Comment to Federal Trade Commission

Kenneth J. Vanko[1]

March 2, 2023

***

Introduction

I am submitting this comment to address some questions on which the Federal Trade Commission is seeking public comment on its Notice of Proposed Rulemaking on the Noncompete Clause Rule. The purpose of this comment is two-fold.

First, I will address the possibility of limiting the categorical ban on noncompete agreements and propose a standard that is both workable in practice and consistent with the policy concerns raised in the NPRM. My discussion on this topic thus relates to Part VI of the NRPM ("Alternatives to the Proposed Rule"), found on pages 137-57.

Second, I address a significant question left unsettled by the NPRM. In particular, the Commission ought to consider the following question in the context of the Proposed Rule's current language: What impact will the Proposed Rule have when a noncompete dispute has been resolved and where some time remains on a worker's covenant? From my initial review, I have seen little, if any, commentary that addresses this question. Thus, I believe it is essential to outline my thoughts about how courts may address this question if the FTC does not clarify this during final rulemaking.

Background

By way of background, I have mainly practiced in the field of employee restrictive covenants and trade secrets for 25 years. A substantial percentage of my practice concerns the representation and counseling of employees at all levels, but I have many employer clients too. Those clients range from publicly traded corporations to small, family-owned businesses. The industries in which I represent clients are diverse and include financial services, manufacturing, industrial supply and distribution, engineering, accounting, staffing, and consumer services, among many others.

For 10 years, I published a website called *Legal Developments in Non-Competition Agreements* (www.non-competes.com), in which I wrote over 600 articles on all aspects of non-competition law, including summaries of legislative updates, case developments,

[1] Member, Clingen Callow & McLean, LLC, Lisle, Illinois. The views I express in this Comment are mine alone and don't necessarily reflect those of my firm, my colleagues, and our firm's clients. I can be reached at vanko@ccmlawyer.com.

policy considerations, and practice guidance for lawyers and clients. I also have published several law review and bar journal articles on various noncompete and related topics.

For examples of cases I have handled, I refer the Commission to three available and representative decisions, both at the trial and appellate levels:

> • *Automated Industrial Machinery, Inc. v. Christofilis*, 2017 IL App (2d) 160301-U (represented mechanical engineer and his new company in noncompete, trade secret, and tort dispute, prevailing as sole counsel at trial and appeal).
>
> • *Pam's Academy of Dance v. Marik*, 2018 IL App (3d) 170803 (represented part-time dance instructor bound by 5-year noncompete agreement).
>
> • *Nygard v. Lawson Products, Inc.*, 2012 WL 13019002 (D. Mont. Oct. 10, 2012) (represented industrial supply distributor in dispute over customer non-solicitation covenant; prevailed in obtaining limited preliminary injunction against ex-sales agents).
>
> • *Tradesman Int'l v. Black*, 724 F.3d 1004 (7th Cir. 2013) (represented individuals and new labor staffing company in noncompete dispute, with court upholding finding that covenants were unenforceable; matter reversed for consideration of employees' fee petition).

I thus feel that my experience is balanced in terms of my client profile, such that I submit this comment with no agenda and no vested interest in the outcome of the Proposed Rule. My study, practice, and experience in this legal area qualifies me to address certain questions in an objective and reasonable way, far more so than the positions advanced by many other lawyers and individuals who have submitted comments to date.

Summary Statement

As a general proposition, I wish to emphasize the following principal points about noncompete agreements, litigation, and the FTC's role in this area. These observations stem from relevant practical experience representing clients the field the FTC now seeks to regulate through rulemaking.

- Noncompete agreements have their legitimate place in the economy, but they should be reserved for a very narrow class of executives and other employees who

are able to negotiate for them in exchange for real, tangible consideration as part of a meaningful and bargained-for exchange.

• Noncompete abuse, or overuse, is a pervasive problem across many sectors of the economy. Most mid-tier employees who come to me lack the means, resources, or support to fight an oppressive contract. Thus, the overwhelming majority of problem noncompetes never are subject to judicial scrutiny.

• Reasonably drafted activity restraints, like nonsolicitation and nondisclosure covenants, work well to protect traditional employer business interests.

