April 19, 2023

Federal Trade Commission
Office of the Secretary
600 Pennsylvania Ave. NW
Suite CC-5610 (Annex C)
Washington, DC 20580

RE: **Notice of Proposed Rulemaking, RIN 3084-AB74**

Dear Ms. Tabor:

HR Policy Association welcomes the opportunity to submit the following comments for consideration by the Federal Trade Commission ("FTC" or "Commission") in response to the published Notice of Proposed Rulemaking ("NPRM") and Request for Comments regarding the use of non-compete agreements between employers and employees.[1]

HR Policy Association ("HR Policy" or "Association") is a public policy advocacy organization that represents the most senior human resources officers in more than 400 of the largest corporations doing business in the United States and globally. Collectively, these companies employ more than 10 million employees in the United States, nearly nine percent of the private sector workforce, and 20 million employees worldwide. The Association's member companies are committed to ensuring that laws and policies affecting the workplace are sound, practical, and responsive to the needs of the modern economy.

Executive Summary

In the first instance, the Association asserts that the Commission does not have authority to ban non-compete agreements, and therefore the Proposed Rule is unlawful. Nevertheless, the Association welcomes the opportunity to provide comment on the substance of the Proposed Rule given the importance of this issue.

The Commission's Proposed Rule to ban non-compete agreements under almost every circumstance is, at its heart, the product of several misconceptions regarding the use of non-compete agreements. These misconceptions include the idea that such agreements unfairly prevent competition, when in reality, when used reasonably, they prevent only *unfair* competition.[2] Non-compete clauses as used by most companies do not prevent employees from leaving the company and working elsewhere – they merely provide a reasonable cooling-off

[1] Notice of Proposed Rulemaking: Non-Compete Clause Rule 88 Fed. Reg. 3482 (proposed Jan. 19, 2023).
[2] *See, e.g.*, *Noncompete Agreements and American Workers: Hearing Before the Subcomm. On Small Business and Entrepreneurship*, 116th Cong. 70-84 (2019) (Written Testimony of Russell Beck, Partner, Beck Reed Riden LLP).

period for employees who intend to perform their same job at a direct competitor. Once the cooling-off period has expired, the employee is free to compete, and in many cases, is able to work the length of the cooling-off period at the new employer in a different role.

A second misconception is the belief that companies regularly coerce workers into signing non-compete agreements to the workers' own detriment. Indeed, the Commission claims that nearly 20 percent of all American workers are subject to non-compete agreements, and that such agreements are generally the product of unequal bargaining power between employers and employees (and low-wage employees in particular). In reality, the available evidence – cited by the Commission itself in the Proposed Rule – indicates both that non-compete agreements are significantly less prevalent than what is being claimed in the Proposed Rule, and that such use is most often limited to senior executives through balanced negotiation.

The Commission eschewed a tailored rule that effectively targets the subset of non-compete agreement usage that may unfairly restrict low-wage workers in favor of a total ban that would also eliminate millions of contractual agreements – the majority of non-compete agreements – that benefit employees, their employers, and the American economy as a whole. In essence, the Commission is throwing the baby out with the bathwater. At minimum, the Association strongly believes that any final rule should specifically exempt executive level employees as well as employees with access to trade secrets and other proprietary or confidential information.

The Association welcomes the opportunity to provide comments to the Commission to properly characterize the lawful and fair use of non-compete agreements and correct several misconceptions to the contrary.

I. THE FTC LACKS THE AUTHORITY TO BAN NON-COMPETE AGREEMENTS

As a threshold matter, the Commission does not have the authority to issue the Proposed Rule for three primary reasons: (1) the Commission does not have statutory authority to issue the type of substantive rulemaking at issue here; (2) the Commission lacks clear Congressional authorization to undertake a rulemaking of this scope, in contradiction with the Supreme Court's decision in *West Virginia v. EPA*; and (3) the rule is an impermissible delegation of legislative authority under the non-delegation doctrine.

A. The Commission Does Not Have Statutory Authority to Issue Substantive Rulemaking Governing Unfair Methods of Competition

The Commission, in its Proposed Rule, argues that its rulemaking is being conducted pursuant to Sections 5 and 6(g) of the Federal Trade Commission Act ("FTC Act"). The relevant portions of statutory text from these sections prohibit "unfair methods of competition" and "unfair or deceptive acts or practices in or affecting commerce" and empower the Commission to enforce such provisions as well as promulgate procedural rules governing such enforcement.[3]

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[3] 15 U.S.C. § 46(g); 15 U.S.C. § 45; *see also* Notice of Proposed Rulemaking: Non-Compete Clause Rule 88 Fed. Reg. 3482, 3544 (proposed Jan. 19, 2023).

The Commission claims that its rulemaking authority under Section 6(g) extends to substantive rules regarding competition – such as the rule in question here – but such a claim has little basis in the history of the FTC Act or the Commission's exercise of its regulatory authority. Indeed, for much of the Commission's history, its leadership consistently testified before Congress that the FTC lacked substantive rulemaking authority.[4] Further, Congress has had ample opportunity to explicitly provide the Commission with substantive rulemaking authority governing unfair methods of competition, both at the time the Act was initially passed, and with several subsequent amendments to the Act over the years. In each instance, it has declined to do so.

Congress has provided the Commission with *some* substantive rulemaking authority in successive amendments, including for unfair or deceptive acts and practices, but has specifically declined to extend such authority to unfair methods of competition.[5] Congress therefore clearly recognizes that it holds the power to delegate substantive rulemaking authority to the Commission, and has in fact done so on several occasions; it has, however, never done so for unfair methods of competition, a category in which the Proposed Rule clearly falls into. In sum, the Commission does not have the statutory authority to issue substantive rules regarding unfair methods of competition, and therefore does not have the authority to issue the Proposed Rule.

