Federal Trade Commission
January 9, 2020
8:30 am to 5:30 pm

www.ftc.gov/noncompetes | #NonCompetesFTC
Welcome and Introductory Remarks

Bilal Sayyed
Director
Federal Trade Commission, Office of Policy Planning
Statutory and Judicial Treatment of Non-Compete Clauses

Orly Lobel
Warren Distinguished Professor of Law and Director of Employment and Labor Law Program
University of San Diego School of Law
What is a non-compete?

Non-competes, or covenants-not-to-compete, require workers, post-employment, to refrain from accepting employment in a similar line of work or establishing a competing business for a specified period in a certain geographic area.

Time – Place - Profession
Law of Non-competes

- Contract law – common law and statutory law
- Intellectual Property Law
- Sherman Act
- Section 5 of the FTC Act
State Law

“A sea – vast and vacillating, overlapping and bewildering. One can fish out of it any kind of strange support for anything, if he lives so long”

– Arthur Murray v. Witter (Ohio 1952)
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A non-compete clause ancillary to a valid agreement is unreasonably in restraint of trade if

(1) the restraint is greater than is needed to protect the business and goodwill of the employer; or
(2) the promisee’s need is outweighed by the hardship to the promisor and the likely injury to the public.
“Grant us wisdom, for industry doth hang in the balance”
Business Interest

protectable interest **trade secrets**, client relations, customer **goodwill**, employee **training**…

…restraining competition is not a legitimate business interest…
“Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void.”
Cal. Business & Professions Code §16601

Sale of goodwill of business or ownership interest in or operating assets of business entity or division or subsidiary thereof; agreement not to compete

§16602 – dissolution of a partnership
Recent Statutory Reforms

- Illinois, Washington, New Hampshire, Maryland prohibit noncompetes for low-wage workers

- Massachusetts law - requires 10 day Written Notice, Right to Consult Counsel; Maximum Duration of One Year; Payment During Non-Compete Period: “garden leave”; Limited Geographic Scope
Severability of Unreasonableness?

1. Never – Red Pencil
2. “Blue-pencil”
3. Reformation States
Specific Industries

- Physicians
- Attorneys
- Security guards
- Broadcasters
- Tech workers

- AMA Opinion 9.02 – Restrictive Covenants and the Practice of Medicine: “Covenants not-to-compete restrict competition, disrupt the continuity of care and potentially deprive the public of medical services.”
Several Recent Federal Bills

**MOVE ACT** - Mobility and Opportunity for Vulnerable Employees prohibit non-compete for low-wage earners

**Freedom to Compete Act** - Prohibit noncompetes for most non-exempt employees

**Workforce Mobility Act** - banning noncompetes nationwide
# Non-Compete Agreements

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Source: Mark Garmaise

UCLA Anderson
Regulatory Need

1. Beyond Spillovers - Multiple Effects
2. Beyond Non-competes Spans Human Capital & IP
3. Beyond Law Comes Action: Ex-Ante Proactive Enforcement
Multiple Effects

- Knowledge Spillovers
- Dense Networks
- Match Quality
- Agglomeration Economies
- Motivation & Behavior
- Carrots & Sticks
- Entrepreneurship
- Brain Gain
- Monopsonies & Wages
- Equality
Human Capital Policy

Insiders → Outsiders

IP

Innovation Assignment
Clauses

Trade Secrets

Duties of Loyalty

NDAs
EEA/DTSA
Non-Competes

Insiders

→ Outsiders
In Terrorem & Behavioral Effects

• In California & North Dakota approximately 19% of workers subject to a non-compete – similar to enforcing states

• Treasury Department 2016 report: Workers unaware of their noncompetes; asked to sign after accepting job

• Chilling mobility beyond enforceability
Regulation & Enforcement

- Antitrust Law
- FTC
- Class Actions
- Attorney Generals
- Notice & Education
Enforcement Mechanisms


- Cal. Labor Code § 432.5 – No employer shall require any employee or applicant to agree, in writing, to any term or condition which is known by such employer to be unlawful.

Antitrust Law

Section 1 of the Sherman Act unlawful contract to restrain trade
Noncompetes fit squarely

Section 2 illegal to "monopolize, or attempt to monopolize, …any part of the trade…”

- The Sherman Act, 15 U.S.C. § 1
Antitrust Guidance for Human Resources Professionals by U.S. DOJ, Antitrust Division, jointly with FTC 2016

- No-Hire Agreements – per se illegal
- Criminal prosecution by DOJ
- Civil enforcement actions by DOJ and/or FTC.
- Action by state Attorneys General
- Civil lawsuits
Vertical No-Hire < Horizontal Non-Compete

→ Horizontal restraints – noncompetes - broader and more pervasive than do-not-hire

→ Empirical evidence of anti-competitive effects & harm on wages, equality, market concentration, entrepreneurship

→ Noncompetes depress wages for all workers, not only those bound by them

FTC Act

• an unfair method of competition - an employer who presents, enforces, or otherwise uses worker non-competes

SCOTUS:

“Congress enacted § 5 of FTC ACT to combat in their incipiency trade practices that exhibit a strong potential for stifling competition.”

“The standard of ‘unfairness’ under the FTC Act encompasses not only practices that violate the Sherman Act and the other antitrust laws, but also practices that the Commission determines are against public policy for other reasons”
Thank You!

lobel@sandiego.edu

ORLY LOBEL
Applying State and Federal UDAP Principles to Non-Compete Clauses

William E. Kovacic
Professor and Director of Competition Law Center
George Washington University Law School
Break
9:20 – 9:35 am
FTC Authority to Address Non-Compete Clauses

Participants:

Moderators:
Sarah Mackey and Jacob Hamburger
Break
11:05 – 11:20 am
Remarks

Rebecca Kelly Slaughter
Commissioner
Federal Trade Commission
Non-compete Contracts: Potential Justifications and the Relevant Evidence

Ryan Nunn
Hamilton Project and Brookings Institution
Non-competes are surprisingly common

• Research on non-compete agreements (NCAs) was originally focused on particular occupations and industries (e.g., Marx 2011; Schwab and Thomas 2006; Garmaise 2011)
• Until recently there was little comprehensive evidence about labor market prevalence of NCAs
  • 2014 survey by Starr, Prescott, and Bishara
  • 2017 survey by Krueger and Posner
  • 2017 survey by Colvin and Shierholz
• → Almost 1/5 of workers have signed a NCA on their current job
The economic context

• Growing understanding that labor markets are characterized by market power
  • Perhaps driven by developments in labor search theory
  • Empirical evidence that firms are not price takers in the LM (e.g., Webber 2015)
    • Search frictions yield bilateral monopoly, but also
    • Recent evidence on LM concentration and its effects (Qiu and Sojourner 2019; Rinz 2018; Azar et al. 2019; Hershbein et al. 2019)

• Also very slow-growing wages for median worker since 1970s
• Consequently many are now reappraising labor market institutions and employer practices
Labor Supply Elasticity versus Median Hourly Wage, by Sector

Median hourly wage (2017 dollars)

Mean labor supply elasticity

Source: BLS 2017; Webber 2015; authors’ calculations.

Note: Median hourly wage is in May 2017 U.S. dollars. See Webber (2015) for details on calculation of mean labor supply elasticity by industry. The solid line depicts the linear relationship between industry elasticity and median hourly wage.
The policy context

• Private-sector unions once bargained on behalf of many workers – and helped set labor market standards for the rest
• Share of private-sector workers in a union fell from 24.2% in 1973 to 6.4% in 2018 (Nunn, O'Donnell, and Shambaugh 2019)
• No-poach agreements are common but now under legal pressure (Ashenfelter and Krueger 2018; Krueger and Posner 2018)
• Other restrictive covenants like non-solicitation and IP assignment are used in conjunction with non-competes (Nunn and Starr, ongoing work)
What are non-competes for?