• The principal problems for most, non-executive workers embroiled in a noncompete dispute include: (a) intentionally overbroad agreements in relation to the harm an employee can plausibly inflict after departure, (b) lack of notice that a noncompete is required as a condition of employment,[2] (c) the ability an employer has to institute litigation and then "ask for less" than the maximum restraint nominally agreed to (or to extract a highly favorable settlement to stop the onslaught of legal fees), and (d) the absence of meaningful consideration given in exchange for a noncompete.

• The legal system generally lacks a cost-effective means to expedite review of overbroad noncompetes, meaning most employees are dissuaded because of financial concerns from challenging even the worst restraints.

• Most employee disputes settle early, often times before litigation starts (but after some kind of a cease-and-desist threat) or after an initial hearing on a request for immediate relief. Barring an unusual fact or a highly oppressive contract term, employees know very quickly that litigation won't be efficient and that it will be burdensome, expensive, and disruptive to their careers. Many settlements enforce some covenant for a reduced term, even if the employee has legitimate grounds to contest the restriction at trial.

• Prospective new employers—even those who actively recruit employees bound by noncompetes—do not provide adequate support and indemnification when litigation ensues.

• Employers who use overbroad noncompetes to stifle fair competition and restrict employee career advancement generally suffer almost no negative repercussions from their conduct.

• Though state law has generally developed along a consistent path with some exceptions, choice of law and venue problems in an increasingly mobile economy

[2] The clear trend of state legislation is to require advance notice, but those laws can't be applied retroactively because of the Contracts Clause in Article 1 of the Constitution.

suggest that a more uniform legal approach is now warranted; the strongly preferred way to accomplish this is through federal legislation similar to the Defend Trade Secrets Act rather than agency rulemaking.

- The FTC has an important enforcement role to play in preventing the unfair use of noncompete agreements even if the Proposed Rule does not advance, such as where an employer deploys an overbroad standard agreement indiscriminately across a large workforce or where an employer knows that its agreement is unreasonable.[3]

- The FTC's enforcement role, though, is necessarily limited because of the pervasive use of noncompetes throughout broad segments of the economy. It seems a stretch to believe that this particular enforcement function will fill a much-needed gap case-by-case.

- The FTC's ability to promulgate—under rulemaking authority—a legislative solution banning noncompete agreements is not clearly established given Supreme Court precedent. Though significant questions remain regarding the FTC's authority to promulgate the Proposed Rule, it is appropriate to assume that such authority exists so that the Proposed Rule can be refined in the best possible way.

Each of those summary remarks may be relevant to one or more topics on which the Commission seeks public comment. But they are intended more for background purposes.

A Response to the Commission's Suggested Alternatives

The draft of the Proposed Rule is categorical, meaning it would apply to lower-level employees and senior executives in the same manner. The FTC has described in the NPRM its justification for an across-the-board ban. Even so, it is seeking comment in Part VI of the NPRM for "alternatives to the proposed rule." (NPRM, at p. 137). The Commission then describes what it calls "two key dimensions of alternatives," namely (1) the adoption of a rebuttable presumption of unlawfulness, and (2) specific carve-outs tied to a "worker's job functions, earnings, another factor, or some combination of factors." (NPRM, at pp. 139-40).

Neither of these works.

First, the rebuttable presumption approach will bring courts and litigants right back to the unpredictable, fact-based inquiry that resembles the current legal landscape. This is little more than an academic approach in a pragmatic field. It thus solves no problem and creates only added confusion to an already murky area. What's more, it complicates

[3] Unreasonableness extends beyond the covenant terms. Just as important are one-sided fee-shifting clauses, jury trial waivers, mandatory arbitration clauses (with cost-splitting), and exclusive venue clauses in far-flung locales.

the advice that lawyers must provide clients, potentially exposing more employees to litigation.[4]

The *second* alternative is just as flawed. Attempting to define allowable noncompetes by job class, description, rank, pay rate, or some other limiting factor inevitably will create arbitrary and silly distinctions that spur on litigation and result in absurd outcomes. For example, a wage threshold may cause firms to depress salaries. And attempting to limit noncompetes to those employees, for instance, with "significant managerial authority" will result in disputes over the level of an employee's responsibility in the organization, which is completely collateral to the central issues in a noncompete dispute. This will generate significant discovery expense, which most employees cannot afford.

