Regulation by (Bad) Proxy: How Selective Application of Transaction Cost Economics Tainted the FTC's Proposed Ban of Employee Noncompete Agreements

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ABSTRACT

Agencies have imperfect information about conduct they regulate. This problem is particularly acute when identical conduct has differing effects in various markets. Determining the economy-wide impact of such conduct can be difficult or impossible.

The FTC faces such a challenge. The Commission has announced a rule banning the nation's 30 million employee noncompete agreements ("NCAs") as unfair methods of competition under Section 5 of the FTC Act. The Commission determined that NCAs likely reduce aggregate wages, helping to establish a presumptive violation. The Commission also found that nearly all NCAs are both procedurally coercive—because employers use overwhelming bargaining power to impose them—and substantively coercive—because they restrict employees from starting new firms or accepting offers from rival employers. The Commission also implied that procedural coercion was a necessary condition for substantive coercion.

The Commission then assessed possible business justifications. Echoing Transaction Cost Economics ("TCE"), the Commission concluded that NCAs sometimes produce cognizable benefits, increasing productivity and product quality. The Commission framed the inquiry as assessing whether, "overall," NCAs' harms exceed benefits. The Notice of Proposed Rulemaking subjected justifications to a "high bar," given its finding that nearly all NCAs are doubly coercive.

Determining the overall impact of 30 million contracts is a daunting task. The Commission employed a creative proxy, however. The Commission hypothesized that employers would share benefits of NCAs by paying premium wages to employees with such agreements. However, most studies find a negative correlation between state-level enforceability of NCAs and wages, implying that harms exceed benefits. The Commission, therefore, rejected justifications and indiscriminately condemned all NCAs.

This proxy seems sound and consistent with TCE. Wages impound vast data generated by innumerable decisions. Resulting wages should reflect benefits employers expect from NCAs as well as the harms resulting from their restrictive impact. This proxy would seemingly generate an economical assessment of the net impact of NCAs.

This essay critiques this proxy and rejection of business justifications. The essay contends that the proxy may produce misleading results reflecting selective application of TCE's model of contract formation. For instance, the proxy could produce false negatives. A positive correlation between enforceability and wages is consistent with two conclusions: (1) NCAs produce net benefits or (2) most raise rivals' costs and injure consumers. Absent additional information, both hypotheses

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would be equally plausible. Immunizing conduct because of a positive correlation between enforceability and wages risks entrenching harmful agreements.

Invocation of a negative correlation between enforceability and wages risks false positives. Markets are not pre-legal entities that generate immutable results. Background rules impact transaction costs and resulting market activity. The Commission implied that transaction costs prevent employees from learning of NCAs before accepting offers and assumed that courts enforce NCAs regardless of precontractual knowledge. These two aspects of the institutional framework will prevent employees from receiving wage premia to compensate for NCAs. Wages will not impound the benefits of NCAs, and condemnation because of a negative correlation between enforceability and wages may produce a false positive.

The prediction that a wage-based proxy can produce false positives assumes that Section 5 is indifferent between whether employers or employees capture the benefits of NCAs. If, however, benefits must offset harms that NCAs impose on employees, the wage-based proxy will produce no false positives. Unfortunately, the Commission did not address whether Section 5 requires such sharing.

Even if business justifications fail, blunt condemnation of NCAs is not the only remedy that can enhance employee welfare. The Commission rejected an alternative derived from TCE, namely, banning NCAs not disclosed in advance. TCE teaches that this change to the institutional framework would reduce transaction costs and induce employers to pay premium wages to employees bound by NCAs, thereby sharing the benefits of such agreements. These higher wages would also force employers to internalize the impact of NCAs on employees. Some employers would abandon NCAs, and some others would narrow their scope. Both effects would reduce the restrictive impact of NCAs, and mitigate NCAs' negative impact on wages, weakening the Commission's prima facie case against such agreements.

Moreover, fully disclosed NCAs that produce net benefits or raise rivals' costs are voluntary. Thus, neither category of agreement is procedurally nor substantively coercive. Mandatory disclosure would thus reduce the proportion of NCAs that are coercive in either sense, further weakening the Commission's prima facie case.

Despite mandatory disclosure, NCAs' harms may still exceed the benefits that employers share with employees. However, the Commission could not apply a "high bar" to efforts to justify all nonexecutive NCAs and would instead have to estimate how many such agreements are voluntary, lowering the bar for those that are. The combination of a weakened prima facie case, lower bar for some NCAs, and increased sharing of benefits could well alter the outcome of a comparison of NCAs' costs and benefits.

Indeed, the Commission need not guess about the impact of changing the institutional framework. Such a change could itself inform empirical tests that would determine whether the benefits of NCAs realized by employees exceed harms in well-functioning labor markets. In such markets, wages would be a more accurate proxy for the overall impact of NCAs. The result could be a conclusion that, "overall," NCAs produce more benefits than harms and that employers share a sufficient portion of such benefits with employees such that NCAs improve employee welfare compared to a regime that indiscriminately bans such agreements.

INTRODUCTION

Agencies have imperfect information about conduct they regulate. This problem is particularly acute when identical conduct has differing effects in various markets. Determining the economy-wide impact of such conduct can be difficult or impossible.

The FTC faces such a challenge. The Commission has issued a rule banning the nation's 30 million employee noncompete agreements ("NCAs") as unfair methods of competition under Section 5 of the FTC Act. The Commission determined that NCAs restrict labor market competition and likely reduce aggregate wages, establishing a presumptive violation. The Commission also found that nearly all NCAs are both procedurally coercive—because employers use overwhelming bargaining power to impose them—and substantively coercive—because they restrict employees from starting new firms or accepting offers from rival employers. The Commission also implied that procedural coercion was a necessary condition for substantive coercion.

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Determining the overall impact of 30 million contracts is a daunting task. The Commission employed a creative proxy, however. The Commission hypothesized that employers would share benefits of NCAs by paying premium wages to employees with such agreements. However, most studies find a *negative* correlation between state-level enforceability of NCAs and wages, implying that harms exceed benefits. The Commission, therefore, rejected justifications and indiscriminately condemned all NCAs.

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This essay critiques this proxy and rejection of business justifications. The essay contends that the proxy may produce misleading results reflecting selective application of TCE's model of contract formation. For instance, the proxy could produce false negatives. A positive correlation between enforceability and wages is consistent with two conclusions: (1) NCAs produce net benefits, or (2) most raise rivals' costs and injure consumers. Absent additional information, both hypotheses would be equally plausible. Immunizing conduct because of a positive correlation between enforceability and wages risks entrenching harmful agreements.

Invocation of a *negative* correlation between enforceability and wages risks false positives. Markets are not pre-legal entities that generate immutable results. Background rules impact transaction costs and resulting market activity. The Commission implied that transaction costs prevent employees from learning of NCAs before accepting offers and assumed that courts enforce NCAs regardless of precontractual knowledge. These two aspects of the institutional framework will prevent employees from receiving wage premia to compensate for NCAs. Wages will not impound the benefits of NCAs, and condemnation because of a negative correlation between enforceability and wages may produce a false positive.

The prediction that a wage-based proxy can produce false positives assumes that Section 5 is indifferent between whether employers or employees capture the benefits of NCAs. If, however, benefits must offset harms that NCAs impose on employees, the wage-based proxy will produce no false positives. Unfortunately, the Commission did not address whether Section 5 requires such sharing.

Even if business justifications fail, blunt condemnation of NCAs is not the only remedy that can enhance employee welfare. The Commission rejected an alternative derived from TCE, namely, banning NCAs not disclosed in advance. TCE teaches that this change to the institutional framework would reduce transaction costs and induce employers to pay premium wages to employees bound by NCAs, thereby sharing the benefits of such agreements. These higher wages would also force employers to internalize the impact of NCAs on employees. Some employers would abandon NCAs, and some others would narrow their scope. Both effects would reduce the restrictive impact of NCAs and mitigate NCAs' negative impact on wages, weakening the Commission's *prima facie* case against such agreements.

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Indeed, the Commission need not guess about the impact of changing the institutional framework. Such a change could itself inform empirical tests that would determine whether the benefits of NCAs realized by employees exceed harms in well-functioning labor markets. In such markets, wages would be more accurate proxies for the overall impact of NCAs. The result could be a conclusion that, "overall," NCAs produce more benefits than harms *and* that employers share a sufficient portion of such benefits with employees such that NCAs improve employee welfare compared to a regime that indiscriminately bans such agreements.

Part I recounts the Commission's rationale for presumptive condemnation of NCAs. Part II describes the Commission's conclusion, drawn from TCE, that NCAs sometimes produce cognizable benefits that may justify such agreements. Part III details the Commission's rejection of business justifications. Part IV describes the case for reliance on a proxy. Part V critiques this proxy, explaining how it can produce both false negatives and false positives. Part VI explains how a regime of mandatory disclosure and condemnation of non-disclosed NCAs, combined with a waiting period, could induce employers to pay premium wages that share benefits with employees, alter the number and content of NCAs, and perhaps improve the welfare of employees compared to the result of an indiscriminate ban.

