

FTC Final Rule May Still Face Historical Hurdles

By **Carl Hittinger, Marc Schildkraut and Tyson Herrold** (May 7, 2024)

On April 23, the Federal Trade Commission issued its much-anticipated final rule banning worker noncompetes. The final rule forwards the Biden administration's goal of reducing barriers to employee mobility.

In its justification for the rule, the commission argues that noncompetes reduce competition for workers, thereby depressing wages. The agency estimates that banning noncompetes would boost wages nationally by about \$53.3 billion per year, or \$524 per worker on average.

If the final rule takes effect, it will prohibit millions of noncompete agreements and prevent employers from entering into such agreements in the future.

The final rule defines noncompete contractual clauses as terms or conditions of employment that prevent workers from seeking or accepting work or operating a business after the conclusion of employment.

The final rule also applies to employer policies that have never been reduced to contractual clauses.

The commission states, however, that it is not categorically prohibiting less restrictive terms or conditions on employment, such as nondisclosure agreements, nonsolicitation clauses, training repayment agreement provisions or long-term employment contracts.

The FTC says the above are "well-established means to protect proprietary and other sensitive information" and can otherwise be used to incentivize an employer to invest in the human capital of its workers.

Nevertheless, the rule prohibits employers from adopting terms less restrictive than outright noncompetes that, in effect, are not actually less restrictive. If the condition on employment is "so broad or onerous that it has the same functional effect" as a noncompete clause, the rule prohibits it.

The commission will adjudicate whether a restrictive covenant is functionally a noncompete clause "case by case." The FTC notes that employers also can compete to retain employees by improving wages and working conditions, which, of course, is one of the rule's main goals.

Under the final rule, as with the proposed rule, the term "worker" is defined more broadly than "employee" and includes independent contractors, volunteers, interns and externs, apprentices, and sole proprietors.



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While it excludes "a franchisee in the context of a franchisor-franchisee relationship," meaning it might include agreements that franchisees will not compete with other franchisees, it covers employees of franchisors and franchisees. In addition, the final rule does not cover workers' concurrent employment.

The final rule would prevent employers from (1) entering into new noncompete clauses; (2) enforcing existing noncompete clauses; and (3) representing that a worker is subject to a noncompete based on company policy.

There are several exceptions, including (1) noncompetes ancillary to the sale of a business and (2) noncompetes predating the final rule with senior executives — workers who are in a policymaking position of the employer and who were compensated at least \$151,164 in the preceding year.[1]

Subject to this senior exception, the final rule would require employers to provide notice to workers covered by a noncompete that the noncompete is no longer enforceable. Notice must be provided within 120 days after the final rule's publication in the Federal Register.

The FTC does not intend for the rule to interfere with pending noncompete enforcement proceedings. And employers will not violate the rule by enforcing noncompete clauses where the employer has a good-faith belief that the rule does not apply.

There is no monetary penalty for a rule violation because under Section 6(g) the FTC only has authority to obtain injunctive relief.

The final rule does not apply to entities outside the commission's jurisdiction. This includes, in part or in whole, nonprofit entities, banks, savings and loan institutions, federal credit unions, common carriers, air carriers, and businesses subject to the Packers and Stockyards Act.

This was particularly an issue for for-profit hospitals that claimed they would be disadvantaged compared to nonprofit hospitals, which may continue to use noncompetes. The FTC "recognizes that not all entities in the healthcare industry fall under its jurisdiction," but did not provide any exception to the rule for profit-making hospitals.

The final rule contains several notable changes from the 2023 proposed rule. First, the limited senior executives exception noted above is new. The FTC found that senior executives are generally less likely to be exploited by noncompetes to the same extent as other workers.

Second, the final rule does not require a rescission agreement, i.e., requiring modification of existing agreements, as the proposed rule contemplated.

The commission found that such a requirement would present practical burdens for employers and could have unintended consequences regarding the other terms of existing labor contracts. Thus, the commission adopted the notice requirement discussed above.

Third, the FTC expanded the exception for the bona fide sale of a business, a transaction called "unique" by the commission and therefore no longer covered by the final rule.

