NEW YORK CITY BAR

REPORT ON FEDERAL TRADE COMMISSION PROPOSED RULE BY THE
ANTITRUST & TRADE REGULATION COMMITTEE
EMPLOYEE BENEFITS & EXECUTIVE COMPENSATION COMMITTEE
LABOR & EMPLOYMENT LAW COMMITTEE
MERGERS, ACQUISITIONS & CORPORATE CONTROL CONTESTS COMMITTEE
TRADE SECRETS COMMITTEE

CONFIDENTIAL

FTC Notice of Proposed Rulemaking, Non-Compete Clause Rule (proposed Jan. 5, 2023) (to be codified at 16 CFR § 910)

A RULE that provides, among other things, that it is an unfair method of competition for an employer to enter into or attempt to enter into a non-compete clause with a worker; to maintain with a worker a non-compete clause; or, under certain circumstances, to represent to a worker that the worker is subject to a non-compete clause.

THIS PROPOSED RULE IS DISAPPROVED

The New York City Bar Association ("City Bar") does not support the Federal Trade Commission's proposed Non-Compete Clause Rule ("Proposed Rule")[1]. We suggest that, if federal action is warranted, certain alternatives to the Proposed Rule, such as the promulgation of guidelines, would be more appropriate given the long-standing and developing law in various States and the current state of knowledge. As discussed in Section V below, the City Bar considers guidelines to be more consistent with the FTC's practices and knowledge. Guidelines

[1] Press Release, 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 ; *see also* Federal Register Notice, Non-Compete Clause Rulemaking, Proposed Rule, Fed. Trade Comm'n (Jan. 5, 2023), https://www.ftc.gov/legal-library/browse/federal-register-notices/non-compete-clause-rulemaking ; Notice of Proposed Rulemaking, Non-Compete Clause Rule (proposed Jan. 5, 2023) (to be codified at 16 CFR § 910), https://www.ftc.gov/system/files/ftc_gov/pdf/p201000noncompetenprm.pdf .

About the Association
The mission of the New York City Bar Association, which was founded in 1870 and has over 23,000 members, is to equip and mobilize a diverse legal profession to practice with excellence, promote reform of the law, and uphold the rule of law and access to justice in support of a fair society and the public interest in our community, our nation, and throughout the world.

may also be more readily revised than a rule, facilitating the FTC tweaking its policy as it gains experience in this area.

If adopted, the Proposed Rule would broadly ban virtually all non-compete clauses with workers as an "unfair method of competition" under Section 5 of the Federal Trade Commission Act. It would also retroactively invalidate existing non-compete agreements with workers. The Notice of Proposed Rulemaking ("NPRM") follows the FTC's November 2022 statement articulating an expansive view of the scope of its authority to challenge "unfair methods of competition" under Section 5 of the FTC Act.[2] The day before the NPRM was announced, the FTC also announced two uncontested enforcement actions, challenging three companies' noncompete clauses as violating Section 5.[3]

The City Bar notes that the Proposed Rule raises questions pertaining to: (1) the FTC's authority to adopt conduct rules generally; (2) its authority to engage in rulemaking premised only on "unfair methods of competition" more specifically; (3) the Proposed Rule's retroactive invalidation of already executed agreements; and (4) the resulting legality of the Proposed Rule in light of these questions, especially given the extensive and longstanding State regulation in this area and the major question doctrine.[4] The City Bar's view is that the adoption of guidelines is more consistent with the level of the FTC's expertise and would likely better withstand judicial scrutiny predicated on any or all the above questions. Accordingly, the City Bar's views on the Proposed Rule do not depend on the resolution to these threshold questions, and this report does not generally address them.

I. STATE LAW

Beyond the significant questions noted above, there may also be federalism considerations, given the numerous state laws addressing non-competes.[5] Indeed, for more than

[2] Policy Statement Regarding the Scope of Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act, Fed. Trade Comm'n (Nov. 10, 2022), https://www.ftc.gov/system/files/ftc_gov/pdf/P221202Section5PolicyStatement.pdf

[3] Press Release, FTC Cracks Down on Companies That Impose Harmful Noncompete Restrictions on Thousands of Workers, Fed. Trade Comm'n (Jan. 4, 2023), https://www.ftc.gov/news-events/news/press-releases/2023/01/ftc-cracks-down-companies-impose-harmful-noncompete-restrictions-thousands-workers

[4] *See W. Virginia v. Env't Prot. Agency*, 213 L. Ed. 2d 896, 142 S. Ct. 2587, 2605 (2022) (Under the major questions doctrine, "a clear statement is necessary for a court to conclude that Congress intended to delegate authority 'of this breadth to regulate a fundamental sector of the economy.'"); *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 468 U.S. 837 (1984) (deference to administrative expertise). These questions have been raised, for example, in Commissioner Wilson's dissent to the NPRM, and in an August 8, 2022 Wall Street Journal article authored by former FTC Chief of Staff Svetlana Gans and former Secretary of Labor Eugene Scalia, "The FTC Heads for Legal Trouble" (a rule like the FTC's Proposed Non-Compete Rule "would run headlong into the major-questions doctrine."), available at https://www.wsj.com/articles/ftc-may-test-the-courts-limits-meta-lina-khan-roberts-nondelegation-major-questions-enforcement-authority-humphreys-executor-administrative-law-noncompete-11659979935?page=1 (paywall).