I. THE COMMISSION'S RATIONALE FOR PRESUMPTIVE CONDEMNATION OF NCAS

Section 5 of the Federal Trade Commission Act prohibits "unfair methods of competition."[1] In 2015, a bipartisan Commission announced that Section 5

1. *See* 15 U.S.C. § 45(a).

incorporated the same consumer welfare standard that Congress meant courts to apply when assessing agreements under Section 1 of the Sherman Act.[2] In July 2021, without seeking public comment, the Commission withdrew this pronouncement, repudiating consumer welfare, albeit without articulating any standard to replace it.[3]

In November 2022, the Commission, again without seeking public comment, released a revised statement of Section 5 enforcement policy ("Section 5 Statement").[4] The statement announced that Section 5 banned, *inter alia*, conduct that was "coercive" or "exploitative[,]" regardless of impact on prices, wages, output, or quality.[5] The focus on coercion as an independent source of liability reflected the Commission's "NeoBrandeisian" approach to Antitrust, which seeks to counteract the anti-democratic impact of concentrated economic power.[6]

This statement explained how the Commission would assess conduct case-by-case when exercising its longstanding power of investigation and adjudication. Unlike most previous Commissions, this Commission has also claimed the power to issue legislative rules banning entire categories of conduct.[7] Unfortunately, neither the Section 5 Statement nor any other pronouncement has explained how the Commission would choose between banning an entire category of conduct or instead subjecting that conduct to case-by-case adjudication. By analogy, under Section 1 of the Sherman Act, courts only condemn a type of restraint as unlawful *per se* after experience allows courts "to predict with confidence that the rule of reason will

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2. FED. TRADE COMM'N, STATEMENT OF ENFORCEMENT PRINCIPLES REGARDING "UNFAIR METHODS OF COMPETITION" UNDER SECTION 5 OF THE FTC ACT (Aug. 13, 2015); NCAA v. Alston, 594 U.S. 69, 81 (2021) (courts should ask whether restraints "are harmful to the consumer"); Standard Oil Co. of N.J. v. United States, 221 U.S. 1, 52, 57–60 (1911) (explaining that the Sherman Act only bans agreements that increase prices, reduce production and/or reduce quality); Robert H. Lande, *Wealth Transfers as the Original and Primary Concern of Antirust*: *The Efficiency Interpretation Challenged*, 34 HASTINGS. L. J. 65, 68–69 (1982) (Congress "subordinate[d] all other concerns to the basic purpose of preventing firms with market power from directly harming consumers."); 15 U.S.C. § 1. *See also* Lande, *Wealth Transfers*, 34 HAST. L. J, at 126 (concluding that "Congress' overall mission in passing the FTC Act was to strengthen and improve the Sherman Act, and to better implement its competition goals. Congress viewed 'competition' as the rule of the marketplace that would best achieve and enhance 'consumer welfare[.]'"); *id.* (concluding that Congress's "ultimate goals" when enacting the FTC Act were "identical to those of the Sherman Act"). .

3. *See* FED. TRADE COMM'N, WITHDRAWAL OF THE STATEMENT OF ENFORCEMENT PRINCIPLES REGARDING "UNFAIR METHODS OF COMPETITION" UNDER SECTION 5 OF THE FTC ACT (July 9, 2021). Although Professor Lande's article, *supra* note 3, has been cited over 1,000 times, the current Commission has ignored Professor Lande's findings.

4. *See* FED. TRADE COMM'N, POLICY STATEMENT REGARDING THE SCOPE OF UNFAIR METHODS OF COMPETITION UNDER SECTION 5 OF THE FEDERAL TRADE COMMISSION ACT (November 10, 2022).

5. *Id.*

6. Lina Khan, *The New Brandeis Movement: America's Anti-Monopoly Debate*, 9 J. EUR. COMPETITION L. & PRAC. 131 (2018) (summarizing this movement); Thomas A. Lambert and Tate Cooper, *Neo-Brandeisianism's Democracy Paradox*, 49 J. CORP. L. 347, 350–361 (2024) (describing NeoBrandeisian antitrust philosophy).

7. *See* Alan J. Meese, *Are Employee Noncompete Agreements Coercive? Why the FTC's Wrong Answer Disqualifies It from Rulemaking (For Now)*, 18 VA L. & BUS. REV. 245, 261–62 (2024).

condemn it"[8] because such restraints "have such predictable and pernicious anticompetitive effect, and such limited potential for procompetitive benefit."[9] The Section 5 Statement did not mention this standard, which the Supreme Court announced in 1958.[10]

Two months later, the Commission issued a Notice of Proposed Rulemaking ("NPRM") articulating its assessment of the entire category of employee noncompete agreements ("NCAs"). Such contracts preclude employees from starting competing businesses or accepting offers to work for rival firms "for a specified period of time in a designated geographical area."[11] The NPRM estimated that one in five employees—about 30 million—are covered by NCAs.[12] The NPRM also explained that NCAs govern employees in innumerable industries and all income brackets.[13] Employees with NCAs range from surgeons and steel company executives to workers at fast-food restaurants, a payday loan company, security firms, and glass manufacturers.[14]

In May 2024, the Commission issued a final rule that largely repeated the findings of the NPRM. Like the NPRM, the Final Rule determined that all NCAs are presumptively "unfair methods of competition," contrary to Section 5. Both the NPRM and Final Rule articulated three ways that NCAs are presumptively unfair.[15] First, *all* NCAs are "restrictive" because they "restrict" an employee's ability to start a competing business or accept a rival employer's offer to switch firms.[16] This restriction on employee mobility, the Commission said, prevented employees from allocating their labor to the highest bidder and weakened employees' post-hire bargaining power *vis a vis* the original employer.[17] Both impacts tended to reduce wages.[18] To bolster this determination, both the Final Rule and the NPRM invoked significant evidence that NCAs likely reduce aggregate wages, and one study finding that NCAs increased prices in one industry.[19]

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8. State Oil Co. v. Khan, 522 U.S. 3, 10 (1997) (*quoting* Arizona v. Maricopa Medical Soc., 457 U.S. 332, 344 (1982)).

9. *Id*. (citing N. Pac. Ry. Co. v. United States, 356 U.S. 1, 5 (1958)).

10. N. Pac. Ry. Co. v. United States, 356 U.S. 1, 5 (1958) ("[T]here are certain agreements or practices which, because of their pernicious effect on competition and lack of any redeeming virtue, are conclusively presumed to be unreasonable, and therefore illegal, without elaborate inquiry as to the precise harm they have caused or the business excuse for their use.").

11. *See* Harlan M. Blake, *Employee Agreements Not to Compete*, 73 HARV. L. REV. 625, 626 (1960).

12. Notice of Proposed Rulemaking, 88 Fed. Reg. 3482 (proposed Jan. 19, 2023) (to be codified at 16 C.F.R. pt. 910) [hereinafter NPRM] at 3485.

13. *Id.* at 3483–84.

14. *Id.*

15. *See* Meese, *supra* note 7, at 272–74 (describing NPRM's articulation of three ways in which NCAs are supposedly unfair).

16. Non-Compete Clause Rule, 89 Fed. Reg. 38342, 38374 (May 7, 2024) (codified at 16 C.F.R. pt. 910) (Hereinafter "Final Rule"); NPRM, 88 Fed. Reg. at 3500.

17. Final Rule, 89 Fed. Reg. at 38380; NPRM, 88 Fed. Reg. at 3485, 3500–01.

18. Final Rule, 89 Fed. Reg. at 38380; NPRM, 88 Fed. Reg. at 3485, 3500–01.

19. Final Rule, 89 Fed. Reg. at 38380; NPRM, 88 Fed. Reg. at 3500–02 (finding that, "in the aggregate," NCAs "materially reduce wages"); *id.* at 3490 (citing study of one industry finding correlation between NCA enforcement and prices). Such evidence also established the

Second, all NCAs, except those entered by "senior executives," are "coercive and exploitative at the time of contracting."[20] That is, employers use a "particularly acute imbalance of bargaining power" coercively to impose NCAs on non-executive employees.[21] The NPRM identified numerous supposed factors indicating the possession and exercise of such power, including labor market concentration, lack of individualized bargaining over such agreements, and the supposed fact that potential employees rarely know of NCAs before accepting employment offers.[22]

Third, the NPRM found that nonexecutive NCAs are "coercive and exploitative" at the time of the employee's "potential departure from the employer."[23] The Commission concluded that the prospect of judicial enforcement of NCAs forces employees to choose between staying in a job they want to leave or an alternative, less attractive position that the agreement does not preclude.[24] The two types of coercion the NPRM identified correspond to the categories of procedural and substantive unconscionability recognized by Contract Law.[25] This essay refers to these categories of coercion as "procedural" and "substantive" accordingly.

