Employment & Labor Law Alert
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The Federal Trade Commission Passes Noncompete Ban That Will Likely Never Take Effect

The Federal Trade Commission (FTC) issued a final rule on April 23 banning nearly all postemployment noncompete agreements for employees and independent contractors. The publication of the final rule has caused a flurry of excitement among employers given the breadth of its ban, but the ban is already subject to legal challenges. While the final rule is currently scheduled to become effective 120 days after being published in the *Federal Register* (which has not yet occurred), as a result of legal challenges ultimately it is unlikely to go into effect.

The initial alarm among employers is not without justification—the final rule would impose a sweeping ban on nearly all postemployment noncompete agreements. It applies to employees and independent contractors, C-suite executives and entry-level employees, and to noncompetes of any duration. It is also retroactive, requiring employers to give notice to workers that their existing noncompete agreements are now unenforceable. The final rule has few exceptions, carving out only existing noncompete agreements with certain senior executives and certain noncompete agreements entered into in connection with the sale of a business.

But the final rule is vulnerable on several fronts. Opponents are challenging, among other aspects, whether the final rule exceeds the FTC's rulemaking authority, whether Congress has authority to empower the FTC to promulgate such rules at all and whether the retroactive nature of the rule constitutes an impermissible taking under the Fifth Amendment. In light of these pending challenges, the final rule's effective date is almost certainly going to be delayed, potentially indefinitely. Employers should monitor these legal challenges to determine whether changes need to be made to their restrictive covenant agreements.

The Final Rule Would Ban Nearly All Noncompetes

The rule applies to all noncompetes and potentially to other restrictive covenants: The final rule broadly defines a "noncompete clause" as a term or condition of employment that prohibits a worker from, penalizes them for, or functions to prevent a worker from (1) seeking or accepting work with a different employer or (2) operating a business after the conclusion of the employment. The final rule further states that it applies to noncompetes imposed by contract or workplace policy, both written and oral.

The rule does not, on its face, ban nonsolicitation restrictions with respect to customers, clients or employees, or nondisclosure agreements. But it does ban any restriction that "functions to prevent a worker from" seeking or accepting work or operating a business after the conclusion of employment. As a result, courts could find that broadly drafted nonsolicitation and nondisclosure restrictions fall under the scope of the final rule.

Narrowly drafted nonsolicitation restrictions, nondisclosure agreements and other trade secret protections likely remain outside of the final rule's scope.

The rule applies to nearly all employees and contractors: The final rule defines "worker" as a natural person who works or who previously worked, whether paid or unpaid, without regard to the worker's title or status under any other state or federal laws. The rule therefore includes noncompetes entered into with employees, independent contractors, interns, volunteers and any other workers.

Unlike many state laws in this area, there is no salary threshold under which the rule applies—it applies to employees who are exempt and nonexempt, at any compensation level.

Carve-outs for existing noncompetes with senior executives: The rule does allow employers to maintain noncompetes with senior executives that were entered into before the rule's effective date. The final rule defines a "senior executive" as a worker earning more than $151,164 who is in a "policy-making position."

The rule applies to noncompetes of any length: The final rule prohibits noncompetes of any duration. Therefore, even a 30-day noncompete entered into with talent in the entertainment industry, or between a brand and an influencer or other individual, would be prohibited.

Garden leave is permitted: "Garden leave" provisions are not considered an impermissible noncompete if the worker would still be employed and continue to receive their salary and benefits during the covered period. If the final rule were to go into effect, employers could look to restructure existing noncompete arrangements to garden leave arrangements, provided they are willing to pay a worker their salary and benefits during any restricted period.

Retroactive effect and required notice: The final rule applies retroactively to all noncompetes, subject to the senior executive carve-out. Employers must provide written notice to workers with existing noncompetes that those provisions are no longer enforceable.

Sale of business exception: The rule does not apply to noncompetes entered into in connection with a bona fide sale of a business entity, a person's ownership interest in a business entity, or all or substantially all of a business entity's operating assets. The final rule does not impose any threshold for an individual's ownership in the business (such as the initially proposed rule, which required an individual to sell at least 25% of an interest in the business for a noncompete to be valid).

Pending Legal Challenges

At least two lawsuits have been filed in federal court in Texas seeking to enjoin the final rule. Opponents of the rule have lobbed a number of objections, including arguing that the rule exceeds the FTC's rulemaking authority or constitutes an arbitrary and capricious agency action. Opponents have also argued that Congress lacks authority to empower the FTC to promulgate the rule at all. The FTC has so far relied on Sections 5 and 6(g) of the FTC Act in issuing the rule. Those sections of the act declare unfair methods of competition unlawful and authorize the FTC to make certain rules. But challengers argue that such a broad rule is too substantive in nature to be an agency rule and constitutes an impermissible delegation of legislative authority—essentially, that this type of sweeping ban would need to come from Congress, not a federal agency. The rule could also be found to be arbitrary and capricious if a court agrees that the FTC did not adequately support its decision to categorically ban all noncompetes, relied on a flawed cost-benefit analysis or failed to consider alternative proposals.

Given the forum in which the challenges have been filed, and the U.S. Supreme Court's recent tendency to scale back agency action that the Court perceives as overstepping an agency's limited, delegated authority, the challenges are likely to be successful. At the very least, they will delay, if not entirely invalidate, the final rule.

Key Takeaways

In the meantime, employers should continue to monitor the pending legal challenges before taking any action to revise existing restrictive covenant agreements or notify employees with noncompetes. Given that the final rule is unlikely to go into effect, no action may be necessary.

The FTC's final rule is part of a growing trend of pushing back against the broad use of noncompetes. Many states now have laws that ban noncompetes entirely, preclude their use with low-wage workers or otherwise limit an employer's ability to impose a broad noncompete. As always, employers should ensure that any restrictive covenants they do impose are narrowly tailored to a protected interest. Employers should give careful thought to which employees are subject to restrictive covenants, what types of restrictive covenants are imposed, and the duration and scope of those restrictions.

Employers can also consider relying more heavily on nondisclosure or nonsolicitation agreements, as well as garden leave provisions, which are more likely to be enforceable regardless of whether the final rule goes into effect.

Related Professionals

Mark Goldberg . . . . . mgoldberg@loeb.com
Michelle La Mar . . . . . mlamar@loeb.com
Lauren Richards . . . . . lrichards@loeb.com
Kimberly Stallworth . . . . . kstallworth@loeb.com
Sarina Saluja . . . . . ssaluja@loeb.com