[5] California, North Dakota, and Oklahoma have generally banned non-competes, with exceptions including non-competes entered into in connection with the sale of a business. CAL. BUS. & PROF. CODE § 16600; N.D.C.C. § 9-08-06; OKLA. STAT. Tit. 15, § 15-219A. Other states, some in response to President Obama's call in 2016, such as Colorado, Illinois, Maine, Maryland, Massachusetts, Nevada, New Hampshire, Oregon, Rhode Island, Virginia, and

200 years and continuing recently at an increased pace,[6] non-competition agreements have been regulated by the States to address current concerns. State legislatures and courts have repeatedly addressed relevant interests, to establish and adjudicate the circumstances under which non-competition agreements may be enforced. Much of this required carefully balancing to appropriately reflect the circumstances presented.

New York's highest court, the Court of Appeals, has recognized that a non-competition agreement may be enforced "to forestall unfair competition,"[7] and New York courts have recognized as legitimate employer interests, supporting enforcement, the protection of trade secrets and confidential information, the employer's client base, customer relationships and good will, as well as protection against irreparable harm where the employee's services are unique or extraordinary. In *BDO Seidman v. Hirshberg*, 93 N.Y.2d 382, 391 (N.Y. 1999), a leading New York case on enforcement of non-competes, the Court of Appeals noted: "Professor [Harlan] Blake, in his seminal article in the Harvard Law Review, explains that the legitimate purpose of an employer in connection with employee restraints is 'to prevent competitive use, for a time, of

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Washington, as well as the District of Columbia, have banned non-compete agreements for low-wage workers, and otherwise require consideration and notice periods. See COLO. REV. STAT. ANN. §8-2-113(2)(a)–(b) (2022) (non-compete clauses are void except where they apply to a "highly compensated worker," currently defined as a worker earning at least $101,250 annually, see also COLO. CODE REGS. §1103-14-1.2); D.C. CODE §32-581.02(a)(1) (2022), as amended by D.C. Law 24-175 § 101(13)(A)(i)-(ii) (where the employee's compensation is less than $150,000, or less than $250,000 if the employee is a medical specialist, employers may not require or request that the employee sign an agreement or comply with a workplace policy that includes a non-compete clause); 820 ILL. COMP. STAT. 90/10(a) (2017) (no employer shall enter into a non-compete clause unless the worker's actual or expected earnings exceed $75,000/year); ME. REV. STAT. ANN. tit. 26, § 599-A (3) (2019) (an employer may not require or permit an employee earning wages at or below 400% of the federal poverty level to enter into a non-compete clause with the employer); MD. CODE ANN., LAB. & EMPL. §3-716(a)(1)(i) (2019) (non-compete clauses are void where an employee earns equal to or less than $15 per hour or $31,200 per year); MASS. GEN. LAWS ANN. Ch. 149, § 24L(c) (2021) (non-compete clauses shall not be enforceable against workers classified as nonexempt under the Fair Labor Standards Act ("FLSA")); NEV. REV. STAT. § 613.195(3) (2021) (non-compete clauses may not apply to hourly workers); N.H. REV. STAT. ANN. § 275:70-a(II) (2019) (employers shall not require a worker who earns an hourly rate less than or equal to 200% of the federal minimum wage to enter into a non-compete clause, and non-compete clauses with such workers are void and unenforceable); OR. REV. STAT. § 653.295(1)(e) (2022) (non-compete clauses are void and unenforceable except where the worker's annualized gross salary and commissions at the time of the worker's termination exceed $100,533); R.I. GEN LAWS § 28-59-3(a)(1) (2020) (non-compete clauses shall not be enforceable against workers classified as nonexempt under the FLSA); VA. CODE ANN. § 40.1-28.7:8(B) (2020) (no employer shall enter into, enforce, or threaten to enforce a non-compete clause with an employee whose average weekly earnings are less than the Commonwealth's average weekly wage); WASH. REV. CODE ANN. §§ 49.62.020(1)(b), 49.62.030(1) (2020) (non-compete clause is void and unenforceable unless worker's annualized earnings exceed $100,000 for employees and $250,000 for independent contractors, to be adjusted for inflation). Many states impose reasonableness standards. For example, New York has a 4-part test (A non-compete is only allowed and enforceable to the extent it (1) is necessary to protect the employer's legitimate interests, (2) does not impose an undue hardship on the employee, (3) does not harm the public, and (4) is reasonable in time period and geographic scope.). New York and other states have a less stringent standard for enforcing sale of business non-competes. Other states are considering legislation applicable to non-competes in their jurisdictions. The long-term effects of these new laws are not yet known. Nonetheless, these efforts attempt to address the perceived problems with current law, and to do so in a manner consistent with the needs of local economies, while the Commission has apparently not considered these developments in formulating the Proposed Rule.

