

**ALERTS**

# FTC Rule Banning Non-Competes: Pause Before Making Drastic Changes

**May 3, 2024**

The Federal Trade Commission (“FTC”) passed its long-anticipated final Non-Compete Rule broadly prohibiting the use of worker non-competition restrictions. The Non-Compete Rule is scheduled to be published in the Federal Register on May 7, 2024, and become effective 120 days later, on Sept. 4, 2024. To the extent the Non-Compete Rule is more restrictive than a state or local law, the Non-Compete Rule will supersede such other law. However, the validity of the Non-Compete Rule is already being challenged in three separate court cases and its effective date may be delayed.

## Banning Non-Compete Clauses

The Non-Compete Rule applies to “workers,” which includes any natural person who is an employee, independent contractor, extern, intern, volunteer, apprentice or sole proprietor who provides services. Although the Non-Compete Rule, itself, does not address whether partners are considered workers, the preamble to the Non-Compete Rule (the “Preamble”) implies that it is intended that partners will be treated as workers.

The Non-Compete Rule prohibits employers and other service recipients from:

- Entering into a “non-compete clause” with a worker,
- Enforcing a worker “non-compete clause” (except in the case of existing non-compete clauses applicable to “senior executives”), and

- Representing that a worker is subject to a “non-compete clause.”

Only non-compete clauses entered into with “senior executives” prior to the effective date of the Non-Compete Rule will remain enforceable.

Although the Non-Compete Rule’s reference to a “non-compete clause” implies a written agreement, a non-compete clause is defined to encompass any term or condition of employment that *prohibits a worker from, penalizes a worker for, or functions to prevent a worker from*.

- Seeking or accepting new employment or other work in the United States with a different person; or
- Operating a business in the United States after the conclusion of the employment or other work that imposed the non-compete clause.

The scope of the Non-Compete Rule is not limited to restricting workers from moving to competitors; rather, it applies to any new employment or other work position.

Due to the breadth and generality of the rule, it appears that the Non-Compete Rule could extend to certain compensation designs that condition vesting on a worker’s continued services as well as garden leave, non-solicitation and non-disclosure provisions. Based on the Preamble, it appears that the determination of whether an arrangement constitutes a non-compete clause will depend on the facts and circumstances and the surrounding market context. For example, the FTC noted in the Preamble that a simple “garden leave” arrangement would not be prohibited as an impermissible post-employment restriction if the worker were to remain employed and continue to receive the same total annual compensation and benefits on a pro rata basis. According to the FTC, “where a worker does not meet a condition to earn a particular aspect of their expected compensation, like a prerequisite for a bonus, the FTC 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.” The Non-Compete Rule, however, omits any guidance regarding how to determine if a particular term or condition imposed on a worker constitutes an impermissible non-compete clause. Accordingly, all compensation arrangements and post-termination obligations imposed on workers should be reviewed closely to determine whether they are permissible under the Non-Compete Rule. To the extent an arrangement or obligation constitutes a non-compete

clause, it should be modified to conform to the rule, if possible, or replaced.

## Existing Senior Executive Non-Competes

Only non-compete clauses covering “senior executives” that are “entered into” prior to the Non-Compete Rule’s effective date will be permitted to be enforced following the rule’s effective date. The category of individuals who qualify as “senior executives” is quite narrow. For purposes of the Non-Compete Rule, a worker is a senior executive only if the worker was in a “policy-making position,” and received:

1. Total annual compensation of at least \$151,164 in the preceding year (or, if the worker was only employed during part of the preceding year, total compensation of at least \$151,164 when annualized), or
2. Total compensation of at least \$151,164, when annualized, in the preceding year prior to the worker’s termination if the worker’s services terminated before the preceding year.

A “*policy-making position*” is limited to 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. “*Policy-making authority*” is narrowly defined. It only includes the “final authority to make policy decisions that control significant aspects of a business entity or common enterprise” and excludes “exerting influence” over policy decisions or having the “final authority to make policy decisions for only an affiliate or subsidiary of a common enterprise.”

Unfortunately, the Non-Compete Rule does not describe what “entered into” means with respect to an already existing employment agreement. Based on this omission, it is unclear if a non-compete clause will continue to be enforceable if either the clause, itself, is amended or modified or, if it is included in another agreement, such as an employment agreement, that is later amended to include a non-compete clause.

## Notice Requirements

The Non-Compete Rule requires that employers and other service recipients who have workers (other than senior executives) who are

subject to non-compete clauses must provide those workers with a “clear and conspicuous” written notice by the Non-Compete Rule’s effective date. The notice must be delivered by hand, mail, email or text, and state that the non-compete clause cannot and will not be enforced against the worker. The Non-Compete Rule provides model language that can be used to satisfy the notice requirement.

## **Sale of Business Exception**

In addition to existing non-compete clauses covering senior executives, the Non-Compete Rule includes an exception for non-compete clauses “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.” Importantly, the Preamble notes that the sale of business exception should apply to a partner who agrees to a non-compete clause in connection with the partner’s sale of interests in a partnership.

## **Challenges to the Non-Compete Rule**

Within three days of the FTC’s issuance of the Non-Compete Rule, three separate lawsuits were filed against the FTC challenging its authority to issue the rule. Two were filed in federal court in Texas on April 24, 2024. The other was filed in federal court in Pennsylvania on April 25, 2024. The complaints allege, among other things, that the FTC lacked the requisite authority to pass the Non-Compete Rule on statutory and constitutional grounds. All three lawsuits request orders delaying the effective date of the Non-Compete Rule, and ultimately seek to bar its enforcement.

Although the final resolution of such litigations will take time, with litigations potentially reaching the US Supreme Court, a court decision on whether to delay the Non-Compete Rule’s effective date is expected prior to Sept. 4, 2024.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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