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Texas Court Grants Preliminary Injunction Blocking FTC's Noncompete Ban

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On July 3, 2024, the US District Court for the Northern District of Texas issued an order temporarily enjoining the Federal Trade Commission (FTC) from implementing or enforcing its rule banning nearly all post-employment noncompete agreements. The court held that the rule "makes unenforceable long-standing contractual agreements that have been judicially recognized as lawful and beneficial to the public interest." While it's a significant initial victory for opponents of the rule, the injunction applies only to the five plaintiffs in the case. Therefore, absent a superseding ruling, all other employers using noncompete agreements still will be subject to the ban on the effective date of the rule, September 4, 2024.

As we reported in April 2024, the FTC's rule banned all future noncompete agreements with workers and rendered unenforceable virtually all existing noncompetes, with limited exception. As rationale for its sweeping rule, the agency stated that noncompetes constitute an unfair method of competition, which violates the FTC Act. After the FTC issued its rule, several plaintiffs' groups, including Ryan LLC, a tax services and software provider, filed suit seeking to block the rule's enforcement.

Decision in *Ryan LLC v. Federal Trade Commission*

In the first filed case challenging the FTC rule, the court agreed with the plaintiffs, finding that they met all the requirements for issuing a preliminary injunction, including that:

1. The plaintiffs are likely to succeed on the merits.
2. Irreparable harm will result without the issuance of injunctive relief.
3. The balance of harms and public interest weigh in favor of granting injunctive relief.

Significantly, on the first requirement, the court found that the FTC rule is likely unlawful, because the agency lacks substantive rulemaking authority with respect to unfair methods of competition under the FTC Act. The court explained that while the FTC has "some authority" to promulgate rules to preclude unfair methods of competition, it lacks authority to create substantive rules under this method. Instead, the court explained that Section 6(g) of the FTC Act (through which the agency promulgated the ban), is merely a "housekeeping statute" and only authorizes "rules of agency organization, procedure or practice" as opposed to "substantive rules."

The court also held that the categorical ban on virtually all noncompetes would be arbitrary and capricious, because the agency's evidence does not warrant such an expansive ban – and because it failed to adequately consider other exceptions or alternatives to the ban. The court stated that the ban is "unreasonably overbroad without a reasonable explanation. It imposes a one-size-fits-all approach with no end date, which fails to establish a 'rational connection between the facts found and the choice made.'" The court also rejected the FTC's "evidence" in support of a ban, declaring that it only relied on a handful of studies examining the economic effect of various state noncompete policies, despite the fact that "no state has ever enacted a non-compete rule as broad as the [FTC rule]." The court also found that the FTC insufficiently addressed alternatives to a ban, because it "dismissed any possible alternatives, merely concluding that either the pro-competitive justifications outweighed the harms, or that employers had other avenues to protect their interests."

What's next?

As noted, the court did not issue a nationwide injunction or extend the ruling to the US Chamber of Commerce's members, or members of the other plaintiff entities. However, in making these holdings, the court stated that the plaintiffs had "offered virtually no briefing" supporting nationwide injunctive relief, nor did the plaintiff-intervenors appear to seek associational standing on behalf of their respective member entities, or brief associational

standing. While the court refused to extend the scope of the injunction, it promised to enter a merits disposition on the case on or before August 30, 2024, which is five days before the FTC rule's effective date. It is possible that, in the interim, the parties may submit further briefing on these issues in support of a broader permanent injunction order. In the meantime, employers should keep a close eye on another legal challenge to the rule, filed in federal court in Pennsylvania. In *ATS Tree Services LLC v. Federal Trade Commission*, the court is expected to issue a decision on the plaintiff's motion for preliminary injunction by July 23, 2024.

Uncertainty remains on the future of the rule, and employers should watch for developments in this area in the immediate future. Companies should continue to take steps now – including identifying employees subject to existing noncompete agreements – while legal challenges continue.

Cooley's employment team will continue to follow developments relating to the FTC rule. If you're an employer with questions about the use of restrictive covenants, contact your Cooley employment lawyer or one of the lawyers listed below.

To learn more, check out Cooley's FTC Noncompete Ban Resources page and our What to Know About the FTC's Noncompete Ban on-demand webinar.

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