[6] *See* n.5.

[7] *Columbia Ribbon Carbon Mfg. Co. v. A-1-A Corp.*, 42 N.Y.2d 496, 499 (1977).

information or relationships which pertain peculiarly to the employer and which the employee acquired in the course of employment' (Blake, op. cit., at 647)."

The Proposed Rule asserts that measures other than non-competes are "viable alternatives" to non-competes for protecting employers' legitimate business interests, including trade secrets laws and nondisclosure/confidentiality agreements. The assertion does not adequately consider the actual experience in the States on this issue, and does not fully credit other significant factors that justify non-competes.[8]

The Proposed Rule notes the example of California's ban on most non-competes, but proposes a rule concerning selling business owners that is more restrictive than California's, and that could jeopardize and devalue, the sales of closely-held and family businesses, when the number of owners exceed 4, and owners hold ownership stakes of less than 25%.

Over the last several years, many States have recognized a need for greater protection of low wage earners, and have responded with legislation appropriate for those States[9]. In addition, several States Attorneys General, including New York's, have acted on behalf of their citizens, to foreclose enforcement of non-competes against low wage and hourly workers.[**Trade Secrets Committee - footnote? We will add footnote here]** These solutions are both less disruptive, and more focused, than the Proposed Rule.

In 2021, the City Bar Trade Secrets Committee issued a report, "Legislating Fairness: Regulating the Use of Noncompetes for Lower-Salary Employees February 2021".[10] In that Report, the Trade Secrets Committee recommended legislation that would substantially restrict the use of non-compete agreements for lower-wage employees, while preserving the flexibility of New York's common law approach, which recognizes important commercial considerations for New York's economy. The Trade Secrets Committee recommended a New York State statute, imposing a presumptive prohibition on non-compete agreements for employees whose salaries fall below a statutorily-defined limit. The presumptive prohibition would be rebuttable when the non-compete is for the protection of protectable interests recognized under decades of New York common law (e.g., trade secrets, protectable customer relationships, employees possessing unique skills or expertise), and when (1) the employer agrees to pay the affected employee's full pro-rated compensation for the duration of any non-competition period; and (2) the employee was provided with notice, prior to the employee's agreement to enter into the employment relationship, of any non-compete agreement and of the employer's intention to enforce the non-compete with respect to the particular position.

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[8] In fact, the FTC concedes that these alternatives "may not be as protective as employers would like", but asserts, without support, that they "reasonably accomplish the same purposes as non-compete clauses while burdening competition to a less significant degree". NPRM, Part IV.B.2. at 93.

[9] *See* n.5.

[10] *See* The New York City Bar Association, Trade Secrets Committee Report, Legislating Fairness: Regulating the Use of Noncompetes for Lower-Salary Employees (February 2021) ("Trade Secrets Committee Report"), *available at* https://s3.amazonaws.com/documents.nycbar.org/files/2020827-RegulatingNonCompetesforLowerSalaryEmployees.pdf

In preparing its Report, the Trade Secrets Committee reviewed and reaffirmed New York's common law in this area. The Committee recognized the strength of New York's well-developed decisional law in the area of trade secrets and non-competes, and that this jurisprudence serves New York's enterprise economy well, by allowing flexibility to enforce non-competes where reasonable and necessary. The FTC has not established a justification for a new set of rules, or for a likely period of uncertainty and litigation, which would likely be required to determine their parameters. Other states have passed or proposed legislation similar to that recommended in the Trade Secrets Committee Report.[11] These alternatives, focused on the same competitive concerns espoused by the FTC, generate less disruption than the Proposed Rule, and offer more focused solutions.

