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FTC non-compete ban on hold

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On July 3, 2024, a federal district court judge in Texas granted Plaintiffs' motion for a preliminary injunction against the FTC's proposed rule banning non-competes.

Background

In an Order issued on July 3, 2024 (the "Order"), U.S. District Judge Ada Brown for the Northern District of Texas granted Plaintiffs' Ryan LLC's and U.S. Chamber of Commerce's motion for a preliminary injunction against the Federal Trade Commission's ("FTC") rule banning non-compete agreements, staying the rule as to the Plaintiffs.[1] The Order's reasoning suggests that the judge is likely to strike down the rule in its entirety by the end of August.

The FTC's rule was promulgated this April by a 3-2 vote by FTC Commissioners along party lines.[2] The FTC sought to enact the rule pursuant to Section 6(g) of the FTC Act, which the FTC claimed provided authority to make substantive rules related to unfair methods of competition. The rule is scheduled to become effective on September 4, 2024, after which time all future employment-based non-competes would be banned and virtually all existing non-competes would be invalidated. On the same day the rule was passed, Ryan LLC filed a lawsuit in the Northern District of Texas challenging the rule; Ryan LLC sought to enjoin and invalidate the rule on various grounds.[3]

Decision

After expedited briefing, Judge Brown – a Trump appointee on the bench since 2019 – declined to have a hearing on the motion for the preliminary injunction and instead ruled on the papers. In her Order granting the motion for a preliminary injunction, Judge Brown held that Plaintiffs had established all required elements of the preliminary injunction test: (1) the movants had a substantial likelihood of success on the merits; (2) there was a substantial threat of irreparable harm in the absence of relief; and (3) the balance of equities tipped in the movants' favor.[4] Critical to Judge Brown's Order was her conclusion that the plaintiffs were likely to succeed on the merits for at least two key reasons: (i) the FTC lacked statutory authority to enact the rule; and (ii) the rule was arbitrary and capricious under the Administrative Procedure Act ("APA").

1. Likelihood of success on the merits

The court concluded that although the FTC Act does authorize the FTC to promulgate "housekeeping" rules relating to unfair methods of competition under Section 6(g), it does ***not*** authorize the FTC authority to create ***substantive*** rules. The court provided a number of reasons why it reached that conclusion, including because (i) the FTC itself disclaimed substantive unfair methods of competition rulemaking authority for long periods of its history, (ii) the lack of a statutory penalty for violating rules promulgated under Section 6(g) of the FTC Act suggested that the authority granted thereunder was not substantive, (iii) Congress expressly granted the FTC authority under the Magnuson-Moss Act of 1975 to promulgate substantive rules relating to unfair deceptive acts or practices, but ***not*** unfair methods of competition, and (iv) since 1978 until the present, the FTC had not attempted to promulgate a substantive rule regarding unfair methods of competition. Further, the court concluded that if Congress had intended to grant the FTC substantive rulemaking authority in this area, it would have done so more expressly rather than through the "piecemeal" mechanisms proffered by the FTC.

The court's decision did not explicitly invoke the so-called "major questions" doctrine but appears to have been motivated by similar concerns. Further, although this decision did not turn on questions of agency deference, the court did cite in passing the Supreme Court's recent decision in *Loper Bright Enterprises*,[5] highlighting the general shift towards constraining agencies' authority in recent case law.

The court also held that Plaintiffs were likely to succeed in their challenge of the rule under the APA because there is a substantial likelihood the FTC rule is arbitrary and capricious.[6] The court stated that the rule appears to be "unreasonably overbroad" and lacked a connection between the evidence presented and the rule's provisions.

Although the FTC attempted to analogize its rule to state laws prohibiting certain kinds of non-competes, the court noted that no state had enacted a ban on non-competes as broad as the FTC's rule. This is an important holding by the court as many proponents of the FTC rule have compared it to California's non-compete rule as an example of how the rule could work in practice. The court explained, however, that the FTC rule is much more "sweeping" than such state non-compete bans. Furthermore, the court found that the Commission failed to justify why the ban prohibits entering or enforcing virtually ***all*** non-competes rather than targeting specific, harmful non-competes. Additionally, the court found the FTC failed to address alternatives to the rule, such as less disruptive options (e.g., case-by-case adjudication). Therefore, the court found the rule is likely outside the zone of reasonableness under the APA.

The court did not discuss whether Plaintiffs were likely to succeed as to any of their other proffered arguments against the FTC's rule, because they were likely to succeed on the merits on the two prongs above.

2. Irreparable harm

In short order, the court credited Plaintiffs' arguments that the rule posed a risk of irreparable harm to the Plaintiffs' business because Plaintiffs' existing non-competes with present and former principals would be invalidated, Plaintiffs would be barred from entering into new non-competes, and Plaintiffs would have to inform workers that their non-competes were invalid resulting in an immediate and severe impact on their business investments and employee relationships. The court noted the FTC's opposing argument on this point was "scant" and added that the Plaintiffs would be unable to recover any costs of compliance from the FTC.

3. Balance of the equities

Finally, the court held that if an injunction were not granted, the harm would be great to Plaintiffs and the public due to the substantial economic impact of the rule, whereas a preliminary injunction would not harm the FTC. Accordingly, the court found that the status quo should be preserved pending an adjudication on the merits.

