

# Federal Courts Split on Legality of the FTC's Non-Compete Rule

September 16, 2024

In April 2024, the Federal Trade Commission (FTC) issued a [rule](#) prohibiting most employers from entering into or enforcing non-compete agreements with workers, subject to exceptions for the sale of a business and preexisting non-competes with senior executives. The rule (the Non-Compete Rule) implicates unsettled issues regarding the FTC's authority to issue substantive competition regulations.

Lawsuits challenging the rule [followed](#). In one of those cases, a federal district court has [declared](#) the Non-Compete Rule unlawful and barred the FTC from enforcing it nationwide. Shortly before that decision, another court [held](#) that a separate challenge to the rule was likely to succeed and preliminarily enjoined the rule's enforcement against the named plaintiff in that case. A third court has taken a more favorable view of the Non-Compete Rule, [denying](#) a motion for a preliminary injunction and concluding that the plaintiff had not established a reasonable probability that the rule exceeds the FTC's legal authority.

This Legal Sidebar provides background on the Non-Compete Rule and associated legal issues, along with an overview of the litigation challenging it.

## Background

### The Non-Compete Rule

The Non-Compete Rule [makes](#) it unlawful to enter into or enforce a non-compete clause with any worker who is not a senior executive. The rule [prohibits](#) employers from entering into non-competes with senior executives after the rule's effective date, but allows employers to enforce preexisting non-competes with senior executives. The rule defines the term “[senior executive](#)” to mean a worker who occupied a “policy-making position” and received total compensation of at least \$151,164 in the preceding year.

The rule's prohibitions are subject to an [exception](#) for non-compete clauses entered into pursuant to a bona fide sale of a business entity, a person's ownership interest in a business entity, or all or substantially all of a business entity's operating assets.

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LSB11228

The rule defines the term “[non-compete clause](#)” to mean a term or condition of employment that “prohibits,” “penalizes,” or “functions to prevent” a worker from seeking or accepting work with a different person after the conclusion of the employment that includes the term or condition. The rule [explains](#) that this definition encompasses “de facto” or “functional” non-competes—for example, “forfeiture-for-competition” clauses that extinguish an employer’s obligation to pay promised compensation or benefits if a worker accepts another job. The rule does not, however, [categorically prohibit](#) non-disclosure agreements (NDAs) or non-solicitation agreements.

The Non-Compete Rule defines the term “[worker](#)” to include employees and independent contractors. That term [does not include](#) franchisees in the context of a franchisor-franchisee relationship, but does include employees of a franchisor or franchisee.

Employers that fall outside of the FTC’s jurisdiction under the FTC Act are [not subject](#) to the rule. These employers [include](#) certain banks, savings and loan institutions, federal credit unions, common carriers, air carriers, and “persons, partnerships, or corporations insofar as they are subject to the Packers and Stockyards Act.” Corporations that are not “organized to carry on business for [their] own profit or that of [their] members” are also [excluded](#) from the FTC Act’s coverage. The rule [explains](#) that simply claiming non-profit status under the tax code is not sufficient to qualify for this exclusion. Instead, the FTC evaluates the economic realities of an entity’s activities to determine whether the exclusion applies.

The Non-Compete Rule [requires](#) employers to provide “clear and conspicuous notice” to workers subject to prohibited non-compete clauses that the clauses “will not be, and cannot legally be” enforced.

## Legal Authority

The FTC [relied](#) on Sections 5 and 6(g) of the Federal Trade Commission Act (FTC Act) in promulgating the Non-Compete Rule. [Section 5](#) prohibits “unfair methods of competition” (UMC) and empowers the FTC to enforce that prohibition through adjudication. [Section 6](#) is titled “Additional powers of Commission.” It confers a range of authorities, most of which involve investigations and the publication of reports. The provision also includes Section 6(g), which empowers the FTC to “from time to time classify corporations and . . . to make rules and regulations for the purpose of carrying out” the FTC Act.