• In a non-classical labor market, there is scope for participants to exploit and extend their market power
• On their face NCAs appear to be one way for employers to exploit and extend
• But NCAs might also serve other purposes, some of which have more social benefit
• Both theory and evidence are necessary
What are non-competes for?

• Potential explanations that emphasize social benefits
  • Protection of trade secrets
  • Encouragement of employer-sponsored training

• Potential explanations that emphasize employer benefits
  • Intertemporal conduit of market power
  • Limited worker understanding of NCA details and enforceability
Trade secrets justification

- Non-competes might be a more effective / lower-cost way to prevent loss of trade secrets (TS) than narrowly targeted TS law
  - Prevention of TS spillover might be necessary to induce employer to share info in the first place
  - But justification limited in scope to employees who plausibly have TS
  - And depends on extent to which employers have a choice about sharing TS with their employees
- Notably, client lists are *not* equivalent to TS for this purpose
  - More likely zero sum than TS
  - Arguably no social interest in facilitating employer investments in client lists
Trade secrets justification

• Workers w/ TS roughly 25 pp more likely to have NCA
• But most workers w/ NCAs report *not* possessing TS, so this isn’t the whole story (Starr, Bishara, and Prescott 2019)
• Several studies have shown NCAs to be common among workers with low pay and/or educational attainment, for whom TS are often not relevant
Training justification

• Theory implies that training will generally be undersupplied:
  • Specific investments undersupplied because of a hold-up problem
  • General investments undersupplied to the extent that workers are unable (liquidity constraints) or unwilling (asymmetric info about training quality) to pay the costs
• NCAs can assure employers that (after firm-sponsored training) workers:
  • Won’t be a higher flight risk, and
  • Won’t have the bargaining power to demand higher wages
• Firm-sponsored training is more common in states with more-stringent NCA enforcement (Starr 2019; Jeffers 2019)
• But any policy that reduces worker bargaining power should have this effect and is not therefore socially beneficial
Intertemporal conduit of market power

- LMs are not kind to those with longer u/e durations (Kroft et al. 2013) and job search is costly and uncertain
  - Workers just before and after job acceptance often have little leverage
  - If worker bargaining position improves over time, employer would eventually have to pay higher wages
- NCAs can be imposed in a moment of worker weakness and used to maintain employer advantage
  - NCAs often presented to workers after the job offer was accepted or even on/after the first day of work (Marx 2011; Marx and Fleming 2012)
  - Need more evidence and theory here
Share of Non-Compete Agreements, by Time of Signing

With offer

After offer, before starting

First day of work

After starting

Percent of non-competes

Source: Marx 2011.

Note: Results are from a survey of the Institute of Electrical and Electronics Engineers with 1,029 respondents and restricted to workers who have signed a non-compete agreement.
Limited salience explanation

- Workers aren’t likely to be compensated for something they don’t understand is bad for them (or they don’t know they signed)
  - Again, NCA timing is suggestive (Marx 2011; Marx and Fleming 2012)
  - Few workers report bargaining over their NCAs (Starr, Bishara, and Prescott 2019)
  - Much worker confusion over whether and how NCAs are enforced (Prescott and Starr 2019; Starr, Prescott, and Bishara 2019)
  - Roughly as many NCAs in states that *don’t* enforce them (e.g., CA) as in states that do (Starr, Bishara, and Prescott 2019)
- A NCA can be very non-salient until an employer brings it to a worker’s attention (e.g., after the worker receives a competing offer)
- Litigation is not required for NCAs to have a chilling effect
Non-Compete Enforcement, by State

Source: Beck Reed Riden LLP 2017; author’s calculations.

Note: The type of enforcement in which courts can rewrite terms of contracts is often called the rule of reformation. When courts can delete provisions but cannot insert new text, the enforcement doctrine is often called blue pencil. These two types of enforcement are combined in the figure category, “Modified and enforced even if contract does not comply.”
Evaluating NCAs and NCA enforceability

• What should we see if NCAs tend to be mutually beneficial?
  • More worker training, more business investment, and higher wages when NCAs more common or more enforceable
• What do we actually see? Limited evidence but
  • Slightly more worker training (Starr 2019; Jeffers 2019)
  • Possibly more investment at existing firms (Jeffers 2019) but diminished firm entry and startup performance (Samila and Sorenson 2011; Jeffers 2019; Ewens and Marx 2017)
  • States that enforce more stringently have lower age-wage profiles (Treasury 2016)
  • Higher wages after NCAs are banned (Lipsitz and Starr 2019) or enforcement is less stringent (Johnson, Lavetti, and Lipsitz 2019)
Additional social welfare considerations

• Assessing NCAs is not just about the employer-employee relationship
• NCAs and/or stringent NCA enforcement appear to have negative spillovers for:
  • Entrepreneurship (Starr, Balasubramanian, and Sakakibara 2017; Ewens and Marx 2017)
  • Innovation (Belenzon and Schankerman 2013)
  • Mobility of workers w/o NCAs (Starr, Frake, and Agarwal 2018)
• Labor market and business dynamism are important for overall wage and productivity growth (Shambaugh, Nunn, and Liu 2018)
What can be done about NCAs?

- Ban NCAs altogether and/or render unenforceable
- Ban for [low-wage, certain occs] workers
- Limit to jobs with credible trade secrets
- Move to less stringent enforcement
  - No judicial modification
  - Tighter scope and shorter duration
- Require that workers receive meaningful compensation for NCAs
  - Require legal consideration beyond continued employment when NCAs signed
  - Require garden leave during NCA enforcement
- Enhanced transparency and notification
Lunch Break
12:00 – 1:00 pm
Effects of Non-Compete Clauses: Analysis of the Current Economic Literature and Topics for Future Research

Participants:
Kurt J. Lavetti, Ryan Nunn, Evan Starr, Ryan Williams

Moderator: John McAdams
Economic Welfare Aspects of Non-Compete Agreements

Kurt Lavetti
Ohio State University
Dimensions of Economic Welfare Consideration

• Employment-based non-compete agreements (NCAs) have the potential to affect welfare beyond the labor market
  • Workers: earnings levels, earnings growth, mobility, job matching, training
  • Firms: hiring costs, innovation and investment incentives, competition in both input and output markets
  • Consumers: product prices, product access, service continuity
Dimensions of Economic Welfare Consideration

- Empirical evidence has convincingly shown that strengthening NCA laws reduces *average* earnings and worker mobility
  - Still far from reaching a scientific standard for concluding NCAs are bad for overall welfare
  - Also don’t yet fully understand the distribution of effects on workers

- Welfare tradeoffs are likely context-specific, and may be heterogeneous:
  - employees: education levels, earnings levels
  - firms: research-intensive firms, manufacturing firms, service firms
  - consumers: healthcare, Jimmy John’s sandwiches
Effects on Workers

• McAdams (2019) provides great overview of literature studying effects on workers
• Johnson, Lavetti, and Lipsitz (WP) study effects of within-state variation in NCA enforceability between 1991-2014
  • Find increasing enforceability from 10th to 90th percentile of distribution decreases hourly wages by 3-4%, decreases job mobility by 9%
  • Negative earnings effects are twice as large from women and black worker relative to white men
Implicit Contracts in Labor Markets

