CAN I STILL HAVE A NONCOMPETE AGREEMENT WITH EMPLOYEES AFTER THE FTC ANNOUNCEMENT? WHAT EMPLOYERS NEED TO KNOW AND DO

By: J. Chadwick Hatmaker
Woolf, McClane, Bright, Allen & Carpenter, PLLC

By: Tim Moore
Vice President, Head of Commercial Legal & Compliance, Corium

On April 24th the FTC announced its long anticipated final rule on noncompete agreements. The final rule largely follows the previously published version and bans noncompete agreements in most circumstances for employees, independent contractors and other "workers." There are, however, some exceptions. Furthermore, the rule is not yet law and may not become law.

In a press release, the FTC justified the action as necessary to address growing concern regarding noncompete clauses, which, according to the agency, "negatively affect competitive conditions in labor markets by inhibiting efficient matching between workers and employers." Per the agency, banning noncompetes will lead to 2.7% more new businesses, increased wages of $524 for the average worker, lowered healthcare costs of $194 billion, and an average of 17,000-19,000 patents annually.

Under the final rule a noncompete agreement is impermissible except for noncompetes entered into pursuant to a bona fide sale of: a business entity; all or substantially all of the entity's assets; or the person's ownership interest in the entity. In a change from the prior version there no longer must be a sale of at least 25% of an ownership interest.

The rule also does not apply to existing noncompete agreements with "senior executives." "Senior executive" means a worker who, at the time the noncompete was signed, was in a policy-making position and received total annual compensation of at least $151,164 in the preceding year, or when annualized if the worker was employed during only part of the preceding year. Salary, commissions and nondiscretionary bonuses count towards the total, but the cost of lodging, board and fringe benefits do not. Since the bonus must be nondiscretionary an employer cannot pay a large discretionary bonus in an effort to make an existing noncompete enforceable against a departing employee.

Policy-making position means president, CEO or equivalent, or any other officer who has policy-making authority. Policy-making authority is defined as final authority to make decisions that control significant aspects of a business entity or common enterprise. This does not include those executives who have authority for policy decisions for only a subsidiary or affiliate of a common enterprise.

A "non-compete clause" means a term or condition of employment that prohibits a worker from, penalizes a worker for, or functions to prevent a worker from (a) seeking or accepting work in the United States with a different person; or (b) operating a business in the United States.

The rule does not specifically refer to non-solicitation provisions. Additionally, in a change from the previously published version, broad confidentiality provisions are no longer specifically included in the definition of noncompetes. However, this does not mean that overbroad nonsolicit and confidentiality provisions would automatically survive a challenge under the FTC final rule.

Unless one of the exceptions applies, it is illegal to enter into or attempt to enter into a noncompete clause, to enforce or attempt to enforce a noncompete clause or to represent that the worker is subject to a noncompete clause. The final rule does not apply to existing causes of action.

The final rule will be published in the Federal Register on May 7th. Within 120 days from publication employers must give notice to non-senior executives subject to a noncompete that the noncompete is no longer in effect and will not be enforced. That means notice must be sent on or before August 5, 2024, absent judicial relief prior to that date. The final rule contains a model notice for employers to copy or use as a guide.

Will the rule become law? To be determined. There are already two lawsuits pending in Texas seeking to enjoin the rule from becoming law. The U.S. Chamber of Commerce and The Business Roundtable are two of the plaintiffs. Seeking declaratory and injunctive relief the plaintiffs argue that the FTC exceeded its authority to regulate anticompetitive conduct. More litigation could follow.

To prepare for the rule possibly becoming law employers should do the following:

1. Review existing noncompetes to see if the rule bans them.

2. Review other restrictive covenants (non-solicits and confidentiality agreements) to see if they could be legitimately viewed as noncompetes. If the clause prohibits or prevents a worker from seeking or accepting work in the U.S. then it could be considered a prohibited noncompete.

3. Prepare a notice for any noncompete that is prohibited. Employers should generally follow the model notice to avoid any argument that they failed to comply.

4. Before the effective date of the final rule (120 days from Federal Register publication) enter into a noncompete with any senior executive that does not have one.