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GUEST COLUMN

Non-competes no more?

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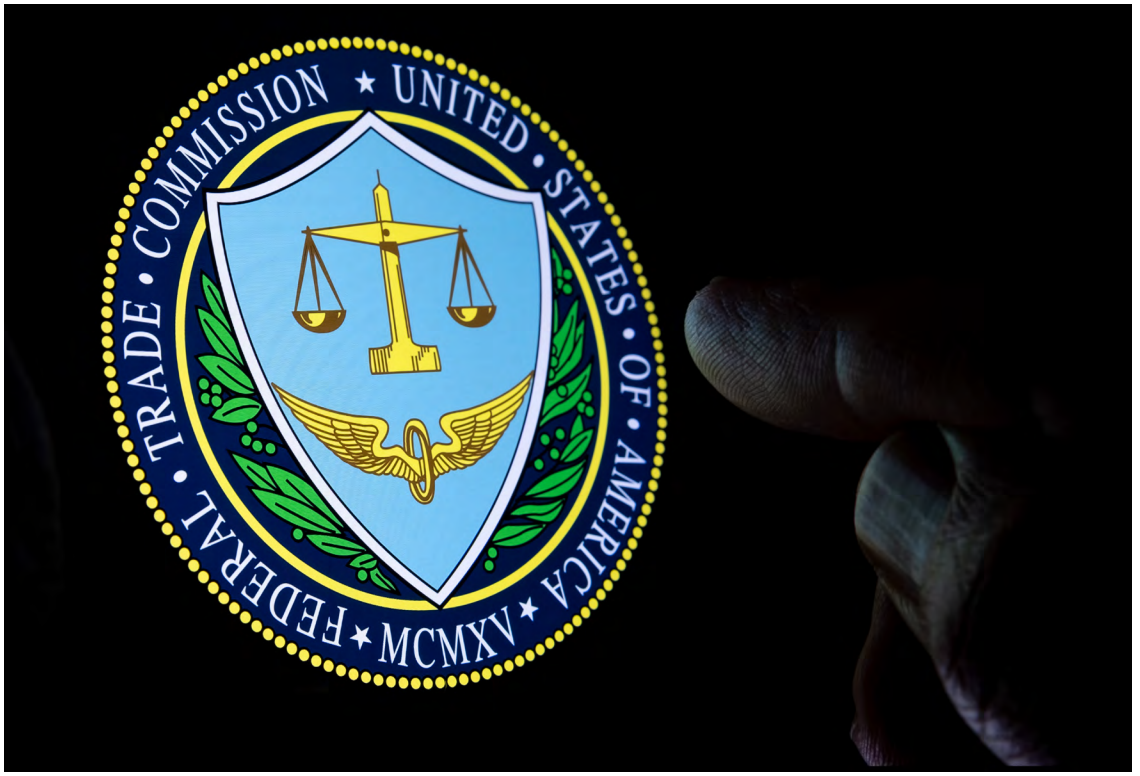

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On Jan. 5 the FTC issued a Notice of Proposed Rulemaking for a Non-Compete Clause Rule (NCCR) that would, if promulgated in its current form, classify non-compete agreements between employers and their workers as an unfair method of competition and functionally prohibit them altogether except in connection with the sale of a business. The Proposed Rulemaking would apply to both employees and independent contractors, whether paid or unpaid, externs, interns and volunteers. The NCCR was an unprecedented move by the FTC, both because the agency had not previously attempted to regulate non-competes and because it invoked FTC Act Section 5 as the sole source of substantive rulemaking authority.

Until 2022, the FTC has challenged non-compete agreements under Section 5 of the FTC Act only once in litigation in *Snap-On Tools Corp. v. FTC*, 321 F.2d 825 (7th Cir. 1963). That challenge was not successful, as the Seventh Circuit determined that the non-compete provision at issue did not violate Section 5, reasoning that "[r]estrictive [non-compete] clauses . . . are legal unless they are unreasonable as to time or geographic scope." *Id*. at 837.

Competition regulators and private parties have more often challenged non-compete clauses under Section 1 of the Sherman Act or state law equivalents, although they have been largely unsuccessful in those cases. See NCCR fn. 183. Courts have generally determined that when evaluating non-compete clauses under the Sherman Act, they need to carefully consider the procompetitive justifications for the restraints. *Consultants & Designers, Inc. v. Butler Serv. Grp., Inc.*, 720 F.2d 1553 (11th Cir. 1983). Defendants have typically argued that non-compete clauses are procompetitive, because they provide employers an incentive to train their employees and protect trade secrets efficiently without having to litigate once the damage is done or ongoing by a former employee.

The various states, however, have adopted a wide array of employment statutes to regulate non-compete agreements to varying degrees. The spectrum of state law ranges from California, North Dakota, and Oklahoma, which have prohibited their use in almost all instances, to Colorado, Illinois, Oregon and the District of Columbia, where non-competes are illegal for workers making below certain amounts (e.g., $101,250 in Colorado), to Nevada and Massachusetts, where these agreements are disallowed for hourly or non-exempt workers. Still other states prohibit the use of non-competes with individuals in particular professions, such as physicians, broadcasters, and technology workers. Other states evaluate non-competes by using a reasonableness test analogous to the federal antitrust approach. The FTC's Proposed NCCR would displace existing state laws (unless those laws are even more restrictive of non-compete agreements), and replace them with a blanket prohibition such as the one in California.

