

The FTC's Non-Compete Ban: Leveling the Playing Field?

By Erin Deal Johnson and Daniel M. Smith

Note: Following the completion of this article, a Texas federal judge issued an opinion and order granting a preliminary injunction prohibiting the Rule (defined below) from taking effect against the plaintiffs.¹ The court intends to rule on the merits of this case by August 30, 2024. Though the Rule remains valid as applied to those not parties to this case, the ruling raises doubts about the Rule's ability to survive legal challenges in the long term.

The Federal Trade Commission ("FTC"), pursuant to the Federal Trade Commission Act (the "FTC Act"), issued its final rule, the Non-Compete Clause Rule (the "Rule"),² on May 7, 2024. Subject to some exceptions, the Rule prohibits entering into and enforcing non-compete clauses with workers on or after the effective date

of September 4, 2024 (the "Effective Date"). The Rule treats a subset of workers, identified as senior executives, differently and does not nullify existing non-competes, those entered into prior to the Effective Date, with such senior executives.³

In issuing the final rule, the FTC expressed many reasons for the Rule but rooted its rationale in its designation of non-compete clauses as "unfair methods of competition in several independent ways."⁴ The FTC explained that "the use of non-competes is restrictive and exclusionary conduct that tends to negatively affect competitive conditions in labor markets" as well as "product and service markets."⁵ They further argued that, especially with non-senior executives, the clauses'

restrictive nature is exploitative and coercive because of the workers' unequal bargaining power.⁶

THE NON-COMPETE CLAUSE RULE

The final rule states that "[w]ith respect to a worker, other than a senior executive, it is an unfair method of competition for a person (i) [t]o enter into or attempt to enter into a non-compete clause; (ii) [t]o enforce or attempt to enforce a non-compete clause; or (iii) [t]o represent that the worker is subject to a non-compete clause."⁷ The rule for senior executives is similar to the foregoing rule for other workers, but it only prohibits enforcing and representing to the senior executive that it is subject to non-compete clauses that were entered into *after* the Effective Date.⁸ In other words, non-compete clauses entered into with a senior executive prior to the Effective Date are still enforceable after the Effective Date.

What is a Non-Compete Clause?

The Rule defines a non-compete clause as a "term or condition of employment" that prohibits, penalizes, or prevents a worker from seeking or accepting work with a different person or entity or operating a business.⁹ As used in the Rule, "a term or condition of employment includes, but is not limited to, a contractual term or workplace policy, whether written or oral."¹⁰ The original purpose of non-competes was to prevent skilled workers or executives of a company from working for a competitor or starting their own competing business. However, the clauses have expanded and started appearing in relatively low-paying jobs as well, one of the many reasons that prompted the FTC to begin exploring the potential for a federal rule with respect to non-competes.¹¹

Who is Affected?

A person is defined as "any natural person, partnership, corporation,



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association, or other legal entity within the Commission's jurisdiction, including any person acting under color or authority of State law."¹²

A worker includes any natural person who works or previously worked, whether paid or unpaid, and includes, but is not limited to, any employee, intern, extern, independent contractor, volunteer, or apprentice.¹³ The definition specifically addresses the situation of a franchise by confirming that a worker "includes a natural person who works for a franchisee or franchisor, but does not include a franchisee in the context of a franchisee-franchisor relationship."¹⁴

As mentioned above, though non-competes entered into by senior executives on and after the Effective Date are prohibited and also not enforceable, those that were entered into *before* the Effective Date, will remain valid and enforceable. The only time a non-compete entered into after the Effective Date will be enforceable is from a bona fide sale of business.

Who is Considered a Senior Executive?

The Rule defines a "senior executive" as a worker who (1) was in a policy-making position; and (2) received total compensation of at least \$151,164, either actual or when annualized if the worker did not work the entire year.¹⁵ A worker such as a business's president, chief executive officer, or the equivalent of an officer who has "policy-making authority" is considered to be in a policy-making position.¹⁶ The FTC further defines policy making authority as "final authority to make policy decisions that control significant aspects of a business entity or common enterprise."¹⁷ Notably, the definition specifically states policy-making authority "does not include authority limited to advising or exerting policy decisions or having final authority to make decisions for only a subsidiary of or affiliate of a common enterprise."¹⁸ Thus, most advisors and managers, unless able to exert control over significant business decisions for an entire company, are not considered senior executives under the Rule.

Notice Requirement

The Rule imposes an affirmative duty on employers that have entered into non-competes prior to the Effective Date that are no longer permitted. Each employer must provide clear and conspicuous notice to each employee that has an existing non-compete that such non-compete clause will not and cannot be legally enforced.¹⁹ The Rule provides specific model language employers should follow in order to ensure complete compliance and sufficient notification to all affected employees.²⁰

EXCEPTIONS AND EXCLUSIONS

Bona Fide Sale of Business

The Rule does not apply to a non-compete clause entered into in connection with 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."²¹ The final rule specifically discarded language from the proposed rule requiring the restricted party to be a substantial owner of the business entity for the exclusion to apply.²²

In order to qualify for this exception, the sale must be one "made between two independent parties at arm's length, and in which the seller has a reasonable opportunity to negotiate the terms of the sale."²³ As a result, "springing" non-competes and those "arising out of repurchase rights or mandatory stock redemption programs" are not considered bona fide sales of business that qualify under the exemption.²⁴

Existing Causes of Action

Additionally, if a cause of action related to a non-compete clause accrued prior to the Effective Date, then the Rule is not applicable.²⁵

Exclusions

The definition of a non-compete clause is specific to working in the United States.²⁶ Accordingly, the Rule does not prohibit an employer from implementing a non-compete clause with a worker that restricts such person from working outside of the United States, subject to other applicable law. Also, certain entities or activities are exempt from the FTC's enforcement jurisdiction,²⁷

meaning those persons will not be subject to the Rule (e.g., banks, and any corporation "that is not 'organized to carry on business for its own profit or that of its members.'"²⁸). Lastly, the Rule is specific to restrictions on work subsequent to the conclusion of employment that imposes the non-compete.²⁹ Therefore, an employer could impose a restriction on a worker's employment during such employment, though this may be simply documenting a pre-existing common law obligation of the employee.

