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FTC Issues Final Rule Banning New Noncompete Provisions and Restricting Prior Noncompete Provisions

On April 23, 2024, the Federal Trade Commission (FTC) voted 3-2 to finalize a new rule, initially proposed last year, to prohibit employers from enforcing new noncompete clauses and invalidating the majority of existing noncompetes in industries governed by the FTC. [1]

Noncompete clauses have faced scrutiny at both state and the federal levels in recent years, with both substantive limits on their use and procedural requirements on their enforcement. Likewise, Congress has considered bills with broad support to limit noncompetes. However, the FTC's decision yesterday is a nationwide, broad restriction on use of contract terms that function as noncompetes, whether in traditional "noncompete" language, or in some other form, such as an overly broad and restrictive non-disclosure agreement.

Yesterday, in its final rule, and its 500 plus page analysis of comments from industry and the public on the rule proposed in January 2023, the FTC determined that noncompetes are an unfair method of competition and violate the FTC Act. The FTC's final rule bans nearly all new noncompetes, with very narrow exceptions, regardless of level of worker, and renders most *existing* noncompetes unenforceable (other than those where the claim accrued, e.g., is in litigation, and for executives at certain levels).

The final rule takes effect 120 days from the final rule being posted in the Federal Register, which is expected to take place over the next week. The rule is expected to be legally challenged, which may ultimately delay its implementation. However, if the

rule remains in place as of the effective date, it will invalidate most noncompetes and is expected to impact up to 30 million workers in the U.S.

Among other things, opponents to the rule assert that it is based on its November 2022 overly broad policy change to the FTC's interpretation of the scope of the FTC Act and its own authority. This broad interpretation of the FTC's authority impacts not just these employment issues, but other issues the FTC finds are unfair competition under traditional common law principles, not limited by federal antitrust laws.

Restrictions and Applicable Definitions

Generally, the rule prohibits employers from (1) entering into "noncompetes" with "workers" after the effective date, and (2) enforcing previously executed noncompetes with workers other than senior executives. The rule defines key terms throughout.

The rule defines "noncompetes" as:

A term or condition of employment that prohibits a worker from, penalizes a worker for, or functions to prevent a worker from:[2]

- Seeking or accepting work in the U.S. with a different person where such work would begin after the conclusion of employment that includes the term or condition; or
- Operating a business in the U.S. after the conclusion of the employment that includes the term or condition.

The term "workers" includes employees, independent contractors, externs, interns, apprentices, volunteers, and sole proprietors who provide a service.

Exceptions

Whether *existing* noncompetes can remain in place is dependent on whether the noncompete agreement is with a "senior executive." Senior executives are workers earning more than $151,164 who have "policy making authority," such as presidents and officers. The FTC estimates that less than 1% of workers are fall into this exemption. "Policy-making authority" is defined as "final authority to make policy

decisions that control significant aspects of a business entity or a common enterprise." Policy-making authority does *not* include "authority limited to advising or exerting influence over such policy decisions or having final authority to make policy decisions for only a subsidiary of or an affiliate of a common enterprise." Importantly, this exception only applies to existing noncompetes as of the effective date and does not permit the execution of new noncompetes with senior executives.

Two other primary key exceptions exist under the rule. First, noncompetes between the seller and buyer of a business are not impacted by the rule and are still permissible. Second, the rule does not apply where a cause of action related to a noncompete accrued prior to the effective date.

Notification Requirement

Importantly, while the rule does not require any formal steps to rescind existing noncompetes, the rule does require employers to notify workers that executed noncompetes that are no longer enforceable that their agreements are no longer in effect and will not be enforced. The FTC provides proposed model language for this. Large employers may find the notification requirement to be a significant time-burden and cost for former employees.

State Law

The FTC rule generally preempts state laws that allow noncompete clauses or that are inconsistent with the rule; however, it does not preclude enforcement of state laws that are consistent with the FTC rule (e.g., the California statute against noncompetes).

Next Steps for Employers

- Stay up to date on when the FTC rule will go into effect, including any impacts that potential legal challenges may have on the effective date.
- Take steps to determine and evaluate existing noncompete restrictions, including employees that are subject to noncompete agreements.
- Consider alternative methods to protect business interests. Other types of restrictive covenants, such as nondisclosure and non-solicitation agreements,

should be narrowly tailored as they could violate the FTC rule if they "function to prevent" a worker from seeking or accepting employment elsewhere or to operate a business after the end of their employment.

This client alert was drafted by Bethany Vanhooser and Danielle Healey, attorneys in the Spencer Fane Nashville and Houston offices, respectively. For more information, please visit www.spencerfane.com.

[1] For example, the FTC does not govern certain industries, such as banks, nonprofits, air carriers, etc. Therefore, the FTC rule is inapplicable to the industries not governed by the FTC.

[2] This language is very similar to that used in the California statute banning noncompetes. *See* Ca. Bus. and Prof'l. Code § 16600.