NEW VISION, OLD MODEL: HOW THE FTC EXAGGERATED HARMS WHEN REJECTING BUSINESS JUSTIFICATIONS FOR NONCOMPETES

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The Federal Trade Commission has rejected consumer welfare and the Rule of Reason—standards that drove antitrust for 50 years—in favor of a "NeoBrandeisian" vision. This approach seeks to enhance democracy by condemning abuses of corporate power that restrict the autonomy of employees and consumers, regardless of impact on prices or wages. Pursuing this agenda, the Commission has proposed banning all employee noncompete agreements ("NCAs") as unfair methods of competition under Section 5 of the FTC Act.

The Notice of Proposed Rulemaking ("NPRM") articulating the Commission's rationale found that NCAs reduce aggregate wages, harm traditionally recognized by the Rule of Reason. But the NPRM also found that nearly all NCAs are both procedurally and substantively coercive, because employers use overwhelming bargaining power to impose agreements that restrict employees' post-employment autonomy. The invocation of coercion as distinct antitrust harm reflected NeoBrandeisian concerns about corporate power in today's economy.

Echoing Transaction Cost Economics ("TCE"), the NPRM conceded that NCAs can encourage employee training and/or creation of trade secrets. The Commission nonetheless rejected such business justifications for two reasons. First, these benefits do not exceed NCAs' harms. Second, NCAs are not "narrowly tailored" because alternative, albeit less effective, means can further such objectives. Both rationales assumed that the benefits of nonexecutive NCAs always coexist with all three harms described above.

This Essay critiques the Commission's assumption that NCAs' benefits coexist with both forms of coercion and the resulting rejection of business justifications for NCAs. The coexistence assumption echoes Price Theory's partial

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equilibrium tradeoff ("PET") model, which informs the same consumer welfare standard the Commission has rejected. This model treats the creation of market power and resulting misallocation of resources as the sole antitrust harm, to be balanced against any productive efficiencies, which necessarily coexist with such harm.

However, the Commission's NeoBrandeisian focus on coercion introduced a new form of antitrust harm, which entailed a particular process of contract formation, independent of any impact on prices or wages. Moreover, TCE teaches that, unlike efficiencies contemplated by Price Theory, efficiencies generated by NCAs are non-technological in nature and often arise in low transaction cost settings. Taken together, the altered definition of harm and TCE's account of efficiencies undermine application of the PET model's coexistence assumption when assessing business justifications for NCAs.

In particular, TCE predicts that fully-disclosed NCAs that produce significant benefits reflect voluntary contractual integration between the parties and are thus not procedurally or substantively coercive. Proof that such NCAs create benefits undermines the prima facie case of coercion and obviates any need to balance benefits against supposed coercive harms. The Commission's assessment of business justifications and condemnation of all nonexecutive NCAs as coercive therefore rested upon an exaggeration of the harms that NCAs produce and may have reached an erroneous result.

To be sure, proof that some or even all NCAs are voluntary does not refute the findings that NCAs have an aggregate negative impact on wages. Perhaps this narrower set of harms still outweighs the benefits that NCAs produce. Or perhaps an assessment of "balanced alternatives" would still conclude that NCAs are on net inferior to alternatives. However, the NPRM performed no such assessment. As a result, the Commission must reconsider its rejection of business justifications, this time unconstrained by the inapposite PET model.

The Commission's erroneous exaggeration of harms highlights the perils of abrupt and ill-considered normative change. The Commission developed its Section 5 enforcement policy without public input and ignored public comment and academic literature explaining TCE's account of voluntary contract formation. Instead of adapting its methodology of assessment to its new normative account of Section 5, the Commission implicitly fell back on the PET model—developed to assess entirely different economic phenomena. The Commission should reconsider its new

normative account of antitrust harm or revise its methodology of assessing business justifications to reflect the best economic account of the formation of NCAs.

INTRODUCTION

There is a new antitrust sheriff in town. The Federal Trade Commission has rejected consumer welfare and the Rule of Reason—the organizing principles of antitrust for 50 years—in favor of a "NeoBrandeisian" vision. This approach seeks to enhance democracy by condemning abuses of corporate power that restrict the autonomy of employees and consumers, regardless of impact on prices or wages.

The Commission has proposed to ban all employee noncompete agreements ("NCAs") as unfair methods of competition under Section 5 of the FTC Act.[1] The Notice of Proposed Rulemaking ("NPRM") articulating the Commission's rationale found that NCAs reduce aggregate wages, ironically establishing a prima facie case under the Rule of Reason. But the NPRM went beyond the Rule of Reason, echoing NeoBrandeisian concerns about the role of corporate power in today's economy. Thus, the NPRM found that all NCAs, unless entered by "senior executives," are procedurally and

[1] For the sake of exposition, the author has minimized the use of footnotes in the introduction. The subsequent sections provide ample support for the assertions made in this section of the Essay.

substantively coercive. Such agreements are procedurally coercive because employers use overwhelming bargaining power to impose them. NCAs are substantively coercive because they restrict employees' ability to start their own firms or accept lucrative offers from rival employers. The NPRM also opined that procedural coercion was necessary, but not sufficient, to establish substantive coercion.

