

**COMMENTS OF THE ANTITRUST LAW  
SECTION OF THE AMERICAN BAR  
ASSOCIATION IN CONNECTION WITH THE  
FEDERAL TRADE COMMISSION  
WORKSHOP ON “NON-COMPETES IN THE  
WORKPLACE: EXAMINING ANTITRUST  
AND CONSUMER PROTECTION ISSUES”**

**April 24, 2020**

*The views expressed here are on behalf of the American Bar Association’s Antitrust Law Section. They have not been approved by the House of Delegates or the Board of Governors of the American Bar Association, and unless otherwise noted, should not be construed as representing the policy of the American Bar Association.*

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## Executive Summary\*

On December 5, 2019, the U.S. Federal Trade Commission announced that it would be holding a public workshop on January 9, 2020, in Washington, DC, to examine whether there is sufficient legal basis and empirical economic support to promulgate a Commission Rule that would restrict the use of non-compete clauses in employment contracts.<sup>1</sup> The Commission noted that its workshop follows a labor market workshop hosted by the U.S. Department of Justice's Antitrust Division in September 2019.<sup>2</sup>

In conjunction with its workshop, the Commission identified the following nonexclusive topics for discussion:

- What impact do non-compete clauses have on labor market participants?
- What are the business justifications for non-compete clauses?
- Is state law insufficient to address harms associated with non-compete clauses?
- Do employers enforce non-compete agreements contained in standard employment contracts? How routine is such enforcement?
- Are there situations in which non-compete clauses constitute an unfair method of competition (UMC) or an unfair or deceptive act or practice (UDAP)? How prevalent are these situations?
- Should the FTC consider using its rulemaking authority to address the potential harms of non-compete clauses, applying either UMC or UDAP principles? What “gap” in existing state or federal law or regulation might such a rule fill? What should be the scope and terms of such a rule? What is the statutory authority for the Commission to promulgate a rule?

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\* The members of the Antitrust Law Section contributing to these comments are listed in the Appendix.

<sup>1</sup> Press Release, Fed. Trade Comm'n, FTC to Hold Workshop on Non-Compete Clauses Used in Employment Contracts (Dec. 5, 2019), <https://bit.ly/2THYgPE>. For the workshop page, see *Non-Competes in the Workplace: Examining Antitrust and Consumer Protection Issues*, U.S. FED. TRADE COMM'N, <https://bit.ly/2ug5FL9> (last visited Jan. 20, 2020).

<sup>2</sup> See *Public Workshop on Competition in Labor Markets*, U.S. DEP'T OF JUSTICE, <https://bit.ly/2G43OMh> (last visited Jan. 20, 2020).

- Should the FTC consider using other tools besides rulemaking to address the potential harms of non-compete clauses, such as law enforcement, advocacy, or consumer/industry guidance?
- What additional economic research should be undertaken to evaluate the net effect of non-compete agreements? Should additional economic research on the empirical effects of non-compete agreements focus on a subset of the employee population? If so, which subset?

The agency invited public comments on these or other related topics, to be submitted on or before February 10, 2020. The agency subsequently extended the submission deadline to March 11, 2020.

In these comments, the American Bar Association’s Antitrust Law Section addresses many of the questions posed by the Commission, regrouped and reordered into eight topics, as reflected in the headings.<sup>3</sup> In general, the Section agrees with the Commission that all of these topics are worthy of further inquiry and dialogue, in a forum or setting that permits public participation and input. The Section suggests, however, that the Commission may want to focus its attention and resources on the following four areas, for reasons that are explained below:

- The prevalence of non-compete clauses in employment agreements among the non-managerial and non-R&D segments of the workforce, and the reasons for their proliferation
- The impact of non-compete clauses on employee signatories, not just when they are actually enforced in court but also when employees are put on notice of their existence and applicability
- The impact of non-compete clauses on potential employers and consumers
- The current efforts and initiatives of the States to address these issues and concerns, and how the Commission can best complement, cooperate, and assist with those efforts and initiatives

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<sup>3</sup> The eight topics are: justifications for non-compete clauses, impact of non-compete clauses, application of state law, applicability of Section 5 of the FTC Act, rulemaking authority, alternatives to rulemaking, economic research, and market definition.

## Introduction

The Section commends the Commission for holding this workshop, especially in light of recent attention given to the issue of non-compete clauses by academics, policymakers, law enforcers, private litigants, and the press.<sup>4</sup> Certainly it makes sense to ask whether the Commission, with its dual missions to promote competition and protect consumers, has a role in this area and, if so, what that role should be. The Section stresses, however, that while the recent attention being given to non-compete clauses seems to suggest the emergence of a new legal or economic issue, non-compete clauses have been a fixture in the workplace since the Middle Ages. Indeed, non-compete clauses have substantially contributed to our modern understanding and analysis of restraints of trade from the standpoint of ancillarity.<sup>5</sup> The Commission therefore should not lose sight of the long legal, economic, and social history associated with non-compete clauses as it proceeds to consider whether their supposedly rampant usage today in the workplace is giving rise to contemporary legal problems.<sup>6</sup>

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<sup>4</sup> See, e.g., Eric A. Posner, *The Antitrust Challenge to Covenants Not to Compete in Employment Agreements* (Sept. 13, 2019), <https://bit.ly/2TVmW74>; Press Release, NOW: Rubio Chairs Hearing on Noncompete Agreements and American Workers, Office of Sen. Marco Rubio (Nov. 14, 2019), <https://bit.ly/2GsWIAQ>; Press Release, Attorney General Bob Ferguson Stops King County Coffee Shop’s Practice Requiring Baristas to Sign Unfair Non-Compete Agreements, Off. of Att’y Gen., Wash. (Oct. 29, 2019), <https://bit.ly/2Go7xnV>; *Brunner v. Liautaud*, No. 1:14-cv-05509, 2015 WL 1598106 (N.D. Ill. Apr. 8, 2015); Lisa Madigan, Att’y Gen., State of Illinois, & Jane Flanagan, Chief, Workplace Rights Bureau, *Overuse of Non-Competition Agreements: Understanding How They Are Used, Who They Harm, and What State Attorneys General Can Do to Protect the Public Interest*, in *Unrigging the Market: Convening to Restore Competitive Labor Markets*, Harvard Law School (June 13, 2018), <https://bit.ly/2TyxmJh>; Harriet Torry, *Interns’ Job Prospects Constrained by Noncompete Agreements*, WALL ST. J. (June 29, 2019, 7:42 AM), <https://on.wsj.com/2RK24wQ>. For the November 2019 Senate committee hearing, see *Noncompete Agreements and American Workers: Hearing on S. 124 and S. 2614 Before the S. Comm. on Small Business & Entrepreneurship*, 116th Cong. (2019), <https://bit.ly/2RqkdRv>.

<sup>5</sup> See *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 282–83 (6th Cir. 1898) (Taft, J.), *aff’d as modified*, 175 U.S. 211 (1899); Harlan M. Blake, *Employment Agreements Not to Compete*, 73 HARV. L. REV. 625, 626 & n.3 (1960) (discussing ancillarity).

<sup>6</sup> As Professor Blake’s 1960 law review article exemplifies, this is hardly the first time that non-compete clauses have attracted the attention of legal scholars. Indeed, Professor Blake’s article stems from a paper that he presented at the August 1959 meeting of the ABA Antitrust Law Section. Blake, *supra* note 5, at 625 n.†. One of his conclusions is that “[f]rom an objective point of view, the employee covenant not to compete is an inefficient and often unfair device for allocating the burden of certain business risks.” *Id.* at 691.

The Section compliments the Commission staff on assembling a diverse and knowledgeable set of panelists for the one-day workshop. Their oral comments and their written contributions will undoubtedly help to lay the groundwork for further inquiry. The workshop discussion, however, highlights the fact that there seem to be more questions than answers at this juncture, and the paucity of systematic, empirical studies in this area. As a result, unlike some other workshops that the Commission has held, this workshop does not present a concrete legal problem that has already been identified and scoped, such that the questions are largely directed to potential solutions and pathways for arriving at them.<sup>7</sup> The Commission should therefore remain cognizant of the need to properly discern and define a problem that invokes its expertise, even as it entertains suggestions and proposals from the public regarding the need for intervention and remedial action.

### **Topic 1: Justifications for Non-Compete Clauses in Employment Agreements**

In the context of an employment agreement, a non-compete clause restricts an employee from going to work for or starting a business that competes with her employer.<sup>8</sup> It is often limited to a particular time period and/or geographic area. Such clauses are not new although, as discussed elsewhere in these Comments, their usage seems to have grown more prevalent, according to some observers.

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<sup>7</sup> Cf. Fed. Trade Comm'n, Consumers and Class Actions: A Retrospective and Analysis of Settlement Campaigns (Oct. 29, 2019), <https://bit.ly/2Gn7fgX>.

<sup>8</sup> In these Comments, unless the context requires otherwise, the Section uses the terms “non-compete clauses” and “non-compete agreements” loosely and interchangeably to refer to provisions inserted into contracts such as employment agreements and buy-sell agreements, as well as to freestanding contracts that are executed along with other contracts as part of the creation of an employment relationship or the closing of a business transaction.

## A. Historical Context

Non-compete agreements have long been the subject of legal dispute and analysis in Anglo-American jurisprudence. In this regard two reported decisions are often cited and discussed as part of the common law foundation.<sup>9</sup> The first one is *John Dyer's Case*,<sup>10</sup> a fifteenth-century English case in which John, a dyer, was sued for allegedly breaching an indenture contract or bond with the plaintiff, under which he had promised not to practice his trade for six months in the plaintiff's town. John argued that he had satisfied this requirement and there was no breach, but the bench (Judge Hull) went further, observing in dictum that John could have attacked the restriction as void under the common law.<sup>11</sup> Professor Harlan Blake has hypothesized that Judge Hull's indignation with this restriction had to do with John being "an apprentice or journeyman who had been oppressed by a grasping master.... Even so brief a restraint, ... might discourage an impecunious and unventuresome journeyman from exercising his customary right to set up shop for himself."<sup>12</sup>

Three centuries later, the English courts decided *Mitchel v. Reynolds*.<sup>13</sup> The defendant, a journeyman baker, had leased his bakery to the plaintiff with an agreement that he would not practice his baker's art in the same parish for the term of the lease. The plaintiff sued the

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<sup>9</sup> See, e.g., Gary Minda, *The Common Law, Labor and Antitrust*, 11 INDUS. RELATIONS L.J. 461, 474–77 (1989); Maureen B. Callahan, *Post-Employment Restraint Agreements: A Reassessment*, 52 U. CHI. L. REV. 703, 707–12 (1985); Blake, *supra* note 5, at 629–37; William L. Letwin, *The English Common Law Concerning Monopolies*, 21 U. CHI. L. REV. 355, 373–79 (1954).

<sup>10</sup> Year-Book Mich. 2 Hen. V, fo. 5, pl. 26 (1414).

<sup>11</sup> See Blake, *supra* note 5, at 636; Letwin, *supra* note 9, at 373. Judge Hull famously wrote: "Per Dieu si le plaintiff fuit icy il irra al prison, tanque il ust fait fine au Roye," which translates to "By God, if the plaintiff were here he would go to prison until he paid a fine to the King."

<sup>12</sup> Blake, *supra* note 5, at 636. See also Letwin, *supra* note 9, at 374–75 ("But the more important basis for deciding against the restraint in the *Dyer's* case was the principle, ... of the individual's right to work. It may appear that to prevent a man from following one trade in one particular town for six months did not very seriously limit his right to work: he might take up another trade, or move to another town. But in the fifteenth century, those alternatives were not in fact open to him.").

<sup>13</sup> 24 E.R. 347 (1711).

defendant for failing to abide by that promise, and the *Mitchel* court (Chief Judge Parker, later known as Lord Macclesfield) upheld the contract and imposed the penalty, finding that this restraint was not unreasonable. In reaching that conclusion, the court distinguished between a situation “where the restraint is general not to exercise a trade throughout the kingdom,” and one “where it is limited to a particular place; for the former of these must be void, being of no benefit to either party, and only oppressive[.]”<sup>14</sup>

These two cases, and the public policies underlying them, were part of the fabric of the common law of covenants not to compete when U.S. courts began interpreting and applying the Sherman Antitrust Act’s prohibition against restraints of trade.<sup>15</sup> As then-Sixth Circuit Judge Taft described when surveying English common law doctrine codified with the 1890 passage of the Sherman Act:

It was the policy of Englishmen to encourage trade in England, and to discourage those voluntary restraints which tradesmen were often induced to impose on themselves by contract . . . The objections to such restraints were mainly two. One was that by such contracts a man disabled himself from earning a livelihood with the risk of becoming a public charge, and deprived the community of the benefit of his labor. The other was that such restraints tended to give the covenantee, the beneficiary of such restraints, a monopoly of the trade, from which he had thus excluded one competitor, and by the same mean might exclude others.<sup>16</sup>

Citing *Dyer*, Judge Taft observed that there was even a time when such covenants were thought to be wholly unenforceable.<sup>17</sup>

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<sup>14</sup> *Id.* at 348.

<sup>15</sup> For contemporary law review articles mentioning *Mitchel v. Reynolds* as part of a survey of the common law on contracts in restraint of trade, see, e.g., Amasa M. Eaton, *On Contracts in Restraint of Trade*, 4 HARV. L. REV. 128, 128–29 (1890); *Validity of Contracts in Restraint of Trade*, 33 AM. L. REG. 281, 281 (May 1885).

<sup>16</sup> *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 279 (6th Cir. 1898), *aff’d as modified*, 175 U.S. 211 (1899).

<sup>17</sup> *Id.* at 280 (“The inhibition against restraints of trade at common law seems at first to have had no exception.” (citing *Language of Justice Hull (Dyer’s Case)*, Year Book, 2 Hen. V., folio 5, pl. 26 (1414))).

Over the course of the development of the common law, however, it became clear there were valid business justifications for many covenants not to compete. For instance, a buyer of a business would be hesitant to consummate the acquisition if the seller could, using his or her established goodwill in the trade, immediately compete with the buyer. A covenant by the seller not to compete with the acquirer would help allay that concern. A similar justification was recognized for covenants not to compete upon dissolution of a partnership.<sup>18</sup>

The common law also came to recognize valid justifications for covenants not to compete in the context of employment. As Judge Taft summarized succinctly,

It was of importance that business men and professional men should have every motive to employ the ablest assistants, and to instruct them thoroughly; but they would naturally be reluctant to do so unless such assistants were able to bind themselves not to set up a rival business in the vicinity after learning the details and secrets of the business of their employers.<sup>19</sup>

As discussed below, these justifications for non-competes continue to be recognized by courts to this day.

Notably, the acceptance in English common law of business justifications for non-competes reflected a recognition of social benefits flowing from such restrictions, apart from private benefits flowing to business owners or employers. Enforcing non-competes, for instance, in connection with the sale of a business would be “an incentive to industry” because it would encourage a business owner to build his or her business and ultimately profit from its sale.<sup>20</sup>

Likewise, in the employment context, a nineteenth century English court recognized:

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<sup>18</sup> *Id.* (“Restrictions in the articles of partnership upon the business activity of the members, with a view of securing their entire effort in the common enterprise, were, of course, only ancillary to the main end of the union, and were to be encouraged.”).

<sup>19</sup> *Id.* at 281.

<sup>20</sup> *See id.* at 280.

The public derives an advantage in the unrestrained choice which [a non-compete] gives to the employer of able assistants, and the security it affords that the master will not withhold from the servant instruction and experience, from the fear of his afterwards having a rival in the same business.<sup>21</sup>

The benefits of non-compete clauses are still recognized today—even in the context of federal antitrust law—and they explain why these agreements, despite clearly being restraints of trade, are afforded rule of reason treatment when ancillary to a significant lawful business interest of another agreement, usually an employment contract or sale of business.<sup>22</sup> In addition to being ancillary to an employment agreement, to avoid running afoul of the Sherman Act, the non-compete must be reasonably tailored to protect that business interest.<sup>23</sup>

Indeed, U.S. courts regard *Mitchel v. Reynolds* as supplying the common law antecedent to the “ancillarity” doctrine. For example, in *Business Electronics Corporation v. Sharp Electronics Corporation*, Justice Scalia cited the *Mitchel* case as support for the proposition that “[t]he classic ‘ancillary’ restraint is an agreement by the seller of a business not to compete within the market.”<sup>24</sup> The modern consensus, firmly rooted in *Mitchel*, is that such “ancillary” restraints are not categorically impermissible if they are reasonably necessary to achieve the legitimate objectives and benefits of the underlying transaction or relationship.<sup>25</sup>

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<sup>21</sup> *Mallan v. May*, 11 M. & W. 652, 666 (1843).

<sup>22</sup> See *Nat’l Soc’y of Prof’l Engrs. v. United States*, 435 U.S. 679, 689 (1978) (“The Rule of Reason suggested by *Mitchel v. Reynolds* has been regarded as a standard for testing the enforceability of covenants in restraint of trade which are ancillary to a legitimate transaction, such as an employment contract or the sale of a going business.” (citing *Mitchel v. Reynolds*, 1 P. Wms. 181, 24 Eng. Rep. 347 (1711))); see also *Addyston Pipe*, 85 F. at 280.

<sup>23</sup> See, e.g., *United States v. Empire Gas Corp.*, 537 F.2d 296, 307 (8th Cir. 1976).

<sup>24</sup> 485 U.S. 717, 729 n.3 (1988).

<sup>25</sup> See, e.g., *United States v. Addyston Pipe & Steel Co.*, 85 F. 271, 282 (6th Cir. 1898) (Taft, J.) (“[N]o conventional restraint of trade can be enforced unless the covenant embodying it is merely ancillary to the main purpose of a lawful contract, and necessary to protect the covenantee in the full enjoyment of the legitimate fruits of the contract ...”) (emphasis added), *aff’d as modified*, 175 U.S. 211 (1899); see also XI PHILLIP E. AREEDA & HERBERT HOVENKAMP, *ANTITRUST LAW* ¶ 1908, at 302 (4th ed. 2013) (“[A] restraint does not qualify as ‘ancillary’ merely because it accompanies some other agreement that is itself lawful.”); *id.* ¶ 1908b (restraint must be

Today, the primary business justifications for non-compete clauses in the employment context largely follow those identified by Judge Taft in *Addyston Pipe*, namely protection of trade secrets and incentives to train employees.<sup>26</sup> These two justifications are still widely recognized today as legitimate support for non-compete clauses in employment agreements. State law treatment of non-competes and related case law indicate there are at least two additional justifications, namely, protection of client relationships and restrictions on unique employees. The Section addresses each justification in turn below.

## **B. Protection of Trade Secrets**

Employers often use non-compete clauses to prevent their trade secrets and other confidential, proprietary information from being used against them by a former employee. For many employers, trade secrets represent extremely valuable assets that could be highly damaging to their businesses in the hands of a competitor. Recognizing this important interest, nearly every state accepts the protection of trade secrets as a viable business justification for an employee non-compete clause.<sup>27</sup> But, even in those states where the justification is recognized, the

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“reasonably necessary” to achieving the purported procompetitive benefits). For a recent application of *Mitchel*, see *York Risk Servs. Grp., Inc. v. Couture*, No. 19-1655, 787 F. App’x 301, 303 (6th Cir. Sept. 27, 2019) (“Just as *Mitchel*’s receipt of benefits from the bakery lease and other facts permitted a non-compete agreement, so too did *Couture*’s receipt of benefits from the stock options allow the restrictive covenants in the circumstances presented here.”).

<sup>26</sup> *Addyston Pipe*, 85 F. 271, 281 (“Before such agreements are upheld, however, the court must find that the restraints attempted thereby are reasonably necessary ... to protection from the danger of loss to the employer’s business caused by the unjust use on the part of the employee of the confidential knowledge acquired in such business.”).

<sup>27</sup> Exceptions include North Dakota and Oklahoma, which do not enforce non-competes generally, and potentially California, which has an “uncertain status” with respect to recognizing protection of trade secrets as a viable business justification for a non-compete. *Employee Non-competes: A State-by-State Survey*, BECK REED RIDEN LLP (Jan. 13, 2019), available at <https://bit.ly/30Yng6N> [hereinafter Beck Reed Survey]. As federal courts in California have noted, the California Supreme Court in *Edwards v. Arthur Andersen LLP*, 44 Cal. 4th 937, 946 n.4, 189 P.3d 285, 291 (2008), expressly declined to “address the applicability of the so-called trade secret exception to section 16600 [of the California Business and Professions Code],” and has not had an occasion to revisit the issue since. See, e.g., *Hiossen, Inc. v. Kim*, No. CV 16-01579 SJO (MRWx), 2016 WL 10987365, at \*12 (C.D. Cal. Aug. 17, 2016).

enforceability of any non-compete clause based on this justification is still subject to the requirements of ancillarity and reasonableness. For instance, protection of purported trade secrets that are not “unique or proprietary” may not provide a sufficient business interest for enforcing a non-compete clause because protection of such information may be unreasonable under the circumstances.<sup>28</sup>

Employers may want to use non-competes for the protection of trade secrets and other confidential information even where other protections may exist for this type of intellectual property. In addition to non-competes, employers can use non-disclosure agreements to prevent the misuse of trade secrets and, when necessary, pursue trade secret misappropriation lawsuits under state and federal law. However, these additional protections may be inadequate mechanisms on their own because of the difficulty of proving disclosure or misuse in certain circumstances and the potential inadequacy of an *ex-post* resolution even if disclosure or misuse can be proven.<sup>29</sup>

There is also a potential broader benefit of non-compete clauses where trade secrets are involved. Non-competes solve an economic holdup problem whereby “both worker and firm

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<sup>28</sup> See, e.g., *Vencor, Inc. v. Webb*, 33 F.3d 840, 846 (7th Cir. 1994) (refusing to enforce a non-compete where the information to which the employee had access was confidential but “not unique or proprietary”); *Lucky Cousins Trucking, Inc. v. QC Energy Resources Tex., LLC*, 223 F. Supp. 3d 1221 (M.D. Fla. 2016) (denying a preliminary injunction based on a non-compete where the plaintiffs had failed to articulate exactly how the protected information is unique or proprietary).

<sup>29</sup> Some states have recognized a claim of threatened misappropriation based on the so-called inevitable disclosure doctrine, which reasons that after an employee has gained knowledge of confidential information while working for a business, she “cannot possibly forget or refrain from relying on that knowledge during her employment with the competitor.” M. Claire Flowers, Note, *Facing the Inevitable: The Inevitable Disclosure Doctrine and the Defend Trade Secrets Act of 2016*, 75 WASH. & LEE L. REV. 2207, 2216 (2018). But it remains a judicially disfavored doctrine, even in the states that recognized it, and an employer may find itself on firmer ground seeking a preliminary injunction based on a non-compete clause. See, e.g., *EarthWeb, Inc. v. Schlack*, 71 F. Supp. 2d 299, 310–11 (S.D.N.Y. 1999) (“Thus, in its purest form, the inevitable disclosure doctrine treads an exceedingly narrow path through judicially disfavored territory.... While the inevitable disclosure doctrine may serve the salutary purpose of protecting a company’s investment in its trade secrets, its application is fraught with hazards.... Clearly, a written agreement that contains a non-compete clause is the best way of promoting predictability during the employment relationship and afterwards.”), *remanded for further explanation*, 205 F.3d 1322 (2d Cir. 2000), *subsequently aff’d*, No. 99-9302, 2000 WL 1093320 (2d Cir. 2000).

have an interest in sharing vital information, as this raises the worker’s productivity[,]” but “the firm is unwilling to share the information” for fear the employee will use the threat of disclosure to a competitor to boost his or her own compensation.<sup>30</sup> By solving this holdup problem and promoting information sharing between employers and employees, non-compete clauses arguably enhance worker productivity, thereby spurring economic growth and innovation.

### **C. Protection of Customer Relationships**

Employers also use non-compete clauses to prevent employees from exploiting customer relationships developed or enhanced during an employee’s tenure with the employer. As with trade secrets, customer relationships can be extremely valuable to a business and, in many instances, vital to its ongoing viability. Accordingly, many states recognize protection of customer relationships as a legitimate business interest for an employee non-compete.<sup>31</sup> Courts have explained that employers have a legitimate business interest in protecting customer relationships developed using their resources and goodwill.<sup>32</sup> Notably, in one Eighth Circuit case, the court recognized an employer’s legitimate business interest to protect customer relationships initiated *before* the employee’s tenure ever began.<sup>33</sup>

A non-compete clause meant to protect an employer’s business interest in customer relationships may solve an economic holdup problem similar to that observed with trade secrets.

