Employee Relations
LAW JOURNAL

The Federal Trade Commission Enters the Noncompete Political Arena

By Mark A. Konkel and Shea O'Meara

In this article, the authors review the Federal Trade Commission's proposed noncompete rule, how it will likely evolve over months of notice-and-comment, the legal challenges brewing to end it, and what employers should consider moving forward.

The political battle around noncompetes just got a major boost from the Federal Trade Commission (FTC or Commission). In a bold new move, the Commission announced a historic new rule that would ban nearly all noncompetes nationwide. While this proposed rule is incredibly unlikely to survive in its nascent state, it does provide considerable insight into how these employment agreements will be scrutinized in the future. Employers would be wise stay ahead of this shifting legal landscape.

To that end, this article reviews the Commission's proposed rule, how it will likely evolve over months of notice-and-comment, the legal challenges brewing to end it, and what employers should consider moving forward.

WHAT HAS THE FTC ACTUALLY PROPOSED?

The FTC's ban is both sweeping and simple: Employers would be prohibited from entering into, attempting to enter into, or maintaining a noncompete agreement. The proposed rule defines these would-be-illegal provisions as "a contractual term between an employer and a worker that prevents the worker from seeking or accepting employment with a person, or operating a business, after the conclusion of

Mark A. Konkel (mkonkel@kelleydrye.com) is a partner in the New York office Kelley Drye & Warren LLP. Shea O'Meara (someara@kelleydrye.com) is a law clerk in the firm's New York office.

the worker's employment with the employer." This would cover agreements made both at the start and throughout an individual's employment. It would also make it considerably easier (and more lucrative) for employees to leave a job and either go work for a direct competitor or launch an enterprise of their own. This is true regardless of how important such a restriction may be to protecting an employer's confidential information, strategies, client relationships, or even trade secrets.

The Commission pulls few punches in its intended scope. Nearly all employees and employers would be subject to the proposed rule. Employees (workers) are broadly defined to include independent contractors, interns, volunteers, and others – paid or unpaid. There's no distinction between large or small employers. Even more striking, the rule would cover *any* employee, whether they make minimum wage or millions. As initiated, the rule makes no distinction the C-suite, high-level directors, business or creative managers, and entry-level assistants or temporary hires. This includes a notably lack of deference for union workers and collective bargaining rights.

From the FTC's current vantage, no employer would retain its ability to restrict employment using a noncompete. The sole existing exception the rule would be for agreements made in connection with business sales and franchise agreements. This position is far outside the norm of state law, which the Commission has seemingly acknowledged. It has signaled some openness to differentiating between types of employees, particularly executives and highly-skilled or paid workers, and has asked for comment on this issue. This is likely to become a lightning rod in the public comments with employers and industry groups pushing the Commission to consider less politically reactive uses of noncompetes than those it references in its rulemaking. Notably, the Commission points to examples of highly restrictive covenants imposed blindly and broadly on low-wage and low-skilled workers like those in manufacturing and sandwich-making. Under existing state law tests, these more egregious examples would be disfavored as overly broad and not narrowly tailored.

With credit for thoroughness, the rule includes several additional measures to ensure compliance. Employers would be prohibited from representing to an employee that they are subject to a noncompete without a good faith basis to believe the worker is actually subject to an enforceable agreement. The rule would also prohibit de facto noncompete agreements, defined as clauses that have "the effect of prohibiting the worker from seeking or accepting employment with a person or operating a business after the conclusion of the worker's employment with the employer." Under this standard, agreements would be subject to a "functional test" to determine whether an otherwise lawful clause is truly a prohibited noncompete. While this would likely be subject to legal (and judicial) debate, the rule expressly questions nondisclosure agreements and training reimbursement requirements.

Even more, under the rule, employers would have an affirmative burden of notifying their current and former workers that any existing noncompete agreement is rescinded. Compliance would be mandatory within 180 days of the final rule and the FTC estimates $1.02 to $1.77 billion in one-time costs associated with direct compliance.

