FTC's Rule Banning Non-Compete Agreements Is "Set Aside" Nationwide in District Court Ruling, But Two District Courts Find FTC Likely Has Authority to Issue Rules Prohibiting Unfair Methods of Competition

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The Federal Trade Commission's (the FTC) rule prohibiting the entering into or enforcement of non-compete clauses between employers and employees (the Non-Compete Rule) made final in April 2024 and originally scheduled to go in effect on September 4, 2024, was recently "set aside" by the district court in *Ryan, LLC v. Federal Trade Commission*. Memorandum Opinion and Order, on August 20, 2024. Employers will not be required to comply with the Non-Compete Rule unless the district court's order is overturned. The FTC is considering appealing, but, as of this writing, has not. (The Commission's Non-Compete Rule is set forth at 16 C.F.R. §910. The scope of the Non-Compete Rule is discussed in a prior article authored by Bilal Sayyed and Peter Bariso, *FTC Adopts Broad Ban on the Use of Non-Compete Clauses in Employment Agreement* (Apr. 24, 2024).)

The Ryan Court's Opinion

On July 3, 2024, the same court had preliminarily enjoined enforcement of the Non-Compete Rule against Ryan (and certain plaintiff-intervenors), but had reserved judgment on the ultimate merits of the Non-Compete Rule. The decision is discussed in a prior article authored by Bilal Sayyed, *District Court Issues Limited Preliminary Injunction in First Challenge to FTC Rule Prohibiting Use and Enforcement of Non-Compete Clauses* (Jul. 10, 2024).

In its decision on the merits, the court identified two grounds for setting aside the Non-Compete Rule.

First, the FTC's effort to prohibit non-compete clauses through the adoption of a rule prohibiting them as an unfair method of competition failed because the FTC lacked authority to create *any* rule prohibiting conduct as an *unfair* method of competition. The court "after reviewing the text, structure, and history of the [Federal Trade Commission] Act, … concludes the FTC lacks the statutory authority to create substantive rules." The provision the FTC relied on to support creation of the Non-Compete Rule was "a housekeeping statute, authorizing what the [Administrative Procedure Act] terms rules of agency organization procedure or practice as opposed to substantive rules."

Second, the FTC failed to consider alternatives to the Non-Compete Rule, and thus, as advanced, it was "arbitrary and capricious." According to the court, "the [Non-Compete] Rule is arbitrary and capricious because it is unreasonably overbroad without a reasonable explanation" and "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 also found that "the Commission's lack of evidence as to why they chose to impose such a sweeping prohibition … instead of targeting specific, harmful non-competes, renders the [Non-Compete] Rule arbitrary and capricious." The court further found the rule-making record "shows that the FTC failed to sufficiently address alternatives to issuing the [Non-Compete] Rule" and thus the court "[could not] conclude the Non-Compete Rule falls within a zone of reasonableness nor [that it is] reasonably explained."

Having so determined, "the Court must hold unlawful and set aside the FTC's Rule"; consistent with recent Fifth Circuit precedent "setting aside agency action … has nationwide effect, is not party-restricted, and affects all persons in all jurisdictions equally."

Two Earlier District Court Opinions Disagree With the Ryan Court's Rejection of FTC Rule?Making Authority

In earlier decided matters, two other district courts reviewing plaintiffs' requests for a preliminary injunction against enforcement of the Non-Compete Rule signaled a different view on the merits of the Commission's authority to adopt any rule defining and prohibiting conduct as an unfair method of competition. However, they reached different conclusions on whether the Commission properly adopted the Non-Compete Rule.

In *ATS Tree Services LLC v. Federal Trade Commission*, on July 23, 2024, the district court in the eastern district of Pennsylvania rejected ATS's request for a preliminary injunction against enforcement of the Non-Compete Rule, finding that ATS was unable to show irreparable harm (a requirement to grant a preliminary injunction) and that it was unlikely to prevail on the merits of their claim that the FTC exceeded its authority in promulgating the Non-Compete Rule.

In contrast to the district court's conclusion in *Ryan*, the *ATS* court found "it clear that the FTC is empowered to make both procedural and substantive rules as is necessary to prevent unfair methods of competition." The court also rejected ATS's alternative arguments: (i) that the Non-Compete Rule ran afoul of the Major Questions Doctrine; (ii) that "reasonable non-compete agreements are fair" and should be reviewed on a case-by-case basis, and (iii) that the FTC overstepped its authority by displacing state law.