Sections 5 and 6(g) were both part of the [original FTC Act](#), which Congress enacted in 1914. Since the statute’s enactment, Congress has [adopted](#) several laws granting the FTC rulemaking authority over discrete subjects, including the [Wool Products Labeling Act](#), the [Textile Fiber Products Identification Act](#), the [Fur Products Labeling Act](#), the [Flammable Fabrics Act](#), and the [Fair Packaging and Labeling Act](#).

The FTC first asserted that Section 6(g) endows it with general substantive rulemaking power [in 1962](#), and the agency adopted a number of [trade regulation rules](#) in the years that followed. Some of those rules [defined](#) certain conduct as both a UMC and an “unfair or deceptive act or practice” (UDAP)—a separate category of conduct prohibited by [Section 5](#). Other rules [relied](#) only on the FTC’s UDAP power. One rule [relied](#) solely on the FTC’s competition authority, but was never enforced and has been [repealed](#).

In the 1970s, a trade association [challenged](#) the FTC’s authority to issue substantive rules under Section 6(g) in [National Petroleum Refiners Association v. FTC](#). The trade association argued that Section 6(g) authorized only procedural rules, emphasizing that the FTC had not asserted substantive rulemaking authority under Section 6(g) until 1962 and that FTC officials had occasionally denied the existence of such authority. The trade association also [contended](#) that Congress’s enactment of several statutes granting the FTC specific rulemaking authorities implied that the FTC lacked general rulemaking authority.

The U.S. Court of Appeals for the D.C. Circuit [rejected](#) those arguments. In affirming the FTC’s power to issue legislative rules under Section 6(g), the court relied on appellate decisions [construing](#) similar statutes as authorizing substantive rulemaking, the [advantages](#) of rulemaking in effectuating the FTC

Act's purposes, and the [absence](#) of any limiting language in the statutory text. The D.C. Circuit [downplayed](#) the fact that the FTC had not claimed general rulemaking authority until 1962, [reasoning](#) that the agency's earlier interpretation of its legal authority did not warrant judicial deference. The court also [concluded](#) that Congress may have provided the FTC with more specific rulemaking authorities based on "uncertainty, understandable caution, and a desire to avoid litigation," rather than a firm conviction that the FTC lacked general rulemaking authority.

Two years after the *National Petroleum Refiners* decision, Congress enacted the [Magnuson-Moss Act](#), which imposed special procedural requirements for the FTC's UDAP rules and eliminated the FTC's authority to issue such rules under Section 6(g). Magnuson-Moss did not by its terms affect the FTC's authority to issue UMC rules: the statute included a [provision](#) disclaiming an intent to affect "any authority of the Commission to prescribe rules (including interpretive rules), and general statements of policy, with respect to unfair methods of competition."

Despite this language in Magnuson-Moss, the FTC's putative authority to issue UMC rules has been dormant since the enactment of that statute. The Non-Compete Rule marks the first rule promulgated under Section 6(g) since the 1970s and the second rule ever that relies solely upon the FTC's competition authority.

A 1983 decision from the U.S. Court of Appeals for the Seventh Circuit [agreed](#) with the D.C. Circuit's reasoning in *National Petroleum Refiners*, but no other federal appellate court has addressed the FTC's authority to issue legislative rules under Section 6(g). Whether the FTC possesses such authority remains unsettled; some [commentators](#) have [argued](#) that *National Petroleum Refiners* was wrongly decided and that it is unlikely that modern courts would reach the same conclusion.

