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Federal Trade Commission Issues Proposed Rule That Would Bar Most Non-Compete Agreements with Workers

SUMMARY

On January 5, 2023, the Federal Trade Commission proposed new "Rules Concerning Unfair Methods of Competition."[1] Those rules would prohibit most non-compete clauses in employment agreements and agreements with independent contractors, with limited exceptions for agreements connected to the sale of a business. According to the Commission, there are more than 30 million worker non-compete agreements in place that would be rendered illegal by its Non-Compete Rulemaking.[2]

The Non-Compete Rulemaking reflects a new approach to antitrust regulation. The Commission's proposal relies on Section 5 of the FTC Act, which prohibits "unfair methods of competition."[3] Only a few months ago, the Commission issued a major policy statement adopting a broad view of Section 5. That new approach to Section 5 policy is reflected in the Non-Compete Rulemaking.[4] The proposal also marks the first competition-related rulemaking from the Commission in decades. There has been an active debate in recent years concerning the Commission's authority to issue rules to address "unfair methods of competition"—a debate that is almost certain to head to litigation if the Commission moves forward with the Non-Compete Rulemaking.

THE PROPOSED RULEMAKING

The FTC's Non-Compete Rulemaking would prohibit employers from "enter[ing] into or attempt[ing] to enter into" new non-compete agreements, "maintain[ing]" existing non-compete agreements, or representing that a non-compete agreement is in place without a "good faith basis to believe" that such an agreement exists.[5] The new limitations would apply to all "workers," a word that is defined to include both employees and independent contractors who work for an employer, "whether paid or unpaid."[6] The only exceptions to the broad prohibition in the rule are for non-competes "entered into by a person who is selling a business entity" or all of the business's operating assets.[7]

The Commission argues that the rules are necessary because "research has shown that the use of non-compete clauses by employers has negatively affected competition in labor markets, resulting in reduced wages for workers across the labor force—including workers not bound by non-compete clauses."[8] In the Commission's view, the proliferation of worker non-compete agreements throughout the economy has harmed competition in the aggregate, even if no particular agreement would be illegal under existing law.[9] Although the Commission's proposal notes that worker non-competes may provide some benefits, it concludes that those benefits could be achieved through other means, such as non-disclosure agreements or trade secret law, and that any benefits from non-compete agreements are outweighed by their costs.[10]

The proposed rule does not include a carve-out for highly skilled or highly paid workers, including senior executives. But the Commission has expressly asked for comments on whether this category of workers should be subject to a different set of requirements and, if so, how that category of workers should be defined.[11] The public is given 60 days to submit comments on the proposal.

Although we anticipate significant litigation challenging any final rule, all employers should review their non-compete policies affecting workers in light of the Non-Compete Rulemaking and consider alternative ways to protect their trade secrets and other sensitive information in the event that the rule were ever to go into effect.

IMPLICATIONS FOR THE COMMISSION'S REGULATORY AUTHORITY

The implications of the Non-Compete Rule could reach beyond labor markets, as the Commission's proposal reflects two conclusions about the reach of its own authority.

First, the Commission's proposal relies on Section 5 of the FTC Act, which prohibits "unfair methods of competition."[12] In July 2021, President Biden issued an Executive Order that called upon the Commission to increase enforcement under Section 5.[13] In November 2022, the Commission issued a policy statement regarding Section 5, which broke from accepted practice by concluding that Section 5 "reaches beyond the Sherman and Clayton Acts to encompass various types of unfair conduct that tend to negatively affect competitive conditions."[14] Under that policy, "unfair methods of competition" include conduct that "has a tendency to generate negative consequences," even if it is not causing "actual harm in the specific instance at issue."[15] That sweeping interpretation of Section 5 is reflected in the Non-Compete Rulemaking, which states that Section 5 "is not confined to conduct that is prohibited by the Sherman Act, Clayton Act, or common law" and "reaches incipient violations of the antitrust laws."[16] Commissioner Wilson's dissent from the Non-Compete Rulemaking commented on this application of the new Section 5 policy statement, stating that the proposed rule was a "graphic illustration of [her] concern" that the policy change would "facilitate expansive enforcement, often without requiring evidence of anticompetitive effects."[17]

