

## ALTA INSIGHTS:

# What to Know About the FTC's Ban of Non-Competes

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# Agenda

- 1. Background**
- 2. Features of the Rule**
- 3. Exceptions to the Rule**
- 4. Status of legal challenges to the Rule**
- 5. What should you be doing?**



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# Background

- Media Attention
- State Legislation
  - Existing bans on most non-competes in CA, ND, OK, and MN
  - Restrictions on use of non-competes in other states include:
    - Notice Requirements
    - Income Floors
- President Biden Request to FTC
  - Directed the FTC to exercise its “statutory rulemaking authority under the Federal Trade Commission Act to ***curtail the unfair use of non-compete clauses*** and other clauses or agreements that may unfairly limit worker mobility.”



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# History of FTC Non-Compete Rule

## January 2023:

- FTC issues proposed Rule banning most non-competes, seeking comments from public before finalizing Rule
- Over 26,000 comments received

## April 2024:

- FTC publishes final Non-Compete Rule
  - Bans most non-competes
  - Largely the same as proposed Rule
  - Some modifications, including in sale-of-business context
- September 4, 2024 effective date



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# Features of FTC Rule

- Defines “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 after the conclusion of the employment that includes the term or condition; or (ii) operating a business in the United States after the conclusion of the employment that includes the term or condition.”*



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# Features of the Non-Compete Rule, Cont'd

- Covers independent contractors.
- Has retroactive effect.
- Effective September 4, 2024 (120 days from publication in Federal Register)
- Contains limited exception for “senior executives”
- Excludes sale-of-business agreements.
  - Regardless of percentage of ownership
- Does not apply to a franchisee in the context of a franchisor-franchisee relationship



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# What is a “Senior Executive”?

- “Senior executive” means a worker who:
  - Was in a policy-making position; and
  - Received total annual compensation of at least \$151,164 in the preceding year (actual or annualized).



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# What is a “Senior Executive”?

- Policy-making position” defined as:
  - “[A] business entity’s president, chief executive officer or the equivalent, any other officer of a business entity who has policy-making authority, or any other natural person who has **policy-making authority** for the business entity similar to an officer with policy-making authority.”
  - “An officer of a subsidiary or affiliate of a business entity that is part of a common enterprise who has **policy-making authority for the common enterprise** may be deemed to have a policy-making position for purposes of this paragraph. A natural person who does not have policy-making authority over a common enterprise may not be deemed to have a policy-making position **even if the person has policy-making authority over a subsidiary or affiliate of a business entity that is part of the common enterprise.**”





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# What is a “Senior Executive”?

- “Policy-making authority” defined as:
  - “[F]inal 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.”



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# What is “Sale of Business”?

- The Rule does “not apply to a noncompete clause that is entered into by a person pursuant to a **bona fide** sale of a business entity, of the person’s ownership interest in a business entity, or of all or substantially all of a business entity’s operating assets.”
  - NOTE: A “bona fide sale” is characterized by the FTC as “one made in good faith as opposed to, for example, a transaction whose sole purpose is to evade the final rule.”



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# What is “Sale of Business”?

- FTC considers a bona fide sale to be “one that is made between two independent parties at arm’s length, and in which the seller has a reasonable opportunity to negotiate the terms of the sale.”
  - “Springing” non-competes and those arising out of repurchase rights or mandatory stock redemption programs “are not entered into pursuant to a bona fide sale.” **WHY?**
    - Per FTC, “because, in each case, the worker has no good will that they are exchanging for the non-compete or knowledge of or ability to negotiate the terms or conditions of the sale at the time of contracting.”
  - “Similarly, sham transactions between wholly owned subsidiaries are not bona fide sales because they are not made between two independent parties.”



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# What About Non-Solicits and NDAs?