For now, the NCCR is just a proposal – it will not become final until the public comment period ends on March 20, and the FTC has had an opportunity to review the comments. And, although the FTC's aggressive enforcement stance on labor market restrictions during the current administration indicates that the agency is unlikely to meaningfully modify the rule based on public comments,

such a modification is not out of the question. The FTC has asked for comments on specific alternatives that would change the scope of the proposed rule, such as whether the rule should apply to higher wage workers and whether there should be a rebuttable presumption of unenforceability. After the FTC reviews public comments and promulgates the final version of the rule, businesses would have a 180-day safe harbor period to comply.

Critics of the proposed rule, such as dissenting FTC Commissioner Christine S. Wilson, have noted that it is an unlawful and unconstitutional expansion of the FTC's authority that is almost certain to be challenged on multiple grounds. For example, interested parties could challenge the FTC's authority to issue the NCCR under the "major questions doctrine," which generally requires that an administrative agency have clear congressional authorization before it regulates matters of major economic significance. A challenge along those lines would argue that the FTC lacks a clear source of congressional authority to issue the proposed NCCR. The proposed rule could also be challenged as an unconstitutional delegation of Congress's legislative power to an administrative agency.

A meritorious challenge to the NCCR could delay the earliest date for non-compliance further, as a court may issue a preliminary injunction halting enforcement of the NCCR while a challenge is decided. Having said that, many state laws (like California's Unfair Competition Law) allow plaintiffs to sue for conduct that is unlawful under federal law. Suits under these more generic unfair competition statutes may follow and may not be stayed pending any legal challenge to the NCCR. Further, once the NCCR is finalized and after the end of the safe harbor period, the FTC could impose penalties of up to $50,120 per day of non-compliance.

Employers should be aware that the FTC may challenge extremely overbroad non-competes even before the final version of the rule is finalized. On Dec. 28, 2022, for example, the agency secured two consent decrees from companies that agreed to terminate their non-compete provisions. In one of these cases, a company imposed a two-year non-compete on low-wage security guard workers that provided for $100,000 in liquidated damages in case the agreement was violated. In another case, a company imposed a non-compete on glass manufacturing workers that prevented them from seeking employment at a competitor anywhere in the United States for a year after termination of employment.

The FTC is thus likely to continue challenging non-compete agreements that apply to low-wage workers, that have large liquidated damages provisions, and that have a broad geographic scope, as these types of agreements are less likely to have a legitimate business justification. Further, as Elizabeth Wilkins, Director of the FTC's Office of Policy Planning, made clear during a Jan. 12 conference call, the FTC plans to apply the NCCR to "de facto" non-compete provisions, such as onerous non-solicitation or training repayment agreements, or overbroad non-disclosure agreements that functionally prevent employees from leaving their employer. Wilkins also made clear that "run-of-the-mill training repayment agreements, such as agreements to repay a $1,000 training cost, provided that the training did cost $1,000, as well as "garden variety" non-solicitation provisions will not be viewed as de-facto non-competes.

Businesses should take this time to review, in consultation with antitrust and employment counsel, their employment-related contracts carefully to ensure that they comply with current laws and to plan for the FTC's regulatory efforts.

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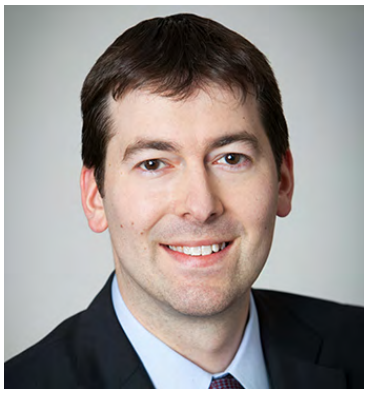
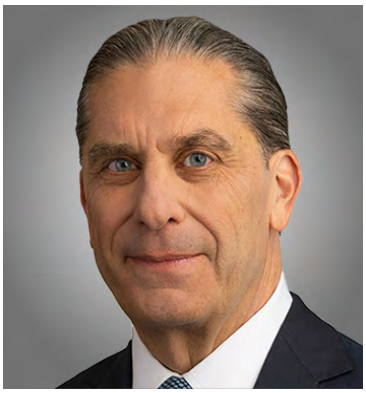
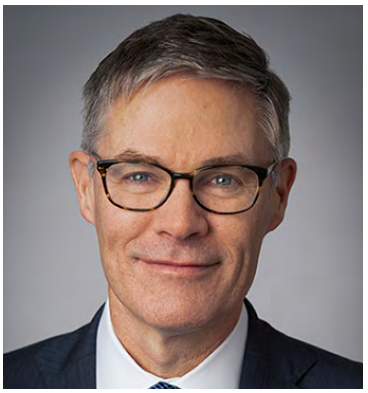

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