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Karl T. Muth

Avery E. Bowen

2024 SECTION 5 REVISIONS: THE VOYAGE HOME OR THE WRATH OF KHAN?

KARL T. MUTH* & AVERY E. BOWEN**

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* Lecturer, Northwestern Pritzker School of Law and Northwestern University. Lecturer, the University of Chicago Booth School of Business. Affiliated Scholar, the Cambridge Centre for International Research. The views and positions expressed here represent Prof. Muth's views only and may not be the views of clients or institutions with whom Muth has been, or is now, affiliated (his current employer(s) and/or client(s)).

The topic of this Article is currently subject to litigation and potential future alteration or amendment; the Authors have made best efforts to ensure statements of law are correct at the time of publication.

For context, this Article's drafting follows the Supreme Court's decision in Corner Post v. Federal Reserve (July 1, 2024), the United States District Court for the Middle District of Florida's decision in Properties of the Villages v. FTC (August 14, 2024), and the late August outcome in Ryan v. SEC (August 20, 2024, an Order with "nationwide effect"), but predates and does not predict, or purport to predict, the appellate resolution of these disputes. Note that at the time of this writing, the Ryan matter incorporates no discussion of the major questions doctrine (avoiding this by suggesting the plaintiff may succeed in establishing that the FTC exceeded its statutory authority), distinguishing the Texas and Florida matters, though the Authors anticipate and expect the question of statutory authority may enter the Florida discussion on appeal and the question of major questions may enter the Texas discussion, also. At the time of this Article's final drafting on 12 September 2024, the FTC's Rule did not come into effect as planned on 4 September 2024, but it is unclear when, if ever, any version of the FTC's rule will traverse the concerns raised in Ryan and other litigation (including litigation yet to be commenced) and take effect.

** Research Assistant to Prof. Muth; Ms. Bowen's contributions to this Article do not reflect the views or analysis of her employer, Simpson Thacher & Bartlett LLP, nor its partners or clients.

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I. INTRODUCTION

Since Chair Lina M. Khan[1] took the reins, the Federal Trade Commission ("FTC") adopted a more interventionist posture toward rule changes, Final Rules,[2] and enforcement actions than that taken in the previous decade—a shift perhaps foreshadowed by Ms. Khan's critique of the market position held by powerful platforms in the *Columbia Law Review*.[3] This proposed Final Rule,[4] currently the subject of multistate litigation, introduces sweeping changes to how employers can affect their employees' future behaviors, raising legitimate philosophical and regulatory questions. Specifically, it raises the issue of whether this signals (1) a return to the FTC's original role and mandates in market regulation, or (2) an expansion of the FTC's powers that amounts to unprecedented overreach.[5] Perhaps no action stoked the flames of this debate more than the April 2024 decision to revise Section 5,[6] a central competition regulation provision.

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1. This regulator's surname created an irresistible opportunity for the Authors to make a *Star Trek* reference in the Article's title; this is a reference to the superhuman/supervillain *Star Trek* character Khan Noonien Singh.

2. Including some that may reach far beyond traditional boundaries of markets fairness regulation and attempt to achieve things like constraining individual users' (arguably) Constitutional freedoms to express views online, for instance. How the FTC plans to become the ultimate arbiter of customer satisfaction in online reviews is a question that escapes the bounds of these Authors' contemplations. *See, e.g.*, Trade Regulation Rule on the Use of Consumer Reviews and Testimonials, 16 C.F.R. pt. 465 (2024). That Final Rule is the only time in this Article that Final Rule refers to a different Final Rule. *Id.*

3. Lina M. Khan, *The Separation of Platforms and Commerce*, 119 COLUM. L. REV. 973 (2019). Khan's interest in, and position on, antitrust is clear in her writings. *See generally* Lina M. Khan, *The End of Antitrust History Revisited*, 133 HARV. L. REV. 1655 (2020) (taking pro-regulatory, Janet-Reno-esque view of allocating "market power" rather than individually policing firms).

4. Though the FTC considers and promulgates dozens of Final Rules in a given year, throughout this Article the term "Final Rule" refers specifically to the Final Rule entitled "Non-Compete Clause Rule" that appears (if codified and paginated as proposed) at 16 C.F.R. pt. 910, 1 (2024 and as amended). Though Ms. Khan was not its lone author, she has been its primary advocate and public proponent, including before Congress.

5. Option 1 represents the *Voyage Home* scenario, while option 2 represents the *Wrath of Khan* scenario. The Authors largely align with FTC Commissioner Melissa Holyoak's sentiment that "absent Congressional authorization, the Commission should not attempt to broaden the FTC's unfairness consumer protection authority," expressed in response to Ms. Khan's ambitions. *See* Brianna Herlihy, *New FTC Decision Could 'Inject' DEI into Business Practices Nationwide, GOP Commissioner Says*, FOX NEWS (Aug. 16, 2024, 1:00 PM), www.foxnews.com/politics/new-ftc-decision-could-inject-dei-business-practices-nationwide-gop-commissioner-says [perma.cc/XGY9-4AQE].

6. And adjusting, to a far lesser extent, Section 6(g), which is a boundary or housekeeping statute that prevents the FTC from adopting or implementing rules too far from the traditional reach of its jurisdiction.

These events do not, however, take place in a vacuum, nor is Ms. Khan the lone protagonist (or is it *antagonist*?) in this recent epoch. Instead, they occur in an environment where the behavior of unelected, powerful administrators[7] is, for the first time in recent memory,[8] deemed worthy of ink on the prominent pages of major newspapers.[9] Recent cases like *SEC v. Jarkesy*,[10] *Loper Bright Enterprises v. Raimondo*,[11] and *Corner Post v. Federal Reserve*[12] all feature the High Court's scrutiny of the behavior, reach, and powers of administrators and bureaucrats who draw their enormous influence from a heretofore Baikalesque reservoir of Article II[13] authority. Now, the once obscure and unfashionable topic of administrative law finds itself in the spotlight.[14]

On April 23, 2024, the FTC made a series of decisions about Section 5, which governs unfair competition, and combined them

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7. Congress and the courts shared deep concern about the ambiguous power and substantial reach of unelected administrators. This concern is evident in *Skidmore v. Swift & Co.*, decided shortly before Congress adopted Administrative Procedure Act (APA), and is also evident in the drafting of the APA itself. *See* Skidmore v. Swift & Co., 323 U.S. 134, 140 (1944) (introducing a sliding scale test for deference to administrators and administrative determinations); *see also* Administrative Procedure Act, 5 U.S.C. §§ 551-559 (1946 and as subsequently amended).

8. The role, and authority, of unelected commissioners of administrative agencies is currently in a state of flux unseen since the Administrative Procedure Act of 1946 (and as subsequently amended and appended). 5 U.S.C. § 500.

9. WSJ Editorial Board, *A Supreme Court Triumph for Trial by Jury*, WALL ST. J. (27 Jun. 2024) (discussing SEC v. Jarkesy); Stefania Palma, *SEC's Use of In-House Courts Curbed by U.S. Supreme Court*, THE FINANCIAL TIMES (27 Jun. 2024) (discussing SEC v. Jarkesy).

10. SEC v. Jarkesy, 144 S. Ct. 2117, 2130 (2024) (holding that the Seventh Amendment entitles defendant to jury trial when Securities and Exchange Commission threatens civil penalties for securities fraud); *see also* Jarkesy v. SEC, 34 F.4th 446 (5th Cir. 2022); Jarkesy v. SEC, 51 F.4th 644 (5th Cir. 2022) (per curiam, denying rehearing en banc).

11. Loper Bright Enters. v. Raimondo, 144 S. Ct. 2244, 2273 (2024) (overruling *Chevron* deference and permitting courts to exercise independent judgment as to whether agency enjoys powers being exerted).

12. Corner Post, Inc. v. Bd. of Governors of the Fed. Rsrv. Sys., 144 S. Ct. 2440, 2450 (2024) (holding that an APA claim does not accrue until subject of enforcement suffers final injury from agency's or regulator's actions).

