# The FTC's Noncompete Rule Is Likely Dead On Arrival

By **Erik Weibust and Stuart Gerson** (April 26, 2024)

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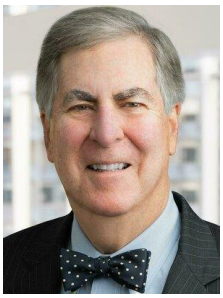

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The Federal Trade Commission issued its **final** noncompete rule on April 23.[1] As expected, it is very similar to the proposed rule announced in January 2023.[2] There are, however, a few changes, some more material than others.

First, the FTC included a very limited exception for preexisting noncompetes with senior executives — although not noncompetes with senior executives entered into after the effective date of the final rule. A senior executive is defined as "a worker who was in a policy-making position" and who received total annual compensation of at least $151,164. This is of marginal import, however, given that it is limited to preexisting agreements.

Similarly, the FTC excepted any causes of action that accrued before the effective date of the rule, which will likewise have a very limited impact given that there are only so many such claims.

And the FTC removed the requirement that employers rescind all existing noncompetes, but nevertheless requires employers to notify employees, in writing, that they are no longer enforceable and will not be enforced; in other words that is essentially just a change in nomenclature.

There are two — and perhaps a third — more impactful changes. First, the FTC removed the 25% equity threshold from the sale of a business exception, excluding all noncompetes entered into in connection with a bona fide sale of a business irrespective of the seller's ownership interest. This would bring it in line with California, and it addresses a big criticism of the proposed rule by the business community.

Second, the FTC removed the de facto noncompete language, but replaced it with a functional test for what constitutes a noncompete. This is likewise just a change in nomenclature and could be interpreted by the current or a future FTC to cover other types of restrictive covenants, such as nonsolicits.

Indeed, the FTC itself states that the definition "does not categorically prohibit other types of restrictive employment agreements, for example, NDAs, [training repayment agreement provisions], and non-solicitation agreements," yet it goes on to say that if an employer adopts a nonsolicitation agreement "that is so broad or onerous that it has the same functional effect as a term or condition prohibiting or penalizing a worker from seeking or accepting other work … such a term is a non-compete clause under the final rule."

Finally, the FTC set a 120-day effective date and compliance deadline, which replaced the previous 60-day effective date and 180-day compliance deadline.[3] This will be impactful only if the rule is not enjoined and goes into effect.

In other words, if it ever goes into effect — a big "if," as explained below — the rule will ban all noncompetes nationwide, with limited exceptions for noncompetes entered into in connection with the sale of a business and preexisting agreements with senior

executives.[4]

The rule will apply retroactively to invalidate all existing post-employment noncompetes with nonsenior executives, and requires employers to affirmatively notify affected employees.[5]

Unfortunately, the FTC does not appear to have seriously considered comments submitted by industry groups, chambers of commerce and other opponents of the proposed rule — or even, for that matter, the two dissenting commissioners and former Commissioner Christine Wilson.

The comments pointed out the FTC's lack of authority to promulgate the rule and the practical effects that doing so would have on companies in virtually every industry nationwide, not to mention the negative impact the rule will have on many employees.

Even if the FTC believes it has the authority to regulate noncompetes, it could have taken a narrower, more nuanced approach, such as by setting minimum compensation thresholds to protect low-wage workers, requiring advance notice to avoid employees learning of a noncompete after having resigned from a prior job, or similar reforms implemented by several states over the past decade or so.[6]

Indeed, simply extending the exception for senior executives prospectively would have gone a long way toward accomplishing this.

These narrower types of reforms are hardly controversial, and at the very least they could create a template for states to follow if the rule is invalidated.

But instead, the FTC decided to use a sledgehammer to kill a fly, and is attempting to ban noncompetes nationwide, irrespective of the consequences to the very people it is supposedly trying to help.

