Considering Noncompete Strategies After Blocked FTC Ban

By **Amanda Cohen, Kimberly Franko and Joseph Deng** (August 26, 2024)

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Employers across the country have been relieved of the obligation to comply with the Federal Trade Commission's rule banning most postemployment noncompetes — for now. On Aug. 20, U.S. District Judge Ada Brown of the U.S. District Court for the Northern District of Texas granted summary judgment for plaintiffs in Ryan LLC v. FTC.[1]

Judge Brown set aside the rule just two weeks before it was scheduled to go into effect on Sept. 4, and ordered that it cannot be enforced nationwide.

As a result, employers do not need to comply with the rule's notice and other requirements at this time. Employers can continue to maintain and enforce their current noncompetes pending resolution of the outstanding challenges to the rule.

Other agreements that may have been banned by the FTC's rule if they function as noncompetes — such as certain nondisclosure and nonsolicitation agreements — can continue as well.

But just because the FTC ban on noncompetes has been set aside for now does not mean that the FTC cannot investigate the enforcement of noncompetes on a case-by-case basis. In addition, other administrative agencies and state legislatures are seeking to limit their use.

For these reasons, employers that have employee noncompetes can still be subject to investigations and enforcement actions from state and federal enforcement officials — particularly to the extent that the employer has a leading industry position or significant operations across the U.S.

In addition, courts are more rigorously reviewing noncompete clauses to determine if they are reasonable and necessary to protect legitimate business interests, and the enforcement of noncompetes against lower-wage workers, in particular, will likely continue to be an uphill battle.

Thus, while the Ryan ruling does away with some immediate compliance obligations, employers will still be well-served to review their overall noncompete strategy and pay close attention to changes to state laws on this topic, as well as monitor the various ongoing cases that are challenging the noncompete rule.

The Reasoning Behind Ryan

As a foreshadowing of what was to come, Judge Brown began her analysis citing Loper Bright Enterprises v. Raimondo.

In this June 28 decision, the U.S. Supreme Court reined in federal agency power by

overturning the so-called Chevron doctrine, and found that courts are not required to defer to government agencies that offer a reasonable interpretation of an unclear statute.

In rejecting the FTC's interpretation of Section 6(g) of the FTC Act, Judge Brown determined that the FTC exceeded its statutory authority in issuing a rule that categorically defined nearly all noncompetes as "unfair methods of competition."

It should be noted, however, that there was no dispute that the FTC retains the ability to challenge noncompetes as unfair methods of competition on a case-by-case basis, including through the FTC's own administrative process.

The court also held that the rule is arbitrary and capricious, concluding that the FTC relied on "inconsistent and flawed empirical evidence" that ignored a "substantial body of evidence supporting these agreements" and failed to reasonably consider alternatives to imposing a categorical ban.

Judge Brown's decision is likely a harbinger of things to come, with courts — no longer tied to Chevron deference — being highly critical of federal agency interpretation of statutes, and rebuking agency action that exceeds the authority specifically granted by Congress.

Next Steps for Ryan and the Other Challenges to the FTC Rule

The FTC has stated that it is considering an appeal of the Ryan decision to the U.S. Court of Appeals for the Fifth Circuit. Depending on the outcomes of the ongoing cases involving the noncompete rule, the case could make its way to the Supreme Court.

Two additional challenges to the rule remain pending in the U.S. District Court for the Eastern District of Pennsylvania and the U.S. District Court for the Middle District of Florida, respectively.

On July 23, U.S. District Judge Kelley Hodge of the Eastern District of Pennsylvania, in contrast to Judge Brown, refused to temporarily block the FTC's ban in ATS Tree Services LLC v. FTC, holding that the plaintiff had not shown that it would be irreparably harmed by enforcement of the rule or a likelihood of success on the merits — i.e., that the FTC exceeded its statutory authority by issuing the rule.

Meanwhile, on Aug. 15, U.S. District Judge Timothy Corrigan of the Middle District of Florida entered a preliminary injunction prohibiting enforcement of the FTC's rule against the plaintiff only in Properties of the Villages Inc. v. FTC, finding that the plaintiff had shown a substantial likelihood of prevailing on its claim that the rule exceeds the FTC's authority — in line with the conclusion reached by Judge Brown that the FTC exceeded its statutory by issuing the rule.

Heightened Focus on Labor Markets

The FTC is not the only federal agency on a campaign to restrict employment-based noncompetes for U.S. workers. Both the National Labor Relations Board and the U.S. Department of Justice have also taken a stance against the use of noncompetes with employees.

In July 2022, the NLRB's general counsel and the DOJ's Antitrust Division's assistant attorney general signed a memorandum of understanding.[2]

The memorandum of understanding cited the agencies' shared interest in promoting the free flow of commerce and fair competition in labor markets by protecting U.S. workers from collusive or anticompetitive employer practices and unlawful interference with employees' right to organize — the NLRB entered into a similar memorandum with the FTC in July 2022.

The DOJ has also publicly stated its support for the FTC's noncompete rule. In April 2023, the Antitrust Division of the DOJ filed a comment supporting the then-proposed rule, stating that protecting workers is a central goal of antitrust, that noncompete clauses harm labor market competition by inhibiting worker mobility, and supporting the FTC's effort[3].

