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Chair's Corner

We hope 2024 is progressing well for all committee members and will mark another great year in the book of the antitrust-IP interface. We hope many of you can make it to the AIPLA annual Meeting in Washington DC's National Harbor on October 27-29, 2024.

This has been another busy year at the intersection of antitrust and IP. The Federal Trade Commission has continued its long-standing interest in the impact of IP rights on competition in the pharmaceutical sector, focusing recently on Orange Book filings. The FTC also promulgated its final rule on employee noncompetes, which raises issues for trade secret protections. As discussed in Stephen Larson's article for this edition to our newsletter, challenges to that rule have been successful in some courts and unsuccessful in other; the ultimate fate of the rule likely awaits appellate determination. We appreciated the opportunity this year to hear from Senior FTC officials at our periodic committee meetings on these and other important topics and look forward to continuing these conversations in the future.

The current newsletter contains an article on three district court decisions addressing challenges to the FTC's rule significantly limiting non-compete clauses. Two of the three decisions upheld challenges to the FTC's rule, but on different grounds. The reasoning of the three district court decisions may provide some insight into how appellate courts will eventually resolve challenges to the FTC's rule.

Our Committee publishes this newsletter annually. We welcome articles on any relevant topic. To contribute, please contact Stephen Larson at Stephen.Larson@knobbe.com.

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Courts Split on Noncompete Rule

Stephen Larson[1]

Three district courts have now examined the FTC's new noncompete rule, with mixed results: (1) a Texas district court in *Ryan v. FTC* found the FTC did not have the power to issue such a substantive rule and found that the rule is arbitrary and capricious;[2] (2) a Pennsylvania district court in *ATS v. FTC* upheld the rule and denied the plaintiff's request for a preliminary injunction staying the FTC's rule;[3] and (3) a Florida district court in *Villages v. FTC* upheld the FTC's authority to issue a substantive rule, but invalidated the FTC's sweeping rule under the "Major Questions" doctrine.[4] The reasoning of these decisions provides some insight into how appellate courts may eventually resolve challenges to the FTC's rule.

This article first summarizes the FTC's rule. This article then summarizes the reasoning of *Ryan, ATS* and *Villages,* with some emphasis on reasoning relating to the potential impact of the FTC's rule on companies that invest in and rely on intellectual property, including trade secrets, and the protection of confidential information through nondisclosure agreements.

The FTC's Rule

As summarized by the FTC, the FTC's new rule "make[s] it illegal for an employer to:

- enter into or attempt to enter into a noncompete with a worker;
- maintain a noncompete with a worker; or
- represent to a worker, under certain circumstances, that the worker is subject to a noncompete"[5]

The FTC's press release explained that the "proposed rule would apply to independent contractors and anyone who works for an employer, whether paid or unpaid."[6]

The FTC's rule does not apply to: (1) noncompete clauses between a buyer and a seller of a business; and (2) noncompete agreements between a franchisor and franchisees that restrict franchises. "[T]he

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[2] *Ryan, LLC v. Fed. Trade Comm'n*, 2024 WL 3879954 (N.D. Tex. Aug. 20, 2024).

[3] *ATS Tree Servs., LLC v. Fed. Trade Comm'n,* 2024 WL 3511630 (E.D. Pa. July 23, 2024).

[4] *Properties of the Villages, Inc. v. FTC*, 2024 WL 3870380 (M.D. Fla. Aug. 15, 2024).

[5] *FTC Proposes Rule to Ban Noncompete Clauses, Which Hurt Workers and Harm Competition*, Fed. Trade Comm'n (Jan. 5, 2023), *available at* https://www.ftc.gov/news-events/news/press-releases/2023/01/ftc-proposes-rule-ban-noncompete-clauses-which-hurt-workers-harm-competition.

[6] *See id*.

definition of non-compete clause would generally not include other types of restrictive employment covenants—such as non-disclosure agreements ("NDAs") and client or customer non-solicitation agreements . . . ."[7] However, the FTC noted that it may consider such covenants non-compete clauses where "they are so unusually broad in scope that they function as such."[8] The FTC's final rule allowed existing non-competes for senior executives to remain in place.[9]

Ryan v. FTC

Ryan filed its lawsuit on April 23, 2024, and several months later, moved for summary judgment.[10] Ryan attacked the FTC's adoption of the rule on multiple grounds, including the FTC's failure to adequately consider the "litigation costs that businesses are certain to incur when relying on trade-secret suits to protect that information."[11] Ryan also attacked the Commission's dismissal of "the cost of businesses' inability to protect their confidential information" by "assuming (without evidence or analysis) that firms can rely on other tools like nondisclosure agreements" despite "having expressly defined noncompetes broadly enough to sweep in at least some nondisclosure agreements."[12]

The Commission opposed Ryan's motion and filed its own motion for summary judgment. In response to Ryan's arguments regarding the inadequacy of alternatives to noncompete agreements, the Commission stated that it considered these arguments in its rule-making and "explained that non-disclosure agreements, patents, and trade secrets law are the appropriate tools to protect employers' legitimate intellectual property interests—not non-competes that categorically cut off competition in an overbroad manner."[13]