The U.S. Chamber of Commerce and a private employer, Ryan LLC, have already challenged the rule in federal court, one or both of which is likely to result in a nationwide injunction, and ultimately may very well end up before U.S. Supreme Court.[7]

These groups will have several meritorious arguments to pursue, which we discuss below. Thus, in our view, the rule is unlikely to go into effect anytime soon, if ever, provided the ideological makeup of the Supreme Court remains the same.

As we discussed even before the FTC issued its proposed rule in a July 2022 Law360 **guest article**, we believe there is a strong likelihood the Supreme Court will strike down the rule under the major questions doctrine.

The FTC's proposed rule having been issued, and its intended scope and effect having been touted by the Biden administration, we continue to believe that there is a substantial probability that the court would strike it down, applying the tenets of the major questions doctrine.

However, recent Supreme Court litigation suggests that the FTC's noncompete proposal might be just as vulnerable under a lesser standard of review.

**The FTC poses a major question that it cannot answer satisfactorily.**

Turning first to major questions analysis, we note that the jurisprudentially conservative wing of the court has in recent terms exhibited a preference to substantially limit, if not eliminate, deference to administrative and regulatory agencies in interpreting their enabling statutes.[8]

While not exactly returning to the Depression-era nondelegation doctrine of A.L.A. Schechter Poultry Corp. v. U.S. in 1935, the court has come close to doing so in adopting the major questions doctrine.

Classic nondelegation analysis focuses on the issue of whether the Congress even has the constitutional authority to delegate a particular function to an agency of another branch of government. The major questions doctrine homes in on whether, in a case of national economic import, Congress expressly and definitively has done so.

As Justice Neil Gorsuch **noted** in West Virginia v. U.S. Environmental Protection Agency in 2022: "an agency must point to clear congressional authorization when it seeks to regulate 'a significant portion of the American economy.'"[9]

In a July 9, 2021, executive order directing a ban on noncompetes, and in reliance upon related reports issued by the U.S. Department of the Treasury, the Biden administration leaves no doubt about the fact that the proposed ban would have precisely that effect on the economy, encompassing "[r]oughly half of private-sector businesses" and as many as 60 million workers.[10]

In applying the major questions doctrine, the Supreme Court held in West Virginia v. EPA that "something more than a merely plausible textual basis for the agency action is necessary. The agency instead must point to 'clear congressional authorization' for the power it claims."[11]

To determine whether "an agency action involves a major question for which clear congressional authority is required," a court must analyze three questions:

1. Does the agency claim the power to resolve a matter of "great political significance"?

2. Does the agency seek to regulate a "significant portion of the American economy"?

3. Does the agency seek to "intrude on an area that is the particular domain of state law"?[12]

If the answer to these questions is yes, Congress must have clearly authorized the agency's action.

Here, the FTC bases its purported authority on Section 5 of the FTC Act, which empowers it to regulate unfair methods of competition.[13] The FTC asserts that the use and enforcement of noncompete agreements by employers constitutes an unfair method of competition, irrespective of the surrounding facts and circumstances.

Echoing President Joe Biden's reference to banning noncompetes in his 2023 State of the Union address, the issue is, by definition, one of national political significance. The FTC and the administration concede the national economic significance of the proposal.

Indeed, their stated intention is to bring about a major economic result, affecting a vast number of American businesses and employees.

Moreover, the FTC is seeking to intrude in an area that, for over 200 years, has been the particular domain of the states, with Minnesota being the only state in the past 133 years to ban noncompetes.[14]

Nothing in the text of Section 5 of the FTC Act authorizing the FTC to regulate unfair methods of competition enunciates a "clear congressional authorization" to regulate, much less ban, noncompetes — which, historically have been a well-entrenched feature of the national economy, as the FTC admits, and the historical province of the states.

Thus, the FTC does not have the authority to do so, and so clearly cannot clear the major questions bar.

The FTC summarily dismissed any arguments concerning its authority with the following bald, conclusory statement:

> Having considered the factors that the Supreme Court has used to identify major questions, the Commission concludes that the final rule does not implicate the major questions doctrine. And even if that doctrine did apply, the Commission concludes that Congress provided clear authorization for the Commission to promulgate this rule.