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<sup>30</sup> U.S. DEP’T OF TREASURY, OFFICE OF ECONOMIC POLICY, NON-COMPETE CONTRACTS: ECONOMIC EFFECTS AND POLICY IMPLICATIONS 7 (Mar. 2016), available at <https://bit.ly/2O3QPyr> [hereinafter TREASURY REPORT].

<sup>31</sup> Beck Reed Survey, *supra* note 27.

<sup>32</sup> *See, e.g.*, Nat’l Interstate Ins. Co. v. Perro, 934 F. Supp. 883, 890 (N.D. Ohio 1996) (recognizing that an employer has legitimate interest in preventing employees from exploiting customer relationships developed at its expense and in its name).

<sup>33</sup> Emerson Elec. Co. v. Rogers, 418 F.3d 841, 845 (8th Cir. 2005) (“Emerson’s interest in protecting its relationships with customers to whom Rogers sold products *prior to his relationship with it* is now as important to Emerson as is its ability to sell to new customers. Emerson has a legitimate business interest in restraining Rogers from violating the terms of their agreement by unfairly using the relationships he developed or strengthened while working with it.”) (emphasis added).

Without a non-compete, an employer may be unwilling to share useful information about customer relationships or support (i.e., invest in) its employees' development of customer relationships because of the risk that an employee, once he or she has used the employer's resources to develop a "book" of customers, will depart with that "book." A non-compete clause mitigates this concern.<sup>34</sup> Although commentators can see a social benefit from an increased willingness on the part of an employer to share customer information, some question whether this justification is on a par with protection of trade secrets.<sup>35</sup>

#### **D. Restrictions on Unique Employees**

In a few states, most notably New York, the "uniqueness" of an employee's services can be a valid business justification for an employee non-compete clause. The question here is whether an employee's services "are not simply of value to the employer, but ... may also truly be said to be special, unique or extraordinary[.]"<sup>36</sup> Not surprisingly, the inquiry is highly fact-dependent and case-specific.<sup>37</sup> If established, however, the justification for a non-compete clause is relatively straightforward. When an employee is unique, "the employer obviously suffers

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<sup>34</sup> Evan Starr, J.J. Prescott & Norman Bishara, *Noncompetes in the U.S. Labor Force* 8 (Univ. Mich. L. & Econ. Research Paper No. 18-013, Aug. 30, 2019) ("[M]uch like patents, noncompetes encourage firms to invest in developing and sharing information and skills that make their employees more productive."), <https://bit.ly/2RSwBJ7>.

<sup>35</sup> Compare *id.* at 8 (noting an increase in employee productivity from greater sharing of client information) with TREASURY REPORT, *supra* note 30, at 7 ("[I]t is not clear that relationships with clients constitute a socially valuable investment analogous to trade secrets.").

<sup>36</sup> *Ticor Title Ins. Co. v. Cohen*, 173 F.3d 63, 70 (2d Cir. 1999). "Unique services have been found in various categories of employment where the services are dependent on an employee's special talents; such categories include musicians, professional athletes, actors and the like." *Id.* (citing, as an example, the case of *Shubert Theatrical Co. v. Rath*, 271 F. 827, 829–30 (2d Cir. 1921), which involved an acrobat who "with one hand raises the other [acrobat], a full-grown man, from the floor, his body being stretched at full length upon the floor"—described as "the most marvelous thing that has ever been before").

<sup>37</sup> *Id.* at 65 ("[T]he inquiry is more focused on the employee's relationship to the employer's business to ascertain whether his or her services and value to that operation may be said to be unique, special or extraordinary; that inquiry, because individual circumstances differ so widely, must of necessity be on a case-by-case basis.").

irreparable harm” if the “services of such employee are available to a competitor.”<sup>38</sup> New York courts have previously enforced non-compete clauses for unique employees in specialized industries,<sup>39</sup> in positions that rely primarily and heavily on the cultivation of personal relationships,<sup>40</sup> and in the entertainment industry where special talents are utilized.<sup>41</sup>

### **E. Restrictions After Employee Training**

Many states recognize employers have a legitimate business interest in imposing a non-compete clause on an employee who has received training.<sup>42</sup> Employers understandably want to ensure that their training expenditures are not wasted on an employee who ends up leaving the business or, worse yet, are used to subsidize an existing competitor or future competitor—often the former employee starting his or her own business.<sup>43</sup> Following this logic, non-competes

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<sup>38</sup> *Id.* at 70, 72 (affirming the enforcement of a six-month non-compete contract on an insurance executive and finding that the executive, as a star employee, provided unique services to his former employer).

<sup>39</sup> *Natsource LLC v. Paribello*, 151 F. Supp. 2d 465, 473 (S.D.N.Y. 2001) (broker of over-the-counter energy-related commodities was unique because he worked in a specialized field with few potential clients, his success depended on his ability to cultivate a relationship with his clients, and the company expended substantial resources to help cultivate those relationships).

<sup>40</sup> *Ticor Title*, 173 F.3d at 71.

<sup>41</sup> *See* *MTV Network v. Fox Kids Worldwide, Inc.*, No. 605580/97, 1998 WL 57480 (N.Y. Sup. Ct. Feb. 4, 1998) (enjoining a former executive from working for a competitor for one year, the term of his non-competition agreement, and finding that the former executive was a unique employee because he had a key role in developing MTV strategies, had access to MTV’s confidential information including MTV’s budget process, and was MTV’s “public face”).

<sup>42</sup> *Beck Reed Survey*, *supra* note 27 (noting a recognition of training, either general or specialized, as a legitimate business interest in Alabama, Alaska, Arkansas, Colorado, District of Columbia, Florida, Georgia, Indiana, Iowa, Kansas, Kentucky, Louisiana, Pennsylvania, Rhode Island, Tennessee, Texas, Utah, and Vermont); *see, e.g., Borg-Warner Protective Servs. Corp. v. Guardsmark, Inc.*, 946 F. Supp. 495, 502 (E.D. Ky. 1996), *aff’d*, 156 F.3d 1228 (6th Cir. 1998) (upholding a narrowly tailored non-compete under either Tennessee or Kentucky law where the employer had spent considerable time, effort, and money in training employees with particularized security requirement of client’s site); *Bus. Commc’ns, Inc. v. Banks*, 91 So. 3d 1, 10 (Miss. Ct. App. 2011) (“Covenants not to compete are valid and enforceable if they protect an employer’s investment in the training and education of an employee.”). *See also* Paul H. Rubin & Peter Shedd, *Human Capital and Covenants Not to Compete*, 10 J. LEGAL STUD. 93, 109 (1981) (arguing that the value of some general training is so high that employees cannot afford to pay for it themselves, and an employer will then have to furnish it as an investment, but only if employees are willing to agree not to use that training in a competing business).

<sup>43</sup> *See, e.g., Penn. Funds Corp. v. Vogel*, 399 Pa. 1, 8–9, 159 A.2d 472, 475–76 (Pa. 1960) (concluding it would be inequitable for the defendant to start a “competitive corporation” after having received extensive, specialized training from the plaintiff “tailored to problems unique to the sale of mutual fund shares”).

should be expected to increase employers' willingness to train their employees because "[employers] get an assurance that workers are unlikely to leave for some period of time, allowing the firm to capture more of the increased productivity from costly training it provides ...."<sup>44</sup> This effect, as a U.S. Treasury Department study of non-competes notes, could have positive social benefits because "workers receive more training than they otherwise would."<sup>45</sup>

As with other business justifications, a non-compete clause meant to protect an employer's legitimate interest in recovering training costs must be reasonably related to that interest. For this reason, some courts may refuse to enforce a non-compete intended to protect long-past training that an employer likely already benefitted from.<sup>46</sup> However, some courts may be unwilling to make this kind of assessment; one commentator has noted that many courts are "reluctant to look beyond scope, duration, and geography when assessing the reasonableness of a noncompete."<sup>47</sup>

## **F. State Law Treatment of Business Justifications**

As discussed in more detail in Topic 3 and as noted above, non-compete clauses receive varying legal treatment among the states. This is true generally and specifically with respect to the recognition of business justifications. Protection of trade secrets enjoys the most universal recognition as a legitimate business justification for non-competes, while protection of customer

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<sup>44</sup> TREASURY REPORT, *supra* note 30, at 8.

<sup>45</sup> *Id.* at 8. Notably, this same study also notes a negative social effect of non-competes as it relates to training: "[n]on-competes sometimes induce workers to leave their occupations entirely, foregoing [sic] accumulated training and experience in their fields." *Id.* at 3.

<sup>46</sup> *See, e.g.,* Orkin Exterminating Co. v. Foti, 302 So. 2d 593, 598 (La. 1974) (finding training received in 1970 did not justify restricting an employee from competing in 1973 and 1974, since "the employer had long received the benefit of its investment").

<sup>47</sup> Brandon S. Long, *Protecting Employer Investment in Training: Noncompetes vs. Repayment Agreements*, 54 DUKE L. J. 1295, 1316 (2005).

relationships, recoupment of training costs, and restrictions on unique employees receive more sporadic recognition.<sup>48</sup>

Some states have outright rejected enforceability of non-compete clauses, in effect deeming as a matter of policy that the potential harms from non-competes outweigh any business justifications.<sup>49</sup> More recently, some states have determined that the potential harms outweigh any business justifications with respect to non-competes for certain groups of employees, such as low-wage workers.<sup>50</sup>

### **G. Business Justifications and Survey Evidence**

A recent comprehensive study on non-competes reports mixed evidence that non-compete clauses are closely linked to frequently cited business justifications.<sup>51</sup> On the protection of trade secrets, for instance, the authors found “[t]he existence of trade secrets is strongly positively associated with non-competes” but that non-competes are “still common in low-skill, low-paying jobs that do not involve trade secrets.”<sup>52</sup> The study also found that employees saw a small uptick in their access to customer information after signing a non-compete, suggesting some non-competes are indeed signed to protect access to customer-related information and customer relationships.<sup>53</sup> Finally, the authors found a limited increase in training associated with

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<sup>48</sup> Beck Reed Survey, *supra* note 27.

<sup>49</sup> States that do not enforce employment non-competes include North Dakota, Oklahoma, and California. *See id.* at 2, 12, 13.

<sup>50</sup> States with prohibitions on non-competes for workers earning below a set wage or salary include Illinois, Maine, Maryland, New Hampshire, Oregon, Rhode Island, and Washington. Tom Spiggle, *How Maryland Is Continuing The Trend Of Restricting Non-Compete Agreements*, FORBES, Aug. 13, 2019, available at <https://bit.ly/36wAXuS>.

<sup>51</sup> *See generally* Starr et al., *supra* note 34.

<sup>52</sup> *Id.* at 2, 20 (“Non-competes are more likely to be found in high-skill, high-paying jobs that involve trade secrets, but they are still common in low-skill, low-paying jobs that do not involve trade secrets. For example, we find that 12% of those without a bachelor’s degree and earning less than \$40,000 a year sign non-competes”).

<sup>53</sup> *Id.* at 31 n.39 & 72 (showing 11% of employees believe they receive “more access to clients/lists” after signing a non-compete).

an increased use of non-competes, but the effect is highly dependent on timing, i.e., whether an employee became aware of the non-compete before accepting the job offer (observed increase in training from the non-compete) or after accepting the job offer (no impact in training from the non-compete).<sup>54</sup>

## **H. Concluding Observations**

In the Section's view, none of the traditional justifications for non-compete clauses in employment agreements should raise the kinds of concerns that are now triggering public scrutiny. Importantly, as illuminated by centuries of court decisions, each of these justifications—trade secrets, customer relationships, unique employee services, and investment in specialized training—reasonably maps to a legitimate employer business interest tied to specific employees and therefore would not support the indiscriminate imposition of non-compete clauses on all employees. Stated differently, the currently observed use of non-compete clauses with low-wage workers should not require a reexamination, much less an invalidation, of the traditional justifications for these clauses in the employment context. As seen in the caselaw, these justifications strike an appropriate balance between protecting an employer's legitimate business interests and an employee's right to seek gainful employment using general knowledge and skills that he or she has acquired through experience.<sup>55</sup>

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<sup>54</sup> *Id.* at 3 (finding that employees who have knowledge of a non-compete before accepting a job offer receive 11% more training than the average employee in the study and find no increase in training from non-competes signed after an employee has accepted an offer). The authors find that “[e]mployees are nearly twice as likely to report negotiating over their noncompete when they are given early notice, and this may explain why early notice is associated with higher wages and more training.”) *Id.* at 33.

<sup>55</sup> *See, e.g.,* *Robbins v. Finlay*, 645 P.2d 623 (Utah 1982):

In this case, the covenant served no purpose other than restricting an employee from competing with a former employer. There is nothing to indicate that Finlay was largely responsible for plaintiff's goodwill, and there is no contention or proof that Finlay was privy to any trade secrets plaintiff may have possessed.... The record shows that Finlay's job required little training and is not unlike the job of many other types of salesmen.... Furthermore, there is no showing that his services were special, unique, or extraordinary, even if their value to his employer was high.... It is of no moment that defendant may have

## Topic 2: Impact of Non-Compete Clauses in Employment Agreements

### A. Introduction

As discussed under Topic 1, protection of trade secrets and customer relationships are often cited and accepted as business justifications for the imposition and enforcement of non-compete clauses. Such justifications, however, have come under increasing public scrutiny as non-compete clauses seemingly have become more prevalent in employment agreements.<sup>56</sup> For example, the U.S. Treasury Department noted in a 2016 report that non-compete clauses reduce worker bargaining power, possibly leading to lower wages; may cause workers to leave their occupations entirely, resulting in the loss of accumulated training and experience in their fields; and dampen labor productivity by reducing job churn.<sup>57</sup> Further, “less than half of workers who have non-competes also report possessing trade secrets, suggesting that trade secrets cannot explain the majority of non-compete activity.”<sup>58</sup> That observation is reinforced by the fact that non-competes are used with a large number of unskilled workers, which one typically would not expect to be the case if trade secrets were the principal concern.<sup>59</sup> The Treasury Department’s findings were cited and echoed by the Obama White House in 2016.<sup>60</sup> Moreover, these concerns

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been especially proficient in his work. General knowledge or expertise acquired through employment in a common calling cannot be appropriated as a trade secret.

*Id.* at 627–28.

<sup>56</sup> See, e.g., Patrick Thibodeau, *As noncompete agreement use expands, backlash grows: Legislative opponents say noncompetes can derail careers and damage people financially*, Computerworld (Feb. 5, 2016, 1:12 PM), <https://bit.ly/2HBThsg>,

<sup>57</sup> TREASURY REPORT, *supra* note 30, at 3–4.

<sup>58</sup> *Id.* at 4.

<sup>59</sup> *Id.* at 11 (citing surveys showing that “the fraction of workers without a four-year college degree reporting a current non-compete agreement is about 15 percent, only slightly below the 18 percent share for all workers”).

<sup>60</sup> See EXEC. OFFICE OF THE PRESIDENT, NON-COMPETE AGREEMENTS: ANALYSIS OF THE USAGE, POTENTIAL ISSUES, AND STATE RESPONSES (May 2016), available at <https://bit.ly/37rGMuJ> [hereinafter WHITE HOUSE REPORT].

have garnered bipartisan attention; in January 2019, for example, Senator Marco Rubio introduced the Freedom to Compete Act, aimed at protecting entry-level, low-wage workers from non-compete agreements that limit their employment opportunities and restrict their ability to negotiate higher wages and benefits.<sup>61</sup>

In sum, there has been a growing concern that the current use of non-compete clauses in employment agreements may be overbroad, going beyond trade secrets or other business/contractual interests traditionally recognized as legitimate objects of protection for such clauses.<sup>62</sup> In this Topic, the Section comments on the impact of non-compete clauses on employees and employers.

## 1. Prevalence

Although non-compete agreements have a long history, they are significantly more prevalent today, deployed in a variety of industries and with respect to a variety of both skilled and unskilled workers and at all salary and wage levels. According to a recent national survey of private-sector American business establishments, 49.4% of businesses indicated that at least some employees were required to sign such agreements, and nearly a third, 31.85%, indicated that *all* their employees were required to do so, regardless of their individual pay or job responsibilities.<sup>63</sup> The Economic Policy Institute estimates that this means 27.8% to 46.5% of

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<sup>61</sup> Press Release, Sen. Marco Rubio, Rubio Introduces Bill to Protect Low-Wage Workers from Non-Compete Agreements (Jan. 15, 2019), <https://bit.ly/2V5dsGT>. See Freedom to Compete Act, S. 124, 116th Cong. (2019), <https://bit.ly/38ITwO4>.

<sup>62</sup> See, e.g., *Wireless Specialty Apparatus Co. v. Mica Condenser Co.*, 239 Mass. 158, 165 (1921) (an employee “upon leaving the plaintiff’s employ, had a right to use his general knowledge, experience, memory and skill so long as he did not use or disclose any of the secret processes which the plaintiff was entitled to keep for its own use and as to which it, as against him, had exclusive property rights”).

<sup>63</sup> Alexander J.S. Colvin & Heidi Shierholz, *Noncompete agreements: Ubiquitous, harmful to wages and to competition, and part of a growing trend of employers requiring workers to sign away their rights*, ECONOMIC POLICY INST., at 1 (Dec. 10, 2019), <http://epi.org/179414>.

private-sector workers (36 to 60 million) are subject to non-compete agreements.<sup>64</sup> The survey reports that the agreements are used in industries as varied as construction, manufacturing, wholesale trade, retail trade, transportation, information, finance, education and health, and leisure and hospitality.<sup>65</sup>

Non-compete agreements are also used with employees of all skill levels and wage rates. For example, EPI found that 29% of employers whose average hourly wage paid to employees is less than \$13 use such agreements. A recent article highlighted a non-compete agreement that Amazon had once used with temporary packing employees making \$13/hour, which prohibited the worker from “engag[ing] or support[ing] the development, manufacture, marketing, or sale of any product or service that competes or is intended to compete with any product or service sold, offered, or otherwise provided by Amazon,” during employment and for 18 months thereafter.<sup>66</sup>

The observed widespread use of non-compete agreements today may well distinguish the present situation from the mine run of cases in one key respect. In the archetypal cases discussed or cited under Topic 1, courts considered the ancillarity and reasonableness of bilateral agreements between an employer and a specific employee. A court could assess the applicability of one or more of the traditional justifications for a non-compete clause as to that particular employee, in view of her position and the circumstances of her hiring, and balance the competing

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<sup>64</sup> *Id.* at 2.

<sup>65</sup> *Id.* at 7. See also Evan Starr, *The Use, Abuse, and Enforceability of Non-Compete and No-Poach Agreements: A Brief Review of the Theory, Evidence, and Recent Reform Efforts*, ECONOMIC INNOVATION GROUP, at 4 (Feb. 2019), <https://eig.org/wp-content/uploads/2019/02/Non-Competes-2.20.19.pdf>.

<sup>66</sup> Starr, *supra* note 65, at 3; Spencer Woodman, *Exclusive: Amazon makes even temporary warehouse workers sign 18-month non-competes*, THE VERGE (Mar. 26, 2015, 11:44 AM), <https://bit.ly/2uWNEIQ>. But see Josh Lowensohn, *Amazon does an about-face on controversial warehouse worker non-compete contracts*, THE VERGE (Mar. 27, 2015, 6:36 PM) (Amazon announcing that it is removing the non-compete clause from its agreements), <https://bit.ly/3bP97xB>.

equities so as to arrive at the fairest and most just result.<sup>67</sup> By contrast, the aggregate effect of non-compete agreements imposed indiscriminately on groups of employees may well call for a different legal analysis of, or approach to, their enforceability. The enforceability of an agreement between a company and a sales executive is one thing but the validity of hundreds or thousands of agreements between that company and all of its employees, particularly if competing employers engage in parallel behavior with their respective employees, may be another thing entirely.<sup>68</sup>

## 2. Existing Regulatory Regime

States vary in their approaches to employment-related non-compete agreements. A handful of states (California, North Dakota, and Oklahoma) have categorically prohibited them.<sup>69</sup> Non-compete agreements are permitted in the remaining states, albeit to varying extents and in

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<sup>67</sup> For modern examples, *see, e.g.*, *Chavers v. Copy Prods. Co., Inc. of Mobile*, 519 So. 2d 942, 945 (Ala. 1988) (“Though he is a highly skilled working man, he is nevertheless still only a working man, and it is undisputed that the only trade he knows and by which he can support himself and his family is copier maintenance and repair. The clear import of *Greenlee* and our other cases is that such people cannot be prevented from plying their trades by blanket postemployment restraints, and we think that rule is applicable here.”); *Calhoun v. Brendle, Inc.*, 502 So. 2d 689, 693 (Ala. 1986) (“The evidence supports Calhoun’s contention that he would be irreparably harmed by enforcement of this noncompetition agreement, which restraint would prohibit him from engaging in the only business for which he is trained and has experience.”). As one can see, in individual cases, courts can and do consider the equities, including hardship to the employee.

<sup>68</sup> This view is not new. Professor Harvey Goldschmid expressed more or less the same concern in a 1973 law review article. Harvey J. Goldschmid, *Antitrust’s Neglected Stepchild: A Proposal for Dealing with Restrictive Covenants under Federal Law*, 73 COLUM. L. REV. 1193, 1206–07 (1973) (“But thousands of executives and other employees and innumerable present lessors and potential lessees are being needlessly restrained by unreasonably broad or vague clauses, and such clauses are being enforced by major corporations on a nationwide scale.”).

<sup>69</sup> CAL. BUS. & PROF. CODE § 16600 (providing that “every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void,” except in connection with the sale of a business or dissolution of a partnership); N.D. CENT. CODE § 9-08-06 (“A contract by which anyone is restrained from exercising a lawful profession, trade, or business of any kind is to that extent void, except” in some circumstances in connection with the sale of a business or upon the dissolution of a partnership, limited liability company, or corporation.); OKLA. STAT. § 15-219A (“A person who makes an agreement with an employer, whether in writing or verbally, not to compete with the employer after the employment relationship has been terminated, shall be permitted to engage in the same business as that conducted by the former employer or in a similar business as that conducted by the former employer as long as the former employee does not directly solicit the sale of goods, services or a combination of goods and services from the established customers of the former employer.”).

varying circumstances.<sup>70</sup> Some states that may generally permit them have imposed partial bans for certain professions.<sup>71</sup>

The Section is not aware of any federal law or regulation that categorically prohibits, or has been enforced to categorically prohibit, non-compete agreements between employers and employees. There is evidence of Congressional interest in protecting employment mobility, however. For instance, in connection with the enactment of the Economic Espionage Act of 1996,<sup>72</sup> the House of Representatives noted that “[t]his legislation is not intended to apply ... to individuals who seek to capitalize on the personal knowledge, skill, or abilities they may have developed.”<sup>73</sup> Furthermore, although the Defend Trade Secrets Act of 2016<sup>74</sup> provides injunctive relief for the misappropriation of trade secrets, it specifically does not permit injunctions to “prevent a person from entering into an employment relationship, and that conditions placed on such employment shall be based on evidence of threatened misappropriation and not merely on the information the person knows.”<sup>75</sup> Thus, although trade secrets have been widely recognized as a legitimate and important business interest warranting federal (and state) legislation, lawmakers have been cognizant of the need to ensure that non-compete clauses do not overreach,

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<sup>70</sup> Compare COLO. REV. STAT. § 8-2-113 (providing that “[a]ny covenant not to compete which restricts the right of any person to receive compensation for performance of skilled or unskilled labor for any employer shall be void,” except for, *e.g.*, “[a]ny contract for the protection of trade secrets” or “providing for recovery of the expense of educating and training an employee who has served an employer for a period of less than two years,” and for agreements concerning physicians), with FLA. STAT. ANN. § 542.335(1) (restrictive covenants that “are reasonable in time, area, and line of business” are not prohibited).

<sup>71</sup> See, *e.g.*, ALA. CODE §§ 8-1-196 (allowing for “professional exemptions”); HAW. REV. STAT. § 480-4(c)(4) (exempting employees in a “technology business”); LA. REV. STAT. ANN. § 23:921(H) (exempting automobile salesmen).

<sup>72</sup> Pub. L. No. 104-294, 110 Stat. 3488 (1996).