13. U.S. CONST. art. II.

14. *See, e.g.*, Note, *Reconciling Textualism with Agency Prioritization Among Clear Statutory Mandates*, 137 HARV. L. REV. 2276 (2024) (examining question of what administrators should do in cases where clear, or where less clear, boundaries of statutory authority exist); Braden Currey, *Rationalizing the Administrative Record for Equitable Constitutional Claims*, 133 YALE L.J. 2017 (2024) (examining scope of powers bestowed and limited by Administrative Procedures Act); Adam B. Cox & Emma Kaufman, *The Adjudicative State*, 132 YALE L.J. 1769 (2023) (examining perennial tension between resolving disputes via executive decision versus Article III proceedings); Karl T. Muth & Vanessa K. Burrows, *Federal Mifepristone Cases: Implications for Industry, Investors, Providers, and Patients*, 78 FOOD & DRUG L.J. ___ (forthcoming 2024) (examining scope and implications of FDA administrative review powers).

into a single rule.[15] Much ink was spilled in the financial and finreg[16] press over whether non-competes are now a valid contractual restraint on trade, particularly in areas like software and healthcare, in this post-rule era (the rule was to take effect in the third quarter of 2024). Far less discussion was afforded to the rule's interesting but deeply flawed taxonomy of for-profits-versus-non-profits,[17] which will no doubt disproportionately hurt the operation of smaller regional, clinic-focused hospital systems—institutions upon which under-resourced communities often rely and which already struggle to attract and retain staff.

In short, these regional health systems and other businesses that are well-intentioned but not without a profit motive (a distinction that is, for reasons explained *infra*, quite important) will be disproportionately punished by Section 5 revision. In contrast, non-profit or faith-aligned but fundamentally-similar health systems will be permitted to use contractual limitations and restrictive covenants to enhance the retention of key staff, including medical personnel. We focus our analysis on this dichotomy.

Aside from targeting outright fraudsters and charlatans, the FTC has rarely ventured to the contentious frontier where some organizations are considered, or even litigated, to be *more validly non-profit* than others. The courts have, understandably and wisely, been hesitant to decide which gods are more or less worthy of worship,[18] which charities or fundraising appeals are more or less

15. Though individual plaintiffs have been spared from Ms. Khan's September 4, 2024 interventions (the effective date of the Final Rule), as of this Article's authoring there is little hope the implementation of the Final Rule will be wholesale delayed or scuttled. *See, e.g.*, Props. of the Vills., Inc. v. FTC, No. 5:24-cv-316-TJC-PRL, 2024 WL 3870380, at *1 (M.D. Fla. Aug. 15, 2024) (granting injunctive relief but limited narrowly to plaintiff and affiliated parties, having no enjoining effect in Florida regarding other similar matters in the same District).

16. Financial regulation (US) or markets regulation (UK).

17. *See* KARL MUTH ET AL., CHARITY AND PHILANTHROPY FOR DUMMIES (Wiley 2012), a how-to book on charitable giving and non-profit organizations from the eponymous, yellow-jacketed series, and a noted philanthropist, having helped endow the Muth Family Scholarship at his alma mater, the University of Chicago. The concept that the FTC has unique and penetrating wisdom that far exceeds the IRS's in discriminating between which organizations are propelled by charity and which are animated by pecuniary motives strains credulity, given the decades of experience and litigation and accrued entity-level surveillance the IRS enjoys and the comparative callowness of the FTC in this area.

18. Generally, courts are shy to provide adjudications of the validity of religious beliefs. *See* United States v. Ballard, 322 U.S. 78 (1944) (regarding impropriety of adjudication of religious belief). In the rare cases where this occurs and a regulator interacts with a religious organization or its clergy where the validity of that organization's links to the supernatural is at issue, the regulation must be applied such that the intervention as proposed "is the least restrictive means of achieving some compelling state interest." *See* Thomas v. Rev. Bd. Ind. Emp. Sec. Div., 450 U.S. 707, 718 (1981) (regarding least restrictive means and compelling state interest standard); *see also* Sherbert v.

deserving of donations,[19] and which community organizations are more or less impactful.[20] However, the FTC rule revisions raise the perennial question of what non-profits do, and whether their actions primarily serve the public interest.

To pose the question concretely: Is most of what modern, secular Harvard University does in the public's interest, and is it materially different from what religiously-aligned Georgetown University or a theoretical—but conceivable—for-profit university of equal quality and gravitas does?

These questions, once abstract evaluations of altruistic validity debated more rigorously in philosophy departments than in law or business schools, may now, if the FTC Final Rule is implemented as drafted, arbitrarily, unnecessarily, and confusingly bifurcate the population of corporate entities in the U.S.

The fact that a rule change is opaque in its effect, clumsy in its implementation, or strange in its conception is not enough to make the rule invalid. But failure to notice these characteristics *ex ante* is itself problematic; some rules are so murky they are unlikely to provide the intended clarity.[21] Beyond this, the Authors voice both concern and skepticism that Ms. Khan possesses the authority she

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Verner, 374 U.S. 398, 406 (1963); W. Va. St. Bd. of Ed. v. Barnette, 319 U.S. 624, 639 (1943); Cantwell v. Conn., 310 U.S. 296, 304 (1940).

19. Nor is the constituent accounting of where the money goes in the process of donation, or once it's donated, of particular interest to the courts unless embezzlement or self-dealing are the accusations at bar. For instance, that over fifty percent of a charity's fundraising might, in turn, be given to the company doing the fundraising does not itself make the charity less deserving of gifts, nor the relationship between the fundraising consultants and the charity inherently suspect as a contractual arrangement. *See, e.g.*, Riley v. Nat'l Fed. of the Blind of N.C., Inc., 487 U.S. 781, 803 (1988) (finding state law limiting solicitations based on fundraising commission fees ran afoul of First Amendment); *see also* Village of Schaumburg v. Citizens for a Better Env't, 444 U.S. 620, 639 (1980) (finding municipal ordinance with criminal penalties requiring 75% of funds raised be used for "charitable purposes" unconstitutionally overbroad). Notably, *Schaumburg*'s lone dissent voices concern for the erosion of local legislative authority. Still, it does not address whether bright-line rules on the use of funds should be allowed more generally. *Id.* (Rehnquist, J., dissenting).

20. Similarly, judges have generally refrained from becoming financial auditors who reward pennywise organizations and critique wasteful ones (if this were not the case, every charity gala that wasn't a blockbuster success would put the sponsoring charity's status at risk).

21. *Compare* Pay Ratio Disclosure, Dodd-Frank Act Release Nos. 33-9877 & 34-75610 (Aug. 15, 2015), which was later codified at 17 C.F.R. pts. 229, 249 (2009 as proposed, 2010 as passed via Pub. L. 111-203, 2015 as amended) (citing Muth three times as to concerns Section 953(b) once implemented would do plenty to burden firms and nothing to protect investors), *with* Karl T. Muth, *Keeping Score: Dodd-Frank Section 953(b) Reporting Ten Years Later*, 53 UIC J. MARSHALL L. REV. 495 (2021) (retrospective study illustrating, as many finance and law scholars predicted before its implementation, how Section 953(b) created onerous additional reporting but little relevant information conveyed to shareholders or regulators).

claims, as her rulemaking and enforcement venture far beyond the fence lines of any predecessor's trodden pastures. No previous FTC Chair (or other senior official) has attempted to reclassify which organizations are "non-profit enough" to make certain decisions, and Congress never asked the FTC to undertake this task.

Ms. Khan's agency's delineation would indicate which enterprises can subject their employees to noncompete restrictions (those deemed more deserving and altruistic) and which must abandon or forget their ambitions to restrict their employees' future endeavors (those viewed as less deserving and more profit-oriented). It is an enormously ambitious undertaking for Ms. Khan to explore this, as well as many other "jurisdictions of first impression," so far removed from the supply lines of precedent and the support of Congress. As Judge Brown (N.D. Tex.) correctly pointed out on August 20, 2024, Ms. Khan "lacks substantive rulemaking authority with respect to unfair methods of competition" and the "role of an administrative agency is to do as told by Congress," rather than bounded by the ambitions and imaginations of the first millennial to guide its policies.[22]

The evident irony lies in that the organizations Ms. Khan considers to be "morally superior" are the ones empowered to impose restrictions on employees' prospects—restrictions that according to the Final Rule, no genuinely charitable[23] organization would want enforced.