'The FTC highlighted that employers may continue to use non-disclosure agreements, non-solicitation clauses, fixed-term employment agreements, and trade secret law as alternatives to non-competes to protect their interests. Practitioners should be careful, however, that any restrictions on solicitation or disclosure are not overly broad, rendering them functional non-competes in violation of the Rule.'

DOES THE FTC ACTUALLY HAVE THIS EXTRAORDINARY POWER?

Opponents of the Rule contend that the FTC does not have the requisite legal authority to implement the Rule. One specific argument contends that the Rule should be struck down based on the recently developed major questions doctrine.³⁰ The FTC methodically addressed the various dissenters' arguments to assert its authority to implement the Rule from Sections 5 and 6 of the FTC Act.

Not surprisingly, the major questions doctrine argument, along with others, has already been furthered in multiple court cases challenging the Rule in both Texas and Pennsylvania, potentially setting up a circuit split.³¹ For now, it is unclear whether the legal challenges will successfully delay or prevent

enforcement of the Rule. Thus, businesses should prepare to comply with the Rule by the Effective Date.

POST-RULE ALTERNATIVES

Assuming it withstands legal challenges, the impact of the Rule on the negotiation of employment agreements and the sale of businesses is going to be profound. The FTC highlighted that employers may continue to use non-disclosure agreements, non-solicitation clauses, fixed-term employment agreements, and trade secret law as alternatives to non-competes to protect their interests.³² Practitioners should be careful, however, that any restrictions on solicitation or disclosure are not overly broad, rendering them functional non-competes in violation of the Rule.³³

Though the FTC did not specifically address drag-along rights in its discussion, which can contemplate that equityholders will agree to similar terms and restrictions in the event of a sale (i.e., a non-compete provision), it covered other ways that non-competes may be imposed, specifically, mandatory repurchase rights, stock redemption agreements, and “springing” non-competes (which require a worker to agree at the time of hiring to a non-compete in the event of a future sale).³⁴ These mechanisms would not qualify under the bona fide sale exception because, according to the FTC, “in each case, the worker has no good will that they are exchanging for the non-compete or knowledge of or ability to negotiate the terms or conditions of the sale at the time of contracting.”³⁵ Accordingly, drag-along provisions that

require an equityholder to accept non-compete restrictions upon the sale are likely no longer permitted. If, however, the terms are negotiated at the time of sale, it is feasible that an employer can still impose and later enforce a non-compete clause on a departing shareholder or member.³⁶

The Rule marks a significant shift in regulations. As the FTC predicts, it will likely have a large impact on the labor market and markets for products and services. Despite the pending litigation, practitioners must prepare for a world without non-compete clauses. Employers should review existing agreements and prepare to provide the requisite notice to affected workers by the Effective Date. ■

Endnotes

1. *Ryan, LLC v. FTC*, Case No. 3:24-cv-00986 (N.D. Tex.) (filed July 3, 2024).
2. FTC Noncompete Rule, 16 C.F.R. § 910 (effective Sept. 4, 2024).
3. 16 C.F.R. § 910.2(a)(2).
4. Non-Compete Clause Rule, 89 Fed. Reg. 38,342, 38,372 (May 7, 2024) (to be codified at 16 C.F.R. pt. 910).
5. *Id.*
6. *Id.*
7. 16 C.F.R. § 910.2(a)(1).
8. *Id.* § 910.2(a)(2).
9. *Id.* § 910.1.
10. *Id.* § 910.1.
11. 89 Fed. Reg. at 38,346.
12. 16 C.F.R. § 910.1
13. *Id.*
14. *Id.*
15. *Id.*
16. *Id.*
17. *Id.*
18. *Id.*
19. 16 C.F.R. § 910.2(b).
20. *Id.*
21. 16 C.F.R. § 910.3(a).
22. *Id.* at 38,360.
23. *Id.* at 38,4398-39.

24. *Id.* at 38,439.
25. 16 C.F.R. § 910.3(b).
26. 16 C.F.R. § 910.1.
27. 89 Fed. Reg. at 38,356.
28. *Id.* (citing The FTC Act).
29. 16 C.F.R. § 910.1.
30. *West Virginia v. Environmental Protection Agency*, 597 U.S. 697, 715 (2022) (stating Congress must grant clear and direct delegation of authority to the agency when such agency makes a decision on a question that has “vast economic and political significance”).
31. *Ryan, LLC v. FTC*, Case No. 3:24-cv-00986 (N.D. Tex.) (filed April 23, 2024); *Chamber of Commerce of the United States of America et al v. FTC and Lisa Khan*, Case No. 6:24-cv-00148 (E.D. Tex.) (filed April 24, 2024); *ATS Tree Services, LLC v. Federal Trade Commission*, Case No. 2:24-cv-1743 (E.D. Pa.) (filed April 25, 2025).
32. 89 Fed. Reg. at 38,440.
33. *Id.* 38,356.
34. 89 Fed. Reg. at 38,438.
35. 89 Fed. Reg. at 38,439.
36. 89 Fed. Reg. at 38,418 (suggesting that physician partners of an independent physician practice “would also likely fall under the sale of business exception . . . if [a] partner leaves the practice and sells their shares of the practice”).

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