Special Report

# Against the Evidence: How the FTC Cast Aside the Input of Experts at Its Own Non-Compete Workshop

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The Federal Trade Commission (FTC) has proposed a paradigm-breaking rule that would ban essentially all non-compete agreements. If enacted, this rule would purport to override tens of millions of contracts in every sector of the economy.

It is vital to understand how the Commission reached this point, as this history illuminates the agency's thought process and offers insight into what might happen next.

The regulatory story began in March 2016, when the Treasury Department issued "Non-Compete Contracts: Economic Effects and Policy Implications." That report, which borrowed facts and conclusions mostly from limited, non-public studies, reached the conclusion that there was pervasive misuse of non-competition agreements, particularly with lower wage earners. A month later, on April 15, 2016, President Barack Obama issued an Executive Order, "Steps to Increase Competition and Better Inform Consumers and Workers to Support Continued Growth of the American Economy," directing federal agencies to identify actions to eliminate anticompetitive behavior and arm workers with information they need to make informed choices. The Executive Order was followed one month later by the White House's "Non-Compete Agreements: Analysis of the Usage, Potential Issues, and State Responses," which mostly excoriated employers' use of non-compete provisions in the United States. It borrowed heavily from the March 2016 Treasury Department report and billed itself as a "starting place for further investigation of the problematic usage of one institutional factor that has the potential to hold back wages—non-compete agreements." It also promised the administration would identify key issues presented by non-compete agreements, examine state efforts to address such issues, and identify the best approaches for policy reform. Moreover, it concluded that most of the power is in the hands of state legislators and policymakers to adopt institutional reforms.

On October 25, 2016, the White House released a "State Call to Action on Non-Compete Agreements," which urged *state* policymakers to ban non-competes for low-wage earners, ban non-competes for employees laid-off or terminated without cause, and require prior notice of a non-compete before a job offer, among other suggestions.

Concurrent with the White House activity, also in October 2016, the FTC and the U.S. Department of Justice issued joint guidance to human resources professionals flagging potential antitrust concerns with several employment practices, including the use of non-compete clauses. This guidance was one of the first signs the FTC might be considering a crackdown on restrictive covenants.

On January 9, 2020, the FTC held a public workshop, "Non-Competes in the Workplace: Examining Antitrust and Consumer Protection Issues," to examine the legal basis and

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empirical support for a rule restricting non-competes. (One of the authors, Erik J. Winton, attended the Commission's workshop and wrote an article commenting on the workshop's discussions shortly thereafter.) The workshop included panels of economists and law professors, as well as remarks from two FTC commissioners.

The Commission framed the event as part of its efforts to answer some of the following questions:

- What impact do non-compete clauses have on labor market participants?
- What are the business justifications for non-compete clauses?
- Is state law insufficient for addressing harms associated with non-compete clauses?
- 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 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 such a rule?
- Should 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?

Afterward, FTC published a full transcript of the event.

The comments made by FTC representatives and outside experts during the January 2020 workshop shed light on numerous aspects of the agency's newly proposed rule. Surprisingly, the Commission appears to have largely ignored the findings and conclusions presented by its assembled experts. What follows is an enumeration of the most-salient points raised during the workshop, along with comments on each by those in attendance. (The views recounted in the following sections are those of the workshop's participants and do not necessarily reflect the views of the authors or of Jackson Lewis.)

### What Are the Benefits of Non-Competes?

Ryan Williams, a finance professor at the University of Arizona, described a study focused exclusively on CEO non-competes across the 1,500 largest public companies in the U.S. These agreements are typically negotiated in detail and accompanied by enhanced compensation to account for the executive's increased job risk. T179. (Citations are to the workshop's transcript (T) in page:line format.) Among other things, the study's data revealed that companies are *more* likely to fire a CEO for poor performance when there is a non-compete in place, potentially benefiting both employees and shareholders. T178. In sum, Professor Williams characterized CEO non-competes as a "positive story,"

concluding that "there is a bargaining going on before the contract is signed, and then after the contract gets signed, the CEO gets compensated for this risk, and the firm compensates them in a way that … makes them make good decisions[.]" T179:16-22.

