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Client Alert

Executive Compensation, Employment & Benefits

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BREAKING: Federal Trade Commission Imposes Broad Non-Compete Ban and U.S. Department of Labor Increases Overtime Salary Threshold

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April 23, 2024, has been a very busy day on the employment front, with significant, far-reaching moves at the federal level.

Non-Compete Ban

First, in a watershed vote during an open commission meeting today, the Federal Trade Commission (FTC) voted 3-2 to approve the final version of a rule that will ban essentially all post-employment noncompete agreements that employers impose on their workers (the Non-Compete Final Rule) as soon as it becomes effective, not likely for at least 120 days. The Non-Compete Final Rule comes more than a year after the FTC issued a proposed rule in January 2023 (the Proposed Rule); since that time, the FTC has been considering over 26,000 comments from the public about the proposal.

As of the effective date of the Non-Compete Final Rule, post-employment noncompete clauses will be **banned** for all workers, including employees and independent contractors, with a limited exception for *existing* noncompete agreements already entered into with "senior executives." The Non-Compete Final Rule defines "senior executive" as a worker with a total annual compensation of at least $151,164 who is in a "policy-making position," defined very narrowly to include only a business entity's president, chief executive officer or the equivalent, any other officer of a business entity who has policy-making authority, or any other person similar to an officer with policy-making authority. After the effective date of the Non-Compete Final Rule, an employer may not enter into a noncompete agreement with any worker, even a senior executive.

The Non-Compete Final Rule defines a "noncompete clause" to mean a term or condition of employment that prohibits a worker from, penalizes a worker for, or functions to prevent a worker from (i) seeking or accepting work in the United States after the conclusion of employment; or (ii) operating a business in the United States after the conclusion of employment. Accordingly, the rule does not prohibit traditional non-solicits of customers or employees; and does not prohibit base level confidentiality/non-disclosure agreements.

If the effective date of the Non-Compete Final Rule follows the presidential election and there is a shift from a Democratic to Republican administration, it is possible that the Non-Compete Final Rule will not become effective. As of this publication, a lawsuit already has been filed in federal court in Texas, ***Ryan LLC v. Federal Trade Commission***, Civil Action No. 3:24-cv-986, challenging the propriety of the Non-Compete Final Rule. The U.S. Chamber of Commerce also announced that it intends to file suit challenging the Non-Compete Final Rule. Any one of these lawsuits could result in a stay of the Non-Compete Final Rule.

Presently under the Non-Compete Final Rule, employers are required to send a notice by the effective date to workers informing them that any noncompete they may have signed will not be, and cannot legally be, enforced against them.
Many businesses have been concerned about how the Non-Compete Final Rule would impact the sale of a business. The Non-Compete Final Rule preserves the right for a buyer to impose a noncompete pursuant to a "bona fide sale of a business entity, of the person's ownership interest in a business entity, or of all or substantially all of a business entity's operating assets." The Non-Compete Final Rule eliminated a requirement, contained in the Proposed Rule, that would have limited this exception to owners, members, or partners holding at least a 25 percent ownership interest in a business entity.

The FTC declined to impose an alternative standard, such as a dollar limit on the proceeds received by a seller, or a "totality of the circumstances" or "reasonableness" test, on the grounds "they would provide little meaningful guidance to buyers and

sellers and would be difficult to administer." The FTC did note that noncompetes allowed under this sale of a business exception will continue to be governed by state law—which generally requires a showing that a noncompete is necessary to protect the value of the business being sold—as well as federal antitrust law.

The FTC expressed concern about this sale of business exception being abused through sham transactions with wholly owned subsidiaries, "springing" noncompetes (i.e., when a worker must agree at the time of hiring to a noncompete in the event of a future sale), repurchase rights, mandatory stock redemption programs, or similar evasion schemes. As noted, the FTC has clarified that, in order to fit within the exception, a noncompete must be "pursuant to a bona fide sale."

The FTC explained that, in general, it 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. The FTC added that "springing" noncompetes and noncompetes arising out of repurchase rights or mandatory stock redemption programs are not entered into pursuant to a bona fide sale because, in each case, workers do not have good will that they are exchanging for the noncompete, or knowledge of or ability to negotiate the terms or conditions of the sale at the time of contracting. Thus, it appears that the Non-Compete Final Rule, if it becomes effective in its current form, will preclude employers from including noncompetes tied to repurchase rights under equity incentive plans or other similar plans or arrangements.

The Non-Compete Final Rule also does not apply to certain nonprofits, including certain health workers who work for nonprofit facilities.

The Non-Compete Final Rule prohibits post-employment paid garden leave, but the FTC comments contemplate a framework in which paid garden leave might be permissible if the worker is receiving the same total annual compensation and benefits on a pro rata basis IF the worker is still employed.

In short, the Non-Compete Final Rule will create a tremendous shift in how employers may protect their legitimate business interest in confidential information, customer relationships, and other good will. We will continue to monitor developments closely.

Exempt Employee Salary Threshold Increase

Separately but also significantly, the U.S. Department of Labor (DOL) released today a final rule raising the salary threshold for "white collar" minimum wage and overtime pay exemptions (the Overtime Final Rule). The Overtime Final Rule departs in some ways from the version that was proposed in August 2023. Employers will need to promptly assess their pay practices and potentially increase salaries to maintain overtime exemptions.
Specifically, the Overtime Final Rule increases the minimum annual salary threshold from $684 per week ($35,568 annualized) to (i) $844 per week ($43,888 annualized), as of July 1, 2024, and (ii) $1,128 per week ($58,656 annualized) as of January 1, 2025, to qualify executive, administrative, and professional positions as exempt from the Fair Labor Standards Act's (FLSA) minimum wage and overtime requirements. To be exempt from overtime, an employee must meet both a salary test and a duties test.

In addition to the "white collar" exemptions, the highly compensated employee exemption is another popular exemption. Under the Overtime Final Rule, the new total annual compensation to meet the highly compensated employee exemption will increase from $107,432 to $132,964 as of July 1, 2024, and up to $151,164 as of January 1, 2025.

The Overtime Final Rule includes a mechanism to automatically increase the salary threshold and total annual compensation requirement for "white collar" and highly compensated employee exemptions, respectively, every three years, beginning July 1, 2027, to reflect current earnings data.

In the past, there have been legal challenges in court to raising the salary threshold; it is likely the Overtime Final Rule will face similar challenges, but employers should expect the Overtime Final Rule to go into effect and plan accordingly to ensure compliance.

As a reminder, to be exempt, employees must meet not only the federal exemption requirements under the FLSA but also any state-specific requirements, which may include a higher salary threshold than even the Overtime Final Rule.

Lowenstein Sandler's Executive Compensation, Employment & Benefits Group regularly counsels employers on the complexities of restrictive covenants, both in the employment and corporate context, as well as on wage and hour compliance. Please contact the authors or any other Lowenstein Sandler attorney with whom you regularly work if you have any questions.

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