

# Client Alert

Employee Benefits and Executive Compensation

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## Effect of the New FTC Rule Banning Post-Employment Non- Compete Agreements on Executive Compensation Arrangements

### BACKGROUND

On April 23, 2024, the Federal Trade Commission issued its final rule imposing a nationwide ban on employers using post-employment non-competes with current and former workers. Other than narrow exceptions for (1) existing non-competes with “senior executives,” (2) non-competes entered into in connection with a bona fide sale of a business, and (3) non-competes in franchisor/franchisee relationships, and a narrow exemption from the FTC’s jurisdiction for non-competes imposed by non-profits, the final rule bans all new post-employment non-competes, invalidates all existing post-employment non-competes and prohibits the enforcement of any post-employment non-competes. Under the final rule, employers must inform all workers subject to post-employment non-competes (other than existing agreements with “senior executives”) that such provisions are no longer valid.

The final rule takes effect 120 days following its May 7 publication in the Federal Register, making its effective date September 4, 2024. Several lawsuits have already been filed challenging the final rule, which could delay its implementation until a final determination has been made regarding its enforceability.

### EXECUTIVE COMPENSATION: WHAT REMAINS UNCHANGED

- Forfeiture or clawback conditions of payments and compensatory awards that are not based on the violation of a post-employment non-compete or do not otherwise punish a worker for working for a competitor will not be affected by the final rule.



- Forfeiture or clawback conditions of payments and compensatory awards that are based on the violation of a non-compete *during* the worker's term of employment will not be affected by the final rule. Such provisions remain enforceable, subject to applicable state law.
- Typical time and performance based vesting provisions in compensatory arrangements will not be affected by the final rule.
- Arrangements with "senior executives" *in place as of the effective date* of the proposed rule will also not be affected by the final rule.

### EXECUTIVE COMPENSATION: WHAT WILL CHANGE

Under the final rule:

- The payment of severance cannot be conditioned upon compliance with a post-employment non-compete.
- Violation of a post-employment non-compete provision can no longer be a basis for clawback or forfeiture.
- Workers who are also classified as shareholders or self-employed partners for tax or other purposes, other than in the context of a sale of a business, cannot be bound by post-employment non-competes provisions.
- Employers subject to 280G of the Internal Revenue Code (the "golden parachute provisions") who are not able to engage in the shareholder waiver and approval process will not be able to exclude compensation paid to disqualified individuals in consideration of a post-employment non-compete from 280G amounts as reasonable compensation for services rendered after a change in control.

### EXPECTED TRENDS

If it becomes effective, we expect that the final rule may cause employers to move towards:

- Entering into arrangements with post-employment non-competes with "senior executives" prior to the effective date of the final rule.
- Longer time-based vesting periods.
- More cliff-based vesting or otherwise requiring workers to be employed at payment to earn a benefit and forfeiture of benefit upon terminations prior to such time.
- More "buy outs" as replacement compensation for forfeited equity and incentive compensation for new hires as a result of the above.
- "Garden leave" replacing severance.
- More equity compensation, based on efforts to assert (1) that shareholder-workers are not investing in the employer or its affiliates in their employment capacity and so such investments and their terms are not covered by the final rule; and/or (2) the sale of equity or equity-like interests in connection with termination of employment qualify as a bona fide sale of a business.

### NEXT STEPS

Given the final rule is currently subject to challenge and non-competes are not prohibited until the proposed rule goes into effect, many companies have made the decision (at least in the short term) to continue to operate in the ordinary



course, including continuing to enter into employment non-compete agreements. Nonetheless, we recommend that companies take the following proactive steps:

- Consider executive compensation arrangements with an eye towards the fact that any payments or benefits given in consideration of a post-employment non-compete may remain even if the benefit of that bargain is eliminated;
- Identify “senior executives”; and
- Audit existing arrangements and form agreements and review the scope of restrictive covenants and forfeiture provisions included in such arrangements.

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