

FTC Issues Final Noncompete Rule

April 24, 2024

On April 23, 2024, the Federal Trade Commission (the “FTC”) issued its [final rule](#) on post-employment noncompete agreements with workers.¹ Key highlights include:

- *No new post-employment noncompetes.* The final rule bans employers from entering into or attempting to enter into new post-employment noncompetes with any worker after the effective date of the rule, including senior executives. The rule applies broadly to all workers, paid or unpaid, including employees, independent contractors and sole proprietors who provide services to a person.²
- *Limited grandfathering of existing noncompetes permitted for senior executives but banned for other workers (with notice required).* The final rule allows noncompetes with certain senior executives entered into before the effective date to remain in effect. However, employers would be prohibited from enforcing or attempting to enforce an existing noncompete clause with any other worker. In addition, employers must provide notice to any such worker by the effective date that the noncompete will not be enforced. The final rule does not require individualized notice or rescission (i.e., legal modification) of existing noncompetes.
- *Exception for seller noncompetes.* The final rule does not apply to noncompetes entered into pursuant to a bona fide sale of a business entity. There is no requirement that the worker have at least a 25% ownership threshold for this exception to apply.

The effective date of the final rule is 120 days after publication of the final rule in the federal register. The final rule will supersede state law to the extent state law would otherwise permit or authorize a person to engage in conduct that is “an unfair method of competition” under the FTC’s final rule or conflict with its notice requirement. State noncompete laws would still govern the enforceability of noncompetes with senior executives that are grandfathered by the FTC’s final rule and sale-of-business

¹ The FTC first [proposed its noncompete rule](#) in January 2023. Our Debevoise In Depth on the FTC’s proposed rule can be accessed [here](#).

² A franchisee in the context of a franchisor-franchisee relationship would not be considered a worker for purposes of the final rule.

noncompetes. In addition, the FTC's final rule allows for parallel enforcement by state attorneys general and other state agencies of state noncompete laws.

The U.S. Chamber of Commerce and other business groups have filed a challenge to the final rule in federal court in the Eastern District of Texas. Other constitutional and jurisdictional challenges to the final rule are expected.

Requirements of the Final Rule

What Is Considered a Noncompete Clause under the Final Rule?

Under the final rule, a noncompete clause is defined as a term or condition of employment (including a contractual term or workplace policy) that prohibits a worker from, penalizes a worker for or functions to prevent a worker from either: (1) seeking or accepting work in the United States with a different person where such work would begin after conclusion of their employment; or (2) operating a business in the United States after conclusion of their employment.

A noncompete clause under the final rule includes a term or condition that expressly prohibits a worker from seeking or accepting other work or starting a business after their employment ends. As noted above, a noncompete also includes a clause that "penalizes" a worker for doing so, such as liquidated damages provisions, forfeiture-for-competition provisions (where post-employment compensation and benefits are forfeited if the employee engages in competitive activity) and severance arrangements in which the worker is paid only if they refrain from competing. Certain other provisions, such as nondisclosure agreements ("NDAs"), training repayment agreement provisions ("TRAPs") and nonsolicitation agreements, may also be considered noncompete clauses under the rule if they are broad enough to "function to prevent" a worker from (or penalize a worker for) seeking or accepting other work or operating a business after they leave their employer. For these other types of provisions, case-by-case adjudication would be required as to whether they are considered noncompetes under the FTC's final rule.

The notice of final rulemaking describes some provisions that would not be considered noncompete clauses under the rule, such as:

- an NDA where the NDA'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 employers or the general public;³

- a clause requiring repayment of a bonus when a worker leaves their job before a certain period of time where the repayment amount is no more than the bonus amount, and the agreement is not tied to who the worker can work for, or their ability to start a business, after they leave their job;
- a garden leave arrangement whereby the worker is still employed and still receiving the same total annual compensation and benefits on a pro rata basis, even if the worker did not meet a condition to earn a particular aspect of their expected compensation, such as a condition for payment of a bonus; and
- mutual fixed-duration employment contracts whereby a worker agrees to remain employed with an employer for a fixed term, and the employer agrees to employ the worker for that period.

