Testimony of Miriam F. Clark for National Employment Lawyers Association/New York

Good morning. Thank you for the opportunity to testify at this morning's hearing.

I am Miriam Clark, the Chair of the Legislative Committee of the National Employment Lawyers Association, New York affiliate, and partner at the firm Ritz Clark & Ben-Asher LLP.

I have been representing employees, including employees bound by restrictive covenants such as non-competes, for more than thirty years.

I know you will be receiving testimony at this hearing from NELA National, and from other organizations describing in detail the overwhelming economic data describing the negative effects of restrictive covenants on employees and worker mobility. I thought it would be helpful if you heard from me as a practitioner about the particular details of non-compete agreements, the expensive and painful litigation they result in, and the resulting chilling effect on our clients.

First, let's take a look at some employees who have been sued recently in New York. They run the gamut: a home health aide (Attentive Home Care Agency, Inc.

v. Galinkin, 2022 NY slip op. 30110(U), ¶¶ 4-6 (Sup. Ct. Kings County Jan. 13, 2022)); a nurse anesthetist (Long Island Anesthesia Physicians Llp v. Wagner, No. 608859/2020E, 2020 N.Y. Misc. LEXIS 20863, at *8 (Sup. Ct. Suffolk County Sept. 30, 2020)); a mid-level sales employee (Statista Inc. v. Gordon, 2022 NY slip op. 31505(U), ¶¶ 3-4 (Sup. Ct. N.Y. County Apr. 12, 2022)); a senior project manager (Truesource v. Niemeter, No. 605526/2021, 2021 N.Y. Misc. LEXIS 11214, at *4-9 (Sup. Ct. Suffolk County Dec. 10, 2021)); an investment banker (Jordan, Edmiston Grp., Inc. v. Wong, 2023 NY slip op. 31443(U), ¶¶ 3-5 (Sup. Ct. N.Y. County May 1, 2023)); a financial planner (AJ Wealth Strategies, LLC v. Smoose, 2022 NY slip op. 33400(U), ¶¶ 15-17 (Sup. Ct. N.Y. County Oct. 5, 2022); and a software sales person (ASAPP, Inc. v. Rowbotham, 2022 NY slip op. 30696(U), ¶¶ 1-3 (Sup. Ct. N.Y. County Mar. 4, 2022)).

A report issued this month by the Government Accountability Office (Government Accountability Office, Report to Congressional Requestors, May 2023, https://www.gao.gov/assets/gao-23-103785.pdf ("the GAO Report")) confirms that nationwide, non-competes are weaponized against employees of all income and professional levels. (GAO Report, at 7). While in some of the reported cases, the court refused to enter an immediate injunction banning the worker from taking on the new job, in each case the litigation itself was painful and costly for the worker, and in many cases by the time the case was resolved the new job was no longer available. This is just the tip of the iceberg, of course, because it does

not capture the more common unseen scenario, where prospective employers decline to even consider hiring valuable employees who are subject to non-compete agreements.

How do employees end up being bound by non-competes?

In our experience, and as confirmed by the GAO Report, many employees have no idea that they are bound by non-competes, and most have no ability to negotiate their terms. (GAO Report, at 13, 17). In many situations, employees are required to sign non-competes after they have already started new jobs. Id. Often, they are simply given non-competes to sign as part of a pile of paper or electronic documents that they are required to sign or click through as part of an "on-boarding" process. (GAO Report, at 22).

Even high-level and sophisticated employees, when faced with restrictive covenants, find they have no bargaining power when it comes to employers who insist on them. Sometimes they are told by recruiters not to worry, because employers never enforce these clauses. It would take a LEXIS search or a PACER search to find out that the opposite is true, something even the most sophisticated business person is not likely to conduct unless represented by counsel. In any event, as a client recently told me, every time an employee is offered a job, they should not have to consult with a lawyer. The unequal bargaining power is even

more acute when a non-compete agreement is demanded of an existing employee. The risk to the employee of not signing is the loss of their employment position.

What happens when a non-compete is enforced?

Typically, the former employer sues the former employee by going to court and asking the judge to issue a preliminary injunction stopping the employee from working at the new employer. The former employer also often sues the new employer. Sometimes, the former employer (or its attorney) sends a threatening letter to the employee and the prospective employer before filing the lawsuit – and that threat often works to intimidate the employee and prospective employer into submission.

In the somewhat rare case where the new employer does not back down, the case moves ahead quickly at first because the new employer is alleging that it will suffer irreparable harm if the competition occurs. But even if the former employer loses the preliminary injunction motion, it can still continue on with a lawsuit against the former employee that go on for years seeking money damages for the injury it allegedly suffered. The employee has to pay many thousands of dollars in legal fees to defend herself, even if she ultimately wins the case.

To repeat, most cases don't get this far. In a more typical situation, a new employer has no interest in being involved in this dispute and fires the employee pro-actively, once it is threatened with litigation by the former employer. Or even more likely, the potential new employer refuses to hire the employee in the first

place – or withdraws its offer - once it has learned of the non-compete. Or the employee learns she is covered by a non-compete and is afraid to leave her job at all – or she feels forced to move out of state, or to leave her field altogether. Therefore, even a patently unenforceable non-compete can have a fatally chilling effect.

How do lawyers advise clients as to whether non-competes are enforceable?

Unfortunately, we often can't, at least not with any certainty. Whether a Court will uphold a non-compete agreement or find it runs afoul of the "reasonableness" requirements under New York law is not readily predictable. The basic premise is that,

"[N]oncompete clauses in employment contracts are not favored and will only be enforced to the extent reasonable and necessary to protect valid business interests". Morris v. Schroder Capital Mgmt. Int'l, 7 N.Y.3d 616, 620-21, 859 N.E.2d 503, 825 N.Y.S.2d 697 (N.Y. 2006). Thus, enforcement of restrictive covenants has been limited to circumstances where they are found to be "reasonable in time and area, necessary to protect the employer's legitimate interests, not harmful to the general public and not unreasonably burdensome to the employee". Bdo Seidman v. Hirshberg, 93 N.Y.2d 382, 389, 712 N.E.2d 1220, 690 N.Y.S.2d 854 (1999), quoting Reed, Roberts, Assocs. v. Strauman, 40 N.Y.2d 303, 307, 353 N.E.2d 590,

386 N.Y.S.2d 677 (N.Y. 1976). Yet, "the formulation of reasonableness may vary with the context and type of restriction imposed". Id.[1]

This language leaves so much space for individual interpretation that it is safe to say that there are no hard and fast rules enabling attorneys to guide employees. For example, there is language in New York case law that the law generally disfavors non-competes that involve long periods of time or large geographic areas. However, just over a year ago a New York trial court upheld a three-year non-compete covering the entire North American continent, against an employee who was a project manager. Truesource v. Niemeter, No. 605526/2021, 2021 N.Y. Misc. LEXIS 11214, at *4-9 (Sup. Ct. Suffolk County Dec. 10, 2021).

To make matters even more confusing and unpredictable, New York judges have the power to "blue-pencil" or rewrite non-competes in order to narrow them. This blue-penciling can lead to an outcome that neither party either wanted or could have predicted. For example, in Karpinski v. Ingrasci, 28 N.Y.2d 45, 52, 320 N.Y.S.2d 1, 7, 268 N.E.2d 751, 755 (1971), a dentist was told by the judge that he was barred from practicing oral surgery, but could still practice as a dentist. His patients who needed oral surgery would have to go elsewhere.

[1] The only clarity presently provided by New York law is that non-management employees in the broadcasting industry cannot be subject to non-competes. Labor Law § 202(k). And, as noted below, attorneys are ethically barred from entering into non-competes.

Who is harmed by these clauses?

First and foremost, employees. Common sense and our own experience tell us, and the GAO Report confirms (GAO Report, at 28), that these clauses negatively affect job mobility, even when the clauses are ultimately not enforceable. The GAO Report cited a study that found that technology workers tend to move away from states that allow the enforcement of non-competes. (GAO Report, at 30). Non-competes also result in increased wage disparities, especially disfavoring women and Black employees. (Id., at 33). Not surprisingly, the GAO Report cited studies that showed increased enforcement of non-competes has been shown to increase the number of employees in the tech industry choosing to switch fields. (Id., at 30). And of course, individual employees can suffer devastating economic consequences as a result of being banned from their fields for months or years – typically with no compensation from the former employer during the term of the non-compete. This creates enormous economic hardship on employees – and on their careers.

Who else is harmed? Consumers – because non-compete agreements often result in doctors and dentists, for example, having to abandon their patients and neighborhoods in order to continue practicing. In this regard, it is instructive (and ironic, given that non-competes are enormous fee-generators for lawyers) to note that lawyers themselves are ethically barred from demanding non-competes from

other lawyers, and from entering into them themselves[2] – because the lawyer-client relationship is deemed to be so sacrosanct that it should not be interfered with merely because a lawyer switches law firms. There is no reason why a doctor's relationship with her patients, or a financial advisor's relationship with her clients, or a home health care worker's relationship with her client families, should be considered any less sacrosanct.

