

The U.S. Federal Trade Commission Votes to Ban Non-Compete Agreements, But the Issue is Far From Settled

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by Aaron Goldstein

Early last year, the U.S. Federal Trade Commission (“FTC”) proposed a rule banning non-compete agreements nationwide. Yesterday, the FTC voted 3 to 2 in favor of adopting this rule.

The FTC’s newly adopted rule bars for-profit employers from entering into new non-compete agreements with employees, including highly compensated and executive employees. Existing non-compete agreements with senior executives are still enforceable under the new rule, but employers must, by the rule’s effective date, notify all other employees with non-compete agreements that those agreements are unenforceable. The rule defines a “senior executive” as a worker who was in a policy-making position and earns at least \$151,164 per year. The rule does not apply to agreements between franchisees and franchisors, nor does it apply to non-profit entities. The rule also includes an exception for non-compete agreements entered into in the context of the sale of a business.

The FTC’s rule requires employers to provide workers who are subject to covered non-compete clauses “with clear and conspicuous notice ... that the worker’s non-compete clause will not be, and cannot legally be, enforced against the worker.” The FTC’s rule also includes a form of notice that satisfies this requirement.

FTC’s final rule defines “non-compete clause” broadly to include “a term or condition of employment that ... *functions* to prevent a worker” from seeking or accepting work from a different entity after the conclusion of employment. Thus, a provision that would function to keep an employee from finding a new job, such as a very broad non-solicitation clause, might run afoul of the new FTC rule. For example, a non-solicitation clause that prohibits a former employee from contacting any customer or potential customer may encompass practically every consumer in the industry and thus effectively bar the employee from obtaining a new job in the industry.

The FTC’s final rule does not specifically address terms such as stay bonuses or

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retention agreements. However, in its comments to its final rule, the FTC did state that agreements for deferred compensation and other structured payments may be permissible as long as they do not fall within the definition of a non-compete clause—that is, so long as they do not function to prevent employees from seeking or accepting a new job. A substantial signing bonus that an employee would have to pay back if they were to accept work with a competitor might function like a non-compete clause if it were so large that it would effectively be impossible for the employee to repay.

While the FTC's rule might sound like the death knell for most non-compete agreements in the U.S., there is a long road ahead for the FTC's rule.

While the FTC's rule is set to become effective 120 days after it is published in the U.S. Federal Register, at least two lawsuits have already been filed to block the rule, including one filed by the U.S. Chamber of Commerce. The U.S. Chamber of Commerce's suit seeks to block the implementation of the rule while an ultimate decision on the rule's merits is pending. Among other arguments, the U.S. Chamber of Commerce's asserts that the FTC rule violates the "major questions doctrine" under which the U.S. Supreme Court has asserted that an administrative agency, such as the FTC, must have "clear congressional authorization" before adopting a rule that implicates a matter of major political or economic significance. During the COVID-19 pandemic, the U.S. Supreme Court relied upon the major questions doctrine to strike down the U.S. Occupational Safety and Health Administration's emergency temporary standard requiring large employers to vaccinate their employees or require them to wear masks and test for COVID-19.

Even if the FTC's ban is ultimately struck down, many U.S. states have been separately restricting or outlawing non-compete agreements altogether.

California has long outlawed non-compete agreements and has more recently passed laws declaring non-compete agreements void in California, even if they were entered into outside of California and the employee performed services for the enforcing employer entirely outside California. In addition to California, Minnesota, North Dakota, and Oklahoma have banned non-compete agreements entirely. New York's legislature recently passed a bill that would outlaw non-compete agreements, which New York's governor vetoed but with a suggestion that she would sign a bill focused on low wage workers.

Colorado has passed a law limiting non-compete agreements to employees deemed "highly compensated" and now requires that employers provide notice to candidates for employment before they accept a job offer and to current employees at least 14 days before the effective date of any additional consideration for the non-compete provision. The District of Columbia recently passed law creating a similar pay threshold that non-compete must meet and Washington State has had such income requirements in place for over three years.

Several states have also included wage thresholds below which non-compete agreements are not enforceable. These states include Colorado, Illinois, Maine,

Maryland, Massachusetts, Nevada, New Hampshire, Oregon, Rhode Island, Virginia, Washington, and Washington D.C. Such thresholds are often tied to a cost of living index such that the threshold will increase each year.

Many of the states that have restricted the use of non-compete agreements, but still allow them under certain circumstances, have created penalties for employers who unsuccessfully attempt to enforce non-compete agreements. Washington, for example, has passed a law requiring the employer to pay the employee's attorney fees if the non-compete agreement is deemed partially or entirely invalid by the court. Other states have even passed laws creating criminal sanctions for employers who try to enforce unenforceable non-compete agreements.

Even in states that have not passed laws restricting non-compete agreements, courts have grown increasingly skeptical of employers' need for such protections. The general rule in states without non-compete legislation is that non-compete agreements are only enforceable if the employer can show a compelling need for them. Such need usually involves a need to protect sensitive confidential information and trade secrets, or a need to protect customer goodwill in situations where employees develop close relationships with customers. U.S. courts are, on average, becoming more skeptical of employers arguments that they need such protections except in cases where employees have access to truly sensitive information, or could do real damage by going to a competitor and taking substantial business with them.

While the fate of the FTC's rule remains uncertain, employers should be prepared to come into compliance by the rule's effective date (120 days after the rule is published in the federal register, barring any judicial injunction). For example, companies should be prepared to issue the required notices to workers that their non-compete agreements will not be enforced and are unenforceable by the rule's effective date. Companies should also consider that their workers may not understand the status of their non-compete agreements or the unfolding process by which the enforceability of those agreements is being determined. Workers may believe that their non-compete agreements are already unenforceable, and begin to act accordingly. Companies with existing non-compete agreements should have plans in place for handling such situations, including how they communicate their intent to enforce or not enforce their existing non-compete agreements while the fate of the FTC rule is up in the air.

There are no one size fits all solutions to such tough questions, and companies should consult with counsel experienced with navigating non-compete agreements to come up with a plan that fits the company's particular needs and goals.