But simply saying so does not make it true.[15]

**The FTC rule also fails a lesser test recently highlighted in the Supreme Court.**

The major questions doctrine, which applies by definition to cases of major national import, is something of an exception to the more typical analysis by which the current Supreme Court approaches unclear legislative text.

Indeed, as Justice Brett Kavanaugh noted in West Virginia v. EPA, if not for the presence of a major question, the federal courts would generally afford deference to an agency's interpretation of an ambiguous statute under the 1984 Chevron U.S.A. Inc. v. Natural Resources Defense Council Inc. ruling.

However, while often applied by the lower federal courts to matters that involve matters of technical, scientific or medical expertise that courts lack so-called Chevron deference, as Chief Justice John Roberts noted in a recent hearing, is not often applied by the Supreme Court itself.

Thus, Chevron merited only a passing footnote reference in the West Virginia case, and didn't figure in the outcome of two recent healthcare cases: Becerra v. Empire Health Foundation and American Hospital Association v. Becerra in 2022.

Thus, in a per curiam opinion in National Federation of Independent Business v. Department of Labor, Occupational Safety and Health Administration that same year, the court struck down a national COVID-19 mandate without reference to the major questions doctrine or even Chevron, simply by examining legislation that nowhere authorized the agency to act across the entire national economy.

As the court stated: "We expect Congress to speak clearly when authorizing an agency to exercise powers of vast economic and political significance."[16]

Whatever the breadth of OSHA's authority was, it did not clearly include a regulation of the

scope that the agency had issued. The same is true of the FTC's authority to regulate noncompetes.

Overhanging all of this discussion is the fact that the Supreme Court has heard argument and is considering overruling or substantially constricting the scope of Chevron deference in two pending cases: Loper Bright Enterprises v. Raimondo and Relentless Inc. v. U.S. Department of Commerce.

Both in light of the questions asked during oral argument and the court's 2019 decision in Kisor v. Wilkie, concerning agency deference with respect to their interpretation of ambiguous regulations, it is not unlikely that the court will more strongly emphasize text and rigid analysis of text to avoid ambiguities.

Thus, as Justice Elena Kagan wrote for the court in Kisor, text takes strong preference over deference. Where regulations don't clearly reflect authority, that is not an automatic default to deference; the agency likely will lose the case at that point.

**What about the Administrative Procedure Act?**

We have demonstrated that the FTC's proposed ban on noncompetes is vulnerable to rejection under the major questions doctrine because of its intended broad national impact and the lack of clear congressional language authorizing it.

We have also shown that several recent cases have made it clear that, in analogous circumstances, the FTC would fail even if there were no major questions doctrine.

Nor, given the evolution of the law concerning deference, would the FTC's interpretation of the law prevail, even if Chevron were applied. And the rule's already doubtful fate under Chevron would be even more probable if, as seems to be the case, Chevron is overruled or narrowed in the manner of Kisor v. Wilkie.

Even putting those formidable barriers aside, we submit that the FTC would fail if all a court examined were the rulemaking provisions of the Administrative Procedure Act.

The APA requires that a "reviewing court shall ... hold unlawful and set aside agency actions, findings, and conclusions found to be ... arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[17]

Here, the FTC's rule is arbitrary and capricious because it is based entirely on cherry-picked academic studies and surveys that are flawed in important ways and simply do not support a broad reaching ban of all noncompetes nationwide, while ignoring other studies and surveys that undermine its worldview.

Moreover, as we have shown, the FTC is not entitled to any deference with respect to its view of a statute that does not clearly assign to it the power it claims.

