Despite the FTC's Final Rule Banning most Employer-Employee Non-compete Clauses, it is not the death of all Non-Compete Clauses.

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On May 7, 2024, the Federal Trade Commission ("FTC") published in the Federal Register its Final Rule purportedly banning employer-employee non-compete clauses. With a few exceptions, the FTC's ban effective September 4, 2024, prohibits a person from: (1) requiring workers to enter non-compete clauses; and (2) enforcing non-compete clauses against workers. The Final Rule applies broadly to "Workers" that are or were employees, independent contractors, or sole proprietorships, and includes interns, externs, and volunteers subject to a non-compete clause. It also broadly defines "Person" and "Non-compete clause" such that the Final Rule bans non-competition clauses in most, but not all, employer-employee relationships. The FTC's ban supersedes conflicting state laws.

Throughout the public comment process, many commentators and industry associations were extremely critical of the FTC's intentions to ban employee-employer non-competition clauses. Some claim the FTC has overreached its authority. Many claim that the FTC's approach will mean the end of non-competition agreements and the protections they are intended to afford their users. Claims that the non-compete clause is at its end ignores the reality of the situation. As discussed in this blog, the FTC's Final Rule is broad but includes exceptions such that it is not a complete ban on employer-employee non-compete clauses. Further, there are legal attacks pending against the Final Rule such that it may be held to be unenforceable. And finally, the FTC's Final Rule does not apply to other common uses of non-compete clauses outside of the employer-employee relationship.

Exceptions to the FTC's Employer-Employee Non-Compete Ban:

Before the FTC's Final Rule, employers seeking to limit an employee's ability to work for competitors after employment ended had to make sure that the restrictions met the non-compete requirements of the respective state's law that governed their employer-employee relationships. Those employers seeking to enforce or maintain non-compete clauses after the FTC's Final Rule comes into effect can only do so in limited circumstances. For example, an employer could enforce an otherwise valid non-compete clause against "Senior executives" (i.e., a worker who was in a policy making position and received at least $151,164 annual compensation in the last year) that entered it before the September 4, 2024 "Effective date." The Final Rule also creates an exception for non-compete clauses entered by a person as part of a bona fide sale of a business entity. It also does not preclude causes of action related to a non-compete clause accrued before the Effective Date. The Final Rule also creates an exception to the enforcement, or attempted enforcement, of a non-compete clause where a person has a good faith basis to believe that the Final Rule is inapplicable.

Legal Challenges to the FTC's Employer-Employee Non-Compete Ban:

Shortly after the FTC issued its Final Rule on April 23, 2024 (and before official publication in the Federal Register), legal challenges concerning its constitutionality started. That same day, Ryan, LLC, a global tax services firm, filed a suit in the Northern District of Texas. On April 24, 2024, the U.S. Chamber of Commerce, The Business Roundtable, Texas Association of Business, and the Longview Chamber of Commerce filed suit in the Eastern District of Texas. The next day, ATS Tree Services, LLC, filed a suit in the Eastern District of Pennsylvania. All three (3) of the federal suits challenge the constitutionality of the Final Rule, and they seek injunctive relief to stop the enforcement of the Final Rule. Notably, the Federal Eastern District Court of Texas has stayed the Chamber of Commerce case, in part on the basis that the Ryan case was first in time and raises identical legal theories and relief.

Due to the injunctive relief sought in these suits, they could have a temporary or lasting impact on the enforcement of the Final Rule. Unless advised otherwise by retained counsel, employers should assume they will be obligated to take measures required in the Final Rule to provide notice to current and former employees subject to pre-September 4, 2024, non-competition agreements.

Uses of non-compete clause outside of the employer-employee relationship:

The FTC's Final Rule defines a "non-compete clause" to narrowly apply to terms or conditions restricting "employment." 16 CFR § 910.1 ("non-compete clause"). By a plain reading of the FTC's Final Rule, it does not preempt or apply outside of the employer-employee relationship. As such, non-compete clauses commonly used in other types of relationships remain available after September 4, 2024.

Franchise agreements, for example, commonly contain restrictive covenants that forbid a franchisee from competing in a protected territory after termination of the franchisee-franchisor relationship. In Texas, as in many states, if the franchise agreement meets the statutory requirements for a valid non-competition clause, the clause is valid and enforceable. The FTC's Final Rule expressly excludes such a relationship from its non-competition clause ban.Specifically, the Final Rule applies to terms or conditions of employment of "a worker" and in the definition of "worker" it expressly clarifies that "the term worker…does not include a franchise in the context of a franchisee-franchisor relationship." 16 CFR 910.1 ("worker").

Many states, including Texas, have also upheld the use of non-compete clauses in commercial leases. Commonly referred to in commercial leases as "business operation exclusivity clause", or the "restricted use provision", these commercial lease provisions can either limit the type of business a tenant conducts in the lease premises, or they can limit the landlord's use of other properties it controls such that they will not be used by persons to compete with the tenant. Commercial leases commonly include provisions that define the relationship between the parties as strictly landlord-tenant. It is not uncommon for these provisions to include express language disavowing any other type of relationship including that of employee-employer. Assuming these provisions comport with statutory exceptions to state-issued anti-trust or restraint on trade laws, these restrictive commercial lease covenants are enforceable under their respective state laws and are outside the Final Rule's preemptive reach.

Employers have options other than non-compete clauses to protect confidential information or trade secrets.

Whether the FTC's ban on non-competition agreements survives judicial scrutiny, employers should look to other tools to ensure the protection of confidential information, goodwill, and trade secrets. For example, employers should strengthen non-disclosure and confidentiality agreements and related policies. To do so, employers should take measures to ensure that their agreements, policies, and practices are specific to their business, clear in scope and application, and (where applicable) compliant with state and federal defense of trade secrets acts.

About the Author

For more than twenty years, Richard L. Hathaway has litigated non-competition, non-solicitation, trade secrets, and other matters protecting business innovation. He has successfully enforced his business clients' agreements and rights in arbitration and Texas state or federal court. He and his team are available to assist your business in protecting its trade secrets via a review of its agreements, policies, and training. If you suspect departing employees are attempting to depart with the business's trade secrets, he and his team are ready to aggressively pursue all available legal avenues. You can reach him via email at: Rhathaway@krcl.com and phone at: 214-777-4270.