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FTC Condemns Non-Competes: An Antitrust Perspective on Practical Next Steps for Companies

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The FTC recently concluded that many noncompete agreements between employers and employees violate federal antitrust law, announcing settlements of two significant antitrust investigations. These settlements were announced the day before the FTC proposed a regulation that, if adopted, would implement a near-universal ban on noncompete agreements. These actions represent a rejection of the centuries-old principle that noncompete provisions are enforceable so long as they are reasonable with respect to scope, duration, and geography. We discussed the FTC's proposed regulations in an alert last week. Here, we describe practical next steps that companies that currently rely on noncompete provisions should take in the short-term, medium-term, and long-term to account for the shift in antitrust law embodied in the settlements and proposed in the regulations.

Background

President Biden's administration continued and expanded the previous administration's focus on antitrust enforcement in the labor markets. In particular, in July of 2021, the President promulgated an Executive Order calling on the FTC to consider applying the antitrust laws to "curtail the unfair use of non-compete clauses and other clauses or agreements that may unfairly limit worker mobility."

Over the course of the next eighteen months, the FTC (and DOJ) heeded this call in merger reviews, investigations, and advocacy. While much of this activity can be seen as increasing aggressiveness in enforcing existing laws and principles, the FTC is more recently pushing for new antitrust requirements that rewrite the existing playbook. It appears that one of the first areas where this will play out is in treatment of noncompete provisions between employers and employees.

Two FTC Settlements Involving Allegedly Problematic Noncompetes

On January 4, the FTC by a vote of three to one (with the Commission's sole Republican commissioner dissenting) announced settlements of two investigations into the use of noncompete agreements in employee contracts. These actions are the first FTC enforcement actions against employee noncompete agreements. Both proceeded under Section 5 of the FTC Act.

The first settlement involved two affiliated companies in the security guard industry and their individual owners. These companies, according to the FTC, exploited their superior bargaining power against security guards paid at or near the minimum wage to impose a 100-mile, two-year noncompete with a

penalty for violation of $100,000. Under the terms of the settlement, the security guard companies and their owners may not enforce, threaten to enforce, or impose noncompete restrictions on current or past workers, including in new business ventures.

The second settlement involves two large glass manufacturers of food and beverage containers. These companies, according to the FTC, imposed one or two-year noncompetes on approximately 1,700 employees to impede the entry of rivals. Under the terms of the settlement, the companies must eliminate the noncompete restrictions.

The FTC majority stated that "[t]oday's actions should put companies and the executives that run them on notice that using noncompetes to restrain workers and restrict competition invites legal scrutiny." Commissioner Wilson dissented in both actions, writing that the FTC majority did not properly interpret Section 5 of the FTC and proceeded without evidence of anticompetitive effects. She further highlighted the fact that noncompete provisions have been judged based on their reasonableness at common law and under various state laws for "several hundred years." The FTC's new use of federal law to rewrite the rules of noncompete enforcement thus indicates a clear intention by the Democratic Commissioners to answer President Biden's call for more aggressive antitrust enforcement.

The FTC's Broader Proposed Regulation Banning All Noncompete Requirements

The day after the announcement of the two settlements referenced above, on January 5, the FTC by a vote of three to one proposed regulations that would ban employers from imposing noncompete agreements on workers. The FTC again relied on Section 5 of the FTC Act, concluding preliminarily that noncompetes constitute an unfair method of competition. As with the settlements, the FTC took the view that proof of anticompetitive effects is not necessary for a Section 5 violation, and further that the long-standing case-by-case treatment of noncompete agreements should be discarded.

Under the proposed rule, it would be illegal for an employer to enter into or attempt to enter into a noncompete with a worker, maintain an existing noncompete with a worker, or represent to a worker, under certain circumstances, that the worker is subject to a noncompete. The proposed rule extends to both paid and unpaid employees and independent contractors. It also extends to non-disclosure agreements or agreements to repay training costs upon early termination of employment if such agreements amount de facto to a noncompete. Finally, the proposal extends to noncompetes related to the sale of a business unless they involve a person who owns at least 25% of the sold business.