B. The Commission Lacks "Clear Congressional Authorization" to Issue the Proposed Rule

The major questions doctrine further casts doubt on the Commission's authority to issue the Proposed Rule. Under the major questions doctrine as articulated in the Supreme Court decision in *West Virginia v. EPA*, administrative agency actions that involve "major questions" are closely scrutinized to determine whether Congress clearly authorized such an action.[6] Where such clear authorization is absent, the agency action is invalid. As Justice Gorsuch explained, agency action involves a "major question" if the agency claims the power to (1) resolve a matter of great political significance; (2) regulate a significant portion of the American economy; or (3) intrude into an area that is the particular domain of state law.[7]

The Commission's Proposed Rule qualifies as a major question under each of the above three categories. The usage of non-compete agreements is undoubtedly a matter of great political significance; Congress has introduced and debated numerous bills over the years that would ban or limit the use of non-compete agreements. Indeed, at least three bills are currently before Congress that would regulate the use of non-compete agreements.[8] The Proposed Rule would similarly clearly regulate a significant portion of the American economy. By the Commission's own admission, the Proposed Rule would render approximately 30 million[9] non-compete agreements null and void across nearly all sectors of the American economy. Finally, the rule would intrude into an area that is governed by state law; as discussed below, 47 states allow for non-compete agreements under certain conditions, while three ban them in almost every

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[4] *See, e.g.* Noah Joshua Phillips*, Against Antitrust Regulation, American Enterprise Institute Report 3,* https://www.aei.org/research-products/report/against- antitrust-regulation/ (Oct. 13, 2022).

[5] *See, e.g.*, Magnuson-Moss Warranty—Federal Trade Commission Improvement Act, Public Law 93–637, 88 Stat. 2183 (1975).

[6] *West Virginia v. EPA*, 142 S. Ct. 2587 (2022).

[7] *Id*. at 26000-01 (Gorsuch, J. concurring).

[8] *See, e.g.* Workforce Mobility Act, S. 220, 118th Cong. (2023).

[9] As discussed further below, the Association submits that this estimate is overstated. Nevertheless, under any reasonable estimate, the Proposed Rule would clearly impact a significant portion of the economy.

circumstance. The use of non-compete agreements has been the domain of state law for over 200 years, which supports the assertion that the Proposed Rule is a major question.

Given that the Proposed Rule is a "major question" under *West Virginia v. EPA*, the question remains whether the Commission was given clear Congressional authorization to issue such a rule. As discussed in Section I.A., the Commission lacks such explicit authorization, and the rule is therefore invalid under the major questions doctrine.

C. The Proposed Rule Violates the Non-Delegation Doctrine

Under the non-delegation doctrine, Congress is constitutionally prohibited from delegating its legislative authority to another branch of government – in this case administrative agencies. Per the Supreme Court, such delegations are only valid as long as Congress has set out "an intelligible principle to which the person or body authorized to fix [rules] is directed to conform."[10] Whether or not such an intelligible principle exists is generally a question of statutory interpretation, with the answer involving "construing the challenged statute to figure out what task it delegates and what instruction it provides."[11] Congress clearly did not delegate the task of issuing substantive rules governing unfair methods of competition to the Commission, nor did it provide any instruction to the same effect. Accordingly, the Proposed Rule is an impermissible delegation of Congressional authority.

II. THE PROPOSED RULE VIOLATES THE ADMINISTRATIVE PROCEDURE ACT

Even assuming *arguendo* that the Commission *does* have the authority to issue the Proposed Rule, we believe it is nevertheless unlawful under the standards set forth in the Administrative Procedure Act ("APA"). The APA empowers courts to invalidate agency rules if they are arbitrary and capricious.[12] Specifically, rules are invalid if they are not the product of "reasoned decision making," and if the agency "failed to consider an important aspect of the problem [and/or] offered an explanation for its decision that runs counter to the evidence before the agency."[13] As outlined below in Sections III, IV, and V, the Proposed Rule is not the product of reasoned decision-making, fails to consider the legitimate use of non-competes at most large companies and the impact of a total ban, and ignores and/or mischaracterizes significant evidence that weighs against the Commission's underlying justifications for its Proposed Rule. The Proposed Rule is therefore arbitrary and capricious in violation of the APA.

While the Proposed Rule overall is arbitrary and capricious, two aspects of the Proposed Rule bear particular mention. First, including "de facto" non-compete agreements in the Proposed Rule's ban provides the Commission with nearly boundless authority to negate almost any type of restrictive covenant while offering no meaningful guidance for employers. The Proposed Rule, while providing some examples of restrictive covenants that would qualify as "de facto" non-compete agreements, fails to articulate meaningful limits or tests on what could constitute a "de facto" non-compete agreement. Companies negotiating employment agreements would be left in the dark regarding whether certain clauses would be lawful under the Rule. For example, the Proposed Rule would

[10] *J.W. Hampton, Jr., & Co. v. United States*, 276 U.S. 394, 409 (1928).
[11] *Gundy v. United States*, 139 S. Ct. 2116, 2123.
[12] 5 U.S.C. §§ 701-706.
[13] *See, e.g.*, *Motor Vehicle Manufacturers Ass'n v. State Farm Auto Mutual Insurance Co.*, 462 U.S. 29 (1983).

create uncertainty as to whether confidentiality agreements between an employer and their current employees would be viewed by the Commission as "de facto" non-compete agreements. This type of legal uncertainty is not the product of reasoned rulemaking and would undoubtedly lead to significant increases in litigation over "de facto" non-compete agreements.

