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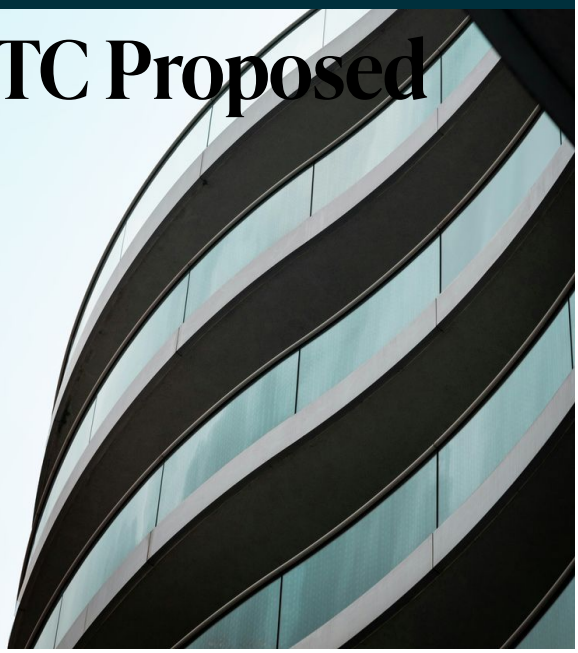
Court Temporarily Halts FTC Proposed Rule on Non-Competes



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July 8, 2024, 7:47 AM
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The FTC's recent rule largely rendering employment-related non-compete covenants unenforceable has hit a roadblock—at least with respect to the named plaintiffs in the first-filed challenge, *Ryan, LLC v. FTC*. To recap briefly, the FTC non-compete ban would render unenforceable the vast majority of existing non-competes and prohibit future non-competes, subject to some narrow exceptions. A fuller overview of the rule and its effects is available here.

On July 3, Judge Ada Brown of the Northern District of Texas preliminarily enjoined enforcement of the non-compete ban but declined to issue a nationwide injunction on procedural/jurisdictional grounds. However, the reasoning of the decision would apply to all parties, and other courts could adopt the same reasoning. Judge Brown intends to enter a merits disposition in *Ryan* on or before August 30. A hearing in another challenge, *ATS Tree Services, LLC v. FTC* in the Eastern District of Pennsylvania, is scheduled for July 10.

Independent of the FTC's non-compete ban and its treatment by the courts, national businesses should continue to be mindful that state-level non-compete bans have recently proliferated, with additional states and at least one city considering bans of their own.[1]

The *Ryan* Decision

The court in *Ryan* concluded that the FTC likely overstepped its substantive rulemaking authority in promulgating the rule under Section 6(g) of the FTC Act, and further that the rule likely was arbitrary and capricious such that Plaintiffs were likely to succeed on the merits that the rule is invalid.

Likelihood of Success. The FTC defended the rule on the basis that non-compete covenants are unfair methods of competition that the FTC is empowered to prevent under Section 5 of the FTC Act, and that Section 6(g) of the FTC Act allows the FTC to promulgate substantive rules related to unfair methods of competition. Judge Brown disagreed. "By a plain reading, Section 6(g) of the Act does not expressly grant the Commission authority to promulgate substantive rules regarding unfair methods of competition." While Judge Brown observed that the FTC has "some authority" to promulgate rules related to unfair methods of competition, she nevertheless concluded that Section 6(g)—a "housekeeping statute"—was not the appropriate vehicle for the non-compete ban. The absence of statutory penalties attached to Section 6(g) further supported the court's determination that Congress did not intend to vest the FTC with such vast substantive rule-making power.

More importantly, the court was unpersuaded by the FTC's evidence in support of the rule and thus concluded that the ban was likely "arbitrary and capricious because it is unreasonably overbroad without a reasonable explanation." Judge Brown criticized the expansive nature and "one-size-fits-all approach" because it was based on "inconsistent and flawed empirical evidence, fails to consider the positive benefits of non-compete agreements, and disregards the substantial body of evidence supporting these agreements." The FTC also entirely failed to analyze less disruptive alternatives to the ban. The vast reach of the rule was not adequately justified, and the FTC should have assessed the significance of competing reliance interests and weighed them against competing policy concerns.

Scope of Injunction. Notably, despite plaintiffs' request for nationwide injunctive relief, the court declined to extend it even while recognizing its own power to issue such a broad injunction in appropriate circumstances. The court cited insufficient briefing in limiting the injunction to the parties, but seemingly left the door open to further argument on the Chamber of Commerce's associational standing claim on behalf of its nationwide members.

