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FTC Passes Sweeping Noncompete Ban

April 24, 2024

On April 23, 2024, the Federal Trade Commission (FTC) voted 3 – 2 in favor of banning all post-employment noncompete agreements. The rule is scheduled to be published in the Federal Register on May 7, 2024, making the effective date of the rule September 4, 2024, barring any injunction or court ruling extending the date. According to the briefing schedule in the lawsuit filed by the US Chamber of Commerce in the US District Court for the Eastern District of Texas, we expect the court to hear argument on an injunction and the merits of the case in late June or early July 2024.

In January 2023, the FTC published a proposed version of the noncompete ban. The final rule is substantially the same as the initial rule. Below are the key provisions of the final rule.

Broad application of categorical ban on noncompetes

All post-employment noncompete agreements with workers will be prohibited beginning on the effective date of the ban. In its final rule, the FTC noted that it determined that noncompetes constitute an unfair method of competition, violating Section 5 of the Federal Trade Commission Act (FTC Act). Among other things, the agency noted that the "case-by-case and State-by-State approaches to non-competes have proven insufficient to address the tendency of non-competes to harm competitive conditions in labor, product, and service markets." Moreover, the FTC posits that noncompetes restrict the freedom of American workers, suppress wages, and stifle new business and innovation. The FTC estimates that banning noncompetes would create new businesses and increase American workers' earnings by $400 – 488 billion over the next decade.

As with its proposed rule, the final rule broadly defines a noncompete clause as "a term or condition of employment that prohibits a worker from, penalizes a worker for, or functions to prevent a worker from (1) 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 (2) operating a business in the United States after the conclusion of the employment that includes the term or condition." In addition, as with the proposed rule, the final rule broadly applies to noncompete agreements affecting virtually all workers – including employees, independent contractors, externs, interns, volunteers, apprentices or sole proprietors. There are narrow exceptions, including for **existing** agreements with senior executives, as detailed below.

Significantly, employers should note this broad definition of a noncompete clause includes certain provisions that are commonly thought to constitute alternatives to noncompetes. As such, the FTC's final rule indicates that these "alternatives" also violate its noncompete ban – for example, if they penalize a worker for seeking or accepting other work or for starting a business after the worker leaves their job. These covenants include forfeiture-for-competition clauses, which the FTC describes as "similar to [an] agreement with liquidated damages … [that] imposes adverse financial consequences on a former employee as a result of the termination of an employment relationship, expressly conditioned on the employee seeking or accepting other work or starting a business."

In addition, the FTC also notes that a severance agreement "in which the worker is paid only if they refrain from competing" also would violate the rule. As the FTC states, "The common thread that makes each of these types of agreements non-compete clauses, whether they 'prohibit' or 'penalize' a worker, is that on their face, they are triggered where a worker seeks to work for another person or start a business after they leave their job—i.e., they prohibit or penalize post-employment work for another employer or business."

Exception for existing agreements with senior executives

The rule does not ban existing noncompete agreements with senior executives. However, after the effective

date, **new** noncompete agreements with senior executives will be subject to the ban. The final rule defines senior executives according to a two-pronged test, with an earnings threshold and a job duties requirement. These workers must earn more than $151,164 annually and be in "policy-making positions." A policy-making position is defined as "a business entity's president, chief executive officer or the equivalent, any other officer of a business entity who has policy-making authority, or any other natural person who has policy-making authority for the business entity similar to an officer with policy-making authority."

The rule further defines an individual with policy-making authority as one who has "final authority to make policy decisions that control significant aspects of a business entity or common enterprise and 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 affiliate of a common enterprise." Employers should note that this class of workers should be very narrowly construed, as the FTC states that it expects less than 1% of workers to qualify as senior executives under this definition.

