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Noncompete Law in Flux—What to Do in the Meantime?

By Neil C. Schur
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In early May, the Federal Trade Commission voted 3-2 to approve a new rule banning most covenants not to compete (widely known as noncompetes) nationwide, with some exceptions. Noncompetes are agreements between employees and employers in which the employee promises not to compete with the employer for a specific period of time or within a particular geographic area should the employment relationship terminate. Many noncompetes bar the employee from working for a competitor for a specified time period after ending employment. The enforceability of the FTC's new rule was challenged in three federal court, and each court ruled differently.


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Neil C. Schur of Anderson Kill.

The Ruling of the Federal Court in Pennsylvania

On July 23, 2024, in *ATS Tree Services v. Federal Trade Commission*, the U.S. District Court for the Eastern District of Pennsylvania denied a motion for preliminary injunction and let the rule stand. The court found that the plaintiff failed to establish irreparable harm or likelihood of success on the merits. The success on the merits turned on whether the FTC has the power to engage in substantive, rather than merely procedural rulemaking. The court stated: "When taken in the context of the goal of the act and the FTC's purpose, the court finds it clear that the FTC is empowered to make both procedural and substantive rules as is necessary to prevent unfair methods of competition." The court further noted that Section 5 of the FTC Act "empowered and directed" the FTC to "prevent" unfair methods of competition and unfair or deceptive acts or practices in competition. The court then reasoned, "If the court adopts plaintiff's interpretation of the act, it would limit the FTC's power to only responsive or remedial methods of addressing unfair methods of competition through adjudication, which is inherently at odds with the ordinary interpretation of the word "prevent." The Pennsylvania federal court has not yet ruled on the plaintiff's request for permanent injunctive relief.

The Ruling of the Federal Court in Florida

On Aug. 14, 2024, the U.S. District Court for the Middle District of Florida granted a motion in *Properties of the Village v. FTC* for preliminary injunction, enjoined enforcement of the FTC rule but limited the scope of its ruling to the plaintiffs in those cases. The court found it substantially likely that the rule presents a major question under the so-called "major questions" doctrine, and further found that Congress has not rendered a sufficiently clear expression of legislative intent to authorize the final rule under that doctrine, as evidenced by the fact that the FTC "has never tried substantive rulemaking of this magnitude before this and had never even brought noncompete enforcement actions until it announced some consent decrees literally the day before it announced its notice of proposed rulemaking." In sum, the court explained: "An administrative agency's power to regulate must always be grounded in a valid grant of authority from Congress. With a rule as sweeping and consequential as this one, the Section 6 language, both by its text, placement, context, and history, falls short."

Like the Pennsylvania case, the Florida federal court has not yet ruled on the plaintiff's request for permanent injunctive relief but ordered the parties to file a joint status report regarding "next steps" by Sept. 25, 2024.

The Ruling of the Federal Court in Texas

On July 3, 2024, in *Ryan v. Federal Trade Commission*, the U.S. District Court for the Northern District of Texas, Dallas Division, granted a motion for preliminary injunction and, in a highly publicized ruling, granted a motion for summary judgment on Aug. 20, permanently enjoining the FTC 's enforcement of the rule nationwide. The rule had been scheduled to go into effect on Sept. 4, and employers nationwide were scrambling to comply.

The Texas federal court found that "the FTC lacks statutory authority to promulgate the noncompete rule, and that the rule is arbitrary and capricious. Thus, the FTC's promulgation of the rule is an unlawful agency action."

The court found that Section 6(g) of the FTC Act "does not authorize substantive rulemaking," including the ban on noncompetes. In particular, the court found it significant that Section 6 does not prescribe any sanctions or statutory penalty for violating rules promulgated under that section, suggesting an authority to issue only "housekeeping rules," which the ban on noncompetes decidedly is not. The court concluded: "After reviewing the test, structure, and history of the act, the court concludes the FTC lacks the authority to create substantive rules through this method, Section 6(g) is indeed a 'housekeeping statute,' authorizing what the APA terms 'rules of agency organization procedure or practice' as opposed to 'substantive rules'." The court further found the FTC's rulemaking was "arbitrary and capricious" because it was "unreasonably overbroad without a reasonable explanation." In line with concerns raised by many when the rule was promulgated, the court took issue with the rule's "one-size-fits all approach with no end date." According to the court, the FTC could not adequately explain why it selected a sweeping prohibition over a more targeted approach aimed at the most harmful noncompete agreements.

The court cited the recent U.S. Supreme Court decision, *Loper Bright Enterprises v. Raimondo*, which overturned the doctrine of deference to agency decisions.

Unlike the Florida federal court, the Texas federal court found that the Administrative Procedures Act required that it "hold unlawful" and "set aside" the FTC's rule, meaning that the relief granted would have nationwide effect.

The FTC is likely to appeal.

What Should Employers and Employees Do Now?

Where does that leave you? These various matters could take years to be resolved.

For now, the Texas federal court's ruling allows employers and employees to enter into and enforce noncompetes—subject to applicable state law. Employers will not be required to provide notice to current and former employees that their post-employment noncompetes are unenforceable, as would have been required by the FTC's rule. In the meantime, non-competition agreements will continue to be governed primarily by state law.

State law regarding noncompetes varies significantly from state to state.

Under Pennsylvania law, for example, restrictive covenants such as noncompetes are strongly disfavored and strictly construed, but they are enforceable if they are incident to an employment relationship between the parties, the restrictions imposed by the covenant are reasonably necessary for the protection of the employer, and the restrictions imposed are reasonably limited in duration and geographic extent.

Although many states' laws take a similar approach, noncompetes—particularly as to lower income employees—have been under attack in recent years. In the last two years, states including Massachusetts, Colorado, Maryland and California have implemented or tightened bans on noncompete agreements, while New York almost did the same until Gov. Kathy Hochul vetoed the bill at the eleventh hour. Other states have full or partial bans of older vintage.

The FTC's rule would have banned most noncompete agreements in the workplace. It made it illegal for an employer:

- To enter into or attempt to enter into a noncompete clause.
- To enforce or attempt to enforce a noncompete clause (subject to the exceptions described below).
- To represent that the worker is subject to a noncompete clause.

Significant exceptions would have applied to: existing noncompetes for senior executives in policy-making positions earning over $151,164; and noncompete clauses agreed to in connection with a bona fide sale of a business entity, of the person's ownership interest in a business entity, or of substantially all of the business entity's operating assets.

The FTC has contended that the practice of allowing noncompetes suppresses wages, hampers innovation, and blocks entrepreneurs from starting new businesses. It has estimated that its rule would impact about 30 million Americans and boost wages by nearly $300 billion per year.

As this litigation challenging the FTC ban plays out, further state legislative initiatives are possible, and bipartisan federal legislation to limit noncompetes already introduced in Congress may also be taken up again. Given these recent developments nationwide, employers and employees should monitor the law governing noncompetes closely, particularly if they conduct business in multiple states.

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