Non-competes also can benefit doctors and medical practices. Kurt Lavetti, associate economics professor at Ohio State University, noted evidence that physician firms and employees "appear to benefit" from non-competes. T144-146. In particular, since it is illegal to buy and sell patient referrals, some other mechanism (like a non-compete) becomes necessary to protect the purchaser in the sale of a medical practice. *Id.*

More broadly, former FTC Commissioner Noah Joshua Phillips described the benefits of non-competes as incentivizing investment in workers (like training) and protecting trade secrets. T218.

### Do Non-Competes Affect Competition?

Some of the workshop's experts questioned whether all non-competes have an anticompetitive effect or, indeed, *any* market effect.

Randy Stutz, vice president of legal advocacy at the American Antitrust Institute, opined that any single non-compete "likely doesn't register an effect on the competitive hiring process in the labor market as a whole unless the labor market is highly concentrated." T61:13-16. But this can change where most of the employers in a given market use non-competes "to lock up most of the employees in the market[.]" T61:17-22.

In a similar vein, Howard Shelanski, a professor at the Georgetown University Law Center and a partner at Davis Polk & Wardwell LLP, commented, "It's very possible that a small employer that ties up six employees in a non-compete has zero effect on the market." T293:4-6.

### What Is the Overall Effect of Non-Competes on the Market?

Professor Lavetti summarized the available empirical evidence as "ha[ving] quite convincingly shown that strengthening the enforceability of non-compete [clauses] reduced average earnings and worker mobility, and that has been consistent across a broad range of studies." T138:19-23. In Professor Lavetti's description, raising non-compete enforcement levels lowers wages by 3%-4% and job mobility by about 9%. T140:9-23. Applying these same methods to an outright ban on non-competes results in a theoretical market-wide wage increase of roughly 7%. T140-141. At the same time, Professor Lavetti cautioned that economists are "still far from reaching a scientific standard of concluding that non-compete agreements are bad for overall welfare[.]" T138:23-25. Among other issues, he noted the lack of evidence about "what the substitution patterns would be if non-competes were banned in a specific occupation" and what "substitution provisions … would likely be used." T212:17-24. Concerns like these may be one motivation behind the FTC's "functional test" for what constitutes a non-compete. *See* Section 910.1(b)(2) of the proposed rule.

Broadly agreeing with Professor Lavetti, Evan Starr, assistant professor at the Robert H. Smith School of Business, University of Maryland, listed a number of unanswered questions in the empirical evidence, including whether "there are other differences outside of the non-compete that are going to cause wages to be different, that are going to cause innovative outcomes to be different," meaning that "it's not clear that you are going to be able to overcome any of those challenges with just purely observational

data." T206:22-207:5. Instead, Professor Starr suggested that a natural experiment, such as comparing states with different non-compete policies, might be a more-promising research path. *Id.*

Richard Pierce, professor of law at George Washington University Law School and author of a leading treatise on administrative law, echoed the empirical uncertainty expressed by Professors Lavetti and Starr and concluded that the FTC lacked "evidentiary support at this point" for non-compete rulemaking. T262:9-10; see T138:23-25 (Professor Lavetti: "I think we're still far from reaching a scientific standard of concluding that non-compete agreements are bad for overall welfare[.]"); T206:22-207:5 (Professor Starr: "[I]t's not clear that you are going to be able to overcome any of those challenges with just purely observational data."). Likewise, Kristen Limarzi, former chief of the Appellate Section of the U.S. Department of Justice Antitrust Division and a partner at Gibson, Dunn & Crutcher LLP, echoed the academic panelists' conclusions: "We don't know as much as we would like to know .... There's a long list of things [the economist panelists] would like to study, data they would like to have, and somewhat-more-modest list of actual conclusions that we can draw in a way that would really support robust rulemaking." T253:3-10.