In *Properties of the Villages v. Federal Trade Commission*, on August 14, 2024, the district court for the middle district of Florida (Ocala Division) granted plaintiff's request for a preliminary injunction against enforcement of the Non-Compete Rule. However, like the *ATS* court, it rejected plaintiff's argument that the FTC did not have authority to promulgate rules prohibiting conduct as an unfair method of competition, finding "the various components of the statute show Congress conferred at least some form of substantive rule-making authority to the FTC with regards to unfair methods of competition."

However, the court accepted an alternative argument of plaintiff – that the "sweep and breadth of the [Non-Compete Rule] … presents a major question." The court relied largely on the FTC's discussion of the scope and potential impact of the Rule in finding that its adoption raised a "major question." The court also found that the statutory language relied on by the Commission, "by its text, placement, content, and history, falls short" of supporting a grant of Congressional authority to issue the Rule. Neither court has indicated when it will issue a decision on the merits of the Non-Compete Rule.

Prospect of Supreme Court Review of FTC Rule-Making Authority Is High

While the FTC appears to be struggling to make the case for its authority to promulgate the Non-Compete Rule, it also appears to be succeeding, on balance, in convincing courts that it has authority to make rules prohibiting unfair methods of competition. If continued, this would be a significant victory for the Commission, as it presently has a significant interest in promulgating a broad array of rules prohibiting conduct believed to be anticompetitive, but for which case?by?case adjudication is time-consuming and usually requires a showing of, or likelihood of, anticompetitive effects.

Fifty years ago, the D.C. Circuit Court of Appeals in *National Petroleum Refiners Ass'n. v. Federal Trade Commission*, held that the Commission had authority to issue rules prohibiting unfair methods of competition. *National Petroleum Refiners Association v. Federal Trade Commission*, 482 F.2d 672 (D.C. Cir. 1973). Many persons who filed comments during the FTC's rule-making process for the Non-Compete Rule suggested it was unlikely that courts would reach the same conclusion today. That the *ATS* and *Properties of the Village* courts both found the FTC has substantive rule-making authority is a significant development in the Commission's efforts to expand the scope of its antitrust enforcement agenda, notwithstanding the *Ryan* court's setting aside of the Non-Compete Rule. Notably, if the Fifth Circuit upholds the *Ryan* court's decision, there will be an appellate split on this question, suggesting Supreme Court review is, at some point, inevitable.

DOJ Announces Corporate Whistleblower Awards Pilot Program

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On August 1, 2024, the U.S. Department of Justice (DOJ) officially unveiled its Corporate Whistleblower Awards Pilot Program (the Program). The three-year pilot program aims to broaden the range of corporate misconduct that may lead to rewards for individuals who report to the government. Like other government whistleblower rewards programs, the Program is designed to incentivize both the reporting of corporate criminal wrongdoing by individuals seeking monetary rewards and the voluntary disclosure of information by companies seeking to maximize the potential benefits of voluntary disclosure and cooperation under the DOJ's Corporate Enforcement Policy (CEP).

In order to be eligible for an award under the Program, an individual must provide the DOJ with original, truthful information in writing about criminal misconduct relating to one or more designated program areas that leads to a criminal or civil forfeiture exceeding $1 million in connection with a successful prosecution, corporate resolution, or forfeiture action. "Original information" is defined in the DOJ's Program guidance and must be, among other criteria, information derived from an individual's independent knowledge or analysis that is non-public and not previously known to the DOJ.

Consistent with prior statements by DOJ officials, the Program is intended to fill gaps in the coverage of existing government rewards programs, including the DOJ's *qui tam* program and the whistleblower rewards programs of the SEC, CFTC, and FinCEN. The Program expressly states that an individual will not be eligible for an award under the Program if they would be eligible under another government program. The Program is also expressly limited to four subject areas: (i) violations by financial institutions or their agents, including violations related to money laundering, money transmitting businesses, fraud, and non-compliance with financial institution regulators; (ii) violations related to foreign corruption, including the Foreign Corrupt Practices Act and the Federal Extortion Prevention Act; (iii) violations related to domestic bribery; and (iv) federal healthcare offenses related to private health care benefit programs, fraud against patients, investors, or other non-governmental entities in the health care industry, and other health care-related offenses not covered by the Federal False Claims Act.