Notice requirement

Unlike the proposed rule, formal rescission of existing noncompete agreements is no longer required. Instead, employers will be required to issue a notice to all nonsenior executive workers who have existing noncompete agreements explaining that those agreements will no longer be in effect and will not be enforced upon the effective date of the rule. To assist employers, the FTC published a model notice on its website. Notably, the model notice contains language stating that the employer will not enforce any noncompete clause against the employee, the employee may seek or accept a job with any company or any person (even if competitive), the employee may run their own business (even if competitive), and the employee may compete with the employer following their employment. The model notice also refers employees to the FTC's website to learn more about the ban.

Exceptions

The rule does not apply to the following entities and contexts:

- **Nonsolicitation and nondisclosure agreements** – The rule excepts nonsolicitation agreements and nondisclosure agreements. However, employers should note that restrictive covenants that effectively prevent a worker from working in the same field would violate the rule, because they functionally operate as a noncompete clause.
- **In-term noncompete agreements** – The rule also does not apply to noncompete agreements prohibiting competing against an employer during employment.
- **Certain employers excepted from the FTC Act** – Certain employers also are excepted from the law's application, because they are not subject to the FTC Act. These employers include banks, insurance companies, nonprofits, transportation and communications common carriers, air carriers and some other entities.
- **Franchisee/franchisor contracts** – The ban does not apply to contracts between franchisees and franchisors themselves, although it does apply to employees working for a franchisee or franchisor.
- **Sale of business exception** – As proposed originally, the ban also includes a sale of business exception. However, unlike the proposed rule, the final rule adopts the exception permitting noncompetes for the "bona fide sale of a business," without requiring that the seller have at least a 25% ownership interest in the business entity, as originally proposed.

Violations

Violations of the rule will be deemed a violation of Section 5 of the FTC Act, which prohibits "unfair or deceptive acts or practices in or affecting commerce." The FTC, however, cannot obtain civil penalties or other monetary relief against parties for using an unfair method of competition. The agency can instead pursue adjudication under Section 5(b) of the FTC Act or seek an injunction in federal court against a party that has engaged in an unfair method of competition. The agency can obtain civil penalties in court if a party is ordered to cease and desist from a violation and fails to do so.

Complaints regarding suspected violations also may be sent to the agency by email or mail.

Next steps

The final rule is expected to face immediate legal challenge. Indeed, a lawsuit filed on April 23, 2024, by Ryan, LLC in the US District Court for the Northern District of Texas challenges the FTC's rulemaking authority under the Administrative Procedure Act – and alleges that the rule constitutes "an unauthorized, unconstitutional attempt to eliminate a long-established private economic arrangement." In addition, the US Chamber of Commerce announced its intent to file an immediate lawsuit with a request for an injunction as early as Wednesday, April 24.

According to the Chamber of Commerce press release, the rule constitutes a "blatant power grab that will undermine American businesses' ability to remain competitive. … 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. Yet, today, three unelected commissioners have unilaterally decided they have the authority to declare what's a legitimate business decision and what's not by moving to ban noncompete agreements in all sectors of the economy. This decision sets a dangerous precedent for government micromanagement of business and can harm employers, workers, and our economy."

Chamber officials stated that their concern lies principally with what this decision would mean for the FTC's power to regulate unfair methods of competition. Objections to the agency's rulemaking authority also were raised by the two FTC commissioners voting against the rule on April 23. In particular, Commissioners Melissa Holyoak and Andrew Ferguson both expressed that the noncompete rule exceeds congressional authorization, and that the agency does not have the authority to undo millions of existing contracts and existing noncompete laws in many states.

In light of imminent legal challenges, the future of the rule is uncertain. It is possible that the rule's effective date will be extended while litigation plays out in courts. In the meantime, employers should take proactive steps now to carefully evaluate their use of noncompete agreements – including the business justifications and goals for imposing such restrictions and the range of employees for whom such covenants are imposed.

Cooley's employment team will continue to follow developments relating to the FTC rule. Employers with questions about the use of restrictive covenants should contact their Cooley employment lawyers.

To learn more, check out Cooley's FTC Noncompete Ban Resources page and our What to Know About the FTC's Noncompete Ban on-demand webinar.

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