worklaw® network

April 19, 2023

Shannon Lane
Attorney, Office of Policy Planning
Federal Trade Commission

Re: Non-Compete Clause Rulemaking, Matter No. P201200

Dear Ms. Lane:

On behalf of more than 350 labor and employment lawyers that comprise Worklaw® Network, we respectfully offer comments on the January 23, 2023 *Federal Register* notice of proposed rulemaking ("NPR") to prohibit employers from imposing noncompete clauses on workers issued by the Federal Trade Commission ostensibly under its authority pursuant to Section 5 of the Clayton Act.

Worklaw® Network is a network of independent law firms practicing management side labor and employment law on behalf of employers. Collectively, Worklaw® Network firms operate 37 offices in 28 U.S. states and internationally, with affiliate members in Canada, China, Europe and India.[1] Every Worklaw® Network member is a local firm with strong ties to the legal and business community that the firm serves, providing knowledge of the local landscape where employers have operations. Our members represent employers and employees throughout the United States in all aspects of non-compete law, including drafting non-compete agreements and advising clients on the legality and enforceability of non-compete agreements under existing state and federal law. Our members also routinely litigate non-compete disputes, both on behalf of employers seeking to enforce non-compete agreements and on behalf of employers and employees jointly defending claims that the employee's hiring violated a non-compete. Because our member firms routinely represent clients on both sides of these issues, we believe we are uniquely suited to comment on both the potential benefits and drawbacks of the NPR.

1. Benefits and Drawbacks of a Uniform Federal Standard.

In theory, a uniform federal standard governing non-compete agreements *could* have numerous benefits for employers, employees and the business community generally by bringing some measure of clarity and conformity to an area of law that is fraught with ambiguity and inconsistency. The NPR as currently formulated, however, does not provide such clarity and is likely to create further uncertainty, to the overall detriment of both employers and employees. Accordingly, for the reasons explained in these comments we oppose the NPR as formulated.

As practitioners who represent employers throughout the United States, we recognize the potential theoretical benefit of a uniform federal standard to both employers and employees. The

[1] A full list of Worklaw® Network firms can be found at https://worklaw.com/locations.

status quo of state-by-state regulation of post-employment restrictive covenants based on often outdated common law principles arguably is inconsistent with the reality of modern commerce. For example, most states will enforce non-compete restrictions if "reasonable" in time period and geographic scope and if the restriction is justified by the need to protect a "legitimate business interest," such as confidential information or longstanding customer relationships. The application of these general principles in individual cases both within and among states often is conflicting and inconsistent, resulting in unpredictable outcomes and the lack of clear guidance. These standards also are based on longstanding common law principles that can be difficult to reconcile with the realities of modern commerce. For example, when "competitors" generally were confined to businesses within the same geographic locale, the use of geographic location as a limiting principle for non-compete enforcement served as a meaningful guidepost to courts, employers, and employees to determine legality and enforceability. The concept of an identifiable "geographic market," however, currently has little utility or meaning for most industries where competition is global. For these reasons, among others, a uniform federal standard that updates existing non-compete law to recognize the realities of modern employment and business relationships certainly could be a positive development.

Unfortunately, however, the NPR as proposed, does not meaningfully address any of these legitimate concerns and, in fact, creates a substantial risk of exacerbating the ambiguity and uncertainty surrounding post-employment restrictive covenants of all types, to the potential detriment of both employers and employees.

First, as the product of agency action, any final rule will be impermanent and subject to dramatic changes based on the policy priorities of the then current administration. In the labor and employment context, one need not look further than the National Labor Relations Board, where key legal precedents and rules that are fundamental to labor relations routinely shift dramatically depending on the party that occupies the White House and holds a majority of the seats on the Board.

Second, the substantive provisions of the NPR, if anything, create additional ambiguity and uncertainty as compared to existing state law. Chairperson Khan notes as purported justification for the NPR that due to inconsistent state standards, some employers continue to use non-competes even in states that declare them null and void. Collectively, we have not found this to be a valid concern. Employers generally seek to be legally compliant, and the risk of private civil litigation arising from an attempt to enforce non-competes in states where they are invalid or unlawful is more than sufficient to deter blatant employer overreach. In our experience, a major drawback of the current state-by-state legal regime is not intentional employer use of unlawful agreements, but rather, it is the substantial cost incurred in attempting to ensure that employer policies and practices are in fact compliant with often inconsistent and conflicting state laws. The NPR does not address this legitimate concern.

Moreover, given that employers have a strong interest in recruiting and hiring new employees without the risk of litigation, most employers have little incentive to require adherence to onerous or unreasonable contractual terms on behalf of their employees that would deter or impede the ability to hire new workers if those same restrictions are adopted by competitors.

