On FTC noncompete ban, it's prepare but wait-and-see, attorneys say

Lawyers see court challenges as likely to succeed

Kris Olson // May 2, 2024 // **Massachusetts Lawyers Weekly**

While there is some skepticism as to whether it will survive the immediate legal challenges it faces, employers should take steps to prepare for the possibility that the comprehensive federal ban on new noncompete agreements recently announced by the Federal Trade Commission becomes a fact of life, attorneys told Lawyers Weekly.

The FTC's final rule, announced on April 23, adopts a comprehensive ban on new noncompetes with all workers, including senior executives, on the basis that they constitute an unfair method of competition in violation of Section 5 of the Federal Trade Commission Act.

Existing noncompete agreements with senior executives, defined as corporate leaders holding policy-making positions and making at least $151,164, would remain effective once the rule takes effect. But with other employees, employers would be required to send notices, informing them that the noncompete agreements they may have signed are null and void.

If left undisturbed, the rule would take effect 120 days after it is published in the Federal Register, meaning it would become effective on Sept. 4.

However, at least three challenges to the rule have been filed in federal court, with the judge in one of those cases issuing a scheduling order that seeks to ensure that at least one of those challenges is fully litigated before the rule takes effect.

That case, *Chamber of Commerce of the United States of America v. Federal Trade Commission*, was filed in the Eastern District of Texas on April 24, one day after the global tax services firm Ryan LLC filed suit in the Northern District of Texas.

A day later, ATS Tree Services, LLC, a tree service company based in Perkasie, Pennsylvania, filed a similar suit in the Eastern District of Pennsylvania.

In the *Chamber of Commerce* case, the government on April 30 filed a motion asking the court to limit the plaintiffs to litigating on behalf of only those members whom they have specifically identified and who have given them authority to do so, rather than millions of anonymous members. Alternatively, the Biden administration is asking to transfer the case to the Northern District of Texas under the first-to-file rule.

If U.S. District Court Judge J. Campbell Barker does not amend his scheduling order, briefing in the *Chamber of Commerce* case will be complete by June 19, with a hearing on preliminary relief and summary judgment and possibly a consolidated bench trial soon thereafter.

"That should allow prompt resolution of the case with sufficient time, before the rule's effective date, for any desired appellate review," Barker wrote in his scheduling order.

Neither the nature of the final rule — the draft rule proposed in January 2023 had the same main thrust — nor the immediate legal challenges are a surprise, attorneys told Lawyers Weekly.

As a result, the thinking about how to adapt to a noncompete-free world began long ago, with the final version of the rule merely reemphasizing the importance of taking advantage of other alternatives, like trade secret laws and non-disclosure agreements, they say.

Be ready to react

Count Boston business litigator Russell Beck among those who believe the legal challenges to the FTC noncompete ban will succeed.

"I think they will get an injunction, and ultimately it will make its way up to the Supreme Court, and we know the temperature of the Supreme Court at this point," Beck said.

As a result, the current attention being given to the noncompete ban may prove to be a "tempest in a teapot," he said.

I would not make any changes just yet. I would be prepared to know what changes I will need to make to my agreements, which may be the elimination of noncompetes, but it may also include narrowing my non-disclosure agreements and my non-solicitation agreements and any other restrictive covenants.

At the end of the day, Beck said, he does not think the ban will be an issue.

"However, companies do need to be ready to react if it does become an issue," he said.

Among Massachusetts employers, some degree of angst is understandable, given that it was a long odyssey that involved a decade-plus of negotiation before the state's noncompete law, G.L.c. 149, §24L, got across the finish line in October 2018, said Boston attorney Gregory S. Bombard.

"It changed the entire landscape for Massachusetts employment relationships with respect to non-competition agreements," he said. "Clients have invested a lot of time and effort and money in ensuring compliance with the 2018 noncompete act. Here we are six years later, in 2024, and the regime quite possibly is changing entirely again."

Still, in a post on his Fair Competition blog, Beck borrows from Kevin Bacon's character in the movie "Animal House" to counsel employers: "Remain calm. All is well … All is well!"

"I would not make any changes just yet," Beck said. "I would be prepared to know what changes I will need to make to my agreements, which may be the elimination of noncompetes, but it may also include narrowing my non-disclosure agreements and my non-solicitation agreements and any other restrictive covenants."

As Beck noted, the FTC rule also seeks to outlaw agreements that are the functional equivalent of noncompete agreements, even if they bear another label.

Given that aspect of the rule, taking an inventory of existing agreements may be a "pretty significant task," Boston attorney Jeffrey S. Siegel said.

