

Now that a court has enjoined the FTC Non-compete rule, can employers go back to business as usual?

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by Nicholas J. Pappas and Krista Bolles

Employers who wish to enter into non-compete agreements with their employees breathed a collective sigh of relief on August 20, 2024, when a federal district court struck down the Federal Trade Commission's ("FTC") new nationwide ban on non-compete agreements (the "Non-Compete Rule" or "Rule"). Although for now the Federal Trade Commission Act does not prohibit the use of non-compete agreements, employers should be vigilant in seeking to comply with other federal laws and the laws in all fifty states which continue to govern the enforceability of non-compete agreements.

In this month's column, we will analyze the court's decision striking down the Non-Compete Rule and provide a brief overview of the patchwork of state laws that apply to non-competes. We will conclude by offering some practical suggestions for employers who wish to use non-compete agreements for their workers in compliance with law.

Injunction of the Non-Compete Rule

In *Ryan, LLC v. Federal Trade Commission*, Case No. 3:24-cv-00986 (N.D. Tex.), the U.S. District Court for the Northern District of Texas concluded that the FTC exceeded its statutory authority in promulgating the Non-Compete Rule and that the Rule is arbitrary and capricious. The court set the Rule aside, preventing it from taking effect shortly before its effective date of September 4, 2024. The *Ryan* decision prevents the FTC from enforcing the Non-Compete Rule against any company nationwide.

The FTC estimates that one in five American Workers—or approximately 30 million workers—is subject to a non-compete agreement. With few exceptions, the Non-Compete Rule would have prevented employers from entering into non-compete agreements with workers, and would have required employers to rescind existing non-compete agreements for all workers except senior executives. The Rule therefore would have rescinded tens of millions of non-compete agreements. It also would have prohibited employers from falsely representing to workers that they were subject to a non-compete clause. The FTC classified each of these practices as "an unfair method of

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competition” under the Rule. See 16 C.F.R. § 910.

The court in *Ryan* conducted its analysis pursuant to the Administrative Procedure Act (“APA”). As the Supreme Court recently explained in *Loper Bright Enters. v. Raimondo*, the APA was enacted “as a check upon administrators whose zeal might otherwise have carried them to excesses not contemplated in the legislation creating their offices.” 144 S. Ct. 2244, 2261 (2024) (quotations omitted). The APA proscribes procedures for agency action and delineates the contours of judicial review of such action. When reviewing an agency action, the APA requires courts to “hold unlawful and set aside agency action, findings and conclusions found to be [*inter alia*] . . . arbitrary and capricious” or “in excess of” statutory authority. 5 U.S.C. § 706(2)(A)–(C).

In concluding that the FTC exceeded its statutory authority in implementing the Non-Compete Rule, the court held that the FTC lacks substantive rulemaking authority with respect to unfair methods of competition under the Federal Trade Commission Act. The court rejected the FTC’s position that Section 6(g) of the Federal Trade Commission Act empowers it to create substantive rules regarding unfair methods of competition. The court described Section 6(g) of the Federal Trade Commission Act as a “housekeeping statute,” which authorizes the FTC to promulgate procedural, rather than substantive, rules.

The court also held that the Non-Compete Rule is “unreasonably overbroad without a reasonable explanation,” rendering it arbitrary and capricious under the APA. The court noted that the Non-Compete Rule is broader than any state law, and that the FTC failed to provide evidence or a reasonable basis to support the imposition of such a sweeping ban, rather than targeting specific, harmful non-competes. The court also criticized the FTC for failing to sufficiently consider less disruptive alternatives to a nationwide ban on non-competes.

The FTC currently is considering an appeal. It has until October 19th to appeal the district court’s decision. If the FTC appeals, it will face an uphill battle. The appeal will be decided by the Court of Appeals for the Fifth Circuit and ultimately the United States Supreme Court, both of which have recently issued decisions curtailing the power of federal agencies. Any appeal will also unfold against the backdrop of the Supreme Court’s recent decision in *Loper Bright*, overruling precedent under which courts afforded deference to a federal agency’s interpretation of its own power, commonly referred to as “Chevron deference.” Thus, courts will not afford deference to the FTC when considering its legal arguments in support of the agency’s authority to promulgate the Non-Compete Rule.

