MAY 15, 2024

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STRATEGIC SERVICES GROUP

## Preparing for the FTC's Noncompete Ban

On April 23, 2024, the Federal Trade Commission (FTC) voted to issue a final rule that would prohibit employers from entering into or enforcing noncompete clauses with most employees. The final rule was published in the Federal Register on May 7, 2024, and is scheduled to take effect 120 days after such date on **Sept. 4, 2024**.

Subject to very limited exceptions, the final rule provides that:

- The use of noncompete clauses will be banned as of the effective date;
- Any existing noncompete clauses (other than those entered into with senior executives) will be invalidated;
- Employers must notify all employees (other than senior executives whose existing noncompete agreements will remain enforceable) that their existing noncompete agreements will not be enforced.

The FTC stated that it aims to promote competition by protecting the freedom of workers to change jobs, increasing innovation and fostering new business formation.

### ACTION STEPS

Employers that use noncompete or similar protective clauses should familiarize themselves with the rule's requirements and take steps now to prepare for its effective date. This Compliance Bulletin provides an overview of the key provisions of the final rule and steps employers may take to prepare for the FTC's ban on noncompete clauses.

Employers should note, however, that at least three lawsuits (including one brought by the U.S. Chamber of Commerce) seeking to block the final rule have already been filed, so employers should monitor for additional legal challenges and prepare for potential uncertainty.

### HIGHLIGHTS

- ✓ The FTC final rule will:
- ✓ Prohibit the use of noncompete clauses for almost all employees as of the effective date;
- ✓ Invalidate any existing noncompete clauses (other than those entered into with senior executives); and
- ✓ Require employers to notify current and former employees (other than senior executives) that their existing noncompete clauses will be unenforceable.

### IMPORTANT DATES

**April 23, 2024**

The FTC voted to issue a final rule to prohibit employers from entering into or enforcing noncompete clauses with most employees.

**May 7, 2024**

The final rule was published in the Federal Register.

**Sept. 4, 2024**

The final rule is scheduled to take effect 120 days after it was filed in the Federal Register.

# Overview of the FTC's Noncompete Ban

## Background

In general, a noncompete clause is a contractual term between an employer and a worker that blocks the worker from working for a competing employer or starting a competing business, typically within a certain geographic area and period of time after the worker's employment ends. Currently, the enforceability of a noncompete clause is determined by state and local legislatures and courts. In January 2023, the FTC issued a proposed rule to govern the enforceability of noncompete clauses at the federal level and supersede any less restrictive state laws or judicial interpretations. The FTC then accepted comments on the proposed rule, which it reviewed and considered in drafting the final rule. The final rule was issued on April 23, 2024 and filed in the Federal Register on May 7, 2024. The final rule is scheduled to take effect 120 days after such filing date, on Sept. 4, 2024.

## Important Provisions in the FTC Noncompete Ban

The final rule states that noncompete clauses are an unfair method of competition. Therefore, the FTC has voted to ban the use of noncompete clauses in almost all circumstances and to invalidate most existing noncompete agreements. Specifically, the final rule:

- **Bans future noncompete clauses**—The final rule prohibits employers from entering into or enforcing noncompete clauses in virtually all circumstances beginning on the effective date. Note that employers may still enforce **existing** noncompete clauses with senior executives but may not enter into new noncompete clauses with senior executives.
- **Invalidates existing noncompete clauses**—The final rule also prohibits employers from enforcing any noncompete clauses entered into with current or former employees. The rule provides an exception for existing noncompete clauses entered into with senior executives, which may remain enforceable under the rule. However, this exception is very narrow, as the FTC estimates that only approximately 0.75% of workers are likely to be considered senior executives.
- **Requires employers to notify employees**—Employers must also provide notice to any current or former employees with existing noncompete clauses (other than senior executives who's existing noncompete clauses may be considered enforceable) that such clauses will not be enforced. The notice must be provided on or prior to the rule's effective date.

