FOUR TAKEAWAYS FROM THE FTC'S UNPRECEDENTED CRACKDOWN ON NONCOMPETE AGREEMENTS

By **Adam M. Acosta, Eric Grannon, Tola Oyeyemi**

The Federal Trade Commission (FTC) kicked off 2023 by using Section 5 of the FTC Act to take legal action against three companies and two individuals, forcing them to drop noncompete provisions. This is the first time that the FTC has brought an enforcement action to halt the use of noncompete agreements. Notably, the FTC did so based on its recently announced policy statement on "unfair competition" under Section 5 of the FTC Act. In addition, after bringing these enforcement actions, the FTC announced a newly proposed rule that would ban employers from imposing noncompetes on their workers. This alert summarizes key takeaways from the FTC's new approach to noncompete enforcement.

I. The FTC's Focus is Primarily on Restrictions that Limit Employees from Seeking Higher Wages and Better Working Conditions

According to the FTC's recent administrative complaints, various companies and individuals allegedly imposed illegal noncompete restrictions on workers, barring them from seeking or accepting work with another employer or operating a competing business after they left the companies.

In one action, two Michigan-based companies and their owners allegedly required low-wage security guards to sign contracts prohibiting them from working for a competing business within a 100-mile radius for two years.[1] The FTC emphasized that along with this restriction, employees in violation of this agreement had to pay $100,000 as a penalty. According to the FTC, "even after a Michigan state court determined that [the security company's] noncompete restrictions were unreasonable and unenforceable under state law, the companies continued to require all of their security guard employees to sign them."[2]

Separately, two of the largest US manufacturers of glass food and beverage containers also allegedly imposed various employment restrictions on their workers, such as banning them for one year after employment "from working for, owning, or being involved in any other way with any business in the United States selling similar products and/or services without the prior, written consent."[3]

Unlike the low-wage security guards, these noncompetes applied to "salaried employees who work with the plants' furnaces and forming equipment and in other glass production, engineering, and quality assurance roles."[4] In bringing these actions, the FTC emphasized that the "glass food and beverage container industry in the United States is highly concentrated," and "it is difficult for new competitors to enter the market in part because of the need to find and hire people who are skilled and experienced in glass container manufacturing."[5]

According to FTC Chair Lina Khan, "these cases highlight how noncompetes can block workers from securing higher wages and prevent businesses from being able to compete."[6] Rahul Rao, Deputy Director of the FTC's Bureau of Competition, stated further that "the FTC is committed to ensuring that workers

have the freedom to seek higher wages and better working conditions without unfair restrictions by employers" and "will continue to investigate, and where appropriate challenge, noncompete restrictions and other restrictive contractual terms that harm workers and competition."[7]

The FTC Commission voted 3-1 to issue the administrative complaints and to accept the related consent decrees halting the use of those noncompete agreements.[8] As discussed below, Commissioner Christine Wilson voted against bringing these actions, issuing separate dissenting statements for each action.

II. The FTC's Noncompete Enforcement is Unprecedented

These enforcement actions are the first time that the FTC has sued to halt allegedly unlawful noncompete restrictions. Noncompetes, however, have been on the federal government's radar for some time.

For example, during President Biden's campaign in 2020, he released a plan vowing to "work with Congress to eliminate all non-compete agreements, except the very few that are absolutely necessary to protect a narrowly defined category of trade secrets, and outright ban all no-poaching agreements."[9] The FTC also held a workshop on this issue in 2020 and has previously considered whether to use its rulemaking authority, although the agency did not actually propose any rules at the time.