Regardless of the final rule's fate, the FTC has authority under the Federal Trade Commission Act to challenge individual noncompetes. This can result in costly investigations and invasive consent decrees.

The move to ban noncompete agreements comes shortly after the FTC challenged noncompete agreements used by specific firms. In January[2] and March 2023,[3] the FTC filed actions against four companies — Anchor Glass Container Corp., Ardagh Group, Prudential Security and O-I Glass, Inc. — and multiple executives for imposing noncompete restrictions on workers.

Hurdles the FTC Will Face in Making the Final Rule Effective

The commission voted 3-2 to adopt the final rule, with the two Republican commissioners dissenting. Before resigning from the FTC in 2023, Commissioner Christine S. Wilson also voted against the proposed rule.[4]

These dissents offered blueprints to challenging the final rule. And indeed, challengers have already filed complaints in U.S. District Courts for Northern and Eastern Districts of Texas, in *Ryan LLC v. FTC* and *Chamber of Commerce v. FTC*, respectively.

In 2023, then-Commissioner Wilson criticized the proposed rule as a "radical departure from hundreds of years of legal precedent that employs a fact-specific inquiry into whether a noncompete clause is unreasonable in duration and scope, given the business justification for the restriction." [5]

All three dissenting commissioners were concerned with the scope of the rule. Take Commissioner Andrew N. Ferguson's oral statement, later reduced to writing, for example.[6]

Ferguson and his dissenting colleagues give several reasons for their dissenting votes. First, they argue, Section 6(g) only confers the power to make procedural rules, not to determine what conduct is prohibited.

Second, they assert, the final rule runs afoul of the major questions doctrine, which holds that a rule that regulates such "a significant portion of the American economy" must be enacted by Congress, or at least authorized by Congress in granting authority to the regulatory agency.

"Extraordinary grants of regulatory authority are rarely accomplished through 'modest words,' 'vague terms,' or subtle device[s]," Ferguson said — quoting from the U.S. Supreme Court's 2022 *West Virginia v. Environmental Protection Agency* decision, which quoted the high court's 2001 *Whitman v. American Trucking Association* decision.[7]

Third, they contend, the final rule is an unconstitutional delegation of legislative power.

Finally, they maintain that the rule is arbitrary and capricious under the Administrative Procedure Act because it is not supported by the evidence the commission cited to justify the final rule.

Section 5 of the FTC Act: Another Hurdle for the Final Rule?

Another potential obstacle to the final rule, one not mentioned in those dissents, concerns the commission's 2022 Statement of Enforcement Principles Regarding Unfair Methods of Competition Under Section 5.[8]

In 2015, the commission determined that unfair methods of competition "will be evaluated

under a framework similar to the rule of reason" used to evaluate restraints under Section 1 of the Sherman Act.[9]

Section 1 of the Sherman Act prohibits contracts, combinations or conspiracies that restrain trade. For quite a long time, the courts have applied two standard methodologies to evaluate restraints under Section 1: the rule of reason and the per se rule.

There are also gray areas where courts apply something in between the two rules, known as the truncated rule of reason or the quick look.

When the FTC replaced the 2015 statement in 2022, it abandoned the rule of reason approach. Instead, it determined that an unfair method of competition violates Section 5 if actors in the marketplace engage in competition that goes beyond the merits.

The two key criteria that establish whether the competition is beyond the merits are, first, whether the conduct may be coercive, exploitative, collusive, abusive, deceptive, predatory, restrictive or exclusionary; and second, whether the conduct "tends to foreclose or impair the opportunities of market participants, reduce competition between rivals, limit choice, or otherwise harm consumers." [10]

The commission applied these new Section 5 enforcement principles in its analysis justifying the ban on noncompetes although, in several respects, the commission's justification for the final rule went beyond these principles.

In other respects, however, there are substantial differences between the commission's 2022 enforcement principles as applied to justify the ban on noncompetes and the court-applied methodologies used to analyze conduct under Section 1.

To put this in context, we summarize how the courts apply the full-blown rule of reason in Sherman Act Section 1 litigation. The plaintiff has the initial burden of establishing that the defendant's contract, combination or conspiracy — collectively, agreements — adversely affected competition.

