

FTC Finalizes Near Total Ban of Noncompetes – How You Can Prepare Now

Client Alerts

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FTC Votes in Favor of Issuing Final Rule.

On April 23, 2024, the Federal Trade Commission (“FTC”) voted in favor of issuing its final rule which essentially bans all noncompetes going forward and invalidates most pre-existing noncompetes. The final version of the FTC’s non-compete ban largely tracks its initial proposed rule despite receiving over 26,000 comments, many of which demonstrated that damage to businesses and innovation will result from forbidding noncompetes. The final rule will be effective on August 31, 2024, so businesses should take steps now to protect their confidential and trade secret information.

The Final Rule Keeps Most of the Proposed Rule’s Restrictions on Noncompetes.

Despite wide-spread criticism of the FTC’s initial proposed rule that it promulgated in January 2023,^[1] the final version of the non-compete rule will largely have the same restrictive impact on noncompetes. As first announced, the proposed rule deemed all noncompetes to be prohibitively unfair and retroactively rendered them in violation of section 5 of the Federal Trade Commission Act (“FTCA”).^[2] It broadly defined such clauses as any “contractual term between an employer and a worker that prevents the worker from seeking or accepting employment with a person, or operating a business, after the conclusion of the worker’s employment with the employer.”^[3]

The initial proposed rule also included a “functional test” that would invalidate agreements that function similarly to a noncompete, including certain non-disclosure and non-solicitation agreements, as “de facto” non-compete clauses.^[4] While the proposed rule did contain a minimal carve out for the sale of a business, this required that the transaction involve those who own more than 25% of the business entity, leaving the majority of sales within the rule’s prohibitive purview.^[5] Notably, the proposed rule did not contain any exceptions or limitations accounting for an employee’s job responsibilities, seniority, or access to confidential information.

As with the proposed rule, the final rule bans virtually all future and existing noncompetes. While it does exempt from the ban pre-existing noncompetes for senior executives making over \$151,164

annually, the final rule prohibits all new noncompetes going forward, including for senior executives.
[6]

In its final rule, the FTC made a few other important changes. With respect to the functional test for determining whether an agreement is a noncompete, the FTC tweaked its definition of “non-compete clause” to clarify what is considered a noncompete, “de facto” or otherwise. Non-compete clauses are now defined as terms or conditions of employment—whether written or oral—that “prohibit . . . penalize . . . or function to prevent” workers from seeking or accepting work with a new employer after the conclusion of their current employment.^[7] It is important to note that the FTC did not view this change as narrowing the types of agreements that the FTC will deem to be noncompetes and thus covered by the ban.

One positive change is that the final rule discarded the 25% ownership threshold for business sales, instead exempting all noncompetes connected to the “bona fide sale” of a business.^[8] This change should help alleviate one concern of the business community that purchasers of a business would be unable to keep the sellers from competing even after having been paid substantial sums for the business.

Legal Challenges to Final Rule are Expected.

The US Chamber of Commerce and other business groups have already filed several different suits challenging the FTC’s authority to ban noncompetes even before the FTC issued its final rule.^[9] These suits challenge the FTC’s legal authority to pass it in the first place, including on the basis of the major questions doctrine. This doctrine limits administrative agencies from enacting rules that amount to “major policy decisions” or “decisions of vast economic and political significance” without “clear congressional authorization” to do so.^[10] Additional legal challenges are to be expected, including in individual lawsuits seeking to enforce existing noncompetes against departing employees.

In enacting this rule, the FTC invoked section 5 of the FTCA, which “prevent persons, partnerships, or corporations . . . from using unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce.”^[11] The FTC undoubtedly will argue that noncompetes are the quintessential unfair method affecting competition.

We expect to see the issue of the FTC’s authority play out in individual noncompete cases where the employee will argue that their noncompete no longer is legally enforceable. Employers will echo the current lawsuit and likely will argue that a rule banning noncompetes almost in their entirety is a major policy decision with vast economic significance. They also may argue that the FTCA’s language lacks the “clear” authorization from Congress that the FTC needs to enact this historic, wide-sweeping ban.^[12] Challengers can point to the statements of the two dissenting commissioners who stated that they believed that the FTC lacked the authority to enact a non-compete ban. Moreover,

the current Supreme Court likely would be receptive to such arguments given its recent statements concerning the major questions doctrine.^[13] It is important to note that challengers likely will ask the Court to stay enforcement of the rule while its legality is being litigated.

In addition to potential litigation, the FTC's rule is subject to challenge under the Congressional Review Act ("CRA"). Under the CRA, within sixty Congressional session days of an agency rule's publication, Congress may pass a joint resolution of disapproval of the rule.^[14] If the resolution is signed by the President—or if Congress overrides a presidential veto—the rule would be ineffective.^[15] Given the required time to act, any resolution would need to be passed by this Congress.

