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Ban on the Run: Federal Court Blocks the FTC's Non-Compete Ban Nationwide

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A Federal Court has blocked the Federal Trade Commission's Final Rule (the "Rule") that was set to broadly ban nearly all forms of non-compete agreements.

On August 20, 2024, Judge Ada Brown of the Northern District of Texas permanently enjoined the Rule, ordering that it "shall not be enforced or otherwise take effect" on its originally intended effective date of September 4, 2024, "or thereafter." Though the FTC may appeal Judge Brown's decision, and has articulated a likely intention to do so, the Rule now faces an extremely difficult path to ultimate enforcement.

Takeaway For Employers

To the extent that an employer already sent out a notice to employees that their non-compete agreements would no longer be enforceable as of September 4, 2024, we recommend that such employers reach out again with an update that due to a court ruling, their non-compete agreements shall remain in effect. Of course, employers can expect a potential waiver argument in this situation.

With an appeal possible (see discussion below), the ultimate resolution of this matter may not be reached for some time. Accordingly, companies should be aware that the Rule may become

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enforceable in the future. Therefore, employers must consider that the September 4, 2024 date (the date that the Rule originally was scheduled to take effect) may still be relevant in determining when non-competes, other than for senior executives and in the sale of a business, could become invalidated. In the interim, employers seeking to maximize the likelihood that their non-compete agreements are enforceable should reasonably tailor them to not be overly broad in terms of time and geographic reach, or otherwise overly restrictive regarding an employee's abilities to perform certain duties for another employer. Further, employers should consider executing non-competes with "senior executives" (see discussion below) prior to September 4, 2024, where none are in place, and otherwise stay the course with existing non-competes that otherwise are in good form.

Of course, employers should continue to follow applicable state law. In jurisdictions that allow modification of such agreements (known as "blue penciling"), employers should include such modification provisions in their agreements, which, in certain states, will allow courts to modify restrictions rather than invalidate the agreement as a whole.

What Would the Rule Have Prohibited?

Overview of the Rule

As we reported in April, the FTC's Rule would have generally prohibited employers from entering into any new non-compete clauses with workers, including senior executives, on or after September 4, 2024. Employers would have been prohibited from enforcing or attempting to enforce a pre-existing non-compete (except as to a "senior executive"), or representing that the worker is subject to a non-compete clause.

Exception for Senior Executives

Although existing non-competes entered into before September 4 would also have been banned under the Final Rule, the Rule carved out an exception for "senior executives," defined as a worker who: (1) earns at least $151,164 annually and (2) is in a "policy-making position," meaning a president, CEO, or the equivalent, or any other officer or similar person who possesses final authority to "make decisions that control significant aspects of a business entity or common enterprise." Though employers would not have had to formally rescind existing non-competes, they would have had to provide "clear and conspicuous notice" to affected workers prior to the then-anticipated September 4, 2024, effective date that their agreements would not and could not be legally enforced, which would have been the same result. Because the Northern District of Texas permanently enjoined the Rule (see discussion below) just days before the notice deadline, presumably at least some employers have already sent out such notices. Employers who have done so are well-advised to take steps to preserve their original agreements by advising those notified that the Rule has been permanently enjoined by court order.

Exception for Bona Fide Sales of a Business and M&A Considerations

The Rule also contained a limited exception for non-competes that are entered into by a person pursuant to a bona fide sale of a business entity; the person's ownership interest in a business entity; or all or substantially all of a business entity's operating assets. The FTC considered a "functional test" that would make it "more difficult for workers and employers to know whether a given non-compete is enforceable in the context of the sale of a business." In general, a "bona fide sale" is "one that is made between two independent parties at arm's length, and in which the seller has a reasonable opportunity to negotiate the terms of the sale."

In the context of M&A transactions, the Rule's accompanying commentary clarified that the "sale of business" exception would not include "springing non-competes" (i.e., where a worker must agree at the time of hiring to a non-compete in the event of a future sale), "non-competes arising out of repurchase rights[,] mandatory stock redemption programs," or similar stock-transfer schemes under which the worker may be required to sell shares if a certain event occurs, because in those cases the worker would have had "no good will that they are exchanging for the non-compete or knowledge of or ability to negotiate the terms or conditions of the sale at the time of contracting." Thus, if the Rule does eventually overcome its legal challenges and go into effect, non-competes with such terms would likely be unenforceable unless the affected worker had the opportunity to review and negotiate the terms and conditions of a transaction that would have triggered the event.