Instead, states have traditionally taken the lead with legislation and enforcement. Indeed, nearly every state has an established body of case law on the reasonableness and enforceability of noncompete agreements, including as to temporal length, geographic reach, and other considerations, such as access to competitively sensitive information and intellectual property.[10]

The FTC's decision to wade into this new enforcement territory is premised on Section 5 of the FTC Act and recent policy changes at the FTC. In July 2021, FTC Commissioners voted 3-2 to rescind the 2015 Statement of Enforcement Principles Regarding "Unfair Methods of Competition" under Section 5 of the FTC Act,[11] which was a bipartisan policy that sought to align Section 5 with the Sherman and Clayton Acts.[12] Divided between party lines, Commissioners Christine Wilson and Noah Phillips, Republican appointees, voted against this recent policy change. Among other criticisms, the dissenting Commissioners focused on the lack of transparency, clarity, and legal support for how Section 5 might be broadly enforced.[13]

In November 2022, the FTC issued another policy statement, again divided on party lines, announcing that the FTC intends to use Section 5 to challenge "unfair methods of competition in or affecting commerce," vaguely outlining "advisory guidance on the scope and meaning" of Section 5.[14]

In that November 2022 policy statement, the FTC explained that Section 5 is broader than the Sherman and Clayton Acts, such as by encompassing "incipient violations" of the antitrust laws that include conduct where the company may not have a full-fledged monopoly or market power.[15] Listing various high-level examples, the FTC also explained that "conduct that violates the spirit of the antitrust laws" may be a Section 5 violation.[16]

The 15-plus page policy statement, however, did not mention noncompetes specifically and only included a few passing references to labor issues. For example, buried in a long footnote, the statement suggests that Section 5 was partially enacted "to protect a broad array of market participants including workers," to guard "the interests of employees," and "to secure labor the highest wage, the largest amount of employment under the most favorable conditions and circumstances."[17] Otherwise, the policy statement simply mentions that "attracting employees and workers through the offering of better employment terms" is a type of competition on the merits that Section 5 "may" encompass.[18]

Following the FTC's January 2023 enforcement actions, Commissioner Wilson issued dissenting statements to emphasize her "continuing disagreement with the new Section 5 Policy Statement and its application to these facts."[19] Her concern is that "the Policy Statement would be used to condemn conduct summarily as an unfair method of competition based on little more than the assignment of adjectives"—an approach she said was taken in the three cases.[20]

In particular, Commissioner Wilson criticized the FTC's complaints for failing to offer any evidence of anticompetitive effect in any relevant markets and other factual support.[21] Such an approach "foreshadows how the Commission will apply the new Section 5 Policy Statement" and sets a dangerous precedent where practices that "three unelected bureaucrats find distasteful will be labeled with nefarious adjectives and summarily condemned, with little to no evidence of harm to competition."[22]

The FTC's use of Section 5 and its limitations has yet to face a legal challenge, but challenges to the scope and meaning of Section 5 are surely on the horizon.

III. The FTC's Proposed New Rule Essentially Imposes a Blanket Ban on Noncompetes

On January 5, 2023, one day after the FTC announced its series of Section 5 enforcement actions, the agency proposed a new rule that would ban noncompete clauses. The FTC is seeking public comment on this newly proposed rule, "which is based

on a preliminary finding that noncompetes constitute an unfair method of competition and therefore violate Section 5 of the Federal Trade Commission Act."[23]

According to the FTC, the proposed rule generally prohibits employers from using noncompete clauses and would make it illegal for an employer to:

- **"enter into or attempt to enter into a noncompete with a worker;"**
- **"maintain a noncompete with a worker;" and**
- **"represent to a worker, under certain circumstances, that the worker is subject to a noncompete."[24]**

The proposed rule would also:

- **"apply to independent contractors and anyone who works for an employer, whether paid or unpaid;" and**
- **"require employers to rescind existing noncompetes and actively inform workers that they are no longer in effect."[25]**

The proposed rule generally would not apply to other types of employment restrictions, such as nondisclosure agreements.26 But "other types of employment restrictions could be subject to the rule if they are so broad in scope that they function as noncompetes."27 The proposed rule therefore adopts a functional test for whether the employment terms amount to a de facto noncompete clause.

