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BLOG

Texas Court Enjoins FTC's Ban on Worker Non-Competes, But Only For the Plaintiffs

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On July 3, 2024, the first court to consider the Federal Trade Commission's (FTC) rule that would ban worker non-competes, found that the rule should be enjoined at this time, but only with respect to the named plaintiff employers involved in the litigation. The rule is set to go into effect on September 4, 2024. That is now stayed for the Texas plaintiffs, but uncertainty remains for all other employers. Nonetheless, the ruling is a major success for those challenging the non-compete ban, and employers now have a template for further challenges.

While the preliminary injunction remains in place, the challenge will now proceed to briefing on the merits in Texas federal court. The court indicated that it plans to issue a final ruling on the merits by August 30, 2024 – just days before the rule is set to become effective. It remains possible that the court could rule differently in its final ruling, or that other courts could reach different decisions on the legality of the FTC's rule.

Amid this continuing uncertainty about the FTC rule, as well as ongoing scrutiny of non-competes at the state level, it remains advisable for businesses to take stock of where they currently use non-competes and consider additional options to protect their legitimate interests when employees depart. Measures such as non-disclosure agreements, non-solicits, garden leaves, incentive forfeitures, and training repayment programs are all additional protections that employers can implement that—when appropriately structured—would not run afoul of the FTC's non-compete ban. Taking such steps will ensure that businesses are well prepared to continue protecting their important interests if the non-compete ban becomes effective and, if it does not, will still provide enhanced protection as a complement to non-competes.

This briefing provides more information on the *Ryan* challenge and preliminary injunction ruling as well as the many options businesses have to protect their interests when workers depart.

THE *RYAN* CHALLENGE AND PRELIMINARY INJUNCTION ORDER

On April 23, the FTC voted 3–2 along party lines to implement a new rule banning worker non-competes, deeming the use of non-compete clauses an unfair method of competition and therefore unenforceable. The rule bars non-competes on a going-forward basis and requires employers to tell their employees that certain existing non-compete agreements are no longer enforceable. (See here for an earlier post about the details of the rule and its implications).

On the same day as the FTC's vote, Ryan LLC was the first to file a challenge of the rule in the Northern District of Texas. The U.S. Chamber of Commerce and other business groups intervened and added their challenges to the case. The challengers argue that the FTC lacks express congressional approval to regulate non-competes and cannot rely on its general authority against unfair methods of competition. The parties further argue that the retroactive effect of the rule against certain pre-existing non-competes raises constitutional concerns. They label such a ban an "arbitrary and capricious" exercise of the FTC's powers, lacking sufficient basis for such a broad, categorical prohibition. Ryan and the Chamber received support from amicus briefs filed by national and international trade associations, while the FTC saw support come in from labor groups, local lawmakers, and members of Congress.

Pending before the court was a motion that would pause the rule's anticipated effective date in September, and which sought to block any enforcement of the rule while the litigation is pending. No oral argument was held on the motion and the court reached its decision on the papers. Siding with plaintiffs, the court found that the effective date of the rule should be enjoined as to Ryan LLC and the plaintiff business groups (but not their members). In other words, the plaintiff business groups are associations that have their own employees and those will be covered by the injunction; however, members of the associations will not have the benefits of the injunction at this time. Additionally, the court stated that it intends to enter a merits disposition on this action on or before August 30, 2024, which could in turn expand the scope of the injunction.

The court granted the stay and preliminary injunction after finding that (i) plaintiffs are likely to succeed on the merits because the FTC lacks the authority to create substantive rules under Section 6(g) of the FTC Act and the rule is likely to be found to be arbitrary and capricious because it imposes a one-size-fits-all approach categorically banning worker non-competes with no end date; (ii) irreparable harm would result without the issuance of injunctive relief because of the costs and burdens of the plaintiffs having to prepare to comply with the rule; and (iii) the balance of harms and public interest weigh in favor of granting injunctive relief as it will maintain the status quo and prevent the substantial economic impact of the rule. However, the court found that the plaintiffs had not sufficiently briefed or established a basis for the court to issue a universal, nationwide preliminary injunction at this time. The court therefore limited its preliminary injunction's application to the plaintiffs, but the ruling leaves open the possibility that plaintiffs could still establish a basis for broader relief in their future briefing on the merits.