Second, the Proposed Rule's arbitrary 25 percent threshold for its business sales exception is arbitrary, unreasonable and would effectively ban non-compete agreements in nearly all larger mergers or acquisitions. The Commission claims that its 25 percent threshold:

> [S]trikes the appropriate balance between a threshold that may be too high (and would exclude many scenarios in which a non-compete clause may be necessary to protect the value of the business acquired by the buyer) and a threshold that may be too low (and would allow the exception to apply more broadly than is needed to protect such an interest).[14]

The 25 percent threshold, and the Commission's justification for it, fails to account for the reality that in the majority of corporate acquisitions, executive officers and employees with access to valuable confidential information (individuals for whom a buyer would require protections provided by non-compete agreements) almost never have ownership in the selling entity that comes even close to the Commission's 25 percent threshold. This threshold is therefore another example of the rule's unreasonable and arbitrary nature.

III. A BLANKET BAN IS UNNECESSARY AND INAPPROPRIATE

To the extent that some non-compete agreements are unfair in use and scope towards workers, we believe a total ban at the federal level is unnecessary to remedy such potential abuses. State laws and the courts that interpret such laws (and the common law) already provide an effective legal backstop against non-compete agreements that are overly broad or restrictive, or used unnecessarily against certain groups of workers.

A. State Laws

In its Proposed Rule, the Commission provides a comprehensive overview of state laws governing the use and enforceability of non-compete agreements.[15] As the Commission notes, nearly all states (47) allow for the use and enforcement of non-compete agreements, with certain conditions and limitations to ensure reasonable and fair usage. Notably, even the state of California (one of three jurisdictions to generally prohibit non-compete agreements) provides certain exceptions that allow for the use of such agreements in limited circumstances.[16] To the extent that certain non-compete agreements unfairly restrict or negatively impact workers, existing state laws already work to protect these same workers against abuse.

[14] Notice of Proposed Rulemaking: Non-Compete Clause Rule 88 Fed. Reg. 3482, 3494-96 (proposed Jan. 19, 2023).
[15] Notice of Proposed Rulemaking: Non-Compete Clause Rule 88 Fed. Reg. 3482, 3494-96 (proposed Jan. 19, 2023).
[16] Cal. Bus. & Prof. Code § 16600-16602.5.

States have governed the usage of non-compete agreements for more than a century. Nearly all state laws in this area explicitly or implicitly recognize the potential benefits of such agreements for all stakeholders under certain conditions, and, accordingly, instead of completely banning their use, provide limitations and conditions on their scope and enforceability to ensure that these benefits may continue without unfairly and unreasonably impacting workers. Such equitable balancing reflects decades of experience with non-compete agreements and employment law in general.

B. Judicial Interpretations

Like state laws, courts already provide a well-established backstop to overly broad or unfair non-compete agreements. Indeed, "most courts...note that the law looks at these contracts with 'disfavor' and subjects them to careful scrutiny."[17] In general, courts will determine the enforceability of a non-compete agreement based on specific factors such as:

> (1) Whether an employer's legitimate business interest exists; (2) whether the geographic scope is reasonable; (3) whether duration is reasonable; (4) whether adequate consideration exists; and (5) whether the non-compete violates public policy or imposes undue hardship on the employee.[18]

The burden is on the employer to prove a legitimate business interest that is worthy of protection via the non-compete agreement in question.[19] Recognized interests include employer investment in employee training, employee knowledge of confidential information or trade secrets, and employee contact with customers (i.e., customers only interact with the business through the employee).[20] Notably, in the first instance, providing general skills training – and not specialized skills training – is not considered a legitimate business interest.[21] Each of these factors are also evaluated based on their "reasonableness." Geographic scope, for example, is limited to "what is reasonably necessary to protect the employer's business," while temporal scope for client-facing employees is typically limited to the time necessary to hire and train a replacement both internally and in the eyes of customers.[22]

In short, judicial interpretation of non-compete agreements provides several limits on the use and scope of non-compete agreements, and employers are therefore already precluded from enforcing overly broad or unfair non-compete agreements. Further, these limits do not just apply to overly broad or unfair non-compete agreements themselves, but to the application of *any* such agreement to employees for which they are unnecessary.

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[17] Kenneth R. Swift, *Void Agreements, Knocked-out Terms, and Blue Pencils: Judicial and Legislative Handling of Unreasonable Terms in Noncompete Agreements*, 24 HOFSTRA LAB. & EMP. L.J. 223, 225 (2007).
[18] Hui Shangguan, *A Comparative Study of Non-Compete Agreements for Trade Secret Protection in the United States and China*, 11 WASH J.L. TECH. & ARTS 405, 410-12 (2016).
[19] *Id*.
[20] Rachel Argenbright Rioux, *The Necessity for Employer Liability in Unenforceable Non-compete Agreements*, 86 UMKC L. Rev., 995, 999 (2018).
[21] Swift, *supra* note 17, at 225-226.
[22] *Id*. at 237-239.

An illustrative example of these safeguards involves the bête noire of those urging prohibitions on the use of non-compete agreements – and perhaps the genesis of the current regulatory and legislative campaign against such agreements – the sandwich chain Jimmy John's. Jimmy John's began requiring their low-wage workers to sign non-compete agreements that prohibited them from working for another sandwich company within three miles of any Jimmy John's location for a certain period of time. The company was subsequently sued by its workers and became the poster child of excessive use of non-compete agreements, particularly for low-wage workers. The various lawsuits were either settled or dropped, in each case on the basis of Jimmy John's submitting that it would not enforce the non-compete agreements in question nor continue to require them for its employees.[23] In short, the very same non-compete agreements that became a flashpoint in the debate over the use of such agreements proved to be either unenforceable in court or such policies were abandoned by employers that had previously utilized them.

