

# Clients & Friends Memo

## District Court Issues Limited Preliminary Injunction in First Challenge to FTC Rule Prohibiting Use and Enforcement of Non-Compete Clauses

July 10, 2024

The United States District Court for the Northern District of Texas (Dallas Division) has issued a preliminary injunction in favor of a plaintiff challenging the Federal Trade Commission's (the "FTC" or the "Commission") adoption and enforcement of a final rule prohibiting the use or enforcement of non-compete clauses in most employment agreements (the "Rule").<sup>1</sup>

Businesses that rely on non-competes and wish to continue to rely on non-competes may not, however, take much immediate comfort from the preliminary injunction decision in *Ryan LLC v. Federal Trade Commission* because it is limited to enforcement of the Rule against the plaintiffs. The court can revisit this decision when it issues its merit decision, but at present the FTC is not substantially hindered in its future enforcement of the ban on non-compete clauses. Additionally, both the FTC and the Department of Justice can challenge specific non-compete clauses or a general practice of entering into or enforcing non-compete clauses as anticompetitive. The FTC has recently challenged the use of non-compete clauses as an unfair method of competition.<sup>2</sup>

Thus, employers considering enforcement of non-compete clauses, and employers and employees considering entering into non-compete clauses, should continue to consider alternative agreements that are consistent with the purpose of non-compete clauses but that do not run afoul of the Rule (or, more generally, the antitrust laws). The court indicated it would rule on the merits of Ryan's challenge to the Commission's issuance of the Rule no later than August 30.

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<sup>1</sup> [Memorandum Opinion and Order](#), *Ryan LLC v. Federal Trade Commission*, Case 3:24-cv-00986-E, U.S. Dist. Court, N.D., Tex. (Dallas Div.) (Jul. 3, 2024) (hereinafter, the "Memorandum Opinion"); [Preliminary Injunction](#), *Ryan LLC v. Federal Trade Commission*, Case 3:24-cv-00986-E, U.S. Dist. Court, N.D., Tex. (Dallas Div.) (Jul. 3, 2024); [Complaint](#), *Ryan LLC v. Federal Trade Commission*, Case 3:24-cv-00986-E, U.S. Dist. Court, N.D., Tex. (Dallas Div.) (Apr. 23, 2024). We previously identified the scope and effective date of the FTC's Rule. See Bilal Sayyed and Peter Bariso, Cadwalader Clients & Friends Memo, [FTC Adopts Broad Ban on the Use of Non-Compete Clauses in Employment Agreements](#) (Apr. 24, 2024). The [Commission's Rule](#) is set forth at 16 C.F.R. § 910 *et seq.*

<sup>2</sup> See, e.g., [In the Matter of O-I Glass, Inc.](#), FTC File No. 211-0182 (Feb. 21, 2023); [In the Matter of Ardagh Group S.A.](#), FTC File No. 211-0182 (Feb. 21, 2023); [In the Matter of Prudential Security, Inc.](#), FTC File No. 221-0026 (Feb. 23, 2023); [In the Matter of Anchor Glass Container Corp.](#), FTC File No. 211-0182 (May 18, 2023).

*Ryan's Challenge to the Rule*

In *Ryan LLC v. Federal Trade Commission*, the plaintiff, a tax services and software provider (joined by plaintiff-intervenors<sup>3</sup>), argued that: (i) the FTC did not have the statutory authority to promulgate the Rule; (ii) the Rule was the product of an unconstitutional exercise of power by the FTC; and (iii) the FTC's promulgation of the Rule was arbitrary and capricious. Ryan requested, in part, that the district court stay the effective date of the Rule – presently scheduled as September 4 – and preliminarily enjoin the FTC from enforcing the Rule. The court granted the plaintiff's request for a preliminary injunction but limited it to enjoining enforcement of the Rule only against the plaintiff and plaintiff-intervenors.

*District Court Considers Ryan's Likelihood of Success on the Merits*

In deciding whether Ryan's request for a preliminary injunction should be granted, the court considered Ryan's likelihood of success on the merits; thus, the opinion provides substantial guidance on the court's likely final adjudication of plaintiff's complaint. In issuing the Rule, the FTC relied on its authority under Section 5 of the FTC Act to declare conduct an unfair method of competition and on a broad reading of Section 6(g) of the FTC Act, that, according to the FTC, allowed it to issue rules prohibiting unfair methods of competition.<sup>4</sup> Section 6(g) gives the FTC authority to issue rules, but the agency and plaintiffs differed on whether that authority supported the issuance of rules that have a substantive effect (such as a prohibition on conduct defined as an unfair method of competition) or is limited to rules that support the agency's adjudicative and administrative functions (such as investigatory or ministerial rules). The court rejected the FTC's reading and application of Section 6(g).

