

WorkSmarts Virtual Seminar

FTC Noncompete Ban: What Companies Need to Know

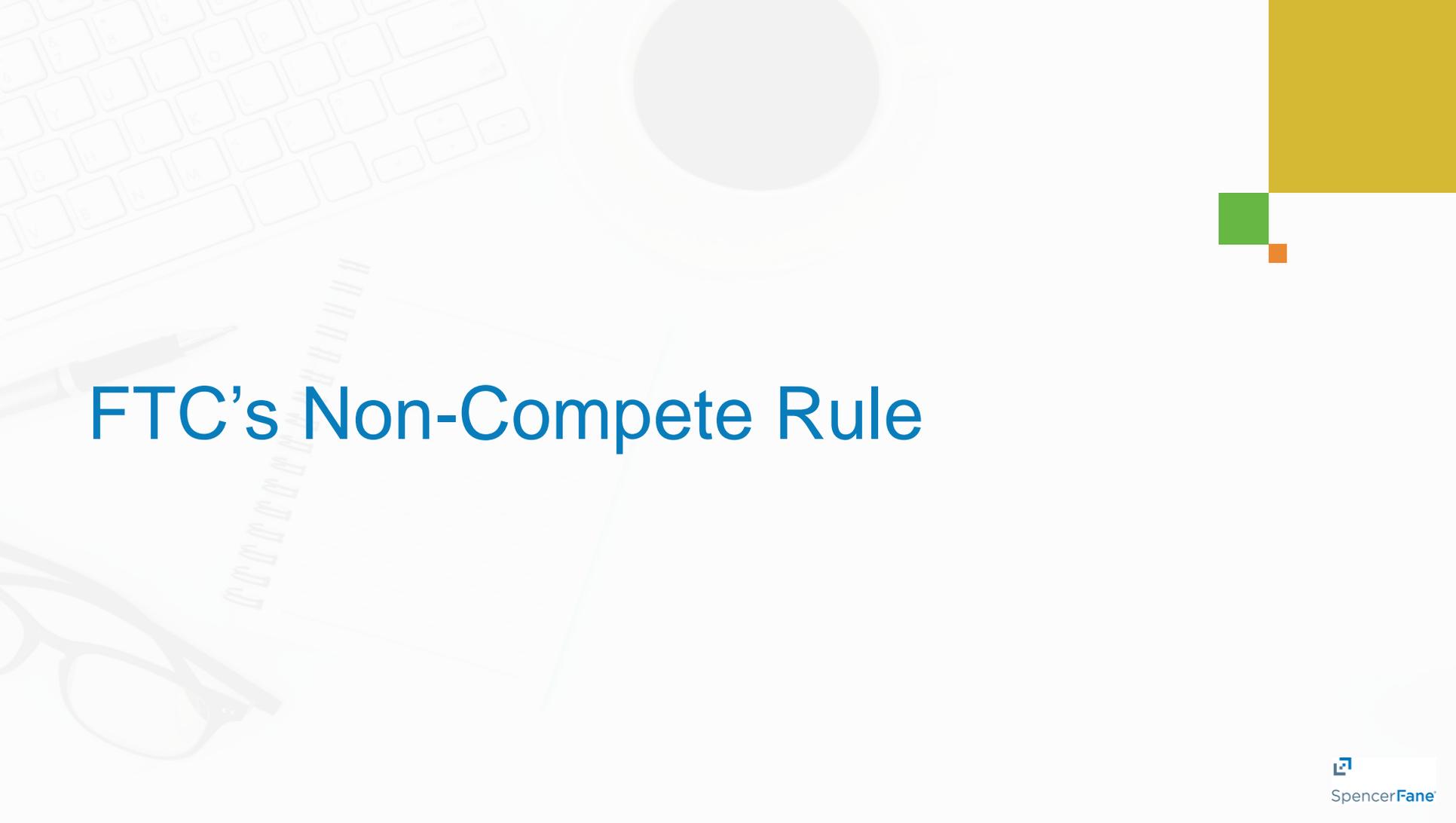
Kunal Shah and Danielle (DJ) Healey



SpencerFane®

Agenda

1. Federal Trade Commission's (FTC) Non-Compete Rule—**set aside on August 20, 2024!**
 - Effect on noncompete agreements.
 - Limited exceptions.
2. *Ryan LLC v. Federal Trade Commission*; No. 3:24-cv-986 (N.D.T.X. 2024)
 - Judge granted Plaintiff's motion for a preliminary injunction and postponed the effective date of the Rule as applied to Plaintiff and intervenors.
 - The Court ruled that the FTC Rule **shall not be enforced** or otherwise take effect on September 4, 2024.
3. *ATS Tree Services, LLC v. Federal Trade Commission*; No. 2:24-cv-1743 (E.D. Pa. 2024)
 - On July 23, 2024, Judge denied Plaintiff's identical motion.
 - FTC *has* such rulemaking authority.
4. *Properties of the Villages, Inc. v. FTC*, No. 5:24-cv-316 (M.D. Fla. 2024)
 - On August 15, 2024, Judge granted Plaintiff's motion for a stay and a preliminary injunction and postponed the effective date of the Rule as applied to Plaintiff. Considered both prior orders.
5. Next steps for employers



FTC's Non-Compete Rule

The Proposed Rule as Discussed in 2023

On January 5, 2023, the FTC published a proposed rule calling for the absolute ban of non-compete agreements.

- The Proposed Rule would also require employers to rescind existing noncompete agreements and notify current and former employees that their non-competes are no longer in effect.
- As we saw last year, the NLRB similarly released Memorandum 23-08, commenting that *“Non-compete provisions ... reasonably tend to chill employees in the exercise of Section 7 rights, when the provisions could reasonably be construed by employees to deny them the ability to quit or change jobs by cutting off their access to other employment opportunities that they are qualified for based on their experience, aptitudes, and preferences as to type and location of work.”* Also sought to invalidate nearly all non-compete agreements.

FTC's Non-Compete Rule

- On April 23, 2024, FTC voted 3-2 to finalize a new rule prohibiting employers from enforcing new noncompete clauses and invalidating the majority of existing noncompetes in industries governed by the FTC.
