Insights: Perspectives

7 Key Takeaways | The FTC's Rule Banning Non-Compete Agreements: What You Need to Know

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7 KEY TAKEAWAYS

The FTC's Rule Banning Non-Compete Agreements: What You Need to Know

The Federal Trade Commission (FTC), in a tight 3–2 vote, recently voted to adopt a rule banning non-compete agreements nationwide. Non-compete agreements have never been regulated at the federal level and the FTC's adoption of its new rule breaks with centuries of state and federal law on the topic. Several lawsuits have already been filed challenging the FTC's rule claiming, among other things, that the United States Congress never empowered the FTC with general rulemaking authority regarding matters under its jurisdiction.

Kilpatrick attorneys Brodie Erwin and Drew Williamson recently hosted a webinar to help you understand what you need to know about this significant shift in non-compete law and provide guidance on next steps for complying with all applicable laws while ensuring your legitimate business interests remain protected.

Their 7 Key Takeaways from the webinar include:

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The FTC's Rule is Part of a Larger Movement to Curtail Non-Competes: Non-competes have been part of employment agreements for hundreds of years and, with limited exception, courts and legislatures have largely approved their use. However, in recent years, there has been a growing trend at the state level to either limit or outright ban the use of employee non-compete agreements.

More recently, federal agencies, at the urging of the Biden administration, have taken aim at curtailing the use of non-competes. The FTC's final rule is simply the latest (and broadest) installment in this larger effort to curtail the use of non-competes by employers.

The FTC's Rule is Expansive: With limited exception, the FTC's final rule impacts every industry and applies to all workers, regardless of "employee" title or classification. The ban on non-competes seeks to preclude the use of not just traditional non-compete agreements but also any other agreements, terms, or conditions that may ultimately "function" as non-competes or otherwise "penalize" workers for post-employment work.

If it survives legal challenges, the FTC's rule could potentially impact the use of customer and investor non-solicitation agreements and non-disclosure/ confidentiality agreements which are standard across most industries. The rule will also necessitate changes to companies' use of common deferred compensation or equity arrangements and would prevent them from employing forfeiture-for-competition clauses in most circumstances.

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Limited Carve-Out for Existing Non-Competes with "Senior Executives": As of its effective date, the final rule renders pre-existing

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Executives": As of its effective date, the final rule renders pre-existing non-compete clauses void and unenforceable for all workers except for "senior executives." However, this term is narrowly defined, which will limit the applicability of this carve-out for most employers. The rule's definition of senior executive requires the worker be in a "policy-making position." To satisfy this criteria, a worker must have "final authority" to make policy decisions controlling significant aspects of a business, which will likely only include C-suite employees and those in similar roles.

The FTC's commentary estimates that just 0.75% of workers are likely to be considered senior executives under the rule. Remember, this exception only applies to existing non-compete agreements with senior executives. Once the rule is effective, you will not even be able to enter into non-compete arrangements with senior executives.

Sale of a Business Exception Limited to "Bona Fide" Sales: The final rule does not apply to non-competes entered into by a person or entity pursuant to a bona fide sale of a business entity. The exception will not be applied literally. In other words, not every sale of a person's ownership interest will qualify for the exception.

Instead, the FTC clarified that the sale must be between independent parties at arm's length, and in which the seller has a reasonable opportunity to negotiate the terms of the sale. As a result, "springing" non-competes and non-competes arising out of repurchase rights or mandatory stock redemption programs will not be excepted.

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Exceptions for Causes of Action Pre-Dating the Rule and Good-Faith: While the rule renders nearly all non-competes unenforceable as of the effective date, it contains an express carve-out for causes related to breach of a non-compete that accrued before that date. For example, if a worker violates a customer non-solicit that functions as a non-compete before the effective date, the former employer is not prohibited from seeking relief related to the earlier breach. The rule also contains an exception for unfair methods of competition committed after the effective date where the party had a good-faith basis for believing the rule did not apply to their actions.

As a result, businesses will be able to rely on the good-faith exception in self-determining whether a worker qualifies as a senior executive or when determining whether a term or condition other than a standard non-compete (i.e., customer non-solicit) is considered a "non-compete" under the rule.

Don't Panic: Litigation challenging the FTC's rule is pending in multiple jurisdictions. Conventional wisdom is that the legal challenges will be successful in either enjoining enforcement of the rule or, at minimum, narrowing its scope. As a result, businesses should not deviate from their current practice of having employee's execute non-compete agreements, particularly in states where continued employment is not sufficient consideration for a non-compete.

Businesses should, however, consider refining the use of severability clauses in non-compete agreements to ensure non-compete terms can be severed if necessary. At the same time, businesses should consider ways to tie a particular aspect of consideration or compensation to the non-compete so that it may also be severed, or clawed back, if the non-compete is ultimately

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made unenforceable by the rule.

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Instead, Adapt and Prepare for a World Without Non-Competes: Employers should nevertheless prepare for a scenario where the rule (or some version of it) becomes effective. Efforts to prepare for potential enforcement of the rule should include an audit of all existing non-competes. During this process, businesses should identify those with employees who would satisfy the rule's definition of senior executive as well as those that would qualify for the sale of a business exception. Business should also review existing job descriptions for workers who may potentially qualify as senior executives to ensure their pre-existing non-compete agreements are grandfathered.

Employers should also make time to review their use of other restrictive covenants like customer and employee non-solicitation agreements and confidentiality agreements. If appropriately tailored, such agreements can still be utilized in lieu of traditional non-competes to protect your legitimate business interests, including your trade secret and confidential information.

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