The Program includes certain limitations on award eligibility and amounts that are not present in other, existing whistleblower programs.

First, unlike the SEC whistleblower program, where the SEC must pay a whistleblower reward where the submission of qualifying information leads to a successful enforcement action, the DOJ Program expressly states that "[a]wards are entirely discretionary and an award is not guaranteed."

Second, under the DOJ Program, an individual is not eligible for an award if they "meaningfully participated in the criminal activity they reported, including by directing, planning, initiating, or knowingly profiting from that criminal activity." The Program contains an exception to this under which an individual who had only a "minimal role" in the reported criminal activity may, at the DOJ's discretion, be eligible for an award.

Third, the DOJ Program has guard rails designed to limit or eliminate the types of astronomical awards that have been made in other whistleblower programs. The

DOJ may award up to 30% of the first $100 million forfeited; up to 5% of forfeiture amounts between $100 million and $500 million; and nothing based on forfeiture amounts over $500 million. This means, for example, that if the amount forfeited is $500 million, the whistleblower reward would be capped at $50 million ($30 million on the first $100 million forfeited and $20 million, or 5%, on the amount between $100 million and $500 million)—still an extraordinary sum but far short of whistleblower awards in the hundreds of millions of dollars as has happened under the SEC's program and the DOJ's *qui tam* program. Under the DOJ Program, assuming none of the enumerated factors which may decrease an award are present, there is a presumption that the DOJ will award the maximum 30% on the first $10 million forfeited.

In an apparent attempt to address criticisms that government whistleblower rewards programs disincentivize internal reporting, thereby undermining corporate compliance programs, the DOJ Program permits a whistleblower to report internally first and still be eligible for an award, provided the whistleblower provides the information to the DOJ within 120 days of reporting internally. This is true even if the corporation first reports the individual's information, or the results of an investigation undertaken in response to the individual's information, to the DOJ. Relatedly, the DOJ amended the CEP to enable a company to remain eligible for the benefits of voluntary self-disclosure under the CEP when it self-discloses a whistleblower's allegations to the DOJ within 120 days, even if the whistleblower already has disclosed the information to the DOJ.

Finally, the DOJ Program contains an express warning to companies about taking actions to "impede" an individual from communicating with the DOJ about possible criminal violations in the enumerated program areas, including "enforcing, or threatening to enforce, a confidentiality agreement . . . ." The DOJ Program guidance states that the DOJ may consider such actions in assessing the corporation's cooperation credit and compliance program and the entity's or individual's culpability, "including for obstruction." This warning is in line with recent SEC enforcement actions against companies for including confidentiality provisions in separation or employment agreements that the SEC viewed as intended to prevent or chill communications by the current or former employee with the SEC about potential violations of securities laws.

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Second Circuit Affirms Dismissal of Securities Fraud Class Action Alleging Undisclosed Projections

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In *Maso Cap. Invs. Ltd. v. E-House (China) Holdings Ltd*., No. 22-355 (2d Cir. June 10, 2024), the United States Court of Appeals for the Second Circuit affirmed the district court's dismissal of a putative securities-fraud class action brought against a company and several of its directors based on, among other things, the alleged failure to disclose newer projections before a go-private merger in violation of Section 10(b) of the Securities Exchange Act of 1934 and its implementing rule, Rule 10b-5.

In June of 2015, E-House (China) Holdings Limited (the Company) received a buyout offer from a group (the Buyer Group) that included several members of the Company's board of directors (the Board). On the date of the offer, the Company formed a transaction committee composed of the Board members who were not part of the Buyer Group in order to evaluate the buyout offer. The transaction committee retained separate counsel and advisors, and engaged in negotiations with the Buyer Group. In April of 2016, the transaction committee and the Board approved the proposed buyout. The Company filed a proxy statement that set forth, among other things, management's projections for the Company (the "Management Projections"), and the reasons for the merger. In August of 2016, the shareholders approved the merger, and the closing occurred shortly thereafter.