In the world Ms. Khan creatively conjures, for-profit companies are compelled to allow their former employees to freely join direct competitors and share know-how and trade secrets, while non-profit entities, adhering to their strict principles, choose not to restrict their former employees' activities—not due to lack of capacity, but because of a lack of desire. Essentially, Ms. Khan's policy vests

22. Ryan LLC v. FTC, No. 3:24-CV-00986-E, 2024 WL 3879954, at *12 (N.D. Tex. Aug. 20, 2024). Ms. Khan is a British-American attorney and bureaucrat who is the youngest-ever chair of the FTC; she was, to give the reader context, born in the same year as Taylor Swift.

23. And a well-informed and reflective person might reasonably ask: "What is a wholly or sufficiently 'charitable' purpose in a world where Rolex watches, IKEA furniture, and Ethereum crypto tokens have all been manufactured by legally-recognized charities or wholly-owned subsidiaries of charities?" *See generally Hans Wilsdorf*, WIKIPEDIA, en.wikipedia.org/wiki/Hans_Wilsdorf [perma.cc/QR5G-DAHP] (last visited Sept. 6, 2024) (a private foundation organized under the canton laws of Genève in southwestern Switzerland, organization documents filed 1945, reconstituted and recapitalized 1960, last substantially amended 1961); *IKEA Foundation*, WIKIPEDIA, en.wikipedia.org/wiki/IKEA_Foundation [perma.cc/TS43-962G] (last visited Sept. 6, 2024) (a Netherlands corporation limited by guarantee, organization documents filed 1982 and as amended); *Ethereum*, WIKIPEDIA, en.wikipedia.org/wiki/Ethereum [perma.cc/5KUT-DE5Y] (last visited Sept. 6, 2024) (a private foundation organized under the canton laws of the canton of Zürich in northern Switzerland, organization documents filed 2014 and revised most recently in 2021).

power to non-competes in presumably-virtuous, altruistically-inclined employers who will not restrict their employees and makes non-competes unavailable to pecuniarily-motivated employers whose managerial decision-making Khan finds less trustworthy.

But what exactly constitutes a non-profit, a for-profit, or something else entirely? The Commission itself stumbles over this in its Final Rule[24] as it tries to differentiate between profit-driven and altruistically-motivated corporations while simultaneously aspiring to assert jurisdiction over both. In its attempt to grasp authority over non-profits,[25] the Commission acknowledged that many commenters on the Proposed Rule (a draft predating the Final Rule) raised the very concerns addressed in this Article:

> Some commenters contended that, to avoid confusion, the rule should state that it does not apply to entities claiming tax-exempt status as non-profits. At least one commenter stated that the Commission should clarify whether and how the rule would apply to healthcare entities claiming tax-exempt status as nonprofits and then reopen the comment period. One commenter sought clarification on how ownership interest in a for-profit entity or joint venture with a for-profit partner by an entity that claims tax-exempt status as a nonprofit would affect the rule's applicability.[26]

These commenters anticipated significant issues with the Final Rule but noted that the FTC ignored their concerns and proposed solutions.

Framing the issue around the question of which organizations are impacted by, or exempt from, the FTC's intervention in employment arrangements, the Authors present example test cases and example frameworks that illustrate the rule's careless ambiguity and advocate for a clearer rule, or better yet, reinstate the *status quo* as it was in 2023.

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24. *See* Non-Compete Clause Rule, 89 Fed. Reg. 38342, 38356-58 (May 7, 2024) (to be codified at 16 C.F.R. pts. 910, 912).

25. Whether the FTC enjoys any jurisdiction at all over non-profits is hardly a cut-and-dried matter, especially since Congress empowered the FTC to "prevent persons, partnerships, or corporations" from employing anticompetitive dealing or overly sharp tactics but then tailored the definition of entities subject to said jurisdiction to only include those "organized to carry on business for its own profit or that of its members." *Id.* at 38357. By any credible modern definition, non-profits do not "carry on business" for their own profit or the profit of any affiliates or stakeholders. The FTC acknowledges, but then quickly sweeps to the side (it is telling that the strongest language the FTC can muster to assert its jurisdiction is to weakly refute that non-profits lie "categorically outside the Commission's authority under the FTC Act") this potentially fatal defect in the Final Rule. *Id.* at 38356. For more voluminous, but otherwise no different, codified versions of definitions employed here, *see* 15 U.S.C. § 45(a)(2) and 15 U.S.C. § 44 et seq.

26. 89 Fed. Reg. 38356-57.

II. EXAMPLES OF PROBLEMATIC WHAT-IFS

Historically, Section 170 of the Internal Revenue Code[27] has governed the deductibility of transfers of value from a taxpayer to an exempt organization. However, purchases of goods[28] or services[29] from these organizations, or those directly related to their beliefs or activities,[30] are generally not deductible. Other statutory and administrative guidelines help regulators and enforcement agencies determine which organizations should receive specific exemptions and benefits. Courts have recognized that gray areas exist, and that both judicial scrutiny and evidence-based inquiry may be needed[31] to distinguish valid charitable enterprises from tax schemes[32] or profiteering masquerading as philanthropy.[33]

The Authors of this Article expect lawyers to understand a patchwork of laws, rules, and tests. The lead Author has published scholarship for years on various legal tests, their component elements, and their requisite factors for consideration, and has at times found these tests less durable[34] (adverse possession), less well-defined[35] (reasonable doubt), or less easily applied[36] (first

27. Sometimes written 26 U.S.C. § 170, *verbatim* (1939 and amended synchronously in 1954, 1986, and with additional, comparatively minor amendments and appendices in subsequent years by act of Congress).

28. *See* Mark J. Cowan, *Nonprofit and the Sales and Use Tax*, 9 FLA. TAX. REV. 1077, 1176 n.501, 1177 (2010) (discussing how Girl Scout Cookies exemplify common items purchased from undisputed non-profit yet still not deductible).

29. Services might include healthcare services or even diagnostic services of dubious medical validity (but perhaps of religious importance), Hernandez v. Comm'r, 490 U.S. 680 (1989) (finding purchases of pseudoscientific diagnostic services available through Scientology-aligned facility were not deductible), or might be as simple as exchanging cash for college tuition (the service being education).

30. *Cf.* State v. McBride, 955 P.2d 133, 140-41 (Kan. Ct. App. 1998) (finding while Rastafarianism may be valid religious collection of beliefs and practices, adherents to these beliefs did not enjoy special exceptions to prohibitions against purchasing or cultivating or utilizing cannabis).

31. *See* Reynolds v. Sims, 377 U.S. 533 (1964) (finding minor variations unique to specific scenarios or local peculiarities require attention of people familiar with specific context).

32. *See, e.g.*, Stephenson v. Comm'r, 748 F.2d 331, 333-34 (6th Cir. 1984) (highly-paid specialist physician claimed to have joined religious order and takes vow of poverty; claimed religious vow of poverty creates tax exemption for all earnings in interim period).

33. *See, e.g.*, United States v. Bennett, 161 F.3d 171, 175 (3d Cir. 1998) (persistent and material misrepresentations made to IRS to induce agency to create favorable audit letter in enterprise's favor as part of $350 million half-dozen-year scheme to defraud).

34. Karl T. Muth & Ashley D. Cox, *Adverse Possession: A Modern Perspective*, 47 REAL EST. L.J. 6 (2018).

35. Hon. James A. Shapiro & Karl T. Muth, *Beyond a Reasonable Doubt: Juries Don't Get It*, 52 LOY. U. CHI. L.J. 1029 (2021).

36. Assistant Att'y Gen. Nancy Jack & Karl T. Muth, *Timmsen: A Criminal*

prong of *Terry*[37]) than previously thought. However, the FTC's newest proposed two-factor test not only lacks coherence in the contemporary context but also encroaches on the historical jurisdiction of one of the most important institutions in rulemaking and definition-making: the IRS.

