The Future of Restrictions on Competition — Fair and/or Unfair

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Will restrictions on competition soon be a thing of the past? The Federal Trade Commission (FTC) announced a proposed rule earlier this year that would essentially ban the use of non-compete agreements for employees and independent contractors, and require employers to rescind existing agreements. *See* Non-Compete Clause Rule, 88 Fed. Reg. 3482 (proposed January 19, 2023) (to be codified at 16 C.F.R. pt. 910) ("Rule"). On February 1, 2023, a bipartisan group of U.S. Senators and Representatives introduced legislation to Congress to ban the use of non-compete agreements nationwide. These bills, collectively, are titled the "Workforce Mobility Act of 2023." *See* S. 220, 118th Cong. (2023); H.R. 731, 118th Cong. (2023) (together, the "Act"). The Act would restrict the use of non-compete agreements to instances of a dissolution of a partnership or the sale of a business; unlike the Rule, however, the Act would not be retroactive. Will these efforts end restrictions on competition? No, for at least four reasons.

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First, neither the Rule nor the Act may ever become law. There are substantial questions as to whether the FTC has the authority to issue any nationwide rule prohibiting non-competes pursuant to Section 6(g) of the Federal Trade Commission Act, 15 U.S.C. § 46(g). *See* Dissenting Statement of Commissioner Christine S. Wilson Regarding the Notice of Proposed Rulemaking for the Non-Compete Clause Rule, Comm'n File No. P201200-1, 11 (Jan. 5, 2023), FTC, https://www.ftc.gov/system/files/ftc_gov/pdf/p201000noncompetewilsondissent.pdf (citing the United States Supreme Court's *West Virginia v. EPA* decision, 142 S. Ct. 2587 (2022), on the major questions doctrine). While Congress indisputably has proper authority, the Act may not pass, as was the case with similar proposed legislation in 2019 and 2021.

Second, if either becomes law, expect substantial narrowing. Instead of a categorical ban on non-competes, there could be a rebuttable presumption of unlawfulness or different standards for different categories of workers. Indeed, the FTC extended the public comment period for the Rule to consider these issues, 88 Fed. Reg. 20441 (Apr. 6, 2023), specifically citing a study that examined whether employers valued the enforceability of non-compete agreements for "threshold wage" workers. Takuya Hiraiwa, Michael Lipsitz & Evan Starr, *Do Firms Value Court Enforceability of Noncompete Agreements? A Revealed Preference Approach* 3-4, 32 (Feb. 20, 2023 Study), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4364674.

Third, even if enacted in their present form, neither the Rule nor the Act would prohibit most non-solicitation, non-recruitment or confidentiality clauses. In fact, both lawmakers and the FTC cite the availability of trade secret protection as a factor that justifies prohibiting non-competes.

Fourth, the Rule and the Act are impractical solutions to a complex legal problem. While there is ample basis for concluding that non-competes are overused and can constitute anticompetitive restrictions on worker mobility, there is likewise reason to conclude that parties should be able to agree to such restrictions to protect legitimate interests, so long as such restrictions are narrowly tailored and agreed to without "overreaching." *Brown & Brown, Inc. v. Johnson*, 25 N.Y.3d 364, 371-72 (2015).

But the Rule and Act not only do too much, they do too little. Legal scholars have long recognized that overbroad confidentiality agreements and baseless trade secret claims are improperly used as anticompetitive tools by former employers just as frequently as are restrictive covenants. *See* Elizabeth Smith, *Eliminating Predatory Litigation in the Context of Baseless Trade Secret Claims: The Need for a More Aggressive Counterattack*, 23 Santa Clara L. Rev. 1095 (1983). Nearly 40 years later, in throwing out a pharmaceutical company's trade secret claim, a federal judge recently recognized that plaintiffs "seem to think that just about anything in the world can be a trade secret." Trial Tr. 827:11-12, *Medidata Sols., Inc. v. Veeva Sys., Inc.*, No. 17 Civ. 589 (JSR) (S.D.N.Y. July 15, 2022), ECF No. 826. Under that false premise, an employer "could never hire away an employee from another company because [such employee could] reveal something they had learned at their prior employment[.]" *See id.* at 827:13-16. While the Rule attempts to address this by treating "unusually broad in scope" confidentiality provisions as impermissible non-competes, the Rule largely fails to flesh-out this "functional test." *See* 88 Fed. Reg. 3509.

But change is coming no matter its form. All companies should revisit their employment agreements, including restrictive covenants and confidentiality agreements, to ensure they are reasonably tailored to protect legitimate interests. They should also consider whether they can protect their interests with less burdensome covenants such as a limited non-solicitation agreement, reasonable confidentiality provisions, severance payments tied to compliance and/or restricted cash awards.

Companies seeking trade secret protection, not intimidation, should differentiate trade secrets from common trade information. Limit trade secret access only to those who need it; train employees how to handle the specific trade secrets and protect against theft in any manner; and implement sufficient technological controls.

If you seek additional information about restrictive covenants and/or choice-of-law provisions, please contact Preston L. Zarlock, partner and co-leader of Phillips Lytle's Commercial Litigation Practice Team, at (716) 847-5496 or pzarlock@phillipslytle.com or Ryan P. Schelwat at (716) 847-7097 or rschelwat@phillipslytle.com.