

FTC's Final Rule Banning Employee Noncompete Agreements Struck Down [Alert]

Related Practice Areas

- Labor & Employment

We first discussed the Federal Trade Commission's (FTC) Proposed Rule banning noncompete agreements in our January 9, 2023, Client Alert, and again on April 25, 2024, when the FTC issued its Final Rule. The effective date of the Final Rule was scheduled to be September 4, 2024, but on August 20, 2024, the Northern District of Texas struck down the Final Rule with nationwide effect and ordered that it "shall not be enforced or otherwise take effect on its effective date of September 4, 2024, or thereafter."

Summary of Prior Legal Challenges

(NDTX) *Ryan LLC v. FTC* – On July 3, 2024, a district judge for the Northern District of Texas preliminarily enjoined the FTC's ban finding that the FTC exceeded the scope of its statutory authority, but limited the injunction to the named plaintiffs at the preliminary stage. On August 20, 2024, the court issued its final decision on the merits and rejected the FTC's request to limit its ruling to only the parties rather than strike down the Final Rule nationally. Specifically, the court found "setting aside agency action under § 706 has 'nationwide effect,' is 'not party-restricted,' and 'affects persons in all judicial districts equally ... Thus, the Court hereby holds unlawful and sets aside the Rule."

(EDTX) *US Chamber of Commerce v. FTC* – a district judge for the Eastern District of Texas stayed and then dismissed this litigation under the first-to-file rule in favor of the *Ryan LLC* case in the Northern District of Texas. In the order staying proceedings, the district judge noted both Texas lawsuits sought the remedy of vacating the Proposed Rule and that if successful, the FTC would not be able to enforce the Rule against anyone regardless of whether they are a party to the lawsuit.

(EDPA) *ATS Tree Services, LLC v. FTC* – On July 23, 2024, a district judge in the Eastern District of Pennsylvania declined to enter an injunction blocking the FTC's rule by finding the FTC did not exceed in statutory authority – the opposite conclusion of its sister court in the Northern District of Texas. This decision is being appealed to the Third Circuit.

(MDFL) *Properties of the Villages, Inc. v. FTC* – On July 2, 2024, the plaintiff filed its motion for preliminary injunction seeking to enjoin the FTC Rule. The FTC filed its opposition on July 25, 2024. On August 15, 2024, the court granted a preliminary injunction stopping the Rule from taking effect on September 4, but limited the order to the parties only.

What Now?

The Final Rule will not take effect on September 4, 2024, and employers should wait for the appeals process to play out, which could take months, if not years. However, employers should recognize the FTC's effort is part of a growing trend at the state and federal level. States such as Oklahoma, California, North Dakota, and Minnesota already prohibit noncompetes under state law. Other states, such as Illinois and Colorado, have passed restrictive laws limiting the use of such agreements. Even in states where such agreements are generally allowed, individual judges have wide discretion in enforcement, and many are elected, making them susceptible to changes in the mood of the population. Make no mistake — it is getting harder to enforce noncompete agreements and most cases come down to whether the employee has engaged in clear wrongdoing (e.g., misappropriating confidential information), sufficient to raise the judge's ire enough to outweigh the inherent sympathy for an employee who just wants to work.

In light of these clear trends in legislation and rule-making, we suggest employers take the following steps:

1. Conduct a regular review of the use of restrictive covenants in your organization to ensure they are lawful and appropriate in light of changing local and state laws, especially for employers with a large geographic footprint. Some states penalize employers who merely require such an agreement, even if it is never enforced.
2. Consider what levels of restrictions are necessary. Would a strong confidentiality agreement suffice? Would a restriction on soliciting customers and employees serve the same practical effect and provide adequate protections?
3. Consider tiering the types of agreements used in your organization, reserving the most onerous restrictions for those at the highest levels of your organization with access to the most critical information to the long-term vitality of your business. The clear trend of state legislation cuts against enforcing noncompetes on low income workers and non-management employees.
4. Lastly, consider tying restrictive covenants to bonuses, stock options or other benefits reserved for key employees. This allows the employer to not only seek to restrict competition (which may not succeed) but to also claw back financial payments.