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FTC Noncompete Rule Is Set Aside, But Appeal Is Expected and States May Act

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On August 20, 2024, in Ryan LLC v. Federal Trade Commission, a district court in the Northern District of Texas held "unlawful and set[] aside" the Federal Trade Commission's (FTC) Non-Compete Rule, 16 C.F.R. § 910.1–.6. That rule, which was scheduled to take effect on September 4, 2024, would have broadly banned virtually all noncompete clauses between employers and workers in the United States.

In *Ryan*, the plaintiff and plaintiff-intervenors challenged the rule as exceeding the FTC's statutory authority and as unconstitutional and arbitrary and capricious. Siding with the challengers, the court held that the FTC exceeded its statutory authority in promulgating the rule and that the rule is arbitrary and capricious, in violation of the Administrative Procedure Act (APA). The district court thus ordered that the rule "shall not be enforced or otherwise take effect."

That decision tees up a likely Fifth Circuit appeal from the FTC. Meanwhile, a Florida federal district court has also preliminarily enjoined the Non-Compete Rule, while a Pennsylvania federal district court has refused to do so, suggesting a likelihood of a different result. Those proceedings thus put the focus on the Third, Fifth, and Eleventh Circuits and raise the possibility of circuit conflict.

The *Ryan* Decision

The district court began by reviewing the history of the FTC's power. The FTC Act of 1914, enacted to protect consumers and promote competition, established the FTC and gave it power in Section 5 to prevent unfair methods of competition. Congress later amended the Act to give the FTC power to prevent unfair or deceptive acts or practices, and to promulgate certain types of regulations. Section 5 of the FTC Act gives the FTC authority to conduct administrative proceedings and hold a hearing to determine if a party is using either unfair methods of competition or unfair or deceptive acts or practices. If the FTC determines that a party engaged in prohibited conduct, it may issue a cease-and-desist order, violations of which are subject to civil penalties.

Section 6 of the FTC Act grants the FTC additional investigatory or ministerial power, as well as authority "to make rules and regulations for the purpose of carrying out the provisions" in that subchapter.

The Ryan court first held that the FTC had exceeded its statutory authority by promulgating the Non-Compete Rule. The FTC asserted that Section 6(g) empowered it to issue substantive rules regarding unfair methods of competition, including noncompete clauses. The court disagreed, holding that Section 6(g), by its plain text, "does not expressly grant the [FTC] authority to promulgate substantive rules regarding unfair methods of competition." And while Section 18 provides some authority to promulgate rules, that power is limited to "unfair or deceptive practices," and does not extend to not "unfair methods of competition." Indeed, Section 18 recognizes some authority to prescribe interpretive rules and general statements of policy "with respect to unfair methods of competition," highlighting that Section 6(g) does not confer substantive rulemaking authority to prevent unfair methods of competition.

The court also explained that the lack of a statutory penalty in Section 6(g) — in sharp contrast with Section 5 adjudications — indicates that Section 6(g) lacks substantive force and encompasses only "housekeeping" rules. The court also reasoned that the history of the FTC Act also supported its analysis.

The district court then held that the Non-Compete Rule was also arbitrary and capricious, in violation of the APA.

The APA requires that agency action be reasonable and reasonably explained. Quoting the Supreme Court's landmark decision in *Motor Vehicle Manufacturers Association of U.S., Inc. v. State Farm Mutual Auto Insurance Co.*, 463 U.S. 29, 43 (1983), the *Ryan* court explained that an agency rule is arbitrary and capricious if the "agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise."

The *Ryan* court concluded that the Non-Compete Rule failed that standard and "is arbitrary and capricious because it is unreasonably overbroad without a reasonable explanation" and it imposes "a one-size-fits-all approach with no end date, which fails to establish a 'rational connection between the facts found and the choice made.'"

First, the court noted that the FTC relied on studies that compared state policies toward noncompete agreements that were much narrower than the noncompete agreements prohibited by the Rule, and were thus completely inapposite. And the FTC provided no explanation why it imposed a categorical ban "instead of targeting specific, harmful non-competes." Second, the court reasoned that "the FTC failed to sufficiently address alternatives to issuing the Rule."

What Comes Next

With the Non-Compete Rule set aside by the Northern District of Texas, the FTC will likely appeal to the Fifth Circuit. There is also ongoing litigation in other federal courts.

On August 14, 2024, a district court in the Middle District of Florida entered a limited preliminary injunction prohibiting the enforcement of the Non-Compete Rule against the plaintiffs in *Properties of the Villages, Inc. v. Federal Trade Commission*. That court concluded that the plaintiffs were likely to succeed on their argument that the FTC lacked statutory authority to promulgate the Non-Compete Rule.

By contrast, a district court in the Eastern District of Pennsylvania declined to grant a preliminary injunction against enforcement of the Non-Compete Rule in *ATS Tree Services, LLC v. Federal Trade Commission*, holding that the plaintiff had failed to establish a reasonable chance of success on the merits of the argument that the Non-Compete Rule exceeded the FTC's statutory authority, among other arguments.

Thus, there will likely be ongoing litigation in the district courts and courts of appeals across the country. The validity of the rule is likely to come before the Third, Fifth and Eleventh Circuits, and the possibility of circuit conflict also means that the issue could potentially receive Supreme Court review.

At the same time, states are also undertaking their own efforts to restrict noncompete clauses under state law. Rhode Island and Maine each passed noncompete bills in both chambers this year, but the governors in each state vetoed the respective bills. Similarly, after a New York noncompete bill was passed by both chambers last year, Governor Hochul vetoed the bill for being too broad. All three bills had proposed broad bans on most noncompete agreements.

In Washington State, meanwhile, a bill that expanded the state's already existing law has taken effect. SB 5935 includes worker-friendly amendments related to expanding the definition of noncompetes, minimum compensation, duration requirements, disclosure or consideration requirements, and garden-leave-type payments. And courts in some states are also taking more aggressive positions with respect to efforts to enforce noncompete clauses.

Employers may thus wish to consider reviewing existing agreements for compliance with state law requirements while monitoring federal and state developments.