The economy of the State of New York is also harmed because non-compete agreements undermine the mobility of the most productive and dynamic employees who are the engines of economic growth. California has successfully grown its economy while imposing a ban on non-compete agreements and its high technology sector has been the model of growth over the past fifty years, growth that many economists attribute to its ban on non-compete clauses.[3] By limiting the movement of our most productive employees, we stifle the growth of the New York economy that comes along with such mobility.

[2] New York Rule of Professional Conduct 5.6(a)(2)

[3] *See generally* ANNALEE SAXENIAN, REGIONAL ADVANTAGE: CULTURE AND COMPETITION IN SILICON VALLEY AND ROUTE 128 (1994); Ronald J. Gilson, *The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete*, 74 N.Y.U. L. REV. 575, 627 (1999); Jason S. Wood, *A Comparison of the Enforceability of Covenants Not To Compete and Recent Economic Histories of Four High Technology Regions*, 5 VA. J.L. & TECH. 14 (2000), cited in *NELA and NIWR Comments on Proposed FTC Noncompete Rule*, April 2023. (Attached as Exhibit A).

How does the law need to change?

It should be clear from the above that no halfway solution to this problem is workable. We need to end once and for all the senseless, expensive, and often economically devastating litigation factory that is the result of our current law. All non-competes should be banned across the board, for workers of all income levels.

Non-competes currently in place should be unenforceable. Without this provision, the non-compete litigation machine will continue on for years, even decades.

Employers should be required to notify employees that non-competes are not enforceable. Otherwise, "ghost" non-competes will continue to chill employee mobility and weaken the economy.

Quasi-noncompete agreements, such as agreements known as TRAPS, under which employers demand that departing employees pay back large amount of money to reimburse them for training costs, should also be banned. Likewise, employer requirements that former employees must forfeit substantial earned but unvested deferred compensation if they go to work for a competitor should be banned, as well as broad nondisparagement clauses, which also often act as competition restrictions.

Employers also should not be allowed to circumvent this fundamental policy banning non-competes through the use of choice of law provisions applying another state's non-compete law to a New York employment contract.

The Attorney General should be empowered to enforce the law, so that workers no longer have to engage lawyers to defend themselves against actions brought by employers.

CONCLUSION

The time has come for New York to protect its workers and consumers and to grow its economy by enacting a complete ban on post-employment non-competes. These restrictions can cause catastrophic harm to workers at all levels of the economy, while protecting only those employers who fear that they cannot otherwise compete in an open and fair job market.

Exhibit A

April 19, 2023

Submitted via: https://www.regulations.gov/commenton/FTC-2023-0007-0001

Lina M. Khan
Chair
Federal Trade Commission
600 Washington Avenue, N.W.
Suite CC-5610 (Annex C)
Washington, D.C. 20580

Re: Comments on Non-Compete Clause Rule,
16 C.F.R. Part 910, RIN 3084-AB74, Matter No. P201200

Dear Chair Khan:

The National Employment Lawyers Association (NELA) and the National Institute for Workers' Rights ("Institute") submits these comments in support of the Federal Trade Commission's Notice of Proposed Rulemaking, entitled, "Non-Compete Clause Rule."

NELA is a national professional membership organization of and for lawyers who represent employees in all aspects of employment law. The largest organization of its kind in the country, NELA, together with its 69 circuit, state, and local affiliates, has more than 4000 members nationwide who variously represent employees in discrimination, whistleblower, wage and hour, health and safety, and contract disputes and who advise employees, partners, and independent contractors on employment-related agreements. NELA's mission is to serve lawyers who represent employees, advance employee rights, and advocate for equality and justice in the workplace. NELA has filed numerous amici curiae briefs before the United States Supreme Court and other federal appellate courts on a wide range of employment law issues as well as comments on relevant Notices of Proposed Rulemaking. The mission of the National Institute for Workers' Rights is to advance workers' rights through research, thought leadership, and education for policymakers, advocates, and the public. As the nation's employee rights advocacy think tank, the Institute influences the broad, macro conversations that shape employment law.

NELA members are the lawyers who represent employees with respect to the non-compete and de facto non-compete clauses covered by the Proposed Rule. Because our members variously represent clients in these matters across industries, functions, and economic levels, from hourly-paid workers to high-level executives, NELA has deep experience with non-compete clauses and a panoramic view of the ongoing harmful anti-competitive effects they impose on workers, the public, and markets. Based on our members' vast experience with non-compete disputes and clauses as unfair methods of competition, NELA and the Institute urge the Commission to issue its Proposed Rule, as drafted, with certain modifications, and to reject the

fallacy cited by opponents of the Proposed Rule that non-compete clauses are necessary to protect trade secrets and other legitimate employer interests.

I. NON-COMPETE CLAUSES ARE UNFAIR METHODS OF COMPETITION.

A. How Non-Competes Unfairly Limit Competition, Harming Workers and Consumers.

NELA supports the Commission's finding that non-compete clauses are unfair methods of competition because they negatively impact mobility in the labor market and are often coercively imposed. Non-compete clauses unfairly tether employees to their jobs and restrain competition by preventing employees from leaving their employment for better or even comparable opportunities within their relevant field of experience or industry. Employees who do leave are forced to sit out from their field for a prolonged period of time, something few workers can afford to do. This leaves the vast majority of workers with no choice but to stay in jobs that may be stagnant and/or underpaying at best, and abusive, intolerable, and/or rife with unlawful treatment, at worst.

For employers, this is a win-win. Non-compete clauses provide them with an inexpensive and easy way to retain talent without having to compete for employees with better pay and working conditions. Meanwhile, the costs and risks of this anti-competitive behavior are shifted to workers, consumers, and the public. Employees must forego opportunities for better pay, better working conditions, and/or career advancement in their chosen field. Even more troubling, many of our members have clients who have experienced unlawful harassment, discrimination, and/or retaliation, wage-and-hour violations, and/or unsafe conditions at the hands of an employer but who cannot escape this mistreatment unless they are willing to change fields or move substantially farther away.[1] More generally, as stated in the Proposed Rule, non-compete clauses depress wages in the geographical areas where they are used both for the employees who are subject to them and those who are not. Non-Compete Clause Rule, 88 Fed. Reg. 3482, 3488 (proposed Jan. 19, 2023) (to be codified at 16 CFR Part 910).

Moreover, because most employers also insist on employment at-will, they are able to both freeze employees in their jobs and retain the option to terminate employees when they choose. Many of the non-compete agreements encountered by our members make no exception

[1] The ability to even work in the same field in another geographic area assumes that the non-compete clause has a geographic limitation; employers have imposed non-compete clauses that are national or global in scope, further drastically limiting the worker's options. *See Ainslie v. Cantor Fitzgerald, L.P.*, Consol. C.A. No. 9436-VCZ, 2023 WL 106924, *17 (Del. Ch. Jan. 4, 2023) (holding that worldwide geographic scope of non-competition, non-solicitation, and no-business provisions was unreasonable and noting that the absence of a geographical limitation does not render the restrictive covenant unenforceable per se, but such clause must be "'narrowly tailored to serve the employer's interests in the circumstances of the case.'" [internal citations omitted]).

to the non-compete if the employee is terminated without "cause," and, although some states will not enforce non-competes against employees terminated without cause,[2] some states will,[3] and others have not decided the issue.[4]

Too often, consumers lose the freedom to choose their professional service providers and other market providers due to non-competes that prohibit the providers from working in the same geographic area after their employment ends. The non-compete clauses deprive or interfere with the public's ability to choose their own professional advisers, because it is usually not feasible for those clients to travel outside the relevant geographic area to maintain the professional relationship during the period of the non-compete. Some states have laws prohibiting or limiting use of non-competes against certain professionals, such as medical professionals, social workers, accountants, and/or broadcasters but these exclusions are not consistent across state lines. Non-Compete Clause Rule, 88 Fed. Reg. 3482, 3494 (proposed Jan. 19, 2023) (to be codified at 16 CFR Part 910).

Similarly, no-service or no-business clauses function as non-competes by prohibiting employees from servicing or accepting business from clients or customers at future employers, even if the employee has not solicited the client or customer. The clients and customers are therefore prohibited from moving their business to their provider of choice.

As the Notice of Proposed Rule-Making aptly notes, non-compete clauses also negatively impact the public by restricting innovation. New entrants to the markets are prevented from recruiting the talent that they need to provide innovative goods and services, and workers subject to non-compete clauses are nearly always prevented from starting competitive businesses, even though they cannot use the employer's trade secrets or confidential information to do so. Rather, they must continue to work for their existing employer or leave the industry for a lengthy period of time before striking out on their own. This also causes harm to the market and the public by delaying or eliminating the introduction of superior products and services.

The cost of litigation means that these negative impacts on competition exist regardless of whether the non-compete is "reasonable" under state law. This is because, regardless of whether a non-compete is enforceable, its very existence creates a chilling effect on worker

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[2] See, e.g., New York, *Kolchins v. Evolution Markets, Inc*., 122 N.Y.S. 3d 288, 290 (1st Dep't 2020); *Buchanan Capital Markets, LLC v. DeLucca*, 41 N.Y.S.3d 229 (1st Dep't. 2016); Massachusetts (as to agreements signed on or after October 1, 2018), Mass Gen. Laws c. 149 § 24L, and Montana, *Wrigg v. Junkermier, Clark, Campanella, Stevens, P.C*., 265 P.3d 646 (Mont. 2011).