IV. THE COMMISSION MISCHARACTERIZES THE USE AND SCOPE OF NON-COMPETE AGREEEMENTS TO SUPPORT AN UNNECESSARILY BROAD BAN

To the extent that some employers continue to utilize non-compete agreements in an excessive and unfair manner, despite the limitations already in place by state laws and courts, such a problem has been grossly mischaracterized and overstated by the Commission in its Proposed Rule. This mischaracterization includes not only flawed assumptions on the scope of usage of non-compete agreements based on inconclusive and incomplete research, but also the nature of such use. While greater safeguards for lower-wage employees lacking sufficient bargaining power may be appropriate, [24] this does not necessitate a total ban on all non-compete agreements for all workers. Limited use of reasonably tailored non-compete agreements, particularly for executive-level employees and those that have access to trade secrets and other proprietary or confidential information, are beneficial for all stakeholders. Such usage should not be prohibited by any final rule regulating non-compete agreements.

A. The Commission Relies on Flawed and Inconclusive Data to Paint a False Narrative of Issues Associated with Non-Compete Agreements

In its Proposed Rule, the Commission makes several assertions regarding the use of non-compete agreements that are misleading at best and erroneous at worst. These assertions form the basis of the Commission's justifications for a broad ban on non-compete agreements, as they collectively paint a portrait of widespread use and abuse of non-compete agreements for all American workers. As discussed below, these assertions do not hold up to close scrutiny, and accordingly, the Commission has mischaracterized the problems associated with such agreements.

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[23] *See, e.g.* Rioux, *supra* note 20, at 997; Daniel Wiessner, *Jimmy John's Settles Illionis Lawsuit Over Non-compete Agreements*, REUTERS (Dec. 7, 2016), https://www.reuters.com/article/us-jimmyjohns-settlement/jimmy-johns-settles-illinois-lawsuit-over-non-compete-agreements-idUSKBN13W2JA

[24] The Association would, however, again submit that such safeguards are already in place at the state level and via judicial review.

1. The Prevalence of Non-Compete Agreements in the Labor Market is Overstated

The Commission "estimates that approximately one in five American workers – or approximately 30 million workers – is bound by a non-compete clause."[25] These estimates are based on three studies: one conducted nearly a decade ago involving less than 12,000 workers,[26] one conducted using a survey of less than 9,000 workers born between 1980-1984, and one conducted using a survey of four specific worker populations: executives, physicians, hair stylists, and electrical and electronic engineers.[27] The Commission ostensibly extrapolated the data from each of these studies to estimate that 20 percent of the working population is bound by a non-compete agreement. This seems to be a significant leap, especially when two of the three studies cited – and the only two of the three to survey across all industries – showed the percentage of workers covered by a non-compete agreement to be less than the 20 percent asserted by the Commission. Indeed, the Commission itself admits that "there is no consistent data available on the prevalence of non-compete clauses over time."[28] It is troubling, then, that the Commission would justify its proposed ban based on ballpark estimates rather than rigorous statistical analysis.

The Association conducted a survey of its more than 400 large member companies regarding their usage of non-compete agreements. More than a quarter of the membership participated in the survey, collectively covering nearly 3 million employees across a wide variety of industries. In stark contrast to the findings of the Commission, 75 percent of respondents indicated that they use non-competes for less than 10 percent of their employees.[29] Nearly a third reported using such agreements for *less than one percent*. Only 11 percent reported using such agreements for more than 20 percent of employees. While the Association's survey does not cover the entirety of the American workforce, it does cover millions more employees than the surveys relied upon by the Commission. These survey results once again cast serious doubt on the assertion that 20 percent of American workers are covered by non-competes.

The Commission's overestimation is significant given that it is being used to justify a total ban on a practice the rule characterizes as widespread, when in reality non-compete usage falls below – perhaps well below – this 20 percent assertion. The Commission is claiming a total ban is necessary to fix what it views as a correspondingly large "problem," but compelling evidence indicates that to the extent a problem exists, it is much smaller in scale than what is being claimed. In short, the usage of non-compete agreements by companies is far more limited than the Commission claims, and to the extent that some of that usage is problematic for American workers, such issues can be solved through a targeted and tailored solution[30] rather than a total ban.

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[25] Notice of Proposed Rulemaking: Non-Compete Clause Rule 88 Fed. Reg. 3482, 3485-86 (proposed Jan. 19, 2023).

[26] Notably, one of the authors of this study, Professor Evan Starr, has in fact testified before Congress in 2019 on the legitimate purposes served by properly used non-compete agreements, including incentivizing worker investment and protecting trade secrets. *See,* Russell Beck & Erika Hahn, *Noncompete Misconceptions May Be Inhibiting Reform*, LAW360 (Dec. 17, 2019), https://www.law360.com/articles/1228569/noncompete-misconceptions-may-be-inhibiting-reform.

[27] Notice of Proposed Rulemaking: Non-Compete Clause Rule 88 Fed. Reg. 3482, 3485-86 (proposed Jan. 19, 2023).

[28] *Id*. at 3486.

[29] A similar survey conducted by the U.S. Chamber of Commerce, which covers *even more* American workers, shows a similarly high rate of employers who use non-compete agreements for less than 10 percent of their workforce: 62 percent.

[30] The Association submits that the states already regulate any such problem but that any federal solution should come from the legislative branch rather than via executive branch regulatory action.

