Articles + Publications | August 21, 2024

Texas Court Issues National Injunction Barring Enforcement of the FTC's Noncompete Ban

WRITTEN BY

Barbara T. Sicalides | Matthew V. DelDuca

In a complete victory for plaintiffs, a Texas court permanently enjoined the Federal Trade Commission's (FTC) rule banning nearly all employee noncompetes. In the absence of the court's decision, the rule had been scheduled to become effective on September 4. While the litigation regarding the FTC rule is pending in Texas, Florida, and Pennsylvania federal courts and the FTC has pledged to continue its efforts to stop the use of noncompetes, the Texas opinion gives businesses much-needed clarity regarding the rule and eliminates the need for employers to address the rule by September 4.

The FTC's noncompete rule, if it had become effective, would have applied to any written or oral employment term or policy that penalized or prevented a worker from (a) seeking or accepting work in the U.S. with a different employer, or (b) operating a business in the U.S. after the conclusion of the employment that includes the term or condition. The rule, with narrow exceptions, prohibited new noncompete agreements on or after the effective date with any worker. The rule also prohibited enforcing or attempting to enforce a noncompete clause that existed before the effective date for any worker except for those who qualified as senior executives.

The Texas and Pennsylvania courts reached conflicting preliminary injunction decisions, with the Pennsylvania court upholding the ban and the Texas court finding that the FTC did not have the authority to issue the noncompete rule. Although the Florida court agreed that its plaintiff was entitled to preliminary relief from the rule, it applied a different analysis to reach that decision. All three of the preliminary rulings applied only to the plaintiffs in each of those cases, leaving other employers with difficult choices regarding compliance with a rule that negated their bargained-for employee arrangements, attempting to preserve their right to enforce noncompete obligations, or even noncompliance in hopes that the ban would, in the future, be struck down.

The central issue before the Texas court was whether the FTC Act gives the FTC the authority to promulgate substantive rules in general, and the broad, sweeping noncompete ban in particular. Unlike the Texas court's earlier ruling limited to only the parties before it, in the instant decision the court held that the FTC's noncompete rule "shall not be enforced or otherwise take effect on its effective date of September 4, 2024, or thereafter." The court agreed that the FTC Act granted the agency the power to prevent unfair methods of competition, but concluded that Congress did not affirmatively grant the FTC the authority to promulgate "substantive rules regarding unfair methods of competition." The court determined that the pertinent section of the FTC Act — Section 6(g) — is "a housekeeping statute," authorizing rules regarding the agency's practices and procedures.

The court also concluded that the FTC's noncompete ban was arbitrary and capricious, and accordingly violated the Administrative Procedures Act (APA) because of its "one-size-fits-all approach with no end date." "The

[FTC]'s lack of evidence as to why [it] chose to impose such a sweeping prohibition — that prohibits entering or enforcing virtually all non-competes — instead of targeting specific, harmful non-competes, renders the Rule arbitrary and capricious."

After concluding that the FTC did not have the statutory authority to establish the noncompete ban and that the ban was arbitrary and capricious, the Texas court found that it was obligated to "hold unlawful" and "set aside" the FTC's rule in its entirety and as required under section 706(2) of the APA.

The FTC's spokesperson issued a statement regarding the Texas decision: "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."

Although not yet certain, it is likely that the Pennsylvania and Florida lawsuits will continue through summary judgment, and that some or all of the pending cases will be reviewed by one or more of the three federal circuit courts implicated — the Third, Fifth, and Eleventh circuits — and ultimately reach the Supreme Court. The Texas case is the first that is ripe for appeal. For now, however, companies need not issue the employee notice required by the FTC's rule. Employers should remain alert to the legal developments regarding noncompetes, particularly given the bipartisan concern that such restrictions can impose improper limits on employee mobility. which has been expressed by all of the FTC commissioners, state attorneys general, and state and federal legislators. Moreover, it is important to remember that the Texas court's decision does not change the many and varied state laws that govern employee noncompetes.

RELATED INDUSTRIES + PRACTICES

- Antitrust
- Business Litigation
- Labor + Employment