The district court granted summary judgment in favor of Ryan. First, the court found that "the text and the structure of the FTC Act reveal the FTC lacks substantive rulemaking authority with respect to unfair methods of competition, under Section 6(g)."[14] The court observed that "[u]nder Section 6(g) of the FTC Act, the Commission has the power to 'classify corporations and . . . to make rules and regulations for the

[7] FTC Notice of Proposed Rule Making regarding Non-Compete Clause Rule, 16 CFR Part 910, RIN 3084-AB74 at 4 (Jan. 5, 2023), *available at https://www.ftc.gov/system/files/ftc_gov/pdf/p201000noncompetenprm.pdf.*

[8] *See id*.

[9] *Ryan,* 2024 WL 3879954 at *4.

[10] *Id.* at *5.

[11] Pl.-Intervenors' Br. in Supp. of Their Mot. for Summ. J., at 40, Dkt. 169.

[12] *Id*.

[13] FTC's Br. in Supp. of Its Mot. for Summ. J. & in Opp'n to Pls.' Mots. for Summ. J., at 40, Dkt. 186,.

[14] *Ryan,* 2024 WL 3879954 at *12.

purpose of carrying out the provisions of this subchapter.'"[15] The court reasoned that Section 6(g) is "a 'housekeeping statute,' authorizing what the APA terms 'rules of agency organization procedure or practice' as opposed to 'substantive rules.'"[16] The court reasoned that this conclusion is supported by the lack of a statutory penalty for violating rules promulgated under Section 6(g).[17] The court also found this conclusion is supported by "the location of the alleged substantive rulemaking authority": "Section 6(g) is the seventh in a list of twelve almost entirely investigative powers."[18]

Second, the court found that the rule "is arbitrary and capricious because it is unreasonably overbroad without a reasonable explanation."[19] The court observed that "[t]he Rule 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."[20] As the court explained, "the Commission relied on a handful of studies that examined the economic effects of various state policies toward non-competes[,]" but the "record shows no state has enacted a non-compete rule as broad as the FTC's Rule."[21] The court further observed that 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."[22] The court also found that the FTC failed to sufficiently address alternatives to issuing the Rule."[23]

ATS v. FTC

In *ATS v. FTC,* the district court in the Eastern District of Pennsylvania upheld the FTC's rule when denying a preliminary injunction.[24] The *ATS* court found that the plaintiff failed to establish irreparable harm and a likelihood of success on the merits.

The *ATS* court largely rejected the plaintiff's irreparable harm arguments as unsupported or speculative. For example, the court found the plaintiff failed to provide sufficient evidence to justify an asserted fear that employees would leave the company in the absence of noncompete protection.[25] The court also observed that, to "the extent ATS fears losing proprietary training information

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[15] *Id.* at *12 (quoting 15 U.S.C. § 46(g)).

[16] *Id.* at *9 (quoting *Chrysler Corp. v. Brown*, 441 U.S. 281, 310 (1979)).

[17] *Id.* at *10.

[18] *Id.*

[19] *Id*. at *13.

[20] *Id*. (internal quotations omitted).

[21] *Id*.

[22] *Id*.

[23] *Id*.

[24] *See ATS Tree Services, LLC v. Federal Trade Comm'n,* 2024 WL 3511630 (E.D. Pa. Jul. 23, 2024).

[25] *See id.* at *10.

to competitors, the Rule highlights less harmful alternatives it may choose to implement to allay such concerns, such as non-disclosure agreements:

> NDAs provide employers with another well-established, viable means for protecting valuable investments. NDAs are contracts in which a party agrees not to disclose and/or use information designated as confidential. If a worker violates an NDA, the worker may be liable for breach of contract. Employers regularly use NDAs to protect trade secrets and other confidential business information . . . . [T]he final rule will not prevent employers from adopting garden-variety NDAs; rather, it prohibits only NDAs that are so overbroad as to function to prevent a worker from seeking or accepting employment or operating a business. Appropriately tailored NDAs burden competition to a lesser degree than non-competes.[26]

When finding a lack of a likelihood of success, the *ATS* court rejected the argument that the FTC lacked the authority for substantive rulemaking.[27] The court observed that "[n]either the word 'procedural' nor the word 'substantive' appears in the text of Section 6(g), and the Court will not infer meaning from that absence, particularly as the ordinary meaning of the text speaks for itself."[28] The court observed that, in "Section 6, entitled 'Additional powers of Commission,' Congress provided the FTC with the power 'to make rules and regulations for the purpose of carrying out the provisions of this subchapter."[29] The court reasoned, based on the plain text, that "Section 5 creates a comprehensive scheme to 'prevent . . . unfair methods of competition,' and Section 6 enumerates additional powers for the FTC to employ in realizing its directive."[30]

The court reasoned that the directive to "prevent" inherently contemplates substantive rulemaking because adjudication would only provide a responsive or remedial method of addressing unfair methods of competition.[31] The court also relied on Congress' adoption of amendments after some court decisions found the FTC had the power to issue rules to prevent unfair competition.[32] The court reasoned that "Congress could have limited the FTC's substantive rulemaking authority on multiple

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[26] *See id*.

