

NEW FTC RULE BANS NON-COMPETITION AGREEMENTS IN EMPLOYMENT CONTRACTS

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Tom Herman, a partner with Smith Duggan Cornell & Gollub LLP in Boston, maintains a broad corporate practice. He has considerable expertise advising clients on corporate organization and governance matters, securities law and corporate finance, M&A, trademark and copyright registration, protection and IP licensing, international law, and employment law.

He also represents nonprofit entities in a range of matters. He often serves as outside general counsel to start-ups, young companies, and emerging growth businesses.

Tom began his career as a litigator with WilmerHale and provides attractive, cost-effective alternatives to legal services available at much larger law firms.

The Federal Trade Commission on April 23, 2024, passed a new rule with broad application banning most post-employment non-competition agreements in employment contracts. It applies to any employee or independent contractor of a for-profit employer.

KEY TAKE-AWAYS FROM THE NEW RULE:

- Employers will be prohibited from entering into new, post-employment non-compete agreements with all employees and consultants, including senior executives.
- Existing non-compete agreements with senior executives remain enforceable.
- Employers must notify all other workers that existing non-competes are unenforceable by the rule's effective date.
- The rule becomes effective 120 days after publication in the Federal Register.
- Court challenges are expected which may delay or ultimately preclude enforcement of the rule.

HERE IS AN OVERVIEW OF WHAT YOU NEED TO KNOW:

SCOPE OF PROHIBITION. Once - and if - the rule goes into effect (see below re effective date), the rule will prohibit employers from imposing post-employment non-competes on workers (including independent contractors and unpaid workers). The ban includes contractual provisions that have the functional effect of a non-compete.

Non-solicitation provisions are generally not banned by the new rule. The rule applies only to post-employment non-compete agreements. It does not apply to in-term non-competes, e.g., those that prohibit employees from competing against the employer while still employed.

EMPLOYEE NOTICE

In addition to preventing employers from entering into new post-employment non-compete agreements, the rule also requires employers to notify their employees that covered existing non-competes are no longer enforceable.

SENIOR EXECUTIVE EXCEPTION

The rule allows existing non-competes with senior executives - workers earning more than \$151,164 who are in a "policy-making position" -- to remain in force; however, it bans new non-competes with senior executives.

SALE OF BUSINESS EXCEPTION

The rule does not apply to non-competition agreements entered into by a person during the "bona fide sale of a business," e.g., sale of the person's ownership interest in a business entity or the sale of all or substantially all of a business's assets.

FEDERAL PRE-EMPTION

The rule supersedes (pre-empts) contrary state laws.

CONSEQUENCES OF VIOLATION/ENFORCEMENT

The rule provides that the use of non-competes is an "unfair method of competition" that violates Section 5 of the FTC Act. Violations of the FTC Act can

result in fines, penalties, and other injunctive relief.

SOME EMPLOYERS EXEMPTED

While the vast majority of employers are subject to the rule, employers who are exempt from the FTC's jurisdiction may not be covered, such as banks, credit unions, savings and loans), some non-profit organizations, etc. The FTC is expected to provide further guidance on these.

EFFECTIVE DATE

The rule goes into effect 120 days following publication in the Federal Register. However, legal challenges to it are all but certain, and actual effectiveness of the rule -- and enforcement - could be further delayed, even barred, by such litigation. For example, a court that hears the lawsuit will have the ability to issue a temporary restraining order or preliminary injunction of the rule, which would delay the implementation while the challenge to its validity plays out

in the courts.

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Smith Duggan attorneys have suggested to clients for some years, especially since the 2018 enactment of a law severely restricting non-competes in Massachusetts, generally to avoid using them (except in connection with the sale of a business). There are other, less expensive and less problematic ways to deal with the some of the issues non-competes traditionally address, such as non-solicitation, confidentiality, proprietary

information, and invention assignment agreements, and other laws and agreements which can protect a company's trade secrets.

Smith Duggan attorneys will continue to follow the developments relating to the FTC's new non-competition rule, the anticipated lawsuits, and any further guidance from the FTC.

If you have any questions or seek further guidance on the new
FTC non-competition ban, please contact
Tom Herman at 617-228-4415 or therman@smithduggan.com.

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The firm now has 22 attorneys with offices in Boston and Lincoln. More information regarding the firm's history and services can be found at www.smithduggan.com.