[3] See, e.g., Connecticut, *Gartner Group Inc. v. Mewes*, 1992 WL 4766, at *2 (Conn. Super. Ct. Jan. 3, 1992), Idaho, and Indiana, Leiza Dolghih, *Are Non-Compete Agreements Enforceable if the Employee is Terminated?,* N. TEXAS LEGAL NEWS, Feb. 21, 2021, https://northtexaslegalnews.com/2021/02/22/are-non-compete-agreements-enforceable-if-the-employee-is-terminated/.

[4] See, e.g., Vermont, Florida, Hawai'i. Dolghih, "Are Non-Compete Agreements Enforceable if the Employee is Terminated?", *supra* note 3.

mobility.[5] Many workers are afraid to leave a job, let alone one that is unfulfilling, underpaying, or abusive, for fear of being sued. The cost to litigate a claim arising out of a non-compete clause can run into five and six figures, a prohibitive amount for the vast majority of employees, whether an hourly worker, mid-level manager, or even a doctor or engineer. A victory in such a case would be pyrrhic at best and financially ruinous at worst. Faced with this impossible choice, in our members' vast experience, many employees rationally resign themselves to complying with the non-compete, even a patently unenforceable one.

The chilling effect also spills onto competitors and other employers, many of whom are deterred from hiring workers bound by non-competes, no matter how unreasonable or unenforceable that non-compete might be, for fear of being swept up in litigation between the employee and former employer and possibly even sued for tortious interference with contractual relations. Competitors seeking to recruit talent are often faced with the challenging choice to forego a desirable job candidate or to pay the cost of litigation or settlement in order to seek closure on a restriction, even when unenforceable.[6]

In our members' experience, clients' former employers, aware that new employers are reluctant to get involved in a potential non-compete dispute, have wielded non-compete clauses like a cudgel, using the clause to improperly interfere in a former employee's ability to obtain a new job by scaring the new employer off. Some employers are willing to hire an employee with a non-compete, only to fire that employee at the first sign of litigation. We have attached a document that collects stories of workers in this and other difficult situations because of non-competes.

Although opponents of the Proposed Rule have attempted to minimize these impacts by arguing that non-compete clauses are imposed selectively to protect trade secrets and similar information and then negotiated between parties of comparable bargaining strength, that position is pure fallacy. First, non-competes are unfair methods of competition no matter how widely used. Second, our members' experience is that many employers, especially larger ones, reflexively use non-competes as invidious boilerplate, imposing them sweepingly throughout

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[5] This *in terrorem* effect means that:

> "[f]or every covenant that finds its way to court, there are thousands which exercise 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."

Harlan M. Blake, *Employee Agreements Not To Compete*, 73 HARV. L. REV. 625, 682-83 (Feb. 1960).

[6] *See* Non-Compete Clause Rule, 88 Fed. Reg. 3482, 3501, at Part IV.A.1.a.ii (proposed Jan. 19, 2023) (to be codified at 16 CFR Part 910).

their organizations without regard to function and/or responsibilities, out of a generalized desire to prevent competition and retain employees and not due to any bona fide threat to a legitimate protectible interest.

Non-competes are rarely negotiated as part of an overall bargained-for employment agreement. In fact, employees are often presented with a non-compete agreement as though it were a routine administrative form and told to sign it in order to accept or start a job. Many workers do not know that they can have a lawyer review and explain the often convoluted and vague language of non-compete clauses or, if they are aware, they cannot afford to hire a lawyer to do so. Even when employees try to negotiate the language, which is often overly broad and/or ambiguous, employers often say that the clause is take-it-or-leave it because it is "standard" in the organization.

Very few employees, whether an hourly worker or an executive, have the luxury of walking away from a job. The reality is that many are forced to accept the non-compete in order to be able to work. Thus, in the vast majority of situations, the notion that non-compete clauses are the product of meaningful negotiations between parties of equal bargaining power is simply not true. While we thus agree with the Proposed Rule that non-compete clauses are coercively imposed on low-wage and middle-income workers, as described further below, our experience is also that such clauses are coercively imposed with respect to employees at more senior levels of employment as well.

Of course, for an employee to even contemplate negotiation of a non-compete assumes that the employee has been provided with the non-compete clause *before* accepting a job. But, some employers spring non-compete clauses on unsuspecting employees at the start of the employment – after the employee has already resigned from a prior position and possibly turned down alternative offers – or impose a new or more onerous non-compete clauses on employees who are mid-tenure, on tight deadlines, upon risk of termination. As the employees typically cannot obtain alternative employment quickly, they are forced to accept the non-compete to keep his or her job, usually without additional compensation or benefits. Although, as described below, some states require employers to provide new consideration to impose a non-compete on an existing at-will employee, other states do not and hold that continued employment of an at-will employee is sufficient consideration for a post-hire non-compete agreement.

While some states have banned or limited the use of non-compete agreements, the complex patchwork of state laws adds to the uncertainty and risk with respect to enforcement of non-compete clauses and highlights the need for a single national standard, especially as employers increasingly impose non-compete clauses without national or even geographic limitations. Below are just a few examples of how non-competes vary by state:

- Three states -- California, North Dakota, and Oklahoma -- ban non-competes altogether, with very limited exceptions like the sale of a business. *See* Cal. Bus. & Prof. Code § 16600; N.D. Cent. Code sec. 9-08-06; Okla. Stat. Ann. tit. 15, sec. 219A.

- Some states, like Colorado, Maryland, Maine, New Hampshire, and Illinois, have banned non-competes for workers below a specified income threshold. *See* Colo Rev. Stat. Ann. § 8-2-113; Md. Code, Lab. & Empl. § 3-716; 26 M.R.S. § 599-A; N.H. R.S.A. § 275:70-a; 820 ILCS 90.

- Some states, like Pennsylvania, Texas, and Montana, require independent consideration, like a raise or promotion, before a non-compete will be imposed on an existing at-will employee. *See Socko v. Mid-Atlantic Sys. of CPA, Inc.*, 126 A.3d 1266 (Pa. 2015); *Martin v. Credit Protection Assoc., Inc.*, 793 S.W.2d 667 (Tex. 1990); *Access Organics, Inc. v. Hernandez*, 175. P.3d 899 (Mont. 2008).

- In other states, like Delaware, Ohio, and Alabama, a non-compete can be imposed on an employee at any time, even after years of service. *See Research & Trading Corp. v. Powell*, 468 A.2d 1301, 1305 (Del. Ct. Ch. 1983); *Lakeland Gp. of Akron, LLC v. Columber*, 804 N.E.2d 27, 32 (Ohio 2004); *Daughtry v. Capital Gas Co.*, 229 So.2d 480, 483 (Ala. 1969).

Employers with workers in states with more restrictive non-compete laws will often exploit more employer-friendly state laws by including foreign choice of law clauses in non-compete agreements. Relatedly, employers may include use choice of forum clauses to require cases to be litigated in venues that employers perceive to be more employer-friendly. The result is often that workers are sued in courts across the country under the laws of states in which they have never worked or lived. Courts will rarely disturb a contractual choice of law provision unless the chosen state's law conflicts with a fundamental policy of a state with a materially greater interest. Even when a court ultimately refuses to enforce another contract-designated state's law,[7] workers are still required to undergo significant litigation expenses, and are likely to have interruptions their new employment relationships while litigation is pending. A single federal standard would eliminate this problem.

[7] *See, e.g., Cabela's LLC v. Highby*, 801 Fed. Appx. 48, 49 (3d Cir. 2020) (declining to apply Delaware non-compete law against Nebraska employee given "a conflict between Delaware's fundamental policy in upholding the freedom of contract and Nebraska's fundamental policy of not enforcing contracts that prohibit ordinary competition"); *Nuvasive, Inc. v. Miles*, No. 2017-0720-SG, 2019 WL 4010814 at *7 (Del. Ct. Ch. Aug. 26, 2019) (declining to apply Delaware non-compete law against California employee because "Delaware's interest in freedom of contract is a fundamental but general interest, and is manifestly outweighed by California's interest in overseeing conditions of employment relationships in that State");

B. Non-Competes Are Not Necessary To Protect Employers' Interests.

1. Employers Have Ample Alternative Protections for Trade Secrets and Confidential Information.

Opponents of the Proposed Rule attempt to depict a bleak picture by claiming that the Proposed Rule will effectively eliminate their ability to protect their confidential information and trade secrets. This argument should be rejected. The notion that an employee should pre-emptively be forced to remain tethered to a job or benched from their field because of the potential for disclosure of confidential information and/or trade secrets is a harmful overreach that would allow employers to use unfair methods of competition to protect a much narrower set of already-amply protected interests.

At the outset, the opponents' argument is in part belied by the way many employers, especially larger ones, themselves use non-competes as invidious boilerplate – imposing them reflexively and sweepingly, without relation to an employee's actual responsibilities, place within the organization, and/or receipt of trade secrets or sensitive confidential information, as stated above. In our members' experience, and as examples provided above and shared during the Commission's February 16, 2023 public hearing session demonstrate, employees across the economic spectrum are frequently subjected to non-compete clauses even though they do not receive trade secrets or competitively sensitive confidential information in performing their job.