As noted above, the NPRM and Final Rule exempted "senior executives" from its finding that NCAs are doubly coercive.[26] Such executives, the NPRM said, bargain individually over NCAs and presumably receive additional compensation for entering them.[27] Thus, the process of forming such agreements is not coercive and instead voluntary.[28] The NPRM also concluded that such NCAs are not substantively

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requisite negative impact on "competitive conditions," which the Commission treated as a distinct element of a *prima facie* case that conduct is an "unfair method of competition." *Id.* at 3500–02; *see* Final Rule, 89 Fed. Reg. at 38358 (describing this second element).

20. NPRM, 88 Fed. Reg. at 3502.

21. Final Rule, 89 Fed. Reg. at 38375 ("The Commission finds that employers almost always unilaterally impose non-competes, exploiting their superior bargaining power to impose—without any meaningful negotiation or compensation—significant restrictions on workers' abilities to leave for better jobs or to engage in competitive activity."); *id.* at 38377 (same); *id*. at 38460 ("[T]here is a significant imbalance in bargaining power between employers and most workers, which is particularly acute in the context of negotiating employment terms such as non-competes."); NPRM, 88 Fed. Reg. at 3503.

22. Final Rule, 89 Fed. Reg. at 38375–79; NPRM, 88 Fed. Reg. at 3502–04. *See also* Meese, *supra* note 7, at 273 (detailing various supposed attributes that render NCAs coercive in this sense).

23. NPRM, 88 Fed. Reg. at 3504; *see* Final Rule, 89 Fed. Reg. at 38405 (recounting NPRM's finding that "senior executives are likely to negotiate the terms of their employment and may often do so with the assistance of counsel.") (*citing* NPRM, 88 Fed. Reg. at 3503); *id.* (reviewing record evidence suggesting that senior executives "frequently negotiate non-competes for valuable consideration and/or typically agree to non-competes only in exchange for compensation."); *id.* (summarizing comments by senior executives stating that NCAs do not coerce or exploit them).

24. NPRM, 88 Fed. Reg. at 3504.

25. *See* JOHN EDWARD MURRAY, MURRAY ON CONTRACTS, 541–42 (5th ed. 2011) (discussing distinction between procedural and substantive unconscionability).

26. Final Rule, 89 Fed. Reg. at 38405 ("[T]he Commission does not find that non-competes with senior executives are exploitative and coercive.").

27. NPRM, 88 Fed. Reg at 3503–04.

28. *Id.* Neither the Final Rule nor the NPRM employed the term "voluntary," although

coercive because the bargaining *process* that produces them is not coercive.[29] Thus, proof of procedural coercion was necessary, but not sufficient, to establish substantive coercion.

The Final Rule defined "senior executive" as any individual who earns more than $151,164 per year and, in addition, holds a "policy-making" position within the employer.[30] The Commission estimated that less than one percent of employees who have entered NCAs satisfy this definition.[31]

As discussed below, the Commission acknowledged that NCAs can produce cognizable benefits. Under ordinary antitrust standards, this recognition would preclude categorical condemnation and require case-by-case assessment of NCAs under the Section 5 Statement.[32] Indeed, two decisions cited by the NPRM asserted that NCAs survive *per se* condemnation precisely because they may produce such benefits.[33] The only possible exception might be for conduct that rarely produces benefits.[34] However, the Commission did not determine what proportion of NCAs produce such benefits.[35]

II. Transaction Cost Economics and Business Justifications

The preliminary finding that NCAs are unfair was potentially subject to a business justification rebuttal.[36] Under the Section 5 Statement, proponents of challenged conduct bear the burden of proving that "asserted benefits outweigh the harm" and that challenged conduct was narrowly tailored to produce such benefits.[37] The burden increases if conduct is "facially unfair."[38] The NPRM recognized three different benefits that NCAs could produce. First, NCAs can incentivize the creation and sharing of trade secrets, by preventing employees from departing to work for rivals.[39] Second, NCAs can protect employers' investments in training that enhance employees' generally-applicable skills, by preventing free-riding by other employers

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this description appears implicit in their accounts of the bargaining process and conclusions that coercion is absent.

29. NPRM, 88 Fed. Reg. at 3504.

30. *See* Final Rule, 89 Fed. Reg. at 38414 (describing this "two-pronged" definition).

31. *Id.* at 38416 (estimating that 0.75% of employees satisfy this definition). *See also* Meese, *supra* note 7, at 275, n.116 (explaining how possible definitions identified by the NPRM covered less than one percent of employees covered by NCAs).

32. *See supra* notes 8-10 and accompanying text.

33. *See* Final Rule, 89 Fed. Reg. at 38422 n.740 (*citing* Polk Bros., Inc. v. Forest City Enters., 776 F.2d 185, 189 (7th Cir. 1985); U.S. v. Addyston Pipe & Steel Co., 85 F. 271, 281 (6th Cir. 1898)); NPRM, 88 Fed. Reg. at 3505 n.295.

34. *Cf.* Broad. Music, Inc. v. CBS, 441 U.S. 1, 19–20 (1979) (reserving *per se* condemnation for restraints that "always or almost always . . . restrict competition and decrease output").

35. *See* NPRM, 88 Fed. Reg. at 3493 (crediting findings that banning NCAs would annually eliminate training for fifteen percent of employees with such agreements in industries where such agreements are prevalent).

36. Fed. Trade Comm'n, *supra* note 4 at 9–12.

37. *Id.* at 11–12.

38. *Id.* at 11.

39. NPRM, 88 Fed. Reg. at 3505.

who might bid away highly-trained employees.[40] Third, NCAs can encourage purchases of capital equipment, by retaining employees with skills complementary to such investments.[41] All three impacts render employees more productive and/or enhance product quality, furthering interbrand competition, the primary concern of antitrust.[42]

These descriptions of possible benefits drew implicitly on transaction cost economics.[43] ("TCE") Beginning in the 1960s, TCE offered beneficial explanations of various nonstandard contracts and explanations independent of the possession or exercise of market power.[44] In particular, economists contended that such agreements could protect parties that had made relationship-specific investments from opportunistic misappropriation of such investments by others.[45] Economists applied these teachings to NCAs over forty years ago.[46]

TCE also illuminated the *process* of negotiation that can produce such agreements. Courts and scholars once believed that firms use market power to impose nonstandard contracts, such as exclusive dealing and tying agreements.[47] However, TCE explained that firms at risk of opportunism by trading partners can obtain voluntary agreement to provisions reducing this risk.[48] Such firms can offer counterparties two options: sale of a product, plus a contractual safeguard, at one price or sale of the product with no restriction, at a higher price.[49] This differential reflects the expectation that the costs of the second option will be higher because of counterparty opportunism that will occur absent some contractual safeguard.[50] Because the differential is cost-justified, it is not an exercise of market power, which entails profitably charging prices above cost.[51] Firms will exercise any (incidental)

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40. *Id*.

41. NPRM, 88 Fed. Reg. at 3493, 3505.

42. Alan J. Meese, *Don't Abolish Employee Noncompete Agreements*, 57 WAKE FOREST. L. REV. 631, 700 (2022) (explaining that such benefits enhance interbrand competition); *Khan*, 522 U.S. at 15 ("[T]he primary purpose of the antitrust laws is to protect interbrand competition.").

43. *See* Meese, *supra* note 7, at 296–97 (characterizing Commission's account as echoing TCE).

44. Alan J. Meese, *The Market Power Model of Contract Formation: How Outmoded Economic Theory Still Distorts Antitrust Doctrine*, 88 NOTRE DAME L. REV. 1291, 1336–40 (2013).

45. *Id.*

46. Paul H. Rubin and Peter Shedd, *Human Capital and Covenants Not to Compete*, 10 J. LEG. STUD. 93, 95–100 (1981) (explaining how NCAs can protect and encourage employers' investments in employee training).

47. *See* Meese, *supra* note 44, at 1310–12, 1320–22.

48. *See* OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM, 32–35 (1985) (describing "contracting schema" whereby seller offers two prices depending on whether buyer accepts a contractual safeguard); Alan J. Meese, *Price Theory and Vertical Restraints: A Misunderstood Relation*, 45 UCLA L. REV. 143, 187–189 (1997) (explaining how price differential induces formation of agreement creating beneficial exclusive territories).

49. *See* WILLIAMSON, *supra* note 48, at 32–34.

50. *See* Meese, *supra* note 44, at 1350–51 (explaining that cost-based price differential that induces acceptance of contractual safeguard does not constitute exercise of market power).

51. *See* A.P. Lerner, *The Concept of Monopoly and the Measurement of Monopoly Power*,

power they possess to increase the price of the underlying product, charging prices that are higher than the corresponding prices charged by firms lacking such power.[52]

Similar logic applies to the formation of beneficial NCAs.[53] Employers can rely upon wage differentials to induce voluntary acceptance of such agreements.[54] Indeed, employers may obtain agreement to NCAs without express differentials. If the employer offers only one option — the employment agreement including the NCA — advance disclosure will induce some potential employees to exit from negotiations.[55] Such withdrawals will reduce the pool of potential employees, increasing wages employers must pay those who remain and replicating the premium wage of a two-option offer. These premia share the benefits the employer will derive from enhanced productivity and/or quality.[56] Employers will use any labor market power to reduce wages below the competitive level.

