



Morgan Lewis

**ADVANCED TOPICS IN
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Current Employment Considerations

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FTC Approval of Final Rule Banning Noncompete Clauses

In January 2023, the FTC announced a notice of proposed rulemaking that would ban employers from entering into and maintaining noncompete clauses with their workers.

Through April 19, 2023, the FTC received more than 26,000 public comments about the proposed ban and various alternatives; the FTC considered those comments through April 2024.

On April 23, 2024, the FTC Commissioners voted along party lines, 3-2, to approve the Final Rule, which prohibits employers from entering into or enforcing a “noncompete clause” with “workers” on or after the Final Rule’s effective date of September 4, 2024.

The Final Rule provides that nearly all existing worker noncompetes are not enforceable because they constitute an unfair method of competition.

The Final Rule's Scope

Bans "noncompete clauses" with "workers"

- Broad definition of "workers": any person who works or who previously worked, whether paid or unpaid, without regard to the worker's title or status under any state or federal laws (i.e., employees, independent contractors, interns, etc.).
- Prevents actual and de facto "noncompete clauses," as well as "terms and conditions that require a worker to pay a penalty for seeking or accepting other work or starting a business after their employment ends."

Does not require rescission of existing noncompetes, which was proffered in the Proposed Rule.

Does require "clear and conspicuous notice" to workers who entered into a noncompete clause, by the effective date of the Final Rule, that the noncompete will not be enforced against such workers.

Limited Exceptions to the Final Rule

- **The Final Rule provides a limited exception for noncompetes entered into with senior executives before the effective date of the rule.**
 - “Senior executive” is defined as a worker earning more than \$151,164 annually who is in a “policy-making position” with respect to the entire business enterprise.

The Final Rule also does not apply where a cause of action related to a noncompete accrued prior to the rule’s effective date (i.e., noncompetes under pending litigation).

There is also an exception to noncompete clauses entered into in connection with the sale of a business, of the person’s ownership interest in a business entity, or of all or substantially all of a business entity’s operating assets.

Statutory exemptions for banks, savings and loan associations, credit unions, air carriers, common carriers, and most nonprofits.

Equity Compensation

The Final Rule	Potential Issue Under the Final Rule
Will apply to equity compensation arrangements	Unclear whether applicable to equity grants where the only remedy for breach of noncompete covenant is forfeiture of equity grant and return of previously issued stock
Includes a limited exception for clauses entered into pursuant to a bona fide sale of a business entity	The preamble to the Final Rule indicates that this exception is not available for “springing” noncompetes, repurchase rights in the ordinary course, or mandatory stock-redemption programs
Forfeiture-for-competition clauses, which are common in equity compensation, will likely fall within the scope of the Final Rule	The Final Rule defines a noncompete clause as including any term that “penalizes” a worker from competing after employment The preamble to the Final Rule characterizes most forfeiture-for-competition clauses as noncompetes that would penalize a worker for post employment competition

Executive Arrangements

The Final Rule	Potential Issue Under the Final Rule
Prohibits noncompete clauses in future contracts with all workers	On a going-forward basis, applies to broad range of workers including executives and sales employees
Applies to existing agreements for workers that are not “senior executives”	This includes noncompete covenants in separation agreements or other agreements entered into in connection with prior terminations of employment*
Arrangements that still appear permissible	Garden-leave arrangements, stay bonuses, and other retention arrangements should in many cases continue to be enforceable as long as they are not tied to noncompetition

* There is a limited exception for clauses entered into in connection with a bona fide sale of business.

Penalties for Not Complying with the Final Rule



- The FTC Act allows the FTC to obtain equitable remedies using:
 - Cease-and-desist orders issued by the FTC after an administrative hearing;
 - Consent orders settling administrative complaints; or
 - Judicial orders.



- The FTC is also entitled to seek monetary remedies in some situations, including:
 - Civil fines for failure to comply with orders or statutory; and
 - Equitable remedies, such as disgorgement or restitution.



- State “mini-FTC Acts” may also provide rights for private litigants.
 - E.g., NY Governor Kathy Hochul vetoed proposed law prohibiting employers from entering noncompetes but suggested she would not veto a bill with narrow exceptions.

Challenges to the Final Rule – Legal Theories



Dissenting Republican FTC Commissioners highlighted several challenges the Final Rule will likely face:

- The FTC is not authorized under the FTC Act to promulgate binding legislative regulations concerning unfair methods of competition; and
- The Final Rule is arbitrary and capricious decision-making in violation of the Administrative Procedure Act.

These objections laid the groundwork for a challenge to the Final Rule under the major-questions doctrine from the Supreme Court. That doctrine requires “clear congressional authority” when an agency claims power to regulate in an area of tremendous “economic and political significance.”

Some also may argue that even if Congress were to grant the FTC this authority, that conferral would be an unconstitutional delegation of legislative power.

Challenges to Final Rule – Litigation

Within hours of the FTC's vote to adopt the Final Rule, the first challenge was filed in the United States District Court for the Northern District of Texas by a tax services firm, Ryan LLC.

- First filed case
- Court committed to issuing a decision on the motion to stay by July 3

The United States Chamber of Commerce filed its legal challenge the next day, on April 24, 2024, and moved for a preliminary injunction to stay the enforcement of the Final Rule in the Eastern District of Texas.

A third lawsuit was filed against the FTC on April 25 by ATS Tree Services LLC in the Eastern District of Pennsylvania.