With non-compete ban looming, employers have alternatives to protect key company info

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By Kate Erdel

On April 23, 2024, the Federal Trade Commission (FTC) issued a final rule ("Final Rule") prohibiting most current non-compete agreements and banning future non-competes, with just a few limited exceptions. This action promptly led to multiple lawsuits in federal courts in Texas and Pennsylvania challenging the Final Rule. Two of the courts where those suits are pending have indicated decisions will be handed down in July. As it currently stands, the Final Rule is set to go into effect 120 days after publication, on Sept. 4, 2024.

Businesses that use non-competes to protect their confidential information and trade secrets may now wonder what to do moving forward. As we wait for the lawsuits to be resolved in court, businesses should start to consider additional options for protecting their interests, so that they are prepared if the Final Rule survives the legal challenges and goes into effect in September.

Background on ban

Non-compete provisions, whether in an employment agreement or standalone contract, are used when a business seeks to prevent employees from engaging in competition with the employer for a period of time after employment ends. These types of agreements – according to the FTC – can be problematic because they have the potential to stifle wages and innovation. The FTC believes that non-compete agreements violate Section 5 of the Federal Trade Commission Act (FTCA) because they are an unfair method of competition. The FTC first proposed a new rule banning non-competes in January 2023 and released the Final Rule after receiving public comment.

Once the Final Rule goes into effect, it retroactively bans nearly all existing non-compete agreements and prohibits new non-competes with any worker, which includes not only employees but also independent contractors, interns, externs and volunteers.

Exceptions

There are two exceptions in the Final Rule. Non-competes for senior executives in place prior to the Final Rule's effective date can remain in force. Senior executives are considered workers in "policy-making decisions" who earn more than $151,164 annually. Some think the Final Rule's definition of "senior executive" may lead to challenges to the scope of who is subject to an existing non-compete.

In addition to allowing existing non-competes with senior executives to remain in effect, the Final Rule does not prohibit non-competes entered into in the course of a bona fide sale of a business executed by the seller of the business or the person selling all of their ownership in a business.

One thing to note is that non-compete agreements between franchisors and franchisees are not included in the Final Rule; however, these groups' workers are subject to the ban.

Notification requirements

Where existing non-competes apply to current or former workers, except senior executives who qualify for the exception to the Final Rule, employers must provide notice that those covenants will no longer be enforceable. There is no express penalty for not providing written notice, but businesses who do not provide notice may find themselves subject to an FTC enforcement action. Businesses can use the model language provided in the FTC Final Rule, which provides a "safe harbor" for compliance with the notification requirements. The notices must be distributed before the effective date of the rule, which currently is set for Sept. 4, 2024.

Non-compete agreement alternatives

Four states have already fully banned non-compete agreements – California, Minnesota, North Dakota and Oklahoma – leading businesses with employees in those states to rely on alternatives to non-compete clauses to protect their proprietary information once a worker's employment period ends.

Often, employees subject to a non-compete agreement also have a non-disclosure agreement, or confidentiality agreement, in place to protect trade secrets. Non-disclosure agreements should clearly define the confidential information in question and explain how the confidential information can be used while the worker is employed and once the employment period ends.

Another alternative to a non-compete provision is a non-solicitation provision. Non-solicitation-of-employees agreements prohibit former employees from soliciting the former employer's employees for a specific period of time. Non-solicitation-of-customers agreements prohibit former employees from soliciting the former employer's customers/clients for a specific period of time.

Work with experienced counsel

Businesses of all sizes and across industries can benefit from working with an experienced labor and employment lawyer who understands the business's goals and needs. As a result of the impending ban on non-competes, existing contracts will need to be reviewed and amended, and new ones created to protect intellectual property and trade secrets. Skilled legal counsel will work with you to identify what information needs protected, which employees should have access to that information, and who may pose a risk to leave and take workers or customers with them.

At Dentons, we know that attracting, retaining and managing your workforce is key to achieving your business goals, and your confidential information and trade secrets are invaluable assets deserving the highest protection. Our team has the depth and breadth of experience to provide thoughtful and practical counsel to keep your business moving forward. Our lawyers work with businesses to draft tailored, strategic contracts that maximize protection and enforceability.

Conclusion

As we await the outcome of litigation challenging the FTC's Final Rule, employers should work with experienced legal counsel to begin reviewing existing contracts, drafting notifications for those subject to non-compete agreements, and determining the best next steps for the employer given its type of work, employees and business goals. If the Final Rule does go into effect, proactive businesses will be prepared to protect important company information and comply with applicable state and federal regulations.●

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