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# THE FTC'S NONCOMPETE RULE

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# MCLE Certificate Information

## MCLE Certificate Information

- Approved for 1.0 hour General PP credit.
  - CLE credit form must be submitted by **Thursday, May 9<sup>th</sup>**.
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  - Most participants should anticipate receiving their certificate of attendance in four to eight weeks following the webcast.
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# Overview of the Rule and How We Got Here

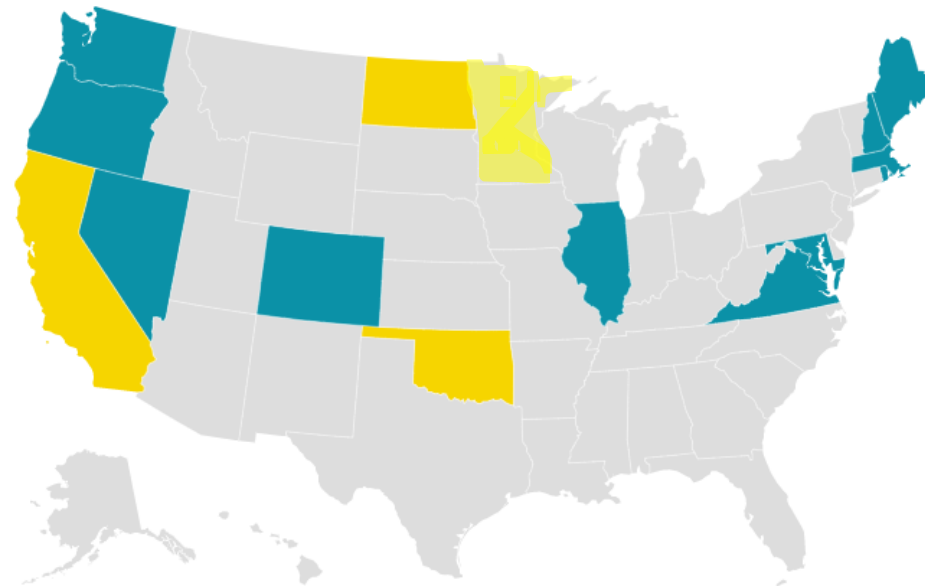
01

# History of Regulation of Non-Competes

- [State-by-State Regulation](#)
- In the U.S., enforceability of non-competes has traditionally been a matter of **state common law**.
- At least sixteen states and D.C. established restrictions on enforceability through **legislation**.
- **California, North Dakota, Oklahoma and Minnesota** ban all or nearly all non-competes. As of 1/1/24, California's near ban applies to non-competes created outside of California.
- Some states, like **New Hampshire**, allow non-competes generally but prohibit them for physicians, nurses, and lawyers.

Numerous states fully or partially ban non-compete agreements

■ Full ban ■ Ban below a certain wage

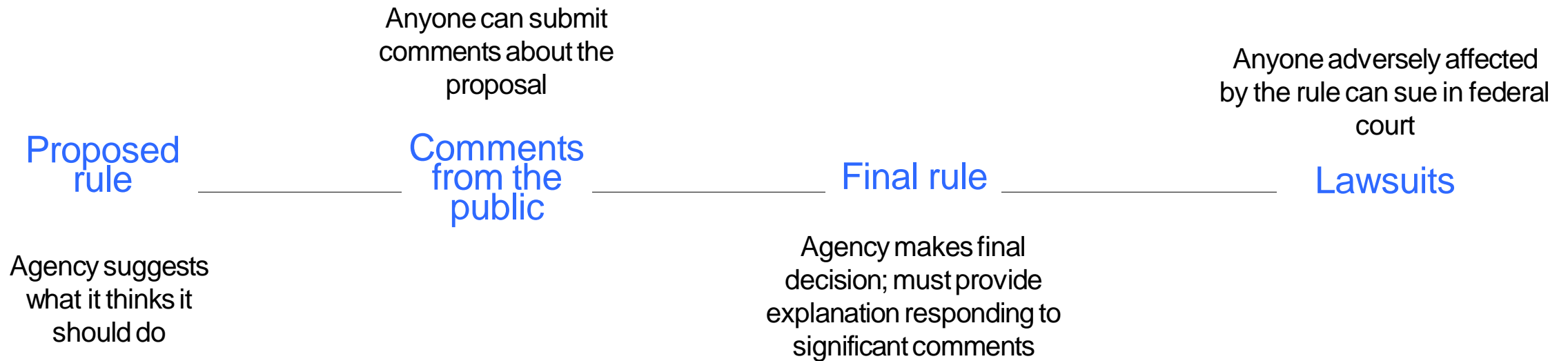


Source: [Fair Competition Law](#)

