

UNCLEAR EYES, FULL COURTS, CAN LOSE? THE FTC'S NON-COMPETE BAN IN LIMBO

Posted on September 9, 2024 by Capes Sokol



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Non-compete agreements have long been a staple in employment contracts across various industries, serving as tools for employers to protect their business interests. However, the widespread use of these agreements has sparked significant debate regarding their impact on workers and the economy. In response to these concerns, the Federal Trade Commission (the "FTC") introduced a sweeping rule aimed at largely banning non-compete agreements nationwide (the "Rule"). While the Rule marks a significant shift in U.S. labor policy, its future has been cast into uncertainty following a recent federal court ruling.

The FTC's Non-Compete Rule: An Overview

The Rule represents one of the most aggressive regulatory actions in recent history aimed at curbing the use of non-compete agreements. The Rule is divided into two main parts, addressing both new and existing non-compete agreements:

1. New Non-Competes: A Comprehensive Ban

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- The Rule imposes a blanket ban on the use of non-compete agreements for all workers, including senior executives, for any agreements entered into after the Rule's effective date, which was originally set to be September 4, 2024. This aspect of the Rule is based on the FTC's determination that non-compete clauses constitute an unfair method of competition under Section 5 of the Federal Trade Commission Act (the "FTC Act"). The ban applies broadly across all industries and types of employment relationships, effectively eliminating the ability of employers to restrict workers from pursuing new employment opportunities through non-compete clauses.
- The Rule may also apply to non-solicit, non-disclosure or similar restrictive covenants if the effect of any such restrictions are "so broad or onerous that it has the same functional effect as a term or condition prohibiting or penalizing a worker from seeking or accepting other work or starting a business after their employment ends."

2. Existing Non-Competes: Differentiated Treatment

- The Rule takes a more nuanced approach when it comes to existing non-compete agreements—those that were entered into before the Rule's effective date. Here, the FTC distinguishes between senior executives and other workers:
 - **Senior Executives:** Existing non-compete agreements for senior executives—defined as individuals in policy-making positions with annual compensation exceeding \$151,164—are allowed to remain in force.
 - **Other Workers:** For all other workers, existing non-compete agreements are rendered unenforceable after the Rule's effective date. This provision is intended to immediately free millions of workers from the constraints of non-compete clauses, thereby enhancing labor mobility and fostering competitive labor markets.

Exceptions to the Rule

While the Rule is broad, it does provide several exceptions under which non-compete agreements may still be considered valid:

1. **Bona Fide Sale of a Business:** Non-compete clauses that are part of a bona fide sale of a business, ownership interest in a business, or substantially all of the operating assets of a business are exempt from the Rule. The FTC included this exception to prevent the Rule from disrupting legitimate business transactions where non-compete agreements may be necessary to protect the value of the business being sold. Importantly, the Rule requires that the sale be bona fide—meaning it must be a genuine transaction between independent parties, not a sham arrangement designed to circumvent the Rule.
2. **Good Faith Exception:** Employers are allowed to enforce or attempt to enforce non-compete agreements if they have a good faith belief that the Rule does not apply. This exception provides a safeguard for employers who may have reasonable grounds to believe that certain agreements fall outside the scope of the Rule's prohibitions.
3. **Existing Causes of Action:** The Rule does not retroactively apply to non-compete agreements

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where a cause of action related to the agreement accrued before the Rule's effective date. This means that if an employer had a valid legal claim based on a non-compete agreement prior to the Rule's implementation, they can still pursue that claim.

The Recent Federal Court Ruling and Its Implications

The ambitious scope of the Rule was met with immediate resistance in court cases filed throughout the country, culminating in a significant legal challenge that has, at least temporarily, halted the Rule's enforcement. On August 20, 2024, U.S. District Judge Ada Brown of the Northern District of Texas issued a ruling that blocked the FTC from enforcing the Rule's near-total ban on non-compete agreements. According to Judge Brown, the FTC's attempt to regulate non-compete agreements through a rulemaking process exceeded the powers granted to the FTC by Congress under the FTC Act. The ruling described the FTC's actions as "unreasonably overbroad without a reasonable explanation." The ruling further highlights the growing judicial divide over the FTC's authority to regulate unfair competition through rulemaking. A separate federal judge in Pennsylvania had previously upheld the FTC's authority, setting the stage for a potential appellate showdown. The divergence in judicial opinions underscores the complexity of the legal issues at play and the likelihood that the Rule may eventually reach higher courts.

The Current State of the Non-Compete Rule

The ruling by Judge Brown has blocked the Rule from taking effect, but the FTC has indicated that it is considering an appeal to the U.S. Court of Appeals for the Fifth Circuit, one of the most conservative appellate courts in the country. The FTC faces a difficult decision: pursue an appeal and risk an unfavorable ruling that could further constrain its regulatory powers, or abandon the Rule and seek alternative avenues to address non-compete agreements. For employers and workers alike, the legal landscape surrounding non-compete agreements is in flux. Businesses should carefully consult with legal counsel to assess the enforceability of their non-compete agreements and consider whether they comply with current legal standards primarily set forth in state statutes and case law, while workers should remain informed about their rights and the potential implications of ongoing legal developments.

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