2. *The Commission's Claims that Non-Compete Agreements Negatively Impact Worker Wages are Overstated*

The Commission also puts forth several assertions that current usage of non-compete agreements negatively impacts American workers and the economy. Specifically, the Commission claims that non-compete agreements "reduce the earnings of workers" generally and increase gender and racial pay gaps.[31] Such claims are overstated and largely based on inconclusive data evidence.

The Commission cites several studies to support its assertion that increased enforceability of non-compete agreements unfairly depresses worker wages across the entirety of the labor market.[32] As part of this same discussion, however, the Commission also notes three separate studies that show a positive association between the use of non-compete agreements and higher wages, seemingly contradicting its own argument.[33] The Commission dismisses such studies as insufficiently "probative of the effects of non-compete clauses on earnings," on the basis that such studies are only concerned with the use of non-compete agreements alone, and not their enforceability.[34] The Commission expresses a "concern...that non-compete clause use and earnings may be both determined by one or more confounding factors," while claiming that such concerns do not exist for the studies cited showing an association between non-compete agreement enforceability and wage depression.[35]

It seems clear, as the Commission itself suggests, that the data linking non-compete agreements and worker wages is "preliminary and inconclusive" at best.[36] While some studies provide some evidence that non-compete agreements may depress worker wages, others show that such agreements may increase worker wages, particularly in industries such as healthcare. Indeed, beyond those cited by the Commission, some studies have concluded that "employees will obtain higher wages that offset any future restrictions on their autonomy," particularly where employees are given full notice before entering into non-compete agreements.[37]

Issues associated with the use and enforceability of non-compete agreements are nuanced and contextual, particularly across different industries and employee groups. Such a multi-faceted problem requires a more tailored solution that addresses the true scope of the problem.[38] Accordingly, a one-size-fits all total ban is inappropriate and threatens to eliminate the positive effects usage of such agreements may have for different groups of workers, companies, and the economy as a whole.

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[31] Notice of Proposed Rulemaking: Non-Compete Clause Rule 88 Fed. Reg. 3482, 3486-92 (proposed Jan. 19, 2023).
[32] Once again, it is worth noting that two of the studies cited were again conducted by Professor Evan Starr, who, as noted in Footnote 26, has testified before Congress on the benefits of non-compete agreements for American companies, American workers, and the American economy as a whole.
[33] Notice of Proposed Rulemaking: Non-Compete Clause Rule 88 Fed. Reg. 3482, 3487-88 (proposed Jan. 19, 2023).
[34] *Id*. at 3487.
[35] *Id*.
[36] Beck & Hahn, *supra* note 26.
[37] *See. e.g.*, Alan J. Meese, *Don't Abolish Employee Noncompete Agreements,* 57 WAKE FOREST L. REV. 631 (2022).
[38] Again, the Association would submit that state laws already achieve such a balanced approach.

The Commission's assertions regarding racial and gender pay gaps and effects on new business formations reveal similar shortcomings and once again indicate that the scope of the non-compete agreement use problem is more limited and nuanced then is represented in the rule. To back up the claim that "non-compete clauses increase racial and gender wage gaps by disproportionately reducing the wages of women and non-white workers," the Commission provides three sentences and one cited study.[39] Such a claim is premised on the initial assertion that non-compete agreements depress wages in general, and thus racial and gender wage gaps are worsened as a result, or that (in the eyes of the Commission) because employees are restricted from leaving for a higher wage at a direct competitor, companies are encouraged to engage in discriminatory behavior. However, the Commission provides no evidence that non-compete agreements are directly tied to discriminatory behavior by employers.[40] To justify a total ban on non-competes on this basis is illogical.

3. *Non-Compete Agreements are Not Generally the Result of Unequal Bargaining Power*

In its Proposed Rule, the Commission paints a picture of non-compete agreements being foisted upon employees with unequal bargaining power, workers who are unaware of (or do not understand) the impact of signing such agreements or do not have a choice. The Association does not deny that there are circumstances where low-wage workers may have little choice but to sign employment contracts that include non-compete agreements, or that such instances may be detrimental to such workers. Such instances, however, represent a significantly minor percentage of the total use of non-compete agreements by companies, as evidenced by our and other trade association surveys.[41]

As detailed further below in Section B, in many cases,[42] non-compete agreements used by companies are the product of negotiation between sophisticated parties, often represented by legal counsel, and often in consideration of a specific benefit such as an equity award or severance agreement. There is little if any inequality in bargaining power in such situations, nor is there significant evidence that non-compete agreements are generally the result of unequal bargaining power.[43] Instead:

> Prospective employees will demand additional compensation in return for entering a noncompete agreement, given that such a contract will restrict employees' ability "to access more lucrative outside employment options during the term of the agreement." These wage demands will induce employers to internalize the prospective costs that the provision imposes on such employees... As a result, employers would only adopt such provisions if the benefits, e.g., higher productivity resulting from enhanced training, exceeded the employee's anticipated costs, reflected in higher wages [or a separate benefit]. The employer's payment of premium wages that induce such an agreement thereby shares with employees the gains that such contracts make possible.[44]

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[39] Notice of Proposed Rulemaking: Non-Compete Clause Rule 88 Fed. Reg. 3482, 3488 (proposed Jan. 19, 2023).
[40] Regardless, workplace discrimination is already prohibited by Title VII, which is enforced by the EEOC. It is therefore unnecessary to ban non-compete agreements on this basis.
[41] Add cite to surveys.
[42] At least amongst Association member companies.
[43] Meese, *supra* note 37, at 666-677.
[44] *Id*. at 666-67.

