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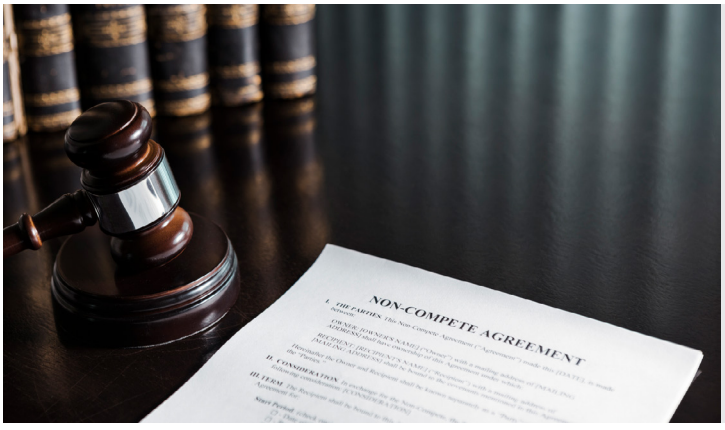
# FTC Rule Banning Noncompetes: Could This Be the End?

On April 23, 2024, the Federal Trade Commission (FTC) introduced a pivotal ruling, which if enacted, has far-reaching implications for the U.S. workforce. The ruling prohibits businesses from enforcing most noncompete agreements for employees, potentially leading to significant changes across various industries.

While current indications suggest delays and potential non-implementation of the final rule, businesses and their employees must understand the possible implications to ensure they remain in a state of compliance.

## THE EVOLUTION OF NONCOMPETE AGREEMENTS

Noncompete agreements, commonly known as noncompetes, were designed to safeguard businesses and have been a mainstay in workplaces nationwide for decades. They are a contractual arrangement in which one party, usually the employee, agrees to refrain from certain activities that could create competition against the other party. These activities may include disclosing proprietary information or trade secrets acquired during employment. Agreements also often include restrictions on working for a direct competitor for a defined period after leaving a role. While each state in the U.S. has its own laws regarding noncompetes, understanding their purpose is essential. Prior to 2023, states like California, North Dakota, and Oklahoma had outright banned these agreements, and others had introduced measures to limit their enforceability for specific employee groups. However, the movement against noncompetes gained significant momentum in 2023, with legislative efforts to restrict their reach increasing considerably.




**An estimated 30 million workers, nearly 20% of Americans, are subject to a noncompete.[1]**



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## THE RULE'S PROVISIONS AND EXCEPTIONS

The FTC ruling casts a wide net of restrictions on noncompete agreements, leaving no stone unturned in its reach, prohibiting the creation of new contracts and the enforcement of existing ones. It also extends to individuals' obligations under such agreements, aiming to limit their influence on labor mobility.

However, there are exceptions to this prohibition. Senior executives who signed noncompete agreements before the ruling are allowed to keep them, but only if they meet specific criteria related to their seniority and compensation package. The rule outlines prerequisite criteria that must be met, and the exception is not unconditional.

In addition to this provision, the FTC delineates specific circumstances where exemptions come into play. These exemptions cover a range of scenarios, including the sale of corporate entities, ongoing legal disputes that preceded the ruling, and geographic jurisdiction limitations. It also recognizes the complexities of international employment agreements, which require different considerations.

The exemption for the sale of corporate entities is particularly significant because it allows noncompete agreements to remain in effect after a change in ownership, provided that the new owner is engaged in the same line of business as the former owner. The exemption for ongoing legal disputes acknowledges that some noncompete agreements may have been signed before the ruling and are already the subject of litigation. Finally, the exemption for geographical jurisdiction limitations recognizes that some noncompete agreements may be valid in one state but not another.

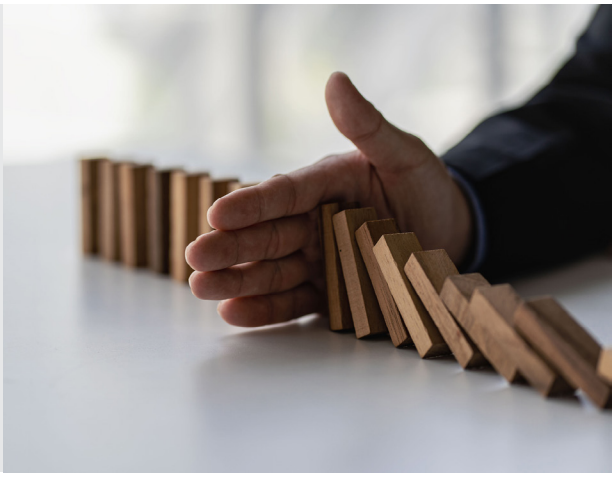
Each exception adds a layer of complexity, acknowledging the nature of employment relationships. The ruling aims to strike a balance between protecting the interests of employers and promoting labor mobility, recognizing that there are circumstances where noncompete agreements may be necessary. Overall, the regulation embodies a robust and assertive structure that provides clear guidance on noncompete agreements and their exceptions.

