

# **To Compete or to Noncompete: FTC's Proposed Rule Banning Noncompetes May Open Labor as We Know It**

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## I. Introduction

In July of 2021, President Joe Biden issued Executive Order No. 14036 (the Executive Order) calling for a whole-government effort to promote the American economy. One of the measures making the biggest waves is the Order's directive requiring federal agencies to address labor market competition issues, primarily by banning noncompete agreements and other employment measures that effectively serve to unnecessarily encumber employees' abilities to work freely.<sup>1</sup> The Executive Order cites "robust competition" as critical to preserving America's role as a global economic leader and claims that in recent history, industries have too greatly weakened competition, "denying Americans the benefits of an open economy."<sup>2</sup> President Biden's Executive Order makes specific reference to noncompete agreements.<sup>3</sup> In simple terms, a noncompete agreement is a common type of contract or provision within a contract between an employer and an employee, generally stating that the employee promises to not work for a competing business or group of competing businesses for a specific duration of time once terminating their time with their employer.<sup>4</sup> Generally speaking, noncompete agreements are

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<sup>1</sup> See Executive Order 14036 on Promoting Competition in the American Economy, Daily Comp. Pres. Docs., 2021 DCPD No. 00578 (July 9, 2021) [hereinafter *Executive Order*] (directing government agencies to address labor market competition issues); *Fact Sheet: Executive Order on Promoting Competition in the American Economy*, WHITE HOUSE (July 9, 2021), <https://www.whitehouse.gov/briefing-room/statements-releases/2021/07/09/fact-sheet-executive-order-on-promoting-competition-in-the-american-economy/> [<https://perma.cc/9RSE-VVK9>] (summarizing contents of Executive Order).

<sup>2</sup> See *Executive Order*, *supra* note 1 (describing Executive Order's primary goal).

<sup>3</sup> See *id.* (stating noncompete agreements restrict Americans' abilities to ever change jobs).

<sup>4</sup> *5 Things You Need to Know About Non-Compete Agreements*, THOMPSON REUTERS (Mar. 11, 2022), <https://legal.thomsonreuters.com/en/insights/articles/the-basics-of-non-compete-agreements> [<https://perma.cc/683D-LEKJ>] (defining most basic terms of noncompetes).

enforceable to prohibit employees from accepting new employment so long as (1) the agreement is necessary to protect the employer's legitimate business interests or confidential information; (2) the agreement is restricted to a reasonable time duration; (3) the agreement is limited to a specific and reasonable geographic location; and sometimes, (4) whether the employee receives consideration, or some type of benefit, in exchange for signing the agreement.<sup>5</sup>

In January of 2023, the Federal Trade Commission (FTC) responded to the Executive Order's directive by proposing a new rule banning the use of noncompete terms in employment agreements across all fifty states.<sup>6</sup> Although the rule is still under consideration and open for public comment, the FTC states it hopes to boost the American economy by increasing wages by nearly \$300 billion per year and create nearly 30 million new jobs.<sup>7</sup> The FTC's proposed rule, as currently written, would operate retroactively, and invalidate any noncompete agreements already signed and in existence.<sup>8</sup> Although many view this proposal positively, many experts and employers alike worry that this proposal will be damaging to companies' abilities to protect confidential information, harm clients of companies that depend on noncompete agreements, and even raise concerns that the FTC may not have the proper legal authority to even ban noncompete agreements altogether in the first place.<sup>9</sup> Despite these concerns, President Biden's

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<sup>5</sup> See *id.* (describing most common legal limitations for enforceable noncompete agreements).

<sup>6</sup> See Proposed FTC Non-Compete Clause Rule, 16 C.F.R. Part 910 (2023), [https://www.ftc.gov/system/files/ftc\\_gov/pdf/p201000noncompetenprm.pdf](https://www.ftc.gov/system/files/ftc_gov/pdf/p201000noncompetenprm.pdf) [<https://perma.cc/U9HU-FQRJ>] ; Press Release, *FTC Proposes Rule to Ban Noncompete Clauses, Which Hurt Workers and Harm Competition*, FED. TRADE COMM'N (Jan. 5, 2023), <https://www.ftc.gov/news-events/news/press-releases/2023/01/ftc-proposes-rule-ban-noncompete-clauses-which-hurt-workers-harm-competition> [<https://perma.cc/YY4N-YSDB>] [hereinafter *FTC Press Release*] (summarizing key points in FTC's proposed rule).

<sup>7</sup> See *FTC Press Release*, *supra* note 6, (describing main goals for banning noncompetes).

<sup>8</sup> See *id.* (noting proposed rule would invalidate all existing noncompete agreements).