Specifically, as we wrote in Law360 guest articles in **January 2023** and **January 2024**, the studies and surveys cited by the FTC are flawed for a variety of reasons, including that "those surveyed may confuse noncompetes with other forms of restrictions, including nondisclosure and nonsolicitation covenants, claiming to be bound by noncompetes when they, in fact, are not" and that "the surveys do not isolate noncompetes from these other types of restrictions."[18]

As Wilson accurately noted in her dissent to the proposed rule, "the current record shows that studies in this area are scant, contain mixed results, and provide insufficient support for the scope of the proposed rule."[19]

By cherry-picking and overstating the findings of flawed academic studies and surveys that support its policy preferences while ignoring those that do not, the FTC is overlooking potential benefits certain types of employees receive from agreeing to noncompetes, and harming those employees by banning noncompetes.

While this consequence may not have been something the FTC considered when it initially proposed the rule in January 2023, the issue has been raised in formal comments submitted to it since — not to mention in public statements by the authors of this article and others.[20]

In other words, assuming the FTC reviewed the comments submitted to it by the public, as it is required by law to do,[21] the FTC is moving forward with the rule despite the negative impact it undoubtedly will have on many employees.

If the Supreme Court addresses this argument, we believe it is likely to find that the rule is arbitrary and capricious.

**The retroactivity of the rule will cause chaos.**

Finally, the rule is retroactive, and would thus invalidate existing noncompete provisions in employment agreements, long-term incentive plans and potentially other types of agreements.

Practically speaking, this would create enormous chaos nationwide, as employers seek new and potentially creative ways to protect their legitimate business interests.

They will also have to contend with whether, for example, employees are entitled to long-term incentive compensation — e.g., stock grants and options — where the primary or sole consideration for that compensation was the employee's execution of a reasonable noncompete.

In other words, this rule could have a major negative effect on hundreds of thousands, if not millions, of employees who could lose valuable benefits — the very people the FTC is purporting to be standing up for — and could call into question the effect of prior merger and acquisition transactions.

Again, while these consequences may not have been something the FTC considered when it initially proposed the rule, they have been discussed in formal comments and public statements since, and are something the FTC undoubtedly is aware of.[22]

And because the rule would invalidate existing contracts, it can be challenged under the Fifth Amendment takings clause.[23] The takings clause provides that the government may not take private property "for public use, without just compensation."[24]

A taking can be physical in nature, such as taking property for a public utility, or regulatory in nature, such as imposing certain restrictions on the use of property.[25]

The Supreme Court has held that companies have property rights in their contracts.[26] Thus, a regulation that invalidates existing noncompetes arguably constitutes a regulatory

taking, and the government may be required to pay just compensation to every employer in the country that utilizes them.

It is difficult to imagine how time-consuming and costly it would be just to value the hundreds of thousands, if not millions, of invalidated agreements, much less compensate employers for the taking. Yet again, this issue was raised to the FTC in comments and public statements.[27]

These are but a few of the arguments opponents of the FTC's noncompete rule have raised and can be expected to raise in future lawsuits.

Assuming the current ideological makeup of the Supreme Court remains, we expect that it is highly probable that, if not already negated in the lower courts, the Supreme Court will strike down the rule and the administration will have to go back to the drawing board.

Perhaps in response to these meritorious legal arguments being raised in comments and otherwise, the National Labor Relations Board has already begun targeting companies that utilize noncompetes, contending that doing so constitutes an unfair labor practice.[28]

Other agencies may similarly get in on the act, although they undoubtedly will face the same legal challenges and industry pushback that the FTC is facing, and may very well suffer the same fate.

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[1] www.law360.com/articles/1828527.

[2] Id. For a detailed discussion of the proposed rule, see https://www.tradesecretsandemployeemobility.com/will-the-ftc-ban-noncompetes-what-employers-need-to-know-about-the-proposed-rule and https://www.wlf.org/2023/01/11/publishing/after-200-years-under-state-law-ftc-proposes-to-sweep-away-all-noncompetes-in-unauthorized-federal-power-grab/.

[3] Id.

[4] Id.

[5] Id.

