

# Employee Relations LAW JOURNAL

## **U.S. Federal Trade Commission Voted to Ban Noncompetes. What Happens Now?**

*By Benjamin R. Nagin, Laura Collins, Margaret H. Allen,  
Wendy M. Lazerson, Katherine A. Roberts and  
Eric Kauffman*

*In this article, the authors discuss the Federal Trade Commission's new rule banning noncompete clauses in employment contracts.*

On April 23, 2024, the U.S. Federal Trade Commission (FTC) voted 3-2 along party lines to ban noncompete clauses in employment contracts.<sup>1</sup> In anticipation of litigation challenging the noncompete rule the Democratic FTC Commissioners have doubled down on the FTC's rulemaking authority as defined by the text of Section 6(g) of the FTC Act and the U.S. Court of Appeals for the District of Columbia Circuit's ruling in *National Petroleum Refiners Association v. FTC*.

Litigation may delay or stop the rule from coming into effect, but if it is unsuccessful, the rule will go into effect on September 4, 2024, 120 days after publication in the Federal Register.

### **WHAT IS CONSIDERED A NONCOMPETE FOR PURPOSES OF THE FTC'S PROHIBITION?**

The new rule prohibits contractual agreements between an employer and employee that (1) prohibit a worker from, (2) penalize a worker

The authors, attorneys with Sidley Austin LLP may be contacted at [bnagin@sidley.com](mailto:bnagin@sidley.com), [laura.collins@sidley.com](mailto:laura.collins@sidley.com), [margaret.allen@sidley.com](mailto:margaret.allen@sidley.com), [wlazerson@sidley.com](mailto:wlazerson@sidley.com), [kate.roberts@sidley.com](mailto:kate.roberts@sidley.com) and [eric.kauffman@sidley.com](mailto:eric.kauffman@sidley.com), respectively.

for, or (3) function to prevent a worker from seeking or accepting other employment in the U.S., including operating a U.S. business, after the employee stops working for the employer. While this encompasses traditional noncompetition agreements, it also purports to include other contractual provisions that create a de facto noncompete clause. For example, a nondisclosure agreement that defines “confidential information” as information that is “usable in” or “relates to” a particular industry may be construed as overbroad by effectively preventing a worker from working in the industry after his or her employment ends. Another de facto noncompete may be found in an employment agreement that contains a liquidated damages provision or analogous financial penalty that is triggered if the employee leaves his or her employment within a certain period of time.

### **WHAT EMPLOYEES ARE COVERED BY THE NEW RULE?**

The new rule covers workers beyond just the traditional paid employee. It also covers independent contractors, consultants, unpaid employees, externs, interns, volunteers, apprentices, and workers who are hired by one party to work for another (e.g., staffing agencies).

### **WHAT ABOUT SENIOR EXECUTIVES OR HIGHLY COMPENSATED EMPLOYEES?**

For senior executives – defined as workers earning more than \$151,164 annually who are in a “policy-making position” – existing noncompetes can remain in force. Noncompetes with senior executives after the rule’s effective date will be prohibited.

### **WHAT HAPPENS TO NONCOMPETES THAT ARE ALREADY IN PLACE?**

The new rule applies retroactively, meaning that it will ban noncompetes that were already entered into prior to the passing of this rule (with the exception of senior executives). The rule will cover prospective noncompetes for all workers (including senior executives).

### **WHAT ABOUT NONDISCLOSURE AGREEMENTS OR NONSOLICITATION AGREEMENTS?**

The new ban on noncompetes does not prohibit other types of restrictive employment covenants such as nondisclosure agreements

and nonsolicitation agreements, so long as they are not so broad that they create a de facto noncompete. Specifically, a nondisclosure agreement is not a noncompete if the agreement's prohibitions on disclosure do not apply to information that (1) arises from the worker's general training, knowledge, skill, or experience, gained on the job or otherwise, or (2) is readily ascertainable to other employees or the general public.

### **WHAT ABOUT COMPENSATION-BASED OR TRAINING-REPAYMENT AGREEMENTS?**

Compensation-based agreements such as garden leave and severance agreements are generally not prohibited under the new rule so long as there are no restrictions on what the employee can do after they are no longer employed. Training-repayment agreements are also not prohibited so long as they do not prevent an employee from seeking or accepting other employment or starting a business after the employment associated with the agreement.

### **WHAT ABOUT FORFEITURE-FOR-COMPETITION CLAUSES?**

The rule specifically prohibits terms that "penalize" workers for working for a competitor after leaving. This includes a prohibition of forfeiture-for-competition clauses, including severance agreements where a worker is paid only if they refrain from competing.

### **IS THERE AN EXCEPTION FOR THE SALE OF A BUSINESS?**

Yes. The new rule does contain an exception to allow noncompetes in bona fide sale-of-business agreements made in good faith between two independent parties at arm's length. A qualifying sale of a business must involve the sale of (1) a business entity, (2) all or substantially all of a business's operating assets, or (3) an individual's ownership interest in the business entity. This reflects a change from the proposed rule, which contained a 25% ownership threshold for the exception to apply.

### **WHAT IF MY STATE LAW ALLOWS NONCOMPETES?**

The new FTC rule purports to supersede any state statute, regulation, or order to the extent the state law is inconsistent with the new rule. State laws that are more stringent than the FTC's rule will still apply.

## **WHEN DOES THE RULE TAKE EFFECT?**

The rule is scheduled to take effect 120 days after it is published in the Federal Register. The FTC announced the publication date as May 7, 2024, making the rule's effective date September 4, 2024. This is the deadline by which employers must provide notice to current employees and any former employees currently bound by a noncompete to inform them that the employee's noncompete clause is no longer valid.<sup>2</sup>

## **IF MY NONCOMPETE IS NOT COVERED BY THIS RULE, OR IF THE RULE DOES NOT GO INTO EFFECT OR IS STAYED DURING LITIGATION, IS MY NONCOMPETE LEGAL?**

The FTC has begun using its authority under Section 5 of the FTC Act to bring enforcement actions against noncompetes and de facto noncompetes that it thinks are anticompetitive, and it may continue to do so even if this rule does not go into effect. For instance, on January 4, 2023, the FTC announced that three companies had settled anticompetitive enforcement actions in which they agreed to cease use of current and future noncompete restrictions in employment contracts.<sup>3</sup>

## **NOTES**

1. [https://www.ftc.gov/system/files/ftc\\_gov/pdf/noncompete-rule.pdf](https://www.ftc.gov/system/files/ftc_gov/pdf/noncompete-rule.pdf).
2. There is model language included in the new rule, available at [https://www.ftc.gov/system/files/ftc\\_gov/pdf/noncompete-rule.pdf](https://www.ftc.gov/system/files/ftc_gov/pdf/noncompete-rule.pdf).
3. The FTC's press release related to those enforcement actions can be found at <https://www.ftc.gov/news-events/news/press-releases/2023/01/ftc-cracks-down-companies-impose-harmful-noncompete-restrictions-thousands-workers>.

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