Continued Uncertainty and State Bans

While uncertainty persists regarding the FTC's seemingly ill-fated fight, states across the country continue pushing the introduction of legislation to restrict the use of non-competes either entirely within the state, within certain industries (e.g. healthcare), for workers making below various income thresholds, or otherwise moving to clarify the legal basis for non-compete agreements. Therefore, companies should continue assessing risk regarding the use of non-competes and consider alternative mechanisms to protect key interests and investments.

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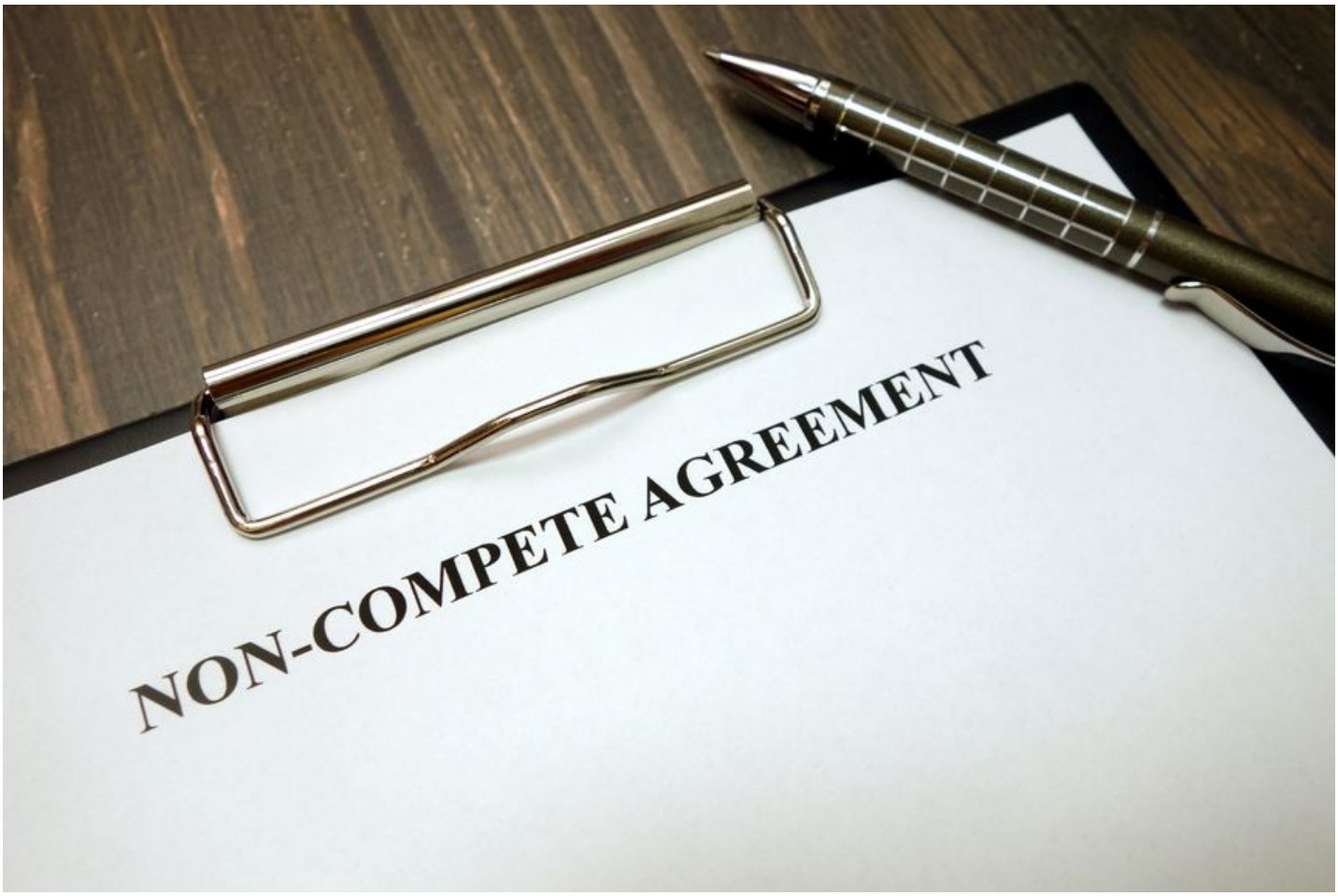
[1]See: Step Aside, FTC: NYC to Banish Non-Competes; Clock is Ticking on New York's Non-Compete-Ban Bill.

"[T]he text, structure, and history of the FTC Act reveal that the FTC lacks substantive rulemaking authority with respect to unfair methods of competition under Section 6(g)."



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