<sup>73</sup> H.R. REP. NO. 104-788, at 7 (1996).

<sup>74</sup> Pub. L. No. 114-153, 130 Stat. 376 (2016).

<sup>75</sup> *Id.* at 379–80 (codified at 18 U.S.C. § 1836(b)(3)(A)(i)(I) (2018)).

precluding an employee's use of knowledge or information that does not squarely meet the definition of a trade secret.

Non-compete agreements between employers and employees may also be subject to scrutiny under federal and state antitrust laws. The Section is not aware of case law holding such agreements to be *per se* unreasonable and hence unlawful.<sup>76</sup> Under the rule of reason, a plaintiff bears the initial burden of demonstrating that a practice has a substantial anticompetitive effect in a relevant market.<sup>77</sup> This can be done with direct or indirect evidence of anticompetitive effects.<sup>78</sup> Direct evidence requires “proof of actual detrimental effects [on competition, such as reduced output, increased prices, or decreased quality in the relevant market.”<sup>79</sup>

In the context of a labor market, such direct evidence might include proof of an actual decrease in employee wages. In contrast, “[i]ndirect evidence would be proof of market power plus some evidence that the challenged restraint harms competition.”<sup>80</sup> If a plaintiff can demonstrate anticompetitive effects, then a defendant will bear the burden of proving that such downsides are outweighed by cognizable procompetitive benefits.

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<sup>76</sup> Indeed, quite the opposite, courts have made clear that non-compete agreements do not warrant *per se* treatment. *See, e.g.,* *Bradford v. New York Times Co.*, 501 F.2d 51, 59 (2d Cir. 1974) (“Not only has the appellant failed to supply us with any case holding an employee restrictive covenant to be a *per se* violation, but no court applying the rule of reason has ever held such a contract violative of section 1 of the Sherman act.”); *Caudill v. Lancaster Bingo Co., Inc.*, No. 2:04-cv-00695, 2005 WL 2738930, at \*4 (S.D. Ohio Oct. 24, 2005) (“Courts have consistently held that non-competition agreements are not *per se* illegal, and therefore, must be analyzed under the rule of reason.”); *Alders v. AFA Corp. of Fla.*, 353 F. Supp. 654, 656 (S.D. Fla. 1973) (“The Plaintiff argues that, because the covenant not to compete on its face restrains him from competing with AFA, it is a contract in restraint of trade, and constitutes a *per se* violation of the Sherman Act, Section 1. This argument is totally without merit.”).

<sup>77</sup> *Ohio v. Am. Exp. Co.*, 138 S. Ct. 2274, 2284 (2018).

<sup>78</sup> *Id.*

<sup>79</sup> *Id.* (quotation and citation omitted).

<sup>80</sup> *Id.*

Private challenges to an employer’s practice of requiring a large number of employees to enter into non-compete agreements are only beginning to be addressed by the courts.<sup>81</sup> Given the likely complexities of private enforcement in this context (e.g., issues of Article III standing, arbitrability of claims, evidence of common class-wide harm), an administrative forum may be superior and preferable to a judicial forum for identifying and analyzing the macro-level effects, if any, of the widespread use of non-compete agreements on competition for labor, competition in other markets, and economic growth and innovation more generally.

## **B. Impact on Employees**

### **1. What bargaining power, if any, do employees have to accept, reject, or negotiate non-compete agreements?**

Current studies suggest that, in the vast majority of cases, employees have little or no bargaining power to accept, reject, or negotiate non-compete agreements. In surveys, employees often report that their employer presented them with a non-compete agreement only after they had accepted employment, and as a routine, non-negotiable part of the onboarding process. In one survey, nearly 70 percent of employees reported that their employer provided the non-compete agreement after they had accepted the job offer, and nearly half of them were presented with the non-compete only after starting work.<sup>82</sup> As perhaps a reflection of the routine manner in

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<sup>81</sup> See, e.g., *Brunner v. Liautaud*, No. 1:14-cv-05509, 2015 WL 1598106, at \*8–11 (N.D. Ill. Apr. 8, 2015) (dismissing claims for declaratory and injunctive relief by putative plaintiff class of current and former Jimmy John’s Sandwich Shop employees with respect to the Confidentiality and Non-Competition Agreements that they signed, based on lack of a justiciable controversy that would confer Article III standing). Relatedly, there are putative class actions challenging “no-poach” agreements by franchisees within a franchised system not to hire or solicit each other’s employees. See, e.g., *In re Papa John’s Employee and Franchise Employee Antitrust Litig.*, No. 3:18-cv-00825-JHM, 2019 WL 5386484, at \*4 (W.D. Ky. Oct. 21, 2019) (granting defendants’ motion to compel arbitration with respect to one of the named plaintiffs’ claims); *Ogden v. Little Caesar Enters., Inc.*, 393 F. Supp. 3d 622, 638–39 (E.D. Mich. 2019) (dismissing the plaintiffs’ complaint, among other grounds, for failing to plead cognizable antitrust injury).

<sup>82</sup> Matt Marx & Lee Fleming, *Non-compete Agreements: Barriers to Entry ... and Exit?*, 12 INNOVATION POL’Y & ECON. 39, 49 (2012); Rachel Arnow-Richman, *Cubewrap Contracts: The Rise of Delayed Term, Standard Form Employment Agreements*, 49 ARIZ. L. REV. 637, 639 (2007).

which many employers impose restrictive covenants on their employees, non-compete clauses are included in employment agreements at approximately the same rate across both enforcing and non-enforcing states.<sup>83</sup> This strongly suggests that many employees are uninformed regarding their rights to mobility and do not negotiate, nor have an opportunity to negotiate, non-compete clauses to which they are subject.<sup>84</sup>

## **2. Do employers exercise power in labor markets and over employees?**

Labor markets are not “perfectly competitive” as that term is understood in economics.<sup>85</sup> That is, employees are not able to immediately change employers in response to very small changes in wages, and employers are not able to immediately substitute employees in response to very small changes in productivity. The reason is that there are substantial frictions in labor markets. Employees and employers alike lack perfect information about each other; it is costly for employers to identify, hire, and train employees; and it is costly for employees to research, interview, and obtain employment elsewhere. As a result, employers generally have at least some power over wages, regardless of the presence of alternative employers in some hypothetical labor market. That power may increase with employer concentration, through collusion with other potential rival employers (for example, “no-poach” agreements), or through the parallel deployment of non-compete agreements.<sup>86</sup>

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<sup>83</sup> Starr et al., *supra* note 34, at 10.

<sup>84</sup> Exec. Office of the President, Council of Economic Advisers Issue Brief, *Labor Market Monopsony: Trends, Consequences, and Policy Responses* 8 (Oct. 2016), <https://bit.ly/2RUUWhu> [hereinafter CEA Brief].

<sup>85</sup> See Bruce E. Kaufman, *The Impossibility of a Perfectly Competitive Labour Market*, 31 CAMBRIDGE J. ECON. 775 (2007).

<sup>86</sup> CEA Brief, *supra* note 84, at 4–5.

### 3. Do non-compete agreements impair job mobility, suppress wages, or hinder the formation of new businesses?

Non-compete clauses are designed to impair job mobility. Their purpose is to limit where employees may work after terminating employment, and they are generally effective in accomplishing that goal, regardless of their enforceability.<sup>87</sup> Research also shows that non-competes can reduce wages. For example, workers in states that enforce such clauses generally earn less than similar workers in states that do not enforce non-competes.<sup>88</sup> Non-compete clauses also reduce the rate of formation of new businesses. One study found that greater enforcement of non-competes results in 12% fewer new firms.<sup>89</sup> Last but not least, non-compete clauses have been shown to have added negative impact for women, people of color, and older workers.<sup>90</sup>

#### C. Impact on Employers

Employers commonly cite the protection of intellectual property (e.g., trade secrets) and the incentivization of training investments as justifications for non-compete agreements. The use of such agreements may not benefit all employers to the same extent, however. Rather, they likely favor established firms. For example, nascent businesses may find it difficult to recruit talent if the most experienced and qualified employees are subject to employment restrictions.<sup>91</sup>

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<sup>87</sup> Starr, et al., *supra* note 34, at 35; Evan Starr, J.J. Prescott & Norman Bishara, *Noncompetes and Employee Mobility* 5, in PROCEEDINGS OF THE ACAD. MGMT. ANNUAL MEETING (Aug. 1, 2019), <https://bit.ly/39S37m5>.

<sup>88</sup> Evan Starr, *Consider This: Training, Wages and the Enforceability of Covenants Not to Compete* 19 (2018), <https://bit.ly/2O5tlc9> (final version of the paper published in 72 INDUS. & LABOR RELATIONS REV. 783 (2019)). *See also infra* note 231 (citing studies showing negative wage effects). That said, some classes of workers, such as corporate CEOs and physicians, may experience wage increases as a result of non-competes. *See infra* note 230 (citing studies showing positive wage effects).

<sup>89</sup> Jessica Jeffers, *The Impact of Restricting Labor Mobility on Corporate Investment and Entrepreneurship* 32 (Working Paper, Dec. 24, 2019), <https://bit.ly/2tYojau>; Orly Lobel, *The Spinoff Advantage: Human Capital Law and Entrepreneurship* 8, in ENTREPRENEURSHIP AND THE LAW (Broughman & Smiths, eds., forthcoming 2019) (San Diego Legal Studies Paper No. 19-418, 2019), <https://bit.ly/2O3M73L>.

<sup>90</sup> Orly Lobel, *Gentlemen Prefer Bonds: How Employers Fix the Talent Market* 16 (San Diego Legal Studies Paper No. 19-382, 2019), <https://bit.ly/2Ru7mOa>.

<sup>91</sup> *See, e.g.,* Marx & Fleming, *supra* note 82, at 51–54 (observing that “[n]on-competes assist in preserving [a] firm’s competitive position by discouraging entry” based on studies showing that “the enforcement of non-competes

## 1. Do non-competes enable employers to incentivize training of employees?

Employers commonly assert that non-compete agreements may help incentivize their investment in employees by eliminating the risk of “free-riding”—*i.e.*, the worry that they might invest time and money to train an employee only to have that employee leave to work for a competitor before that investment has been recouped. Employers contend that this investment in training also accrues to the worker, who strengthens his or her skillset.

There has been scant empirical analysis of the relationship between non-compete agreements and training but a recent study attempts to analyze this question. The study found that higher enforceability of non-compete agreements in fact tended to be associated with greater firm-sponsored training of employees.<sup>92</sup> However, it also found that this benefit accrues principally to the employer rather than the employee because higher enforceability of non-compete agreements was also associated with reduced wages.<sup>93</sup> Thus, it appears that employers are the principal beneficiaries of non-compete agreements with their existing employees.

Non-compete agreements, however, may also disadvantage employers. As an alternative to training, an employer may improve the overall skill level of its workforce by simply hiring more skilled employees. But the widespread use of non-compete agreements in the labor force may decrease worker mobility, thereby depriving an employer of what may be an efficient option of paying more for skilled candidates in lieu of investing in training.

In sum, although non-compete agreements may be one way to incentivize employer investments in training, it is not altogether clear that they are the only way or that they are, on the

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discouraged the founding of new firms following liquidity events such as acquisitions or initial public offerings,” and that “non-competes may favor large firms over smaller ones because of the asymmetric costs of the legal system”).

<sup>92</sup> Starr, *supra* note 88, at 15–16.

<sup>93</sup> *Id.* at 16.

whole, beneficial to employers as a group. Clearly, the use of non-compete agreements by one firm can have spillover effects in the labor market, which may negatively impact the choices that other employers make, and are able to make, with respect to recruitment and training.

## **2. Do non-competes enable employers to protect their intellectual property?**

An employer's right and ability to exclude third parties from using its intellectual property, including trade secrets, exists regardless of whether it requires its employees to enter into non-compete agreements.<sup>94</sup> The introduction of a non-compete clause into the employment relationship presumes, in a sense, that an employee's departure to a competitor could involve the disclosure and use of cognizable trade secrets or other protectable intellectual property, as opposed to general skills or knowledge.<sup>95</sup> Therefore, the "fit" between a non-compete clause and the interest in protecting intellectual property can be a loose one, in the sense that there is a risk the non-compete could preclude the use of knowledge or information that would not qualify as a

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<sup>94</sup> See, e.g., 35 U.S.C. §§ 271, 281, & 283 (2018) (providing a civil action for patent infringement and injunctive relief as a remedy); 17 U.S.C. §§ 501 & 502 (2018) (providing a civil action for copyright infringement and injunctive relief as a remedy); 18 U.S.C. §§ 1836(b)(1) & (b)(3)(A) (2018) (providing a civil action for trade secret misappropriation and injunctive relief as a remedy).

<sup>95</sup> Indeed, courts have recognized a close kinship between non-compete agreements and the "inevitable use" or "inevitable disclosure" doctrine in trade secret law—that an individual who accepts employment with a competitor of her former employer in a position that is substantially similar to the position she held during her former employment will inevitably put her knowledge of her former employer's trade secrets to use in her new role, see, e.g., *Pepsico, Inc. v. Redmond*, 54 F.3d 1262, 1269 (7th Cir. 1995). For example, state law protections against the inevitable use or disclosure of trade secrets can provide a basis for holding that a "non-compete covenant is reasonable and enforceable to the extent it is limited to an employee's use of trade secret, proprietary, and confidential information." *McGowan & Co., Inc. v. Bogan*, 93 F. Supp. 3d 624, 645 (S.D. Tex. 2015) (construing Ohio law). Conversely, "[t]o the extent that the theory of inevitable disclosure creates a de facto covenant not to compete without a nontrivial showing of actual or threatened use or disclosure," it can be inconsistent with the policy and case law in other states. *Bayer Corp. v. Roche Molecular Sys., Inc.*, 72 F. Supp. 2d 1111, 1120 (N.D. Cal. 1999) (construing California law). And in states that look upon the inevitable disclosure doctrine with disfavor and apply it in the rarest of cases, securing "a written agreement that contains a non-compete clause is the best way of promoting predictability during the employment relationship and afterwards." *EarthWeb, Inc. v. Schlack*, 71 F. Supp. 2d 299, 311 (S.D.N.Y. 1999) (construing New York law), *remanded for further explanation*, 205 F.3d 1322 (2d Cir. 2000), *subsequently aff'd*, No. 99-9302, 2000 WL 1093320 (2d Cir. 2000).

trade secret or other intellectual property.<sup>96</sup> Furthermore, as discussed above, the protection of intellectual property alone likely cannot explain the prevalence of non-compete clauses in employment agreements.

### **3. Do non-competes affect employers' ability to hire talent?**

A non-compete agreement restricts the opportunities not only for the signing employee, but also for alternative employers who are potentially denied the ability to hire that employee, or at least may face additional costs in doing so, including the cost of compliance and the risk of litigation. As alluded to below, startup firms, established firms wishing to gain a foothold in a new technology or business, and risk-averse employers are likely to be most affected by non-compete agreements that may constrict their labor pool and stifle efforts to build new teams or hire highly-skilled and experienced employees from other firms.

### **4. Can employers adequately protect their interests without using non-compete agreements? What alternatives may employers have to the use of non-compete agreements?**

There is growing concern that “non-competes ... are blunt instruments that may unnecessarily harm workers when less restrictive options may similarly protect trade secrets or intellectual property (IP)[,] ... includ[ing] non-disclosure agreements, non-solicitation of client agreements, IP assignment agreements, and training repayment agreements, to name a few.”<sup>97</sup>

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<sup>96</sup> See, e.g., Viva R. Moffat, *The Wrong Tool for the Job: The IP Problem with Noncompetition Agreements*, 52 WM. & MARY L. REV. 873, 911–12 (2010) (“Noncompetes are simply not a good tool for protecting IP rights. First, to the extent that noncompetes are used as a supplement or an alternative to IP protection, we ought to be concerned that they may upset the balance struck by the IP regimes between protection and disclosure; that is, between private rights and the public availability of inventions, information, and creations.”). Additionally, non-competes of this nature should be distinguished from agreements that merely restrict an employee’s ability to solicit the first employer’s customers or clients, which implicate company goodwill and proprietary information as opposed to intellectual property rights.

<sup>97</sup> Starr, *supra* note 88, at 12. See also Long, *supra* note 47, at 1297 (“In contrast to traditional noncompetes, repayment agreements offer a sensible alternative whereby an employer’s level of protection moves in lockstep with

The benefit of these alternatives is that they do not directly prohibit employment mobility, and are tailored more precisely to a business's protectable interests. Another strategy would be to offer employees higher salaries or other benefits to incentivize and strengthen their long-term commitment to an employer.

#### **D. Concluding Observations**

As the above review of the current literature suggests, studies of the impact of non-compete clauses, both positive and negative, have largely focused on the immediate parties to the bilateral agreement—namely, the employee and the employer. In contrast, comparatively little has been done to elucidate the impact of non-compete clauses on third parties—namely, competitors of the employer who may benefit from hiring the affected employee, and consumers of the affected employee's services. To fully understand and appreciate the effects of non-compete clauses on competition and consumer protection, the Commission should focus its attention and resources on researching their impact on third-party employers and consumers.

Additionally, regarding the impact of non-compete clauses on employees, more research and analysis could be done regarding the effect of their inclusion in employment agreements as opposed to their enforcement. Professor Harlan Blake has been credited by some as the first scholar (in 1960) to highlight the *in terrorem* effect that these clauses can have on employees, even if they never see a courtroom.<sup>98</sup> To investigate this concern, Professor Evan Starr and his

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the cost of, and value derived from, the training. That is, repayment agreements more closely approximate the degree of protection required to encourage employer investment in training.”).

<sup>98</sup> Blake, *supra* note 5, at 682–83 (“For every covenant that finds its way into court, there are thousands which an *in terrorem* effect on employees who respect their contractual obligations and on competitors who fear legal complications if they employ a covenantor, or who are anxious to maintain gentlemanly relations with their competitors. Thus. The mobility of untold numbers of employees is restricted by the intimidation of restrictions whose severity no court would sanction.”). See also Catherine L. Fisk, *Reflections on The New Psychological Contract and the Ownership of Human Capital*, 34 CONN. L. REV. 765, 782–83 (2002) (noting that even though non-compete clauses have been unenforceable against employees in California since 1872, “[e]mployers ask their

colleagues have designed survey instruments designed to elucidate the behavioral effects of these clauses, regardless of their enforceability in court.<sup>99</sup> Their preliminary findings, however, may not hold true in certain sectors like technology, as others have argued.<sup>100</sup> Still, the impact of the inclusion of non-compete clauses in employment agreements, regardless of their actual enforcement and enforceability in court, on the behavior of low-wage workers and prospective employers is a question worthy of deeper exploration. Perhaps the Commission can contribute to this debate its accumulated experience and expertise relating to the study of the collection of time-barred debts against consumers, where an attempt to collect can create a mistaken impression that the debt in question is legally enforceable in court.<sup>101</sup>

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employees to sign such contracts anyway, presumably counting on the *in terrorem* value of the contract when the employee does not know that the contract is unenforceable”).

<sup>99</sup> Evan Starr, J.J. Prescott & Norman Bishara, *The Behavioral Effects of (Unenforceable) Contracts* 25 (Univ. Mich. L. & Econ. Research Paper No. 16-032, Dec. 18, 2019) (finding that “beliefs about noncompete enforceability and the likelihood of being sued, as well as simple reminders by the employer, are strong predictors of whether an employee will decline an offer from a competitor, while the actual law appears to be largely irrelevant”), <https://bit.ly/32boHzf>; Starr et al., *supra* note 87, at 5 (finding that “noncompete *use* is associated with significantly longer employee tenure and with the redirection of employees away from competitors and toward noncompetitors, regardless of state-level noncompete enforceability”).

<sup>100</sup> Robert W. Gomulkiewicz, *Leaky Covenants-Not-to-Compete as the Legal Instructure for Innovation*, 49 U.C. DAVIS L. REV. 251, 288 (2015) (rejecting the “stylized story” of an unsophisticated, risk-adverse worker paralyzed by fear of litigation and arguing that “both employees and employers in the technology sector approach non-competes in a more nuanced, sophisticated way than this simple sketch suggests”).

<sup>101</sup> See FED. TRADE COMM’N, THE STRUCTURE AND PRACTICES OF THE DEBT BUYING INDUSTRY 46 (Jan. 2013) (“When collectors attempt to recover on debts, in many circumstances, such efforts may convey or imply to consumers that the collectors could sue them if they do not pay.”) (noting, however, that the information the Commission collected through its Section 6(b) orders did not permit it to determine how often debt buyers filed actions in court to recover on time-barred debts and the effect of such actions on consumers), <https://bit.ly/2RaUjRe>; FED. TRADE COMM’N, REPAIRING A BROKEN SYSTEM: PROTECTING CONSUMERS IN DEBT COLLECTION LITIGATION AND ARBITRATION 26 (July 2010) (“[B]ecause most consumers do not know or understand their legal rights with respect to the collection of time-barred debt, the Commission believes that in many circumstances such a collection attempt may create a misleading impression that the collector can sue the consumer in court to collect the debt, ...”), <https://bit.ly/2wliKEu>. The parallel being drawn here between time-barred debts and unenforceable non-compete clauses is the behavioral question that each raises, and not a legal question about whether Section 5’s ban on deceptive acts and practices would likewise apply to the imposition of unenforceable non-compete clauses.

### **Topic 3:      Applicable State Law**

The Commission has asked for views on whether state law is insufficient to address the harms associated with non-compete clauses in employment agreements. As a threshold matter, this question presupposes that there is general consensus about the nature and extent of the harms, including an identification of who is being harmed and in what way(s). The Section does not have the impression that the research and analysis of non-compete clauses are far enough along such that lawmakers and policymakers—whether at the federal, state, or local level—have a clear sense of the nature and extent of the harms, an ability to evaluate the adequacy of existing legislative and regulatory regimes to address those harms, and a blueprint for additional legislation or regulation should current regimes be deemed inadequate.

Next, the Section observes that, historically, the law and policy surrounding non-compete clauses—and, more generally, restrictive covenants in employment agreements—has largely been left to the states to develop and address through legislation and case law.<sup>102</sup> Federal courts, sitting in diversity, often must take into account state policies regarding non-compete clauses in choice-of-law analyses to determine whether a particular state’s substantive law

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<sup>102</sup> *See, e.g.*, *BMC Software, Inc. v. Mahoney*, 2015 WL 3616069, at \*5 (D. Minn. June 9, 2015) (referring to the non-compete claim as a matter of substantive state law); *Applied Micro, Inc. v. SJI Fulfillment, Inc.*, 941 F. Supp. 750, 753 (N.D. Ill. 1996) (noting that the validity of a restrictive covenant is “a question of law and, more particularly, of state law”). Numerous decisions evaluate the validity and enforceability of non-compete clauses against the backdrop of state policy. *See, e.g.*, *Mohanty v. St. John Heart Clinic, S.C.*, 866 N.E.2d 85, 92–93 (Ill. 2006) (public policy of the State of Illinois); *Bowlus v. Alexander & Alexander Servs., Inc.*, 659 F. Supp. 914, 920 (S.D.N.Y. 1987) (“The validity of a restrictive covenant contained in an employment contract is generally a matter of state policy.”) (noting that “federal antitrust law is not the traditional means of dealing with this issue”); *Hi-Line Elec. Co., Inc. v. Cryer*, 659 S.W.2d 118, 120–21 (Tex. 1983) (public policy of the State of Texas).

should apply.<sup>103</sup> As a byproduct of this historical deference to the states,<sup>104</sup> wide variation exists among state laws and regulations, common-law principles, and policies governing non-compete clauses.<sup>105</sup> Moreover, within and across states, wide variation exists across industries.<sup>106</sup>

Additionally, state policies towards non-compete clauses and with them, corresponding laws and regulations, are not static; they can and do change or shift over time. During the 1990s and early 2000s, the trend in state law and enforcement moved slightly towards greater permissibility of non-compete clauses.<sup>107</sup> But more recently, states have shifted towards less

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<sup>103</sup> See, e.g., *DJR Assocs., LLC v. Hammonds*, 241 F. Supp. 3d 1208, 1232 (N.D. Ala. 2017) (“[T]he enforceability of non-compete covenants touches on the conflicting fundamental public policies of many states, including Alabama and Georgia. Beyond the interests of the parties in the contractual provisions they have created, the interests of the states themselves in enforcing the law within their authority must be considered.”); *McKissock, LLC v. Martin*, 267 F. Supp. 3d 841, 851–52 (W.D. Tex. 2016) (noting that Texas has a fundamental policy of ensuring a uniform rule for enforcement of noncompetition agreements within the state); *United Rentals, Inc. v. Pruett*, 296 F. Supp. 2d 220, 231 (D. Conn. 2003) (“Resolution of this case will require application of either Connecticut or California’s law governing restrictive covenants in employment agreements, and both parties are in agreement that California law conflicts with Connecticut law in this area.”). See also Blake, *supra* note 5, at 688 n.211 (noting that “[t]he resolution which will be made of the conflict-of-laws question which arises when an effort is made to enforce a multistate restraint outside the jurisdiction in which the employment took place is not easily predictable”).