The NPRM rejected business justifications for NCAs. Echoing Transaction Cost Economics ("TCE"), the Commission conceded that NCAs can encourage employee training and/or creation of trade secrets. However, the Commission rejected such justifications, for two reasons. First, these benefits do not exceed NCAs' harms. Second, NCAs are not "narrowly tailored," because alternative, less effective means can further such objectives. This second rationale apparently reflected a "balanced alternatives" standard, that is, comparison of the net impact of NCAs with the net impact of less effective alternatives. Both rationales for rejecting business justifications assumed that NCAs' benefits coexist with all three harms.

This Essay critiques the Commission's assumption that NCAs' benefits coexist with both forms of coercion. This assumption echoes Price Theory's partial equilibrium tradeoff ("PET") model, which informs the same consumer welfare standard the Commission has rejected. This model treats the creation of market power and resulting misallocation of resources as the relevant antitrust harm, to be balanced against any productive efficiencies, which necessarily coexist with such harm.

However, the Commission's NeoBrandeisian approach expands the definition of antitrust harm to include two forms of coercion, both dependent upon a particular process of contract formation. Moreover, TCE teaches that, unlike efficiencies contemplated by Price Theory, efficiencies generated by NCAs are non-technological and arise in low transaction cost settings. The revised theory of harm combined with TCE's account of NCAs' benefits undermine the usefulness of the PET model when assessing business justifications for NCAs.

In particular, TCE predicts that fully-disclosed NCAs that produce significant benefits reflect voluntary contractual integration between the parties. Proof that such NCAs create benefits undermines the prima facie case of coercion and any need to "balance" benefits against coercive harms. The Commission's assessment of business justifications and

condemnation of all nonexecutive NCAs therefore rested upon an exaggeration of NCAs' harms and thus may have reached an erroneous result.

To be sure, proof that some NCAs are voluntary does *not* refute the findings that such agreements have an aggregate negative impact on wages. Perhaps this narrower harm outweighs NCAs' benefits. Moreover, an assessment of "balanced alternatives" could still conclude that NCAs are more harmful than other means of furthering the same objectives. However, the NPRM performed no such assessment but instead "stacked the deck" against NCAs by assuming, incorrectly, that fully-disclosed beneficial NCAs are coercive. The Commission must reconsider its rejection of business justifications, this time without assuming that NCAs' benefits coexist with coercive harms.

The NPRM's erroneous exaggeration of harms highlights the perils of abrupt and ill-considered normative change. New principles do not implement themselves. Agencies must instead draw upon economic theory to ask and answer the questions posed by new standards.

The Commission's new enforcement policy required an economic assessment of the process of forming NCAs, independent of their economic effect. Unfortunately, the Commission developed its Section 5 enforcement policy without public input and ignored public comment and academic literature explaining TCE's account of voluntary contract formation. Instead, the Commission implicitly embraced the PET model—developed to assess entirely different economic phenomena—when assessing business justifications. The Commission should reconsider its new normative account of antitrust harm or revise its methodology of determining the presence of coercion and assessing business justifications to reflect the best economic account of the formation of NCAs.

Part I describes the Commission's rationale for declaring all NCAs to be presumptive unfair methods of competition, particularly the conclusion that nearly all NCAs entail procedural and substantive coercion. Part II describes the rejection of business justifications for NCAs, despite recognition that NCAs can produce cognizable benefits. This rejection was premised on the assumption that such benefits necessarily coexist with harms, including the two forms of coercion attributed to nearly all NCAs.

Part III explains how the coexistence assumption echoes Price Theory's PET model, which assumes that productive

efficiencies coexist with harm presumed once a plaintiff establishes a prima facie case. By contrast, TCE predicts that fully-disclosed NCAs that produce significant benefits result from voluntary integration between the parties. When coercion establishes a prima facie case, proof that a fully-disclosed NCA produces benefits and is thus voluntary undermines any assumption that coercion is present and that benefits coexist with coercive harms. The Commission therefore exaggerated the magnitude of harm that NCAs create when it balanced harms against benefits and applied its narrow tailoring test.

Part IV raises and rejects two possible counterarguments. First, the Commission might contend that employees rarely have pre-contractual knowledge of NCAs, with the result that agreements are almost never voluntary. Second, the Commission might claim that even voluntary NCAs are not narrowly-tailored because such agreements still reduce aggregate wages, while various alternatives, although less effective, have no such negative impact. Neither argument survives scrutiny.

I
THE COMMISSION'S RATIONALE FOR PRESUMPTIVE CONDEMNATION OF NCAS

In March 2019 the Open Markets Institute ("OMI") filed a petition requesting that the Federal Trade Commission ("FTC" or "Commission") ban all Employee Noncompete Agreements ("NCAs") as "Unfair Methods of Competition" under Section 5 of the FTC Act.[2] Such agreements prevent employees from departing for rival employers or starting competing firms during a prescribed period. In 2015, the Commission had reiterated that Section 5 incorporates the Sherman Act's Rule of Reason, informed by the goal of consumer welfare.[3] Applying this standard, a late 2019 review of the economic literature by John McAdams, a Commission economist, concluded that NCAs could reduce wages and harm employees or increase wages by enhancing employee productivity, and that "evidence on which channel" predominated was "mixed."[4]

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2 Open Mkts. Inst., Petition for Rulemaking to Prohibit Worker NonCompete Clauses (Mar. 20, 2019) ("2019 Petition").

