July 10, 2024

Texas Ruling Puts Future of FTC Noncompete Rule in Doubt

With a Texas federal court's July 3 ruling, the future of the Federal Trade Commission's (FTC) noncompete rule remains uncertain. As we previously reported, in April the FTC issued a final rule that bans nearly all noncompete agreements, which ban is scheduled to take effect September 4. On July 3, the U.S. District Court for the Northern District of Texas granted a preliminary injunction postponing the effective date of the rule, but only for the plaintiffs to the Texas lawsuit. For now, the rule remains slated to take effect for all other employers, though the July 3 decision calls its viability into question.

The Final Rule

On April 23, the FTC issued a final rule banning nearly all noncompete agreements, with certain limited exceptions. The rule does not apply to workers for banks (over which the FTC does not have jurisdiction, though the rule does apply to bank affiliates, such as bank holding companies), to workers for nonprofit organizations, to agreements between franchisors and franchisees, or to business owners in connection with the sale of a business.

The final rule prohibits employers from enforcing existing noncompete agreements with all workers except senior executives whose noncompete agreements are in effect as of the final rule's effective date. The final rule defines "senior executive" as a worker earning more than $151,164 who is in a policymaking position, which in turn is defined as a business entity's president, chief executive officer or equivalent, any other officer of a business entity who has policymaking authority or any other natural person who has policymaking authority for the business entity similar to an officer with policymaking authority. The rule's definition of senior executive indicates that the term is meant to be construed narrowly and include only workers at the highest levels of a business. Except for senior executives with existing noncompete agreements, the final rule will require employers to provide notice to workers by the effective date—currently set for September 4—that their noncompete agreements will be unenforceable after the effective date of the final rule. The final rule further prohibits employers from entering into new noncompete agreements with all workers, including senior executives, on or after the effective date.

The Preliminary Injunction

Immediately after the FTC issued the final rule, a Dallas-based tax services firm, Ryan LLC, sued to block it from taking effect (*Ryan LLC v. FTC*). Several organizations, including the U.S. Chamber of Commerce, joined the action as plaintiffs. The plaintiffs requested a preliminary injunction and to stay the effective date of the final rule, arguing that the FTC lacked authority to issue the rule and that its conclusions were arbitrary and capricious.

In a July 3 Memorandum Opinion and Order, the court granted the plaintiffs' motion, issuing a preliminary injunction and staying the effective date of the final rule. The court concluded that the plaintiffs had shown a substantial likelihood of success on the merits for two reasons: (1) the FTC lacks substantive rulemaking authority with respect to unfair methods of competition under the relevant portion of the Federal Trade Commission Act; and (2) the final rule is arbitrary and capricious because it is unreasonably overbroad without a reasonable explanation. On the latter point, the court noted the FTC's failure to present evidence as to why it chose to prohibit virtually all noncompete agreements rather than target specific, harmful noncompetes and its failure to analyze sufficiently less disruptive alternatives to the final rule.

The court limited the applicability of its preliminary injunction to the parties to the Texas case. Although the plaintiffs had requested a nationwide injunction, the court noted that they had not provided briefing that would support such relief. The court also stated that the intervening organizational plaintiffs (e.g., the U.S. Chamber of Commerce) had not briefed

"associational standing," i.e., their ability to obtain relief on behalf of their members. Therefore, the court limited the injunctive relief to the organizational plaintiffs themselves, not their members.

The Road Ahead

Having issued a preliminary injunction, the Texas court stated that it intends to issue a final decision on or before August 30. The preliminary injunction ruling is a strong indication that the court's final decision will also be in the plaintiffs' favor. However, the scope of any final decision is unclear. Although the preliminary injunction applies only to the parties to the Texas case, the plaintiffs may try to address the issues that the court found to have been inadequately briefed in an effort to obtain a final injunction that applies more broadly.