Examples of de facto noncompete clauses may include:

- **"A non-disclosure agreement between an employer and a worker that is written so broadly that it effectively precludes the worker from working in the same field after the conclusion of the worker's employment with the employer;" or**
- **"A contractual term between an employer and a worker that requires the worker to pay the employer or a third-party entity for training costs if the worker's employment terminates within a specified time period, where the required payment is not reasonably related to the costs the employer incurred for training the worker."[28]**

The proposed rule includes only one exception. The rule would not apply to:

- **"a non-compete clause that is entered into by a person who is selling a business entity or otherwise disposing of all of the person's ownership interest in the business entity, or by a person who is selling all or substantially all of a business entity's operating assets, when the person restricted by the non-compete clause is a substantial owner of, or substantial member or substantial partner in, the business entity at the time the person enters into the non-compete clause."[29]**

However, antitrust or other federal and state laws may still apply in such a situation.

Finally, the proposed rule also includes affirmative rescission and notice requirements for existing noncompetes. Compliance with these specific rules is required 180 days after the date the final rule is published.

This rulemaking proposal, however, is already drawing opposition. The US Chamber of Commerce is calling the proposal "blatantly unlawful," and Commissioner Wilson issued a 14-page dissent "arguing that the agency doesn't have the rulemaking authority it claims over unfair methods of competition and that noncompetes must be assessed on a case-by-case basis because they could have legitimate business justifications."[30]

IV. The FTC's New Enforcement Approach Means That Employers Should Reassess Legal Risks

Against this backdrop, companies should carefully assess their noncompete policies and compliance strategies. While it remains to be seen how the FTC's proposed rule will ultimately take shape, it provides the best guidance for what the FTC is likely to challenge.

An effective compliance strategy for noncompete clauses should consider factors such as:

- **JUSTIFICATIONS. The FTC and virtually every state law recognize the need to protect against the disclosure of trade secrets, customer lists, and other confidential and proprietary information. Noncompete agreements that focus on these concerns are more appropriately categorized as nondisclosure agreements and are less likely to be susceptible to a legal challenge when the agreement is tailored to such interests.**
- **STATE ENFORCEMENT. With state laws frequently changing and state attorneys general challenging noncompetes, it is still imperative to understand the varying legal rules in the relevant jurisdictions in which a company operates and how state laws may apply. Where the FTC might not opt to bring an enforcement action, state enforcers may do so, especially when the state law is stricter or different remedies might be available.**
- **HIGH-SALARY VERSUS LOW-WAGE WORKERS. When noncompetes are required for all workers, particularly low-wage workers, they are more likely to face scrutiny. Thus, it generally makes sense for companies to customize their employment agreements to fit different categories or levels of employment, particularly for**

nondisclosures. But the FTC's proposed noncompete rule is largely a blanket ban, essentially eliminating a key distinction that has long existed in many state jurisdictions.

- **TIME AND GEOGRAPHIC LIMITATIONS. Similarly, adding reasonable time and geographic limitations has long been an important guidepost at the state level for ensuring that noncompetes and nondisclosures are not overbroad. The FTC's January 2023 enforcement actions also involved restrictions that applied one year or more after the employment ended, signaling that longer-term restrictions may be where the FTC is likely to focus enforcement efforts. Even so, the FTC's proposed rule does not appear to contemplate reasonable or short-term time and geography limitations, so what has traditionally helped employers avoid findings of unenforceability may no longer apply.**

Conclusion

The intersection between competition and employment law is a hot area across both Republican and Democratic administrations and is quickly evolving.[31] Proactively establishing and updating compliance strategies is essential, which often takes relatively minimal time and resources compared to navigating prolonged and expensive government investigations and enforcement. At the same time, the FTC's new and aggressive approach to challenging noncompetes, and the use of its Section 5 authority more generally, is unprecedented and yet to be tested in courts, making this emerging area one to carefully navigate.

Adam Acosta *is a partner in White & Case LLP's Global Antitrust and Competition practice. He focuses on government investigations and complex litigation, often involving antitrust, consumer protection, and other commercial claims. He served as president of the Hispanic Bar Association of the District of Columbia from 2021-2022.*

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9 The Biden Plan for Strengthening Worker Organizing, Collective Bargaining, and Unions, Joe Biden – Official Campaign Page, https://joebiden.com/empowerworkers/ [joebiden.com].

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