The Commission claims that most labor markets are highly competitive and concentrated, and as such, employers are incentivized to coerce employees into non-compete agreements restricting their movements within such markets. Again, available evidence pushes against such an assertion; in fact, "most employees work in unconcentrated markets," and "even if all employee non-compete agreements arose in [concentrated markets], this would not justify even a rebuttable presumption that these agreements are the result of economic coercion," as "even firms with monopoly or monopsony power" would not be incentivized to impose unfair contractual terms on employees.[45]

To the extent that some non-compete agreements are the result of unequal bargaining power between an employer and (most often) low wage workers, such agreements are only a fraction of the overall usage of non-competes, and do not alone justify a total ban on all such agreements.

B. Most Companies Limit the Usage and Scope of Non-Compete Agreements for Specific Purposes and Employee Groups

As discussed briefly above, the majority of Association member companies utilize non-compete agreements for less than 10 percent of their employees. More specifically, our survey showed that our member companies, in nearly all cases, used non-compete agreements solely for executive or leadership level employees or those employees with specific access to confidential and proprietary information.[46] Further, a majority of survey respondents reported that their non-compete agreements remain in effect for no more than a year after the employee's departure, and as little as six months for non-executive officers. Finally, a majority of survey respondents reported that their non-compete agreements are included in equity plans, award agreements, or severance agreements, and not as part of the initial employment agreement.[47]

To put it succinctly, Association member companies, which again, collectively employ millions of workers, generally only use non-compete agreements for executive level employees or those employees that have access to sensitive information. Further, such agreements are limited in temporal scope and are most often included as consideration for equity awards or severance agreements (i.e., tied to a specific benefit). These agreements are the result of negotiation between sophisticated parties often represented by legal counsel, not an imbalance in bargaining power between the employer and the employee. Finally, these agreements are entered into to protect trade secrets, intellectual property, and proprietary information and (to a lesser extent) the company's goodwill and reputation with its customer base, each of which are reasonable justifications recognized under state law and by the courts.[48]

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[45] *Id*. at 668.

[46] Nearly half of respondents also reported using non-compete agreements for equity recipients, as a condition of receiving such equity.

[47] It is important to note that our survey specifically asked about the use of non-compete agreements. It is our understanding that the FTC's proposed rule only applies to non-compete agreements, and does not (and should not) apply to forfeiture clauses (in which the employee is free to compete but may forfeit unpaid severance, unvested equity or other benefits if they do) or other reasonable restrictive covenants such as non-disclosure agreements or clawback provisions.

[48] *Noncompete Agreements and American Workers: Hearing Before the Subcomm. On Small Business and Entrepreneurship*, 116th Cong. 70-84 (2019) (Written Testimony of Russell Beck, Partner, Beck Reed Riden LLP).

V. A TOTAL BAN ON NON-COMPETE AGREEMENTS WOULD HAVE NEGATIVE CONSEQUENCES FOR ALL STAKEHOLDERS

The Commission is proposing a total ban on nearly all uses of non-compete agreements on the basis of a subset of abusive practices that would likely be rendered unlawful in a court of law at any rate. Such a ban would destroy the significant majority of non-compete agreements that are reasonable in scope and created for legitimate business purposes to the substantial detriment of companies and workers alike. Negative consequences of such a wide-ranging ban include disincentivizing employers to invest in their employees, significant corporate forfeiture as a result of the ban retroactively rescinding existing non-compete agreements, a chilling effect on corporate dealmaking and the value of sale assets, and significant loss of trade secrets and confidential information – including exfiltration of trade secrets to other countries. Such wide-ranging implications alone support the Commission moving away from a blanket ban.

A. Eliminating Non-Compete Agreements Would Disincentivize and Decrease Investments in Employees

In its Proposed Rule, the Commission acknowledges that "there is evidence that non-compete clauses increase employee training and other forms of investment," and cites three studies that demonstrate the same.[49] One such study observed that rendering non-compete agreements unenforceable "would decrease the number of workers receiving training" by nearly 15 percent, while "knowledge-intensive firms [would] invest 32% less in capital equipment." [50]

A separate report published by the U.S. Department of the Treasury found:

> Firms and workers use non-competes to encourage more investment in workers. In general, firms are reluctant to pay for training that improves a worker's "general" skills and makes her more valuable to it and other firms alike. Economists usually think of general training as occurring when workers accept wage cuts to compensate their employer for its expenses in providing the training. For various practical reasons, however, workers may be unwilling to pay for training. Non-competes offer an alternative: firms get an assurance that workers are unlikely to leave for some period of time, allowing the firm to capture more of the increased productivity from costly training it provides, and workers receive more training than they otherwise would.[51]

These findings align with Association member company practices, particularly in STEM and tech industries, which both involve intensive, continuous, job-specific training while facing a critical shortage of qualified talent. For Association members, research and development investments with longer-term time horizons need to be protected and safeguarded to drive growth and competitive success, particularly globally. As with any long-term investment, training investments in employees necessitate certain protections both for their success and to

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[49] Notice of Proposed Rulemaking: Non-Compete Clause Rule 88 Fed. Reg. 3482, 3493 (proposed Jan. 19, 2023).
[50] *Id*.
[51] OFF. OF ECON. POL'Y, U.S. DEP'T OF THE TREASURY, NON-COMPETE CONTRACTS: ECONOMIC EFFECTS AND POLICY IMPLICATIONS (Mar. 2016) https://home.treasury.gov/system/files/226/Non_Compete_Contracts_Econimic_Effects_and_Policy_Implications_MAR2016.pdf.

incentivize companies to take on such a risk in the first instance. Reasonably tailored non-compete agreements allow companies to protect against the risk of employees using the considerable training and skilling investment from their employer to *immediately* and *directly* compete against that employer.[52]

As has virtually every one of his recent predecessors, President Biden has repeatedly acknowledged the critical skills gap existing within the American labor force and the need for increased investment to boost job skilling and training.[53] There is widespread bipartisan agreement on this need. As discussed above, the Commission's Proposed Rule would have the opposite effect and chill employer investments in employee training and skilling at a time when it is needed more than ever.