The final rule applies to noncompete agreements with **all** current and former workers, whether full-time or part-time, including but not limited to employees, independent contractors, interns, externs and apprentices. However, employers should note that the FTC ban will only prohibit **post-employment** noncompetes. Employers may still restrict employees from engaging in competitive activities while employed with the employer.

***Key Definitions in the Final Rule***

The FTC defines the following key terms in the final rule:

- **"Noncompete clause"** is a term or condition of employment that prohibits a worker from, 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;
  - "Senior executive" is a worker who was in a policy-making position and earned more than $151,164 in annual compensation during the preceding year (including salary, commissions, bonuses and any other compensation agreed to that the worker knows and can expect but excluding items like benefits or board and lodging); and
  - "Term or condition of employment" includes but is not limited to a contractual term or workplace policy, whether written or oral.

### Exceptions to the Noncompete Ban

The final rule bans noncompete clauses in virtually all circumstances. However, the final rule provides a few narrow exceptions to the ban, including:

- **Bona fide sale of business**—The requirements of the final rule do not apply to a noncompete clause that is 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;
- **Existing causes of action**—The final rule does not apply where a cause of action related to a noncompete clause accrued prior to the effective date of the final rule; and
- **Good-faith belief that the final rule is inapplicable**—The FTC will not consider it to be an unfair method of competition to enforce or attempt to enforce a noncompete clause or make representations about a noncompete clause where a person has a good-faith basis to believe that the final rule is inapplicable.

In addition to the above exceptions, the final rule does not apply to any of the following:

- Banks;
- Savings and loan institutions;
- Federal credit unions;
- Common carriers;
- Air carriers; and
- Certain nonprofit organizations.

### Enforcement of the Final Rule

The final rule states that the use of noncompete clauses in violation of the rule is considered an unfair method of competition in violation of the FTC Act. The FTC may enforce the final rule either through enforcement actions or civil litigation. Moreover, while the final rule does not contemplate a private right of action, an employee can file an action seeking court judgment that any illegal noncompete clause is unenforceable. Employers may be subject to additional actual and punitive damages if they attempt to enforce an illegal noncompete.

## Steps to Prepare for the Noncompete Ban

### Audit Existing Employment Agreements and Employer Policies

To prepare for the noncompete ban, employers should consider conducting an audit of existing agreements, handbooks and other policies to determine whether any such documents contain noncompete clauses. As noted above, a noncompete clause may be clearly identifiable or explicitly labeled as a noncompete. However, there may be other provisions or agreements that function as a noncompete clause, even if they are not labeled as such. Therefore, employers should carefully review any agreement or policy terms that may prevent an employee or former employee from accepting employment with another employer.

### Update Existing Agreements

Because the final rule will not take effect until September 2024 and is already subject to legal challenges, employers may consider waiting to implement any changes to existing agreements and policies until there is more certainty as to when and if the final rule will take effect. However, after identifying any applicable agreements or policies, employers should begin preparing updated form agreements and policies that do not contain noncompete clauses or other provisions that may be considered so overbroad or burdensome that they function as noncompetes.

## Prepare Communications for Affected Employees

The final rule requires employers to notify employees (other than senior executives) who have entered into noncompete clauses that the employer will not enforce such clauses against the employees. Consistent with updates to existing agreements, employers may consider waiting to issue any notices until there is more certainty as to when and if the final rule will take effect. The final rule contains model language that an employer may use to satisfy its notice requirement and asserts that employers may satisfy the notice requirement by sending such language in an email to all employees. Employers should note that the final rule requires notice to both existing and former employees. Therefore, employers should confirm that they have contact information on file for all applicable employees.

## Consider Alternatives to Noncompetes

Many employers rely on noncompete agreements to protect an organization's trade secrets, proprietary and confidential information, and other competitive assets. However, employers may want to consider alternative methods to protect their business interests if the noncompete ban takes effect. Some alternatives include confidentiality, customer nonsolicitation and employee nonsolicitation agreements, as well as fixed-term employment agreements and garden leave, each of which is described in more detail below.