Following the closing, during an appraisal hearing initiated by a dissenting shareholder, it was asserted that another set of projections (the Parallel Projections) – purportedly approved by the co-chair of the Board before the date of the final proxy statement but not disclosed in such proxy statement – showed higher profit figures, sales figures, earnings before interest and taxes, and consolidated annual growth rates than those included in tho Management Projections. While the parties to the appraisal action settled, certain Company investors (the Investors) subsequently brought a putative class action alleging that the proxy contained false and misleading statements because, among other things, the Management Projections contained in the proxy had been supplanted by the Parallel Projections. The United States District Court for the Southern District of New York, holding that the Investors failed to plead any actionable misstatement or omission, granted the defendants' motion to dismiss, and the Investors appealed.

The Court noted that to state a claim under Section 10(b) and Rule 10b-5, a plaintiff must, among other things, plead a material misrepresentation or omission by the defendant. Addressing this element of a claim, the Court stated that, to establish liability under Rule 10b–5(b), there must be (1) a false statement (an actual statement that is untrue outright), or (2) a half-truth (a representation that omits critical qualifying information). Notably, the Court underscored that Section 10(b) and Rule 10b-5 "do not create an affirmative duty to disclose any and all material information", instead requiring disclosure only when necessary to make "statements made, in the light of the circumstances under which they were made, not misleading".

The Court then examined the Investors' contention that the Management Projections contained in the proxy did not reflect management's "best currently available estimates and judgments" because they had been superseded by the Parallel Projections. In disagreeing with this contention, the Court noted that the projection would be misleading only if the speaker "(1) did not hold the belief [that was] professed, (2) supplied" "supporting fact[s]" that "were untrue," or (3) "omit[ted] information whose omission ma[de] the statement misleading to a

reasonable investor." According to the Court, the Investors failed to explain who created the Parallel Projections, for what purpose they were prepared, and to whom they were made available – in other words, the complaint did not contain the requisite detail as to the "who, what, when, where, and how" of the Parallel Projections. While the Investors alleged that the Parallel Projections were prepared by the Company's management, the Court found that the Investors provided no particularized facts suggesting that the Parallel Projections were even created by or shared with the Company, the Board, or the transaction committee prior to the date of the final proxy. Applying the standard for a misleading projection finding described above, the Court concluded that the Investors failed to adequately plead that the defendants "did not believe that the Management Projections were accurate at the time they were published, that they disclosed any untrue facts, or that they concealed information that made such projections misleading".

Moreover, the Court stated that the "bespeaks caution" doctrine required it to credit cautionary language contained in the proxy and to consider the context of the alleged misstatements or omissions "to determine whether a reasonable investor would have been misled". Because the proxy contained express cautionary language (including a statement in bold print and capital letters warning investors that the Company undertook no obligation to update the Management Projections for circumstances or events occurring after their preparation) that did not only "bespeak caution" but "shout[ed] it from the rooftops…", the Court found that it would be difficult to conceive how a reasonable investor could have been misled about the risks presented by the Management Projections. As for the Investors' "pure-omission" theory claim that the defendants had an independent duty to disclose the Parallel Projections, it was rejected by the Court because such claims are no longer actionable under Rule 10b-5 following the Supreme Court ruling in *Macquarie Infrastructure Corp. v. Moab Partners, L. P.*, 601 U.S. 257 (2024).

Additionally, the Investors claimed that, while the proxy statement disclaimed any Buyer Group plans to materially change the Company's business, the Buyer Group had at that time already had plans to relist the Company on the Hong Kong Stock Exchange. The Court rejected this claim because "virtually all" of the evidence presented by the Investors related to post-merger periods, and because the proxy explicitly stated that the Buyer Group may in the future "propose or develop plans and proposals", "including the possibility of relisting the Company…on another stock exchange".

The *Maso* case provides some helpful guidance regarding 10b-5 claims based on projections included in a merger proxy statement. The dismissal of the case, in part, because the plaintiffs failed to establish the details of the origin and use of the Parallel Projections should guide issuers to consider and analyze all available projections when preparing a proxy statement. Later dated projections that are provided to a board, a financial advisor or bidders could potentially render earlier dated projections misleading and their omission could form the basis of a 10b-5 claim. While the court cited to the clear cautionary language included in the proxy statement around projections, whether the "bespeaks caution" doctrine alone is sufficient to protect defendants in a case involving a different set of parallel projections will likely depend on the actual facts in issue.

