

## *Practical Tips and FAQ's*

- **When is the FTC Rule effective?**

September 4, 2024, unless legal challenges delay the effective date.

- **What qualifies as a Non-Compete Clause?**

Under the FTC Rule, a Non-Compete Clause is defined very broadly and not limited to just formal non-competition agreements. A Non-Compete Clause is any term, condition, provision or clause, in any document (including any workplace policy, whether oral or written) relating to engagement of an individual person, which prevents, prohibits or functions to prevent a worker from working for another employer in the same industry, after the end of such worker's current employment or engagement.

- **What is the effect of the FTC Rule on existing non-compete agreements?**

The FTC Rule renders all Non-Compete Clauses unenforceable after the Effective Date, except as may be permitted under one of the exceptions listed above—i.e., in the case of Senior Executives already subject to a valid Non-Compete Clause prior to the Effective Date, a person's sale of their business, pre-existing causes of action, certain franchisee/franchisor situations, and certain industries that are exempt from the FTC's jurisdiction.

- **Does the FTC Rule apply only to employees?**

No. The FTC Rule applies to all individual "workers", which include employees, consultants, advisors, independent contractors, interns, externs and other individuals even if not W-2 employees.

- **Does the FTC Rule ban Non-Compete Clauses for partners in a limited partnership or members of an LLC?**

Most likely, yes, provided that the partner or member is providing services to the entity. The plain language of the FTC Rule suggests that, except in connection with the bona fide sale and purchase of a partner or member's ownership interests, the FTC Rule bans new Non-Compete Clauses for all "workers" alike, even if partners or members of the entity. However, the FTC Rule commentary on this point appeared to primarily address a scenario where a partner or member was simultaneously providing services to the entity ("The [FTC] declines to specify that a 'worker' includes an owner who provides services to or for the benefit of their business because the definition already encompasses the same"). Whether a partner or member who does not provide services for the entity or who did provide services, but stops working for the business and retains their ownership stake can be subject to a Non-Compete Clause is unclear and likely will be a subject of further legal challenge.

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- **Does the FTC Rule prohibit non-solicitation clauses with respect to customers, clients or employees?**

Most likely, no. Restrictions on solicitation of customers, clients or employees should continue to be enforceable provided they are not overbroad. The FTC Rule prohibits non-solicitation clauses only to the extent that such clauses are overbroad and function to prevent a worker from working for another employer after the end of such worker's currently employment or engagement.

- **In what circumstances would a non-solicitation clause with respect to customers, clients or employees, or a non-disclosure agreement (NDA), be unenforceable under the FTC Rule?**

The FTC's position is that any terms which "penalize, prohibit or function to prohibit" workers from pursuing work in any field post-employment are unlawful Non-Compete Clauses. The commentary to the FTC Rule provides examples of terms that may be considered Non-Compete Clauses, including (1) a non-disclosure agreement "that is written so broadly that it effectively precludes the worker from working in the same field after the conclusion of the worker's employment", (2) a non-disclosure agreement that defines "Confidential Information" as including general knowledge and skills not particular to the employer's business and/or generally public information that the employer itself had not previously disclosed to the public, and (3) contractual terms that would require the worker to pay the employer for training costs if the worker's employment terminates within a specified time period, where the required payment is not reasonably related to the costs the employer incurred for training the worker.

- **Who qualifies as a Senior Executive?**

A Senior Executive is a worker who: (1) had total compensation from providing services (including salary, nondiscretionary bonuses and other nondiscretionary benefits, but not including payments for medical or life insurance, contributions to retirement plans and the cost of other similar fringe benefits) of at least \$151,164 in the preceding year (or on an annualized basis if the worker was employed during only part of the preceding year or as annualized in the preceding year prior to the worker's departure from employment); **and** (2) was in a "policy-making position".

- **How do we know if someone who makes more than \$151K is in a policy making position?**

This is a factual determination, but it is typically someone person who has final authority to make policy decisions that control significant aspects of a business entity or common enterprise. The FTC Rule also states that "[p]residents, chief executive officers and their equivalents are presumed to be senior executives (i.e., employers do not need to consider the further element of 'policy-making authority')".

- **We want to hire a new employee who will make more than the \$151K dollar threshold and such employee will be in a policy-making position upon employment. Can they be subject to a Non-Compete Clause?**

If the Non-Compete Clause is entered into prior to the Effective Date (September 4, 2024), the worker may be subject to a Non-Compete Clause if they meet the definition of a Senior

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Executive. However, beginning September 4, 2024, if such an employee were hired, you could not enter into a Non-Compete Clause restricting such individual's right to pursue work post-employment in any field.

○ **Are Non-Compete Clauses which apply only during a workers term of employment or engagement enforceable?**

Yes, the FTC Rule does not appear to ban the use of Non-Compete Clauses which run concurrently with the period of employment.

○ **What can we do to protect our clients and customers from being poached by one of our former employees?**

You should still be able to use tailored non-solicitation clauses to restrict former employees (or other workers) from engaging with, encouraging or soliciting your clients and customers, provided that such non-solicitation clauses are not written so broadly that they effectively preclude the worker from working in the same field after the conclusion of the worker's employment.

