Two Recent Federal Court Decisions Conflict with Exception to FTC Non-Compete Ban: Your 3 Steps for Litigating Accrued Non-Compete Violation Claims

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Even though the FTC's impending rule that will ban most non-competition agreements specifically carves out claims for violations that accrue before the rule goes into effect – an exception that many federal courts have recognized – two federal courts recently rejected requests for injunctive relief in light of the impending ban. Because of this trend, employers that have required their employees to sign non-competition agreements should be mindful of developments in this area. Here's what you need to know about both rulings so that you can better position your accrued claims for success.

The Accrued Claims Exception to the FTC's Final Rule

The FTC's rule that bans employers from enforcing non-competition agreements expressly contains an exception for the enforcement of claims that accrued prior to the date it takes effect (slated for September 4) – for example, where an employer alleges that a worker accepted employment in breach of a non-competition agreement prior to the effective date. The FTC included this exception to alleviate concerns that the rule would apply retroactively and extinguish or impair vested rights under existing law prior to the effective date.

But two federal courts have just stepped in and broadened the impact of the rule by preliminarily ruling that current non-competes may be in violation of the rule, weeks before the rule has even taken effect.

The Arizona Case

In Arizona, an employer sought a temporary restraining order against its former employees and their new employer for alleged violations of restrictive covenants in their employment agreements. The employer requested an order preventing the former employees from working with their new employer, soliciting its customers and employees, and from using the former employer's confidential information.

The District Court held that the former employer failed to show a likelihood of success on the merits for its breach of contract claims. In rendering its decision, the court noted that the FTC's rule is slated to take effect in the near future and would apply to the non-competition covenants at issue. The court determined the looming non-compete ban weakened the former employer's ability to

The court determined the looming non-compete ban weakened the former employer's ability to show a likelihood of success on the merits. However, it does not appear that the former employer raised the express exception by the FTC of accrued claims from the non-compete ban in its request to enforce its non-competition covenants.

The Florida Case

In Florida, a franchisor sued its franchisee and the franchisee's guarantor. The parties agreed to a consent injunction in which the franchisee and its guarantor would be blocked from competing with the franchisor for two years. But the Florida District Court rejected the agreed motion for injunction.

The court specifically noted that a non-compete that potentially prohibits non-senior, executive workers employed from seeking or accepting work with a competitive business within the restricted territory for two years – the agreed injunction before the court – would become unenforceable on September 4. The court then provided the parties approximately one month to file a renewed motion that contains a proposed preliminary injunction that either complies with the rule or does not contain reference to any non-compete requirements.

Although the FTC's rule contains a carveout for "senior executives" who enter into non-competes prior to the rule's effective date the court also determined:

- it was unclear whether that carveout applied to any of the workers who would be subject to the proposed non-compete; and
- the parties did not demonstrate that the persons subject to the proposed restriction were properly noticed or consented to the restrictions.

The court further ordered that if the parties' renewed, proposed preliminary injunction includes a non-compete to restrain those who qualify as "senior executives," they must attach proof of the senior executives' notice of and consent to the restraint.

Finally, the court directed the parties to amend the employee non-solicitation portion of any renewed proposed injunction so that it would not prohibit the defendants from hiring persons who voluntarily seek employment with them.

What are the Key Takeaways?

Accrued Claims. Employers that seek to enforce accrued non-competition claims should expressly allege and reference the exception that appears in Section 910.3(b) of the FTC's impending rule. This exception expressly excludes accrued claims.

Franchisor-Franchisees. Although the impending rule does not apply to franchisees in the context of their franchisor-franchisee relationship, non-competes impacting a franchisee's workers are not enforceable if the rule goes into effect unless the employees are senior executives.

Senior Executives. The final rule defines "senior executives" as workers earning more than $151,164 annually and who are in policy-making positions. If the Final Rule goes into effect, employers should be prepared to prove how the senior executive exception applies to employees who are identified as senior executives.

What Steps Can Employers Take?

1. **Assess whether any non-compete claims have accrued** and whether you should move forward in prosecuting such claims prior to the FTC's rule taking effect.

2. Assess the need to send **cease and desist correspondence** to former employees that violate their non-competition agreements prior to the rule taking effect. That way you can use the correspondence to show when the violation occurred and when you became aware of it.

3. Make an adequate determination of whether workers fall under **the senior executive exemption**, and if so, how you will be able to prove that the executive is in a policy-making role.

4. You should also generally familiarize yourself with the **exceptions to the rule** – i.e., the sale of a business, claims that accrued before the rule goes into effect, and industries that fall outside of the FTC's jurisdiction (like banks or non-profits).

5. Work with legal counsel to assess the impact of **ongoing litigation and the litigation developments** that may derail or sidetrack the FTC's rule (such as the decision that just came down earlier this week). Because courts have not been entirely consistent about whether the FTC rule is valid, it is important to remain informed about developments to make sure you are in the know about whether the rule will take effect on September 4 as scheduled.

Conclusion

Because the outcome of the current cases challenging the rule is uncertain, you should continue to prepare for the rule to take effect September 4. And while the rule could still be blocked nationwide before that date, you may want to start investing some time and resources to prepare for compliance. You can read our full five-step recommended plan by clicking here.

We will be monitoring the situation and providing updates as the court battles continue and the effective date approaches. Make sure you are subscribed to Fisher Phillips' Insight System to gather the most up-to-date information directly to your inbox. You can also check out Blue Pencil Box for our daily updates on restrictive covenant law. This comprehensive resource not only provides detailed daily summaries of cases and laws involving non-competes and other restrictive covenants, but also maintains a comprehensive database and customizable checklists to help you comply.

If you have questions, please contact the authors of this Insight, your Fisher Phillips attorney, or any attorney in our Employee Defection and Trade Secrets Practice Group.

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