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The Impact of the FTC's Noncompete Rule on Current and Future Noncompete Litigation

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On April 23, the Federal Trade Commission (FTC) voted 3-2 to publish a final rule with sweeping effect, purporting to bar prospectively and invalidate retroactively most employee noncompete agreements.

Three lawsuits have been filed challenging the FTC's rule: (1) *Ryan, LLC v. FTC*, 24-cv-986 (N.D. Tex.); (2) *Chamber of Commerce v. FTC*, 24-cv-148 (E.D. Tex.); and (3) *ATS Tree Services, LLC v. FTC*, 24-cv-1743 (E.D. Pa.). The Northern District of Texas stated its intent to issue a decision on whether to enjoin and stay the FTC's rule by July 3. If the court enters the requested injunction, it is expected to be nationwide in scope.

ArentFox Schiff has been providing coverage of this issue since January 2023 when the FTC first issued its notice of proposed rulemaking. Our past alerts and additional resources may be found here. This alert addresses how the new rule may impact noncompete litigation, even if the rule never actually takes effect. Although multiple suits have been brought in an effort to block enforcement of the final rule, the rule still is very relevant for pending and future noncompete cases, even if the rule is struck down before it ever is officially implemented.

On a first reading, the rule may seem to have no relevance for current disputes. The rule includes an express carve out for pending litigation and future suits where the "cause of action related to a noncompete accrued prior to the effective date." *See* Section 910.3(b). However, employers should

not underestimate the potential persuasive authority of the FTC's 560 pages of "Supplementary Information" accompanying the final rule. Litigants challenging enforcement of a noncompete agreement may rely on the FTC's analysis to advance public policy-based and equitable arguments before the final rule's effective date, or even if the rule is eventually struck down. The FTC's extensive factual findings in support of the final rule, setting out in detail the purported competitive harms the FTC believes are attributable to the use of employee noncompetes, may be persuasive to some courts, who may rely on the FTC's findings as persuasive authority that the noncompete at issue is an unlawful restraint of trade or a method of unfair competition.

Thus, the terms of the FTC's rule and the text of the "Supplementary Information" may become a litigation battleground regardless of the litigation to stay enforcement. Employers seeking to enforce noncompete covenants would be well advised to frame their claims to show that they would be exempted from the new rule if or when it becomes effective.

Additionally, the FTC's rule contains several important carve outs that are potentially ambiguous and likely to be hotly contested.

First, the rule defines a senior executive as an employee earning an annualized compensation of at least $151,164 and who holds a "policy-making position" in which they have the final authority "to make policy decisions that control significant aspects of a business entity or common enterprise." The FTC states that it is insufficient for the employee to have simply advised or exerted influence over such policy decisions. This subtle distinction invites fact-intensive disputes in litigation.

Second, the rule could be used to void other restrictive covenants beyond express noncompete covenants. While the FTC asserts that noncompetes are unnecessary because employers have other less restrictive means of protecting their business interests, such as confidentiality and nonsolicitation covenants, the FTC puts these restrictive covenants at risk, too, by asserting that *any* restrictive covenant could be construed as a prohibited noncompete covenant if it "prohibits a worker from, penalizes a worker for, or *functions to prevent a worker from*: (i) seeking or accepting work in the United States with a different person where such work would begin after the conclusion of the employment … ; or (ii) operating a business in the United States after the conclusion of the employment." *See* Section 910.1. This conflict indicates that other types of restrictive covenants that an employer may choose to rely on as an alternative to an express noncompete may be at risk.

Third, the final rule contains a limited exemption for noncompete covenants entered into "by a person pursuant to a bona fide sale of a business entity, of the person's ownership interest in a business entity, or of all or substantially all of a business entity's operating assets." In the Supplementary Information accompanying the rule, the FTC states that, while the Commission rejected a bright line percentage or dollar value test for an equity participation sufficient to trigger this carve-out, the FTC would interpret the exception narrowly and would look behind the form of a transaction to evaluate whether its "bona fide" substance was in fact consistent with the rule. As a result, the "bona fide sale" exemption, though on its face potentially broad according to its plain language, may be interpreted much more narrowly and again may give rise to fact-intensive disputes.

Fourth, the FTC's rule excludes some sectors that are beyond the reach of the FTC's jurisdiction. The FTC lacks jurisdiction to prevent Section 5 violations by nonprofit organizations, including healthcare nonprofits. Comments by Commissioner Slaughter at last week's open meeting, however, suggest that the FTC may seek to apply the final rule to nonprofit businesses if those businesses are "actually" being run for profit. Furthermore, the Supplementary Information notes that Congress has removed certain enumerated industries (*e.g.*, banks, savings and loan institutions, and certain

common carriers) from the FTC's jurisdiction. The FTC also expressly chose not to extend the new rule to franchise agreements.

Takeaways

Employers with active noncompete litigation matters should consult with counsel to determine the extent to which they may need to adjust their litigation strategy to anticipate that the FTC's rule may be cited as persuasive authority even before it is effective.

For employers who suspect a breach of an employee's noncompete has already occurred, it will be important that they consider the potential impact of the new rule's effective date and develop a showing that the claim accrued prior to the effective date.

Employers considering whether to require senior executives to sign noncompete agreements may wish to take advantage of the 120-day window until the rule's effective date to enter into a noncompete agreement that would be grandfathered under the rule.

Employers who rely on confidentiality and nonsolicitation covenants should review their existing templates and ensure they are not overbroad and vulnerable to attack.

And, regardless of whether the final rule ultimately survives legal challenge, employers should anticipate that noncompete enforcement in the coming years will remain uncertain as the courts, legislatures, and government agencies continue to erode the legal and policy justifications for employee noncompetes. This counsels in favor of a "belt and suspenders" approach for employers to protect their legitimate business interests rather than relying solely on noncompetes.

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