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COMMENTARY

Non-Compete Agreements—Preventing Unfair Competition or Unfairly Preventing Competition?

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In January 2023, the Federal Trade Commission ("FTC") announced proposed rules that would effectively ban non-compete agreements, citing concerns regarding competition and harmful effects on workers.[1] A non-compete agreement is a contractual provision or document provided by an employer to an employee, that stipulates conditions restricting the employee's ability to work in a particular industry or geographic region for a period of time following the termination of their employment. Proponents assert that these restrictions help prevent unfair competition. The proposed rules would invalidate existing non-competes, ban new ones, and require employers to inform their employees that their non-competes are no longer in effect.[2] An estimated eighteen percent of workers in the United States are subject to such an agreement.[3] Advocates for workers' rights oppose non-competes on the grounds that they prevent individuals from switching jobs and earning higher wages, and remove incentive for employers to improve working conditions.[4] The FTC references these issues in its briefing, as well as its intention

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

[2] *Id.*

[3] *Id.*

[4] Norman D. Bishara & Michelle Westermann-Behaylo, *The Law and Ethics of Restrictions on an Employee's Post-Employment Mobility*, 49 AM. BUS. L.J. 1, 45 (2012).

to improve "healthy competition."[5] If approved, the ban could reshape employer-employee relations, though it will certainly face legal challenges on the way.

Non-compete agreements have historically been permitted due to concerns over unfair competition by former employees with their employers' businesses. This blanket ban implicates the tension between differing policy perspectives on contracts—whether the law should promote freedom of contract or advance social goals. The ban would affect companies large and small, the workforce, and the market as a whole, but it is unclear to what extent. Finally, the ban would supersede state laws, which in most states are already restrictive regarding enforceability of non-competes. The proposed ban thus may be either redundant or require states to be permissive toward unfair competition as well as healthy competition. To be considered beneficial, this ban will need to balance the needs of opposing stakeholder groups while taking economic effects into account.

The most notable policy argument in favor of non-competes is freedom of contract. This theory posits that the law should give deference to the intent of the contracting parties, so long as they are adults who knowingly and voluntarily assented to the contract. However, in situations where a non-compete agreement is a standard provision in a company's offer letter or employment contract, workers may face pressure to agree as a condition of their employment, without sufficient time to consider and negotiate. This implicates the policy perspective that the law should regulate contracts to promote the common good. While many state non-compete laws analyze factors such as education, consideration, access to legal representation, financial situation, and time to consider the agreement when determining whether assent was knowing and voluntary, the difference in sophistication and resources between the average worker and company raises the question of whether non-competes are ever truly knowing and voluntary.[6] Invalidating all non-competes thus arguably advances a social goal, freedom to change jobs, by limiting the freedom of contracting parties.

The FTC estimates the ban will increase workers' total earnings by $300 billion, help close gender- and race-based wage gaps, and improve working conditions.[7] There is certainly research that supports these claims, but it is challenging for economists to pin down exact figures.[8] Many people who are

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[5] FED. TRADE COMM'N, *supra* note 1.

[6] *See* Progressive Techs., Inc. v. Chaffin Holdings, Inc., 33 F.4th 481, 485 (8th Cir. 2022); Puentes v. United Parcel Serv., Inc., 86 F.3d 196, 198 (11th Cir. 1996); Lakeside Oil Co. v. Slutsky, 98 N.W.2d 415, 417 (Wis. 1959).

[7] FED. TRADE COMM'N, *supra* note 1.

[8] Erik J. Winton et al., *Against the Evidence: How the FTC Cast Aside the Input of Experts at Its Own Non-Compete Workshop*, JACKSON LEWIS P.C. (Feb. 7, 2023), https://www.jacksonlewis.com/publication/against-evidence-how-ftc-cast-aside-input-experts-its-own-non-compete-workshop.

subject to a non-compete occupy blue collar jobs in industries such as construction and hospitality and fifteen percent have attained less than a college degree.[9] It is easy to see how sophisticated parties could use non-compete agreements to their benefit and to the detriment of unsophisticated parties with fewer resources. Many workers may not know their rights and may not be able to afford to bring an action against an employer even if the non-compete in question would severely limit their job opportunities.

Limitation of job opportunities is one of the FTC's chief concerns. Even agreements that would not ordinarily be considered a non-compete may come within the ambit of these new regulations, because the FTC has proposed a functional test.[10] Under this test, if a contractual provision operates as a *de facto* non-compete clause, meaning "it has the effect of prohibiting the worker from seeking or accepting employment . . . or operating a business after the conclusion of the worker's employment with the employer" it is prohibited.[11] Thus employers cannot simply craft an agreement intended to produce the same effect under a different name. Despite this, the FTC's proposed rules would not extend to all restrictive covenants, so non-solicitation agreements and non-disclosure agreements will remain enforceable unless they are so restrictive that they effectively act as a non-compete.[12]

