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April 19, 2023

Via Electronic Submission: http://www.regulations.gov

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Office of Policy Planning
Federal Trade Commission
Office of the Secretary
600 Pennsylvania Avenue, NW
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Washington, DC 20580

Re: Non-Compete Clause Rule, Matter No. P201200
88 Fed. Reg. 3482 (January 19, 2023)
RIN No. 3084-AB74

Dear Ms. Lane:

Littler Mendelson P.C.'s Workplace Policy Institute (WPI) submits these comments to the Federal Trade Commission ("FTC," "Commission," or "the agency") with respect to the Notice of Proposed Rulemaking relating to non-competition agreements published in the *Federal Register* on January 19, 2023 ("NPRM" or "proposed rule"). We thank you for the opportunity to comment on this important matter.

By way of background, WPI facilitates the employer community's engagement in legislative and regulatory developments that affect their workplaces and business strategies. WPI harnesses the deep subject matter expertise of Littler, the largest law firm in the world with a practice devoted exclusively to the representation of employers in employment and labor law matters. Littler's clients range from new and emerging businesses to Fortune 100 companies

throughout the country and around the world. We appreciate the opportunity to provide the Commission with the benefit of our experience and that of our clients.

I. **Introduction**

For hundreds of years, courts (first English common-law courts, and later, American courts applying the common law) have recognized the ability of two parties to enter into a contract to refrain from competing with one another.[1] For more than a century, U.S. courts have recognized that federal antitrust law does not ban any contract that so much as minimally restrains trade, but rather permits reasonable restraints while prohibiting unreasonable ones.[2] And for decades, courts have recognized that reasonable non-competition agreements are legal under Section 5 of the Federal Trade Commission Act ("FTC Act" or "the Act").[3] The Commission itself, throughout most of its history, has taken the same view. States have regulated these agreements in varying degree, with 47 out of 50 allowing employers to enter into some form of non-competition agreement lawfully with their workers. State courts have effectively and efficiently regulated the use of non-compete agreements under statutory or common law, ensuring the enforcement of only those agreements that are reasonable in scope and duration, and which protect legitimate business interests, while modifying, negating, or declining to enforce those agreements that are not.

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[1] *See Mitchel v. Reynolds,* 1 P. Wms. 181 (1711). For a thorough exposition of the historical precedent for and development of non-competition law in the United States, *see* A. MacDonald, "The FTC's Ahistorical Attack on Noncompetes" (Fed. Soc. Jan. 24, 2023), available at: https://fedsoc.org/commentary/fedsoc-blog/the-ftc-s-ahistorical-attack-on-noncompetes.
[2] *See Addyston Pipe & Steel Co. v. United States*, 85 F. 271, 281 (6th Cir. 1898), *aff'd in relevant part*, 175 U.S. 211 (1899).
[3] *See, e.g., Snap-On Tools Corp. v. Federal Trade Comm'n*, 321 F.2d 825, 837 (7th Cir. 1963) (agreement between company and dealer that dealer refrain for one year from operating a competing business in states in which he operated for company was "legal unless [] unreasonable as to time or geographic scope").

It is against this historical legal landscape that on January 4, 2023, the FTC announced that it had issued complaints against three employers alleging that the non-competition agreements they maintained with their employees violated the FTC Act, and had reached consent agreements in each—the first such cases in the agency's 100+ year history. Less than 24 hours later, on January 5, the Commission unveiled a proposed rule under which literally every non-competition agreement entered into between a company and an employee would be an unlawful violation of federal antitrust law (specifically, an "unfair method of competition" under the FTC Act), as would be the proffer or enforcement of such an agreement. The proposed rule would nullify all existing non-competition agreements entered into by employers in the past, and require employers to proactively provide notice of their recission. Put bluntly, in a single document, the Commission proposes to scrap literally hundreds of years of settled case law, and invalidate millions of contracts employers have entered into with their employees. As set forth below, the FTC did so based on faulty reasoning and without legal support, foremost its lack of statutory authority to issue rules relating to methods of unfair competition.

Even if the Commission had the authority to promulgate legislative regulations governing methods of unfair competition—which it does not—the NPRM is fundamentally flawed as a matter of fact and policy. It is founded on plainly incorrect assumptions; it is patently overbroad; it is at once both overly simplistic and unworkably vague; it wrongly concludes that existing trade secrets law affords employers adequate protection of their interests; and it fails to account for the effective regulation of non-compete agreements by state courts and legislatures. We urge the Commission

to rethink its position, withdraw the proposed rule, and allow the *status quo ante* of non-competition law to exist and evolve as it has for centuries.

II. **The Proposed Rule Is Unlawful as a Matter of Statutory and Constitutional Law.**

The proposed rule fails as a matter of law for a host of reasons. Foremost, the Commission's proposal to regulate unfair methods of competition by way of a legislative rule is outside of its statutory authority. Beyond that, the NPRM is unconstitutional, violating both the major questions doctrine and the non-delegation doctrine. To the extent it purports to deprive employers of contractual rights they have bargained (and in many cases already paid) for, it is an unconstitutional violation of the Takings Clause. Finally, the NPRM is arbitrary and capricious, thus violating the Administrative Procedure Act.

A. **The Commission Lacks Statutory Authority to Issue Substantive Rules Relating to Unfair Methods of Competition.**

The FTC Act simply does not grant the Commission the authority to issue substantive rules relating to unfair methods of competition. This fact alone should be the alpha and omega of this ill-conceived proposal. As the Supreme Court has squarely held, the Commission "is entirely a creature of Congress, and the determinative question is not what [the Commission] thinks it should do, but what Congress has said it can do."[4]

The NPRM is promulgated purportedly pursuant to Sections 5 and 6(g) of the Act.[5] As set forth below, neither of these provisions authorizes the Commission to promulgate substantive rules

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[4] *CAB v. Delta Airlines*, 367 U.S. 316, 322 (1961) citing *United States v. Seatrain Lines*, 329 U.S. 424, 433 (1947).
[5] 88 Fed. Reg. 3482; *see* 15 U.S.C. §§ 45, 46(g).

relating to unfair methods of competition. Nor can this authority be found in any other provision of the Act. Insofar as the proposed rule is wholly beyond the scope of the Commission's statutory authority, it is void *ab initio*, and should be withdrawn.

1. **Sections (5) and 6(g) of the Federal Trade Commission Act Do Not Confer UMC Rulemaking Authority on the Commission.**

Section 5(a)(1) first declares "unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce" as unlawful.[6] It goes on to "empower[] and direct[]" the Commission to prevent covered entities from using or engaging in such unfair methods of competition (UMC) and unfair or deceptive acts or practices (UDAP).[7] Section 5(b) prescribes in precise detail the manner in which the agency is directed to enforce its mission by way of case-by-case administrative adjudication, including requirements that where it suspects a violation of the Act, the Commission must: (1) issue a complaint; (2) provide notice and hearing to any person alleged to be engaging in unfair methods of competition; (3) provide such persons the opportunity to show cause as to why they are not in violation of the Act; (4) reduce its findings of unlawful competition to writing; and (5) issue a cease and desist order to those found to be in violation.[8] Under section 5, the Commission is authorized to bring an action in district court to recover a civil penalty of up to $50,120 per knowing violation of any rule

[6] 15 U.S.C. § 45(a)(1).
[7] 15 U.S.C. § 45(a)(2).
[8] *See id.* § 45(b).

or final order regarding "unfair or deceptive" acts.[9] All other enforcement actions are brought by the Department of Justice in federal district court.[10]

Section 6, in contrast, authorizes the Commission to gather information relating to businesses and business practices; to require businesses within the jurisdiction of the agency to file certain reports and to publish such reports; and to investigate alleged violations of antitrust laws and antitrust decrees.[11] The limits of the Commission's enforcement authority under this section are plain: upon application of the Attorney General, the Commission can investigate and make recommendations for the readjustment of the business of any corporation alleged to be in violation of the Act, and, where the Commission finds evidence to suggest a violation of criminal law, it can make a referral to the Attorney General for criminal prosecution.[12] Finally, section 6(g) provides that in addition to its authority to "[f]rom time to time classify corporations," the Commission may "make rules and regulations for the purpose of carrying out the provisions of this subchapter."[13] It is from this tiny acorn that the Commission proposes to grow a forest of regulatory oak.

Statutory language must be interpreted "in [its] context and with a view to [its] place in the overall statutory scheme,"[14] and the FTC Act should be read as an "integrated whole."[15] Utilizing this approach, the Supreme Court less than two years ago in *AMC Capital Management, LLC v. Federal Trade Commission* struck down an attempt by the FTC to construe its authority

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[9] *See id.* § 45(l).
[10] *See id.* § 45(m)(1)(A).
[11] *See id.* §§ 46(a)-(f).
[12] *See id.* §§ 46(e), 46(k).
[13] *Id.* § 46(g).
[14] *West Virginia v. EPA*, 142 S. Ct. 2587, 2607-08 (2022).
[15] *United States v. Morton Salt Co*., 338 U.S. 632, 650 (1950).

overbroadly in contravention of plain statutory language, holding that the agency was not entitled to obtain monetary relief without utilizing section 5 administrative processes. As the Court then observed:

> [T]o read those words as allowing what they do not say… is to read the words as going well beyond the provision's subject matter. In light of the historical importance of administrative proceedings, that reading would allow a small statutory tail to wag a very large dog.
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> …
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> ***Nor is it likely that Congress, without mentioning the matter, would have granted the Commission authority so readily to circumvent its traditional § 5 administrative proceedings.***[16]

The FTC's attempt in *AMG* to bypass section 5 administrative proceedings as a means to its desired end (monetary relief) is exactly what it seeks to do here with respect to non-compete agreements—declare them unlawful by way of a legislative rule so as to bypass section 5 administrative processes and an individualized assessment of the conduct at issue, notwithstanding the plain language of the law. It was not allowed to do so then, and should not be allowed to do so now. It is clear that the rulemaking authority granted to the Commission in section 6(g) was intended to authorize the Commission to promulgate procedural, not substantive rules. This is evident from its placement in the statute; its lack of an enforcement mechanism; its legislative history; the contemporary response of Congress to issues relating to non-competition agreements; and, ultimately, the long-standing position of the FTC itself.

[16] *AMG Capital Mgt., LLC v. FTC*, 141 S. Ct. 1341, 1349 (2021) (emphasis added).