[6] For example, Colorado Illinois, Maine, Massachusetts, New Hampshire, Oregon, Virginia, Washington, and Washington, D.C. require advance notice, and the same states plus Maryland, Nevada, and Rhode Island have instituted minimum compensation thresholds.

See https://ebglaw.com/50-state-noncompete-survey-download; see also https://faircompetitionlaw.com/wp-content/uploads/2024/01/BRR-20231203-State-Low-Wage-Worker-Criteria-Expected-for-2024-corrected-20240114.pdf; https://faircompetitionlaw.com/wp-content/uploads/2023/02/Noncompete-Notice-Requirements-Chart-20230205-1.pdf.

[7] Suzanne P. Clark, "The Chamber of Commerce Will Fight the FTC," Wall Street Journal (Jan. 22, 2023), available at https://www.wsj.com/articles/chamber-of-commerce-will-fight-ftc-lina-khan-noncompete-agreements-free-markets-overregulation-authority-11674410656.

[8] See, e.g., Gundy v. United States, 139 S. Ct. 2116, 2130-48 (2019) (Alito, J., concurring; Gorsuch, Roberts, and Thomas, JJ., dissenting).

[9] 597 U.S. 697, 744 (June 30, 2022) (Gorsuch, J. concurring).

[10] https://www.whitehouse.gov/briefing-room/statements-releases/2021/07/09/fact-sheet-executive-order-on-promoting-competition-in-the-american-economy/

[11] West Virginia v. EPA, 597 U.S. at 723.

[12] Id., at 743-45.

[13] 15 U.S.C. § 45(a)(2).

[14] Minnesota banned noncompetes in July 2023. The other states that have done so are California (1872), North Dakota (1865), and Oklahoma (1890). Michigan legislatively banned noncompetes in 1905, but the legislature repealed the law in 1985. Both the District of Columbia Council and the New York Legislature passed legislation banning noncompetes in 2020 and 2023, respectively, but the former was amended and watered down substantially to include minimum compensation thresholds and notice requirements, and New York's governor vetoed the latter.

[15] This other conclusory statement is particularly rich: "Additionally, non-competes have already been the subject of FTC scrutiny and enforcement actions, so subjecting them to rulemaking is a more incremental — and thus less significant — step than it would be for an agency to wade into an area not currently subject to its enforcement authority." The first time the FTC announced an enforcement action involving noncompetes was one day before it announced the proposed noncompete rule in January 2023. Some experience that is.

[16] Alabama Assn. of Realtors v. Department of Health and Human Servs., 594 U.S. ___, ___ (2021) (per curiam) (slip op., at 6) (internal quotation marks omitted).

[17] 5 U.S.C. § 706(2)(A).

[18] To be sure, this has little to do with the design of these surveys, which do seek to isolate noncompetes, and more to do with the fact that even sophisticated actors often confuse noncompetes with other, lesser, restrictions, or fall into the trap of using the term "noncompete" colloquially to refer to a broader array of post-employment restrictive covenants.

[19]
See https://www.ftc.gov/system/files/ftc_gov/pdf/p201000noncompetewilsondissent.pdf ("I

am dubious that three unelected technocrats have somehow hit upon the right way to think about non-competes, and that all the preceding legal minds to examine this issue have gotten it wrong.").

[20] See, e.g., Final Transcript of January 9, 2020 FTC Workshop ("FTC Workshop Tr.") — "Non-competes in the Workplace: Examining Antitrust and Consumer Protection Issues," p. 158-59, available at https://www.ftc.gov/system/files/documents/public_events/1556256/non-compete-workshoptranscript-full.pdf ("[W]hen you compare workers who have signed a non-compete to those who haven't, you have to worry that there are other differences between those workers, not just whether they have signed the non-compete, which could be driving any outcomes you observe ... . And it makes it really tricky, and I don't think we really have any great studies so far that really isolate random variation in the use of non-competes ... ."); Russell Beck, et al., "Written Submission of Practicing Attorneys Concerning Potential Federal Regulation of Noncompetition Agreements" ("Practicing Attorney Letter"), at 24-25, available at https://faircompetitionlaw.com/wp-content/uploads/2023/04/FTC-20230419-Joint-Submission-of-Trade-Secret-Lawyers-Beck-et-al.pdf ("A major source of confusion that permeates existing research is that people often conflate or confuse noncompete agreements with nondisclosure agreements and nonsolicitation covenants... . This confusion is a potential foundational problem in the data used in many of [the] studies assessing the effects of noncompetes, as the agreements being compared are not necessarily all noncompetes, much less noncompetes with the same time, scope, or geographic restrictions.").

