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FTC Noncompete Ban Could Open State Litigation Floodgate

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On Jan. 5, the Federal Trade Commission issued a notice of proposed rulemaking that, if adopted as final, would ban virtually all noncompete agreements nationwide between employers and employees.[1] Noncompetes that would be voided are believed to cover approximately 30 million American workers.[2]

In addition, the proposed rule contemplates retroactivity such that employers would be required to rescind previously executed noncompetes, and notify current and former employees individually within 45 days that those prior agreements are canceled and ineffective.[3]

While excising the use of noncompetes prospectively may be easier for businesses to operationalize, the rescission-and-notice requirement presents a significantly more onerous administrative burden on companies — even ones that intend to follow the law — and it therefore necessarily carries with it significant risk of noncompliance.

That compliance risk correspondingly carries with it grave regulatory and litigation risk.

While much has been written already on the FTC's proposal to assess fines of $50,127 per day for violations, the national discourse has largely overlooked the cascade of effects at the state level that employers will face if this proposed rule is finalized.

Cloaked in sweeping language about consumer protection, the proposed rule is likely to attract significant attention from the state attorneys general across the country. Given the long-standing hostility and aversion to noncompetes already existent in many states, state attorneys general may be poised to use the FTC's bold action as a springboard to serve as additional enforcers of the proposed rule through the deployment of even more powerful tools available to them: the state unfair and deceptive practices, or UDAP, statutes.

And once a state attorney general asserts a novel theory under a UDAP statute, it is usually not long after that the plaintiffs bar, on behalf of consumers, begins to assert similar claims in private or consumer class litigation.

State Attorney General Enforcement of UDAP Statutes

State consumer protection acts across the country generally empower state attorneys general to investigate any unfair or deceptive acts or practices affecting consumers in their states.[4] All 50 states have a UDAP statute, and nearly all prohibit acts or practices that constitute fraud on consumers, or that are otherwise inherently unfair or deceptive.[5]

Most of these statutes leave those vague terms undefined, resulting in state courts commonly giving them very broad definitions in light of the statutes' underlying policy objectives of protecting consumers[6] and, in some cases, deferring to a state attorney general's promulgation of rules and regulations that identify the practices that qualify as unfair or deceptive.[7]

Critically, all that is normally required for a state attorney general to issue a civil investigative demand or subpoena under these statutes is reasonable cause to believe that a violation of the statute has occurred, is occurring or is about to occur.[8]

Thus, particularly given the FTC's explicit designation of noncompetes as unfair, state attorneys general could plausibly allege that entering into or maintaining a noncompete constitutes an unfair practice in violation of state UDAP laws.

Indeed, when federal agencies like the FTC or the Consumer Financial Protection

Bureau publicly announce a policy that will target a particular business practice as unfair or deceptive, it is common for state attorneys general to follow their lead and characterize those practices as independent violations of their own state UDAP statutes.

A state attorney general's decision to treat a business's use of a noncompete agreement, or failure to comply with the rescission-and-notice requirement, as a companion UDAP violation would have significant consequences.

First, enforcement of a ban on noncompetes under state UDAP statutes would enable state attorneys general to seek remedies that are not available to the FTC under the FTC Act,[9] which is the source of statutory authority that the FTC has claimed as its basis for issuing the proposed rule.

Critically, state UDAP statutes permit the state attorneys general to seek civil penalties. While state civil penalty amounts vary significantly, many states permit civil penalties that exceed $10,000 per violation.[10] State case law on the meaning of per violation is usually undeveloped, and use of the vaguely defined term "per violation" runs a significant risk of meaning per impacted consumer.

That potential interpretation causes defendants facing the prospect of UDAP civil penalties to grapple with potentially astronomical exposure. That is especially true in a situation where a state attorney general could theorize that noncompetes reduce employee mobility, which consequently weakens competition, hinders innovation and market disrupters, and consolidates power in dominant corporations.

All of that, state attorneys general could argue, results in the dominant corporation having the ability to maintain artificially inflated prices, thereby unfairly harming consumers.

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For those companies with products and services that touch many consumers in a state, a state attorney general could aver that tens of thousands of consumers paid higher prices for that corporation's goods or services because of the suppressed or weakened competition in the marketplace caused by the use of prohibited noncompetes — and that each such impacted consumer constitutes a separate violation that gives rise to its own civil penalty.

Another significant consequence of state enforcement of a noncompete ban is that corporations would need to defend themselves on multiple fronts in different venues, battling FTC investigations or enforcement actions in federal court, while simultaneously responding to state investigations or litigation in state courts.

This development would be particularly unwelcome for employers because it is particularly challenging to litigate against a state attorney general, the state's top law enforcement official, in that attorney general's home forum — given that state courts are often seen as more plaintiff-friendly and more hostile to corporate defendants than their federal counterparts.

