# The FTC's Proposal to Ban Noncompetes is on Shaky Legal Ground

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By now, most of our readers have likely heard about the FTC's proposed rule to ban noncompete clauses in employment contracts, including from Kelley Drye's other posts on the topic discussing the sheer breadth of the proposal and the potential implications for employers. In this post, we zero in on an issue that merits a lot more attention than it's getting – namely, the serious legal and practical questions that the FTC's proposal raises.

**Brief recap of how we got here and what the rule would require**

This is the first of many rulemakings that the FTC has said it will launch based on its supposed authority to issue rules banning "unfair methods of competition" ("UMCs") under the FTC Act. Notably, starting with a statement of regulatory priorities submitted to OMB in December 2021, the FTC has said repeatedly that it may launch multiple competition rulemakings based on this authority (as well as multiple consumer protection rulemakings based on its Magnuson-Moss authority, which it has done). More recently, the FTC issued a policy statement taking an expansive view of what's an UMC, so the scope of the FTC's intended reach here could be very broad indeed.

In brief, as described in more detail in our earlier posts, the proposed rule would:

- Make it illegal for an employer to: (1) enter into or attempt to enter into a noncompete with a worker, defined broadly to include a range of employees and independent contractors at all levels of income and seniority, with few exceptions; (2) "maintain" a noncompete with a worker, meaning that employers must rescind existing agreements and inform current and former employees that the agreements are no longer in effect; or (3) represent that a worker is subject to a noncompete if the employer has no good faith basis to believe the worker is subject to an enforceable noncompete.
- Preempt inconsistent state statutes, regulations, orders, or interpretations unless such laws afford a worker greater protection than the protection provided under the rule.
- Extend to other agreements – e.g., non-disclosure agreements or agreements to pay for the costs of training new employees – if they "function like" noncompetes.

The FTC is conducting this rulemaking under the Administrative Procedures Act, meaning that the rule could be finalized and published in the Federal Register after just one round of public comments. Stakeholders can challenge the rule in court (as, e.g., arbitrary or capricious, unconstitutional, or in excess of statutory authority) but only after the final rule has been issued.

**Legal and Practical Questions**

There are a host of ways that the FTC's proposal is vulnerable to challenge, some of which are highlighted in Commissioner Wilson's fourteen-page dissent to the proposed rule. Here are some of the concerns we believe are most significant:

- **Does FTC even have UMC rulemaking authority?** The language on which the FTC is basing the rulemaking (Section 6(g) of the FTC Act) gives the FTC authority to "from time to time classify corporations and…to make rules and regulations for the purpose of carrying out the provisions of this subchapter." Over the years, there's been controversy about whether this refers to substantive rule of the sort the FTC is proposing here, or internal FTC housekeeping rules. While one Circuit Court upheld a UMC rulemaking in 1973, will current courts (which are increasingly skeptical of agency power grabs) be as deferential?

- **Major Question?** Relatedly, given the breadth of the proposed rule (banning noncompetes across the entire US economy and preempting numerous state laws and determinations), a court could find that it raises a "major question" within the meaning of the Supreme Court's West Virginia v. EPA ruling. If so, the FTC must be able to point to clear Congressional authorization, not "vague," "rarely used," or "ancillary" statutory language. To the Supreme Court and lower courts following its lead, the language in Section 6(g) may look like a textbook example of vague, rarely used, ancillary language. Alternatively, it could be a vague, unintelligible, and improper delegation of legislative power.

- **Is the FTC's sweeping preemption determination valid?** Beyond the political issues and confusion created by suddenly preempting multiple state laws, is the FTC's aggressive preemption assertion legally valid? As the cases cited in the FTC's NPRM make clear, an agency's ability to preempt state laws through regulation depends on the clarity and solidity of its grant of authority from Congress – which, as we've discussed here, is on shaky ground (even before considering the deference that antitrust law accords the states). In addition, the FTC's preemption language refers to greater protection for *workers* when it should instead refer to greater protection for *competition*.

- **Retroactivity?** The rule would require an employer to unwind previous agreements and notify former employees it has done so (if contact information is available). Might this be a retroactive application of the rule, disfavored in the law? (See, e.g., Bowen v. Georgetown Univ. Hosp., 488 U.S. 204 (1988).) In the NPRM, the FTC asserts that the rule isn't retroactive because it applies to "maintaining" a noncompete after the rule is final. That's a cute semantic argument (the FTC tried something similar – unsuccessfully – in its first rulemaking to implement the Children's Online Privacy Protection Act) but the fact remains that the rule would require companies to un-do agreements reached in the past.

- **Intrusion on collective bargaining?** The NPRM states (at p. 203) that the FTC is not aware of any duplicative, overlapping, or conflicting federal regulations. We think there may be more to this story. In 1965, the Supreme Court held that certain union-employer agreements could be given a non-statutory exemption from antitrust liability. The NLRB and the courts have subsequently applied this exemption to parties dealing with non-union workers that engage in concerted activity, and there is little doubt that the exemption limits the reach of the FTC Act. In addition, the NLRB has said that employers generally have a duty to bargain over noncompete agreements with unions representing their employees – a ruling that would seem to put noncompetes that are the subject of collective bargaining squarely within the scope of the exemption. How the non-statutory exemption might apply in a UMC rulemaking is an open question. However, this issue should be addressed in the final rule.

- **Will the rule be a morass when companies try to follow it?** Several features of the proposal could make it a true mess if and when the rule becomes final. For example, who decides whether state laws are more or less protective than the rule – the FTC or the courts? While those questions are being resolved, how will companies know what law to follow? Also, how will companies (especially small companies without HR departments) determine whether various agreement that aren't noncompetes "function like noncompetes"? And how difficult, costly, and confusing might it be for small and large companies alike to reach out to former employees to rescind agreements? These are just some of the thorny questions raised by the FTC's far-reaching proposal.
- **Arbitrary and Capricious?** Finally, if the rule remains as sweeping and potentially confusing as what the FTC has proposed, it's very possible that a court could ultimately find it to be "arbitrary and capricious" – which, as articulated recently by the Supreme Court, means not reasonable and reasonably explained, with reasonable consideration of the relevant issues. Indeed, on top of the issues we have outlined above, Commissioner Wilson argues in her dissent that the majority's proposal relies on studies that are a "mixed bag" (as well as a scant enforcement record) and gives insufficient consideration to business justifications. The FTC may correct or reduce these problems in its final rule, but only if stakeholders submit strong and persuasive comments.

We are tracking developments on this rulemaking closely, and will continue to post updates here.