## FROM STATE LAWS TO FEDERAL REGULATIONS

**Required Notice:** The ruling mandates that employers provide unequivocal notice to employees whose noncompete agreements fall under the rule's purview and are consequently deemed unenforceable. This requirement aims to ensure transparency and inform affected individuals of the legal status of their agreements, empowering them with knowledge about their rights and obligations in light of the regulatory changes.

**Impact on State Laws:** Historically, noncompete clauses fell under the purview of state laws. However, the FTC's ruling introduces a significant shift by asserting federal authority, albeit selectively, over certain aspects of these agreements. Nevertheless, the interplay between federal and state regulations remains intricate, with state laws retaining relevance depending on their specific provisions.

**California, North Dakota, Oklahoma, and Washington, D.C. explicitly ban enforceability of noncompete agreements.[2]**



**Legal Challenges and Next Steps:** As the dust settles on the recent noncompete ruling, anticipation mounts for legal challenges and subsequent steps that lie ahead. With the ink barely dry, critics have already begun to voice their dissent, signaling potential courtroom clashes on the horizon. Organizations such as the National Federation of Independent Business and prominent legal firms have expressed concerns about the ruling's potential impact on business and labor markets, likely manifesting in legal challenges to contest the ruling's validity and implications. The ruling's enforcement and interpretations are also coming under scrutiny, further fueling the legal debate. As the legal battleground takes shape, stakeholders eagerly await the next steps, with the outcomes poised to shape the core of noncompete agreements for years to come. This legal saga promises to be a dynamic one, with implications reaching far beyond the courtroom, ultimately reshaping labor relations as we know them.

## GUIDANCE FOR EMPLOYERS

At this point, immediate action in response to the ban is not required. The ruling has 120 days before it takes effect, and multiple challenges expected. For example, the Chamber of Commerce of the United States of America filed suit against the FTC in the Eastern District of Texas, citing, among other things, the FTC's lack of substantive rulemaking authority.[3] A strong constitutional argument is being made that the FTC has no authority to make this ruling and that the federal government cannot override state legislative powers.

In recent years, the NLRB has also been very active in increasing scrutiny regarding unfair labor practices, such as requiring long notice periods and repayment of exorbitant training costs. The combined scrutiny of the NLRB and FTC means that it would be wise for employers to become familiar with the FTC ruling and what it does and does not impact. Reviewing current employment practices to ensure compliance with applicable state laws and the National Labor Relations Act is also essential.

**Colorado, Illinois, Maine, Maryland, New Hampshire, Oregon, Rhode Island, Virginia, and Washington prohibit noncompetes for employees under specific income thresholds.[2]**

## BOTTOM LINE

The implementation of the FTC's ruling represents a significant shift in regulatory oversight, signaling a new era. The final rule is extensive, covering a wide range of agreements that govern employer-employee relationships, going beyond traditional noncompete clauses. While awaiting further legal clarification, it's clear that it will have a far-reaching impact on many industries, influencing employer-employee relationships in the near future.

Once a district court decision is made, appeals will follow, and a Supreme Court stay decision is likely before the September 2024 effective date. Regardless of the final decision, the FTC has investigative authority and will continue to investigate the conduct of companies regarding noncompete agreements. There is likely to be increased scrutiny of noncompetes during and arising from transactions. If the FTC ruling is enacted in its current form, breach of contract claims and trade secret misappropriation claims are likely. Litigation between employees and employers is expected, and insurance policies like Directors & Officers Liability (D&O) and Employment Practices Liability would potentially be impacted, emphasizing the urgency of reviewing and updating these policies.

A wait-and see approach that avoids making any sweeping changes is best at this time. Instead, the legal challenges must be monitored, and the client's noncompete agreements must comply with state law as there is renewed scrutiny in this area. There will be a law change moving forward, which may result in greater regulation to confirm employers are complying with the applicable state law, a change in noncompete guidelines at the state level, or, ultimately, an amended version of the current FTC ruling. Keeping up-to-date with new developments and seeking advice from specialists will be crucial. One thing is certain: this situation will continue to evolve. Contact your BenefitMall sales team for the latest information and guidance.

## CONTRIBUTOR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## END NOTES

[1]FTC Announces Rule Banning Noncompetes, Federal Trade Commission, April 23, 2024.
https://www.ftc.gov/news-events/news/press-releases/2024/04/ftc-announces-rule-banning-noncompetes

[2] Potential Impacts of FTC's Near-Blanket Ban on Noncompetes, Insurance Journal, May 2, 2024.
https://www.insurancejournal.com/blogs/agentsync/2023/05/02/718555.html

[3]Lawsuits Filed Challenging the FTC's Final Rule Banning Non-Competes, The National Law Review, April 30, 2024.
https://natlawreview.com/article/lawsuits-filed-challenging-ftcs-final-rule-banning-non-competes