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FTC Noncompete Rule Risks a Wave of State AG Actions

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On April 23, the FTC promulgated its final rule[1] banning noncompetes nationwide.[2]

While most commentary has focused on the scrutiny noncompetes would now garner at the federal level, few discussed the waterfall enforcement effect at the state level that would follow as state attorneys general could deploy their broad authority under state unfair or deceptive acts or practices, or UDAP, laws to treat noncompetes as separate and independent violations.[3]

The national ban's final language coupled with regulators' recent actions confirms that this risk is real and starting to materialize.

Overview of the Final Rule

The final regulation "provides that it is an unfair method of competition" under Section 5 of the Federal Trade Commission Act for employers to enter into non-compete clauses" with any worker beginning on the rule's effective date — 120 days after publication in the Federal Register.[4]

The regulation, however, excepts existing noncompetes for senior executives to remain in force — banning them only prospectively — while noncompetes for other workers are not enforceable immediately upon the effective date.[5]

And in a deviation from the proposed rule, the final rule no longer requires employers to rescind existing noncompetes, although employers still cannot enforce those clauses with nonsenior executives and must notify those workers that their noncompetes are unenforceable by the effective date.[6]

How the Final Rule Portends Future State Actions

Having deemed noncompetes an unfair method of competition, the FTC will have the ability to enforce its ban under Section 5 by issuing cease-and-desist letters to suspected violators and ultimately seeking injunctive relief and/or civil penalties — up to $50,120 per violation — in federal court if a target company continues using

noncompetes.

But, significantly, all 50 states have UDAP statutes, empowering their attorneys general to "investigate any unfair or deceptive acts or practices affecting consumers in their states."[7]

Generally, UDAP laws leave the terms "unfair" and "deceptive" undefined, and state courts routinely give them broad definitions — often deferring to attorneys generals' own rules and regulations.[8]

And when federal agencies like the FTC announce that they will consider a particular business practice "unfair or deceptive" in violation of federal law, attorneys general commonly "follow their lead and characterize those practices as independent violations of their own state UDAP statutes."[9]

In fact, certain UDAP statutes, like the District of Columbia's, expressly incorporate FTC guidance as instructive around what business practices qualify as unfair and deceptive.[10]

Thus, when the FTC proposed its noncompete ban, it was reasonable to expect attorneys general to leverage the agency's "bold action as a springboard to serve as additional enforcers of the proposed rule" through UDAP statutes.[11]

During the 15-month period since the FTC's proposal, state actors' conduct confirmed this preliminary assessment was correct. Indeed, shortly after the FTC proposed its ban, a coalition of 18 attorneys general "submitt[ed] a comment in support of the [FTC's] proposed rule" arguing that a uniform national ban on noncompetes would aid their enforcement efforts.[12]

Attorneys general also ramped up enforcement actions targeting noncompetes and similar post-employment restrictions. For example, District of Columbia Attorney General Brian Schwalb announced settlements with three district employers over noncompetes in November 2023 alone.[13]

State legislatures similarly took aim at noncompetes. For example, Minnesota became the fifth state to enact an all-out ban on noncompetes,[14] New York's legislature passed a bill that would have made it the sixth,[15] and California enacted two measures strengthening its long-standing prohibition.[16]

The final rule's similarity to the FTC's proposal only increases the predicted state regulatory risks for employers. As the agency made clear, its ban "does not limit or affect enforcement of State laws that restrict noncompetes where the State laws do not conflict with the final rule."[17]

Moreover, the regulation provides that it

will not be construed to annul, or exempt any person from complying with, any State statute, regulation, order, or interpretation applicable to a noncompete, including … State antitrust and consumer protection laws and State common law.[18]

Thus, the final rule practically encourages attorneys general to use UDAP laws to crack down on noncompetes and augment the FTC's enforcement efforts — a practice many federal agencies have turned to recently to expand

their authority.[19]

The FTC, specifically, issued a report to Congress in April detailing the agency's "law enforcement cooperation with state [attorneys general] nationwide and presenting best practices to ensure continued effective collaboration."[20]

After the FTC announced the final rule, many attorneys general were quick to praise the rule's passage and signal their intent to cooperate in implementing the ban. For example, on the social media platform X, Minnesota Attorney General Keith Ellison called the ban "great news" and stated he has "long been an opponent of non-compete agreements."[21]

