

# WEISS



**AUGUST 30, 2024**

Dear Jessa,

There's far more to the non-compete story than the court order knocking out the FTC's rule banning them.

That was the subject of Monday's blog post, **You Need to Know What the Order Striking the FTC's Ban on Non-Competes Means For You**. You can follow the link to read the post online, or just keep reading.

Sources from the *Wall Street Journal* to, probably, the throwaway paper that serves as a wrapper for supermarket advertisements, featured the news that on August 20, 2024, a federal District Court in Texas issued a nationwide order striking the Federal Trade Commission's Final Rule banning non-compete agreements.

But I've yet to see one report that explains what this really means for you. Keep reading to find out.

## **Background**

On January 5, 2023, the U.S. Federal Trade Commission ("FTC") proposed a broad new rule banning employers from imposing non-compete provisions on their workers. The rule would supersede all state laws, except to the extent that a state's law gives workers greater rights.

Note that per the proposed rule, "employer" and "worker" are not limited to the true employer-employee relationship, and include subcontractor and independent contractor relationships as well.

Subsequently, the proposed rule, with some modification, was finalized (the "Final Rule") and set to go into effect on September 4, 2024.

As was to be expected, litigation ensued over the FTC's authority to issue the Final Rule. In the case at hand, brought by Ryan, LLC and joined by plaintiff-intervenors including the U.S. Chamber of Commerce, the plaintiffs initially obtained an injunction against the FTC's enforcement of the rule against them alone. The case moved forward until last week, when the judge granted the plaintiffs' motion for summary judgment and issued an order completely setting aside the Final Rule; in laymen's terms, the court blocked the Final Rule from taking effect as to anyone.

## If You Want To Know Why, Read This Section

The court's decision was based on two major grounds.

The first ground was the scope of the FTC's statutory authority to adopt rules. Congress enacted the Federal Trade Commission Act (the "Act") in 1914. It contains multiple sections granting authority to the FTC.

Section 5 of the Act prohibits "unfair methods of competition" and grants the FTC enforcement authority via adjudication. Section 6 of the Act is entitled "Additional powers of Commission", and grants the FTC certain administrative-type powers including, at Section 6(g), the power to "from time to time classify corporations and . . . to make rules and regulations for the purpose of carrying out" the FTC Act.

In adopting the Final Rule, the FTC asserted that Section 6(g) empowers the FTC to make *substantive* rules related to unfair methods of competition.

However, the court disagreed, finding that Section 6(g) is a "housekeeping statute" that does not confer "substantive rulemaking power." Therefore, the FTC exceeded its statutory authority in adopting the Final Rule.

*The second ground* for the court's decision was that it found the Final Rule to be "arbitrary and capricious" under the law governing agency rulemaking, the Administrative Procedure Act (the "APA"). It came to that conclusion because it found that the Final Rule is "unreasonably overbroad without a reasonable explanation. [It] imposes a one-size-fits-all approach with no end date, which fails to establish a 'rational connection between the facts found and the choice made.'"

The court stated that, in "enacting the Final Rule, the Commission relied on a handful of studies that examined the economic effects of various state policies toward non-competes. . . . The record shows no state has enacted a non-compete rule as broad as the [Final Rule]. . . . The FTC's evidence compares different states' approaches to enforcing non-competes based on specific factual situations—completely inapposite to the [Final Rule's] imposition of a categorical ban. . . . As to this latter point, the FTC provides no evidence or reasoned basis. The Commission's lack of evidence as to why they chose to impose such a sweeping prohibition—that prohibits entering or enforcing virtually all non-competes—instead of targeting specific, harmful non-competes, renders the Rule arbitrary and capricious."

## OK, So What Does This Mean for You?

As to the Final Rule itself, that is, a nationwide prohibition on non-competes, it certainly means that *current* enforcement is dead, but until the deadline for the government to appeal and, if so, the outcome of that appeal, it can't be known for certain whether the Final Rule will, either Phoenix-like or Dracula-like, depending upon your position, rise from the dead.

However, even if the Final Rule is completely dead, that does not mean that the issue itself is dead because, depending on what particular state law applies, non-competes and other restrictive covenants might or might not be enforceable. In other words, things are more complicated than a narrow focus on the FTC's Final Rule.

According to the U.S. Chamber of Commerce, 46 states permit non-compete clauses. However, it's certainly the fact that some of those states permit non-competes only under certain limited circumstances, as do, for example, California and Texas.

But the reality, for both businesses and workers, or in the context in which most of our clients do business, hospitals and medical groups on the one hand, and physicians and other professionals on the other hand, is even more complex.

That's because despite the fact that some of these states have strong prohibitions against the enforcement of non-competes, California being the classic example, there are, depending upon the particular state, still ways to create agreements that can function as proxies for non-competes.

Note that these issues are not only dependent upon the particular state law that governs, but also the particular facts involved. It's a significant issue but it can have significant benefits for businesses and can have particular implications, sometimes "bad" and, perhaps surprisingly, sometimes of benefit, for the "worker".

If you wish to discuss your particular situation, please **contact me**.

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Click below to watch the video version.



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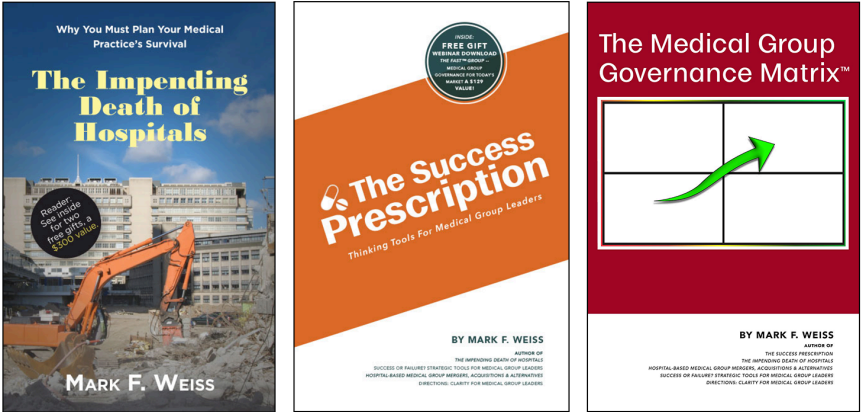
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