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FTC Votes to Approve Rules Banning Noncompete Employment Agreements Nationwide

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Insights for Employers

Following up on proposed rules issued on January 5, 2023, after the public comment period, the Federal Trade Commission (FTC) issued final rules on April 23, 2024, banning noncompete agreements in most employment contexts. The Commission voted in favor of the rules along party lines, 3-2. The new Rules can be found at 16 CFR Part 910.

Multiple legal challenges are inevitable as the FTC has not traditionally regulated labor and employment matters. It is debatable whether noncompete agreements with individual employees fall under Section 45 of the FTC Act (15 U.S.C. § 45(a), which gives the FTC power to bar "unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce," the relevant authority the agency has invoked in promulgating the new rules. On April 24, 2024, the U.S. Chamber of Commerce filed suit in the United States District Court for the Eastern District of Texas, challenging the rule. The Chamber said in its press release that “[S]ince 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.”

In the FTC’s announcement, the agency recited a litany of previous rules and decisions, most of which are in the field of deceptive advertising or merger reviews under the antitrust laws, to justify its assumption of authority in this area. For the most part, the FTC relies on its own decisions and its own view of its authority, citing court decisions arising in the antitrust context, such as National Petroleum Refiners Ass'n v. FTC, 482 F.2d 672, 686 (D.C. Cir. 1973) and Atl. Refin. Co. v. FTC, 381 U.S. 357, 371 (1965).

What are the New Rules?

The rules provide that state laws that are not in conflict with it (i.e., presumably which impose even greater restrictions) are not preempted and include a 'severance clause' making the remainder of the rules continue in effect even if a portion is found unconstitutional or outside the agency's statutory authority.

As a justification for its action, the FTC alleges that "concerns about noncompetes have increased substantially in recent years in light of empirical research showing that they tend to harm competitive conditions in labor,

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product, and service markets" and states that out of over 26,000 public comments received regarding the proposed regulations, 25,000 were in favor of them. Much is made of the allegedly positive economic effect of eliminating noncompetes, including the supposed creation of 8,000 businesses. Little consideration is given by the agency to potential negative effects.

The final version of the rules makes all noncompete agreements, with certain narrow exceptions, unenforceable immediately, even if already in effect. It exempts from this retroactive effect covenants with "senior executives," and it does not apply to "noncompetes entered into by a person pursuant to a bona fide sale of a business entity." It also does not void existing causes of action, whether or not they are actually being litigated, accruing before the rules' effective date.

Final Rule Definitions

The FTC did consider narrowing its definition of a noncompete, but in the end, it adopted a broad definition. The final rule defines a **"noncompete clause"** as a term or condition of employment that either "prohibits" a worker from, "penalizes" a worker for, or "functions to prevent" a worker from:

> (A) seeking or accepting work in the United States with a different person where such work would begin after the conclusion of the employment that includes the term or condition; or
> (B) operating a business in the United States after the conclusion of the employment that includes the term or condition.

Pursuant to the term **"prohibits,"** the definition applies to terms and conditions that expressly prohibit a worker from seeking or accepting other work or starting a business after their employment ends.

The term **"penalizes,"** also applies to terms and conditions that require a worker to pay a penalty for seeking or accepting other work or starting a business after their employment ends. Nondisclosure agreements, nonsolicitation agreements, and training repayment agreements are not "categorically prohibited." Still, they may be barred by the Rules if they are deemed to have the same effect as a noncompete.

Subject to limited circumstances, the term "senior executive" generally means a worker who (1) was in a policy-making position and (2) received from a person for the employment: (i) total annual compensation of at least $151,164 in the preceding year; or (ii) total compensation of at least $151,164 when annualized if the worker was employed during only part of the preceding year.

What's Next?

The effective date of the Rules will be 120 days after their publication in the Federal Register, and other court challenges (in addition to the suit filed by the Chamber) may follow. Whether any court will impose a temporary restraining order on enforcement of the Rules pending a final decision on the merits remains to be seen.

The new rule already has generated concern among clients with respect to potential harm to their businesses, the impact on the equity or value of their businesses, and how clients lawfully could protect client relationships that were developed over time with significant expenditures of money and other resources. These concerns are legitimate, and specific strategies should be developed with legal counsel to deal with the possible enforcement of the final rule.