Legal Update Article

Battle Over/War Isn't: Employer Considerations Now That FTC Non-Compete Ban Is Set Aside

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Restrictive Covenants, Trade Secrets and Unfair Competition

A Texas court has set aside the Federal Trade Commission's (FTC's) Final Rule banning almost all non-compete clauses days before it was set to take effect on Sept. 4. *Ryan LLC v. FTC,* No. 3:24-CV-00986-E, 2024 U.S. Dist. LEXIS 148488 (N.D. Tex. Aug. 20, 2024). The court's ruling bars the FTC from enforcing the Final Rule nationwide. Although the FTC lost this battle, it may be winning the war.

Nationwide Effect

The FTC promulgated the Final Rule on April 23, 2024. Ryan LLC filed suit the same day, moving for a preliminary injunction and seeking to vacate the Final Rule. The U.S. Chamber of Commerce, as well as several other employer associations, later joined the lawsuit as intervenor plaintiffs seeking the same relief.

On July 3, 2024, the court granted the motion for preliminary injunction in part, limiting relief only to the named plaintiffs.

The Aug. 20, 2024, decision granted plaintiffs' motion for summary judgment and, unlike the order granting the preliminary injunction, explicitly applies nationwide.

Judge Ada Brown held the Federal Trade Commission Act (FTCA) did not authorize the FTC to issue substantive rules like the Final Rule banning non-compete clauses. Rather, the FTCA limits the FTC's authority to the prevention of unfair methods of competition through case-by-case adjudication, she explained. The court found promulgating a rule that retroactively invalidated millions of existing contracts exceeded the FTC's statutory authority.

Judge Brown also concluded the Final Rule was arbitrary and capricious because the FTC lacked sufficient evidence to support a categorical ban on non-compete agreements and failed to consider less restrictive alternatives. Further, the court held the Final Rule implicated constitutional concerns relating to the non-delegation doctrine.

Potential Appeal; Two Pending Challenges

As a federal government agency, the FTC has 60 days, or until Oct. 19, 2024, to appeal the decision to the U.S. Court of Appeals for the Fifth Circuit. Until and unless a court orders otherwise, the Final Rule has no weight. Absent an unlikely interim order to the contrary, the Final Rule will remain unenforceable during any potential appeal. Given the Fifth Circuit's rejection of federal agency rulemaking in *Restaurant Law Center v. U.S. Department of Labor,* No. 23-50562 (Aug. 23, 2024), the FTC's success on appeal seems doubtful.

The outcome of two other cases challenging the Final Rule remains uncertain. The U.S. District Court for the Middle District of Florida granted injunctive relief to the named plaintiff only in *Properties of the Villages v. FTC,* No. 5:24-cv-316 (M.D. Fla. Aug. 15, 2024). After Judge Brown set aside the Final Rule in *Ryan,* the Florida court granted the FTC's motion to suspend pleading deadlines, effectively staying the case.

Pending in the U.S. District Court for the Eastern District of Pennsylvania is *ATS Tree Services, LLC v. FTC,* No. 24-1743. That court had declined to preliminarily enjoin the Final Rule from going into effect, finding the FTC had substantive authority to issue the Final Rule. The parties are briefing dispositive motions. Given the nationwide applicability of the *Ryan* decision, this case, like *Properties of the Villages,* is potentially moot.

Depending on how the Pennsylvania case proceeds and how the Third Circuit rules, a split in the circuits could land the validity of the Final Rule at the U.S. Supreme Court, where it may encounter a similar challenge as expected at the Fifth Circuit.

Other Considerations for Employers

The FTC likely anticipated the latest ruling and may have understood the limits of its own authority. Indeed, as far back as January 2020, at the FTC's own workshop, both economists and administrative law experts questioned the agency's authority to move forward with a rule banning non-competes. After the FTC issued a Notice of Proposed Rulemaking in early 2023, the agency continued to encourage state legislatures to ban or limit the use of non-compete clauses. Such encouragement conflicts with a belief that the FTC has the authority to enact a nationwide ban on non-competes.

While the FTC may have lost this battle, it ultimately may win the war on non-competes. Regardless of the outcome of the pending lawsuits, the FTC's cause — restricting or eliminating non-competes — lives on. In fact, by attempting to ban non-competes so broadly, the FTC effectively brought the issue into the public consciousness.

Although federal and state legislation likely will affect the use of non-compete agreements, future limitations may not be as draconian as the Final Rule's total, retroactive ban. Opposition to non-competes enjoys rare bipartisan support in Congress. Senators Christopher Murphy (D-Conn.) and Todd Young (R-Ind.) introduced the "Workforce Mobility Act of 2023" in 2019, 2021, and 2023. This act would largely ban the use of employer non-compete agreements nationwide as a matter of federal law and may gain momentum.

Notwithstanding governor vetoes of laws totally banning non-compete clauses in New York, Maine, and Rhode Island, state legislatures continue to introduce and pass laws that whittle away at the scope of permissible use of non-compete clauses. California, Minnesota, Oklahoma, and North Dakota prohibit non-compete agreements. Many states where non-compete agreements are enforceable allow exemptions for certain professions or income levels. Laws introduced in Arizona, Connecticut, Georgia, Illinois, Kentucky, Missouri, New York, Rhode Island, and Tennessee would further limit the enforceability of non-compete clauses. The FTC has also indicated it will continue to bring individual enforcement actions as it deems appropriate, separate from the now-defunct Final Rule.

Until federal legislation is enacted or future rulemaking limiting or prohibiting non-compete clauses sticks, employers should continue to assess their business interests that need to be protected and consider how to protect those interests. This includes deciding which, if any, employees should be entering into non-competition agreements and drafting such agreements to narrowly protect those interests in accordance with state law.

In addition, employers should:

1. Bolster the other provisions in their restrictive covenants on non-solicitation and non-disclosure;

2. Take steps to protect trade secrets and other confidential information appropriately; and

3. Solidify their practices and policies on onboarding and offboarding employees.

Because the law on restrictive covenants varies from state to state in ways both nuanced and significant, careful and competent drafting is critical.

Jackson Lewis attorneys are available to discuss the current state of non-compete laws and to help review and revise restrictive covenant agreements.