II. CURRENT STATE OF KNOWLEDGE

The City Bar recognizes both the breadth and limitations of the research cited in the NPRM to support the proposed rules.[12] The FTC's justification for the Proposed Rule is predicated on data highlighting anticompetitive effects of non-compete clauses—specifically, on research suggesting that the prevalence of non-compete agreements results in lower pay for workers subject to such clauses; lower pay for other workers because of the aggregate effects on the labor market; potential harm to competition in products and services; and potential harm to innovation.[13] The NPRM cites multiple studies suggesting that non-compete agreements are generally problematic in certain employment contexts, such as when applied to entry-level and low wage positions. Virtually all research cited in the NPRM indicates that non-compete clauses reduce labor mobility and job turnover. With a few exceptions, the research cited supports the Commission's conclusions that non-compete clauses for low-wage workers result in lower wages and earnings. However, some research finds that non-compete clauses can have beneficial effects, namely with respect to increasing employee training and investment, and also to increased employment levels.[14] Moreover, relatively little of the empirical research systematically evaluates how non-competes affect low-wage workers, specifically.[15] More generally, the data offer weak support to a conclusion that non-compete agreements are harmful to groups such as company executives and higher paid workers, where there is no "unequal bargaining power" between the parties, or where non-competes reasonably protect a business's legitimate interest and are otherwise not exploitative. In fact, the NPRM has specifically

[11] *See* n.5.
[12] *See* FTC, "Workshop on Non-Compete Clauses in the Workplace", January 9, 2020 https://www.regulations.gov/docket/FTC-2019-0093 .
[13] In addition to studies cited in the NPRM illustrating the harm of non-competes for low-wage workers, there are also studies which call for further exploration on the topic. For example, the NPRM includes data suggesting that non-competes encourage employer-provided training, which may be especially valuable for entry-level employees, filling in, in some contexts, for training earlier provided by vocational schools.
[14] See, e.g., Potter, Tristan, Bart Hobijn, Andre Kurmann, "On the Inefficiency of Non-Competes in Low-Wage Labor Markets" (Model is consistent with empirical data that non-competes reduce turnover, average wages, and wage dispersion for low-wage workers, and predicts that, by reducing turnover, non-competes raise recruitment and employment. Optimal non-competes policy depends on many factors, including critically on the minimum wage, such that enforcing NCAs can be efficient with a sufficiently high minimum wage.) (Potter et al.).
[15] See nn.14, 16.

requested more information on the impact of non-competes, suggesting that adoption of any rule is inappropriate and establishing guidelines is premature.[16]

The City Bar suggests that additional data gathering is warranted in a number of areas. First, it is crucial to consider whether the Proposed Rule could result in unintended "unfair" consequences for employers, employees and/or consumers across industries.[17] For example, if non-competes suppress compensation and a prohibition will allow compensation to rise, what impact would a prohibition have on employment levels?[18]

The NPRM cites no data to identify or address potential unintended consequences of the application of the Proposed Rule to former employees with non-competes, or regarding the proposed identification of "*de facto*" non-competes. The application of the Proposed Rule to former employees and other former workers, for example, would require firms to furnish individualized notice that restrictions are rescinded, an administrative task that may take substantial time and resources.[19] Where non-competes are the consideration for employment, separation and other compensation agreements, substantial additional work will be required around restructuring the agreements, work that cannot be achieved unilaterally by the employer. If previously entered non-competes are invalidated, thorny questions about consideration previously paid or promised to be paid in the future in exchange for the invalidated restrictions arise. For example, an employee subject to a post-employment covenant corresponding to a severance payment period could experience a cessation of payments or clawback demand. The costs of these activities may be prohibitive for many employers, who depending on the circumstances (e.g., if a newly released employee begins competing) may find itself less able to afford the additional costs of compliance. The application of the Proposed Rule to existing agreements will prove particularly problematic in an M&A context, where post-closing compensation is frequently negotiated on the basis that a broad and presumptively valid non-compete covenant can be included in the employment agreement. The value of any disputes arising from forced rescission under the Proposed Rule may be greater than under non-M&A-related agreements. In short, the FTC both lacks critical data to properly formulate its views on non-competes and haphazardly proposes the retroactive application of the Proposed Rule that would upset reasonable expectations based on existing law as well as impermissibly modifies the legal consequences of past actions.[20]

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[16] NPRM at 48 ("The Commission requests comment on all aspects of its description, in this Part II.B [Evidence Relating to the Effects of Non-Compete Clauses on Competition], of the empirical evidence relating to non-compete clauses and their effects on competition. In particular, the Commission seeks submissions of additional data that could inform the Commission's understanding of these effects."). See n.13.

[17] Commissioner Wilson cites one such study in her dissent, which found that the elimination of non-compete agreements among financial advisory firms led to higher prices and a decrease in the quality of services provided to customers.

[18] See n.14.

[19] Depending on the amount of turnover and mobility of the former workforce during the protected period, tracking down former employees to provide the notice may be particularly burdensome for companies that have utilized the challenged practice of including non-competes in their standard employment documents.

[20] *Cf. Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 219-20 (1988) (J. Scalia, concurring).

