Updates
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Employers Left in Limbo by FTC Noncompete Decision

In *Ryan v. Federal Trade Commission*, Federal District Court Judge Ada Brown released a much-anticipated preliminary injunction decision against the Federal Trade Commission (FTC) regarding its pending "Non-Compete Ban." Case No. 3:24-CV-00986 (N.D. Tex. July 3, 2024).

The decision is a mixed one for businesses using noncompete agreements. The judge's findings will be encouraging news to businesses that have argued that the FTC does not have the authority to ban noncompete agreements affecting millions of workers. However, because the ruling is specifically limited to the plaintiffs before the court, it will be disappointing to many employers who had hoped for clear direction on a national level before the ban takes effect.

FTC Likely Exceeded Authority, According to Court

On July 3, 2024, the U.S. District Court for the Northern District of Texas found that several plaintiffs were likely to succeed on the merits of their challenge to the FTC's sweeping noncompete ban. The district court concluded that (1) the FTC likely exceeded its statutory authority, and (2) the pending noncompete ban is "arbitrary and capricious" and violates the Administrative Procedures Act (APA). The court, however, declined to craft a broader injunction that would prevent the ban from taking effect nationwide. Instead, it merely prohibited enforcement of the rule against the named plaintiffs, including Ryan, LLC and four trade associations, such as the U.S. Chamber of Commerce. The district court also declined to extend protections of the injunction to individual members of the trade association plaintiffs, citing unresolved questions of standing. Judge Brown committed to enter a dispositive order resolving the case on the merits by August 30, 2024—less than one week before the rule is due to take effect on September 4, 2024.

Central to the decision was the court's finding that Section 6(g) of the Federal Trade Commission Act of 1914 (15 U.S.C. § 46(g)), is a "housekeeping statute" which did not empower the FTC with "authority to make

substantive rules related to unfair methods of competition." Here, the FTC relies upon Section 6(g) to assert its statutory authority to ban noncompete agreements on an across-the-board basis as an "unfair competition method." Judge Brown found that Section 6(g) was intended by Congress to grant authority for "rules of agency organization procedure or practice" but not for "substantive rules," such as a ban on noncompetes.

Secondarily, the court found that—in addition to the lack of statutory authority to make a substantive rule—the noncompete ban was "unreasonably overbroad without a reasonable explanation." Further, the court highlighted that the noncompete ban "imposes a one-size-fits-all approach with no end date" and does not offer a "rational connection between the facts found and the choice made." According to Judge Brown, the flawed basis for the rule was "a handful of studies that examined the economic effects of various state policies toward non-competes" without any recognition of the fact that "no state has ever enacted a non-compete rule as broad as the FTC's Non-Compete Rule." Thus, under the district court's analysis, even if the cited academic studies of state noncompete laws superficially supported the concept of limiting noncompetes, those studies failed to supply sufficient "evidence or [a] reasoned basis" for the FTC rule. The court also criticized the FTC for failing to "consider the positive benefits of non-compete agreements" and "insufficiently address[ing] alternatives" to the broad ban.

Preliminary Injunction Affects Named Plaintiffs Only

Judge Brown's ruling has no legal impact on any businesses other than the named plaintiffs. Others hoping for a nationwide outcome will have to wait. Based on Judge Brown's opinion, we should not expect a permanent injunction with national effect (*i.e.*, by entirely preventing the rule from taking effect). Barring additional court challenges in other jurisdictions, the FTC's rule banning noncompetes will become effective on September 4, 2024.

This decision (or other similar cases) will likely reach federal appellate courts over time, but not before the rule's effective date. For businesses engaged in a wait-and-see approach, this uncertainty may raise difficult questions of whether to prepare for compliance with the rule or to wait for clarifying court decisions.

