

Federal Trade Commission announces final rule banning non-compete clauses

By Gregory Grogan, Esq., Sara Razi, Esq., Abram Ellis, Esq., and Daniel Venditti, Esq., Simpson Thacher & Bartlett LLP*

MAY 1, 2024

The Federal Trade Commission (“FTC”) voted to prohibit all non-compete provisions with workers, with retroactive effect except for existing non-competes with very senior executives.

On April 23, 2024, the FTC held a special open commission meeting during which the FTC voted 3-2 along party lines in favor of issuing its final rule¹ preventing most employers from using non-competes against workers (the “Final Rule”).²

The Final Rule bans new non-competes with all workers, regardless of compensation level, seniority, or policy-making function, after the effective date.

Below are key elements of the Final Rule that were announced.

- The Final Rule bans new non-competes with all workers, regardless of compensation level, seniority, or policy-making function, after the effective date (which will be 120 days after publication in the Federal Register).
- The Final Rule contains a “grandfathering” exception for existing non-competes with respect to “Senior Executives.” The definition of “Senior Executive” is very narrow and likely will apply to only a small number of high-level, “policy-making” officers at most organizations (see definitions provided below).
- Under the Final Rule, employers are required to provide written notice to workers subject to unenforceable non-competes, by or before the effective date, stating that the non-compete will not be, and legally cannot be, enforced. The Final Rule provides a model form of notice that complies with this requirement.
- The Final Rule exempts only those non-competes that (1) are entered into pursuant to a bona fide sale of a business entity, of a person’s ownership interest in a business entity, or of all or substantially all of a business entity’s operating assets, or (2) are the subject of a cause of action relating to a non-compete violation which accrued prior to the effective date. Helpfully, the sale-of-business exception does not include the 25% ownership threshold from the FTC’s proposed rule.

- The Final Rule purports to preempt conflicting state laws except those state laws that are more restrictive than the Final Rule.
- Key definitions:
 - **“Non-Compete”** is broadly defined as “[a] term or condition of employment that prohibits a worker from, penalizes a worker for, or functions to prevent a worker from:
 - 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
 - operating a business in the United States after the conclusion of the employment that includes the term or condition.”

This definition would appear to capture customary forfeiture-for-competition provisions, such as a term that provides that a former employee will cease to be paid severance installments if the employee competes. Until now, most states have applied more liberal rules to monetary remedies associated with non-competes.

- **“Employment”** is broadly defined as “work for a person.” Person includes natural persons, partnerships, corporations, associations or other legal entities within the FTC’s jurisdiction. Notably, while some non-profits may be exempt, according to the FTC, not all entities claiming tax-exempt status as non-profits fall outside its jurisdiction.
- **“Senior Executive”** means an individual in a “policy-making position” who also earned total annual compensation (including bonuses but excluding benefits) of at least \$151,164³ in the preceding year.
 - **“Policy-making position”** means a company’s president, chief executive officer or the equivalent, or any other position with similar policy-making authority. Officers of a subsidiary or affiliate of a business entity that is part of a common enterprise must have policy-making authority with respect to

the common enterprise, and not just the subsidiary or affiliate. *Therefore, individuals who are in charge of one division or a function of a company generally would not be considered to be in a policy-making position for the entire company and would not be restrained by a grandfathered non-compete.*

- “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 or affiliate of a common enterprise.”
- The adopting release says: “For example, if the head of a marketing division in a manufacturing firm only makes policy decisions for the marketing division, and those decisions do not control significant aspects of the business (which would likely be decisions that impact the business outside the marketing division), that worker would not be considered a senior executive. Similarly, in the medical context, neither the head of a hospital’s surgery practice nor a physician who runs an internal medical practice that is part of a hospital system would be senior executives, assuming they are decision-makers only for their particular division.”
- The adopting release also says: “Partners in a business, such as physician partners of an independent physician practice, would also generally qualify as senior executives under the duties prong,

assuming the partners have authority to make policy decisions about the business.”

- “Worker” is broadly defined to cover any form of paid or unpaid work, regardless of title or status. This includes independent contractors.

Two commissioners dissented from the decision to publish the Final Rule on the basis that, among other grounds, doing so exceeds the FTC’s authority.

The Chamber of Commerce and other entities have signaled they plan to challenge the Final Rule.⁴ The outcome of those anticipated legal challenges is highly uncertain.

It is quite possible that legal challenges could result in the Final Rule being stayed by a court pending litigation. If the Final Rule is stayed during the pendency of appeals, it may take years of litigation before the Final Rule will be enforced.

Notes:

¹ <https://bit.ly/3UiikHIN>

² For background on the FTC’s proposed rule banning non-competes, see our prior memorandum *FTC Issues Proposed Rule Barring Non-Compete Clauses With Workers, Spurring Questions About Agency’s Rulemaking Authority*, <https://bit.ly/3WlCiSv>

³ The Final Rule contains detailed guidance on determining total annual compensation, but generally includes salary, commissions, **nondiscretionary** bonuses and other **nondiscretionary** compensation. It generally excludes board, lodging, payments for medical insurance, payments for life insurance, contributions to retirement plans and the cost of other similar fringe benefits.

⁴ Immediately after the FTC voted in favor of issuing the Final Rule, U.S. Chamber of Commerce President and CEO Suzanne P. Clark issued a statement saying that “[t]he Chamber will sue the FTC to block [it].” *U.S. Chamber to Sue FTC Over Unlawful Power Grab on Noncompete Agreements Ban*, U.S. CHAMBER OF COMM. (Apr. 23, 2024), <https://bit.ly/3WkZj8a>

About the authors



(L-R) **Gregory Grogan** is head of **Simpson Thacher & Bartlett's** executive compensation and employee benefits practice. Based in the firm's New York office, Grogan focuses on executive retention and motivation in merger and acquisition transactions and initial public offerings, with a concentration on private equity. He also routinely advises boards of directors on CEO succession matters. He can be reached at ggrogan@stblaw.com. **Sara Razi** is global co-chair of the firm's antitrust and trade regulation practice and is based in Washington, D.C. Razi focuses on merger reviews, government antitrust investigations, antitrust litigation and counseling on a variety of competition issues in multiple jurisdictions. She regularly represents clients before the Federal Trade Commission and the antitrust division of the Justice Department. Before joining the firm, Razi served in senior roles at the FTC for nearly a decade. She can be reached at sara.razi@stblaw.com. **Abram Ellis** is an antitrust partner and co-head of the firm's international trade regulation practice. Based in Washington, D.C., he focuses his antitrust practice on class-action litigation, antitrust merger review and antitrust counseling. He can be reached at aellis@stblaw.com. **Daniel Venditti** is counsel in the firm's corporate department. Based in New York, Venditti focuses on labor and employment aspects of mergers and acquisitions, private equity transactions and financing transactions. He also provides counseling on labor and employment issues that arise under federal and state laws. He can be reached at daniel.venditti@stblaw.com. This article was originally published April 23, 2024, on the firm's website. Republished with permission.

This article was published on Westlaw Today on May 1, 2024.

* © 2024 Gregory Grogan, Esq., Sara Razi, Esq., Abram Ellis, Esq., and Daniel Venditti, Esq., Simpson Thacher & Bartlett LLP

This publication was created to provide you with accurate and authoritative information concerning the subject matter covered, however it may not necessarily have been prepared by persons licensed to practice law in a particular jurisdiction. The publisher is not engaged in rendering legal or other professional advice, and this publication is not a substitute for the advice of an attorney. If you require legal or other expert advice, you should seek the services of a competent attorney or other professional. For subscription information, please visit legalsolutions.thomsonreuters.com.