As Justice Powell opines in his concurrence in *Bob Jones University*,[38] "[g]iven the importance of our tradition of pluralism, the interest in preserving an area of untrammeled choice for private philanthropy is very great."[39] Undoubtedly, great works are achieved by organizations with closely-held altruistic and honest aims. But is the FTC, among all candidates for this important gatekeeping position, best-positioned to distinguish between lesser charities and those animated by pure altruism?

Allowing the FTC to implement and police the rule as proposed needlessly creates three problems, for which, unfortunately, the Final Rule offers little in the way of solutions to any but the simplest of imaginable scenarios. Consider these more complex, but by no means unimaginable, situations:

1. What happens in the common subsidiary scenario wherein a charitable organization is the principal or controlling shareholder in one or more for-profit ventures? Would the parent charitable organization risk losing its own exemption from the Final Rule due to these sensible investments, or conversely, should the for-profit venture enjoy protection from the Final Rule's mandates due to its altruistic shareholder?

2. When a non-profit organization operates a profitable venture to support its fundraising operations or to offset its inevitably unprofitable charitable activities—such as a religious organization that principally controls a hospital system and uses its profits to serve the sick, or a religious organization that controls a university—what quantum of activity qualifies as being "for charitable purposes" or benefiting a "public interest"?

3. Suppose a small charity receives a substantial gift of securities from a wealthy donor, as was the case of the Poetry Foundation in Chicago after receiving Ms. Lily's

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Procedure U-Turn or Just a Detour?, 55 LOY. U. CHI. L.J. 831 (2024).

37. Terry v. Ohio, 392 U.S. 1, 30 (1968).

38. Bob Jones Univ. v. United States, 461 U.S. 574, 610 (1983) (Powell, J., concurring).

39. *Id.* (citing Jackson v. Statler Found., 496 F.2d 623, 639 (2d Cir. 1974) (Friendly, J., dissenting) (internal brackets and quotations omitted).

> gift.[40] In this instance, financial responsibility may necessitate that the organization shift its primary focus from publishing a poetry magazine to managing investments. In the FTC's view, does this change of priorities, demanded by IRS guidance, render the organization not sufficiently non-profit?

The FTC's involvement, i.e., applying a two-prong test that was clumsily adapted from the Eighth Circuit to 600 Pennsylvania Avenue,[41] adds ample complexity, but little clarity. Fortunately, the High Court's ruling in *Loper Bright* provides much needed guidance: as of 2024,[42] only when Congress—not the Executive—explicitly delegates interpretive authority to an agency can that agency exercise such discretion.[43]

III. A FLAWED TWO-PRONG TEST

To resolve this range of sticky situations that the FTC purports to have considered, the Commission offers what it frames as a threshold test. This test is intended to determine whether the FTC enjoys jurisdiction over a non-profit,[44] but it does not dispositively predict or govern the FTC's subsequent treatment of that non-profit. The two prongs are as follows:

> Prong 1: Is the organization's business solely for charitable purposes?
>
> Prong 2: Does the organization's income benefit public (rather than private) interests?

Importantly, the Authors began drafting this Article in early

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40. The now-famous Lily gift to the Poetry Foundation exceeded the charity's previous annual budget by a factor of one hundred. It is discussed in some depth in MUTH ET AL., *supra* note 17.

41. The Federal Trade Commission's headquarters in Washington, D.C. is at 600 Pennsylvania Avenue, NW, though experts, practitioners, and special witnesses interacting with the agency more often visit its offices at 400 7th Street, SW.

42. Chief Justice Roberts, in *Loper Bright*, makes clear that the opinion is not an invitation to re-litigate forty years of jurisprudence under *Chevron* by installing language that the Court does "not call into question prior cases that relied on the *Chevron* framework" but, instead, the Court divides administrative law into a pre-*Loper Bright* (*Chevron*) epoch and a post-*Loper Bright* epoch. *Loper Bright*, 144 S. Ct. at 2273.

43. This is the Authors' interpretation of Chief Justice Roberts's suggestion that an agency is "authorized to exercise a degree of discretion" only where Congress has "expressly delegate[d]" such discretion to the agency. *Id.* at 2263.

44. As discussed, *supra*, there remain legitimate concerns as to the FTC's breadth of jurisdiction over these entities, both categorically and in specific instances.

2024, anticipating a wave of litigation[45] and administrative[46] tailoring of the Final Rule.[47] The Authors seek to illustrate why the Final Rule as written creates more questions than it answers and introduces uncertainty in areas where the IRS and other agencies have tried—for decades—to reconcile conflicting rules and achieve clarity through fresh rulemaking.

The Authors argue that while it is reasonable and prudent for the FTC to establish and adhere to jurisdictional boundaries,[48] the needless additional taxonomy of non-profit and religious organizations spawns a vast assortment of questions. Importantly, these questions represent a substantial compliance burden and minimal societal benefit—a pattern that is evident in other well-meaning but labyrinthine rules. Examples include Dodd-Frank's Section 953(b) requirement for reporting CEO pay in relative

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45. An early example of this litigation and the arguments that will saturate it can be seen in Ryan LLC v. FTC, No. 3:24-CV-00986-E, 2024 WL 3297524, at *1 (N.D. Tex. Jul. 3, 2024) (granting injunctive relief). On July 3, 2024, the Federal District Court for the Northern District of Texas granted plaintiffs' motion to bar the FTC from enforcing or implementing its rule changes while further motion practice occurred. *Id.* at *17. On August 20, 2024, that same Court found the FTC had meaningfully exceeded its Congressionally-granted authority. Ryan LLC v. FTC, No. 3:24-CV-00986-E, 2024 WL 3879954, at *1 (N.D. Tex. Aug. 20, 2024).

As we write this Article, other notable cases are proceeding through federal district courts in Pennsylvania and Florida that are substantively similar to *Ryan*, though litigation will no doubt continue until, and likely plow right through, the FTC's stated September date for implementation of the Final Rule.

Litigation also continues, in parallel, contemporaneous to this Article's authoring, as to when precisely harm is suffered from administrative regulators' rulemaking and the precise depth of the well of undiluted power an elected administrator may draw from. *See* recent jurisprudential pruning, by chainsaw rather than shears, of *Chevron* and legislative and constitutional assaults on the same; *see* H.B. 2238 (Ariz. 2018); *see also* FLA. CONST. art. V, §21, which is essentially a refutation of the Florida Supreme Court's 1952 decision in Gay v. Canada Dry Bottling Co. of Fla., Inc., 59 So. 2d 788, 790 (Fla. 1952). *See generally Corner Post*, 144 S. Ct. at 2440.

46. And possibly even Congressional [tailoring].

47. "Tailoring" is used to allude to the fact that administrative agencies have a dual responsibility to stay within scope and are (1) supposed to do things that are narrowly tailored to purpose and (2) never do things that are not within the authority explicitly granted by Congress. *See generally Loper Bright*, 144 S. Ct. 2244 (restating this basic principle of administrative law).

48. The bounds of the FTC's jurisdiction in the Eighth Circuit are and have been since before the relevant community blood banking case, subject to traditional and relatively simple rules, including that any commission or administrative entity whose jurisdiction is challenged then shoulders the burden to show it enjoys the relevant jurisdiction. Thomson v. Gaskill, 315 U.S. 442, 446 (1942); McNutt v. General Motors Acceptance Corp. of Ind., 298 U.S. 178, 189 (1936); Hedberg v. St. Farm Mut. Auto Ins. Co., 350 F.2d 924 (8th Cir. 1965).

terms[49] and the 1992 "food pyramid," which was intended to encourage healthy eating, but overstated the benefits of obesity-linked foods[50] while contemporary legislation created compliance hurdles for smaller farms. Its successor, the Nutrition Facts Table, also creates a dubious, lasting compliance burden. In sum, the failure to balance merits of intervention with associated costs is not unique to the FTC but is a well-trod and avoidable blunder.

IV. THE EIGHTH CIRCUIT'S TEST

From the Eighth Circuit in *Community Blood Bank of Kansas City Area, Inc. v. FTC*, the FTC draws a difficult-to-interpret first prong: "whether the corporation is organized for and actually engaged in business for *only* charitable purposes."[51] The meaning of "only for charitable purposes"[52] is open to and likely to receive varied interpretation. This prong, now adopted by the FTC, is terribly problematic.