Businesses that choose to ignore the noncompete ban will be weighing the risk of uncertainty in potential private litigation or the possibility of FTC enforcement against the "unfair methods of competition" that Judge Brown has found to be improper but not affirmatively foreclosed. While the pending rule purports to invalidate existing noncompete agreements and to supersede state laws that would otherwise allow them to be enforced, it remains to be seen how state court judges will react to such broad interpretations of agency authority.

It seems plausible, if not likely, that some state court judges may opt to disregard the pending FTC rule and continue to permit noncompete agreements to be enforced in accordance with existing state laws, a position buttressed by the fact that a federal court has now found the noncompete ban to be the product of the agency exceeding its statutory rulemaking authority and violating the APA. On the other hand, for state courts that have taken a skeptical view of most noncompete agreements, the FTC's rule provides additional ammunition for declining enforcement of such agreements. In the short term, the FTC's pending rule may promote even greater uncertainty for parties seeking enforcement of noncompete agreements after the effective date.

The *Ryan* decision does nothing to foreclose the FTC's ability to pursue enforcement against any persons who are not parties to that case. This is another factor that must be considered by any employer opting to disregard the FTC's pending rule.

Considerations for Continuing To "Wait and See" What Happens Next

For businesses that prefer to continue taking a "wait-and-see" approach before the September 4 effective date of the FTC rule, fewer than two months remain to prepare compliance measures. These measures may include

getting ready to provide notice to current and former workers that noncompete agreements will not be enforced. They would also include, on a case-by-case basis, potentially major revamps of existing onboarding documents for new hires, including standardized confidentiality or nonsolicitation agreements.

For some, given the broad scope of the pending rule, a business's notice of nonenforcement may need to be sent to current and former workers (including independent contractors). Wait-and-see planners will likely not wish to distribute any announcement until just before the FTC noncompete ban goes live, as there may well be broader injunctions entered in the interim that go further than the preliminary injunction in the *Ryan* case.

Under any wait-and-see strategy, businesses are likely to need substantial guidance from outside counsel to ensure proper preparation for last-minute compliance and implementation changes. Employers should also develop a communications strategy anticipating that, as the implementation date approaches, employees and former employees who have not received any communication about the employer's intent may start asking whether they are being released from noncompete agreements. Such communication strategies should also consider whether the business has noncompete agreements that are excepted from the broad ban, since the FTC's rule does not purport to invalidate preexisting noncompete agreements signed by certain "senior executives." Although the scope of "grandfathered" noncompetes is very narrow, such agreements are also likely to be among the most significant.

Pivoting From Traditional "Non-compete" Restrictions

Regardless of the eventual fate of the FTC's noncompete ban, the presently applicable law for enforceability of these agreements remains a patchwork of state statutes and state court decisions. Many states have relevant statutory provisions that are idiosyncratic and nuanced, and some represent recently enacted or amended legislation. The trend toward multijurisdictional workforces (especially with remote workers) can make it challenging for businesses to effectively administer noncompete agreements on a national basis. As a result, some businesses may opt to embrace certainty rather than awaiting the outcome of what-if courtroom scenarios.

Businesses considering affirmatively discontinuing use of noncompetes, whether or not the FTC regulation takes effect, may have substantial work to do. The decision to treat the noncompete ban as an entry point for new company policy would involve implementing narrower post-employment restrictions, such as specific provisions for protection against disclosure of confidential information, solicitation of certain employees, and/or solicitation of certain customers. Such an implementation would require clear communication to affected workers and the execution of amended or new legal agreements with new and existing workers. Guidance from counsel may be critical to the successful implementation of this strategy.

Some businesses may determine that continuation of the use of noncompete agreements is important enough, and the need for certainty of outcome demands development of a litigation strategy. Litigation may come in several forms, including (1) affirmative enforcement of existing noncompete agreements against persons in breach, (2) defending against challenges to noncompete agreements by those who wish them invalidated, or (3) involvement in legal disputes arising from judicial challenges to the pending FTC rule.

In any scenario, proactive decision-making and consultation with experienced legal counsel appear to be the path forward for most businesses in the path of the noncompete ban.

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