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Federal District Court Sets Aside FTC's Non-Compete Rule

On August 20, 2024, a federal judge in the Northern District of Texas ruled in *Ryan LLC v. Federal Trade Commission* that the FTC exceeded its authority in issuing a rule that would have prohibited most non-compete agreements between employers and employees (the “Non-Compete Rule”), and set aside the Non-Compete Rule, which was set to take effect on September 4, 2024 (the “Effective Date”). As she previously held when she granted the plaintiff’s motion for a preliminary injunction, Judge Ada Brown, appointed by President Trump, again held both that the FTC lacked the statutory authority to engage in substantive rulemaking and also that the Non-Compete Rule was arbitrary and capricious. For those reasons, the court determined that the proper remedy was to set aside the Rule on a nation-wide basis, such that the “Rule shall not be enforced or otherwise take effect.”

Background

As described in more detail in our previous client alerts,¹ on April 23, 2024, the U.S. Federal Trade Commission (“FTC”) voted 3-2 to approve a rule that, with limited exceptions, prohibits employers from entering into or enforcing existing non-compete agreements with or against employees. The FTC determined that the vast majority of non-competes were an unfair method of competition under Section 5 of the FTC Act (“Section 5”). The rule would have taken effect on September 4, 2024, and would have required:

1. Employers to no longer enter into non-compete agreements with an employee after the Effective Date; and,
2. Employers to send a notice prior to the Effective Date to employees subject to existing non-competes, other than “senior executives” (as defined by the Non-Compete Rule), informing the employee that the restriction is no longer enforceable.

¹ Clifford Chance, Briefing, *Federal District Court Rules that Federal Trade Commission Lacks Substantive Rulemaking Authority and Stays Non-Compete Ban* (July 4, 2024), at <https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2024/07/Federal%20District%20Court%20Rules%20That%20Federal%20Trade%20Commission%20Lacks%20Substantive%20Rulemaking%20Authority%20and%20Stays%20Non%20Compete%20Ban.pdf>; Clifford Chance, Briefing, *Federal Trade Commission Approves Non-Compete Ban* (Apr. 25, 2024), at <https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2024/04/Federal%20Trade%20Commission%20Approves%20Non-Compete%20Ban.pdf>.

The Non-Compete Rule was immediately challenged by plaintiffs in the Northern District of Texas,² followed by additional cases in the Eastern District of Pennsylvania³ and the Middle District of Florida.⁴ In both the Northern District of Texas and the Middle District of Florida, the courts granted the plaintiffs' motions for a preliminary injunction but limited the injunctions' scope to the named plaintiffs. In *Ryan LLC*, Judge Brown found both that the FTC lacked statutory authority for substantive rulemaking and also that the Non-Compete Rule was arbitrary and capricious. In *the Villages*, Judge Timothy Corrigan, an appointee of President George W. Bush, found that the FTC *did* have statutory substantive rulemaking authority, but that the Non-Compete Rule ran afoul of the major questions doctrine. The court in the Eastern District of Pennsylvania, however, ruled in favor of the FTC and denied the plaintiff's motion for a preliminary injunction. In *ATS Tree Services*, Judge Kelley Hodge, an appointee of President Biden, also found that the FTC had statutory substantive rulemaking authority, but that the major questions doctrine was inapplicable because the Non-Compete Rule "falls squarely within [the FTC's] core mandate" and the FTC had previously used its rulemaking power in similar ways.⁵

The Court Ruling

The *Ryan LLC* court in the Northern District of Texas was the first court to make a final ruling on the merits. On August 20, 2024, the court held, first, that the FTC lacked the rulemaking authority to implement the Rule. While acknowledging that, "plainly read, the Court concludes the FTC has some authority to promulgate rules to preclude unfair methods of competition," the court concluded that the FTC lacks the authority to issue substantive rules, including the broad non-compete ban, and instead, is limited to "housekeeping rules" under Section 6(g) of the FTC Act or to case-by-case enforcement under its administrative enforcement authority under Section 5.⁶

The court also held that the FTC's adoption of the Non-Compete Rule was arbitrary and capricious. Despite the FTC's publication of a 570-page document detailing its justifications for the Non-Compete Rule and answering prospective counter-arguments,⁷ the court nevertheless determined that "the Rule is 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."⁸

Based on these holdings, under the Administrative Procedure Act,⁹ the court set aside the Non-Compete Rule, prohibiting it from being enforced or taking effect.

What Now?

Because of the ruling in the Northern District of Texas, the FTC's Non-Compete Rule will not go into effect on September 4, 2024. Companies do not need to amend existing employment agreements to remove non-competes; they may continue to use otherwise-reasonable non-competes, and employers do not need to send out notices to employees indicating that existing non-competes are ineffective.

² Complaint, *Ryan LLC v. Federal Trade Commission*, No. 3:24-cv-986 (N.D. Tex. Apr. 23, 2024) ("*Ryan LLC*").

³ Complaint, *ATS Tree Services, LLC v. Federal Trade Commission*, No. 2:24-cv-01743 (E.D. Pa. Apr. 25, 2024) ("*ATS Tree Services*").

⁴ Complaint, *Properties of the Villages, Inc. v. Federal Trade Commission*, No. 5:24-cv-00316 (M.D. Fla. June 21, 2024) ("*the Villages*").

⁵ Memorandum at 37, *ATS Tree Services* (E.D. Pa. July 23, 2024).

⁶ Memorandum Opinion and Order at 22, *Ryan LLC* (N.D. Tex. Aug. 20, 2024) ("*Ryan LLC Order*").

⁷ See *Non-Compete Clause Final Rule* (Apr. 23, 2024) (codified at 16 C.F.R. § 910), https://www.ftc.gov/system/files/ftc_gov/pdf/noncompete-rule.pdf.

⁸ *Ryan LLC Order* at 24.

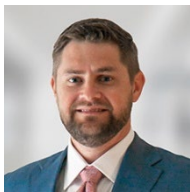
⁹ 5 U.S.C. § 706(2)(A)-(C).

That said, there are two important considerations. First, employers should continue to monitor this issue because the FTC will likely appeal the court's decision.

Second, despite the ruling, we expect that the FTC will continue to focus on non-competes, on a case-by-case basis, as a potential violation of Section 5. At a federal level, the legality of non-compete agreements are still evaluated under the rule of reason, which weighs an agreement's procompetitive effects against any anticompetitive effects. Employers should ensure that existing non-competes, and any new non-competes, are reasonably tailored in scope and duration, and justified for each employee.

Many states also have their own laws governing the legality of non-compete agreements. California, North Dakota, and Oklahoma have had near-complete bans on non-competes since the 19th century, and Minnesota recently prohibited nearly all new non-competes as of July 1, 2023.¹⁰ And additional states may follow the FTC's lead by prohibiting non-competes through state legislation.

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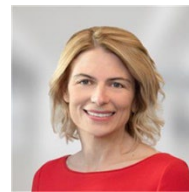
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¹⁰ See CAL. BUS. & PROF. CODE § 16600 (2024) (California's blanket ban on non-competes with limited exceptions in connection to the sale of a business or the dissolution of a partnership); MINN. STAT. § 181.988 (2023) (Minnesota's blanket ban on all new non-competes with limited exceptions in connection to the sale of a business or the dissolution of a partnership); N.D. CENT. CODE § 9-08-06 (2023) (North Dakota's blanket ban on non-competes with limited exceptions in connection to the sale of a business or the dissolution of a partnership); OKLA. STAT. tit. 15, § 219A (2023) (Oklahoma's blanket ban on non-competes with limited exceptions in connection to the sale of a business or the dissolution of a partnership).