TCE's model of contract formation can also apply to certain harmful NCAs. Employers without labor market power can use wage premia to obtain NCAs that deprive rivals of access to talented employees.[57] Such agreements raise rival employers' costs and injure consumers by exercising newly-acquired market power.[58] The wage premia will share with employees the expected proceeds from the employer's acquisition of such power.[59]

III. THE COMMISSION'S REJECTION OF BUSINESS JUSTIFICATIONS

As noted earlier, the prospect of such benefits would ordinarily preclude *per se* condemnation of NCAs.[60] The Commission identified two independent reasons that this prospect did not rebut the initial finding that NCAs are unfair. First, there are alternative means that supposedly further the legitimate objectives that NCAs

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1 REV. ECON. STUD. 157, 157–58, 168–69 (1934) (defining market power in this manner).

52. Richard Craswell, *Freedom of Contract*, in CHICAGO LECTURES IN LAW & ECONOMICS 81, 84–87 (2000) (explaining why monopolists will offer same contractual terms as competitive firms, assuming consumers understand alternatives).

53. Meese, *supra* note 7, at 295–97; Rubin & Shedd, *supra* note 46, at 95–100; *id*. at 100 ("[B]oth parties must prospectively expect to benefit from the agreement, independently of their respective bargaining power.").

54. *See* Meese, *supra* note 42, at 690 (explaining how employers will use cost-based wage differentials unrelated to market power to induce acceptance of beneficial NCAs).

55. *Id*.

56. *See* Donna Rothstein & Evan Starr, *Noncompete agreements, bargaining, and wages: evidence from the National Longitudinal Survey of Youth 1997*, Monthly LAB. REV. (June 2022) (contending that disclosed NCAs create "pressure" for employees to "receive compensation for their post-employment concessions" and thus "a compensating differential" in "the posted wages, *rendering bargaining unnecessary*") (emphasis added).

57. *See* Meese, *supra* note 42, at 705; Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price*, 96 YALE L. J. 209, 251 (1986) ("[A] firm need not enjoy or acquire traditional market power to gain the ability to price above pre-exclusionary-rights competitive levels.").

58. *See* Meese, *supra* note 42, at 705.

59. *Id*. (describing such agreements as "entirely voluntary").

60. *See supra* 32–33 and accompanying text.

achieve. [61] Second, the benefits of NCAs do not outweigh their harms.[62] This essay focuses on the second finding; the author has critiqued the first finding elsewhere.[63]

The Commission did not estimate how many NCAs produce benefits. Instead, the Final Rule emphasized what it considered the overwhelming (but unquantified) harms that NCAs create. Nonexecutive NCAs — nearly all such agreements — the Commission said, were both procedurally and substantively coercive.[64] Such coercion rendered such agreements "facially unfair".[65] Such coercion, the NPRM said, required any justifications to "overcome a high bar" to rebut the presumption against them.[66]

Having set this "high bar," the Commission compared the "overall" benefits and harms of 30 million NCAs. The Commission reiterated that NCAs reduced wages. These harms, the Commission said, were "significant."[67] The Commission conceded that "there is some evidence that non-competes increase human and physical capital investment"[68] and reported that "[t]here is evidence [NCAs] increase employee training and capital investment . . . ."[69] It also noted the lack of evidence regarding NCAs' impact on the production of trade secrets.[70] The Commission did not assess the magnitude of NCAs' benefits or compare benefits to any estimate of harm. Instead, the Commission's only effort to compare harms and benefits entailed reliance upon a proxy for such net impact.

The Commission drew this proxy from studies that assessed the relationship between the strength of NCA enforcement in various states and state-level wages. Such studies rely upon an index that measures the "enforceability" of NCAs by state, based on several attributes of each state's law.[71] Scholars then employ econometric techniques to isolate the correlation between a state's score on this index and wages

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61. Final Rule, 89 Fed. Reg. at 38424 ("Employers have alternatives to non-competes for protection of valuable investments that burden competition to a less significant degree."); *see also* NPRM, 88 Fed. Reg. at 3505 (finding that various alternatives "reasonably accomplish the same purposes as [NCAs] while burdening competition to a less significant degree").

62. Final Rule, 89 Fed. Reg. at 38433 ("The benefits from the justifications cited in Part IV.D.1 clearly do not justify the harms from non-competes."); NPRM, 88 Fed. Reg. at 3507 ("*[O]verall*, the asserted benefits from these justifications do not outweigh the harms from [NCAs].") (emphasis added).

63. *See* Alan J. Meese, *New Vision Old Model: How* the *FTC Exaggerated Harms When Rejecting Business Justifications for Noncompetes,* 109 CORNELL L. REV. ONLINE 13, 42–44 (2024).

64. *See supra* notes 20-29 and accompanying text.

65. NPRM, 88 Fed. Reg. at 3508 (describing NCAs entered by nonexecutive employees as "facially unfair").

66. *Id*. The Final Rule apparently did not reiterate this "high bar" language.

67. Final Rule, 89 Fed. Reg. at 38433 ("Not all the harms from non-competes are readily susceptible to monetization."); *id*. ("[E]ven the quantifiable harms from non-competes are substantial . . . . The available evidence indicates that increased enforceability of non-competes substantially suppresses workers' earnings, on average, across the labor force generally and for specific types of workers.").

68. *Id*

69. NPRM, 88 Fed. Reg. at 3508.

70. *Id*.

71. *See* Evan Starr, *Consider This: Training, Wages, and the Enforceability of Covenants Not to Compete*, 72 ILR REV. 783, 790 (2019) (describing different indices).

and/or other variables.[72]

Implicitly drawing on TCE, the Commission generated a prediction about the relationship between enforceability of NCAs and wages. If benefits of NCAs exceeded harms, the Commission said, employees would earn more in states that score higher on enforceability indices.[73] As the Final Rule put it:

> In theory, if increased human capital investment from non-competes benefited workers, they would likely have higher wages when non-compete are more readily available to firms (i.e., legal enforceability of non-competes increases). However, as explained in Parts IV.B.3.a ii and IV.C.2.c.ii, the empirical evidence indicates that, on net, greater enforceability of non-competes reduces workers' earnings.[74]

In so doing, the Commission echoed the NPRM, which had stated:

> [T]he considerable harms to [employees] are not outweighed [by various benefits]. If they were, [employees] would have higher earnings when [NCAs] are more readily available to firms (*i.e.*, when legal enforceability of [NCAs] increases) . . . .[75]

However, as the Commission correctly reported, most studies find a *negative* relationship between NCA enforceability and wages.[76] Therefore, the Commission concluded that the benefits NCAs create do not exceed the harms.[77] This was the only concrete evidence the Commission invoked regarding the relative magnitude of harms and benefits.

IV. THE CASE FOR RELIANCE ON A PROXY

The Commission's proposed proxy seems laudable and consistent with the same TCE that informs business justifications. Even when confined to individual cases, antitrust balancing is roundly criticized as beyond the capacity of courts and agencies.[78] If case-by-case balancing is so difficult, determining the net impact of 30 million heterogenous NCAs—a question the Commission insisted on asking—would seem impossible.

Balancing is even more difficult in this context. The Commission noted the lack

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72. *Id*. at 790 (reporting positive correlation between state-level enforceability and employee training investments); Matthew S. Johnson, Kurt J. Lavetti & Michael Lipsitz, *The Labor Market Effects of Legal Restrictions on Worker Mobility* (Unpublished NBER Working Paper 2023) (reporting negative correlation between enforceability and wages).

73. NPRM, 88 Fed. Reg. at 3508.

74. Final Rule, 89 Fed. Reg. at 38343.

75. NPRM, 88 Fed. Reg. at 3508.

76. Final Rule, 89 Fed. Reg. at 38343.

77. *Id*.

78. *See* Herbert Hovenkamp, *The Rule of Reason*, 70 FLA. L. REV. 81, 132 (2018) ("balancing [is] unworkable and actual attempts at it [are] rare"); Rebecca Haw Allensworth, *The Commensurability Myth in Antitrust*, 69 VAND. L. REV. 1, 16-43 (2016).

of data regarding how many trade secrets that NCAs help employers create.[79] Among state courts, the creation of such secrets is the most widely recognized benefit of NCAs.[80] Any effort to balance harms against benefits would have to ignore such benefits or speculate about their magnitude, further counseling reliance upon some proxy.

