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FEDS BAN NON-COMPETE AGREEMENTS: A 5-STEP PLAN FOR EMPLOYERS

Insights
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The federal government took an unprecedented step yesterday by finalizing a rule that seeks to ban non-competition agreements between nearly all employers and all workers. If the rule survives legal challenges, you will not only be prohibited from entering into most new non-competes, you'll also be prevented from enforcing existing non-competes in all but a few circumstances, such as against a limited class of senior executives. Moreover, you'll be required to provide notice to current and former workers that their non-competes are no longer valid. While the rule is not slated to take effect until August and is already being challenged in court — which could derail it or kill it altogether — you may not want to wait to start preparing. Here is an overview of the final rule and a five-step plan for you to consider.

[EDITOR'S NOTE: A Texas federal court struck down the FTC's proposed ban on non-competition agreements on a nationwide basis on August 20, meaning employers across the country can continue to maintain non-competes as their state laws allow. Employers will not have to comply with the rule by September 4 as originally scheduled. Read more about the decision and practical pointers on next steps by clicking here.]

The Rule Does 3 Major Things

The rule finalized by the Federal Trade Commission (FTC) on April 23 does three critical things:

- You will **no longer be able to enter into non-compete clauses** with workers.

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- You can **no longer enforce existing non-compete agreements** – unless they cover certain senior executives.
- You must **provide explicit notice** to both current and former employees that their non-competes are no longer enforceable.

2 Key Definitions to Explain

After reading that summary, you probably have two main questions: What does the FTC consider a "non-compete"? And who is considered a "senior executive"?

What is a Non-Compete?

The rule defines "non-competition agreements" as any term or condition of employment that prohibits a worker from, penalizes a worker for, or functions to prevent a worker from seeking or accepting employment with another business or operating a business.

The FTC's rule does not go so far as to explicitly ban other forms of protection for employers, such as customer non-solicitation agreements or employee non-recruitment, confidentiality, or non-disclosure provisions. Rather, the FTC said those provisions are still valid so long as they do not have the effect of preventing someone from getting a job, but the determination will be made on a case-by-case basis. This highlights the importance of consulting with your FP counsel for guidance on these agreements, especially since the FTC's rule may ultimately be blocked by a court.

Who Are Senior Executives?

The final rule defines "senior executives" as workers earning more than $151,164 annually and who are in policy-making positions. You are allowed to maintain and enforce existing non-compete agreements with these higher-level workers. But you should note that the FTC estimates "senior executives" make up fewer than 0.75% of all workers.

The FTC's Concessions

In response to the tens of thousands of comments, the FTC did reduce the scope of its original proposed rule in two meaningful ways:

- **No need to rescind.** You do not need to take active steps to formally rescind existing non-competes. The initial

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proposal, released in January 2023, would have required you to modify all existing agreements. The agency determined that would have been too large of an administrative burden for employers.

- **Business sale exemption expanded.** The final rule also allows for non-competes during the bona fide sale of a business or the sale of someone's ownership interest. The original proposal only allowed sale-of-business exceptions where the seller owned at least a 25% stake in the business being sold.

More Info on Notice Requirement

Before the effective date, you must provide notice to workers that their non-compete clause is no longer in effect and, unless they are senior executives, may not be enforced against them. Such notices must follow several guidelines:

- You must provide "**clear and conspicuous**" notice that identifies the person who entered into the non-compete with the worker.
- You have to provide it in **digital format (such as email or text) or on paper**. Oral notice does not count.
- The worker is exempt from the notice requirement if you have "no record" of a street address, email address, or mobile telephone number.

You must provide this notice to both current and former workers (at least to those former workers who are potentially subject to active non-compete clauses as of the rule's compliance date).

The rule also includes model notice language and creates a **safe harbor** for employers that use the model notice. You do not have to use this language to comply with the law, however, so long as you use language that effectively communicates the requirements above. But it is currently uncertain whether you will gain the safe harbor's protections if you veer from the model notice.

What Are The Next Steps?

- **Effective date in August.** The rule will first be formally published in the Federal Register. Once published there, it is slated to take effect 120 days later. That means the

earliest we can see the rule taking effect would be August 22, 2024.

- **Court battles already underway.** But the next few months will be very active in the courts, with business advocacy groups taking aim at the rule and the feds working furiously to preserve it. The U.S. Chamber of Commerce has already promised to file legal action against the FTC to block the rule from taking effect – but they are not the only party fighting against the government. Within hours of the rule being released, in fact, at least one business had filed a lawsuit in Texas with the goal of striking down the rule. It would not be surprising to see a federal court judge strike down the rule or put it on hold.

- **Long road ahead.** But it would also not be surprising to see a federal appeals court being called on to issue a sweeping ruling on the matter at some point. This issue is of such importance that Supreme Court intervention is also a distinct possibility. Appeals take time, so don't be surprised if this battle drags on into 2025 and beyond. Additionally, the FTC's direction would likely change if there is a change in control of the White House.

Your 5-Step Plan

You can't count on the courts blocking the rule and releasing you from your obligations. But at the same time, it might not make sense to invest a tremendous amount of time and resources getting into compliance only to see the rule struck down and your efforts wasted. Given the need to strike the right balance, here are five steps to consider:

1. Develop a Personalized Strategy Plan

You will want to work with your legal counsel as soon as possible to craft an individualized strategy plan in light of these developments. You'll want to take into consideration the size of your business, the number of non-competes in play, the importance of such agreements to your business, your risk tolerance levels, the resources you have on hand, and a variety of other factors to determine your next steps.

2. Use the Next Few Months to Take Stock

Even if you have a high risk tolerance and feel confident that the rule will be blocked by court action, you might not want to do nothing between now and the summer.

- Between now and the Fourth of July, even the most risk tolerant employers may want to take an inventory of all existing restrictive covenant agreements – including those that bind former workers. This is often a good use of time and money even without the looming FTC rule.
- Make sure you determine which workers fall under the "senior executive" category to allow for enforcement.
- At the same time, make sure you are tracking all new non-competes you put into effect from here on out.

3. Begin Plotting Alternatives

Start strategizing with your leaders about whether your organization can protect your interests with a less burdensome covenant. A properly tailored customer non-solicitation or confidentiality provision could achieve the same goals with less risk involved.

4. Don't Ignore Other Restrictive Covenants

Speaking of other restrictive covenants, remember that the final version of the rule does not specifically render them unenforceable. Make sure to review your non-solicitation, non-recruitment, non-servicing, and non-disclosure clauses, knowing they may soon be subjected to scrutiny. You should reasonably tailor them with the help of your Fisher Phillips counsel to protect your legitimate interests.

5. Get Your Trade Secrets House in Order

This is perhaps more important now than ever. The FTC cites the availability of trade secret protection as a factor that could mitigate the harm of abrogating non-competes. You should identify your trade secrets and ensure that you have proper policies and procedures in place to protect them. Limit trade secret access only to those who need it. Train employees how to handle trade secrets and protect against theft. Implement suitable technological controls. In short, think through what your answer would be under oath to the question "tell me everything you have done to prevent your trade secrets from falling in the hands of a competitor."

Conclusion

We will be monitoring the situation and providing updates as the court battles begin and the effective date approaches. Make sure you are subscribed to Fisher Phillips' Insight

System to gather the most up-to-date information directly to your inbox. If you have questions, please contact the authors of this Insight, your Fisher Phillips attorney, or any attorney in our Employee Defection and Trade Secrets Practice Group.