

FTC Issues Rule Banning Noncompete Clauses

What Does This Mean for Nonqualified Benefit Plans?

On April 23, 2024, the Federal Trade Commission (FTC) issued a final rule that would ban noncompete clauses. The rule would impact both existing noncompetes within the scope of this new rule and ban any future noncompetes. While the merits of such a change are up for debate, the rule may significantly impact the ability for many plan sponsors to reach their benefits goals and objectives through nonqualified plans.

What does this new FTC rule change and when is it effective?

- **Comprehensive ban on all new noncompetes.**
 - Under the new FTC rule, the FTC adopts a comprehensive ban on new noncompetes with all workers, including senior executives.
- **Existing noncompetes with existing workers other than senior executives are not enforceable after the effective date.**
- **For senior executives, existing noncompetes can remain in force under certain circumstances.**
 - A senior executive refers to workers earning more than \$151,164 who are in a “policy-making position”.
- **The rule becomes effective September 4, 2024.**
 - 120 days after it was published in the Federal Register on May 7, 2024.
 - There is currently pending litigation challenging the provisions and scope of the FTC rule that may delay the effective date or potentially rule it invalid.

Do my clients need to take any action?

If the client entered into noncompete clauses with workers, yes.

- The Final Rule will require employers who entered into noncompete clauses with employees to provide notice by the Effective Date that any subject noncompete clause will not be, and cannot legally be, enforced against any covered employee.
- The Final Rule faces strong statutory and constitutional challenges which may delay the Effective Date.

How does the FTC's noncompete rule impact nonqualified deferred compensation plans (NQDC plans)?

The short answer is, at this point it's somewhat unclear.

A few things to consider:

- The rule targets not only noncompete clauses but also forfeiture-for-competition clauses.
- The proposed rule does not explicitly address how it affects NQDC plans, however there is a definition of “senior executive” which would be exempt from the new rule. The definition leaves more room for interpretation.
 - For purposes of the rule, a senior executive is defined as “workers earning more than \$151,164 who are in a “policy-making position.”
 - The term “policy-making position” brings more complexity to who would be considered a senior executive.ⁱ

Some potential scenarios:

- The rule might not affect NQDC plans: If the courts determine the FTC can't regulate NQDC plan provisions, the rule might not impact them.
- Forfeiture provisions might need revising: Employers might need to adjust NQDC plan forfeiture provisions to ensure they don't violate the FTC's broader definition of noncompetes.
- Impact on FICA taxes is unclear: The link between noncompetes and FICA tax treatment in NQDC plans needs clarification.

Now that the rule has an effective date, how should I prepare?

We recommend reviewing all nonqualified plan documents and agreements that may contain noncompete clauses. The specifics of these clauses; how they are enforced, what benefits are tied to the noncompete, the source of the impacted benefits, and the details of the affected employee population, will likely determine any recommended or required actions.

Connect with Nolan Financial

For a consultation regarding the FTC noncompete rule, potential solutions and/or remediation actions or to discuss any nonqualified executive benefit plan related question, please contact Michael Nolan, NolanM@nolanfinancial.com, or Kenton Quick, QuickK@nolanfinancial.com, or by phone at 301-907-9500.

ⁱ *Senior executive* means a worker who:

- (1) Was in a policy-making position; and
- (2) Received from a person for the employment:
 - (i) Total annual compensation of at least \$151,164 in the preceding year; or
 - (ii) Total compensation of at least \$151,164 when annualized if the worker was employed during only part of the preceding year; or
 - (iii) Total compensation of at least \$151,164 when annualized in the preceding year prior to the worker's departure if the worker departed from employment prior to the preceding year and the worker is subject to a non-compete clause.

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 of or affiliate of a common enterprise.

Policy-making position means 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 natural person who has policy-making authority for the business entity similar to an officer with policy-making authority. An officer of a subsidiary or affiliate of a business entity that is part of a common enterprise who has policy-making authority for the common enterprise may be deemed to have a policy-making position for purposes of this paragraph. A natural person who does not have policy-making authority over a common enterprise may not be deemed to have a policy-making position even if the person has policy-making authority over a subsidiary or affiliate of a business entity that is part of the common enterprise.