Furthermore, it is worth noting that the FTC bizarrely selected

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49. While Senators of the "progressive" (or "pro-regulation") political persuasion like Sen. Elizabeth Warren (D-MA) and subsequently-indicted Sen. Robert Menendez (then D-NJ) surely meant well in loudly supporting a measure requiring firms to report CEO pay in terms of the firm's average worker, the measure contributed no useful information to investors (or anyone else) while creating millions and millions of dollars of accounting and consulting costs for the companies involved–costs which no doubt showed up in the prices of the Ford automobiles, United Airlines tickets, and Coca-Cola beverages bought by the "regular folks" these Senators purport to care so passionately about protecting. *See* Muth, *supra* note 21.

50. United States Department of Agriculture, *The Food Pyramid* (1992). The original pyramid, tightly linked to the controversial lobbying surrounding the Farm Bill, suggested half a dozen servings of bread or pasta was appropriate and that a daily half-pound hamburger could be considered a healthy choice. For more on the policy and advocacy framework that led to this disastrous illustration of a permissible diet, *See* Marion Nestle, *Food Lobbies, the Food Pyramid, and U.S. Nutrition Policy*, 23 INT'L J. SOC. DETERMINANTS HEALTH & HEALTH SERVS. 483 (1993).

51. This is the Final Rule's mirror image, in essence, of the widely-adopted test of whether an organization is for-profit, drawn from Southerland: "[w]hether dividends or other pecuniary benefits are contemplated to be paid to its members is generally the test to be applied to determine whether a given corporation is organized for profit." Southerland v. Decimo Club, 142 A. 786, 790 (Del. Ch. 1928). But, unlike the test in *Southerland*, which is not phrased "whether a corporation's sole purpose is profit," the Final Rule's test requires the organization be not only fundamentally or primarily, but *exclusively*, charitable in purpose, a very significant change.

52. What effect does a non-profit have on competition, which is the primary basis for the FTC's intervention in the first place? Scholars and judges have differed as to the effect of non-profit activity on markets. *Compare* Cmty. Blood Bank, 405 F.2d at 1011 *with* Cal. Dental Assn. v. FTC, 526 U.S. 756 (1999) (former suggesting substantial market effect from non-profit's activities, latter more skeptical of large market effects from operation of charities and non-profit associations).

language of its choosing from this case—a case in which the FTC lost[53]—to frame its rule. In the case, the Eighth Circuit held that "under § 4 the [FTC] lacks jurisdiction over nonprofit corporations without shares of capital, which are organized for and actually engaged in business for only charitable purposes, and do not derive any 'profit' for themselves or their members within the meaning of the word 'profit' as attributed to corporations having shares of capital."[54]

One ought to consider the following example: A fictional charity accepts blood donations but sells the donated blood to fund education about a variety of health-related topics: blood transfusions, cardiovascular health, the HIV-AIDS epidemic,[55] bloodborne diseases, IV drug use or needle sharing, and the safety of transfusion and transplantations. Suppose the hypothetical charity's mission is "to help educate patients and help them gain and maintain access to clean, safe blood." Does this entity meet the FTC's definition of limiting its engagement to "only charitable purposes"?

While it may seem straightforward, reasonable minds may differ on this point, due to the complex nature of such entities.

One can suppose that while the charity redistributes blood between patients at no cost, it occasionally cannot find a match for some of the donated blood in its possession. To avoid waste, it sells standard 450mL blood bags to local hospital blood banks before they expire. If the state in which the charity operates taxes these sales as a merchant activity, does that hold evidentiary value as to the entity's charitable intent, or is it simply a feature of the local tax regime?[56] One ought to also consider the possibility that the charity, through negligence, fails to monitor its blood supply for contamination, thereby contravening its core mission of providing "access to clean, safe blood." In such a case, are its activities no longer considered "for only charitable purposes"?[57] If all the revenue from selling blood is then directed toward the charitable purpose of

53. The FTC takes the only salvageable positive language from this decision and reads it in the way friendliest to its ambitions, namely, "the question of the jurisdiction over the corporations or other associations involved should be determined on an *ad hoc* basis." *Cmty. Blood Bank*, 405 F.2d at 1018.

54. *Id.* at 1022.

55. Non-profits working in partnership with public health officials were a critical source of information on the AIDS epidemic early in its course. *See generally* Kozup v. Georgetown Univ., 663 F. Supp. 1048 (D.D.C. 1987) (providing context for early AIDS infections and surrounding hysteria).

56. *See generally* American Nat'l Red Cross v. ASD Specialty Healthcare, Inc., 888 So. 2d 464 (Ala. 2004) (addressing confusion over whether the Red Cross's act of transferring blood products was a sale of goods or a provision of services).

57. *See* Doe v. Am. Nat'l Red Cross, 788 F. Supp. 884 (D.S.C. 1992) (examining charity's alleged failure to screen blood supply properly, leading to HIV infection of patients, contrary to stated purpose for charity's blood banking operations to make safe blood accessible).

providing other blood to patients at no cost, does this salvage or restore the "charitable purpose" of selling the blood, or is selling the blood, by definition, not able to be a charitable activity?[58]

A. Test as Applied in Community Blood Bank

The Community Blood Bank of the Kansas City Area, Inc. ("CBB") was a not-for-profit blood collection and distribution center. Its operations included collecting blood from volunteers, processing it, performing quality checks, and distributing it to hospitals, clinics, and other healthcare facilities throughout the Midwest. CBB also engaged in significant community outreach to encourage blood donations and raise awareness regarding the need for donations.[59]

On July 5, 1962, the FTC filed a complaint against the CBB, challenging its not-for-profit status. The lawsuit also named the Kansas City Area Hospital Association ("AHA") and several individual pathologists affiliated with Kansas City hospitals as petitioners. The FTC alleged that the petitioners were engaged in monopolistic practices and violated § 5 of the FTC Act by "...[carrying] out an agreement, understanding, combination or planned course of action to hinder the development of two commercial blood banks, Midwest Blood Bank and Plasma Center, Inc. (Midwest) and World Blood Bank ("World)."[60] The practices under scrutiny included the AHA's refusal to accept blood from Midwest and World, informing customers that blood from these banks would not be accepted in exchange for blood obtained from the hospitals or the CBB, and advising the district blood-clearing house and American Association of Blood Banks that Kansas City hospitals would not accept blood from the two banks.[61] In addition to violating § 5, these actions were deemed *not solely driven by charitable intent*, potentially leading to the disqualification of the CBB from not-for-profit status, either in the eyes of the IRS, the FTC, or both.

On appeal, the Eighth Circuit set aside the Commission's Order and went on to devise a test to determine whether an organization qualifies for not-for-profit status in an FTC context.[62] The first part of the test evaluates whether an organization's operations are "only for charitable purposes," i.e., whether they operate without any intent of engaging in activities for private

58. *See* Schiff v. AARP, 697 A.2d 1193, 1197 (D.C. 1997) (examining an instance where charity acted as "merchant" selling donated blood at profit).

59. *About Us*, CMTY. BLOOD CENTER, www.savealifenow.org/about-us/ [perma.cc/A8TX-CYZX](last visited July 11, 2024).

60. *Cmty. Blood Bank*, 405 F.2d at 1013.

61. *Id.* at 1011.

62. Note the various organizations' exempt or charitable status with the IRS was not being litigated as part of this matter.

benefit or non-charitable interests.[63] Since a precise definition of "only for charitable purposes" has yet to be established,[64] its interpretation is left to be decided on a case-by-case basis.

