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FTC's Rule Banning Non-Compete Agreements Is "Set Aside" Nationwide in District Court Ruling, But Two District Courts Find FTC Likely Has Authority to Issue Rules Prohibiting Unfair Methods of Competition

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The Federal Trade Commission's (the FTC) rule prohibiting the entering into or enforcement of non-compete clauses between employers and employees (the Non-Compete Rule) made final in April 2024 and originally scheduled to go in effect on September 4, 2024, was recently "set aside" by the district court in *Ryan, LLC v. Federal Trade Commission*. Memorandum Opinion and Order, on August 20, 2024. Employers will not be required to comply with the Non-Compete Rule unless the district court's order is overturned. The FTC is considering appealing, but, as of this writing, has not. (The Commission's Non-Compete Rule is set forth at 16 C.F.R. §910. The scope of the Non-Compete Rule is discussed in a prior article authored by Bilal Sayyed and Peter Bariso, *FTC Adopts Broad Ban on the Use of Non-Compete Clauses in Employment Agreement* (Apr. 24, 2024).)

The Ryan Court's Opinion

On July 3, 2024, the same court had preliminarily enjoined enforcement of the Non-Compete Rule against Ryan (and certain plaintiff-intervenors), but had reserved judgment on the ultimate merits of the Non-Compete Rule. The decision is discussed in a prior article authored by Bilal Sayyed, *District Court Issues Limited Preliminary Injunction in First Challenge to FTC Rule Prohibiting Use and Enforcement of Non-Compete Clauses* (Jul. 10, 2024).

In its decision on the merits, the court identified two grounds for setting aside the Non-Compete Rule.

First, the FTC's effort to prohibit non-compete clauses through the adoption of a rule prohibiting them as an unfair method of competition failed because the FTC lacked authority to create *any* rule prohibiting conduct as an *unfair* method of competition. The court "after reviewing the text, structure, and history of the [Federal Trade Commission] Act, … concludes the FTC lacks the statutory authority to create substantive rules." The provision the FTC relied on to support creation of the Non-Compete Rule was "a housekeeping statute, authorizing what the [Administrative Procedure Act] terms rules of agency organization procedure or practice as opposed to substantive rules."

Second, the FTC failed to consider alternatives to the Non-Compete Rule, and thus, as advanced, it was "arbitrary and capricious." According to the court, "the [Non-Compete] Rule is arbitrary and capricious because it is unreasonably overbroad without a reasonable explanation" and "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." The court also found that "the Commission's lack of evidence as to why they chose to impose such a sweeping prohibition … instead of targeting specific, harmful non-competes, renders the [Non-Compete] Rule arbitrary and capricious." The court further found the rule-making record "shows that the FTC failed to sufficiently address alternatives to issuing the [Non-Compete] Rule" and thus the court "[could not] conclude the Non-Compete Rule falls within a zone of reasonableness nor [that it is] reasonably explained."

Having so determined, "the Court must hold unlawful and set aside the FTC's Rule"; consistent with recent Fifth Circuit precedent "setting aside agency action …

has nationwide effect, is not party-restricted, and affects all persons in all jurisdictions equally."

Two Earlier District Court Opinions Disagree With the Ryan Court's Rejection of FTC Rule?Making Authority

In earlier decided matters, two other district courts reviewing plaintiffs' requests for a preliminary injunction against enforcement of the Non-Compete Rule signaled a different view on the merits of the Commission's authority to adopt any rule defining and prohibiting conduct as an unfair method of competition. However, they reached different conclusions on whether the Commission properly adopted the Non-Compete Rule.

In *ATS Tree Services LLC v. Federal Trade Commission*, on July 23, 2024, the district court in the eastern district of Pennsylvania rejected ATS's request for a preliminary injunction against enforcement of the Non-Compete Rule, finding that ATS was unable to show irreparable harm (a requirement to grant a preliminary injunction) and that it was unlikely to prevail on the merits of their claim that the FTC exceeded its authority in promulgating the Non-Compete Rule.

In contrast to the district court's conclusion in *Ryan*, the *ATS* court found "it clear that the FTC is empowered to make both procedural and substantive rules as is necessary to prevent unfair methods of competition." The court also rejected ATS's alternative arguments: (i) that the Non-Compete Rule ran afoul of the Major Questions Doctrine; (ii) that "reasonable non-compete agreements are fair" and should be reviewed on a case-by-case basis, and (iii) that the FTC overstepped its authority by displacing state law.

In *Properties of the Villages v. Federal Trade Commission*, on August 14, 2024, the district court for the middle district of Florida (Ocala Division) granted plaintiff's request for a preliminary injunction against enforcement of the Non-Compete Rule. However, like the *ATS* court, it rejected plaintiff's argument that the FTC did not have authority to promulgate rules prohibiting conduct as an unfair method of competition, finding "the various components of the statute show Congress conferred at least some form of substantive rule-making authority to the FTC with regards to unfair methods of competition."

However, the court accepted an alternative argument of plaintiff – that the "sweep and breadth of the [Non-Compete Rule] … presents a major question." The court relied largely on the FTC's discussion of the scope and potential impact of the Rule in finding that its adoption raised a "major question." The court also found that the statutory language relied on by the Commission, "by its text, placement, content, and history, falls short" of supporting a grant of Congressional authority to issue the Rule. Neither court has indicated when it will issue a decision on the merits of the Non-Compete Rule.

Prospect of Supreme Court Review of FTC Rule-Making Authority Is High

While the FTC appears to be struggling to make the case for its authority to promulgate the Non-Compete Rule, it also appears to be succeeding, on balance, in convincing courts that it has authority to make rules prohibiting unfair methods of competition. If continued, this would be a significant victory for the Commission, as it presently has a significant interest in promulgating a broad array of rules prohibiting conduct believed to be anticompetitive, but for which case?by?case adjudication is time-consuming and usually requires a showing of, or likelihood of, anticompetitive effects.

Fifty years ago, the D.C. Circuit Court of Appeals in *National Petroleum Refiners Ass'n. v. Federal Trade Commission*, held that the Commission had authority to issue rules prohibiting unfair methods of competition. *National Petroleum Refiners Association v. Federal Trade Commission*, 482 F.2d 672 (D.C. Cir. 1973). Many persons who filed comments during the FTC's rule-making process for the Non-Compete Rule suggested it was unlikely that courts would reach the same conclusion today. That the *ATS* and *Properties of the Village* courts both found the FTC has substantive rule-making authority is a significant development in the Commission's efforts to expand the scope of its antitrust enforcement agenda,

notwithstanding the *Ryan* court's setting aside of the Non-Compete Rule. Notably, if the Fifth Circuit upholds the *Ryan* court's decision, there will be an appellate split on this question, suggesting Supreme Court review is, at some point, inevitable.