According to the court "Section 5 creates a comprehensive scheme to prevent unfair methods of competition"<sup>5</sup> while "Section 6 gives the FTC the power to make rules and regulations for the purpose of carrying out the provisions of [the FTC Act]"<sup>6</sup> and "enumerates additional powers that generally aid in the administration of th[e] adjudication-focused scheme [of the FTC Act]."<sup>7</sup> In analyzing the text, structure and history of the FTC Act, the court concluded that while "the FTC has some authority to promulgate rules to preclude unfair methods of competition" it "lacks the authority to create

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<sup>3</sup> The Chamber of Commerce (USA), Business Roundtable, Texas Association of Business and the Longview Chamber of Commerce joined the lawsuit as plaintiff-intervenors and argued similarly that the FTC had exceeded its authority in advancing the Rule.

<sup>4</sup> *See* 15 U.S.C. §§ 45, 46.

<sup>5</sup> Memorandum Opinion at 13.

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

substantive rules.”<sup>8</sup> The FTC’s reliance on Section 6(g) was misplaced because it is merely a “housekeeping statute” authorizing “rules of agency organization, procedure, or practice as opposed to substantive rules.”<sup>9</sup>

The court:

[C]oncludes the text and structure of the FTC Act reveal the FTC lacks substantive rulemaking authority with respect to unfair methods of competition, under Section 6(g). Thus, when considering the text, Section 6(g) specifically, the Court concludes the Commission has exceeded its statutory authority in promulgating the Non-Compete Rule, and thus Plaintiffs are likely to succeed on the merits.<sup>10</sup>

The court reached this conclusion, in part, by noting that Congress, where it wishes to grant substantive rule-making authority, prescribes sanctions for violations of an agency’s rules. Here, Section 6(g), according to the court, “contains no penalty provision – which indicates a lack of substantive force” – in contrast to the penalty provisions associated with an adjudication finding a violation of Section 5’s prohibition of unfair methods of competition.<sup>11</sup>

The court also found “a substantial likelihood the Rule is arbitrary and capricious because it is unreasonably overbroad without a reasonable explanation.”<sup>12</sup> According to the court, the Rule “imposes a one-size-fits-all approach ... which fail[ed] to establish a rational connection between the facts found and the choice made.”<sup>13</sup> The failure to target “specific, harmful non-competes render[ed] the Rule arbitrary and capricious.”<sup>14</sup>

#### *Limited Scope of the Preliminary Injunction*

While the court granted Ryan’s request for a stay, its review of 5th Circuit precedent suggested it was not appropriate to issue a nationwide injunction against enforcement of the Rule. The court identified several reasons for not issuing a nationwide injunction: (i) failure of the plaintiffs to explain why such an injunction was needed at the preliminary stage; (ii) recent 5th Circuit case law supported limiting injunctive relief to the parties before the court (citing *Braidwood Management Inc. v. Becerra*,

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<sup>8</sup> *Id.* at 15.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.* at 19.

<sup>11</sup> *Id.* at 15-16.

<sup>12</sup> *Id.* at 21.

<sup>13</sup> *Id.* at 21.

<sup>14</sup> *Id.* at 22. The court also found that a preliminary injunction was in the public interest because it would “maintain[] the status quo and prevent[] the substantial economic impact of the Rule, while simultaneously inflicting no harm on the FTC.” *Id.* at 28.

No. 23-10326, 2024 WL 307934 (5th Cir. Jun. 21, 2024)); (iii) the plaintiffs were not a governmental entity; and (iv) the failure of plaintiff-intervenors to provide evidence of “associational standing” of their members.”<sup>15</sup> The court can revisit this decision in its ruling on the merits of Ryan’s challenge to the Rule.

*Other Challenges to the Rule*

*Ryan* is only one of three challenges to the Rule. In *ATS Tree Services* and *Properties of the Villages*, other private entities are challenging the Rule.<sup>16</sup> The multiple challenges to the Rule create the possibility of different rulings on the merits of the statutory and constitutional challenges to the Rule. This also creates a strong likelihood of appellate court review, and continued uncertainty, especially if the FTC has the right to, and moves to, enforce the Rule in some jurisdictions and not others. The court in *ATS Tree Services* has indicated it will issue a ruling on ATS’s request for a preliminary injunction no later than July 23.<sup>17</sup> The court in *Properties of the Villages* has not announced a timeline for a decision.

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If you have questions on the scope of the Rule and the impact of the court’s decision, please contact the following Cadwalader attorney.

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<sup>15</sup> Id. at 28-32.

<sup>16</sup> See [Complaint](#), *ATS Tree Services, LLC v. FTC*, No. 2:24-cv-1743 (E.D. Penn.) (Apr. 25, 2024) and [Complaint](#), *Properties of the Villages v. FTC*, No. 5:24-cv-00316-JSM-PRL (M.D. Florida) (Ocala Division) (Jun. 21, 2024).

<sup>17</sup> Order, *ATS Tree Services, LLC v. FTC*, No. 2:24-cv-1743 (E.D. Penn.) (May 21, 2024).