Navigating the New FTC Rule on Noncompetes: Strategies for In-House Counsel

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Overview of Webinar Topics

- **Background**
- **The Final Rule**
- **Legal Challenges**
- **Practical Implications/Next Steps**

How did we get here?

Background

- **President Biden's July 9, 2021 Executive Order on Promoting Competition in the American Economy (EO) encouraged the Federal Trade Commission (FTC) to ban or limit noncompete agreements.**
  - ✓ **"FACT SHEET" accompanying EO made the intent clear: "to ban or limit noncompete agreements."**
- **In November 2022, the FTC released a policy statement to reinvigorate Section 5 of the FTC Act (bans unfair methods of competition), noting that the FTC is obligated to protect workers from unfair methods of competition. This significantly broadened the FTC's enforcement powers.**

Day Before FTC's Proposed Rule

- On January 4, 2023, FTC brought filed and alleged three "unfair" use of noncompete cases in violation of Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45. Each case involved a small employer and a settlement (consent order). Each case involved egregiously overbroad noncompete agreements. For example:
  - One case involved noncompetes for security guards who were prevented from working as security guards within 100 miles of their employer upon threat of a $100,000 penalty for violating their agreement.
- Prior to these cases, the FTC had ***never*** brought a single case alleging a noncompete clause harmed competition in labor markets.
- On January 5, 2023, the FTC released a Notice of Proposed Rulemaking (NPRM) to prohibit employers from imposing noncompete clauses on workers.
- On April 23, 2024, the FTC released its Final Rule.

The Final Rule:
What is it and what does it do?

The Rule

§ 910.2 Unfair methods of competition.

(a) *Unfair methods of competition*—(1) *Workers other than senior executives*. With respect to a worker other than a senior executive, it is an unfair method of competition for a person:

(i) To enter into or attempt to enter into a non-compete clause;

(ii) To enforce or attempt to enforce a non-compete clause; or

(iii) To represent that the worker is subject to a non-compete clause.

(2) *Senior executives*. With respect to a senior executive, it is an unfair method of competition for a person:

(i) To enter into or attempt to enter into a non-compete clause;

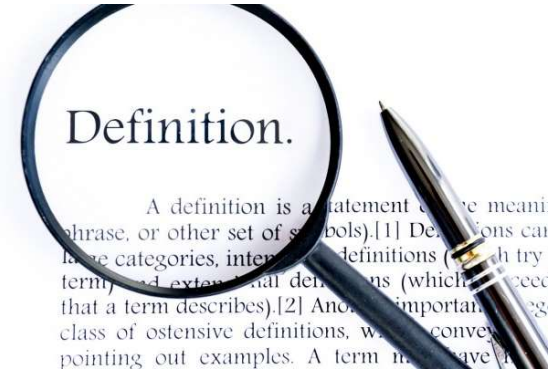
(ii) To enforce or attempt to enforce a non-compete clause entered into after the effective date; or

(iii) To represent that the senior executive is subject to a non-compete clause, where the non-compete clause was entered into after the effective date.

Definitions

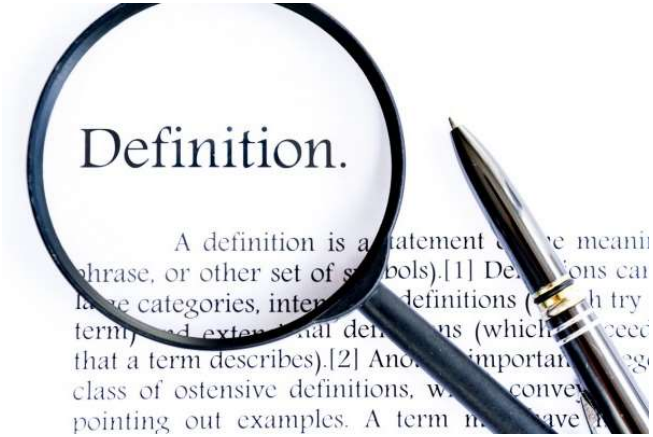
- **Worker: a natural person who works, whether paid or unpaid, for an employer.**
  - **The term includes, without limitation, an employee, individual classified as an independent contractor, extern, intern, volunteer, apprentice, or sole proprietor who provides a service to a client or customer.**
  - **Excludes franchisees (though includes those working for a franchisee or franchisor)**
- **Employer: a person, as defined in 15 U.S.C. 57b-1(a)(6), that hires or contracts with a worker to work for the person.**
- **Person: any natural person, partnership, corporation, association, or other legal entity, including any person acting under color or authority of State law.**