A More Sensible Alternative to a Categorical Ban

The better alternative is to allow noncompetes where employees either (1) agree to a noncompete covenant in connection with a severance agreement, where the covenant is given in exchange for an equivalent monetary benefit, or (2) obtain, through an employment contract, a paid noncompete period or receive garden-leave pay during a notice period at the end of employment.

Though the concept of severance is widely understood and prevalent, that's less so with paid noncompetes and garden-leave arrangements. The two terms are not synonymous, but they operate in a similar way. I'll describe them briefly.

Paid noncompetes are common in algorithmic or "high-frequency" trading firms where competition for talent is intense. Typically, employees agree not to compete after termination of employment (whether voluntary or involuntary) in exchange for receiving a payment during the noncompete period commensurate with their earnings. Most paid noncompetes offer the employer some flexibility to select the paid noncompete term, ranging from 0 to 12 months. This flexibility is understandable, because only at the time of termination can an employer truly assess how valuable a departing employee may be to competitors.[5]

Garden-leave arrangements are more common in the financial services sector and borrow from experiences in the United Kingdom. Put simply, a garden-leave arrangement is a variation on a notice period preceding the end of a worker's employment. Employees seldom work during this notice period, with 1 to 6 months being common, but remain employed and thus unable to work for a competitor.

---

[4] Remember: The punishment is often the litigation process, not the litigation outcome.

[5] This stands in marked contrast to the typical noncompete which defines a restricted period *before* an employee ever works a day for an employer and before the employee's market value is established. This is as backwards as it sounds.

The case law is sparse, at best, involving these types of restrictions. There are two reasons for this. *First*, given that the employees receive pay in exchange for sitting out, there is far less room to claim that the agreement is unreasonable and against public policy. That materially reduces the chance for litigation. *Second*, most employers can still use noncompetes effectively, even if they are of dubious enforceability. Employers have become accustomed to the deterrent effect that a traditional noncompete has. Thus, even if they're not inclined to enforce the agreement in court, the mere threat employers will do so ends up dissuading many employees from violating the restriction. In the main, employers do well even in a legal regime that nominally disfavors noncompetes.

These three exceptions to a categorical ban align with the Commission's concerns over competitive problems in the marketplace. For instance, none of them interferes in an anticompetitive way with the "functioning of labor markets without compensating benefits." (NPRM, at p. 158). That's because, in my exceptions, employers only obtain the benefits of a restraint by paying an employee equivalent compensation. Presumably, employers who elect to use either the severance or paid noncompete/garden-leave alternative make an economic choice that the restraint furthers a truly legitimate business interest. But to protect that interest, it must compensate the employee for giving up a valuable right at an objectively reasonable method of fair compensation. In other words, the tradeoff seems logical and balanced.

Nor do any of these exceptions to a categorical ban result in a material negative impact to the markets for products or services. Severance agreements are entirely voluntary, meaning employees who do not compete in exchange for severance determine that it is economically beneficial to do so. A severance period, in fact, can enable an employee to seek professional certifications, explore new areas of interest, or assess the viability of starting a new business. In other words, a severance period can be additive to the economy given the flexibility that provides a worker. In any event, a negotiated covenant in this type of severance arrangement does not create a drag on an employee's career path when the employee controls whether to accept it.

In the case of paid noncompete/garden-leave arrangements, employees can plan their next opportunities well in advance, knowing they are bound by a short sit-out period (and, as I would propose, one that wouldn't last for more than nine months). What's more, an employer does not have to invoke any paid noncompete or garden-leave period at all. They are normally drafted as optional clauses. Thus, employers are motivated to make an economically rational choice because they won't pay for a noncompete period unless the restriction truly serves a compelling business purpose.

Two other points are worth mentioning regarding these exceptions to a categorical ban. *First*, my proposal solves a drafting problem. Neither is hard to describe in the context of a final rule. But a carve-out for "senior executives" or those with other responsibilities leads not only to a clumsy rule, but also more to litigation and wasted legal fees.

