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FTC's New Rule Prohibiting Non-Competes Faces Legal Challenges

The Federal Trade Commission's ("FTC") new rule prohibiting non-competes on a nationwide basis is set to take effect on September 4, 2024, as discussed in our prior [Client Alert](#). As September draws near, the FTC continues to face legal and constitutional challenges over its power to enact and enforce the rule. Three lawsuits in Texas, Pennsylvania and Florida request declaratory, injunctive and preliminary relief. While the businesses in these cases may receive preliminary relief from the rule, to date no court has issued a nationwide injunction. Therefore—for now—employers still must prepare to comply with the rule.

Employers should start preparing to notify current and former employees who are subject to non-competes that such agreements cannot and will not be enforced. While employers should start taking steps to comply with the rule, employers may want to delay issuing notices to employees with non-competes until courts in the pending cases determine if a nationwide injunction will be issued. A brief summary of each of those cases is provided below.

Ryan, LLC v. Federal Trade Commission

Ryan, LLC ("Ryan"), a global tax services firm, was the first business to challenge the FTC's rule prohibiting non-compete agreements. Ryan filed suit in the U.S. District Court for the Northern District of Texas. The U.S. Chamber of Commerce, Business Roundtable, the Texas Association of Business and the Longview Chamber of Commerce have since joined Ryan as plaintiff-intervenors and will act as co-plaintiffs moving forward.

On July 3rd the Texas federal court entered a preliminary injunction precluding the enforcement of the rule until final adjudication on the merits. The injunction, however, covers only the named parties in this case. The court issued a detailed and well-reasoned opinion explaining why the plaintiffs would likely succeed on the merits of the lawsuit challenging the FTC's authority to issue the rule. But the court clarified that while a nationwide injunction might be appropriate, the plaintiffs offered little to no briefing that would support universal or nationwide injunctive relief. Further, the court declined to extend injunctive relief to members of the plaintiff-intervenors because they did not brief associational standing.

After the court declined to extend the preliminary injunction beyond the named parties in the case, the plaintiffs filed a motion seeking limited reconsideration of the scope of preliminary relief. The plaintiffs argued that virtually all businesses affected by the non-compete rule, including plaintiff-intervenors' members, would incur substantial cost preparing to comply with an unlawful regulation. The court denied this motion for reconsideration.

The plaintiffs and the FTC are expected to file motions for summary judgment within the next few weeks, in which they will present arguments regarding the basis for a nationwide injunction before the September 4 effective date. If this happens, the court could issue a permanent injunction beyond the named parties in the case. The court has indicated it will issue a decision on a permanent injunction on or about August 30, just before the rule is set to take effect.

ATS Tree Services, Inc. v. Federal Trade Commission

Another lawsuit challenging the FTC's rule is pending in the U.S. District Court for the Eastern District of Pennsylvania. ATS Tree Services ("ATS") is a Pennsylvania-based company that serves residential, commercial, industrial and municipal clients.

Like Ryan, ATS filed a motion for preliminary injunction. On July 10, Judge Hodge presided over a three-hour hearing on the motion.

During the FTC's argument, the judge asked why the FTC chose certain exceptions to the rule and why it did not take a narrower approach instead of a complete ban on non-competes. The FTC responded by noting that the scope of its authority is to regulate only covered employers and highlighted the use of non-competes for senior executives is not considered an unfair method of competition.¹ The judge also asked numerous questions on non-competes generally, the rule's irreparable harm to ATS, and the textual arguments about the FTC's authority to issue rules concerning unfair methods of competition.

On July 23 the court issued a comprehensive opinion denying the motion for preliminary injunction because ATS failed to show how the rule would cause irreparable harm. Most notably, the court emphasized ATS is unlikely to succeed on the merits because the FTC has substantive rulemaking authority and can broadly ban non-competes to prevent unfair methods of competition. This opinion stands in stark contrast to the Texas court's decision to issue a preliminary injunction in *Ryan* and may indicate an eventual ruling in favor of the FTC in Pennsylvania.

¹ The FTC specifically mentioned it cannot regulate nonprofits or banks. The comments to the final rule, however, note that having tax-exempt status under the Internal Revenue Code will not necessarily exempt an organization from coverage. According to the rule, to determine if the FTC has jurisdiction, the FTC will evaluate (1) whether an organization is engaged in business for a charitable purpose, and (2) whether the organization or its members derive a profit.

Properties of the Villages, Inc. v. Federal Trade Commission

Properties of the Village (the “Properties”) is a Florida corporation that sells real estate. The Properties filed suit in the U.S. District Court for the Middle District of Florida against the FTC. On July 2 the Properties then filed a motion for preliminary injunction and to stay the rule’s effective date.

The FTC must respond to the Properties’ motion for preliminary injunction by July 25. The court then will decide whether to grant the Properties’ request for an oral argument on the motion.

Preparing for the Rule’s Effective Date

The *Ryan* court is anticipated to be the first to decide whether to issue a nationwide injunction, as a decision is expected August 30, just before the rule’s effective date. Notably, such an injunction would be effective notwithstanding the order denying the request for injunction in the *ATS* court. However, until a nationwide injunction exists, employers must be prepared to comply with the requirements of the rule by September 4, 2024.

Pursuant to the rule, clauses or agreements effectively precluding employment or ownership in a competing business after employment ends will no longer be effective, except for employees who qualify as senior executives. The rule narrowly defines a senior executive. Therefore, employers should consider involving legal counsel to assist in evaluating whether any employees qualify for the senior executive exemption.

In addition, by or before September 4, employers must send written notice to their current and former employees who signed non-compete agreements. This notice must state that the non-compete will no longer remain in effect and thus will not be enforced. A sample notification [form](#) is contained within the final rule.

Employers also should review and revise their current restrictive covenants to ensure they protect business relationships and confidential information through narrowly tailored non-solicitation and confidentiality agreements. Employers also should begin reviewing their internal policies to protect confidential information and consider whether to implement garden leave agreements to prohibit key employees from working for a competitor for a period after employment ends.

If you have any questions about the FTC’s rule, the status of these legal challenges, or how your organization may be impacted, please contact your Kutak Rock attorney or a member of the firm’s [National Employment Law Group](#). You may also visit us at www.KutakRock.com.

