FTC Doubles Down Against Long Odds on Noncompete Rule

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After two federal courts condemned the Federal Trade Commission's audacious effort to ban noncompete agreements in the United States, the agency is gambling that a circuit court will rescue its Noncompete Rule. At stake in the bet is the rulemaking authority of the FTC, the definition of unfair methods of competition, some thirty million employment contracts, and the laws of forty-six States.

We covered the Rule and its potential effects in a series of blogs and articles, beginning with this report on the proposal and the dissent it provoked in January 2023. Fifteen months later a divided Commission issued the Rule, despite vigorous dissents from two other commissioners who doubted its wisdom and disputed the agency's authority to issue it.

Almost immediately, companies and associations sued the FTC in three federal courts. Two judges entered preliminary injunctions against its enforcement, first in Texas in *Ryan LLC**[1]* and then in Florida in *Properties of the Villages (POV)*.[2] The *Ryan* court then rendered a summary judgment setting aside the Rule in its entirety and permanently barring its enforcement. A Pennsylvania court, holding that compliance costs did not amount to irreparable harm, was unwilling to add a third injunction.[3]

Now that the FTC has appealed both losses, it's time to weigh the odds that the Rule will ever take effect. Its controversial inception, troubled rise, and sudden fall lay bare the long odds facing the Commission and the encouraging signs for the companies it sought to regulate. Here are a few of the highlights:

A Commissioner's Warning at the Inception

When the FTC proposed the rule, Commissioner Christine Wilson dissented, citing a lack of rulemaking authority, a flawed concept of competitive harm, and evidence from earlier FTC hearings that the economic literature was "far from reaching a scientific standard for concluding [noncompete clauses] are bad for overall welfare." One study, she noted, had found such clauses in the brokerage sector were associated with lower prices and higher customer satisfaction. After questioning the Commission's legal authority to proceed at all, she warned:

> Using the approach of the Section 5 Policy Statement that enables the majority summarily to condemn conduct it finds distasteful, the Commission today proposes a rule that prohibits conduct that 47 state legislators have chosen to allow. Similarly, the Commission's proposed rule bans conduct that courts have found to be legal.[4]

The Commissioner predicted numerous successful legal challenges to the FTC's authority to issue the Rule, if it were to become final.

Two Commissioners Protest the Promulgation

By the time the FTC issued the final rule, Commissioner Wilson had resigned and two new Commissioners had the opportunity to weigh in on it, now with the benefit of a record containing thousands of comments, annals of published literature, and extensive analysis by FTC staff. It all led the Commissioners to the same conclusions Wilson had expressed fifteen months earlier.

In a forty-five-page dissent joined by Commissioner Holyoak, Commissioner Ferguson summarized his position with this:

> Whatever the Final Rule's wisdom as a matter of public policy, it is unlawful. Congress has not authorized us to issue it. The Constitution forbids it. And it violates the basic requirements of the Administrative Procedure Act.

On the merits of a categorical ban, he reminded his colleagues that noncompete clauses had been recognized as potentially beneficial since the beginning of antitrust jurisprudence three hundred years earlier in *Mitchel v. Reynolds,* **[5]** a case upholding such a clause. Common law and state statutes have reconfirmed the ruling again and again.

Dissenting separately, and joined by Ferguson, Commissioner Holyoak examined the language of the FTC Act, the cases construing it, and the academic literature (including my article). She concluded, as had I, that the agency did not have the authority to issue substantive competition rules. Reviewing the economic evidence, she opined, "Based upon the mixed effects from both the theory and the empirics, continued enforcement under the rule of reason seems more appropriate than a wide-sweeping rule that fails to grapple with the economics or the specific context of individual non-compete clauses."

Federal Judges Side with the Dissents

My colleague John Villafranco recently wrote that dissents play important roles in the development of law and policy. The Noncompete Rule could be a case study, since the arguments in the Commissioners' dissents proved persuasive in the courts. The *Ryan* court rendered two decisions – one granting a preliminary Injunction (*Ryan I*) and another granting a permanent Injunction (*Ryan II*).