Moreover, employers have ample ability to protect trade secrets and confidential information. The Uniform Trade Secrets Act, which has been adopted by forty-seven states and the District of Columbia, and the federal Defend Trade Secrets Act of 2016, separately provide for a civil cause of action for trade secret misappropriation. Non-Compete Clause Rule, 88 Fed. Reg. 3482, 3505, at Part IV.B.1. Trade secret theft is also a federal crime under the Economic Espionage Act of 1996. *Id*. Intellectual property law also provides significant legal protections for an employer's trade secrets. *Id.*

Employers also can protect trade secrets, inventions, and confidential information contractually, through non-disclosure, intellectual property, and/or confidentiality agreements. In fact, it has never been easier for employers to protect their confidential information, as they have found ever more ways to electronically track employees' work emails, downloads, and other transactions on work platforms. Moreover, employers can protect client lists through contractual non-solicitation clauses that prohibit an employee from soliciting a client's business after employment with the employer ends.

The Notice of Proposed Rule Making makes clear that the Proposed Rule will not eliminate any of these protections. Non-Compete Clause Rule, 88 Fed. Reg. 3482 (proposed Jan. 19, 2023).

2. California: Where Business Not Only Survives but Thrives.

We need only look to California's long statutory history and public policy prohibiting non-competes for assurance that prohibitions on non-competes have not caused employer chaos or economic decline.

California Business and Professions Code and relabeled as section 16600 provides: "Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void." Cal. Bus. & Prof. Code § 16600; see *Edwards v. Arthur Andersen LLP,* 44 Cal. 4th 937 (2008).[8] California has effectively had a ban on non-competes for over 150 years, yet the California economy—and in particular, its technology sector—has flourished. The California economy is thriving. It has the largest economy in the U.S. and is poised to overtake Germany as the world's 4th largest economy.[9]

Many economists have suggested that its ban on non-competes has played a key role in the development of its technology sector.[10] Many scholars and commentators have posited that the success of Silicon Valley, the heart of California's technology industry, is precisely *because of* California's statutory bar on non-competes.[11] This prohibition has led technology employers to cooperate and compete, generating a "dynamic process leading to Silicon Valley's characteristic career pattern, lack of vertical integration, knowledge spillovers, and business culture."[12] In an influential book, AnnaLee Saxenian compared the technology industries of Silicon Valley in California with Route 128 in Massachusetts, crediting California's ban on non-competes as a key factor explaining Silicon Valley's far superior rates of growth and innovation to Route 128.[13]

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[8] In 1872, California first codified its prohibitions on non-competition by enacting Section 1673 of its Civil Code, which read: "Every contract by which any one is restrained from exercising a lawful profession, trade, or business of any kind, otherwise than is provided by the next two sections, is to that extent void." Cal. Civ. Code § 1673 (1872). In 1937, this code section was moved to the California Business and Professions Code.

[9] "ICYMI: California Poised to Become World's 4th Biggest Economy," Office of Governor Gavin Newsom, Oct. 24, 2022 https://www.gov.ca.gov/2022/10/24/icymi-california-poised-to-become-worlds-4th-biggest-economy/.

[10] *See, e.g.*, ANNALEE SAXENIAN, REGIONAL ADVANTAGE: CULTURE AND COMPETITION IN SILICON VALLEY AND ROUTE 128 (1994); Ronald J. Gilson, *The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete*, 74 N.Y.U. L. REV. 575, 627 (1999).

[11] *See e.g.* Jason S. Wood, *A Comparison of the Enforceability of Covenants Not To Compete and Recent Economic Histories of Four High Technology Regions*, 5 VA. J.L. & TECH. 14 (2000).

[12] Gilson, *supra* note 20, at 609.

[13] SAXENIAN, *supra* note 20.

Economic research has found that technology workers in California move jobs more frequently than in other states, leading to more rapid knowledge diffusion and innovation.[14] Another economic study found that bans on non-competes are associated with increased job mobility and higher employee wages.[15] Numerous studies have found that non-competes stifle the creation of new businesses;[16] startups are more likely to be successful and to grow larger in states like California that ban non-competes.[17] States that ban non-compete clauses tend to show greater innovation, more entrepreneurship, higher job growth, and greater venture capital investment.[18]

Thus, the weight of the empirical evidence unambiguously not only refutes arguments about the illusory parade of horrors that would be caused by a ban on non-competes but also demonstrates that banning noncompete agreements, as exemplified by California's experience, fuels greater innovation, entrepreneurship, higher wages and job mobility, and greater higher economic growth, making a compelling case for their prohibition nationwide.

Although the sentiment runs counter to the current loud protestations from Chamber of Commerce groups, many employer-side attorneys in California generally agree that the state's ban on non-compete agreements is a good thing. "It's bad for business and bad for morale," reported one in-house attorney, "if you're an employer, you want the people working for you to *want* to work for you." She reasoned that if employees feel trapped, the employer ends up with a very disenchanted and unmotivated workforce. This attorney also previously worked in-house for a national company that used non-compete agreements with its employees in states which allowed them. She reported that the threatened litigation between companies over these agreements created "make-believe work" for legal departments. She also pointed out that employers still have a solid backstop of trade secret protection agreements, which are fully enforceable in California.

Venture capitalist Bijan Sabet has stated that he does not require noncompete agreements from companies he invests in, and that he asks other companies to abandon them too, because

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[14] Bruce Fallick, Charles Fleischman, and James Rebitzer, *Job-Hopping in Silicon Valley: Some Evidence Concerning the Microfoundations of a High-Technology Cluster*, 88 REV. ECON. AND STATS. 471 (2006).
[15] Natarajan Balasubramanian, Jin Woo Chang, Mariko Sakakibara, Jagadeesh Sivadasan, and Evan Starr, *Locked In? The Enforceability of Covenants Not to Compete and the Careers of High-Tech Workers*, 57 J. HUMAN RESOURCES 2349 (Apr. 2020).
[16] EVAN STARR, THE USE, ABUSE, AND ENFORCEABILITY OF NON-COMPETE AND NO-POACH AGREEMENTS, ECON. INNOVATION GROUP, Feb. 2019, https://eig.org/wp-content/uploads/2019/02/Non-Competes-2.20.19.pdf.
[17] Evan Starr, Natarajan Balasubramanian, and Mariko Sakakibara, *Screening Spinouts? How Noncompete Enforceability Affects the Creation, Growth, and Survival of New Firms*, 64 MANAGEMENT SCIENCE 552 (2017).
[18] Sampsa Samila and Olav Sorenson, *Noncompete Covenants: Incentives to Innovate or Impediments to Growth*, 57 MANAGEMENT SCIENCE 425 (2011).

they do more harm than good.[19] Another Silicon Valley-based investor has cited noncompete agreements as a major impediment to hiring talent to promising new startup ideas. Oftentimes, they identify strong candidates who are interested in the job, but do not accept because they are too afraid to take a job because they are bound by a noncompete. This slows down the pace of innovation and hinders the flow of talent to the best ideas.[20]

I. NELA SUPPORTS THE PROPOSED RULE BUT RECOMMENDS MODIFICATIONS TO STRENGTHEN ITS POWER AGAINST UNFAIR METHODS OF COMPETITION.

A. Definitions of Non-Compete and De Facto Non-Compete in Section 910.1(b)(1) and (2).

Section 910.1(b)(1) defines "non-compete clause" as "a contractual term that prevents a worker from seeking or accepting employment with a person, or operating a business, after the conclusion of the worker's employment with the employer." 88 Fed. Reg. 3535 (proposed Jan. 19, 2023). Importantly, Section 910.1(b)(2) of the Proposed Rule uses a functional test to determine whether a contractual term is prohibited and states that a contractual term may be a "*de facto* non-compete clause because it has the effect of prohibiting the worker from seeking or accepting employment with a person or operating a business after the conclusion of the worker's employment with the employer."

NELA supports this broad definition and use of a functional test. This aspect of the rule reflects the common principle in employment law that what matters is the reality of the worker's situation, not the words and labels used to describe it. Employers might not always cleanly and clearly label as "non-competes" contractual obligations that have the effect of imposing a non-compete. A rule that permits employers to limit employees' freedom to seek other employment by simply using a different label would eviscerate the purpose and efficacy of the Proposed Rule.

We are concerned, however, that the use of the words "prevents" and "prohibiting" in Section 910.1(b)(1) and (2), respectively, could be construed more narrowly than the Commission intends by failing to capture the types of de facto non-compete clauses that the Proposed Rule intends to proscribe. The Restatement (Second) of Contracts § 186(2)(1981) uses a more expansive definition: "A promise is in restraint of trade if its performance would limit competition in any business or restrict the promisor in the exercise of a gainful occupation." Likewise, the Uniform Restrictive Employment Agreement Act (UREAA) drafted by the

[19] Matt Marshall, *Case closed: Non-competes aren't good*, VENTURE BEAT, 2007, https://venturebeat.com/business/case-closed-non-competes-arent-good/.
[20] Timothy Lee, *A little-known California law is Silicon Valley's secret weapon*, VOX, Feb. 13, 2017, https://www.vox.com/new-money/2017/2/13/14580874/google-self-driving-noncompetes.