B. Test as Applied in Alliance Housing

Alliance Housing Inc. (hereinafter "Alliance") faced a similar issue in the case of *Alliance Housing Inc. v. County of Hennepin*. Alliance is a not-for-profit organization based in Minnesota that constructs and manages affordable housing for low-income individuals across the state.[65] In 2018, Alliance applied to have its Minneapolis properties exempt from taxes beginning in 2020.[66]

The Minneapolis City Assessor denied Alliance's request, determining that Alliance's work was not "only for charitable purposes" since its properties were leased to individuals who paid rent to Alliance. However, in 2020, when Alliance litigated a subsequent request for 2021 tax exemption, the local tax court[67] ruled that Alliance's practices were, in fact, charitable enough to be categorized as "only for charitable purposes," despite receiving payment from the individuals it was assisting. The Minnesota Supreme Court[68] affirmed the tax court's decision, stating that "an institution of purely public charity with a purpose of providing housing for low-income individuals uses its real property in furtherance of its charitable purpose when it leases its property to its intended beneficiaries for personal residence."[69]

Alliance Housing Inc. was deemed to be operating with *exclusively* charitable intent.[70] Despite leasing its properties to individuals for residential purposes, Alliance's mission to provide low-income housing meant that the properties were used for charitable purposes. Hence, the properties were granted tax exemptions.

This decision is in contrast to the aforementioned blood bank example, where CBB was initially deemed ineligible for similar tax

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63. *Cmty. Blood Bank*, 405 F.2d at 1016. This includes the benefit of third parties or stakeholders other than the organization and those it serves.

64. No robust, portable definition yet exists that has been promulgated by any intermediate appellate court of the federal judiciary and tested by subsequent and similar exemplar case law, despite the Authors' research to locate the same.

65. *About Us*, ALL. HOUS. INC., www.alliancehousinginc.org/about-us/ [perma.cc/XC7S-4AHW] (last visited July 11, 2024).

66. This is a determination exclusive to the local taxing power and outside the FTC's ambit.

67. Minnesota has courts sponsored by the executive branch (the Governor's Office) for this purpose.

68. A court of ultimate appeal and general jurisdiction in that state.

69. All. Hous. Inc. v. Cnty. of Hennepin, 4 N.W.3d 355, 356 (Minn. 2024) (syllabus).

70. *Id.*

exemptions due to its commercial practices. It can be argued that the CBB was, in fact, acting for charitable purposes; despite the FTC's criticisms, CBB's actions could be viewed as an effort to ensure that patients receive the highest-quality blood affordably, rather than an attempt to optimize profits. Meanwhile, Alliance's actions directly benefited its chosen charitable market, without affecting the broader housing market or other operating entities. In each case, a well-meaning organization attempts to provide a high-quality basic need (blood, shelter) to a disadvantaged population.

These cases illustrate the difficulty in defining what not-for-profit practices are considered *exclusively charitable* versus *not exclusively charitable*. Not-for-profit organizations are, therefore, left to arbitrarily and autobiographically define their own practices as "entirely charitable," in the hope that the FTC will concur. This lack of clarity forces not-for-profits to continuously assess their activities to align with not only their own philanthropic goals, but also with the FTC's arbitrary and undefined expectations.

If an organization is found to have acted without an acceptable philanthropic purpose, scrutiny by the FTC can pose a significant burden, even if the organization ultimately maintains its not-for-profit status. Even an exonerated organization[71] may find donors hesitant to support it or may suffer subsequent, unpredictable reputational damage.[72] Defending an organization against any accusation from a federal administrative entity requires considerable time, money, and staff, which can divert attention and resources away from charitable work. Additionally, the uncertainty about what qualifies as "only for charitable purposes" may prompt not-for-profits to exercise excessive caution. They may fear that their activities could be perceived as having a commercial aspect, despite helping the organization.[73] Such practices have the potential to hobble initiatives that might otherwise significantly

71. Arthur Andersen, the storied Chicago-based consultancy firm once upon the top such firms in the world, never recovered from its alleged association with disgraced energy client Enron. Despite having its conviction reversed and vacated in the venue of ultimate appeal, the firm eventually had to rebrand as "Accenture" at a cost of millions, if not billions, of dollars and innocent partners and associates who worked at the firm during the Enron years had to unfairly endure clouds over sections of their resumes (or, nowadays, "LinkedIn" accounts) for years, if not decades. *See generally* Arthur Andersen LLP v. United States, 544 U.S. 696 (2005) (holding unanimously firm and its equity partners had no criminal liability, despite Southern District of Texas guilty verdict on June 15, 2002, and same conviction affirmed in Fifth Circuit in 2004 at 374 F.3d 281).

72. It is difficult, if not impossible, to anticipate every source and size of harm to a non-profit organization's revenues or reputation at the outset of a dispute. *See, e.g.*, Wright-Upshaw v. Nelson, No. 13-CV-3367(ARR)(LB), 2024 WL 692870, at *1 (E.D.N.Y. Feb. 19, 2014).

73. For instance, under a conservative FTC Commissioner, can Planned Parenthood charge anything at all for pregnancy termination services, or is even a negligible fee likely to be used to impeach its motives as profit?

benefit the communities they serve.

C. No Need for More Tests

The present Article argues that while tests can be helpful in certain situations by adding consistency and clarity to policy scenarios,[74] no additional tests are needed.

The IRS already determines, revisits, and audits non-profit status, including for religious or faith-aligned organizations.[75] The FTC does not need to employ a separate test and can defer to the IRS's determinations without relinquishing its jurisdiction[76] over FTC-appropriate matters. For the FTC to implement a similar—or worse, a divergent and redundant—process to determine the degree of altruism[77] an enterprise exhibits seems like a terrible use of time and resources for everyone involved, especially as the taxpayers, via their Congresspeople, never asked the FTC to take on the task.

Non-profits in the U.S. can apply for 501(c)(3) status from the IRS, which is the broadest category for charities. This status exempts them from federal income taxes, makes them eligible for competitive grants, and allows donors to deduct their contributions from their taxable income when filing tax returns. Such privileges enable non-profit organizations to redirect funds that would otherwise go to taxes toward furthering their charitable missions.

The IRS considers three key components when determining whether an organization qualifies for 501(c)(3) status: its organization, operations, and exempt purposes.[78] To qualify, the entity must be structured as a corporation, unincorporated association, community chest, fund, or foundation.[79] The

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74. The Authors refer the reader to the Wheeler-Lea Act of 1938 for plentiful examples of definitional artistry.

75. Lloyd H. Mayer, *"The Better Part of Valour Is Discretion": Should the IRS Change or Surrender Its Oversight of Tax Exempt Organizations?*, 7 COLUM. J. TAX L. 80, 102 (2016).

76. This idea of administrative jurisdictional conflict, especially for financial and financial-sector-adjacent regulators, in determining the intentions, suspectness, or legitimacy of an organization's actions is hardly new. *See generally* William E. Murane, *SEC, FTC, and the Federal Bank Regulators: Emerging Problems of Administrative Jurisdictional Overlap*, 61 GEO. L.J. 37 (1972) (anticipating correctly that overlap between FDIC, SEC, CFTC, FTC, and others would result in tensions between regulators and confusion in markets as to interventionist intent or regulatory capacity of various regulators to alter or interrupt market activity).

77. Though altruism is not a trait only present in non-profit organizations, many for-profit entities have altruistic aims, ambitions, policies, and initiatives. Burwell v. Hobby Lobby Stores Inc., 573 U.S. 682 (2014) ("[I]t is not at all uncommon for such corporations to further humanitarian and other altruistic objectives.").

78. *See generally* Simon v. E. Ky. Welfare Rts. Org., 426 U.S. 26 (1976).

