Federal Trade Commission Prohibits Noncompete Agreements for Almost All U.S. Workers, Legal Challenges Expected

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The U.S. Federal Trade Commission (FTC) issued a final rule yesterday (April 23, 2024) to take effect in 120 days prohibiting most noncompete agreements between employers and workers.

The basics for understanding the final rule include:

- The new rule would ban almost all noncompete agreements in effect and require companies to inform current and former employees that their noncompete agreements will no longer be enforced.
- Some existing noncompete agreements covering "senior executives" can remain in effect, but employers will be banned from imposing any new noncompete agreements on their senior executives going forward.
- Some noncompete agreements entered into as part of a sale of a business entity, including a person's sale of their ownership interest in a business entity, remain enforceable.
- Certain industries the FTC does not regulate are exempt from the rule, including nonprofit organizations, airlines, banks, credit unions and insurance companies.
- Several states have already passed laws banning or restricting noncompete agreements including California, Colorado, Minnesota, North Dakota and Oklahoma. If implemented, the new rule will override all state laws, regulations or orders that conflict with the FTC's regulations.

The FTC approved the new rule on 3-2 vote along party lines. The Commission says the new regulations will ensure that American workers have the freedom to pursue a new job, start a new business or introduce a new product or service to the market.

Legal Challenges to Noncompete Rule Are Certain

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A group of business advocates representing an array of industries and interests have criticized the final rule since it was proposed over a year ago. They claim noncompetes are a critical tool that is important to protecting trade secrets and they actually increase competition.

The U.S. Chamber of Commerce, the country's preeminent pro-business group, has said it will commence legal action against the FTC over the final rule. According to the Chamber, its suit will argue that the Commission lacks the full legal authority to issue the final rule and will ask a federal court to invalidate it.

The FTC counters this argument by noting that its legal authority to regulate business activity stems directly from the 110-year-old law that created the agency.

What Employers Need to Know About the New Noncompete Rule

The final rule is a sweeping measure that essentially bans the use of noncompete agreements for most U.S. workers. Some action steps recommended for employers include:

- Review Existing Noncompete Agreements – Employers should review all current noncompetes with employees. Except for a carve-out affecting some senior-level executives, the rule renders noncompete arrangements unenforceable.
- Review individual shareholder Stock Redemption Agreements for enforceable noncompetition clauses.
- Develop Alternative Strategies – The FTC acknowledges that many businesses must have mechanisms to protect confidential industry information and customer relationships. The agency recommends alternatives to the traditional noncompete agreement. These include agreements which prohibit ex-workers from accessing or utilizing defined trade secrets or specific customer lists for a set timeframe after they depart from the company.
- Open Communication and Transparency --The final rule requires employers to notify workers that they are no longer subject to their noncompete agreements. In addition to issuing compulsory notices, employers are recommended to take the opportunity to open a dialogue with workers on the topic and freely exchange information regarding the changes brought about by the new rule. Explain the rationale behind the move away from noncompetes and address questions and concerns about the way forward.

Under the Biden Administration, the FTC has adopted a more aggressive posture toward regulating corporate America. In addition to banning most non-competes through the FTC, increased regulation has been implemented through the National Labor Relations Board (NLRB), which has implemented several new or revised rules and is suing companies to enforce them. And in another action taken yesterday, the U.S. Department of Labor (DOL) announced another final rule, which will raise the minimum weekly salary to qualify to qualify for certain exemptions from overtime requirement of the Fair Labor Standards Act (FLSA) from $684/week ($35,568 annually) to $844/week ($$43,888 annually) by July 1, 2024, and to $1,128/week ($58,656 annually) by January 1, 2025.

These regulatory changes are subject to court challenges, but may result in significant operation changes and costs to companies. Companies should promptly begin reviewing their noncompete agreements, payroll processes and policies, and employment work rules.

The attorneys with Foster Swift's Labor and Employment Practice Group have decades of experience with noncompete agreements and other restrictive covenants. They understand the details and nuances of the new FTC rules regarding these arrangements and can respond to any questions or concerns you may have. Please contact Michael Blum (mblum@fosterswift.com/248-785-4722) or another member of the firm's Labor and Employment Practice Group.