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FTC's Non-Compete Ban Fails First Judicial Challenge

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What Happened?

On July 3, 2024, Judge Ada Brown preliminarily enjoined enforcement of the FTC's Non-Compete Ban in *Ryan, LLC v. Federal Trade Commission* (N.D. Tex.). Judge Brown reasoned that the ban was not authorized by the text, structure, or history behind Section 6(g) of the FTC Act, the provision the agency had primarily relied upon as a basis for the ban. She also reasoned that the rule was arbitrary and capricious in light of the FTC's failure to consider sufficient alternatives before imposing a categorical ban. Judge Brown limited the injunction to the plaintiffs that brought the challenge, declining to extend the injunctive relief nationwide, but intends to issue a ruling on the merits by August 30, four days before the Non-Compete Ban is set to become effective.

How Did We Get There?

As covered in our earlier alert, the FTC has been increasing its scrutiny of restrictive covenants affecting workers for the last several years. On January 5, 2023, the FTC promulgated a Notice of Proposed Rulemaking (NPRM) banning virtually all employee non-compete agreements. Immediately after the FTC issued its proposed rule, the Chamber of Commerce, other industry associations, and legal scholars raised concerns regarding the statutory basis and constitutionality of the NPRM. On April 23, 2024, following a lengthy public comment period, during which interested parties submitted over 26,000 comments about the NPRM, the FTC issued a largely-unchanged final rule. Over 200 business associations have since urged the FTC to postpone the rule's effective date, citing the compliance burdens the proposed rule has created for businesses around the country.

Once the rule was published, several lawsuits were filed. Three took center stage: The first-filed Texas case (*Ryan*), another filed by the Chamber of Commerce in Texas the next day, and a third case filed two days later in the Eastern District of Pennsylvania (*ATS*). However, the FTC moved to apply the "first-to-file" doctrine in the *Chamber of Commerce* case, successfully staying the case and leading the Chamber of Commerce to intervene in the *Ryan* case. The parties in *Ryan* have since completed preliminary injunction briefing, but have yet to brief the final merits of a permanent nationwide injunction. The plaintiffs have received amicus briefs in support of their challenge from national and international trade associations, while the FTC saw backing from labor groups and lawmakers such as Florida Congressman Matt Gaetz.

In her July 3 ruling, Judge Brown concluded that (i) plaintiffs have a substantial likelihood of prevailing on the merits, (ii) plaintiffs are irreparably harmed by having to prepare to comply with the Non-Compete Ban, (iii) the balance of harms and public interest weigh in favor of granting preliminary injunctive relief. She did not, however, issue a nationwide preliminary injunction or determine whether (or not) the association intervenors have standing, including to seek relief on behalf of their many members.

Judge Brown emphasized the FTC's lack of express Congressional authorization for issuing substantive rules prohibiting unfair methods of competition. She reasoned that FTC Act Section 6(g) does not authorize the FTC to make substantive rules prohibiting unfair methods of competition, because it is a housekeeping provision conveying authority only over procedural rules. According to Judge Brown, Congress could not have conveyed such sweeping power by hiding it in the seventh clause of a provision authorizing the FTC to "classify corporations and . . . to make rules and regulations for the purpose of carrying out the provisions of this subchapter." Judge Brown explained that Section 6(g)'s lack of a penalty provision for violating the rule further confirmed that Section 6(g) encompassed only housekeeping rules—not substantive rulemaking power.

Judge Brown then discussed Congress's 1967 and 1968 Amendments to the FTC Act expressly allowing force of law rulemaking on specific subjects. According to the Court, if Congress had already given the Commission such substantive power, these amendments would be superfluous. Judge Brown acknowledged the 1973 *National Petroleum* decision, where the D.C. Circuit held that Section 6(g) authorized the Commission to promulgate substantive rules, but noted that the agency had not issued a rule to prohibit an unfair method of competition in the fifty-plus years between that ruling and the Non-Compete Ban. Additionally, Judge Brown contrasted the Commission's authority to make substantive rules for *unfair or deceptive acts or practices*, not unfair methods of competition, which was codified by Congress in 1975 with the Magnuson-Moss Act. The ruling also cited the Supreme Court's recent decision in *Loper Bright Enterprises v. Raimondo*, No. 22-1219, 2024 WL 3208360, at *14 (U.S. June 28, 2024), which overturned *Chevron U.S.A. v. Natural Resources Defense Council*, 467 US 837 (1984), requiring courts to defer to agencies on their interpretation of Congress's delegation of authority. Judge Brown's ruling confirms that the *Loper* decision will be an additional obstacle for the FTC to overcome in its litigation to enforce its Non-Compete Ban.