Second, the NPRM suggests that non-disclosure agreements and trade secret law may be used in place of non-competes to protect employers, but does not provide any evidence about the efficacy of these mechanisms, nor addresses the actual experience with these laws in the fifty States. For example, enforcement of a trade secret or a non-disclosure agreement may be a costly and lengthy process that attempts to shut the barn door after the horse has escaped. And non-disclosure agreements can over- or under- deter, depending on their enforcement, rendering them anywhere between ineffective or de facto non-competes[21]. The NPRM assumes, moreover, that ordinary non-disclosure agreements would remain enforceable. However, non-disclosure agreements themselves are being restricted, making them potentially less available over time to protect legitimate employer interests than at the time the NPRM was issued.[22] More data is thus needed on the costs and benefits of these alternatives.

Third, the NPRM observes that companies are successful in states where non-competes are unenforceable (even if still often ubiquitous),[23] but provides no significant quantitative or qualitative cross-state data to compare company success or competition.

Fourth, even if one were to assume a correlation between non-competes and the harms cited by the FTC, the NPRM lacks data to measure whether other justifications for non-competes offset the harms in some instances. For example, an entry-level worker may have detailed information about specific trade secrets, which may suggest that the need for a targeted restriction to protect the company's secret business information outweighs potential harm in that situation.

Finally, where the data support a conclusion that non-compete agreements are problematic, and even assuming the FTC's jurisdiction in this area, there still remains the question of the appropriate remedy. Specifically, the NPRM does not clearly articulate why rulemaking would necessarily be the appropriate remedy, even if it were a valid exercise of the Commission's authority—as opposed, for example, to the publication of guidelines, a more traditional remedy the FTC has successfully implemented in several areas.[24] We also question whether the Proposed Rule adequately identifies and addresses the problematic situations for non-competes.

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[21] The Proposed Rule provides that "de facto" non-competes may be violations, but provides no guidance as to what may constitute such non-competes.

[22] *See e.g., McLaren McComb*, 372 NLRB 58 (Feb. 21, 2023), and NLRB Memorandum GC 23-05 (Mar. 23, 2023) (inclusion of a comprehensive confidentiality clause in a *proposed* severance agreement is an unfair labor practice because it interferes with the Section 7 rights of employees facing severance). *See also Gary Van Zeeland Talent, Inc. v. Sandas*, 84 Wis.2d 202, 218 (1978) (WI. STAT. §103.454, which regulates restrictive covenants, applies to confidentiality agreements restricting disclosure of customer data and business practices and must have a limited temporal and geographic scope).

[23] No state has a blanket prohibition on non-competes; all states with limits provide exceptions.

[24] See, e.g., Antitrust Guidelines for the Licensing of Intellectual Property (January 12, 2017) (justice.gov); Horizontal Merger Guidelines (August 19, 2020) (justice.gov); Antitrust Guidelines for Collaborations Among Competitors (April 2000) (justice.gov). Moreover, even if the Commission has the authority to issue the Proposed Rule, is the problem one to be addressed by §5 of the FTC Act, or by another law enforced by another agency, such as labor laws? See nn.13, 27.

Given that the data in the NPRM do not address all circumstances uniformly, the issuance of a blanket per se rule that would apply broadly to all groups of workers in all situations is controversial and, in the view of the City Bar, likely counterproductive. A more modest approach, which recognizes both the strengths of the data collected to date and their limitations, would be advisable.

III. ANTITRUST ANALYSIS

Consistent with modern-day antitrust jurisprudence, non-compete agreements should not be the subject of a blanket *per se* ban. In antitrust law, *per se* rules of illegality have been adopted "only when they relate to conduct that is manifestly anticompetitive", *Cont'l T. V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 50 (1977), such that the court "can predict with confidence that [the type of restraint at issue] would be invalidated in all or almost all instances." *Nat'l Collegiate Athletic Ass'n v. Alston*, 141 S. Ct. 2141, 2156 (2021) (internal citation omitted). In fact, there has been a trend in antitrust case law away from *per se* illegality and towards a fact-specific rule of reason analysis. For example, courts have moved from treating tying claims as per se illegal to analyzing virtually all such claims under the rule of reason, recognizing that tying may be anti- or pro-competitive, depending on the circumstances. Similar changes in the law have occurred with respect to vertical market allocation and retail price maintenance.[25]

For over 100 years, federal and most state courts have rejected *per se* bans on non-compete agreements, as they consistently recognized that non-compete clauses may have a broad spectrum of competitive effects.[26] This broad spectrum is in fact supported by some of the studies cited in the NPRM. The FTC posits that the proposed rule addresses an antitrust problem, arguing that non-competes are often followed by lower wages and reflect monopsony power on the part of employers.[27] But such monopsony power, if it exists, is much more likely a

[25] *See, e.g., Illinois Tool Works Inc. v. Indep. Ink, Inc.*, 547 U.S. 28, (2006) (Holding that tying arrangements involving patented products should no longer be evaluated under the per se rule.); *Leegin Creative Leather Prod., Inc. v. PSKS, Inc*., 551 U.S. 877, 881 (2007) ("We now hold that . . . vertical price restraints are to be judged by the rule of reason.").

