FTC Issues Clumsy, Overbroad Noncompete Rule. Luckily, It Probably Will Fail.

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On April 23, 2024, the Federal Trade Commission (FTC) issued a final rule (the "Rule") which bans businesses from using most noncompete agreements against workers.

Surprisingly, the Rule does not contain many exceptions, such as exceptions for noncompetes that are not conditional on continued employment but rather are voluntarily opted into to receive something else of value, noncompetes against highly paid salespeople or owners, or employee equity agreements.

The good news is that all signs point to the Rule being delayed and (hopefully) never implemented. Here is what you need to know.

What Are the Core Terms of the Rule?

Effective Date. The Rule will be published in the Federal Register on May 7, 2024, and the Rule is scheduled to go into effect on Wednesday, September 4, 2024 (120 days after publication). Challenges to the Rule have already been filed.

Ban. The Rule imposes a comprehensive ban on (a) entering into new noncompetes with all workers after the Rule's effective date, (b) enforcing or attempting to enforce noncompetes, and (c) representing that a worker is subject to a noncompete. Noncompetes include 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.

To be clear, this doesn't just include employees. This includes anyone signing a noncompete as a condition of ***work***. It covers 1099 and owners.

Exception for Existing Noncompetes for a Small Group of Senior Executives. There is an exception in the Rule for a limited class of senior executives who sign noncompetes prior to the September 4, 2024 effective date. Importantly, there is no exception for this group, including the highest level officer, after the effective date.

The Rule defines "Senior Executive" as a worker (a) in a "policy-making position" and (b) earning an actual or annualized sum of $151,164 (through salary, bonuses, and/or commissions, but excluding fringe benefits, retirement contributions, and medical/life insurance premium payments). A "policy-making position," is one with "policy-making authority" for the business, similar to a corporate officer with policy-making authority. The term "policy-making authority," in turn, means the authority to make policy decisions controlling "significant aspects of a business entity or common enterprise." Expressly carved out are positions that only have the ability to "advis[e] or exert influence over such policy decisions" or positions only having "final authority to make policy decisions for . . . a subsidiary of or affiliate of a common enterprise." The vague definition undoubtedly will cause controversy should it go into effect, but clearly would be unlikely to cover salespeople and many other employees who may be highly paid but not involved in policy decisions.

Other Exceptions. There are a few other exceptions to the Rule. The Rule does not apply:

- To noncompetes entered into by a person pursuant to a bona fide sale of a business entity. This exception is sufficiently broad and effective to cover most concerns surrounding a transaction.

- Where a cause of action related to a noncompete accrued prior to the effective date (e.g., where a person breached a noncompete prior to the effective date).
- To a person or entity outside of the FTC's jurisdiction (such as those acting under color or authority of state law, nonprofits which are not sufficiently tied to for-profit partners, or the very rare local business not engaging in interstate commerce).
- To noncompetes that are aimed at work performed outside the United States.
- To noncompetes that apply during the term of the worker's employment or engagement.

Required Notice. Employers are required to provide "clear and conspicuous notice" to all workers whose agreements have been declared unenforceable by the Rule that the worker's noncompete clause will not be, and cannot legally be, enforced against the worker. This notice must be in written form and delivered by hand, mail, email, or text message by the Rule's effective date. The Rule provides model language for this notice.

Which Types of Agreements Are Covered by the Rule?

Severance, Shareholder Agreements, Forfeiture and Clawback Provisions

The Rule bans noncompetes entered into as a "term or condition" of the work. Because there is no definition of "term or condition" of the work, it is not clear on the face of the Rule whether voluntarily noncompetes, not conditional on continued employment, but rather agreed to as a term or a benefit for something else, such as payment of a bonus or an employee shareholder agreement, would be covered. However, in the preamble to the Rule, it is clear that the FTC intends to reach these agreements as well.[1] Thus, employers that have promised payment during a noncompete period or have given a benefit to get the noncompete will be robbed of the benefit of their bargain and may be in breach of the agreement if the benefit is not paid or if the employer tries to claw back the agreement.

Pursuant to the preamble, agreements where the employer paid the worker money or provided a benefit and is allowing the money or the costs of the benefit to be forgiven, as is common with tuition agreements, would clearly also be noncompetes implicated by the Rule if the employer's obligation to forgive the money or the cost of the benefit is extinguished if the worker competes. The FTC also speaks to the proportionality of these sorts of agreements, although it is difficult to tell whether the intent is to prohibit agreements that hinge competition upon non-proportional forfeiture and repayment or, given the vagueness in the FTC comments, the FTC also intended to reach all nonproportional agreements that provide for forfeiture upon termination of employment (regardless of competition). If the latter is the intent, it is contrary to the Rule's language, as well as other comments by the FTC indicating an employment agreement providing for employment for period of time (thus requiring the employee to be employed for the employer for a period of time) would be a viable option to protect employer's interests.

The FTC confusingly speaks to severance agreements as being covered in the preamble. By the face of the Rule itself, a noncompete has to be a "term or condition" of the work. Traditionally, post-employment agreements, offered to someone that is no longer a worker or employee because their employment is over, by definition could not be a "term or condition" of the work because the work was over. It is possible that the FTC only intended these comments to apply to severance agreements promised during employment (which is common with executives), severance agreements offered *prior* to the termination of employment (such as severance agreements employees can opt into or have a transition period) or employees receiving severance as part of a severance policy, but the FTC did not highlight this distinction in their comments and made comments about the law applying to severance agreements in response to some questions and feedback that appeared to be concerning post-employment covenants. If the Rule were enforced in this manner, the interpretation would be in direct conflict with the language of the Rule.