Employers considering any of these alternatives to noncompete clauses should note a few caveats. First, although the final rule does not categorically prohibit other restrictive agreements, such as confidentiality and nonsolicitation agreements, the FTC notes that such agreements could violate the final rule if they are so broad and onerous that they have the same functional effect as a noncompete clause. Second, states and municipalities may have additional restrictions on the use of such agreements. Therefore, employers should work with local counsel to understand the risks and enforceability of such alternatives.

### *Confidentiality Agreements*

A confidentiality agreement, also known as a nondisclosure agreement, proprietary information agreement or similar term, can be an effective way to protect sensitive company information without restricting an employee's ability to seek or accept a new position. A confidentiality agreement is a binding contract or clause pursuant to which an employee agrees not to disclose specified confidential or proprietary information.

### *Customer Nonsolicitation Agreements*

Employers that are concerned about losing customers to former employees and their new employers absent a noncompete may consider implementing customer nonsolicitation agreements. A customer nonsolicitation agreement generally prohibits former employees from soliciting business from their former employer's customers or clients either independently or while employed by a new employer.

### *Employee Nonsolicitation Agreements*

Employee nonsolicitation agreements, sometimes referred to as no-hire or anti-raiding agreements, can be an effective way to prevent former employees from luring current employees to a new employer. An employee nonsolicitation agreement generally prohibits a former employee from soliciting current employees of their former employer from terminating their employment or accepting new employment with another employer.

. ***Fixed-term Employment Agreements***

The FTC noted that employers may consider entering into fixed-term employment contracts as a method of protecting an employer's trade secrets and investment. By entering into fixed-term employment contracts, employers can sue an employee who leaves before the end of the contract term for damages arising from the contractual breach. However, the employer cannot bar them from accepting a position with a new employer. Further, a fixed-term employment agreement may limit an employer's ability to terminate the employee without cause prior to the end of the contract term.

***Garden Leave Provisions***

The FTC confirmed that a traditional garden leave provision, where the worker remains employed and receives the same total annual compensation and benefits on a pro rata basis, would not be considered a noncompete clause under the final rule because it is not a post-employment restriction. Garden leave generally serves as a notice provision. However, unlike typical employee notices where the employee continues to actively work during the notice period, employees on garden leave are typically relieved of their duties and responsibilities yet remain employed by the employer. By offering garden leave, employers can ensure that the employee does not work for a competitor shortly after ceasing their work for the employer.

### Prioritize Employee Retention

Under the final rule, employers may consider focusing on employee retention as a method of preventing employees from leaving to work for competitors. For example, employers could offer long-term incentives that require continued employment as a condition of eligibility, such as equity awards subject to time-based vesting or deferred compensation programs. Employers may also consider offering greater compensation packages or more generous employee benefits than those offered by competitors.

### Prepare for Uncertainty

While employers may begin preparing for the FTC's ban on noncompetes now, they may want to wait to implement any final changes. The ban is already subject to multiple legal challenges—at least three lawsuits have been filed seeking to block the final rule, including one filed by the U.S. Chamber of Commerce in the U.S. District Court for the Eastern District of Texas—which may result in the ban being delayed, modified or even vacated.

Further, a number of provisions in the final rule are ambiguous as drafted. For example, the final rule bans clauses that "function to prevent" a worker from seeking or accepting work or operating a business. The FTC stated that whether a clause functions as a noncompete clause is a "fact-specific inquiry." It is unclear how that will operate in practice and the extent to which other protective agreements, such as nonsolicitation agreements, may violate the noncompete ban. Therefore, if the ban takes effect, employers should continue to monitor for additional legal challenges or clarification regarding such ambiguous provisions.

## Additional Resources

Employers may also refer to the following resources in preparing for the FTC's final rule banning noncompetes:

- Fact Sheet on the FTC's Noncompete Rule
- Business and Small Entity Compliance Guide