Section 5 provides substantive authority for the Commission to investigate and remedy violations of the Act, and proscribes the precise mechanism for it to do so—namely, via case-by-case adjudication, not rulemaking. Section 6, in contrast, provides no remedy for substantive violations of the Act, indicating that the section is meant only to confer procedural, not substantive, legislative authority. As one commentator has explained:

> [I]n 1914 both Congress and the courts followed a convention for differentiating between grants of legislative and procedural rulemaking authority. ***Grants of rulemaking were regarded as legislative only if the organic statute provided some sanction or penalty for violation of the rules in question. If the grant did not include such a provision, it was understood to confer only procedural or internal housekeeping authority.*** The rulemaking grant in Section 6 of the FTC Act contains no mention of any sanction for violation of the rules issued under its authority. Thus, it was clearly understood at the time of enactment to be a grant of procedural rulemaking authority.[17]

Nor does the legislative history of the Act suggest in any way that Congress intended section 6(g) to provide the Commission with nearly-limitless authority to promulgate substantive rules. When the Act was debated in 1914, the bill that passed the U.S. House of Representatives granted only investigative power to the Commission; it included section 6(g) to provide rulemaking authority to further that goal, but otherwise no adjudicative authority. In contrast, the bill approved by the Senate granted the agency adjudicative authority, but included no provision for rulemaking akin to section 6(g). The compromise that ultimately became law incorporated the House bill's language regarding the investigative powers of the Commission in section 6, and the

[17] Thomas A. Merrill, "Antitrust Rulemaking: The FTC's Delegation Deficit," CSAS Working Paper 22-18 (Sept. 19, 2022) at 24 (citations omitted) (emphasis added).

Senate's grant of quasi-judicial adjudicative powers of the Commission in section 5. At no time did either chamber entertain a version of the bill that provided rulemaking authority in furtherance of the Commission's adjudicatory powers.[18] The conference committee that hammered out the differences in the two versions of the legislation did not include such a provision, insofar as it was not included in either chamber's version of the bill, and thus not permitted under the rules governing the permissible scope of congressional conference committees.[19] Put simply, section 6(g) could not confer legislative rulemaking authority on the Commission when it was adopted in 1914, and it does not do so now.[20]

Throughout the history of the Act, only one court has ever held that section 6(g) grants the Commission the authority to engage in substantive rulemaking relating to unfair methods of competition: the U.S. Court of Appeals for the D.C. Circuit, in a single case almost 50 years ago,

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[18] *See generally id.* at 17.
[19]*See* JEFFERSON'S MANUAL § 546 ("The managers of a conference must confine themselves to the differences committed to them, and may not include subjects not within the disagreements, even though germane to a question in issue." (citations omitted)).
[20] This fact is underscored by the contemporaneous records of Congressional debate over the Act. *See, e.g.,* 51 Cong. Rec. 12916 (1914), reprinted in The Legislative History of the Federal Antitrust Laws and Related Statutes 4368 (Earl W. Kintner ed., 1982) (statement of Sen. Cummins) (''[I]f we were to attempt to go further in this act and to give the commission the authority to prescribe a code of rules governing the conduct of the business men of this country for the future, we would clash with the principle that we cannot confer upon the commission in that respect legislative authority; but we have not made any such attempt as that, and no one proposes any attempt of that sort.''); *id*. at 14932 (statement of Rep. Covington) ("The Federal trade commission will have no power to prescribe the methods of competition to be used in the future. In issuing orders it will not be exercising power of a legislative nature . . . The function of the Federal trade commission will be to determine whether an existing method of competition is unfair, and, if it finds it to be unfair, to order the discontinuance of its use. In doing this it will exercise power of a judicial nature."); *id*. at 13317 (statement of Sen Walsh) ("We are not going to give to the trade commission the general power to regulate and prescribe rules under which the business of this country shall in the future be conducted; we propose simply to give it the power to denounce as unlawful a particular practice that is pursued by that business.").

National Petroleum Refiners Association v. FTC.[21] As discussed *infra*, *National Petroleum* was met with decisive action by Congress to clarify and cabin the Commission's rulemaking authority. Whether the underlying decision was correctly decided originally, or would be decided the same way today, may be debatable (although we submit it is not). What is indubitable, however, is that the court in *National Petroleum* did not find that Congress unequivocally authorized the agency to engage in legislative rulemaking, and indeed observed that "the specific intent of Congress [with respect to the question] cannot be stated with any assurance…. [T]he question before us—whether the Commission can elaborate the meaning of Section 5's standard of illegality through rule-making as well as through case-by-case adjudication—was not confronted straightforwardly and decisively."[22] On the question of rulemaking authority Congress at best "spoke ambiguously."[23]

Where Congress has sought to give the FTC substantive rulemaking authority, it has not hesitated to do so in a plain and forthright manner.[24] Similarly, the fact that in recent years numerous proposals have been introduced in Congress to regulate non-competes under federal law strongly suggests that the agency does not have existing authority under its authorizing statute to do so. Indeed, shortly after the publication of the proposed rule in the *Federal Registe*r, bipartisan legislation was introduced that would classify a wide range of non-competition agreements as

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[21] *See National Petroleum Refiners Ass'n v. FTC*, 482 F.2d 672 (D.C. Cir. 1973).
[22] *Id*. at 686.
[23] *Id.* at 709 (Appendix).
[24] Examples of specific rulemaking authority given to the FTC by Congress can be found in, *inter alia*, the Wool Products Labeling Act, 15 U.S.C. §§ 68-68j (1971); the Textile Fiber Products Identification Act, 15 U.S.C. §§ 70-70k (1971); the Fur Products Labeling Act, 15 U.S.C. §§ 69-69j (1971); the Flammable Fabrics Act, 15 U.S.C. §§ 1191-1200 (1971); and the Fair Packaging and Labeling Act, 15 U.S.C. §§ 1451-61 (1971).

"unfair or deceptive acts" under the FTC Act, and empower the Commission to enforce them via its section 5 adjudicatory authority.[25] The introduction of this bill bears particular note for two reasons: First, it makes plain that to the extent non-competition agreements fall within the ambit of the FTC Act, they are "unfair or deceptive acts or practices"—not "unfair methods of competition"—and thus, as discussed below, subject to an extensive statutory rulemaking scheme the Commission has not undertaken with respect to the proposed rule. Second, Congress plainly views the agency as without clear authority to regulate non-competition agreements under existing law.[26]

In light of these facts, it is hardly surprising that throughout most of the history of the agency, the Commission itself disclaimed the authority to issue substantive rules relating to unfair methods of competition. Prior to 1962, the Commission did not even purport to believe that it had rulemaking authority with respect to unfair methods of competition, articulating its view that section 5's prohibitions on unfair methods of competition could be supplemented by way of rulemaking only when it amended its rules of practice that same year.[27] But, as the *National Petroleum* Court observed, whether those rules were merely interpretive rather than legislative was even then unclear, and subsequent to 1962, the Commission held and articulated the view that it

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[25] *See* S.220, the "Workforce Mobility Act of 2023," (118th Congress); *see also* S. 2375, the "Freedom to Compete Act," (117th Congress) (amending Fair Labor Standards Act to prohibit employers from entering into non-competition agreements with non-exempt employees).
[26] Statements of the bill's sponsors upon its introduction underscore this point: "[W]e'd like to give [the FTC] clear statutory authority" (statement of Senator Murphy (D-CT)); "[T]here are a number of members of Congress who question the legality of [the FTC's] actions" regarding non-competition agreements. (statement of Senator Young (R-IN)), available at: https://www.murphy.senate.gov/newsroom/in-the-news/ftc-noncompete-proposal-breathes-new-life-into-lawmaker-efforts.
[27] *See National Petroleum,* 482 F. 2d at 695 n. 29.

did not have substantive rulemaking authority under section 6(g). This calls into doubt its ability to do so now.[28] Where, as here, "an agency claims to have found a previously 'unheralded power,' its assertion generally warrants 'a measure of skepticism.'"[29]

In sum, Congress "does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions—it does not … hide elephants in mouseholes."[30] In the absence of the clear and unambiguous authorization of Congress—to which it cannot point—the Commission cannot construe section 6(g) to provide it with nearly-limitless authority to promulgate substantive rules relating to any violation of the Act, or to fashion entirely new remedial schemes as it sees fit. This alone dooms the proposed rule and warrants its withdrawal.

2. <u>Section 18(a)(2) of the Federal Trade Commission Act Likewise Does Not Confer UMC Rulemaking Authority on the Commission</u>.

As noted above, in the wake of the *National Petroleum* decision, Congress in 1975 adopted the Magnuson-Moss Warranty—Federal Trade Commission Improvement Act ("Magnuson-Moss" or "the FTC Improvement Act"). Broadly speaking, by way of Magnuson-Moss, Congress granted the FTC with express authority to issue legislative rules, as well as

[28] *See id.*
[29] *West Virginia,*142 S. Ct. at 2,623 (Gorsuch, J. concurring) citing *Util. Air Regulatory Group*, 573 U.S. 302, 324 (2014). *See also FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 158-59 (2000) (finding relevant agency's position for decades that it lacked statutory authority to regulate cigarettes); *Loving v. IRS*, 742 F.3d 1013, 1021 (D.C. Cir. 2014) ("In light of the text, history, structure, and context of the statute, it becomes apparent that the IRS never adopted its current interpretation for a reason: It is incorrect."); *Fin Planning Ass'n v. SEC,* 482 F.3d 481, 490 (D.C. Cir. 2007)(noting "weakness" where agency's position regarding its authority was at odds with six decades of its prior position).
[30] *Whitman v. Am. Trucking Assoc., Inc.,* 531 U.S. 457, 468 (2001), citing *MCI Telecommunications Corp.* v. *American Telephone* & *Telegraph Co.,* 512 U. S. 218, 231 (1994).

interpretive rules and general statements of policy, but *only* with regard to unfair or deceptive acts or practices under section 5(a). Specifically, section 18(a) of the FTC Improvement Act provides:

> (1) Except as provided in subsection (h) of this section, the Commission may prescribe—
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> > (A) interpretive rules and general statements of policy with respect to unfair or deceptive acts or practices in or affecting commerce (within the meaning of section 45(a)(1) of this title), and
> >
> > (B) rules which define with specificity acts or practices which are unfair or deceptive acts or practices in or affecting commerce (within the meaning of section 45(a)(1) of this title)…
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> (2) The Commission shall have no authority under this subchapter, other than its authority under this section, to prescribe any rule with respect to unfair or deceptive acts or practices in or affecting commerce (within the meaning of section 45(a)(1) of this title). The preceding sentence shall not affect any authority of the Commission to prescribe rules (including interpretive rules), and general statements of policy, with respect to unfair methods of competition in or affecting commerce.[31]

The remainder of section 18 sets forth precise and heightened requirements for promulgating interpretive and substantive UDAP regulations. In keeping with its desire to cabin FTC's rulemaking, Congress adopted a series of heightened procedural requirements for Magnuson-Moss rulemaking beyond those required for standard notice-and-comment procedures under the Administrative Procedure Act (APA), including heightened requirements for notice; an informal hearing (if requested by interested parties), followed by a staff report published for public comment; a detailed regulatory analysis, including an assessment of alternatives to the rule that were considered; and an analysis of projected benefits and adverse economic effects under the

[31] 15 U.S.C. § 57a(a).

rule. Put briefly, Magnuson-Moss requires the FTC, when it undertakes UDAP rulemaking, to engage in more than what would be required under the APA for informal notice-and-comment rulemaking.