"It's going to involve looking in employees' personnel records for agreements," he said. "It's going to be looking and thinking about severance agreements

that might have forfeiture clauses. It's going to be looking at policies. It's going to be looking at deferred comp and figuring out which employees may or may not be covered by noncompete provisions that are in all sorts of places."

Since a California state appellate court decision in the case *Brown v. TGS Management Co., LLC*, along with the 1st U.S. Circuit Court of Appeals' 2020 decision in *TLS Management and Marketing Services, LLC v. Rodriguez-Toledo, et al.*, Beck said he has been recommending clients be very clear on what their non-disclosure agreements do not cover.

"They should not cover employees' general knowledge, skill or experience, and I think moving forward that should be expressed in non-disclosure agreements, so that it's clear that the company's not trying to claim the employee's general skill, knowledge and experience as information belonging to the company," he said.

Similarly, Beck added, non-disclosure agreements should make it very clear that any information that is or becomes public or publicly available through no fault of the employee is also not claimed as confidential information.

By narrowing agreements in such a manner, they should pass muster, even if the new FTC rule takes effect, Beck said.

The best advice attorneys can give employers is to use such clauses thoughtfully and restrict individuals only to the extent necessary and only to the extent the law allows, Siegel agreed.

Other prophylactic measures

One thing organizations may want to consider is whether to use the time between now and when the rule would take effect to bind a senior executive to a noncompete agreement, given that the window to do so may be about to close, Siegel said.

The prospect of the FTC rule taking effect should also prompt employers to review what information they believe is confidential or a trade secret to ensure they are taking appropriate steps to protect it, including limiting the individuals who have access to that information, he said.

Siegel believes there may also be a proliferation of garden leave provisions, in which employees must provide notice before they leave and are paid for some period before their employment ends, giving the employer some buffer of time without running afoul of the FTC rule.

If it appears that the rule will, in fact, be taking effect, employers should expect dozens, if not hundreds, of calls from their employees once they receive the required notices that their noncompetes will not be enforced.

“Employers, particularly the large ones, are going to have to set up the appropriate infrastructure to handle that or make the conscious choice not to provide any additional information other than what’s required in the notice,” Siegel said.

If the rule does take effect, almost certainly additional litigation will follow, if for no other reason than there are some terms — particularly who is a “senior executive” — that are crying out for additional definition, said Providence attorney Matthew H. Parker.

“We’re going to be litigating whether they had enough decision-making or policy-making authority to be covered by the exemption,” he said.

In addition to not having a carve-out for senior executives, the original proposed rule limited the circumstances under which a noncompete could be connected to the sale of a business, requiring the sale to involve a specific amount of equity in the business to be exempt.

In the final rule, that provision is less specific, potentially providing more leeway for noncompetes connected to the sale of a business to remain enforceable. But here, too, litigation is likely to ensue, Parker said.

Sledgehammer over scalpel

Many have been left questioning the wisdom of the Biden administration’s heavy-handed approach to noncompetes, especially after seeing nuanced approaches that balance competing interests develop at the state level.

The rule is “taking some power away from states that they’ve had for a long time to regulate [noncompetes], consistent with their local politics and agendas,” Parker said.

A bit of uniformity among the states is not necessarily a bad thing, Parker allowed.

“Right now, it really varies, depending upon where you’re doing business and where you live, whether or not a noncompete can be enforced, and that can be frustrating in this day and age where employers are doing state business in multiple states,” he said.

But the FTC rule would also not eliminate the need to comply with the patchwork of state laws that currently exist, Siegel noted.

“It just sets a sort of a threshold for what you can’t do,” he said.

The FTC has made some big claims about what banning noncompetes will accomplish. It has estimated that the ban will result in the creation of 8,500 new businesses and the issuance of an average of between 17,000 and 29,000 more patents each year. The FTC believes the rule will also lead to increased wages and lower health care costs.

But Andover lawyer Andrew Botti, the former chairman of the Smaller Business Association of New England, thinks those claims are overstated at best. The data — whether related to unemployment rates or startup rates — tells a far different story than the one the Biden administration is promoting, Botti said.

“Part of the reason why I think they’re wrong about what they say is that they don’t look at the whole picture,” he said. “The whole picture includes whether or not the employer that holds the noncompete wants to enforce it once the employee says they’re leaving, because a lot of times they don’t.”

Botti and others noted that, since last year, near-complete bans have reached the governors’ desks in New York and Maine, only to be vetoed as Govs. Kathy Hochul and Janet Mills responded to concerns from the business communities in their states.

Massachusetts has been served well by the aspect of its law that grants power to the courts to reform overly broad noncompete agreements, Botti said.

“There were a lot of things that happened and revolve around different issues when it comes to noncompetes, which I don’t think the FTC is really paying any attention to,” he said. **MLW**