In the corporate context, non-competes are often used to restrict executives and partners from taking advantage of their resources and insider knowledge after leaving these roles and involve significant negotiation with both parties represented by counsel. Eliminating non-competes may remove deterrents for high-level employees and allow them to compete unfairly with their former employer until or unless legal action is brought. Even so, this is likely moot due to the resources of the parties involved—an established corporation will typically have patents, trademarks, and other protections in place on their products or services. Non-competes are also frequently used by businesses in relationship-based industries such as sales and distribution, which rely on restrictive covenants to protect trade secrets and customer lists. However, companies will still be able to use non-

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[9] Alexander J.S. Colvin & Heidi Shierholz, *Noncompete Agreements*, ECON. POL'Y INST. (Dec. 10, 2019), https://www.epi.org/publication/non-compete-agreements/; U.S. DEP'T TREASURY, NON-COMPETE CONTRACTS: ECONOMIC EFFECTS AND POLICY 4 (2016) https://home.treasury.gov/system/files/226/Non_Compete_Contracts_Econimic_Effects_and_Policy_Implications_MAR2016.pdf.

[10] Non-Compete Clause Rule, 88 Fed. Reg. 3482 (proposed Jan. 19, 2023) (to be codified at 16 C.F.R. pt. 910).

[11] *Id.*

[12] Clifford R. Atlas et al., *A Deeper Dive into FTC's Proposed Non-Compete Rule*, JACKSON LEWIS P.C. (Jan. 10, 2023), https://www.jacksonlewis.com/publication/deeper-dive-ftc-s-proposed-non-compete-rule.

solicitation and non-disclosure agreements to protect these assets. Additionally, according to the Department of the Treasury, only about twenty-four percent of workers possess trade secrets, so the concern may be disproportionate.[13]

Ultimately, non-competes may harm the workforce while offering little-to-no benefit to employers, for two reasons. First, several states, including California, Nevada, Maryland, Virginia, North Dakota, and Oklahoma have already banned non-competes outright or severely restricted their use, rendering them unenforceable in those jurisdictions.[14] Secondly, if there is a state law cause of action, non-competes are costly to enforce if violated, because they are disfavored and construed strictly in favor of the employee.[15] Even in a favorable outcome, the remedies available typically do not reach beyond the employee's limited resources, and the most common remedy is injunction, rather than an award of monetary damages.[16]

As discussed above, most states that permit non-competes construe them strictly in favor of the employee, and in many, non-compete agreements are restricted or prohibited.[17] The FTC derives their authority to supersede these state laws from a federal unfair competition law.[18] There are complex administrative law questions surrounding this interpretation, and the FTC's authority is likely to be the subject of legal action if the ban is effectuated. Courts may use *Chevron* to analyze whether the FTC appropriately construed its statutory authority.[19] Under *Chevron*, courts conduct a two-part inquiry. Simply put, the inquiry is: 1) whether congress's intent is clear, and 2) if it is not, whether the agency's action is based on a "permissible construction" of the statute.[20]

Even if the ban passes the *Chevron* test, there is a contention that it would violate the "major questions" doctrine in *West Virginia v. EPA*.[21] Under this doctrine, because of the breadth and nature of the ban, a court could require the FTC to point to "clear congressional authorization" of its noncompete

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[13] OFF. ECON. POL'Y, *supra* note 9.

[14] THOMSON REUTERS, 50 STATE STATUTORY SURVEYS: EMPLOYMENT: PRIVATE EMPLOYMENT, NON-COMPETE AGREEMENTS, 0060 SURVEYS 23 (2021, West).

[15] *Id.*

[16] *Id.*

[17] *Id.*

[18] Interestingly, this claimed authority does not extend to banks, federal credit unions, air carriers, common carriers, and meat and poultry dealers, under the code. 15 U.S.C. § 45(a)(2) (2006).

[19] Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837, 842, 104 S. Ct. 2778, 2781, 81 L. Ed. 2d 694 (1984).

[20] *Id.*

[21] W. Virginia v. Env't Prot. Agency, 213 L. Ed. 2d 896, 142 S. Ct. 2587, 2608 (2022) (discussing how the "major questions doctrine" necessitated greater scrutiny of a claim of Congressionally-bestowed authorization for agency actions in "extraordinary cases" where the action is broad, and there are significant economic and political consequences).

rulemaking.[22] Historically, the FTC has a record of denouncing this authority rather than affirming it, and explicit authorization is a challenging standard to meet.[23] Thus, the ban may not survive a legal challenge to the FTC's authority. If it does, because market effects are yet unknown, concern about the negative impact of these broad rules is not entirely misplaced. On balance, the success of the ban will turn on whether the benefits to individuals in the workforce will be significant enough to outweigh any negative economic impact.

[22] *Id.*

[23] Fed. Trade Comm'n, *Dissenting Statement of Commissioner Christine S. Wilson Regarding the Notice of Proposed Rulemaking for the Non-Compete Clause Rule* (Jan. 5, 2023), https://www.ftc.gov/system/files/ftc_gov/pdf/p201000noncompetewilsondissent.pdf.