3 *See* Statement of Enforcement Principles Regarding "Unfair Methods of Competition" under Section 5 of the Federal Trade Commission Act, 80 Fed. Reg. 57055 (Aug. 13, 2015) [hereinafter 2015 Section 5 Statement].

4 John M. McAdams, Non-Compete Agreements: A Review of the Literature (Dec. 31, 2019) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3513639.

The Petition languished until the summer of 2021, when President Biden appointed Lina Khan, a former employee of the Petitioner, to chair the FTC.[5] Two weeks after her appointment, a sharply divided Commission withdrew its 2015 interpretation of Section 5, thereby repudiating consumer welfare and the Rule of Reason.[6] The Commission did not, however, replace the withdrawn standard.

A few weeks later, the Commission sought comment on the 2019 Petition.[7] The Commission also worked on a revised statement of Section 5 enforcement policy without seeking public input and issued a new statement in November 2022.[8] The statement announced that Section 5 banned, inter alia, conduct that was "coercive," "exploitative," or a "use of economic power of a similar nature," regardless of any impact on prices, wages, output, or quality.[9] The focus on coercion and exploitation as independent sources of liability reflected Chair Khan's "NeoBrandeisian" approach to antitrust, which seeks to counteract the anti-democratic impact of supposed large concentrations of economic power.[10]

In January 2023, the Commission issued a Notice of Proposed Rulemaking ("NPRM") articulating its tentative assessment of NCAs.[11] The NPRM found that NCAs arise in a wide variety of industries and bind about thirty million American employees.[12] The NPRM also found that nearly all states enforce NCAs deemed reasonable after robust state-court review.[13]

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5 *See* Fed Trade Comm'n, *Lina M. Khan Sworn in as Chair of the FTC* (June 15, 2021), https://www.ftc.gov/news-events/news/press-releases/2021/06/lina-m-khan-sworn-chair-ftc [https://perma.cc/Z3BX-QYGD].

6 *See* Statement Withdrawing 2015 Section 5 Statement (July 1, 2021).

7 *See* FED. TRADE COMM'N, REQUEST FOR PUBLIC COMMENT REGARDING CONTRACT TERMS THAT MAY HARM FAIR COMPETITION, (last visited Jan. 13, 2024), https://www.regulations.gov/docket/FTC-2021-0036 [https://perma.cc/4V7X-GK84].

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

9 *Id.* at 9.

10 *See* Lina Khan, *The New Brandeis Movement: America's Antimonopoly Debate*, 9 J. EUR. COMPETITION L. & PRAC. 131 (2018) (summarizing this movement). *See also* Thomas A. Lambert & Tate Cooper, *NeoBrandesianism's Democracy Paradox*, 49 J. CORP. L. 347, 350-361 (2023) (describing NeoBrandeisian antitrust philosophy).

11 *See* Non-Compete Clause Rule, 88 Fed. Reg. 3482 (Jan. 19, 2023) (to be codified at 16 C.F.R. pt. 910) [hereinafter NPRM].

12 *Id.* at 3485.

13 *Id.* at 3494-96. *See also* Alan J. Meese, *Are Employee Noncompete*

The NPRM determined that all NCAs are apparently "'unfair'" method[s] of competition" and presumptively violate Section 5.[14] The NPRM articulated three independent ways that NCAs are apparently unfair. First, *all* NCAs are "restrictive" because they "restrict a[n employee's] ability to work for a competitor of the employer" and also "restrict" the ability of rivals to hire employees subject to NCAs.[15] To bolster this rationale, the NPRM invokes indirect evidence that NCAs tend to reduce aggregate wages.[16]

This first rationale seemed to follow from a Rule of Reason assessment. The gravamen of an offense under the Sherman Act entails the exercise of market power to produce noncompetitive prices, output or quality, including noncompetitive wages (prices for labor), without offsetting benefits.[17] Proof that an NCA reduces wages would establish a prima facie case of harm and require condemnation unless the defendant could prove that benefits outweigh the harm.[18]

But the Commission had recently rejected the consumer welfare standard in favor of a broader construction of Section 5 that reflected NeoBrandeisian concerns.[19] The second and third rationales for presumptive condemnation reflect this new construction, consistent with the Commission's 2022 Section 5 Statement. For instance, the NPRM found that nearly all NCAs are "exploitative and coercive at the time of contracting."[20] Employers, the NPRM found, use an "imbalance of bargaining power" that is "particularly acute" to impose NCAs.[21] The NPRM identified numerous supposed

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Agreements Coercive? Why the Federal Trade Commission's Wrong Answer Disentitles it from Rulemaking (For Now), 18 VA. L. & BUS. REV. 245, 271 (2024) (discussing standards that state courts employ when assessing NCAs); Alan J. Meese, *Don't Abolish Employee Noncompete Agreements*, 57 WAKE FOREST L. REV. 631, 646-47 (2022) (suggesting that state law standards are "more intrusive" than Sherman Act's Rule of Reason in this context).

14 NPRM, *supra* note 11, at 3482.

15 *Id.* at 3500.

16 *Id.* at 3500-02; *id.* at 3501 (finding that, "in the aggregate," NCAs "materially reduce[] wages"). The NPRM also invoked far less robust evidence that NCAs increase prices. *See id.* at 3490 (discussing single study finding price impact in one industry).