Because this non-compete ban has been a centerpiece of President Biden's agenda, it is unlikely, however, that the Democratic Senate would pass such a resolution.

Employers Should Prepare for Impact of Rule as Enacted.

Even if there is a good chance that the rule ultimately will be invalidated, it is risky for employers to wait and see. As we already have seen, the FTC has been aggressive in seeking consent orders with companies that use noncompetes on a broad scale even before it issued its final rule.^[16] We expect that the FTC may try to secure additional orders quickly while the legality of the rule is being litigated. Even if the FTC's ban is ultimately invalidated, the trend against noncompetes at the federal, state, and local levels will likely continue, and could result in legislation with a similar impact as the FTC's ban.

As a result, employers should consider alternatives to noncompetes, such as non-disclosure agreements and deferred compensation plans, that can protect the company's legitimate business interests and confidential information while avoiding being covered by the new rule. These agreements should not be part of any employment agreement, but separate agreements with the employees where specific consideration is paid and referenced in the agreements .

Also, because of the FTC's functional test, employers should use narrowly tailored agreements only for those senior executives and other employees who are likely to have access to the employer's most important confidential and trade secret information. Otherwise, employers risk having those agreements deemed unlawful non-competes as well.

Further, while existing noncompetes with senior executives will remain lawful, employers should audit these noncompetes to ensure they are narrowly tailored to a legitimate business interest and connected with material consideration, as the executives may still challenge the enforceability of these provisions in court as not reasonable to protect any purported legitimate business interests. Employers will also need to evaluate other options for any new executives that they plan on hiring and for current executives who are not already subject to a noncompete.

We recommend partnering with experienced outside counsel to help your business navigate this new landscape to try to maximize the protection of your confidential and trade secret information.

Jenner & Block's Trade Secrets and Restrictive Covenants team is here to help.

Footnotes

- [1] *See, e.g.*, Stakeholders Speak Out During Webinar on FTC's Proposed Rule Banning Noncompetes (Mar. 6, 2023), <https://www.jenner.com/en/news-insights/publications/client-alert-stakeholders-speak-out-during-webinar-on-ftcs-proposed-rule-banning-noncompetes>.
- [2] Non-Compete Clause Rulemaking, Federal Trade Commission (Jan. 5, 2023), <https://www.ftc.gov/legal-library/browse/federal-register-notices/non-compete-clause-rulemaking>.
- [3] Non-Compete Clause Rule, Federal Register (Jan. 19, 2023), <https://www.federalregister.gov/documents/2023/01/19/2023-00414/non-compete-clause-rule>.
- [4] *Id.*
- [5] *Id.*
- [6] FTC Announces Rule Banning Noncompetes, Federal Trade Commission (Apr. 23, 2024), <https://www.ftc.gov/news-events/news/press-releases/2024/04/ftc-announces-rule-banning-noncompetes>.
- [7] Non-Compete Clause Rule, Federal Trade Commission, https://www.ftc.gov/system/files/ftc_gov/pdf/noncompete-rule.pdf.
- [8] Non-Compete Clause Rule, Federal Trade Commission, https://www.ftc.gov/system/files/ftc_gov/pdf/noncompete-rule.pdf.
- [9] *Chamber of Commerce, et al. v. FTC*, No. 6:24-cv-00148, ECF No. 1 (E.D. Tex. Apr. 24, 2024); *Ryan, LLC v. FTC*, No. 3:24-cv-00986, ECF No. 1 (N.D. Tex. Apr. 23, 2024).
- [10] *West Virginia v. EPA*, 142 S. Ct. 2587 (2022).
- [11] 15 U.S.C.A. § 45.
- [12] *See* The FTC Proposes Ban on Non-Competes (Jan. 6, 2023), <https://www.jenner.com/en/news-insights/publications/client-alert-the-ftc-proposes-ban-on-non-competes>.
- [13] *See West Virginia v. EPA*, 142 S. Ct. 2587, 2605 (2022).
- [14] The Congressional Review Act (CRA): A Brief Overview, Congressional Research Service (Feb. 27, 2023).
- [15] *Id.*
- [16] *See* DOJ Continues Push Against Non-Competes, Non-Solicitations, and Other Post-Employment Restrictions (Mar. 1, 2022), <https://www.jenner.com/en/news-insights/publications/client-alert-doj-continues-push-against-non-competes-non-solicitations-and-other-post-employment-restrictions>; Latest Decisions in Criminal No-Poach and Civil Non-Compete Cases Indicate Continuing Scrutiny of Restrictive Covenants (July 12, 2022), <https://www.jenner.com/en/news-insights/publications/client-alert-latest-decisions-in-criminal-no-poach-and-civil-non-compete-cases-indicate-continuing-scrutiny-of-restrictive-covenants>.

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