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### FTC bans noncompete agreements

On April 23, the Federal Trade Commission voted to ban new noncompete agreements nationwide and render most existing noncompetes unenforceable. The final rule is slated to go into effect September 4.

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#### Background

In January 2023, the Federal Trade Commission (FTC) proposed the Non-Compete Clause Rule which was intended to generally prohibit employers from using noncompete clauses (“noncompetes”). Based on a preliminary finding that noncompetes violate Section 5 of the FTC Act which bans unfair methods of competition, the proposed rule would have categorically banned noncompetes and required rescission of all existing noncompetes.

#### FTC’s final rule

In a 3-2 party-line vote on April 23 the FTC approved a nationwide ban on new noncompetes between employers and almost all U.S. “workers” and, with limited exception, on the enforcement of existing noncompetes. In a significant departure from the proposed rule, the FTC’s final rule allows existing noncompetes with “senior executives” to remain in force and expands the sale of business exception while simplifying employer notice and compliance requirements. The final rule is scheduled to become effective on September 4.

#### Noncompete defined

The final rule broadly defines a noncompete clause as an oral or written term or condition of employment that expressly prohibits a worker from — or penalizes a worker for (e.g., severance or equity forfeiture-for-competition provisions) — seeking or accepting other work in the U.S. or starting a business in the U.S. after their employment ends. The final rule also applies to clauses that function to prevent a worker from doing so. Noncompetes may be found in standalone agreements, as well as in a variety of employment, compensation, and severance policies, plans and other arrangements.

## Noncompete ban

Deeming noncompete agreements to be an unfair method of competition, the final rule generally bans noncompetes between employers and “workers” — broadly defined as employees, independent contractors, externs, interns, volunteers, apprentices, or sole proprietors who provide a service to a client or customer.

With several limited — but important — exceptions, the final rule would prohibit employers from:

- Entering into, or attempting to enter into, new noncompetes with workers.
- Enforcing, or attempting to enforce, existing noncompetes with workers.
- Representing that a worker is subject to a noncompete clause.

## Exceptions

The final rule adopts a different approach for “senior executives” that allows existing noncompetes with them to remain in force after the rule’s effective date. A senior executive is an individual who: (1) received total annual compensation of at least \$151,164 in the preceding year and (2) occupies a “policymaking position” (i.e., the president, CEO or equivalent, and any other officer with policymaking authority for the entire business entity). Because the position is so narrowly defined, many high-earning executives would be released from existing noncompetes should the rule take effect.

The final rule also would not bar noncompetes made in connection with the sale of a business entity, an ownership interest in a business entity, or all or substantially all of a business entity’s operating assets. Nor would it prohibit enforcement of noncompetes where the cause of action related to the noncompete accrued prior to the rule’s effective date.

While nondisclosure agreements, customer or employee non-solicitation agreements, no-hire provisions, training repayment agreement provisions, and “garden leave” provisions are not explicitly prohibited, the FTC cautions that they could run afoul of the final rule if drafted too broadly. The final rule also clarifies that fixed-duration employment agreements with noncompetes during the employment term are not prohibited because they do not restrain post-employment conduct.

## FTC authority

The final rule does not apply to certain industries because they are not under the jurisdiction of the FTC. These include banks, savings and loan institutions, federal credit unions, common carriers, air carriers and foreign air carriers, and persons and businesses subject to the Packers and Stockyards Act. The final rule also does not cover franchisor/franchisee noncompetes.

While the FTC lacks statutory authority over bona fide not-for-profit entities, it cautions that merely claiming tax exempt nonprofit status under the Internal Revenue Code is not sufficient to exempt an entity from its jurisdiction. Rather, the FTC indicates that it will make its own determination whether the entity is in fact a profit-making enterprise subject to its authority.

## Notice requirement

The rule would require employers to notify workers (other than senior executives) that their existing noncompetes are no longer in effect and will not be enforced as of the final rule's effective date. Individual notices must be provided by the effective date by hand delivery, regular mail, email, or text message. The FTC provides model language employers may use to provide the required notice.

## State laws

The final rule supersedes state laws to the extent that they permit conduct it prohibits or conflict with its notice requirements. However, it is not intended to prevent enforcement of other state laws that restrict noncompetes where they do not conflict with the final rule, including state antitrust and consumer protection laws and state common law.

## Legal challenges

The final rule already faces multiple legal challenges which may delay the final rule's effective date or invalidate it entirely. Three separate lawsuits seeking to block the final rule were filed in federal court shortly after the FTC's April 23 vote. The first to file — Ryan, LLC, a global tax services firm — brought suit in the Northern District of Texas challenging the FTC's rulemaking authority and moving to stay the rule's effective date and preliminarily enjoin enforcement. The court has set a schedule to decide the motion by July 3. The U.S. Chamber of Commerce brought a similar suit in the Eastern District of Texas that was stayed under the "first to file rule," but has now intervened in the Ryan suit. A third suit filed by ATS Tree Services, LLC that also seeks injunctive relief is moving forward in the Eastern District of Pennsylvania.

## In closing

Companies should continue to monitor the status of pending legal challenges as we await court action in Texas by early July. Despite the uncertainty surrounding the final rule, employers should consider taking steps to identify current noncompetes, individuals who would need to receive notice, and post-employment restrictions for senior executives that may need to be shored up in the event that the rule takes effect on September 4.

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