Likewise, Pennsylvania Gov. Josh Shapiro, who previously served as the state's attorney general, promised that his administration "will work with [its] federal partners to hold companies accountable," also on X.[22]

The looming threat of state enforcement actions targeting noncompetes — now with the federal government's endorsement — presents significant risks to employers of all sizes. All an attorney general needs is "reasonable cause to believe that a violation of the [UDAP] statue has occurred, is occurring, or is about to occur" to "issue a civil investigative demand or subpoena."[23]

And attorneys general have the power to "seek civil penalties" for UDAP violations, which penalties can "exceed $10,000 per violation."[24]

Whereas the FTC brings enforcement actions in administrative settings or litigates in federal court, attorney general-led actions generally occur in the state courts of the attorney general's home state, which "are often seen as more plaintiff-friendly and more hostile to corporate defendants than their federal counterparts."[25]

Additionally, nearly all UDAPs afford individual "consumers a private right of action to bring a claim … for violations of the statute that have allegedly caused them harm" whereby they can often "seek treble damages or punitive damages … and attorney fees."[26]

It is also important to note that while the FTC tends to focus enforcement resources on large multistate companies, state attorneys general will often not shy away from targeting smaller local or regional actors they suspect of violations.[27]

Actions and Parasitic Plaintiff Class Actions in the Noncompete Space That May Become Common

While the blackletter rule banning noncompetes likely means most companies will oblige and remove their noncompete provisions, there are likely several areas that will remain ripe for state attorney general inquiries and enforcement action.

First, the exemption for existing noncompetes with "senior executives" creates a legal gray area that could become the subject of litigation. The FTC's two-part definition requires a "senior executive" to make at least $151,164 annually, but it is unclear what constitutes "policy-making authority."

The FTC broadly defines "policy-making authority" as "final authority to make policy decisions that control significant aspects of a business entity."[28] This ambiguous definition could expose employers to a significant compliance risk if they do not carefully evaluate the types of decisions any worker with an existing noncompete has the authority to make before attempting to enforce those agreements.

Second, while the FTC abandoned its recission requirement, the notification requirement remains and raises a compliance concern.

Employers should begin identifying workers currently subject to noncompetes, so they can complete the notification process before the FTC's 120-days-post-publication deadline.

Last, defining "non-compete clause" to include any term or condition that "functions" to prohibit, penalize, or prevent workers from seeking or accepting work after their employment concludes risks sweeping a host of contractual provisions not expressly defined as noncompete clauses under the FTC's ban.

State attorneys general are likely to take aim where companies maintain provisions in their employee contracts or company policies that could be considered a noncompete under the FTC's broad definition, including certain types of nonsolicitation clauses.

How Challenges to the Final Rule Could Affect Enforcement

The FTC's ban will not go unchallenged. On April 24, the day after the FTC announcement, the U.S. Chamber of Commerce filed a lawsuit in the U.S. District Court for the Eastern District of Texas seeking to enjoin the FTC's enforcement of the ban as unconstitutional.[29]

On April 23, a Texas-based accounting firm, Ryan LLC, filed suit in the U.S. District Court for the Northern District of Texas similarly seeking to enjoin the FTC's ban and challenging the FTC's current structure.[30]

But even if such challenges are successful in temporarily or even permanently preventing the FTC from enforcing the federal ban, state regulators will remain free to target noncompetes.

Even for states with consumer protection statutes that expressly incorporate FTC guidance,[31] enjoining the FTC's rule would not prevent attorneys general from independently determining that entering or enforcing noncompetes falls under their states' broad definitions of "unfair" or "deceptive" practices.

The federal ban remaining in place could justify an attorney general's position in settlement negotiations or litigation, but it is not necessary for an attorney general to bring an enforcement action alleging that a noncompete violates the state's UDAP statute.

The federal government formally blessing a national ban will likely be more than enough to embolden some attorneys general to bring enforcement actions targeting noncompetes — regardless of whether courts ultimately strike down the ban.

For these reasons, all companies, both large and small, should, irrespective of pending challenges to the

enforceability of the FTC's new rule, begin to operationalize business changes that enable them to succeed in a business environment where noncompetes are generally unavailable or simply too risky to deploy.

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[1] *See* 16 C.F.R. Part 910, available at https://www.ftc.gov/system/files/ftc_gov/pdf/noncompete-rule.pdf.