Second, the exceptions I am proposing allow lawyers to counsel clients and do not require us to guess as to outcomes in an area where it's vital to be correct. In short, the exceptions will reduce litigation and lead to much greater certainty. Litigation costs in noncompete disputes are disproportionately high and can be unpredictable. It does the FTC no good to craft exceptions to a categorical ban if those exceptions themselves generate substantial litigation.[6]

What the Proposed Rule Does Not Address

The NPRM is 218 pages with citations to various cases, statutes, articles, and academic studies. In the wake of the NPRM, commentators (mostly large law firms) have undertaken an extensive analysis of the Proposed Rule's impact. But from what I can tell, neither the Commission nor leading analysts have addressed an obvious spillover consequence from the Proposed Rule's adoption. I frame the issue as:

What happens to employees who remain subject to some unexpired noncompete restriction as a result of a settlement? I take the rest of this Comment to address and describe this problem and what could happen in the absence of any clarifying provision in a final rule.

From my review, the NPRM suggests that the FTC does *not* intend to exclude from the rule's reach employees who have time remaining on a noncompete that is tied to a settlement or an injunction. But the language of the Proposed Rule may not reflect this assumed intent. That is because of how the terms "Non-compete clause" and "worker" are defined in Sections 910.1(b)(1) and (f).

I will take the rest of this comment to describe what is likely to happen without clarification. By necessity, I start my discussion on this topic with two assumptions: (1) the FTC enacts the Proposed Rule mainly in the form as it's proposed, and (2) no injunction is issued that prohibits enforcement of a final rule under the "major questions" rule or nondelegation doctrine.

Once the Proposed Rule takes effect, many employees will still have time remaining on noncompete restrictions as a result of settlements and injunctions. Courts

[6] This analysis does not attempt to address nonsoliciation covenants (designed to protect an employer's client relationships) or nondisclosure covenants (designed to protect an employer's confidential information). Those are nominally allowable under the Proposed Rule. Determining whether either operates as a stealth or "de facto" noncompete is not an easy question to answer. There will be plenty of lawsuits over these questions if the FTC enacts the Proposed Rule and bans noncompetes. What's more, other commenters who have experience practicing in this field have adequately explained both the justifications for these narrower classes of covenants and the problems with addressing what rises to the level of a "de facto" noncompete. From an employee's perspective, the Proposed Rule gives him or her an added line of attack to challenge a potentially overbroad nonsolicitation covenant, for instance. And the employer is incentivized to revisit both nonsolicitation and nondisclosure clauses to ensure they are narrowly tailored. In other words, I'm not that worked up over this.

immediately will be flooded with various motions (including those post-judgment) and new civil actions seeking to undo restraints that were agreed to after employment ended or entered by a court after a contested hearing. This is entirely foreseeable; the FTC must have anticipated this during rulemaking.

Yet the Proposed Rule is unclear as to what happens here. Even with added clarity on the rule's substance, the procedural route is murky. I will briefly address how an employee might seek to vacate a settlement-oriented noncompete or an injunction that continues past the Proposed Rule's effective date. As I show, the route to relief progresses from clear to murky.

Permanent Injunctions

Federal Rule of Civil Procedure 60(b)(5) enables a party to seek relief from a final judgment if "applying it prospectively is no longer equitable." A change in the law, which renders the noncompete obligation impermissible under federal law, meets that standard.[7]

This is the procedural route that many litigants have employed after the Supreme Court decided *Dobbs v. Jackson Women's Health Org.*, which overturned *Roe v. Wade*.[8] A number of aggressive state laws seeking to limit abortion or abortion access were enjoined under *Roe* but are now valid under *Dobbs*. The case law is clear that a shift in the legal landscape, such that conduct once proscribed is now lawful, requires a district court to vacate a permanent injunction under Rule 60(b)(5).

Thus, for workers who are enjoined at the time any final rule goes into effect, they have clear legal recourse under Rule 60(b)(5) to vacate the rest of any injunction if that injunction stemmed from the enforcement of an employment-based noncompete that the Proposed Rule invalidates.

Stipulated Injunctions

Settlements that involve continued noncompetes present a much harder question. If an employee loses an injunction trial and has a judgment entered against him, he hasn't bargained anything or compromised a commercial dispute. But most employees make a reasonable decision not to fight a noncompete lawsuit, even if it is is flimsy on the merits. That is due to cost constraints and the impact the lawsuit can have on a new employer or the new employer's business partners.

Very often, a settlement in a civil action embodies some stipulated injunction that confirms the employee's existing noncompete. Though the procedural route is unclear, employees may have recourse to vacate a stipulated injunction under Rule 60(b)(5).

[7] Many states model their civil procedure rules on the federal rules.