After finding that the FTC lacked the express Congressional authority it needed to issue the Non-Compete Ban, Judge Brown also reasoned that the Ban was arbitrary and capricious under the APA. The ruling is critical of the FTC's evidence to justify a categorical ban (which antitrust law has reserved for a narrow range of conduct involving certain agreements between competitors, such as price-fixing, that is so inherently anticompetitive that it is deemed always unlawful no matter the context). Judge Brown explained that, since no state has ever enacted a non-compete rule as broad as the FTC's, the FTC lacked a basis to rely on empirical studies of statewide non-compete prohibitions to implement a categorical ban. She also concluded that the FTC had failed to adequately consider alternatives to that ban before adopting it.

Judge Brown's preliminary injunction order is narrowly tailored to enjoin only the rule only as to the plaintiffs (Ryan, LLC, the Chamber of Commerce, Business Roundtable, Texas Association of Business, and Longview Chamber of Commerce), but not for other businesses or for the plaintiff associations' members. However, Brown's order provided a roadmap for the plaintiffs to brief the issue of associational standing in advance of August 30th. To do so, the plaintiffs must demonstrate "(1) the association[s'] members would independently meet the Article III standing requirements; (2) the interests the association[s] seek[ ] to protect are germane to the purpose of the organization[s]; and (3) neither the claim asserted nor the relief requested requires participation of individual members." The plaintiffs may also offer briefing as to "how or why nationwide injunctive relief is necessary", but have not done so "at this preliminary stage".

Next Steps:

Judge Brown's ruling—although preliminary and applying only to the plaintiffs—represents a serious blow to the FTC and establishes a blueprint for future plaintiffs who seek to challenge the constitutionality of the FTC's Non-Compete Ban proactively or reactively in the context of an investigation or enforcement action. As noted in our earlier alert, the Commission's Republican commissioners have all voted against the rule—whether in its final or proposed form—while the Commission's Democratic commissioners have all voted in support. Judge Kelley Hodge has scheduled a hearing on a similar preliminary injunction motion in *ATS Tree Services, LLC v. Federal Trade Commission* in the Eastern District of Pennsylvania on July 10th, 2024. ATS has already filed a Notice of Supplemental Authorities attaching the *Ryan* decision. If Judge Hodge declines to issue a preliminary injunction, her ruling could create division of authority, deepening the uncertainty around the Ban's enforceability. But if Judge Hodge sides with the plaintiffs in *ATS*, the FTC will suffer another serious blow. Ultimately, the legality of the Non-Compete Ban will have to be decided by one or more of the federal courts of appeals, and perhaps the Supreme Court.

Key Takeaways:

If either court were to permanently enjoin the Ban's nationwide application, the FTC would likely continue to bring individual actions against allegedly overbroad or unlawful non-competes under the antitrust laws—as it has done over the last two years. A permanent injunction could spur certain states to increase law enforcement activity or enact new legislation barring non-competes, as we have already seen occurring in some states. However, as Judge Brown pointed out, states often ban non-competes in a more tailored fashion, such as by condemning only non-competes against lower-paid workers or by including carve-outs for employees in more senior positions.

In light of the shifting landscape, employers should continue to work with counsel to monitor these state and federal non-compete developments and ensure their non-compete agreements are compliant with both state and federal laws. Employers should also consider other types of employment restrictions—such as trade secret law, non-disclosure agreements, non-solicit agreements, incentive forfeitures, training cost repayment programs, and garden leave-provisions, which, when properly structured, would not run afoul of current non-compete prohibitions, and even of the FTC's ban, whether or not it is ultimately enacted.

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