

Federal Trade Commission Non-Compete Clause Rule May Exempt Certain Nonprofit and Other Types of Employers

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As covered in an earlier client alert by our firm, The Federal Trade Commission (FTC)'s final Non-Compete Clause Rule—if it survives legal challenges and becomes effective—would ban most post-employment non-compete agreements for most workers throughout the country. The final rule bans post-employment non-compete agreements after the effective date of the rule and retroactively voids existing non-compete agreements other than those with "senior executives" as defined by the rule. Importantly, however, certain types of entities are exempt from the rule if they fall outside the jurisdiction of the FTC.

The final rule prohibits any "person" from requiring an unlawful non-compete, and the rule defines the term "person" to mean "any natural person, partnership, corporation, association, or other legal entity within the Commission's jurisdiction, including any person acting under color or authority of State law." In turn, the FTC Act, pursuant to which the final rule is being issued, only applies to an entity "organized to carry on business for its own profit or for that of its members."

Based on this language, bona fide nonprofit organizations will likely be able to claim exemption from the Non-Compete Clause Rule. Significantly, this exemption would likely extend to nonprofit health systems, which have traditionally sought to include non-compete clauses in contracts with senior executives and medical practitioners. Nonprofits should take care, however, to do a careful coverage analysis because, in announcing the Non-Compete Clause Rule, the FTC stated that merely claiming nonprofit status, and/or receiving recognition of tax-exempt status from the IRS is not, in and of itself, sufficient to exempt an organization from the FTC Act and the Non-Compete Clause Rule. The FTC pointed to caselaw holding that, if the organization confers more than incidental private benefits to itself or its members (or other insiders, including for-profit businesses), the organization is subject to FTC jurisdiction. In addition, the FTC noted that it uses a two-part test to determine if an entity is organized for profit for purposes of the FTC's jurisdiction, which includes evaluating (i) whether the organization "is organized for and actually engaged in business for only charitable purposes" and (ii) whether "either the corporation or its members derive a profit." The FTC also cited caselaw that stated the question of whether an entity qualifies for tax-exempt status under the Internal Revenue Code is "analogous" to the question of whether an entity is subject to the FTC's



jurisdiction, but IRS recognition of an entity's tax-exempt status is not controlling. Given this, if presented with an appropriate test case, the FTC might seek to assert jurisdiction over nonprofits engaged in relatively commercial activities, even if they are recognized by the IRS as tax-exempt.

Apart from nonprofit organizations, a few other categories of entities may have exemptions based on falling outside of FTC jurisdiction. The FTC Act provides, at 15 U.S.C. §45(a)(2), certain entities exempt from the Act's coverage, including certain banks and savings and loan institutions, certain common carriers, and some entities subject to the Packers and Stockyards Act.

It will be important to watch for additional developments on the effectiveness of the Non-Complete Clause Rule and its scope of coverage. Lawsuits have already been filed challenging the Non-Compete Clause Rule and the FTC's authority to issue the rule.

Entities that may be exempt from the FTC Act and final Non-Compete Clause Rule should, apart from tracking further developments related to the rule, also consider the implications of any applicable state law. Even if a nonprofit or other type of entity is exempt from the FTC Act and the FTC's Non-Compete Clause Rule, state law may cover that entity and ban or restrict noncompetition and/or nonsolicitation agreements. As an example, Minnesota banned noncompetition agreements with employees and contractors effective July 1, 2023, and the state law applies to all types of employers. Minnesota's law does not apply to non-compete agreements entered before the effective date of that law.

If you have any questions about the application of the new FTC rule, please contact any of the authors listed above or your regular Lathrop GPM attorney.