As set forth above, the final sentence of Section 18(a)(2) provides that "The preceding sentence shall not affect any authority of the Commission to prescribe rules (including interpretive rules), and general statements of policy, with respect to unfair methods of competition in or affecting commerce."[32] Some have argued that this language in some fashion suggests that, in 1975, Congress understood the Commission to have UMC rulemaking authority, which this section (a)(2) is intended to preserve. This argument is unavailing.

First, if Congress wanted to ensure that the Commission had substantive rulemaking authority with respect to UMC rules, it would not have limited the express grant of authority to the agency to promulgate UDAP rules only. Second, this interpretation leads to absurd results. Under the reasoning of *National Petroleum* (which was decided two years prior to the enactment of Magnuson-Moss), the FTC would be empowered to engage in both UDAP and UMC rulemaking by way of simple APA notice-and-comment procedures. It defies logic to suggest that, in the years following *National Petroleum*, Congress sought to limit the agency's authority with respect to UDAP rulemaking, while leaving it virtually unfettered where UMC rulemaking was concerned.

Where Congress wishes to confer express authority for the Commission to engage in legislative rulemaking, it has demonstrated it is fully able to do so.[33] And where it has wished to

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[32] *Id.* § 57a(a)(2).
[33] *See* n. 24 *supra.*

provide legislative rulemaking authority subject to procedural constraints, as with Magnuson-Moss, it has done likewise. Despite both of these facts, nowhere in the 100+ year history of the Commission has Congress seen fit to clearly or unambiguously grant substantive UMC rulemaking authority to the agency, despite ample opportunity. Congress did not hide an elephant in a mousehole by way of section 6(g) when it was enacted in 1914, and it did not hide a flea on said elephant by way of section 18 in 1975. Put simply, the Commission lacks the statutory authority to promulgate the proposed rule. It should be withdrawn.

B. The Proposed Rule Violates the Major Questions Doctrine.

"It is axiomatic that an administrative agency's power to promulgate legislative regulations is limited to the authority delegated by Congress."[34] From this fundamental proposition, courts have fashioned the major questions doctrine, which generally provides that, as a matter of the constitutional separation of powers, where an administrative agency claims regulatory authority over matters of "vast economic and political significance," the statute in question must "plainly authorize" the action in question.[35]

Under the major questions doctrine, statutes are not read to confer authority on agencies to answer "question[s] of deep 'economic and political significance'" unless Congress has delegated the authority to do so "expressly."[36] Put another way, where an agency seeks to impose novel and incredibly broad regulation, courts will closely scrutinize statutory text, and in the absence of

[34] *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 208 (1988).
[35] *NFIB v. OSHA*, 142 S. Ct. 661, 665 (2022).
[36] *King v. Burwell*, 576 U.S. 473, 486 (2015) quoting *Util. Air Regulatory Group v. EPA*, 573 U.S. 302, 324 (2014).

express authorization, conclude that "Congress could not have intended to delegate a decision of such economic and political significance to an agency in so cryptic a fashion."[37] A mere "colorable textual basis" in the statute is insufficient; Congress must be "clear."[38] "Modest words, vague terms, or subtle devices" are insufficient.[39] Applying the doctrine, reviewing courts have invalidated a wide range of overreaching attempts at rulemaking, including the regulation of tobacco,[40] the Centers for Disease Control and Prevention's nationwide eviction moratorium during the COVID-19 pandemic,[41] and, in the employment context, the Occupational Safety and Health Administration (OSHA)'s attempt to impose a COVID-19 vaccination requirement on millions of private-sector workers.[42] Measured against these standards, the proposed rule plainly violates the major questions doctrine.

First, there can be no question that the proposed rules would represent an "extraordinary grant of regulatory authority" of "vast economic and political significance." The Commission itself claims that one in five American workers currently is subject to a non-competition agreement, with twice that—almost 40% of workers—working under such an agreement during some point in their career.[43] At the same time, it would invalidate millions of contractual agreements previously entered into, at great cost to employers that have bargained and already paid (either directly or

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[37] *Brown & Williamson*, 529 U.S. at 160.
[38] *West Virginia*, 142 S. Ct. 2587 at 2609.
[39] *Id.* at 2609, quoting *Whitman v. American Trucking Association*, 531 U.S. 457, 468 (2001).
[40] *See Brown & Williamson*, 529 U.S. 120 (2000).
[41] *See Alabama Ass'n of Realtors v. HHS*, 141 S. Ct. 2485 (2021).
[42] *See NFIB v. OSHA*, 142 S. Ct. 661 (2022).
[43] *See* 88 Fed. Reg. 3485. To put this in context, in *Alabama Association of Realtors,* the Supreme Court readily concluded that a regulatory action affecting, at most, 17 million Americans presented a matter of "vast economic and political significance." 141 S. Ct. at 2489.

indirectly) for them. Nor can it be seriously disputed that the proposed rule "intrudes into an area that is the particular domain of state law."[44] Indeed, the proposed rule does not merely "intrude" upon state law—it wholly and entirely preempts statutory law and judicial precedent establishing the contours of lawful non-compete agreements in almost every state in the union. It likewise ignores the fact that state legislatures have been actively regulating the use of non-competition agreements, with more than 29 states and the District of Columbia adopting or modifying non-compete laws in the last decade alone.[45] Finally, as a matter of economic significance, by its own estimate, the proposed rule would transfer roughly $300 billion in wages from business to workers. To put that number in perspective, the COVID-19 vaccination standard proposed by OSHA, which the Supreme Court held to be a matter of "vast economic and political significance" was less than 1% of that figure—less than $3 billion.[46]

Second, there is absolutely no language the agency can point to within the FTC Act that provides "clear" or "express" authority to engage in substantive rulemaking with respect to unfair methods of competition. As explained previously, its purported authority to issue the subject rule is premised on a single line of ambiguous text, appended to a recordkeeping provision in a section of the statute wholly unrelated to enforcement.

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[44] *Alabama Ass'n of Realtors*, 141 S. Ct. 2,489 (Gorsuch, J. concurring).
[45] *See* Fair Competition Law, "Almost 60 percent of states updated their noncompete laws in the last decade," (Feb. 12, 2023), available at: https://faircompetitionlaw.com/2023/02/12/noncompete-law-changes-in-the-last-decade-updated-february-12-2023/.
[46] *See* Occupational Safety and Health Administration, "COVID-19 Vaccination and Testing: Emergency Temporary Standard," 86 Fed. Reg. 61402, 61495 (Nov. 5, 2021).

But even if reasonable minds could differ as to that ultimate conclusion, it is beyond debate that the language of the statute is *at best* entirely unclear as to the scope of the agency's substantive UMC rulemaking authority. Even the single court that held that the statute authorized substantive UMC rulemaking conceded that the point was at best unclear: "[T]he specific intent of Congress [with respect to the question] cannot be stated with any assurance…. the question before us—whether the Commission can elaborate the meaning of Section 5's standard of illegality through rule-making as well as through case-by-case adjudication—was not confronted straightforwardly and decisively."[47] On the question of rulemaking authority, Congress "spoke ambiguously"[48]—this is, put simply, wholly insufficient to withstand scrutiny under the major questions doctrine.

Similarly, Congress must use "exceedingly clear language if it wishes to significantly alter the balance between federal and state power and the power of the Government over private property."[49] Moreover, the major questions doctrine has particular force "when an agency seeks to 'intrud[e] into an area that is the particular domain of state law.'"[50] It is beyond dispute that the regulation of non-compete agreements has for hundreds of years been the exclusive province of state law and state courts (or federal courts applying state law). Forty-seven out of 50 states allow for employers to enter into some form of agreement to not compete post-employment with workers, subject to varying limitations (such as the income level of the worker), and of course bounded by the requirements of reasonableness as to duration and scope.

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[47] *National Petroleum,* 482 F.2d. at 686.
[48] *Id.* at 709 (Appendix).
[49] *Alabama Ass'n of Realtors*, 141 S. Ct. at 2,489 (citations omitted).
[50] *West Virginia*, 142 S. Ct. at 2,621 (Gorsuch, J. concurring) citing *Alabama Ass'n of Realtors*, 141 S. Ct. at 2,489.

Finally, "just as established practice may shed light on the extent of power conveyed by general statutory language, so the want of assertion of power by those who presumably would be alert to exercise it, is equally significant in determining whether such power was actually conferred."[51] As discussed above, for the first 50 years of its existence, the agency did not even suggest that it had substantive UMC rulemaking authority. Even after it hinted that it might, by way of its amended rules of practice, the agency continued to disclaim its authority to regulate, to Congress and to others. And for more than 60 years after that, the agency made no serious effort to argue that non-competition agreements represented unfair methods of competition, until its announcement of three settlements in January of this year—the day before it unveiled the proposed rule. It defies logic (and, more important, the conventions applying the major questions doctrine) to suggest that the agency has had the ability to regulate non-competition agreements for over 100 years, but simply chose not to exercise or acknowledge it until now.

The proposed rule plainly fails as a matter of law under the major questions doctrine. It should be withdrawn.

