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Federal Courts Divided over FTC's Non-Compete Ban Final Rule

Only a few weeks after a Texas federal court found the Federal Trade Commission's (FTC) Final Rule ("Rule") banning most non-compete agreements likely unconstitutional, a Pennsylvania federal court reached a dramatically different conclusion. In direct contrast to the Texas court's decision, the Pennsylvania court held that the FTC likely has the legal authority to issue the Rule and declined to enter an injunction preventing the Rule from going into effect.

An appeal of the Pennsylvania court's decision to the Third Circuit Court of Appeals is expected. If it is upheld, then these opposite decisions between the Pennsylvania and Texas courts set up a potential circuit split and showdown at the U.S. Supreme Court.

Background of the Rule and the Texas Court's Decision

On April 23, 2024, the FTC issued the Rule prohibiting employers under the FTC's jurisdiction from entering into new non-compete agreements with workers and making most existing non-compete agreements unenforceable. The Rule is scheduled to go into effect on September 4, 2024.

On July 3, 2024, the U.S. District Court for the Northern District of Texas [granted a motion to stay enforcement of the Rule](#) solely for the plaintiffs in *Ryan LLC et al. v. FTC* until a ruling on the merits is issued on or before August 30, 2024. The Texas court found the plaintiffs were likely to succeed in proving the Rule is unconstitutional and unreasonably overbroad. The Texas court declined to issue a nationwide preliminary injunction, but the decision suggests that an order vacating the Rule may be coming.

The Pennsylvania Court's Decision

Like the plaintiffs in *Ryan LLC*, plaintiff ATS Tree Services, LLC filed suit against the FTC on May 14, 2024, shortly after the Rule was announced, pursuant to the Administrative Procedure Act. ATS

sought a preliminary injunction to prevent enforcement of the Rule while the lawsuit played out. In support, ATS made the following arguments:

- The FTC lacked statutory authority to engage in substantive rulemaking with respect to unfair methods of competition under the Federal Trade Commission Act (“FTC Act”).
- Even if the FTC did have substantive rulemaking power, the scope of the Rule banning *all* non-compete agreements exceeded the FTC’s authority and was arbitrary and capricious. Indeed, the FTC ban would render existing non-competes for all workers unenforceable except for senior executives.
- The FTC Act was an unconstitutional delegation of legislative power to the FTC.
- ATS would suffer irreparable harm if the Rule were not temporarily enjoined, including the non-recoverable costs associated with (1) notifying employees that their non-compete agreements are no longer enforceable as required by the Rule; (2) reviewing and modifying its business strategy; and (3) altering its specialized training program. ATS also claimed that employees would immediately leave for a competitor if the Rule went into effect.

The Pennsylvania court disagreed. It declined to find irreparable harm, noting that nonrecoverable compliance costs are not a basis for showing irreparable harm under Third Circuit law. The court also cited the lack of evidence in support of any feared mass resignation of employees.

The Pennsylvania court further found that even if ATS could establish irreparable harm, ATS could not establish a likelihood of success on the merits as required for injunctive relief. In so finding, the court determined that Sections 5 and 6 of the FTC Act provide the FTC with the authority to promulgate substantive rules. Specifically, the court held that Section 5 of the FTC Act creates a comprehensive scheme to “prevent...unfair methods of competition,” and Section 6 gives the FTC the power to take actions to achieve that purpose. While ATS argued the FTC’s power under

Section 6 is merely procedural in nature, the court concluded the text of the statute contains no such limitations on the FTC's authority.

In reaching its decision, the Pennsylvania court looked to the legislative history of the FTC Act, noting that Congress had the ability to specifically define and restrain the FTC's rulemaking powers in the 1975 and 1980 Amendments to the FTC Act, but imposed no such limitations. Additionally, the FTC had previously invoked its Section 6 rulemaking authority to promulgate substantive rules to prevent unfair methods of competition that had a significant economic impact, further supporting its authority to do so here.

What Happens Now?

The decision from the Pennsylvania court, which directly contradicts the Texas court's decision, suggests the possibility of an eventual circuit split and that the U.S. Supreme Court will ultimately decide whether the Rule is lawful. In the meantime, a decision on the merits from the Texas court is expected on or before August 30, 2024. If the Texas court vacates the Rule on a nationwide basis, that order could remain in effect while any related appeals play out. As we await final decisions in the above cases, employers should continue to monitor legal developments and work with counsel to ensure existing agreements comply with state and federal law. Employers also may want to prepare for the contingency that the FTC Rule remains unsettled by the September 4, 2024 effective date.

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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