Although the court in *Ryan* set aside the Non-Compete Rule, the decision does not prevent the FTC from continuing to bring enforcement actions against employers who use non-compete agreements. The FTC remains free to target conduct it considers to be unfair methods of competition by adjudicating the merits of individual non-compete agreements on a case-by-case basis. Moreover, although no federal law comprehensively addresses the enforceability of employment non-compete agreements, other federal agencies, including the Department of Justice—through its Antitrust

Division—and the National Labor Relations Board, have taken hostile positions towards non-compete agreements and other restrictions on employee mobility and have sought to rein in their use. Proposed legislation to ban or limit non-compete agreements has been introduced in Congress several times in recent years, but such proposals appear to have made little progress.

State Non-Compete Laws

Now that a court has set aside the FTC's Non-Compete Rule, employers should focus more of their attention on legislative and administrative actions by the states. In recent years, states have enacted a flurry of laws limiting the use of non-compete agreements. At least thirty-seven states and the District of Columbia have statutes in place that restrict the use of non-compete agreements.^[1] California, Oklahoma, North Dakota and Minnesota have near-total bans on non-compete agreements. Eleven states and the District of Columbia ban non-competes for low-wage workers. Eight states and the District of Columbia impose notice requirements that must be satisfied in order for non-compete agreements to be enforceable. In 2022, Colorado severely restricted the use of non-compete agreements and added a criminal sanction to its statute. Additionally, proposed legislation restricting the use of non-competes is pending in states across country.

Many states restrict the use of non-competes in other ways. State common law imposes additional restrictions on non-competes, both in states with statutory restrictions and those without any. For example, state common law may govern issues such as the nature and adequacy of consideration, the enforceability of clauses allowing judicial reformation of overbroad agreements, and requirements that a non-compete agreement be reasonable in duration, geographic coverage and scope.

A new statute restricting the use of non-competes in New York may be on the horizon. In 2023, the New York State Legislature passed a bill that would have prohibited most non-competes in New York. See Senate Bill S.3100-A. The bill would also have created a private right of action for workers to sue their employers to void unlawful non-competes and allowed them to recover up to \$10,000 in damages. However, New York Governor Kathy Hochul ultimately vetoed the bill, after failing to negotiate an amendment to narrow the ban to apply to low and middle-income workers. Nevertheless, Governor Hochul has expressed support for a ban on non-competes for middle-class and low-wage workers, leaving open the possibility that more narrowly tailored non-compete legislation may be reintroduced in the future.^[2]

In addition to legislative activity at the state-level, state attorneys general may bring more enforcement actions against companies that use non-compete agreements, particularly for low-wage workers. In 2016, New York Attorney General Eric Schneiderman conducted high-profile investigations into the non-compete policies and practices of three major companies: Law360, a legal publishing company, Jimmy John's, a gourmet sandwich chain, and Examination Management Services, a nationwide medical information services provider. As a result of these investigations, all three companies agreed to limit their use of non-compete agreements with respect to lower-level

employees.[3]

Practice Considerations

In light of the decision in *Ryan v. Federal Trade Commission*, for now employers need not worry about compliance with the Non-Compete Rule, which would have required employers to

notify millions of workers that their non-compete agreements were unenforceable. However, employers should continue to be mindful of potential government enforcement actions and compliance with state law. Employers should review their non-compete agreements and assess whether they are necessary to protect legitimate business interests, such as confidential information or goodwill. Employers should consider whether less restrictive means will suffice to protect their legitimate interests, including the use of garden leave (wherein an employer pays the departing employee not to compete during the restricted period), non-solicitation and confidentiality agreements, and policies and practices restricting the use and disclosure of confidential information.

For multi-state employers, given the present patchwork of state laws governing non-compete agreements across the country, crafting a one-size-fits-all non-compete agreement for employees in different states is an increasingly complex task. Employers seeking to use a single form of agreement may craft agreements imposing a lowest common denominator approach, essentially allowing the most restrictive state laws to govern all or most of their workers. Even in such agreements, employers will often expressly exempt application to workers in states where non-competes are not enforceable, such as California. Employers may instead choose to use several forms of agreement to take advantage of the laws in states allowing restrictions that are more favorable to the employer. Employers using multiple forms of non-compete agreement will need to invest in training human resources and benefits professionals in charge of onboarding workers subject to non-competes on when and how the various forms of agreement should be used.

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[1] Economic Innovation Group, State Noncompete Law Tracker: <https://eig.org/state-noncompete-map/>.

[2] <https://www.nytimes.com/2023/12/22/nyregion/kathy-hochul-veto-noncompete.html>.

[3] <https://ag.ny.gov/press-release/2016/ag-schneiderman-announces-settlement-jimmy-johns-stop-including-non-compete> (Jimmy John's and Law360); <https://ag.ny.gov/press-release/2016/ag-schneiderman-agreement-ends-non-compete-agreements-employees-national-medical> (Examination Management Services).