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Texas Federal Court's Limited Ruling Enjoining the FTC's Non-Compete Rule Leaves Employers with Questions

July 8, 2024

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As previously reported, the Federal Trade Commission ("FTC") finalized a sweeping rule that, if effective, would ban nearly every post-employment non-compete provision. Lawsuits challenging the rule, which is scheduled to go into effect on September 4, 2024, were commenced in various federal courts around the country immediately following the FTC's vote to adopt the rule.

This past week, a federal court in Texas became the first to weigh in on the FTC's actions. In doing so, the Court issued an order preliminarily enjoining the non-compete ban. However, the ruling was not a nationwide injunction and only applied to the named plaintiffs in that case. While the instant ruling continues to leave employers in a state of limbo with the rule's effective date approaching, the Court's opinion appears to forecast the FTC's rule will ultimately be overturned. Moreover, the Court indicated that it plans to rule on the merits of the case by August in advance of the rule's September effective date.

The *Ryan* Court's Preliminary Injunction Decision

The first lawsuit challenging the non-compete rule was filed by Ryan LLC, a global tax services firm, in the United States District Court for the Northern District of Texas. Eventually, the United States Chamber of Commerce and several other business groups joined the action as plaintiff-intervenors, arguing in support of Ryan's challenge to the rule. On July 3, 2024, and after extensive briefing, the United States District Court for the North District of Texas issued an order granting a preliminary injunction in favor of the plaintiffs.

First, the Court noted that the FTC Act does not "expressly grant the [FTC] authority to promulgate substantive rules regarding unfair method of competition." As a result, the Court reasoned that because agencies only have the powers that Congress grants through legislation and Congress has not expressly delegated substantive rulemaking authority to the FTC to regulate unfair competition, the FTC likely exceeded its authority in enacting the rule.

Next, the Court also determined that the FTC's rule was arbitrary and capricious because it "imposes a one-size-fits-all approach." More specifically, the Court reasoned that the FTC's rule implementing a categorical ban on post-employment non-compete provisions lacked a rational connection to the agency's goal of preventing unfair competition.

Finally, the Court determined that the effectiveness of the rule would result in irreparable harm to the plaintiffs, as it would “announce open season” for poaching competitors' workers and increase the risk that departing employees would misappropriate their former employers' intellectual property and other confidential information for the benefit of their new employers.

However, as stated, the Court's order only stays the effective date of the rule as to the parties in the *Ryan* case. In other words, unless there is a superseding order, the September 4 effective date for the FTC's rule remains valid as applied to employers who are not parties to the action. Notwithstanding this fact, the Court noted it intends to “enter a merits disposition” by August 30.

The *ATS Tree Services* Action

As mentioned above, several lawsuits challenging the FTC's rule were filed in the days following the FTC rule's publication. One such case was filed in the United States District Court for the Eastern District of Pennsylvania by ATS Tree Services LLC, a small private employer.

Like the plaintiffs in *Ryan*, ATS Tree Services filed a motion for a preliminary injunction against enforcement of the rule. Oral argument on the motion is scheduled for July 10, 2024. The Court is scheduled to rule on the motion by July 23, 2024. As a result, the decision should come before the merits decision in *Ryan*. Whether either decision will involve broader injunctive relief, such as a nationwide injunction, remains to be seen.

Next Steps

The earliest the FTC's non-compete rule could become effective is September 4, while the United States District Court for the North District of Texas has declared an intent to issue a ruling on the merits of the FTC's rule by August 30, 2024. Employers should have more certainty as to whether the rule will become effective on September 4, albeit just five days in advance. Employer's may get advanced relief from the Pennsylvania federal court's ruling in the *ATS Tree Services, LLC* case. Regardless, the United States District Court for the North District of Texas' recent order suggests it is likely that the Court will permanently enjoin the rule in its merits decision, likely on a nationwide basis that applies to all employers.

Still given the lack of certainty surrounding the scope and nature of potential rulings by these federal courts, businesses should continue analyzing whether their legitimate businesses interests can and should be protected through contractual terms other than noncompete provisions. Indeed, appropriately tailored non-disclosure or confidentiality agreements, non-solicitation provisions, and garden leave arrangements will often provide the same level of protection of a non-compete without running afoul of the FTC's rule should it become effective.

If you have any questions about this Alert, the effects of the final rule, the status of the final rule's effectiveness, or defenses to its applicability, please contact one of the authors or the attorney(s) in our firm with whom you are regularly in contact.

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