In a further sign of the sparse evidence available, panelists encouraged the FTC to begin collecting non-compete data from companies on a longitudinal basis. T205. Although possible, there is no public indication that the Commission has collected any such data since the January 2020 workshop nor is there any mention of such data collection in the notice of proposed rulemaking.

### Does FTC Have Authority Over Non-Competes?

Cognizant of concerns regarding the FTC's authority over non-competes between employers and employees, Bilal Sayyed, then-director of the Office of Policy Planning, the Commission's internal think tank, opened the workshop by observing that it's likely "not ... sufficient just to tell [FTC] that Section 5 [of the FTC Act] allows us or gives us broad authority to prohibit all sorts of conduct. The Commission lost a number of cases in the appellate courts in the 1980s that suggest there were limits to our Section 5 competition authority. This [was] well before the alleged conservative takeover of the judiciary." T5:2-8. Director Sayyed also noted that the Commission's *Chevron* deference "appears to be on its last legs at the Supreme Court[.]" T5:9-18. ("*Chevron* deference" refers to the deferential standard for review of administrative agency interpretations established by the U.S. Supreme Court in *Chevron, U.S.A., Inc. v. NRDC, Inc.*, 467 U.S. 837 (1984).)

The workshop's assembled experts shared Director Sayyed's skepticism of FTC's authority. Discussion focused on *National Petroleum Refiners Association v. FTC*, 482 F.2d 672 (D.C. Cir. 1973). In that case, the D.C. Circuit Court of Appeals concluded that FTC has the authority "to promulgate rules defining the meaning of the statutory standards of illegality [*i.e.*, 'unfair methods of competition'] the Commission is empowered to prevent." *Id.* at 698. Congress responded to the D.C. Circuit's *National Petroleum Refiners* decision by passing the Magnuson-Moss Warranty—Federal Trade Commission Improvement Act, 15 U.S.C. §§ 2301-2312. The Magnuson-Moss Act imposed a new, far-more-complex, rulemaking scheme to govern the FTC's authority to define "unfair or deceptive acts or practices" under the FTC Act. The Magnusson-Moss Act, however, did not address the Commission's authority to promulgate rules defining "unfair

methods of competition" under the Act. Some commentators have argued that Congress's action is best interpreted "as declining to endorse the FTC's [unfair-methods-of-competition] rulemaking authority and instead leaving the question open for future consideration by the courts."

At the workshop, Professor Pierce opined that reliance on *National Petroleum Refiners* 50 years later would be an "extraordinarily fragile" legal position, as the opinion's reasoning is "preposterous" by modern standards. T294:18-295:6. For this reason, Professor Pierce characterized "standalone" reliance on Section 5 of the FTC Act for a non-compete rule as "very risky" in terms of judicial review, and he recommended that if the Commission were to proceed, it do so under the Sherman Antitrust Act instead. T280:9-15. Aaron Nielson, professor at Brigham Young University Law School, noted Congress's response to *National Petroleum Refiners* and the heightened rulemaking requirements imposed on FTC by the Magnuson-Moss Act. T225.

Former DOJ Antitrust Appellate Chief Limarzi explained that the variety of state regulatory and enforcement approaches to non-competes "suggest[s] a lack of national consensus" and that the absence of such consensus "ought to give a federal regulator some pause." T255:5-16.

In his prepared remarks, Commissioner Phillips also recognized issues with FTC's rulemaking authority and potential separation-of-powers concerns, observing that FTC has issued a competition rule "just once in its history, in the 1960s[,] which was never enforced and was withdrawn in the 1990s[.]" T219:19-220:17 (citing 16 C.F.R. § 412). The rule in question, called the "Men's and Boy's Tailored Clothing Rule," was issued in 1968 and required that promotional allowances given to sellers in the men's clothing industry be made available equally to all sellers under written plans. (In 1994, that rule was rescinded.) Commissioner Phillips, joined by a majority of the panelists, also expressed concerns that a rule predicated solely on FTC's Section 5 authority would raise a substantial risk of failing judicial review should the court apply the non-delegation doctrine. T307-318.