<sup>104</sup> Interestingly, before *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938), which directed federal courts in diversity actions to apply the substantive law of the state in which they sit, some federal decisions instead consulted federal common law regarding the validity and enforceability of non-compete clauses. See, e.g., *Hall Mfg. Co. v. Western Steel & Iron Works*, 227 F. 588, 591 (7th Cir. 1915) (rejecting the invitation to apply Wisconsin law because “[t]he validity of a contract in interstate commerce must be determined by the general law” and “[i]f any statute applies, it must be federal”); *Harrison v. Glucose Sugar Refining Co.*, 116 F. 304, 309 (7th Cir. 1902) (“State lines cannot justly be applied within the reason of the rule. It is a question not of state policy, but of national policy and of general law.”).

<sup>105</sup> Norman D. Bishara, *Fifty Ways to Leave Your Employer: Relative Enforcement of Covenants Not to Compete, Trends, and Implications for Employee Mobility Policy*, 13 U. PENN. J. BUS. LAW 751, 771 (2011) (“Systematically evaluating the covenant not to compete enforcement policies of the fifty states, and the District of Columbia, is obviously a labor-intensive endeavor. This is a particularly onerous task since noncompete policy is an evolving area of law that is comprised of some instances of legislation, but the implementation of enforcement primarily falls to the state courts, with much of the common law being tied to the facts of individual cases.”). See also *id.* at 778 (“A review of the rankings and the overall data for the most recent 2009 observation reveals that eighteen states (approximately 35%) have noncompete legislation of some sort.”) & 795 (Figure 2 shows a distribution of non-compete enforceability). See also TREASURY REPORT, *supra* note 30, at 15 (“Currently, nearly all states will enforce non-compete agreements to some extent. Within those states, non-compete enforcement may be restricted in a variety of ways that vary from state to state.”).

<sup>106</sup> See, e.g., Evan Starr, Justin Frake & Rajshree Agarwal, *Mobility Constraint Externalities* 34 (Fig. 1) (2018), <https://bit.ly/311q3Mq> (final version published in 30 ORG. SCI. 961 (2019)).

<sup>107</sup> Bishara, *supra* note 105, at 779 (“Both Figure 4 and Figure 5 also show that overall the scores are generally higher in 2009 than 1991, providing evidence of a general drift toward more enforcement in the United States in the aggregate. This is, perhaps, due to the greater formalization of noncompete policy in the states and a growing

permissibility (i.e., non-compete clauses are less enforceable). Notably, a report from Beck Reed Riden LLP shows a cross-sectional view of non-compete enforcement as of 2017.<sup>108</sup> Based on this report, roughly half of the states (23) restrict non-compete clauses in some fashion, which reflects an increase from the 18 states that did so as of 2009, as shown by Professor Bishara in an earlier study.<sup>109</sup> Thus, in the last ten years, roughly five additional states (10% of states overall) have adopted new restrictions on the use and enforcement of non-compete clauses.

In the Section’s view, the question of whether state law is sufficient to address the harms associated with non-compete clauses in employment agreements requires a state-by-state examination of the policies underlying each jurisdiction’s attitudes and treatment towards the use and enforcement of such clauses. Put another way, this question does not seem susceptible to a generalized response that fails to take into account varying experiences at the state level. The Section submits that cross-state variations are seemingly justified, as views and literature on non-compete clauses (and restrictive covenants in employment contracts, generally) are mixed. Non-competes can affect different workers and different businesses in different ways.<sup>110</sup> As such,

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collection of observable cases of noncompete litigation.”); Matthew S. Johnson, Kurt Lavetti & Michael Lipsitz, *The Labor Market Effects of Legal Restrictions on Worker Mobility* 5–6 (Oct. 5, 2019) (“Hausman and Lavetti (2017) created the panel version by replicating the cross-sectional scores from Bishara (201[1]) in 1991 and 2009 ... We supplement the Hausman and Lavetti (2017) dataset with changes to NCA enforceability between 2009 and 2014.... Furthermore, law changes have led to sizable changes in the NCA Enforceability Score within states over time.... Figure 1 shows the timing of NCA law change events from the combined database. Changes were relatively evenly dispersed throughout the study time period. There are a few more enforceability increases than decreases, though both are well-represented. Figure 2 shows the sample-weighted mean NCA Enforceability Score across states over the sample period. NCA enforceability has been generally increasing over time, with an especially steep increase during the mid to late 1990s.”), <https://bit.ly/311vwD5>.

<sup>108</sup> Beck Reed Survey, *supra* note 27.

<sup>109</sup> Bishara, *supra* note 105, at 778.

<sup>110</sup> *See generally* Section comments under Topic 2.

there is generally a longstanding history of leaving issues in the employment arena like this (where substantial heterogeneity exists and issues are still in their infancy) to the states.<sup>111</sup>

The Section further submits that—in light of the heterogeneity and still emerging views and literature—there does not appear to be a reasonable basis to conclude at this time that state law and regulation are insufficient to address most, if not all, issues relating to non-compete clauses. In contrast to federal rulemaking, which would result in the promulgation of a nationwide solution, individual states may be better equipped to address questions that are specific to local or regional market and labor conditions at issue, such as:

- Should there be different rules for urban versus rural states?
- Are there industries that warrant partial or complete exemption?
- How do restrictions imposed by non-compete clauses interact with the use and enforcement of other restrictive covenants in employment contracts or other contexts?

As noted above, states can and do legislate and regulate in this arena, and the Section is not aware of concrete evidence suggesting that states are systematically attempting—and failing—to implement laws and regulations addressing identified problems associated with non-compete clauses.<sup>112</sup>

In summary, the Section respectfully advises that—consistent with the principles of federalism—states should be given leeway to continue to legislate and regulate on their own in the employment arena, and any federal rulemaking should be cognizant of ongoing state

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<sup>111</sup> See *Hawaiian Airlines, Inc. v. Norris*, 512 U.S. 246, 252 (1994) (noting that employment standards fall within the traditional police power of the States and federal preemption should therefore not be lightly inferred); *Fort Halifax Packing Co. v. Coyne*, 482 U.S. 1, 21 (1987) (same).

<sup>112</sup> For example, the Uniform Law Commission (also known as the National Conference of Commissioners on Uniform State Laws (NCCUSL)) has convened a Study Committee on Covenants Not to Compete that likely will be reconvened as a Drafting Committee in the summer of 2020. See <https://bit.ly/2wCSKnA>. Discussions to date point to a basic statement as to the “traditional” business justifications for non-compete clauses plus possibly some regulatory provisions (e.g., low-wage prohibition, possible length restrictions).

efforts.<sup>113</sup> That said, the Section is aware, of course, of two developments relevant to the question of whether federal legislation or regulation is needed to supplement, or even trump, state efforts. In July 2019, a group of 18 states jointly filed public comments with the Commission, urging the agency to consider using its Section 5 enforcement authority to stop the use of non-compete clauses for low-wage workers and non-compete clauses involving multi-sided platforms in the “gig” economy.<sup>114</sup> In November 2019, a group of 19 states jointly submitted a letter to the Commission, as a follow-up to the July 2019 comments, asking the agency to initiate a rulemaking “to classify abusive worker non-compete clauses as an ‘unfair method of competition’ and per se illegal under the FTC Act for low wage workers or where the clause is not explicitly negotiated.”<sup>115</sup>

While the Commission should consider these calls for action by some states, it should also keep in mind that the majority of states did not sign on to either the July 2019 comments or the November 2019 letter. The product of any Commission rulemaking of course would apply to businesses and employers in those states as well as the ones that signed on to the comments and/or the letter. Furthermore, even the signatories to the July 2019 comments and the November 2019 letter recognize ongoing efforts at the state level to address the perceived harms

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<sup>113</sup> For example, Commission rulemaking may be too broad to account for local or industry-specific commercial ethics, customs, and practices that speak to the use and disclosure of trade secrets and proprietary information. It may be difficult to define concepts like trade secrets, confidential information, and good will adequately and sufficiently so as to support the traditional applications of non-compete clauses in a variety of settings and industries.

<sup>114</sup> Karl A. Racine, Att’y Gen., D.C., et al., *Federal Trade Commission Hearings on Competition and Consumer Protection in the 21st Century: Public Comments of 18 State Attorneys General on Labor Issues in Antitrust* 13 (July 15, 2019) [hereinafter 18 States Comment], <https://bit.ly/39SHrGa>. The 18 state signatories to the comments are: California, Delaware, District of Columbia, Hawaii, Illinois, Iowa, Maine, Maryland, Massachusetts, Michigan, Minnesota, Nevada, New Jersey, New York, Pennsylvania, Rhode Island, Virginia, and Washington.

<sup>115</sup> Letter from Keith Ellison, Att’y Gen., Minn., et al., to Joseph Simons, Chairman, Fed. Trade Comm’n 1, 2 (Nov. 15, 2019), <https://bit.ly/2Tv0rW2>. The 19 state signatories to the letter are: California, Delaware, District of Columbia, Illinois, Iowa, Maine, Maryland, Massachusetts, Michigan, Minnesota, New Mexico, North Carolina, Oregon, Pennsylvania, Rhode Island, Vermont, Virginia, Washington, and Wisconsin.

of non-compete clauses and support continuing progress on those fronts.<sup>116</sup> Accordingly, the Commission should carefully consider how best to proceed in this area, in order not to disrupt or override state-level efforts but, rather, to complement and supplement those efforts.

#### **Topic 4: Applicability of Section 5 of the FTC Act**

On this topic the Section focuses its comments on whether there are situations in which the imposition or enforcement of non-compete clauses in employment agreements could constitute either an unfair method of competition (“UMC”), or an unfair or deceptive act or practice (“UDAP”), within the meaning of Section 5 of the FTC Act.<sup>117</sup>

##### **A. Are there situations in which non-compete clauses constitute an unfair method of competition?**

The Commission’s UMC authority covers both conduct that violates the antitrust laws<sup>118</sup> and conduct outside the scope of the antitrust laws that nonetheless violates the spirit of the antitrust laws (the latter is sometimes referred to as the Commission’s “standalone” authority).<sup>119</sup> Below, the Section discusses first the application of the antitrust laws to the use of non-compete

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<sup>116</sup> Racine et al., *supra* note 114, at 6–8; *see, e.g., id.* at 7 (“This spate of state activity shows states are experimenting with limiting non-competes, and that there will be much to learn from these disparate approaches.”). Ellison et al., *supra* note 115, at 2 (“While we will continue to support state and federal legislative reforms on non-competes, we believe an FTC rule offers the quickest, most comprehensive regulatory path to protecting all workers from these exploitative contracts.”).

<sup>117</sup> 15 U.S.C. § 45(a)(1) (2018) (“Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful.”). Section 5 of the FTC Act goes on to empower and direct the Commission “to prevent persons, partnerships, or corporations [with enumerated exceptions] ... from using unfair methods of competition in or affecting commerce and unfair or deceptive acts or practices in or affecting commerce.” 15 U.S.C. § 45(a)(2) (2018).

<sup>118</sup> *FTC v. Ind. Fed’n of Dentists*, 476 U.S. 447, 455 (1986); *FTC v. Cement Institute*, 333 U.S. 683, 693 (1948); *Realcomp II, Ltd. v. FTC*, 635 F.3d 815, 824 (6th Cir. Cir. 2011)

<sup>119</sup> *FTC v. Brown Shoe Co.*, 384 U.S. 316, 321 (1966); *Fashion Originators’ Guild of Am. v. FTC*, 312 U.S. 457, 463 (1941); *E.I. du Pont de Nemours & Co. v. FTC*, 729 F.2d 128, 136–37 (2d Cir. 1984). *See* FED. TRADE COMM’N, STATEMENT OF ENFORCEMENT PRINCIPLES REGARDING “UNFAIR METHODS OF COMPETITION” UNDER SECTION 5 OF THE FTC ACT (Aug. 13, 2015), *published at* 80 Fed. Reg. 57,056 (Sept. 21, 2015) [hereinafter SECTION 5 ENFORCEMENT PRINCIPLES], <https://bit.ly/3cCVBxt>.

clauses in employment agreements, and then the potential application of the FTC’s standalone authority under Section 5.

In a nutshell, there are situations—if the supporting facts are present—in which the imposition or enforcement of non-compete clauses could potentially give rise to potential antitrust violations. For example, suppose that a dominant firm in a given product market imposes non-compete clauses on workers who are critical to the supply of the product that it manufactures and sells (i.e., labor as a key input). Some have argued that the use of non-compete clauses in this setting could be viewed as an anticompetitive scheme to raise rivals’ costs and to exclude would-be rivals from entering the product market.<sup>120</sup> Alternatively, there may also be some, we think likely narrow, circumstances in which a firm that is a dominant buyer in a given labor market potentially could use non-compete clauses to limit the pool of labor available to competing firms, and at the same time prevent those workers who are bound by the non-compete from securing higher wages elsewhere, as they ordinarily would be able to do with a limited labor pool.<sup>121</sup>

Whether the imposition or enforcement of non-compete clauses could give rise to a standalone unfair method of competition violation is an open question, however.<sup>122</sup> As discussed

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<sup>120</sup> Posner, *supra* note 4, at 22 (describing the potential impact of non-compete clauses imposed by a hospital on physicians on the potential entry of a new hospital). The anticompetitive use of covenants not-to-compete in this fashion may be viewed as having an effect analogous to that of predatory hiring. *See Univ. Analytics, Inc. v. MacNeal Schwendler Corp.*, 914 F.2d 1256, 1258 (9th Cir. 1990) (“Unlawful predatory hiring occurs when talent is acquired not for purposes of using that talent but for purposes of denying it to a competitor.”). *See generally* Richard J. Braun & Michael A. Williams, *Predatory Hiring as Exclusionary Conduct: A New Perspective*, 7 J. BUS., ENTREPRENEURSHIP & L. 1, 25 (2013) (arguing that the legal requirement that the would-be monopolist *not* use the talent it has predatorily acquired is too stringent); Steven C. Salop, *Anticompetitive Overbuying by Power Buyers*, 72 ANTITRUST L.J. 669, 690 (2005).

<sup>121</sup> Posner, *supra* note 4, at 23.

<sup>122</sup> The FTC has issued a “Statement of Enforcement Principles” regarding the enforcement of standalone Section 5 violations. *See SECTION 5 ENFORCEMENT PRINCIPLES*, *supra* note 119. But that statement is not entirely clear on what the Commission sees as potential standalone Section 5 violations and focuses more on the properties

below, there is some older—and now generally ignored—authority from the early years of the Commission’s existence essentially declaring conduct that forces competitors to engage in directly unproductive, profit-seeking activity (e.g., deceptive labeling) to be an unfair method of competition.<sup>123</sup> But the use of standalone UMC authority to combat business practices like deceptive labeling has largely been supplanted by the Commission’s exercise of its generally more directly applicable UDAP authority, which was subsequently added to the FTC Act following this early line of cases.<sup>124</sup> Moreover, modern case law supporting the Commission’s exercise of its UMC authority has markedly shifted from whether the challenged business practices are unscrupulous or immoral to whether they contravene the policy or spirit of the antitrust laws.<sup>125</sup> Accordingly, the notion that a firm’s use of non-compete clauses may induce other market participants to do the same (particularly where such clauses are unenforceable) would not constitute a standalone unfair method of competition absent evidence of harm to competition or the competitive process.

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of such a violation. *See generally*, Robert Davis, *One Step on the Road to Clarity: The 2015 FTC Statement on Unfair Methods of Competition*, THE ANTITRUST SOURCE, Feb. 2016, at 2–4.

<sup>123</sup> *See, e.g.*, FTC v. R.F. Keppel & Bro., Inc., 291 U.S. 304, 313 (1934) (“A method of competition which casts upon one’s competitors the burden of the loss of business unless they will descend to a practice which they are under a powerful moral compulsion not to adopt, even though it is not criminal, was thought to involve the kind of unfairness at which the statute was aimed.”); FTC v. Algoma Lumber Co., 291 U.S. 67, 78–79 (1934) (“Dealers and manufacturers are prejudiced when orders that would have come to them if the lumber had been rightly named, are diverted to others whose methods are less scrupulous.... The careless and the unscrupulous must rise to the standards of the scrupulous. The Commission was not organized to drag standards down.”). *See also* Jagdish N. Bhagwati, *Directly Unproductive, Profit-Seeking (DUP) Activities*, 90 J. POL. ECON. 988, 989 (Oct. 1982) (defining DUP activities as activities that “yield pecuniary returns but do not produce goods or services that enter a utility function directly or indirectly via increased production or availability to the economy of goods that enter a utility function”) (examining DUP in the context of government policy-seeking activities).

<sup>124</sup> Wheeler-Lea Act, Pub. L. No. 75-447, 52 Stat. 111, ch. 49 (1938).

<sup>125</sup> *See, e.g.*, FTC v. Brown Shoe Co., 384 U.S. 316, 321 (1966) (“This broad power of the Commission [to declare trade practices as unfair] is particularly well established with regard to trade practices which conflict with the basic policies of the Sherman and Clayton Acts even though such practices may not actually violate these laws.”); Fashion Originators’ Guild of Am. v. FTC, 312 U.S. 457, 463 (1941) (“If the purpose and practice of the combination of garment manufacturers and their affiliates runs counter to the public policy declared in the Sherman and Clayton Acts, the Federal Trade Commission has the power to suppress it as an unfair method of competition.”).

## 1. Antitrust

Whether the imposition or enforcement of non-compete clauses in employment agreements violates Section 1 or Section 2 of the Sherman Act should be based on a rule of reason analysis, given their vertical nature.<sup>126</sup> Indeed, courts that have had occasion to evaluate the legality of non-compete clauses under the Sherman Act have declined to subject them to *per se* treatment and have applied the rule of reason instead.<sup>127</sup> Such an inquiry requires evaluating the imposition or enforcement of non-compete clauses in employment agreements through the lens of the market(s) impacted by the arrangement.

### a. Market Definition

As also discussed in Topics 2 and 8, non-compete clauses may impact not only the participants in the labor market at issue but also the competitive process in adjacent and downstream markets. Specifically, potentially affected markets include (1) “direct” labor markets in which the clauses are imposed, (2) related product markets for which the labor restrained by the clauses is an input, and (3) “indirect” labor markets in which demand may be reduced because the labor offered is a complement to the labor restrained by the clauses.<sup>128</sup>

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<sup>126</sup> See, e.g., *FTC v. Ind. Fed’n of Dentists*, 476 U.S. 447, 458–59 (1986) (“Moreover, we have been slow . . . , in general, to extend *per se* analysis to restraints imposed in the context of business relationships where the economic impact of certain practices is not immediately obvious[.]”) (citations omitted); *Broadcast Music, Inc. v. Columbia Broadcasting Sys., Inc.*, 441 U.S. 1, 8–10 (1979) (“In construing and applying the Sherman Act’s ban against contracts, conspiracies, and combinations in restraint of trade, the Court has held that certain agreements or practices are so ‘plainly anticompetitive,’ and so often ‘lack . . . any redeeming virtue,’ that they are conclusively presumed illegal without further examination under the rule of reason generally applied in Sherman Act cases.”) (citations omitted).

<sup>127</sup> See, e.g., *Med. Ctr. at Elizabeth Place, LLC v. Atrium Health Sys.*, 922 F.3d 713, 731 (6th Cir. 2019) (“In this context, MCEP’s failure to produce any on-point precedent is damning, as we refuse to apply the *per se* rule in the absence of judicial experience with the challenged restraint.”); *Bradford v. N.Y. Times Co.*, 501 F.2d 51, 60 (2d Cir. 1974) (“Although employee restraints have been known to the common law since the 15th century, their evolving history illustrates that rule of reason considerations continue to apply; . . . There is therefore not enough here to justify our acceptance of the invitation to classify such a restraint as a *per se* violation of the Sherman Act.”).

<sup>128</sup> See Posner, *supra* note 4, at 22.

Because these comments focus on the possibility that non-compete clauses in employment agreements could protect or create the market power for employers, the focus of the market definition exercise is on the ability of sellers (workers) to find substitute “purchasers.”<sup>129</sup> As such, the “market is comprised of buyers who are seen by sellers as being reasonably good substitutes. The greater the number of good substitutes from the point of view of sellers, the lower the monopsony power of the ... firm.”<sup>130</sup> As discussed further in Topic 8 below, there are a number of techniques that have been used to establish product markets,<sup>131</sup> and it seems likely that they can be adapted to the context of antitrust cases involving labor markets where there is concern regarding the unlawful acquisition or maintenance of monopsony power.

**b. Anticompetitive Conduct and Effect**

An agreement among firms (as competing buyers in a labor market) to impose non-compete clauses on their respective workers likely would be prohibited under Section 1 of the Sherman Act.<sup>132</sup> More difficult and uncertain an assessment is whether a unilateral decision by a dominant firm to impose non-compete clauses on a class of employees may constitute either

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<sup>129</sup> See, e.g., *Mandeville Island Farms, Inc. v. American Crystal Sugar Co.*, 334 U.S. 219, 240 (1948) (describing the competitive alternatives available to farmers selling sugar beets in light of an alleged conspiracy of sugar refiners who are sugar beet purchasers); see also *Nat’l Macaroni Mfrs. Ass’n v. FTC*, 345 F.2d 421, 424 (7th Cir. 1965).

<sup>130</sup> Roger D. Blair & Jeffrey L. Harrison, *Antitrust Policy and Monopsony*, 76 CORNELL L. REV. 297, 324 (1991); see generally *Todd v. Exxon Corp.*, 975 F.3d 191, 201–02 (2d Cir. 2001) (reversing dismissal of a complaint alleging anticompetitive information sharing by energy companies) (“There is a danger in applying [the standard market definition methods] mechanically in the context of monopsony or oligopsony. These factors are *reversed* in the context of a buyer-side conspiracy.”).

<sup>131</sup> See, e.g., Ioana Marinescu & Herbert Hovenkamp, *Anticompetitive Mergers in Labor Markets*, 94 IND. L. J. 1031, 1048–51 (2019) (laying out methodologies for ascertaining both a product market and a geographic market when there is a concern that a merger might impact labor markets); see also Suresh Naidu, Eric A. Posner & Glen Weyl, *Antitrust Remedies for Labor Market Power*, 132 HARV. L. REV. 536, 574–78 (2018).

<sup>132</sup> See, e.g., *Mandeville Island Farms*, 334 U.S. at 240 (describing an alleged conspiracy of sugar refiners who are sugar beet purchasers). In terms of the practical effect, an agreement among employer firms to impose non-compete clauses on their respective employees is not materially different from an agreement among those firms not to poach on each other’s employees. Cf. *Hunter v. Booz Allen Hamilton, Inc.*, 2019 WL 5893835 (S.D. Ohio 2019); *United States v. eBay, Inc.*, 968 F. Supp. 2d 1030 (N.D. Cal. 2013).

monopsonization of the labor market, or an illegal vertical agreement between an employer and its employees. The analytical difficulty extends to the use of monopsony power to exclude rivals in a downstream output market as well.

Some recent literature proposes that a labor market monopsonist may secure its monopsony power by imposing non-compete clauses on worker sellers in that market.<sup>133</sup> To be sure, individual employees who are bound by non-compete clauses may have fewer employment options post-termination than they would in the absence of those clauses. For example, recent literature describes the “widespread inclusion of noncompete clauses in the contracts of low-skill workers, including sandwich makers who work for chains,” outlining how, in some cases, the imposition of a non-compete can have a broad impact on the ability of an employee to change jobs.<sup>134</sup>

But it is less clear that the imposition of non-compete clauses would affect competition in some relevant labor market.<sup>135</sup> Assuming that non-compete clauses are imposed on employees at the time they are hired,<sup>136</sup> it seems likely that there would have been, at that time, other jobs that

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<sup>133</sup> See, e.g., Natarajan Balasubramanian, Jin Woo Chang, Mariko Sakakibara, Jagadeesh Sivadasan & Evan Starr, *Locked In? The Enforceability of Covenants Not to Compete and the Careers of High-Tech Workers* 34 (U.S. Census Bureau Ctr. for Econ. Stud. Paper No. CES-WP-17-09, Dec. 5, 2019), <https://bit.ly/39At1uE>.