National Conference of Commissioners on Uniform State Laws, utilizes a broader, more generalized protective focus: "Even if an agreement does not meet the definition of a non-solicitation agreement, confidentiality agreement or other named agreement, however, it is a restrictive employment agreement if it prohibits, *limits, or sets conditions* on working elsewhere after the work relationship ends or a sale of business is consummated." UREAA at 14 (Feb. 14, 2023), available at https://www.uniformlaws.org/committees/community-home?communitykey=f870a839-27cd-4150-ad5f-51d8214f1cd2 (emphasis added).

Therefore, NELA therefore recommends that, in the definition of "non-compete clause" in Section 910.1(b)(1), the Commission replace "prevents" with "**restrains or limits**," so that the definition reads: "a contractual term that **restrains or limits** a worker from seeking or accepting employment with a person, or operating a business, after the conclusion of the worker's employment with the employer." Further, NELA recommends that, in Section 910.1(b)(2), the Commission replace "prohibiting" with "restraining or limiting" so that Section 910.1(b)(2) states: "The term non-compete clause includes a contractual term that is a de facto non-compete clause because it has the effect of **restraining or limiting** the worker from seeking or accepting employment with a person or operating a business after the conclusion of the worker's employment with the employer." 88 Fed. Reg. 3482, 3509 (proposed Jan. 19, 2023).

B. The Commission Should Strengthen the Ban by Expressly Including Non-Competes with Unfair Enforcement Remedies and Providing More Examples of De Facto Non-Compete Clauses.

NELA applauds the inclusion of two non-exhaustive examples of de facto non-competes in the Proposed Rule. We do, however, believe that greater clarity by way of additional examples of prohibited clause would assure uniformity, avoid the *in terrorem* effect of any uncertainty, and preempt creative contract writing that would undermine the intent of the Proposed Rule. More specifically, NELA requests that the Commission confirm that the clauses set forth below are prohibited by the Proposed Rule because they are explicitly or functionally non-compete clauses.

1. <u>Forfeiture-for-Competition Clauses</u>: We incorporate the extensive discussion of forfeiture-for-competition clauses set forth in the Comments submitted by NELA/NY, NELA's New York affiliate, on April 19, 2023. In summary, with forfeiture-for-competition clauses, an employee who violates a non-competition obligation forfeits compensation, rather than being subjected to injunctive relief. While many jurisdictions scrutinize these provisions under the same reasonableness standards as applied to other non-competes, s*ee, e.g., Deming v. Nationwide Mut. Ins. Co*., 279 Conn. 745, 763, 905 A.2d 623, 635 (2006), several jurisdictions do not, reasoning that the employee is not prohibited from working because he or she has the "choice" of competing or accepting compensation and that such scrutiny is unnecessary.

In reality, such choice is illusory. Often, the employee risks forfeiting meaningful compensation for work performed, while the employer stands to receive a liquidated remedy that may bear little, if any, relation to the damages actually incurred as a result of the alleged breach. *See, e.g., Ainslie*, Consol. C.A. No. 9436-VCZ, 2023 WL 106924, *17, 22-24 (analogizing the forfeiture for competition clauses at issue to liquidated damages provisions and noting that such provisions create the same "undue chilling effect on employment and upward mobility as a restrictive covenant" where the liquidated damages have no relation to actual harm suffered). Thus, forfeiture for competition clauses deter competition and worker mobility just like other non-compete clauses; they simply provide the employer with a pre-determined economic remedy. The Commission should explicitly clarify that forfeiture for competition clauses are non-compete clauses prohibited by the Proposed Rule.

2. <u>Liquidated Damages Clauses:</u> Like forfeiture for competition clauses, restrictive covenants with liquidated damages provisions are enforced through payment of a fixed amount of damages rather than through injunctive relief. Such clauses restrain competition and limit mobility like other non-competes; they simply allow the employer to avail itself of a preset amount of damages that may bear no relation to the damages actually incurred as a result of an alleged breach. *See generally Ainslie*, Consol. C.A. No. 9436-VCZ, 2023 WL 106924, *22-24.

As with forfeiture-for-competition clauses, however, some courts hold that liquidated damages provisions are not restraints of trade. In *Eastern Carolina Internal Medicine, P. A. v. Faidas*, 149 N.C. App. 940, 564 S.E.2d 53 (2002), for instance, the court ruled that a physician's contract which required payment of liquidated damages in the amount of $109,000 in the event the physician worked for another healthcare provider within a three-county territory, was not a non-compete and thus not "subject to strict scrutiny as to reasonableness and public policy required with a covenant not to compete," because the clause did not forbid competition but instead required payment of a fee. *Id.* at 945, 56. The Commission should, with clarity, debunk and invalidate this type of reasoning that is still upheld in parts of the country and confirm that liquidated damages provisions are prohibited under the Proposed Rule.

3. <u>No-Service/No-Business Agreements</u>: Often misnamed "non-solicitation" clauses, no-service/no-business agreements prohibit former employees from servicing or accepting business from customers or clients of their former employer after employment ends, even where the employee does not solicit the business. These clauses have the same impact as a non-compete clause, especially as to salespersons and licensed professionals, as they eliminate consumers' market choice and impede worker mobility, particularly where such clauses are drafted so broadly as to apply to clients with whom the employee had no direct contact and/or contain no exception for an employee's pre-existing clients. Courts have rejected attempts to pass off as "mere…non-solicitation provision[s]" covenants that prevent former employees from engaging in business with customers and recognized that such clauses constitute non-compete clauses. *Dent Wizard Int'l Corp. v.*

Andrzejewski, 2021 IL App (2d) 200574-U, ¶ 35, 2021 Ill. Ap. Unpub. LEXIS 687, *18 (IL App. April 23, 2021) (citing *Zabaneh Franchises, LLC v. Walker*, 2012 IL. App (4th) 110215, P21, 972 N.E.2d 344, 361 Ill. Dec. 859 (2012)).

Accordingly, NELA proposes that no-service/no-business agreements be included among the examples of de facto non-competes in Section 910.1(b)(2) of the Proposed Rule. This addition would be particularly helpful in order to distinguish these no-service agreements from actual non-solicitation agreements, which are not prohibited by the Proposed Rule.

4. No-S h op / "Forward " Contracts. We incorporate the NELA/NY Comments with respect to no-shop or "forward contract" clauses, which prohibit employees
from accepting an offer for future employment while still employed by the current employer. By putting employees in this professionally and economically untenable position, i.e., requiring an employee to be unemployed before accepting a new position, these clauses restrain employee mobility and decrease the employee's bargaining position with a new employer for wages and other benefits. NELA thus requests that no-shop/forward contract clauses be included as examples of de facto non-competes.

5. Non-Disparagement Clauses. We incorporate the discussion set forth in the NELA/NY Comments with respect to non-disparagement clauses that function as non-competes, insofar as they prohibit a former employee from making otherwise lawful statements in the normal course of competition on behalf of a future employer or engagement. We request that the Commission include as an example of a de facto non-compete an agreement prohibiting a former employee from making otherwise lawful statements in furtherance of lawful competition.

C. Section 910.1(c): Definition of Employer.

Section 910.1(c) of the Proposed Rule defines "employer" to mean a "person, as defined in 15 U.S.C. § 57b-1(a)(6), that hires or contracts with a worker to work for the person." 88 Fed. Reg. at 3510 (proposed Jan. 19, 2023) ("Person" under 15 U.S.C. § 57b-1(a)(6) means: "any natural person, partnership, corporation, association, or other legal entity, including any person acting under color or authority of State law." 15 U.S.C. § 57b-1(a)(6)).

NELA generally supports the FTC's proposed definition of "employer," but believes that the Commission should adopt a more expansive definition to ensure that no worker falls through the cracks as a result of complex arrangements by which a worker is subject to control by multiple entities or employed by one entity while subject to a non-compete clause through a compensation or equity agreement with a different entity, such as a parent, affiliate, or subsidiary of the employer. Non-competes are deployed to the detriment of workers and fair competition not just by traditional employers but across an array of opaque relationships whereby multiple entities act variously or in concert to constrict worker freedom. Thus, we propose that the

definition of employer apply to an employer's affiliates, parents, subsidiaries, persons or entities under common control, and joint employers.

This definition would better ensure that employers do not escape the rule's proscriptions through various affiliated or shell entities not arguably otherwise covered by the Rule's definition of employer. Such an approach is in keeping with the Commission's broad definition of "worker" to mean workers classified as independent contractors, as well as externs, interns, volunteers, apprentices, or sole proprietors providing service to a client or customer.

D. The Proposed Requirements of Retroactive Application and Rescission Are Critical to Curtail the Harms Imposed by Non-Competes.

The Commission has identified a number of economic and market-based harms that result from the use and abuse of non-compete provisions. These harms continue at least through the life of the contract and the term of the non-compete period and, in some cases, longer. The depression of wages, limits on career progression, and lack of market choice for consumers caused by non-competes can be reasonably be viewed as cumulative and extending beyond the term of the non-compete clause.

