

## FEDERAL TRADE COMMISSION APPROVES NON-COMPETE BAN

On April 23, 2024, the U.S. Federal Trade Commission ("**FTC**") voted 3-2 to approve a rule that, with limited exceptions, prohibits employers from entering into or imposing existing non-compete clauses with employees ("**Final Rule**").<sup>1</sup> Under the Final Rule, prohibited non-competes are considered an unfair method of competition under Section 5 of the FTC Act ("**Section 5**"). The Final Rule provides exceptions for existing non-competes with specifically-defined "senior executives" and non-competes entered into as part of the bona fide sale of a business. The Final Rule is set to go into effect 120 days after it is published in the Federal Register, likely in late August. The promulgation of the Final Rule continues the FTC's focus on labor issues; however, it runs counter to decades of federal court decisions where non-competes have been evaluated under the rule of reason (i.e., on a case-by-case basis, considering the reasonableness and market impact of the clause's duration, geographic scope, and business justifications). Several lawsuits have already been filed challenging the authority of the FTC to promulgate the Final Rule, and more are expected to come.

### BACKGROUND

For years, non-compete agreements have been legal under federal precedent and contract law in many states, although some jurisdictions (such as California, Massachusetts, and the District of Columbia) have statutes barring various forms of, if not all, non-compete agreements. The Final Rule will now also supersede state laws that would allow for the enforcement of non-compete agreements.

The FTC introduced its proposed rule to ban non-compete clauses in January 2023 ("Proposed Rule"), and spent the subsequent year plus reviewing over

<sup>1</sup> See *Non-Compete Clause Final Rule*, (Apr. 23, 2024) (codified at 16 C.F.R. §910). Available at [https://www.ftc.gov/system/files/ftc\\_gov/pdf/noncompete-rule.pdf](https://www.ftc.gov/system/files/ftc_gov/pdf/noncompete-rule.pdf)

26,000 comments submitted to the FTC. When the Proposed Rule was initially published, the FTC stated that non-competes were unfair methods of competition under Section 5 for three reasons: (i) they restrict conduct that negatively affects competitive conditions; (ii) they are exploitative and coercive of workers at the time of contracting; and (iii) they are exploitative and coercive at the time of the worker's potential departure from the employer.

When the FTC met to vote on the Proposed Rule, Chair Lina Khan and Commissioners Alvaro Bedoya and Rebecca Slaughter echoed similar sentiments. Chair Khan stated that "[n]oncompete clauses keep wages low, suppress new ideas, and rob the American economy of dynamism, including from the more than 8,500 new startups that would be created a year once non-competes are banned...The FTC's final rule to ban non-competes will ensure Americans have the freedom to pursue a new job, start a new business, or bring a new idea to market."<sup>2</sup>

Commissioner Slaughter similarly claimed that non-competes slow innovation and deprive consumers of better products and prices. Looking forward, Commissioner Slaughter suggested potential expansions of this Final Rule to franchisees and franchisors. She also acknowledged that the Final Rule likely does not apply to not-for-profit organizations, which fall outside of the purview of Section 5 under existing precedent.<sup>3</sup>

## THE FINAL RULE

The Final Rule provides that non-competes between employers and employees are an unfair method of competition and are thus a violation of Section 5. After the Final Rule's effective date:

- No employer can enter into a new non-compete agreement with an employee;
- Except for non-competes with "senior executives," existing non-competes are no longer enforceable; and
- Employers are obligated to provide notice to employees subject to now-unlawful non-compete agreements that such provisions are no longer enforceable by the effective date.<sup>4</sup>

The Final Rule, therefore, provides an exception for existing non-competes with "senior executives," defined as those in a "policy-making position" that received annual compensation of at least USD 151,164, including salary, commissions, bonuses, and other nondiscretionary compensation, but excluding payments for insurance, contributions to retirement plans, and similar "fringe benefits."<sup>5</sup>

Those in a "policy-making position" qualifying as "senior executives" include a business':

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<sup>2</sup> Press Release, Federal Trade Commission, FTC Announces Rule Banning Noncompetes (Apr. 23, 2024), <https://www.ftc.gov/news-events/news/press-releases/2024/04/ftc-announces-rule-banning-noncompetes>.

<sup>3</sup> Commissioner Rebecca Slaughter, Remarks Supporting the Final Rule Banning Noncompete Agreements (Apr. 23, 2024), [https://www.ftc.gov/system/files/ftc\\_gov/pdf/noncompetes-oral-statement-slaughter.pdf](https://www.ftc.gov/system/files/ftc_gov/pdf/noncompetes-oral-statement-slaughter.pdf).

<sup>4</sup> 16 C.F.R. § 910.2(a)-(b).

<sup>5</sup> 16 C.F.R. § 910.1.

- President;
- CEO or equivalent;
- Any other officer with "policy-making authority," which may extend to a company secretary; treasurer or principal financial officer; comptroller or principal accounting officer; or other individuals carrying out corresponding functions.

