FTC Imposes Ban on Virtually All Employment-Related Noncompete Agreements

On Tuesday, the Federal Trade Commission (FTC) voted 3-2 to ban virtually all noncompete agreements that employers have with their workers. The rule applies to all workers in the United States (including employees and independent contractors). The rule bans "noncompete" provisions, which are defined as either oral or written contracts that prevent a worker from (i) seeking or accepting work within the United States with a different employer after the employment concludes; or (ii) operating a business in the United States after the conclusion of employment. The effective date of the rule will be 120 days after publication of the rule in the Federal Register (which is imminent), which means that it is anticipated to take effect in approximately September of 2024 (subject to potential delays from legal challenges, discussed below).

The FTC's final rule generally does not affect non-solicitation or non-disclosure agreements, although the FTC notes that such provisions could be invalid if they are so broad that "they function to prevent a worker from seeking or accepting other work or starting a business after their employment ends." The FTC noted that whether or not a non-solicitation or non-disclosure clause meets this threshold is a "fact-specific inquiry."

The final rule bans both existing and future noncompete agreements, with one noteworthy exception: the rule does not invalidate existing noncompetes with senior executives. "Senior executives" are defined as workers who, when employed, were in a policy-making position and received total annual compensation of at least $151,164 in the year preceding departure. Note that while existing noncompetes with senior executives remain in force, such agreements cannot be signed after the effective date of the rule.

The new rule also includes a notification component, such that employers will be required to notify current and former employees who are subject to noncompetes that their noncompete agreements are now invalid. This notification must be made not later than the effective date of the rule. The FTC provided model notification language. If an employer provided consideration (including compensation or equity) in exchange for the noncompete, the employer may not claw back or force forfeiture of that consideration as a result of the invalidation of the noncompete. In other words, workers are entitled to keep the consideration and to benefit from the invalidation of their noncompetes.

On a going-forward basis starting on the effective date, employers are not permitted to enter into noncompetes with any workers, including senior executives. Noncompetes with workers are impermissible even if they are given in exchange for compensation, equity, or other consideration.

The rule provides an exception for a bona fide sale of business, in that it expressly excludes "a noncompete 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." However, the FTC states that this exception cannot be used to require executives or key employees who are not sellers to sign noncompete agreements in connection with a sale.

The United States Chamber of Commerce (the "Chamber") has already announced that it intends to file suit in an attempt to block this rule from going into effect. The Chamber asserts, "Since its inception over 100 years ago, the FTC has never been granted the constitutional and statutory authority to write its own competition rules. Noncompete agreements are either upheld or dismissed under well-established state laws governing their use." The two dissenting FTC members made similar arguments that the FTC is over-stepping its authority in issuing this rule.

Because of the imminent legal challenges and the potential for an injunction that would delay the effective date of the new rule, employers do not need to take immediate action on existing noncompete agreements. However, employers should audit existing agreements so that they understand what agreements exist and can prepare to send out notices when and if it becomes necessary to do so. In addition, between now and the effective date, employers should carefully consider whether to include noncompetition provisions in new employment-related agreements, or whether other forms of robust restrictive covenants are sufficient to protect the employer's interests. We will keep you updated as legal challenges progress.

If you have any questions about these developments, please contact one of the following attorneys:

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