- The rule prohibits: Employers from (1) entering into noncompetes with workers after the September 4, 2024 effective date, and (2) enforcing previously executed noncompetes with workers other than senior executives.
- This term “workers” includes employees, independent contractors, externs, interns, apprentices, volunteers, and sole proprietors who provide a service.

FTC's Non-Compete Rule

- **Notice Requirements**: employers must notify ex-workers that their executed noncompetes are no longer enforceable...awkward...yes.
Burdensome...yes.
- Preempts inconsistent state laws, but not those state laws that are consistent with the rule, i.e. California's statute against noncompetes.

FTC's Non-Compete Rule

- The rule bans nearly all **new** noncompetes, with very narrow exceptions.
- Exception 1: **existing** noncompetes with senior executives with “policy making authority.”
 - Policy-making authority” is defined as “final authority to make policy decisions that control significant aspects of a business entity or a common enterprise.”
- Exception 2: noncompetes between seller and buyer of a business.
- Exception 3: Does not apply where a cause of action related to a noncompete accrued prior to September 4, 2024.



Legal Challenges to the FTC's Rule

Ryan LLC v. Federal Trade Commission;

No. 3:24-cv-986 (N.D.T.X. 2024)

- On July 3, 2024, Judge Ada Brown of the Northern District of Texas granted a motion enjoining enforcement of the FTC's rule banning nearly all non-competes against Plaintiff Ryan, LLC and all Plaintiff Intervenors, which was slated to go into effect on September 4, 2024. The Judge declined issuing a nationwide stay.
- This Court intends to enter its merits disposition on or before August 30, 2024. This includes ruling on the validity and constitutionality of the FTC Non-Compete Rule.

Ryan LLC v. Federal Trade Commission;

No. 3:24-cv-986 (N.D.T.X. 2024)

- Several groups have filed amicus briefs in support of and against Plaintiffs' position.
- Both Plaintiffs' and the FTC's respective summary judgment motions have been fully briefed.

