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Expert Q&A on Legal Challenges to the FTC's Non-Compete Ban (Updated)

by Practical Law Labor & Employment

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An Expert Q&A with Peter A. Steinmeyer, Erik W. Weibust, and Carolyn O. Boucek of Epstein Becker & Green, P.C. regarding the legal challenges to the Federal Trade Commission's (FTC) non-compete ban, updated to reflect recent court decisions, including the order of the US District Court for the Northern District of Texas setting aside the FTC rule and ordering that the rule not be enforced or otherwise take effect on the scheduled September 4, 2024 effective date (*Ryan, LLC v. Fed. Trade Comm'n,* 2024 WL 3879954 (N.D. Tex. Aug. 20, 2024)).

On April 23, 2024, the Federal Trade Commission (FTC) announced the issuance of a final rule banning employers from entering into, enforcing, or attempting to enforce post-employment non-compete clauses, subject to limited exceptions, and invalidating all existing non-competes with a narrow exception for certain senior executives (FTC: Non-Compete Clause Rule, 89 Fed. Reg. 38342 (May 7, 2024)). For more details on the rule, see Expert Q&A on the FTC's Final Rule Banning Post-Employment Non-Competes.

As predicted, shortly after the rule's publication, there were multiple legal challenges to its validity. Lawsuits were filed against the FTC in US District Courts for:

- The Northern District of Texas by Ryan, LLC, an accounting firm, with the US Chamber of Commerce and other trade groups intervening.
- The Eastern District of Pennsylvania by ATS Tree Services, LLC, a 12-person tree care company.
- The Middle District of Florida by the Property of the Villages, LLC, a real estate company.

Plaintiffs in all cases sought injunctive relief and a stay of the rule's effective date.

While the various preliminary injunction rulings were conflicting, on August 20, 2024, the *Ryan* court in Texas granted summary judgment for the plaintiffs, ruling that the FTC lacked the authority to issue the rule and that the rule was arbitrary and capricious. As a result, the court issued an order and final judgment setting aside the final rule nationwide and ordering that it not be enforced or otherwise take effect on September 4, 2024 or thereafter. (*Ryan, LLC v. Fed. Trade Comm'n*, 2024 WL 3879954 (N.D. Tex. Aug. 20, 2024).)

The *Ryan* court's ruling directly contradicts the Pennsylvania court's July order denying the plaintiff's request for injunctive relief entirely, holding that the FTC had the statutory authority to issue the rule and rejecting all other challenges.

While the final rule has been set aside for the moment, the legal challenges continue, and uncertainty persists. The district court orders are likely to be appealed, setting up the possibility of conflicting appellate rulings. For now, though, employers are relieved from their obligations under the final rule and, unless and until a Circuit Court or the US Supreme Court rules otherwise, the rule will not go into effect.

Given the significance of this rule for employers, Practical Law Labor & Employment once again reached out to trusted experts Peter A. Steinmeyer, Erik W. Weibust, and Carolyn O. Boucek of Epstein Becker & Green, P.C. to provide updated insights about the legal challenges to the FTC's rule, the recent court decisions in Florida and Texas court, and guidance for employers going forward.

Pete and Erik are Members of Epstein Becker & Green, P.C. and Co-Chairs of the firm's Trade Secret & Employee Mobility practice group. They both focus on trade secrets and employee mobility issues and are two of the co-hosts

of EBG's *Spilling Secrets* podcast on trade secrets and non-compete law. Pete is also a valued member of the Practical Law Labor & Employment Advisory Board.

Carolyn is an associate in Epstein Becker & Green P.C.'s Chicago office with a particular focus on employee mobility issues.

What Happened in the Texas (Ryan) Case?

On the day the FTC's final rule was announced, Ryan, LLC, a global tax services firm that uses non-competes with its shareholder principals and certain other employees with access to particularly sensitive business information, filed the first challenge to the FTC's ban in the US District Court for the Northern District of Texas (*Ryan, LLC v. Fed. Trade Comm'n*, Case No. 3:24-cv-00986-E (N.D. Tex. Apr. 23, 2024) (complaint)).

The *Ryan* lawsuit alleged that the FTC's rule:

- Contravenes the Federal Trade Commission Act (FTC Act).
- Violates the US Constitution.
- Is arbitrary, capricious, and otherwise unlawful.