<sup>134</sup> Posner, *supra* note 4, at 595 (citing Dave Jamieson, *Jimmy John’s Makes Low-Wage Workers Sign “Oppressive” Noncompete Agreements*, HUFFINGTON POST (Oct. 13, 2004), <https://perma.cc/L87W-V8UL> (“the effective blackout area for a former Jimmy John’s worker would cover 6,000 square miles in 44 states and the District of Columbia.”); *Butler v. Jimmy John’s Franchise, LLC*, 331 F. Supp. 3d 786, 793–94 (S.D. Ill. 2018).

<sup>135</sup> See, e.g., *Queen City Pizza v. Domino’s Pizza*, 124 F.3d 430, 437–41 (3d Cir. 1997) (“A court making a relevant market determination looks not to the contractual restraints assumed by a particular plaintiff when determining whether a product is interchangeable, but to the uses to which the product is put by consumers in general.”); *but see* Marinescu & Hovenkamp, *supra* note 131, at 1056 (“Assuming the noncompete agreements are enforceable, existing employees of [firms constituting 40% of the relevant labor market] are in a situation of monopsony, since there is only one employer that can hire them for the present job function.”).

<sup>136</sup> This may not be a reasonable assumption for all employees working under a non-compete, as discussed during the workshop. Workshop Tr. (R. Nunn) at 130:1–10 (Jan. 9, 2020). In an apparently significant number of cases, non-compete clauses are imposed on workers *after* they are hired. See also Posner, *supra* note 4, at 16 (citing to literature showing that 30% of employees were asked to sign a noncompete after accepting employment). This is discussed more fully in the section on the Commission’s UDAP authority.

are substitutable for the current job and do not require a non-compete, which would be in the relevant labor market. In that case, it may be difficult for plaintiffs to argue that the non-compete clauses have allowed the dominant firm imposing them to monopsonize that—likely much broader—market.

Employees may argue, however, that by virtue of their on-the-job training and experience, the jobs that are reasonably substitutable for their current jobs are not necessarily the jobs that were available to them at the time of hire. Rather, the effect of the non-compete clauses is to restrain them from pursuing substitute positions for which they would qualify, given their training and experience at the current job. Those positions, which are likely to be higher-paying, are the ones that should be part of any relevant labor market.

The difference between franchising cases like *Queen City Pizza* and these cases thus lies in whether a relevant labor market should be defined *ex ante*, i.e., the options available to an employee when she is accepting the position with the restrictive covenant, or *ex post*, i.e., the options available to her—as well as those closed to her because of the covenant—when she is considering leaving the position with the covenant. The scope of the relevant market *ex post* may well be different from the one *ex ante*, due to the training and experience that the employee receives after she started work.<sup>137</sup> The broader set of jobs that were close substitutes *ex ante* may no longer be close substitutes *ex post* due to the employee’s added training and experience.

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<sup>137</sup> See *Queen City Pizza*, 124 F.3d at 438 (“Here, the dough, tomato sauce, and paper cups that meet Domino’s Pizza, Inc. standards and are used by Domino’s stores are interchangeable with dough, sauce and cups available from other suppliers and used by other pizza companies.”); see generally John M. McAdams, *Non-Compete Agreements: A Review of the Literature* 5–7 (2019) (discussing the theoretical impact of training on wages in light of hold-up and lock-in effects), <https://bit.ly/32XwQri>.

Instead, the *ex post* relevant market may be defined by a narrower range of jobs that are more likely to fall within the scope of the non-compete clause.<sup>138</sup>

From the employer's perspective, however, an *ex post* market definition may underscore the value of the training and experience that is now allowing the employee to differentiate herself in the labor market. That training and experience came at some cost to the employer, who now understandably expects some return on its investment, which the non-compete clause is intended to help secure.<sup>139</sup> The competitive significance of the non-compete clause therefore turns on how reasonable the restriction is in terms of time and scope, relative to the employer's interest in recouping its training investment and the employee's interest in leveraging her training and experience to secure comparable jobs post-termination.<sup>140</sup>

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<sup>138</sup> A concrete example is probably useful here. Suppose that a recent college graduate interviews for legal file clerk positions with law firms and accepts one that offers in-house corporate paralegal training but with a non-compete clause that precludes her from working for other law firm corporate practices in the same city for a one-year period after termination. The employing firm's rationale for the non-compete clause is that its corporate practice competes with the corporate practices of other firms in the city for the deal work of three companies that are headquartered there. The employing firm views the capabilities of its corporate paralegals as integral to its ability to beat out its rivals in beauty contests. In this hypothetical, the *ex ante* market would be a relatively broad, undifferentiated market for legal file clerk positions, which the non-compete clause does not preclude the employee from pursuing. By contrast, the *ex post* market would be a comparatively narrower, more specialized market for corporate paralegal positions, given the employee's training and experience, which the non-compete clause would foreclose, at least as to positions in the same city and for one year following termination.

<sup>139</sup> See McAdams, *supra* note 137, at 13–19 (discussing the empirical evidence regarding the effects of non-competes on investments in intangible assets like training, worker mobility, firm entry, wages and output markets).

<sup>140</sup> Under the 2010 Horizontal Merger Guidelines, the targeted customers might receive price increases from a hypothetical monopolist. In the case of employees subject to non-compete clauses, those employees might receive lower wages because they cannot move to other opportunities. There is at least some evidence that, despite the fact that the imposition of a non-compete provision is something that the employer should bargain for and that should *increase* wages, in fact wages are lower for some employees who are subject to these provisions. See Posner, *supra* note 4, at 18–20 (citing to literature showing the potential impact on wages from non-competes); *but see* McAdams, *supra* note 137, at 17–18 (“There are several channels through which [non-competes] can affect wages, including increasing investments in human and other non-tangible forms of capital, and reducing wage competition by improving the bargaining position of employers and reducing entry of competitors. The empirical evidence on which channel tends to dominate is mixed.”).

A monopsonist may be able to use its market power in the labor market to exclude rivals in a downstream output market that depends on that labor.<sup>141</sup> This theory—likely rare and difficult to observe in real-world settings<sup>142</sup>—could apply in situations that might also accommodate a predatory hiring theory—although the two theories are likely mutually exclusive.<sup>143</sup> Moreover, unlike predatory hiring where the allegedly monopolizing firm must

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<sup>141</sup> See Kevin Caves & Hal Singer, *When the Econometrician Shrugged: Identifying and Plugging Gaps in the Consumer-Welfare Standard*, 26 GEO. MASON L. REV. 395, 423 (2018) (“It follows that a dominant firm with monopsony power in a relevant labor market, or multiple firms capable of collectively exercising monopsony power, could use non-competes to foreclose competition in the labor market.”).

<sup>142</sup> For starters, “[t]raditional monopsony is clearly unrealistic, since employers obviously compete with one another to some extent.” V. Bhaskar, Allan Manning & Ted To, *Oligopsony and Monopsonistic Competition in Labor Markets*, 16 J. ECON. PERSP. 155, 156 (2002) (suggesting that “oligopsony” and “monopsonistic competition” are more accurate terms than “monopsony”). And it has been observed that empirical evidence of monopsonistic competition is “quite mixed.” Douglas O. Staiger, Joanne Spetz & Ciaran S. Phibbs, *Is There Monopsony in the Labor Market? Evidence from a Natural Experiment*, 28 J. LABOR ECON. 211, 212 (2010) (reviewing the literature). See, e.g., William M. Boal & Michael R. Ransom, *Monopsony in the Labor Market*, 35 J. ECON. LITERATURE 86, 110 (1997) (noting, for example, that “[m]onopsonistic exploitation arising from tacitly collusive or Cournot behavior may exist in some professions with small numbers of employers, but the existing evidence is inconclusive”).

<sup>143</sup> See, e.g., *Univ. Analytics, Inc. v. MacNeal Schwendler Corp.*, 914 F.2d 1256, 1258 (9th Cir. 1990) (“Acquiring talent not to use it but to deny it to possible rivals is exclusionary. Such an arrangement has the same harmful tendency and the same lack of redeeming virtue as the promise by a non-employee that he will not compete with the monopolist. But unlike the latter agreement whose existence or nonexistence is a rather clear-cut question, exclusionary employment would be hard to identify.”). *Accord* *Taylor Publ’g Co. v. Jostens, Inc.*, 216 F.3d 465, 480 (5th Cir. 2000); *but see* *Mercatus Grp., LLC v. Lake Forest Hosp.*, 641 F.3d 834, 854 n.12 (7th Cir. 2011) (noting in dictum that the court has never recognized a predatory hiring theory). See also Naidu et al., *supra* note 131, at 598–99.

The reason why an input foreclosure theory based on non-compete clauses and a predatory hiring theory are likely mutually exclusive is because under *Universal Analytics*, predatory hiring requires a showing of predatory intent, “i.e., to harm the competition without helping the monopolist, or by showing a clear nonuse in fact.” 914 F.2d at 1258. Stated differently, the facts do not support a predatory hiring theory if the monopolist’s “primary motivation was to obtain a productive employee for [itself, and [it] had no intention of retaining the employee unproductively.” *Id.* at 1259.

By contrast, an input foreclosure theory does not preclude the monopolist from hiring employees for its own benefit. Although the imposition of non-compete clauses has the simultaneous effect of denying competitors access to those employees, a monopolist may also be using those clauses to “lock up” key employees who take “10 to 12 weeks to train” and “can’t be along [sic] in the unit for six months after they’re trained.” *Total Renal Care, Inc. v. Western Nephrology & Metabolic Bone Disease, P.C.*, 2009 WL 2596493, at \*11 & \*13 (D. Colo. Aug. 21, 2009) (dismissing the plaintiff’s predatory hiring claims but allowing its allegations regarding the defendant’s pattern of baseless lawsuits against former employees based on their non-compete agreements to stand).

As an aside, note that the Supreme Court’s decision regarding predatory bidding in *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.* 549 U.S. 312 (2007), speaks to predatory hiring as well, although no reported decisions have drawn an explicit connection. Although a predatory hiring theory is based on the employment of key workers so as to prevent competitors from hiring them, whereas a predatory bidding theory would involve offering increasingly higher salaries or wages for workers so as to make them unaffordable to competitors, the end result is

actually hire critical employees to keep them from rivals, which is a costly activity,<sup>144</sup> the imposition of non-compete clauses on employees may or may not be a costly strategy.<sup>145</sup> For example, if a firm inserts non-compete clauses into its standard form employment agreements across the board, without regard to employee type or role, and if the majority of its employees are not aware of the inclusion of these clauses until they are advised of the restrictions upon termination of their employment, then the clauses may produce an exclusionary effect, at little or no cost to the employer firm.

Last but not least, the imposition of non-compete clauses in employment agreements may prevent entry by would-be rivals in a downstream product market. Of all the scenarios that may violate the antitrust laws, this one arguably rests most solidly in the Commission's enforcement experience.<sup>146</sup> Specifically, in order to open a commercially viable and competitive dialysis clinic in a given locality, a firm needs a nephrologist to serve as the clinic's physician medical

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the same—forcing rivals to exit the market (or preventing them from entering the market). Such a tactic is costly, especially since the antitrust defendant cannot make productive use of the employees, thereby making recoupment a necessary element of either theory. *Weyerhaeuser*, 549 U.S. at 325 (“A predatory-bidding plaintiff also must prove that the defendant has a dangerous probability of recouping the losses incurred in bidding up input prices through the exercise of monopsony power. Absent proof of likely recoupment, a strategy of predatory bidding makes no economic sense because it would involve short-term losses with no likelihood of offsetting long-term gains.”).

<sup>144</sup> See generally Salop, *supra* note 120, at 675–79 (describing predatory purchasing of an input generally). *But see* Braun & Williams, *supra* note 120, at 3 & 16 (arguing that predatory hiring, although costly, need not be unprofitable in order to be anticompetitive; the hiring can have the desired exclusionary effect *and* be profit-maximizing when taking into account the monopoly rents that the hiring has created).

The use of non-compete clauses to raise rivals' costs should also be considered as a potential anticompetitive theory where rivals' costs to compete with the monopsonist rise as a result of the use of the non-competes. See Salop, *supra* note 120, at 679 (“If [the monopsonists'] output market rivals have materially increased input costs, then they would have the incentive to reduce their output or rise their output prices. Either way, the reduced competition would permit the [monopsonist] to increase both the price it charges for its output and its market share.”).

<sup>145</sup> See Posner, *supra* note 4, at 18–20 (citing to literature showing the potential impact on wages from non-competes).

<sup>146</sup> See, e.g., Matter of Am. Renal Assocs., Inc., FTC File No. 051 0234, 72 Fed. Reg. 53,585 (Sept. 19, 2007). For the case page, see *American Renal Associates, Inc. and Fresenius Medical Care Holdings, Inc.*, FED. TRADE COMM'N, <https://bit.ly/2VR23Lr>.

director.<sup>147</sup> A primary barrier to entry therefore is “the difficulty associated with locating nephrologists with established patient pools who are willing and able to serve as medical directors.”<sup>148</sup> In this setting, the imposition and enforcement of non-compete clauses on nephrologists who serve as medical directors for one chain of dialysis clinics can prevent the entry of rival dialysis clinics into a relevant market.<sup>149</sup> The Commission should continue to monitor settings involving the imposition and enforcement of non-compete clauses on key employees who are critical ingredients for successful market entry to ascertain whether the conduct is both designed to and capable of insulating an incumbent from competition.<sup>150</sup>

## 2. Standalone Theories of Unfair Methods of Competition

The Commission has had the authority to take enforcement action against “unfair methods of competition in or affecting commerce” since the agency was established in 1914.<sup>151</sup> Between then and the passage of the Wheeler-Lea Act in 1938, the agency pursued a line of cases enforcing its UMC authority against deceptive and other “unfair” conduct that was deemed to be a method of competition regardless of whether that conduct violated the Sherman Act.<sup>152</sup> In

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<sup>147</sup> *Id.* at 53,586 (“As a practical matter, having a nephrologist serve as medical director is essential to the success of a clinic because medical directors are the primary source of referrals.”).

<sup>148</sup> *Id.*

<sup>149</sup> *Id.* (alleging a per se unlawful agreement between American Renal Associates (ARA) and Fresenius AG “that Fresenius would not reopen any outpatient dialysis clinics within 10 to 12 miles of the closed facilities for at least five years, and would attempt to enforce the non-compete provisions of its agreements with the medical directors of the closed facilities for ARA’s benefit, preventing those physicians from serving as medical directors for any potential new entrant”).

<sup>150</sup> See generally Maureen K. Ohlhausen & Gregory P. Luib, *Brother, May I?: The Challenge of Competitor Control Over Market Entry*, 4 J. ANTITRUST ENFORCEMENT 111, 128 (2016) (discussing a third “Brother, May I” situation “in which a would-be entrant must effectively rely on its competitor’s permission before entering or expanding its business”). Although the authors chose *FTC v. McWane, Inc.*, to illustrate this situation in their article, a firm that needs to hire key personnel, who are bound by non-compete clauses to its competitor, in order to enter a market is similarly subject to “the whims of its monopolist-competitor to succeed in such entry[.]” *Id.*

<sup>151</sup> See Section 5(a)(2) of the FTC Act, 15 U.S.C. § 45(a)(2) (2018).

<sup>152</sup> *FTC v. R.F. Keppel & Bro., Inc.*, 291 U.S. 304 (1934) (marketing of “games of chance” to children held to be contrary to public policy and therefore an unfair method of competition); *FTC v. Algoma Lumber Co.*,

those cases, several of which advanced to the Supreme Court, the Commission generally used its authority to address deceptive conduct by competitors, but also enforced Section 5 against methods of competition that were deemed contrary to “public policy.”<sup>153</sup> The standard for enforcement in those cases was that the conduct in question had to be (1) a method of competition; (2) “unfair” as that term was understood at the time, and (3) enforcement against the conduct had to be in the public interest and not a private matter.<sup>154</sup> In those cases, the benefit redounding to consumers from enforcement was limited by the fact that the Commission could only go after unfair methods of competition where competition on the merits was possible; where legitimate competition was *impossible* (e.g., the marketing of deceptive weight loss solutions), the Supreme Court found the Commission could not attack illegitimate competition.<sup>155</sup>

As is plain from the holding and language of the *Raladam* case, the principal beneficiaries of these cases were thought to be other competitors, who would be protected against unfair methods of competition, lest they join the offender in a proverbial “race to the bottom.”<sup>156</sup> Consumers benefited as well from a presumably fairer and cleaner state of

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291 U.S. 67 (1934) (deceptive labelling of lumber held to be an unfair method of competition); *FTC v. Winsted Hosiery Co.*, 258 U.S. 483 (1922) (deceptive labelling of underwear held to be an unfair method of competition). *Compare* *FTC v. Raladam Co.*, 283 U.S. 643 (1931) (marketing of obesity cure not an unfair method of competition because there was no fair method of competition in that market).

<sup>153</sup> *Id.*

<sup>154</sup> *See Raladam*, 283 U.S. at 646–47. The conduct had to affect interstate commerce as well.

<sup>155</sup> *Id.* at 647–48 (“The paramount aim of the Act is the protection of the public from the evils likely to result from the destruction of competition or the restriction of it in a substantial degree, and this presupposes the existence of some substantial competition to be affected, since the public is not concerned in the maintenance of competition which itself is without real substance.”).

<sup>156</sup> *Id.* at 649 (“It is obvious that the word ‘competition’ imports the existence of present or potential competitors, and the unfair methods must be such as injuriously affect or tend thus to affect the business of these competitors—that is to say, the trader whose methods are assailed as unfair must have present or potential rivals in trade whose business will be, or is likely to be, lessened or otherwise injured. It is that condition of affairs which the Commission is given power to correct, and it is against that condition of affairs, and not some other, that the Commission is authorized to protect the public.”). *See also Algoma Lumber*, 291 U.S. at 79 (“The careless and the unscrupulous must rise to the standards of the scrupulous and diligent. The Commission was not organized to drag the standards down.”).

competition. But the Commission did not have the enforcement authority at that time to protect consumers directly from unfair conduct like deception or games of chance.<sup>157</sup>

This line of cases generally came to an end after the Wheeler-Lea Act was passed, giving the Commission additional enforcement authority to combat unfair and deceptive acts or practices and the mandate to protect consumers directly. However, the pre-Wheeler-Lea line of cases has never been expressly overruled by the Supreme Court or superseded by an act of Congress.

Although it has on occasion exercised its standalone UMC authority in the years after the passage of the Wheeler-Lea Act, the Commission has not made use of this line of cases since then. Instead, the Commission has episodically used its standalone authority under different theories of unfairness.<sup>158</sup> Although there are exceptions for some conduct where cases were settled with the parties, in general these efforts have fared poorly.<sup>159</sup>

In 2015, as renewed attention was being directed at its potential use of this authority, the Commission issued its Statement of Enforcement Principles Regarding “Unfair Methods of Competition” Under Section 5 of the Federal Trade Commission Act.<sup>160</sup> In that statement, the

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<sup>157</sup> See *R.F. Keppel*, 291 U.S. at 313 (“But here the competitive method is shown to exploit consumers, children, who are unable to protect themselves.”); *Algoma Lumber*, 291 U.S. at 78 (“The courts must set their faces against a conception of business standards so corrupting in its tendency. The consumer is prejudiced if upon giving an order for one thing, he is supplied with something else.”).

<sup>158</sup> See FED. TRADE COMM’N, REPORT ON STANDALONE SECTION 5 TO ADDRESS HIGH PHARMACEUTICAL DRUG AND BIOLOGIC PRICES 2–5 (June 2019), <https://bit.ly/3aAcWp0> [hereinafter DRUG PRICES REPORT].

<sup>159</sup> *Id.* at 2 (“For example, courts expressed concerns that the FTC was substituting its own business judgment for that of the monopolist, was making decisions without showing collusion or anticompetitive effects, was prohibiting parallel conduct without a showing of collusive behavior, and might make enforcement decisions for social, political, or personal reasons.”); see generally Davis, *supra* note 122, at 4–7. Notable in this regard are the trilogy of appellate cases reversing Commission efforts to exercise its standalone UMC authority. *E.I. du Pont de Nemours & Co. v. FTC*, 729 F.2d 128, 139 (2d Cir. 1984); *Boise Cascade Corp. v. FTC*, 637 F.2d 573, 582 (9th Cir. 1980); *Official Airline Guides, Inc. v. FTC*, 630 F.2d 920, 927 (2d Cir. 1980).

<sup>160</sup> SECTION 5 ENFORCEMENT PRINCIPLES, *supra* note 119. See DRUG PRICES REPORT, *supra* note 158, at 3 (“In August 2015, in response to concerns from Members of Congress and others that the FTC’s standalone Section 5 authority was too undefined, the FTC issued a written framework for the application of this authority to acts or practices that fall outside the scope of Sherman Act or Clayton Act violations.”).

Commission announced that future enforcement actions under its standalone authority would follow three principles:<sup>161</sup>

- the Commission will be guided by the public policy underlying the antitrust laws, namely, the promotion of consumer welfare;
- the act or practice will be evaluated under a framework similar to the rule of reason, that is, an act or practice challenged by the Commission must cause, or be likely to cause, harm to competition or the competitive process, taking into account any associated cognizable efficiencies and business justifications; and
- the Commission is less likely to challenge an act or practice as an unfair method of competition on a standalone basis if enforcement of the Sherman or Clayton Act is sufficient to address the competitive harm arising from the act or practice.

However, as the Commission indicated in an accompanying statement, the agency “will continue to rely, when sufficient and appropriate, on the Sherman and Clayton Acts as its primary enforcement tools for protecting competition and promoting consumer welfare.”<sup>162</sup> Moreover, as some have observed, including former Commissioner Maureen Ohlhausen, who dissented from the Commission’s issuance of the policy statement, the principles themselves are too general to provide meaningful guidance as to the type of conduct that might trigger the Commission’s standalone authority.<sup>163</sup>

Consequently, whether the Commission can assert its standalone enforcement authority to ban certain uses of non-compete clauses as an unfair method of competition is not a question

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<sup>161</sup> SECTION 5 ENFORCEMENT PRINCIPLES, *supra* note 119.

<sup>162</sup> Statement of the Federal Trade Commission on the Issuance of Enforcement Principles Regarding “Unfair Methods of Competition” Under Section 5 of the FTC Act, at 1 (Aug. 13, 2015), *published at* 80 Fed. Reg. 57,056, 57,056 (Sept. 21, 2015), <https://bit.ly/2XkwWJl>.

<sup>163</sup> *See, e.g.*, Dissenting Statement of Comm’r Maureen K. Ohlhausen, FTC Act Section 5 Policy Statement, at 2 (Aug. 13, 2015) (“Because the policy statement fails to address past case law or give examples of lawful and unlawful conduct, ... the business community and other agency stakeholders are left guessing whether these previous theories of liability are now revived.”), *published at* 80 Fed. Reg. 57,056, 57,057 (Sept. 21, 2015), <https://bit.ly/2TzUgA5>. *See also* Laura C. Onken & Terry Calvani, *It May Not Be Perfect, But It Is Progress: Reflecting on the FTC’s Section 5 Guidance* 4, 11 CPI ANTITRUST CHRON., Nov. 2015. *See generally* Davis, *supra* note 122, at 2–4 (“As a political document, a number of ambiguities in the text presumably were necessary for the Statement to be voted out at all. But if the Statement is to have much value, the Commission will need to flesh out those ambiguities by its future actions and perhaps follow-up statements.”).

that can be readily answered by consulting its Statement of Enforcement Principles. And while the imposition of non-compete clauses on employees without legitimate business justification or regard to their enforceability in court once might have been proscribed as an unscrupulous or immoral business practice under pre-Wheeler-Lea Section 5 case law, that bygone enforcement era has been replaced by the modern line of cases that developed following the passage of the Wheeler-Lea Act. Under the contemporary and prevailing view, the Commission’s exercise of its standalone authority should be directed at business practices that contravene the policy or spirit of the antitrust laws, such as invitations to collude that can ripen into unreasonable restraints of trade in violation of Section 1 of the Sherman Act.<sup>164</sup>

Critical here is a showing of harm to competition or the competitive process. As the Second Circuit pointed out in *E.I. du Pont de Nemours & Co. v. FTC*, there has to be “evidence of collusive, coercive, predatory, or exclusionary conduct” in order for a challenged business practice to be declared “unfair” under Section 5, or else that practice either must have “an anticompetitive purpose” or lack support by “an independent legitimate reason.”<sup>165</sup> The mere fact that a challenged business practice is widely used within an industry is not enough to trigger standalone Section 5 enforcement. In *Boise Cascade Corp. v. FTC*, the Ninth Circuit made this very point, holding that, in the absence of “collusion or actual effect on competition,” “to allow a finding of a section 5 violation on the theory that the mere widespread use of the practice makes it an incipient threat to competition would be to blur the distinction between guilty and innocent commercial behavior.”<sup>166</sup>

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<sup>164</sup> See *FTC v. Brown Shoe Co.*, 384 U.S. 316, 322 (1966); *Liu v. Amerco*, 677 F.3d 489, 494 (1st Cir. 2012).