17 *See* NCAA v. Alston, 141 S. Ct. 2141, 2151 (2022) (Rule of Reason "distinguish[es] between restraints with anticompetitive effect that are harmful to the consumer and restraints stimulating competition that are in the consumer's best interest.") (citing Ohio v. Am. Express Co., 585 U.S. 529, 541 (2018)).

18 *Id.* at 2160-66 (condemning horizontal restraint reducing student-athlete compensation).

19 *See supra* notes 6 & 10-11 and accompanying text.

20 NPRM, *supra* note 11, at 3500.

21 *Id.* at 3503.

factors that indicated the near-universal possession and exercise of such power, including labor market concentration, employers' use of form contracts, 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 NCAs are "exploitative and coercive" at the time of employees' "potential departure from the employer," because they force employees to either stay in a job they want to leave or choose an alternative but less attractive position not precluded by the NCA.[23]

These distinct types of coercion correspond to the categories of procedural and substantive unconscionability within contract law.[24] The first consists of a coercive *process* of contract formation, while the second entails particular *substantive* content of the agreement. This Essay employs these labels to describe these two categories of coercion.

The NPRM exempts "senior executives" from its finding that NCAs are doubly coercive.[25] These executives, the NPRM says, bargain individually over NCAs and presumably receive additional compensation for accepting them.[26] Thus, the process of forming such agreements is not coercive.[27]

This absence of procedural coercion informs the assessment of whether senior executive NCAs are substantively coercive. The NPRM concludes that, regardless of content, such restraints are never *substantively* coercive because the bargaining process that produces them is not coercive and ensures compensation.[28] Thus, the NPRM's conclusion that *non*executive NCAs *are* substantively coercive depends on both the *substance* of such agreements and the coercive *process* of obtaining them. Procedural coercion is necessary, but not sufficient, to establish substantive coercion.[29]

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22 *Id.* at 3502-04.

23 *Id.* at 3503-04; Meese, *Are Employee Noncompete Agreements Coercive, supra* note 13, at 273-74 (describing NPRM's invocation of these two forms of coercion).

24 *See* JOHN EDWARD MURRAY, MURRAY ON CONTRACTS, 541-542 (5th ed. 2011) (discussing distinction between procedural and substantive unconscionability); Meese, *Are Employee Noncompete Agreements Coercive*, *supra* note 13, at 274 (identifying parallel between two forms of coercion identified by the Commission and these doctrines of contract law).

25 NPRM, *supra* note 11, at 3503-04.

26 *Id.*

27 *Id.*

28 *Id.* at 3504.

29 The NPRM incorporates by reference a previous discussion regarding the

The NPRM invites public comment on the definition of "senior executive," suggesting several possible options.[30] Each definition would cover a tiny fraction of the thirty million NCAs that apparently govern American employees, implying that *non*executive NCAs constitute ninety-nine percent or more of such agreements.[31]

Invocation of procedural and substantive coercion as independent harms echoed NeoBrandeisian concerns regarding the role of corporate power in the U.S. economy. Indeed, when serving as the Petitioner's Director of Legal Policy, Chair Khan had invoked Justice Brandeis's concern that overbearing corporate power "preclude[s individuals'] experience of liberty[,]" including when negotiating employment terms.[32] Moreover, just days after appointing Chair Khan, President Biden issued an executive order opining that "excessive market concentration threatens basic economic liberties" and that a competitive marketplace ensures the "economic freedom to switch jobs or negotiate a higher wage."[33] The order also claims that "Powerful companies require [employees] to sign [NCAs] that restrict their ability to change jobs" and "encouraged the [FTC] to curtail the unfair use of [NCAs]."[34] While the NPRM does not mention "liberty," Chair Khan posted on X that NCAs abridge "core economic liberties."[35] Given the NPRM's emphasis on procedural and substantive coercion, the obvious implication of this remark was that banning NPRMs would enhance liberty for employees bound by NCAs.

II

impact of NCAs on "competitive conditions." *See id.* The Final Rule, it should be noted, reiterated the NPRM's conclusion that NCAs entered by employees who are not senior executives all produce the same three harms described in the text. *See* Non-Compete Clause Rule, 89 Fed. Reg. 38342, 38372 (May 7, 2024) (to be codified at 16 C.F.R. pts. 910, 912) (summarizing the Commission's findings with respect to such agreements).

30 *Id.*

31 *See* Meese, *Are Employee Noncompete Agreements Coercive*, *supra* note 13, at 275 n.116 (explaining how one such definition would cover less than one percent of NCAs).

32 Khan, *supra* note 10, at 131. *See also* Meese, *Are Employee Noncompete Agreements Coercive*, *supra* note 13, at 272-73 (identifying Neobrandeisian basis for invocation of these two forms of coercion as independent sources of liability).

33 Exec. Order No. 14036, 86 Fed. Reg. 36987 (Jul. 9, 2021), at 1.

34 *Id.*

35 Lina Khan (@linakhanFTC), X ("Noncompetes undermine core economic liberties"), https://twitter.com/ /linakhanFTC/status/1611025897481453568 [https://perma.cc/CX6E-QYK8] (last visited Aug. 18, 2023).