[26] *See, e.g., Aydin Corp. v. Loral Corp.*, 718 F.2d 897, 900 (9th Cir. 1983) ("Employee covenants not to compete or interfere with the employer's business after the end of the employment relationship should not be tested under the per se rule" because "such covenants often serve legitimate business concerns such as preserving trade secrets and protecting investments in personnel."). The case cited in fn. 1 of the NPRM, to support the proposition that "non-compete clauses have always been considered proper subjects for scrutiny under the nation's antitrust laws", itself analyzes the contested non-compete clause under the Sherman Act Section 1 framework, applying the rule of reason. *Newburger, Loeb & Co. v. Gross*, 563 F.2d 1057, 1082 (2d Cir. 1977) ("In certain cases, postemployment restraints do serve legitimate business purposes: they prevent a departing employee from expropriating his employer's secrets and clientele. Consequently, we have held that a per se ban on all such restrictive covenants would not be warranted.") (internal citation omitted).

[27] In certain industries, there may be such monopsony power on the part of employers or their analogues. *See, e.g., U.S. v. Bertelsmann SE & Co. KGaA*, 1:21-cv-02886-FYP, D.D.C. Oct. 31, 2022; G. Schubert, A. Stansbury, and B. Taska, Employer Concentration and Outside Options (December 16, 2022), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3599454. Otherwise, wage levels may more appropriately be within the purview of labor law and policy rather than antitrust law and policy. See, e.g., Potter et al. n.13 (an optimal non-compete depends on factors such as the minimum wage level and therefore should be considered in the context of such other relevant laws).

concern with respect to lower-paid employees and in certain industries or markets than it is with respect to executives or highly-skilled employees. Consistent with that intuition, and as noted above, the FTC's data are much less robust with respect to other effects of non-compete agreements in other circumstances. In particular, the FTC does not present robust data showing anticompetitive effects on products and services. Moreover, the FTC's data are at most neutral and likely suggest some pro-competitive benefits of non-compete clauses in terms of their effect on employers' incentive to invest in employee training and in terms of their effect on innovation.[28] The NPRM also cites data which suggest that, while non-compete agreements are problematic in certain situations, they do offer concrete benefits in other circumstances – for example, when applied to high-level executives, in industries that depend on heavy investment in employee training, and in innovation-driven industries.

These disparate effects of non-compete clauses in different circumstances strongly suggest that a "one size fits all" blanket rule declaring all non-competes illegal *per se* is inappropriate. Indeed, a rule that would apply uniformly to all workers, regardless of industry, role or responsibility, would likely outlaw extensive economic activity that is not anticompetitive or "unfair", but procompetitive and welfare-enhancing. Therefore, we believe that non-compete agreements should continue to be assessed under a more nuanced set of rules akin to the rule of reason approach. By adopting guidelines, the FTC can allow for a nuanced approach, while clearly addressing the concerns raised in the NPRM.

IV. NON-COMPETES IN BUSINESS SALES, BUSINESS COMBINATIONS AND CAPITAL STRUCTURE TRANSACTIONS

The NPRM states that non-compete agreements that are not entered into with workers are not covered by the Proposed Rule. While the City Bar does not believe the FTC should issue the Proposed Rule, and is not addressing many of the substantive concerns with specific provisions of the Proposed Rule, the City Bar does address some of the specific concerns that arise in a business sale and capital structuring context, particularly because the values of numerous sales of businesses are dependent upon effective non-competes, and, if existing non-compete covenants are required to be rescinded on the enforcement date of the Proposed Rule, the consideration for prior and prospective payments under those existing agreements will be called into question.[29]

[28] In fact, two studies cited in the NPRM find that non-compete agreements increase employer training and investment in workers. See NPRM Part II.B.2.e; Evan Starr, Consider This: Training, Wages, and the Enforceability of Non-Compete Clauses, 72 I.L.R. Rev. 783, 799 (2019); and Jessica Jeffers, The Impact of Restricting Labor Mobility on Corporate Investment and Entrepreneurship 22 (2019)).

[29] See Section II above.

A. Sale of Business Transactions

Courts have long recognized that covenants not to compete entered into in connection with the sale of a business are to be more liberally enforced than those entered into in a pure employment context.[30]

Section 910.3 of the Proposed Rule contains an exception from the Proposed Rule's general prohibition on non-compete covenants for covenants entered into in connection with the sale of a business or a substantial equity interest in a business, but the exclusion is so narrowly drawn as to make it inoperative for many sales. Although the City Bar endorses neither a national standard, nor the use of any individual state's laws as the basis for a national standard, we note that California, North Dakota and Oklahoma, the three states that have imposed the most severe restrictions on non-compete covenants, permit non-compete covenants for selling owners under a more flexible approach than that set forth in § 910.3.[31] Indeed, at a minimum, the FTC failed to consider the actual experience of thousands of buyers and sellers of businesses under these well-established standards, and the impact such experience should have on any standard the FTC considers.