SEC Approves Nasdaq Corporate Governance Rule Amendments to Cure Periods and Phase-In Schedules

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On August 26, 2024, the U.S. Securities and Exchange Commission (SEC) issued an order approving proposed amendments by The Nasdaq Stock Market LLC (Nasdaq) to clarify and modify the phase-in schedules for certain corporate governance requirements and clarify the applicability of certain cure periods where companies fail to meet the majority independent board, audit committee composition or compensation committee requirements. The proposed amendments were submitted to the SEC by Nasdaq on May 8, 2024 and are generally consistent with rules that have previously been approved for the New York Stock Exchange. Nasdaq Listing Rules provide companies seeking to list on Nasdaq with "phase-in" schedules for compliance with certain Nasdaq corporate governance requirements. The revised phase-in schedules aim to provide a more manageable implementation timeline for companies.

Phase-In Schedules

Initial Public Offerings. The amendments include the following modifications to the independent director and committee requirements for initial public offering (IPO) companies:

- As amended, (i) one member of the audit committee must satisfy the heightened independence and other requirements of Rule 10A-3 of the Securities Exchange Act of 1934, as amended (the "Exchange Act") by the date the company's securities first trade on Nasdaq (the "Listing Date"); (ii) a majority of members must satisfy the requirements within 90 days of the effective date of its registration statement; and (iii) all members must satisfy the requirements within one year of the effective date of its registration statement.

- IPO companies can now satisfy the requirement that the audit committee consist of a minimum of three members by designating at least one member by the Listing Date, at least two members within 90 days of the Listing Date, and at least three members within a year of the Listing Date.

- IPO companies can now satisfy the previous requirement of having one independent director on the compensation and nominations committees at the time of listing by appointing an independent director by the earlier of (i) the IPO closing date or (ii) five business days from the Listing Date.

Emerging From Bankruptcy. Nasdaq Listing Rule 5615(b)(2) was amended to codify its previous position that a company emerging from bankruptcy must comply with the audit committee composition requirements set forth in Nasdaq Listing Rule 5605(c)(2)8 by the Listing Date unless an exemption is available pursuant to Rule 10A-3 of the Exchange Act.

Transferring from National Securities Exchanges. Nasdaq Listing Rule 5615(b)(3) provides that companies that are transferring from other exchanges with substantially similar requirements are granted the balance of any grace period afforded by the other exchange. Companies that are transferring from other exchanges that do not have substantially similar requirements are afforded one year from the Listing date to comply. The amendments clarify that the phase-ins apply only where a company transfers securities registered under Exchange Act Section 12(b) from another national securities exchange. A new provision has been

added to address phase-in schedules for companies previously registered pursuant to Exchange Act Section 12(g).

Listing in Connection with a Carve-out or Spin-off Transaction. New Nasdaq Rule 5615(b)(4) provides that a company listing in connection with a carve-out or spin-off transaction is permitted to phase-in certain requirements, such as the majority independent board requirement, the independent nominations, compensation, and audit committees' requirements, and the number of compensation and audit committee members' requirements, in a similar manner as IPO companies.

Ceasing to Qualify as a Foreign Private Issuer. Under the Exchange Act, companies are required to test their status as foreign private issuers annually at the end of their most recently completed second fiscal quarters (the determination date). The amendments provide that companies ceasing to be foreign private issuers have six months from the determination date to meet domestic corporate governance standards such as the majority independent board and executive sessions requirements in Nasdaq Rule 5605(b), the independent compensation and nominations committee requirements in Nasdaq Rules 5605(d)(2) and (e)(1)(B), and the audit committee requirements in Nasdaq Rule 5605(c)(2).

Cure Periods

Nasdaq Listing Rules 5605(b)(1)(A), 5605(c)(4), and 5605(d)(4) provide cure periods that apply where companies fail to meet the majority independent board, audit committee composition, or compensation committee requirements as a result of one vacancy or one member losing independence due to factors beyond their control. The recent rule change introduces a new provision stipulating that companies cannot access these cure periods immediately after their phase-in period under Nasdaq Rule 5615(b) expires, unless they demonstrated compliance during the phase-in but later fell out of compliance. If a company relies on the phase-in period but does not show compliance before it ends, Nasdaq Rule 5810(c)(E) has been updated to state that the Listing Qualifications Department may issue a Staff Delisting Determination letter to delist the company's securities.