If a plaintiff meets its initial burden, the burden shifts to the defendant to show procompetitive effects of the agreement are so great that they outweigh the anticompetitive effects on consumer welfare. If so, the defendant prevails.[11] If not, the plaintiff prevails.

Typically, plaintiffs must prove there is an agreement. They then must prove that the defendant has market power. The analysis of market power typically begins with defining a product and geographic antitrust market,[12] and then establishes that the defendant has market power as a result of high market shares and barriers to entry into the market.[13]

Under certain circumstances, plaintiffs may attempt to prove the defendant's market power by demonstrating that the restraint resulted in prices above the competitive level — or below the competitive level if an agreement among buyers was depressing prices.

As noted, in some respects, the commission's justification for the final rule went beyond what the commission said it had to prove under its new Section 5 enforcement principles.

For example, the commission provided studies and other evidence asserted to show that wages would be higher without noncompetes.

The commission also provided evidence alleged to establish that the efficiencies of

noncompetes were not sufficient to justify the anticompetitive effects of noncompetes.

However, the commission did not define relevant antitrust markets and did not establish that all the employers subject to the final rule had market power.

Indeed, the commission could not do so: There probably would have been hundreds of thousands of markets that had to be defined, and even more employers whose market power would have had to be evaluated in those markets.

Many, maybe most, of the markets would not have been sufficiently concentrated to establish market power for any of the employers, at least under conventional methodologies.

As mentioned above, sometimes plaintiffs can meet their burden by proving direct anticompetitive effects of the agreement, such as the agreement causing prices above the competitive level. However, the agreements at issue in the final rule are vertical agreements as opposed to horizontal agreements.

A horizontal agreement is between competitors. A vertical agreement is an agreement between parties at two different levels of an industry — for example, between a supplier and a distributor, or in the case of noncompetes, between an employer and a worker.

In vertical agreements, Sherman Act plaintiffs must define the relevant antitrust market as the U.S. Supreme Court stated in its 2014 decision in *Ohio v. American Express Co.*[14]

Not only did the commission hesitate to define the relevant markets in justifying the final rule, but when the agreement at issue is vertical, it also seems doubtful that Sherman Act plaintiffs could prevail without proof of market power within the relevant market.[15]

To be sure, the commission's justification for the rule asserts that employers have market power, but the commission does so without defining relevant markets.

It will be difficult for the commission to defend its methodology where a multitude of employers have de minimis market shares in relevant antitrust markets. It is simply not consistent with decades of judicial precedents.[16]

It is also not consistent with precedents regarding the scope of unfair competition under Section 5 of the FTC Act. At an earlier time, the FTC had adopted an expansive interpretation of Section 5.

To understand the origin of these expansive interpretations, one must go back to the late 1960s, when Ralph Nader published a highly critical report about the FTC, arguing that the FTC was ineffective and passive; needed to prioritize high-impact problems and improve detection of such problems; and had to distance itself from business.[17]

This was followed by a 1970 American Bar Association report, which echoed many of the same themes.[18] This prompted the commission to change course: Beginning in the 1970s, a much more aggressive commission brought shared monopoly and other unfair competition lawsuits that went well beyond Section 1 of the Sherman Act.

All of these lawsuits failed. For example, in 1980, the U.S. Court of Appeals for the Second Circuit rejected the FTC's decision in *Official Airlines Guides v. FTC* because the anticompetitive conduct at issue was outside the market in which the respondent competed.

The court reached this conclusion even while upholding the commission's finding that the conduct was arbitrary and anticompetitive.[19]

Upholding the commission's decision, according to the court, "would give the FTC too much power to substitute its own business judgment for that of the monopolist in any decision that arguably affects competition in another industry." [20]

Soon after, the U.S. Court of Appeals for the Ninth Circuit, also in 1980, overturned the FTC decision in *Boise Cascade Corp. v. FTC* that respondent manufacturers violated Section 5 by noncollusively engaging in a delivered pricing system.[21]

The court held that the agency could neither condemn the practice without proving that prices were above the competitive level nor do so by applying a per se analysis.[22] In addition, according to the court, the commission's decision could not be sustained under a theory of incipient trade restraints.[23]