[2] Press Release, FTC Announces Rule Banning Noncompetes, FTC (Apr. 23, 2024), available at https://www.ftc.gov/news-events/news/press-releases/2024/04/ftc-announces-rule-banning-noncompetes.

[3] For a discussion of the FTC's notice of proposed rulemaking and the final rule's likely consequences, see Ryan Strasser & Carson Cox, FTC Noncompete Ban Could Open State Litigation Floodgate, *Law360* (Jan. 30, 2023), available at https://www.law360.com/articles/1570312.

[4] *See* 16 C.F.R. Part 910.

[5] *See* id. §910.

[6] *See* FTC, supra n.1.

[7] Strasser & Cox, supra n.2.

[8] *Id.*

[9] *Id.*

[10] *See* D.C. Code § 28-3901(d); *see*, e.g., Mass. Gen. L. ch. 93A §2(b); Fla. Stat. §§501.201, 501.205; Cal. Bus. & Prof. Code §17580.5.

[11] *See id*.

[12] *See* Press Release, AG Schwalb Leads 18 Attorneys General Supporting US Federal Trade Commission Rule to Ban Workplace Non-Competes (Apr. 19, 2023), available at https://oag.dc.gov/release/ag-schwalb-leads-18-attorneys-general-supporting.

[13] *See* Press Release, Attorney General Schwalb Announces Three District Employers Must Pay More Than $150K for Violating DC's Ban on Non-compete Agreements (Nov. 17, 2023), available at https://oag.dc.gov/release/attorney-general-schwalb-announces-three-district.

[14] *See* Minn. Stat. §181.988.

[15] *See* 2023 N.Y. SB S3100A.

[16] *See* 2023 Cal. AB 1076; 2023 Cal. SB 699.

[17] 16 C.F.R. §910.

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[18] *See* id. § 910.4.

[19] *See* Ryan J. Strasser, Timothy L. McHugh, Abigail D. Hylton, & William H. Smith III, Should Conscription of State Attorneys General Be a Recognized Fourth Form of Federal Action? How Federal Agencies Are Using the States to Expand Their Regulatory Reach and Advance Their Missions, 1 J. Fed. Agency Action 9 (Jan. 2023).

[20] Press Release, FTC, FTC Issues Report to Congress on Collaboration with State Attorneys General (Apr. 10, 2024), available at https://www.ftc.gov/news-events/news/press-releases/2024/04/ftc-issues-report-congress-collaboration-state-attorneys-general.

[21] Keith Ellison (@AGEllison), X (Apr. 23, 2024, 5:08 PM).

[22] Josh Shapiro (@GovernorShapiro), X (Apr. 24, 2024, 9:40 AM).

[23] Strasser & Cox, supra n.2.

[24] *Id.*

[25] *Id.; see* also Amy P. Williams, Ryan Strasser, & Ashley Taylor, State Attorney General Actions: Strategies for Venue and Settlement Differ from Typical Litigation, *Reuters* (Feb. 16, 2023).

[26] Strasser & Cox, supra n.2.

[27] *See id*.

[28] 16 C.F.R. §910.2(a)(2).

[29] *See* Daniel Wiessner, US Chamber of Commerce Sues FTC for Ban on Noncompete Agreements, *Reuters* (Apr. 24, 2024), available at https://www.reuters.com/legal/us-ban-worker-noncompete-agreements-faces-lawsuit-major-business-group-2024-04-24/; Dkt. 1, *Chamber of Commerce of the United States of America v. Federal Trade Comm'n*, No.6:24-cv-00148 (E.D. Tex Apr. 24, 2024), available at https://fingfx.thomsonreuters.com/gfx/legaldocs/zdpxnznkepx/frankel-ftcnoncompete–chambercomplaint.pdf.

[30] Dkt.1, *Ryan, LLC v. Federal Trade Comm'n*, No.3:24-cv-00986-E (N.D. Tex. Apr. 23, 2024), available at https://fingfx.thomsonreuters.com/gfx/legaldocs/mypmkekxqpr/frankel-ftcnoncompete–ryancomplaint.pdf.

[31] *See* National Consumer Law Center, Consumer Protection in the States: A 50-State Evaluation of Unfair and Deceptive Practices Laws, 10–13 (Mar. 2018), available at https://www.nclc.org/wp-content/uploads/2022/09/UDAP_rpt.pdf (noting that many states' UDAP statutes are based on the FTC Act and often adopt the FTC's definitions of deceptive practices).

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