REJECTION OF BUSINESS JUSTIFICATIONS

The preliminary finding that NCAs are unfair was potentially subject to an affirmative defense based on one or more business justifications.[36] The Commission's 2022 Section 5 Statement describes this inquiry as assessing whether "the benefits [of the conduct] outweigh the harm and are of the kind that courts have recognized as cognizable[.]"[37] The Statement also condemns conduct not "narrowly tailored" to achieve such benefits.[38] The NPRM applies these standards to determine whether NCAs are justified.

A. The NPRM Found that NCAs Sometimes Produce Cognizable Benefits

The 2019 Petition that sought the rulemaking asserted that NCAs never produce cognizable benefits.[39] This assertion echoed the approach to other nonstandard agreements, such as vertical exclusive territories, prevalent during antitrust's inhospitality era.[40] Drawing on Price Theory, including various assumptions of the perfect competition model, scholars and courts had concluded that nonstandard agreements could not produce cognizable benefits.[41] Both also concluded that manufacturers and franchisors obtained such agreements coercively.[42] Indeed, Chicago School price theorist George Stigler explained that sellers can only obtain tying and requirements contracts by exercising pre-existing market

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36 *See* FED. TRADE COMM'N, POLICY STATEMENT REGARDING THE SCOPE OF UNFAIR METHODS OF COMPETITION UNDER SECTION 5 OF THE FEDERAL TRADE COMMISSION ACT at 9-11.

37 *Id.* at 12.

38 *Id.*

39 *See* Open Mkts. Inst., Petition for Rulemaking, at 3 ("[N]on-competes do not have a credible justification.")

40 *See* Alan J. Meese, *Don't Abolish Employee Noncompete Agreements*, *supra* note 13, at 637, 667 & 677-79 (2021) (explaining that Petition echoed inhospitality era's hostility toward nonstandard agreements).

41 *See* Alan J. Meese, *Price Theory, Competition, and the Rule of Reason*, 2003 ILL. L. REV. 77, 115-23 (describing Price Theory's hostile interpretation of nonstandard agreements); *id.* at 124 (describing "inhospitality era of antitrust"); *id.* at n.240 (explaining that this era "began about 1940 and ended in 1977.").

42 *See* Alan J. Meese, *The Market Power Model of Contract Formation: How Outmoded Economic Theory Still Distorts Antitrust Doctrine*, 88 NOTRE DAME L. REV. 1291, 1320-22, 1329-35 (2013) (describing academic assertions that nonstandard agreements are imposed coercively); Perma Life Mufflers, Inc. v. Int'l Parts Co., 392 U.S. 134, 139 (1968) (rejecting defendants' claim that plaintiffs were equally at fault for such agreements because franchisees' "participation was not voluntary in any meaningful sense"); *id.* at 142-43 (White, J., concurring) (ascribing agreements to "defendant's [sic] superior bargaining power.")

power.[43] According to Stigler and other price theorists, this exercise entailed the seller providing a discount below the profit-maximizing price, conditioned on the buyer's agreement to the provision.[44]

Subsequent developments in economic theory, particularly Transaction Cost Economics ("TCE"), undermined Price Theory's account of nonstandard agreements.[45] TCE concluded that such contracts are often designed to overcome market failures that would occur if, for instance, manufacturers relied upon an atomistic retail market to distribute their products.[46]

The Commission rejected the Petition's pre-modern view, recognizing that NCAs can produce three types of benefits. First, NCAs can help protect trade secrets, by preventing employees from departing to work for rivals eager to obtain such information.[47] Such protection incentivizes the creation, production, and sharing of such knowledge, enhancing interbrand competition.[48]

Second, NCAs can protect employers' investments in training that enhance employees' generally-applicable skills, by preventing other employers from free riding on such investments by bidding away trained employees.[49] Indeed, the Commission credited research finding a positive correlation between a state's propensity to enforce NCAs and such investments.[50] Extrapolating from these findings, the NPRM concluded that banning NCAs would deprive around 15 percent of employees with NCAs of training each year.[51] Third,

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43 George J. Stigler, *Mergers and Preventative Antitrust Policy*, 104 U. PA. L. REV. 176, 176 (1955) ("[Tying and requirements contracts] can arise only when monopoly power is already possessed.")

44 *Id.* (monopoly sellers obtain such agreements via "an offsetting reduction in price"); Meese, *supra* note 42, at 1330 n.164 (collecting similar assertions by other scholars).

45 Meese, *Don't Abolish Employee Noncompete Agreements*, *supra* note 13, at 677-86.

46 *Id.* at 680.

47 NPRM, *supra* note 11, at 3505.

48 *See* Meese, *Don't Abolish Employee Noncompete Agreements*, *supra* note 13, at 690, 700 (explaining that NCAs that produce such benefits enhance interbrand competition).

49 *Id.* at 687 n.286 (collecting numerous state decisions treating this impact as legitimate interest that can justify NCA enforcement); NPRM, *supra* note 11, at 3505.

50 *See* NPRM, *supra* note 11, at 3543 (discussing Evan Starr, *Consider This: Training, Wages, and the Enforceability of Covenants Not to Compete*, 72 I.L.R. REV. 783, 796-98 (2019) (finding such a positive correlation)).