79. *See Bob Jones Univ.*, 461 U.S. at 613 (Rehnquist, J., dissenting); *see also* Regan v. Tax'n with Representation of Wash., 461 U.S. 540, 542 n.1 (1983).

organization's governing documents must clearly outline and restrict activities to those conducted for charitable purposes. Under section 501(c)(3), charitable purposes include religion, education, science, literacy, public safety, fostering amateur sports competitions, preventing animal or child cruelty, and other activities aimed at relieving the poor, distressed, or underprivileged.[80] Additionally, an organization's assets must be strictly used to aid its charitable efforts.[81] The organization cannot be organized or operated in a way that benefits private interests, shareholders, or individuals.[82]

Applying for 501(c)(3) status is a lengthy process for both applicants and the IRS. Applicants must complete Form 1023-EZ, adhere to their governing documents, provide a detailed description of their charitable activities and purposes, and submit four tax years of financial statements. This information is then reviewed by the IRS, which may request additional information if needed, potentially prolonging the application process. Although most applicants are approved for 501(c)(3) status,[83] organizations must invest considerable time, energy, and resources to fulfill the IRS's requirement of having a "charitable purpose."[84]

The standard that an organization must not be organized or operated in a way that benefits private interests, shareholders, or individuals seems to parallel, and perhaps entirely eclipse, the "only for charitable purposes" language in the Final Rule (that Ms. Khan favors) from the Eighth Circuit's jurisprudence. Introducing yet another test that requires substantial compliance and investigatory effort to be expended, only to reach the same conclusion[85] for the vast majority of these organizations, seems at best circuitous and at worst terribly wasteful. Most concerning, the Final Rule fails to

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80. *Exempt Purposes - Internal Revenue Code Section 501(c)(3)*, I.R.S., www.irs.gov/charities-non-profits/charitable-organizations/exempt-purposes-internal-revenue-code-section-501c3 [perma.cc/KJ7K-2LR2] (last visited July 11, 2024).

81. Universal Life Church, Inc. v. United States, 372 F. Supp. 770, 775 (E.D. Cal. 1974).

82. 26 U.S.C. § 501 (2019).

83. The volume of 501(c)(3) applications is substantial and the number of existing active entities is huge. As of 2022, the IRS recorded that 1.48 million such organizations were maintained as active, which is one non-profit for roughly every 233 American citizens. The number of such organizations increased between 4.7% and 5.1% year-on-year during the 2018-23 period. *SOI Tax Stats – Charities and Other Tax-Exempt Organizations Statistics*, I.R.S., www.irs.gov/statistics/soi-tax-stats-charities-and-other-tax-exempt-organizations-statistics [perma.cc/US6F-Y72M] (last visited Aug. 25, 2024) (download Form 990 Tax Exempt Organizations Supplementary Reporting, Tables 1 and 3 (2023-24)).

84. Manoj Viswanathan, *Form 1023-EZ and the Streamlined Process for the Federal Income Tax Exemption: Is the IRS Slashing Red Tape or Opening Pandora's Box?,* 163 U. PA. L. REV. ONLINE 89, 90 (2014).

85. For the FTC to reach the same conclusion of the IRS or other administrative agencies through similar investigative or audit activities.

answer the more fundamental question of whether competing firms should behave differently or be held to different rules. For instance, it seems unlikely that the University of Chicago's hospital—part of the university's non-profit portfolio of operating entities—behaves more virtuously, invoices patients less frequently, or administers medical care differently than the for-profit hospital systems in Illinois. If an enormous divergence existed between the services provided by for-profit and non-profit hospitals, they would exist in different markets; however, they co-exist in the same market as competitors.

It seems unlikely, almost unbelievable, that an organization's tax status or general gestalt would influence its managerial and operational decisions—such as how much to charge for ibuprofen or to set a broken bone—especially in a landscape where non-profit, for-profit, and government hospitals often rely on the same third-party billing system provider,[86] utilize personnel trained in the same hospital administration systems, and follow the same billing codes and patient invoicing systems. From a patient's vantage point, non-profit and for-profit hospitals operate in ways that are virtually indistinguishable.

D. If Another Test, Don't Choose the Eighth Circuit Test

This test adds unnecessary bureaucracy by creating a solution to a question[87] no one is asking—or, to the extent it has already been asked, a question that has already been answered by tens of thousands of pages of IRS Proposed Rules, Final Rules, adjudications, enforcement actions, and audit guidelines. The more interesting test is less mechanical, more philosophical, and appreciably more complex than the one Ms. Khan chose to address.

There are two multi-billion-dollar industries in the U.S. where for-profit and non-profit firms have historically competed head-to-head: healthcare[88] and higher education.[89] Although the incentives

86. *See Community*, EPIC SYS. CORP., www.epic.com/community/list [perma.cc/SZ2X-BSZD] (last visited Aug. 25, 2024) (listing Epic Systems customers as of 2024).

87. That question being "which entities should be non-profit by an FTC definition, setting side an IRS or other definition?" or, put more bluntly, "what does operating '*only* for a charitable purpose' actually mean?"

88. *See* White & White, Inc. v. Am. Hosp. Supply Corp., 723 F.2d 495, 508 (6th Cir. 1983) ("[T]here is abundant proof that . . . competition from franchised for-profit hospital chains[] forced non-profit hospitals to realize that they cannot continue business as usual.").

89. The history of for-profit universities is mixed and punctuated with litigation alleging fraud or false advertising, but nonetheless for-profit, government-funded, and non-profit offerings do coexist in the higher education space and often credibly compete with one another for students, faculty, real estate, government funding, and other resources. *See, e.g.*, Makaeff v. Trump Univ., LLC, 715 F.3d 254 (9th Cir. 2013); Ass'n of Priv. Sector Colls. v. Duncan, 681 F.3d 427 (D.C. App. 2012); State v. Minn. Sch. Bus., 935 N.W.2d 124 (Minn.

in for-profit healthcare[90] and the quality of for-profit universities[91] have been scrutinized and litigated frequently,[92] the fact remains that these models coexist in these industries, a rarity in other sectors. In some cases, they also compete with the government, adding further complexity.

Unsurprisingly, differently-structured firms compete not only for resources but on other fronts as well. Stanford University ("Stanford") and the University of California, Berkeley ("Berkeley"), for instance, are structurally different, yet compete for everything from research grants to philanthropic attention, student applications, and faculty researchers. Few credible commentators would assert these universities are not competitors on many fronts.

The market, ostensibly under the FTC's broad jurisdiction, does a relatively good job of resolving most of the tensions between these institutions through simple mechanisms like pricing, market information, and comparison shopping. A talented faculty job applicant might receive offers from both Stanford and Berkeley, with the two institutions competing on terms such as salary, paid time off, health benefits, and retirement packages. Similarly, these institutions vie for coveted research grants, high-achieving students, and even Bay Area real estate to expand their campuses.

However, in a Khan-led model of the world, some employers (e.g., Stanford) might be able to constrain their employees' choices of a subsequent employer to an extent others[93] cannot, based on decisions made long before the employment negotiation began, on a basis unrelated to the contractual negotiation at issue.[94] Why assign this "superpower" to some players in this market and not others, *especially when Ms. Khan herself has framed the FTC's role as one of ensuring market fairness among all players*?

2019).

90. *See* Barton v. Tomacek, 11-CV-0619-CVE-TLW, 2012 WL 4735927, at *3-5 (N.D. Okla. Oct. 3, 2012) (inconsistent capitalization omitted) (considering civil conspiracy action brought in Oklahoma against for-profit hospital for performing unnecessary lucrative surgeries). "The hospital is a for-profit business and it is undisputed that the hospital intended to make money by having plaintiff's surgery performed at its facilities." *Id.* at *4. "Plaintiff could be arguing that the hospital and Dr. Tomecek engaged in a pattern or practice of performing unnecessary surgeries at the hospital." *Id.*

91. *See generally* United States v. Univ. of Phx., No. 2:10-cv-02478-MCE-KJN, 2014 WL 3689764, at *1 (E.D. Cal. July 24, 2014) ("Defendant UOPX offers a broad variety of courses both online and at campuses located throughout the United States. Its overall enrollment is estimated at nearly 500,000 students. The vast bulk of UOPX's tuition revenue is derived from federally guaranteed loans.").

92. *See, e.g.*, Daghlian v. DeVry Univ., Inc., 582 F. Supp. 2d 1231, 1235-36 (C.D. Cal. 2008) (DeVry alleged to have falsely and knowingly misrepresented credits would likely be transferrable to other institutions).

93. A hypothetical "For-Profit Prestigious University of San Francisco," which sadly does not yet exist.

94. The decision for Stanford to be a non-profit was made 97 years before Ms. Khan was born.

V. BROADLY: THE PROBLEM OF INCONSISTENT, DISPARATE DETERMINATIONS

The revised Section-5-related Final Rule is prone to create situations where a small, but meaningful, percentage of organizations are recognized as legitimate not-for-profit organizations by the IRS, but *not* recognized as engaging in business "for only charitable purposes" by the FTC. Such situations are especially likely to be prevalent in sectors like healthcare and higher education.

