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FTC Bans (Most) Worker Covenants Not to Compete and Their Equivalents

On April 23, 2024, the U.S. Federal Trade Commission issued its final Non-Compete Clause Rule (the "Rule") prohibiting most covenants not to compete and other equivalent restrictions applicable to workers, completing a process begun in January 2023 when it issued a proposed rule.

As expected, the Rule is drawing both cheers and criticism.

Whether one chooses to see it as a pretext or as a context, the FTC maintains that banning non-competes is within its purview. However, within two days of the Rule's release, multiple lawsuits were filed challenging the FTC's authority.

The Shorthand Version (but don't skip the rest)

In essence, the Rule provides that it is an unfair method of competition, and therefore a violation of Section 5 of the Federal Trade Commission Act, for businesses to, among other things, enter into non-compete clauses and other equivalent provisions ("non-competes") with workers on or after the Rule's effective date, which will be the date 120 days following the Rule's formal publication in the Federal Register.

With respect to *existing* non-competes, i.e., non-competes entered into before the effective date — the Rule adopts a different approach for "senior executives" than for other workers:

For those within the definition of "senior executives", existing non-competes can remain in force.

However, *existing* non-competes with all other workers are not enforceable after the effective date; even worse, from the business's perspective, businesses are required to inform workers of such fact.

A violation subjects the employer to a potential enforcement action by the FTC to enjoin unfair competition.

What You Need to Know (But Not All There is to Know)

Here, in numbered nuggets, are the key points you need to know. Note, though, that should the FTC's power to adopt the Rule survive frontal attack, the Rule itself contains ambiguities and will undoubtedly be shaped by legal challenges over coming years.

1. The Rule applies to businesses of any sort, from sole proprietorships to entities of any type, whether a partnership, corporation, association, limited liability company, or other legal entity, or a division or subsidiary thereof. It applies equally to for profit and "non-profit", i.e., non-taxpaying, entities as long as they are under the FTC's jurisdiction.

2. Each of those businesses is a "person" under the Rule which might employ a worker.

3. "Employment" isn't restricted to the employer-employee relationship. It simply means work for a person. In that context, a "worker" is a natural person who works or previously worked, whether paid or unpaid, without regard to title or status under any other state or federal laws, including but not limited to, whether the worker is an employee, independent contractor, extern, intern, volunteer, apprentice, or a sole proprietor who provides a service to a person.

4. A "non-compete clause" is much more than what's popularly referred to as a covenant not to compete. Instead, it's any term or condition, written or oral, of "employment" (see above) that prohibits a worker from, penalizes a worker for, or functions to prevent a worker from

   i. Seeking or accepting work in the U.S. with a different person for a term beginning after the employment that includes the non-compete term or condition.

   ii. Operating a business in the U.S. after the conclusion of the employment that includes the term or condition.

5. The Rule become effective 120 days after its formal publication in the Federal Register.

6. Any non-compete clause entered into with a worker *on or after the effective date* is unenforceable.

7. Any non-complete clause entered into with a worker *prior to the Rule's effective date* is unenforceable unless the worker falls within the definition of a "senior executive".

8. A "senior executive" is a worker who:

   i. Was in a "policy-making position" (note that that is a defined term, the nuances of which are beyond the scope of this article), and

   ii. Received:

   a. Total annual compensation (note that this is determined pursuant to the Rule and excludes benefits) of at least $151,164 in the "preceding year", a concept with some flexibility and subject to the employer's election; or

   b. Total annual compensation of at least $151,164 when annualized if the worker was employed during only a part of the preceding year; or

   c. Total annual compensation of at least $151,164 when annualized in the preceding year prior to the worker's departure if the worker departed from employment prior to the preceding year.

9. If a non-complete clause is unenforceable per the Rule, it's also a violation to enter into a new such clause or to represent that the worker is subject to one (in other words, you can't B.S. a worker to make him or her think that a non-compete clause is enforceable).

10. By the Rule's effective date, employers must give written notice to each person subject to a now-unenforceable non-compete clause that the clause will not be, and cannot legally be, enforced against the worker. The Rule specifies the notice's requirements and provides model language.

