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‘Can’t we just be like California?’ Another solution in search of a problem

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DAWN MERTINEIT
Partner, Seyfarth Shaw LLP

Dawn regularly litigates trade secrets and restrictive covenants matters in state and federal courts throughout the country.

ROBERT B. MILLIGAN
Partner, Seyfarth Shaw LLP

Robert is the co-chair of the Trade Secret, Computer Fraud and Non-Competes Practice Group and editor of the firm's Trading Secrets blog.

While historically the issue of noncompete enforcement has been left to the states, the last year has seen the U.S. Department of Justice and the Federal Trade Commission begin to examine the effect of such covenants on the labor market. The two groups, which are responsible for enforcing antitrust laws, held workshops in September 2019 and January 2020, respectively, with the FTC workshop billed as an attempt “to examine whether there is a sufficient legal basis and empirical economic support to promulgate a commission rule that would restrict the use of noncompete clauses in employer-employee employment contracts.” Specifically, the FTC is analyzing whether noncompetes can be considered an unfair method of competition or an unfair or deceptive act or practice within the meaning of Section 5 of the FTC Act. Many embraced the FTC’s consideration of its authority to regulate noncompetes, including 18 Democratic state attorneys general and labor unions, but also senators from both sides of the aisle. The FTC workshop included commentary from those opposed to noncompetes, including warnings that such provisions chill labor mobility, stifle wage growth, exacerbate income disparity, and are anti-competitive — despite the fact that there is not clear evidence that these claims are accurate.

> More recently, in April, the DOJ's Antitrust Division and the FTC's Bureau of Competition released a joint statement and press release regarding "competition in labor markets" and potential agency actions in the face of the COVID-19 crisis. While some interpreted this joint statement as a signal that the agencies are cracking down on noncompetes generally, a close review of the statement does not back that view up. Instead, the joint statement seems to mostly reiterate what the DOJ had already identified as an enforcement priority — namely, collusion between employers, especially as it relates to no-poach and wage-fixing agreements. The "anticompetitive noncompete agreements" mentioned in the statement, i.e., noncompete agreements not justified by any legitimate business purpose of the employer but purely intended to prevent ordinary competition, are already unenforceable in every state. The agencies' statement does not suggest that narrowly-tailored noncompete agreements (or other restrictive covenants) that protect an employer's legitimate business interests in, for example, protecting confidential information and/or trade secrets, work force, long-term customer relationships, or preserving goodwill with customers, are necessarily unenforceable or subject to heightened scrutiny.

It remains an open question whether the FTC even has the authority to regulate noncompetes, and in fact, there is scant support for such authority. For example, it is hardly clear that unfair deceptive act or practice laws cover employer-employee relationships. But even assuming the FTC has authority to regulate noncompetes, should it? While those in states that refuse to enforce all but the smallest subset of noncompetes might say yes, we believe the answer is not so simple.

Indeed, many who are opposed to noncompete enforcement seem to ignore the fact that such clauses are frequently used for the express purpose of protecting trade secrets. Likewise, often lost in the debate over noncompete enforceability is the fact that in every state, a noncompete (or any other restrictive covenant for that matter) must be supported by a legitimate business interest — usually, protection of trade secrets and/or goodwill. It is not the case, as the anti-noncompete faction will tell you, that noncompetes may be used simply to stifle competition; to the contrary, decades of caselaw in all jurisdictions expressly states that such agreements cannot operate solely to prohibit ordinary competition.

Some commenters have, rightfully, pointed out that certain organizations may seek to implement restrictive covenants against low-level workers for improper purposes. But again, if the covenant does not serve a legitimate business interest, it will not be enforceable. Additionally, more and more states are passing legislation expressly prohibiting use of noncompetes against low-wage workers, reflecting a growing belief that noncompetes should be used primarily with higher-paid workers (although this theory ignores that in certain cases, low-wage workers may have access to trade secrets and thus may still pose a threat). Likewise, over the last few years, multiple federal bills have been introduced in Congress addressing the issue of noncompetes.

This all underscores the key question: Why does the FTC need to be involved at all? States can act on their own to limit the use of noncompetes and set appropriate boundaries and requirements for enforcement of noncompetes. And they have — the last few years alone have seen several states pass legislation aimed at limiting use of noncompetes. These new laws often strictly limit the categories of employees who may be bound by such clauses, and/or mandate (sometimes draconian) requirements that a business must comply with in order to enforce its agreements. In some states, such as Washington and Maine, failure to abide by a noncompete statute's requirements will not just render the agreement unenforceable – it will render the company liable for damages and/or attorney fees. And, of course, attempted enforcement of noncompete provisions with California employees, with certain extremely limited exceptions, in California will result in exposure for unfair competition under Cal. Bus. & Prof. Code Section 17200.

As a result, even if the FTC does have the ability to regulate noncompetes, we believe that it would not be a wise use of its rulemaking authority to do so. The authority to limit restrictive covenants should be left to the states, which are more than capable of enacting legislation to place appropriate limits on the use of noncompetes.

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Ilan Isaacs
Associate Legal Editor
ilan_isaacs@dailyjournal.com