Likewise, the FTC identified "sham transactions between wholly owned subsidiaries" as excluded from the "bona fide sale" exception, as such transactions are not made between independent parties. The FTC also confirmed that non-competes allowed under the sale-of-business exception would have remained subject to federal and state antitrust laws.

Additional Limited Exceptions

The Rule also would not have applied where a cause of action accrued prior to the effective date, or where an employer has a good faith basis to believe that the Rule is not applicable. The FTC explained that this "good faith" exception was included "in an abundance of caution to ensure the [Rule] does not infringe on any activity that is protected by the First Amendment."

The Northern District of Texas Permanently Enjoins the Rule

The first legal challenge to the Rule came mere hours after its approval when Ryan LLC, a tax services and software provider, filed suit in the Northern District of Texas.

In *Ryan, LLC v. FTC*, Ryan challenged the FTC's rulemaking authority and claimed that the FTC Act unconstitutionally delegates legislative power to the FTC. Ryan also argued that the FTC Act violated the Vesting Clause of Article II of the Constitution by restricting the President's "ability to remove Commissioners by granting them fixed terms and providing that they can be removed only for 'inefficiency, neglect of duty, or malfeasance of office.'" In other words, Ryan argued, the FTC unlawfully "exercises 'executive power in the constitutional sense.'"

On July 3, 2024, Judge Ada Brown preliminarily sided with Ryan (and various intervenors, including the Chamber of Commerce), holding that they were "substantially likely to prevail on the merits of their challenge to the FTC's Non-Compete Rule," that they "will suffer irreparable harm if no preliminary injunction issues," and that the balance of harms and public interest favored institution of a preliminary injunction. At the time, Judge Brown limited the preliminary injunction to Ryan as the named plaintiff and the intervenors, temporarily leaving the Rule's September 4 effective date in place for all other employers nationwide. However, Judge Brown also advised that the Court intended to rule on the merits of the action by the end of August.

That ruling came on August 20, 2024. Judge Brown permanently enjoined the rule, and held that "by plain reading," the FTC Act "does not expressly grant the Commission authority to promulgate substantive rules regarding unfair methods of competition." Rather, the Act "limits the FTC's ability to make rules dealing with *unfair or deceptive practices* – not *unfair methods of competition*." Thus, Judge Brown concluded that while "the FTC has some authority to promulgate rules to preclude unfair

methods of competition," it did not have authority to "create substantive rules through this method." As further support for the ruling, Judge Brown agreed with Ryan's argument that "the lack of a statutory penalty for violating rules promulgated under [the FTC Act] demonstrates its lack of substantive rulemaking power." Judge Brown found that the Rule impermissibly was arbitrary and capricious for its reliance on only a "handful of studies," for supposedly not providing a rationale for the Rule's broad scope, and for its evident failure to adequately examine less restrictive alternative solutions.

Two More Ongoing Legal Challenges to the FTC Rule May Increase the Likelihood that the Supreme Court Will Weigh In

Two more major lawsuits also have challenged the Rule: *ATS Tree Services, LLC v. FTC*, in the Eastern District of Pennsylvania, and *Properties of the Villages Inc. v. FTC*, in the Middle District of Florida. Though the Rule has been enjoined nationwide pursuant to the *Ryan* holding, these cases may play a role in the likelihood that the Supreme Court ultimately may take up an appeal due to a potential circuit split.

ATS Tree Services, LLC v. FTC

In *ATS Tree Services, LLC v. FTC*, the plaintiff challenged the Rule on similar grounds as the plaintiff in *Ryan LLC*. Specifically, the plaintiff argued that: (1) the FTC lacks statutory authority to promulgate substantive rules to prevent unfair methods of competition; (2) even if the FTC does have substantive rulemaking power, its ban on *all* non-compete agreements exceeded its statutory authority to prevent methods of unfair competition; (3) rendering existing non-compete agreements for non-senior executives unenforceable was arbitrary and capricious; and (4) the FTC Act unconstitutionally delegates legislative power to the FTC.

