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Noncompete Ban Tees Up 1st Test Of FTC's Rule Powers

By **Bryan Koenig**

Law360 (January 6, 2023, 9:17 PM EST) -- Industry advocates and members of the bar have come out swinging against the Federal Trade Commission's first attempt to deploy its essentially unused power to regulate unfair competition, a sweeping proposed ban on employment noncompete agreements.

Many attorneys characterize the move as an overreaction to the occasional misuse of legitimate contract language.

If the Jan. 5 proposal is enacted as is, it's sure to draw legal challenges claiming that the FTC plan would usurp the traditional role of state legislatures and state courts in determining whether noncompetes are reasonably crafted, and questioning whether the FTC even has the authority to impose a blanket ban. Opponents of the FTC plan are almost certain to note that the commission's lone Republican member contends that the agency has no such regulatory authority.

But William E. Kovacic, a former FTC Chairman who's now a professor at George Washington University Law School, contends that successfully defending the FTC's rulemaking authority may not be the primary goal of FTC Chair Lina M. Khan, who was picked to lead the agency as part of an administration-wide effort to rewrite the rules of U.S. antitrust law and enforcement.

The plan makes good on many FTC Democrats' long-time desire to make better use of the agency's statutory power to combat unfair methods of competition under Section 5 of the FTC Act.

"It's a demonstration of the frequently stated willingness to take more risks," said Kovacic, who asserted that simply making the attempt at regulating under Section 5 "has powerful symbolic value."

Biden administration officials at both the FTC and the U.S. Department of Justice Antitrust Division have frequently called for taking more risks and worrying less about potential court pushback as they try to correct for what advocates say has been decades of lax competition enforcement against mergers and conduct.

The new rulemaking also fits well with broader administration efforts to safeguard workers and with a recent FTC interest in noncompetes exemplified by what is perhaps the agency's first enforcement foray into the space, announced a day before the rule was proposed.

Kovacic said that the FTC's Democrats, who approved the proposed rulemaking on a 3-1 vote, likely see making the attempt at using their regulatory authority as what they were put in place to do, regardless

of the end outcome.

Many think that outcome will be a court rebuke.

"Today's actions by the Federal Trade Commission to outright ban noncompete clauses in all employer contracts is blatantly unlawful," the U.S. Chamber of Commerce's senior vice president for international regulatory affairs and antitrust, Sean Heather, said in a statement Thursday. "Since the agency's creation over 100 years ago, Congress has never delegated the FTC anything close to the authority it would need to promulgate such a competition rule.The Chamber is confident that this unlawful action will not stand."

However, the FTC's Democrats projected confidence Thursday that the proposal could survive a legal challenge. Khan told reporters there's "clear precedent" that the FTC can regulate unfair methods of competition, an authority she's pushed the FTC to use and that likely won't end with the noncompete regulation.

"This is a big pivot. It is something that's clearly been a priority for the chair," Crowell & Moring LLP antitrust partner Megan L. Wolf said of the move to antitrust rulemaking, which now goes out for public comment.

Wolf noted that the FTC's powers under Section 5, especially to issue antitrust rules — the agency frequently employs its consumer protection rulemaking authority — have largely gone unused, and there's little legal precedent establishing the FTC's regulatory power over unfair methods of competition.

Majed Dakak, a Kesselman Brantly Stockinger LLP partner, predicts the FTC can prevail over any legal challenges. The regulatory authority should be upheld "if read fairly," Dakak said. "The FTC Act is very broad in its breadth."

Whether the courts will agree is an open question, he said, conceding that judges, especially the U.S. Supreme Court, may push back on the breadth of agency power.

The FTC's sole Republican, Commissioner Christine S. Wilson, argued in a dissent that Section 5 is not clear enough in its delegation of rulemaking powers to be used in this way.

One key angle of attack on the rule if passed as is would be under the so-called major questions doctrine, in which the Supreme Court's conservative majority has said broad legislative language isn't enough to authorize regulations on significant national issues without clear Congressional say-so. Michael C. Schmidt, the vice chair of Cozen O'Connor's labor and employment department, said that noncompetes could be considered of such significance, one with important implications that have traditionally been handled under state law.

"For major questions, you need to find that Congress expressly and very clearly authorized the agency to issue this kind of regulation," Schmidt said.

Employment, trade secrets and antitrust attorneys also raised concerns on the breadth of the proposed ban when contrasted with the states that have attempted to limit the use of noncompetes, mostly with restrictions against noncompetes for lower-wage workers, although California has rendered all noncompetes unenforceable.

"This is not a narrow attempt to regulate commerce. This is basically attempting to do away with state legislation," said Robert B. Milligan, a partner with Seyfarth Shaw LLP's trade secrets, computer fraud and noncompetes practice. "This rule will have the effect of displacing that law," he continued, raising potential issues of federalism and state rights.