***Takeaway*: As broad as possible**



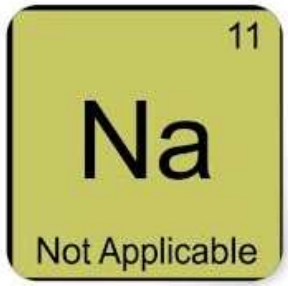
Definitions

- **Noncompete: a contractual term between an employer and a worker that prevents the worker from (i) seeking or accepting employment with a person, or (ii) operating a business, after the conclusion of the worker's employment with the employer. Can be either written or oral.**
- **Functional test for a noncompete clause (i.e. *de facto noncompete*): A contractual term that has the effect of prohibiting the worker from seeking or accepting employment with a person or operating a business after the conclusion of the worker's employment with the employer.**
- **Examples of *functional* noncompetes from Proposed Rule:**
  1. **A non-disclosure agreement so broad that it effectively precludes a worker from working in the same field after the conclusion of employment.**
  2. **A contractual term requiring the worker to pay the employer (or a 3rd party) for training costs if the worker's employment terminated within a certain period of time where the payment is not reasonably related to the costs incurred for training the worker.**



Exceptions to the Final Rule

- **Entities exempt FTC Act:**
  - Banks, savings and loan institutions, federal credit unions;
  - Common carriers, air carriers, foreign air carriers;
  - Persons/entities subject to the Packers and Stockyards Act of 1921; or
  - Any entity that is not "organized to carry on business for its own profit or that of its members"
- **Exempt from Proposed Rule:**
  - Franchise Agreements (not franchisee itself)
  - Bona fide sale of a business
  - Cause of action accrued prior to the effective date



The Rule will operate retroactively for all noncompetes except those agreed to by "senior executives" executed prior to the effective date of the Final Rule.

- "senior executive" is a worker who both: (1) is in a policy-making position (CEO/Pres. or other officer who has policy-making authority); and (2) earned at least $151,164 in the preceding year (or the equivalent annualized for partial year employment).

No private cause of action – FTC must still enforce

Preexisting Agreements

- **Requires that a covered entity, by the rule's effective date on Sept. 4, 2024, provide notice to workers who are parties to a noncompete agreement that is prohibited by the rule (that is, any workers other than "senior executives") that the noncompete cannot and will not be enforced.**
- **Notice can be on paper, by mail, by email, or by text.**

Notice Model Language

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].

Legal Challenges

Race to the Courthouse

- **In her dissent, former FTC Member Christine Wilson predicted the legal challenges the Proposed Rule would face.**
- **Current FTC Commissioners Melissa Holyoak and Andrew Ferguson voted against the Final Rule**
- ***Ryan LLC v. Federal Trade Commission* (Court File No. 24-cv-00986) filed April 23, 2024 (same day as vote) in the Northern District of Texas**
- ***U.S. Chamber of Commerce v. Federal Trade Commission* (24-cv-00148) filed April 24, 2024 in the Eastern District of Texas**
- ***ATS Tree Services, LLC v. Federal Trade Commission* (Court File No. 24-cv-1743) filed on April 25, 2024 in the Eastern District of Pennsylvania**

Rulemaking Authority, the Major Question, and Non-Delegation Doctrines, Oh My!

Section 5 of the FTC act prohibits "unfair methods of competition" and empowers the FTC to enforce that prohibition through adjudication.

Section 6 of the FTC Act Provides:

> **§ 46. Additional powers of Commission**
>
> **The Commission shall also have power…**
>
> **(g) Classification of corporations; regulations**
>
> ***From time to time classify corporations and (except as provided in [Section 18 of the FTC Act] to make rules and regulations for the purpose of carrying out provisions of this subchapter." 15 U.S.C.A. § 46.***

Major Questions Doctrine: When agency action claims power of great political, economic or state-law significance, then a Court must ask "whether Congress in fact meant to confer the power the agency has asserted." In other words, general or vague statutory delegation of authority is insufficient to support major actions by a government agency.

- **In *West Virginia v. EPA*, decided June 30, 2022, the SCOTUS struck down the EPA's authority to devise emission caps under the Clean Air Act. The Court reasons that if Congress wanted to delegate to an agency the authority to make "decisions of vast economic and political significance," it must clearly do so. Vague or ambiguous statutory language will not suffice.**