In announcing the proposal, the FTC majority stated that "noncompete clauses reduce competition in labor markets, suppressing earnings and opportunity even for workers who are not directly subject to a noncompete." The agency estimated that the proposed rule could increase wages by nearly $300 billion and expand opportunities for about 30 million Americans. Commissioner Wilson again dissented, stating that the FTC lacks authority to engage in rulemaking, especially of this magnitude, under Section 5 of the FTC Act and that the proposal "represents a radical departure from hundreds of years of legal precedent that employs a fact-specific inquiry into whether a non-compete clause is unreasonable in duration and scope, given the business justification for the restriction."

The proposed rule is now subject to notice and comment. The agency explicitly called for comment on whether the regulation should apply to all workers, including executives and highly paid workers and franchisees.

Antitrust Takeaways

The FTC's settlements and proposed regulations present new risks for the use of noncompete clauses. There are three notable features of the FTC's actions.

- First, the FTC's condemnation of noncompete clauses does not turn on an assessment of their reasonableness. In the settlements, the FTC did not rest its allegations on the unreasonableness of the clauses with respect to scope or duration. In the proposed regulation, the FTC proposes to ban all noncompetes regardless of reasonableness.
- Second, the FTC's condemnation of noncompete clauses does not turn on their enforcement. In the glass manufacturers' settlement, the FTC did not mention any history of enforcement of the noncompetes. In both the settlements and the proposed regulation, the FTC would require the rescission, with notice to employees, of existing noncompete clauses.
- Third, the FTC's condemnation of noncompete clauses does not soften when they are imposed on executives, highly-skilled workers, or in connection with the sale of a business (except for owners). The glass manufacturers' settlement involved skilled laborers, including trained workers, and the FTC's proposed regulation explicitly extends to executives and transactions.

More generally, the FTC's approach to noncompetes demonstrates a clear willingness to challenge existing norms for competition law enforcement. Indeed, if Section 5 no longer requires proof of an anticompetitive effect to demonstrate a violation, it would significantly expand the categories of conduct that the FTC might view as "unfair" and therefore subject to sanction.

Practical Next Steps

In light of the FTC's settlements and proposed regulations, companies should take the following three steps with respect to noncompetes in those local jurisdictions in which they are allowed:

A. Short-term—Re-evaluate the current risks.

The FTC's settlements concern noncompetes enforced against low-wage workers and noncompetes imposed on (even if not enforced against) skilled workers who are necessary for new companies to enter a market. Because those practices have drawn the ire of the FTC, companies should evaluate whether they use noncompetes in similar circumstances. While we await adoption of a final rule, companies can consider a mitigation plan that would identify employees who would be impacted and determine steps for complying with a potential ban on noncompetes. In addition, companies that rely heavily on noncompetes for the protection of their businesses may consider whether to join potential declaratory actions that are likely to materialize as a means to forestall the FTC's enforcement of this proposed ban.

B. Medium-term—Prepare for nationwide, retroactive ban.

The FTC is likely to finalize regulations similar to those that it proposed, with perhaps some tweaks for executives, high-wage workers, or franchisees. Preparing now for a future in which existing noncompetes are illegal likely involves considering existing protections in place for trade secrets and the dissemination and use of confidential information. It may also affect training plans and HR policies that can impact employee mobility.

C. Long-term—Plan for transactions.

After the FTC finalizes its regulations, companies will need to take into account the possibility that non-owner officials of targets for acquisition may not be bound by noncompetes. That could change valuations or inspire acquirers to negotiate other provisions to protect their investments.

The FTC's settlements and proposed regulations represent a significant development in antitrust treatment of noncompetes. Companies should plan now to mitigate risk of enforcement later.

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If you have any questions concerning these developing issues, please do not hesitate to contact the following Paul Hastings lawyer:

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