

# Clients & Friends Memo

## FTC Adopts Broad Ban on the Use of Non-Compete Clauses in Employment Agreements

April 24, 2024

The Federal Trade Commission has adopted a [final rule](#)<sup>1</sup> (“Rule”) declaring it to be an unfair method of competition:<sup>2</sup>

- (i) With respect to *a worker*<sup>3</sup> other than a senior executive:
  - a. To enter into or attempt to enter into a non-compete clause;
  - b. To enforce or attempt to enforce a non-compete clause; or
  - c. To represent that the worker is subject to a non-compete clause.
- (ii) With respect to a *senior executive*:
  - a. To enter into or attempt to enter into a non-compete clause;
  - b. To enforce or attempt to enforce a non-compete clause entered into after the effective date of the Rule; or
  - c. To represent that the senior executive<sup>4</sup> is subject to a non-compete clause, where the non-compete clause was entered into after the effective date of the Rule.

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<sup>1</sup> The final rule is at 16 C.F.R. §910 et seq. Accompanying the publication of the Rule is a Statement of Basis and Purpose that responds to comments received on the proposed rule and that articulates the rationale for specific components of the Rule, its breadth and its limitations.

<sup>2</sup> *Id.*, at §910.2(a)(1), (2).

<sup>3</sup> A *worker* is a *natural person* who works or who previously worked, whether paid or unpaid, without regard to the worker’s title or status under any other state or federal law, including whether the worker is an employee, independent contractor, extern, intern, volunteer, apprentice, or a sole proprietor who provides a service to a person. It includes a person who works for a franchisee or franchisor but does not include a franchisee in the context of a franchisee-franchisor relationship. *Id.*, at §910.1.

<sup>4</sup> A *senior executive* is a worker in a *policy-making position* who received *total compensation* of at least \$151,164 in the *preceding year* (or the same on an annualized basis) or in the year prior to the worker’s departure (or the same on an annualized basis). A *policy-making position* means either “president, chief

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A non-compete clause<sup>5</sup> is:

- 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 work in the United States<sup>6</sup> with a different person where such work would begin after the conclusion of the employment that includes the term or condition; or
  - Operating a business in the United States after the conclusion of the employment that includes the term or condition.

The Rule:

- will take effect 120 days from its publication in the Federal Register;<sup>7</sup>
- preempts state law and state regulation with respect to such clauses, unless state law or state regulation is more restrictive;<sup>8</sup>
- requires “clear and conspicuous” notice to each worker, other than senior executives, subject to a non-compete clause, that enforcing or attempting to enforce the non-compete clause will not be and cannot legally be, enforced against the worker;<sup>9</sup>

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executive officer or the equivalent” or any other *officer* or *person* who has *policy-making authority* for a business entity. *Policy-making authority* means final authority to make policy decisions that control significant aspects of a business entity or common enterprise but does not include authority limited to advising or exerting influence over such policy decisions or having final authority to make policy decisions for only a subsidiary or affiliate of a common enterprise. *Officer* means a “president, vice president, secretary, treasurer or principal financial officer, comptroller or principal accounting officer and any natural person routinely performing corresponding functions with respect to any business entity whether incorporated or unincorporated.” *Person* means “any natural person, partnership, corporation, association, or other legal entity within the Commission’s jurisdiction, including any person acting under color or authority of state law.” *Preceding year* means a person’s choice of “the most recent 52-week year, the most recent calendar year, the most recent fiscal year, or the most recent anniversary of hire year.” Total compensation may include salary, commissions, nondiscretionary bonuses and other nondiscretionary compensation, but does not include payments for medical insurance, payments for life insurance, contributions to retirement plans and other “similar fringe benefits.” *Id.*

<sup>5</sup> 16 C.F.R. §910.1. The Rule defines a term or condition of employment to include contractual terms or workplace policies, whether written or oral. *Id.*

<sup>6</sup> By its terms, the Rule does not apply to non-competes if they restrict only work outside the U.S. or starting a business outside the U.S.

<sup>7</sup> *Id.*, at §910.6.

<sup>8</sup> *Id.*, at §910.4.

<sup>9</sup> The Rule provides safe harbor model language for this notice requirement which can be provided on paper, by mail, by email or by text. *Id.*, at §910.2(b)(1), (4).