- Generally not prohibited by the Non-Compete Rule.
  - FTC says that “these types of agreements do not by their terms prohibit a worker from or penalize a worker for seeking or accepting other work or starting a business after they leave their job ....”
- *BUT*, the FTC notes that depending on how they are drafted, they may “function to prevent” a worker from seeking or accepting other work or starting a new business, in which case they would be treated as a non-compete.
  - NDAs? “[A]n NDA would not be a non-compete ... where the NDA’s prohibitions on disclosure do not apply to information that (1) arises from the worker’s general training, knowledge, skill or experience, gained on the job or otherwise; or (2) is readily ascertainable to other employers or the general public.”
  - Non-acceptance provisions?
  - No-hire provisions?



# How About Other Provisions?

- **Liquidated damages:**

- FTC says that pursuant to the term “penalizes,” the definition of non-compete also applies to terms and conditions that require a worker to pay a penalty for seeking or accepting other work or starting a business after their employment ends.
- FTC example: “[A] term providing that, for two years after the worker’s employment ends, the worker may not engage in any business within a certain geographic area that competes with the employer unless the worker pays the employer liquidated damages of \$50,000.”

- **Forfeiture for competition**

- FTC example of another term that “penalizes” a worker: “[A]n agreement that extinguishes a person’s obligation to provide promised compensation or to pay benefits as a result of a worker seeking or accepting other work or starting a business after they leave their job. One example of such an agreement is a forfeiture-for-competition clause, which ... imposes adverse financial consequences on a former employee as a result of the termination of an employment relationship, expressly conditioned on the employee seeking or accepting other work or starting a business.”

- **Severance arrangements**

- FTC says severance arrangements in which a worker is paid only if they refrain from competing would also be a term that “penalizes” a worker.



# How About Other Provisions?

- Garden leave clauses

- FTC says that “[A]n 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.”
- Also, “where a worker does not meet a condition to earn a particular aspect of their expected compensation, like a prerequisite for a bonus, the Commission would still consider the arrangement ‘garden leave’ that is not a non-compete clause under this final rule even if the employer did not pay the bonus or other expected compensation.”
- Definition of “**total annual compensation**”:
  - Is based on the worker’s earnings over the preceding year.
  - May include salary, commissions, *nondiscretionary* bonuses and other *nondiscretionary* compensation earned during that 52-week period.
  - Does not include board, lodging and other facilities ... and does not include payments for medical insurance, payments for life insurance, contributions to retirement plans and the cost of other similar fringe benefits.



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# What About Other Provisions?

- TRAPs

- Not categorically banned
- “May be functional non-competes”, depending on how they are drafted.
- FTC examples:
  - “[A] TRAP that required entry-level workers at an IT staffing agency who were earning minimum wage or nothing at all during their training periods to pay over \$20,000 if they failed to complete a certain number of billable hours.”
  - “[A] TRAP requiring nurses to work for three years or else repay all they have earned, plus paying the company’s “future profits,” attorney’s fees, and arbitration costs.”

- Bonus repayment provisions

- FTC says ok as long as not tied to working for a competitor



# Notice Requirements

By September 4 effective date of Rule, send notice that must:

- Identify the person (company) who entered into the non-compete clause with the worker;
- Be on paper delivered by hand, or by mail to last known personal street address, or by email at an address belonging to the worker (including current work email or last known personal email address), or by text message at a mobile phone number belonging to the worker.

Do NOT have to send IF no record of a address, email, or mobile number.

- Includes former employees.
- “Safe harbor” if model notice used.

*Notice in foreign languages: may provide notice in another language (some translations available on FTC website for model notice) BUT must also provide in English.*



# FTC Model Language for Notice:

A new rule enforced by the Federal Trade Commission makes it unlawful for us to enforce a non-compete clause. As of [DATE EMPLOYER CHOOSES BUT NO LATER THAN EFFECTIVE DATE OF THE FINAL RULE], [EMPLOYER NAME] will not enforce any non-compete clause against you. This means that as of [DATE EMPLOYER CHOOSES BUT NO LATER THAN EFFECTIVE DATE OF THE FINAL RULE]:

- You may seek or accept a job with any company or any person—even if they compete with [EMPLOYER NAME].
- You may run your own business—even if it competes with [EMPLOYER NAME].
- You may compete with [EMPLOYER NAME] following your employment with [EMPLOYER NAME].