Ryan LLC v. Federal Trade Commission;

No. 3:24-cv-986 (N.D.T.X. 2024)

- On August 20, 2024 The Court sets aside the Non-Compete Rule, stating it shall not be enforced or otherwise take effect on its effective date of September 4, 2024 or thereafter.
- *"Having concluded that (i) the FTC promulgated the Non-Compete Rule in excess of its statutory authority, and (ii) the Rule is arbitrary and capricious, the Court must "hold unlawful" and "set aside" the FTC's Rule...setting aside agency action under § 706 has 'nationwide effect,' is 'not party-restricted,' and 'affects persons in all judicial districts equally.'"*

Ryan LLC v. Federal Trade Commission;

No. 3:24-cv-986 (N.D.T.X. 2024)

What does this mean?

- *The FTC may appeal this decision to the Fifth Circuit.*

From an FTC spokesperson:

- *“We are disappointed by Judge Brown’s decision and will keep fighting to stop noncompetes that restrict the economic liberty of hardworking Americans, hamper economic growth, limit innovation, and depress wages.”*
- *“We are seriously considering a potential appeal, and today’s decision does not prevent the FTC from addressing noncompetes through case-by-case enforcement actions.”*

ATS Tree Services, LLC v. FTC;

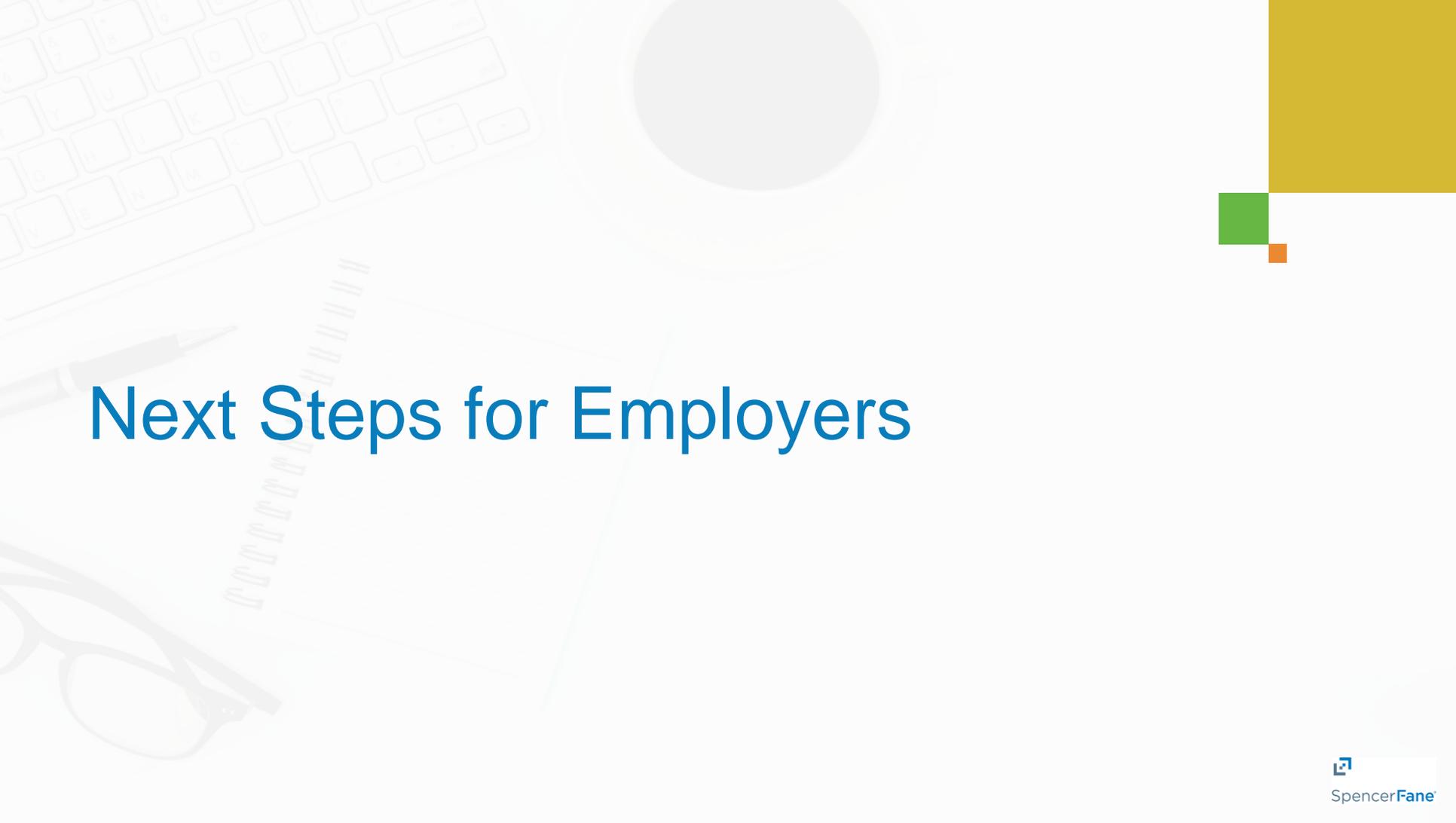
No. 2:24-cv-1743 (E.D. Pa. 2024)

