SQUIRE PATTON BOGGS

FTC Bans Non-Competes Throughout the US

Legal Challenges Already Filed

April 2024

In a long-anticipated move that dramatically alters the employment landscape, the Federal Trade Commission (FTC) issued its final Non-Compete Clause Rule (final rule) effectively banning employee non-compete agreements throughout the US. After receiving over 26,000 public comments, the FTC determined that the use of non-compete agreements with workers constitutes an "unfair method of competition" in violation of Section 5 of the FTC Act.

The rule arguably represents a novel extension of the FTC's authority by broadly proscribing a type of business practice as a stand-alone "unfair method of competition." Historically, the FTC has made such determinations on a case-by-case basis.

Scope of Final Rule

The final rule is sweepingly broad and imposes a prospective ban on new non-competes for all workers, while retroactively invalidating all existing non-competes except for those with senior executives. Under the final rule, "senior executives," whose existing non-compete agreements remain enforceable, are defined as workers in policy-making positions earning more than US$151,164 annually. The final rule requires employers to provide notice to affected employees, other than senior executives, that their existing non-compete agreements will not be enforced by the effective date of the rule, though it does not require employers to formally rescind those agreements as the initially proposed version of the rule would have required.

The FTC's ban targets non-compete clauses that are "a term or condition of employment that prohibits a worker from, penalizes a worker for or functions to prevent a worker from" seeking or accepting different work in the US or operating a business in the US. Other types of non-compete agreements, such as those entered in connection with the sale of a business, are excluded. Likewise, the rule does not apply to employees of some banks (see Appendix on following page), nonprofits and common carriers because the FTC's jurisdiction generally does not extend to those sectors.

The prohibition applies to both contractual terms and workplace policies, whether written or oral and it preempts conflicting state laws.

The final rule will become effective 120 days after it is published in the Federal Register.

Legal Challenges Underway and More Expected

As anticipated, the final rule is facing legal challenges out of the gate. Less than 24 hours after the FTC announced the final rule, the US Chamber of Commerce filed a lawsuit in the US District Court for the Eastern District of Texas, challenging the non-compete ban, arguing that the FTC does not have authority under the FTC Act to make rules regulating unfair methods of competition and that under the US Supreme Court's "major questions doctrine," the final rule must be vacated because the FTC acted without clear Congressional authorization. Given the Supreme Court's increasingly skeptical view of administrative rulemaking of late, these arguments may find favor should they reach the Supreme Court. The Chamber also challenges the final rule on other grounds, including that it is an unconstitutional delegation of legislative power, that it impermissibly applies retroactively to existing non-compete agreements and that it is arbitrary and capricious, as the FTC issued the final rule based on limited and flawed studies without sufficient consideration of the concerns and alternatives raised during the public comment period.

We expect that other interested parties will raise similar challenges and that the status of the final rule will remain in flux while legal battles unfold. The ultimate resolution of these challenges will not only clarify the applicability of the final rule but also shed light on the FTC's authority to promulgate additional rules proscribing "unfair methods of competition" in the employment context and more broadly.

Proactive Steps for Employers

Although there may be strong bases to challenge the final rule and its ultimate fate is unknown, the recent trends at both the federal and state levels have decidedly been to narrow and restrict the use of employment-based non-compete agreements. Employers should of course continue to ensure their practices comply with applicable state and local obligations relating to non-compete agreements, including in states like California that effectively ban them entirely.

Employers should also use this opportunity to think about their protectible business interests and take stock of the alternative tools available, including, for example, by implementing or updating non-disclosure and non-solicitation agreements, ensuring systems are in place to safeguard and restrict access to trade secrets and other confidential business information, investing in training and culture to promote retention and reinforce employee duties and implementing robust exit interviews and transition planning. As legal challenges to the final rule play out, these measures can provide more certainty for employers and offer additional protections of their investments beyond the non-compete agreements implicated by the final rule.

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Appendix

"**Banks**" are statutorily excluded from the FTC's jurisdiction to prevent unfair competition and/or unfair or deceptive acts, and are defined in the FTC Act as:

- National banks and Federal branches and Federal agencies of foreign banks;
- member banks of the Federal Reserve System (other than national banks), branches and agencies of foreign banks (other than Federal branches, Federal agencies, and insured State branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act [12 U.S.C. 601 et seq., 611 et seq.]; and
- banks insured by the Federal Deposit Insurance Corporation (other than banks referred to in subparagraph (A) or (B)) and insured State branches of foreign banks.

The FTC's final non-compete rule notes with respect to banks, bank holding companies, subsidiaries and affiliates:

> "At least one financial services industry commenter stated that national banks are outside of the Commission's jurisdiction and argued the final rule should exclude bank holding companies, subsidiaries, and other affiliates of Federally regulated banks to avoid disparate treatment of workers employed by different affiliates within the same organization, and because those entities are already heavily regulated. The Commission declines to exclude bank holding companies, subsidiaries, and other affiliates of Federally regulated banks that fall within the Commission's jurisdiction. While these institutions may be highly regulated, and depending on the corporate structure non-competes may be allowed for some workers but not others, the Commission finds that neither factor justifies excluding them from the final rule. If Federally regulated banks are concerned about disparate treatment of workers employed by their own different affiliates, they have the option to stop using non-competes across all their affiliates."

It is worth noting that the FTC is not marching to the beat of its own drum. Federal bank regulatory agencies have also been very aggressive in the recent past, consistently promulgating new rules and/or providing new guidance that expand the scope of regulation. Also, Federal bank regulatory agencies have aggressively pursued enforcement action against banks. Time will tell how the FTC's new rule fares in court. In the meantime, the FDIC could adopt a similar rule applicable to all institutions with deposit insurance and, in the interim, recommend that banks comply with the FTC rule.