## Is an Outright Ban on Non-Competes Viable?

The workshop's participants were nearly unanimous in their assessment that an outright ban on non-competes would not survive judicial review. Professor Lavetti concluded, "[M]ore empirical evidence is necessary before a comprehensive ban would be scientifically justified to curtail non-competes in all contexts." T151:16-19.

Likewise, Eric Posner, professor of law at the University of Chicago Law School, predicted that it would be difficult "to persuade a court at this point that there is empirical evidence that a flat ban [on non-competes] would maximize social welfare, whatever your criterion is .... And so a rule that limited a ban to low-income workers or workers making ... less than the median wage would probably be more acceptable to a court." T75:21-76:6. Professors Shelanski and Limarzi also opposed a total ban, while Professor Nielson expressed doubt that a total ban could survive judicial review. T283; T286-287.

## Are Non-Competes More Susceptible to Regulation as "Unfair Methods of Competition" or "Unfair or Deceptive Acts or Practices"?

William Kovacic, former FTC chair and professor and director of the Competition Law Center at George Washington University Law School, explained that state and federal

UDAP principles have historically focused on business-consumer and business-business relationships, not the employer-employee relationship. T29:6-30:14. In Professor Kovacic's view, characterizing non-competes as "a basic distortion of the competitive process itself" rather than as UDAP is a "more-promising foundation [on which] to build an enforcement program[.]" T34:1-7.

While acknowledging that "FTC has succeeded in the past [in] using either rulemaking or litigation to expand the boundaries of its authority … in an environment in which the judiciary was largely sympathetic[,]" Professor Kovacic suggested that "that judicial environment doesn't exist today." T35:17-36:2. Like his fellow panelists, Professor Kovacic noted the challenges inherent in pursuing a total ban on non-competes, observing that designating an area of *per se* illegality "requires the finding that[,] far more often than not[,] the behavior is harmful," which in turn requires "impressive" empirical support. T39:11-15.

Similarly, Derek Moore, an attorney advisor in FTC's Office of Policy Planning, noted that some of the harms attributed to non-competes during the workshop "sound more like [UDAP]." T290:16-19. Furthermore, "when the remedy is a notice requirement, that … sounds very clearly like a consumer-protection issue rather than an antitrust or market-power issue." T290:19-22. For these reasons, Moore anticipated that a reviewing court might conclude that FTC should have followed the Magnuson-Moss Act's UDAP rulemaking procedures rather than the less-onerous procedures applicable to unfair methods of competition under Section 5. T290-291.

### Will the FTC Issue Another Proposed Rule on Non-Competes?

Near the end of the workshop, Professor Shelanski suggested that FTC pursue both an "unfair methods of competition" rule under normal rulemaking procedures and an UDAP rule under Magnuson-Moss Act procedures simultaneously, as this approach might carry a greater chance of achieving the Commission's regulatory aims and surviving judicial review. T293-294. Given that FTC's recent non-compete enforcement actions reflect a course consistent with the strategy outlined by Professor Pierce — make a policy statement against non-competes, followed by "selective individual case enforcement actions" to motivate broad compliance by employers — the Commission could very well implement Professor Shelanski's advice by issuing a second rule proposing to regulate non-competes as UDAP in the near future. *See* T259-262.

### What Has Transpired Since the Workshop?

In the three years since the workshop, the Commission has undergone a leadership change, rescinded prior enforcement policy, taken a more aggressive view of its FTC Act enforcement authority, and commenced enforcement actions against employers who use non-competes.

On June 15, 2021, President Joe Biden named Lina M. Khan as chair of the Commission. This move came just hours after her Senate confirmation as Commissioner and without prior notice, a surprising break from custom that deprived lawmakers of the opportunity to question Khan in her anticipated role as chair during her confirmation hearing. Khan, a 2017 law school graduate and, at 32 years old at the time of her appointment, the youngest FTC chair in history, appears to have had limited to no experience litigating antitrust or consumer-protection cases prior to her nomination.

Following her confirmation, Commissioner Khan promptly began overhauling the

Commission's enforcement approach. On July 1, 2021, the agency rescinded its 2015 policy statement that had limited its enforcement ability to pursue "unfair methods of competition" under Section 5 of the FTC Act, signaling a more-aggressive agenda in this area.