THE WASHINGTON POST

- [From Medieval England to the 118th Congress](#)
- *Dyer's Case* (1414): non-compete unlawful for want of consideration
- *Mitchel v. Reynolds* (1711): non-competes lawful if reasonable
- *U.S. v. Addyston Pipe* (6th Cir. 1898) (Taft, J.): “rule of reason” under Sherman Act
- *Snap-On Tools Corp. v. FTC* (7th Cir. 1963): “Restrictive clauses of this kind are legal unless they are unreasonable as to time or geographic scope....”
- 2023: proposed federal legislation

# How Regulations Are Made—and Challenged



# The FTC's **Final Rule**

- Effective **September 4, 2024**.
- It's a **ban**. Cannot attempt to enter into non-compete, maintain one, or represent to a worker that they are covered by one.
- Other restrictive covenants (e.g., NDAs; training-repayment) could be treated as noncompetes if they are “**so broad and onerous**” that they have “**the same functional effect as a term or condition prohibiting or penalizing a worker from seeking or accepting other work or starting a business.**”
- Ban is **retroactive**: employers must **notify employees that existing noncompetes are void**. But causes of action that **accrue before September 4, 2024**, can be enforced.
- Two **exceptions**: (i) **Sale of the business**; (ii) **Existing noncompetes with senior executives**.
- Ban is **national**: preempts state laws that are less restrictive.

# Litigation Challenges to the Rule

02



# Timeline

## *Ryan (N.D. Tex.)*

Complaint filed 4/23/24

Motion for stay and preliminary injunction filed 5/1/24

Ryan requested: briefing completed by 5/22/24; decision by 7/3/24

## *Chamber (E.D. Tex.)*

Complaint filed 4/24/24

Motion for stay and preliminary injunction filed 4/24/24

Judge issued scheduling order on 4/26/24 – summary judgment + PI

Briefing to be completed 6/19/24

But: FTC requested transfer to N.D. Tex.

## *ATS Tree Servs. (E.D. Pa.)*

Complaint filed 4/25/24

More?

# Merits

## Statutory Authority

FTC Act grants “**power**” “[f]rom time to time [to] classify corporations and ... to **make rules and regulations** for the purpose of carrying out the provisions of this subchapter.”

FTC report in 1922: “common mistake[] . . . to suppose that the commission can issue orders, rulings, or regulations unconnected with any proceeding before it.”

D.C. Circuit in 1973: **FTC can make substantive rules**. Highly criticized decision.

Congress in 1975: **FTC can make rules about deceptive practices**, but subject to **enhanced procedural hurdles**.

Agencies cannot regulate “a **question of deep economic and political significance**” absent “**clear**” authority from Congress. *Biden v. Nebraska*, 143 S. Ct. 2355, 2375 (2023)

## Constitutional Concerns

Congress cannot delegate **legislative** power to **executive** branch agency.

If FTC can issue unfair method of competition rules, what “**intelligible principle**” guides the agency? *Mistretta v. United States*, 488 U.S. 361, 372 (1989).

**Gorsuch test**: Filling up details?

**Constitutional avoidance**—read the statute to avoid the problem.

Moreover, are Commissioner’s **removal protections unconstitutional**?

## Flawed Reasoning

Broad ban is not supported by the evidence.

Inconsistent reasoning and treatment of the evidence.

Does not adequately engage with alternative approaches.

Cost-benefit analysis is flawed.

FTC straying beyond **consumer protection** mission—and failing even at that. Commissioner Slaughter: “We are understanding that people are **whole people who participate in the economy**, as consumers, as users, as workers, as small business owners, as patients in the healthcare system.”

# Irreparable Injury & Balance of Equities

## Irreparable Injury

“[C]omplying with a regulation later held invalid almost *always* produces the irreparable harm of nonrecoverable compliance costs.”

*Texas v. EPA*, 829 F.3d 405, 433 (5th Cir. 2016).

For example—

Loss of IP and poaching

Review of and changes to contracts

Sending out notices

## Balance of Equities

Stay and injunction maintain the status quo.

Non-competes have existed for hundreds of years – what’s a few more months?

