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Proposed FTC Noncompete Ban Throws Out Good With Bad

By **William MacLeod** (February 17, 2023, 5:04 PM EST)

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Imagine the CEOs of competing health care clinics sharing information about their plans for geographic expansion, new product offerings and promotional discounts.

The communications help the companies postpone mistimed openings, reduce operating uncertainties and reschedule redundant promotions. They save millions of dollars avoiding regrettable decisions.

Suppose two drug companies have been seeking to develop a cure for a vexing disease. Each has formulated numerous compounds that failed to deliver meaningful results after expensive trials.

The companies decide to form a joint venture and pool their efforts so that they can prioritize the most promising prospects. The money they save steering clear of blind alleys could amount to hundreds of millions.

Information is precious, especially in auctions where competition is keen. Sales managers hungry for intelligence work their phones and canvass their contacts to gather tips that would improve their chances for getting business.

The best intelligence, of course, comes from other bidders. Knowing what rivals are planning to do can help sellers save time and money by concentrating on proposals less likely to lose. With painful layoffs and expensive overhead at stake, some managers yield to the temptation to call their counterparts.

These gambits might be appealing, but for one serious problem: They would violate the antitrust laws. CEOs exchanging strategic and promotional plans got their companies sued[1] by the Federal Trade Commission.

Drug companies with parallel research and development efforts have been enjoined[2] from merging them. Sales managers who tip off their rivals can end up in jail.[3]

Sharing nonpublic information that can facilitate coordination with a rival has long been illegal, because, as the FTC has often explained, this kind of intelligence sharing can reduce choices and raise prices. Avoiding costly mistakes is no defense to an anti-competitive information exchange.

But now the FTC is offering an antitrust loophole that would allow — indeed invite — forbidden information to pass from competitor to competitor.

A new rule the agency has proposed[4] would ban clauses in employment contracts that prevent employees who know the deepest secrets of their employers from taking that information to their closest rivals.

Under the rule, CEOs, scientists and sales execs with years of accumulated intelligence could resign today and turn that experience into counter-strategies tomorrow. Companies could take advantage of knowledge that their new recruits never could have imparted from their former posts.

With the critical advantage of knowing what rivals are planning — and equally important, not planning — companies can steer clear of bruising battles in the marketplace.

Employers often guard their most sensitive information by securing employees' promises that they will not jump directly to rivals. Typical agreements call for a pause — typically a year or two — before departing employees can assume competing responsibilities at another company.

Courts have long recognized that these contracts can enhance competition, if reasonably tailored to the interests of both parties. Laws in the vast majority of states authorize companies to enforce them.

The proposed rule would overturn these laws. Companies could simply lure employees who know what rivals are doing and thinking. The new employers could reformulate strategies, redirect research and development, and pad proposals on opportunities that their former employers are not pursuing aggressively.

In each case, competition would suffer, but because competitors are not coordinating, antitrust risk would evaporate.

The FTC justifies its proposal with two arguments, neither of which passes muster under the laws of antitrust or contracts.

The first argument is that employees will make more money if they can move at will among competing companies. For the rank and file, the potential wage hikes are estimated to be modest, around 2% or 3%.

Senior executives and specialized professionals, however, stand to gain the most. By some estimates, they could get raises exceeding 10% when they are allowed to take the human capital they acquired on the job and put it to work against the company that cultivated it with them.

It is no wonder that people with the most sensitive knowledge of a company's operations are estimated to reap the largest rewards by defecting to competitors. Inexplicably, the FTC did not analyze whether the salary gains it identified would be fairly earned or ill-gotten.

The record does not reveal to what extent pay increases offered to skilled employees might be due to breached promises, betrayed confidences or unfair advantages. This omission is ironic, given that the agency is responsible for enforcing information security and preventing unfair and deceptive practices in the marketplace.

Nor did the agency determine that encouraging employees to move to competitors would increase innovation, lower prices, or improve quality of the goods and services we buy. The evidence — mainly academic literature — is sparse and ambiguous on those consequences.

Only a few industries have been studied in depth. No study has demonstrated nationwide benefits to competition or consumers.

To concerns that trade secrets and other valuable information might be compromised in a world without noncompetes, the FTC offers its second argument: Companies can enforce nondisclosure agreements and other restrictions that restrict departing employees from trading on the secrets they acquire.

These are less restrictive, in the agency's assessment. Granted, the alternative measures could mean more lawsuits, the agency acknowledged. It did not address, however, the damage that lawsuits cannot undo. The harm from a disclosed secret can be irreparable.

And the lesser restrictions come with a Catch-22. The proposed rule would ban nondisclosure agreements, nonrecruiting contracts and other measures if they operate as functional noncompetes.

In other words, if promising not to recruit former subordinates would disqualify executives from jumping to competitors, then those agreements would be prohibited, too.

The whole C-suite could decamp to a competitor and invoke the rule as its defense for imitating the business they left behind. No competitor, they could contend, would hire them without a mass defection.

Nobody seriously disputes that noncompetes can exceed legitimate purposes. In many circumstances, the clauses are impossible to defend. But the FTC's proposed rule does not just target them. It would ban the good and the bad, regardless of the consequences.

This rulemaking will reveal whether the commission remains an antitrust agency or subordinates competition to other goals.

The agency has already declared[5] independence from antitrust and announced an expansive interpretation[6] of its authority. We are now seeing how far the agency could roam.

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[1] Federal Trade Commission, Bosley, Inc., Aderans America Holdings, Inc., and Aderans Co., Ltd., June5, 2013, available at https://www.ftc.gov/legal-library/browse/cases-proceedings/1210184-bosley-inc-aderans-america-holdings-inc-aderans-co-ltd.

[2] Federal Trade Commission, Overview of FTC Actions in Pharmaceutical Products and Distribution, June 2019, available at https://www.ftc.gov/system/files/attachments/competition-policy-

guidance/overview_pharma_june_2019.pdf.

[3] Federal Trade Commission, Bid Rigging, available at https://www.ftc.gov/advice-guidance/competition-guidance/guide-antitrust-laws/dealings-competitors/bid-rigging.

[4] Federal Trade Commission, FTC Proposes Rule to Ban Noncompete Clauses, Which Hurt Workers and Harm Competition, January 5, 2023, available at https://www.ftc.gov/news-events/news/press-releases/2023/01/ftc-proposes-rule-ban-noncompete-clauses-which-hurt-workers-harm-competition?trk=organization_guest_main-feed-card_feed-article-content.

[5] Federal Trade Commission, FTC Rescinds 2015 Policy that Limited Its Enforcement Ability Under the FTC Act, July 1, 2021, available at https://www.ftc.gov/news-events/news/press-releases/2021/07/ftc-rescinds-2015-policy-limited-its-enforcement-ability-under-ftc-act.

[6] Federal Trade Commission, Policy Statement Regarding the Scope of Unfair Methods of Competition Under Section 5 of the Federal Trade Commission Act, November 10, 2022, available at https://www.ftc.gov/legal-library/browse/policy-statement-regarding-scope-unfair-methods-competition-under-section-5-federal-trade-commission.