As framed by the Commission, assessment of business justifications for all NCAs presents a problem of aggregating and acting upon widely dispersed, heterogenous information. As Friedrich Hayek explained, prices incorporate innumerable data that no economic actor could gather and act upon, especially when such action includes coordination with others.[81] For instance, countless factors influence the supply and demand of tin, which determines its price.[82] Abrupt changes in one or more factors could impact supply, demand, or both, increasing prices. Innumerable purchasers, most unknown to each other, will naturally respond by changing production methods, choosing substitute inputs, or both, thus allocating scarce supplies to the highest valued use.[83] All this will occur even if such purchasers have no idea what changes impacted supply, demand, and prices.[84]

Hayek's insights were a key building block of TCE, which treats information costs as an important transaction cost.[85] Moreover, the claim that prices impound various data implicitly informs TCE's model of contract formation. Regarding NCAs, the model posits that employers will pay lower wages for transactions that leave them at risk of opportunism and higher wages if employees agree to NCAs that

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79. Final Rule, 89 Fed. Reg. at 38424 ("As the Commission stated in the NPRM, it is unaware of any evidence of a relationship between the enforceability of non-competes and the rate at which companies invest in creating or sharing trade secrets. Similarly, the Commission is unaware of any evidence non-competes reduce trade secret misappropriation or the loss of other types of confidential information, difficult areas for researchers to study given the lack of reliable data on firms' trade secrets and confidential information." (footnote omitted)); NPRM, 88 Fed. Reg. at 3505 (finding "no reliable data" on "investments in trade secrets" or "how [NCAs] affect these practices.").

80. *See* RESTATEMENT (SECOND) CONTRACTS, § 188 (AM. L. INST. 1981) (recognizing "creation of trade secrets as a legitimate interest" supporting NCA enforcement); *id*. cmt. g (treating enhancement of employee skills as noncognizable). *But see* Meese, *supra* note 42, at 687 n.286 (collecting several decisions stating that encouraging investments in employee training is a cognizable benefit).

81. *See* F.A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519, 525-527 (1945).

82. *Id*. at 526.

83. *Id*. at 526–27.

84. *Id*. ("The most significant fact about this system is the economy of knowledge with which it operates, or how little the individual participants need to know in order to be able to take the right action.").

85. *See* OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES, 4–5 (1975) (*quoting* several passages from Hayek, *supra* note 81); *id*. at 5 ("[E]ach of these observations is important to the argument of this book."); Williamson, *supra* note 48, at 8 (describing Hayek's emphasis on idiosyncratic knowledge, misleading nature of statistical aggregates, and decentralized adaptation to change as elements of TCE); *see also* Ronald H. Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1, 15 (1960) (treating communication of transactional terms to trading partners as a transaction cost).

counter this risk and encourage beneficial investments.[86] Wage premia will reflect the benefits employers expect from these investments, knowledge uniquely within their possession.[87]

Like tin purchasers, potential employees need not know *why* employers pay premium wages in return for NCAs. They need only know the magnitude of the premium and the terms of the safeguard: *i.e*., the geographic, occupational, and temporal scope of NCAs. With this (more manageable) knowledge, potential employees can compare the impact of NCAs with wage premia and decide whether to accept the offer.[88]

Sometimes the offered premium will not convince employees to accept the restraint, leading employers to narrow or abandon the agreement. Here again employers need not know *why* potential employees resist. This iterative process will result in coordination between the parties and contractual solutions to market failures that would have manifested themselves as underinvestment in employee training, trade secrets, or capital equipment.[89]

Imagine now that NCAs generally produce cognizable benefits. TCE's account of contract formation, including wages' role in impounding information, would indeed predict that, other things being equal, employees in states that enforce NCAs more robustly will earn higher wages. Absent robust enforcement, employers will enter fewer NCAs, make fewer beneficial investments, and pay premium wages less often.

Yet, as the Commission explained, studies find a *negative* association between wages and state-level enforceability. This conclusion apparently falsifies TCE's imagined prediction. While the NPRM did not specify the reason for this negative association, there are two possibilities. First, only a small subset of NCAs produce benefits. Second, even if all NCAs produce benefits, they may produce greater harm. The Commission did not, however, estimate what proportion of NCAs produce benefits and thus did not choose between these two alternatives. Either way, it seems, this proxy for the net impact of NCAs overall would seemingly require rejection of business justifications.

However, as explained below, the Commission's shortcut—reliance on aggregate wage effects—can produce both false negatives and false positives. This realization apparently undermines the case for the Commission's proxy.

V. THE COMMISSION'S PROXY COULD PRODUCE FALSE NEGATIVES AND FALSE

86. *See* Meese, *supra* note 42, at 690.

87. *See id.* at 666–67; Meese, *supra* note 44, at 1349–50 ("price—a single variable—will also impound the cost of possible opportunistic behavior[.]") (*citing* Hayek, *supra* note 81, at 526).

88. *Cf.* Jonathan M. Barnett & Ted Sichelman, *The Case for Noncompetes*, 87 U. CHI. L. REV. 953, 1037–38 (2020) (explaining that employers may be unwilling to pay sufficient compensation to induce acceptance of NCAs).

89. *See* Meese, *supra* note. 7, at 318 (describing this "iterated process"); Hayek, *supra* note 81, at 526 ("[W]here knowledge of the relevant facts is dispersed among many people, prices can coordinate separate actions of different people [.]").

POSITIVES

As then-Judge Breyer explained, administrative costs prevent tribunals from considering every possible attribute of challenged conduct, even if economic theory deems that attribute relevant.[90] Instead, the legal system must announce and enforce some clear rules that give firms notice and ease burdens on tribunals and litigating parties. Such rules may produce one of two types of errors.[91] First, a rule might be underinclusive and fail to condemn conduct that produces net harm: that is, produce false negatives. Second, a rule might be overinclusive and thus condemn conduct that does not produce net harm, that is, produce false positives.

Generally, a rule runs one risk or the other. Thus, a safe harbor for above-cost pricing risks false negatives but cannot produce false positives.[92] However, the Commission's reliance on wage effects as a proxy for the "overall" impact of NCAs would seem to risk both errors.

A. False Negatives

The Commission asserted that a positive correlation between NCA enforceability and wages would indicate that NCAs produce net benefits. However, TCE does not mandate this conclusion. Instead, such proof is equally consistent with the inference that NCAs produce unmitigated or net harm.

As explained earlier, NCAs can deprive an employer's rivals of talent, raising rivals' costs and allowing the employer to exercise market power in product markets.[93] In this context, wage premia "purchase" exclusionary rights from employees, sharing expected market power and increasing employee welfare at consumers' expense.[94] Proof of a positive correlation between robust enforcement of NCAs and aggregate wages is thus entirely consistent with a finding that all or most NCAs raise rivals' costs, without offsetting benefits, thereby producing net harm.

Of course, such proof is also consistent with a conclusion that most or all NCAs produce net benefits that employers share via higher wages, supporting a business justification defense. Absent additional evidence, however, there is no basis for choosing between the beneficial and harmful accounts. Proponents of justifications could respond by proving that most markets where NCAs arise are not susceptible to raising rivals' costs strategies. However, requiring such additional proof would defeat the purpose of reliance upon a proxy.

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90. *See* Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227, 234 (1st Cir. 1983) (Breyer, J.) ("Rules that seek to embody every economic complexity and qualification may well, through the vagaries of administration, prove counterproductive[.]").

91. *See* Andrew I. Gavil & Steven C. Salop, *Probability, Presumptions and Evidentiary Burdens in Antitrust Analysis*: *Revitalizing the Rule of Reason for Exclusionary Conduct*, 168 U. PA. L. REV. 2107, 2119–20 (2020) (describing distinction between false negatives and false positives).

92. *See* Oliver E. Williamson, *Predatory Pricing: A Strategic and Welfare Analysis*, 87 YALE L.J. 284 (1977) (contending that pure cost-based test for predatory pricing will result in some false negatives and proposing alternative standard).

93. *See supra* notes 57–58 and accompanying text.

94. *See supra* note 59 and accompanying text.

B. Reliance on Negative Wage Effects Can Produce False Positives

Assume now that NCAs cannot raise rivals' costs. There is still a risk of *false positives*. This risk seems particularly salient given one of the Commission's key findings, as discussed below. The Commission assumed that NCAs producing net benefits will result in higher wages.[95] Here again, however, the Commission misapplied TCE, which makes no such broad prediction. Instead, TCE predicts that beneficial NCAs will produce higher wages *in a well-functioning labor market*, that is, a market amenable to the voluntary process of contract formation described earlier. Most importantly, TCE's contract formation model assumes that potential employees *know* whether employment offers include NCAs.[96] The model also assumes that potential employees understand the content of NCAs, such as what geographic area they cover. Put differently, the model assumes that transaction costs, including costs of learning about contractual terms, are low at the time of contracting.[97]

Assume however that transaction costs are high, blocking employees' pre-contractual knowledge of NCAs. Inclusion of NCAs will not cause any potential employees to reject the employer's offer, leaving labor supply and wages unchanged.[98] Nor will any potential employees demand higher wages, less restrictive NCAs, or both.[99] Nor can the resulting restrictions, obtained without true consent, be characterized as voluntary coordination, even in an otherwise competitive market.

Notably, such agreements will still protect employers' investments in creating secrets, capital equipment, employee training, or all of the above. Such investments will render employees more productive, improve product quality, or both. Employers can increase wages to share these gains. However, employers may also behave opportunistically. Having obtained NCAs and made value-increasing investments, employers now have incentives to capture the resulting benefits.[100] Increasing wages would needlessly share such gains with employees bound by NCAs that prevent them

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95. *See supra* notes 73–75 and accompanying text.