- Longstanding evidence in labor economics that firms insure workers against shocks to productivity (Beaudry and DiNardo 1991)
  - Past labor market conditions affect wages conditional on current conditions
  - Workers can leverage labor market improvements to increase wages, but are protected from wage cuts during slowdowns
- Johnson et al. (WP) show that this fact is only true on average
  - Holds in states with weak NCA laws, but does not hold in states with strong laws
  - Mechanism: NCAs dampen within-job earnings growth during tight labor markets
Freedom to Contract

• One argument in support of NCA enforceability is that such agreements fall within scope of freedom to contract
• Concern for policymakers in evaluating this argument is whether allowing NCAs imposes negative externalities on workers who do not agree to them
• Johnson et al. (WP) study labor markets (commuting zones) bisected by state borders
  • Show that when NCA laws change in one state, there are spillover effects on workers who live across the state border, and therefore are not directly affected by the law change
  • Estimate that 90% of wage effect spills over onto border counties across state lines (reject spillover smaller than 10% with 95% confidence)
Context Matters

• Although NCAs may reduce earnings *on average*, in some contexts there is evidence they systematically increase earnings
  • Corporate executives (Kini, Williams, and Yin 2019)
  • Physicians (Lavetti, Simon, White 2020)
Case Study: Primary Care Physicians

• Lavetti et al. 2020 show that about 45% of primary care physicians in group practices are bound by NCAs
• NCAs appear to play a valuable role in this market
  • Patient relationships are valuable assets to physicians
  • Illegal to implicitly buy/sell patient referrals, so asset cannot be priced (except through practice sale)
  • NCAs allow practices to protect investments in client relationships
• Physician groups that use NCAs:
  • Generate 17% more revenue per hour
  • Pay employed physicians $650,000 more per average job-spell
  • Have 12% lower turnover
• These gains do not occur in states with unenforceable NCA laws
Evidence from physicians may suggest that NCAs are beneficial in high-skilled service sector in general.

However, Gurun, Stoffman, Yonker (2019) study a comparable market for financial advisors:

- Show that when NCA policies are relaxed, advisors take clients with them to other firms.
  - Appears similar to physician context—NCAs prevent investment holdup distortions that could otherwise reduce welfare.
- However, relaxing NCAs causes firms to be less willing to fire workers, leads to higher rate of misconduct, higher fees charged to clients.

**Takeaway:** even in similar high-skilled service markets, with similar motivation for the use of NCAs, policy recommendation could be different.
Effects on Firms

• Suggestive evidence that innovation and investment incentives depend on ability to use and enforce NCAs
• Do not yet have comprehensive empirical evidence that quantifies the benefits to firms of having the option to use NCAs
  • Could deter investments in innovation (especially if new ideas cannot be patented quickly) or client relationships
Effects on Firms

- Hausman and Lavetti (2020) study effect of NCA law changes on physician practice organization and prices

- Following an increase in state NCA enforceability, HHI of physician establishments declines

- Fewer physicians per office, changes in practice entry/exit rates
Effects on Firms

- However, firm-level market concentration increases. Each office is smaller, but firm overall is larger.

- Suggests that enforceable NCA laws may affect rates of multi-establishment firms and/or merger incentives
- Is this good or bad for workers/consumers?
- Multi-establishment physician groups may provide convenient, integrated access to care
- Could also increase prices
Effects on Firms and Consumers

- Increasing NCA enforceability by $1/10^{th}$ of the state policy spectrum leads to 10% higher avg prices for bundle of physician services

- Simple extrapolation (many caveats!) suggests a national NCA ban would reduce physician spending by $25$ billion per year
Discussion and Opinion

- More empirical evidence is necessary before comprehensive curtailing of NCAs in all contexts
- Workers appear to be harmed on average, but there are important exceptions
  - So far, evidence of exceptions appear to be high-earning workers
- Opinion: a reasonable compromise between worker protection and the need for more thorough evidence could be to require an earnings floor for all contracts with NCAs (OR, MA, WA)
Discussion and Opinion

• Attributing aggregate wage stagnation to NCAs is oversimplification—many factors have contributed to this, and no thorough decomposition of factors
  • Opinion: NCA policies have contributed modestly

• Empirical evidence is even more sparse on the firm and consumer sides
  • Even in case of physicians, where NCAs appear mutually beneficial (on average) for workers and firms, still difficult to assess consumer welfare effects
Discussion and Opinion

• Summary Opinions:
  • The scientific standard for complete ban of NCAs should be high
    • NCAs have been used for centuries, and empirical evidence on effects is relatively nascent
  • Policies can protect vulnerable workers while still permitting NCAs in many other contexts
    • Setting minimum earnings and wage floors for NCA-bound workers
    • This would allow more thorough evaluation of pros and cons
  • Timing regulation: firms should be obligated to disclose the use of NCAs at the time of initial offer
Covenants Not to Compete: The Debate and Recent Evidence

Evan Starr
Assistant Professor
estarr@rhsmith.umd.edu
Why should the FTC care about CNCs?

CNCs are restraints of trade in the labor and product markets
• They prohibit workers from joining and starting a competitor

CNCs are relevant for measuring labor market concentration:
• If CNCs unobservable: effective > observed concentration
• So also relevant for thinking about effects of M&A

Also relevant for measuring (future) product market concentration (i.e., from new entrants)
The Key Tension in the Debate

CNCs give firms *future* labor/product market power
- Potential for reduced wages, employment, entrepreneurship and firm output, with higher prices
- Potential negative externalities

What are the efficiency justifications?
- Incentivize firms to invest to resolve hold-up problem
- Worker "freedom-to-contract"
  - Would not agree if not better off

My Goal Today
- Summarize Existing Evidence and Arguments
- Highlight Discrepancies in Empirical Work
- Directions for Future Work
Key Distinction: *Use vs. Enforceability*

**Enforceability:** Most studies exploit within- or cross-state changes in CNC law.

**Use:** A few recent studies estimate effect of CNCs themselves.

The approaches estimate DIFFERENT, though related, parameters:
- Which should we care about, especially if they are inconsistent?
- Much harder to estimate *causal effect of use*
CNCs are Widespread

- 18-28% of current US labor force (Starr et al. 2019, Colvin and Shierholz 2019)

- More frequently found in high paying, more technical jobs:
  - Executives: 70-80% (Bishara et al. 2015, Garmaise 2009)
  - Technical Workers: 35-45% (Starr et al. 2019, Marx 2011)
  - Physicians: 45% (Lavetti 2014)

- Still found in low-paying, less technical jobs:
  - 14% earning less than $40k (Starr et al. 2019)

- 53% of CNC-bound workers are paid by the hour (Lipsitz and Starr 2019)
Banning CNCs for **Low-Wage Workers** Raises Wages and Mobility

Lipsitz and Starr (2019): “Low-Wage Workers and the Enforceability of Non-Compete Agreements”
Banning CNCs for **High-Tech Workers** Raises Wages and Mobility

Balasubramanian et al. (2019): “Locked In?” Covenants Not to Compete and the Careers of High Tech Workers.” See also, Garmaise (2009), Johnson, Lavetti, and Lipsitz (2019)
Enforcing CNCs ⇒ More Training, Lower Wages

Starr (2019): “Consider This: Training, Wages, and the Enforceability of Covenants Not to Compete”
Banning CNCs Raises New Firm Entry

Enforcing CNCs ⇒ New Firms Struggle to Hire

Table 3. CNC Enforceability and Initial Size of New Firms

<table>
<thead>
<tr>
<th></th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
<th>(5)</th>
<th>(6)</th>
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<tr>
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<td>0.027**</td>
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<td>-0.019***</td>
<td>-0.009</td>
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<td>-0.021***</td>
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<td>(0.002)</td>
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</table>

Relevant sample: All
Industry-year FE: Yes
State FE: No
Other controls: No
N: 5,538,000

Is “Freedom-to-Contract” Wrong?

