

Should I Stay or Can I Go Now?: The FTC's New Non-Compete Rule

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Key Takeaways

1. The FTC issued its Final Rule seeking to prohibit most employee non-compete clauses (outside of non-competes relating to the sale of a business and for certain executives).
2. The Chamber of Commerce has filed suit to stop the Final Rule from going into effect and has already filed a motion for a stay of the effective date – it remains to be seen if and when the Final Rule will become effective.
3. While the Final Rule is overbroad and short on details, there are practical ways businesses can deal with compliance, if necessary, that include use of:
 - a. garden leave and a limited type of severance agreement; and
 - b. other restrictions, including non-solicitation of clients/customers and employees and non-disclosure agreements.
4. The Final Rule has to be enforced by the FTC. There is no private cause of action.

Non-Compete Clause Rule

On April 23, 2024, the Federal Trade Commission (the “FTC”) issued the Non-Compete Clause Rule (the “Final Rule”) that bans all new non-compete clauses with employees at all levels, including senior executives, after the effective date. The Final Rule will be effective 120 days after the date of publication in the Federal Register.

The following highlights key provisions of the Final Rule:

<p>What is a “noncompete” under the Final Rule?</p>	<p>A “term or condition of employment” that prohibits a worker from, penalizes a worker for, or functions to prevent a worker from:</p> <ul style="list-style-type: none"> • seeking or accepting work in the United States with a person, or • operating a business, after the conclusion of the worker’s employment with the employer. <p>In addition to explicit non-compete clauses, the Final Rule prohibits clauses that are the functional equivalent of a non-compete—that “prohibit,” “penalize,” or “function to prevent” a worker from seeking or accepting other work or starting a business.</p>
<p>Who is covered?</p>	<p>All workers, regardless of title or wage, are covered. Although the Final Rule does not apply to franchisor-franchisee agreements, it does apply to agreements between franchisees and their employees.</p>
<p>What is or may be permitted?</p>	<p>The Final Rule permits:</p> <ul style="list-style-type: none"> • Garden Leave: A worker remains on the payroll but does no work for the employer; they also cannot work for other employers. Garden leave provisions are not non-competes under the Final Rule, as long the employee is compensated for the specified period; compensation may include the employee’s base salary but need not include bonuses or “other expected compensation.” <p>The Final Rule permits the following, if they do not “prohibit,” “penalize,” or “function to prevent” a worker from seeking or accepting work or starting a business:</p> <ul style="list-style-type: none"> • Severance Arrangements: A worker receives a payout equivalent to an agreed-upon number of months’ salary. The FTC contemplates the affected individual continuing to be an employee during this period and notes this may be like being on administrative leave. However, the FTC notes that a severance arrangement in which the worker is paid only if they refrain from competing may be construed as “penalizing” a worker and, therefore, the functional equivalent of a non-compete. • Non-Disclosure Agreements (NDAs): A worker agrees not to disclose certain confidential information. NDAs must be narrowly drafted and not include general training, knowledge, skill or experience gained on the job or public knowledge, such that it would “function to prevent” a worker from seeking or accepting other work or starting a business. • Non-Solicitation Agreements: A worker agrees not to solicit customers or employees of their employer post-termination.

	<p>Non-Solicitation Agreements should be narrowly drawn to avoid being construed as “functioning to prevent” a worker from seeking or accepting work or starting a business.</p> <ul style="list-style-type: none"> • Deferred Compensation and Other Structured Payment Agreements: Such agreements may be permitted as long as they do not fall within the definition of the non-compete clause.
How are existing non-competes treated?	<p>Existing non-competes are enforceable only with respect to “<u>senior executives</u>” who:</p> <ul style="list-style-type: none"> • Have responsibilities that involve policy making authority (which is narrowly defined), and • Receive an annualized salary of at least \$151,164.
What is the Sale of Business Exception?	<p>The Final Rule permits non-compete agreements in connection with a bona fide sale of a person’s ownership interest in a business entity, or of all or substantially all of a business entity’s operating assets. Unlike the proposed rule, the Final Rule does not impose a minimum ownership percentage requirement.</p>
Does the Final Rule apply to Franchise Agreements?	<p>The Final Rule does not apply to franchisor-franchisee agreements but does apply to agreements between franchisees and their employees.</p>
What are employers expected to do?	<p>The Final Rule requires employers to provide written notice to affected workers, on or before the date the rule takes effect, explaining that it is now unlawful to enforce a non-compete agreement.</p>
Who may enforce the Final Rule, and what are the Potential Penalties?	<p>The FTC may issue a cease-and-desist order but cannot seek monetary penalties or damages for a violation of the Rule. The FTC can seek penalties, by court order, for an employer’s failure to comply with the cease-and-desist order.</p> <p>There is no private cause of action under the Final Rule or Section 5 of the Federal Trade Commission Act, on which the Final Rule is based.</p> <p>Employers may be liable for damages under other federal or state antitrust and unfair competition laws, and face lawsuits from state enforcers and private plaintiffs under those laws.</p>
Will the Final Rule face legal challenges?	<p>The US Chamber of Commerce has filed a lawsuit, challenging the authority of the FTC to promulgate the rule, and has asked the court to stay the effective date pending resolution of the lawsuit. The suit was filed in a jurisdiction that has demonstrated a receptiveness to rulemaking challenges.</p>
When will the Final Rule become effective?	<p>The Final Rule takes effect 120 days after publication in the <i>Federal Register</i>; however, that date may be stayed</p>

	pending resolution of the US Chamber of Commerce's lawsuit.
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Employers should consult with Milbank if you have questions about the Final Rule, process and timing, or if you would like input on how to structure your policies and employee agreements, including incentive arrangements and restrictive covenants, most effectively, going forward to ensure effective retention. Milbank will continue to closely monitor developments in this area and Milbank attorneys are available to assist in navigating the changing law in this area while still accomplishing your specific business goals.

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