In issuing the Non-Compete Rule, the FTC defended its authority to issue substantive rules under Section 6(g) by pointing to the provision's [plain meaning](#) and the D.C. Circuit's [decision](#) in *National Petroleum Refiners*. The FTC also argued that Congress implicitly ratified the D.C. Circuit's decision in both the Magnuson-Moss Act and the [Federal Trade Commission Improvements Act of 1980](#) (the 1980 Amendments). The 1980 Amendments [imposed](#) procedural requirements that the FTC must follow in issuing any "rule." It [defined](#) the term "rule" to include rules promulgated under Section 6 or Magnuson-Moss. The statute excluded from that definition "interpretive rules, rules involving Commission management or personnel, general statements of policy, or rules relating to Commission organization, procedure, or practice." The FTC [argued](#) that this exclusion confirms its authority to issue rules under Section 6 that are *not* merely "interpretive rules, rules involving Commission management or personnel, general statements of policy, or rules relating to Commission organization, procedure, or practice."

The FTC's authority to issue the Non-Compete Rule depends not only on whether Section 6(g) authorizes legislative rulemaking, but also on the scope of Section 5's prohibition of UMC. The [Supreme Court](#) has repeatedly [said](#) that Section 5 is [broader](#) than the Sherman Act and the Clayton Act (the other core federal antitrust laws). However, the scope of this additional coverage—often called the FTC's "[standalone](#)" Section 5 authority—is unsettled.

Under previous leadership, the FTC took a narrow view of its standalone Section 5 authority. In a [2015 policy statement](#), the FTC indicated that decisions to bring standalone Section 5 actions would be guided by considerations of consumer welfare, that the FTC would evaluate challenged conduct under "a framework similar to the rule of reason," and that the FTC was less likely to bring a standalone Section 5 action if enforcement of the Sherman Act or Clayton Act was sufficient to address the relevant competitive harm.

The FTC [rescinded](#) this policy statement in 2021 and issued a [new Section 5 policy statement](#) the following year. In the 2022 policy statement, the FTC [identified](#) "two key criteria" it will consider in evaluating whether a "method of competition" is "unfair." First, the FTC [indicated](#) that "unfair" conduct

“may be coercive, exploitative, collusive, abusive, deceptive, predatory, or involve the use of economic power of a similar nature,” and “may also be otherwise restrictive or exclusionary.” Second, the FTC [explained](#) that such conduct “must tend to negatively affect competitive conditions”—for example, by foreclosing or impairing the opportunities of market participants, reducing competition between rivals, limiting choice, or otherwise harming consumers. The 2022 policy statement [indicated](#) that this second inquiry will not turn on whether conduct directly causes harm in particular cases, but instead will focus on whether conduct “has a tendency to generate negative consequences.”

In promulgating the Non-Compete Rule, the FTC [found](#) that non-competes violate Section 5 because they represent “restrictive and exclusionary conduct that tends to negatively affect competitive conditions” in labor markets and product and service markets. The FTC also [determined](#) that non-competes for workers other than senior executives violate Section 5 because they constitute “exploitative and coercive conduct that tends to negatively affect competitive conditions” in labor markets and product and service markets. (A [previous Legal Sidebar](#) provides a more extensive discussion of the FTC’s justification for the Non-Compete Rule.)

Two FTC Commissioners voted [against](#) the Non-Compete Rule, [arguing](#) that the FTC lacks the authority to issue substantive competition regulations and that the evidence did not justify a categorical prohibition of non-competes.

## Litigation

After the FTC finalized the Non-Compete Rule, various employers and trade groups filed federal lawsuits challenging it. The following subsections review three lawsuits challenging the rule.

### *Ryan LLC v. FTC*

Ryan LLC, a tax services and software provider, filed a [challenge](#) to the Non-Compete Rule in the U.S. District Court for the Northern District of Texas on the day the FTC issued the final rule. The U.S. Chamber of Commerce and several other business associations filed a [similar suit](#) in the Eastern District of Texas the next day, but ultimately intervened in the *Ryan* case as additional plaintiffs. The plaintiffs moved for a stay of the effective date of the rule and a preliminary injunction, raising the following statutory and constitutional challenges:

- **Absence of Statutory Authority.** The plaintiffs [argued](#) that the FTC does not have statutory authority to adopt UMC rules [based](#) on the text, structure, and history of the FTC Act. The plaintiffs also contended that, even if the FTC possesses some form of substantive competition rulemaking authority, Section 5 does not authorize a rule that makes non-competes *per se* illegal.
- **Major Questions Doctrine.** The plaintiffs [argued](#) that the Non-Compete Rule runs [afoul](#) of the major questions doctrine, which requires that agencies have “[clear congressional authorization](#)” to issue rules that involve issues of “[vast economic and political significance](#).”
- **Unlawful Retroactivity.** The plaintiffs [contended](#) that upending existing non-compete clauses [constitutes](#) retroactive rulemaking that is permissible only with clear congressional authorization.
- **“Arbitrary and Capricious” Rulemaking.** The plaintiffs [argued](#) that the Non-Compete Rule is “arbitrary and capricious” and thus violates the [Administrative Procedure Act](#) (APA). Here, the lawsuit [claimed](#) that the FTC [failed](#) to meaningfully consider alternatives to a blanket ban, offered no “reasoned response” to [comments](#) regarding the

rule's effect on partnerships, did not adequately [consider](#) the rule's impact on consumer welfare, and [relied](#) on insufficient empirical data to support its conclusions, among other alleged deficiencies.

- **Non-Delegation Doctrine.** The plaintiffs [asserted](#) that the FTC's interpretation of its rulemaking authority would [produce](#) an unconstitutional delegation of legislative power, lacking the required [intelligible principle](#) to guide executive discretion.
- **Article II and the FTC's Structure.** The plaintiffs [alleged](#) that the FTC is unconstitutionally structured because the FTC Act limits the President's ability to remove FTC Commissioners.

On July 3, 2024, the court [preliminarily enjoined](#) the FTC from enforcing the Non-Compete Rule against the plaintiffs, finding that some of the plaintiffs' claims were likely to succeed on the merits. The court [held](#) that the plain text of the FTC Act authorizes only procedural rules regarding UMC. The court [found](#) further support for this conclusion in the lack of a statutory penalty for violations of rules promulgated under Section 6(g) and in the [location](#) of Section 6(g) within the FTC Act. Reviewing the history of the FTC Act and subsequent amendments, the court [noted](#) the absence of a robust historical pedigree for substantive competition rules. It also [rejected](#) the FTC's arguments that the Magnuson-Moss Act and the 1980 Amendments ratified the agency's substantive competition rulemaking authority. The court thus [concluded](#) that the Non-Compete Rule exceeds the FTC's statutory authority.

The court also [considered](#) the plaintiffs' APA arguments and found a substantial likelihood that the Non-Compete Rule is arbitrary and capricious because it is unreasonably overbroad without a reasonable explanation. The court [criticized](#) the FTC's reliance on a small number of studies on the effects of state regulations of non-competes, highlighting that the state regulations at issue in the studies are narrower than the Non-Compete Rule. The court determined that the FTC failed to [justify](#) the broad sweep of the rule, sufficiently [substantiate](#) its rejection of narrower alternatives, and adequately weigh the benefits of non-compete agreements.

After determining that the plaintiffs were likely to succeed on the merits, the court [found](#) that the [remaining factors](#) in the preliminary injunction analysis, including irreparable harm, also favored the plaintiffs. The court [limited](#) the preliminary injunction to enforcement against the named plaintiffs, but indicated that it would enter a merits disposition by August 30, before the effective date of the Non-Compete Rule. The [parties](#) then [cross-moved](#) for [summary judgment](#), largely restating their prior substantive arguments alongside new briefing on the proper remedy.

On August 20, the court [ruled](#) for the plaintiffs and ordered that the Non-Compete Rule be set aside and not take effect. The court's analysis on the merits was nearly identical to its analysis of the plaintiffs' likelihood of success in the earlier opinion. Unlike its earlier ruling, however, the court [ordered](#) nationwide relief, holding the Non-Compete Rule unlawful and setting it aside under the APA. The FTC has [said](#) that it is [considering](#) an appeal.