- On July 23, 2024, Judge Hodge of the Eastern District of Pennsylvania denied Plaintiff’s motion for stay of the effective date of the Rule and Preliminary Injunction ruling that the FTC has *clear* authority to issue “procedural and substantive rules as is necessary to prevent unfair methods of competition.”
- *“The Court finds Plaintiff has failed to establish a reasonable likelihood that it will succeed on the merits of its claims that the FTC lacks substantive rulemaking authority under its enabling statute, that the FTC exceeded its authority, and that Congress unconstitutionally delegated legislative power to the FTC.”*
- This is in stark contrast to the ruling out of the Northern District of Texas enjoining enforcement of the rule.

Properties of the Villages, Inc. v. FTC;

No. 5:24-cv-316 (M.D. Fla. 2024)

- On August 15, 2024, Judge Corrigan of the Middle District of Florida granted Plaintiff's motion for stay of the effective date and preliminary injunction.
- *“Indeed, this lack of historical precedent, coupled with the breath of authority the Commission now claims, is a telling indication that the final rule extends beyond the Commission’s legitimate reach.”*
- *“I disagree with the ATS court that the Commission has ever exercised its Section 6(g) rulemaking power in the scope and the manner that it seeks to do with the final rule.”*



Next Steps for Employers

Climate Change is Coming ...

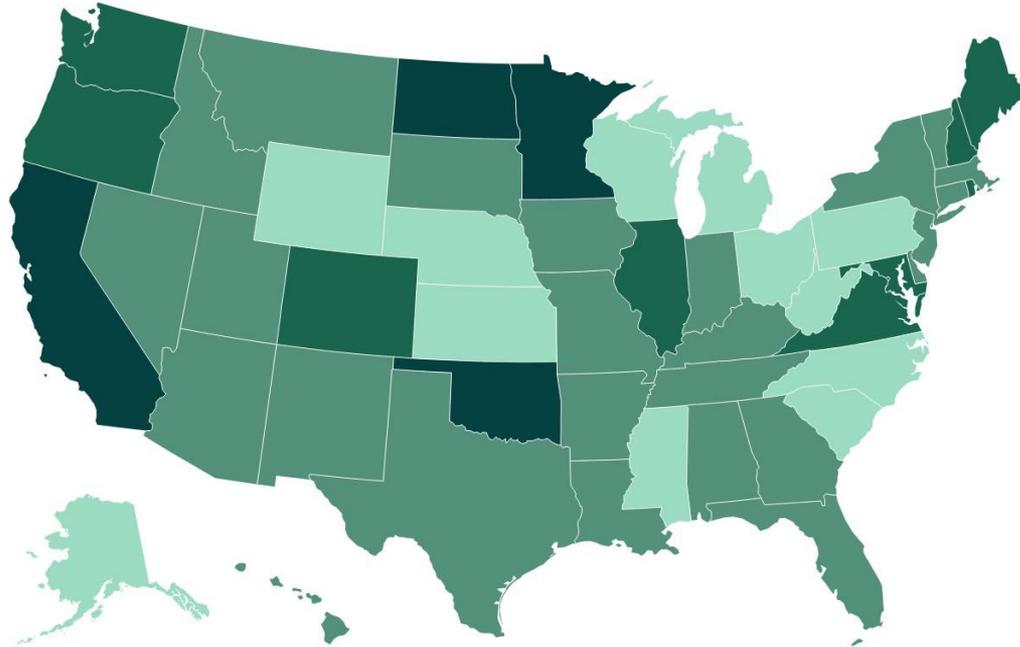
- Regardless of the decision on the FTC ban, non-competes are under fire.
- Trend in state legislatures is to bar or restrict non-competes...
- Over 30 million Americans have Covenants Not to Compete...
- Over half of those are in low skilled/unskilled jobs...
- Legislators and Regulators complain this is chilling employee movement and competition for their services...resulting in billions of lost wages...

