

Business Groups Challenge New FTC Rule Prohibiting Noncompete Agreements

April 29, 2024

On April 23, the Federal Trade Commission adopted a near-total ban on noncompete agreements, with limited exceptions. The following day, the U.S. Chamber of Commerce and other business groups sued, seeking to block the rule from taking effect. Unless it is enjoined, the FTC rule will become effective 120 days from the date it is published in the Federal Register.

For decades, employers have used noncompete agreements to protect trade secrets and other confidential business information by preventing departing employees and independent contractors from working for competitors for a certain amount of time and/or within a specified geographic area. Most states, including Michigan, have longstanding statutory or common laws enforcing reasonable noncompete agreements. The FTC's rule will preempt state law, prohibiting employers from entering into new noncompete agreements with *any* employees, and from enforcing *existing* noncompetes except with certain senior-level executives.

The noncompete rule will also require employers to notify workers who are bound by a noncompete agreement—including former employees—that the employer cannot and will not enforce the noncompete. Employers must provide this notice to workers by the rule's effective date by mail, email, text message, or hand-delivered writing. The rule includes model language that employers can use to satisfy the rule's requirement that the notice must be "clear and conspicuous."

The FTC's decision was based on its determination that noncompete agreements amount to an unfair method of competition in violation of Section 5 of the Federal Trade Commission Act. According to the FTC, noncompetes restrict approximately 30 million workers (nearly one-fifth of all workers in the United States) from leaving existing employment for new jobs or to start new businesses. The FTC expects that, by banning noncompetes, the United States will see significant increases in new business formation, wages, and innovation, as well as reduced healthcare costs. Approximately 4 million businesses may be impacted by the FTC's rule.

The FTC's rule includes some noteworthy exceptions to the noncompete ban. First, the prohibition does not apply to senior executives who are subject to existing—but not future—noncompete agreements. Senior executives are defined as employees who earn more than \$151,164 annually and who hold policy-making roles. Second, the ban does not apply to a noncompete agreement entered in connection with the sale of a business or a person's ownership interest in a business. Third, the rule will not apply to an employer's cause of action related to a noncompete if the cause of action accrued before the rule's effective date. Finally, the rule clarifies that it is not a violation for an employer to attempt to enforce or make representations about a noncompete clause if the employer has a good-faith basis to believe that the rule does not apply in a particular situation.

On April 24, the U.S. Chamber of Commerce, along with other business-based non-profits, filed suit on behalf of its members in Texas challenging the rule on several grounds, including: the FTC does not have authority under the Federal Trade Commission Act to promulgate the rule; the FTC ignored procompetitive justifications for the noncompetes; the rule has no exceptions based on an employee's salary, skill set, or seniority, or the type of information used or learned by the employee; and the FTC has no authority to retroactively apply the rule. It argues that the rule will

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harm businesses and workers. According to the Chamber, the rule will result in a substantial increase in legal costs as it will “force businesses...to turn to inadequate and expensive alternatives to protect their confidential information, such as nondisclosure agreements and trade secret lawsuits.” It also argues that it will prevent employees from bargaining for increased compensation in exchange for noncompete agreements and that businesses will decrease their investment in and training of employees to reduce the possibility that their trade secrets will be disclosed to competitors. The Chamber predicts that the economy will be harmed by start-ups and small businesses losing knowledgeable and valuable employees to dominant firms.

The Chamber of Commerce has asked the Texas court to stay the effective date of the noncompete rule and preliminarily enjoin its enforcement. The parties will complete their briefing by June 19, 2024. No hearing date has been set yet for the motion.

Miller Canfield will be closely following the challenges to the rules and publishing additional alerts as this situation unfolds in courtrooms around the country and likely makes its way to the United States Supreme Court.

For more information, please see **Non-Compete Clause Rule** and **FTC Announces Rule Banning Noncompetes**.

If you have questions about the new FTC rule or other legal matters, please contact your Miller Canfield attorney or the authors of this alert.