### *ATS Tree Services v. FTC*

On July 23, 2024, the U.S. District Court for the Eastern District of Pennsylvania issued a [decision](#) reflecting a more favorable view of the Non-Compete Rule. In *ATS Tree Services v. FTC*, a tree care company [challenged](#) the rule on a variety of grounds, several of which overlapped with the theories advanced by the plaintiffs in the Texas lawsuit. The court rejected the plaintiff's motion for a preliminary injunction, [concluding](#) that the plaintiff failed to show (1) that it would be irreparably harmed without such relief, and (2) a reasonable probability of prevailing on the merits.

The plaintiff had [alleged](#) that it would suffer two types of irreparable harm without a preliminary injunction: nonrecoverable compliance costs and loss of contractual benefits from its existing



non-compete agreements. Citing Third Circuit precedent, the court [rejected](#) the argument that nonrecoverable monetary costs of complying with the rule constituted a valid basis for finding irreparable harm. The court also [determined](#) that the plaintiff's asserted loss of contractual benefits was insufficient to establish irreparable harm because none of the plaintiff's employees had quit or indicated an intention to resign.

The court further [concluded](#) that the plaintiff failed to establish a reasonable probability of success on the merits. The court rejected the plaintiff's argument that Section 6(g) of the FTC Act confers only procedural rulemaking authority, [observing](#) that the plain language of that provision does not include any such limitation. The court also [emphasized](#) that Section 5 of the FTC Act directs the FTC to "prevent" UMC, reasoning that the use of this "inherently forward-looking" language contemplates substantive authorities beyond adjudications that remediate past harm. Reviewing the FTC Act's history, the court [agreed](#) with the FTC that the Magnuson-Moss Act and the 1980 Amendments confirmed the agency's substantive competition rulemaking authority.

After determining that the FTC has substantive competition rulemaking power, the court [analyzed](#) the plaintiff's allegation that the Non-Compete Rule exceeds that power. Here, the plaintiff had [argued](#) that (1) Section 5 requires a case-by-case approach to non-competes that is similar to the rule of reason, (2) the Non-Compete Rule improperly intrudes upon an area traditionally regulated by state law, (3) the Non-Compete Rule violates the major questions doctrine, and (4) the FTC's interpretation of its rulemaking authority would produce an unconstitutional delegation of legislative power.

The court rejected each of these arguments. In upholding the FTC's authority to issue rules that extend beyond the rule of reason, the court [pointed](#) to Section 5 case law holding that the FTC Act has a broader reach than the other federal antitrust laws. The court was also [unpersuaded](#) by the plaintiff's federalism argument, observing that federal antitrust law overlaps with state authority to regulate non-competes. Citing the FTC's past use of Section 6(g) to issue UMC and UDAP rules with significant economic impact, the court likewise [rejected](#) the plaintiff's argument that the Non-Compete Rule runs afoul of the major questions doctrine. Finally, the court determined that the rule did not violate the non-delegation doctrine, [declining](#) to hold that Section 5's prohibition of UMC represented an unconstitutional delegation in the context of rulemaking but not adjudication.

The court thus [denied](#) the plaintiff's motion for a preliminary injunction. In September 2024, the plaintiff [moved](#) for a temporary stay of the proceedings in light of the nationwide relief ordered in the Texas case. The motion [requests](#) a stay until the expiration of the time for the FTC to file a notice of appeal of the Texas decision, a merits appellate decision in the Texas litigation, or another event that changes the scope of the relief ordered in the Texas case such that it would not apply to the plaintiff. The court had not ruled on the plaintiff's motion as of the publication of this Sidebar.

