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# Client Alert

June 2024

## FTC Bans Non-Competes: What's the Latest and What Employers Need to Know

On April 23, 2024, the Federal Trade Commission ("FTC") promulgated a final rule (the "Rule") severely restricting the use of post-services non-compete provisions for workers (defined to include both employees and independent contractors) nationwide. Under the Rule, the FTC considers the use of non-competes to be an "unfair method of competition," prohibited by section 5 of the Federal Trade Commission Act (the "FTC Act"). The Rule references current state laws that render non-competes, with very few exceptions, unenforceable in California, North Dakota, and Oklahoma and cites economic outcomes for cost of living, income, and business growth in those states. The FTC specifically opines that earnings in those states are likely higher than they would be if non-competes were enforceable. The Rule is scheduled to take effect on September 4, 2024.

The Rule prohibits most for-profit employers (banks and air carriers are among the few for-profit companies not subject to the jurisdiction of the FTC) from entering into an agreement containing a non-compete clause with workers after September 4. The Rule renders agreements with non-compete clauses in effect as of September 4 unenforceable, unless the individual is a "senior executive", which is defined as a worker who (1) is in a "policy-making position" for the organization and (2) earned more than $151,164 per year in the prior year. While not specifically defined, the "policy-making" authority would appear to be similar to the authority of an executive officer as defined by the Securities and Exchange Commission. Significantly, the "senior executive" exception does not permit companies to enter into such agreements after September 4, but the Rule permits those senior executive agreements entered into prior to the effective date to remain enforceable.

The Rule defines a non-compete clause as:

> a term or condition of employment that prohibits a worker from, penalizes a worker for, or functions to prevent a worker from (1) seeking or accepting work in the United States with a different person where such work would

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begin after the conclusion of the employment that includes the term or condition; or (2) operating a business in the United States after the conclusion of the employment that includes the term or condition.

Restrictive covenants placing limitations on a worker's post-employment services to another entity come in various forms. While a bare prohibition on future competition clearly violates the Rule, the extent to which non-disclosure and non-solicitation agreements are permissible depends on whether such agreements function to prevent a worker from accepting work. The FTC notes that "less restrictive alternatives, including, for example, NDAs, fixed term contracts, and worker retention policies, would allow small businesses to maintain the same or near same level of protection for [] confidential information," and would presumably be enforceable. Non-solicitation agreements are also permitted "unless they meet the definition of non-compete clause." Therefore, a properly drafted and tailored non-solicitation agreement that prevents a departing employee from soliciting certain clients or customers with whom the employee worked during his or her employment or confidentiality agreements preventing disclosure of an employer's information will still, almost always, be permitted.

The Rule does permit the enforcement and post-effective date execution of non-compete agreements that are incident to the sale of a business. Companies may continue to include non-competes in sale agreements to prevent those with an ownership interest in the seller from competing after the sale or after a certain period of employment or service to the buyer. The FTC specifically noted that such agreements will be permitted to the extent allowed under state law. This exception permitting a non-compete should include situations involving a departing partner where the remaining partners purchase the departing partner's equity or shares. Unlike the rule initially proposed by the FTC, the Rule does not require the restricted individual in a sale to have had a certain threshold ownership interest.

In addition to prohibiting traditional non-competes, the Rule expressly disallows "forfeiture-for-competition" clauses whereby workers lose deferred compensation or other benefits if they work for a competitor. The FTC takes the position that such an arrangement "penalizes" a worker for accepting work elsewhere and, therefore, acts as a de facto non-compete. Similarly, severance agreements may not contain provisions whereby an employee loses severance or severance payments cease because the employee begins work during the severance or other proscribed period. Again, the FTC considers such a provision as functioning to prevent an employee from accepting work.

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While forfeiture provisions are prohibited, the Rule does permit the use of garden leave arrangements (i.e., where an employee must give certain notice before ending employment). The FTC stated in the Rule that "an agreement whereby the worker is still employed and receiving the same total annual compensation and benefits on a *pro rata* basis would not be a non-compete clause under the definition because such an agreement is not a post-employment restriction." The FTC continued that even if the employee cannot meet a bonus condition because, during the garden leave period, certain duties or access are curtailed, it would not be considered a prohibited non-compete. Many practitioners expect the issue of garden leave, particularly overly lengthy ones, to be a highly litigated issue.

The Rule and corresponding guidance are, of course, potentially moot if legal challenges to the Rule are successful. The U.S. Chamber of Commerce (the "Chamber") called the Rule "unnecessary and unlawful" and "a blatant power grab that will undermine American businesses' ability to remain competitive." The Chamber has filed litigation and intervened in two other cases, each seeking an injunction to prevent the implementation of the Rule. *Ryan LLC v. FTC*, brought in the Eastern District of Texas, is assigned to Judge J. Campbell Barker, who ruled in favor of the Chamber and against another federal agency, the National Labor Relations Board, in March. The Court expects to issue its decision on or before July 3. Decisions are expected in the other cases, in the Northern District of Texas and the Eastern District of Pennsylvania, shortly thereafter.

Meanwhile, while the courts review the Rule, state legislators continue to debate statutory restrictions on non-competes. Bills are pending before the Illinois, Massachusetts, Rhode Island, and Wisconsin legislatures to restrict (or further restrict) non-competes. New York's legislature had passed a broad ban of non-competes before—after intense lobbying efforts from the business community, Governor Hochul refused to sign the legislation.

**Key Takeaways**

While there is still uncertainty regarding when and if the Rule will take effect, employers should strongly consider taking the following steps now (and certainly before September 4):

- Take inventory of employment agreements, confidentiality agreements, and equity/stock agreements and determine which agreements contain provisions that would fall within the definition of a non-compete and/or contain forfeiture-for-competition provisions. At the same time, determine which employees are subject to these restrictions and determine which ones fall within the FTC's definition of a "senior executive."

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- Consider providing "senior executives" with non-competes or forfeiture-for-competition agreements prior to the September 4 effective date. Also determine whether consideration is necessary legally (depending on your jurisdiction) or practically for such agreements.

- Consider whether creating or expanding notice/garden leave provisions make sense for your organization.

- Ensure that non-solicitation and confidentiality agreements are properly tailored to avoid being defined as a prohibited "non-compete" and ensure that any agreements containing restrictive covenants have necessary severability language so that the rest of the agreement remains in force.

- Consider implementing retention bonuses as opposed to deferred compensation with forfeiture provisions to increase retention without running afoul of the FTC's prohibitions.

Please contact the Olshan attorney with whom you regularly work or one of the attorneys listed herein if you would like to discuss further or have questions.

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