Non-Complete Map



Legislative Restrictions

No restrictions Full Ban Income Restrictions Other Restrictions



Iowa, Louisiana,
banned or restricted
non-competes in
Healthcare

New York moving
toward complete
ban

Do We Need Covenants Not to Compete?

- California statutes wiped out most Covenants Not to Compete 75 years ago...
- New York is moving to a near total ban...
- Other states have enacted significant restrictions...
- Worker Mobility Bill has been introduced in 2021-2022 & 2023-2024 Congressional Sessions, it will likely be reintroduced in 2025...

It is time for businesses to re-visit non-competes...

When Are Non-Competes Agreement Acceptable?

- **Senior highly compensated executives** have knowledge, bargaining power, and access to counsel
- **Business Sale:** Hard assets + Intellectual Property + Goodwill
 - Goodwill is amorphous, hard to transfer, hard to value.
 - Goodwill is generally measured as the difference between the purchase price and value of the assets of the sold business.
 - Transfer of trademarks, trade dress, customer information
 - But also, may require owners/operators to commit not to compete, including solicitation of customers and employees to give the buyer benefit of its bargain.
 - Lower risk of abuse because B2B generally reduces imbalance in negotiations between buyer and seller.

Legitimate Purposes of Non-competes?

- Employees have **no legitimate interests** in being able to use a former Employer's **trade secrets** in another business.
- But Employers have **no legitimate interests** in:
 - Inhibiting movement of Employees...
 - Reducing competition for Employees...
 - Protecting public information ...(e.g. customers)
 - Raising barriers to entry into a market...

Are Non-Competes Unfair to Most Workers?

- Approximately 30 million U.S. workers are covered by non-compete clauses
- **53% of workers covered by non-competes are hourly employees.**
- Non-compete clauses depress wages for all workers because they inhibit movement.
- Non-competes inhibit business formation by limiting the pool of available workers and foreclosing employees from starting new businesses in their fields – **new business are biggest source of new jobs.**
- Legitimate trade secret non-disclosure agreements service legitimate ends of non-competes without foreclosing worker mobility and make non-competes unnecessary.

Workforce Mobility Act of 2023: SB 220 & HB 731

- Workforce Mobility Act of 2023: Eliminates covenants not to compete by statute.
- Exempts trade secret non-disclosure agreements
- Authorizes enforcement by FTC and Department of Labor (DOL)
- Authorizes private civil causes of action for compensatory damages
- **Voids enforceability of arbitration clauses and waivers of joint/class action clauses**
- Permits suits by individuals, joint-class actions, parens patriae by state attorneys generals

Presenters



Kunal Shah

Partner

Plano, Dallas

972.324.0334

kshah@spencerfane.com



Danielle (DJ) Healey

Partner

Houston

713.212.2697

dhealey@spencerfane.com