The decisions were not close calls. Among the conclusions the courts delivered with the preliminary injunctions were rebukes such as these:

- The "FTC provides no evidence or reasoned basis [for prohibiting] "virtually all non-competes." Sweeping away all, "instead of targeting specific, harmful non-competes, renders the Rule arbitrary and capricious." *Ryan I*
- 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." *Ryan I*
- The Rule "makes unenforceable long-standing contractual agreements that have been judicially recognized as lawful and beneficial to the public interest." *Ryan I*
- The FTC "has acknowledged that the cost of compliance in the aggregate will be in the billions of dollars." *POV*

- The Commission “has never tried substantive rulemaking of this magnitude before this and had never even brought non-compete enforcement actions until it announced some consent decrees literally the day before it announced its Notice of Proposed Rulemaking.” *POV*
- “The Court rejects the FTC's argument that by not filing suit and its motion immediately after the rule was passed, POV sat on its rights and forfeited any argument that the harm is irreparable.” *POV*
- If “injunctive relief is not granted, the injury to both Plaintiffs and the public interest would be great. Granting the preliminary injunction serves the public interest by maintaining the status quo and preventing the substantial economic impact of the Rule, while simultaneously inflicting no harm on the FTC.” *Ryan I*

Rendering summary judgment and effectively making the injunction permanent and nationwide, the *Ryan II* court again rejected the Commission’s argument that it had authority to promulgate the Rule:

> The FTC alleges that Congress must have “understood rules issued under Section 6 to include legislative rules …. Again, the Court rejects such reasoning as a piecemeal attempt to confer rulemaking authority that Congress has not affirmatively granted to the FTC. The role of an administrative agency is to do as told by Congress, not to do what the agency thinks it should do. “Agencies do not have unlimited power to accomplish their policy preferences until Congress stops them; they have only the powers that Congress grants through a textual commitment of authority. [I]f Congress has granted only limited powers to the agency, and the regulation bears little kinship to the rulemaking authority expressed by statute, the validity of the regulation is suspect.”[6]

Off to the Circuits

Either or both circuit courts could concur and obviate review of the factual analysis. But the merits will be tempting to address, because a dual analysis would buttress the opinions should the FTC take one last gamble and petition the Supreme Court.

Should either court of appeals delve into the factual findings, it will be hard to escape this assessment in *Ryan II*.

> The record does not support the Rule. In enacting the Rule, the Commission relied on a handful of studies that examined the economic effects of various state policies toward noncompetes. The record shows no state has enacted a non-compete rule as broad as the FTC's Rule. The FTC's evidence compares different states' approaches to enforcing non-competes based on specific factual situations- completely inapposite to the Rule's imposition of a categorical ban. As to this latter point, the FTC provides no evidence or reasoned basis. The Commission's lack of evidence as to why they chose to impose such a sweeping prohibition-that prohibits entering or enforcing virtually all non-competes-instead of targeting specific, harmful non-competes, renders the Rule arbitrary and capricious…. In sum, 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.[7]

An intriguing question outside control of the courts is whether the FTC will abandon the appeals.

Under new leadership, the agency may decide to cut its losses and avoid two circuit court decisions declaring that unfair methods of competition are not amenable to nationwide rules and regulations and affirming that the FTC's rulemaking was arbitrary and capricious. On the other hand, it would be tempting for the new leadership to let the courts resolve these issues once and for all.

Meanwhile, companies can continue to rely on the law that has governs noncompete clauses – state laws, the Sherman and FTC Acts. In federal cases, the precedent supports Commissioner Holyoak's conclusion that the rule of reason should and will apply, case-by-case.

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[1] Ryan LLC v. Federal Trade Commission, Civil Action No. 3:24-CV-00986-E, N.D. TX, (Preliminary Injunction, July 3, 2024) (Permanent Injunction, August 20, 2024).

[2] Properties Of The Villages, Inc., v. Federal Trade Commission, Case No. 5:24-cv-316-TJC-PRL, M.D. FL. (August, 2024).

[3] ATS Tree Services, LLC V. Federal Trade Commission, No. 24-1743, E.D. PA. (July 23, 2024) (explaining, "nonrecoverable compliance costs are not a valid basis for a finding of irreparable harm."

[4] Footnotes omitted.

[5] 24 Eng. Rep. 347 (Q.B. 1711).

[6] Ryan II at 21-22 (citations omitted).

[7] *Id*. at 24 (citations and footnotes omitted).