[27] *See id.* at *12-16.

[28] *Id.* at *13.

[29] *Id.* (quoting 15 U.S.C. § 46(g)).

[30] *Id.* (quoting 15 U.S.C.A. § 45(a)(2)).

[31] *Id.* at *14.

[32] *Id.* at *15 (citing *Nat'l Petroleum Refiners, Ass'n v. FTC*, 482 F.2d 672, 673 (D.C. Cir. 1973)).

occasions, including during the 1975 Amendments convention, but it did not."[33]

The court rejected the plaintiffs' argument that, even if the FTC had authority, the FTC exceeded it by banning all non-compete clauses.[34] The court specifically rejected the argument that a rule-of-reason analysis was necessary, and found that the FTC "determined through an extensive and thorough research and rule-making process, with over 26,000 public comments, that non-compete clauses are not justified by legitimate business purposes" and are "exploitative and coercive."[35]

The court also found that the rule did not "raise issues of federalism due to its overlap with states laws" because "states and federal government have shared jurisdiction in this area . . . ."[36] The court further found that because "the FTC's Rule falls squarely within its core mandate, and it has previously used its Section 6(g) rulemaking power in similar ways, . . . the Major Question Doctrine is not applicable."[37]

Finally, the court rejected the argument that "Congress unconstitutionally delegated legislative authority to the FTC in authorizing substantive rulemaking under Section 6(g) . . . ."[38] The court observed that "Only twice in this country's history has the Court found a delegation excessive, in each case because 'Congress had failed to articulate any policy or standard' to confine discretion," which is not the case under Section 6(g).[39]

Villages v. FTC

The court in *Properties of the Villages, Inc. v. FTC* invalidated the FTC's rule, but on different grounds than *Ryan*.[40] In an oral ruling, the court remarked that it had read the *Ryan* and *ATS* decisions. The court largely agreed with the *ATS* court's analysis, including that the FTC had authority for substantive rulemaking under Section 6(g).[41] However, the court disagreed with the *ATS* court that the "Major Question Doctrine" is not applicable.[42]

The court explained that "[u]nder the major questions doctrine, the Court assumes that Section 6(g) of the FTC Act grants some type of substantive rulemaking authority and that there's a plausible textual basis for it. But the question is: Does it grant the FTC the

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33 *Id.* at *15.

34 *Id.* at *16.

35 *Id.* at *17 (internal quotation omitted).

36 *Id.*

37 *Id.* at *18.

38 *Id.*

39 *Id.*

40 *Properties of the Villages, Inc. v. Federal Trade Comm'n*, 2024 WL 3870380 (M.D. Fla. Aug. 15, 2024).

41 *Id.* at *5.

42 *Id.*

authority to issue this particular rule?"[43] The court observed that "the Commission estimates that one-fifth of American workers, or approximately 30 million employees, are subject to a non-compete that would be affected by this rule."[44] The court colorfully borrowed from Justice Barrett's concurring opinion in *Biden v. Nebraska*, explaining that "if a parent gives a babysitter a credit card and says 'make sure the kids have fun while we're out, the parent might expect that the babysitter would take the kids out for ice cream, but would not expect the babysitter to take the kids on an overnight trip to Las Vegas. Likewise here: Without clear Congressional permission, the final rule, the FTC's equivalent of a trip to Las Vegas, is unauthorized."[45]

Conclusion

The *Ryan*, *ATS* and *Villages* decisions may result in a circuit split the Supreme Court will eventually have to resolve. If the overall reasoning of these decisions provides any guidance as to the ultimate outcome, they suggest that the FTC has some substantive rulemaking authority, but the FTC's noncompete rule is too broad in scope and impact.

Specifically, two of the three courts (*ATS* and *Villages*) agreed that the FTC had some authority to engage in substantive rulemaking under Section 6(g). However, two of the three courts (*Ryan* and *Villages*) took issue with the sweeping scope of the FTC's rule, which invalidates millions of private contracts and trumps the laws of forty-seven states that permit noncompete agreements in some capacity. The *Ryan* court found the rule to be arbitrary and capricious, whereas the *Villages* court found that such a sweeping rule implicated the "Major Question Doctrine" questioning whether Congress granted the FTC authority to issue such a rule.

A final decision invalidating the FTC's noncompete rule may be welcome news to companies that invest in and rely heavily on confidential information and intellectual property, including trade secrets. Of particular concern is the FTC's guidance that it may consider nondisclosure agreements and non-solicitation agreements as noncompete agreements where they are so broad in scope that they function as such. In addition, trade secret law and nondisclosure agreements may not be effective substitutes for non-compete agreements.

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[43] *Id*. at *6.

[44] *Id*.

[45] *Id*. at *9.