The US Chamber of Commerce and other business associations filed a similar lawsuit in federal district court in Texas, which was dismissed in favor of *Ryan* as the first-filed action raising the same issues (*U.S. Chamber of Com. v. Fed. Trade Comm'n*, 2024 WL 1954139 (E.D. Tex. May 3, 2024)). The US Chamber plaintiffs have since intervened in the *Ryan* action (see Intervenor Complaint (N.D. Tex. May 9, 2024)). The plaintiff and intervenors moved to enjoin and stay the effective date of the FTC's ban.

On July 3, 2024, the *Ryan* court issued an order, pending a resolution on the merits, staying the final rule's effective date and enjoining the final rule, but only as against the plaintiff and plaintiff-intervenors, and not including the individual members of the trade associations. The court held that:

- The plaintiffs are substantially likely to succeed on the merits of their arguments that:
  - the FTC lacks substantive rulemaking authority under Section 6(g) of the FTC Act regarding unfair methods of competition; and
  - the final rule was arbitrary and capricious.
- The plaintiffs would be irreparably harmed because they would incur nonrecoverable compliance costs.
- The public interest and equities weighed in the plaintiffs' favor.

(2024 WL 3297524 (N.D. Tex. July 3, 2024.)

The court denied the plaintiffs' motion for reconsideration regarding the injunction's scope and the associational standing of their members. The court promised a merits decision on or before August 30, 2024, just days before the rule's scheduled effective date, and set a briefing schedule for the merits disposition on summary judgment.

For more resources about the FTC's authority to investigate and prosecute deceptive and anticompetitive business conduct, including unfair methods of competition, see FTC Act Section 5 Toolkit.

How Did the Texas Court Rule on the Merits?

On August 20, 2024, the *Ryan* court issued a Memorandum Opinion and Order (Docket No. 211) and a Final Judgment (Docket No. 212):

- Granting the plaintiffs' motion for summary judgment.
- Denying the FTC's cross-motion for summary judgment.
- Setting aside the final rule on a nationwide basis.
- Ordering that the rule shall not be enforced or otherwise take effect on September 4, 2024, or thereafter.

(*Ryan, LLC*, 2024 WL 3879954, at *1.)

Consistent with the order granting the preliminary injunction, the court concluded that plaintiffs were entitled to summary judgment on all claims because:

- The FTC exceeded its statutory authority in implementing the rule based on the text and structure of the FTC Act (*Ryan, LLC*, 2024 WL 3879954, at *9-12).
- The rule is arbitrary and capricious because it:
  - is "unreasonably overbroad without a reasonable explanation" (*Ryan, LLC*, 2024 WL 3879954, at *13);
  - is based on inconsistent and flawed empirical evidence;
  - fails to consider the positive benefits of non-competes; and
  - disregards the substantial body of evidence supporting non-competes.
- The FTC failed to consider less disruptive alternatives to the rule (*Ryan, LLC*, 2024 WL 3879954, at *13-14).

The court therefore held unlawful and set aside the rule with nationwide effect, as required under the Administrative Procedures Act (APA) (5 U.S. C. § 706(2)(A)). (*Ryan, LLC*, 2024 WL 3879954, at *14.)

The court's order is final and immediately appealable. The FTC is likely to appeal the order, and may file an emergency motion seeking to stay the order.

What Happened in the Pennsylvania (ATS) Case?

ATS Tree Services, LLC (ATS) is a small tree-care company with only 12 employees. ATS requires its employees to enter into non-compete agreements to protect its investment in providing specialized training for its employees. The non-competes restrict the company's employees' ability to work for competing businesses within a specific geographic area for one year after leaving ATS.

ATS, represented by a public interest law firm (Pacific Legal Services), filed suit in the US District Court for the Eastern District of Pennsylvania, challenging the FTC's non-compete ban. Like the Texas plaintiffs, ATS sought injunctive relief and a stay of the rule's effective date. ATS raised similar legal arguments to the *Ryan* plaintiffs and intervenors.