96. *See* Meese, supra note 7, at 300-301 (describing role of pre-contractual knowledge in formation of NCAs).

97. *See id*. at 301; Coase, *supra* note 85, at 15 (explaining that transaction costs include: "inform[ing] people that one wishes to deal *and on what terms"*) (emphasis added); Meese, *supra* note 44*,* at 1349 (describing how parties can form nonstandard agreements that combat opportunism when "*ex ante* bargaining costs [are] low").

98. *Cf. supra* notes 55–56 and accompanying text (explaining how inclusion of fully disclosed NCA in employment agreements will induce some potential employees to decline employer's offer, thereby reducing pool of potential employees available to the employer). *See* Meese, *supra* note 42, at 675–76.

99. *Id.*; Eric A. Posner, *The Antitrust Challenge to Covenants Not to Compete*, 83 ANTITRUST L.J. 165, 190 (2020) ("It is possible that noncompetes suppress wages because workers who sign [such agreements] do not demand a wage premium—because of ignorance [.]"); Rothstein and Starr, *supra* note 56 (NCAs that are "sufficiently observable and perceived as costly to the worker" will induce upward "pressure" on wages).

100. *See* Rubin & Shedd, *supra* note 46, at 99 ("Once [NCAs] are signed and workers trained . . . employers may behave opportunistically [by] underpay[ing] workers[.]").

from taking new skills and/or knowledge elsewhere.[101]

The recognition that TCE's contract formation model is limited to low transaction cost settings is not merely academic; the Commission found that employees usually lack pre-contractual knowledge of NCAs.[102] This knowledge deficit, the Commission said, indicated that employers possess labor market power and have exercised this power to impose NCAs.[103] These two findings helped support the Commission's determination that nonexecutive NCAs result from procedural coercion, a necessary condition for substantive coercion.[104] Thus, the Commission expressly found that the conditions necessary for wages to impound the benefits of NCAs are not present. This finding suggests that a wage-based proxy for the net impact of NCA's is misleading.

However, the supposed ignorance the Commission invoked and resulting coercive restriction on employee autonomy did not arise in a vacuum. As practitioners of TCE and others have recognized, well-functioning markets require background rules that facilitate contracting.[105] Changing such rules can alter the number and content of resulting transactions for better or worse, impacting resource allocation and resulting social wealth.[106] For instance, states can alter transaction costs by changing the requirements for making legally binding contracts.[107]

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101. I therefore disagree with assertions that employers would favor advanced disclosure of beneficial NCAs. *See* Matt Marx, *The Firm Strikes Back: Non-compete Agreements and the Mobility of Technical Professionals*, 76 AM. SOCIO. REV. 695, 705 (2011) (articulating this claim).

102. *See* Final Rule, 89 Fed. Reg. at 38375. *But see* Meese, *supra* note 7, at 305–07 (discussing record evidence that most employees possess pre-contractual knowledge of NCAs).

103. *See* Final Rule, 89 Fed. Reg. at 38375–38376; *id.* at 38376 ("Research has also found that employers exploit their power over workers by providing them with non-competes after they have accepted the job offer—and in many cases, on or after their first day of work—when the worker's negotiating power is at its weakest, since the worker may have turned down other job offers or left their job."); NPRM, 88 Fed. Reg., at 3503.

104. *See supra* notes 21–22, 28–29 and accompanying text. The Commission invoked other factors as well, such as supposed labor market concentration. However, the Commission ignored data discussed in the Petition itself establishing that over seventy-five percent of employees bargain in unconcentrated labor markets. *See* Meese, *supra* note 7, at 287–90 (discussing such evidence). Indeed, this evidence may have *overstated* the extent of labor market concentration. *Id.* at 290–93 (discussing study suggesting that the average HHI in private sector labor markets is less than 350, *i.e.*, very unconcentrated) (citing Elizabeth Weber Handwerker & Matthew Dey, *Some Facts About Concentrated Labor Markets in the United States*, INDUS. RELS. (July 2023)).

105. *See* Ronald H. Coase, *The Institutional Structure of Production*, 82 AM. ECON. REV. 713 (1992); National Society of Professional Engineers v. United States, 435 U.S. 679, 687–88 (1978) ("NSPE") (explaining that enforcement of contracts "enables competitive markets—indeed a competitive economy—to function effectively."); F.A. Hayek, *Free Enterprise and Competitive Order*, 110–11 in INDIVIDUALISM AND ECONOMIC ORDER (1948) (competitive market presupposes background rules of contract, property and tort).

106. *See* Coase, *supra* note 105, at 717–18.

107. *See* R.H. Coase, *The Firm, The Market & The Law,* 27–28 *in* THE FIRM, THE MARKET & THE LAW (1988) (explaining that government may alter economic conduct through "a change in the law" and that governments "may . . . make transactions more or less costly by altering the requirements for making a legally binding contract.").

The Commission's assertion that precontractual ignorance helped give rise to procedural and substantive coercion implicitly assumed an institutional framework with two key features. First, the absence of any legal requirement that employers disclose NCAs in advance. Second, judicial enforcement of NCAs "as is," even if employees lack precontractual knowledge of such agreements.[108] Absent this latter assumption, the Commission's finding that nonexecutive NCAs are always substantively coercive, because of threatened enforcement of such agreements, would make no sense with respect to undisclosed agreements, as courts would *decline* to enforce such contracts, leaving employees free to depart as they wish.

The Commission's finding of precontractual ignorance, combined with assumptions regarding the institutional framework, suggest a third explanation for the negative correlation between NCA enforceability and wages.[109] That is, NCAs may produce more benefits than harm, but wages may impound a small portion of such benefits, which employers capture instead. If, as the Commission found, employees are ignorant of NCAs before accepting offers, and if courts nonetheless enforce them, there is no reason to expect any positive correlation between beneficial NCAs and wages. Indeed, any correlation should be negative. Profit maximizing employers operating in such a regime will take full advantage of the background rules posited by the Commission and *not* disclose NCAs to potential employees, hoping to induce acceptance of job offers without paying premium wages. Resulting wages will *not* impound the benefits that NCAs create.

Moreover, such agreements will preclude employees from starting rival businesses or accepting some offers from rival employers. Such limits on employee mobility will also weaken employee bargaining power *vis a vis* current employers. Both impacts will dampen wages.[110] Employers who succeed in such tactics would be analogous to homeowners who, knowing that their homes have termites, decline to disclose this defect, selling homes for prices with no discount for this condition.[111] Both employers and homeowners could rationally pursue such a strategy regardless of whether they possess market power in labor markets or product markets, respectively.[112]

In short, the Commission found that transaction costs preclude employees from understanding NCAs before they accept such offers, thereby resulting in a predictable market failure. Reliance on wage effects as a proxy for the net impact of NCAs can thus produce false positives. This is so even if such agreements produce more social benefits than harm. The result would be condemnation of NCAs that produce more benefits than harm.

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108. *See* Restatement (First) of Contracts § 70 (AM. L. INST. 1932) (party who accepts offer "is bound by the contract, though ignorant of the terms of the writing").

109. *See supra* notes 102–104 and accompanying text.

110. *See supra* notes 16–18 and accompanying text.

111. *See* Swinton v. Whitensville Sav. Bank, 42 N.E.2d 808 (Mass. 1942) (rejecting fraud action against seller who declined to disclose that home was infested with termites because plaintiff did not allege any affirmative misstatement).

112. *See e.g.*, Meese, *supra* note 42, at 675 ("[Despite] substantial competition in the relevant labor market . . . . imperfect information, however caused, could allow employers to obtain putative agreement to [NCAs]."); Craswell, *supra* note 52, at 87 ("[I]f buyers don't realize what clauses are hidden away in the fine print, even markets with lots of competitors may still generate inefficient contract terms.").

C. Possible Rehabilitation

The zero-knowledge supposition that supports the finding of coercion undermines the assumption that aggregate wages will impound the benefits of NCAs. Thus, the Commission's reliance upon the association between NCA enforceability and wages as a proxy for net effects was bound to understate the benefits that NCAs create by ignoring benefits that employers capture for themselves. If so, reliance on this proxy to assess the net benefits of NCAs may have produced a false positive.

It may be possible to rehabilitate the Commission's proxy, although the rehabilitation exposes other shortcomings in the application of TCE. The critique in subsection V.B above treated benefits captured by employers as cognizable and thus part of the net benefits calculus. The lack of pre-contractual knowledge resulting from transaction costs did not impact the *magnitude* of benefits but instead altered the *distribution* of benefits between employers and employees.

However, there are hints that the Commission discounted or ignored benefits captured by employers. For instance, the NPRM summarized its view of business justifications as follows:

> "[W]hile there is considerable evidence [NCAs] harm both workers and consumers, the evidence that [NCAs] *benefit workers or consumers* is scant."[113]

The Final Rule echoed this observation as follows:

> "[T]he empirical literature does not show the extent to which human capital investment and other investment benefits from non-competes accrue to any party besides the employer, and to the extent it addresses this issue it suggests otherwise."[114]

The Final Rule also stated that a party's realization of pecuniary benefits from a challenged practice cannot itself justify such an otherwise unfair practice.[115] However, the possible benefits the Final Rule identified were not merely pecuniary but instead cognizable under the antitrust laws.[116]

Both the Final Rule and the NPRM also referred to three states that have banned NCAs, and the Commission reported that it knew of no evidence that the inability to enforce such agreements had "materially harmed employers, consumers, innovation (or economic conditions more generally), or workers in those states."[117]

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113. NPRM, 88 Fed. Reg. at 3508 (emphasis added).