<sup>165</sup> *E.I. du Pont de Nemours & Co. v. FTC*, 729 F.2d 128, 140 (2d Cir. 1984).

<sup>166</sup> *Boise Cascade Corp. v. FTC*, 637 F.2d 573, 582 (9th Cir. 1980) (challenging an industry-wide practice of “delivered pricing” that computed a price for southern plywood using rail freight charges for delivery from the West Coast).

The foregoing judicial pronouncements should be taken into account if the Commission is determined to evaluate the applicability of its standalone UMC authority.

**B. Noncompete provisions in employment agreements as unfair or deceptive acts or practices**

Laws designed to protect consumers from unfair or deceptive acts and practices—commonly called “UDAP” laws—are a key component of state and federal consumer protection laws. They have been used as an alternative to common law remedies in tort and contract, which often proved inadequate in addressing fraud in an evolving and more complex economy.<sup>167</sup> In the Wheeler-Lea Act, Congress passed the first UDAP statute in 1938 and gave the Commission enforcement authority.<sup>168</sup> Beginning in the 1960s, states began to adopt similar UDAP laws.

Given that the goal of UDAP laws is to protect consumers, a fundamental question that the Commission should ask is whether UDAP laws should apply at all to non-compete clauses in employment agreements and, if so, why. Put another way: do UDAP laws cover employer-employee relationships as well as business-consumer relationships?<sup>169</sup> If not, they may not be an effective or appropriate tool to address the use of non-compete clauses in employment agreements.

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<sup>167</sup> Prentiss Cox, Amy Wiedman & Mark Totten, *Strategies of Public UDAP Enforcement*, 55 HARV. J. LEGIS. 37, 42 (2018).

<sup>168</sup> Wheeler-Lea Act, Pub. L. No. 75-447, sec. 3, 52 Stat. 111 (1938) (codified, as amended, at 15 U.S.C. § 45(a)(1) (2018)).

<sup>169</sup> See Workshop Tr. (W. Kovacic) at 35:1–9 (Jan. 9, 2020). See, e.g., *Guest-Tek Interactive Entm’t, Inc. v. Pullen*, 665 F. Supp. 2d 42, 46 (D. Mass. 2009) (holding that Massachusetts’ UDAP statute does not extend to employment relationships). *But see* Madigan & Flanagan, *supra* note 4, at 8 (“While consumer laws cannot generally be used to address individual employment issues, illegal non-competes applied broadly to all employees also impact and harm competitor businesses and state economies. This is a harm that state consumer statutes may be equipped to remedy.”).

By their own terms, most state UDAP laws are generally applicable to personal consumer transactions involving products and services.<sup>170</sup> In other words, state UDAP laws typically address the business-consumer relationship. Federal consumer protection laws likewise focus on consumers, although they sometimes address business-to-business relationships.

There is a dearth of case law on the application of UDAP laws to address the use of non-compete clauses in the employment context. To the extent a few courts have addressed the issue, it has been in the context of an employee's claim that the enforcement by an employer of an *invalid* non-compete provision constituted an unfair practice, rather than a claim that an otherwise *valid* non-compete provision was an unfair practice.<sup>171</sup> For example, in *Boudreaux v. OS Restaurant Services, L.L.C.*,<sup>172</sup> the Louisiana district court found that the plaintiff had stated a plausible claim under the Louisiana Unfair Trade Practices Act, sufficient to survive a motion to dismiss, based on his employer's alleged enforcement of a "noncompetition agreement [that] is invalid and unenforceable [because it had no geographical restriction] and that plaintiff's livelihood was substantially impacted."<sup>173</sup>

The absence of relevant case law applying UDAP laws to facially valid non-compete provisions in the employment context is likely due to the existence of other state laws specifically focused on the validity of such non-compete provisions in employment agreements. For example, many states define the parameters of valid non-compete provisions and require that

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<sup>170</sup> Cox, et al., *supra* note 167, at 44.

<sup>171</sup> Indeed, the case law points in the opposite direction—a competitor's inducement of a former employee to breach her non-compete agreement with her former employer may be actionable as an unfair or deceptive act or practice under state UDAP laws. *See, e.g.,* Static Control Components, Inc. v. Darkprint Imaging, Inc., 135 F. Supp. 2d 722, 731 (M.D.N.C. 2001).

<sup>172</sup> No. 14-1169, 2015 U.S. Dist. LEXIS 8090 (S.D. La. Jan. 23, 2015).

<sup>173</sup> *Id.* at \*8–9.

the restrictions be reasonable as to time and location and other factors.<sup>174</sup> Other states ban the enforcement of non-compete provisions in the employment context altogether.<sup>175</sup> As a middle ground, at least one state has banned the use of non-compete provisions with respect to low-wage workers.<sup>176</sup> And the United States Senate is considering the “Workforce Mobility Act of 2019” which would prohibit non-compete provisions in the employment context except in connection with the sale of goodwill or ownership of a business with respect to the owner and/or senior executives.<sup>177</sup>

There are already existing employment-focused laws available to address non-compete provisions in individual cases and other laws, such as the antitrust laws and other targeted state laws, are available to address overall effects of the broad use of non-compete provisions.<sup>178</sup> Thus, “stretching” UDAP laws, which are intended to protect consumers in commercial relationships rather than employees in employment relationships, and further complicating compliance for employers (especially those with employees in multiple states) who are already burdened by a patchwork of varying state and federal employment laws, is not necessary.

## **Topic 5: Rulemaking Authority**

### **A. Historical Context of the FTC’s Rulemaking Authority**

The question of whether the Commission has rulemaking authority on the competition side—i.e., to address “unfair methods of competition in or affecting commerce” proscribed by

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<sup>174</sup> See, e.g., FLA. STA. § 542.335; MASS. GEN. LAWS ch. 149 § 24L.

<sup>175</sup> See, e.g., CAL. BUS. & PROF. CODE § 16600; N.D. CENT. CODE § 9-08-06; COLO. REV. STAT. § 8-2-113.

<sup>176</sup> See 820 ILL. COMP. STAT. 90/10 (“[a] covenant not to compete entered into between an employer and a low-wage employee is illegal and void.”).

<sup>177</sup> Workforce Mobility Act of 2019, S. 2614, 116th Cong. (2019).

<sup>178</sup> See Workshop Tr. (W. Kovacic) at 35:1–9 (Jan. 9, 2020).

Section 5(a)(1) of the Federal Trade Commission Act<sup>179</sup>—rests with the interpretation and application of Section 6(g) of the Act, which grants the Commission the additional powers “[f]rom time to time to classify corporations and (except as provided in section 57a(a)(2) of this title) to make rules and regulations for the purpose of carrying out the provisions of this subchapter.”<sup>180</sup> With the exception of the parenthetical, which was added by Section 202(b) of the Magnuson-Moss Warranty – Federal Trade Commission Improvements Act of 1975,<sup>181</sup> the text of Section 6(g) has remained unchanged since its enactment by Congress in 1914.<sup>182</sup>

Notably, under the Federal Trade Commission Act, the Commission’s rulemaking authority is buried within an enumerated list of investigative powers, such as the power to require reports from corporations and partnerships, for example.<sup>183</sup> Furthermore, the Act fails to provide any sanctions for violating any rule adopted pursuant to Section 6(g). These two features strongly suggest that Congress did not intend to give the agency substantive rulemaking powers when it passed the Federal Trade Commission Act.<sup>184</sup>

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<sup>179</sup> 15 U.S.C. § 45(a)(1) (2018).

<sup>180</sup> 15 U.S.C. § 46(g) (2018).

<sup>181</sup> Magnuson–Moss Warranty – Federal Trade Commission Improvements Act of 1975, § 202(b), Pub. L. No. 93-637, 88 Stat. 2183, 2198 (1975).

<sup>182</sup> Federal Trade Commission Act of 1914, § 6(g), Pub. L. No. 63-203, 37 Stat. 717, 722 (1914). This rulemaking power was originally proposed in the House Bill (H.R. 15613, § 8 – “That the commission may from time to time make rules and regulations and classifications of corporations for the purpose of carrying out the provisions of this Act.”) but not there was no identical or comparable power in the Senate Bill (S. 4160). The provision ended up in the final version of the Act through conference agreement. *See* S. Doc. No. 63-573 (Aug. 25, 1914) (comparative print of the texts of the House Bill, the Senate Bill, and the amendments by conference agreement).

<sup>183</sup> *See* 15 U.S.C. § 46 (2018).

<sup>184</sup> Thomas W. Merrill & Kathryn Tongue Watts, *Agency Rules with the Force of Law: The Original Convention*, 116 HARV. L. REV. 467, 504–05 (2002) (“The failure to provide any sanction for the violation of rules adopted under section 6(g), along with the placement of the rulemaking grant in section 6, which conferred the FTC’s investigative powers, clearly suggests that Congress intended the rulemaking grant to serve as an adjunct to the FTC’s investigative duties, regarding which Congress had not given the agency the authority to act with the force of law.”).

For nearly five decades after its creation, the Commission did not exercise its rulemaking power under Section 6(g) to promulgate substantive rules identifying and prohibiting unlawful trade practices as constituting “unfair methods of competition.” Instead, it chose to enforce Section 5 exclusively through its adjudicative process, employing Section 6(g) merely to promulgate rules of practice and procedure used in the adjudicative setting.<sup>185</sup> It was not until 1962 that the Commission announced its intent to promulgate so-called trade regulation rules—i.e., “rules and regulations applicable to unlawful trade practices which, where relevant to subsequent adjudicative proceedings, may be relied upon by the Commission as provided in § 1.63 (Title 16, Chapter 1, CFR).”<sup>186</sup>

That announcement ushered in the first era of Commission rulemaking, beginning with the Cigarette Rule in 1965.<sup>187</sup> These trade regulation rules were promulgated by the Commission through the informal rulemaking procedures under Section 553 of the Administrative Procedure Act.<sup>188</sup> This was a period during which the courts, including the Supreme Court, recognized that agencies could resolve recurring issues through the promulgation of a general rule instead of proceeding with case-by-case adjudications.<sup>189</sup> For the Commission, this trend culminated with

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<sup>185</sup> See, e.g., *Hunt Foods & Indus., Inc. v. FTC*, 286 F.2d 803, 810 (9th Cir. 1960) (procedural rule governing the service of subpoenas); *Kritzik v. FTC*, 125 F.2d 351, 352 (7th Cir. 1942) (rules of practice addressing the treatment of factual allegations admitted in an answer); *Hill v. FTC*, 124 F.2d 104, 106 (5th Cir. 1941) (same).

<sup>186</sup> Federal Trade Comm’n, Statement of Organization (Revision), 62 Fed. Reg. 4636, 4636 (announcing the establishment of a Bureau of Industry Guidance with a Division of General Rules and Regulations Applicable to Unlawful Trade Practices), *as corrected*, 62 Fed. Reg. 4796, 4797 (May 15, 1962). See also 109 Cong. Rec. 9584 (May 27, 1964) (statement of Rep. Patman referencing and reading into the record a recent speech delivered by Comm’r E. MacIntyre explaining “the new trade regulation rule procedures which procedures are designed to inform all concerned of their obligations under the law and to assure equitable treatment in obtaining compliance with the law”).

<sup>187</sup> *Deceptive Advertising and Labeling of Cigarettes in Relation to the Health Hazards of Smoking*, 16 C.F.R. pt. 408, 30 Fed. Reg. 9485 (July 29, 1965).

<sup>188</sup> 5 U.S.C. § 553 (2018).

<sup>189</sup> *FPC v. Texaco, Inc.*, 377 U.S. 33 (1964). See generally Richard K. Berg, *Re-examining Policy Procedures: The Choice Between Rulemaking and Adjudication*, 38 ADMIN. L. REV. 149, 164 (1986).

the D.C. Circuit’s 1973 decision in *National Petroleum Refiners Association v. FTC*,<sup>190</sup> which upheld the agency’s power to use informal rulemaking to declare the failure to post octane ratings on gasoline pumps to be both an unfair method of competition and an unfair or deceptive act or practice, in lieu of formal adjudication.<sup>191</sup>

That case in turn led to Congress’ passage of the Magnuson-Moss Warranty – Federal Trade Commission Improvement Act in 1975, which granted the FTC specific authority to promulgate rules defining “unfair or deceptive acts or practices,” but imposed several additional requirements over and above the informal rulemaking process under the APA.<sup>192</sup> Magnuson-Moss represented a compromise between those who opposed the idea of giving the FTC broad legislative rulemaking authority, especially when unaccompanied by restrictions on its exercise, and those who thought that the FTC always had rulemaking authority, but acknowledged that explicit codification of that authority would be helpful.<sup>193</sup>

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<sup>190</sup> 482 F.2d 672 (D.C. Cir. 1973), *reversing* 340 F. Supp. 1343 (D.D.C. 1972), *cert. denied*, 415 U.S. 951 (1974). Even though they reach different conclusions, both the D.C. Circuit and district court’s opinions are exhaustive in their treatment of the issues surrounding the interpretation of Section 6(g), and merit close reading.

<sup>191</sup> *Id.* at 698 (“We rely, therefore, on the plain language of Section 6(g) which gives the Commission the authority to “make rules and regulations for the purpose of carrying out the provisions of [Section 5].” *See Mourning v. Family Publications Service, Inc., supra.* We hold that under the terms of its governing statute, 15 U.S.C. § 41 *et seq.*, and under Section 6(g), 15 U.S.C. § 46(g), in particular, the Federal Trade Commission is authorized to promulgate rules defining the meaning of the statutory standards of the illegality the Commission is empowered to prevent.”). In *Mourning v. Family Publications Service, Inc.*, the Supreme Court upheld that the Federal Reserve Board’s rulemaking power to promulgate Regulation Z pursuant to Section 105 of the Truth in Lending Act, which provides that the Board “shall prescribe regulations to carry out the purposes of [the Act].” 411 U.S. 356, 361–62 (1973). The Court held that “[w]here the empowering provision of a statute states simply that the agency may ‘make . . . such rules and regulations as may be necessary to carry out the provisions of this Act,’ we have held that the validity of a regulation promulgated thereunder will be sustained so long as it is ‘reasonably related to the purposes of the enabling legislation.’” *Id.* at 369.

<sup>192</sup> Magnuson–Moss Warranty – Federal Trade Commission Improvements Act of 1975, § 202(a), Pub. L. No. 93-637, 88 Stat. 2183, 2193–98 (1975).

<sup>193</sup> ADMINISTRATIVE CONFERENCE OF THE UNITED STATES RECOMMENDATION 79-1, HYBRID RULEMAKING PROCEDURES OF THE FEDERAL TRADE COMMISSION 2–3 (June 1979).

Although Magnuson-Moss purported to leave the Commission’s rulemaking power under Section 6(g) with respect to unfair methods of competition undisturbed,<sup>194</sup> Congress did nothing to clarify the nature and extent of that authority.<sup>195</sup> And given that Magnuson-Moss was enacted to address concerns raised by *National Petroleum Refiners* and similar cases, it’s hard to see Section 6(g), with its vague and broad language, as providing a firm footing for informal antitrust rulemaking by the Commission. Accordingly, in 1980, the Section observed: “It clearly would be anomalous if the FTC could adopt an antitrust rule based simply on a notice and comment proceeding under the Administrative Procedure Act, while being required to follow the procedural guards Congress mandated for rules in the consumer protection area.”<sup>196</sup>

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<sup>194</sup> See *id.* § 202(a), 88 Stat. at 2193 (“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.”), *codified at* 15 U.S.C. § 57a(a)(2) (2018).

<sup>195</sup> Being a product of compromise, the legislative history of Magnuson-Moss reflects divergent and muddled views about the intent behind Section 202 of the Act. See H. Rep. No. 93-1107 (1974) (committee report accompanying H.R. 7917 with separate and individual views): *compare id.* at 45–46 (committee view that Section 202 “would be the exclusive substantive rulemaking authority of the FTC under the Federal Trade Commission Act. Thus, the Commission would not have rulemaking authority with respect to unfair methods of competition to the extent they are not unfair [or] deceptive acts or practices”), *with id.* at 84–85 (separate view that *National Petroleum Refiners* made “clear in June of 1973 that the Commission did have the authority to issue rules having the substantive force and effect of law” but expressing concern about the “fundamental fairness” of the informal rulemaking procedures under Section 553 of the Administrative Procedure Act); H. Rep. No. 93-1606 (1974) (conference report accompanying S. 356): *id.* at 32 (conferees’ view that the Commission’s substantive rulemaking authority with respect to unfair or deceptive acts or practices is an important power that should be codified but “[t]he conference substitute does not affect any authority of the FTC under existing law to prescribe rules with respect to unfair methods of competition in or affecting commerce”).

The floor statements are likewise divergent and muddled. *Compare* 120 Cong. Rec. S21976, S21978 (1974) (statement of Sen. Hart accompanying conference report on S. 356) (“These provisions and limitations are not intended to affect the Commission’s authority to prescribe and enforce rules respecting unfair methods of competition. Rules respecting unfair methods of competition should continue to be prescribed in accordance with the informal rulemaking procedures of section 553, title 5, United States Code.”), *with* 120 Cong. Rec. H12346, H12348 (1974) (statement of Rep. Broyhill accompanying conference report on S. 356) (“The rulemaking provision, I might add, does not affect any authority the FTC might have to promulgate rules which respect to ‘unfair methods of competition’ including, of course, antitrust prohibitions. I myself do not believe that the FTC has any such authority.... [*National Petroleum Refiners*] did not deal with antitrust rules. Antitrust rules would obviously have a far more pervasive effect than rules defining unfair or deceptive acts or practices, and I would feel very uncomfortable giving such antitrust rules the same effect as this bill gives consumer practice rules.”).

<sup>196</sup> ABA SECTION OF ANTITRUST LAW, REPORT OF THE SECTION CONCERNING FEDERAL TRADE COMMISSION STRUCTURES, POWERS, AND PROCEDURES 340 (1980).

Moreover, the Commission has looked for opportunities to engage in antitrust rulemaking without success, strongly suggesting that antitrust issues do not lend themselves to rulemaking.<sup>197</sup> The only pre-Magnuson Moss antitrust rule that the agency promulgated dealt with price discrimination in men’s and boys’ tailored clothing.<sup>198</sup> It was apparently never enforced, and with the Commission’s publication of the Fred Meyers Guides, it was eventually rescinded.<sup>199</sup> The near-nonexistent record of antitrust rulemaking prompted the Section to observe in 1989: “Although the Commission retains its pre-Magnuson-Moss authority to engage in competition rulemaking, we are not optimistic about the chances that the FTC could codify antitrust-oriented prohibitions on specific types of business conduct.”<sup>200</sup>

There have been no antitrust rules promulgated by the Commission post-Magnuson-Moss. Accordingly, the Section remains skeptical of the Commission’s authority under Section 6(g) of the Federal Trade Commission Act to promulgate antitrust rules—in this case, one banning or limiting the use of non-compete clauses in employment agreements as an unfair

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<sup>197</sup> Indeed, the Commission suggested to Congress that Section 202 of Magnuson-Moss should not curtail its rulemaking authority with respect to unfair methods of competition because “the Commission’s consumer protection responsibilities are more conducive to the rulemaking process, and, for this reason, the Commission does not foresee a high level of rulemaking activity in the antitrust area.” H. Rep. No. 93-1107, at 57 (1974) (committee report accompanying H.R. 7917 with separate and individual views).

Also, commenting on the Commission’s experiment with rulemaking relating to vertical mergers in the cement industry, Commissioner Elman observed: “[T]his much is clear: the object of the Commission’s rulemaking and other administrative procedures in the administration of section 7 is not to promulgate per se rules or codes rigidly demarcating the lawful limits of merger activity. Rulemaking in this area should be regarded as primarily a method of inquiry—of finding the facts respecting specific market situations, appraising their significance, and making public the conclusions reached.” Philip Elman, *Rulemaking Procedures in the FTC’s Enforcement of the Merger Law*, 78 HARV. L. REV. 385, 390 (1964).

<sup>198</sup> Trade Regulation Rule: Discriminatory Practices in Men’s and Boys’ Tailored Clothing Industry, 16 C.F.R. pt. 412 (1968).

<sup>199</sup> Trade Regulation Rule: Discriminatory Practices in Men’s and Boys’ Tailored Clothing Industry, 59 Fed. Reg. 8527 (1994) (notice of repeal of rule); Trade Regulation Rule: Discriminatory Practices in Men’s and Boys’ Tailored Clothing Industry, 58 Fed. Reg. 35907 (1993) (notice of proposed rulemaking).

<sup>200</sup> 1989 REPORT OF THE ABA ANTITRUST SECTION SPECIAL COMMITTEE TO STUDY THE ROLE OF THE FEDERAL TRADE COMMISSION, at 68 n.103 (1989).

method of competition. Antitrust problems are in general too fact-specific and context-specific to lend themselves to a broad sweeping rule.<sup>201</sup> Assuming for the sake of argument that non-compete clauses can raise competition concerns, they would seem to do so only under particular circumstances and conditions, thereby requiring case-by-case adjudication instead of the issuance of a trade regulation rule.

The second era of Commission rulemaking came with the passage of Magnuson-Moss. Magnuson-Moss explicitly and exclusively governs Commission rulemaking with respect to unfair or deceptive acts or practices. The Act replaces informal, notice-and-comment rulemaking under Section 553 of the APA with “hybrid” rulemaking, which incorporates adjudicatory procedures such as the taking of oral testimony and cross-examination, an opportunity for rebuttal where there are disputed issues of fact, and a requirement of specific agency findings.<sup>202</sup> Experience has shown that hybrid rulemaking under Magnuson-Moss can be extremely unwieldy and time-consuming. For example, the Credit Practices Rule and the Mobile Homes Rule have records totaling over 200,000 pages, which, unless they are properly organized, are too voluminous and scattered to be of much use to participants in the rulemaking process.<sup>203</sup>

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<sup>201</sup> The Commission’s own view to Congress about the prospect of antitrust rulemaking was that “where the legality of identical, similar, or related practices of an anticompetitive nature may be addressed responsibly and more efficiently in a single proceeding than in a case-by-case adjudication, law enforcement by rulemaking would be considered more favorably.” H. Rep. No. 93-1107, at 57 (1974) (committee report accompanying H.R. 7917 with separate and individual views).

<sup>202</sup> Magnuson–Moss Warranty – Federal Trade Commission Improvements Act of 1975, § 202(a), Pub. L. No. 93-637, 88 Stat. 2183, 2193–98 (1975), *codified at* 15 U.S.C. § 57a (2018). *See generally* TODD GARVEY, A BRIEF OVERVIEW OF RULEMAKING AND JUDICIAL REVIEW, at 4, CONG. RES. SERV. REP. NO. R41546 (2017); ADMINISTRATIVE CONFERENCE OF THE UNITED STATES RECOMMENDATION 79-1, HYBRID RULEMAKING PROCEDURES OF THE FEDERAL TRADE COMMISSION 3–5 (June 1979).

