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Client Alert

FTC Cracks Down on Non-Competes as Unfair Methods of Competition

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In a first-of-its kind enforcement action, on Wednesday the Federal Trade Commission announced settlements with three companies and two individuals who the agency claimed violated Section 5 of the FTC Act by imposing non-compete restrictions on their workers that the agency said constituted an unfair method of competition. The agency said these non-compete restrictions prevented workers from obtaining higher wages and impeded other companies' ability to compete.

This development is the latest in a string of moves by the federal antitrust agencies to increase enforcement of labor-related antitrust violations, and finds its footing in the FTC's recently issued Policy Statement on "rigorous enforcement" against unfair methods of competition. The FTC also separately announced a proposed new rule that would limit the use of non-compete clauses. Companies should expect continued scrutiny of restrictive covenants in the labor arena as part of this increased enforcement climate.

This week's enforcement actions targeted restrictive covenants in the security and glass manufacturing industries. The complaint against Prudential Security, Inc., Prudential Command Inc., and their owners, Greg Wier and Matthew Keywell, alleges that they required low-wage security guards to sign non-compete agreements prohibiting them from working for a competing business within a 100-mile radius of their job site for two years post-employment. The complaint asserts that Prudential used the agreements to block employees from accepting employment at higher wages with competitors. The FTC alleges these actions were coercive and exploitative.

In separate complaints against two glass container manufacturers, the FTC alleged that O-I Glass, Inc. and Ardagh Group S.A. used non-compete agreements that prohibited employees from working for any business selling similar products or services for one year in the United States (O-I Glass) or two years in North America (Ardagh) after termination. The complaints allege that the non-competes impeded competitor expansion of glass container manufacturing and harmed workers, including salaried employees such as engineers, with reduced wages.

Notably, the FTC's enforcement actions reflect the agency's view that workers are a competitive asset. In the O-I Glass and Ardagh cases, the FTC alleged that the non-compete provisions in this concentrated industry "locked up highly specialized workers, tending to impede the entry and expansion of rivals." These restrictions "deprive[d] aspiring entrants of access to a critical talent pool, thereby impeding entry into a relatively consolidated industry that has experienced tight supply and unmet customer demand."

In all three cases, the FTC ordered the companies to cease enforcing the agreements and to notify all affected employees that they are no longer bound by the provisions.

Chair Khan and Commissioners Slaughter and Bedoya issued a statement in connection with the administrative complaints, noting "the distinct grounds on which non-competes can be found to violate Section 5," which varied in these cases. In the Prudential case, the majority pointed to the presence of low-wage workers with minimal training, that a Michigan state court had previously held the non-competes unreasonable and unenforceable, and a liquidated damages clause of $100,000 for employees violating the noncompete. In the glass cases, the majority focused on the context of a concentrated industry with highly specialized workers. Mirroring language found in the Section 5 policy statement, the majority statement said that, "when a small number of dominant players engage in the same restrictive practices, the negative effects can compound. Section 5 of the FTC Act is uniquely designed to address this type of conduct, where the cumulative effect of parallel actions can in the aggregate tend to negatively affect competitive conditions."

Commissioner Wilson voted against issuing the administrative complaints, stating that: "Practices that three unelected bureaucrats find distasteful will be labeled with nefarious adjectives and summarily condemned, with little to no evidence of harm to competition. I fear the consequences for our economy, and for the FTC as an institution." Commissioner Wilson issued two dissenting statements noting that the Prudential complaint does not allege any anticompetitive effects and, because Prudential was sold to another company that does not employ non-compete agreements, is meant to send a signal rather than being a necessary enforcement action. In the other case, Commission Wilson says that the O-I Glass and Ardagh complaints do not allege that the non-competes are unreasonable, improperly discount business justifications for the provisions, and threaten due process given the fact that the companies had no notice that their conduct would be viewed as unlawful.

In a press release, Rahul Rao, Deputy Director of the FTC's Bureau of Competition, stated that the "FTC will continue to investigate, and where appropriate challenge, noncompete restrictions and other restrictive contractual terms that harm workers and competition."

With the FTC cracking down and the regulatory climate surrounding non-compete clauses rapidly evolving, companies that use restrictive covenants in employment agreements should ensure that they are as narrowly tailored as possible in terms of duration, geography, and industry scope to protect legitimate business interests, and that the rationale for the scope of the non-compete provisions is documented, to ensure that they do not expose companies to unnecessary antitrust risk.

Crowell & Moring's Antitrust and Competition, Labor and Employment, and Trade Secrets practices will continue to monitor and report on developments, including the FTC's announcement today launching a broad rulemaking proceeding regarding non-compete provisions in employment agreements.

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