Evidence from Enforceability: Yes

Evidence from CNC use: More nuanced (Starr et al. 2019)
- Negotiation: < 10%
- 83% simply read & sign; 17% consult friends/family/lawyer
- 86% say promised nothing in exchange for signing
- 30% delayed until after accepting job, without a change in responsibilities.

BUT: Positive wage effects when CNCs are provided with job offer
- Caveat 1: Less positive when including related controls
- Caveat 2: Positive wage effects reduced in higher enforcing states

Two Other Studies: Positive wage effects from use & enforceability in Lavetti et al. (2019) for physicians and for executives in Kini et al. (2019).
Is the Investment Argument Wrong?

CNC Enforceability hurts investment & innovation:
- Silicon Valley (Hyde 2003)
- Samila and Sorenson (2011), Garmaise 2009

CNC use and Enforceability boosts investment

Which is correct? Important avenue for future work.
Unenforceable Noncompetes are Common

Colvin and Shierholz (2019)

<table>
<thead>
<tr>
<th>STATE (IN ORDER OF POPULATION SIZE)</th>
<th>SHARE OF WORKPLACES WHERE EMPLOYEES ARE SUBJECT TO NONCOMPETES</th>
</tr>
</thead>
<tbody>
<tr>
<td>All</td>
<td>All employees Any employees</td>
</tr>
<tr>
<td>California</td>
<td>31.8% 49.4%</td>
</tr>
<tr>
<td>Texas</td>
<td>28.6% 45.1%</td>
</tr>
<tr>
<td>Florida</td>
<td>50.0%* 60.7%</td>
</tr>
<tr>
<td>New York</td>
<td>39.3% 46.4%</td>
</tr>
<tr>
<td>Illinois</td>
<td>21.7% 44.2%</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>14.3%* 50.0%</td>
</tr>
<tr>
<td>Ohio</td>
<td>31.1% 42.2%</td>
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<tr>
<td>Georgia</td>
<td>41.4% 66.7%*</td>
</tr>
<tr>
<td>North Carolina</td>
<td>33.3% 51.4%</td>
</tr>
<tr>
<td>Michigan</td>
<td>29.0% 51.6%</td>
</tr>
<tr>
<td>New Jersey</td>
<td>37.9% 55.2%</td>
</tr>
<tr>
<td>Virginia</td>
<td>25.6% 48.8%</td>
</tr>
<tr>
<td>Virginia</td>
<td>44.8% 64.3%</td>
</tr>
</tbody>
</table>

Source: Beck Reed Riden 50 State Non-compete Chart
Unenforceable Noncompetes Still Affect Worker Choices

Table 5: Turning Down Job Offers

<table>
<thead>
<tr>
<th>Sample</th>
<th>(1) States That Do Not Enforce Noncompetes</th>
<th>(2) States That Enforce Noncompetes</th>
</tr>
</thead>
<tbody>
<tr>
<td>All</td>
<td>41.4%</td>
<td>37.5%</td>
</tr>
</tbody>
</table>

Panel A: Was your noncompete a factor in your choice to turn down your offer from a competitor?

Yes 41.4% 37.5% 42.3%

Panel B: If you received an offer from a competitor, would your noncompete be a factor in your choice to accept it?

Yes 47.6% 46.6% 47.8%

Panel C: How important is your noncompete in determining if you leave for a competitor?

Not at all Important 9.0% 6.2% 9.5%
Very Unimportant 6.0% 7.4% 5.8%
Somewhat Unimportant 6.5% 5.3% 6.6%
Neither Important nor Unimportant 23.3% 26.4% 22.8%
Somewhat Important 21.3% 19.1% 21.6%
Very Important 17.5% 17.2% 17.5%
Extremely Important 16.5% 18.4% 16.3%
Somewhat or Very or Extremely Important 55.3% 54.7% 55.3%

Table 6: Why Do Some Turn Down Offers Because of the Noncompete But Not Others?

<table>
<thead>
<tr>
<th>Condition of offer:</th>
<th>(1) Employer is unaware of offer from competitor</th>
<th>(2) Employer is aware of offer from competitor</th>
<th>(3) Hypothetical offer from competitor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reminded of Noncompete</td>
<td>0.407*** (0.074)</td>
<td>0.158* (0.081)</td>
<td>0.160* (0.080)</td>
</tr>
<tr>
<td>Subjective P(Lawsuit)</td>
<td>0.293* (0.146)</td>
<td>0.288* (0.143)</td>
<td>0.185** (0.085)</td>
</tr>
<tr>
<td>Subjective P(Enforced)</td>
<td>0.321** (0.132)</td>
<td>0.324** (0.130)</td>
<td>0.283* (0.140)</td>
</tr>
<tr>
<td>Actual Enforceability</td>
<td>0.006 (0.015)</td>
<td>-0.067*** (0.021)</td>
<td>-0.060*** (0.022)</td>
</tr>
</tbody>
</table>

Observations 219 219 382 382 2261 2261

Basic Controls Yes Yes Yes Yes Yes Yes

Workers Unaware of Law; More Likely Reminded about Unenforceable CNCs

Prescott and Starr (2020): “Subjective Beliefs about Contract Enforceability”
Other Provisions: Are they used? And are they sufficient for investment?

Six Different Provisions

• Nondisclosure
• Nonsolicitation of clients
• Nonsolicitation of coworkers
• Noncompete
• IP Assignment Agreement
• Arbitration Agreement

Nunn and Starr (2019): “The co-adoption of overlapping restrictive employment provisions” ---- VERY PRELIMINARY
Other directions for future work

- Estimate *causal* effect of CNC use
  - Need longitudinal data of some sort + exogenous variation

- Reconcile investment discrepancies

- Examine substitution across provisions, especially re: investment.
  - Need data on actual contracts (and investment)

- Examine product market effects:
  - prices, quality, productivity, and quantity (output) effects
There is consensus on a few points

• **CNCs are widespread, even in jobs where they are unwarranted**
  • 53% of workers bound by CNCs are paid hourly (Lipsitz and Starr 2019)
  • They can be implemented in less than transparent ways

• **Banning CNCs raises wages and mobility for even technical workers**
  • Evidence of negative spillovers
  • Challenges validity of the freedom to contract / investment arguments

• **CNCs are prevalent & effective in states where they are surely unenforceable**
  • Since courts won’t enforce them, they serve little legitimate investment purposes
  • Raises concerns about the validity of the investment argument in states where CNCs are actually enforceable.
CEO Non-Compete Agreements, Job Risk, and Compensation

Omesh Kini – Georgia State University
Ryan Williams – University of Arizona
David Yin – Miami University
Background

• Human capital is an important asset for firms.

• However, it is unique from other capital in that firms cannot exercise full ownership, i.e. “The inalienability of human capital is a basic human right” in most developed economies/legal systems

• We explore the use of non-compete contracts as a mechanism to keep these human-capital assets within the boundaries of the firm. (note – we focus on CEO non-compete contracts)
Our Questions

• How do non-compete contracts arise in equilibrium?

• How do non-compete contracts affect optimal divestiture of human capital assets (i.e., CEO turnover and the performance-turnover puzzle)?

