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Texas District Court Sets Aside the FTC's Non-Compete Rule

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What Happened

On August 20, 2024, Judge Ada Brown of the Northern District of Texas struck down the FTC's Non-Compete Rule that, had it gone into effect, would have prohibited virtually all employee non-compete agreements nationwide. Granting summary judgment for the challengers, the court held that the FTC lacks statutory authority to promulgate the Rule and that the Rule is arbitrary and capricious. Accordingly, the court invalidated the Rule under the Administrative Procedure Act ("APA"), and the FTC cannot enforce it against any business in the United States. The district court's decision, however, is still subject to appellate review.

How We Got Here

Generally speaking, a non-compete agreement is a contractual covenant under which employees agree not to compete with their employers or work for the employers' competitors for some time after their employment ends. These agreements come in all shapes and sizes, and vary widely in scope and application.

On January 5, 2023, the FTC voted 3-2 to issue a **notice of proposed rulemaking**, proposing to ban non-compete agreements between employers and workers. On April 23, 2024, after a lengthy notice-and-comment period, the closely divided Commission promulgated a **final Non-Compete Rule** that banned almost all employee non-compete agreements around the country, with very few, limited exceptions. While several states have passed laws restricting certain types of non-competes, and while such agreements are subject to individual lawsuits under the antitrust laws, the FTC's Rule sweeps much more broadly. The FTC determined that all such agreements are "unfair methods of competition," and that the FTC Act gives the Commission the authority to ban them.

The Non-Compete Rule was originally set to take effect in September of this year. But several businesses and industry groups challenged the Rule shortly after it was promulgated. Ryan LLC filed a challenge in the Northern District of Texas in April, and associational plaintiffs intervened. Several parties filed *amicus* briefs in the district court, many in favor of the Rule and many against it.

Ryan moved for a preliminary injunction. In a July 3, 2024 order, the court held that Ryan met the requirements for preliminary relief, as it was likely to succeed on the merits and was irreparably harmed by having to prepare to comply with the Rule. The court did not preliminarily enjoin the Rule nationwide, however, and did not determine whether the association-intervenors had standing to enjoin the rule on behalf of their business-members. The court enjoined the Rule only as to the named plaintiff and intervenors. It then denied motions by Ryan and the intervenors to reconsider the scope of the preliminary injunction.

Less than two months after the preliminary injunction ruling, the court addressed the parties' cross-motions for summary judgment. It ruled for the challengers, holding that the Non-Compete Rule violates the APA because (1) the FTC lacks statutory authority, and (2) the Rule is arbitrary and capricious.

First, the court held that the FTC lacks statutory authority to promulgate the Rule because the provision the Commission had relied on for its rulemaking power—Section 6(g) of the FTC Act—does not expressly authorize substantive rulemaking. Under Section 5 of the Act, the FTC has power to prevent "unfair methods of competition"—which it typically enforces through case-by-case administrative adjudications. But, as the Court explained, Section 6(g) does not grant the FTC authority to promulgate substantive, legislative-like rules regarding unfair methods of competition that dictate private conduct. The text, context, and history of Section 6(g) all make clear that the provision allows the FTC to make only certain "housekeeping" procedural rules, not substantive rules.

Second, the district court held that the Rule is arbitrary and capricious because there is insufficient evidence in the administrate record to support the Commission's one-size-fits-all approach. The studies comparing various state-level non-compete laws, for example, contradict the categorical nature of the FTC's ban and do not justify such a vast sweep. Further, the FTC does not sufficiently explain why it chose a categorical ban rather than try to target the most harmful categories of non-compete agreements. Because the FTC did not seriously consider these alternatives, the court held that its categorical approach is arbitrary and capricious.

Having concluded that the Non-Compete Rule violates the APA, the court decided that the appropriate remedy is to "hold unlawful and set aside" the Rule in its entirety, nationwide. Rejecting the FTC's argument, the court held that the APA does not permit single-party relief for unlawful agency rules.

Next Steps

The FTC likely will appeal the decision to the Fifth Circuit. Because the Non-Compete Rule was originally set to take effect in September of this year, the FTC could seek a stay of the district court's ruling pending appeal and ask for an expedited appellate schedule. The case may well make its way to the Supreme Court, particularly because at least one other court has issued a contrary ruling, as discussed in an **earlier Weil alert**.

Key Takeaways

Both the Fifth Circuit and Supreme Court have been skeptical of agency overreach and are likely to view the FTC's attempt to impose a categorical ban on non-competes—in every market and in every jurisdiction—with a fair degree of skepticism. In its landmark *Loper Bright* decision last Term, the Supreme Court overruled the longstanding *Chevron* doctrine, which had required courts to defer to an agency's reasonable interpretation of an ambiguous statute. After *Loper Bright*, the courts will not need to defer to the FTC's position that the FTC Act gives it power to promulgate a rule banning non-competes as an unfair method of competition, even if the relevant provisions of the statute are deemed to be ambiguous. Indeed, non-competes appear to raise the type of "major question" that the Supreme Court has said requires clear and unambiguous statutory authority for an agency to act. Here, the Rule likely presents a major question, not only because of its massive economic impact, but also because non-competes are subject to ongoing political and legislative debates at the state and federal levels. Even without the "major questions" doctrine, the Fifth Circuit and Supreme Court could still hold—as did the district court—that a plain text reading of the statute leads to the conclusion that the FTC lacks authority to promulgate the Rule.

The district court's conclusion that the Rule is arbitrary and capricious also raises interesting legal and factual questions. The agency's final rule spans 570 pages, and cites numerous articles and studies. The district court's analysis is comparatively short. But the court held that, regardless of the sheer volume of evidence, the FTC lacked evidence to make the leap to a categorical ban. This ruling sets up an interesting fight over the nature of arbitrary-and-capricious review, and the rigor with which a court must review an agency's decision-making and the administrative record.

Finally, the scope of relief may present another noteworthy issue on appeal. In the Supreme Court last Term, the Solicitor General's office advanced the argument that the APA does not permit courts to vacate agency rules but only to provide relief to individual parties. In a concurring opinion, Justice Kavanaugh rebuked the agency's argument, but no other Justice joined his concurrence. If the government presses that argument again here, it could create another issue for potential Supreme Court review.

Businesses and employers should be aware that the future is uncertain with regard to the FTC's Non-Compete Rule, and should work with counsel to monitor further developments in this area. They should also be aware that the state of the law remains in flux, as states continue to pass laws addressing non-compete agreements, and individual challenges to such agreements are percolating in the lower federal courts.

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