If such a situation arose, it would create substantial and avoidable confusion regarding the purpose of these ventures, placing them in a twilight where their recent mandates, mission statements, and past behaviors are "good enough for the IRS but not for the FTC." Some enterprises likely to be affected are important drivers of American innovation, including healthcare research sites and science labs within top non-profit universities. These entities may struggle to manage their human capital and intellectual assets optimally, given the FTC's confusing case-by-case approach for this regulatory regime.

In general, it is beneficial to reaffirm (though perhaps not permanently cement) the status of institutions in society. We observe this in the codified rigidity and judicial reiteration of the roles of regulators from aviation to insurance to finance.

Despite the banking sector's enormous expansion, the Federal Deposit Insurance Corporation's ("FDIC") role has shown little variation for nearly a century. There has been little change in the legal or colloquial understanding of what the word "bank" means, despite changes in online banking, rise of so-called neobanks, prevalence of non-bank credit facilities, and emergence of mutual fund originators that resemble traditional banks but are not regulated as such (e.g., Fidelity). This consistency is helpful for markets and for society, allowing any given layperson on the street to articulate the general concept of a bank, the role of the FDIC, and how the two interact.

Meanwhile, the FTC's role has been turbulent—powerful, yet often aimless; a solution in search of a problem; Batman in a crimeless Gotham.

Expanding the FTC's ambit by increasing the ambiguity of where and how it is empowered to intervene, is perhaps the most disruptive, confusing, and strange choice available to Ms. Khan. But that's precisely–or, more appropriately, *imprecisely*–what this peculiar and unneeded bifurcation of American enterprises achieves. Rather than clarifying the FTC's role and identifying which organizations need to be concerned with compliance, the proposed Final Rule changes blur more lines than they sharpen. They position the FTC as a possible, but not guaranteed, arbiter of

the virtue of any organization in the U.S. that claims to engage in activities not primarily driven by profit.

If the FTC were to take action on a substantial number of these enforcement cases, which is unlikely to occur, one can expect more courts to concur with the *Ryan* court[95]—namely, that while the FTC's enforcement path is frightening at first blush, in the end, it is unlikely to create a wholesale change in the behavior of American businesspeople.

One can suppose, for instance, that a top research university employs a leading researcher of new antibiotics, Rachel Researcher, and wants to restrict her employment opportunities after her departure from the university lab. The university itself is a non-profit and primarily involved in charitable activities per the IRS. But this may not fully shield the lab, as it is also engaged in profitable collaborations with drug manufacturers, chemical companies, and materials science firms. In this situation, what should the person managing Rachel do upon hiring her?[96]

Given that someone like Rachel has high earning potential, high potential to damage the lab's research output if she were to depart unexpectedly, and high employability among a known set of industries and firms, many managers would likely choose to implement a noncompete arrangement appurtenant to Rachel's employment offer, knowing this could violate the FTC Final Rule.

The reason for this is that there is significant uncertainty about whether the Final Rule applies to an employer like the university lab, and the $10,000 maximum penalty is a pittance compared to the $500,000 that Rachel earns annually or the $25,000,000 the university stands to gain from Rachel's patents to be filed in the next three years. However, this maximum penalty is not what the manager should have in mind.

If there is a 50% chance that the university lab is subject to the Final Rule, and if 5% of the time an enterprise subject to the Final Rule is found liable for violating it and forced to pay a penalty, and if the anticipated penalty is $5,000 (the maximum penalty is $10,000), then the expected value of noncompliance in the lab's manager's mind should be a mere $125. The mathematical equation is as follows: $5,000 x 0.5 x 0.05 = $125.00.

In short, while the FTC's determination framework for whether firms are subject to the proposed revisions is cumbersome and problematic, it should not be something over which most

95. That court enjoined any implementation of the Rule or the enforcement of FTC findings or damages against the plaintiff (and plaintiffs-intervenors) related to banning (or nearly banning) noncompete agreements between those hired and those hiring them. That court also stayed the Rule's September 4, 2024 effective date as to those parties.

96. This is an anecdote created in July of 2024 when this question was unsettled law and should not be construed as legal advice or corporate strategy advice from the Authors.

managers lose sleep. Enforcement is historically rare, and the money involved will amount to trivial penalties in most instances.

VI. CONCLUSION: HIGH STAKES IN THEORY, LOW STAKES IN PRACTICE?

Although other courts may indeed rule differently—and this is a matter on which reasonable minds differ—the recent analysis of the district court in *Ryan* suggests that while the changes Ms. Khan proposed seem substantial for employers, the FTC's proverbial bark may be worse than its bite.[97] The *Ryan* court appears to suggest[98] that at most, the FTC can seek $10,000 per violation in civil penalties[99] (a non-trivial, but also non-fatal, amount to pay to limit the post-employment behavior of a high-value employee earning an annual $500,000 to $2,000,000), and that nationwide, ubiquitous enforcement of the rule by the FTC would be cumbersome.

This is because civil enforcement procedure is substantially onerous—as it should be when the government seeks to comprehensively and perennially interfere with how businesspeople manage their enterprises. The procedural process is straightforward for the FTC to create and enforce a penalty against an employer in violation of the new rule. Ms. Khan's FTC would need to properly draft and duly file an administrative complaint against the firm. It would then assuage due process concerns by holding a hearing and issuing an Order (e.g., cease-and-desist), which would then need to mature into finality. Only at that point, and only if the employer was found to have violated the Order, could the FTC file a lawsuit asking a court to award civil penalties of up to $10,000.

Regardless of what lies ahead, the FTC must strike a balance between its fulfilling its role as market regulator and maintaining clarity in its rules. When the uncertainty around how, when, and to what extent rules will be enforced is substantial—as it is here—it places business managers in an impossible position. This is especially true in the current U.S. economy, which is increasingly-centered around human capital and so-called "knowledge workers," whose abilities to write computer code or discover new pharmaceuticals is at issue, not workers' abilities to dig ditches, swing hammers, or shovel coal into locomotives. In this more intellectual, technological, and advanced type of economy, labor is

97. The rule involved here involves "unfair or deceptive trade acts or practices," something the FTC has been empowered to oversee, investigate, and sanction since its genesis. The rule's legitimacy and enforceability depends upon the FTC's determination that non-compete arrangements are an unfair method of competition.

98. *See Ryan*, 2024 WL 3297524, at *1.

99. Seeking to collect any penalties at all is currently premature per the rule change's implementation schedule and also stayed by the Texas' court's order.

inherently more mobilized, and in some cases, more versatile. This is something the U.S. should celebrate, but also something to be guarded from private parties trying to reach bargains around it and, in some cases, constrain it through appurtenant-to-employment-agreement[100] arrangements. Regardless of the standard employed, it is difficult to argue that an employer's qualitative placement on the charitability spectrum should be a primary metric used to examine whether a firm should be subject to certain FTC rules.

The Authors hope that Ms. Khan (and perhaps her less ambitious successors) will take a step back, appreciate the beauty and complexity of American markets, and implement rules that encourage markets to flourish, rather than constrain their growth through administrative overregulation and unnecessary interference. Most importantly, clarity must emerge by whatever date replaces September 4, 2024 (i.e., the original date upon which the Final Rule was to take effect, now replaced by an unknown date due to the *Ryan* court's nationwide intervention), or employers will be forced to make difficult decisions with limited information about how future administrators will interpret their hiring practices, employment arrangements, and contractual language in an election year—a suboptimal and avoidable quandary.

The coming weeks represent the best, and likely last, chance for Ms. Khan and her colleagues to adjust course, reduce speed, soften their tone, and reassure markets that they can interact with the labor market in a way that, at a minimum, satisfies a "do no harm" standard.[101]

So now, in September 2024, the clock is ticking, Ms. Khan.

100. This word is chosen carefully. Many, but not all, states require restrictive covenants to be appurtenant to, but separate from, employment agreements (often with separate good and valuable consideration).

101. Unknown Scribe, *Hippocratic Oath*, Oxyrhynchus Papyri Fragment Catalogue No. 2547, Vatican Library Permanent Collection (c. 275 AD).