• What are *ex-post* responses by firms and executives after the contract is negotiated?
Findings - 1

• Non-compete contracts appear to be the result of a bargaining game between firms and CEOs. As product-market risks increase, firms are more likely to insist on them. But as job risks increase, CEOs are less likely to agree to them.
Findings - 2

• Non-compete agreements enhance the performance-turnover relation. In other words, CEOs are more likely to be (optimally) fired for poor performance when a non-compete is in place.
Findings – 3

• CEOs demand more compensation in exchange for signing a non-compete (tradeoff for higher job risk).

• The firm responds with higher compensation, but in the form of equity based compensation to alleviate agency problems associated with risk-shifting.
Example – Non-Compete Contract – DirecTv (headquarters in Cali)

- EMPLOYMENT AGREEMENT (the “Agreement”), is entered into effective as of January 1, 2010 (“Effective Date”), by and between DIRECTV, a Delaware corporation (the “Company”), and Michael D. White (“Executive”).

- Non-Compete. Executive agrees that, while employed by the Company and for a period of two years thereafter, he will not, in any manner directly or indirectly, own, manage, operate, join, control or participate in the ownership, management, operation or control of, or be employed by, or connected in any manner with, in any capacity (including, without limitation, as an employee, consultant, officer, director, partner, advisor or joint venturer), or provide services to or on behalf of, any corporation, firm or business, or any affiliate of any corporation, firm or business, that directly or indirectly engages in any business which competes with the Company or any of its affiliates in the multi-channel video programming distribution business in the United States or in Latin America (whether satellite, cable, telephone or other method of distribution). The foregoing does not prohibit Executive’s ownership of less than five percent (5%) of the outstanding common stock of any company whose shares are publicly traded on a national stock exchange, are reported on NASDAQ, or are regularly traded in the over-the-counter market by a member of a national securities exchange.

- Governing Law; Consent to Jurisdiction. This Agreement shall be governed by and construed in accordance with the laws of the State of New York applicable to agreements made within the State of New York, without regard to its conflict of law rules which are deemed applicable herein. The parties hereto agree that any controversy which may arise under this Agreement or out of the relationship established by this Agreement would involve complicated and difficult factual and legal issues and that, therefore, any action brought by the Company against Executive or brought by Executive, alone or in combination with others, against the Company, whether arising out of this Agreement or otherwise, shall be determined by a judge sitting without a jury.
Example – Non-Compete Contract – Petsmart

• NON-SOLICITATION OF EMPLOYEES/NON COMPETE. Executive agrees to the following terms:

• (a) As used in the Agreement, to “compete” shall include any action by Executive, directly or indirectly, to own, manage, operate, join, control, be employed by, participate in, or become a director, officer, shareholder (holding more than 1% of shares) of, consultant to, or otherwise a participant in, any pet food, pet supplies or pet services superstore business. For the purposes of this Agreement, “superstore business” is defined to mean a business with: (a) at least one store with at least 10,000 square feet of retail space; or (b) more than one store with at least 8,000 square feet of retail space.

• (b) During the term of Executive’s employment by the Company and continuing for a period of one (1) year after the termination of Executive’s employment for any reason (whether by resignation, dismissal, retirement or otherwise), Executive shall not compete with the Company anywhere within the Company’s sales territory as it exists during the period of Executive’s employment or in any sales territory added by the Company during the one (1) year period after Executive’s departure provided that during Executive’s employment with the Company, the Company distributes to Executive information indicating a plan to add such sales territory or publicly announces such a plan; or Executive or Executive’s subsequent employer otherwise acquires knowledge of such a plan. In view of the Company’s business style and character, its marketing methods, and its strategy, Executive agrees that it is reasonable to reconsider that the Company’s sales territory extends throughout each state in which it is doing business and Executive shall not Compete within such area.
Data

• Execucomp sample from 1992-2014.

• Firms are required to report employment contracts for executives to the SEC.

• Manually search EDGAR for each CEO in this time period. Contracts are usually mentioned in the 10-K and reported as 8-K filings.

• As noted in Bishara, Martin, and Thomas (2009), roughly half of firms do not report employment contracts. They worry it is missing data; Gillan, Hartzell, and Parrino (2009) use this variation to test implicit v. explicit contracting.

• We find employment contracts for 17,486 CEO-years. Of those, 60.3% have non-compete clauses.
Determinants of Non-Compete Contracts in Equilibrium

- Include proxy variables for:

- Job risk => Ind Credit Rating (Peters and Wagner (2014)).

- Predation risk => # of in-state competitors, difference in Lifecycle from industry, intangible assets, CEO retirement age.

- Enforcement of non-compete contracts. States have variation in how strictly they enforce these contracts (more on this later in the identification section).
Non-Compete Score

Question 1. Is there a state statute of general application that governs the enforceability of covenants not to compete?

Question 8. Who has the burden of proving the reasonableness or unreasonableness of the covenant not to compete?

Question 10. If the restrictions in the covenant not to compete are unenforceable because they are overbroad, are the courts permitted to modify the covenant to make the restrictions more narrow and to make the covenants enforceable?

Question 11. If the employer terminates the employment relationship, is the covenant enforceable?

• Important to note that in many states not all of these issues are settled due to common law system.
• Garmaise (2011) + Beck Reed Riden LLP
## Non-Compete Agreements

<table>
<thead>
<tr>
<th>State</th>
<th>From</th>
<th>Score</th>
<th>% CEOs with CNC</th>
<th>Fire Enforce</th>
<th>State</th>
<th>From</th>
<th>Score</th>
<th>% CEOs with CNC</th>
<th>Fire Enforce</th>
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<td>0.00%</td>
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<td>81.08%</td>
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<td>OR</td>
<td>1992-2008</td>
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Cross-Sectional Variation
## Time-Series Shocks

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<tr>
<th>State</th>
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<tr>
<td>Texas</td>
<td><em>Light v. Centel Cellular Co.</em></td>
<td>1994</td>
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<td>Florida</td>
<td>Florida Legislature</td>
<td>1996</td>
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<td>Louisiana</td>
<td><em>SWAT 24 Shreveport Bossier, Inc. v. Bond</em></td>
<td>2001</td>
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<td>Kentucky</td>
<td><em>Gardner Denver Drum LLC v. Peter Goodier and Tuthill Vacuum and Blower Systems</em></td>
<td>2006</td>
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<td><em>Baker Petrolite Corp. v. Spicer</em></td>
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<td>Idaho</td>
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<td>Texas</td>
<td><em>Mann Frankfort Stein &amp; Lipp Advisors, Inc. v. Fielding</em></td>
<td>2009</td>
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<td>Wisconsin</td>
<td><em>Star Direct, Inc. v. Dal Pra.</em></td>
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<td>South Carolina</td>
<td><em>Poynter Investments, Inc. v. Century Builders of Piedmont, Inc.</em></td>
<td>2010</td>
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<td>Colorado</td>
<td><em>Lucht’s Concrete Pumping, Inc. v. Horner</em></td>
<td>2011</td>
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<td>Georgia</td>
<td>Georgia Legislature</td>
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<tr>
<td>Texas</td>
<td><em>Marsh USA, Inc. v. Cook</em></td>
<td>2011</td>
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<td>Illinois</td>
<td><em>Fifield v. Premier Dealership Servs.</em></td>
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<td>Virginia</td>
<td><em>Assurance Data Inc. v. Malyevac</em></td>
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<tr>
<td>Colorado</td>
<td>Change in Russell Beck Data, from blue pencil to purple pencil</td>
<td>2013</td>
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Summary

• Non-compete agreements appear to optimally arise out of bargaining game between executives and firms (may be different for lower-level employees with less bargaining power).