C. <u>The Proposed Rule Exceeds the Limits of the Non-Delegation Doctrine</u>.

"Congress manifestly is not permitted to abdicate or transfer to others the essential legislative functions with which it is thus vested."[52] To survive constitutional scrutiny, Congress, when it gives an executive agency the authority to regulate, must give the agency an "intelligible

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[51] *West Virginia*, 59142 S. Ct. at 2,610, citing *FTC v. Bunte Brothers, Inc*., 312 U.S. 349, 352 (1941).
[52] *Panama Refining Co. v. Ryan*, 293 U.S. 388, 421 (1925); *see also A. L. A. Schecter Poultry Corp. v. United States*, 295 U.S. 495, 529 (1935) (affirming same).

principle" on which to base their regulations.[53] From these principles arise the non-delegation doctrine, which requires that, when interpreting a statute, courts should "giv[e] narrow construction to statutory delegation that might otherwise be thought to be unconstitutional."[54] Put another way, where ambiguous statutory language is susceptible to one reading that would broadly devolve power to an executive agency with no limiting principle, and another reading that would not, the latter reading "should certainly be favored."[55]

In applying the nondelegation doctrine, courts have upheld rulemaking only where a delegation of power is sufficiently detailed to provide guiding and limiting principles to the regulating agency. For example, the Supreme Court upheld the United States Sentencing Commission's ability to create sentencing guidelines for all federal offenses because Congress charged the Commission with three "goals," four "purposes," and seven "factors" that the Commission must abide by when developing the guidelines. Congress mandated that the Commission develop a system of "'sentencing ranges' applicable 'for each category of offense involving each category of defendant.'"[56] Although Congress granted the Commission substantial discretion, it did so only after it legislated a full hierarchy of punishment and stipulated the most important offense and offender characteristics to place defendants within these categories.[57]

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[53] *J.W. Hampton v. United States*, 276 U.S. 394 (1928); *see also Touby v. United States*, 500 U.S. 160, 165 (1991).
[54] *See* Eugene Scalia, "The Major Questions Doctrine, *National Petroleum*, and the Federal Trade Commission's Competition Rulemaking Authority," American Enterprise Institute (Dec. 2022), at 9 citing *Mistretta v. United States,* 488 U.S. 361, 373 (1989).
[55] *Industrial Union Department, AFL-CIO v. American Petroleum Institute,* 448 U.S. 607, 646 (1980).
[56] *Mistretta v. United States*, 488 U.S. 361, 374 (1989) citing 28 U.S.C. § 994(b).
[57] *See id.* at 377.

Similarly, in *Whitman v. American Trucking Association*s, the Court held that Congress had properly delegated authority to the Environmental Protection Agency when it required that the agency set ambient air quality standards based on the criteria of a list of documents found in section 108 of the Environmental Protection Act.[58]

Conversely, where Congress fails to articulate any policy or standard that would serve to confine the discretion of the authority to another, courts have struck down the overreach and unconstitutional delegation of legislative authority. In 1935, the Supreme Court held that Section 9(c) of the National Industrial Act was an unconstitutional delegation of power. Section 9(c) gave the President unfettered discretion to prohibit the transportation of petroleum in interstate or foreign commerce. The court held that "Congress has declared no policy, has established no standard, has laid down no rule. There is no requirement, no definition of circumstances and conditions in which the transportation is to be allowed prohibited."[59] Months later, in *A.L.A. Schechter Poultry*, the Court again found that Congress failed to provide necessary guidelines for the implementation of legislative authority, and struck down an overreaching administrative power. The Court found that the Section 3 of the Recovery Act was unconstitutional because Congress:

> [S]upplies no standards for any trade, industry or activity. It does not undertake to prescribe rules of conduct to be applied to particular states of fact determined by appropriate administrative procedure. ***Instead of prescribing rules of conduct, it authorizes the making of codes to prescribe them. For that legislative undertaking, § 3 sets up no standards, aside from the statement of the general aims of rehabilitation, correction and expansion described in section one.*** In view

[58] *Whitman v. American Trucking Assns., Inc.*, 531 U.S. 457, 472 (2001).
[59] *Panama Refining Co.,* 293 U.S. at 430.

> of the scope of that broad declaration, and of the nature of the few restrictions that are imposed, the discretion of the President in approving or prescribing codes, and thus enacting laws for the government of trade and industry throughout the country, is virtually unfettered.[60]

To be clear, while the origins of the nondelegation stretch back almost 100 years, it is still applied robustly today. Just last year, the Fifth Circuit found that Congress unconstitutionally delegated legislative power to the Securities and Exchange Commission when it gave it full discretion to choose whether to bring actions in an Article III court or before an administrative law judge.[61] The Fifth Circuit found that Congress's grant of authority was so open-ended that it offered no guidance whatsoever to the agency.[62] If the intelligible principle standard means anything, it means that a total absence of guidance to a regulating agency, as is the case here, is impermissible under the Constitution.[63]

Section 5(a) provides the Commission with the authority to prevent what it determines to be "unfair or deceptive acts or practices in commerce" and "unfair methods of competition." While enumerating specific procedural requirements in that section to guide the Commission in making such determinations, Congress offered no substantive definition or principle for the Commission to draw upon, instead directing the Commission to rely on administrative proceedings in case-by-case adjudications. Section 6(g), upon which the Commission bases its purported authority to promulgate the proposed rule, likewise offers no "intelligible principle" or substantive limitation to guide the agency in its rulemaking.

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[60] *Schecter Poultry*, 295 U.S. at 541-42 (emphasis added).
[61] *Jarkesy v. Sec. & Exch. Comm'n* 34 F.4th 446, 456 (5th Cir. 2022).
[62] *See Id.* at 462.
[63] *See Gundy v. United States*, 139 S. Ct. 2116, 2123 (2019).

As noted above, under the most generous of circumstances one might argue, as the *National Petroleum* court did, that the language of section 6(g) is susceptible to two readings: a narrow, cabined interpretation which confines the scope of the agency's rulemaking authority to procedural or housekeeping rules, or an incredibly broad one which would grant the Commission virtually limitless authority to bypass the procedural adjudicative requirements set down by Congress in section 5 and instead by fiat issue substantive regulations declaring unlawful an almost limitless range of practices it chooses to deem unfair or deceptive. The non-delegation doctrine requires the former reading.

The *Schecter Poultry* Court differentiated the authority to promulgate "codes of fair competition" given to the President under the National Industrial Recovery Act (NIRA), which it held was as an unduly broad delegation of authority, and the authority delegated to the Federal Trade Commission to prohibit "unfair methods of competition" under the FTC Act, which it had found to be permissible, in large part based on the means by which "fair" or "unfair" practices were to be determined by each agency.[64] In contrast to the unlimited authority granted under the NIRA, the Court noted that the FTC was not given broad authority to promulgate regulations defining "unfair methods of competition." Rather, the agency was created as a "quasi-judicial" body which would define such methods, "determined in particular instances, upon evidence, in light of particular competitive conditions."[65] To read section 6(g) as broadly as the Commission would like would be to eliminate the distinctions that distinguished the FTC from the NIRA in

[64] *Schecter Poultry,* 295 U.S. at 533.
[65] *Id.*

Schecter Poultry, and grant the agency the "sweeping delegation of legislative power" the Court found to be unconstitutional and impermissible.[66] The nondelegation doctrine does not allow the statute to be so broadly construed, and would hold the proposed rule to be unconstitutional. It should be withdrawn.

D. The Proposed Rule Constitutes an Improper Taking Under the "Takings Clause" by Requiring Rescission of Previously Effectuated Contracts Containing Non-Compete Clauses.

While purporting *not* to be retroactive,[67] the proposed rule would make unlawful any and all non-competition agreements entered into by employers with their workers in the past, irrespective of whether consideration or other value has already been paid.[68] It would further require such employers to proactively notify workers that the contractual agreements they have entered into are now unlawful and void.[69] In so doing, it nullifies contract rights that employers have bought and paid for, and thus violates the Takings Clause of the Fifth Amendment of the Constitution.

Intangible interests, including those created by contracts, are considered property for purposes of the Takings Clause.[70] When analyzing whether government action that targets existing contract rights constitutes a taking, the Supreme Court has identified three factors of "particular

[66] *Schechter Poultry*, 295 U.S. at 539.
[67] *See* 88 Fed. Reg. 3512; *cf*. I. Montoya, The Princess Bride (1987) ("I do not think [that word] means what you think it means.").
[68] *See* Proposed Rule § 910.2(a).
[69] See Proposed Rule § 910(b).
[70] *See Lynch v. United States*, 292 U.S. 571, 579 (1934)("[v]alid contracts are property"); *see also 767 Third Ave. Associates v. U.S.*, 48 F.3d 1575, 1578 n.2 (Fed. Cir. 1995) citing *Connolly v. Pension Benefit Guar. Corp.*, 475 U.S. 211, 223 (1986) ("Contracts may create rights of property. . . ."); *cf. Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1003-04, (1984) (trade secrets may be "property" under Takings Clause).

significance:" (1) the economic impact of the regulation on the claimant; (2) the extent to which the regulation has interfered with distinct investment-backed expectations; and (3) the character of the governmental action.[71]

With respect to the first factor, the proposed rule would constitute an illegal taking as it would level significant economic harm on the countless companies and individuals that have entered into previously-valid contracts containing non-compete clauses. While speculative damages as to future financial harm are generally insufficient to form the basis of a successful Takings Clause claim,[72] the harm that will result from the proposed rule is both inevitable and quantifiable. If implemented, the requirement to rescind nearly all previously-valid contracts containing such a clause would allow the government to effectively strip employers of contractual benefits they are legally entitled to, without just compensation. Specifically, for many executed non-compete agreements there has already been partial performance on the part of the employer. This partial performance may be explicit, where an employer has offered (and paid) an employee increased compensation or eligibility for additional benefits in exchange for the individual's entering into a non-compete agreement. Or it may be implicit, in the form of higher wages to

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[71] *See Connolly v. Pension Benefit Guar. Corp.*, 475 U.S. at 224-25 quoting *Penn Central Transp. Co. v. New York City*, 428 U.S. 104, 124 (1978)). The precise nature of the "character" factor is a subject of debate—whether the Court intended "character" to only distinguish between the taking of physical property versus intangible property, or whether it was meant to encompass a wider variety of considerations was not made clear by the Court. *See* Thomas W. Merrill, *The Character of the Governmental Action*, 36 Vt. L. Rev. 649, 654-55 (2012) (concluding that the "character of the governmental action" was meant to encompass more than the tangible/intangible distinction).