Potential for Individual Enforcement Under UDAP Laws

There is yet another layer to the waterfall, beyond state attorney general regulatory enforcement. In addition to empowering the state attorney general to bring an action, virtually every UDAP statute also affords consumers a private right of action to bring a claim.[11] As a result, consumers are empowered to serve as private attorneys general, to initiate suits for violations of the statute that have allegedly caused them harm.[12]

Most state consumer protection acts, or the case law interpreting them, authorize such private rights of action. Although some states do limit citizen suits to particular types of violations, or commit the plenary authority to enforce the broad, undefined ban on unfair or deceptive practices to only state attorneys general, most of these laws contain no discernible gap in enforcement ability between state attorneys general and consumers.[13]

Moreover, in addition to actual or compensatory damages, most state UDAP statutes permit private plaintiffs to seek treble damages or punitive damages, and confer discretion on courts to assess costs and shift attorney fees in cases of willful violations of the UDAP.[14]

The UDAP framework means that corporate defendants will potentially confront two categories of plaintiffs. The first category consists of those individuals in the state directly harmed by the continued use of noncompetes or failure to comply with the rescission-and-notice obligation: the current and former employees of the company who signed a noncompete.

These individuals could plausibly assert that the company's use of these unlawful agreements is per se unfair or deceptive, and that the bound employee should thus be able to avail themselves of the private remedies listed in the state UDAP statute.

The second category of private UDAP plaintiffs is further removed from the unlawful agreement but perhaps far more dangerous to corporate defendants. This category consists of the individual consumers who theoretically paid higher prices because the company's unfair or deceptive use of prohibited noncompetes stifled competition and caused inflated prices in the marketplace.

Although a corporate defendant may have causation arguments to challenge this theory, a consumer plaintiff in this category presents a more complex challenge: their ability to file consumer a class action containing thousands of putative class members.

Dozens of UDAP statutes and state rules of civil procedure intersect in a way that enables a private plaintiff to bring a consumer class action under the UDAP,[15] which means noncompliant corporations risk being named as defendants in a consumer class action simply due to their failure to comply with the noncompete ban in all respects.

Conclusion

What all of this means is that while the FTC may be laying siege on employee noncompetes nationwide, the downstream effects at the state level could be more severe than employers fully appreciate right now.

In addition to large daily fines from the FTC, corporations could simultaneously face state investigations, lawsuits, private litigation and consumer class actions. This concern is a significant one as such suits could drag employers into potentially hostile state courts where state attorneys general and private plaintiffs could seek remedies not available to the FTC, including civil penalties, restitution, punitive damages, attorney fees and costs.

Even if the FTC's proposed rule fails or is significantly watered down, corporations should continue to monitor how state attorneys general treat companies operating in their states that continue to use noncompetes.

While a statutory or regulatory ban on a business practice can certainly help justify a state attorney general's position when negotiating a settlement with a target company or litigating before a judge, it is not strictly necessary to enable the attorney general to bring an enforcement action and allege that a disfavored business practice qualifies as unfair or deceptive in violation of the state's UDAP statute.

Now that the potential for a federal ban on noncompetes has entered the national discourse and triggered great debate, some state attorneys general may feel emboldened to bring such enforcement actions — irrespective of whether the proposed rule is ever finalized and irrespective of whether a federal court approves its legality and enforceability, if challenged.

Thus, the waterfall that the FTC proposed rule has set off will likely be felt for years to come, no matter what happens after March 20, the deadline for comments on the proposal.

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[1] The FTC's proposed rule is available at https://www.ftc.gov/legal-library/browse/federal-register-notices/non-compete-clause-rulemaking.

[2] See Press Release, F.T.C., FTC Proposes Rule to Ban Noncompete Clauses, Which Hurt Workers and Harm Competition (Jan. 5, 2023), https://www.ftc.gov/news-events/news/press-releases/2023/01/ftc-proposes-rule-ban-noncompete-clauses-which-hurt-workers-harm-competition.

[3] Non-Compete Clause Rulemaking, 16 Fed. Reg. 910 (proposed Jan. 5, 2023) (to be codified at 16 C.F.R. pt. 910).

[4] Georgia's primary consumer protection statute, the Fair Business Practices Act, for instance, prohibits "unfair or deceptive acts or practices in the conduct of consumer transactions and consumer acts or practices in trade or commerce." Ga. Code § 10-1-393 (2020).

[5] See id.

[6] For example, North Caroline state courts have interpreted an unfair act under the state's consumer protection act to be one that is "immoral unethical, oppressive, unscrupulous, or substantially injurious to consumers" and a deceptive practice to be one that "has the capacity or tendency to deceive" or mislead consumers. See Harty v. Underhill, 710 S.E. 2d 327 (N.C. Ct. App. 2011).

[7] See, e.g., Purity Supreme, Inc. v. Attorney General¸ 407 N.E.2d 297, 310 (Mass. 1980).

[8] See, e.g., Va. Code § 59.1-201.1 ("Whenever the Attorney General has reasonable cause to believe that any person has engaged in, or is engaging in, or is about to engage in, any violation of this chapter, the Attorney General is empowered to issue a civil investigative demand.").

[9] 15 U.S.C. § 45.

[10] See, e.g., Kan. Stat. § 50-636.

[11] See National Consumer Law Center, Consumer Protection in the States: A 50-State Evaluation of Unfair and Deceptive Practices Laws, 32–37 (Mar. 2018), available at https://www.nclc.org/wp-content/uploads/2022/09/UDAP_rpt.pdf ("NCLC Report").

[12] See NCLC Report, supra note 11, at 32–37.

[13] See NCLC Report, supra note 11, at 33–34.

[14] See, e.g., Va. Code § 59.1-204.

[15] See NCLC Report, supra note 11, at 36–37.

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