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FTC Puts Employers on Notice: Employee Non-Competes Are Problematic and Could Soon be Unlawful

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Over the summer, Federal Trade Commission (FTC) Chair Lina Khan announced that the FTC was considering a new regulation targeting employee non-competes and that the agency would also use enforcement actions to target them. The FTC just followed through and in the span of 24 hours, took two unprecedented steps: On Wednesday, January 4, 2023, the FTC brought its first-ever enforcement actions against the use of non-competes, announcing settlements with three companies over allegations that their respective non-compete restrictions were unfair methods of competition in violation of Section 5 of the FTC Act. The FTC followed up the morning of January 5 by announcing a Notice of Proposed Rulemaking that would render most employee non-compete provisions "unfair methods of competition" and therefore unlawful under Section 5 of the FTC Act.

Until the FTC enforcement actions, the enforceability of employee restrictive covenants and non-competes was governed by applicable state law. These enforcement actions and the proposed rule are likely to be controversial because they are moving into an area that has traditionally been left to the states and because the method represents an expansive exercise of the FTC's "unfair methods of competition" enforcement authority, which was previewed in a November policy statement.

The back-to-back announcements come in the wake of FTC and Department of Justice workshops in 2020 and 2021 about the economic effects of restrictions on worker movement; a growing chorus of advocacy groups and economists; and a Presidential Executive Order calling on the FTC to curtail, or do away entirely, with employee non-competes.

The Enforcement Actions

The FTC complaints against Prudential Security, Inc. and Prudential Command, Inc.; O-I Glass, inc.; and Ardagh Group, S.A. implicate restrictions the companies imposed on workers in positions ranging from low-wage security guards to manufacturing workers to engineers that barred them from seeking or accepting work with another employer or operating a competing business after they left the companies. The Commission voted 3–1 to bring the actions, with Commissioner Christine Wilson (R) opposing and filing a dissent.

The complaint against the Prudential companies specifically focuses on those restrictions aimed at employees earning wages at or near minimum wage. Indeed, the FTC alleges Prudential required its minimum-wage security guards to sign non-compete agreements as a condition of employment (meaning no additional consideration beyond employment was offered), which prohibited them from competing with Prudential within a 100-mile radius. The non-competes also imposed a hefty $100,000 penalty for violating the agreements, which the FTC implies is out of step with the minimal wages paid to the guards and lack of additional consideration for signing the agreements. The other two complaints covered employees "across a variety of positions," including salaried employees such as engineers.

The complaints against Ardagh and O-I Glass focused on the alleged impact that the restrictive covenants have on the ability of new companies to enter into the "highly concentrated" glass food and beverage container industry. The FTC noted that the restrictions on workers in a variety of positions, including salaried employees

with expertise in glass production, engineers, quality assurance, sales, design, and development, acted as a barrier to new entry. As to each company's practices, the FTC alleged that the companies' intended ends "could have been achieved through significantly less restrictive means, including, for example, by entering [into] confidentiality agreements that prohibit employees and former employees from disclosing company trade secrets and other confidential information."

As FTC Chair Khan noted in the agency's statement, "These cases highlight how non-competes can block workers from securing higher wages and prevent businesses from being able to compete[.]"

The Rulemaking

The proposed rule would bar employers from entering into or enforcing non-compete clauses with employees or independent contractors and require companies to nullify any existing restrictions within six months of the final rule. The rule would exempt non-compete clauses between the seller and buyer of a business from coverage where the seller is an owner, member, or partner holding at least a 25 percent ownership interest in the business entity, although such agreements would remain subject to federal antitrust law and other applicable laws. In its press release announcing the proposed rule, Khan said that non-compete restrictions "block workers from freely switching jobs, depriving them of higher wages and better working conditions."

The proposed rulemaking was supported by Chair Khan and Commissioners Rebecca Slaughter Kelly (D) and Alvaro Bedoya (D), who filed a joint statement. Commissioner Wilson opposed the rulemaking and filed a dissent. Whether the proposed rule becomes final and enforceable is uncertain. In its 109 year existence, the FTC has issued only a few rules under the umbrella of its Section 5 "unfair methods of competition" authority, and none of them are currently in effect. As Commissioner Wilson articulates in her dissent, "there is a great deal of debate as to whether the FTC even has rulemaking authority under Section 5." It is therefore likely that this rule will be subjected to court challenges and ultimately a determination by the Supreme Court as to whether such rulemaking authority is found within the FTC Act.

Takeaways for Employers

- The enforceability of restrictive covenants continues to vary by state. We anticipate judicial challenges to the FTC rulemaking authority with regard to this new proposed rule.

- Despite the uncertainty about the rule, the FTC is likely to continue pursuing investigations and enforcement action under Section 5 during the rulemaking process.

- In light of the likelihood that the FTC will continue to bring enforcement actions, employers should consider undertaking a review of their non-compete and non-solicitation agreements, especially when those agreements are entered into with large numbers of low-wage employees and/or include large penalties that are inconsistent with the wages paid to the employee. Where there is concern about the misuse of confidential information or trade secrets, alternative approaches may be available.

- The FTC has invited public comments on the proposed rule. Comments must be submitted within 60 days after the *Federal Register* publishes the proposed rule. Baker Donelson is available to assist clients in drafting and submitting comments.

- Importantly, Section 5 of the FTC Act, unlike other antitrust statutes, does not include a private right of action. Only the FTC can bring enforcement actions.

Baker Donelson will continue to monitor these developments at the FTC. If you have questions about this topic or need assistance with reviewing your non-compete agreements, reach out to Katherine Funk, Ashby Angell, or any member of Baker Donelson's Labor & Employment Team.