There is another lawsuit pending that challenges the FTC's final rule, in the U.S. District Court for the Eastern District of Pennsylvania (*ATS Tree Services, LLC v. FTC*). A hearing on the plaintiff's motion for a preliminary injunction in that case was scheduled for July 10 and the court has stated that it will issue its decision by July 23.

Except for the parties to the Texas case, to whom this particular injunction applies, the noncompete rule remains scheduled to take effect on September 4. While it is possible the Texas or Pennsylvania court could issue a ruling that includes a nationwide stay of the final rule, employers should continue to plan for the possibility that the final rule will take effect. Proactive steps include taking inventory of the restrictive covenants currently in place and how the final rule could impact its viability. Employers also should ensure that sufficient measures are in place for all workers to protect confidential and trade secret information and relationships with clients and employees. Finally, employers must be mindful of the final rule's notice provision requiring implementation on September 4. Given the uncertainty surrounding the current landscape of the final rule, it is prudent to consult with counsel to evaluate the risks and timing and to develop an action plan.

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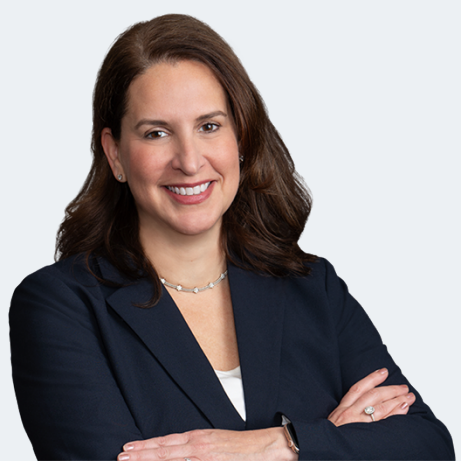

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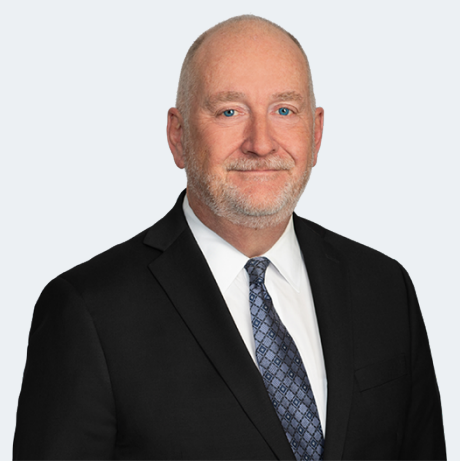

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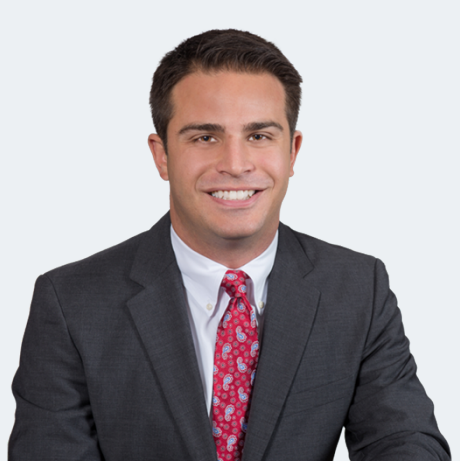

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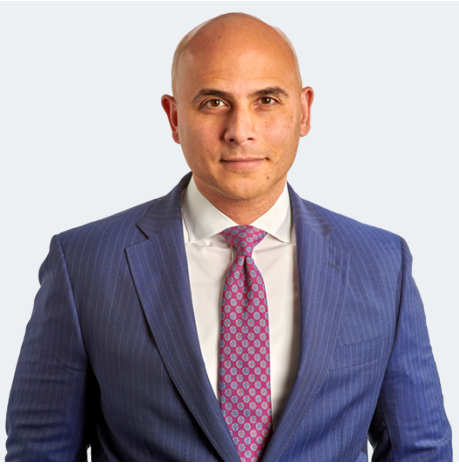

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