• Enforceability and existence of non-compete agreements appear to improve performance-turnover sensitivity.

• CEOs appear compensated for enhanced job risk and firms provide this compensation principally through incentive-based pay, cognizant of the potential agency issues.
Effects of Non-Compete Clauses: Analysis of the Current Economic Literature and Topics for Future Research

Participants:
Kurt J. Lavetti, Ryan Nunn, Evan Starr, Ryan Williams

Moderator: John McAdams
Break

2:30 – 2:45 pm
Remarks

Noah Joshua Phillips
Commissioner
Federal Trade Commission
A Primer on FTC Rulemaking: Non-Compete Clauses in the Workplace

January 9, 2020

Aaron L. Nielson
Professor of Law
Disclaimer

My presentation is about the procedures the FTC must follow to conduct a rulemaking.

My intention is not to address substantive questions about whether non-compete clauses (or, indeed, any other issue) should be regulated by an FTC rulemaking, much less what the content of such regulation should be.

Today’s presentation, in short, is about process.
The Federal Rulemaking Process: An Overview

Maeve P. Carey, Coordinator
Analyst in Government Organization and Management

June 17, 2013

The Basics (Generally)

Figure 1. Federal Rulemaking Process

Congress Passes Statute

Initiating Event

Agency Develops Draft Proposed Rule

Newsworthy or Draft Proposed Rule within Appropriations Act

OIRA: A Review of Critical Proposed Rule

Publication of Notice of Proposed Rulemaking

Public Comments

Response to Senate Report on Development of Draft Final Rule

Reconsideration of Draft Final Rule within Agency’s Discretion

OMB/IRA Review of Draft Final Rule

Publication of Final Rule

Legal Challenge

Rule Takes Effect

Congressional Review

Good Determination of Legality of Rule

Congressional Action on Disapproved Rule

Source: CRS

* The Office of Management and Budget’s (OMB) Office of Information and Regulatory Affairs (OIRA) reviews only significant rules, and does not review any rules submitted by independent regulatory agencies.
The Federal Rulemaking Process: An Overview

Maeve P. Carey, Coordinator
Analyst in Government Organization and Management

June 17, 2013

The Basics (for the FTC)

Figure 1. Federal Rulemaking Process

Congress Passes Statute
Regulating/Restricting an Activity

Agency Develops Draft Proposed Rule

Publication of Notice of Proposed Rulemaking

Public Comments
Review and Harmonization
Development of Draft Final Rule

Advocacy

Publication of Final Rule

Rate Takes Effect

Legal Challenge

Court Determines Legality of Rule

Congressional Review

Congress Takes Action on Disapproval Resolution

Initiating Event

Source: CRS

* The Office of Management and Budget's (OMB) Office of Information and Regulatory Affairs (OIRA) reviews only significant rules, and does not review any rules submitted by independent regulatory agencies.
Which Law Authorizes Rulemaking?

It is essential to know under which statute an agency is regulating because different statutes have different requirements.
III. RULEMAKING AUTHORITY

In lieu of relying solely on actions against individual respondents to determine that practices are unfair or deceptive, the Commission may use trade regulation rules to address unfair or deceptive practices that occur commonly.

Prior to enactment of Section 18 of the FTC Act, 15 U.S.C. Sec. 57a, the Commission issued substantive trade regulation rules under Section 6(b), 15 U.S.C. Sec. 46, which authorizes the Commission "to make rules and regulations for the purpose of carrying out the provisions of this subchapter." See Nat’l Petroleum Refiners Ass’n v. FTC, 482 F.2d 672, 693 (D.C. Cir. 1973), cert. denied, 415 U.S. 951 (1974) (Commission has authority to require octane labels on gasoline pumps). Nearly all of the rules that the Commission actually promulgated under Section 6(b) were consumer protection rules. In 1975, Section 18 became the Commission’s exclusive authority for issuing rules with respect to unfair or deceptive acts or practices under the FTC Act, 15 U.S.C. Sec. 57a(a)(2). Section 6(b) continues to authorize rules concerning unfair methods of competition.

Under Section 18 of the FTC Act, 15 U.S.C. Sec. 57a, the Commission is authorized to prescribe "rules which define with specificity acts or practices which are unfair or deceptive acts or practices in or affecting commerce within the meaning of Section 5(a)(1) of the Act. Among other things, the statute requires that Commission rulemaking proceedings provide an opportunity for informal hearings at which interested parties are accorded limited rights of cross-examination. Before commencing a rulemaking proceeding, the Commission must have reason to believe that the practices to be addressed by the rulemaking are "prevalent." 15 U.S.C. Sec. 57a(b)(3).

Once the Commission has promulgated a trade regulation rule, anyone who violates the rule "with actual knowledge or knowledge fairly implied on the basis of objective circumstances that such act is unfair or deceptive and is prohibited by such rule" is liable for civil penalties for each violation. The Commission obtains such penalties by filing a suit in federal district court under Section 5(m)(1)(A) of the FTC Act, 15 U.S.C. Sec. 45(m)(1)(A). In addition, any person who violates a rule "is liable for any injury caused to consumers by the rule violation, in addition to being able to seek redress under Section 13(b), the Commission may pursue such recovery in a suit for consumer redress under Section 19 of the FTC Act, 15 U.S.C. Sec. 57b.

These procedures apply only to rules with respect to unfair or deceptive acts or practices promulgated under authority of the FTC Act. In addition, various other statutes authorize Commission rulemaking; such rulemaking is typically promulgated in accordance with section 553 of title 5, United States Code. These statutes generally provide that a violation is treated as a violation of the FTC Act, and often provide that a violation is treated as a violation of a trade regulation rule promulgated under FTC Act Section 18. All Commission rules are published in Title 16 of the Code of Federal Regulations.

https://www.ftc.gov/about-ftc/what-we-do/enforcement-authority
III. RULEMAKING AUTHORITY

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Prior to enactment of Section 18 of the FTC Act, 15 U.S.C. Sec. 57a, the Commission issued substantive trade regulation rules under Section 6(d), 15 U.S.C. Sec. 46, which authorizes the Commission to make rules and regulations for the purpose of carrying out the provisions of this subchapter. See Nat’l Petroleum Refiners Ass’n v. FTC, 482 F.2d 672, 693 (D.C. Cir. 1973), cert. denied, 415 U.S. 951 (1974) (Commission has authority to require octane labels on gasoline pumps). Nearly all of the rules that the Commission actually promulgated under Section 6(d) were consumer protection rules. In 1975, Section 18 became the Commission’s exclusive authority for issuing rules with respect to unfair or deceptive acts or practices in non-commercial transactions. Under Section 18 of the FTC Act, 15 U.S.C. Sec. 57a, the Commission is authorized to prescribe “rules which define with specificity acts or practices which are unfair or deceptive acts or practices in or affecting commerce” within the meaning of Section 5(a)(1) of the Act. Among other things, the statute requires that Commission rulemaking proceedings provide an opportunity for informal hearings at which interested parties are accorded limited rights of cross-examination. Before commencing a rulemaking proceeding, the Commission must have reason to believe that the practices to be addressed by the rulemaking are “prevalent.” 15 U.S.C. Sec. 57a(b)(3).