- does not apply to a non-compete clause that is entered into by a person pursuant to 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;<sup>10</sup>
- does not prohibit non-compete agreements between a franchisor and franchisee (but such agreements remain subject to the antitrust laws), but does prohibit non-compete agreements between natural persons who work for either a franchisee or franchisor;<sup>11</sup> and
- adopts a functional test towards identifying non-compete clauses, noting that other restrictive employment covenants may be a non-compete clause if the covenant expressly prohibits a worker from, or penalizes a worker for, seeking or accepting other work or starting a business, or, if it does not do so expressly but is so broad or onerous in scope that it functionally has the same effect as preventing a worker from doing the same.<sup>12</sup>

The Rule identifies a few exceptions: (i) the bona fide sale of a business, discussed above; (ii) existing causes of action related to a non-compete clause accrued prior to the effective date of the Rule; and (iii) good faith belief that the Rule is inapplicable.<sup>13</sup> Additionally, because the FTC does not have jurisdiction over non-profit entities, the Rule does not apply to non-profit entities.<sup>14</sup>

The vote to adopt the Rule was 3-2, with the two newest Commissioners voting against adoption, and both noting their belief that the FTC did not have authority to promulgate rules defining conduct as an unfair method of competition, nor a rule with

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<sup>10</sup> Generally, the Rule considers a bona fide sale to be "one that is 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." *Id.*, at §910.3(a).

<sup>11</sup> *Id.*, at §910.1 (defining "worker"); Statement of Basis and Purpose, at 388-89.

<sup>12</sup> The proposed rule provided two examples of restrictive covenants that might be functionally equivalent to a non-compete clause: overly broad non-disclosure agreements and requirements that workers repay training costs, if such costs are not reasonably related to the costs incurred by the employer in training the worker. Both are undoubtedly covered by the Rule. The reference to "penalizes" in the Rule relates directly to requirements that a worker repay unreasonable training costs. The Statement of Basis and Purpose discusses the potential breadth of restrictive covenants that may be equivalent to a non-compete clause but declines to define the scope of such covenants. Statement of Basis and Purpose at 75-85.

<sup>13</sup> 16 C.F.R. §910.3.

<sup>14</sup> Whether an entity falls into the category of a non-profit is complex and should be reviewed with counsel prior to concluding the Rule does not apply to an entity claiming non-profit status. According to the Commission, "the not-for profit jurisdictional exemption ... requires both that there be an adequate nexus between an organization's activities and its alleged public purposes and that its net proceeds be properly devoted to recognized public, rather than private, interests." Statement of Basis and Purpose at 52.

the breadth and scope of this Rule. There is substantial recent literature on the authority of the FTC to issue so-called “competition rules” with much of it questioning whether the FTC will be able to sustain such rules. Affected businesses and their trade association representatives are likely to have substantial grounds for seeking to delay implementation of the Rule, and, ultimately, to reverse or substantially narrow the Rule. The U.S. Chamber of Commerce has already filed a complaint for Declaratory and Injunctive Relief<sup>15</sup>, and its President and CEO Suzanne P. Clark declared the FTC’s decision to ban employer noncompete agreements as “not only unlawful but also a blatant power grab that will undermine American businesses’ ability to remain competitive.”

Uncertainty with respect to whether the FTC can sustain the Rule, after judicial review, makes it likely that states and localities will continue to legislate and regulate on this issue. Recently, after the Governor of New York and the State Legislature could not agree on legislation that would have limited the use of non-compete clauses, the New York City Council proposed its own legislation prohibiting non-compete clauses.<sup>16</sup> The Rule does not preclude additional efforts such as these, and we expect they will continue. Affected parties should take notice of these efforts.

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If you have any questions on the FTC’s Rule, please feel free to contact the following Cadwalader attorneys.

Bilal Sayyed +1 202 862 2417 [bilal.sayyed@cwt.com](mailto:bilal.sayyed@cwt.com)

Peter Bariso +1 212 504 6535 [peter.bariso@cwt.com](mailto:peter.bariso@cwt.com)

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<sup>15</sup> Complaint, Chamber of Commerce of the United States of America v. Federal Trade Commission, Case No. 6:24-cv-00148 (E.D. Tyler Division, Texas) (Apr. 24, 2024).

<sup>16</sup> See [New York City Council, Int. No. 140](#), proposing the prohibition of non-compete agreements.