Scope of relief and next steps

As noted above, the earliest that the FTC's rule could become effective is September 4, and Judge Brown has noted that she intends to issue her ruling on the merits by August 30, 2024.[7] One limiting aspect of the court's Order is that it only preliminarily enjoins enforcement of the non-compete rule against the Plaintiffs Ryan LLC and the U.S. Chamber of Commerce (but not its members), rather than providing any broader injunctive relief. Judge Brown noted there was not yet support in the briefing for nationwide preliminary injunctive relief or for extending relief to the Chamber of Commerce's associational members, particularly at this preliminary stage. As a practical matter, no entities will be subject to enforcement during this interim period before the rule is set to take effect on September 4.

The Order seems to suggest strongly that Judge Brown is likely to invalidate or enjoin the rule—since the court focused its decision on the Plaintiffs' likelihood of success and found it likely on two separate prongs. Assuming the court rules against the FTC on the merits in August, it can: (a) vacate the rule in its entirety as unlawful and/or (b) issue a permanent injunction, the scope of which is uncertain at this time.

In advance of any final decision, our recommendation for businesses is to continue to analyze where in their companies they use non-competes and consider alternative options to protect their interests. These alternatives include non-disclosure agreements, invention protection, non-solicits, training repayment programs, garden leaves, and non-competes entered into in connection with sales of businesses. The FTC has indicated in their guidance that these agreements, if structured correctly, should not violate the rule.

Even if the FTC rule is ultimately struck down, there remains substantial interest at the state level in legislation that would ban or significantly curtail the use of non-competes. Additionally, the National Labor Relations Board ("NLRB") has taken the view that the proffer, maintenance, and enforcement of non-competes generally violate the National Labor Relations

Act,[8] and on June 13, 2024, an administrative law judge for the NLRB held that certain non-compete and non-solicit covenants violated an employee's labor rights under that act.[9]

Takeaways

Overall, despite the limited scope of the preliminary injunction, the Order is still a significant setback to the FTC's agenda to revive its substantive rulemaking authority relating to unfair methods of competition, as well as to the FTC's efforts to police labor markets more generally using its antitrust toolkit. The decision also comes shortly after the Supreme Court's decision in *Loper Bright Enterprises* (issued June 28, 2024), which overturned the longstanding precedent of agency deference established by *Chevron*. Recent case law thus suggests a trend toward meaningfully constraining the reach of administrative agency rulemaking authority.

The ruling is likely also viewed as foreshadowing an eventual win for the business community, which has been vocally critical of the rule since it was initially proposed in January 2023. Many business groups and trade associations filed amicus briefs in their support of the injunction in the *Ryan LLC* action.

In the meantime, there is a separate challenge to the rule pending in the Eastern District of Pennsylvania[10] where U.S. District Judge Kelley Brisbon Hodge has scheduled a hearing on July 10, 2024 on the motion for a preliminary injunction. There is an opportunity in that case for Judge Hodge to issue a nationwide preliminary injunction.

We will continue to monitor both these actions closely and provide updates to our clients as necessary.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

Arthur J. Burke
+1 212 450 4352
+1 650 752 2005
arthur.burke@davispolk.com

Jennifer S. Conway
+1 212 450 3055
jennifer.conway@davispolk.com

Ronan P. Harty
+1 212 450 4870
ronan.harty@davispolk.com

Kyoko Takahashi Lin
+1 212 450 4706
kyoko.lin@davispolk.com

Christopher Lynch
+1 212 450 4034
christopher.lynch@davispolk.com

Suzanne Munck af Rosenschold
+1 202 962 7146
suzanne.munck@davispolk.com

Howard Shelanski
+1 202 962 7060
howard.shelanski@davispolk.com

Margaret E. Tahyar
+1 212 450 4379
margaret.tahyar@davispolk.com

Caroline Ziser Smith
+1 650 752 2009
caroline.zisersmith@davispolk.com

1 *Ryan LLC v. Federal Trade Commission*, No. 3:24-cv-00986 (N.D. Tex. 2024).

2 For additional details on the FTC's non-compete rule, its exceptions, and potential impact, please see our previous client update.

3 The U.S. Chamber of Commerce initially brought their own action in the Eastern District of Texas. *See Chamber of Commerce of the United States v. FTC*, No. 6:24-cv-00148 (E.D. Tex. 2024). However that action was stayed due to federal comity; subsequently, the Chamber of Commerce's motion to intervene was granted in the *Ryan LLC* suit.

4 *Winter v. Nat. Res. Def. Council, Inc.*, 555 U.S. 7, 20 (2008).

5 *Loper Bright Enterprises v. Raimondo*, No. 22-1219, 2024 WL 3208360 (U.S. June 28, 2024).

6 § 706(2)(A).

[7] The court has also ordered the parties to file a joint status report by July 9, 2024, which will provide deadlines for responsive pleadings, any amended pleadings, further filings of the administrative record, and the Parties' briefing on the merits.

[8] Office of Pub. Affairs, *NLRB General Counsel Issues Memo on Non-competes Violating the National Labor Relations Act*, NLRB (May 30, 2023), https://www.nlrb.gov/news-outreach/news-story/nlrb-general-counsel-issues-memo-on-non-competes-violating-the-national.

[9] *J.O. Mory, Inc.*, 25-CA-309577, 25-CA-336995, JD-36-24 (2024).

[10] *ATS Tree Services, LLC v. FTC*, No. 2:24-cv-1743 (E.D. Pa. 2024).