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https://www.ftc.gov/about-ftc/what-we-do/enforcement-authority
I. THE FTC’S MAGNUSON-MOSS RULEMAKING PROCEDURES

The FTC’s rulemaking procedures go far beyond the relatively streamlined notice-and-comment procedures mandated in Section 553 of the APA to which most agencies are subject. They include:

- An Advance Notice of Proposed Rulemaking
- A Detailed Notice of Proposed Rulemaking
- Advance Notice of NPRM to Congress
- A Preliminary Regulatory Analysis
- An Oral Hearing (if requested)
- Cross-Examination
- On-the-Record Staff Report
- Hearing Officer “Recommended Decision”
- Comments on Report and Recommended Decision
- Notice of & “Verbatim Record” with Outside Parties
- Commissioner Communications on the Record
- A Final Regulatory Analysis
- Statement of Basis and Purpose
- Special Judicial Review (Substantial Evidence)
An Advance Notice of Proposed Rulemaking

“A mandatory advance notice of proposed rulemaking (‘ANPRM’), preceding the notice of proposed rulemaking (‘NPRM’), which shall be published in the Federal Register and submitted to several congressional committees.”

“This ANPRM must ‘(i) contain a brief description of the area of inquiry under consideration, the objectives which the Commission seeks to achieve, and possible regulatory alternatives under consideration by the Commission and (ii) invite the response of interested parties with respect to such proposed rulemaking, including any suggestions or alternative methods for achieving such objectives.’”

“The named committees are the Senate Committee on Commerce, Science, and Transportation and the House Committee on Energy and Commerce.”
“Magnuson-Moss Rulemaking”

A Detailed Notice of Proposed Rulemaking

“An NPRM, which must ‘state[e] with particularity the text of the rule, including any alternatives, which the Commission proposes to promulgate, and the reason for the proposed rule.’”

Quoting 15 U.S.C. § 57a(b)(1)
“Magnuson-Moss Rulemaking”

A Preliminary Regulatory Analysis

“A preliminary regulatory analysis relating to the proposed rule, containing:

(A) a concise statement of the need for, and the objectives of, the proposed rule;
(B) a description of any reasonable alternatives to the proposed rule which may accomplish the stated objective of the rule in a manner consistent with applicable law; and
(C) for the proposed rule, and for each of the alternatives described in the analysis, a preliminary analysis of the projected benefits and any adverse economic effects and any other effects, and of the effectiveness of the proposed rule and each alternative in meeting the stated objectives of the proposed rule.”

Citing 15 U.S.C. § 57b-3(b)(1)
“Magnuson-Moss Rulemaking”

- An Oral Hearing (if requested) with Cross-Examination

“A mandatory oral hearing, if any person requests one, presided over by an independent hearing officer.”

“Designation of disputed issues of material fact with opportunities for cross-examination by affected persons or group representatives, with special judicial review available later on for Commission denials of this opportunity.”

“Taking of a verbatim transcript of any oral presentation and cross-examination in the hearing.”

Citing 15 U.S.C. §§ 57a(b)(1), 57a(c), 57a(e)
“Magnuson-Moss Rulemaking”

|| Staff Report and Hearing Officer “Recommended Decision”

| Preparation of a staff report and recommendations to the Commission on the rulemaking record. |

| “A hearing officer’s ‘recommended decision’ to the Commission after the hearing, taking into account the staff report and recommendations.” |

| “Publication of a Federal Register notice seeking comments for at least sixty days on the staff report and on the hearing officer’s report.” |

Citing 16 C.F.R. § 1.13 and 15 U.S.C. § 57a(c)(1)
“Magnuson-Moss Rulemaking”

Communication with Outside Parties and Commissioners

“Notice of meetings with outside parties must be included on the FTC’s weekly calendar, and ‘a verbatim record or summary of any such meeting, or of any communication relating to any such meeting, shall be kept, made available to the public, and included in the rulemaking record.’”

“Communications between officers, employees, and agents of the FTC—‘with any investigative responsibility . . . relating to any rulemaking proceeding within any operating bureau of the Commission’—and Commissioners or their personal staff must be ‘made available to the public and . . . included in the rulemaking record.’”

Quoting 15 U.S.C. §§ 57a(i), (j)
“Magnuson-Moss Rulemaking”

Final Regulatory Analysis

“A final regulatory analysis relating to the final rule, containing:

(A) a concise statement of the need for, and the objectives of, the final rule;

(B) a description of any alternatives to the final rule which were considered by the Commission;

(C) an analysis of the projected benefits and any adverse economic effects and any other effects of the final rule;

(D) an explanation of the reasons for the determination of the Commission that the final rule will attain its objectives in a manner consistent with applicable law and the reasons the particular alternative was chosen; and

(E) a summary of any significant issues raised by the comments submitted during the public comment period in response to the preliminary regulatory analysis, and a summary of the assessment by the Commission of such issues.”

Citing 15 U.S.C. § 57b-3(b)
“Magnuson-Moss Rulemaking”

Statement of Basis and Purpose

“A statement of basis and purpose accompanying the final rule, including:

(A) a statement as to the prevalence of the acts or practices treated by the rule;

(B) a statement as to the manner and context in which such acts or practices are unfair or deceptive; and

(C) a statement as to the economic effect of the rule, taking into account the effect on small business and consumers.”

Citing 15 U.S.C. § 57a(dj)
“Magnuson-Moss Rulemaking”

Special Judicial Review

“Special judicial review provisions that allow parties to apply to the court for leave to make additional oral submissions or written presentations and that apply the substantial evidence test to the rule instead of the normal arbitrary-and-capricious test.”

Citing 15 U.S.C. § 57a(e)
“Mossification”?

Currently, the FTC is required to do rulemaking under positively medieval procedures known as the Magnuson-Moss Act – also called “Mag-Moss.” The requirements to promulgate a rule under these procedures are so onerous that the agency has not proposed a new Mag-Moss rule in 32 years.

Thirty-two.

For instance, under Mag-Moss, if any member of the public requests it, the agency has to hold a hearing where interested persons have the right to examine, rebut, and cross-examine witnesses.

I think many of you are probably familiar with our Funeral Rule, which the agency promulgated under Mag-Moss procedures. The rule requires funeral homes to provide consumers with itemized price lists for services and caskets so that they are able to comparison shop and pick and choose only the services they want. The rule provides much needed protections to consumers at a time when they are especially vulnerable to exploitation. This is a critical rule that brought order to an industry once rife with abuse. Consumers should not be forced to pay a small fortune for an elaborate bundle of funeral services, including a lavish casket, when they might be just as satisfied with more modest products and services instead.

The agency began the Mag-Moss rulemaking for the Funeral Rule in 1975. For this rule, the agency held 52 days of hearings. This wasn’t a two-month period with a few days of hearings scattered here and there, but hearings that took place on 52 separate days. It took the Commission seven years and one month to actually promulgate the Funeral Rule under Mag-Moss procedures – and that doesn’t even count the additional two years between 1973 and 1975 when the agency was working on the Rule before Mag-Moss took effect.

And a lot of the time we spent trying to promulgate other rules was for nothing. We spent over ten years on a rule regarding health spas – no rule enacted. We spent ten years and three months on a rule regarding hearing aids – no rule enacted. And we spent eleven years and eleven months working on a mobile home rule – but no rule was enacted.
But is “Magnuson-Moss Rulemaking” Always Required?

