



# FTC FINAL NONCOMPETE RULE GAME PLAN CHECKLIST

## EXISTING CONTRACTS

- Identify All Existing Contracts With Noncompete Provisions
  - Agreements that may contain noncompete provisions include:
    - Employment agreements
    - Offer letters
    - Restrictive covenant agreements
    - Equity award agreements
    - Nonqualified deferred compensation plans
    - Severance plans
    - Contracts at non-US affiliates covering US citizens or resident aliens
    - Agreements entered into by acquired companies that may remain outstanding
- Identify All Existing Contracts With Functional Noncompete Provisions
  - Forfeiture of accrued benefits and compensation because of noncompete activities
  - Liquidated damage clauses if the worker engages in competitive activities
  - Call provisions that apply to the repurchase of company stock after employment termination for less than fair market value, particularly in the private equity context
  - Overly broad client nonsolicitation restrictions
- Determine Whether Existing Contracts With Noncompete Provisions Cover Senior Executives
  - A senior executive means a worker who, as of September 4, 2024, (a) is in a **policy-making position** and (b) received from a person for their employment: (i) total annual compensation of at least \$151,164 in the preceding year, (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

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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 noncompete clause.

- **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 and 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.
- **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.

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If an Existing Contract With Noncompete Provisions Covers Someone Who Is Not a Senior Executive, Determine What Actions Must Be Taken by September 4, 2024, to Comply With the FTC Rule (If It Is Upheld)

- Provide a "clear and conspicuous notice" to affected current and former employees before September 4, 2024, that any violative noncompete will not be enforced.
- Decide whether to use the FTC's model safe harbor notice.
- Determine whether there is a fail-safe provision negating the noncompete provisions in the existing contract and, if not, evaluate whether an amendment is appropriate or feasible.
- If the noncompete includes restrictions on activities outside of the United States, modifying the geographic scope to only cover outside of the US may be appropriate.

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Consider Whether, How and When to Protect the Company's Interests if the Noncompete Provisions in an Existing Contract Become Unenforceable Because of the FTC Rule

- Enhance nonsolicitation and confidentiality restrictions for all employees.
    - Restrictions on soliciting clients/customers or using client/customer lists
    - Restrictions on soliciting employees
    - Restrictions on the use and disclosure of confidential information and trade secrets
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- Include safeguards to avoid additional restrictions being considered a functional noncompete, which may turn on the facts and circumstances of certain covenants and the surrounding market context.
  - Consider applicable state law restrictions that may apply when enhancing confidentiality and nonsolicitation provisions, including whether continued employment is sufficient consideration for a revised restriction.
  - Address whether changes need to be made to upcoming proxy statements because of prior disclosures about executives being subject to noncompete provisions.
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Consider Whether to Notify Senior Executives That the Noncompete Provisions in Their Existing Contracts Remain Enforceable Under Current Law

- Assess whether this is necessary or helpful, particularly for former employees who may believe they were not senior executives.
  - Providing notice as to currently employed executives may be relevant if there is a dispute about the issue, particularly if later incentive awards include an acknowledgment and agreement as to senior executive status.
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Assess Whether Noncompete Provisions in Existing Contracts for Senior Executives (i) Are Enforceable and Consider Remedial Action Before September 4, 2024 and/or (ii) should be strengthened from a business perspective

- There have been many recent state law changes governing the enforceability of noncompete restrictions.
  - Changes may be required to comply with current state law and modifying noncompete provisions under existing contracts after September 4, 2024, may result in loss of grandfathering treatment.
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Understand How the Unenforceability of Noncompete Provisions Will Impact Existing Equity Awards

- Noncompete provisions have been used as part of restricted stock awards in a manner that defers when the award becomes taxable compensation. If the noncompete provisions are no longer enforceable, there would be no substantial risk that the restricted stock is forfeitable and immediate tax withholding would be required.
  - Other types of equity awards (e.g., stock options, restricted stock units and performance stock units) provide for continued vesting over time if a former employee complies with noncompete restrictions. Can employers forfeit the portion of the award that would vest after September 4, 2024, because of the impossibility of complying with the provisions or must the entire award be treated as vested and, if so, when?
  - Some equity awards are expressly conditioned on the employee agreeing to restrictive covenants, including noncompete provisions. Will the FTC rule allow an employer to cancel those awards for failure of consideration?
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Address the Impact of the FTC Rule on Prior Golden Parachute Positions

- A former employee who is treated as a “disqualified individual” under Section 280G of the Internal Revenue Code may be subject to adverse taxation due to the FTC rule.
  - The scope of who is a disqualified person is much broader than who is a senior executive under the FTC rule. It includes any officer, regardless of policy-making authority, and highly compensated employees who are not officers.
- Payments that are considered to be in exchange for an enforceable noncompete are often treated as reasonable compensation for services rendered after a change in control (CIC) and, therefore, are exempt from being treated as parachute payments subject to the golden parachute excise tax.
  - Common examples of CIC-related payments that have been treated as reasonable compensation include severance benefits and accelerated vesting of equity awards.
- Public companies and buyers that cannot rely on the more than 75% shareholder approval exception for private companies will be particularly impacted by the FTC rule.
- Many contracts include “better of” or “cutback” provisions requiring reduced CIC-related benefits to avoid adverse golden parachute excise tax treatment for the employee and employer. Recalculations may be required to reflect the unenforceability of a noncompete.
  - It is also possible that a tax gross-up payment may be triggered under contract provisions as a result of a recalculation.
- A former employee may dispute that a cutback of future benefits (or a clawback of previously paid benefits) is required to avoid the golden parachute excise tax depending upon the valuation of the noncompete and whether the sale-of-business exception is available for it to be enforceable and respected by the Internal Revenue Service.
  - The final rule omitted a restriction in the proposed rule that the sale-of-business exception would apply only to sales by business owners holding at least a 25% ownership interest in a business entity. The restriction now only applies to holders of “substantial” ownership.

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## FUTURE CONTRACTS

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- Identify and Complete Any Pending Agreements or Plans With Noncompete Provisions Covering Senior Executives Before September 4, 2024
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- Consider Alternatives to Noncompete Restrictions
    - **“Garden leave” arrangements:** Worker remains actively employed and receives the “same total annual compensation” and benefits on a pro rata basis, even though their job duties or access to their colleagues or the workplace may be significantly or entirely curtailed.
    - **Retention or stay bonuses with or without clawbacks:** Generally enforceable under the FTC rule so long as they are not tied to competitive activity after employment termination.

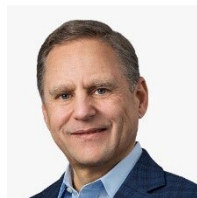
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- Assess Whether the Current Structure for Equity Awards Should Be Changed Going Forward
    - Accelerated vesting on employment termination?
    - Continued post-termination vesting tied to compliance with noncompete provisions?

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- Determine the Extent to Which Noncompete Provisions Need to Be Altered as Part of Any Planned Acquisition and the Resulting Impact on Golden Parachute Exposures

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## KEY CONTACTS

For any questions regarding the FTC Final Noncompete Rule, please contact your regular McDermott lawyer or one of the authors listed below.



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