It is also notable that, like the FTC, the DOJ can pursue case-by-case investigations and enforcement actions against companies that employ noncompetes to evaluate them for potential antitrust concerns.

The NLRB has also broadcast its opposition to noncompetes. In May 2023, NLRB general counsel Jennifer Abruzzo issued a memo to NLRB regional offices, condemning most employment noncompete agreements as unlawfully interfering with employees' exercise of Section 7 rights under the NLRA.[4]

In the June 13 J.O. Mory Inc. decision, NLRB Administrative Law Judge Sarah Karpinen found that noncompete and nonsolicitation provisions in an employment agreement chilled employees' rights to engage in protected concerted activity under Section 7 of the NLRA, and required the employer to rescind the challenged provisions and notify current and former employees that the provisions' requirements were no longer in effect.[5]

Suffice to say, federal agencies are demonstrating opposition to workplace noncompetes.

State Laws' Continued Restriction of Use Of Employee Noncompetes

Regardless of what happens at the federal level, U.S. states continue to limit the use of noncompetes. Four states — California, North Dakota, Oklahoma and Minnesota — largely prohibit noncompetes, subject to certain narrow exceptions, such as for certain sales of businesses.

A number of states prohibit the use of noncompete agreements for low-wage earners, including Colorado, Illinois, Washington, Maine, Maryland, New Hampshire, Oregon, Rhode Island and Virginia.

There are a range of other restrictions that state laws apply to limit the use of noncompetes, including maximum duration, minimum consideration, prehire notifications and waiver if the employee is terminated without cause.

Some of this year's legislation proposed to limit noncompetes included the following:

- Connecticut H.B. 5269 would mandate that an employee or independent contractor cannot be subject to a noncompete unless the employee is an exempt employee earning at least three times the minimum wage, or the independent contractor earns at least five times the minimum wage.

- Illinois. H.B. 5385 would expand the state's existing law restricting noncompetes for lower-wage earners by banning employers from entering into noncompetes or nonsolicitation agreements with any employee, making existing noncompetes that do

not comply with Illinois' current requirements void and unenforceable — including out-of-state noncompetes — and requiring employers to notify current and former employees who were employed after Jan. 1, 2023, in writing by April 1, 2025, if their noncompetes and nonsolicitation agreements are void and unenforceable.

- New York S. 6748 would make it an unfair method of competition to enter into or maintain a noncompete clause with a worker, and would require employers to rescind existing noncompetes and inform workers that the noncompete is unenforceable.

Assuming the FTC's rule remains set aside, we expect states to be even more active in this space and to see additional legislation introduced in the 2025 legislative sessions.

Actions To Take Now

Know where your noncompetes are.

You should take inventory of your noncompete covenants now. Employees are often subject to multiple and conflicting noncompetes and other restrictive covenants.

Noncompetes can be found in employment policies or handbooks, offer letters, employment agreements, proprietary information and invention assignments, stock option and other equity award agreements, severance arrangements, and other compensation-related agreements.

Overlapping and conflicting covenants are ripe for challenge on a variety of grounds.

Review your noncompetes for consistency and integration.

If it is not administratively feasible to limit the use of multiple restrictive covenants, the clauses should be reviewed for consistency and integration.

If, for instance you have a noncompete in a global equity award, you don't want an ex-employee to claim that an invalid global noncompete supersedes an otherwise enforceable local noncompete because the global noncompete was signed last, integrates the local noncompete and is not valid under local law.

Less is more.

Given the growing opposition to noncompetes, companies should consider limiting such restrictive covenants to key workers who require highly specialized training or have access to sensitive company information, and focus on protecting high value assets like trade secrets. Narrowing the scope and duration of any noncompetes will generally enhance the enforceability of noncompetes.

Know where your employees are.

Employers need to know where their employees are located who they are seeking to have bound by an enforceable noncompete.

Especially for employers with remote workforces, often times noncompetes are not aligned with the state law where the employee is actually working — and in some instances

employers may not even know or track the actual location of their remote employees. Multistate agreements are another option for employers with largely remote workforces.

Other Strategies to Protect the Company

In locations where noncompetes are not available, employers should consider other strategies to protect confidential and trade secret information and other business interests.

These include customer nonsolicit agreements, where permitted; appropriately tailored confidentiality agreements and policies; and procedures for protecting and maintaining trade secrets and other intellectual property.

Employers should also tailor their employment terms and compensation strategy to protect their business interests.

Depending on the state, options may include longer notice periods, paid garden leave, staggered severance payments that terminate when the employee takes another job, retention bonuses conditioned on employment through a certain period of time, and equity forfeiture or clawback provisions.

The FTC's rule banning noncompetes has been set aside for now. But the general trend is to limit their use. Companies should take inventory now and continue to plan for the likely changes in the future.

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[1] Ryan LLC v. Fed. Trade Comm'n, Civil Action 3:24-CV-00986-E, 32 (N.D. Tex. Jul. 3, 2024)

[2] https://www.justice.gov/opa/pr/justice-department-and-national-labor-relations-board-announce-partnership-protect-workers.

[3] https://www.justice.gov/atr/page/file/1580551/dl?inline.

[4] https://www.nlrb.gov/news-outreach/news-story/nlrb-general-counsel-issues-memo-on-non-competes-violating-the-national.

[5] https://apps.nlrb.gov/link/document.aspx/09031d4583d765f7.