51 *See* NPRM, *supra* note 11, at 3529 (summarizing this study's finding that one standard deviation increase in NCA enforceability index results in a 14.7%

the NPRM recognized that NCAs can encourage investments in capital equipment, by retaining employees whose skills are complementary to such investments.[52]

The NPRM's characterization of these first two benefits reflected TCE's influence.[53] As the NPRM explained, employer investments that generate information and/or confer training create an "investment hold-up problem," *i.e.*, risk that employees might depart for rivals or start their own firms.[54] Either result deprives the employer of the benefits of such expenditures and confers an unfair advantage on rivals (including ex-employee start-ups), who could employ such investments without paying for them.[55] The prospect of such opportunism could deter such investments, thereby dampening productivity growth.[56]

The invocation of "investment hold-up" recalled the work of Ronald Coase, Benjamin Klein, Oliver Williamson, and other TCE scholars who explained that relationship-specific investments could render the investing party vulnerable to opportunistic appropriation of such investments.[57] These

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"increase in the number of [employees] who reported receiving training" in occupations where NCAs are prevalent).

52 *Id.* at 3493 (discussing Jessica Jeffers, *The Impact of Restricting Labor Mobility on Corporate Investment and Entrepreneurship* 28 (2019) (working paper)).

53 By contrast, the academic literature discussing the third benefit does not invoke the possibility of opportunism or TCE literature. *See id.*

54 NPRM, *supra* note 11, at 3505.

55 *Id.* ("[W]ithout [NCAs], employment relationships are subject to an investment hold-up problem . . . [This] occurs where an employer—faced with the possibility a worker may depart after receiving some sort of valuable investment—opts not to make that investment in the first place, thereby decreasing the firm's productivity and overall social welfare."). *See also* Paul H. Rubin & Peter Shedd, *Human Capital and Covenants Not to Compete*, 10 J. LEG. STUD. 93, 95–100 (1981) (describing identical account of how NCAs can protect and encourage employer investments in employee training from opportunistic appropriation); Gillian Lester, *Restrictive Covenants, Employee Training, and the Limits of Transaction-Cost Analysis*, 76 IND. L. J. 49, 62-65 (2001) (describing "Transaction Cost Economic Analysis" of NCAs); *id.* at 62 ("The worker may 'hold up' the employer by demanding a higher wage under threat of defecting to a competitor who offers a higher wage. Restrictive covenants might reduce this temptation by preventing the employee from working for competitors for some specified period following separation."); *id.* at 65 (describing Rubin & Shedd's approach as applying TCE).

56 *See* Rubin & Shedd, *supra* note 55, at 95–100.

57 *See* Ronald H. Coase, *Nature of the Firm: Origin*, 4 J. L. ECON. & ORG. 3, 15–16 (1988) (explaining how manufacturer's investment in customer-specific machinery could give rise to risk of customer opportunism); OLIVER E. WILLIAMSON, ECONOMIC INSTITUTIONS OF CAPITALISM, 30-34, 60-63 (1985) (explaining how relationship-specific investments create risk that counterparties will opportunistically appropriate such investments); Benjamin Klein, *Transaction Cost Determinants of "Unfair" Contractual Arrangements*, 70 AMER. ECON. REV. 356, 356–57, 358 (1980) (describing "hold-up problem" in

scholars concluded that complete vertical integration or partial integration by contract could minimize such opportunism.[58] In 1981, two scholars applied such logic to NCAs, explaining how such agreements can encourage training investments by minimizing the risk post-training opportunism.[59]

No one asserts that NCAs always produce benefits. However, neither the NPRM nor the Final Rule estimated the proportion of NCAs that do so. Nor did either quantify the relative magnitude of harms and benefits produced by NCAs that do produce benefits.

B. The Commission Nonetheless Rejected Business Justifications for NCAs

The NPRM found that NCAs' benefits did not rebut the presumption that all NCAs are unfair, for two independent reasons.[60] For instance, the Commission found that these benefits "do not outweigh the considerable harm from [NCAs]."[61] The Commission also found that NCAs are not "narrowly tailored" to produce such benefits because alternative means "reasonably accomplish the same purposes as [NCAs]" but produced less harm.[62] The Commission did not, it should be noted, find that any alternative produced the same or nearly the same benefits as NCAs.[63] Conceptually, the assessment producing these conclusions required the Commission to specify the nature and gravity of NCAs' harms and benefits. Otherwise, the Commission could not compare harms and benefits or determine whether alternatives produced less harm and/or the same benefits.

As noted above, the Commission did not estimate how many NCAs produce cognizable benefits or assess the

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franchisor-franchisee relationships).

58 *See* Coase, *Nature of the Firm: Origin*, 4 J. L. ECON. & ORG. at 15–16 (explaining how supplier would increase prices to compensate for risk of customer opportunism); *id.* at 16–17 (explaining how complete and partial integration combat opportunism); Oliver E. Williamson, *Assessing Vertical Market Restrictions: Antitrust Ramifications of the Transaction Cost Approach*, 127 U. PA. L. REV. 953, 975–980 (1979) (explaining how exclusive territories can combat market failures and reduce manufacturer's cost of relying upon unbridled market to distribute its products). *See also* Robert H. Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division*, 75 YALE L. J. 381, 430–38 (1966) (explaining how exclusive territories can prevent dealers from underinvesting in local promotion and thus enhance demand for the manufacturer's product).