### *Properties of the Villages v. FTC*

Properties of the Villages, a real estate broker, [filed](#) a challenge to the Non-Compete Rule in the U.S. District Court for the Middle District of Florida. Like the plaintiffs in the *Ryan* case, Properties of the Villages argued that the FTC [lacks](#) substantive competition rulemaking authority, that the rule [exceeds](#) the legitimate scope of any authority the FTC might have, and that the rule is unlawfully [retroactive](#) and [violates](#) the non-delegation doctrine. The plaintiff also [argued](#) that, given the geographically limited scope of its non-compete agreements, the Non-Compete Rule applied to purely intrastate activity that did not fall within the federal government's authorities under the Commerce Clause. The plaintiff did not argue that the rule is arbitrary and capricious.

The plaintiff [moved](#) for a stay of the rule's effective date and a preliminary injunction. On August 14, 2024, the court heard oral argument on the motion and [issued](#) an oral ruling in lieu of a written opinion. Evaluating the plaintiff's likelihood of success on the merits, the court [first held](#) that the FTC Act confers

some form of substantive competition rulemaking authority. In addition to the statutory text, the court [cited](#) the *National Petroleum Refiners* case and the Seventh Circuit’s related 1983 decision, as well as the Eastern District of Pennsylvania’s decision in the *ATS Tree Services* case. The court [held](#), however, that the plaintiffs demonstrated a likelihood of succeeding under the major questions doctrine. The court [found](#) that the Non-Compete Rule would affect a significant portion of the American economy. It also [determined](#) that the rule’s political significance and intervention in an area of traditional state regulation bolstered the case for applying the major questions doctrine. While the court acknowledged that the regulation of UMC is within the FTC’s “wheelhouse,” it [concluded](#) that the rule presented a major question given its sweep and breadth.

After deciding that the Non-Compete Rule implicated a major question, the court [ruled](#) that Sections 5 and 6(g) of the FTC Act did not provide a sufficiently clear expression of legislative intent to authorize the rule. The court [relied](#) on text of the provisions, statutory structure, and the FTC’s limited past exercise of its claimed authority. Although the court acknowledged that *National Petroleum Refiners* supports the FTC’s position, it [distinguished](#) the case based on intervening Supreme Court decisions regarding the major questions doctrine and the sweeping nature of the Non-Compete Rule. The court [acknowledged](#) that its assessment of the history of substantive FTC rulemaking, and the implications of that history for the major questions analysis, departed from the Eastern District of Pennsylvania’s conclusions in the *ATS Tree Services* case.

The court [concluded](#) that the plaintiff demonstrated a likelihood of success on the basis of the major questions doctrine, but took pains to explain that it was not assessing the policy questions involved or whether a narrower rule on non-competes might fit within the FTC’s statutory authority. The court then [found](#) that the [other](#) preliminary injunction factors favored the plaintiff and [entered](#) a preliminary injunction limited to Properties of the Villages.

## Considerations for Congress

Some of the issues in the lawsuits discussed above are questions of statutory construction that Congress could potentially clarify in legislation. For example, Congress could clarify whether Section 6(g) of the FTC Act confers substantive rulemaking authority. If made retroactive, legislation that precludes substantive rulemaking under Section 6(g) would presumably invalidate the Non-Compete Rule. Legislation confirming the FTC’s substantive competition rulemaking authority would address one of the core disputes in the litigation challenging the rule, but would not necessarily resolve the relevant constitutional claims or the claims alleging arbitrary and capricious rulemaking.

Other legislative options involve non-compete clauses. Congress could, for example, pass legislation affirming or denying the FTC’s power to issue rules governing non-competes. Alternatively, Congress could pass legislation that directly regulates non-competes. In the 118th Congress, the Workforce Mobility Act ([S. 220](#) and [H.R. 731](#)) would prohibit non-competes, subject to exceptions for the sale of a business or the dissolution of a partnership. [S. 379, the Freedom to Compete Act](#), would adopt a narrower approach and ban non-compete clauses in employment contracts that are subject to the wage and overtime requirements of the Fair Labor Standards Act.

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