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Texas Court Temporarily Enjoins FTC Noncompete Ban Rule

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As workers were leaving their offices for the Fourth of July holiday, the Northern District of Texas issued its much-anticipated order preliminarily enjoining the effective date of the Federal Trade Commission's (FTC) controversial noncompete ban rule. The court's decision, however, is limited to the named plaintiffs — a tax accounting firm and several business groups — in the case. Although the stay is temporary pending the court's final decision on the merits of the case and applies only to the movants in the case, it signals that a permanent and nationwide injunction is likely.

The FTC's noncompete rule, if it becomes effective,[1] will apply to any written or oral employment term or policy that penalizes or prevents 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 prohibits entering into new noncompete agreements on or after the effective date with any worker. The rule also prohibits enforcing or attempting to enforce a noncompete clause that existed before the effective date for any worker except for those who qualify as senior executives. The ban does not apply to customer or employee nonsolicitation agreements.[2]

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. The court rejected the FTC's interpretation of the FTC Act and ruled that a "plain reading" of Section 6(g) of the FTC Act "does not expressly grant the Commission authority to promulgate substantive rules regarding unfair methods of competition." Further, the court cited a 1979 Supreme Court case which referred to Section 6(g) as a "housekeeping statute," authorizing rules related to "procedure or practice," not "substantive rules." Ultimately, the court found that "the text, structure, and history of the FTC Act reveal that the FTC lacks substantive rulemaking authority with respect to unfair methods of competition under Section 6(g)." The court also determined that the FTC rule is likely "arbitrary and capricious."

Notably, the Texas court limited its preliminary ruling to the parties and declined to enter an order enjoining enforcement of the FTC rule nationwide. As a result, the court's preliminary injunction order does not invalidate the FTC rule for any nonparty.

The court's ruling on the preliminary injunction is not a final judgment in the case, however, its approach to the preliminary injunction and finding that the plaintiffs demonstrated a "substantial likelihood of success on the merits" strongly suggest that it will strike down the rule on the merits.[3] The court committed to issuing its decision on the merits by August 30. In the interim, the parties will further brief the merits issues and the narrow scope of

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the court's order, including whether the injunction should be expanded to be national.

A separate case brought by ATS Tree Services LLC is proceeding in a Pennsylvania federal court, which currently has a preliminary injunction hearing scheduled for July 10. The *ATS* court anticipated that it would publish its opinion by or before July 23. The *ATS* court is not bound by the Texas court's reasoning or decision, but it will doubtless be taken into consideration.

What's Next?

Because the Texas court limited its preliminary injunction ruling to only the plaintiffs and rejected a request to issue a nationwide preliminary injunction, companies should continue to plan for implementation of the rule on September 4.

A few things employers can do to be prepared include:

- Assess existing agreements imposing post-employment restrictions, including noncompetition agreements that would be banned under the FTC rule, and confidentiality and nonsolicitation agreements that are not.

- Consider improvements and clarifications that could strengthen your nonsolicitation and confidentiality agreements regardless of the noncompete ban's future. Clear and precise drafting is essential, and employers with workers in multiple states must account in their agreements for the many different and evolving state laws.

- Prepare to provide the required notice under the final rule because it could take time to identify the workers who are subject to oral or written noncompetes or equivalent employee policies, compile the relevant worker address information, and draft the notices. If the rule becomes effective, the notification must be made by the effective date.

Troutman Pepper will continue to monitor the developments and progress concerning the rulemaking, the lawsuits challenging the ban, and its potential impact on employers and their operations. If you have any questions, comments, or concerns about the proposed rule and its implications, our Labor + Employment and Antitrust attorneys are available to guide you through these issues and evaluate the best strategy for your business.

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[1] The rule's effective date, in the absence of a continuing and broadly applicable injunction, is September 4.

[2] For a more thorough review of the rule see FTC Bans Employee Noncompete Clauses | Troutman Pepper

[3] Notably, the court also cited the Supreme Court decision overturning the recent *Chevron* doctrine, *Loper Bright Enterprises v. Raimondo*.

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