○ **What is a bona fide sale of a business?**

The commentary to the FTC Rule states that a bona fide sale of a business is one in which the seller has a reasonable opportunity to negotiate the terms of the sale. Transactions such as mandatory stock repurchases or transactions designed specifically to evade the FTC Rule are not considered bona fide and the sale of business exception is not available in those cases.

○ **We bought a business and entered into a Non-Compete Clause with the former owner and some of its key employees. Are those Non-Compete Clauses valid?**

The Non-Compete Clause with the former owner is not rendered unenforceable by the FTC Rule but is still subject to state law. The FTC Rule provides that this sale-of-business exception does not extend to the business entity's workers who are not sellers, but the question of whether non-competes entered into with key employees prior to the Effective Date are enforceable depends on whether such employees are "Senior Executives".

○ **Does the FTC Rule apply to Non-Compete Clauses between business entities?**

The FTC Rule does not ban Non-Compete Clauses between business entities, but such non-competes are still subject to federal antitrust laws.

○ **We are repurchasing the equity of one of our employees, can we require them to enter into Non-Compete Clauses as a condition to the purchase?**

If such repurchase is a "bona fide" purchase where the employee has the opportunity to negotiate and determine the terms and conditions of the sale, this may be lawful or enforceable under the sale of business exception of the FTC Rule. However, the FTC Rule does note that mandatory repurchase agreements which are not negotiable by the worker are Non-Compete Clauses which are not lawful enforceable under the FTC Rule.

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- **Our incentive compensation plan requires employees who leave to enter into an equity repurchase agreement that includes a Non-Compete Clause as a condition to buying their equity. Is that enforceable? If not, can I amend the plan?**

Based on the current language of the FTC Rule, such a requirement does not appear likely to be enforceable, permissible or lawful. The exact mechanics of amending such an incentive plan will be specific to each employer, but in many instances, there should exist the possibility that you can amend the plan.

- **Can we enter into a Non-Compete Clause if we pay an employee to cancel an option to purchase our equity?**

This circumstance is not specifically addressed in the commentary to the FTC Rule, and so the answer is uncertain. If such purchase is a “bona fide” transaction where the employee has had the reasonable opportunity to negotiate the terms of the sale, the FTC may view it as a permissible Non-Compete Clause. However, you should speak with your counsel regarding the specific circumstances at issue.

- **I have a severance agreement that is conditioned upon compliance with a Non-Compete Clause. Is that Non-Compete Clause still valid? Does the employer have the right to stop making the severance payments if the Non-Compete is now invalid?**

In most cases, as of September 4, 2024, a Non-Compete Clause in a severance agreement would no longer be enforceable by an employer. The FTC Rule makes unlawful “forfeiture-for-competition” clauses, in which adverse financial consequences are imposed due to competition with the employer following termination of the relationship between the employer and the worker. Therefore, if the employer withholds such severance payments after September 4, 2024, such action likely would be unlawful under the FTC Rule. However, you should consult with counsel to determine the answer based on your specific circumstances before making any decision regarding the severance agreement.

- **Is the FTC Rule being challenged?**

Yes, there are currently at least two challenges to the Rule in federal court objecting to the FTC’s authority to issue this ban. The U.S. Chamber of Commerce has indicated that it will file legal action, along with other business advocacy groups and business owners. These legal challenges may result in the FTC Rule being delayed or changed.

- **Does the FTC Rule make compliance with state law unnecessary?**

No, the FTC Rule states that even restrictive covenants which may be lawful under the FTC Rule must continue to comply with state laws and federal antitrust statutes. Conversely, even if a restrictive covenant complies with state law, it must still comply with the FTC Rule in order to be lawful and enforceable.

- **What happens if I violate the FTC Rule as an employer?**

The FTC may use its powers under the FTC Act to bring civil enforcement actions against you if you violate the FTC Rule, including seeking imposition of fines, penalties,

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injunctions and cease-and-desist orders. There is no private right of action provided under the FTC Rule as currently written.

○ **What steps should we take now?**

- Review and evaluate all company policies, handbooks, employment and consulting or contracting agreements, any equity compensation plans, severance agreements and, if applicable, operating agreements or bylaws to evaluate whether any Non-Compete Clauses exist or may exist in such documents, and in consultation with counsel, determine the best way to amend or revise such documentation.
- Identify which workers may be deemed “Senior Executives” and evaluate whether such workers should sign Non-Compete Clauses prior to the Effective Date of the FTC Rule if they have not already done so.
- Compile a list of current and former workers who may be entitled to notice at or before the Effective Date.

***Contact Us***

Brenner, Saltzman & Wallman LLP attorneys will continue to monitor developments related to the FTC Rule and any other actions the FTC might take related to non-compete clauses and restrictive covenants. If you have additional questions, please contact your Brenner, Saltzman & Wallman LLP counsel.

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