The Final Rule further notes that officers of a subsidiary or affiliate may only qualify for the exception if they have policy-making authority over the entire common enterprise, rather than only their subsidiary or affiliate.

Two points of note. First, the Final Rule broadly defines those workers covered by the prohibition. The definition extends to paid and unpaid employees, independent contractors, externs, interns, volunteers, and apprentices. Second, the Final Rule's language prohibits non-competes that would prevent an individual from accepting work in the U.S. or operating a business in the U.S. Therefore, the scope of the prohibition arguably reaches beyond just U.S. companies to any company that requires a covered employee to sign a non-compete prohibiting the employee from taking a job in the U.S.

In addition to the exception for qualifying "senior executives," the Final Rule includes an exception for non-compete agreements entered into as part of the sale of a business, in the sale of a person's ownership in a business, or in the sale of substantially all of a business' operating assets. This is a significant departure from the Proposed Rule, which had included a narrower exception for sales by certain owners, and recognizes that non-competes are not only common, but justified, in the context of a corporate acquisition or similar transaction.

In another change from the Proposed Rule, the FTC eliminated a provision that would have required employers to legally modify existing non-competes by formally rescinding them. Instead, under the Final Rule, employers must provide notice to workers who are bound to an existing non-compete that the non-compete agreement will not be enforced against them in the future. The notice can be delivered in writing or in a digital format (such as via email or text message). To aid employers' compliance with this requirement, the FTC has included model language in the Final Rule that employers can use to communicate to workers.<sup>6</sup>

## **DISSENT**

Republican Commissioners Melissa Holyoak and Andrew Ferguson voted against the Final Rule, with the latter writing a dissent. In his dissent, Ferguson stated that the Final Rule is defective on both statutory and constitutional grounds. Ferguson stated that the FTC is an administrative agency, not a legislature, and that, "[t]he administrative state cannot legislate because Congress declines to do so."<sup>7</sup> He disagreed with the FTC's authority to implement such a ban under Section 6(g) of the FTC Act and argued that the FTC was running afoul of the major questions doctrine since the Supreme Court has held that when a federal agency claims power to regulate in an area of "tremendous 'economic and political significance,'" "

<sup>6</sup> See FTC, Noncompete Rule ("Model Notices" section), <https://www.ftc.gov/legal-library/browse/rules/noncompete-rule>

<sup>7</sup> Commissioner Andrew Ferguson, Oral Statement In the Matter of the Non-Compete Clause Rule (Apr. 23, 2024), [https://www.ftc.gov/system/files/ftc\\_gov/pdf/ferguson-oral-statement-noncompete.pdf](https://www.ftc.gov/system/files/ftc_gov/pdf/ferguson-oral-statement-noncompete.pdf).

the agency may not rely on 'a merely plausible textual basis for the agency action.'<sup>8</sup> The agency must instead point to the clear congressional authorization for the power it claims. The Final Rule, according to Commissioner Ferguson, proposes to adopt a major policy question without the clear written authority to do so and should, accordingly, not be decided by the FTC.

## CHALLENGES TO THE FINAL RULE

As expected, mere hours after the vote, two legal challenges were made against the Final Rule. First, Ryan LLC, a Dallas-based tax service and software provider, filed a lawsuit in the Northern District of Texas challenging the Final Rule. In their complaint, Ryan contends that the FTC lacks the authority to prohibit non-compete agreements and that the FTC is itself unconstitutional.<sup>9</sup>

The U.S. Chamber of Commerce (the "Chamber") filed a separate legal challenge in the Eastern District of Texas, asking the court to vacate and enjoin the FTC from enforcing the Final Rule. Like Ryan, the Chamber challenged the authority of the FTC to issue the Final Rule, claiming that Congress never empowered the Commission with general rulemaking authority regarding matters under its jurisdiction. The Chamber also claims that even if the FTC had the proper authority to issue such a ruling, the Final Rule would still be unlawful because non-compete agreements are not categorically unlawful under Section 5. Lastly, the Chamber's complaint alleges that the Final Rule is impermissibly retroactive and an arbitrary and capricious exercise of the Commission's power.<sup>10</sup>

In the coming days and weeks, we expect there to be additional challenges on similar grounds.

## THE INTERNATIONAL PERSPECTIVE

Non-compete clauses are also coming under scrutiny from both an employment law and antitrust perspective in other jurisdictions. Although the Final Rule does make the U.S. an outlier as non-compete covenants are subject to various limitations (for example, in relation to geographical application, duration or the need for compensation) generally enforceable in many jurisdictions, India and Bulgaria being exceptions where non-compete covenants are not permissible.

In the U.K. non-solicit and non-compete clauses are currently an area of policy focus of the U.K.'s principal competition authority, the Competition and Markets Association (CMA), which is of the view that while individual employer to employee restrictive covenant disputes might not be squarely a competition law issue, the effects of such practices, if they are practiced widely enough, could have anticompetitive repercussions for the wider labor market.