“If, however, the FTC does promulgate rules in this area, it will amount to nothing less than a legal revolution—it will mean a determination before adjudication whether a particular act covered by the rule constitutes an unfair method of competition under § 5. Debate in legal journals on both sides of this topic has been fierce. The stakes are enormous: nothing less than a bypassing of the traditional adjudicative and legislative process to allow the commission to define unfair methods of competition for American industry. Given the uncertainty as to whether the FTC has the statutory authority to promulgate these rules after the Magnuson-Moss Act at all, policy considerations become important. … A question that is sure to inspire future litigation is whether the Federal Trade Commission presently has the power to promulgate rules with the force and effect of law which proscribe acts which are solely ‘unfair methods of competition’ without being ‘unfair or deceptive acts or practices.’ … The Magnuson-Moss Act added a new § 18 to the FTCA, providing clear and exclusive statutory authority for the commission’s issuance of rules dealing with ‘unfair or deceptive acts or practices,’ but does not settle whether the agency has the power to issue rules dealing with ‘unfair methods of competition.’”

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In lieu of relying solely on actions against individual respondents to determine that practices are unfair or deceptive, the Commission may use trade regulation rules to address unfair or deceptive practices that occur commonly.

Prior to enactment of Section 18 of the FTC Act, 15 U.S.C. Sec. 57a, the Commission issued substantive trade regulation rules under Section 6(a), 15 U.S.C. Sec. 45(a) which authorizes the Commission to "make rules and regulations for the purpose of carrying out the provisions of this subchapter." See Nat’l Petroleum Refiners Ass’n v. FTC, 482 F.2d 672, 693 (D.C. Cir. 1973), cert. denied, 415 U.S. 951 (1974) (Commission has authority to require octane labels on gasoline pumps). Nearly all of the rules that the Commission actually promulgated under Section 6(a) were consumer protection rules. In 1975, Section 18 became the Commission’s exclusive authority for issuing rules with respect to unfair or deceptive acts or practices under the FTC Act, 15 U.S.C. Sec. 57a(a)(2), Section 6(a) continues to authorize rules concerning unfair methods of competition.

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Once the Commission has promulgated a trade regulation rule, anyone who violates the rule “with actual knowledge or knowledge fairly implied on the basis of objective circumstances that such act is unfair or deceptive and is prohibited by such rule” is liable for civil penalties for each violation. 17 The Commission obtains such penalties by filing a suit in federal district court under Section 5(m)(1)(A) of the FTC Act, 15 U.S.C. Sec. 45(m)(1)(A). In addition, any person who violates a rule (irrespective of the state of knowledge) is liable for injury caused to consumers by the rule violation. In addition to being able to seek redress under Section 13(b), the Commission may pursue such recovery in a suit for consumer redress under Section 19 of the FTC Act, 15 U.S.C. Sec. 57b.

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Ordinary APA Rulemaking: On Paper

(a) Notice.—General notice of proposed rule making shall be published in the Federal Register (unless all persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law) and shall include (1) a statement of the time, place, and nature of public rule making proceedings; (2) reference to the authority under which the rule is proposed; and (3) either the terms or substance of the proposed rule or a description of the subjects and issues involved. Except where notice or hearing is required by statute, this subsection shall not apply to interpretative rules, general statements of policy, rules of agency organization, procedure, or practice, or in any situation in which the agency for good cause finds (and incorporates the finding and a brief statement of the reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.

(b) Procedures.—After notice required by this section, the agency shall afford interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity to present the same orally in any manner; and, after consideration of all relevant matter presented, the agency shall incorporate in any rules adopted a concise general statement of their basis and purpose. Where rules are required by statute to be made on the record after opportunity for an agency hearing, the requirements of sections 7 and 8 shall apply in place of the provisions of this subsection.
Ordinary APA Process: On Paper

ADMINISTRATIVE PROCEDURE

[Public Law 404—79th Congress]
[Chapter 324—2d Session]

§ 71

AN ACT To improve the administration of justice by administrative procedure

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

TITLE

Section 1. This Act may be cited as the “Administrative Procedure Act”.

5 U.S.C. § 553

Ordinary APA Process: In Reality

Purported Causes of “Ossification”
Portland Cement Doctrine
Material Comments Doctrine
Logical Outgrown Doctrine
“Hard Look” Review
Portland Cement Doctrine

“It is not consonant with the purpose of a rule-making proceeding to promulgate rules on the basis of inadequate data, or on data that, critical degree, is known only to the agency.”

Portland Cement v. Ruckelshaus, 486 F.2d 375 (D.C. Cir. 1973)

➔ When an agency proposes a rule, it must share with the public its methodology and its data.
Logical Outgrowth Doctrine

“A final rule is a logical outgrowth of the proposed rule ‘only if interested parties should have anticipated that the change was possible, and thus reasonably should have filed their comments on the subject during the notice-and-comment period.’ ” Notice of agency action is “crucial to ‘ensure that agency regulations are tested via exposure to diverse public comment, ... to ensure fairness to affected parties, and ... to give affected parties an opportunity to develop evidence in the record to support their objections to the rule and thereby enhance the quality of judicial review.’”

(standard D.C. Circuit language)

→ **A final rule cannot depart too much from a proposed rule.**
Material Comments Doctrine

An agency “must respond to those comments which, if true, would require a change in the proposed rule.”


An agency must review all comments, identify material ones, and then respond to them.
Hard Look Review

Reasoned Decisionmaking – “the agency must examine the relevant data and articulate a satisfactory explanation for its actions including a rational connection between the facts found and the choice made. … Normally, an agency rule would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference of view.”


An agency must consider all “important aspect[s] of the problem.”
Results?

There is a debate about just how ossified the rulemaking process is. But many contend that the more significant the rule, the more challenging rulemaking becomes.
An Aside: The Upside of Ossification

Not only should procedural requirements generally result in higher quality rules, but they also create greater stickiness.

An agency’s authority is bolstered when it can credibly tell the world that the regulation is not going to change. Procedural requirements, enforced by an external force like a court, can act as a credible commitment mechanism.

Not all rules, however, benefit from stickiness. Nor is this to say that there can’t be too much stickiness even for rules that do benefit from it.

Aaron L. Nielson, Sticky Regulations, 85 U. Chi. L. Rev. 85 (2018);
One Last Thought

ADMINISTRATIVE PROCEDURE ACT

[Public Law 404—79th Congress]

[Chapter 394—2d Session]

[S. 7]

AN ACT To improve the administration of justice by presidential administrative procedure.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

TITLE

Section 1. This Act may be cited as the "Administrative Procedure Act".

Notice & Comment

A blog from the Yale Journal on Regulation and ABA Section of Administrative Law & Regulatory Practice.

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Breaking News: Two Major Executive Orders

Amar A. Assilmi - October 14, 2019

President Trump today issued two new executive orders on administrative law. The "Promoting the Rule of Law Through Improved Agency Transparency" E.O. and the "Rule of Law Through Transparency and Fairness in Civil Administrative Enforcement and Adjudication" E.O.
Conclusion

Especially for important rules, rulemaking can be difficult.

Agencies must carefully consider whether limited resources are best used for rulemaking or for other activities. And where there is not sufficient need for regulation, agencies would do well to use their limited resources in other ways.

Where, however, there is sufficient need for regulation, rulemaking has important advantages: (1) it can better provide fair notice, (2) it can address industry-wide problems; (3) and the very difficulty associated with rulemaking creates greater certainty.
Should the FTC Initiate a Rulemaking Regarding Non-Compete Clauses?

Participants:
Sally Katzen, Kristen C. Limarzi, Aaron L. Nielson, Richard J. Pierce, Jr., Howard Shelanski

Moderators:
Derek Moore and Kenny Wright
Closing Remarks

Sarah Mackey
Acting Deputy Director
Federal Trade Commission, Office of Policy Planning
Thank You For Attending

Public Comments May Be Submitted Through February 10, 2020
www.ftc.gov/noncompetes