WHAT IS DRIVING THE FTC'S RULEMAKING?

The Biden Administration has left little doubt on its sentiments toward noncompetes. In 2021, the president issued an executive order condemning these agreements as unfair restraints of competition. He also called on the FTC to investigate its own ability to curb their use. In response, the FTC has proposed a rule that would regulate almost every labor and service relationship in the country.

While noncompetes are often associated with highly-skilled, high-wage employees like corporate executives, they are also used in some lower-paid workforces. According to the Commission, an estimated 30 million people – about one in five American workers – are currently bound to one. The Commission provides an in-depth review of the pros and cons of noncompetes and ultimately found these agreements do more harm than good. It draws heavily from public research, including a host of academic journals. On the legal front, it points to less restrictive alternatives like nondisclosure agreements and trade-secret laws as delivering the benefits without the costs.

The Commission's analysis of noncompetes points to an increasingly popular way for skeptics to think about them: as unfair methods of competition. Rather than considering noncompetes from the employee/employer perspective, the proposed rule analyzes them more broadly in terms of their potential effects on both the labor market and the American economy more broadly. The FTC estimates that the proposed rule would increase workers' earnings across industries by $250 to $296 billion per year. It also estimates that the rule would save consumers up to $148 billion annually in health care costs while vastly increasing the number of new, competitive start-ups launched each year.

As has also become popular among noncompete skeptics, the FTC looks to state law trends in justifying its rulemaking. This federal initiative aside, noncompetes are creatures of state law. While certain states – notably California – are more restrictive, states generally look to whether a restriction is reasonable. A court asked to enforce a noncompete will consider whether that agreement is narrowly tailored and protects a legitimate business interests. This often includes looking at the duration, the geographic range, and the employer's broader justification for the restriction. Protecting trade secrets, confidential information, and training investments are generally considered legitimate interests.

In recent years, some states have passed statutes restricting noncompetes on the basis of a worker's earning or some similar factor. Some

new and notables are Washington D.C. (targeting employees earning less than $150,000 or $250,000 if they are a medical specialist), Maryland (focusing on employees earning $15 per hour or $31,200 per year or less), Virginia (protecting those who earn less than the Commonwealth's weekly average), and Colorado (narrowing in on the "highly compensated worker"). Even among states that have cracked down on noncompetes, there are a broad range of exemptions that make the laws considerably more nuanced than the FTC's inaugural noncompete ban. That said, if the FTC rules takes effect, it would supersede any state statute, regulation, order or interpretation that is inconsistent with it. The Commission has expressly allowed, however, any such state provision that would be more protective of workers.

WILL THIS RULE SURVIVE?

First things first: The rule is subject to a public notice-and-comment period. In short, the FTC must collect and consider public comments before promulgating a final rule.

By design, proposed rules are often broad and leave room for some winnowing and reconsidering. The FTC's proposal contains several specific questions and Chair Lina M. Khan issued a statement encouraging a broad swath of market participants, including those with firsthand experience using noncompetes, to submit comments. Of particular importance to employers, the FTC has asked for comment on: (1) whether senior executives or other highly paid workers should be exempt; (2) whether other legal tools like trade secrets law and confidentiality agreements are sufficient to safeguard their investments and interests in the absence of enforceable noncompetes; (3) whether the FTC should adopt a "rebuttal presumption" that noncompetes are unlawful in lieu of an outright ban; and (4) whether any other alternative to the FTC's rule may better serve workers and employers. We already have seen thousands of public comments come in, though an analysis from the FTC is still months away.

And next: The court challenges. Because it is so broad, this proposed rule is particularly vulnerable. Among the host of questions is whether the FTC Act gives the Commission "unfair methods of competition" rulemaking authority. There is considerable debate over the specific provision of the Act – Section 6(g) – which the FTC relies on for this rulemaking. Second, can the FTC actually preempt state law on this issue? In vague terms, the Commission's ability to preempt state laws through regulation depends on the strength of its grant of authority from Congress. Did Congress actually empower this agency to upset state law on this issue? Would this conflict with collective bargaining rights typically regulated by the National Labor Relations Board? And finally, would this rule be subject to a Supreme Court strike-down under the Major Question Doctrine or as "arbitrary and capricious?"