114. *See* Final Rule, 89 Fed. Reg. at 38433.

115. *Id.*

116. *See* Meese, *supra* note 42, 684-91 (explaining that benefits attributed to NCAs are cognizable under current antitrust standards).

117. Final Rule, 89 Fed. Reg. at 38433 ("Furthermore, there is no evidence that, in the three States in which non-competes are generally void, the inability to enforce non-competes has materially harmed employers, consumers, innovation (or economic conditions more

These passages may imply that the Commission was comparing the harms that NCAs impose on employees to the benefits conferred *on employees* and asking whether banning NCAs would deprive *employees* of such benefits. Benefits captured by employers would, under this approach, be irrelevant.

Still, the November 2022 Section 5 Statement was itself cautious—indeed opaque—on this question of which benefits count for Section 5 purposes. That statement merely offered that whether putative victims also "share in the purported benefits" of challenged conduct "*may* be relevant to the inquiry."[118] The Statement provided no citation for this assertion or any suggestion about when sharing was relevant and, if so, how much sharing was necessary.

The Commission's tentative approach is understandable; analogous antitrust sources provide conflicting guidance. Under Section 2 of the Sherman Act, a monopolist avoids liability if it gained or maintains its monopoly by engaging in conduct supported by "valid business reasons."[119] There is no requirement that defendants share benefits with consumers; instead courts ask whether conduct reduces total welfare, including the welfare of producers.[120]

By contrast, decisions implementing Section 1 of the Sherman Act reject rebuttals unless supposed benefits offset harms the restraint would otherwise impose on victims such as consumers.[121] The Section 5 Statement refuses to choose between these two approaches. Perhaps the NPRM meant to signal agreement with the Section 1 approach, two months after temporizing on the issue. If so, the signal was weak.

Assuming a Section 1 approach applies, a negative correlation between NCA enforceability and wages *would* refute claims that benefits exceed harms, given the stipulation that only benefits that accrue to employees are included in the calculus. If so, such a proxy would not risk generating false positives after all.[122]

VI. REMEDY

Let us assume that Section 5 requires benefits to offset harms suffered by employees. Assume further a negative correlation between NCA enforceability and

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generally), or workers.); NPRM, 88 Fed. Reg. at 3507 (same).

118. Section 5 Statement, at 11 (emphasis added).

119. *See* Eastman Kodak Co. v. Image Tech. Servs., 504 U.S. 451, 483 (1992); Trans Sport, Inc. v. Starter Sportswear, Inc., 964 F.2d 186, 190 (2d Cir. 1992) (Marshall, J.) (holding that defendant's proof that alleged monopolistic conduct had "legitimate business justifications . . . prevent[ed] a rational trier of fact from finding Section 2 liability"); *id.* at 189–190 (collecting authorities to this effect).

120. *See* Alan J. Meese, *Debunking the Purchaser Welfare Account of Section 2 of the Sherman Act: How Harvard Brought Us a Total Welfare Standard and Why We Should Keep It*, 85 N.Y.U. L. REV. 659, 667–73, 708–15 (2010) (describing "purchaser welfare" and "total welfare" standards and explaining that courts adopt the latter under Section 2).

121. NCAA v. Bd. of Regents of Univ. of Okla., 468 U.S. 85, 114 (1984) (efficiencies must manifest themselves as reduced prices and/or higher output); *NSPE*, 435 U.S. at 693 (rejecting proposed rebuttal contemplating that prices would exceed those that pre-existed the agreement).

122. This would not mean that a *positive* correlation should establish a business justification defense. Instead, a positive correlation would still be equally consistent with a harmful explanation. *See supra* Section V.A.

wages and thus proper rejection of a business justification defense. There is still the separate question of the appropriate remedy.

The Commission chose condemnation of all thirty million NCAs, regardless of the actual impact of each restraint. Perhaps such wholesale condemnation will improve employee welfare compared to results of the current regime governing NCAs. However, the current state of affairs and the state without NCAs are not the only two possible states of the world. If Section 5 treats employee welfare as the ultimate goal in this context, the Commission should have considered whether there are other states of affairs that would have generated increased employee welfare compared to a complete ban.

There are three possible explanations for the negative correlation between NCA enforceability and wages.[123] First, NCAs may produce few benefits, with modest harms exceeding any positive impacts. Second, NCAs may produce substantial benefits but even greater harms.[124] Third, NCAs may produce benefits that exceed harms, but employers may capture such a large share of such benefits that, overall, wages fall.[125]

The Commission did not choose between these three explanations. At one level this is understandable. Banning NCAs would seemingly improve employee welfare regardless of which explanation is correct. However, the Commission apparently did not realize that, if the third explanation is accurate, an alternative to an outright ban could simultaneously minimize harms, preserve benefits and improve employee welfare compared to the state resulting from an outright ban. Nor did the Commission realize that it could facilitate empirical work that would help select between these three explanations.

The Commission's own findings suggest that lack of sharing and thus negative correlation between enforceability and wages reflects transaction costs preventing employees from learning about NCAs before accepting employment offers.[126] Of course, agencies must sometimes take transaction costs as given and resistant to policy change. Written contracts require paper and ink, for instance, and the supply of both is likely resistant to changes in contractual background rules.[127]

However, as the Commission's Chair once explained, industrial conditions are not determined by impersonal market forces, but reflect policy choices that impact the structure of relevant markets and relative bargaining positions of economic actors.[128] Or, as Ronald Coase put it three decades earlier, changes in background rules, including rules governing the enforcement of contracts, can impact transaction costs

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123. *See supra* notes 71–72, 76 and accompanying text (describing studies finding such a correlation).

124. *See generally supra* notes 69–75 and accompanying text (describing Commission's conclusion that NCAs produce benefits in the form of investments in employee training but also produce "considerable" harms that outweigh such benefits).

125. *See supra* notes 97-102 and accompanying text.

126. *See supra* note 102 and accompanying text (describing Commission's finding that most employees lack precontractual knowledge of NCAs).

127. *See, e.g.*, Benjamin Klein, *Vertical Integration as Organizational Ownership: The Fisher Body-General Motors Relationship Revisited*, 4 J.L. ECON. & ORG. 199, 200 (1988) (some transaction costs are "ink costs").

128. *See* Khan, *supra* note 6, at 131 ("The New Brandeisians, by contrast, believe the political economy is structured only through law and policy."). *See also, e.g.*, Victor Goldberg, *Institutional Change and the Quasi-Invisible Hand*, 17 J. L. & ECON. 461 (1974).

and thus the content of transactions and allocation of resources.[129]

If transaction costs prevent voluntary formation of NCAs and resulting benefit sharing, the Commission could alter background rules to reduce such costs. The Commission could issue a rule invalidating as unfair all NCAs adopted without sufficient precontractual disclosure. The Commission could also follow those states that have imposed waiting periods between disclosure and employees' acceptance of offers that include NCAs.[130] The Commission could even require precise disclosure of the geographic, occupational and temporal scope of such restraints.[131] Indeed, one set of comments responsive to the NPRM contended that the Commission's authority to promulgate such a mandatory disclosure rule was more certain than the supposed authority to ban all NCAs as unfair methods of competition.[132]

Such a rule would alter the two components of the institutional framework that raise transaction costs, reduce substantive autonomy of employees and prevent sharing of NCAs' benefits: (1) non-disclosure of NCAs and (2) judicial enforcement regardless of precontractual knowledge.[133] Employers hoping to enforce such agreements would presumably comply with the Commission's disclosure and waiting period requirements. Such mandated disclosure would alter the institutional framework in a way that would reduce transaction costs, inform potential employees of the presence and content of NCAs, and induce employers to pay premium wages, sharing the benefits of NCAs. Aggregate wages would therefore better reflect the benefits of NCAs.

Employers who did not comply but attempted to enforce NCAs anyway would find that such agreements are invalid.[134] Absent judicial enforcement, such agreements cannot reduce employee autonomy; nor can they be "substantively coercive."[135] Such changes would, to paraphrase the Commission's Chair, "structure the political economy though law" and alter the content of economic activity to create results potentially superior to either the current regime or a complete ban.

Banning nondisclosed agreements would not immunize fully-disclosed NCAs. The Commission could investigate and challenge NCAs deemed unfair despite pre-agreement disclosure, applying the standards announced in the 2022 Section 5

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129. *See supra* notes 106–107 and accompanying text.

130. *See* Meese, *supra* note 7 at 301-302, notes 283–84 (describing such statutes).

