



# The End of Noncompetes?

An Update on the  
FTC Rule and Its Impact  
on Asset Managers

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Proskauer»

# Presenters

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# Overview

# Overview of the Rule

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- **Existing Non-Competes**: After the Rule's effective date of **September 4, 2024**, existing non-competes are unenforceable as to all workers other than Senior Executives.
- **Senior Executives** are workers who: (i) are in a “policy-making position,” such as a business’s “president, CEO or the equivalent,” or any officer or person who has “policy-making authority,” which is final authority to make policy decisions that control significant aspects of a business entity or a common enterprise; and (ii) receive total annual compensation of at least \$151,164 per year.
- **New Non-Competes**: Employers may not enter into new non-competes with any workers (even Senior Executives) after the effective date.
- **Notice**: Employers must provide notice (by physical or electronic means) to current and former employees that their existing non-competes are unenforceable.
- **Sale of Business Exception**: Non-competes may be entered into pursuant to a bona fide sale of a business entity, a person's ownership interest in a business entity, or all or substantially all of a business entity's operating assets.

# Legal Challenges

## ***Ryan LLC v. Federal Trade Commission (N.D. Tex.)***

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- On July 3, 2024, the court issued a preliminary injunction staying effective date of the Rule ***only as to the named plaintiffs in that case*** (i.e., Ryan LLC and the U.S. Chamber of Commerce and affiliated groups) but ***declined to vacate it nationwide***.
- The court held that the plaintiffs demonstrated a likelihood of success on the merits, agreeing with their arguments that: (1) the FTC lacks the authority to issue substantive rules; and (2) the Rule was “arbitrary and capricious” under the Administrative Procedure Act.
- The court will issue a summary judgment decision on August 30.

## ***Ryan LLC v. Federal Trade Commission (N.D. Tex.)***

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- The plaintiffs argue that the default remedy under the APA is to fully vacate and set aside the Final Rule so that it cannot be applied to ***any employer or business***.
- The summary judgment decision will be appealable to the U.S. Court of Appeals for the Fifth Circuit (and then to the Supreme Court).
- If the court finds against the plaintiffs on August 30 or does not fully vacate the Rule, the plaintiffs are likely to request an emergency stay of the Rule pending a determination on appeal.

## Other Legal Challenges

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- On July 23, 2024, in *ATS Tree Services, LLC v. FTC* (E.D. Pa.), the court denied the plaintiff's motion for a preliminary injunction of the Rule, finding that the plaintiff had not shown the risk of irreparable harm.
- On August 14, 2024, the court in *Properties of the Villages, Inc. v. FTC* (M.D. Fla.) will hear oral argument on the plaintiff's motion for a preliminary injunction and to stay the effective date of the Rule.
- ***Ryan* is likely the best chance to get the Rule enjoined nationally.**

# The Rule: Details and Questions

## What's a “Non-Compete”?

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- A term or condition of employment that “**prohibits,**” “**penalizes,**” or “**functions to prevent**” a worker from seeking or accepting work, or operating a business, in the United States, with a different person after the conclusion of the employment that includes the term or condition.

# Does the Rule Apply to Partners/Partnerships?

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- The Rule applies to “partnerships, corporations, [and any] other legal entity” within the FTC’s jurisdiction. § 910.1.
- The Rule applies to “workers,” defined as any “person who works or previously worked ... without regard to that person’s title or status under any other ... laws.”
- As such, the Rule applies to partners, K-1 recipients, and those who receive carried or profits interest unless the individuals qualify as “**senior executives.**”
- And even then, only if their non-competes are already in place as of the effective date.

# Who Qualifies as a Senior Executive?

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- \$151,164 in total annualized compensation in the preceding year.
- Must have a “**policy-making position**,” which is defined as:
  - a business entity’s president, chief executive officer, or the equivalent, **or**
  - any other officer or natural person who has “**policy-making authority**” for the business entity.
- **Policy-Making Authority**: final authority to make policy decisions that control significant aspects of a business entity or a common enterprise
- 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.**” § 910.1.

# Policy Making Position/Authority

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- What about portfolio managers or others who have overall responsibility for a particular fund, segment, or platform?
- FTC Statements:
  - “Policy-making authority” is “assessed based on the business as a whole, not a particular office, department, or other sublevel.” (Preamble.)
  - The worker “must have policy-making authority with respect to the common enterprise as a whole, not just a segment of it.” (*Id.*)

# NDAs and Non-Solicitation Covenants

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- **Remain enforceable.**
- NDAs and covenants not to solicit employees, investors, clients, etc. “do not by their terms prohibit a worker from or penalize a worker” from working elsewhere, “and in many instances may not have that functional effect.” (Preamble.)
- The only exception is if the covenant “is so broad or onerous that it has the same functional effect as a term or condition prohibiting or penalizing a worker from” working elsewhere. (*Id.*)

# Forfeiture for Competition Provisions

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- **Unclear, but not likely to be enforceable in the FTC's view.**
- An example of a provision that “penalizes” a worker (*i.e.*, is a prohibited “non-compete”) is an agreement that “extinguishes a person’s obligation to provide promised compensation or to pay benefits as a result of a worker seeking or accepting other work or starting a business after they leave their job.” (Preamble.)
- “One example of such an agreement is a **forfeiture-for-competition** clause which ... imposes adverse financial consequences on a former employee as a result of the termination of an employment relationship, expressly conditioned on the employee seeking or accepting other work or starting a business after their employment ends.” (*Id.*)
- Other examples in the preamble of covenants that penalize a worker are liquidated damages provisions and severance arrangements in which the worker is only paid if they refrain from competing.