On July 23, 2024, the court issued a memorandum and order, denying the plaintiff's motion in its entirety (*ATS Tree Servs., LLC v. Fed. Trade Comm'n*, 2024 WL 3511630 (E.D. Pa. July 23, 2024)). The court held that ATS had not shown that it would suffer irreparable harm and therefore did not meet the minimum requirements for granting injunctive relief. The court noted that:

- Nonrecoverable costs of complying with a government rule or regulation do not support a finding of irreparable harm under Third Circuit precedent.
- The possibility that ATS would scale back its training and investment in employees is "too attenuated to constitute an immediate, irreparable harm" and is not mandated by the FTC's rule (*ATS Tree Servs.*, 2024 WL 3511630, at *10).

The court also held that even if ATS had shown irreparable harm it was not likely to succeed on the merits because the FTC had authority to issue the non-compete ban. Specifically, the court held that:

- The FTC has authority under Section 6(g) of the FTC Act to issue substantive rules to prevent unfair competition. The court specifically rejected the plaintiff's argument that the FTC's authority was limited to procedural rulemaking and enforcement. The court relied on the FTC's authority to "prevent" unfair methods of competition, which is an "inherently forward-looking directive," and therefore contemplates substantive rulemaking (*ATS Tree Servs.*, 2024 WL 3511630, at *14-15).
- The FTC's rule does not exceed the agency's rulemaking authority by banning **all** non-competes, rather than adjudicating the reasonableness of each non-compete on an individual basis, and therefore a "rule-of-reason analysis is not proper in this context" (*ATS Tree Servs.*, 2024 WL 3511630, at *17).
- Because the FTC has clear Congressional authority to issue the rule, the major questions doctrine is inapplicable (*ATS Tree Servs.*, 2024 WL 3511630, at *18).

These holdings directly contradict the *Ryan* court's rulings.

The *ATS* court also specifically rejected the plaintiff's arguments, which were largely accepted by the *Ryan* court, that:

- The final rule improperly displaces an area traditionally regulated by state law, noting that states "may continue to enforce in parallel laws that restrict noncompetes and do not conflict with the final rule" and "state laws are not entirely preempted," even though as a practical matter only those few states with laws more comprehensively banning non-competes would not be preempted (*ATS Tree Servs.*, 2024 WL 3511630, at *17).
- Congress unconstitutionally delegated legislative authority to the FTC through the FTC Act (*ATS Tree Servs.*, 2024 WL 3511630, at *18-19).

Given the court's ruling on irreparable harm and likelihood of success, the court did not reach the questions of balancing equities or the public interest.

Notably, there seems to be some dispute about the precise terms of the non-compete provisions used by ATS, and ATS failed to provide copies of its employment agreements or the non-compete language to the court (*ATS Tree Servs.*, 2024 WL 3511630, at *1, n.2). That failure may have had a material impact on the Court's ruling, as the court was unable to determine whether ATS's non-compete agreements would have been enforceable under Pennsylvania law, independent of the impact of the FTC's ban.

What About the Florida Case?

Joining the fray of legal challenges to the FTC's rule, on June 21, 2024, Properties of the Villages, Inc. (POV) filed suit in the US District Court for the Middle District of Florida. POV is a real estate company that sells properties

in an adult community in Florida. It hires sales associates and provides extensive training and a network of sales leads, and in return requires sales associates to agree to limited non-compete agreements, restricting their ability to sell real estate for 24 months after their employment ends, but only within The Villages community. They remain free to sell real estate anywhere else in the state.

Notably, the Florida courts have upheld POV's non-competes as reasonable in past litigation (see *Props. of the Villages, Inc. v. Kranz*, 2021 WL 2144178, at *5 (M.D. Fla. May 24, 2021)).

Like the *Ryan* and *ATS Tree Services* plaintiffs, POV contends that:

- The FTC lacks substantive rulemaking authority regarding unfair methods of competition under Section 5 of the FTC Act.
- Even if the FTC has this substantive rulemaking authority regarding unfair methods of competition, it lacks authority to ban virtually all non-competes because not all non-competes are per se unlawful under the antitrust laws.
- The ban on existing non-competes is an unlawful retroactive application of the rule, as Congress did not clearly authorize retroactive rulemaking.
- The ban is unconstitutional under the Commerce Clause as applied to POV because its non-competes concern purely intrastate commerce.
- Even if Congress authorized this rulemaking, this broad and unbounded delegation of authority violates the non-delegation doctrine.

(*Props. of the Villages, Inc. v. Fed. Trade Comm'n*, Case No. 5:24-cv-316-TJC-PRL (M.D. Fla. June 21, 2024) (see complaint) (Docket Entry No. 1).)