Non-Disclosure and Non-Solicitation Agreements

Non-Disclosure and Non-Solicitation Agreements generally are allowed, as they do not prevent a worker from accepting a job. In the preamble, the FTC specifically noted that an NDA would not be a noncompete under § 910.1 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. In its comments, the FTC notes that the Rule's ban on noncompetes applies not only to noncompetes, but terms that function as noncompetes—meaning any contractual provision that **"has the effect of prohibiting the worker from seeking or accepting employment."** As examples of agreements/terms that may function as noncompetes, the FTC identifies a non-disclosure provision that is "written so broadly that it effectively precludes the worker" from working in the same position for a new employer. The FTC also notes that "whether a specific clause falls within the scope of the final rule will necessarily depend on the precise language of the agreement at issue." If the Rule survives, it is possible that rare non-solicitation agreements will be implicated under the Rule when the worker is in an industry where there are few clients that are all serviced by the prior employer or the employer is so large and prevalent that it does business with virtually all potential clients.

The FTC also declined to exempt partners, and noted: (a) a partner could qualify as a senior executive if the partner has policy-making authority about the business and meets the compensation requirement; and (b) partners could fall under the sale of business exception if the sale met those requirements.

What Impact Does the Rule Have on Existing State Laws?

State laws historically have governed noncompete clauses, and numerous states (which have enforcement authority independent of the FTC) have their own more restrictive laws that ban or regulate noncompetes. For example, the Massachusetts exception for the sale of a business from the garden leave requirements is narrower than the exception from the FTC Rule, so the Massachusetts garden leave requirements would still apply.

What Happens Next?

As of this publication, the U.S. Chamber of Commerce, the country's largest business lobby, filed a lawsuit in the U.S. District Court for the Eastern District of Texas[2] on April 24, 2024, seeking to strike down the Rule. The Chamber's lawsuit alleges that the FTC lacks the power to issue the Rule under Section 5 of the FTC Act, the primary section the FTC cites as providing its rulemaking authority. In addition, we expect a wave of lawsuits challenging the Rule in the coming weeks. We also anticipate that the Chamber or a similar entity will obtain a preliminary injunction which will delay the implementation of the Rule while the challenge to its validity plays out in the courts.

Even if the federal courts conclude that the FTC has the authority to make a rule under the FTC Act, there will be challenges to the legality of the Rule itself. Indeed, when the FTC initially proposed the Rule, now-former FTC Commissioner Christine S. Wilson issued a 14-page dissent, in which she outlined the "numerous and likely successful legal challenges regarding the Commission's authority to issue the rule." Commissioners Melissa Holyoak and Andrew N. Ferguson, the two dissenting Commissioners who voted against the Rule, echoed their belief that the FTC lacked the authority to promulgate the Rule, along with a host of other objections.

In short, it is more likely than not that the Rule never becomes law.

What Employers Should Do Now

Employers should not stop using noncompetes, at least if and until the Rule actually becomes effective. Employers should:

- Provide a notice to an employee who leaves in the interim stating that the noncompete Rule is not in effect and the noncompete will be enforced unless/until the Rule actually comes into effect, which is considered unlikely. Employees will undoubtedly read headlines and assume that their noncompete is not effective and may compete for that reason.
- Where possible, insert a provision in any agreement promising or providing a benefit or payment conditioned on the worker's agreement not to compete that the benefit will not be paid, or will be clawed back at the employer's option, should the noncompete become unenforceable due to a change in the

law.
- Be sure that Massachusetts noncompete garden leave noncompetes leave it to the company's discretion as to whether to pay the garden leave and enforce the noncompete when the time of separation comes.

If the Rule is not enjoined a month before the effective date, employers should:

- Ensure you have already asked qualifying senior executives the company needs a noncompete with to sign those noncompetes prior to the effective date and that the company has a copy of the executed document in their files.
- Revise NDAs to include a clause that states that the NDA does 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. Because this is a fairly reasonable carve-out, companies may want to simply adopt this language.
- Revise non-solicitations and non-poach agreements to have the worker acknowledge that the restrictions do not prohibit the worker from seeking or accepting employment with any future employer. If your company is in one of the likely rare categories where the non-solicit could be overbroad, consider narrowing the agreement to include less clients and potential clients.
- Implement stronger NDAs and non-solicitations with workers with noncompetes.
- Try to limit sharing of confidential information and building of relationships with the least number of people.
- For people that the company feels a noncompete is essential, consider having an "interim period" where the worker promises to stay a worker for a few hours a week (likely remotely and just doing transitional duties) upon notice of resignation or termination for a period of time (and during the period of time, you can have a noncompete). The comments state a period of employment where the worker remains employed and cannot work is **not** a noncompete, even if the worker is relieved of all duties, as this clearly would not be a post-employment covenant. The example given by the FTC is an employee who receives full pay and benefits, so the FTC could still try to strike down this sort of garden leave provision if it were at drastically reduced pay, but the logic of non-applicability applies the same regardless of how much an employee is paid.
- Review the pool of candidates working at competitors that you might want to hire and be more aggressive about recruiting those candidates. Their noncompete may have previously held them back from jumping ship, so now may be the time your company can lure them over.

[1] Note, however, that the FTC has not claimed that the Rule preempts the Employee Retirement Income Security Act (ERISA). The effect of the Rule on forfeiture and/or clawback provisions that are part of an ERISA plan is a separate question.

[2] Notably, this is the same court that issued an order officially invalidating the U.S. Department of Labor's 2016 overtime rule under the Obama administration, which would have more than doubled the minimum salary level for most overtime-exempt employees.

The Employment & Labor Practice Group at Partridge Snow and Hahn LLP is available to answer questions about the FTC's noncompete rule. For more information or assistance on agreements covered by noncompetes, please connect with Alicia Samolis, Sean Fontes, Morgan Hedly, or Michael Gamboli.

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