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FTC non-compete rule vacated nationwide

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A federal district court judge in Texas blocked the FTC's rule banning non-competes nationwide. Absent extraordinary circumstances, the FTC's rule will not go into effect on September 4, 2024, and companies will not be required to send out any notices to employees regarding their non-competes. We expect appeals but these will take time.

Background

As previously discussed, on July 3, 2024, 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 blocking the Federal Trade Commission's (FTC) rule banning non-compete agreements, staying the rule as to the Plaintiffs.[1] Following that preliminary decision, both Plaintiffs and the FTC moved for summary judgment on the merits.

This ruling follows decisions by two other federal district courts. A decision from the Eastern District of Pennsylvania denied a preliminary injunction against the FTC's rule. More recently, a federal district court in Florida enjoined the non-compete rule as to the plaintiffs in that case on the basis of the major questions doctrine.[2] Judge Brown's ruling overtakes these other opinions by vacating the rule on a nationwide basis.

Decision

Judge Brown's preliminary injunction decision strongly suggested that she would invalidate the rule on the merits, and she did exactly that. Yesterday, in a decision closely following her preliminary injunction ruling, Judge Brown concluded that (1) the FTC lacks statutory authority to enact the rule, and (2) the non-compete rule is arbitrary and capricious under the Administrative Procedure Act (APA).

1. The FTC lacks authority to issue the rule

As in the preliminary injunction decision, 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 to create **substantive** rules.

The court provided a number of reasons why it reached that conclusion, including because (1) the FTC disclaimed substantive unfair methods of competition rulemaking authority for long periods of its history, (2) the lack of a statutory penalty for violating rules promulgated under Section 6(g) of the FTC Act suggests that the Commission's authority is not substantive, (3) 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 (4) from 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.

Judge Brown did not reach Plaintiffs' constitutional challenges to the non-compete rule. The decision cites the Supreme Court's recent decision in *Loper Bright Enterprises*[3] as part of the general legal standard governing judicial review of agency decisions, but the opinion does not turn on questions of agency deference. Nor does the decision invoke the major questions doctrine as grounds for invalidating the rule. (Last week, a federal district court in Florida enjoined the non-compete rule as to the plaintiffs in that case on the basis of the major questions doctrine.) Nevertheless, Judge Brown's decision may be seen as consistent with a general trend in recent cases towards constraining agencies' rulemaking and adjudication authority.

2. The rule is arbitrary and capricious

Again closely tracking the preliminary injunction decision, the court also held that the FTC rule is arbitrary and capricious. The court concluded that the rule was "unreasonably overbroad" as an improper "one-size-fits-all approach" that failed to establish a connection between the evidence presented and the rule's provisions.

The court noted that no state had enacted a ban on non-competes as broad as the FTC's rule. Furthermore, the court explained that the Commission failed to justify the "sweeping prohibition" against 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 outside of the "zone of reasonableness" under the APA.

3. The scope of the remedy

Unlike the preliminary injunction decision, the court's decision on the merits vacates the FTC's non-compete rule on a nationwide basis. Invoking the language of the APA, the court "set aside" the FTC's rule entirely.

This has important practical ramifications. Absent a stay pending appeal from the Fifth Circuit, the FTC's non-compete rule will not go into effect on September 4, 2024. In that regard, this decision overtakes the recent Eastern District of Pennsylvania decision denying a preliminary injunction against the FTC's rule.

Next steps and takeaways

We expect the FTC to appeal this decision and possibly to seek an emergency stay of the district court's order. It may be some time before a decision from the Fifth Circuit and perhaps, ultimately, the Supreme Court on the validity of the rule. The only way the rule will go into effect on September 4, 2024, the effective date identified in the rule, would be if the FTC obtains a stay of the district court's order before that date. Both the timeline for such a petition and the legal hurdles the FTC will face in obtaining interim relief make such a scenario unlikely, meaning that the Commission's rule is unlikely to go into effect in September and will have to wait for a potentially lengthy appeals process to run its course.

Crucially, businesses do not need to send out the required notices to employees unless this decision is stayed or overturned. In the meantime, 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.

Even if this decision invalidating the FTC's rule is ultimately affirmed, there remain a number of state laws (including in California and Minnesota) that broadly prohibit non-compete provisions in employment agreements, and we expect continued interest in similar state legislation elsewhere. It is also possible that the FTC will respond to this decision by seeking to enact a narrower rule. The FTC could also seek to invalidate non-compete agreements in individual adjudications. Additionally, as we previously noted, other federal agencies, such as the National Labor Relations Board, may attempt to curtail the use of non-compete agreements.

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.

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

2 *Props. of the Vills., Inc. v. FTC*, No. 5:24-cv-316 (M.D. Fla. Aug. 15, 2024).

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