[72] *See, e.g., Chang v. United States*, 859 F.2d 898 (Fed. Cir. 1988); *see also Andrus v. Allard*, 444 U.S. 51, 66 (1979) ("loss of future profits—unaccompanied by any physical restriction—provides a slender reed upon which to rest a takings claim").

compensate for the flexibility an employee chooses to give up when they enter into a non-competition agreement (which, again, will have already been paid). In either event, the employer has performed its obligations under the contract, while the employee has yet to perform theirs.

The proposed rule will preclude an employer from obtaining their property right granted under the non-compete (*i.e.*, the contractual guarantee to not compete with the company) despite this quantifiable prepayment. Parties that have already expended resources in compensation will have lost the benefit of their bargain because of government action directly blocking the transfer of their bargained-for consideration. This measurable outcome is distinguishable from those cases that have found that a future, speculative harm is insufficient to meet the economic impact test.[73]

The proposed rule's interference with legitimate, investment-backed expectations also indicates an illegal taking based on its impact on preexisting contracts and the reasonable expectations of the parties entering into them. This factor essentially asks whether it is reasonable for a party to enter into an investment-backed agreement with an expectation to be free from government interference that may negatively impact future benefits stemming from that contract.[74] This is often seen in the context where a contract relates to an industry in which significant regulation already exists, and a contracting party cannot validly complain of frustrated

[73] *See, e.g.*, *Dorn's Transp., Inc. v. I.A.M Nat. Pension Fund* 578 F. Supp. 1222, 1235 (D.D.C 1984); *Sanitation & Recycling Indus. v. City of New York*, 928 F. Supp. 407, 41 (S.D.N.Y. 1996) (determining that speculative damages do not form the basis for a successful Takings Claims); *Chang* 859 F.3d at 898 (loss of contingent right to future damages speculative and merely consequential to the valid exercise of government power).
[74] *See, e.g.*, *767 Third Ave. Associates v. U.S.*, 48 F.3d 1575, 1580 (Fed. Cir. 1995).

expectations from a new regulatory scheme.[75] Without question, the broad area of private employment contracts, even those containing non-compete clauses, does not have the same history or expectation of heavy federal regulation as countless other regulated industries (*e.g.*, aviation, foreign affairs, public housing, pension plans, etc.). Thus, if the proposed rule is implemented, it will undoubtedly cause significant interference with the legitimate expectations of employers that invested in compensation plans in exchange for their employees' willingness to enter into such agreements.

Business owners obviously could not have anticipated the FTC implementing a federal rule that would essentially nullify countless previously valid (and paid for) contracts. This is simply not a situation where parties knowingly entered into a contract with an assumption of risk based on their participation in a highly regulated field. Indeed, as set forth above, reasonable non-competition agreements have been routinely enforced by state and federal courts for literally hundreds of years, and have been almost exclusively the provenance of state law and state courts. No reasonable individual would expect that, one day after announcing the first cases brought in its 100+ year history, the Commission would propose a federalized, national ban of virtually every non-compete in the United States.[76]

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[75] *See Connolly*, 475 U.S. at 226-27; *see also FHA v. The Darlington, Inc.*, 358 U.S. 84, 91 (1958) ("Those who do business in the regulated field cannot object if the legislative scheme is buttressed by subsequent amendments to achieve the legislative end").

[76] While some might argue that the adoption of Executive Order 14036 put businesses on notice that future regulation was a possibility, this potential is insufficient to allow for an assumption of risk argument. In Executive Order 14036, issued on July 9, 2021, President Biden encouraged the FTC to engage in rulemaking to "curtail the unfair use of non-compete clauses and other clauses or agreements that may unfairly limit worker mobility." The Executive Order specifically calls for action to curtail unfair non-competes, which does not contemplate an all-out ban or potential requirement to rescind previously fair and

Finally, the retroactive character of the proposed rule likewise suggests that it is a prohibited taking. As noted above, despite claims to the contrary, the requirement that employers rescind prior contracts makes the proposed rule retroactive in practice. Retroactive legislation is generally disfavored as it inherently presents problems of unfairness by not only depriving citizens of legitimate expectations, but also by upsetting settled transactions.[77] Like explicitly retroactive legislation, as outlined above, the proposed rule significantly interferes with the legitimate, investment-backed expectations contained in countless contracts. Likewise, the distance into the past that the proposed rule reaches back (*i.e.*, indefinitely) presents substantial fairness questions by examining the validity of an infinite number of contracts entered into over the course of several decades. There could not be a clearer example of upsetting settled transactions than the broad sweeping effect of the proposed rule.

In issuing this proposed rule, the FTC fails to consider the grave economic impact the rule will have on countless businesses and organizations if implemented. Importantly, that impact, and the rule's potential interference with legitimate, investment-backed expectations, will result in an unconstitutional taking under the "Taking Clause."

* * *

As a matter of both statutory and constitutional law, the Commission's proposed rule cannot be sustained. The agency has impermissibly gone far beyond the authority granted to it by

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valid agreements. Likewise, knowledge of the potential for future legislative action that could curtail some agreements differs dramatically from reasonably foreseeing an all-encompassing ban on every previously valid contract *See. e.g.*, *United Real Estate Co. v. Hudson*, 889 F. Supp. 818, 834 (W.D. Pa. 1995).

[77] *See Eastern Enterprises v. Apfel*, 524 U.S. 498, 501 (1998) (plurality opinion) citing *General Motors Corp. v Romein*, 503 U.S. 181, 191 (1992).

Congress, and has promulgated a proposed standard that is constitutionally infirm for numerous reasons, and almost certain to fail at its inevitable legal challenge. The Commission should abandon this effort.

III. As a Matter of Substance, the Proposed Rule Is Fundamentally Flawed.

Setting aside the proposed rule's numerous legal shortcomings, the NPRM is fundamentally flawed as a matter of substance in myriad respects. These shortcomings are detailed below.

A. The Proposed Rule Proceeds from a Flawed Assumption as to How Non-Compete Agreements Are Generally Utilized.

The Commission proceeds from a flawed and singular view of how non-compete agreements are actually used by employers today, and has proposed a "lowest common denominator" standard based on a few high-profile but isolated instances that largely do not reflect how non-compete agreements are used by businesses as a practical matter. The Commission's view, it would appear, is that employers are forcing their employees across the board, from lower-wage, non-exempt hourly workers to senior executives and management, to enter into draconian and restrictive non-compete agreements, often without notice, and in exchange for nothing of value.

In our experience, representing literally thousands of employers, this is not at all the case. Rather, most non-compete agreements are used strategically, selectively, and only where the employer believes it has a critical interest to protect. Often, these agreements are accompanied by independent consideration, such as bonus eligibility or increased wages. And, when the question

of enforcement arises, it is never a rote exercise, but rather a careful weighing of the costs and benefits of pursuing enforcement. While not as costly as trade secret litigation (discussed *infra*), it is not a small or inexpensive undertaking to pursue judicial enforcement of a non-compete agreement. This means that as a practical matter, absent exigent circumstances, it will rarely be a lower-level or lower-paid employee against whom an employer seeks to enforce an agreement, but rather only those employees who possess knowledge of a business that would directly benefit a competitor.

Indeed, consider the following examples of non-competition agreement arrangements utilized by some of Littler's clients:

- A national transportation and logistics company invested millions of dollars in a program designed to compensate executives who voluntarily choose to enter into a non-compete agreement for a reasonable period of time post-employment. The program is only open to certain senior employees, and participation is entirely voluntary. Acceptance of a non-compete is not required, but executives who choose to enter into such agreements are awarded additional compensation and bonus eligibility.

- An automated proprietary trading client maintains non-compete agreements for employees with confidential information regarding the client's critical technology, proprietary algorithms, and trading infrastructure. The restricted period for these agreements is calibrated specifically to employees' exposure to the client's confidential information, is typically enforced for a total of six months, and, where longer, the client compensates the employee for the remainder of the elected enforcement period.

- A health care practice allows participating physicians to compete directly upon leaving the practice, and to provide services to practice group patients in their new employment, but requires that the physician compensate the practice relative to their prior year's income for the training, goodwill, and overhead associated with the development of those patient relationships.

- A privately-held manufacturing company in a highly-specialized industry maintains non-compete agreements with its key executive and director employees ranging in time from six months to 1.5 years. It does so only to maintain confidentiality with respect to its financial and shareholder information, compensates employees for participation, and factors the reasons for an employee's separation into any decision as to whether to seek judicial enforcement of the agreement—something that has not happened in over 15 years.

- A privately-held tech company in a high-growth field uses non-competes in connection with acquisitions. These non-competes apply only to high-level personnel, those with strategic or creative importance who would pose a competitive risk immediately on departure. These non-competes vary in length, but rarely exceed one year, and typically apply only to the specified industry and activity the high-level personnel engaged in with the acquired company. The non-competes are tailored to protect legitimate investments.

In each instance, the subject non-competition agreement is supported by significant consideration, and, equally important, tailored to protect a legitimate business interest. Decisions as to whether to seek judicial enforcement are measured and made in context, and made only to protect the value of the business—in short, a far cry from the heavy-handed and exploitative, one-size-fits-all model the proposed rule wrongly presumes to be commonplace. Based on an incorrect, preconceived notion, the proposed rule's "solution" both overstates the problem and misses the mark entirely.

B. <u>The NPRM Is Based on Selective Citation of Inconclusive Academic Research and Ignores a Host of Studies Demonstrating the Benefit of Non-Competition Agreements</u>.

