Lawyer Insights

FTC Issues Final Rule Banning Most Noncompetes, but Immediate Legal Challenges Ensue

By Ryan Glasgow and Jason Brown
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The Federal Trade Commission (FTC) voted last month to approve a final rule banning most noncompete agreements between employers and their workers. The final rule is scheduled to go into effect on Sept. 4, 2024, though legal challenges may delay its effective date and FTC enforcement actions.

The Final Rule

The most significant pieces of the final rule are that:

- It makes noncompete agreements with workers an unfair method of competition that violates Section 5 of the FTC Act.
- It defines "noncompete" agreement broadly "as any term or condition of employment that prohibits a worker from, penalizes a worker for, or functions to prevent a worker from" seeking or accepting employment with another business or operating a business after their working relationship ends.
- It is not limited to employees, but instead covers anyone "who works or who previously worked, whether paid or unpaid … including, but not limited to, whether the worker is an employee, independent contractor, extern, intern, volunteer, apprentice, or a sole proprietor …"
- It prohibits new noncompetes after the effective date, including agreements with highly compensated executives. Pre-existing noncompete agreements with "senior executives," defined as an employee earning more than $151,164 a year in a "policy-making position," will remain in force, but the final rule's definitions suggest this exception is designed to govern a very limited set of executives within companies.
- All other pre-existing noncompetes are void as of the effective date. The final rule requires employers to provide current and past workers notice that they will not enforce existing non\competes, but not to formally rescind noncompete agreements. The final rule includes model language for the notice requirement that businesses can use to comply with this section of the final rule.

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- The definition of ”noncompete” agreements does not include (and are, therefore, not prohibited by the final rule): noncompetes that prohibit employees from competing against employers during their employment; sufficiently tailored non-solicitation of customers and employees provisions; noncompete agreements entered into in conjunction with sale of a business; and franchisee/franchisor agreements.

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There are important limitations to the final rule based on limitations in the reach of the FTC Act, which does not apply to nonprofits, banks, savings and loan companies, transportation and communications common carriers, air carriers, and some other entities. However, the Federal Deposit Insurance Corp.’s recent bank merger guidelines banned the enforcement of noncompetes for employees at banks of all sizes in certain contexts. FTC Commissioner Rebecca Kelly Slaughter also warned that nonprofits registered as tax-exempt, but organized for the profit of members, would be subject to the FTC Act. Further, the Biden administration has issued, and likely will continue to issue, executive orders and regulations to close any gaps in the final rule. Companies that violate the final rule may be subject to civil enforcement actions and penalties.

Legal Challenges to the Rule

There have already been two notable legal challenges to the final rule in Ryan v. Federal Trade Commission, 3:24-cv-986(N.D. Tex., Apr. 23, 2024) (the Ryan case), and then in Chamber of Commerce of the United States of America v. Federal Trade Commission, 6:24-cv-00148 (E.D. Tex., Apr. 24, 2024) (the Chamber case). The Chamber case was assigned to Judge J. Campbell Barker and the Ryan case was assigned to Judge Ada Brown, both Trump appointees.

Plaintiffs in both cases allege the final rule violates the Administrative Procedure Act because it: is outside the FTC’s rule making authority; is premised on a legally erroneous understanding of “unfair methods of competition”; rests on an unconstitutional delegation of authority to the agency; is unlawfully retroactive; is not rationally connected to economic data; and (vi) is arbitrarily chosen without duly considering alternatives. The plaintiffs in both cases moved for preliminary injunctions and to stay the effective date of the final rule.

The Ryan case will be the battleground for this dispute after some early procedural maneuvering. Judge Barker stayed the Chamber case under the “first-to-file” doctrine because Ryan filed its case first and the two cases seek the same relief based on the same legal theories, and suggested the Chamber plaintiffs move to intervene or for joinder in the Ryan case. Judge Brown appears poised to order expedited briefing on Ryan’s motion for preliminary injunction. There very well may be a decision on the merits prior to the final rule’s effective date. We anticipate that the losing side will appeal to the U.S. Court of Appeals for the Fifth Circuit Court, and that the Supreme Court may ultimately provide the last word related to this dispute.

What Employers Should Do in the Near Future

Employers should begin evaluating how they will comply with the Final Rule in the event it becomes effective, including by doing the following:

- Consider whether to require certain “senior executives” to execute noncompetes before the Final Rule becomes effective.

- Consider adding other restrictive covenants to adequately protect employers' interests for individuals who would typically sign noncompetes (e.g., the protection of its trade secrets, employees, and other confidential or proprietary information). Note, however, that, under the final rule, other types of restrictive covenants cannot be so onerous that they function as a noncompete.

- Review existing policies, offer letters, and agreements related to noncompetition and identify which provisions will require revision if the final rule takes effect.

- Ensure that other workplace policies and procedures adequately protect them from violations of nondisclosure or confidentiality obligations.

- Develop a plan for efficiently sending notice to current and former workers who are subject to non competes, and who are not "senior executives," prior to the effective date.

- Consult with counsel for advice about how to begin planning for the final rule.

Employers do not need to not rush to immediately implement changes. Instead, they should allow time for the above litigation to play out over the next few months to see, among other things, if the courts invalidate the final rule or stay it pending the outcome of the litigation and inevitable appeals.

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