<sup>203</sup> *See* RECOMMENDATION 79-1, at 10 (June 1979). The Commission and the Administrative Conference of the United States were each directed to conduct a study and evaluation of the rulemaking procedures imposed by Magnuson-Moss and to submit a report of its study with legislative recommendations, if any, within 18 months after the date of the Act’s enactment. Magnuson–Moss Warranty – Federal Trade Commission Improvements Act of 1975, § 202(d), Pub. L. No. 93-637, 88 Stat. 2183, 2198 (1975).

Given the extensive incorporation of adjudicatory procedures under Magnuson-Moss, hybrid rulemaking has been viewed as “ill-suited for the exploration of broad and largely normative issues.”<sup>204</sup> Instead, hybrid rulemaking is more productively and efficiently deployed in settings where the agency’s substantive decisionmaking is structured much like an adjudication, with specific legal and factual boundaries for the inquiry, and specific guidelines regarding what evidence is relevant and probative. “In the absence of such standards, judicialized public proceedings with extensive opportunities to participate can be an enormously expensive way to educate an agency.”<sup>205</sup>

The above observations about the Commission’s use of Magnuson-Moss, which incidentally has progressively diminished over the ensuing decades, suggest that the question of non-compete clauses is likely to be ill-suited to hybrid rulemaking. As presently framed, the perceived “unfairness” of such clauses would seem to raise a broad normative issue, unless the Commission were able to confine its inquiry to, say, a specific class of workers, or a specific industry in which the use of such clauses has been prevalent.

## **B. Additional Considerations for Any Commission Rulemaking with Respect to Non-Compete Clauses**

As the Commission’s historical experience with rulemaking suggests, adjudication may be a superior way to address the potential problem of non-compete clauses.<sup>206</sup> Importantly, case-

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<sup>204</sup> Richard K. Berg, *Re-Examining Policy Procedures: The Choice Between Rulemaking and Adjudication*, 38 ADMIN. L. REV. 149, 166 (1986) (an article by the chair of an ABA Administrative Law Section subcommittee that studied *Ford Motor Co. v. FTC*, 673 F.2d 1008 (9th Cir. 1981), which led to an ABA resolution regarding an agency’s choice between adjudication and rulemaking).

<sup>205</sup> *Id.* at 166.

<sup>206</sup> “When an agency creates rules on a blank slate, it generally has the option of choosing whether to establish new policies through notice-and-comment rulemaking or adjudication.” *Masters Pharm. Inc. v. DEA*, 861 F.3d 206, 219 (D.C. Cir. 2017). “[I]t ‘is well settled that an agency is not precluded from announcing new principles in an adjudicative proceeding,’ and that ‘the choice between rulemaking and adjudication lies in the first instance within the agency’s discretion.’” *POM Wonderful, LLC v. FTC*, 777 F.3d 478, 497 (D.C. Cir. 2015) (quoting *Cassell v. FCC*, 154 F.3d 478, 486 (D.C. Cir. 1998) (internal quotation marks omitted) (advertising substantiation standard

by-case adjudication may more quickly and pointedly lead to the identification of problems associated with the use of non-compete clauses, whether framed as unfair methods of competition, or unfair or deceptive acts or practices, which can in turn serve as the evidentiary basis for commencing the hybrid rulemaking process under Magnuson-Moss. Moreover, remedies negotiated in settlement or imposed after adjudication can provide working templates for a least restrictive rule that sufficiently addresses the antitrust or consumer harms without chilling pro-competitive or pro-innovation uses of non-compete clauses.

Contrary to the *Ford Motor Co. v. FTC* decision, there is no impediment to the Commission using adjudication to announce a new policy or rule, provided that third-party departures from the agency's holdings in the adjudication are not treated as *ipso facto* violations of law.<sup>207</sup> Instead, a third party should be given a meaningful opportunity to persuade the Commission that the new policy or rule is inapplicable to its situation, or that the policy or rule should be modified in some way to account for differences between the third party's situation and that of the respondent in the adjudication.<sup>208</sup>

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applied in the case did not require notice-and-comment rulemaking). And the “fact that an order rendered in an adjudication may affect agency policy and have general prospective application does not make it rulemaking subject to APA section 553 notice and comment.” *Conference Grp., LLC v. FCC*, 720 F.3d 957, 966 (D.C. Cir. 2013) (citation and internal quotation marks omitted).

<sup>207</sup> What *Ford Motor Co. v. FTC* held was that the Commission could not use adjudication to supplant a pending rulemaking proceeding. 673 F.2d 1008, 1010 (9th Cir. 1981), *cert. denied*, 459 U.S. 999 (1982). The Ninth Circuit has clarified *Ford Motor* in subsequent decisions. *See, e.g.,* *Cities of Anaheim, Riverside, Banning, Colton and Azusa, Cal. v. FERC*, 723 F.2d 656, 659 (9th Cir. 1984) (confirming that “[a]dministrative agencies are free to announce new principles during adjudication,” subject to two limiting principles: (1) “agencies may not impose undue hardship by suddenly changing direction, to the detriment of those who have relied on past policy,” and (2) “agencies may not use adjudication to circumvent the Administrative Procedure Act’s rulemaking procedures”). In a situation in which an agency is indeed writing on a blank slate, as would be the case with non-compete clauses, neither limiting principle comes into play.

<sup>208</sup> Berg, *supra* note 204, at 177. Mr. Berg’s suggested safeguards ensure that an agency’s application of a new policy or rule announced through administrative adjudication to other firms within a given industry would not violate their due process rights.

If the Commission is determined to embark on a rulemaking process, then it should take the following considerations into account:

- The Commission should consider whether a definitional rule declaring a particular act or practice involving non-compete clauses to be an unfair method of competition, or an unfair or deceptive act or practice, would be sufficient to address the problem, as opposed to a preventive rule that imposes affirmative requirements on an industry.<sup>209</sup>
- Before promulgating an industry-wide rule, the Commission should develop reliable evidence concerning the prevalence of the use of non-compete clauses in that industry and their harms. Both the Octane Posting Rule at issue in *National Petroleum Refiners* and the Care Labeling Rule addressed information that simply was not being provided by the industry to consumers.<sup>210</sup>
- As already alluded to above, the Commission should ensure that any rule it promulgates represents the least restrictive alternative among possible rule formulations so that the rule does not chill pro-competitive and pro-innovation uses of non-compete clauses.<sup>211</sup>

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<sup>209</sup> Miles Kirkpatrick, *FTC Rulemaking in Historical Perspective*, 48 ANTITRUST L.J. 1561, 1564–65 (1979). See also ABA SECTION OF ANTITRUST LAW, REPORT OF THE SECTION CONCERNING FTC TRADE REGULATION RULEMAKING PROCEDURES PURSUANT TO THE MAGNUSON-MOSS ACT 385–86 (1980) (discussing the differences between definitional and preventive rules).

<sup>210</sup> Kirkpatrick, *supra* note 209, at 1563–64, 1565.

<sup>211</sup> *Id.*, at 1564, 1565.

## Topic 6: Alternatives to Rulemaking

As already discussed under Topic 3, the Commission should consider the implications of rulemaking for federalism, given the history of legislation and regulation at the state level.<sup>212</sup> The agency should be cognizant of pre-existing differences in state legislation and regulation of non-compete clauses, and pay attention to the points where a new federal rule may come into conflict.

Of course, the Commission should also consider the other tools at its disposal besides enforcement and rulemaking—in particular, its unique ability and capacity to provide advocacy and guidance, leveraging its expertise on a broad range of issues relating to competition and consumer protection. The Section respectfully submits that the approaches the agency has taken to other issues—where an analogous question of federalism exists—is instructive. In particular, two examples in the merger-and-acquisition context are salient.

First, consider the Commission’s approach to Certificate of Public Advantage (COPA) regulation. The agency’s position is quite clear on this issue—it views COPA regulations as highly likely to be harmful to consumers and competition.<sup>213</sup> And yet, the Commission has not intruded into state authority over COPA. Instead, it continues to monitor state-specific developments on this front and to advise policymakers as necessary regarding the implications for healthcare competition and consumers.<sup>214</sup>

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<sup>212</sup> See Topic 3 *supra*.

<sup>213</sup> Fed. Trade Comm’n, Statement of the Federal Trade Commission In the Matter of Cabell Huntington Hospital, Inc., Docket No. 9366, July 6, 2016 (“The Commission believes that state cooperative agreement laws such as SB 597 are likely to harm communities through higher healthcare prices and lower healthcare quality.”).

<sup>214</sup> See generally Fed. Trade Comm’n, Staff Notice of COPA Assessment: Request for Empirical Research and Public Comments (Nov. 1, 2017; revised Mar. 27, 2019), <https://bit.ly/2TS4MIQ>; A Health Check on COPAs: Assessing the Impact of Certificates of Public Advantage in Healthcare Markets (Jun. 18, 2019), <https://bit.ly/2Ixa54m>.

A similarly instructive example would be the Commission’s comments to state legislatures regarding professional regulation—another area that traditionally falls within the scope of state police power. See, e.g., Letter from Marina Lao, Dir., Office of Policy & Planning, Fed. Trade Comm’n, and Robert Potter, Chief, Legal Policy Section, U.S. Dep’t of Justice, Antitrust Div., to Hon. Bill Cook, Sen., State of North Carolina (June 10, 2016)

Second, consider the Commission’s approach to merger investigations and challenges. The keys to coordination between individual states and the FTC involve (a) decision making on an individual basis and (b) adherence to a general rules (e.g., Clayton 7 and states’ individual competition laws). Under this cooperative framework, there are many mergers where FTC and states agree, mergers in which states pursue cases that the FTC declines,<sup>215</sup> and mergers in which the FTC pursues mergers that the states do not.

### **Topic 7: Economic Research**

Most empirical research on the effects of non-compete clauses is recent, and much is in working paper form. The research, while mixed, generally finds that workers in states that enforce non-compete clauses have lower wages than similar workers in states that do not enforce such clauses, or that enforce them only to a limited degree. The very limited research on the effect of non-compete clauses indicates that the low-skill/low-wage workers population generally bears negative wage effects, whereas positive wage effects were found in studies that examined high skilled workers.

The research also generally finds that non-compete clauses reduce worker mobility, limit employers’ ability to hire, and dampen entrepreneurship. While mixed on the issue of firm/industry investment and innovation, several studies have found that the enforceability of

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(regarding the definition of the practice of law), <https://bit.ly/2xdJd6O>; Letter from Tara Isa Koslov, Acting Dir., Office of Policy & Planning, Fed. Trade Comm’n; Michael G. Vita, Acting Dir., Bureau of Economics, Fed. Trade Comm’n; & D. Bruce Hoffman, Acting Dir., Bureau of Competition, Fed. Trade Comm’n, to Hon. Jesse Topper, Rep., Commonwealth of Pennsylvania (Jan. 3, 2018) (regarding independent practice by certified nurse practitioners), <https://bit.ly/2PWXwmS>.

<sup>215</sup> For recent examples, *see* State of New York, et al. v. Deutsche Telekom AG, et al. (S.D.N.Y. 2019); State of Washington v. Franciscan Health System, et al., No. C17-5690 BHS (W.D. Wash. 2018); State of California v. Valero Energy Corporation, et al., No. 3:2017cv03786 (N.D. Cal. 2017).

non-compete clauses is associated with more firm-sponsored training of workers, increases in net capital investment rates, the exploration of new fields, and the creation of riskier patents.

Some studies advocate a ban of (or heavy restrictions on) non-compete clauses, particularly as applied to low-skill/low-wage workers. The bases for advocating such restrictions include:

- 1) Employers use non-compete clauses to suppress labor market competition among low-skill, low-wage workers, such as using clauses that are explicitly unenforceable, or crafting illegal or unreasonable terms.
- 2) Low-skill, low-wage workers are much less likely to have access to trade secrets and other intangibles that firms seek to protect through the use of non-compete clauses, but they are nevertheless asked to sign such clauses at a high rate.
- 3) Low-wage workers are less sophisticated regarding bargaining over or understanding their rights under non-compete clauses, and they are less likely or able to hire an attorney ensure their rights are protected.
- 4) Employers face virtually no penalty in requiring workers to sign unreasonable non-compete clauses that are either unenforceable in their state or where unreasonable terms are eventually stricken or revised to be less broad.
- 5) Very few non-compete clauses are challenged via antitrust laws, and such challenges are very difficult.
- 6) The legal remedies available to protect low-wage workers from illegal or unreasonable non-compete clauses appear to be inadequate or ineffective.

The Commission should evaluate the economic support for such proposals carefully. For example, the net effect of non-compete agreements is likely to vary for different types of workers (field, skill/education level, high wage/low wage worker, location, etc.) for a variety of reasons, including differences in contractual terms, worker type and level, labor market sophistication, and demand and supply conditions. As such, sweeping proposals for regulating all non-compete clauses are likely to generate some adverse outcomes as measured by the consumer or total welfare standards.

Very few studies focus on the effects on low-wage workers, and importantly the results from general studies or on studies focusing on high tech or high-wage labor may not extend to the low-wage worker population due to differences in contracting sophistication and the level of substitutability of human capital across occupations and industries. For these reasons, more research on the effect of non-compete clauses on low-wage labor would be helpful, given the general belief and anecdotal evidence that this is a relatively vulnerable population and that non-compete clauses restricting low-wage workers are more likely to be exploitative rather than protective of bona fide firm intangibles.

Further, there has been no academic research that addresses the percentage of employers who have attempted to enforce non-compete clauses through lawsuits or threats to sue, or the percentage of agreements that employers have attempted to enforce through these mechanisms. It is possible that the deterrent effect of imposing non-compete clauses could tend to constrain worker mobility or competition, separate from the incidence of employer enforcement.<sup>216</sup> Such possibilities warrant further research.

Existing empirical research suggests specific additional areas for study. For example, Azar, Marinescu, Steinbaum, and Taska (2019) note there is limited systematic research on the extent to which workers confine their job searches to an education- or skills-delimited segment of available jobs, and therefore, more empirical research is needed addressing workers' propensity to transition into a different job segment in the face of limited job availability.<sup>217</sup>

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<sup>216</sup> See, e.g., Matt Marx & Ryan Nunn, *The Chilling Effect of Non-Compete Agreements*, ECONOFACT (May 20, 2018) (“[E]ven the possibility of legal action by one’s ex-employer produces a ‘chilling effect’ on job mobility. Rather than risk a lawsuit, workers might stay with their current employer or switch industries entirely to comply with the contract.”), <https://bit.ly/3cJIMRV>.

<sup>217</sup> José A. Azar, Ioana Marinescu, Marshall I. Steinbaum & Bledi Taska, *Concentration in U.S. Labor Markets: Evidence from Online Vacancy Data* (NBER Working Paper 24395, Feb. 2019), <https://bit.ly/39zgGqL>.

Marinescu and Posner (Dec. 2018) suggest analyzing whether job “vacancy share” or employment share may be more appropriate for measuring concentration.<sup>218</sup>

## **Topic 8: Market Definition**

If the Commission were to apply a competition analysis to non-compete clauses, several relevant markets can be contemplated for purposes of market definition. Research addressing market definition in labor markets is fairly recent and limited to a small number of researchers. There is no consensus on how best to evaluate market power and define markets and some of the existing research is not particularly robust. The inclusion of a paper in this comment should not be interpreted as the Section’s endorsement of or agreement with its findings. Rather, the Section is merely highlighting to the Commission the extent of the research that has been done to date. Accordingly, the agency should conduct its own research on the most appropriate methods for determining both market power and market definition in labor markets. In addition, the agency should consider and evaluate academic research empirically showing that many firms commonly face a relatively low elasticity of labor supply, including for low-wage workers, suggesting that often firms have monopsony power in labor markets. As such, empirical research that performs a direct effects test on the relevant set of workers may circumvent the need to conduct a market definition analysis. Additional research, such as natural experiments, attempting to measure the direct effects of non-compete clauses on different segments of the labor force would be valuable. Papers addressing relevant market definition include:

- 1) **Posner (Sept. 2019):**<sup>219</sup> Explains that when a plaintiff alleges that a non-compete clause violates antitrust law, the first step should be to identify all the markets in which the non-compete clause may cause harm. There are three types of markets

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<sup>218</sup> Ioana Elena Marinescu & Eric A. Posner, *A Proposal to Enhance Antitrust Protection Against Labor Market Monopsony* (Roosevelt Institute Working Paper, Dec. 2018), <https://bit.ly/3cCY7Uu>.

<sup>219</sup> Posner, *supra* note 4.

to explore: direct labor markets, indirect labor markets, and product markets. However, Posner does not directly address “how” to define the direct or indirect labor markets in this paper.

- 2) **Steinbaum (2019):**<sup>220</sup> Argues for the need to side-step traditional market definition procedures in order to examine market power in labor markets. Examples of factors to consider would include firms’ ability to unilaterally raise prices, wage- or price-discriminate, impose uncompensated contractual provisions on counterparties, impede entry, or earn profits exceeding their market cost of capital.
- 3) **Azar, Marinescu, Steinbaum, and Taska (2019):**<sup>221</sup> Proposes use of a hypothetical monopsonist test analogous to the hypothetical monopolist (SSNIP) test in antitrust product markets to define (direct) labor markets. The essence of such a test is to ask whether significant wage suppression is profitable for firms. Empirical evidence cited by the authors indicates that in general, job search behavior is quite local, implying that labor markets may generally be narrowly defined geographically. The authors calculate HHIs for “baseline” labor markets (*based on the share of vacancies of all firms that post vacancies in a market*) at the occupation (6-digit standard occupational classifications (“SOC”)), commuting zone, and quarterly level.
- 4) **Marinescu and Posner (Dec. 2018):**<sup>222</sup> The authors advocate for the “codification” of antitrust protections for labor markets. They propose and outline a model law that mirrors Section 2 of the Sherman Act, creating liability standards for attempted monopsony and conspiracy to monopsonize, including rules for defining the relevant market, determining market power, outlining allowable affirmative defenses, and anticompetitive acts.
- 5) **Naidu, Posner, Weyl (2018):**<sup>223</sup> Contends that market definition guidelines as described in the Horizontal Merger Guidelines can be used to address monopsony in labor markets (at least in the context of mergers). The authors define market concentration in labor markets in terms of the HHI used in product markets.
- 6) **Naidu and Posner (2018):**<sup>224</sup> Explains that, with respect to defining labor markets, the particularities of such markets may complicate market definition relative to product market definition. Specifically, the authors assert that labor markets are highly fragmented—far more so than most product markets. The

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<sup>220</sup> Marshall I. Steinbaum, *Antitrust, the Gig Economy, and Labor Market Power*, 82 LAW & CONTEMP. PROBLEMS 45 (2019).

<sup>221</sup> Azar et al., *supra* note 217.

<sup>222</sup> Marinescu & Posner, *supra* note 218.

<sup>223</sup> Naidu et al., *supra* note 131.

<sup>224</sup> Suresh Naidu & Eric A. Posner, *Labor Monopsony and the Limits of the Law* (Working Paper, Jan. 13, 2019), <https://bit.ly/3cJrVyH>.

reason is that people are less mobile than goods, with the result that labor market areas are typically (though not always) smaller than product market areas.

## **Appendix A. List of Contributing Section Members**

The ABA members responsible for these comments include task force co-chairs Hollis Salzman and Koren Wong-Ervin, and drafters Matthew Adler, Wendy Arends, Kay Lynn Brumbaugh, Michaelyn Corbett, Rob Davis, Michael Gleason, Melanie Hallas, Dean Harvey, January Kim, Jim Langenfeld, Chris Ring, Deena Jo Schneider, Yaman Salahi, Henry Su, Mark Tobey, and Paul Wong.

## **Appendix B. Review of Economic Literature Regarding Non-Compete Clauses**

### **A. Economic Research on Non-Compete Clauses That Has Been Undertaken**

There are a number of studies that advocate a ban of (or heavy restrictions on) non-compete clauses. These studies offer six bases.<sup>225</sup> The first basis is evidence that employers are using non-compete clauses to suppress labor market competition among low-skill, low-wage workers, such as the use of non-compete clauses even in states where it is explicitly unenforceable, or the crafting of terms that are illegal or unreasonable, suggests that firms can generally implement non-compete clauses on low-wage workers as a way to reduce labor and turnover costs, and create obstacles for competitive firms to hire workers. Research finds that a significant number of non-compete clauses are imposed on workers, even in states (such as California) where it is completely unenforceable, which informs the actual motivations for such clauses.

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<sup>225</sup> See, e.g., Alan B. Krueger & Eric A. Posner, *A Proposal for Protecting Low-income Workers from Monopsony and Collusion* (The Hamilton Project Policy Proposal 2018-05, Feb. 2018), <https://bit.ly/32YSWd4>; Starr et al., *supra* note 34; Michael Lipsitz & Evan Starr, *Low-Wage Workers and the Enforceability of Non-Compete Agreements* (Working Paper, Dec. 9, 2019) (“The results herein, combined with the fact that more than 40 states do not currently have NCA bans for low-wage workers, make banning NCAs for low-wage workers an opportunity to improve the lives of the lowest earning workers.”), <https://bit.ly/3cG2cXU>. The Open Market Institute advocates for a general ban of non-compete clauses. See Open Mkts. Institute et al., *Petition for Rulemaking to Prohibit Worker Non-Compete Clauses*, filed with the Fed. Trade Comm’n (Mar. 2019), <https://bit.ly/2PWLHwO>.

The second basis is that low-skill, low-wage workers are much less likely to have access to trade secrets and other intangibles that firms seek to protect through the use of non-compete clauses but are nevertheless asked to sign non-compete clauses at a high rate.<sup>226</sup> Other research surveying workers (rather than firms) finds that about 18% of those earning less than \$40,000/annually were bound by a non-compete clause.<sup>227</sup> Often vague and unsubstantiated reasons are offered by employers for imposing non-compete clauses on low wage workers.

The third basis is that low wage workers are less sophisticated regarding bargaining over or understanding their rights under non-compete clauses, and are less likely or able to hire an attorney to counsel them or ensure their rights are protected. Additionally, a large percentage of those who sign are asked to do so after already accepting a job when they have reduced leverage to refuse; very few ask for or receive consideration for signing a non-compete clause. Many low skill, low-wage workers are unaware that they have actually signed non-compete clauses until they are ready to depart their employer for another job. They are more susceptible to threats from their (former) employers regarding enforcement of non-compete clauses.

The fourth basis is that employers face virtually no penalty in requiring workers to sign unreasonable non-compete clauses that are either unenforceable in their state or where unreasonable terms are eventually stricken or revised to be less broad. This increases the probability that restrictive non-compete clauses will be imposed on workers, especially low wage workers.

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<sup>226</sup> For example, a December 2019 Economic Policy Institute (EPI) study found that 29% of firms responding to its survey where the average wage is less than \$13.00/hour use non-compete clauses for all their workers. Alexander J.S. Colvin & Heidi Shierholz, *Noncompete Agreements* (Econ. Policy Institute, Dec. 10, 2019), <https://bit.ly/2v0wh3s>. See also TREASURY REPORT, *supra* note 30.

<sup>227</sup> Johnson, Lavetti, and Lipsitz (2019) similarly find that 30% of hair stylists signed non-compete agreements. Despite the fact that non-compete agreements are more prevalent among high-wage workers, hourly workers make up 53% of non-compete signers across the US (with median earnings of \$14.22 per hour) because they make up such a large segment of the US labor force. Johnson et al., *supra* note 107. See also Starr et al., *supra* note 34.

The fifth basis is that very few non-compete clauses are challenged via antitrust laws, and those that are, face insurmountable hurdles and are rarely successful (e.g., difficult to prove market-wide impact).<sup>228</sup>

The sixth basis is that, more generally, the legal remedies available to protect low-wage workers from illegal or unreasonable non-compete clauses appears to be inadequate or ineffective, whether they evolve from common law or antitrust. Workers generally cannot afford to bring lawsuits, let alone antitrust cases, on their own. Even class action labor market antitrust matters face significant challenges and are relatively rare.<sup>229</sup> Most class actions are on behalf of professionals or specialists rather than vulnerable low wage populations.

It is important for the Commission to evaluate the economic support for restrictions on the use of non-compete clauses carefully. For example, the net effect of non-compete agreements is likely to vary for different types of workers (field, skill/education level, high wage/low wage worker, location, etc.) for a variety of reasons, including differences in contractual terms, worker type and level, labor market sophistication, and demand and supply conditions. As such, sweeping proposals for regulating all non-compete clauses are likely to generate some adverse outcomes as measured by the consumer or total welfare standards.

