

FTC's Noncompete Proposal Is Based On Misrepresentations

By **Erik Weibust and Stuart Gerson** (January 26, 2023, 4:04 PM EST)

The Federal Trade Commission kicked off 2023 by taking two aggressive actions against employers who have sought to protect their business strategies, intellectual property and customer relationships by holding their employees to agreements not to compete with them after they leave employment.

The FTC first announced that it had entered into consent decrees arising out of two enforcement actions accusing employers of engaging in alleged unfair competition merely by utilizing noncompetes;^[1] and the next day, proposed a rule that would ban virtually all noncompetes nationwide with retroactive and preemptive effect.^[2]

The FTC's announcement of these two actions was clearly coordinated, and the former may have been intended as a warning to companies considering publicly opposing the latter.

These lawless actions standing alone are troubling enough.

But in announcing them to the public, the FTC made numerous misrepresentations about the use and effects of noncompetes, presumably for purposes of garnering public support for a move of the sort that no state legislature has taken since the 1800s, despite repeated attempts over the years by opponents of noncompetes in some of the most employee-friendly states and cities in the country.^[3]

FTC Chairwoman Lina Khan repeated these misrepresentations in a widely read op-ed published in The New York Times earlier this month.^[4]

Khan asserted that noncompetes are regularly enforced against low-wage workers, such as fast-food workers, arborists and manual laborers. This is a common refrain that the media uses to draw viewers and clicks, but it is misleading at best.

While there are always outlier cases, the FTC cites no conclusive evidence that they are the norm. Indeed, they are not. Anecdotes are not evidence of a systemic issue.

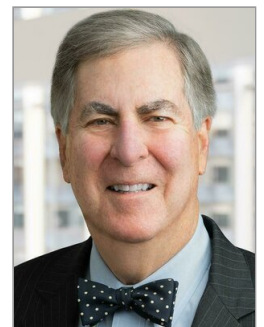
If indeed protecting low-wage workers were truly the FTC's concern — leaving aside for the moment its demonstrable lack of authority to regulate noncompetes at all^[5] — it could have taken a far more modest approach as several states recently have done, such as by limiting the proposed rule to low-wage workers and requiring advance notice to prospective employees.

Given the lack of conclusive evidence that noncompetes are regularly used with low-wage workers, the statutory protections already in place for employees in several states — with more following the trend each year^[6] — and the fact that courts are typically hesitant to enforce noncompetes against "fast-food workers, arborists and manual laborers" in any event, the FTC's proposed rule seems like using a sledgehammer to kill a fly.

Khan also asserted that "[n]oncompete clauses systemically drive down wages, even for workers who



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aren't bound by one." That, too, is unsupported by any conclusive evidence.

Instead, it relies entirely upon a 2019 study co-authored by an FTC employee called "The Labor Market Effects of Legal Restrictions on Worker Mobility,"[7] which acknowledged that noncompetes "might increase incentives for firms to invest in training, knowledge creation, and other portable assets ... that could increase their workers' productivity and earnings."

The same study admitted that its findings with respect to the effect of noncompetes on wages were based on a "back of the envelope calculation using an out-of-sample extrapolation," and even then it only implied that banning noncompetes would increase wages. Yet that inconvenient fact went effectively ignored in the remainder of the study, as well as in the proposed rule and the FTC's public statements about it.

There are, in fact, reputable studies showing exactly the opposite of what the FTC claims — i.e., that workers who are presented with noncompetes before accepting job offers receive higher wages and more training, and are more satisfied in their jobs than those who are not bound by noncompetes.[8]

And as other academics the FTC relies on in support of the proposed rule have acknowledged, like Boston University and The Hamilton Project, Brookings Institution published in an article titled, "The Chilling Effect of Non-Compete Agreements." The article states:

If it were the case that workers made fully informed decisions about signing a non-compete and could negotiate higher compensation in exchange for doing so, these agreements could be valuable for both workers and firms.[9]

As FTC Commissioner Christine Wilson pointed out in her dissenting Jan. 5 opinion, the research on this subject "reveals a mixed bag. ... An alternative interpretation of these findings is that the scientific literature is still muddled as to who is helped and who is harmed by non-compete clauses." [10]

Khan claimed in her op-ed that, "noncompete clauses tend to make markets less competitive. Rather than encouraging dynamism and new ideas, they can enable stale incumbents to lock out new rivals," and opined that "noncompetes reduce entrepreneurship and start-up formation." This, too, is unsupported.

If noncompetes really did make markets less competitive and discourage new ideas, then the only innovation in the U.S. would be coming from California, North Dakota and Oklahoma — the only three states that prohibit post-employment noncompetes.

Clearly that is not the case, with many of the more recent hubs of innovation being located in states that permit the enforcement of noncompetes — e.g., Arizona, Texas, Tennessee and Utah[11] — and relatively little in the way of innovation or entrepreneurship coming from North Dakota or Oklahoma, [12] or even outside of Silicon Valley in California.[13]

When Khan said in her op-ed that "[s]ome observers have even suggested that Silicon Valley became the epicenter of America's tech industry precisely because noncompetes were unenforceable there," she was referring to a discredited hypothesis in a 1994 book that has been widely panned as simplistic and unpersuasive, confusing correlation with causation.[14]

Indeed, to the contrary, banning noncompetes would likely weaken competition, in that new market entrants would be at enhanced risk of having key employees and critical information, techniques and strategies stripped from them by well-heeled large companies. One might think the FTC and the administration would want to encourage, for example, small technology companies of the sort.