11. The Rule sets out three exceptions:

    i. Bona fide sales of business. It does not apply to a non-compete clause entered into by a person [note that "person" is broader than "worker" and includes, for example, a professional corporation] pursuant to **a bona fide sale** [see below] (A) of a business entity, (B) of the person's ownership interest in a business entity, or (C) of all or substantially all of a business entity's operating assets.

    a. The FTC's preamble, or introductory text, to the Rule, which is not part of the Rule but which would likely be received by a court as an expression of the Rule's meaning/interpretation, states as follows: "In general, the Commission considers a bona fide sale to be one that is made between **two independent parties at arm's length, and in which the seller has a reasonable opportunity to negotiate the terms of the sale**. So-called "springing" non-competes [Note: ones entered into in, for example, a shareholders agreement, that spring to life upon some later event] and non-competes arising out of repurchase rights or mandatory stock redemption programs are not entered into pursuant to a bona fide sale [Note: this, too, describes the average shareholders agreement] because, in each case, 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."

    ii. Existing causes of action. The Rule does not apply where a cause of action related to a non-compete *accrued prior to the Rule's effective date*. In other words, even if a worker's noncompete clause becomes unenforceable as of the effective date, if he or she breached it prior to the effective date, the employer can still seek remedies related to that prior breach.

    iii. Good faith. It's not a violation to enforce or attempt to enforce a non-compete clause or to make representations about a non-compete clause where a person has a good faith basis to believe that the rule is inapplicable.

12. Last, the Rule only supersedes state law, including, for example, private rights of action and state government enforcement, to the extent that the state law would otherwise authorize a person to engage in what the Rule defines as unfair competition. So, for example, a state law that prohibits all covenants not to compete would apply to prohibit more conduct than the Rule itself.

Takeaways

Even in face of the existing challenges to the Rule, it makes the utmost sense to immediately analyze all agreements that include post-relationship restrictive covenants, even if not common parlance "covenants not to compete", whether those agreements are already in place with a specific person or whether they are your entity's regular-use forms, such as employment agreements or amendments to add partners to a partnership agreement.

Although the Rule's non-compete clause concept is broad, there may be other protective provisions that can be added to existing as well as new agreements to protect your business.

And last, there may be other strategies to accomplish permissible restrictions, even similarly restrictive provisions, in the context of materially revised agreements.

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Wisdom. Applied. 185: Is Your Group A Vendor...Or A Partner?

We change vendors like we change underwear.

All Things Personal

I'm in an American Airlines Admirals Club in Dallas, waiting for my flight.

Across from me, perhaps 7 feet away, is a guy doing a video conference on his iPad. And, he's not wearing headphones. I can clearly everyone in the meeting.

Didn't anyone teach this self-absorbed moron any manners? Does he honestly think anyone else is interested? I'm certainly not.

But wait . . . what if I were?

Years ago, I was having dinner in a small restaurant, just eight or 10 tables or so. In a booth close by was someone, let's call him Dr. X, who was on the other side of some major litigation my firm was handling.

Dr. X was with one other guy and they were clearly drinking too much, so much so that Dr. X began loudly laying out some of the facts and strategy of his case.

I flagged down a waiter, got a pad and pencil from him, and took wonderful notes the rest of the evening.

Sure, "Mr. Videoconference" in the Admirals Club can be seen as the poster boy for poor manners. But even worse, and the broader lesson for you, is that sometimes talking out loud in a public setting isn't just annoying others, it's giving them tremendously valuable information.

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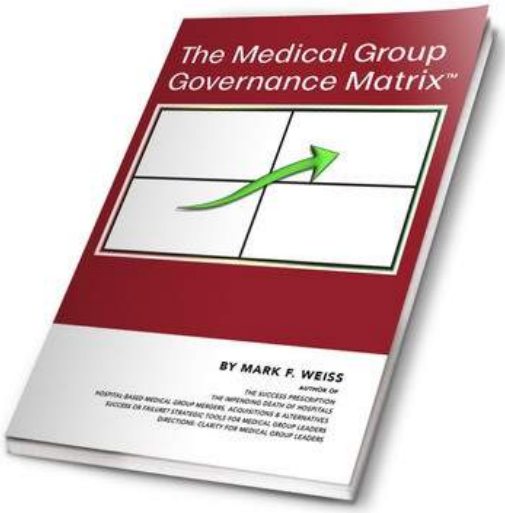
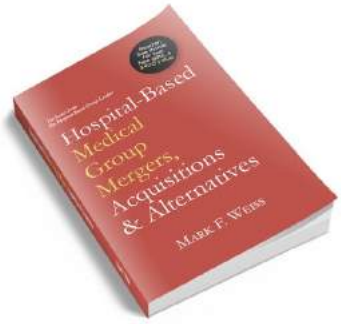


We all hear, and most of us say, that the pace of change in healthcare is quickening. That means that the pace of required decision-making is increasing, too. Unless, that is, you want to take the “default” route. That’s the one is which you let someone else make the decisions that impact you; you’re just along for the ride. Of course, playing a bit part in scripting your own future isn’t the smart route to stardom. But despite your own best intentions, perhaps it’s your medical group’s governance structure that’s holding you back. In fact, it’s very likely that the problem is systemic. The Medical Group Governance Matrix introduces a simple four-quadrant diagnostic tool to help you find out. It then shows you how to use that tool to build your better, more profitable future. Get your free copy here.



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