In addition, in May 2023 the U.K. Government published its Response<sup>11</sup> to a consultation on measures to reform post-termination non-compete clauses in

<sup>8</sup> *Id.*, at 3 (quoting *West Virginia v. Env't Prot. Agency*, 597 U.S. 697, 721-3 (2022)).

<sup>9</sup> Complaint at 3-4, *Ryan, LLC v. Federal Trade Commission*, No. 3:24-cv-986 (N.D. Tex. Apr. 23, 2024).

<sup>10</sup> Complaint at 11, *Chamber of Comm. of the U.S., et al. v. Federal Trade Commission*, No. 6:24-cv-00148 (E.D. Tex. Apr. 24, 2024).

<sup>11</sup> See U.K. Dep't for Bus. & Trade, *Non-Compete Clauses – Response to the Government consultation on measures to reform post-termination non-compete clauses in contracts of employment* (May 12, 2023), at [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/1156211/non-compete-government-response.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1156211/non-compete-government-response.pdf).

contracts of employment. It is proposed that there will be a new statutory limit of 3 months on non-compete covenants in both employment and worker contracts.

No timeframe has been indicated for when the new non-compete regime will come into effect other than when parliamentary time allows. In addition, in the absence of any draft legislation there are many outstanding questions (some of which may apply in the context of the introduction of the Final Rule) including:

- Whether the three-month prohibition will apply retrospectively or whether there will be a transition period.
- Will it be permissible to use 'back door' non-competes in variable remuneration arrangements (i.e. where deferred compensation is forfeit if the individual joins a competitor within a defined timeframe)?
- Whether non-compete restrictions can be imposed in the context of the use of non-disclosure /termination agreements?

The Dutch government is also considering revising the statutory non-compete undertaking framework. A public consultation on this bill closed on April 15, 2024. The draft bill includes more extensive conditionality in order for a non-compete provision to be enforceable, such as (i) a maximum duration of 12 months, (ii) the mandatory inclusion of a geographical scope, (iii) mandatory compensation equal to 50% of the employee's salary; and (iv) the employer must substantiate the business and service interests that justify the inclusion of a non-compete clause in writing.

In China, on July 31, 2023, the State Administration for Market Regulation ("SAMR") summoned four hog breeders, Muyuan Food Co., Ltd., Wens Foodstuff Group Co., Ltd., Twin Group Co., Ltd., and CP Group Co., Ltd., that were found to have initiated and signed a no-poach agreement, advocating non-poaching and non-solicitation during an industrial forum on in June 2023. SAMR pointed out that the agreement goes against the spirit of the Anti-Monopoly Law ("AML") and ordered the four companies to rectify their actions and ensure compliance with antitrust rules. After the meeting with SAMR, the four companies issued a joint statement, stating that they would implement corrective measures and revoke the problematic no-poach agreement. While SAMR did not refer to the specific provisions in the AML that were violated or issue a penalty decision, SAMR's move marks the first time the Chinese antitrust regulator has expressed concerns about competition issues in the labor market. In the same press release, SAMR also announced its determination to closely monitor the competition landscape in the country's labor market. This finally echoes global antitrust regulators' increasing clampdown of no-poaching arrangements among competing firms.

## **OPEN QUESTIONS**

In addition to how the Final Rule will fare in the face of mounting legal challenges, the Final Rule raises a number of questions that will require close factual examination on a case-by-case basis, as well as time to see how the FTC enforces the Final Rule, such as:

- How will the FTC try to enforce the Final Rule, if at all, over multi-national employers with employees in other jurisdictions subject to non-competes?

- If former employees or employees on garden leave are receiving compensation, at least in part, tied to a non-compete, what rights do employers have to withhold compensation?
- Is it possible that key employees in research and development roles, who often have some of a company's most sensitive secrets, can qualify as having "policy-making authority," meaning the "authority to make policy decisions that control significant aspects of a business entity or common enterprise...?"

## **NEXT STEPS**

Moving forward, entities must start working with their HR teams to identify the scope of their non-compete agreements and prepare the appropriate notices. While employers do not need to formally rescind the non-compete provisions in their ongoing contracts, they will need to provide notice to those bound by non-compete agreements that the enforcement of such provisions will be prohibited by the Final Rule. Employers should start preparing those notices to send before the effective date of the Final Rule.

Existing employee contracts as well as separation agreements should be reviewed to remove references to non-competes where not permitted under the Final Rule and ensure that other provisions around confidentiality, trade secrets, and non-solicitation provide the employer with the maximum protections. Without the protection of non-competes, employers will want to closely monitor potential breaches involving confidentiality and trade secrets.

Despite the breadth of the Final Rule, companies should also continue to remain mindful of applicable state laws, especially in states with total bans on non-compete agreements like California and Minnesota.

For further information on a comparison of the treatment of non-compete agreements around the world, please see our international employment app:

**Web version available here:** <https://apps.fliplet.com/clifford-chance-clifford-chance-employment-law-guide/menu-impd>

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