A rule that only banned future non-compete clauses would leave these existing harms and their *sequella* in place and unchecked. Employees who have already entered into non-competes would still be prevented from switching jobs. Entrants into the job market would still be precluded from positions filled by dissatisfied workers whose mobility is limited by non-competes. Consumers would still lose their ability to choose. Innovation would continue to be stymied to the extent would-be entrepreneurs are subject to non-competes.

A rule that only applies on a going-forward basis would have at least two detrimental effects. It would create a perverse incentive for employers to enter into non-compete provisions with employees before the Proposed Rule's effective date and create two classes of workers arbitrarily: those who are subject to a non-compete provision and those who are not. This would result in depressing employee mobility – and, as a result, earnings potential – for the more senior members of the labor market, with a disparate impact on our nation's oldest workers. While we already see hiring preferences for younger workers, we would undoubtedly see more of this preferential treatment where employers view younger job candidates as being presumptively more mobile and thus attractive, given that they would be less likely to be subject to restrictive non-competes.

But the retroactive application alone will not be enough. A change in enforceability is not self-enforcing: it requires the parties to each individual contract to understand the change and to conduct themselves accordingly. Based on the experiences of our members as representatives of employees, many workers who are subject to unenforceable non-competes are not aware of

their unenforceability.[21] As stated above, whether and to what extent a contractual provision is enforceable has become increasingly challenging for a layperson to understand as the patchwork of state laws has become more complex and divergent over the past decade.[22] Moreover, most workers lack the means to seek legal counsel as to the enforceability of a non-compete and, if determined to be unenforceable, to mount a costly legal challenge to declare the non-compete unenforceable or to defend a suit against enforcement of such a restriction.[23]

In this regard, the Proposed Rule's rescission requirement, as set forth in Section 910.2(b), provides for an elegant and impactful solution. Employees would be provided an individual, written notice that their restriction is no longer in effect. This written rescission would make the employee more aware of their rights and therefore increase employee mobility within the labor market.[24] Further, the ability to provide a prospective employer with a written rescission of a non-compete provision would give job-seekers the ability to assuage any concerns of litigation risk held by a prospective employer.

E. The Proposed Rule Should Have A Clear Sale-of-Business Exception for a *Bona Fide* Corporate Transaction.

The Commission's Proposed Rule's single exception, as outlined in Section 910.3, as applicable to the sale of an ownership interest by a substantial owner, substantial member or substantial partner should be further limited to apply to those corporate transactions that constitute a *bona fide* transfer of assets or ownership interests to an independent third party. As drafted, the Proposed Rule would permit a non-compete with a substantial owner, member or partner in the context of a repurchase right or a mandatory stock redemption program that is triggered upon the termination of the service relationship. These terms are particularly common in the context or private companies' equity incentive plans, which have become increasingly common terms and conditions of employment in light of the increased of venture capital-backed employers.

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[21] *See also* J.J. PRESCOTT AND EVAN STARR, SUBJECTIVE BELIEFS ABOUT CONTRACT ENFORCEABILITY 2 (2022) (finding that "70% of employees with unenforceable non-competes mistakenly believe their non-competes are enforceable").

[22] *See generally* Non-Compete Clause Rule, 88 Fed. Reg. 3482, 3494 at Part II.C.1 (proposed Jan. 19, 2023) (outlining the landscape of state law governing non-competes, including recent legislative changes).

[23] *Id.* at 3489 (noting that employees who believe their non-competes are unenforceable are still less likely to breach their terms, seemingly to avoid the specter of a lawsuit or risk the reputational harm associated with breaching a contract).

[24] PRESCOTT AND STARR, *supra* note 21, at 26 (concluding that information campaigns, such as individualized notice to workers, regarding the unenforceability of a non-compete will likely improve an employee's ability to take a competitive job).

Although the threshold ownership percentage of 25% does require that the person hold a truly substantial ownership in the selling entity,[25] we fear that employers will use wholly-owned subsidiary entities to create an ownership on paper that might meet this threshold percentage, but that is considerably less than the ownership in the parent or holding entity where the actual assets of the company lie. We believe that limiting Section 910.3 to a *bona fide* corporate transaction with an independent third party, would prevent employers from creating a large loophole out of this exception.

In addition, we propose that the Commission further clarify that any non-compete permitted under the exception outlined in Section 910.3 must run from the consummation of the transaction and not the termination of a worker's service relationship (*e.g.* employment or contracting). This would prevent companies from using restrictions to be an end-run around the ban on post-employment non-competes. Non-competes in the context of a corporate transaction are intended to provide the seller the benefit of the goodwill they have just purchased. To permit a non-compete to run post-employment rather than post-transaction does not serve to protect that legitimate business interest, [26] and also has the harmful economic effects outlined by the Commission with respect to the labor market. [27]

III. NELA STRONGLY OPPOSES THE COMMIS S ION' S PROPOSED ALTERNATIVES.

NELA strongly opposes the three potential alternatives to a complete ban identified by the Commission because the alternatives would unjustifiably leave the economic and market-based harms caused by non-compete agreements intact, create uncertainty, and allow for easy evasion.

A. NELA Opposes Exceptions and Separate Rules for Senior Executives.

The Notice of Proposed Rule Making seeks comments on whether "senior executives" should be subject to different rules or carved-out from the non-compete ban. At the outset, as the Commission itself noted, there is no agreed-upon definition of "senior executive." 88 Fed. Reg. 3482, 3520 at Part IV.C (proposed Jan. 19, 2023). It is an amorphous category that can expand and contract depending on usage and context and is not an appropriate basis on which to determine eligibility for workplace protections. Creating exceptions or separate rules for senior executives would invite arbitrary distinctions that are unrelated to any legitimate protectible employer interest, be ripe for abuse, and perpetuate the unfair competition targeted by the Proposed Rule.

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[25][25] We support the use of a clear threshold percentage rather than a more vague definition that would require adjudication and interpretation by courts.

[26] *See Reed Mill & Lumber Co., Inc. v. Jensen*, 165 P.3d 733, 737-38 (Colo. Ct. App. 2006).

[27] *See* Non-Compete Clause Rule, 88 Fed. Reg. 3482, 3484 at Part II.B (proposed Jan. 19, 2023).

A carve-out or separate rule for senior executives would still deprive competitors, consumers, and the public of the ability to fairly compete for the executive's talent or benefit from their innovation. Moreover, that someone is a senior executive or highly compensated does not insulate him or her from the untenable choices that other workers who are subject to non-competes face; they too need to earn a livelihood and pursue their careers. Although the Commission preliminarily notes that non-competes are not exploitative and coercive for senior executives, most high earners and/or senior executives do not have the bargaining power to avoid a non-compete. More generally, the fact that an employee was highly paid or advanced in their career to hold a senior position for the work they performed for a former employer is simply not a legitimate protectible reason to force them to remain tethered to a job or to force them to sit out of their career after the employment ends. As stated above, to the extent that employers need to protect trade secrets and the like, they have ample alternative options for protecting those interests.

In fact, given that senior employees tend to be older than junior employees, saddling only senior executives with non-compete agreements can make them less attractive to potential employers in favor of younger and more junior employees, and forcing senior executives to sit-out of their fields can deprive them of their livelihoods during critical earning years. Compounding this problem is that the number of available comparable jobs decreases as employees become more senior, making it that much more difficult for a high-level employee to find a comparable job after being forced to sit-out from their field.

B. NELA Opposes Exceptions and Separate Rules Based on Income Thresholds.

NELA further opposes exceptions and separate rules based on income levels because, as with separation rules for senior executives, distinctions based on income levels are arbitrary, are unrelated to any legitimate protectible interest, would be ripe for abuse, and would perpetuate the anti-competitive harms identified by the proposed rule, while there are viable alternatives for employers to protect trade secrets, confidential information, and client lists. The anti-competitive effects of non-competes occur at all wage levels – the market, consumers, and the public are still deprived of the ability to compete for the innovation and talent of high earners who can contribute to new and existing market entrants. As with senior executives, although the Commission preliminary found that non-competes are not coercively imposed on high wage earners, most high wage earners do not have the bargaining power to avoid a non-compete. In any event, the fact that someone earned a high wage for performance of their job is not a legitimate basis to limit such employees' mobility post-employment.

Using salary or wages as a metric is also inapt and unfair because doing so ignores the compensation and opportunities that can reasonably be expected to be lost during the non-compete period. An employee who earns a salary of $100,000 per year but who is required to sit out from his or her career or field for one year after employment may need to stretch his prior

earnings to cover a lack of comparable pay during the non-compete period or may have lost better-paying opportunities at the result of the non-compete. Once those costs are factored in, the employee may well have earned less than $100,000 per year for one or more years of his or her prior job but still would be deprived of the protections of a rule that only banned non-compete clauses for those paid salaries of less than $100,000 per year. The non-competes themselves would make any eligibility test based on salaries and wages inherently inaccurate and deprive intended beneficiaries of the protections of the Proposed Rule.

In addition, any threshold amount that would apply to all locations would be difficult to find. What would be high wages in some parts of the country, would not be in others. Any attempt at equalizing for cost of living would increase uncertainty and impede the goal of providing a clear rule. Further, an employer would not necessarily have to pay a worker the threshold amount for any set amount of time. At-will employees can be terminated at any time, with little, if any severance pay. Employers seeking to evade the rule could simply raise an employee's salary to meet the threshold and terminate them after they sign the non-compete.

