Legal Update Article

Why Employers' Non-Competes Could Still Be at Risk Despite FTC Rule Being 'Set Aside'

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The U.S. District Court for the Northern District of Texas in *Ryan LLC v. FTC* granted summary judgment "setting aside" the Federal Trade Commission's (FTC's) Final Rule banning non-compete clauses between employers and workers on Aug. 20, 2024. The outcomes of two other cases challenging the Final Rule are unlikely to impact the status. The FTC appealed the district court's injunction in *Properties of the Villages, Inc. v. FTC* to the Eleventh Circuit, which likely will affirm the lower court. The plaintiff in *ATS Tree Service v. FTC* voluntarily dismissed the case after unsuccessfully attempting to stay the litigation after the *Ryan* decision. Despite these cases, however, the FTC's authority to identify anti-competitive activity and pursue enforcement mechanisms case-by-case remains unchallenged and intact.

The language of the now-set-aside Final Rule provides a key to understanding how the FTC will approach case-by-case enforcement. The FTC considers non-compete agreements between employers and employees to be unfair methods of competition and therefore violations of Section 5 of the Federal Trade Commission Act (FTCA), which bans "unfair methods of competition" and "unfair or deceptive acts or practices." The FTC's review and enforcement likely will mirror its enforcement processes in cases of monopolization or agreements to limit competition.

FTC's Investigative Authority Under FTCA

The FTC has the authority to prohibit conduct it believes to be an unfair method of competition. The following scenario provides a high-level illustration of how its process against a company can play out.

Imagine the FTC suspects that hypothetical XYZ Corp. engaged in unfair methods of competition by entering into and attempting to enforce an overbroad non-compete agreement and decides to investigate. As part of the investigation, the FTC subpoenas witnesses and documentary evidence from XYZ Corp. XYZ Corp. initially refuses to comply with the subpoena until the FTC threatens to exercise its authority to seek enforcement in the appropriate federal district court.

After completing its investigation, the FTC determines that XYZ Corp. violated the law and files an administrative complaint. The FTC also issues a notice of hearing. XYZ Corp. considers whether to appear at the hearing to present evidence in its defense or settle the charges by entering into a consent agreement with the FTC, confirming entry of a final order waiving judicial review, but not admitting liability. The final cease-

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and-desist order will be subject to public comment for 30 days.

XYZ Corp. decides it has a persuasive case and appears at the hearing before an administrative law judge (ALJ). The ALJ concludes that the non-compete agreement at issue constituted an unfair method of competition because it prevented employees from obtaining better or more competitive wages or seeking employment in relevant labor markets or industries. The ALJ issues an order mandating XYZ Corp. cease and desist from attempting to enforce the unlawful non-compete agreement.

XYZ Corp. petitions for review with an appropriate court of appeals within 60 days of service of the ALJ's order. While the court of appeals must accept the ALJ's finding of fact, the court can order the FTC to collect additional evidence. Similarly, either party can petition the court for permission to present evidence in addition to the hearing record. In this hypothetical, the court of appeals affirms the ALJ's decision and the FTC's cease-and-desist order against XYZ Corp. becomes final and enforceable.

Even so, XYZ Corp. remains steadfast in its belief that its non-compete agreement is lawful and continues to require new employees to enter into the agreement. It also continues to threaten enforcement of the non-compete agreement against employees it suspects intend to work for competitors. In response, the FTC imposes a civil penalty of $10,000 for each violation, and the U.S. attorney general files a civil action in district court to recover the penalty. The district court orders XYZ Corp. to pay the imposed penalty and to notify its employees in writing that the non-compete agreement is void and unenforceable.

Criminal Prosecution Under Sherman Antitrust Act

While the FTCA does not provide employees with a private right of action, the FTC and Department of Justice (DOJ) together could prosecute employers who seek to enforce unlawful non-compete agreements under the Sherman Antitrust Act. The Sherman Antitrust Act makes conspiracies to restrain trade felonies subject to significant penalties, including fines up to $100 million or up to 10 years in prison.

Although the FTC and the DOJ have yet to challenge non-compete agreements directly under the Sherman Antitrust Act, the FTC and DOJ have pursued a number of criminal actions under the Act against employers who entered "no-poach" or wage-fixing agreements with one another. The DOJ argued that no-poach and wage fixing agreements "eliminate competition in the same irredeemable way as agreements to fix products prices or allocate customers," which the DOJ analogizes to "hardcore cartel conduct."

The DOJ's criminal prosecution efforts under the Sherman Antitrust Act have been unsuccessful. To date, the DOJ has not secured a single jury conviction on any of the no-poach or wage-fixing indictments. Despite this, on March 31, 2023, the DOJ reiterated its intention to prosecute these cases, characterizing its efforts as "righteous." The DOJ voluntarily dismissed the last of these actions in November 2023.

As with no-poach and wage-fixing agreements, the FTC views non-compete agreements as the type of conduct worthy of "righteous" prosecutions. The DOJ recently filed a Statement of Interest in a civil class action case challenging the use of non-compete agreements as anti-competitive monopolization. We expect that the FTC will begin testing the waters by opening investigations and enforcement

proceedings and filing Statements of Interest, in certain industries, with respect to non-compete agreements it believes are anti-competitive. The FTC will consider the industry, level of the employee, company size, and scope and reasonableness of the non-compete in effectuating case-by-case enforcement.

We continue to encourage employers to review and update non-compete agreements, such that the agreements clearly articulate the employer's protectible interest, limit the scope of restrictions to a narrow geographic area and reasonable time frame, and apply only to select individuals. Employers should also remember that state non-compete laws may apply.

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