The FTC Rule Banning Non-Compete Agreements

By **JEFFERY M. CROSS**

A hot topic in antitrust today is the FTC's proposed rule banning non-compete agreements as an unfair method of competition under Section 5 of the FTC Act. The proposed rule has been published in the Federal Register and the FTC is now seeking comments.

The FTC defines a non-compete agreement as "a contractual term between an employer and a worker that prevents the worker from seeking or accepting employment with a person, or operating a business, after the conclusion of the worker's employment with the employer." The proposed rule exempts any non-compete agreements that are entered into by a person who is selling a business or ownership interest in a business, when the person restricted is a substantial owner or member of the business being sold.

The materials published in the Federal Register acknowledge that the treatment of non-compete agreements is basically addressed by state law. Private enforcement or challenges to non-compete agreements under the federal antitrust laws are usually unsuccessful because section 4 of the Clayton Act requires that the plaintiff establish an injury to competition. The proposed rule, however, would preempt

state law to the extent the state law is inconsistent.

Interestingly, in 1898, just eight years after the Sherman Act was passed establishing a national antitrust regime, then Judge William Howard Taft issued a seminal antitrust decision that still resonates today. Judge Taft was sitting on the Sixth Circuit Court of Appeals. He would go on, of course, to become President of the United States and then Chief Justice of the Supreme Court. The United States v. Addyston Pipe & Steel Co. decision set forth a framework to analyze restraints of trade under the new antitrust law. Under this framework, a court or jury would consider whether the restraint was ancillary and necessary to an otherwise pro-competitive arrangement and whether the restraint was greater than necessary to achieve the pro-competitive purpose.

In explaining his test, Judge Taft provided five examples of restraints that were considered lawful under the common law. These included non-compete agreements relating to the sale of a business and non-compete agreements between an employer and an employee. Both types of restraints were real restraints on competition but were considered lawful because they were ancillary or necessary to an otherwise legitimate, pro-competitive arrangement. Take, for example, a non-compete agreement in connection with the sale of a business. When I teach antitrust law, the example I use is the sale of a pizza restaurant under the name "Sally's Pizza." Sally wants to sell more than the pizza ovens and other fixtures. She wants to sell the goodwill that she has developed over the years because her dough and sauce have developed a strong following. The buyer is willing to pay for this goodwill, but wants some protection so that Sally does not open a pizza restaurant across the street called "Sally's Original Pizza." A non-compete agreement protects the buyer's purchase of Sally's goodwill and encourages persons like Sally to develop goodwill.

What about an employer-employee non-compete agreement? Judge Taft noted that business owners want to employ the best assistants and train them thoroughly, including in the secrets of the business. Judge Taft pointed out that the owner of a business would be reluctant to do so if the employee could set up a rival business in the vicinity after learning the details and secrets of the business.

The FTC has concluded that a complete ban on non-competes is preferable to having courts or juries apply a test like Judge Taft's test. The published materials set forth studies and analyses to support this conclusion.

Judge Taft in an oft-quoted passage cautioned that courts that seek to determine how much restraint is in the public interest "set sail on a sea of doubt." The FTC's total ban on non-competes is also a determination as to how much a non-compete is in the public interest. Of course, the total ban now is a proposed rule only. It remains to be seen if the FTC concludes that it also has set sail on a sea of doubt.

Jeffery Cross is a columnist for Today's General Counsel and a member of the Editorial Advisory Board. He is a partner in the Litigation Practice Group of Freeborn and Peters LLP and a member of the firm's Antitrust and Trade Regulation Group.
jcross@freeborn.com