The FTC's new rule does not affect any other terms or conditions of your employment. For more information about the rule, visit [*link to final rule landing page*]. Complete and accurate translations of the notice in certain languages other than English, including Spanish, Chinese, Arabic, Vietnamese, Tagalog, and Korean, are available at [URL on FTC's website].



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# What About State Laws Under FTC Rule?

- FTC Rule supersedes state laws that are less favorable to employees.
- Does not affect state laws that are *more* favorable to employees.
  - *E.g.*, State antitrust and consumer protection laws and common law



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# Legal Challenges

- Dissenting Commissioners' critiques:
  - The FTC lacks authority to engage in “unfair methods of competition” rulemaking.
  - Major questions doctrine (*West Virginia v. EPA*) applies, and FTC lacks clear Congressional authorization to undertake this initiative.
  - Even if agency has authority for this rulemaking, it's an impermissible delegation of legislative authority under non-delegation doctrine.



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# Legal Challenges

- Lawsuits to date:
  - *Ryan LLC v FTC* (ND Tex) (*US Chamber of Commerce is Intervenor*)
  - *ATS Tree Services v FTC* (ED Pa)
  - *Properties of the Villages v FTC* (MD Fl)
- Only takes one district court judge to issue an injunction.

# Impact on Existing Claims & Pending Litigation?



- Does not apply “where a cause of action related to a non-compete clause accrued prior to the effective date”
- *Copeland LP v. Thurston* (ED Mo. Apr. 29, 2024)
  - Court rejected argument by former employee that FTC Rule foreclosed plaintiff’s likelihood of success on the merits of its breach of contract action. Court held that FTC’s rule had “no bearing” on the non-compete at issue.
- *Shores Global, LLC v. Kirenzen* (SD Fl. Aug. 2, 2024)
  - Court concluded it must rule on a motion for summary judgment “as if the non-competition agreements are valid and enforceable,” since the FTC’s Rule had not yet taken effect.
- *Paint Nail Bar Franchise Co., LLC v. Boss Beauty Brands* (MD Fl. Aug. 8, 2024)
  - Court declined to enter stipulated injunction pursuant to settlement agreement because it contained 2-year non-compete that would potentially become unenforceable when the FTC Rule goes into effect.



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# Recommended Action by Employers

## **Develop a Personalized Strategy**

Work with your legal counsel as soon as possible to craft an individualized strategy. Take into consideration the size of your business, the number of non-competes in use, the importance of such agreements to your business, your risk tolerance levels, the resources you have on hand, and other factors to determine your next steps.

## **Use Time Before Effective Date to Take Stock**

- Take an inventory of all existing restrictive covenant agreements – including those that bind former workers. This is often a good use of time and money even without the looming FTC rule.
- Make sure you determine which workers fall under the “senior executive” category to allow for enforcement.
- Identify sale-of-business covenants that would remain viable.
- Track all new non-competes you put into effect from here on out.

## **Monitor Legal Developments**

Follow the pending lawsuits and any new ones that may be filed to determine status of the Rule and its potential effective date, and plan accordingly.



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# Recommended Action by Employers

## **Begin Considering Alternatives**

Start strategizing with your leaders about whether your organization can protect your interests with a lesser covenant. A properly tailored customer non-solicitation or confidentiality provision could achieve the much or all of the same goals with less risk involved. Other companies may consider using permissible 'garden leave' agreements, if the cost would be justifiable from a business protection perspective.

## **Don't Ignore Other Restrictive Covenants**

Ensure your other restrictive covenants are reasonably tailored so they are less likely to be construed to function as a non-compete. This includes non-solicitation, non-recruitment, non-servicing, and non-disclosure clauses.

## **Review and Strengthen Trade Secrets Policies and Procedures**

Identify your trade secrets and ensure that you have proper policies and procedures in place to protect them. Limit trade secret access only to those who need it. Train employees how to handle trade secrets and protect against theft. Implement suitable technological controls.



# Questions?

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