<sup>9</sup> See Aaron Levin & Matt Todd, *FTC Noncompete Ban Could Erode Trade Secret Protections*, LAW360 (Feb. 28, 2023), <https://www.law360.com/articles/1579186/ftc-noncompete-ban-could-erode-trade-secret-protections> [<https://perma.cc/R7HB-3L8M>] (raising concerns about

Executive Order and the FTC's new proposed rule make it a very distinct possibility that the American labor market will rapidly shift in the near future, granting workers increased freedom to compete for more jobs and higher wages—a win for the everyday working American.

## II. Current Legal Scheme of Noncompete Agreements Among the States

Aside from the FTC's proposed rule, there is currently no federal legislation banning or listing requirements for noncompete agreements—rather, each individual state decides whether employers may use noncompetes and their functional equivalents, and if so, what requirements employers must follow to ensure the contract is binding. Although the tide of states allowing or disallowing noncompetes is ever-shifting—especially following the Executive Order and FTC's proposed rule—most states currently allow employers to use noncompete agreements.<sup>10</sup>

According to a fifty-state survey completed as of July 21, 2022, forty-seven states and Washington, D.C. allowed for noncompete agreements in at least some capacity.<sup>11</sup> California, North Dakota, and Oklahoma were the only states that expressly banned noncompetes prior to the FTC's proposal in 2023.<sup>12</sup>

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protections for trade secrets without noncompete agreements); Adam Gersh & Mariel Giletto, *FTC Noncompete Ban Could Harm Buyers and Sellers in M&A*, LAW360 (Feb. 10, 2023), <https://www.law360.com/articles/1573803/ftc-noncompete-ban-could-harm-buyers-and-sellers-in-m-a> [<https://perma.cc/489R-6X3N>] (speculating lack of noncompetes could harm clients of companies relying on noncompetes); Kendall Coffey, *FTC Noncompete Ban May Face Intensified Judicial Hurdle*, LAW 360 (Jan. 23, 2023), <https://www.law360.com/articles/1567383/ftc-noncompete-ban-may-face-intensified-judicial-hurdle> [<https://perma.cc/5HVH-K7M6>] (questioning FTC's legal authority to ban noncompete agreements nationwide).

<sup>10</sup> See Russel Beck, *Employee Noncompetes, A State-by-State Survey*, BECK REED RIDEN LLP (July 21, 2022), <https://beckreedriden.com/wp-content/uploads/2022/07/Noncompetes-50-State-Survey-Chart-20220721.pdf> [<https://perma.cc/N9S2-DXLF>] (listing which states allow noncompetes, standards, exemptions, and more).

<sup>11</sup> See *id.* (showing forty-seven states and D.C. allowed noncompete agreements as of 2022).

<sup>12</sup> See *id.* (showing three states that expressly banned noncompete agreements as of 2022).

Thus, noncompete agreements have generally been commonplace in American labor markets, though the trend among states has been to ban noncompete agreements following the FTC's announcements. Since the 2022 fifty-state survey, several states have taken actions to at least restrict how often noncompetes can be used and how far they can extend. Colorado, Illinois, Maine, Maryland, New Hampshire, Oregon, Rhode Island, Virginia, and Washington now all ban the use of noncompete agreements for workers who make less than a specific salary amount.<sup>13</sup> Other states are adopting general noncompete agreement restrictions. For example, Hawaii ruled that noncompete agreements are only appropriate where employers have a legitimate business interest for using one, such as protecting trade secrets, confidential information, or special customer relationships.<sup>14</sup> Generally, the trend among states adjusting their noncompete agreement laws has been to restrict how they are used, rather than further empower or encourage companies to use them.

### III. The Problem with Noncompete Agreements

President Biden and the FTC's impetus behind banning noncompete agreements is that such restrictive agreements favor companies over laborers and, within the worker class, favor higher wage earners over lower wage earners. Noncompete agreements are so pervasive in the American economy that as of 2014, one-fifth of Americans were bound by noncompetes of some form.<sup>15</sup> Additionally, in the past few decades, job mobility has declined by 22%, and wages for

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<sup>13</sup> See Leah Shepherd, *More States Block Noncompete Agreements*, SHRM (Sept. 15, 2022), <https://www.shrm.org/topics-tools/employment-law-compliance/states-block-noncompete-agreements> [<https://perma.cc/ZBX2-PJYA>] (discussing new limitations from states restricting when noncompete agreements appropriate).

<sup>14</sup> See *id.* (explaining new restrictions in Hawaii).

