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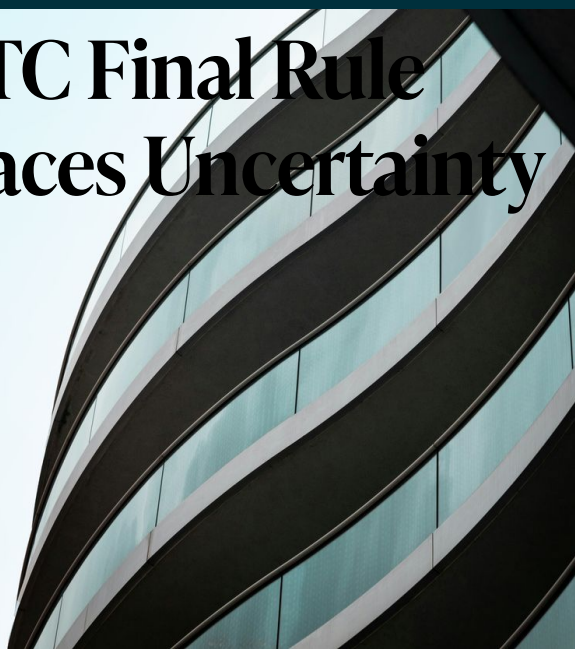
Axinn Antitrust Insight: FTC Final Rule Banning Non-Competes Faces Uncertainty



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May 7, 2024

What You Need to Know

The Federal Trade Commission's final rule banning non-competes was published in the Federal Register today, potentially becoming effective on September 4, 2024. The new rule would prohibit employers from imposing restrictions on workers seeking or accepting employment with a competitor or starting a competing business. But pending lawsuits against the FTC related to the rule cast doubt on if and when the rule will be implemented.

Overview of Final Rule Banning Non-competes

The FTC initially proposed its Non-Compete Clause Rule on January 19, 2023, and received more than 26,000 public comments from a wide range of employers and workers from every state, as well as trade and professional groups and academics and researchers. The FTC identified 25,000 of the comments as supportive of the ban.

The FTC claims that non-competes (i) prevent and deter new business formation and innovation and (ii) result in exploitation and coercion of workers, and that eliminating non-competes will mean more innovation, more startups, and higher earnings. In addition, the FTC claims that less restrictive alternatives are available, including protecting proprietary and

sensitive information using non-disclosure agreements and trade secret laws and protecting investments using fixed-duration contracts and offering better compensation and benefits.

The final rule announced on April 23, 2024, deems non-compete clauses - defined as terms or conditions of employment that prohibit or penalize a worker from accepting work from a different person in the U.S. or operating a business in the U.S. after conclusion of the employment - to be an unfair method of competition under Section 5 of the FTC Act. Under the rule, **existing non-competes for the vast majority of workers would no longer be enforceable**. The rule imposes obligations on employers to stop enforcing or attempting to enforce existing non-competes and to **provide written notice to most affected workers that non-competes cannot be enforced**. The rule also **outlaws any new non-competes against any types of workers**.

Notable Exceptions to the Final Rule

The final rule does not affect **existing non-competes for senior executives** - workers earning more than $151,164 annually who possess "policy-making authority," or "final authority to make policy decisions that control significant aspects of a business entity or a common enterprise." But the rule does prevent the imposition of non-competes in new agreements.

Another exception to the rule are non-competes for a **bona fide sale of a business**. Parties to a bona fide sale of (i) a business entity, (ii) person's ownership interest in a business entity, or (iii) all or substantially all of a business entity's operating assets may continue to enter into non-compete clauses in connection with the sale.

While certain industries, activities, and entities including **nonprofits** are outside of the FTC's jurisdiction, the FTC contends its ban on non-competes could apply to certain nonprofits, particularly healthcare entities. The FTC asserts nonprofit entities "are not categorically beyond the Commission's jurisdiction," including "some portion of the 58% of hospitals that claim tax-exempt status as nonprofits and the 19% of hospitals that are identified as State or local government hospitals." Relying on case law and FTC precedent, the FTC argues a nonprofit that claims tax exempt-status but is "organized for its own profit or that of its members" may come under the Commission's jurisdiction and the purview of its rule.

Efforts by the FTC to enforce the rule on nonprofits or other entities clearly excluded under the FTC Act will likely face legal challenges.

Challenges to the New Rule

The FTC Commissioners voted 3-2 along party lines on the non-compete rule with both Republican commissioners dissenting. Commissioners Melissa Holyoak and Andrew Ferguson argued that the rule is unlawful because Section 6(g) of the FTC Act does not give the FTC the authority to promulgate substantive rules. Commissioner Ferguson added that the rule also violates (i) the "major questions doctrine" because the FTC lacks clear authorization from Congress to promulgate the rule and (ii) the nondelegation doctrine because Congress cannot delegate its legislative powers to the FTC. Commissioner Ferguson also asserts that the rule is arbitrary and capricious in violation of the Administrative Procedure Act.

The new rule is also facing two lawsuits alleging similar concerns to the dissenting Commissioners. Ryan, LLC, a tax service firm, and ATS Tree Services LLC filed lawsuits in federal district courts in Texas and Pennsylvania, respectively, demanding vacating the rule and permanently enjoining the FTC from enforcing the rule. A coalition of the U.S. Chamber of Commerce and other business organizations also sued in Texas federal court, but the case was stayed because Ryan was "first-to-file" with similar claims.

The rule was published in the Federal Register on May 7, 2024, and is expected to go into effect September 4, 2024, unless delayed or prevented by the ongoing or potentially other legal challenges.

In anticipation of the rule going into effect, employers may want to consider the following:

- Adding or modifying other clauses in employment agreements to protect proprietary and sensitive information
- Identify those employees who may be considered senior executives under the rule, and all non-senior executive employees currently subject to a non-compete who will need to be notified
- Prepare written notifications for non-senior-executive employees subject to a non-compete; the FTC has offered a model notice

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