

FTC Prohibits Noncompete Agreements; Business Groups Sue

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The Federal Trade Commission (“FTC”) just approved a rule that would largely prohibit making or enforcing employee noncompete agreements. The U.S. Chamber of Commerce and others have already sued to block the new rule. What should businesses and employees know?

Timing. The earliest possible effective date for the rule is four months from now—120 days after publication in the Federal Register. The date will be even later (if ever) if a court delays or blocks the rule’s implementation. If the rule goes into effect as written, however, it will prohibit making new agreements and enforcing most existing agreements (unless the agreement was breached before the effective date).

Prohibition. The rule is broad. It prohibits every “term or condition of employment that prohibits a worker from, or penalizes a worker for, or functions to prevent a worker from... 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 “operating a business in the United States after the conclusion of the employment that includes the term or condition.”

Limited Exemption for Noncompetes with Senior Executives. The rule prohibits new noncompete agreements across the board, but permits enforcement of noncompete agreements with certain “senior executives” that exist as of the effective date. “Senior executive” means that the employee must earn at least \$151,164 in annualized compensation (including salary, commissions, and nondiscretionary bonuses, but excluding payments for medical insurance, payments for life insurance, contributions to retirement plans, and the cost of other similar fringe benefits). The “senior executive” must also hold a “policy-making position,” such as president or CEO. An officer of a subsidiary, however, will probably not be considered a senior executive. The meaning of “policy-making position” is not at all clear.

Notice Requirement. The rule also requires employers to provide workers who are

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subject to covered noncompete clauses “with clear and conspicuous notice ... that the worker’s non-compete clause is no longer in effect and will not be, and cannot legally be, enforced against the worker.”

Sale-of-Business Exception. The rule exempts noncompete clauses that are “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.” Whether the exception applies to executives that have rights to shares in a corporation as part of their equity awards will likely be a topic of future litigation.

State Laws. The FTC rule sets a floor but not a ceiling for state law. A state can continue to prohibit noncompetes altogether, or it can set a lower compensation level than the \$151,164 at which the FTC rule would render existing noncompetes with “senior executives” unenforceable.

Enforcement. The rule does not directly create any cause of action for employees. It is possible that the FTC will bring enforcement actions. It is also possible that state attorneys general will enforce their states “little FTC Acts” and use the FTC’s rule as an indicator of what constitutes “unfair methods of competition” under state law. Finally, an employee might argue that a state should update its own common law principles in light of the rule or (where state law permits it) bring a private action under the state’s statutory law.

Legal Challenges. The U.S. Chamber of Commerce, joined by several other business groups, has filed a lawsuit in Texas federal court seeking to prevent implementation of the rule. Private employers have also started lawsuits. The Chamber claims that the FTC lacks statutory authority for this rulemaking, that not all noncompetes can be considered anticompetitive, that the rule is impermissibly retroactive (applying to agreements that were already negotiated), and that the rule is arbitrary and capricious.

Actions for Employers

Use the Time. This rule has been in the works for more than a year, so many employers have already prepared for this day. But if your company has not developed a contingency plan, use the next several months wisely. As employers in states that have already banned noncompetes know, there are many ways to protect legitimate business interests, even if noncompetes are prohibited.

Review Key Non-Disclosure, Non-Solicitation, and Confidentiality Provisions and Agreements. Employers should evaluate how to protect their highly sensitive information through means other than a noncompete, such as strengthening confidentiality and nondisclosure provisions. Employers should consider limiting the number of employees who have access to highly sensitive information—and ensure that those who do have access also have strong confidentiality agreements and receive training on their obligations to maintain confidentiality during and after employment. Employers should carefully review provisions prohibiting the solicitation of customers and clients to determine whether they come within the rule’s prohibition. Employers should also put

measures in place to prohibit new hires from breaching confidentiality provisions entered into with previous employers.

Identify “Senior Executives.” Employers should do their best to identify which of their employees might qualify as “senior executives.” That includes ensuring they meet the compensation requirement, and developing the employer’s rationale for why those employees have “policy-making” authority.

Review Template Noncompete Agreements. Employers should also revisit template agreements for lower-level employees to identify provisions that might violate the rule and consider alternative provisions to protect the company’s legitimate business interests.

Be Mindful of State Laws. Even if a court prohibits implementation of the FTC’s rule, remember that relevant state laws will remain in effect. California, Minnesota, North Dakota, and Oklahoma have banned most noncompete agreements entirely. Several states prohibit noncompete agreements with employees whose compensation is below a statutory amount. These states include Colorado, Illinois, Maine, Maryland, Massachusetts, Nevada, New Hampshire, Oregon, Rhode Island, Virginia, Washington, and Washington D.C.

Prepare for Notifications. Employers should develop plans for complying with the rule’s notice provisions—and make sure that they comply with any applicable notice requirements under state law. For example, California recently implemented a notice requirement with a deadline of February 14, 2024 for employers to provide the notice.

Consider Alternative Retention Strategies. The rule prohibits the stick, but not the carrot. Employers should consider whether alternative retention strategies will now become more necessary if the rule goes into effect. For example, an employer might offer hiring bonuses in their compensation packages, payable after a satisfactory employment period (one year, for example) but advanced to the employee upon hire. Employees who leave before the period can then be on the hook to repay the bonus if they leave early, which protects a company’s investment in an employee by incentivizing a certain minimum tenure.

Think About the Opportunities. If the rule goes into effect, your noncompete agreements will become largely unenforceable—but so will those of your competitors. Consider whether the rule might create hiring opportunities.

Comply with Antitrust Laws. The rule deals only with agreements between employers and their workers. Making those agreements unenforceable might increase the incentive to work out informal agreements with competing employers not to hire each other’s workers. Don’t succumb to that temptation! In 2016 the FTC and the U.S. Department of Justice (“DOJ”) announced their position that “no poaching” agreements between employers were not only per se illegal, but also criminal violations. It took DOJ several years to bring a criminal enforcement action, and it has yet to win a conviction from judge or jury, but that is cold comfort to anyone who has to endure a criminal prosecution.

Moreover, civil private class-action litigation against no-poaching agreements continues apace.