The proposed regulation in fact would proactively preempt any state rules that are "inconsistent" with the federal rule.

Around 10 states have already imposed wage-based limits on noncompetes, in ways that many attorneys say allow for nuance and balancing of distinct needs and policy goals, balancing that a blanket ban doesn't allow.

"Why does the FTC need to be as aggressive as it's trying to be when a state legislature is already filling the gaps?" asked Tobias Schlueter, the head of the unfair competition and trade secrets practice group at Ogletree Deakins Nash Smoak & Stewart PC.

Many attorneys, like Ogletree shareholder Christine Townsend of the firm's labor and employment practice, say that there's a general recognition that banning noncompetes for low-wage workers would be appropriate. But Townsend expressed surprise that the FTC would consider a rule that could lump in low-wage employees with senior executives, sales professionals and others who could be privy to important trade secrets.

"The proposed rule doesn't acknowledge that long history of enforcement of legitimate noncompetes," said Jason M. Knott, a partner and employment lawyer with Zuckerman Spaeder LLP.

Others argue there's a reason states have applied a balancing test to judging the reasonableness of noncompete provisions.

"It is not a one-size-fits-all rationale for why a noncompete makes sense," said Amanda Wait, the head of antitrust at Norton Rose Fulbright and a former FTC lawyer.

The FTC, for its part, asserts that there are other ways to safeguard trade secrets without restricting worker mobility in a way it contends costs the economy hundreds of billions of dollars annually.

"There's already laws on the books," said Dakak, who likened noncompetes to "starting a forest fire because you've got one tree you want to chop down."

Others argue that nondisclosure, non-solicitation and similar contract provisions aren't enough to protect trade secrets and the investments employers pour into training new workers.

"You have no visibility as to what happens when someone goes to a new employer," said David J. Woolf, an employment attorney and partner at Faegre Drinker Biddle & Reath LLP.

Compliance with NDAs, Woolf said, is "impossible to monitor," and many workers are under great pressure to use what's in their head at a new employer. "There's just no way to protect that through an NDA," he said.

Norton Rose's Wait also argues that antitrust enforcers themselves have expressed skepticism at the

efficacy of contractual safeguards. For instance, in its unsuccessful challenge of UnitedHealth's purchase of Change Healthcare, the DOJ had argued that legal firewalls were insufficient to prevent United Healthcare from gaining access to confidential data from rival health insurers that passed through Change's networks.

Nor would all other safeguards be acceptable under an FTC warning in the rulemaking that it would also target NDAs and similar restrictions deemed so sweeping that they amount to "de facto" noncompetes. The FTC left the definition of such de facto language largely open-ended, raising concerns that it would be up to the agency to decide what counts and what doesn't.

"The proposed rule is not clear," said Eric Akira Tate, co-chair of the global employment and labor group at Morrison Foerster LLP.

Blank Rome LLP employment partner Leigh Ann Buziak also said the de facto agreements are a relatively "nascent trendline" that have only been addressed in a few court cases, making it surprising for her that the FTC would weigh in when the law is relatively underdeveloped and when confidentiality agreements are in most cases "almost certainly enforceable."

Discussions about the currently proposed rule's propriety depend on it remaining the same. But the FTC's Democrats left open the possibility for change, asking for public comment on whether the rule should treat senior executives, chain franchisees and others differently.

Narrowing the rule could draw its own kind of pushback, according to Kovacic.

"There's only so far they can go in narrowing the scope of the rule but to still satisfy their advocates in the White House, in the Congress, in the advocacy groups," he said.

One advocate for the rule as proposed is Rep. David N. Cicilline, D-R.I., who chaired the House antitrust subcommittee until Democrats lost control of the chamber. In a statement, Cicilline called noncompetes "a fundamental threat to workers' economic freedom."

"Some of these agreements even prevent workers from finding new employment after being fired without cause," said Cicilline. "These clauses drive down wages and prevent workers from moving onto better, and sometimes more lucrative, job opportunities and, in some cases, can hinder an employee's ability from leaving a hostile work environment."

Other lawmakers on both sides of the aisle also voiced support for the rulemaking.

"Restrictive noncompete agreements suppress economic growth, discourage innovation and are barriers to market entry for entrepreneurs. Noncompetes are neither pro-business nor pro-worker, and Americans deserve flexibility to freely pursue their careers," Sen. Kevin Cramer, R-N.D., said in a group of statements also issued by Sens. Chris Murphy, D-Conn.; Todd Young, R-Ind. and Tim Kaine, D-Va., who have collectively pushed legislation that would restrict noncompetes.

"This is why North Dakota largely prohibited noncompetes years ago. The FTC's proposed rule follows our state's leadership."

--Editing by Dave Trumbore.

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