B. Eliminating Non-Compete Agreements Would Drastically Increase the Loss of Trade Secrets and Proprietary or Confidential Information

As discussed above, the protection of trade secrets and other proprietary confidential information is the primary reason for employers entering into non-compete agreements. Nearly three-quarters of employees who change jobs take – and are willing to use – their employer's trade secrets.[54] It is further estimated that the total cost of trade secret misappropriation is nearly $500 billion. Non-compete agreements "are an important tool to meaningfully protect against such losses," and indeed are the most effective in doing so.[55]

While the Commission claims that employers can substitute nondisclosure agreements ("NDAs") or other restrictive covenants to protect against trade secret and confidential information theft, in reality, such alternatives are not nearly as effective as non-compete agreements.[56] Unlike non-compete agreements, nondisclosure agreements and other restrictive covenants do not prevent an employee from immediately performing a similar job for a direct competitor:

> [T]hereby leaving the former employer to police the former employee's conduct (i.e. use of trade secrets) without the tools necessary to do so (i.e. the former employer has no ability to know what the employee is doing until, in the worst case, it is too late, and the former employees has used the information). [57]

In essence, NDAs merely serve to allow the employer to recoup any measurable losses associated with the information theft; they do not stop the theft from occurring in the first place, as non-compete agreements do (by requiring a cooling-off period before the employee can perform their same job at a direct competitor). Accordingly, eliminating non-compete agreements would

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[52] It should be noted, however, that such employees may still freely leave the company – they are only subject to "cooling off" periods proscribed by their non-compete agreements.
[53] *See, e.g.*, Austin Landis, 'A 21st century workforce': Biden puts focus on effort to boost infrastructure training, jobs, SPECTRUM NEWS NY1, Nov. 2, 2022, https://www.ny1.com/nyc/all-boroughs/news/2022/11/02/biden-puts-focuson-effort-to-build-infrastructure-workforce.
[54] Beck, *supra* note 48.
[55] *Id*.
[56] *See, e.g.* Beck, *supra* note 48. Further, the Proposed Rule's treatment of "de facto" non-competes would likely preclude the usage of NDAs in this manner anyway – a further reason why companies cannot rely solely on NDAs to protect trade secrets.
[57] *Id*.

substantially increase the instances of trade secret theft that is already occurring at an alarming and costly rate. This would be particularly destructive for smaller companies which often only have one trade secret "that forms the basis of their value, but cannot afford costly trade secrets litigation."[58] Banning non-compete agreements would also make it easier for bad actors – whether inadvertent or intentional – to exfiltrate trade secrets to another country, by for example, transmitting the trade secret from a U.S. subsidiary to a foreign parent entity.

Notably, trade secrets and proprietary or confidential information do not always take the form of easily identified facts and formulas. For example, in the case of a senior executive who is responsible for overall corporate strategy or product design, it is almost impossible to "ringfence" the proprietary information that would do competitive harm if that executive immediately joined a direct competitor with no cooling-off period. The executive has been exposed to every aspect of the company's customer, product and business strategy; he or she knows what has worked and vice versa, and what is planned for the future. For these individuals, non-compete agreements serve to protect both the company (from having its confidential information used against it) and the individual (from inadvertently using trade secrets against the former employer).

Further, an ancillary but no less significant consequence of eliminating non-compete agreements would be skyrocketing trade secrets litigation. As discussed above, employers would be increasingly forced to sue employees over trade secret theft, as they would no longer be able to prevent it from occurring in the first place. Indeed, such litigation has already increased astronomically in California since the state banned non-compete agreements.[59]

C. Eliminating Existing Non-Compete Agreements Would Result in Significant Corporate Forfeiture

The Proposed Rule, if finalized in its current form, would wipe out all existing non-compete agreements. As discussed in Section IV.B., many companies offer equity awards, bonuses, or other compensation as part of severance agreements in exchange for non-compete agreements.

Accordingly, there are numerous potential scenarios resulting from the Proposed Rule in which a company has provided an existing or departed employee with equity or some other form of compensation in return for adherence to a non-compete agreement that is suddenly no longer enforceable. As a result, the employee is free to break the no longer enforceable non-compete agreement while retaining the consideration offered by the employer in exchange for the agreement not to immediately compete. In short, an employer is left having already paid out consideration to an employee without receiving the benefit for which it paid such consideration. The Proposed Rule, to the extent it covers forfeiture provisions, is completely silent on whether an employer would be able to "claw back" such benefit, nor is it realistic to expect an employer to be able to do so in most instances. In essence, the Commission is expecting an employer to be left holding the bill on something they are no longer legally able to receive, with no reasonable expectation of being able to recoup their investment.

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[58] *Id*.
[59] *California Trade Secrets Litigation Supplants Noncompete Litigation,* https://www.faircompetitionlaw.com/2017/06/25/california-trade-secrets-litigation-supplantsnoncompete-litigation/.

Such an untenable situation is made even worse in the context of corporate acquisitions. For example, a company acquires another entity and uses non-compete agreements both to ensure that they will retain certain talent acquired as well as be protected against those bought out simply starting up a competitor in the same space.[60] Those protections are baked into the acquisition price; in other words, the acquiring company is literally paying for such protections. Again, as in the case of individual agreements described above, the Proposed Rule would render such protections already paid for immediately ineffective, while providing no recourse for the acquiring company to recoup the original higher price. Not only is the acquiring company left with an asset for which it has now overpaid, but it is faced with the prospect of a competitor springing up in the same space run by those it just bought out and/or talent brought in through the acquisition, thus further devaluing the acquisition as well as the acquiring company. Such a situation is untenable and supports rescinding or substantially revising the Proposed Rule.

