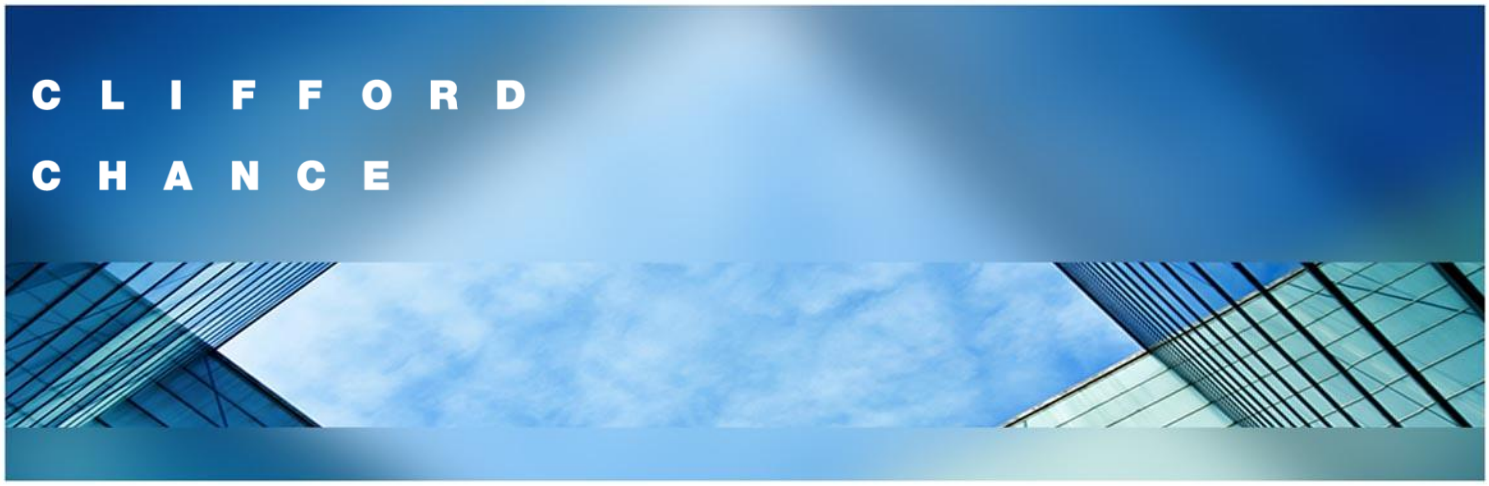

FEDERAL DISTRICT COURT RULES THAT FEDERAL TRADE COMMISSION LACKS SUBSTANTIVE RULEMAKING AUTHORITY AND STAYS NON-COMPETE BAN

Stay does not apply nationwide; applies only to plaintiffs and plaintiff-intervenors

Judge Ada Brown of the Northern District of Texas issued a preliminary injunction on July 3, 2024, staying the Federal Trade Commission ("**FTC**") rule that would prohibit, with limited exceptions, employers from entering into non-compete clauses with employees or enforcing existing non-compete clauses against employees (the "**Non-Compete Rule**").[1] Notably, the stay does not apply nationwide, but rather only to the plaintiff and plaintiff-intervenors. In issuing the preliminary injunction, Judge Brown, a Trump appointee, found that the FTC exceeded its authority in issuing the Non-Compete Rule because Section 6(g) of the Federal Trade Commission Act (the "**FTC Act**") does not grant rulemaking authority to the FTC with respect to unfair methods of competition. While Judge Brown's order is preliminary, she intends to rule on the ultimate merits of the case by August 30, 2024.

RYAN LLC V. FEDERAL TRADE COMMISSION

Ryan LLC, a Dallas-based tax services provider, had filed suit challenging the FTC's authority to issue the Non-Compete Rule on April 23, 2024 – the same day the rule was issued – alleging not only that Congress did not statutorily grant substantive rulemaking powers to the FTC with regards to defining unfair methods of competition, but also that the non-compete issue is a major question that Congress did not authorize the FTC to resolve, and that the very structure of the FTC is unconstitutional.[2] Judge Brown found that Congress did not, through the FTC Act, grant the FTC statutory substantive rulemaking powers and that the FTC's Non-Compete Rule was arbitrary and capricious, and therefore the plaintiff was likely to succeed on the merits. The opinion did not address the plaintiff's other constitutional claims.