At bottom, the proposed rule is based solely on highly selective excerption of academic studies which the agency's own economist describes as highly lacking and in need of much more development:

> ***[T]he existing empirical literature on non-compete agreements suffers from several important limitations that raise questions as to whether it has successfully estimated the causal effect of such agreements on mobility, wages, entrepreneurship, and innovation.*** Due to the limited availability of data and a shortage of natural experiments to assess the impact of non-competes, much of the literature relies on cross-sectional comparisons of signers and non-signers, or high-enforceability states and low-enforceability ones.
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> Nevertheless, the literature offers some *tentative* findings. Across the board, the literature finds that non-compete agreements are associated with longer worker tenure and less mobility. ***The findings for other outcomes, however, are mixed.*** The papers relying on state policy changes for identification find that non-competes lead to more firm-sponsored training among top public executives but lower wages generally and for technology workers specifically. ***Estimates for executives at public companies are mixed.*** Studies relying on cross-sectional comparisons tend to find that non-competes are associated with more training and information sharing, as well as higher wages in some instances.
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> Regarding firm entry and innovation, the only paper using state law changes finds no discernable effect of a state law that changed non-compete enforceability.
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> ***Further research is needed in several areas.***[78]

Indeed, in selectively choosing data points that support its argument, the agency largely ignores or discounts the findings of those studies that demonstrate the value of non-compete agreements (or conversely, their positive effect on consumers and other stakeholders), including:

- Non-competition agreements can increase wages for certain employees (for example, senior executives and physicians); this is especially true where advance notice of a non-compete agreement is provided.[79] Indeed, non-competition agreements among physicians have been shown to increase

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[78] John M. McAdams, Ph.D., Economist, Federal Trade Commission, "Non-Compete Agreements: A Review of the Literature" (Dec. 31, 2009), at 20 (emphases added; citations omitted).

[79] Written Submission of Practicing Attorneys Concerning Potential Federal Regulation of Noncompetition Agreements to Federal Trade Commission (July 14, 2021) at 16 n. 42, available at: https://faircompetitionlaw.com/wp-content/uploads/2021/07/White-House-and-FTC-20210714-Joint-Submission-of-Trade-Secret-Lawyers-Beck-et-al.pdf.

earnings by 14%, and greater earnings growth thereafter.[80] The NPRM goes as far to acknowledge this fact, noting that "there is evidence that increased enforceability of non-compete clauses increases the rate of earnings growth for physicians," but then ignores this fact because the study "does not allow for a precise calculation." [81]

- Employees in the mutual fund industry who had signed non-compete agreements were found to be "more productive, take fewer risks and align their behaviors with the goals of their employers."[82]

- The elimination of non-compete agreements will reduce employer-sponsored training by 14.7%. Indeed, as the NPRM acknowledges (but then chooses to ignore), such training is the type of training non-competition agreements protect, because in the absence of some assurance that an employee receiving training will not immediately flip to a competitor, employers are likely "unwilling to make an unprotected investment."[83] The NPRM likewise discounts analyses showing that employing firms reduce their investment in capital equipment when faced with a decreased ability to enforce non-compete agreements.[84]

- "[C]ontext matters. So although non-compete agreements can reduce earnings on average, in some contexts, there's evidence that they might systematically increase earnings. … I have a paper with some co-authors studying physicians that shows that [] both physician firms and workers appear to benefit from the

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[80] *See* Kurt Lavetti, Carol Simon, & William D. White, "The Impacts of Restricting Mobility of Skilled Service Workers Evidence from Physicians," 55 J. Hum. Res. 1025, 1042 (2020).

[81] 88 Fed. Reg. at 3501 n. 248

[82] Study Finds Noncompete Clauses Affect How Employees Behave, To Benefit Of Employers, available at: https://news.ku.edu/2019/03/25/study-finds-non-compete-clauses-affect-how-employees-behave-benefit-employers; *see also* Gjergji Cici, Mario Hendriock, & Alexander Kempf, "The Impact of Labor Mobility Restrictions on Managerial Actions; Evidence from the Mutual Fund Industry" (University of Cologne) at 2, 5 (Mar. 28, 2018) ("Our first set of results shows unambiguously that increased enforceability of NCCs [i.e., noncompetes] leads to better fund performance. . . . Our empirical results show that fund managers increase effort even more in large fund families after NCC enforceability becomes stricter."), available at https://www.econstor.eu/bitstream/10419/177385/1/1017934355.pdf.

[83] *See* 88 Fed. Reg. 3,493 (citing Evan Starr, Consider This: Training, Wages, and the Enforceability of Non-Compete Clauses, 72 I.L.R. Rev. 783, 796-97 (2019).

[84] *See id.* citing Jessica Jeffers, The Impact of Restricting Labor Mobility on Corporate Investment and Entrepreneurship, p. 22 (2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3040393 (noting that knowledge-intensive businesses invest almost one-third less in capital equipment where non-compete clause enforceability is reduced).

> use of non-compete agreements. … What we conclude is that non-compete agreements actually appear to play a fairly valuable role in this context. [Physicians] make substantially more money, and all of that difference comes from larger within-job earnings growth."[85]

A recent analysis by Edgeworth Economics comes to the same conclusion, namely, that the evidence of a causal relationship between the use of non-compete clauses and lower earnings upon which the proposed rule relies "is, at best, inconclusive" and "cannot be extrapolated to reliably predict the effects of the [proposed rule] on earnings."[86] Moreover, the economic analysis of the rule fails to account for the fact that, particularly with regard to skilled workers, employers are likely to pay more where a position requires the employee to enter into a non-compete agreement (indeed, one study cited indicated that, all things equal, this pay differential was highest in states where non-compete agreements are more strongly enforced), and that most of the studies cited in support of the proposal fail to compare employees working under a non-compete with employees with similar skills who are not.[87] "The inability to compare workers with similar skills and qualifications across jurisdictions (or time periods) with differing [non-compete] enforceability causes the interpretation of the correlation between [non-compete] enforceability and earnings in these studies to be speculative."[88]

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[85] Remarks of Kurt Lavetti, Ph.D., Associate Professor, Department of Economics, The Ohio State University, at FTC's workshop, "Non-Competes in the Workplace: Examining Antitrust and Consumer Protection Issues" (January 9, 2020), transcript at pp. 144-46.
[86] Stephen Bronars, Ph.D., Partner, Edgeworth Economics, "A Critical Evaluation of The FTC's Empirical Evidence That Prohibiting Non-Compete Clauses Will Increase Earnings" (Mar. 7, 2023), at 1; available at: https://www.edgewortheconomics.com/publication-ftc-evidence-that-non-competes-reduce-earnings-is-inconclusive.
[87] *See id.* at 2.
[88] *Id.* at 5.

Finally, as a matter of policy, the proposed rule ignores two important trends which counsel against a broad ban on non-compete agreements. The first is the fact that on a national basis, workers are leaving their jobs in record numbers—suggesting that a purported lack of "worker mobility" is, at best, overstated in the proposed rule. Second, the fact that the American workforce is currently facing an historic skills gap—there are millions more skilled jobs than there are workers qualified to fill them, with the advent of automation and artificial intelligence expected only to exacerbate this trend—suggests that any policy proposal which on its face acknowledges that it is likely to lead to reduced training and skilling opportunity for employees—is at worst wrong-headed and at best ill-timed.

In short, the proposed rule ignores the significant evidence that the costs and benefits of non-competition agreements are highly individualized and contextual, and instead proposes a blunderbuss solution based on highly selective academic abstraction. In doing so, it fails to contemplate or address how these agreements are actually used in practice, and should be rejected.

C. The Proposed Rule Ignores the Benefit of Non-Competition Agreements to Small Businesses, and How Non-Competes Level the Playing Field with Large, Established Businesses.

The NPRM likewise wholly fails to acknowledge that, for the reasons set forth above, the elimination of non-compete agreements is unlikely to benefit the common laborer, the low-wage worker, or the small business owner. Rather, the worker who is most likely to benefit is the high-profile employee that the employer has invested heavily in educating and promoting in the marketplace, the employee who has been paid to be the face of the company with its biggest customers, or the employee entrusted with trade secrets and other confidential information that can

be used by a competitor to gain an advantage in often undetectable ways. These are almost always already relatively highly-paid employees with significant bargaining leverage.

Likewise, it is rarely the small business or startup venture ("David") which first employs the worker and invests in him that would benefit from the elimination of non-competition agreements. Rather, it is the large, well-financed company ("Goliath") which can afford to overpay to induce key employees to leave a startup's employ because it is so big and well-financed that it can take this financial gamble. Goliath can offer that worker an increase in compensation that David can't match, and by doing so, get not only the benefit of its competitor's knowledge, but also the added benefit of crippling the upstart new competitor.

With no non-compete to stop it, Goliath can lure a key employee away with a raise that his current employer could never afford. David made years of investment in educating the worker about its business and/or promoting the worker in the market to get him to his current highly productive level. David may have introduced him to key business contacts and customers, paid for dinners, entertainment, travel, and the like to build his relationship with these contacts. These are investments from which Goliath immediately benefits but does not have to pay for, which is one reason why it can almost always afford to pay more than David can. What David invested in its employee cannot be replaced overnight, but Goliath can immediately put him to work using David's investment for its own benefit since the worker has no non-compete. As a result, David loses customers previously attended by the worker and has to lay off support personnel who did all the back-office work that helped make him look good. Goliath doesn't need them. It already has its own crew of support people.

This is an especial concern for small businesses, which would likely suffer the most harm from an absolute ban of non-compete agreements, insofar as they will often have a small number of key trade secrets that form the basis of their business, and are in the least-able position to finance costly litigation. Given this, it is unsurprising that for over 100 years in this country, the best equalizer tool that the small business owner had to combat this sort of predatory Goliath competitor has been the non-compete agreement. Properly utilized, the non-compete agreement protects the small business owner's investment in its workers. In every state in the United States where non-compete agreements are in some form permitted (which is almost all of them), the value of this tool has been recognized within limitations. The agreement must always be limited in time and scope to be enforceable. Goliath can still hire away a key employee but must sit him on the bench and give David time to replace him and try to catch up before Goliath uses him to compete against him. This reduces the unfair advantage that Goliath has by having avoided the front-end investment costs in training the employee. Essentially, the non-compete has leveled the playing field.

This point was highlighted in the comment submitted to the record in this rulemaking by the Small Business Administration (SBA)'s Office of Advocacy. There, SBA pointed out that the FTC's own estimate is that the proposed rule will affect 2.94 million small businesses, many of which use non-compete clauses to protect their business.[89] As SBA explained, "Small businesses use non-compete clauses to protect assets such as client lists, business practices, teaching

[89] Comment of Small Business Administration Office of Advocacy (Mar. 20, 2023), at 3.

techniques, technology, intellectual property, and others. ***If the critical competitive information they have built and created is not protected adequately, some small businesses could face a serious risk of loss and potential closure.***"[90]

The NPRM posits that "non-compete clauses prevent small firms from existing in the first place."[91] In grounding its proposal exclusively in academic literature, rather than the real-world experience of businesses, employees, and practitioners, the Commission has missed the forest for the trees. The proposed rule wholly fails to account for the real-world application and enforcement of non-competition agreements in the modern workplace, relying again on select facts and academic research that is inconclusive at best, to arrive at a conclusion completely at odds with the reality of how small businesses utilize and benefit from such agreements.