131. *Cf.* Brunner v. Liautaud, 2015 WL 1598106, No. 14-c-5509 at *2 (N.D. Ill. Apr. 15, 2015) (reporting plaintiff's allegation that she was "unsure [which rival] food service establishments are covered under the [NCA].").

132. *See* Bilal Sayed, *Comments of TechFreedom*, In the Matter of Non-Compete Clause Rulemaking, Matter No. P201200, Docket No. FTC-2023-0007 (Apr. 19, 2023) (contending that the Commission should promulgate such a rule under its authority to combat "unfair and deceptive practices"). *See also* 15 U.S.C. § 45(a) (declaring "unfair or deceptive acts in or affecting commerce" unlawful); 15 U.S.C. § 57a(b) (prescribing procedures that Commission must follow before promulgating rules defining "unfair or deceptive practices").

133. *See supra* notes 106–108 and accompanying text.

134. *Cf.* Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911) (rejecting state law claim for tortious interference with contract because contract violated the Sherman Act).

135. Nor could such unenforceable agreements restrict the "liberty" of employees insofar as employees would be free to ignore such agreements, the enforcement of which would presumably violate Section 5. *See generally*, *supra* note 7, at 280 (describing claim by Chair Khan that NCAs restrict economic liberty).

Statement.[136] Possible targets would include agreements that raise rivals' costs and injure consumers in product markets.[137] This process would generate information about the impact of various NCAs and the markets where they arise.[138] The Commission could also separately gather data that has eluded it thus far, including accurate information about the concentration of labor markets where NCAs arise.[139]

The Final Rule and NPRM did consider the mandatory disclosure alternative.[140] The Commission rejected this alternative for two reasons. First, despite disclosure, employers would nonetheless use bargaining power coercively to impose NCAs.[141] Second, fully disclosed NCAs would impose the same aggregate negative impact on wages that NCAs currently impose.[142] The second conclusion depended on the first, as it assumed that disclosure would have little or no impact on the number or content of NCAs.[143]

As explained elsewhere, the Commission's rejection of the disclosure remedy ignored TCE's model of voluntary contract formation.[144] Moreover, appreciation of this error reveals other salutary impacts of mandatory disclosure. Mandated disclosure will induce employers to increase wages to attract employees who now understand the presence and restrictive impact of NCAs. These increases will alter the distribution of benefits, in favor of employees. Also, the prospect of paying wage premia will force employers to internalize the impact on employees of adopting NCAs. Employers may respond to such internalization in one of three ways. First, some will abandon NCAs. Second, some who retain such agreements will narrow their terms. Third, some will retain the same agreements, while increasing wages. Case-by-case adjudications could condemn some fully-disclosed NCAs, further altering their number and content.

The result would be a different aggregate population of NCAs, with a different economic impact. There would be fewer NCAs, while some that remained would impose less onerous restrictions on employees' ability to start new firms and/or accept offers from rival employers. Thus, changing the institutional framework would not only induce employers to share benefits of NCAs.[145] Such changes would also reduce the overall "restrictive" impact of NCAs, mitigating the negative impact of such agreements on wages, weakening to that extent the Commission's *prima*

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136. *See supra* notes 4–5 and accompanying text.

137. *See supra* notes 57–58 and accompanying text (describing how voluntary NCAs can raise rivals' costs and injure consumers).

138. HERBERT HOVENKAMP, FEDERAL ANTITRUST POLICY: THE LAW OF COMPETITION AND ITS PRACTICE, 612 (2024) ("[P]olicy makers . . . learn a great deal from studying the records of business litigation"); California Dental Ass'n v. FTC, 526 U.S. 756, 781 (1999) (case-by-case rule of reason assessment can clarify impact of particular restraints over time).

139. *See* Meese, *supra* note 7, at 284–93 (discussing studies refuting NPRM's claim that labor markets are generally concentrated).

140. *See* Final Rule, 89 Fed. Reg. at 38459–60; NPRM, 88 Fed. Reg. at 3521.

141. Final Rule, 89 Fed. Reg. at 38460; NPRM, 88 Fed. Reg. at 3521.

142. Final Rule, 89 Fed. Reg. at 38460 (finding that "a disclosure rule is not likely to significantly reduce the negative competitive impacts of non-competes on labor markets and on product and service markets [.]"); NPRM, 88 Fed. Reg. at 3521.

143. *See* Meese, *supra* note 7, at 278–79 (describing this aspect of the NPRM's reasoning).

144. *Id.* at 304.

145. *See supra* notes 128–34 and accompanying text.

facie case.[146]

Mandatory disclosure would reduce other harms as well. The Commission found that nearly all NCAs are procedurally and substantively coercive, with the former a necessary condition for the latter.[147] Each form of coercion independently established a *prima facie* case of unfairness.[148] However, advanced disclosure would support the voluntary process of forming beneficial NCAs described earlier, even if employers possess labor market power. Such disclosure would also support voluntary adoption of agreements that raise rivals' costs.[149] Thus, such a mandate would reduce the proportion of NCAs that are procedurally coercive and, therefore, the proportion that is substantively coercive. This result would undermine to that extent the *prima facie* case of unfairness against such restraints. Finally, some proportion of non-executive NCAs would no longer be "facially unfair," undermining the rationale for imposing a "high bar" on attempts to justify such agreements.

In short, the Commission did not understand that mandatory disclosure, perhaps combined with a waiting period, could reduce transaction costs. This reduction would undo the market failure that manifested itself as too many NCAs, NCAs that are too broad, and wages that reflect both: (1) undue restrictions on post-employment autonomy and (2) employer capture of all benefits that NCAs produce.[150] Instead, the Commission invoked, as a rationale for rejecting business justifications, wage effects that flowed at least in part from the very transaction costs and resulting market failure the Commission itself could have corrected.

Despite the impact of mandatory disclosure, the Commission may still be able to establish a (weaker) *prima facie* case against NCAs. Moreover, such harms may still exceed the benefits that employers share with employees. However, the Commission would have to estimate how many such agreements are voluntary and produce cognizable benefits. The result of such an inquiry could well alter the outcome of a comparison of NCAs' costs and benefits. The result could also inform a revised rule more carefully focused on those restraints that produce net harm.

Indeed, the Commission need not guess about the impact of changing the institutional framework. Such change could itself inform empirical testing that would determine whether the benefits of NCAs realized by employees exceed harms within a regime that mandates disclosure. The Commission's unanticipated announcement of a disclosure-based regime could itself constitute a "natural experiment" that would affect aggregate wages, providing economists with an opportunity to assess the overall impact of NCAs under the new regime.[151] Economists could also produce revised estimates of the relationship between NCA enforceability and wages, thereby developing a more accurate proxy for the overall impact of NCAs under both a total welfare and employee welfare standard. The result could be a conclusion that,

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146. *See supra* note 16 and accompanying text (describing Commission's conclusion that NCAs are "restrictive" and reduce aggregate wages).

147. *See supra* notes 20–29 and accompanying text.

148. *See id.*

149. *See supra* notes 57–58 and accompanying text.

150. *Cf.* Meese, *supra* note 42, at 676 ("[Absent full disclosure], equilibrium would reflect too many such agreements and/or agreements with unduly onerous terms.").

151. *See* NPRM, 88 Fed. Reg. at 3486 (describing studies that rely upon "natural experiments" resulting from state law changes to assess relationship between the enforceability of NCAs and wages).

"overall," NCAs produce more benefits than harms *and* that employees receive enough such benefits that NCAs improve employee welfare compared to a regime that indiscriminately bans such agreements.

CONCLUSION

NCAs are not a unitary phenomenon, and global assessment of such agreements is a daunting task. The Commission invoked a proxy for the overall impact of NCAs, namely, the relationship between enforceability and wages. This shortcut apparently promises an accurate and inexpensive estimate of the net impact of NCAs, given the propensity of wages to incorporate innumerable data generated by bargains in local labor markets.

This essay contends that the Commission's proxy risks both false negatives and false positives. Most importantly, the Commission's findings regarding the institutional framework establish that bargaining will not generate wages that impound NCAs' benefits. Instead, employers will themselves capture such benefits. Reliance on this proxy may thus condemn NCAs even if they improve total welfare by producing more benefits than harms.

However, this proxy will not produce false positives if Section 5 ignores benefits captured by employers, in the same way that Section 1 of the Sherman Act apparently ignores benefits captured by producers. If Section 5 condemns restraints that, taken as a whole, reduce aggregate employee welfare regardless of other benefits, proof that more robust enforcement of NCAs reduces wages would seem to support a conclusion that NCAs as a class produce more harms than cognizable benefits.

Still, if employee welfare is paramount, the Commission should have considered a less drastic remedy. The Commission could have altered the institutional framework to condemn those NCAs that employers do not adequately disclose in advance and to require a waiting period. Such changes to the institutional framework would force employers to pay premium wages to employees bound by NCAs, sharing at least some benefits of such agreements. The prospect of paying such wages would induce some employers to abandon NCAs and some others to reduce their scope. These changes would render NCAs less restrictive in the aggregate, reducing their negative impact on wages. Taken together, these various impacts could improve the welfare of employees more than a wholesale ban of such agreements.