The vast majority of the existing empirical research on the effects of non-compete clauses has been done in the last several years, with many in working paper format and so may be regarded as preliminary. This research examines the following areas with respect to the net effect of non-competes:

- a. Effect on wages,
- b. Effect on worker mobility, hiring, and entrepreneurship, and

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<sup>228</sup> Posner, *supra* note 4, at 6 (“A search in the Westlaw database yielded a grand total of zero cases in which an employee noncompete was successfully challenged under the antitrust laws.”).

<sup>229</sup> Naidu et al., *supra* note 131, at 572–73.

c. Effect on firm and industry training, investment, and innovation.

### 1. Wages

Empirical studies on the wage effects of non-compete clauses are mixed,<sup>230</sup> although more have generally found that workers in states that enforce non-compete clauses earn less than similar workers in states that do not enforce non-compete clauses or enforce them only to a limited degree.<sup>231</sup> Additionally, other research has found that the negative wage effects of non-compete clauses spill over to others not bound by them.<sup>232</sup> Moreover, the results from general studies or on studies focusing on high tech or high-wage labor may not extend to the low-wage worker population due to differences in contracting sophistication and the level of substitutability of human capital across occupations and industries.

Few studies focus on low-wage workers. Starr (2019) examined broad segments of the labor market, and documented that the negative wage effects of non-compete enforceability are generally borne by those with less education.<sup>233</sup> A paper by Lipsitz and Starr specifically examined the impact of non-compete clauses on lower wage (hourly) workers, and found that the

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<sup>230</sup> For example, studies that find *positive wage effects* from non-compete clauses include Omesh Kini, Ryan Williams & David Yin, *Restrictions on CEO Mobility, Performance-Turnover Sensitivity, and Compensation: Evidence from Non-Compete Agreements* (Working Paper, May 29, 2018), <https://bit.ly/2ItWcUj>; and Kurt Lavetti, Carol Simon & William D. White, *The Impacts of Restricting Mobility of Skilled Service Workers: Evidence from Physicians*, J. HUMAN RES. (Feb. 7, 2019), <https://bit.ly/332indR>. As noted in the body of this Appendix, these studies focus on highly skilled and high earning workers such as physicians and corporate CEOs, and therefore do not inform the current debate as to low-wage workers.

<sup>231</sup> The following studies find that non-compete clauses have a *negative effect on wages*: Starr, *supra* note 88; Mark J. Garmaise, *Ties that Truly Bind: Noncompetition Agreements, Executive Compensation, and Firm Investment*, 27 J. LAW, ECON. & ORG. 376 (2011); Balasubramanian et al., *supra* note 133; Lipsitz and Starr, *supra* note 223; Johnson et al., *supra* note 107; Thor Berger & Carl Benedikt Frey, *Industrial Renewal in the 21st Century: Evidence from U.S. Cities*, 51 REGIONAL STUDIES 404 (2017); Starr et al., *supra* note 106; Zhaozhao He & M. Babajide Wintoki, *Non-Competes and Profit Generation by Corporate Employees* (Working Paper, July 6, 2018), <https://bit.ly/2Xcbaa0>.

<sup>232</sup> See Starr et al., *supra* note 106; Johnson et al., *supra* note 107.

<sup>233</sup> Starr, *supra* note 88; Lipsitz & Starr, *supra* note 225.

2008 Oregon ban on non-compete clauses increased hourly wages for workers covered by non-compete clauses as well as workers not covered by non-compete clauses.<sup>234</sup>

For the above reasons, more research on the effect of non-compete clauses on low-wage labor would be helpful given the general belief and anecdotal evidence that this is a relatively vulnerable population and non-compete clauses restricting low-wage workers are more likely to be exploitative rather than protecting bona fide firm intangibles, and the limited number of studies that have been conducted to confirm the anecdotal evidence.

## **2. Worker Mobility, Hiring, and Entrepreneurship**

Non-compete clauses function to limit the set of potential employers available to workers who sign them, and research suggests such clauses reduce worker mobility. These findings are corroborated across different research samples and methodological approaches.<sup>235</sup> In addition, empirical research finds that non-compete clauses also negatively affect employers' ability to hire the workers they want to hire.<sup>236</sup> Also, many recent studies that examined the relationship

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<sup>234</sup> Lipsitz & Starr, *supra* note 225.

<sup>235</sup> Starr et al., *supra* note 34; Lavetti et al., *supra* note 230; Balasubramanian et al., *supra* note 133; Starr et al., *supra* note 106. For patent holders, see Matt Marx, Deborah Strumsky & Lee Fleming, *Mobility, Skills, and the Michigan Non-Compete Experiment*, 55 MGMT. SCI. 875 (2009). For executives, see Garmaise, *supra* note 231. For tech workers, see Bruce Fallick, Charles A. Fleischman & James B. Rebitzer, *Job-Hopping in Silicon Valley: Some Evidence Concerning the Microfoundations of a High-Technology Cluster*, 88 REV. ECON. & STATISTICS 472 (2006). For workers on LinkedIn, see Jeffers, *supra* note 89.

<sup>236</sup> See, e.g., Evan Starr, Martin Ganco & Benjamin A. Campbell, *Strategic Human Capital Management in the Context of Cross-Industry and Within-Industry Mobility Frictions*, 39 STRATEGIC MGMT. J. 2226 (2018); Michael Ewens & Matt Marx, *Founder Replacement and Startup Performance*, 31 REV. FIN. STUDIES 1532 (2018); Evan Starr, Natarajan Balasubramanian & Mariko Sakakibara, *Screening Spinouts? How Noncompete Enforceability Affects the Creation, Growth, and Survival of New Firms*, 64 MGMT. SCI. 552 (2017); Natarajan Balasubramanian, Mariko Sakakibara, Evan Starr & Seethalakshmi Ramanathan, *Association between Restricting Physician Noncompete Agreements and Healthcare Access* (Working Paper, Nov. 2019) (under review); Jeffers, *supra* note 89. Nevertheless, there are some discrepancies in the growing literature. Sampsa Samila & Olav Sorenson, *Non-Compete Covenants: Incentives to Innovate or Impediments to Growth*, 57 MGMT. SCI. 425 (2011).

between non-compete enforceability and entrepreneurship generally found that the enforceability of non-compete clauses dampens entrepreneurship and new firm creation.<sup>237</sup>

### 3. Training, Investment, and Innovation

Several studies have found that the enforceability of non-compete clauses is associated with more firm-sponsored training of workers (although nevertheless, often not resulting in higher wages), increases in net capital investment rates, the exploration of new fields, and the creation of *riskier* patents.<sup>238</sup> However, at least one study documents a negative relationship between non-compete enforceability and firm investment per capita.<sup>239</sup> Berger and Frey (2017) found a reduction in technological dynamism in Michigan after the state repealed its ban on non-compete clauses.<sup>240</sup> Other empirical evidence suggests that the mobility-inhibiting effects of non-compete enforceability, on net, works to dampen knowledge flows and reduce new venture formation (as noted above).<sup>241</sup> Additional research on the firm-level effect of non-compete clauses on innovative activity is warranted given that the current consensus may appear

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<sup>237</sup> Starr, Balasubramanian & Sakakibara, *supra* note 236; Toby E. Stuart & Olav Sorenson, *Liquidity Events and the Geographic Distribution of Entrepreneurial Activity*, 48 ADMIN. SCI. Q. 175 (2003); Samila & Sorenson, *supra* note 236; Balasubramanian et al., *supra* note 236; Matt Marx, *Punctuated Entrepreneurship (Among Women)* (U.S. Census Bureau, Center for Economic Studies Working Paper 18-26, May 2018), <https://bit.ly/2TxjUFG>. One study finds no effects of non-compete enforceability on entrepreneurship. Gerald Carlino, *Do Non-Compete Covenants Influence State Startup Activity? Evidence from the Michigan Experiment* (Federal Reserve Bank of Philadelphia Working Paper 17-30, Sept. 21, 2017), <https://bit.ly/2TRdcZR>.

<sup>238</sup> Starr et al., *supra* note 34; Raffaele Conti, *Do Non-Competition Agreements Lead Firms to Pursue Risky R&D Projects?*, 35 STRATEGIC MGMT. J. 1230 (2014); Sam Arts & Lee Fleming, *Paradise of Novelty – Or Loss of Human Capital? Exploring New Fields and Inventive Output*, 29 ORG. SCI. 1074 (2018); Starr et al., *supra* note 236; Jeffers, *supra* note 89; Liyan Shi, *Restrictions on Executive Mobility and Reallocation: The Aggregate Effect of Non-Competition Contracts* (Society for Economic Dynamics Working Paper 852, Feb. 2019), <https://bit.ly/2vROvgd>.

<sup>239</sup> Garmaise, *supra* note 231.

<sup>240</sup> Berger & Frey, *supra* note 231.

<sup>241</sup> Starr et al., *supra* note 236; Stuart & Sorenson, *supra* note 237.

inconclusive, and research has tended to focus on discrete effects under the broad umbrella of firm investment and innovation.

## **B. How to Define the Relevant Market When Applying a Competition Analysis to Non-Compete Clauses**

If the Commission were to apply a competition analysis to non-compete clauses, several relevant markets can be contemplated for purposes of market definition. Some of the specific findings and issues regarding market definition that have been raised in the literature are discussed below. Research addressing market definition in labor markets is fairly recent and limited to a small number of researchers. As can be surmised from the different studies discussed below, there is no consensus on how best to evaluate market power and define markets. Accordingly, the Commission should conduct further research on the most appropriate methods for determining both market power and market definition in labor markets.

In addition, the Commission should consider academic research showing that many firms commonly face a relatively low elasticity of labor supply, including for low-wage workers, suggesting that often firms may have monopsony power or, more accurately, enjoy some degree of monopsonistic competition, in labor markets.<sup>242</sup> As such, empirical research that performs a direct effects test on the relevant set of workers may circumvent the need to conduct a market definition analysis. Additional research, such as natural experiments, attempting to measure the direct effects of non-compete clauses on different segments of the labor force would be valuable.

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<sup>242</sup> Naidu et al., *supra* note 131, at 564 (“[R]ecent evidence suggests that low labor elasticities, ranging from 1 to 5 (and possibly even lower), are surprisingly common throughout the economy. Even the residual supply of low-skill labor is relatively inelastic, in the range of 1 to 3, despite the earlier conventional wisdom that inelastic labor markets were caused by the time and cost of obtaining education and specialized training, which low-skill workers, by definition, lack.”); Boal & Ransom, *supra* note 142, at 110 (“Monopsonistic exploitation arising from supply frictions, whether modeled as differentiation or search, is probably widespread but small on average.”). *See also* José Azar, Emiliano Huet-Vaughn, Ioana Elena Marinescu, Bledi Taska & Till von Wachter, *Minimum Wage Employment Effects and Labor Market Concentration* (NBER Working Paper No. 26101, July 2019), <https://bit.ly/3c1af61>; Pedro S. Martins, *Making Their Own Weather? Estimating Employer Labour-Market Power and Its Wage Effects* (Working Paper, Oct. 24, 2018), <https://bit.ly/3aEj2F0>.

**1. Posner (Sept. 2019)<sup>243</sup>**

Posner explains that when a plaintiff alleges that a non-compete agreement violates antitrust law, the first step should be to *identify all the markets in which the non-compete agreement may cause harm*. There are three types of markets to explore: direct labor markets, indirect labor markets, and product markets. However, *Posner does not directly address “how” to define the direct or indirect labor markets* in this paper.

Posner argues that the application of the “rule of reason” to non-compete clauses in Section 1 cases is a mistake, and also the death knell for most such cases. He argues that because the empirical literature shows that non-compete clauses typically cause anticompetitive harm in the form of lower wages for workers,<sup>244</sup> such clauses should be regarded as presumptively illegal—possibly under the *per se* standard. Courts should not demand proof of market power, and should be more skeptical of the employer’s business justification than under the rule of reason.

Regarding Section 2 cases, Posner says the major challenge is proving that the defendant is a monopolist. The usual threshold is market share of 70-80%, though sometimes as low as 50%, and those thresholds are often hard to meet. In merger reviews, the FTC and Justice Department start worrying about mergers when the HHI is 1500 or higher. Whether or not they are too low for product-market cases, *Posner contends they should be lower for labor markets than product markets because of the evidence that non-compete clauses reduce wages*.

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<sup>243</sup> Posner, *supra* note 4.

<sup>244</sup> As noted above, however, not all studies find negative wage impacts of non-compete clauses, especially for high earning individuals.

## 2. Steinbaum (2019)<sup>245</sup>

The author advocates for the need to side-step traditional market definition procedures in order to examine market power in labor markets. Specifically, antitrust’s definition of market power must, in turn, be expanded beyond the confined market-share-based Sherman Act jurisprudence to take account instead of the many ways economists have of testing for the existence of market power. Firms would be judged to have market power if they:

- Have the power to unilaterally raise prices for their customers or lower them for their suppliers, including workers;
- Wage- or price-discriminate among customers, suppliers, or workers;
- Unilaterally impose non-price, uncompensated contractual provisions on their counterparties, like non-compete agreements in labor contracts;
- Impede or control entry by would-be competitors; or
- Earn profits and/or make payments to their shareholders at a rate in excess of their market cost of capital.

According to Steinbaum, all of these things are economic indicia of market power because they could not be done by any one or more firms acting in concert in the face of competition from rivals—therefore they should be legal indicia of market power as well.

## 3. Azar, Marinescu, Steinbaum, and Taska (2019)<sup>246</sup>

Azar, Marinescu, Steinbaum, and Taska discuss a potential approach to market definition of (direct) labor markets. In particular, the authors make use of a hypothetical monopsonist test analogous to the hypothetical monopolist (SSNIP) test in antitrust product markets. The essence of such a test is to ask whether significant wage suppression is profitable for firms; the

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<sup>245</sup> Steinbaum, *supra* note 220.

<sup>246</sup> Azar et al., *supra* note 217.

profitability of wage suppression depends on how many workers will quit in the face of wage suppression, i.e., the labor supply elasticity.<sup>247</sup> The authors calculate HHIs for “baseline” labor markets (*based on the share of vacancies of all firms that post vacancies in a market*)<sup>248</sup> at the occupation (6-digit standard occupational classifications (“SOC”))<sup>249</sup>, commuting zone,<sup>250</sup> and quarterly level.<sup>251</sup> Some noteworthy findings:

- Empirical evidence cited by the authors indicates that in general, job search behavior is quite local, implying that labor markets may generally be narrowly defined geographically.
- Using their broad baseline definition of markets (which they argue is very conservative), the authors found that 60% of markets are highly concentrated (above 2,500 HHI) by DOJ/FTC standards and another 11% are moderately concentrated.<sup>252</sup> When weighted by BLS total employment, the authors find that 20% of workers work in highly concentrated labor markets and 8% work in moderately concentrated labor markets. Most preliminary research shows that labor market concentration (using various measures of labor markets) is

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<sup>247</sup> Note that ultimately there may not be consensus in how to assess firm profitability in the context of worker quits.

<sup>248</sup> Other researchers have looked at overall employment concentration, rather than vacancy concentration. The appropriate unit of measure of concentration is an area worth further consideration. Regardless the evidence shows that labor market concentration is robustly negatively correlated with wages. *See, e.g.,* Kevin Rinz, Labor Market Concentration, Earnings Inequality, and Earnings Mobility (CARRA Working Paper 2018-10, Sept. 24, 2018), <https://bit.ly/2wAXzy2>; Efraim Benmelech, Nittai Berman & Hyunseob Kim, *Strong Employers and Weak Employees: How Does Employer Concentration Affect Wages* (NBER Working Paper No. 24307, Nov. 2019), <https://bit.ly/3cGb2oK>; Brad Hershbein, Claudia Macaluso & Chen Yeh, *Concentration in U.S. Local Labor Markets: Evidence from Vacancy and Employment Data* (Working Paper, Mar. 15, 2019), <https://bit.ly/3cISRhZ>.

<sup>249</sup> In their research brief, the authors assert: “For the purpose of monopsonization, just as in merger review, the rule of thumb for labor market definition should be a 6-digit SOC code by commuting zone. This rule of thumb could be modified with evidence that the labor market over which a hypothetical monopsonist could impose a wage reduction is either wider or narrower.” José Azar, Ioana Marinescu & Marshall Steinbaum, *Antitrust and Labor Market Power* 6 (Econ. for Inclusive Prosperity Policy Brief 12, May 2019), <https://bit.ly/38EwJ5v>.

<sup>250</sup> Commuting zones are geographic area definitions based on clusters of counties that were developed by the United States Department of Agriculture (USDA), using data from the 2000 Census on commuting patterns across counties, to capture local economies and local labor markets in a way that is more economically meaningful than county boundaries. Marinescu and Rathelot (2018) show that 81% of applications on CareerBuilder.com are within the commuting zone, with the probability of submitting an application strongly declining in the distance between the applicant’s and the job’s zip code. *See* Ioana Marinescu & Ronald Rathelot, *Mismatch Unemployment and the Geography of Job Search*, 10 AM. ECON. J.: MACROECONOMICS 42, 47 (July 2018).

<sup>251</sup> *See also* Marinescu & Posner, *supra* note 218 (proposing the same/similar market definition approach to labor markets).

<sup>252</sup> When using *standardized job titles* to define occupational labor markets, the authors find that 78% of markets are highly concentrated. Azar et al., *supra* note 217, at 16.

significantly negatively correlated with occupational wages across defined labor markets, but not with product market concentration.<sup>253</sup>

- There is limited systematic research on the extent to which workers confine their job searches to an education- or skills-delimited segment of available jobs,<sup>254</sup> therefore, more empirical research is needed addressing workers' propensity to transition into a different job segment in the face of limited job availability. This should be an issue of further exploration when it comes to determining the contours of relevant labor markets.
- The authors propose the hypothetical monopsonist test to define the relevant antitrust market as the smallest labor market for which a hypothetical monopsonist that controlled that labor market would find profitable to implement a "small but significant non-transitory reduction in wages" (SSNRW), which is the analogue to the hypothetical monopolist SSNIP test (p. 10).<sup>255</sup> While the literature suggests that most individual firms face such a low elasticity of labor supply so that most firms can be seen as a labor market unto its own, the authors take a less radical approach of defining a relevant market as a 6-digit SOC, which they note is likely too broad, thereby underestimating concentration as measured by HHI.<sup>256</sup>
- For manufacturing, the authors show that labor market concentration is barely correlated with product market concentration, which shows that, practically speaking, it would make a difference if antitrust authorities examined labor market definition and concentration rather than product market definition and concentration when investigating effects on labor markets. With respect to concentration measures, it is worth noting that the extent of Non-compete clauses in a marketplace, which is largely unknown, can mask the true measures of concentration with respect to labor markets since they "silently" impede mobility.

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<sup>253</sup> A predecessor paper, Azar, Marinescu and Steinbaum (2019), uses a data set from CareerBuilder rather than the Burning Glass Technologies data and uses "posted wages" found in job vacancy listings to estimate labor supply elasticities. José Azar, Ioana Marinescu & Marshall Steinbaum, *Labor Market Concentration* (NBER Working Paper No. 24147, Feb. 2019), <https://bit.ly/38C9BV0>. One critique of the authors' approach of the estimation is that at least for a subset of jobs (e.g., high wage jobs) the posted wage may be a poor proxy of the actual wage that is consummated with an employee. *But some differences in the measures of labor supply elasticity (see Webber (2015) for example) suggest that more work on the definition of boundaries of the labor market is required.*

<sup>254</sup> Marinescu & Rathelot, *supra* note 250, provide some evidence on search across occupations.

<sup>255</sup> Given that workers do transition occasionally across essentially any market, it is not reasonable to define a market by the requirement that no worker ever goes outside the boundaries of this market. Instead, a market can conceptually be defined by a threshold level of across-market transitions such that if transitions are above this threshold, the market is too narrow, and if they are below this threshold, the market is too broad.

<sup>256</sup> The authors note that a "job title" may alternatively serve as a legitimate labor market for the purposes of antitrust analysis, based on their finding that the elasticity of labor supply for job titles is about 1.5, which is below the critical elasticity of 2 implied by a 45% markdown on wages. Azar et al., *supra* note 217, at 12–13.

#### **4. Marinescu and Posner (Dec. 2018)<sup>257</sup>**

The authors advocate for the “codification” of antitrust protections for labor markets. They propose and outline a model law that mirrors Section 2 of the Sherman Act, creating liability standards for attempted monopsony and conspiracy to monopsonize, including rules for defining the relevant market, determining market power, outlining allowable affirmative defenses, and anticompetitive acts.

One issue worth further investigation is whether job “vacancy share” or employment share may be more appropriate for measuring concentration. The authors claim that vacancy share is more appropriate from an economic theory standpoint because if few or no vacancies exist in an area, then employers possess significant market power, as their workers have few other options (this point was also discussed above).

#### **5. Naidu, Posner, Weyl (2018)<sup>258</sup>**

The authors contend that market definition guidelines as described in the Horizontal Merger Guidelines can be used to address monopsony in labor markets (at least in the context of mergers) as well as product markets. This includes employing an SSNRW test (the analogue to the SSNIP test) to define relevant markets, or using the “downward wage pressure” approach or a merger simulation approach. Some issues raised by the authors include consideration of the labor market as a “matching market” so that the needs of firms and preferences of workers help determine the bounds of the market. Along this line, complicating issues include a better

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<sup>257</sup> Marinescu & Posner, *supra* note 218.

<sup>258</sup> Naidu et al., *supra* note 131.

understanding of how far heterogeneous workers are willing to commute to jobs and under what conditions.<sup>259</sup>

The authors propose that, analogous to typical product market thresholds, a 5% decrease in wages in one year could be employed when estimating an SSNRW;<sup>260</sup> however, more research is needed to determine if this is a reasonable threshold in the context of labor markets.

The authors define market concentration in labor markets in terms of the HHI used in product markets. In labor markets, HHI equals the sum of the squared of the share of the labor market. But the authors do not go into detail regarding the nuances of the various types of specialized vs. general labor of a tentatively defined labor market and this issue likely deserves more scrutiny. Also, the HHI method does not take account that different employers within a market may be different quality substitutes for each other in a way that HHI obscures (e.g., day vs. night shift or employee vs. independent contractor). The authors suggest that use of the diversion ratio approach may help to overcome some of the weaknesses of the HHI. Thus, it is worth considering whether the HHI measure overestimates the options available to workers since, as described above, labor markets (unlike product markets) can be viewed as two-sided (i.e., meaning, workers not only have to find an employer, but one who is willing to hire them).

## **6. Naidu and Posner (2018)<sup>261</sup>**

With respect to defining labor markets, the authors point to particularities of such markets that may complicate market definition relative to product market definition. Specifically, the authors assert that labor markets are highly fragmented—far more so than most product markets.

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<sup>259</sup> *Id.* at 575.

<sup>260</sup> *Id.* at 575–76.

<sup>261</sup> Naidu & Posner, *supra* note 224.

The reason is that people are less mobile than goods, with the result that labor market areas are typically (though not always) smaller than product market areas. To understand this point, consider, for example, that the market for farm equipment is national in scope, and hence an agency or court that evaluates anticompetitive conduct in product markets can focus on that single national market. To evaluate labor market effects, by contrast, one must identify the location of the factories of the firm, which may be scattered throughout the country (or world). One then must evaluate all aspects of the local labor market(s)—such as whether other employers, including employers in different industries, offer comparable jobs. And one must take into account the different types of workers in each factory—for example, line workers and IT workers may belong in different labor markets. *While some product markets are fragmented in this way, the problem for labor market antitrust is that fragmentation is pervasive if not universal. Indeed, applying existing market definition tests to labor markets may conclude that the relevant market is just the firm itself!*

Models of monopsonistic competition suggest that considerable monopsony power can persist even in large, non-concentrated labor markets with many employers. This makes antitrust law an unwieldy device to handle labor market monopsony. While concentration can exacerbate the monopsony originating in either search or differentiation, it is by itself not a sufficient metric for market power, nor a target for alleviating it. Antitrust is, by and large, set up to police concentration or egregious price-fixing behaviors. But if market power is generated by search frictions or heterogeneous, privately held preferences (not concentration), then antitrust law can do little. However, this does not mean that antitrust enforcement labor markets should be abandoned as fruitless. The authors argue that antitrust enforcement has been shamefully

neglected, and should be strengthened because it can do some good. Stronger and more tailored policy instruments are needed to make significant progress on the problem of labor monopsony.