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FTC avoids preliminary injunction of non-compete ban

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On July 23, 2024, a federal district court judge in Pennsylvania denied Plaintiff ATS Tree Services LLC's motion for a preliminary injunction against the FTC's rule banning non-competes.

Background

In a decision issued on July 23, 2024 (the ATS Decision), U.S. District Judge Kelley Brisbon Hodge for the Eastern District of Pennsylvania denied Plaintiff ATS Tree Services LLC's motion for a stay of effective date and preliminary injunction against the Federal Trade Commission's rule effectively banning almost all non-compete agreements.[1] The court held that ATS was unable to establish either irreparable harm or a likelihood of success on the merits.

In almost all respects, the ATS Decision is directly contrary to the ruling reached by the Northern District of Texas earlier this month in *Ryan LLC v. Federal Trade Commission*, which granted a limited preliminary injunction against the rule after holding that plaintiffs there were likely to succeed on the merits.[2] In that case, U.S. District Judge Ada Brown strongly signaled that she is likely to strike the non-compete rule down in its entirety by the end of August—prior to the rule's effective date of September 4, 2024.[3]

Decision

Judge Hodge—a Biden appointee on the bench since 2022—issued the ATS Decision after a hearing earlier this month, where she previewed her skepticism toward the harms that Plaintiff ATS, a tree services company, would suffer if the FTC's ban were to take effect as scheduled. In the ruling denying the stay and preliminary injunction, Judge Hodge held that ATS had failed to establish: (1) irreparable harm, or (2) a likelihood of success on the merits.

1. No irreparable harm

The court concluded that it must deny the motion for a preliminary injunction, after holding that ATS failed to establish that it would suffer irreparable harm because of the rule. The court held that both of ATS' alleged irreparable harms: (i) nonrecoverable costs of compliance and (ii) the loss of contractual benefits, were speculative and not irreparable under applicable precedent. The court held that under governing precedent in the Third Circuit, nonrecoverable compliance costs, such as monetary losses or business expenses, are not a valid basis for irreparable harm. The court rejected ATS's other compliance costs, such as the potential costs of modifying its training program or possible loss of employees, as based upon either a choice or a "speculative risk," which did not rise to the level of irreparable and immediate harm required for an injunction.

Similarly, as to ATS's loss of contractual rights, the court held that ATS offered no binding precedent to support its argument that the loss of contractual rights, in it of itself, is an irreparable harm, and reiterated that this must be determined on a case-by-case basis.

2. No likelihood of success on the merits

The court held that even if ATS could establish irreparable harm, it had failed to establish a likelihood of success on the merits. In analyzing ATS' likelihood of success, the court devoted the majority of its opinion to an analysis of whether the FTC has statutory authority to promulgate substantive rules as to unfair methods of competition. The court held that the FTC did have such authority. The court noted that nowhere in Section 6 of the FTC Act is the FTC's power limited only to procedural rules. Further, the court explained that the use of the word "prevent" in the FTC's mandate in Section 5 of the Act underscores that the FTC can take actions, such as rulemaking, to avoid future harms before they occur and is not limited only to remediating harms via adjudications. In addition, the court found the FTC's rulemaking authority has been confirmed by other circuit courts (citing to *National Petroleum*[4]and *JS&A Group*[5]) and was implicitly affirmed by Congress through its subsequent actions after these cases. In particular, the court held that the Magnuson-Moss Act, which amended the FTC Act, left Section 6(g) in place with no material changes and portions of legislative history explicitly noted the holding of *National Petroleum.*

Subsequently, in short order, the court disposed of all four of ATS's other alternatives challenges to the rule's validity. *First,* the court held that the FTC has authority broadly to designate all non-compete clauses as unfair methods of competition rather than adjudicating them on a case by case under the rule of reason because they are: (i) exploitative and coercive and (ii) unjustified by legitimate business purposes. *Second*, the court held that regulation of non-competes is within the purview of both states and the federal government. In doing so, the court stated that, to the extent state laws rules conflict with the FTC rule, they are preempted. *Third*, the court held that the Major Questions Doctrine does not apply to the FTC rule because the FTC has previously used its Section 6(g) rulemaking authority to promulgate rules to prevent unfair methods of competition and because the rule falls squarely within the FTC's "core mandate" of prohibiting unfair methods of competition. *Finally*, as to ATS's nondelegation challenge, the court found that Congress has articulated an intelligible guiding principle to the FTC for its substantive rulemaking authority under the FTC Act.

3. Balance of the equities / public interest

Based upon its holding that ATS failed to establish irreparable harm or a reasonable likelihood of success on the merits, the court declined to analyze the balance of equities or public interest considerations.

Takeaways

Overall, while the ATS Decision is a win for the FTC—as Judge Hodge held that the FTC has statutory authority to promulgate substantive unfair methods of competition rulemaking authority under Section 6(g)—the win may be a temporary one given that Judge Brown in *Ryan LLC* has foreshadowed that she will invalidate the FTC's rule before its September 4, 2024 effective date. The Texas federal district court strongly indicated in its July 3, 2024 Order granting plaintiffs' preliminary injunction that plaintiffs were likely to succeed on the merits on two separate prongs: (i) the FTC lacked statutory authority to enact the rule and (ii) the rule was arbitrary and capricious under the Administrative Procedure Act (the APA).[6] Assuming the Texas court rules against the FTC on the merits, it can either: (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.

Next steps for clients

In advance of any final decision by the Texas court, our recommendation remains for businesses to continue to map and document where in their companies they use non-competes, as well as to consider alternative options that can adequately 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.

As mentioned in our prior client update, even if the FTC rule is ultimately struck down, there remains substantial interest by states in legislation that would ban or significantly curtail the use of non-competes and actions and statements by other federal agencies, such as the National Labor Relations Board (the NLRB), which may indicate that certain non-competes violate other provisions of federal law.

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 *ATS Tree Services, LLC v. Federal Trade Commission*, No. 24-1743 (E.D. Pa. 2024). Memorandum Opinion linked here.

2 *Ryan LLC v. Federal Trade Commission*, No. 3:24-cv-00986 (N.D. Tex. 2024). Memorandum Opinion and Order linked here.

3 For additional details on the decision in the *Ryan LLC* action, please see our previous client update.

4 *Nat'l Petroleum Refiners Association v. FTC*, 482 F.2d 672 (D.C. Cir. 1973).

5 *United States v. JS&A Grp., Inc.*, 716 F.2d 451, 454 (7th Cir. 1983).

6 Interestingly, unlike the plaintiffs in *Ryan*, ATS did not challenge rule as arbitrary and capricious under the Administrative Procedure Act (APA).