D. The Proposed Rule Fails to Acknowledge That Existing Trade Secret Law Is Insufficient to Protect an Employer's Interest.

Research indicates that "59% of ex-employees admit to stealing confidential company information" when they leave a job.[92] The cost of this misappropriation of intellectual property has been estimated to range from one to three percent of U.S. Domestic Product, potentially costing

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[90] *Id*. (emphasis added).
[91] 88 Fed. Reg. 3489.
[92] *See More Than Half Of Ex-Employees Admit To Stealing Company Data According To New Study*, Ponemon Institute & Symantec Corporation (Feb. 23, 2009), available at https://investor.nortonlifelock.com/About/Investors/press-releases/press-release-details/2009/More-Than-Half-Of-Ex-Employees-Admit-To-Stealing-Company-Data-According-To-New-Study/default.aspx. *See also* Symantec Corporation, "What's Yours Is Mine: How Employees are Putting Your Intellectual Property at Risk," (Feb. 6, 2013) ("Half of the survey respondents say they have taken information, and 40 percent say they will use it in their new jobs."), available at: https://www.ciosummits.com/media/solution_spotlight/OnlineAssett_Symantec_WhatsYoursIsMine.pdf.

U.S. employers up to $480 billion per year.[93] Yet the NPRM takes the position that intellectual property law, specifically, federal and state laws regarding the use, abuse, and disclosure of trade secrets and confidential information provide employers with a "viable" means of protecting their investment in trade secrets.[94] It cites the dramatic increase in trade secret litigation following the passage of the federal Defend Trade Secrets Act of 2015 (DTSA) as evidence that employers "view trade secret law as a viable means of obtaining redress for trade secret theft."[95] In doing so, it misses a number of crucial points, and arrives at a faulty conclusion.

Prosecution of a trade secret case is expensive, time-consuming, and often highly technical.[96] As SBA observed, with respect to small businesses in particular, "the legal process often involves protracted proceedings and astronomical legal fees which small entities may not be able to afford."[97] Most of the evidence of trade secret misappropriation will be solely in the hands of the defendant and virtually unknown and unknowable to the party looking to protect its trade secret until it gets deep into the trade secret litigation. Cases of this nature routinely require the

[93] *See* "Economic Impact of Trade Secret Theft: A framework for companies to safeguard trade secrets and mitigate potential threats," CREATe.org and PwC (Feb. 2014), available at: https://www.innovation-asset.com/hubfs/blog-files/CREATe.org-PwC-Trade-Secret-Theft-FINALFeb-2014_01.pdf.
[94] 88 Fed. Reg. 3506.
[95] *Id.*
[96] *See generally* Christina L. Wu, Noncompete Agreements in California: Should California Courts Uphold Choice of Law Provisions Specifying Another State's Law?, 51 UCLA L. Rev. 593, 610-11 (2003) ("Noncompete agreements can also reduce the cost of trade secret litigation. . . . Instead of claiming misappropriation of trade secrets, an employer can simply bring a contract action for breach of the covenant not to compete, which would be less costly and easier to prove. Trade secret misappropriation cases can involve extensive discovery. They also consume the time of other employees, who would otherwise be performing more productive tasks. In contrast, proving a violation of a noncompete agreement would not involve extensive discovery or exhaust other employees' time." (footnotes omitted)).
[97] SBA, n. 83 *supra*, at 3.

investment of millions of dollars in attorneys' fees, expert fees, and detailed investigation efforts. This is the kind of commercial litigation where there are very, very few attorneys who will take the case on a contingency and the few who will do so are very selective and take only the most promising big-ticket cases. As a result, in the aforementioned example of a battle between David's startup with modest funding and well-established, well-financed Goliath, David's odds of success are tiny. Goliath can simply run up the litigation costs to the point that David can no longer continue the fight. The Goliaths of the world can rely upon trade secret protections to war with each other over employees, but it is certainly no refuge for David.

Moreover, the proposed rule fails to acknowledge that trade secret law offers insufficient protection to an employer insofar as it fails to protect employer information that may be confidential and proprietary, but outside the strict definition of "trade secret." In most states, "trade secrets" are defined by way of some variation of the Uniform Trade Secrets Act, which as a practical matter defines "trade secrets" as a limited subset of the proprietary, confidential information an employer has a legitimate business interest in protecting. For example, whether customer information and customer lists are protected "trade secrets" are a common subject of dispute.[98] Similarly, information about customer pricing, bid development, and market pricing may fall outside the definition of "trade secret" notwithstanding the fact that an employee who leaves a company to join a competitor may immediately use this sort of information to underbid their former employer. Insofar as many trade secret laws have both civil and criminal applications,

[98] *See* Written Submission of Practicing Attorneys, n. 79 *supra*, at 9-10

the threat of criminal penalties results in a definition of "trade secret" that is drawn much more narrowly than that which is needed to prevent unfair competition by the use and disclosure of confidential and proprietary information outside of that definition.

More to the point, and as explained to the Commission at its public forum on the proposed rule, non-disclosure agreements and trade secret law offer certain protections for certain information, they are insufficient, and fail to provide the "crucial protections that [non-competition agreements] provide that non-disclosure agreements and trade secret laws don't."[99]

Similarly, existing trade secret law will often fail to account for the doctrine of "inevitable disclosure." Inevitable disclosure rests on the theory that certain information learned by an employee cannot be "unlearned," or that an employee will be unable to compartmentalize and refrain from using confidential information or trade secrets learned in a prior position.[100] Established by the Seventh Circuit applying Illinois trade secrets law in the seminal case *PepsiCo, Inc. v. Redmond,*[101] the doctrine has been inconsistently adopted across states.[102] At bottom, it seeks to address two distinct issues: (a) how the information a departing employee has learned with his prior employer will, necessarily, inform and influence the decisions with a new, competing employer; and (b) the converse "negative information" conundrum—that an employee in

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[99] Federal Trade Commission Forum, "Examining Proposed Rule to Ban Noncompete Clauses" (February 16, 2023), at 8 (testimony of Emily Glendinning).

[100] *See generally* United States Patent and Trademark Office, "The Defend Trade Secrets Act at Five: The Inevitable Disclosure Doctrine" (U.S. Patent and Trademark Office, Office of Policy and International Affairs) (October 2021).

[101] 54 F.3d 1262 (7th Cir. 1995).

[102] *See Phoseon Tech., Inc. v. Heathcote*, 2019 WL 72497, *11 (D. Or. Dec. 27, 2019) ("Seventeen states appear to have adopted the inevitable disclosure doctrine in one form or another… Five states appear to have rejected the doctrine.").

possession of trade secrets will not only have learned what has been successful for its prior employer, but also what has *not* been successful and can be avoided at a new competitor, thus saving significant research and development time and cost. The archetypal example is the chemist who develops products for an employer, learning through trial and error what works and what does not. It is impossible to imagine that upon moving to a competitor, that experience will be "unlearned" or that the chemist will not draw on their knowledge to avoid repeating experiments or theories they know to have failed in the past. DTSA does not afford adequate protection in these use cases.

Indeed, in the absence of a non-compete agreement, an employee who had access to confidential information from one employer who goes to work for a competitor will often find themselves in an untenable position: in a meeting at the new employer to discuss a new business approach or strategy, the employee knows, based on confidential information obtained during their tenure with their prior employer, that certain approaches are infeasible, and a waste of the new employer's resources. That employee now has to decide whether to breach a duty of loyalty to their new employer by not speaking up, or breach a non-disclosure agreement with their prior employer.

Finally, DTSA provides that while an employer may seek an injunction where it fears a departing employee will impart trade secrets, such an injunction: (a) may not prevent a person from entering into an employment relationship with another firm; and (b) must be based on

"evidence of threatened misappropriation and not merely on the information the person knows."[103] Courts have split as to whether that language permits an injunction to be based on a theory of inevitable disclosure,[104] leaving employers with no certainty that DTSA or other trade secrets law will protect their investments and confidential information from disclosure in a timely manner.

In short, while trade secret law provides some protection to employers concerned with the disclosure of trade secrets and confidential information, it is inefficient, costly, inconsistent, and an inadequate substitute for a contractual agreement not to compete.

E. The Proposed Rule Is Unworkable as a Practical Matter.

For all of the reasons set forth above, we submit that the FTC should withdraw the proposed rule entirely. It also suffers from a number of specific flaws that, were it to become final in its current form, would likely be unworkable in practice. While we believe the Commission does not have the authority to regulate within this area at all, we offer these comments to inform a final rule if the Commission is bound and determined to promulgate one.

1. The Proposed Rule Makes No Effort to Differentiate Among Employees and the Propriety of Their Noncompete Agreements.

Foremost, the proposed rule errs in making no distinction whatsoever with regard to the nature of an employee's job and job duties, their position within their employer's firm, their income, their access to confidential or proprietary information, or any other tangible factor.

[103] 18 U.S.C. § 1836(b)(3)(A)(i)(l).
[104] Compare *Fres-Co Sys. USA, Inc. v. Hawkins*, 690 F. App'x 72 (3d Cir. 2017) & *Packing Corp. of Am., Inc. v. Carter*, 419 F. Supp. 3d 1059 (N.D. Ill. 2020) (allowing DTSA claims based on theory of inevitable disclosure) with *Kinship Partners, Inc. v. Embark Veterinary, Inc.*, 2022 WL 72123 (D. Or. Jan. 3, 2022) & *IDEXX Lab'ys v. Billbrought*, 2022 U.S. Dist. LEXIS 136676 (D. ME. Aug. 2, 2022) (disallowing injunction based on 18 U.S.C. § 1836(b)(3)(A)(i)).

