



U.S. District Court Stays and Enjoins Enforcement of FTC's Non-Compete Ban: What Texas Employers Should (or Shouldn't) Do Next

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On July 3, 2024, the United States District Court for the Northern District of Texas issued a Memorandum Opinion and Order, granting a stay and preliminary injunction against the enforcement and effective date of the Federal Trade Commission's ("FTC") Non-Compete Rule. The ruling is not nationwide and applies only to Plaintiff, Ryan, LLC and Plaintiff-Intervenors, the U.S. Chamber of Commerce, Business Roundtable, Texas Association of Business, and Longview Chamber of Commerce (collectively "Plaintiffs"). Judge Ada Brown's Memorandum Opinion expressed the intention of entering a merits disposition on this lawsuit on or before August 30, 2024; just days before the Non-Compete Rule's September 4, 2024, effective date. This blog summarizes the court's rationale, holdings, and the scope of the relief ordered.

A. Brief Background on Texas Non-Compete Agreements and the FTC's Non-Compete Rule:

At its heart, the consolidated lawsuit is a dispute over the FTC's rulemaking authority concerning the enforceability of employer-employee non-compete agreements. Before the FTC issued its Non-Compete Rule, the legality and use of non-compete agreements was controlled by a patchwork of state laws. Like most states, Texas permits the use of employee-employer non-compete agreements. Many Texas employers entrust employees with their trade secrets, goodwill, or specialized training in exchange for those employees agreeing not to compete against them. Since 1989, Texas employers could look to the Texas' Covenants Not to Compete statute and extensive common law authority to develop balanced and enforceable non-compete agreements. Relying upon well-established Texas law, many Texas employers protect their business through the routine use of non-compete agreements and policies.



Congress enacted the FTC Act in 1914 to protect consumers and promote competition. The Act established the Federal Trade Commission and initially empowered it to prevent unfair methods of competition. By enacting the Wheeler-Lea Act in 1938, Congress expanded the FTC's power to the prevention of unfair or deceptive acts or practices. Section 5 of the FTC Act explicitly directs the Commission to prevent such unfair methods and acts. Section 6 of the Act grants the FTC additional powers to support its functions, including the power to classify corporations and make rules and regulations.

Despite its long history, it was not until April 23, 2023, when the FTC adopted its Non-Compete Rule. Effective September 4, 2024, the Rule bans most (but not all) employer-employee non-compete agreements. Like many other states that legalize some form of non-compete agreement in employer-employee relationships, the Non-Compete Rule supersedes Texas law. As the effective date approaches, the Non-Compete Rule has many Texas employers scrambling for options to protect themselves from the loss of trade secrets, goodwill, or training once protected by non-compete agreements that, under Texas law, were otherwise legal.

B. Ryan LLC v. Federal Trade Commission's Procedural History:

In late April 2024, Texas employer, Ryan, LLC sued the FTC in the Northern District of Texas challenging the constitutionality and authority of the FTC to issue its Non-Compete Rule banning most (but not all) employer-employee non-compete agreements effective September 4, 2024. Shortly thereafter, the U.S. Chamber of Commerce, Business Roundtable, Texas Association of Business, and Longview Chamber of Commerce ("Business Associations") sued the FTC in the Eastern District of Texas alleging, generally, the same grounds as Ryan, LLC. After the Eastern District of Texas stayed the Business Associations' lawsuit because Ryan, LLC was first to file, the Business Associations successfully intervened in the Ryan, LLC suit. Plaintiffs subsequently filed opposed motions to stay enforcement of and to preliminarily enjoin the FTC from enforcing the Non-Compete Rule during the pendency of the lawsuit.

C. The Basis of the Stay and Preliminary Injunction against the FTC's Non-Compete Ban:

To preserve the status quo and prevent irreparable injury so the court could render a meaningful decision on the merits without Plaintiffs having to comply with the disputed rule, they sought an order staying the effective date and a preliminary injunction on the FTC's ability to enforce its Non-Compete Rule.



After examining and applying the facts to the legal standards required for injunctive relief, the court determined that Plaintiffs met their burdens and granted their motions. The court's analysis for each of the preliminary injunction elements provides some insight into what it may ultimately hold on to the merits. To obtain a preliminary injunction, Plaintiffs had to establish the following: a substantial likelihood of success on the merits; a substantial threat of irreparable harm in the absence of preliminary relief; that the balance of equities tips in the movant's favor; and the injunction serves the public interest.

i. Plaintiffs established "a substantial likelihood of ultimately succeeding on the merits."

The court held that Plaintiffs met their burden to show "a substantial likelihood of ultimately succeeding on the merits." Specifically, it held that Plaintiffs succeeded in establishing that the FTC exceeded its statutory authority by enacting the Non-Compete Rule and the agency's actions, findings, and conclusions were arbitrary and capricious in violation of the Administrative Procedure Act ("APA"). In reaching its conclusions, the court analyzed the statutory history of the FTC as well as its historical use, or lack thereof, of Section 6(g) to promulgate substantive rules as well as the scope, effect of the Rule and whether the agency considered alternatives to an out-right ban.

