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CLIENT ALERT

FTC Finalizes Rule Banning Non-Compete Clauses

On April 23, 2024, the Federal Trade Commission (the FTC) voted to finalize and adopt a rule (the FTC Rule¹) that: (i) bans nearly all new non-compete clauses with workers; (ii) bans enforcement of all existing non-compete clauses except for certain Senior Executives; and (iii) requires that any current and former workers subject to a non-compete clause be notified that such non-compete clause is legally unenforceable and that such employer will not try to enforce such non-compete clause.

The FTC Rule has broad-reaching implications for employers and workers countrywide and for the protection of intellectual property. Lawsuits have been filed objecting to the FTC’s authority to issue this ban, but unless litigation is successful in delaying or changing the FTC Rule, the ban will go into effect on September 4, 2024.

Below are some key provisions of the FTC Rule and the extensive FTC-published commentary to the rule. We have also outlined some practical application tips in the “Practical Tips and FAQ’s” which can be found in the link below.

<https://bswlaw.com/wp-content/uploads/2024/05/FTC-Non-Compete-Final-Rule-FAQs.pdf>

We recommend consulting with your legal counsel to discuss next steps for your business before the FTC Rule goes into effect.

Ban of Non-Compete Clauses

Under the FTC Rule, with limited exceptions, entering into or attempting to enter into, enforcing or attempting to enforce, or representing to a worker that such worker is subject to a Non-Compete Clause on or after September 4, 2024 (the Effective Date) is prohibited, as an unfair method of competition and unfair or deceptive act or practice in or affecting commerce.

The FTC Rule broadly 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: (i) seeking or accepting work in the United States with a different person where such work would begin...; or (ii) operating a business in the United States”, in each case after the conclusion of the worker’s current

¹ This Client Alert is intended only as a summary of certain key provisions of the FTC Rule. You should refer to the full FTC Rule for definitive guidance. The full FTC Rule can be found at: https://www.ftc.gov/system/files/ftc_gov/pdf/noncompete-rule.pdf. A summary of the FTC Rule can be found at: <https://www.ftc.gov/legal-library/browse/rules/noncompete-rule>.

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employment. The effect of this definition of Non-Compete Clause is that it not only bars “true” post-employment non-competes, but also bars terms that function as non-competes (even if not referred to as such).

Additional Considerations:

- The FTC Rule covers all types of individual workers, including employees, consultants, advisors, independent contractors, interns, externs, and other individuals even if not W-2 employees.
- Non-Compete Clauses in existence before September 4, 2024 can remain in force for only Senior Executives, who are defined as workers (1) earning more than \$151,164 and (2) who are in a policy-making position.
- Prohibitions on solicitation of customers and employees and non-disclosure agreements (NDAs) may still be enforceable so long as such terms are not overly broad and otherwise compliant with state and federal law.
- The FTC Rule does not apply to non-competition obligations between two entities or in the context of the bona fide sale of a business.

Senior Executive

A Non-Compete Clause entered into with a Senior Executive prior to the Effective Date may be enforced, but new Non-Compete Clauses may not be entered into with Senior Executives after the Effective Date.

A Senior Executive means a worker who: (1) had total compensation (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”. Typically, a policy-making position means a business entity’s president, chief executive officer, or any other person who has final authority to make policy decisions that control significant aspects of a business entity or common enterprise and does not include authority limited to advising or exerting influence over such policy decisions or having final authority to make policy decisions for only a subsidiary of or affiliate of a common enterprise.

Effect on other Restrictive Covenants

While the FTC Rule does not purport to ban restrictive covenants categorically, as outlined above, the rule may capture non-solicitation, non-disclosure and other similar terms if drafted in an overbroad fashion “where they function to prevent a worker from seeking or accepting other work or starting a business after their employment ends.”

The FTC Rule does not try to capture all potential forms of restrictive covenants. For example, the FTC Rule notes that “garden leave” arrangements may not fall under the Non-Compete Clause ban at issue because, so long as the individual is employed and receiving the same compensation and benefits on a pro

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rata basis, the restriction is not a post-employment restriction. On the other hand, arrangements where compensation is paid to a worker specifically for, and predicated on the workers compliance with, the obligation not to compete (a forfeiture-for-competition term), and without employment of the worker, would not be permissible under the FTC Rule. The FTC Rule also applies to severance arrangements which purport to stop severance payments in the event the worker competes during the severance payment period.

Furthermore, restrictive covenants (including any Non-Compete Clauses that may be permissible under the FTC Rule) remain subject to varying degrees of scrutiny based on individual state law.

Notice Requirement

The FTC Rule requires that clear and conspicuous notice be provided to each worker subject to an impermissible Non-Compete Clause (regardless of whether the worker is a current worker or a former worker) not later than the Effective Date. Such notice must identify the person who entered into the Non-Compete Clause with the worker and must inform the worker that the Non-Compete Clause is no longer in effect and may not, and will not, be enforced against the worker. The FTC Rule provides a Safe Harbor model letter (<https://www.ftc.gov/legal-library/browse/rules/noncompete-rule>), which if sent to each applicable worker shall constitute compliance by such employer. Notice can be delivered by email or text message, or by delivering a paper notice by hand or mail.

Exceptions to FTC Rule

Bona Fide Sale of Business. Section 910.3(a) of the FTC Rule provides an exception to this broad ban on non-compete clauses, which permits non-compete clauses or agreements in connection with the bona fide sale of a business. A bona fide sale of a business includes the sale of a business entity, of a person's ownership interest in a business entity or of all of substantially all of a business entity's operating assets.

Existing Causes of Action. Section 910.3(b) of the FTC Rule provides that the FTC Rule does not apply where a cause of action related to a Non-Compete Clause accrued prior to the Effective Date. For example, lawsuits filed before the Effective Date based on violations of non-compete clauses which occurred before the Effective Date may continue to be prosecuted. It is uncertain, however, whether new lawsuits may be initiated after the Effective Date regarding violations of non-compete clauses which occurred prior to the Effective Date.

Good Faith. Section 910.3(c) of the FTC Rule provides that enforcing, attempting to enforce or making representations about a Non-Compete Clause is not applicable where a person has a good faith basis to believe the FTC Rule is inapplicable.

Certain Franchisee-Franchisor Situations. The FTC Rule notes that it does not cover franchisor/franchisee Non-Compete Clauses, however such Non-Compete Clauses remain subject to state law, federal antitrust law and Section 5 of the FTC Act.

Industry-Specific, Non-Profits. The FTC Rule notes that, pursuant to statute, the FTC does not have the authority to impose the FTC Rule restrictions on not for profits entities or banks, savings and loan institutions, federal credit unions, common carriers, air carriers and foreign air carriers, and persons and businesses subject to the Packers and Stockyards Act.

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Timing, Next Steps

Legal challenges are expected to the FTC Rule which could delay or curtail enforcement of the prohibitions on Non-Compete Clauses. However, employers should begin preparing to comply with the FTC Rule before the Effective Date by identifying which workers may be deemed “Senior Executives” and compiling a list of current and former workers who may be entitled to notice at or before the Effective Date. Employers should also evaluate whether there are Senior Executives who should sign Non-Compete Clauses prior to the Effective Date.

Employers should review and evaluate all of their 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. Since the Effective Date is not until September, the FTC Rule may not implicate many severance agreements currently in effect. However, severance agreement payments which are conditioned on restrictive covenants and are due to be paid after the Effective Date should be reviewed for enforceability.

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