Even assuming Chairperson Khan's concern about employers intentionally attempting to use non-competes that run afoul of some state laws is well founded, the NPR is unlikely to remedy this concern. As Chairperson Khan notes, there is no private right of action under Section 5 of the FTC Act, so the standards set forth in the FTC Act would not be enforceable through a private right of action in any event, and the FTC itself likely lacks the resources to prosecute all potential violations of a complete ban on non-competes proposed in the NPR.

Finally, the unprecedented nature of the FTC's attempt to regulate in this area creates further uncertainty. As labor and employment practitioners, we do not take a formal position on whether the proposed rule is within the FTC's statutory authority, however, we also note that based on public announcements from other interested parties, the NPR is likely to be subject to legal challenge on the grounds that it exceeds the FTC's constitutional and statutory authority. These challenges will inevitably exacerbate the current uncertainty and unpredictability in the law.

2. Comments on Specific Provisions

As explained below, the specific substantive provisions of the NPR as currently formulated also further exacerbate the uncertainty and unpredictability of current non-compete law.

A. Sections 910.1(b)(1) and (2): Definition of "non-compete clause" and "functional test" for whether a contractual term is a non-compete clause.

Both the proposed definition of a "non-compete" agreement and the proposed "functional test" for determining whether a contractual clause is a prohibited *de facto* non-compete provision are ambiguous and inconsistent, and fail to provide the sort of pro-competitive clarity that a uniform federal rule should provide to both employers and employees.

One glaring ambiguity is the extent to which post-employment restrictive covenants other than "pure" non-compete agreements, such as confidentiality or non-solicitation agreements, are potentially prohibited as "*de facto*" non-compete agreements under the proposed definition. The NPR does not clearly define what constitutes a "*de facto*" non-compete, and the examples provided potentially conflict with the FTC's underlying rationale for the NPR as well as existing federal law.

For instance, the NPR provides as an example of a "*de facto*" prohibited non-compete agreement: "[A] non-disclosure agreement between an employer and a worker that is written so broadly that it effectively precludes the worker from working in the same field after the conclusion of the worker's employment with the employer."

This example, which arguably expands the application of the NPR's non-compete ban to common contractual terms that merely prevent the misuse or misappropriation of confidential information, is inconsistent with Chairperson Khan's recognition in her comments that confidentiality agreements and trade secret laws "reasonably achieve the goal of protecting investments without unduly burdening competition and are a legitimate means for employers to protect intellectual property." The example also potentially conflicts with the federal Defend Trade Secrets Act of 2016, 18 U.S.C. § 1836 *et seq.* ("DTSA"), which was signed into law by

President Obama and became effective on May 11, 20216, to provide a federal cause of action for trade secret misappropriation. Among other concerns, the scenario provided in the NPR implies that the legality of a confidentiality restriction depends solely on the impact of the restriction on the worker's future employment opportunities, as opposed to whether the employer has a legitimate interest in protecting the confidentiality of proprietary or trade secret information, even if the restriction may also impact future employment opportunities.

At a minimum, the NPR should be clarified to provide that nothing in the final Rule shall prohibit an employer from requiring or enforcing a post-employment confidentiality restriction that is justified by the need to protect information that qualifies as a "Trade Secret" under the DTSA, irrespective of the impact such restriction may have on a worker's prospective employment opportunities.

The "*de facto*" definition also fails to provide needed clarity and guidance as to whether other common post-employment restrictive covenants may constitute a prohibited "*de facto*" non-compete agreement. Among other unanswered questions:

- To what extent are contractual terms that restrict an employee from soliciting or doing business with certain customers of the former employer prohibited under the "*de facto"* non-compete or "functional test" definitions?

- Are "garden leave" provisions in which a former employee is being paid all or substantially all of their salary during the non-compete period prohibited as "*de facto*" non-compete agreements? What level of compensation needs to be provided during "garden leave" for a garden leave provision to be permissible?

In our experience, post-employment non-solicit restrictions and garden leave provisions are commonly utilized by employers for legitimate pro-competitive reasons, particularly among businesses that invest substantially in client/customer acquisition and retention, such as insurance brokerage, financial services and other professional services. These types of restrictions promote free and fair competition by allowing businesses to invest heavily in customer service and customer acquisition while reducing the risk that this investment can be unfairly and potentially unlawfully exploited by employees and competitors. The NPR does not address these compelling pro-competitive justifications for post-employment restrictive covenants or offer any guidance as to the legality of such provisions in appropriate circumstances.