# What About Forfeiture for Leaving?

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- **Open question, but should be fine under the Rule.**
- Such a covenant is not tied to competition, so the FTC would presumably have no authority to regulate this.
- “[C]lauses requiring repayment of a bonus when a worker leaves their job would not be non-competes ... where they do not penalize or function to prevent a worker from seeking or accepting work with a person or operating a business after the worker leaves their job.” (Preamble.)
- The “good leaver” issue.

# Notice and Garden Leave Provisions

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- **Permissible under the Rule**, so long as the employee is still employed.
- Language in the FTC's preamble suggests it does not view these kinds of provisions as "post-employment restrictions," and therefore that they would continue to be enforceable.
- "With respect to garden leave agreements, ... the [FTC] notes that an agreement whereby the worker is still employed and receiving the same total annual compensation and benefits on a pro rata basis **would not be a non-compete clause** ..., because **such an agreement is not a post-employment restriction**. Instead, the worker continues to be employed, even though the worker's job duties or access to colleagues or the workplace may be significantly or entirely curtailed." (Preamble.)

# Fixed Term Contracts

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- The same rationale applies to **fixed term contracts**.
- “[F]ixed-term employment contracts ... are viable alternatives to non-competes.” (Preamble.)
- “[Employers] have alternatives to non-competes to retain key personnel, including by using fixed-term employment contracts.” (Preamble.)

# The Problem

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- **What happens if the employee violates the notice or garden leave provision or fixed term contract and quits?**
- Then they are no longer an “employee.”
- In those cases, the employer would ostensibly have to seek specific enforcement of the notice or garden leave provision to take the covenant outside the scope of the FTC rule.
- But there is always a risk that, notwithstanding the preamble language, a court—relying on the language of the Rule itself—would not enjoin the worker from working elsewhere or award damages for breaching the garden leave or notice provision unless the worker was a “senior executive” who signed an agreement containing those provisions before the effective date.

# Court Decisions Addressing Garden Leave and Notice Periods

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- Courts have been reluctant to specifically enforce notice or garden leave provisions:
  - *Bear, Stearns & Co. v. Sharon*, 550 F. Supp. 2d 174, 178 (D. Mass. 2008) (declining to enforce 90-day garden leave provision “[b]ecause the effect of specific performance in this case would be to require the defendant to continue an at-will employment relationship against his will”)
  - *Smiths Grp., plc v. Frisbie*, 2013 WL 268988, at \*3 (D. Minn. Jan. 24, 2013) (declining to enforce 6-month notice provision on equitable grounds)
- *But see Aitkin v. USI Ins. Servs., LLC*, 2021 WL 755475, at \*5 (D. Or. Feb. 26, 2021) (finding that until expiration of 60-day notice provision, plaintiff was “still considered” defendant’s employee and granting 14-day TRO restraining plaintiff from working for any competitor)

# Notice

# Notice Considerations

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- Who should receive notice
- Timing of notice
- Modifications or additional language
- Good-faith exception
  - “It is not an unfair method of competition 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 this part 910 is inapplicable.” § 910.3(c).

## The Rule’s Model Language:

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].

# Notice Considerations

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- Risks of sending a notice
- Risks of not sending a notice
- Sending a conditional/modified notice
- What companies are doing...

# Alternative Strategies to Non-competes

# Alternative Strategies

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- Strong NDAs and strict IP security/usage protocols
- “Carrot versus stick” incentives—*e.g.*, stay/retention bonuses, deferred compensation/equity based on being here in x years (and neutral to competition).
- “Forfeiture-for-leaving” clauses (as opposed to forfeiture-for-competition)
- Continued use of non-solicit covenants (investors and employees)
- Term contracts
- Garden leave and notice provisions

# What to Do Now

# What To Do Now

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- Take a ***complete inventory*** of where your “non-competes” (as defined by the Rule) may reside.
  - Offer letters, employment agreements, partner services agreements, partnership agreements, operating agreements, GP/LP agreements, subscription agreements, equity and profits interest plans and award agreements, deferred compensation rules, etc.
- Continue to use ***reasonably-scoped non-competes*** in states that permit them, for both new joiners and existing team members.
- Consider ***alternative strategies*** to protect IP/trade secrets and prevent/disincentivize sudden departures.
- Follow the legal challenges

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