[21] 5 U.S.C. § 553; see also Perez v. Mortg. Bankers Ass'n, 575 U.S. __, 135 S. Ct. 1199, 1203 (2015) ("An agency must consider and respond to significant comments received during the period for public comment.")

[22] See, e.g., Practicing Attorney Letter, at 51 ("[I]f a ban were to go into effect, employers will, at that time, presumably suspend mid-stream any benefits still to be provided in exchange for the noncompete, terminate all unvested options and stock provided in exchange for the noncompete, and cancel bonuses agreed to in exchange for the noncompete.").

[23] The Contracts Clause would not apply here because it only applies to the states, not the federal government.

[24] U.S. Const. amend. V.

[25] See Penn Cent. Transp. Co. v. City of New York, 438 U.S. 104, 124-28 (1978).

[26] See Cienega Gardens v. U.S., 331 F.3d 1319, 1329-30, 1334 (Fed. Cir. 2003) (noting that there is ... ample precedent for acknowledging a property interest in contract rights under the Fifth Amendment") (citing Lynch v. U.S., 292 U.S. 571, 579 (1934) ("The Fifth Amendment commands that property be not taken without making just compensation. Valid contracts are property, whether the obligor be a private individual, a municipality, a State or the United States."); U.S. v. Petty Motor Co., 327 U.S. 372, 381 (1946) (holding that plaintiff was entitled to just compensation for government's taking of option to renew a lease); U.S. Trust Co. of N.Y. v. New Jersey, 431 U.S. 1, 19 n. 16 (1977) ("Contract rights are a form of property and as such may be taken for a public purpose provided that just compensation is paid.")).

[27] See, e.g., Comments of the U.S. Chamber of Commerce, available

at https://www.uschamber.com/assets/documents/FTC-Noncompete-Comment-Letter_FINAL_04.17.23.pdf; Comments of the American Hospital Association, available at https://www.aha.org/system/files/media/file/2023/02/aha-comments-on-ftc-proposed-non-compete-clause-rule-letter-2-22-23.pdf; Comments of the New Civil Liberties Alliance, available at https://nclalegal.org/wp-content/uploads/2023/04/2023.04.19-NCLA-comments-re-FTC-Noncompete-Rule-Final.pdf; Comments of the Workplace Policy Institute, available at https://www.littler.com/files/wpi_ftc_comments.pdf.

[28] Additional information about the NLRB's actions (as well as the FTC's) can be found on Epstein Becker & Green's blog, Trade Secrets & Employee Mobility: https://www.tradesecretsandemployeemobility.com/nlrb-general-counsel-issues-memo-targeting-noncompete-agreements-for-nonmanagerial-and-nonsupervisory-employees; https://www.tradesecretsandemployeemobility.com/nlrb-finds-its-first-noncompete-targetand-its-charges-go-well-beyond-an-overbroad-noncompete; https://www.tradesecretsandemployeemobility.com/preemption-questions-continue-as-ftc-and-nlrb-fight-restrictive-covenants; https://www.tradesecretsandemployeemobility.com/nlrb-issues-complaint-against-company-for-maintenance-and-enforcement-of-noncompete-and-non-solicit-provisions, as well as on the firm's monthly podcast, Spilling Secrets: https://www.tradesecretsandemployeemobility.com/spilling-secrets-podcast-nlrb-general-counsel-issues-memo-on-non-competes.