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1 Memorandum Opinion and Order at 1-2, *Ryan LLC, et al. v. Federal Trade Commission*, No. 3:24-cv-986 (N.D. Tex. July 3, 2024) ("Opinion").
2 Complaint at 3-4, *Ryan LLC v. Federal Trade Commission*, No. 3:24-CV-986 (N.D. Tex. Apr. 23, 2024).

Statutory Authority

The FTC had argued, both when issuing the Non-Compete Rule and in this litigation, that it derived its substantive rulemaking authority from Sections 5 and 6(g) of the FTC Act. Section 5 empowered the FTC to prevent unfair methods of competition, and Section 6(g) gave the FTC the power "to make rules and regulations for the purposes of carrying out the provisions of" the FTC Act.[3]

Despite recognizing that the FTC Act grants "some authority to promulgate rules to preclude unfair methods of competition," Judge Brown held that Section 6(g) is merely a "housekeeping statute" that authorizes "'rules of agency organization procedure or practice' as opposed to 'substantive rules.'"[4] If Congress had intended to grant "substantive" rules instead of "housekeeping" rules, she writes, it would have included sanctions for violating promulgated rules. In contrast to Section 5, which sets out penalties for violations in FTC adjudications, Section 6(g) does not contain a provision discussing consequences for rule violations. Furthermore, Judge Brown views "the location of the alleged substantive rulemaking authority [to be] suspect" since "Section 6(g) is the seventh in a list of twelve" and Congress would have "cho[sen] to place such substantial power in a primary, independent place."[5]

Judge Brown acknowledged existing but non-binding precedent holding that Section 6(g) grants the FTC substantive rulemaking authority. For example, in the 1973 *National Petroleum Refiners Association v. Federal Trade Commission* case, the D.C. Circuit explicitly found substantive rulemaking authority in Section 6(g).[6] However, Judge Brown points out that, until the Non-Compete Rule, the FTC had not promulgated a substantive rule under Section 6(g) since 1978. She also read the 1975 Magnuson-Moss Act, which "codif[ied] the Commission's authority to make substantive rules for unfair or deceptive acts or practices" after *National Petroleum* was decided, to mean that Congress did not intend to also codify the same authority for unfair methods of competition, even though the statute states that it "shall not affect any authority of the Commission to prescribe rules … with respective to unfair methods of competition."[7]

Arbitrary and Capricious

Judge Brown also found the Non-Compete Rule to be arbitrary and capricious because: (i) the rule is "unreasonably overbroad without a reasonable explanation"; and (ii) the FTC "insufficiently addressed alternatives to issuing the Rule."[8]

In terms of the Non-Compete Rule's breadth, Judge Brown characterized the rule as "a one-size-fits-all approach with no end date" and broadly found that the FTC "fails to establish a 'rational connection between the facts found and the choice

3 *See* 15 U.S.C. § 46(g).
4 Opinion at 15 (quoting *Chrysler Corp. v. Brown*, 441 U.S. 289, 310 (1979)).
5 Opinion at 16.
6 *National Petroleum Refiners Ass'n v. Federal Trade Commission*, 482 F.2d 672, 677 (D.C. Cir. 1973) (rejecting a challenge to an FTC rule requiring gas pumps to post octane rating numbers "for the simple reason that Section 6(g) clearly states that the Commission 'may' make rules and regulations for the purpose of carrying out the provisions of Section 6 and it has been so applied.").
7 *See* Opinion at 17-19; 15 U.S.C. § 57(a)(2).
8 Opinion at 21-22.

made.'"[9] She also wrote that "no state has ever enacted a non-compete rule as broad as the FTC's Non-Compete Rule."[10] In addition, the fact that some states enforced non-competes on a fact-specific basis (i.e., using the rule of reason) convinced the Court that the FTC's "categorical ban" was "completely inapposite," especially given the Commission's "lack of evidence as to why they chose such a sweeping prohibition … instead of targeting specific, harmful non-competes."[11]

According to Judge Brown, the FTC was also arbitrary and capricious in insufficiently addressing alternatives to issuing the Non-Compete Rule, due to "[t]he record show[ing] the Commission did not conduct such analysis, dismissing arguments from the FTC "that employers had other avenues to protect their interests."[12]

EFFECTS OF THE CASE

Given the above analysis, Judge Brown concluded that the plaintiff and plaintiff-intervenors were likely to succeed on the merits and granted a preliminary stay of the Non-Compete Rule, but only as it applied to the plaintiff and plaintiff-intervenors (and not members of plaintiff-intervenors). Although the Court noted that it had the power to issue a nationwide injunction in an "appropriate circumstance," the Court explained that the plaintiffs had not provided sufficient evidence to show that the Non-Compete Rule was an appropriate circumstance meriting nationwide relief.[13]

In light of the Court's preliminary finding, we expect that Judge Brown will similarly find that the FTC exceeded its authority when she rules on the ultimate merits of the action by August 30, 2024, days before the Non-Compete Rule becomes effective on September 4, 2024.