59 *See* Rubin & Shedd, *supra* note 55, at 95–100.

60 NPRM, *supra* note 11, at 3505.

61 *Id.*

62 *Id.*

63 *See infra* notes 147-53 and accompanying text (discussing this omission).

magnitude of benefits an NCA may produce. Instead, the NPRM emphasized the supposed overwhelming (but unquantified) magnitude of harms that nonexecutive NCAs—nearly all such agreements—create. Describing these harms, the NPRM began by emphasizing that "some" NCAs were coercive in both senses the Commission had identified.[64] The adjective "some" understated the proportion of such NCAs, given the Commission's findings that *all* NCAs, except that tiny fraction entered by senior executives, are doubly coercive.[65] Such coercion, the Commission said, rendered such NCAs "facially unfair."[66] As a result, any justifications for NCAs entered by nonexecutives had to "overcome a high bar" to rebut the presumption against them.[67] This finding of "facial unfairness" and resulting "high bar" reflected the Commission's NeoBrandeisian account of antitrust harm.

Having set this "high bar," the Commission briefly compared the benefits and harms of thirty million NCAs. The Commission reiterated its earlier conclusions that NCAs as a whole have a "significant" negative impact on wages.[68] The Commission did not consider whether any subcategories of NCAs produce no harms, unambiguous benefits without harms, or net benefits. Instead, the Commission took an all-or-nothing approach, treating every NCA as harmful and asking whether the benefits of all NCAs exceed their harms.

The Commission conceded that "[t]here is evidence . . . [NCAs] increase employee training and capital investment."[69] Still, the Commission opined that, if such benefits exceeded NCAs' harms, employees would share such benefits in the form of higher wages in those states that enforce NCAs more robustly, other things being equal.[70] This assertion, however, assumes that employees know of NCAs before they accept employment offers and thus demand higher wages in return for such restrictions, an assumption the NPRM rejected.[71] Absent such knowledge, employers would not share the benefits of NCAs. Instead, employers would obtain nominal

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64 NPRM, *supra* note 11, at 3507-08.

65 *See supra* notes 20-31 and accompanying text.

66 *See* NPRM, *supra* note 11, at 3508.

67 *Id.* (stating that "justifications for [nonexecutive NCAs] must overcome a high bar.")

68 *Id.*

69 *Id.*

70 *Id.*

71 *Id.* at 3503 (asserting that consumers "rarely read standard-form contracts" and that employees "likely display similar cognitive biases.")

agreement to such provisions at the same wage they would pay absent NCAs, capturing all the benefits of such agreements.[72] Moreover, even proof that wages fall *on average* does not establish that NCAs never produce net benefits. Based in part on this erroneous interpretation of the data, the Commission found that the benefits of NCAs do not exceed the harms.

When assessing whether benefits justified nonexecutive NCAs, the Commission assumed that all such agreements resulted from a coercive process of contract formation and were also substantively coercive, with the result that any such benefits necessarily coexist with such harms. Absent this assumption, it made no sense to ask whether benefits "exceed" harms—including both forms of coercion—that NCAs supposedly produce. Nor did it make sense to ask whether there is a *le*ss harmful way of producing such benefits. Nor, finally, did it make sense to invoke such coercion to justify a "high bar" when comparing harms and benefits. In procedural terms, the Commission's assessment of business justifications assumed that its finding of coercive harm is irrebuttable, thereby surviving proof that an NCA produces sizable benefits.

III
TCE AND THE VOLUNTARY FORMATION OF NONSTANDARD CONTRACTS

The Commission's articulation of NCAs' potential benefits largely echoed TCE's account of such agreements. The Commission also assumed that all nonexecutive NCAs—including those that produce benefits—result from a coercive process of contract formation. As explained earlier, price theorists also once asserted that firms necessarily employ market power coercively to impose nonstandard agreements.[73] Moreover, the Commission's assessment of possible business justifications assumed that such coercive harms always coexist with any benefits that nonexecutive NCAs produce. As shown below, this "coexistence assumption" echoes Price Theory's partial equilibrium trade-off model, developed to assess the net impact of particular types of harms and benefits, *i.e.*, enhanced market power and technological

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72 *Id.* (explaining that employees who learn of NCAs after accepting employment offers are in a far weaker bargaining position than those who consider offers that include NCAs before leaving their current job). *See also* Eric A. Posner, *The Antitrust Challenge to Covenants Not to Compete in Employment Contracts*, 83 ANTITRUST L. J. 165, 190 (2020) (contending that some employees who enter NCAs "do not demand a wage premium—because of ignorance.").

73 *See supra* notes 42-44 and accompanying text.

efficiencies.

However, two factors combine to undermine the Commission's implicit embrace of the PET model's coexistence assumption when assessing NCAs. First, implementing its new NeoBrandeisian vision, the Commission included two forms of "coercion" as distinct antitrust harms when assessing NCAs. Second, TCE's account of NCAs refutes Price Theory's claim that nonstandard agreements necessarily result from coercive market power. Because the coexistence assumption is erroneous, the Commission's assessment of possible business justifications and the process of forming nonexecutive NCAs was biased against such agreements, depending as it did upon an exaggeration of the harms that NCAs produce.

