

Publications

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Court Rules that the FTC Rule Banning Non-Competition Clauses in Employment Agreements is Unlawful and Order Has “Nationwide Effect”: Impact on Franchisors

On August 20, 2024, the Northern District of Texas in the case of *Ryan, LLC v. Federal Trade Commission* granted summary judgment to the Plaintiff Ryan, LLC, enjoining the FTC from implementing its rule banning non-compete agreements nationwide.

On April 23, 2024, the FTC passed a final rule banning most non-compete clauses in employment agreements on the purported basis of the unfair impact on competition. The ban was scheduled to go into effect on September 4, 2024. See Polsinelli Restrictive Covenant & Trade Secret Group alert.

There were multiple challenges filed in various courts, including the *Ryan, LLC v. FTC* case. On July 3, 2024, the court granted a preliminary injunction preventing the FTC from enforcing its ban on non-competition clauses only with respect to the plaintiff in that case, a tax preparation company. The preliminary injunction order otherwise left the FTC’s rule in effect. This was the first court to render a ruling on a challenge to the new FTC rule. See Polsinelli Global Franchise & Supply Network alert. In its order, the court previewed that it would rule on the motion for summary judgment within a short period.

That order came on August 20. In that Order, the court concluded “that (i) the FTC promulgated the Non-Compete Rule in excess of its statutory authority, and (ii) the Rule is arbitrary and capricious.” *Ryan, LLC v. FTC*, 3-24-cv-00986-No.-211, 26 (N.D. Tex. Aug. 20, 2024). The Court also held that its Order has a “nationwide effect” and is not limited to the parties to the case. Thus, at this time, the FTC’s ban will not go into effect.

Following the decision, FTC’s spokesperson made the following statement, “[w]e are seriously considering a potential appeal, and today’s decision does not prevent the FTC from addressing non-competes through case-by-case enforcement actions.” If the FTC appeals, then there are several pending cases that collectively could find their way to the Supreme Court, including the Eastern District of Pennsylvania case of *ATS Tree Services, LLC v. Federal Trade Commission*, in which that court took the opposite position in denying a preliminary injunction on July 23, 2024 and finding that the plaintiff there failed to show that the FTC lacks the power to ban non-competes based on its authority to

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promulgate rules prohibiting unfair methods of competition. That court also acknowledged the FTC's comprehensive analysis in its effort to demonstrate that non-competes are broadly anti-competitive and detrimental to economic growth.

Almost all franchise agreements contain non-compete clauses and franchisors often require that franchisees have non-compete clauses with the franchisee's management-level employees. Franchisors and franchisees should not remove non-competition covenants from their agreements, but should continue to monitor this issue and recognize the FTC ban could be reinstated or the FTC could attempt to revise it. It is likely the challenge to the ban will make its way to the Supreme Court. The FTC's ban on non-competition covenants, as it was written, does not prohibit non-compete clauses in franchise agreements between franchisors and franchisees. However, if ultimately upheld as written, there would be a potential impact on such clauses in franchise agreements if they extend to non-owner managers. To the extent franchisors have required franchisees to use agreements with non-compete clauses with certain of the franchisee's employees, if the FTC rule banning non-compete clauses were ultimately upheld, franchisors will need to remove that requirement and ensure franchisees are aware the obligation is removed.

The FTC maintains the power to decide case-by-case enforcement actions. These federal enforcements are in addition to continued pressure by the states that ban employee non-competes (when they are not a part of the sale of business) including California, Oklahoma, North Dakota, and Minnesota, with six more states that have pending legislation to do the same.

Polsinelli attorneys are continuing to watch for appeals and developments to the challenges brought in other jurisdictions. We are also available to assist with understanding and preparing for franchise business operations in a world of continuously changing non-compete and restrictive covenant regulations.