D. Eliminating Non-Compete Agreements Would Chill Dealmaking, Increase Buyer Risk, and Devalue Selling Companies

For the same reasons outlined in the preceding section, eliminating non-compete agreements would create a slowdown in dealmaking by increasing buyer risk and correspondingly devaluing selling companies. Non-compete agreements are factored into the price of corporate assets by offering protections on talent acquired by the buyer and against competition (for a limited period of time) created by those the company bought out. Indeed:

> Non-compete agreements are incredibly valuable to any given business. These agreements help companies in a variety of ways, including: preventing employees from unfairly stealing business; eliminating the risk of wasting assets training and recruiting an employee only to lose him or her to a competitor; protecting valuable interests and information; and dissuading competitors from "cherry picking" valuable employees. As one commentator explained, "[I]t goes without saying that a non-competition agreement is a valuable asset of a business that is likewise viewed as a valuable asset to a prospective business purchaser or candidate for merger." Especially if a business has spent a lot of time and effort developing customer lists, highly specialized operating procedures, or revolutionary technology, it is always a wise course of action to arrange noncompete agreements to protect such information from possible competitors.[61]

Accordingly, the elimination of non-compete agreements would significantly increase the risk for a buyer of an asset and correspondingly drive down the price of such asset, either pre or post acquisition.[62] Thus, in the short term at the very least, the elimination of non-compete agreements would have a significant chilling effect on mergers and acquisitions throughout the entirety of the economy, which would correspondingly disincentivize company investments into fostering innovation.

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[60] Again, limited to a certain time period which is generally one year.

[61] William Vorys, *Unreasonable State Restrictions on Business Transactions: The Enforceability of Non-compete Agreements Post-merger or Acquisition*, 43 Cap. U.L. Rev. 721, 745 (2015).

[62] *Id*. at 746.

E. Eliminating Non-Compete Agreements Would Encourage Certain Types of Unfair Competition

The elimination of non-compete agreements could incentivize some companies to raid another entity's talent, with the target entity no longer having any legal protection to defend itself. The target entity could not only lose crucial talent but potentially also any confidential information or trade secrets that such talent has acquired while working at the target entity. This type of aggressive "talent acquisition" strategy would particularly place small and medium business entities in especially vulnerable positions because the theft of one or more of their key business executives could cause the business to suffer irreparable harm. Indeed, "startups" and even established business entities may not be able to survive if key individuals are suddenly "stolen" and moved to either an existing competitor or to form the nucleus of a new entity to compete with their previous employer. Stated alternatively, non-compete agreement provide a firewall of protection to prevent inappropriate talent raiding, safeguard business trade secrets, and protect confidential and other important corporate sensitive information. If those legitimate business interests are not protected, virtually any business entity may be at risk. The result may be fewer companies in a given market, increased concentration, and lack of competition.

VI. ANY FINAL RULE SHOULD AVOID BLANKET PROHIBITIONS AND EXEMPT SPECIFIC EMPLOYEE GROUPS

Despite the attempt by the Commission to characterize non-compete agreements as a widespread and inherent problem, the scope of such a problem is far smaller. Indeed, it is "the abuses that define the problem"[63] and not non-compete agreements themselves, which, as articulated above, are far more limited than the Commission suggests. There is simply no evidence-based justification for a blanket ban on all non-compete agreements, and the Commission provides none.

As discussed above in Section III, the Commission lacks the legal authority to restrict non-compete agreements in any way. Nevertheless, should the Commission move forward with its rulemaking, it should substantially revise its Proposed Rule to avoid a blanket prohibition on non-compete agreements. Further, any such final rule should specifically exempt executive level employees as well as employees with access to trade secrets and other proprietary confidential information from any ban or further restrictions.[64] For those employees who do not fall under either exemption, rather than a blanket ban, we suggest the Commission should instead create a rebuttable presumption of unenforceability under which employers could meet their burden through a showing of legitimate business purposes and reasonableness, in line with current treatment of non-compete agreements in the courts and under state law.

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[63] *Noncompete Agreements and American Workers: Hearing Before the Subcomm. On Small Business and Entrepreneurship*, 116th Cong. 70-84 (2019) (Written Testimony of Russell Beck, Partner, Beck Reed Riden LLP).
[64] While the Association does not specifically endorse any one specific approach, this exemption could be defined in part through a certain income level or through the definition of non-exempt employees under the Fair Labor Standards Act, for example.

Finally, many companies do not utilize non-compete agreements but do utilize forfeiture clauses, in which the employer offers equity awards, bonuses, or other compensation as part of severance agreements in exchange for an employee's promise not to compete with the former employer for a set period. By their nature, these agreements do not prevent an employee from working for a direct competitor; they merely require forfeiture of future compensation if the employee chooses to do so. The Commission should make it clear that forfeiture provisions under which an employee forfeits amounts to be paid in the future, such as severance pay, non-qualified deferred compensation, or unexercised stock options, are not subject to the Commission's restrictions on non-compete agreements.[65]

VII. CONCLUSION

The HR Policy Association appreciates this opportunity to provide comments on the rulemaking process regarding the use of non-compete agreements between employers and employees. If you have any questions about the Association's comments, please feel free to contact me at ghoff@hrpolicy.org.

Sincerely,

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[65] These types of provisions are accepted in many states as not violating public policy under the "employee choice" doctrine. See, e.g., *Morris v. Schroder Capital*, 859 N.E.2d 503 (N.Y. 2006).