April 19, 2023

<u>By Electronic Submission to Regulations.Gov</u>

April Tabor
Secretary of the Commission
Federal Trade Commission
Office of the Secretary
600 Pennsylvania Avenue, NW
Suite CC-5610
Washington, DC 20580

Re: Federal Trade Commission Non-Compete Clause Rulemaking, Matter No. P201200,
       88 Fed. Reg. 3482 RIN 3084-AB74

Dear Secretary Tabor:

TechServe Alliance ("TechServe") submits these comments in response to RIN 3084_AB74 concerning the Federal Trade Commission's (FTC) proposed rule to ban non-compete clauses ("Proposed Rule").

The Proposed Rule would nullify non-compete clauses in existing contracts and ban non-compete clauses in future contracts. Non-compete clauses are used for several reasons by a wide range of businesses and industries. Our comments are limited to the potential impact on the IT and engineering staffing sectors. Our members rarely use non-competes but include non-solicitation and confidentiality clauses in employment agreements. This precedent-setting, overly broad rule may have the sweeping effect of misclassifying these business-necessary provisions as non-competes.

TechServe Alliance is the national trade association representing IT and engineering staffing firms dedicated to advancing excellence and ethics. TechServe represents hundreds of companies and serves as the industry's voice before policymakers and the national and trade press. Our members are U.S.-based businesses providing just-in-time talent that builds critical systems and infrastructure for America's corporations, government, and other organizations. These companies include IT and engineering staffing firms, which supply clients with on-site consultants to support their IT and engineering projects, and IT solutions firms, which take on client projects and deliver a complete solution. Approximately 84% of our members generate less than $30 million in annual revenue and qualify as a "small business" under the most recent Small Business Administration (SBA) guidelines.

FTC May Lack Authority to Issue Regulations

On January 19, 2023, the FTC's proposed Non-Compete Clause Rule ("Proposed Rule") was published in the Federal Register. After extensions, comments are due on April 19, 2023.

The FTC explains that the agency acts under Sections 5 and 6(g) of the Federal Trade Commission Act because non-compete clauses allow employers to submit workers to unfair trade practices.

TechServe understands that the FTC may have exceeded the scope of its authority in promulgating this regulation. Other organizations and businesses have submitted extensive comments questioning the FTC's authority to issue nationwide regulations when Section 5 only provides authority to pursue potential violations of the Act on a case-by-case basis. Furthermore, Section 6(g) is limited to the FTC's developing internal administrative rules, and these sweeping regulations would also be subject to the major questions doctrine.[1]

Noting these concerns, TechServe submits these comments about compliance costs, needing more guidance when non-solicitation, non-disclosure, and no-recruitment clauses might be considered a de facto non-compete, and the 25% substantial ownership requirement to qualify for the sale-of-business exemption.

FTC Rule is Overly Broad in Banning Non-Competes and De Facto Non-Competes

The Proposed Rule bans non-compete agreements, including existing non-competes, with narrow exceptions. A non-compete is defined 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."[2] (Emphasis added.)

The Proposed Rule is limited to employer-employee relationships[3] and generally does not impact business-to-business negotiated non-competes where neither business qualifies as a worker nor impacts non-competes agreed upon pursuant to the sale of a business.[4] However, the ban would extend to de facto noncompete agreements, defined as other restrictive clauses drafted so broadly that they are, in effect, a non-compete.[5] Other restrictive convents include non-solicitation, non-disclosure, and no recruitment provisions.

TechServe members generally do not use non-competes but instead use other restrictive covenants to protect proprietary information and prevent solicitation of the former employer's clients or the recruitment of the former employer's workers. Throughout the Proposed Rule, the FTC repeatedly promotes such clauses as the far less restrictive

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[1] See U.S. Chamber of Commerce Comments on FTC Proposed Rule to Ban Noncompetes. https://www.uschamber.com/finance/antitrust/chamber-comments-on-ftc-proposed-rule-to-ban-noncompetes

[2] § 910.1(b)(1).

[3] Worker is broadly defined. § 910.1(f) defines a worker as a natural person who works, whether paid or unpaid, for an employer. "Worker" includes an employee, an individual classified as an independent contractor, contactor, extern, intern, volunteer, apprentice, or sole proprietor who provides a service to a client or customer.

[4] § 910.1(a) and (b)(1). Proposed § 910.1(a) defines business ownership forms and how substantial ownership is determined.

[5] 88 Fed.Reg. at 3482.

alternative to a non-compete.[6] Moreover, the FTC states that banning non-competes won't have much impact because employers who use them tend to have several layers of legal protection; non-solicitation, non-disclosure, and similar provisions would remain in effect.

But at the same time, the FTC cautions that, depending on how broadly they are drafted, non-solicitation and non-disclosure agreements could be deemed a de facto non-compete and subject to the ban.[7] The FTC's advice is a double-edged sword that concerns our members.

TechServe members employ in-house sales and recruiting professionals to develop new business opportunities and the company's talent pool. These individuals have access to confidential business information and knowledge of and contacts for the IT and engineering staffing team. IT and engineering staffing firms generally require account executives (sales) and recruiters to sign employment agreements that may include non-solicitation and nondisclosure/confidentiality provisions. These provisions do not limit employees' ability to work, leave the company, or open their own company.

IT and engineering staffing firms generally also require highly paid, highly skilled IT employees/consultants to sign confidentiality agreements necessary to maintain proprietary information.