In order to fall within the § 910.3 exception in the Proposed Rule, the party bound by the non-compete must be at least a 25% owner of the relevant business entity at the time of the transaction and, in a transaction structured as a sale of equity, is required to dispose of all of such party's ownership interest in the business. These constraints will result in the exclusion being available in only an arbitrary set of cases. The value of a business is equally threatened by competition from a 24% or 26% owner as well as, potentially, much smaller owners. The requirement that the seller hold a 25% ownership stake in the business entity in order to be subject to an enforceable non-compete would reflect a departure from current M&A practice and would be disruptive to the market for purchases and sales of businesses, particularly those that are privately held. Comparable businesses being considered for purchase would be valued based not only on their operating results but also on the distribution of their capital stock.

When a selling owner contracts to provide post-closing services to the target business, it is typical for the parties to enter into both an unconditional non-compete covenant for a set period of time and a second non-compete covenant that continues for a year or two after the selling owner ceases to be employed. There is no rational reason that the value and goodwill preservation function of these unconditional non-compete covenants should be undermined by the continued employment of a selling owner. A covenant tied to worker status may be fair and appropriate within a framework that recognizes the unique value of such post-closing service arrangements in protecting the value of the business sold.

[30] *E.g.*, *Capital One Financial Corporation v Kanas*, 871 F.Supp.2d 520 (E.D.Va. 2012); *Alexander & Alexander, Inc. v. Danahy*, 212 Mass.App.Ct. 488 (1986).
[31] Cal. Bus.& Prof. Code §16601; NDCC § 9-08-06; 15 Okl.Stat.Ann § 218.

The City Bar believes that it is fair and appropriate for an enforceable non-compete to be based on (1) a much lower minimum ownership threshold,[32] or, (2) the receipt of substantial proceeds from a business sale or disposition of capital stock[33]. In any case, the issue needs to be carefully considered in light of the many years of real world experience, and any guidelines established by the FTC should be grounded in data supporting the consistency of such requirements with the transaction practices that buyers and sellers of businesses have determined over time, at arms'-length, to be necessary to protect the value and goodwill of businesses sold. The FTC has recognized in the NPRM that non-competes between buyers and sellers of businesses have not yet been subject to the same types of empirical studies as non-competes entered into in a pure employment context, and such data is essential before the FTC adopts any views on the matter.

The Proposed Rule requires that an owner dispose of <u>all</u> equity in the business as a condition to the creation or an enforceable non-compete covenant. This requirement would inappropriately prevent the entry into a non-compete with a selling owner whose interests are aligned with those of the purchaser through the retention of an equity stake in the business, even though such a transaction structure is often seen as enhancing value and ensuring that the seller and buyer are equally committed to the effective transfer of the goodwill of the business. This requirement also wrongly disregards the receipt by sellers of rollover equity consideration and/or stock options and other equity-based incentives.

In its effort to preserve worker mobility and protect low wage workers, there is no reason why the FTC should adopt methods such as the Proposed Rule, which could radically undercut a key aspect of the economy and the value of businesses built through years of effort.

B. Considerations Relative to Executives and other Key Employees

The entry into non-competition covenants by executives and other key employees is often critical to the success of an M&A initiative, even where these individuals are not substantial equity sellers in the transaction. The NPRM acknowledges that non-competes entered into with executives and other highly compensated individuals are unlikely to be "coercive" or "exploitative" but contends that they may nevertheless be "unfair" under certain circumstances. Any determination that such an arrangement is "unfair" is questionable given their critical role in acquisitions, and is likely fact dependent. In stark contrast to non-competition covenants imposed uniformly on low-level employees, executives and key employees often have

[32] See *Vacco Industries, Inc. v. Van Den Berg,* 5 Cal. App. 4th 34 (Cal. App. 1992) (rejecting defendant's argument that as a 3% owner he was not a "substantial shareholder" under *Bosley Medical Group v Abramson*, 161 Cal.App.3d 284 (1984) and as such not subject to the exception contained Cal. Bus.& Prof. Code §16601 to California's prohibition on non-compete covenants, where defendant's sale was part of a transfer of all of the capital stock of the subject business entity).