# Deeper Dive into the Rule's Requirements and Ramifications

03

# To Whom Does the Rule Apply?

- The final rule bans **new** noncompetes with all workers, including senior executives after the effective date.
  - After the effective date, it is a violation to (i) enter into or attempt to enter into a non-compete clause; (ii) to enforce or attempt to enforce a non-compete clause; or (iii) represent that the worker is subject to a non-compete clause.
- There is an exception for “senior executives” with respect to noncompetes entered **before** the effective date (no **new** noncompetes for senior executives after the effective date).
  - A “senior executive” is an individual who both:
    - Has total annual compensation of at least \$151,164; and
    - Is in a “policy-making position.”
      - Policy-making position means an entity’s president, CEO and/or any other officer 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 means “final authority to make policy decisions that control significant aspects of a business entity or common enterprise and does not include authority limited to advising or exerting influence over such policy decisions or having final authority to make policy decisions for only a subsidiary of or affiliate of a common enterprise.”
      - Officers of subsidiaries or affiliates do not have it unless they have such authority over the “common enterprise.”

# What is a Noncompete?

- It is broadly defined to include:
  - A “term or condition of employment that prohibits a worker from, penalizes a worker for, or functions to prevent a worker from (1) 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 (2) operating a business in the United States after the conclusion of the employment that includes the term or condition.”
- Can be anywhere (e.g., employee handbook) not limited to individual agreements

# Notice Requirement

- No later than the effective date, the company must “provide clear and conspicuous notice” to workers that “the worker’s non-compete clause will not be, and cannot legally be, enforced against the worker.”
- Flexibility on form of notice (paper copy, email, text message)
- Model notice provided
- No such notice required for senior executives

# Exceptions

- Bona fide sale of business
- Does not apply “to a noncompete clause that is 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.”
- Where cause of action regarding noncompete accrued before the effective date
- Good faith
- Where there is a good-faith basis to believe the new rules are not applicable



# Sale of Business Exception

- Eliminated 25% holdings standard from proposed rule
- Per the preamble, “a bona fide sale is one made in good faith as opposed to, for example, a transaction whose sole purpose is to evade the final rule.”
- The exception does not apply to repurchase rights or mandatory stock redemptions because “the worker has no good will that they are exchanging for the non-compete or knowledge of or ability to negotiate the terms or conditions of the sale at the time of contracting.”
- As with the other exceptions (e.g., for senior executives), this exception does **not** supersede more restrictive state laws.
- It raises many questions; some key ones include:
  - Does the noncompete period have to be tied to the closing of the sale, and not include any employment-related “tail”? What about “earlier of” constructs (e.g., earlier of six months after termination of employment or three years after deal closing)?
  - Any minimum consideration threshold beyond what state law may require?
  - Does the person have to be an equity holder? What about CIC bonuses? Phantom equity?

## Other Key Issues

- Forfeiture for competition clauses are noncompetes
  - Equity awards
  - Severance
    - If someone breaches noncompete before the effective date, can stop severance; thereafter, generally could not (unless senior executive exception applies)
- Fixed term contracts generally ok
- Garden leave not always prohibited
  - Remedies unclear though (just stop paying or can get damages/injunction)

# Possible Alternatives **Post- Effective Date**

- Severance ceases upon obtaining **any** new position
- Equity awards – tie noncompete to continued ownership of the equity, not to employment
  - Could put the company in a difficult position if it wants to exercise a repurchase right
- Additional focus on provisions not implicated by the rule (e.g., nonsolicits and confidentiality protections, subject to the concern that they can be “disguised” noncompetes)
- For PE-owned companies, tie more of equity vesting to remaining employed through the liquidity event
- Make more compensation contingent on continued employment (e.g., retention bonuses)

# Recommended Next Steps for Businesses

04

# What Should I Do Now?

- **Review your agreements**, including with former employees, independent contractors, and volunteers:
  - Standalone non-competes;
  - Non-solicitation, no-business, and no-recruit agreements;
  - Offer letters and onboarding paperwork;
  - Employee handbooks;
  - Severance agreements and settlement agreements;
  - Non-disclosure agreements;
  - Training-repayment agreements;
  - Deal-based noncompetes;
  - Forfeiture and claw back clauses; and
  - Liquidated damages provisions.
- **Identify the business justifications** for your agreements and consider whether the agreements are **reasonably tailored to those justifications**.
- Consider whether your business justifications can be or already are accomplished through different means.
- Exercise caution in benchmarking with others; **consult with counsel** as needed.
- Consider **new pre-effective date agreements for senior executives** (need to take state law considerations into account)
- Ensure you have **up-to-date contact information** for current workers. For former workers, determine what contact information is readily available.

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