The Proposed Rule provides limited guidance on when a non-solicitation or other agreement would be considered a de facto non-compete, e.g., the agreement extends two years or includes a definition of proprietary information prohibiting the former employee from ever working again. But this is not enough to ensure that companies can be confident they can use these provisions to protect confidential information and business resources without running afoul of the rule. For example, could a non-solicitation clause restricting the solicitation of one or more dominant companies in a smaller market rise to the level of being deemed a non-compete? It is unclear based on the limited guidance the FTC has provided. The lack of a "bright line" test to know when the "de facto" threshold has been crossed has the potential to chill business activity that would otherwise contribute to growth, new hiring, and employment, as well as drive up compliance costs.

We urge the FTC to delete the sections of the Proposed Rule pertaining to de facto non-competes. Or, in the alternative, provide more guidance related to high-tech, knowledge workers and dealing with the new norm of remote work.

Rule Compliance Costs May Far Exceed FTC's Calculations

TechServe agrees with the Small Business Administration's comments, which question the FTC's cost calculations and impact on small businesses.[8] Approximately 84% of TechServe members are small businesses. The FTC estimates that the cost of compliance would be limited to updating contracts and contractual practices, between $317.88 and $563.84 for single establishment firms.[9]

Legal drafting would be only one of the costs. The Proposed Rule requires employers to rescind existing non-competes and provides a 180-day compliance period to notify

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[6] 88 Fed.Reg. at 3482, 3509.
[7] 88 Fed.Reg at 3482.
[8] The SBA went further and called the FTC's total ban approach "inappropriate" and recommended that the FTC pursue alternatives based on size and type of businesses.
[9] Id. at 3581.

employees and former employees. This would require employers to contact workers who left the company months or even years ago.

Firms that use non-solicitation, confidentiality, and other restrictive covenants should review existing agreements. The FTC cautions that, depending on how broadly they are drafted, non-solicitation and non-disclosure agreements could be deemed a de facto non-compete and subject to the ban.[10] Therefore, the retroactivity provision will require a prudent employer to review their legal documents and files for all restrictive agreements. Moreover, in many cases, including business sales, consideration was provided to obtain the non-compete or other restrictive agreement.

We agree with the SBA and other organizations that the FTC did not identify or consider the full cost of compliance. Therefore, we urge the FTC to complete a more comprehensive analysis.

TechServe Supports Sale-of-Business Exemption; Eliminate 25% Test

The Proposed Rule bans non-compete agreements with the narrow exception of negotiated non-competes in the case of the sale of a business, division, or subsidiary. § 910.1(a). However, § 910.3 limits this exception to "where the party restricted by the non-compete clause is a substantial owner or substantial partner in, the business entity, with at least 25% ownership interest in the business required to qualify for the exemption.[11]

The FTC explains that the 25% minimum ownership was selected, instead of 51%, to ensure that start-ups with several entrepreneurs sharing ownership interests could sell their businesses. The FTC states that the exemption allowing a non-compete "should not be available if the ownership interest is so small the transfer of ownership interest would not be necessary to protect the value of the business acquired by the buyer." The example of an ownership interest too small to qualify for the exemption was about a worker selling stock back to the company as part of a redemption plan at the end of their employment.

In this Proposed Rule, the FTC seeks to establish a threshold level of ownership to qualify for the exception. Accordingly, the FTC asks if the Proposed Rule should include a number or just the term substantial owner without a further definition; the outcome would be established on a case-by-case basis.

We urge the FTC to eliminate the minimum percentage ownership. The exemption that would allow non-competes in the sale of a business should apply to all owners, regardless of ownership percentage. Another commenter noted that owners holding far less than 25% share could earn millions of dollars in the transaction depending on the business.[12] It is nonsensical to allow even a minority owner who walks away with millions or some cases, tens of millions of dollars to immediately be able to compete with the business in which they just sold their interest. We heard from one of TechServe's large employer members that the 25% level was too high and that several acquisitions would not have been finalized without the non-compete provisions. This, in

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[10] 88 Fed.Reg at 3482.
[11] § 910.1(e).
[12] Comments submitted by Ashford Inc. and subsidiaries.
https://www.regulations.gov/comment/FTC-2023-0007-10522

turn, would have the effect of depressing firm valuations as prospective buyers would either not buy companies without the ability to restrict the former owners from competing or would pay far less for the company if they had limited ability to protect the newly acquired asset.

By comparison, all states have varying laws addressing the enforcement of non-competes. Three states, Oklahoma, California, and North Dakota, do not allow enforcement of non-competes.[13] Upon review of the business sale exemptions in these three states, none of their laws include a substantial owner test.

We urge the FTC to eliminate the substantial owner test in the sale of business exemption.

TechServe Urges the FTC to Withdraw the Proposed Regulation or Resubmit with Changes

If the FTC proceeds to finalize this Proposed Rule, TechServe recommends the following changes:
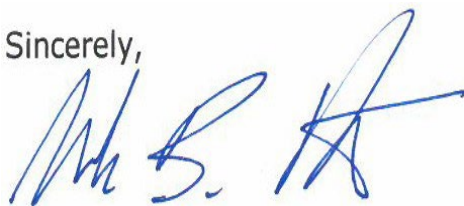
1. Eliminate the section in the proposed regulation that includes non-solicitation, non-disclosure, and other similar provisions as possible de facto non-competes.
2. Eliminate the section that retroactively bans non-competes.
3. Exempt all owners selling their businesses from a non-compete ban, regardless of the percentage of ownership.

Conclusion

For all the reasons stated above, TechServe Alliance urges the FTC to withdraw the Proposed Rule or, at a minimum, modify the Proposed Rule to reflect the above-referenced changes.

Thank you for your consideration.

Sincerely,

Mark B. Roberts
Chief Executive Officer

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[13] Cal. Bus. & Prof. Code sec. 16601; ND 9-08-06; 15 OK Stat § 15-218 (2021). According to the FTC, all 50 states have laws that address non-competes. Three states, California, Oklahoma, and North Dakota, ban non-competes except in sale-of-business transactions.