[33] See, e.g., *Alexander & Alexander, Inc. v. Danahy,* supra (among the factors supporting more liberal enforcement of non-competes arising from a sale of business is the fact that "the proceeds of the sale generally enable the seller to support himself temporarily without the immediate practical need to enter into competition with his former business").

substantial leverage in negotiating acquisition-related restrictive covenants, and those covenants are generally integral to a sophisticated post-transaction employment compensation package. Such individuals may also be the recipients of transaction-related bonuses that substitute for the absence of pre-transaction equity ownership, obtain post-closing equity incentives or otherwise be compensated for their non-competes in a variety of forms.

Employees provided with the opportunity to purchase, or who are granted, material equity in an employer in connection with the purchase or sale of a business are typically required to enter into a non-compete covenant simultaneously as part of a value preservation strategy by the acquiror. Similar to non-compete covenants entered into by the disposition of equity interests in a seller, non-compete covenants entered into by the purchaser or grantee of interests in an acquiror take place in an environment distinct from a traditional employment relationship negotiation, and have not been the subject of rigorous empirical analysis establishing anticompetitive effects or other harms that justify their inclusion in any guidelines issued by the FTC.

V. GUIDELINES INSTEAD OF RULE

As detailed in Section II, there remain significant gaps in data and areas covered by the Proposed Rule that would benefit from further study before any remedy is determined to be necessary or adopted.[34] It is clear that even with respect to low-wage workers, data is limited.

The City Bar suggests that the FTC consider issuing guidelines to inform businesses and the public of its interpretation and intended enforcement policy of Section 5 of the FTC Act with respect to non-compete agreements, rather than issuing a rule. These guidelines should be informed by the substantial body of common law on non-competes. Guidelines would be more consistent with FTC practices and, as noted above, may avoid some of the thorny threshold constitutional, jurisdictional and procedural issues that the Proposed Rule may raise. Guidelines may also be more susceptible to future revisions, enabling the FTC to develop its policy as it gains more experience in this area. We suggest that these guidelines consider the substantive steps taken or being considered by many States, distinguishing between different groups of workers.

Existing antitrust guidelines issued by the FTC—such as the Antitrust Guidelines for the Licensing of Intellectual Property,[35] Horizontal Merger Guidelines,[36] and Antitrust Guidelines for Collaborations Among Competitors[37] (April 2000) (justice.gov)--can serve as an example of a framework where guiding principles and general policies are outlined to help an employer predict whether a non-compete agreement will be considered a violation of Section 5 or rather an enforceable, pro-competitive measure. Agency guidelines can include a number of benefits, such as greater transparency, predictability, and consistency to the antitrust community (legal

[34] See n.16 and accompanying text.
[35] Antitrust Guidelines for the Licensing of Intellectual Property (January 12, 2017) (justice.gov).
[36] Horizontal Merger Guidelines (August 19, 2020) (justice.gov).
[37] Antitrust Guidelines for Collaborations Among Competitors (April 2000) (justice.gov).

practitioners, antitrust economists, scholars, businesses and individuals, journalists among others) as to how the agencies will generally conduct non-compete investigations and make enforcement decisions. This involves: identifying the central questions that agency staff will ask during a review of a non-compete; helping businesses and their legal counsel to understand the kinds of evidence that will be the focus of agency attention; and explaining how that evidence will be analyzed. An equally important objective of agency enforcement guidelines is to ensure that the analytical framework adopted promotes sound antitrust policy. This can be done by connecting the guidelines to economics and other empirical studies.[38] Guidelines have been effective in other antitrust contexts, and we believe that guidelines would be effective in the non-compete context as well.

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[38] See, e.g., the ABA Section of Antitrust Law's Presidential Transition Report: The State of Antitrust Enforcement, January, 2017, at 5, 7-9, 16, 39; The Continuing Pursuit of Better Practices: Federal Trade Commission at 100: Into Our 2nd Century, The Continuing Pursuit of Better Practices, 2009, GWU Legal Studies Research Paper No. 596, GWU Law School Public Law Research Paper No. 596, at xvii, 128-32, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1967708 ; Daniel Francis, NYU School of Law, Revisiting the Merger Guidelines: Protecting an Enforcement Asset, CPI Antitrust Chronicle (Nov. 2022), at 3-7, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4273253 ; Hillary Greene, University of Connecticut School of Law, Guideline Institutionalization: The Role of Merger Guidelines in Antitrust Discourse, William & Mary Law Review, Vol. 48, No. 3, 2006, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1072982 ; Hillary Greene, University of Connecticut School of Law, Agency Character and Character of Agency Guidelines: An Historical and Institutional Perspective, Antitrust Law Journal, Vol. 72, p. 1039, 2005; Posted: 6 May 2008 Last revised: 15 Aug 2011, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1128263 ; DOJ/FTC Draft 2020 Vertical Merger Guidelines Comment of the Global Antitrust Institute, Antonin Scalia Law School, George Mason University, at 2, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3534352 .

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