To address the above concerns, we suggest that, at a minimum, any proposed rule should contain "safe harbor" provisions that contain a rebuttable presumption such that certain types of post-employment restrictions are presumptively reasonable and lawful, including:

- Non-solicit restrictions which only prevent the employee from soliciting or doing business with customers or clients which the employee developed, personally had contact with, or obtained confidential information regarding, during their employment for a limited period time following the separation of employment.

- Garden leave provisions under which an employee is compensated at a substantial percentage of their base salary during the period of garden leave and is precluded from obtaining competitive employment during the garden leave period.

B. 910.2(b)(1) Rescission requirement for existing non-compete clauses.

The proposed requirement that all non-competes entered into prior to the effective date of the Act be "rescinded" is probably the most concerning and problematic aspect of the NPR for our employer clients. This provision arbitrarily nullifies and modifies existing employment and contractual relationships without notice or regard for the individual circumstances of those relationships. As such, it will have unintended and unpredictable adverse consequences on existing employment and business relationships.

The proposed retroactive "rescission" rule appears to be based on an inaccurate and unsupported presumption that all non-compete restrictions in existing employment relationships were unilaterally imposed by employers on employees with little to no bargaining power and are not supported by consideration. While this may be a legitimate concern in some instances, particularly in lower wage positions where the legitimate business need for such restrictions is not readily apparent, the NPR's blanket recission requirement goes too far. In our experience, for a highly compensated executive or highly skilled technical employee, the compensation or other consideration provided to the employee can be the result of significant negotiation and is often based in part, on the employee's agreement to post-employment non-compete restrictions. For example, highly compensated employees often agree to post-employment restrictive covenants in return for often highly lucrative equity participation in the form of stock options or grants not available to lower wage employees or employees who do not agree to such restrictions.

Chairman Khan implicitly acknowledges the questionable policy rationale for retroactively rescinding all non-compete agreements, stating that "employers' use of non-competes to bind low-wage workers may be coercive and unfair in ways that the use of non-competes to bind senior executives is not." Nevertheless, she goes on to conclude, without any evidentiary support, that "in the aggregate, employers' use of non-competes undermines competition across markets in ways that are harmful to workers and consumers and warrant a prohibition."

Chairman Khan specifically asks for public comment on whether the rule should apply "different standards to non-competes that cover senior executives or other highly paid workers." The answer to that question, in our opinion, is yes -- if the FTC proceeds with rulemaking, any final rule, at a minimum, should make a distinction among highly paid employees and low wage workers. Among other exemptions, the rule should not apply to highly paid executives or technical employees with access to significant trade secrets or who otherwise have the ability by virtue of their position to utilize relationships developed during their employment to divert clients or customers to competitors (e.g., sales employees). Also, the rule should clarify that imposing reasonable non-compete restrictions as a condition of equity participation and providing that violation of those restrictions will result in forfeiture of that equity is generally lawful.

If the Commission's main concern is the use of potentially onerous non-compete restrictions in anti-competitive or potentially exploitive situations such as in lower-wage positions,

this concern could be better and more narrowly addressed by prohibiting the use of non-compete agreements in positions below a certain compensation threshold, as has occurred in several states in recent years, or requiring consideration above and beyond mere "at will" employment to support a post-employment non-compete restriction.[2]

Given the dramatic change in existing law that the NPR represents, if passed in any form, any restriction on non-compete use should permit businesses and their legal counsel to plan, prepare and develop strategies to protect their interests prospectively, which is why any rule change should be prospective only and apply to agreements entered into on or after the effective date of the final rule.

3. Conclusion

While a uniform federal standard clarifying the legality and enforceability of post-employment non-compete restrictions could, in theory, have substantial pro-competitive benefits to both employers and employees, the NPR as currently proposed fails to meet these goals for the reasons explained above. Any attempt to implement federal standards in this area should be through legislation, not regulation.

If the FTC proceeds with rulemaking notwithstanding these concerns, the modifications suggested above will provide needed clarification that will benefit both employers and employees and will also limit the risk of unintended adverse consequences created by the broad sweep of the current NPR.

Submitted on behalf of Worklaw® Network
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[2] For example, the Illinois Workplace Transparency Act prohibits the use of non-compete agreements for employees earning less than $75,000 per year and prohibits the use of non-solicit restrictions for employees earning less than $45,000 per year. *See* 820 ILCS 90/10. Similarly, Colorado's non-compete statute, C.R.S. § 8-2-113, was amended in 2022 to, among other things, prohibit non-compete agreements for employees who do not earn at least $112,500 in annualized cash compensation and non-solicitation agreements for employees who do not earn at least 60% of this highly compensated threshold amount.

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