Notably, since the FTC's vote to implement the new rule and the parties' briefing in the *Ryan* matter, the Supreme Court overruled its own landmark *Chevron* decision from 1984, which previously held that courts should defer to federal agencies when laws passed by Congress do not clearly answer a question arising under a statute administered by the agency. The June 28 decision in *Loper Bright Enterprises v. Raimondo and Relentless, Inc. v. Department of Commerce* does not, however, prohibit courts from looking to the expertise of the relevant agencies for assistance in interpreting federal statutes. The *Ryan* court did not consider this decision at length, but did cite it in support of the principle that statutes must be read in their context and with a view to their place in the overall statutory scheme. Regardless, the *Loper* decision overturning *Chevron* at least presents a new hurdle for the FTC to overcome in the process.

WHAT EMPLOYERS CAN DO TO PROTECT THEIR INTERESTS WHEN WORKERS DEPART

For employers who use non-competes, today's decision is certainly reason for increased optimism that the FTC's rule will not go into force, but it does not fully resolve the uncertainty of if and when the ban may become effective. As it stands, the rule is still set to become effective and apply to all other business nationwide, except for the Texas plaintiffs. How this court will come out in its final ruling (expected August 30), and how other courts address the FTC rule are also uncertain.

Amid this continuing uncertainty about the FTC rule, as well as ongoing scrutiny of non-competes at the state level, it remains advisable for businesses to take stock of where they currently use non-competes and consider additional options to protect their legitimate interests when employees depart. Taking such steps will ensure that businesses are well prepared to continue protecting their important interests if the non-compete ban becomes effective and, if it does not, will still provide enhanced protection as a complement to non-competes.

Certain protections do not fall under the FTC's rule and remain measures that would be legal even if the rule becomes effective. Companies should proactively consider when the following types of provisions are appropriate

for their agreements and what information they are seeking to protect:

- **Non-disclosure agreements (NDAs).** Targeted NDAs and confidentiality agreements can help protect a company's intellectual property information or trade secrets. Additionally, information-management policies can be updated and enhanced in order to better keep access to sensitive information limited to those employees that need to know the information and who have agreed to heightened confidentiality terms in advance.
- **Non-solicits.** Non-solicits can protect customer relationships and ensure that a former employee does not take advantage of the company's relationships. Such agreements are at their strongest when tailored to specific customers or other valuable relationships in which the employee was involved at the company.
- **Garden leaves.** Employers can contractually agree with employees to extend notification periods before the employee departs the company. During this notice period, employers can instruct a departing employee not to work, deny them access to confidential information, and prohibit them from communicating with customers, company employees, or other important business partners. During this garden leave period, the employer continues to pay the employee their salary, but typically does not need to pay bonus or other compensation above that base salary. The FTC has recognized that such garden leaves are not a post-employment restriction on competition and are therefore explicitly carved out of the FTC's non-compete rule.
- **Incentives forfeitures.** A wide variety of incentive award structures can be used to encourage long-term employment and reduce the likelihood that an employee will depart for a competitor. Terms that require departing employees to forfeit incentives or future compensation if they leave for a competitor can be effective while not actually prohibiting an employee from potentially competing.
- **Training cost repayment programs.** Training cost repayment programs aim to protect investments in training workers and require repayment of training expenses if the employee leaves the company within a certain period of time. Repayment terms should generally be tied to the company's actual costs associated with the training.

Winston attorneys are carefully monitoring the developments involving non-competes and are regularly advising clients on ways to navigate the shifting landscape and to implement additional protections including these examples and beyond. Reach out to the authors of this post or your regular Winston contacts with any questions.

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