C. NELA Opposes a Rebuttable Presumption Would Leave Intact the Harms Identified by the Commission.

The Commission's Notice of Proposed Rulemaking requests comments on a potential alternative in which a rebuttable presumption of enforceability would be used in lieu of a categorical ban. We strongly oppose a rule that would include such a presumption. For the reasons described in Part I of our comments, a rule that would require employees to both know the contours of the law and also when it is being overstepped has a chilling effect on both an employee's desire to consider new job prospects and a prospective employer's desire to hire a restricted candidate.

We need look no further than existing state laws to see that statutes with a rebuttable presumption of enforceability can still have a detrimental impact on employee mobility and, consequently, labor markets. Florida, which has a statute that sets forth presumptive enforceability standards,[28] is considered the state with the highest enforceability of non-competes and, consequently, a more depressed labor market in terms of wages for even the most senior employees.[29]

[28] FLA STAT. § 542.335.
[29] *See* Non-Compete Clause Rule, 88 Fed. Reg. 3482, 3524 at Part VII.B.1.a.iv (proposed Jan. 19, 2023).

D. Blue- and Purple-Penciling to Salvage Non-Compete Agreements Should Be Prohibited.

If the Commission ultimately permits any exceptions, however, the problem of reformation of overbroad restrictions will certainly arise. The Commission has noted that states apply a variety of approaches towards reformation of overly broad restrictive covenants:

> • Some States, like Wyoming, will not enforce or reform overbroad restrictions (red-penciling);
> • Other States, like North Carolina, permit a court to strike overly broad provisions, but do not permit the court to otherwise modify the terms (blue-penciling);
> • Other States, like Texas, allow the Court to reform or re-write overly broad provisions so the restrictions can be enforced, and sometimes only where the contract authorizes court revisions (purple-penciling).

In addition, non-compete agreements frequently contain reformation or blue pencil clauses which state that the contracting parties agree to seek reformation or permit the court to make an otherwise unenforceable contract clause enforceable.

If the Commission permits any exceptions – such as exempting professions or income categories – the Proposed Rule should also provide that contracts cannot require reformation of overbroad non-compete provisions. Contract reformation is equitable in nature. Contract re-writing is largely not countenanced in other areas of contract law. *Penn v. Standard Life Ins. Co.*, 76 S.E. 262, 263 (N.C. 1912) ("Courts are not at liberty to rewrite contracts for the parties. We are not their guardians, but the interpreters of their words."). Indeed, why should the Court invoke its equitable powers to enforce a provision disfavored under the common law, when the drafter has overstepped its bounds? They should not, particularly given the *in terrorem* effect of overly broad non-competes. That is, for each non-compete salvaged by a court's reformation, thousands more workers will be penalized by adhering to overly broad provisions, believing them to be legal, or at least not worth challenging.

As the Wyoming Supreme Court recently recognized, it does not make sense to heap these judicial benefits on an overreaching employer:

> When challenged, the employer gets the benefit of the court redrafting the agreement to make it reasonable. *Golden Rd. Motor Inn*, 376 P.3d at 158; Pivateau, 86 Neb. L. Rev. at 689-90. The employer receives what "amounts to a free ride on a contractual provision that the employer is . . . aware would never be enforced." Pivateau, 86 Neb. L. Rev. at 689-90. "'[T]his smacks of having one's employee's cake[] and eating it too.'" *Richard P. Rita Pers. Servs. Int'l, Inc. v. Kot*, 229 Ga. 314, 191 S.E.2d 79, 81 (Ga. 1972) (quoting Harlan M. Blake,

> Employee Agreements Not to Compete, 73 Harv. L. Rev. 625, 683 (1960) [hereinafter referred to as Blake]). *See also Reddy*, 298 S.E.2d at 914-15 (in rejecting the liberal blue pencil rule, the West Virginia Supreme Court reasoned it "will necessarily encourage employers to draft overly broad agreements in the belief that . . . if they [are challenged], the terms will simply be judicially narrowed").

Hassler v. Circle C Res., 505 P.3d 169, 177 (Wyo. 2022). We agree with the sound reasoning of the Wyoming court and urges the Commission that, if any exceptions to the non-compete ban are allowed, it should forbid employers from obtaining reformation, or blue-penciling, of overbroad provisions.

IV. THE FTC'S AUTHORITY TO ISSUE THE PROPOSED RULE AND THE MAJOR QUESTIONS ISSUE.

The FTC has broad authority to interpret the FTC Act's prohibition on unfair methods of competition and to issue regulations declaring practices to be unfair methods of competition. Section 5 of the FTC Act directs the Commission to "prevent persons, partnerships, or corporations … from using unfair methods of competition in or affecting commerce," 15 U.S.C. § 45(a)(2), and Section 6(g) authorizes the FTC to "make rules and regulations for the purpose of carrying out the provisions of [the FTC Act]." 15 U.S.C. § 46(g).

As the Commission stated in its NPRM, courts have long held that Section 5's prohibition of unfair methods of competition encompasses all practices that violate either the Sherman or Clayton Acts, as well as extends to incipient violations of the antitrust laws. As the Supreme Court noted in *FTC v. Texaco Inc.*, "Congress enacted § 5 of the Federal Trade Commission Act to combat in their incipiency trade practices that exhibit a strong potential for stifling competition." 393 U.S. 223, 225 (1968).

In addition to the enacting Congress' clear grant of authority to the FTC to promulgate substantive rules in 1914 with the passage of the FTC Act, the FTC's authority to issue substantive regulations proscribing unfair methods of competition was both tested and affirmed again in the 1970s. In *National Petroleum Refiners v. FTC*, the United States Court of Appeals for the District of Columbia upheld the FTC's authority to conduct substantive rulemaking under both its unfair-methods-of-competition and consumer protection mandates. 482 F.2d 672 (D.C. Cir. 1973). After the Supreme Court denied certiori and thus left the D.C. Circuit's ruling in place, Congress passed the 1975 Magnuson-Moss Warranty Act, Magnuson-Moss Warranty—Federal Trade Commission Improvement Act, Public Law 93–637, 88 Stat. 2183 (1975). The Magnuson-Moss Warranty Act put in place heightened procedural requirements for the FTC to engage in rulemaking pursuant to its consumer protection mandate. Notably, however, Congress did not disturb the FTC's authority to engage in rule-making under its unfair-methods-of-

competition mandate and thus ratified the D.C. Circuit's ruling in that regard. Non-Compete Clause Rule, 88 Fed. Reg. 3482, 3544 at Part XI.II (proposed Jan. 19, 2023).

Moreover, as UCLA law professor Blake Emerson has noted, *National Petroleum Refiners* is a bedrock holding on agency rulemaking authority by the nation's most important administrative law circuit court and is frequently taught in administrative law courses.[30] If *National Petroleum Refiners* were wrong, not only would the FTC's rulemaking power be under threat, but also those of other agencies like the EPA which have long issued substantive regulations under general grants of rulemaking authority.[31] As a result, unless administrative rulemaking writ large is on the chopping block, the FTC's authority to conduct substantive rulemaking on the basis of the FTC Act's general enabling legislation is on stable footing.

Despite the clear legal basis for the FTC's proposed rule, certain commentators might seek to argue that the FTC rulemaking against non-compete agreements runs afoul of the Supreme Court's bourgeoning "major questions doctrine," whereby the broader the authority an agency purports to exert, the more demanding the showing required that Congress intended the agency to exert that power. However, such an argument should not be reason for the FTC to shy away from fully exercising its authority under the FTC Act to promulgate a rule banning non-compete agreements as an unfair method of competition.

First, accepting the Supreme Court's "major questions doctrine" on its own terms, the FTC's proposed rule should easily pass muster. Given the FTC Act's clear grant of authority to the FTC, the 1975 Congress' implied ratification of that authority, the longstanding amenability of non-compete clauses to government regulation, and the necessary limitations on agency policies the Court is apt to declare "major," there is little reason to hesitate before concluding that Congress meant to confer on the FTC the authority it claims under Sections 5 and 6(g) of the FTC Act to promulgate its proposed rule. *Cf. FDA v. Brown & Williamson*, 529 U.S. 120, 159-60 (2000).

Unlike the bulk of the Supreme Court's "major questions" jurisprudence, where the agencies in question claimed authority to prescribe a regulation of vast "economic and political significance" based on statutory language described by the Court as "modest words," "vague terms," or subtle devices," *Whitman v. American Trucking Ass'ns*, 531 U.S. 457, 468 (2001), here the FTC Act is quite clear in conferring substantive rulemaking authority to the FTC, particularly if one reads Sections 5 and 6(g) together, in view of the canon that a statute must be construed as a whole. 15 U.S.C. Sec. 45, 46(g). Moreover, despite recent academic critiques of the reasoning employed by the D.C. Circuit in *National Petroleum Refiners* to affirm the FTC's

[30] Blake Emerson, *The Progress of FTC Rulemaking, by Blake Emerson,* Notice & Comment, YALE J. REG., Mar. 21, 2023, https://www.yalejreg.com/nc/the-progress-of-ftc-rulemaking-by-blake-emerson/.
[31] *Id.*

rulemaking authority, the fact that Congress subsequently impliedly ratified the decision via the 1975 Magnuson-Moss Warranty Act should lay such concerns to rest.

