the Final Rule apply to franchises?

Yes and no. The Final Rule's definition of "worker" includes individuals who work for a franchisee or franchisor but, importantly, the Final Rule does not apply to franchisees in the context of a franchisee-franchisor relationship.

5. How does the Rule treat future non-competition clauses versus non-competition clauses already in place?

Businesses within the FTC's jurisdiction are prohibited from entering into non-competition agreements with workers on or after the Final Rule's effective date. Non-competition agreements entered into before the Final Rule's effective date are presumptively unenforceable for everyone except "senior executives."

A senior executive is a worker who worked or works in a policy-making position and: (i) earned annual compensation of at least \$151,164 in the preceding year; (ii) earned annual compensation of at least \$151,164 on a pro-rata basis if employed during only part of the preceding year; or (iii) earned annual compensation of at least \$151,164 when annualized in the year preceding the worker's departure and the worker was subject to a non-compete clause. A worker is in a policy-making position if the worker worked as the business's president, chief executive officer, or worked in an officer-level position with policy-making authority.

Importantly, covered employers must provide current and former employees who previously entered into agreements with non-competition clauses with "clear and conspicuous notice" by the effective date that their non-compete clause will not be, and cannot legally be, enforced against them.

6. Does the Final Rule prevent an employer from having non-competition agreements that only apply to employees during their employment?

No. Non-competition agreements that only prevent competition during a worker's employment are still permissible subject to compliance with various state and local laws.

7. What happens to existing lawsuits that allege violations of non-competition clauses?

The Final Rule does not affect a business's ability to enforce a non-compete clause if the violation occurred prior to the Final Rule's effective date. Additionally, the Final Rule does not prohibit the enforcement of a non-competition clause if the party bringing the enforcement action has a good-faith basis to believe that the Final Rule is inapplicable.

8. Are non-competes allowed as part of the sale of a business?

Yes. The Final Rule expressly allows a non-competition clause to prohibit a seller from competing with a buyer in connection with the sale of a business. However, key employees who are not sellers but whose employment is expected to continue after the sale of a business cannot be bound by non-competition agreements under the Final Rule.

9. If the Final Rule survives legal challenges and goes into effect, how will it be enforced?

The FTC is the only entity that can enforce the Act and its civil penalty. At the same time, private parties can raise the Final Rule in a declaratory judgment action or as an affirmative defense to void prohibited agreements.

10. What should I do now?

Right now, employers do not need to take immediate action to comply with the Final Rule. It may be several weeks before an injunction decision is issued. At the same time, even in the absence of the Final Rule, enforcing non-competition agreements is becoming increasingly harder in many states and impossible in others. Employers should take this time to review all their restrictive covenant agreements to ensure that they are appropriately and narrowly tailored to comply with state laws and are no broader than necessary to protect their competitive advantage and confidential information.

If you have questions concerning the FTC's ruling, please reach out to [David Gevertz](#), [Hannah Elizabeth Jarrells](#), [Katherine I. Funk](#), or your Baker Donelson team lead.