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Understanding and navigating the FTC's new non-compete ban

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On April 23, 2024, the Federal Trade Commission voted 3-2 to ban many types of employment non-compete agreements, deeming them anticompetitive in what amounts to an extraordinary departure from the traditional view of such agreements. As Commissioner Ferguson contended in his dissent which set forth his belief that the Commission lacked the power to adopt the Rule, the Commission's Rule will "nullify tens of millions of existing contracts."

Because non-competes are common, determining the Rule's scope is crucial, as is understanding its key exceptions (e.g., Franchisor/Franchisee agreements). Fortunately, employers and employees have time to breathe. Assuming

legal and political challenges do not create additional delays, the Rule does not go into effect until 120 days after publication in the Federal Register, providing a needed pause to analyze existing non-competes and prepare.

What you need to know

The Rule invalidates all new and existing post-employment "non-compete clauses" between employers and their "workers," with the exception of existing non-competes for "senior executives" (a term defined by the Commission in the Rule).

The Rule's true breadth comes from its expansive definitions of "worker" and "non-compete clause."

- The ban broadly defines "worker" to include any "natural person who works, whether paid or unpaid, without regard to the worker's title or the worker's status under any other State or Federal laws including, but not limited to, whether the worker is an employee, independent contractor, extern, intern, volunteer, apprentice, or a sole proprietor who provides a service to a person."
- The ban applies to any "term or 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 "penalizes" category of non-competes is designed to address tactics such as equity forfeiture provisions, which have the effect of prohibiting employees from moving to a competitor. The "functions to prevent" category of the definition extends the Rule to, for instance, a broad non-disclosure agreement that functionally prevents a worker from changing jobs where doing so might involve revealing a former employer's sensitive information.

Once published in the Federal Register, the Rule takes effect after 120 days (barring judicial intervention). Employers should prepare for the Rule by taking stock of their employment policy and agreement landscape, including their existing use of traditional non-competes, non-disclosure agreements, non-solicitation agreements, restrictive covenants, and similar policies. By the effective date, the Rule requires employers to give "clear and conspicuous" notice to all workers that their existing non-competes are no longer enforceable, and includes sample language for this purpose. Thereafter, new non-competes falling under the Rule's purview will be deemed an "unfair method of competition" in violation of Section 5 of the FTC Act, which can result in fines, penalties, and other injunctive relief.

Key exceptions: Franchise relationships and sale-of-business transactions

The Rule permits several exceptions, and notable among them are exceptions for two types of transactions that often employ non-competes.

First, the Rule does not apply to non-competes in "franchisor/franchisee relationships." While the Commission acknowledged that "in some cases, franchisor/franchisee non-competes may present concerns . . . similar to the concerns presented by non-competes between employers and workers[,]" it justified its exception of franchise relationships on the theory that agreements in this context are more akin to business-to-business transactions.

While this is a welcome relief to franchisors, they should keep in mind that their non-competes in other contexts (i.e. with their direct employees) will still be subject to the Rule and its notice requirements. The inability to use non-competes with key executives and employees who also learn and share in the franchisors' proprietary information is still an area of concern. Notably, the Commission confirmed that businesses still have access to other alternatives to protect their proprietary information, such as non-disclosure agreements, protections under trade secret, patent, and copyright law, and well-tailored invention assignment agreements.

Second, the Rule exempts non-competes that are part of 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." The Commission's main rationale for this exception is to preserve the acquisition value of businesses, which can be destroyed if not protected by reasonable competitive restrictions on the seller.

Going forward

The Rule's impact will continue to reveal itself in the coming months. Unsurprisingly, it has already drawn legal challenge to the Commission's authority to enact it. On April 24, 2024, just a day after the Commission's vote, the U.S. Chamber of Commerce filed suit. Similar suits concerning the Commission's authority and the Rule's validity are likely to follow, and these may delay the effective date of the Rule.

Saxton & Stump will continue to follow the implementation of the Rule and the legal challenges to it.

Sam Harrison is Senior Counsel in Saxton & Stump's Philadelphia Office, where he is a member of the firm's Franchising, Licensing and Distribution Practice Group. He regularly advises businesses on an array of competition and antitrust law issues, including pricing/distribution policy design and implementation, distributor termination disputes, employee training, and antitrust compliance. In addition to business counseling, he has litigated and won competition-related lawsuits in federal court and international arbitration forums.

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