What Is the Effect on New Noncompetes?

The final rule would ban employers from entering into or attempting to enter into new post-employment noncompetes with any worker (including senior executives) following the effective date of the final rule. The final rule would also prohibit an employer from representing that a worker is subject to a noncompete.

What Is the Effect on Existing Noncompete Clauses?

The final rule prohibits employers from enforcing or attempting to enforce an existing noncompete clause with any worker after the effective date, other than that employers are permitted to maintain and enforce a noncompete clause entered into with a “senior executive” before the effective date of the final rule.

In addition, by the effective date of the final rule, the employer must provide notice to each such non-senior executive worker who is party to a noncompete that the noncompete will not be, and cannot legally be, enforced. The final rule includes safe harbor model language for this notice, and it can be hand-delivered, mailed, emailed or texted. The notice must also be sent to former workers subject to a continuing noncompete clause unless the employer does not have record of a street address, email

³ However, the notice of final rulemaking provides that an NDA may be a noncompete where they cover such a large scope of information that they function to prevent workers from seeking or accepting other work or starting a business. An example in the notice is an NDA that “bars a worker from disclosing, in a future job, any information that is ‘usable in’ or ‘relates to’ the industry in which they work. A second example is an NDA that “bars a worker from disclosing any information or knowledge the worker may obtain during their employment whatsoever, including publicly available information.”

address or mobile telephone number. The notice does not require identifying the recipient as having a noncompete, so employers have an option to send a mass communication such as an email to current and former workers. The final rule does not require rescission (i.e., legal modification) of existing noncompetes.

How Is “Senior Executive” Defined in the Final Rule?

A “senior executive” is defined as a worker who is in a “policy-making position” and received total annual compensation of at least \$151,164 in the preceding year (on an annualized basis if the worker was employed during only part of the year). Key terms used in this definition are defined by the final rule:

- A “policy-making position” means a president, CEO or the equivalent or any other officer of a business entity who has policy-making authority (or similar person).⁴ This can include an officer of a subsidiary or affiliate of a common enterprise if the officer also has policy-making authority for the common enterprise in its entirety—i.e., not just for a subsidiary or business unit or function. Whether a subsidiary or a business unit is part of a common enterprise would be a factual inquiry.⁵
- “Policy-making authority” is defined as final authority to make policy decisions that control significant aspects of a business entity or common enterprise; it does not include authority limited to advising or exerting influence over such policy decisions or having final authority to make policy decisions for only a subsidiary of or an affiliate of a common enterprise.
- “Total annual compensation” may include salary, commissions, nondiscretionary bonuses and other nondiscretionary compensation (i.e., compensation paid pursuant to any prior contract, agreement or promise, including performance bonuses the terms of which the worker knows and can expect) but does not include board, lodging or other facilities or fringe benefits.

This narrow definition of a senior executive will limit the applicability of this exception for most employers. The notice of final rulemaking estimates that 0.75% of workers are likely to be considered senior executives under the final rule.

⁴ “Officer” is defined in the final rule to mean a president, vice president, secretary, treasurer or principal financial officer, comptroller or principal accounting officer and any natural person routinely performing corresponding functions with respect to any business entity, whether incorporated or unincorporated. This definition was derived from the SEC’s definition of “officer” in 17 CFR 240.3b-2.

⁵ To be considered a “common enterprise,” the FTC states that it will look to whether there is a common enterprise of “integrated business entities”—e.g., the various components of the common enterprise maintain officers, directors and workers in common; operate under common control; share offices; commingle funds; and/or share advertising and marketing.

What Is the Impact on Seller Noncompetes?

The final rule permits noncompete clauses entered into with workers pursuant to a bona fide sale of a business entity, either structured as a sale of the worker's ownership interest in the business entity or a sale of all or substantially all of a business entity's operating assets. There is no minimum ownership threshold under this exception. A number of interpretive questions may remain about the scope of this exception. State noncompete laws would still govern the enforceability of noncompetes exempt from the FTC's rule as a sale-of-business noncompete.

What Would Be the Impact on State Law?

The FTC's final rule would supersede any state statute, regulation, order or interpretation only to the extent it would permit or authorize actions prohibited by the final rule or otherwise conflict with the notice requirement.