The plaintiff then moved for a stay of the September 4, 2024, effective date, as well as a preliminary injunction. On July 23, 2024, the E.D. PA declined to do so, ruling that the plaintiff failed to meet its "burden of demonstrating it will suffer irreparable harm in the absence of injunctive relief," where the plaintiff's claimed harm was "nonrecoverable efforts to comply" with the Rule and loss of "contractual benefits from its existing non-compete agreements." The Court further concluded that even if the plaintiff could prove irreparable harm, it was unlikely to succeed on the merits, because the FTC did have authority to promulgate the Rule. For instance, the Court held that "the statutory text [of the FTC Act] provides the FTC with the authority to promulgate rules prohibiting unfair methods of competition," and "provides no express limitations on the FTC's rulemaking authority[.]" As such, the Court concluded that "it would undermine the purpose of the FTC Act to interpret the statute as providing only adjudicative authority[.]"

The case now is continuing through the summary judgment process. The fully briefed summary judgment motion, opposition, and reply are due by October 25, 2024. However, in light of the contrary holding in *Ryan LLC*, *ATS Tree Services* has requested an expedited final decision on its summary judgment motion. Even if the FTC prevails in the *ATS Tree Services* matter, the Rule will remain enjoined nationwide – but such a circuit split would make it more likely that the Supreme Court would take up the case on appeal.

Properties of the Villages, Inc. v. FTC

In *Properties of the Villages, Inc. v. FTC*, the plaintiff also sought a preliminary injunction for similar reasons as the plaintiffs in *Ryan LLC* and *ATS Tree Services* – namely, that: (1) the Rule would damage the competitive benefits of non-compete agreements (such as protecting company confidential information) and harm employees by depriving them of the benefits of such agreements (such as

company investment in employee development); and (2) the Rule exceeds the FTC's statutory authority.

Notably, here the plaintiff's motion for an injunction cited to the Court's prior holding in *Properties of the Villages, Inc. v. Kranz*, No. 5:19-CV-647-JSM-PRL, 2021 WL 2144178, at *5 (M.D. Fla. May 24, 2021), which upheld that same plaintiff's non-compete agreements under a Florida statute banning non-competes in certain circumstances. Thus, the plaintiff contended, "non-compete agreements have traditionally been regulated at the state level and assessed on a case-by-case basis."

On August 14, 2024, the Court granted the plaintiff's request for a preliminary injunction and stayed the Rule's effective date, but limited its preliminary ruling to the named plaintiff only. As a result, the Court appears primed to align with the holding in *Ryan*.

The Rule Now Faces an Uphill Battle at the Appellate Level and Beyond

With the "score" now 2 to 1, the FTC is down, but not out. The split decisions between the Northern District of Texas and the Middle District of Florida on the one hand, and the Eastern District of Pennsylvania on the other, increases the likelihood that the FTC will appeal in the cases where it came up short. If, as some court watchers anticipate, these appeals result in a circuit split, we may see the U.S. Supreme Court intervene to make a final determination.

The Supreme Court's recent decision in *Loper Bright Enterprises v. Raimondo* may inform what happens next at the appellate level and beyond. As we previously reported, *Loper Bright* overruled the longstanding *Chevron* Doctrine, holding that federal regulatory agencies no longer are entitled to deference as to their interpretation of a statute that is ambiguous. Instead, federal courts have regained the

authority to exercise their discretion in determining whether an agency – such as the FTC – has acted within the scope of its statutory authority. In the aftermath of *Loper Bright*, the FTC's reliance on its statutory authority is on shakier ground, as courts may be less inclined to defer to the FTC on a fundamental argument in each of the three challenges: whether the FTC has statutory authority to implement the Rule. Indeed, Judge Brown cited extensively to *Loper Bright* in justifying a permanent injunction.

The results of the upcoming Presidential Election also may play a role in deciding the Rule's fate. Currently, the FTC's five-member commission is comprised of three Democrats who voted in favor of the Rule, and two Republicans who opposed it. If a Republican administration comes into power, it is more likely that the FTC ultimately will abandon its defense of the Rule. While a Republican president would not have the authority to remove Democratic FTC Chair Lina Khan from the Commission, he *could* remove her as chair and select a new chair from the existing commissioners. But regardless of which candidate wins the 2024 election, the FTC's 3-2 Democratic majority would remain in place until either a commissioner retires or a commissioner's seven-year term expires.

For guidance on the developing legal landscape for non-competes and other workplace issues, consult your Akerman attorney.