Second, on a conceptual level, the argument that the FTC's proposed rule would violate the so-called "major questions doctrine" would lead to absurd results that would likewise prevent judicial as well as administrative development of antitrust rules. The "major questions" objection is ostensibly grounded in the separation of powers, namely a protection of Congress's exclusive Article I power to legislate and a limitation on executive branch agencies' encroachment thereon. Yet if this argument were evenly applied, it would equally prohibit both the judicial as well as the executive branch from developing major antitrust rules. If the FTC as an executive agency usurps Congress' legislative power by developing "major" antitrust rules, then seemingly any such rules developed by the courts would do the same. But such an outcome would render the last century of judge-made doctrine in antitrust law invalid. Indeed, the courts' development of "per se" versus "rule of reason" tests would all presumably be unconstitutional, since these would be "major questions" of antitrust law that should have been reserved for Congress.

Unsurprisingly, the Supreme Court has already rejected this view with respect to its own authority to develop antitrust law. In *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, for example, the Court described the Sherman Act as a "common law statute" that gives courts the authority to frame and revise major antitrust rules, without having to defer until Congress takes action. 551 U.S. 877, 899 (2007). As the Court noted, "[j]ust as the common law adapts to modern understanding and greater experience, so too does the Sherman Act's prohibition on 'restraint[s] of trade' evolve to meet the dynamics of present economic conditions." *Id.*

In *Leegin*, the Court specifically supported its change of law on that major question by invoking the FTC's stated expertise: "It is also significant that both the Department of Justice and the Federal Trade Commission—the antitrust enforcement agencies with the ability to assess the long-term impacts of resale price maintenance—have recommended that this Court replace the *per se* rule with the traditional rule of reason." *Id.* at 900. This repeats the Court's consistent reliance on the FTC's lawful authority to develop antitrust policy under the fair-competition laws. Indeed, in *FTC v. Sperry & Hutchinson Co.*, the Court affirmed that the FTC, in defining "the congressionally mandated standard of fairness," can "like a court of equity, consider[ ] public values beyond simply those enshrined in the letter or encompassed in the spirit of the antitrust laws." 405 U.S. 233, 244 (1972). See also *FTC v. Ind. Fed. of Dentists*, 476 U.S. 447, 454 (1986) (noting that the standard of "unfairness" under the FTC Act encompasses "not only practices that violate the Sherman Act and other antitrust laws, but also practices that the Commission determines are against public policy for other reasons").

Yet now, the employer commenters argue the exact opposite—that the FTC's views on antitrust rules are irrelevant, because the FTC cannot displace Congress. That argument is foreclosed by *Leegin.* The Supreme Court sees no separation-of-powers issue in its own "common law" development of major antitrust rules, and justifies its own change in antitrust

rules by invoking the FTC's expertise. The employer commenters' "major questions" objection has no merit against this background.

VI. CONCLUSION

For the reasons set forth above, NELA and the Institute urge the FTC to finalize the Proposed Rule as drafted, with the modifications requested above, and prohibit the use of non-compete agreements except in the limited circumstances related to a sale of business described above.

If you have questions regarding these comments, or difficulty opening the attachment, please contact Jeffrey A. Mittman, Executive Director, jmittman@nelahq.org.

Sincerely,

Jeffrey A. Mittman
Executive Director

Attachment: Stories of Workers Harmed by Non-Compete Clauses

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APPENDIX

Stories of Workers Harmed by Non-Compete Clauses

Following are examples of the untenable choices and Kafka-esque circumstances that some of our members' clients have faced when they were forced to choose between their dignity, rights, and need to work, and compliance with a non-compete agreement.

• An LGBTQ+ traffic flagger for a traffic safety company in Ohio was required to sign a non-compete agreement when she was promoted to trainer. The non-compete agreement prohibited her from working for similar companies for 12-months within 100-miles of her employer. When co-workers started spreading rumors that she was in a relationship with a fellow LGBTQ co-worker, she complained about harassment. The employer then transferred her to a new work location, which was further from her home. Believing that the transfer was retaliatory, she resigned and filed a charge of discrimination with the EEOC. She moved to Texas in order to start a new job that was well outside the 100-mile radius of the non-compete agreement -- and her former employer sued her for violating the non-compete anyway. Her new employer laid her off because of the litigation. She was required to defend the lawsuit in Pennsylvania, where she neither lived nor worked, because of the choice of venue clause in the non-compete agreement. The Time's Up Legal Defense Fund ultimately subsidized her litigation costs, and the case eventually settled.

• A salesman with twenty years of experience in steel sales, brought a large book of business with him to his employer. He signed a non-compete that prohibited from working for competitors for 2 years "within the geographic area [employer] solicits," an area that included approximately half of the United States, and a non-solicitation agreement, which prevented him from soliciting the business's clients after leaving. Because the employer's president was abusive, the salesman decided to resign but, because of the non-compete agreement, he had to accept a job in Arizona, take a large pay cut, and rebuild his business from clients on the west coast from scratch. When he had to work from Indiana remotely during the pandemic, the former employer sued him for violating the non-compete agreement, and, after a year of litigation and more than $25,000 in (heavily discounted) attorneys' fees, the case resolved through settlement.

• A bar in a university town in Georgia required all of its managers and bartenders to sign non-compete agreements preventing them from working for any bars within two miles of the bar for two years, even though the bartenders had no specialized training or trade secrets from the bar. Those who violated the non-compete clause were required to pay a penalty of $5,000 to the bar, disguised as reimbursement for "training costs." The non-compete functionally prevented the bartenders and managers from working for any other bar in the town, yet the bar also failed to pay employees for all their hours of work. When one employee quit and went to work for another bar in the town because she was not being paid properly, the employer threatened to seek

a temporary restraining order against her. She had to take an advance of salary from her new employer in order to pay her former employer and end the risk of protracted litigation.

• A children's gymnastic coach at a local gym, was subject to a non-compete prohibiting her from working as for *any* gymnastics, dance, tumbling, or movement education organization within 30 miles of the gym for a year after her employment ended. Because the gym owners were disrespectful and abusive to her and the students, she quit and took a job as an assistant coach at another gym several miles away. The former employer sued her, seeking a temporary restraining order blocking her employment at the new gym and seeking damages.

• Two women worked for a small housekeeping business in Utah, cleaning approximately ten houses per week, were laid off after less than one year of tenure. They had signed non-compete agreements prohibiting them from working for a competing business for one year in the county where the business operating *plus a neighboring county where the business did not conduct any work.* When they were laid off, the former employer threatened them with a lawsuit and withheld their final pay based on a "liquidated damages" clause in the contract (even though they had not violated the non-compete). The women were afraid to continue working in the area covered by the non-compete, even though the business had not even operated in one of those counties.

• A project manager for a construction company in Utah had a non-compete agreement that prohibited him from working on any construction projects *in five states for two years* post-employment, even though the company did not work at all in two of the five states (and was not even licensed to work in those states) and never took jobs below a certain dollar value in Utah. After the project manager was fired, he took on some small construction jobs in Utah – jobs that were too small for his former employer to take. The former employer sued the project manager for violation of the non-compete. The litigation costs forced him out of business and put him on the brink of bankruptcy.

• A salesperson for a large national construction supply company, was subject to a non-compete preventing him from working for a competitor *within 100 miles for two years* post-employment, even though his sales territory was smaller than the area covered by the 100-mile radius. When the salesperson was hired by a small competing company within the 100-mile radius (but outside his former sales territory), the former employer sued. Although the salesperson was able to continue working for his new employer, he was forced to engage in expensive litigation to challenge the overly broad non-compete.

• An online content writer in New Jersey for an online medical website had a non-compete agreement prohibiting her from working for a competitor of the website and its parent for one-year post-employment. The non-compete clause effected prevented the writer from working for *any medical publishing company*, even though she was not involved in strategic decision-making for the website in any way. She had the opportunity to move to a much better

paying job with more potential advancement with a large company, which wanted to hire her, but the company would not proceed with her offer unless she obtained a waiver of the non-compete clause from her employer. The employer refused. Only after she filed a lawsuit seeking a declaratory judgment and preliminary junction to invalidate the non-compete did her former employer agree to negotiate the non-compete clause, and she was ultimately able to join the company, but only after retaining counsel and incurring litigation costs.

• An audio and video technologist for a company that ran large concerts and corporate events. His non-compete agreement barred him from working in the audio-visual industry for *three* years anywhere in *the Midwest*, which basically meant that he would either need to move across the company or leave the field after his employment ended. After the company furloughed him during the pandemic, he was hired by a competitor. When the former employer accused him of violating the non-compete agreement, he found yet another job, but the former employer again accused him of violating the non-compete agreement. After the technologist sued for a declaratory judgment to invalidate the non-compete agreement, the employer counter-sued to extend the non-compete agreement and recover attorneys' fees and costs. The litigation is ongoing.