Perhaps Khan's oddest claim is that "noncompetes lead to higher prices for consumers by reducing competition."

Leaving aside that the FTC has no conclusive evidence for this assertion, and relies entirely on a single study of the health care industry, if it were true — as the FTC would have us believe — that noncompetes drive down wages, and that doing away with them will increase workers' earnings by hundreds of billions of dollars annually, then prices will naturally increase as employers attempt to recoup their lost profits.

Assuming that increasing a company's costs will somehow lead to lower prices is illogical. Again, Wilson points out that the proposed rule "omits studies showing that reducing the enforceability of non-compete restrictions leads to higher prices for consumers."

Finally, Khan states in her op-ed: "Noncompetes are the type of restriction that Section 5 of the F.T.C. Act, a federal law passed by Congress more than a century ago, is supposed to prevent." [15] This is simply not true.

Rather, that statute vaguely delegated to the FTC the authority to regulate unfair methods of competition. As the U.S. Supreme Court made clear in its 2022 decision in *West Virginia v. U.S. Environmental Protection Agency*, there must be clear congressional authority for executive agencies such as the FTC to regulate any issues that are of "substantial political significance" and would "affect a major portion of the economy."

When Congress created the FTC in 1914, it did not clearly authorize it to regulate noncompetes, which were commonplace in the U.S. at the time. And in the 109 years since, the FTC has never done so.

Likewise, the FTC's limited enforcement powers do not give it license to hound employers that utilize agreements that are legal in almost every state in the country. Neither of the FTC's actions is authorized, and both are thus unconstitutional.

Regardless of whether one favors or disfavors the use and enforcement of noncompetes, the FTC should be forthright in its communications so that the public can make informed decisions about whether to support its actions — and thus the administration on whose behalf they are acting.

Khan has failed us in that regard. Although this proposed rule will no doubt be finalized in one form or another in the coming months, as Khan has been arguing against noncompetes since her earliest days as a law school professor, [16] concerned employers should take her up on the invitation to submit comments.

The FTC does not have the authority to ban noncompetes, and even if it did, the lack of conclusive evidence that doing so is warranted would render any such action arbitrary and capricious, and otherwise unlawful. Given that no state has banned noncompetes since 1890, there is plainly no need to do what the FTC arbitrarily is attempting to impose.

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[1] <https://www.tradesecretsandemployeemobility.com/2023/01/articles/non-compete-agreements/ftc-enforcement-actions-stake-out-aggressive-new-position-on-post-employment-non-compete-agreements/>.

[2] <https://www.ebglaw.com/insights/ftc-proposes-rule-banning-noncompetes-what-employers-need-to-know-now/>.

[3] <https://www.tradesecretsandemployeemobility.com/2022/06/articles/non-compete-agreements/ftc-signals-new-action-on-noncompetes-but-is-that-the-will-of-the-people/>.

[4] <https://www.nytimes.com/2023/01/09/opinion/linakhan-ftc-noncompete.html>.

[5] <https://www.law360.com/articles/1511340/ftc-authority-to-ban-noncompetes-shaky-after-epa->

ruling; <https://www.wlf.org/2023/01/11/publishing/after-200-years-under-state-law-ftc-proposes-to-sweep-away-all-noncompetes-in-unauthorized-federal-power-grab/>.

[6] <https://www.ebglaw.com/50-State-Noncompete-Survey>.

[7] <https://ssrn.com/abstract=3455381>.

[8] <https://ssrn.com/abstract=2625714>.

[9] <https://econofact.org/the-chilling-effect-of-non-compete-agreements>.

[10] https://www.ftc.gov/system/files/ftc_gov/pdf/p201000noncompetewilsondissent.pdf.

[11] https://joelkotkin.com/wp-content/uploads/2022/01/Restoring_the_California_Dream.pdf.

[12] <https://wallethub.com/edu/most-innovative-states/31890>.

[13] <https://www.latimes.com/opinion/story/2021-12-26/innovation-sectors-jobs-competition-california-western-states>.

[14] <https://www.law360.com/articles/1174776/misconceptions-in-the-debate-about-noncompetes>.

[15] <https://www.law360.com/articles/1511340/ftc-authority-to-ban-noncompetes-shaky-after-epa-ruling>; <https://www.wlf.org/2023/01/11/publishing/after-200-years-under-state-law-ftc-proposes-to-sweep-away-all-noncompetes-in-unauthorized-federal-power-grab/>.

[16] Chairwoman Khan is an acolyte of the "New Brandeis" antitrust movement and was one of the principal authors of the 2019 "Utah Statement," which set forth a series of concrete proposals for the future of antitrust law and enforcement, including that "[b]y rule or statute, non-compete agreements should be made presumptively unlawful." Moreover, in a 2020 law review article she co-authored with former FTC Commissioner Rohit Chopra, she opined that noncompetes "deter workers from switching employers, weakening workers' credible threat of exit, and diminishing their bargaining power" and that "[b]y reducing the set of employment options available to workers, employers can suppress wages." Rohit Chopra and Lina M. Khan, The Case for "Unfair Methods of Competition" Rulemaking, 87 U. Chi. L. Rev. 357, 373 (Mar. 5, 2020). Chairwoman Khan previously served as legal director at the Open Markets Institute, which petitioned the FTC in 2019 to ban noncompetes. See Petition for Rulemaking to Prohibit Worker Non-Compete Clauses (Mar. 20, 2019).