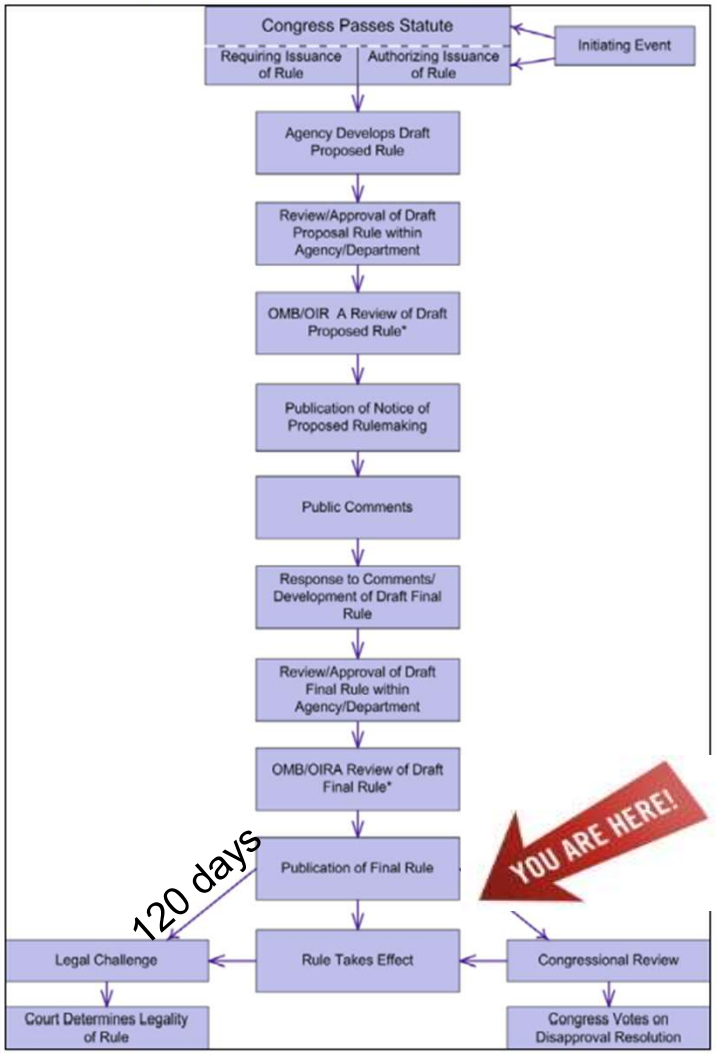
Non-delegation Doctrine: Congress cannot delegate its lawmaking power to any other branch of government. Since the 1920s, Congress has not made an improper delegation of authority so long as it articulates an "intelligible principle to which the person or body authorized to fix [rules] is directed to conform."

What Now?

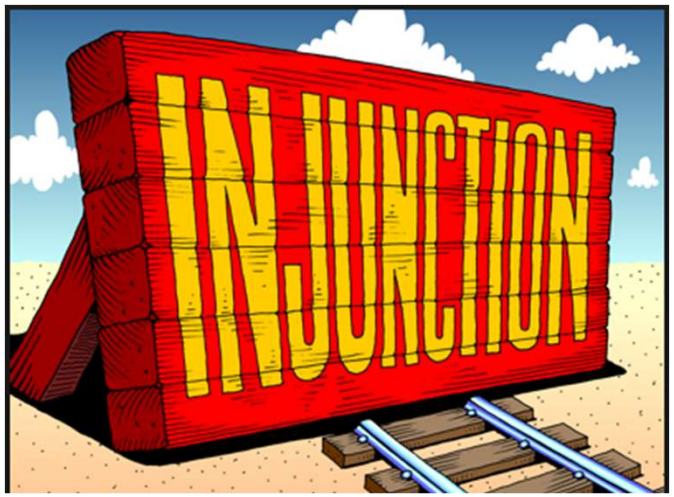
Current Status

- **Final Rule published in Federal Register on May 7, 2024**
- **Will become effective 120 days later on September 4, 2024, unless enjoined in Court**
- **Legal challenges seeking an injunction were filed in April, including by the US Chamber of Commerce**

Figure 1. Federal Rulemaking Process



Procedural Status



- May 1, 2024, Ryan filed a motion for stay of the effective date and for a preliminary injunction.
- May 9, 2024, Ryan Court granted U.S. Chamber of Commerce's motion to intervene in the *Ryan LLC v. Federal Trade Commission* matter and the judge dismissed *U.S. Chamber of Commerce v. Federal Trade Commission* without prejudice on May 30, 2024
- Coming up:
  - Briefing concluded; court denied request for hearing and will decide on filed briefing.
  - Court committed to issuing decision by July 3, 2024

Predictions

What Now?

- Political winds are against noncompetes. States such as Oklahoma, California, North Dakota, and Minnesota already prohibit noncompetes. Other states, such as Illinois and Colorado, have passed restrictive laws limiting the use of such agreements. Even in states where such agreements are generally allowed, individual judges have wide discretion in enforcement, and many are elected, making them susceptible to changes in the mood of the population.
- Consider what levels of restrictions are necessary. Would a strong confidentiality agreement suffice? What about garden leave? Would a restriction on soliciting customers and employees serve the same practical effect and provide adequate protections?
- Tier your Agreements. Consider tiering the types of agreements used in your organization, reserving the most onerous restrictions for those at the highest levels of your organization with access to the most critical information to the long-term vitality of your business. The clear trend of state legislation cuts against enforcing a noncompetes on a low income workers and non-management employees.
- Get Creative. Consider tying restrictive covenants to bonuses, stock options or other benefits reserved for key employees. This allows the employer to not only seek to restrict competition (which may not succeed) but to also claw back financial payments.

Action Items

- **Reexamine your existing noncompete agreements**
- **If not enjoined, then prepare notices (FTC's Model Language)**
- **Consider entering into noncompetes with existing "senior executives" now.**
- **Alternative protections:**
  - **Confidentiality/NDA**
  - **Non-solicitation agreement**
  - **Consider tiering the types of agreements used within your organization**
- **Consider tying restrictive covenants to bonuses, stock options or other benefits reserved for key employees. This allows the employer to not only seek to restrict competition (which may not succeed) but to also claw back financial payments.**