POV moved for an injunction against the FTC's enforcement of the rule and a stay of the effective date pending the litigation (Docket Entry No. 25). Following oral argument on August 14, 2024, the court announced the reasons for its ruling orally from the bench and issued a minute order granting the motion for a preliminary injunction and staying the effective date (Docket Entry No. 58). On August 15, 2024, the court issued the preliminary injunction:

- Ordering that POV's Motion for Stay of Effective Date and Preliminary Injunction (Doc. 25) is granted.
- Enjoining the FTC from implementing and enforcing the non-compete rule, but only as against POV.

The court attached an excerpt of the hearing transcript with the court's reasoning supporting the order. (Docket Entry 59.) In assessing POV's likelihood of success on the merits, the court concluded that POV was:

- Not likely to prevail on its arguments that:
  - the FTC lacks any substantive rulemaking authority regarding unfair methods of competition. In doing so, the court rejected the argument that rulemaking under Section 6(g) is limited to procedural rules and cited to the court's decision in ATS Tree Services regarding the FTC's authority to "prevent" unfair methods of competition; and
  - the non-compete rule is unconstitutional and violates the Commerce Clause.
- Likely to prevail on its argument that the FTC's rule "presents a major question as defined by the Supreme Court." In analyzing the "major question" factors, the court found that:
  - the rule affects "a significant portion of the American economy;"
  - the final rule would preempt state laws that allowed certain post-employment non-competes;
  - neither the FTC nor any other federal agency has previously tried to regulate non-competes in a meaningful way; and
  - the final rule was a "hugely consequential expansion of regulatory authority."
- Likely to prevail on its argument that Congress did not render "a sufficiently clear expression to authorize the final rule." While the FTC has some rulemaking authority under Section 6(g), the court noted that:
  - the FTC has never engaged in rulemaking of this magnitude before;
  - the FTC had even not brought individual enforcement actions regarding non-competes until those announced days before issuing the NPRM; and
  - the circumstances are sufficiently "extraordinary" to warrant the application of the major questions doctrine.

(*Props. of the Villages, Inc. v. Fed. Trade Comm'n*, 2024 WL 3870380 (M.D. Fla. Aug. 15, 2024).)

The court expressly noted that the injunction only applied to POV and that it was not ordering a stay of the final rule generally or granting a nationwide injunction. However, the significance of the limited scope of the injunction is diminished given the *Ryan* court's order setting aside the rule nationwide.

What About Appeals? Is This Issue Headed to the Supreme Court?

Given the *Ryan* court's ruling setting aside the final rule, it is unclear whether ATS will continue to pursue the litigation through a ruling on the merits. If it does so, and the final merits ruling is ultimately appealed by either or both parties, it creates the possibility of a circuit split between the Third and Fifth Circuits (assuming the Fifth Circuit affirms the District Court's decision in *Ryan*) about the legitimacy of the FTC ban, potentially setting up an appeal to the US Supreme Court.

Given the Supreme Court's June 28, 2024, decision in *Loper Bright Enterprises v. Raimondo*, where the Court categorically overturned *Chevron* and its doctrine of agency deference (*Loper*, 144 S. Ct. 2244 (2024)), and its recent rulings on the Major Questions Doctrine, the Supreme Court can be expected, at minimum, to cast a skeptical eye on the FTC's non-compete ban.

Can Employers Ignore the Final Rule and Get Back to Business As Usual?

For the moment, employers that rely on employee non-competes can breathe a sigh of relief and return to running their businesses. They need not comply with the final rule or worry about sending notices to employees and former employees informing them that their non-competes are not enforceable.

However, even without the FTC's ban coming into effect, we expect that state legislators will continue the trend of enacting laws to restrict the enforceability of non-competes. Employers therefore should remain cautious if using non-competes, especially with lower wage or "rank and file" workers, and keep abreast of new laws in jurisdictions where they operate.

Employers also may want to use this moment as an opportunity to:

- Reevaluate the company's general approach to non-competes and ensure they are valid under applicable state laws.
- Evaluate the viability and effectiveness of alternatives to non-competes, such as garden leave provisions, enhanced confidentiality provisions, non-solicitation provisions, trade secret audits, and trade secret training programs.