Finally, in 1984, the Second Circuit in *E.I. du Pont de Nemours & Co. v. FTC* rejected a commission decision that conduct encompassing uniform delivered prices, advanced notice of price increases, and most favored nation clauses represented unfair methods of competition because the practices resulted in supracompetitive prices.[24]

According to the court, the commission needed to, but failed to, elicit evidence of anticompetitive intent or of the absence of a legitimate business reason for the conduct.[25]

The court was also concerned that the FTC failed "to discriminate between normally accepted business practices and conduct that is unreasonable." [26]

It was not only the courts of appeal that were reining in the commission; Congress also cabined the consumer protection half of the FTC, enacting the Magnuson-Moss Warranty — Federal Trade Commission Improvement Act,[27] which requires consumer protection rules under Section 5 to be promulgated with enhanced procedural safeguards.

As a result, for over 40 years thereafter, the commission became much more cautious about its use of Section 5. And it is little wonder that the FTC's 2015 Unfair Methods of Competition statement limited the commission to Sherman Act methodologies.

The commission's 2022 updated Statement on Unfair Methods of Competition shows some commission awareness of the track record of the commission in the 1970s and '80s but relies on some general statements of those courts while ignoring their holdings.[28]

Arguably, under the 2022 Section 5 Enforcement Principles statement, the commission could find a violation of Section 5 for the conduct at issue in each of these cases.

The commission also may have some difficulty reconciling its final rule with those cases. For example, in *Official Airlines Guides*, the anticompetitive effect was outside the relevant market where the monopolist operated.

Obviously, one must define the market to understand where the monopolist operated. The commission did not define markets to justify its final rule.

Further, contrary to *Official Airlines Guides*, in justifying the final rule, the commission substituted its own judgment for the business judgment of employers.

In *Boise Cascade*, the court held that the FTC could not condemn the practice without proving that prices were above the competitive level.

The FTC supports the final rule by offering evidence that wages would rise if noncompetes were prohibited. But that is plausibly different from proving that noncompetes are depressing wages below the competitive level. In *E.I. du Pont de Nemours & Co*, the court required evidence of anticompetitive intent or the absence of a legitimate business reason for the practices at issue.

The commission does not support the final rule with evidence of anticompetitive intent and never asserts that employers lack legitimate business reasons for noncompetes; the commission only argues that prohibiting noncompetes would result in a net benefit to the economy.

The *du Pont* court also required the commission to discriminate between normally accepted business practices and conduct that is unreasonable. The commission could not do this to justify the final rule because employer-employee noncompetes are normally accepted business practices.

It is also worth pointing out that the commission has not litigated a single case under its 2022 statement regarding Section 5.

One might have thought, given past history, that the commission would have been more cautious when facing a mountain of judicial precedent justifying employer-employee noncompetes, attempting, at first, to select cases where the commission could apply the 2022 statement without directly challenging past precedents.

After prevailing in those cases, the commission could select additional cases that nibble at the edges of those precedents and only then engage in a full-frontal assault on past precedents.

But the commission appears to be in a hurry, engaging in a full-frontal assault now. We don't know yet whether the commission's tactics will succeed or its conduct will result in what the present FTC majority would see as another 40 years of antitrust dark ages.

Already, a House committee has voted to remove the FTC's antitrust jurisdiction.[29] Stay tuned.

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[1] To see a more fulsome discussion of the parameters of what positions qualify as a "senior executive," see Daryl Leon, "Client Alert: FtC Issues Final Rule Banning Non-Competes," Bakerlaw.com, available at [<https://www.bakerlaw.com/insights/ftc-issues-final-rule-banning-non-competes/>].

[2] <https://www.ftc.gov/news-events/news/press-releases/2023/01/ftc-cracks-down-companies-impose-harmful-noncompete-restrictions-thousands-workers>.

[3] <https://www.ftc.gov/news-events/news/press-releases/2023/03/ftc-takes-action-against-another-company-imposed-harmful-noncompete-restrictions-its-workers>.

