REICHARD & ESCALERA
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the LEGAL UPDATE

May 9, 2024

Litigation Update

New FTC Rule Bans Employee Non-Competition Agreements That Prevent Employees from Accepting Subsequent Employment or Operating a Business

On April 23, the Federal Trade Commission approved a rule ***(16 CFR Part 910)*** prohibiting employers from requiring their workers to enter non-compete agreements or requiring them to comply with any such existing agreement. The ban is based on the FTC's interpretation that these agreements constitute a method of unfair competition.

The rule defines a worker broadly to include independent contractors. It also defines a **non-compete agreement** as one that **prohibits**, penalizes, or **functions to prevent** a worker from seeking or **accepting employment or operating a business** in the U.S., when the employment or business would begin *after* the termination of the employment in which he or she has the non-compete contract.

The rule is expected to go into effect **on September 4, 2024**. No later than then, employers must notify their workers that they will not enforce their non-compete agreements. The FTC issued sample notices that employers can use for that purpose.

Significantly, the ban has the following limitations:

- By its definition, the prohibition does not apply to agreements not to compete while the person is employed.
- The prohibition does not apply to causes of action that arose before the effective date of the rule.
- Former senior executives who already have a non-compete agreement in place may continue to be bound by such agreements. But if they don't have one, they can't be required to enter one. Senior executives are those who earn more than **$151,264 per year** and hold a position where they have **final authority to make decisions** that control significant aspects of the business (not merely a subsidiary or affiliate of the business).
- A non-compete agreement that an individual enters into as part of a sale of his interests in a business or a substantial part of its operating assets is valid as long as it is granted as part of a ***bona fide* sale** (a contract between independent parties who negotiate arms length).
- There are other types of restrictive agreements used in the employment context that do not "prohibit" or "penalize" an employee for accepting a job or starting a business after his or her employment

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ends, and that protect the employer's interests in its business. These include **customer and employee** non-solicitation agreements and **confidentiality agreements**. But if their prohibitions are so broad as to **effectively "function to prevent"** an employee from accepting employment or starting a business, such covenant would fall under the prohibition of this rule.

On the same day the rule was announced, a global accounting firm filed a lawsuit in the U.S. District Court for the Northern District of Texas, challenging its validity. The next day, the U.S. Chamber of Commerce, along with other organizations representing business interests, did the same in the U.S. District Court for the Eastern District of Texas. The plaintiffs are seeking an injunction to block the rule from being enforced.

Our team is available to help you navigate any questions you may have in relation to this new rule.

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