COMMENTARY

The FTC's Noncompete Ban: Don't Put the Cart Before the Horse

"There is vast uncertainty as to whether the ban will actually go into effect," writes Darren Braun.

June 20, 2024 at 11:30 AM

Employment Law

By Darren Braun | June 20, 2024 at 11:30 AM

Nearly two months have passed since the FTC approved its new rule banning noncompete agreements, and the ban is set to go into effect in early September 2024. Since then, many articles have analyzed the main effect of the noncompete ban, and explaining how employers should protect their business interests going forward.

The purpose of this article is to take a step back to examine the ongoing litigation surrounding the rule, and—if the ban goes into effect—anticipate future issues that will arise concerning its interpretation and application.

Will the Ban Even Take Effect?

There is vast uncertainty as to whether the ban will actually go into effect. When the FTC passed the ban, several entities (including various chambers of commerce) predictably filed suit to enjoin it from taking effect in September. Many of these lawsuits were consolidated into the Northern District of Dallas in front of Judge Ada Brown, who was appointed to the federal bench in 2019 by President Donald Trump after serving for six years on the Dallas Court of Appeals. Many more plaintiffs intervened. Brown has permitted substantial briefing from the parties and amicus curae, and stated that she will issue a decision no later than July 3, 2024. The ban will not take effect anytime soon if Brown grants the injunction.

Regardless of Brown's ruling, the ban faces an uncertain future in the Fifth Circuit Court of Appeals, to whom the losing party will certainly appeal. The highly-conservative Fifth Circuit has a reputation for striking down Biden-era administrative actions, including recently upholding an injunction against the Cybersecurity and Infrastructure Security Agency related to its contact with social media companies. It would not be unreasonable to expect a multi-year delay in the ban's implementation while the appeal process plays out.

Future Issues Concerning the Ban's Interpretation and Application

Assuming the ban eventually takes effect, there will need to be litigation in order to flesh out the exact contours of the ban.

The ban defines "noncompete clause" to mean, in relevant part, "a term or condition of employment that prohibits a worker from, penalizes a worker for, or functions to prevent a worker from (i) [s]eeking or accepting work in the United States … or (ii) operating a business in the United States[.]"

Clearly, this definition prohibits clauses that prohibit former employees for working in certain areas, in certain industries, or for certain competitors.

But, at first glance, the rule seems ambiguous as to whether it applies to contractual provisions that, although not noncompetes in the colloquial sense, still restrict professional mobility and thus are governed by the same enforceability standards as noncompetes. In Texas, for example, noncompetes are governed by the Covenants Not to Compete Act which imposes, among other things, reasonableness standards. Texas courts have further held that this act applies to nonsolicitation clauses and certain forfeiture clauses because, like noncompetes, such clauses impede and restrict professional mobility. Does the FTC ban also apply to nonsolicitation clauses then?

The FTC addressed nonsolicitation clauses in its discussion of the rule, stating that although the ban does not "categorically" prohibit enforcement of nonsolicitation clauses, such clauses could fall within the ban if they are so "broad or onerous" that they nonetheless "function" to prevent a worker from accepting other employment. Such a situation is likely rare, but possible in certain industries. A salesman in the oil and gas industry, where the same major customers are shared among all competitors, may well be functionally barred from accepting employment if they cannot contact those customers.

Whether the ban applies to forfeiture clauses is, to some extent, more clear. Forfeiture clauses take many forms, and typically require an employee to forfeit stock or deferred compensation (or, in more extreme cases, already earned and paid compensation) if they compete. On its face, the FTC's ban prohibits these clauses: They are "term[s] or condition[s] of employment" that "penaliz[e] a worker" for accepting employment elsewhere. The FTC, in its discussion of the ban, also confirmed that it was meant to prohibit clauses that "require a worker to pay a penalty for seeking or accepting other work" or that "extinguis[h] a person's obligation to provide promised compensation or to pay benefits."

Despite this clarity, this portion of the ban is likely to provide fodder for future litigation. While many courts have analyzed forfeiture clauses as equivalent to noncompetes, some courts, including those in Texas and New York, have distinguished clauses that penalize employees for competing versus clauses that reward employees for not competing—a sometimes confusing and seemingly arbitrary distinction. The Texas Supreme Court stated in *Exxon Mobil v. Drennen* (which involved a non-contributory profit-sharing plan): "Forfeiture provisions conditioned on loyalty, however, do not restrict or prohibit the employees' future employment opportunities[;] [i]nstead, they reward employees for continued employment and loyalty." Accordingly, it remains to be seen whether certain types of forfeiture provisions like the one at issue in *Drennen* survive the ban.

For litigation attorneys, the ban is already having a practical effect. Most noncompete litigation begins with the employer seeking an injunction to enjoin the employee from violating the noncompete, and the employer—to obtain the injunction—must show that it has a likelihood of success on the merits of its claim. Due to the looming ban, attorneys should be defending against such requests on the basis that the ban will take effect at some point, and thus the employer cannot meet their burden to show a likelihood of success.

Darren Braun *is an attorney with The Litigation Group.*