The court started by analyzing the FTC's statutory authority. It determined that the substantive issue presented was "whether the FTC's ability to promulgate rules concerning unfair methods of competition include the authority to create substantive rules regarding unfair methods of competition." The Court agreed with Plaintiffs and found that the text, structure, and history of the FTC Act reveal that the FTC does not have substantive rulemaking authority with respect to unfair methods of competition. It further determined that the plain language, structure, and history of the Act indicate that Section 6(g), the FTC's basis for purported substantive rule making authority, is a housekeeping statute, authorizing procedural, not substantive, rulemaking. The court further agreed with Plaintiffs' contention that the Act did not provide for a statutory penalty for violating rules created by Section 6(g) and that was further indicia that the section did not create substantive obligations on regulated parties. The court concluded that, based on Section 6(g)'s text, the FTC "exceeded its statutory authority in promulgating the Non-Compete Rule, and thus Plaintiffs are likely to succeed on the merits."



Turning to whether the FTC acted inconsistent with the APA's standard, the court outlined the elements APA's arbitrary and capricious standard and noted that, when applying the standard, it was limited to "the basis articulated by the agency itself." The court found that the Rule is arbitrary and capricious because it is unreasonably overbroad and does not consider alternatives or reliance interests. The court was particularly critical of the rule's "one-size-fits-all approach with no end date." It noted that no state has ever enacted a non-compete rule as broad as the FTC's Non-Compete Rule and ignored the FTC's own evidence comparing different state's case-by-case approach to non-compete agreements, rather than imposing a categorical ban. The Rule's approach of banning all non-compete agreements ignored any of the benefits of the agreements and was not specifically targeted at harmful non-compete agreements. The Rule also failed to sufficiently consider less disruptive alternatives to an outright ban. The court concluded that Plaintiff would likely succeed on the merits of its argument that the Rule is arbitrary and capricious.

ii. Plaintiffs demonstrated irreparable harm in the absence of a preliminary injunction.

The court concluded that Plaintiffs also met their burden to establish they would suffer irreparable harm if the court failed to grant a preliminary injunction against the FTC's enforcement of the Non-Compete Rule. Plaintiffs argue that the Rule results in the loss of non-competes with present and former principals, an inability to enter into new non-competes, increases proliferation risk for trade secrets and other intellectual property, and would result in Plaintiffs incurring costs associated with providing notice to current and past employees subject to a non-compete agreement as well as time and resources to counteract the Rule and update all existing agreements. Relying on Fifth Circuit precedent, the court determined that costs of compliance associated with the Rule are non-recoverable and that the unrecoverable costs of complying with an invalid regulation typically constitute irreparable harm.

iii. Plaintiffs also demonstrated that the balance of equities and public interest tip in favor of granting injunctive relief.

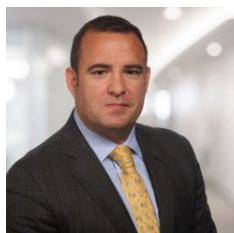
Noting that the remaining two elements of a preliminary injunction analysis merge "when the Government is the opposing party," the court analyzed the balance of equities and public interest contemporaneously. The court concluded that, on the record provided, the injury to both the public and Plaintiffs would be great if the status quo was not maintained. It further concluded that the FTC would suffer no harm from the court granting the preliminary injunction.



D. The limited scope of the stay and preliminary injunction leaves other employers with no guidance on whether they will have to ultimately comply with the FTC's Non-Compete Rule.

The court stayed the effective date of the Non-Compete Rule and enjoined the FTC from implementing or enforcing the Non-Compete Rule against the Plaintiffs. Importantly, the court expressly declined to extend the stay or preliminary injunction beyond the Plaintiffs. After analyzing Plaintiffs' request for a nationwide preliminary injunction, for example, the court declined to grant the request. It concluded that it did not, per Fifth Circuit authority, have sufficient circumstances based on the current record to grant a nationwide preliminary injunction. Further, the court denied the Business Associations' request to include their respective member entities, noting that they did not sufficiently brief the issue of associational standing.

For employers other than the Plaintiffs, the court's representations that it will issue a final ruling on the lawsuit on or before August 30, 2024, days before the September 4, 2024, effective date, is a ray of hope. Based on the court's strongly worded preliminary rulings, the stage is set for the Plaintiffs to provide further briefing that could lead the court to hold that the Rule is unconstitutional, and the FTC is unable to enforce it. Due to the tight timetable involved, however, employers would be wise to prepare to comply with Rule's notice provisions as well as the implementation of agreements, policies, and practices that allow employers to protect trade secrets, training, and proprietary information without the use of a non-compete agreements with their workers.



About the Author

For more than twenty years, [Richard L. Hathaway](#) has litigated non-competition, non-solicitation, trade secrets, and other matters protecting business innovation. He has successfully enforced his business clients' agreements and rights in arbitration and Texas state or federal court. He and his team are available to assist your business in protecting its trade secrets via a review of its agreements, policies, and training. If you suspect departing employees are attempting to depart with the business's trade secrets, he and his team are ready to aggressively pursue all available legal avenues. You can reach him via email at: Rhathaway@krcl.com and phone at: 214-777-4270.