While the majority of states currently permit the enforcement of noncompetes, subject to reasonableness limitations imposed by case law, some states ban employee noncompetes entirely or prohibit them for specific subsets of employees (e.g., lower-paid employees or certain occupations). Other states have adopted a variety of limitations on noncompetes, including limitations on the length of noncompetes, notice requirements or requirements to provide continued compensation during the period in which a noncompete is in effect. The FTC's final rule would preempt any elements of state law that conflicted with its final rule.

The FTC's final rule provides that it does not impact the authority of a state attorney general or other regulatory or enforcement agency or entity or the rights of a person to bring a claim or regulatory action under applicable state law. For example, a state may continue to enforce a ban on noncompetes under its state statute for workers earning less than a specified wage even though all noncompetes covered by the FTC's final rule are banned (regardless of earnings).

Importantly, the state noncompete law framework would still apply to (1) noncompetes with senior executives that are permitted to remain in effect under the final rule and (2) non-competes allowed under the FTC's sale-of-business exception.

Are There Any Other Exceptions to the Final Rule?

The FTC's final rule does not apply where a cause of action related to a noncompete accrued prior to the effective date. In addition, a person is permitted to enforce or attempt to enforce a noncompete or make representations about a noncompete where a person has a good-faith basis to believe the FTC's final rule is inapplicable.

In addition, certain companies are not subject to the rule because they are exempted from coverage under the Federal Trade Commission Act, such as certain banks, persons subject to the Packers and Stockyards Act of 1921 and non-profit entities. The FTC did not exclude bank holding companies, subsidiaries or other affiliates of federally regulated banks from the final rule.

And finally, the FTC's final rule does not apply to noncompetes if they restrict only work or the operation of a business outside the United States.

What Happens Next?

The effective date of the final rule is 120 days after publication of the final rule in the federal register.

We expect legal challenges to the FTC's rulemaking and enforcement of the rule on jurisdictional and constitutional grounds. The U.S. Chamber of Commerce and other business groups have filed a challenge to the final rule in the U.S. District Court for the Eastern District of Texas.

The FTC's final rule includes a severability clause that, if a reviewing court were to hold any provision or application of the rule invalid or unenforceable, the remainder of the final rule would remain in effect.

Advice for Employers

We recommend that employers audit current noncompete programs, even while we await the outcome of legal challenges to the FTC's final rule. Although noncompetes with "senior executives" entered into before the effective date may remain enforceable, for all other workers, employers should be prepared to send out notice of unenforceability by the effective date of the final rule. (Note that a mass communication to current and former workers would be an option because the model notice does not identify the recipient as having a noncompete.) Employers will also need to review and revise any employment policies or handbooks that include noncompete clauses. Employers may also want to enter into new or modify existing noncompetes with "senior executives" prior to the effective date to take advantage of the final rule's limited grandfathering.

We also recommend that employers focus on enhancing trade secret protections beyond the use of noncompetes. For example, employers can take steps to ensure that they have

in place effective and enforceable policies and NDAs and invention assignment agreements. Employers should also review or put in place new internal processes that limit, control and track access to trade secrets. Employers could also consider enhancing the remedies for breach of other restrictive covenants (although with care not to violate the FTC's rule by functionally preventing an employee from working for another employer or operating a business following termination of employment).

Employers may also begin to consider compensation changes to enhance retention. For example, employers may consider retention bonuses or longer vesting periods for long-term awards (e.g., cliff-vesting or back-loaded schedules), pay annual bonuses in part in equity or deferred compensation subject to vesting or reduce severance entitlements on a going-forward basis. Employers may also consider bonus repayment agreements or garden leave arrangements, as described in the FTC's notice of final rulemaking.

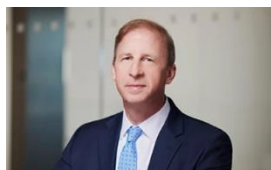
Employers should also stay on top of state legal developments in this area, as state law will continue to apply to noncompetes with senior executives that are permitted to remain in effect under the final rule and non-competes permitted under the FTC's sale-of-business exception.

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