Second, the Commission argues it has authority to issue the Non-Compete Rulemaking under Section 6(g) of the FTC Act, which empowers the Commission to "make rules and regulations for the purpose of carrying

out the provisions of" the Act.[18] The Commission has not pursued rulemaking related to unfair methods of competition since the 1970s,[19] and there has been an active debate in recent years about whether the Commission has authority to promulgate rules to enforce Section 5.[20] Although the Commission's Policy Statement on Section 5 asserted its authority to issue rules,[21] the Non-Compete Rulemaking is the first test of that approach and may offer an opportunity for regulated parties to litigate the Commission's authority in court. According to Commissioner Wilson's dissent, "the uncertainty about the language of [Section 6(g)] will be the starting point for challenges [to] the" Non-Compete Rulemaking.[22] In her view, the proposal is also subject to challenge on the grounds that "the Commission lacks clear congressional authorization to undertake this initiative" under the major questions doctrine, which presumes that Congress explicitly authorizes regulatory actions with major economic and political significance, and that any interpretation of the FTC Act to authorize the Non-Compete Rulemaking would run afoul of the non-delegation doctrine, which prevents Congress from delegating legislative authority to executive branch agencies.[23]

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ENDNOTES

1 *See* Fed. Trade Comm'n, *Notice of Proposed Rulemaking: Non-Compete Clause Rulemaking*, RIN 3084-AB74 (Jan. 5, 2023) (Non-Compete Rulemaking).

2 *Id*. at 15.

3 *Id.* at 68.

4 Fed. Trade Comm'n, *Policy Statement Regarding the Scope of Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act*, Comm'n File No. P221202 (Nov. 10, 2022) (Section 5 Policy Statement).

5 The Non-Compete Rulemaking defines "non-compete" very broadly to include "a contractual term that is a de facto non-compete clause because it has 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." Non-Compete Rulemaking at 214.

6 Non-Compete Rulemaking at 5.

7 *Id*. at 5-6.

8 *Id*. at 3.

9 *Id*. at 15 ("Non-compete clauses affect competition in labor markets through their use in the aggregate.").

10 *Id*. at 93-105.

11 *Id.* at 6 ("In this Notice of Proposed Rulemaking (NPRM), the Commission describes and seeks comment on several alternatives to the proposed rule, including whether non-compete clauses between employers and senior executives should be subject to a different standard than non-compete clauses with other workers."); *id*. at 73 ("The Commission seeks comment on whether this different unfairness analysis should apply to other highly paid or highly skilled workers who are not senior executives. Furthermore[,] the Commission seeks comment on how this category of workers—whether 'senior executives' or a broader category of highly paid or highly skilled workers—should be defined, and whether different regulatory standards should apply to this category of workers.").

12 15 U.S.C. § 45.

13 Exec. Order 14036, 86 Fed. Reg. 36,987, 36,992 (July 14, 2021).

14 Section 5 Policy Statement at 1.

15 *Id*. at 9-10.

16 Non-Compete Rulemaking at 68.

17 Dissenting Statement of Commissioner Christine S. Wilson Concerning the Notice of Proposed Rulemaking for the Non-Compete Clause Rule 4 (Jan. 5, 2023) (Wilson Dissent).

18 15 U.S.C. § 46(g).

19 *See Nat'l Petroleum Refiners Ass'n* v. *Fed. Trade Comm'n*, 482 F.2d 672, 678 (D.C. Cir. 1973).

20 *Compare* Rohit Chopra & Lina Khan, *The Case for "Unfair Method of Competition" Rulemaking*, 87 U. Chi. L. Rev. 367 (2020) (arguing that Section 6(g) authorizes competition rulemaking), *with* Noah Joshua Phillips, *Against Antitrust Regulation*, Am. Enterprise Inst. (Oct. 13, 2022) (arguing that antitrust rulemaking is not supported by the text or structure of the FTC Act).

21 Section 5 Policy Statement at 6 & n.33.

22 Wilson Dissent at 11.

ENDNOTES (CONTINUED)

[23] *Id*. at 1.

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