Rather, the proposed rule would nullify both the non-compete agreement of a cashier in a fast-casual restaurant and that of the restaurant chain's Senior Vice President for Marketing and Development. It is simply common sense that the chain is likely to have far greater business justification for limiting the employee in the senior position from going directly to a competitor, given the access they have had to the company's strategic and business planning, product development, and the like. Insofar as the proposed rule seeks opinion on whether "senior executives" should be subject to a different standard with regard to the enforceability of non-compete agreements, we submit that this is a bare minimum. If the Commission proceeds with a final rule addressing non-compete agreements broadly, it should distinguish, as states have, between different categories of employee. At least ten states have banned the enforcement of non-compete agreements against workers earning less than a threshold amount, or make distinctions based on exempt/non-exempt status under the Fair Labor Standards Act. While these are useful distinctions, they may not in all instances capture the complete nature of an employee's position and responsibilities. While a salary threshold would be preferable to a universal ban on non-competes, it would still lack the case-by-case, individualized assessment of both the employee's and the employer's needs and justifications for the agreement. The Commission should also consider excluding from any ban those non-compete agreements that are bargained-for between the employer and the employee, those in which the employer compensates the former employee for some or all of the restricted period, and those that are entered into for additional consideration (such as salary or bonus eligibility). Such an approach would be in accord with the recommendations of the SBA: "Because of the wide range of industries and the nature of economic

impacts, [SBA] asserts that a universal ban on non-compete clauses is inappropriate. Accordingly, [SBA] encourages the FTC to adopt an approach that addresses the different concerns of small businesses in the marketplace."[105]

2. **The Use of a "Functional" Test for Confidentiality, Non-Disclosure, and Other Ancillary Agreements Is Vague and Overbroad.**

The proposed rule adopts a bright-line prohibition on all employer/employee non-compete agreements—an over-inclusive and overreaching standard. It compounds this error by proposing to prohibit a wide and undefined range of agreements, ranging from confidentiality and non-disclosure agreements to training repayment agreements, or other provisions that may require some form of remuneration from an employee if they choose to compete with their former employer by way of a so-called "functional test." As set forth in the NPRM:

> Whether a contractual term is a non-compete clause [and thus made unlawful under the proposed rule] would depend not on what the term is called, but how the term functions…. The purpose of § 910.1(b)(2) is to clarify that, if an employer implements a restrictive covenant not called a "non-compete clause" but so unusually broad in scope it functions as such, the covenant would be within the definition of non-compete clause… Proposed § 910.1(b)(2) would state that the term non-compete clause includes a contractual term that is a *de facto* non-compete clause because it has the effect of prohibiting the worker from seeking or accepting work with a person or operating a business after the conclusion of the worker's employment with the employer.[106]

Apart from two examples of limited utility, the proposed rule provides almost no detail as to what the Commission will view as "unusually broad." For example, when is a non-disclosure

[105] SBA, n. 83 *supra*, at 3-4.
[106] 88 Fed. Reg. at 3509.

agreement (NDA) "too broad?" When it covers information outside the employee's work duties? When it covers information the employee could have learned from public sources? Something else? At a minimum, if the Commission is to retain this approach in a final rule, it should provide guidance and additional concrete examples of the sorts of provisions that will and will not trigger this "*de facto* non-compete" finding. The NPRM notes only that *de facto* non-compete status may be found beyond the two examples it proposes, but offers no limiting principle beyond that. This should be addressed in any final rule, insofar as absent concrete guidance, employers are likely to immediately find themselves mired in litigation over their "non-non-compete" agreements. This litigation will take years (and an enormous amount of resources) to sort out. And in the meantime, these employers will be left not knowing whether they can enforce their agreements, an uncertainty that will lead them to make inefficient decisions: If a company does not know whether it can protect its trade secrets, it will share those secrets with fewer workers; workers in turn will lose out on valuable information, making them less efficient. In short, in the absence of clarification, everyone loses.

3. The 25% Ownership Interest for the Application of the Sale of Business Exception Is Arbitrary and Underinclusive.

The proposed rule generally bans all non-compete agreements entered into between and employer and its employees. It makes but one exception: a company can enter a non-compete with a worker in connection with the sale of a business. However, to qualify for the sale exception, the worker has to be a "substantial" owner or partner. "Substantial" means that the worker has to own at least 25% of the business being sold, in effect applying only to (some) founders and major

shareholders of an entity. The exception is underinclusive, insofar as it fails to cover the day-to-day leadership of a business. Assume, for example that an acquired business's CEO knows everything about the business—its tech, its customers, its market strategy, etc.—but that CEO has only 10% equity in the company. Under these facts, an acquiring firm is unable to protect its investment: as soon as it buys the business, the CEO could turn around and start another, competing one. Conversely, an individual who owns 25% of a business may poses little competitive risk—the passive investor who has no knowledge of the business's customers, strategies, technologies, or methods. The exception is therefore both under- and overinclusive.

We submit that rather than focusing on a worker's arbitrary ownership stake, a final rule should focus on the worker's competitive risks. In connection with an acquisition, a firm should be able to enter non-compete agreements with any key talent who are competitive risks: those with access to competitive information about the business's tech, market, or business strategy. Such an exception would make more economic sense, and would better protect investments while applying to a narrower and more salient universe of workers.

IV. The Proposed Rule Is Arbitrary and Capricious In Violation of the Administrative Procedure Act.

Taken together, the foregoing shortcomings of the proposed rule render it arbitrary and capricious and invalid under the APA. Under the APA, an agency cannot act in an arbitrary and capricious manner in promulgating regulations.[107] If an agency action is arbitrary and capricious,

[107] *See* 5 U.S.C. § 706(2)(A).

that action is unlawful and invalid, and must be put aside.[108] "The APA's arbitrary-and-capricious standard requires that agency action be reasonable and reasonably explained."[109] An agency action is arbitrary and capricious if:

> [T] he agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise.[110]

This is especially true, where, as here, the agency is purporting to exercise power that for most of its existence it disclaimed that it possessed: an agency "must provide … a 'detailed justification' to explain why it is changing course" and may not "casually ignor[e]" its previous findings and "arbitrarily chang[e] course."[111] When a 'new policy rests upon factual findings that contradict those which underlay[an agency's] prior policy,' the agency must provide 'a more detailed justification' than usual to avoid arbitrariness and capriciousness."[112] Agency reversals have been vacated where they rely on factors that they should not have considered, and where they offer explanations for new rules that run counter to the evidence.[113] The use of internally

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108 *See Texas v. Biden*, 20 F.4th 928, 988 (5th Cir. 2021) quoting 5 U.S.C. § 706(2)(A).
109 *Federal Communications Comm'n v. Prometheus Radio Project*, 141 S. Ct. 1150, 1158 (2021); *accord Texas*, 20 F.4th at 988-89.
110 *977 Motor Vehicle Mfrs. Ass'n of the U.S., Inc.*, 463 U.S. at 43; *accord* Sierra Club v. U.S. Env'tl Protection Agency, 939 F.3d 649, 663-64 (5th Cir. 2019) quoting *Tex. Oil & Gas Ass'n v. U.S. Envtl. Prot. Agency*, 161 F.3d 923, 933 (5th Cir. 1998)).
111 California v. BLM, 286 F. Supp. 3d at 1064, 1068; *see also Connecticut Light & Power Co. v. Nuclear Regulatory Comm'n*, 673 F.2d 525, 528 (D.C. Cir. 1982).
112 See *Texas*, 20 F.4th at 99 quoting *Federal Communications Commission*, 556 U.S. at 515.
113 *Id.*; *see also FCC v. Fox TV Stations, Inc.*, 556 U.S. 502, 515 (2009).

contradictory reasoning also indicates arbitrary action.[114] Measured against each of these standards, the proposed rule is arbitrary and capricious, and fails as a matter of law under the APA.

First, as detailed above, any examination beyond the most cursory scan makes clear that the FTC Act does not grant the Commission the authority to promulgate substantive rules relating to unfair methods of competition. Indeed, throughout most of its history the Commission has taken the position that it lacks such authority. The proposed rule does not even begin to justify the reversal of its longstanding position, or attempt to explain how it has come to believe that the statute confers upon it such broad and unlimited authority. Nor does it offer any legal analysis in support of this proposition, citing a single case which led Congress to affirmatively limit the Commission's rulemaking authority. Rather, the proposed rule simply states as a foregone conclusion that "[t]aken together, Sections 5 and 6 provide the Commission with the authority" to issue the proposed rule.[115] This is exactly the sort of arbitrary and unsupported regulating that the APA was designed to prohibit.

Second, the Commission's rationale for and the evidence it relies upon in support of its position are wholly lacking. The agency itself concedes in numerous instances that the academic literature upon which it solely relies offers mixed conclusions at best. Indeed, it ignores evidence demonstrating that in at least some instances, the use of non-compete agreements has been to the benefit of both workers and employers. While recognizing that the use of non-competition agreements is highly situationally dependent, it ignores this fact and instead proposes a blanket

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[114] *See Southwestern Elec. Power Co. v. EPA*, 920 F.3d 999, 1030 (5th Cir. 2019) ("[T]he agency's rationales contradict themselves... and therefore cannot stand.").
[115] 88 Fed. Reg. 3499.

ban. In doing so, it rejects the longstanding precedent established by federal and state courts that non-competition agreements that are reasonable in scope and duration are legal under the FTC Act. Moreover, the proposed rule engages in no serious analysis and offers little evidence to support its conclusions that non-competition agreements are, in all instances, "restrictive conduct that negatively affects competitive conditions" and, in most instances, "exploitive" and "coercive." In doing so, it again ignores the holdings of innumerable courts that have upheld and enforced reasonable non-compete agreements.

Finally, the APA requires that an agency consider the costs to and reliance interests of regulated parties.[116] As noted above, the proposed fails to meaningfully address the reliance interests of businesses (and employees) that have relied on the expectation that pursuant to decades of federal and state caselaw, a non-compete agreement which is reasonable in scope and duration, and in furtherance of a legitimate business interest, is valid and enforceable. The NPRM does not recognize the significant capital employers may have invested directly in obtaining non-competition agreements from employees (where, for example, additional compensation or benefits are provided in exchange for an agreement to forego competing post-employment) or the indirect costs employers have invested based on the expectation that reasonable non-competition agreements would be enforceable.

For all of the foregoing reasons, the proposed rule is arbitrary and capricious, in contravention of the APA. It should be withdrawn.

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[116] S*ee Encino Motorcars v. Navarr*o, 136 S. Ct. 2117, 2125-26 (2016); *Brackeen v. Haaland*, 994 F.3d 249 (5th Cir. 2021) (en banc).

V. Conclusion

The proposed rule is fatally flawed as a matter of fact, law, and policy. The Commission should abandon an ill-conceived effort to upset centuries of precedent under federal and state law, and it should withdraw the proposed rule.

Respectfully submitted,

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