FTC Non-Compete Ban on Life Support

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On July 3, 2024, in the case of *Ryan LLC et al. v. FTC*, the United States District Court for the Northern District of Texas ("Court") issued a preliminary injunction staying enforcement of the Federal Trade Commission's (FTC) Final Rule ("Rule") prohibiting non-compete agreements for most workers. The preliminary injunction only applies to the parties in that case. It is not a nationwide injunction against the implementation or enforcement of the Rule and does not apply to any other businesses. However, the decision signals that the Rule likely will be found unlawful when a decision on the merits is issued on or before August 30, 2024.

Background of the Rule

On April 23, 2024, the FTC issued a Final Rule prohibiting employers subject to the FTC's jurisdiction from entering into non-compete agreements with *any* worker, regardless of title or income level, unless the agreement is part of a bona fide sale of a person's ownership interest in a business. The Rule also would make *existing* non-compete agreements unenforceable for all employees *except* "senior executives," as defined by the Rule. Upon the Rule's current effective date of September 4, 2024, employers are required to provide notice to applicable workers that their non-compete provisions are no longer enforceable. Other provisions, like non-solicitation and confidentiality agreements, could remain enforceable so long as they do not have the ultimate effect of preventing competition.

The same day the Rule was announced, Ryan LLC filed a lawsuit against the FTC pursuant to the Administrative Procedure Act ("APA"), which permits a court to hold unlawful and set aside certain agency actions. Ryan LLC alleged that the FTC's actions implementing the Rule were unlawful because the FTC lacked statutory authority under the Federal Trade Commission Act ("FTC Act") to engage in such substantive rulemaking. Accordingly, the Rule was an unconstitutional exercise of power. Ryan LLC sought a

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declaration from the Court that the Rule was unlawful. Ryan also sought an order staying the effective date of the Rule and enjoining the FTC from enforcing the Rule while the Court considered the merits of the underlying action. Other plaintiffs to the lawsuit include the U.S. Chamber of Commerce; Business Roundtable; Texas Association of Business; and Longview Chamber of Commerce. They each intervened in the suit and filed motions to stay and for preliminary injunction.

The FTC has argued that it has the statutory authority to promulgate the Rule—and to determine that *all* non-compete agreements are "unfair methods of competition"—and that Congress lawfully delegated that authority to the FTC.

District Court's Decision Enjoining the Rule

The Court granted the plaintiffs' motions for stay and for preliminary injunction, prohibiting the FTC from implementing or enforcing the Rule *against any of the plaintiffs* until a ruling on the merits is issued on or before August 30, 2024.

In issuing the preliminary injunction, the Court found that the plaintiffs had a likelihood of ultimately succeeding on the merits. Under the APA, courts must find unlawful and set aside agency actions that are arbitrary and capricious or contrary to constitutional right, power, or privilege. Examining the language of the FTC Act, the Court concluded that Congress did vest the FTC with the power to prevent unfair methods of competition (in Section 5), and to make rules and regulations for the purpose of carrying out that power (in Section 6). However, the rulemaking authority annunciated in Section 6 does not apply to *substantive* rules (or rules creating substantive obligations that have the force of law) regarding unfair methods of competition. Rather, the FTC Act permits only "housekeeping" rules, such as "interpretative or procedural rules." The Court also reviewed the history of the FTC Act and noted that the FTC had previously "explicitly disclaimed substantive rulemaking authority."

Notably, in a buried parenthetical, the Court quoted from the recent United States Supreme Court decision in *Loper Bright*, which

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abolished the *Chevron* deference doctrine. In *Loper Bright*, the Supreme Court wrote, "The deference that *Chevron* requires of courts reviewing agency action cannot be squared with the APA," which requires a reviewing court to interpret statutory provisions.

The Court also held that the Rule is likely arbitrary and capricious because it is unreasonably overbroad. The Court wrote, "It imposes a one-size-fits-all approach with no end date," thereby failing to establish a "rational connection between the facts found and the choices made." The Court observed that in enacting the Rule, the FTC relied on a handful of studies that examined the economic effects of various state policies toward non-competes. But no state had enacted a non-compete ban as expansive as the FTC's Rule. And the FTC provided no explanation for why it enacted such a sweeping ban rather than targeting specific, harmful non-competes.

The Court found that failing to enter an injunction would cause irreparable harm, because complying with the Rule would result in financial injury, including the costs associated with notifying workers subject to existing non-compete clauses, which costs were not recoverable. Lastly, the Court found that because the Rule would make long-standing contractual agreements unenforceable, granting injunctive relief would serve the public interest.

Importantly, the Court's ruling granting injunctive relief does *not* extend nationwide but only to the parties included in the lawsuit. In making this decision, the Court acknowledged that there is limited guidance on the appropriate circumstances for issuing nationwide relief with respect to preliminary injunctions, and that injunctive relief is typically limited to the "plaintiffs" before the Court.

Impact of the Case

While limited in scope for now, the Court's ruling signals that the Rule likely will be set aside as unlawful. If the Rule is found unlawful, it is unknown whether the Court's decision on the merits will include a nationwide injunction, but it is possible that it will. As the Court noted, "the judicial power of a federal district court 'is not limited to the district wherein the court sits but extends across the country.'"

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The Court will rule on the substantive merits of the lawsuit on or before August 30, 2024—five days before the Rule is currently scheduled to go into effect. Meanwhile, a second lawsuit challenging the Rule, *ATS Tree Services, LLC v. FTC,* is pending in the Eastern District of Pennsylvania, with a hearing scheduled for July 10 on a motion for a preliminary injunction.

As we await decisions in the above cases, employers should continue to monitor legal developments before assuming non-compete agreements are lawful or unlawful. Regardless of what happens with the Rule, now is a good time to ensure that existing agreements, including non-solicitation and confidentiality provisions, comply with existing law. For example, in most states, restrictive covenants are only lawful if they are reasonable in scope and necessary to protect a legitimate business interest. Similarly, trade secret protections typically only apply if an employer has taken appropriate steps to maintain the confidentiality of the trade secret information. Employers also may consider entering into non-compete agreements with "senior executives" now, while it is clearly lawful to do so, if they have need for such agreements. As always, employers should work with legal counsel to evaluate the enforceability and effectiveness of their agreements and business practices.

Frost Brown Todd's Labor and Employment Practice Group continues to monitor and advise on the Rule as developments occur. If you have any questions about this ruling or any other non-compete issue, please contact the authors or any member of Frost Brown Todd's Labor and Employment Practice Group.

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