[8] *See, e.g.*, *Cincinnati Women's Servs., Inc. v. DeWine*, No. 1:98-cv-289, 2022 WL 17536828 (S.D. Ohio 2022).

Federal courts have applied this rule to consent decrees arising out of litigation seeking institutional reforms, such as remediating unconstitutional conditions in prisons. A consent decree is part contract and part procedural remedy, meaning it's not a perfect fit for Rule 60(b)(5). In short, it's a judicially blessed settlement agreement, for which a court may retain jurisdiction for a while.

Much the same, a stipulated injunction that enforces a noncompete has elements of contract law along with a court remedy for its breach. It is the equivalent of a consent decree, even if less sweeping and far-reaching in duration. According to the Supreme Court in *Rufo v. Inmates of Suffolk Cnty. Jail*, a consent decree "must be modified if, as it later turns out, one or more of the obligations placed on the parties has become impermissible under federal law."

That would seem to include settlements in which the court enters some kind of an agreed or stipulated injunction with an unexpired noncompete restriction in aiding enforcement. In other words, here, Rule 60(b)(5) *might* provide a procedural route to vacate an agreed injunction that enforces a noncompete no longer valid under federal law. Clarity on the substantive reach of the Proposed Rule could help provide needed guidance on whether stipulated injunctions, reached as part of a noncompete settlement, can be vacated. As noted previously, I have doubts that the definitions in the Proposed Rule apply to a settlement-based noncompete, rather than one entered into between a worker and an employer.

Settlement Agreements

Even more complex, though, are purely private settlement agreements that are unaccompanied by a stipulated injunction. That is not an insubstantial number of settlements. And Rule 60(b)(5) by its own terms does not apply as a procedural route to vacate any unexpired restrictive covenant contained in a settlement contract.

What's more, a settlement that contains a covenant could be not a "noncompete clause" between an employer and a "worker," as the current Proposed Rule defines those terms. Instead, it would be a noncompete covenant between an individual and his or her ex-employer. Thus, employers challenging any attempt to set aside a settlement would first rely on the text of the agency's rule.

Again, without clarity, the procedural route for an employee to attack a settlement-based noncompete is unclear at best. Settlements are sometimes complex, complicated documents, whose terms represent tradeoffs. It's just as likely that other commercial terms appear in settlement agreements, which don't allow for easy severability of the noncompete restriction that remains. As one court has stated, "[w]hen it comes to civil

settlements, a deal is a deal…."[9]

Unwinding a noncompete as part of a negotiated resolution may undermine reliance interests related to other terms that remain valid. Courts understandably hesitate to set aside settlement agreements, with some holding a change in the law post-settlement is no basis to set it aside.[10] State law will dictate the grounds on which a party can seek to set aside a settlement agreement, unless the preemptive effect of a final rule addresses the question I've presented.[11]

The clear path that the Commission seems to be taking—for instance, repeatedly suggesting that any alternatives are less preferable than a categorical noncompete ban—shows why clarity is needed on the open questions that I've discussed in this section.

Under the current legal landscape, employees operating under a noncompete restraint who've settled with their former companies likely will be treated differently, and a final agency rule may not offer any protection. The FTC could clarify a final rule by stating that an unexpired noncompete restraint entered into as part of a settlement between a worker and his ex-employer is void to the extent it remains in effect. If this is not what the FTC intends, then it should make that clear too.

Without clarity, the enactment of a final rule banning noncompetes will flood state and federal courts with claims or motions to vacate settlements and injunctions. The procedural route to securing such relief from a settlement is, as I've described, already fraught.

The Proposed Rule complicates this landscape by leaving open whether it even applies at all.

---

[9] *SEC v. Conradt*, 309 F.R.D. 186, 188 (S.D.N.Y. 2015).

[10] *See, e.g.*, *Zuccarelli v. State, Dep't of Env. Prot.*, 741 A.2d 599 (N.J. Sup. Ct. App. Div. 1999).

[11] Even so, I would suspect that many lawyers who are familiar with the Proposed Rule, and who've studied the ambiguity I am identifying, are counseling their clients *against* restating the noncompete restriction in a private settlement agreement. It would seem more prudent to either stipulate to an injunction and preserve Rule 60(b)(5) relief or affirm an existing employment-based noncompete in a settlement to preserve a challenge later if the FTC adopts the Proposed Rule.