

Basics of Representing Business Owners: FTC Bans Non-Compete Agreements

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Planning Impact of FTC Ban

- Inability for small, closely-held and family businesses to protect themselves
- Valuation of companies may be significantly affected
- Succession planning for closely-held businesses may be limited
- Use of NC to reduce parachute payments will cease



Penalties for failing to comply

- Equitable remedies:
 - Cease-and-desist orders after an administrative hearing
 - Consent orders settling administrative complaints
 - Judicial Orders
- Monetary remedies including:
 - Civil fines for failure to comply with orders or statutory requirements
 - Equitable remedies, such as a disgorgement or restitution
- Civil penalties:
 - \$51,744 per violations of issued orders
 - Each day of continued violation is a separate offense



Time is Not on Our Side – Notice Requirement

- FTC Ban goes into effect September 4, 2024
- The “worker” who is subject to the NC must receive “clear and conspicuous notice” by September 4th that the NC clause will not be and cannot legally be enforced.
- Model language included in Section 910.2(b)(4)
- Must be delivered to the worker by hand, mail, email or text no later than September 4th



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].

Who is Subject to the FTC Ban?

- Definition of “Worker”
- Special definition for “Senior executives”
 - Total annual compensation of at least \$151,164 per year; AND
 - Policy-making position
- “Business Entity” includes partnership, corporation, association, LLC or other legal entity and a division or subsidiary of an entity



What is a Policy Making Position?

Includes:

- President or CEO or any officer who has policy-making authority over a common enterprise, but not a person who has policy-making authority over a subsidiary or affiliate of a business entity that is part of a common enterprise
- Person who has final authority to make policy decisions that control significant aspects of a business entity or common enterprise – not just advising or exerting influence

Does Not Include:

- Key sales person or producer
- Division or Department heads
- Head of Surgery or Head of Internal Medicine of hospital system



Exempt Business Entities

- Rule only applies to employers within FTC jurisdiction which excludes:
 - Banks, savings and loans, and credit unions;
 - Federal banking agencies like the FDIC are authorized to enforce the unfair competition rules of the FTC Act
 - Air carriers;
 - Common carriers; and
 - Most nonprofit organizations



Non-Profit Orgs Subject to the Ban

- FTC looks to the source of the income and to the destination of the income to determine nonprofit status (*In the Matter of Coll. Football Ass'n*, 117 F.T.C. 971, 992-999 (1990))
- Physician hospital organization because it engaged in business on behalf of for-profit physician members (*In the Matter of Preferred Health Servs., Inc.*, FTC No. 41-0099, 2005 WL 593181, at *1 (Mar. 2, 2005))
- Independent physician association because it “contract[ed] with payers, on behalf of its [for-profit] physician members, for the provision of physician services for a fee (*In the Matter of Boulder Valley Individual Prac. Assoc.*, 149 F.T.C. 1147, 2010 WL 9434809, at *2 (Apr. 2, 2010))



Broad definition of Non Compete

- A term or condition of employment;
- Oral or written;
- Contractual term OR workplace policy;
- That “functions to prevent a worker from”
 - Seeking or accepting work in the US with a different person where such work would begin after the conclusion of the employment that includes the term or condition
 - Operating a business in the US after the conclusion of the employment that includes the term or condition



Applying the Definition of NC

- What is considered unlawful:
 - True NC covenant
 - Including those currently in existence (except for senior execs)
 - “Forfeiture-for-competition” clauses
 - Severance pay that terminates or offsets upon subsequent re-employment unclear
 - Clawbacks unrelated to competition should be ok (e.g., return signing bonus due to early termination of employment)
 - Some deferred compensation clauses
 - E.g., non-compete used as a “substantial risk of forfeiture” for a 457(f) plan



Applying the Definition of NC

- What is still lawful:
 - Forfeiture for competing during term of employment (breach of fiduciary duty to employer)
 - Garden leave payments
 - E.g., paying a current employee not to work (only post-employment NC restrictions are unlawful)
 - Vesting profits interests
 - Time-based vesting ok, but forfeiture or forced sale for competition may be invalid
 - Generally, non-solicitation clauses, non-service/ non-accept clauses, and NDA, BUT...



Exceptions to the Ban

- Bona fide sale of person's interest in a business entity or of a substantially all assets
- Existing causes of action
- Good faith belief the rule is not applicable
- Non-competes with senior executives entered into prior to the September 4th
 - Senior executive definition is limited (not just dollar threshold)
- Most Franchisees in a Franchisor/ Franchisee relationship



Next Steps

- Audit existing noncompetes and identify “senior executives”
 - Including those “hidden” in employment agreements, deferred compensation plans, equity compensation plans, shareholder agreements
 - Consider tax impact when NC clauses have been used to create a “substantial risk of forfeiture” (e.g., Section 457(f) and Section 83 plans)
- Review existing restrictive covenants including NDAs and non-solicitation clauses
- Develop language of notification to workers – keeping in mind the model language in the Rule
- Determine timing of notification (last second, most likely)



Planning Opportunities

- Identify senior executives not subject to NC and enter into NC prior to Sept. 4th
- Consider paying bonuses or additional compensation and adding responsibilities to create “senior executive” status
- Consider creating ownership opportunity
 - No owner exception per se, but may be able to obtain NC upon future sale of interest
- Consider converting NC to garden leave payments
- More robust non-solicitation and NDA agreements . . . but not too robust
 - State law may still restrict, especially non-solicitation
- Consider adjusting time-based vesting schedules to encourage long-term employment
 - May not be able to unilaterally adjust, but may work into future awards
 - “Cliff” vesting may be preferred over “graded” vesting



State Level Bans on NonCompetes

- California enacted new non-compete law effective January 1, 2024 (SB-699)
 - Most noncompetes are unenforceable regardless of where and when the contract was signed and regardless of how narrowly tailored
 - Creates new private right of action for the employee to sue for injunctive relief, actual damages, legal fees and costs
 - California employers must notify current and former employee employed after Jan 1, 2022 that their NCs are void
- New York proposed non-compete ban in June 2023 – vetoed by Governor Hochul; Proposed legislation expected in 2024



Legal Challenges to FTC Ban

- First lawsuit filed in the Northern District in Texas in Ryan, LLC v. Federal Trade Commission.
- US Chamber of Commerce v. FTC in the Eastern District of Texas.
 - Stayed pending the Ryan case (first to file); US Chamber intervened in Ryan case
- Third lawsuit was filed in the Eastern District of Pennsylvania
ATS Tree Services, LLC v. Federal Trade Commission, et al w
- Not likely to survive in its current form; preliminary injunction relief may be implemented prior to September 4th