One week later, President Biden signed Executive Order 14036, 'Executive Order on Promoting Competition in the American Economy," entreating the FTC to "to exercise [its] statutory rulemaking authority under the Federal Trade Commission Act to curtail the unfair use of non-compete clauses and other clauses or agreements that may unfairly limit worker mobility." (Executive Order 14036 invited the FTC to use its rulemaking authority to address a variety of issues ranging from "unfair data collection and surveillance practices" to "restrictions on third-party repair or self-repair of items" to "unfair competition in major Internet marketplaces.")

In August 2022, former FTC Chief of Staff Svetlana Gans and former Secretary of Labor Eugene Scalia wrote in the *Wall Street Journal* that a rule like the FTC's Proposed Non-Compete Rule "would run headlong into the major-questions doctrine." As the authors explained:

> The agency would claim the rule is an exercise of its authority to regulate "unfair methods of competition." But historically the FTC has addressed unfair competition by case-by-case adjudication targeting specific companies' practices, not through binding nationwide rules.
>
> Fifty years ago a federal appellate court ruled that the FTC had the authority to make rules regarding specific competitive practices. But the judges recognized the question was close, the FTC hasn't adopted a competition rule since, and the FTC throughout its history has questioned whether it has any such rule-making authority.

Then, in November 2022, the Commission published its 2022 Policy Statement Regarding the Scope of Unfair Methods of Competition Under Section 5 of the FTC Act, which centered on the Commission's renewed enforcement of Section 5 and presaged the rule now proposed. In recent months, the Commission has applied its new policy to non-competes in particular, bringing enforcement actions against employers that use such agreements, with a focus on low-wage employees in competitive industries. Indeed, the agency announced three such actions the day before publicizing the new rule. On January 5, 2023, the Commission announced its proposed rule to the public. On January 19, the rule was published in the *Federal Register,* making comments due March 20. As of the publication of this article, it has already received more than 5,000 comments. Due to the high volume of comments and the public controversy surrounding the rule, the Commission is unlikely to complete the rulemaking process for many months, possibly until 2024.

## Concluding Thoughts

One common theme emerges from all of this discussion: Why would the FTC propose a rule that ignores the input of multidisciplinary experts at a conference that the agency itself sponsored?

Indeed, the Commission's current course veers from its assembled experts' recommendations in a number of ways:

- The Commission's notice of proposed rulemaking does not adequately account for the fact that many non-competes have no market effect. *See* T61:13-22; T293:4-6. The notice admits that a non-compete's effect on competition "may be marginal or may be impossible to discern statistically," but the proposed rule makes no distinction between non-competes with competitive effect and those without.

- The proposed rulemaking ignores the lack of empirical evidence that non-competes are negative for overall welfare, as expounded by Professors Lavetti, Pierce, and Starr. *See* T138:23-25; T262:9-10; T206:22-207:5.

- The Commission's decision to proceed solely under Section 5 of the FTC Act runs counter to the assessments of Professor Pierce, former Commissioner Phillips, and the majority of the workshop's experts that such action is unlikely to survive judicial review. *See* T294:18-295:6; T219:19-220:17; T307-318.

- The Commission's choice to pursue an outright ban ignores the recommendations made by Limarzi and Professors Kovacic, Lavetti, Nielson, Posner, and Starr favoring a more-targeted rule. *See* T35:17-36:2; T39:11-15; T151:16-19; T75:21-76:6; T283; T286-287.

At the same time, the FTC appears to have some awareness of these concerns. The agency has solicited comments and data submissions on nearly every aspect of its proposed rulemaking, and it has laid out a number of potential narrower alternative rules, including a wage threshold and a rebuttable presumption that non-competes are unlawful, rather than an outright ban. For the present, however, the Commission continues to pursue an across-the-board ban on non-competes, disregarding the consensus expressed by the hand-picked experts it invited to its own workshop. Only time will tell whether the experts' warnings come to pass.