[4] Procedurally, the Congressional Review Act permits Congress to review "major" rules within 60 days of the rule's publication in the Federal Register. A rule is "major" if the Office of Information and Regulatory Affairs (OIRA) determines it (1) has an annual effect on the economy of at least \$100 million; (2) results in major increases in costs or process for consumers, individual industries, federal, state, or local government agencies, or geographic regions; or (3) affects competition, employment, investment, productivity, or innovation, or on the ability of United States-based enterprises to compete internationally. OIRA has already made such a determination that this is a major rule. If both the House and Senate pass resolutions disapproving the rule, the resolution would be transmitted to the President, who could sign or veto it, and in the event of a veto, it could be overridden by a two-thirds majority in both houses of Congress. If the disapproval resolution is enacted, the Final Rule is rendered void and cannot be republished without Congressional approval.

[5] https://www.ftc.gov/system/files/ftc_gov/pdf/p201000noncompetewilsondissent.pdf.

[6] Our Constitution assigns Congress the legislative power because Congress answers to the people for its choices. . . . Thus, whenever we undertake to make rules governing the private conduct of hundreds of millions of people who do not vote for us, we should not begin with determining what the right answer to the policy question is. Rather, we must first assure ourselves of the power to answer the question at all. I do not believe we have the power to nullify tens of millions of existing contracts; to preempt the laws of forty-six States; to declare categorically unlawful a species of contract that was lawful when the Federal Trade Commission Act (FTC Act) was adopted in 1914; and to declare those contracts unlawful across the whole country irrespective of their terms, conditions, historical contexts, and competitive effects. https://www.ftc.gov/system/files/ftc_gov/pdf/p205405_hbnr_mhstmt_0.pdf.

[7] *West Virginia v. Env't Prot. Agency*, 597 U.S. 697, 723 (2022), (quoting *Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457, 468 (2001)).

[8] https://www.ftc.gov/system/files/ftc_gov/pdf/P221202Section5PolicyStatement.pdf.

[9] https://www.ftc.gov/system/files/documents/public_statements/735201/150813section5enforcement.pdf.

[10] <https://www.ftc.gov/legal-library/browse/ftc-policy-statement-unfairness>.

[11] See, e.g., *United States v. Visa U.S.A., Inc.*, 344 F.3d 229, 238 (2d Cir. 2003).

[12] See *Times-Picayune Publ'g Co. v. United States*, 345 U.S. 594, 611-13 (1953).

[13] See, e.g., *Sanderson v. Culligan Int'l Co.*, 415 F.3d 620, 622-23 (7th Cir. 2005).

[14] The plaintiffs argue that we need not define the relevant market in this case because they have offered actual evidence of adverse effects on competition . . . We disagree. The cases that the plaintiffs cite for this proposition evaluated whether horizontal restraints had an adverse effect on competition. . . . Vertical restraints often pose no risk to competition unless the entity imposing them has market power, which cannot be evaluated unless the Court first defines the relevant market. 138 S. Ct. 2274, 2285 n. 7 (2018).

[15] *Id.* at 2284 ("The rule of reason requires courts to conduct a fact-specific assessment of 'market power and market structure . . . to assess the [restraint]'s actual effect on competition.").

[16] Even a 30 percent market share was insufficient to establish market power in *Jefferson Parish Hosp. Dist. 2 v. Hyde*, 466 U.S. 2, 26-29 (1984).

[17] The Nader Report on the Federal Trade Commission, https://en.wikipedia.org/wiki/The_Nader_Report_on_the_Federal_Trade_Commission.

[18] *Id.*

[19] 630 F.2d 920 (2d Cir. 1980).

[20] *Id.* at 927.

[21] 637 F.2d 573 (9th Cir. 1980).

[22] *Id.* at 579.

[23] *Id.* at 581-82.

[24] 729 F.2d 128 (2d Cir. 1984).

[25] *Id.* at 139-140.

[26] *Id.* at 138-39.

[27] Pub. L. No. 93-637, 88 Stat. 2183 (1975).

[28] 2022 Statement at 7-8.

[29] <https://www.congress.gov/bill/118th-congress/house-bill/7737/text>.