<sup>15</sup> See Evan Starr, *The Use, Abuse, and Enforceability of Non-Compete and No-Poach Agreements: A Brief Review of the Theory, Evidence, and Recent Reform Efforts*, ECON. INNOVATION GRP. (Feb. 20, 2019), <https://eig.org/wp-content/uploads/2019/02/Non-Competes->

the bottom earners have either decreased or grown only very modestly at most, partly due to the fact that employees are unable to leave companies for more competitive opportunities because they are contractually bound, and oftentimes influenced to remain in their current positions.<sup>16</sup> Not only do the noncompete agreements force this situation by nature, but workers may often be uninformed, or even if fully informed, powerless to change their situation if they must accept the employment. For example, one study uncovered several shocking results: (1) less than 10% of workers successfully negotiate better noncompete terms for themselves; (2) more than 85% of workers did not receive any additional consideration for signing the noncompete agreements; and (3) around 30-40% of workers reported that they were not aware of the noncompete agreement when they first accepted their offers, and employers only asked the workers to sign the noncompetes after they had already accepted the job offer.<sup>17</sup>

Noncompete agreements pose problems not only for workers who inevitably become trapped with a specific company, but also for companies struggling to hire from an exhausted pool of workers. Even if a worker leaves their old company and is an attractive and experienced candidate, competing companies are clearly unable to hire them. The struggle to hire workers is especially pronounced for new businesses—one study shows that “new firms . . . are more likely to die in their first three years, and that even the firms that survive stay smaller in their first five years” in states with permissive noncompete agreement regimes.<sup>18</sup> In this structure, noncompete

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2.20.19.pdf [<https://perma.cc/TGT3-9Q9Q>] (discussing negative effects noncompete agreements have on American economy).

<sup>16</sup> *See id.* (discussing effect of noncompete agreements on stifled job mobility and wage-earning potential).

<sup>17</sup> *See id.* (explaining power imbalance between employer and employee when dealing with noncompete agreements).

<sup>18</sup> *See id.* (discussing the effects of noncompete agreements on not only workers, but smaller companies seeking to hire said workers).

agreements serve established companies and stifle free-market competition by eliminating qualified employees from consideration at newer companies.

#### IV. Challenges to the Proposed Rule

Opponents of the FTC's proposed rule harken back to why noncompete agreements are ubiquitous in the first place: protecting companies with important trade secrets and sensitive or confidential client information. Some critics point out that noncompete and nondisclosure agreements alike are critical for trade secrets protection, citing the fact that "trade secret theft has led to the loss of 2.1 million American jobs each year," costing employers and employees alike.<sup>19</sup> Rather, these critics propose creating more specific restrictions for enforceable noncompete agreements instead of eliminating them altogether. For example, by construing the agreements more narrowly, they can be tailored to protect trade secrets as efficiently as possible.<sup>20</sup> Likewise, other critics propose that the legal regime for noncompete agreements is sufficient as is—"employees who are being unfairly prevented from taking another job can go to court and ask the judge to limit the scope of a noncompete agreement or even throw it out entirely if it is poorly written or overly broad."<sup>21</sup> In sum, the critique is that any new legislation regarding noncompete agreements should focus on remedies for the rare cases of abuse, rather than changing the entire legal scheme.

Another group of critics question whether the FTC even has the legal authority to ban noncompete agreements. Recently, the Supreme Court decided *West Virginia v. Environmental*

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<sup>19</sup> See Levin & Todd, *supra* note 9 (discussing ill effects of removing noncompete agreements for trade secrets protections).

<sup>20</sup> See *id.* (stating alternative proposed solution).

<sup>21</sup> See Peter Glennon, *FTC Noncompete Ban Could Split Health Industry, Raise Costs*, LAW360 (Feb. 24, 2023), <https://www.law360.com/articles/1578838/ftc-noncompete-ban-could-split-health-industry-raise-costs> [<https://perma.cc/K3EP-DW3U>] (stating majority of noncompete agreements totally fair and remedies exist for unfair agreements).

*Protection Agency*,<sup>22</sup> wherein the Court prevented the Environmental Protection Agency (EPA) from directly regulating carbon emissions by dictating energy sources throughout the country.<sup>23</sup> Rather, the Court invoked the “major questions doctrine,” giving Congress alone the authority to address issues of “major national significance.”<sup>24</sup> This group of critics predicts that the FTC will face the same fate as the EPA, and that the Court may ultimately declare entirely eliminating noncompete agreements an event of major national significance, given how entrenched it is in the current American legal scheme.<sup>25</sup>

## V. Conclusion

On the whole, the proposed changes from the Biden Administration and the FTC suggesting eliminating noncompete agreements would certainly be a drastic departure from the current American employment scheme. Although many are evidently split regarding whether eliminating noncompete agreements will ultimately be a net benefit or detriment to the economy and free market, it is clear that the current scheme is rife with abuse by employers, and change in some form is necessary.

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<sup>22</sup> 142 S. Ct. 2587 (2022).

<sup>23</sup> See Coffey, *supra* note 9 (summarizing EPA case).

<sup>24</sup> See *id.* (explaining the “major questions doctrine”).

<sup>25</sup> See *id.* (voicing criticisms about whether the FTC in same position as EPA).