Even in the unlikely scenario that the FTC comes out victorious and its authority is vindicated by the court system, the litigation will hardly dry up. For instance, the rule allows state laws that are more protective of workers. But who will decide whether a specific provision of a law is less or more protective? The FTC or the courts? And even more, how will companies determine whether the agreement they hope to enforce is actually a *de facto* noncompete? What exactly does "function like a noncompete" mean? And how much will employers be expected to spend – both in time and money – to make these determinations?

IS THIS RULE THE BEGINNING OR THE END?

Noncompetes are in the midst of a political firestorm and these challenges aren't going away any time soon. There has been some reporting that state attorneys general are embracing the FTC's theory that noncompetes can constitute "unfair and deceptive practices." Every state has an Unfair or Deceptive Acts or Practices (UDAP) statute that prohibits unfair or deceptive trade practices, many of which are broadly construed in the interest of protecting consumers. State AGs often take their cues from federal agency agendas and some may attempt to restrict noncompete use through their own state UDAP statutes. These statutes also generally provide a private right of action, allowing private plaintiffs to bring a claim and seek damages. This could mean new litigation from two groups of plaintiffs: (1) current and former employees who signed a noncompete and now argue it is an unfair or deceptive trade practice, and (2) consumers who theoretically paid higher prices because of a company's use of noncompetes which stifled competition and raised prices. Even if ultimately unsuccessful, this type of lawsuit may burden larger employers who use noncompetes indiscriminately.

And on the heels of the FTC rulemaking, a bipartisan coalition of U.S. Senators and Representatives have reintroduced the "Workforce Mobility Act," which would codify the use of employment non-competes as an unfair trade practice under federal law and prohibit their use except in certain circumstances. There is similarly some chatter that states may follow suit.

Even before a final rule is promulgated (if one is), the FTC can still bring enforcement actions under Section 5 of the FTC Act, as shown by two it announced (against three companies and two individuals) on the eve of launching this rulemaking. In these first-of-their-kind cases, the FTC argued that the noncompete agreements at hand – including one and two-year post-employment restrictions for workers including security guards, manufacturing workers, and engineers – constituted prohibited unfair methods of competition. The companies were ordered to cease imposing the relevant restrictions and to cease enforcing (and threatening to enforce) the noncompetes. The employers were also required to

notify affected employees that they were no longer bound by the existing agreement. In many ways, this order mirrors the requirements under the proposed rule with a similar focus on lower-wage employees.

WHAT SHOULD EMPLOYERS DO TO PREPARE?

Given the evolving landscape around noncompete law, prudent actions include:

- *Submitting or Supporting a Public Comment*. Companies interested in submitting a comment, or supporting a broader industry group comment, should contact counsel for guidance quickly.

- *Review Agreements, Past and Present*. While there's no immediate need to take action, employers should be aware of how various state laws already impact the enforceability of these agreements. This includes reviewing contracts and terms for existing employees as well as former workers who may still be subject to noncompetes or related restrictions.

- *Prepare for New Negotiation Dynamics*. The proposed rule would become effective 60 days after the rule is published but delay compliance for 180 days after publication. It also would offer a 45-day period to provide employees notice of any rescissions – if it does not succumb to legal challenges. That means there are at least several months before any ban becomes effective. However, because the publicity surrounding the rulemaking is bound to affect negotiations, employers may want to consider alternative approaches such as ensuring noncompetes are not overly broad or do not target lower-wage workers.

- *Consider Different Types of Agreements*. While the proposed rule would preempt state laws, noncompetes are already enforced differently across the country. As a practical measure, employers may want to consider alternative agreements such as targeted nondisclosure clauses or confidentiality agreements and post-employment consulting agreements that are more uniformly enforced.