Judge Brown's opinion only briefly mentions the Supreme Court's recent decision in *Loper Bright Enterprises v. Raimondo ("**Loper Bright**")* to note that *Chevron* deference "cannot be squared with the APA."[14] While the full implications of *Loper Bright* may take years to be revealed, the decision likely will make administrative regulations more vulnerable to legal challenges, as the federal judiciary will no longer need to defer to agency interpretations of federal statutes. Another recent Supreme Court case, *Corner Post, Inc. v. Board of Governors of the Federal Reserve System ("**Corner Post**")*, also facilitates challenges to federal regulations, including those promulgated by the FTC. In Corner Post, the Supreme Court ruled that the six-year limitation to bring claims under the Administrative Procedures Act did not "accrue" from the point an agency promulgates a rule, but rather from when a plaintiff is injured by the agency rule.[15]

9 *Id*. at 21.
10 *Id*.
11 *Id*. at 21-22.
12 *Id*. at 22-23; *see also* Final Rule at 290-324 (chapter of FTC's Non-Compete Rule finding trade secret laws and non-disclosure agreements to be viable alternatives for protecting valuable investments and considering public comments and counter-arguments).
13 Opinion at 31.
14 *Id*. at 13 (quoting *Loper Bright Enterprises v. Raimondo*, No. 22-1219, 2024 WL 3208360, at *14 (U.S. June 28, 2024)).
15 *Corner Post, Inc. v. Board of Governors of the Federal Reserve System*, No. 22-1008, 2024 WL 3237691, at *6 (U.S. July 1, 2024).

The additional challenges Loper Bright and Corner Post could pose to administrative agencies' rulemaking efforts are further explored here.[16]

Because the stay and injunction in *Ryan LLC* was narrowly applied to the plaintiff and plaintiff-intervenors, the FTC may still expect all other employers to comply with the Non-Compete Rule and send out the required notices by September 3, 2024, unless Judge Brown or another district court issues a broader stay before the rule goes into effect.

Employers should also monitor another challenge to the FTC's Non-Compete Rule in the Eastern District of Pennsylvania, where a preliminary injunction ruling is expected by July 23, 2024.[17] As several weeks will have passed from the *Loper Bright* decision, the ruling in that case should also provide more insight as to how the judiciary will react to the overturning of *Chevron* deference.

Even if a court issues a nationwide injunction against the FTC's Non-Compete Rule, employers should be conscious that many states have their own restrictions on non-competes that are unaffected by challenges to the federal rule. 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.[18] Other jurisdictions, like the District of Columbia, Maryland, and Virginia, have prohibitions on non-competes for employees earning below a certain income threshold.[19]

We will continue to carefully monitor developments on this matter.

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16 Clifford Chance, Briefing, *U.S. Supreme Court reels in federal agency interpretation power, overturning Chevron Doctrine, and lengthens deadline for bringing challenges* (July 3, 2024), at https://www.cliffordchance.com/briefings/2024/07/u-s--supreme-court-reels-in-federal-agency-interpretation-power-.html.

17 *ATS Tree Services, LLC v. Federal Trade Commission*, No. 2:24-cv-01743 (E.D. Pa.).

18 *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).

19 *See generally* D.C. CODE § 32-581 (2024) (D.C. municipal law generally prohibiting non-competes for employees earning below a certain income, annually-adjusted); MD. CODE ANN., LAB. & EMPL. § 3-716 (2024) (Maryland state law generally prohibiting non-competes for employees earning 150% or less of the state minimum wage, and also for certain healthcare professionals); VA. CODE ANN. § 40.1-28.7 (2020) (Virginia commonwealth law generally prohibiting non-competes for employees earning less than the average weekly wage of the Commonwealth, determined annually).

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