A. Origins of the Coexistence Assumption

Perhaps ironically, the coexistence assumption replicates a key attribute of Price Theory's "partial equilibrium tradeoff" ("PET") model. This foundational model informs the "consumer welfare" approach to antitrust, popularized by Robert Bork in the 1960s, including the burden-shifting framework for analyzing contracts under Section 1 of the Sherman Act and mergers under Section 7 of the Clayton Act.[74] This model posits that transactions that create market power and resulting misallocation of resources may simultaneously produce benefits that may offset such harms.

Oliver Williamson's articulation of the model treated horizontal mergers as the paradigm case. However, Bork later embraced the model to "illustrate all antitrust problems."[75] Bork viewed Price Theory as the only "body of knowledge . . . that can serve as a guide to the effects of business behavior

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74 *See* Oliver E. Williamson, *Economies as an Antitrust Defense*: *The Welfare Tradeoffs*, 58 AMER. ECON. REV. 18, 21-23 (1968) (describing partial equilibrium trade-off model as applied to merger to monopoly); Alan J. Meese, *Reframing Antitrust in Light of Scientific Revolution: Accounting for Transaction Costs in Rule of Reason Analysis*, 62 HASTINGS L. J. 457, 471 nn. 61-64 (2010) (collecting authorities invoking trade-off model as informing antitrust analysis, including under Section 1 and Section 7); 15 U.S.C. §§ 1, 18. *See also* Robert H. Bork, *The Goals of Antitrust Policy*, 57 AMER. ECON. REV. 242 (1967). Indeed, Professor Williamson described Bork's consumer welfare approach as "essentially an allocative efficiency standard for antitrust" and described himself as "broadly in accord with . . . [Bork's] position." *See* Oliver E. Williamson, *Allocative Efficiency and the Limits of Antitrust*, 59 AMER ECON. REV. 105, 105 (1969); *id.* at 107 (expressing agreement with Bork's approach subject to some qualifications regarding application).

75 *See* ROBERT H. BORK, THE ANTITRUST PARADOX, 108 (1978).

upon consumer welfare,"[76] and Price Theory's PET model incorporated "the only two factors involved" in assessment of challenged conduct: "allocative efficiency and productive efficiency."[77] Bork did not believe that all business conduct produced both harms and benefits. Where, however, enforcers proved that conduct produced harm and defendants proved benefits, the model assumed that such effects coexist.[78] Determining the actual impact of such agreements thus requires the tribunal to "balance" benefits against harms.[79]

In some circumstances, this coexistence assumption makes sense. For instance, the Commission might establish that a horizontal merger will facilitate the exercise of market power.[80] The burden would then shift to defendants to adduce evidence that "the market-share statistics [give] an inaccurate account of the probable effects on competition."[81] Defendants could satisfy this burden by proving that the transaction produces technological efficiencies, such as economies of scale, offsetting harms that coexist with such benefits.[82]

In some cases**,** however, proof of benefits undermines the prima facie case of harm. In 1986, two scholars explained that, in Rule of Reason adjudication, proof that a restraint produces efficiencies after a plaintiff has established a prima facie case *principally* results in "subjecting assertions of anticompetitive effects to closer scrutiny."[83] Such scrutiny could conclude that the restraint is harmless, thereby negating the prima facie case and requiring dismissal.[84]

These authors offered no proof that rebuttal evidence "principally" results in closer examination of supposed harm.

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76 *Id.* at 117.

77 *Id.* at 108.

78 *See* Meese, *Price Theory, Competition, and the Rule of Reason*, *supra* note 41, at 161-162 (describing role of PET model's coexistence assumption in rule of reason analysis).

79 *See id.* at 108-109 (collecting decisions describing such balancing). *See also* Herbert Hovenkamp, *The Rule of Reason*, 70 FLA. L. REV. 81, 119-121 (2018) (invoking "Oliver Williamson's famous welfare tradeoff model" to inform discussion of "consumer welfare" and "general welfare" approaches to comparing harms and benefits under Section 1's Rule of Reason); *id.* (assuming that such harms and benefits coexist).

80 *See, e.g.*, F.T.C. v. H.J. Heinz Co., 246 F.3d 708, 715 (D.C. Cir. 2001).

81 *Id.*

82 *See* Williamson, *Welfare Tradeoffs*, *supra* note 74, at 20-23; *id.* at 20 ("[T]here is no way in which the tradeoff can be avoided.")

83 Thomas G. Krattenmaker & Steven C. Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price*, 96 YALE L. J. 209, 278 (1986).

84 *See, e.g.* K.M.B. Warehouse v. Walker Mfg. Co., 61 F.3d 123 (2d Cir. 1996) (dismissing Section 1 case because plaintiff failed to adduce evidence of anticompetitive harm).

Theoretically, though, there are some cases where rebuttal evidence should have such an impact. In particular, the impact of rebuttal evidence turns upon: (1) the nature of the factual predicate that establishes a prima facie case and (2) the type of benefits the agreement produces.

Ordinarily the Rule of Reason allows plaintiffs to establish a prima facie case by demonstrating "actual detrimental effects," such as proof that the challenged conduct resulted in higher prices.[85] Such proof indicates that the challenged conduct exercises market power. This approach treats pre-restraint prices as a baseline against which to assess the impact of challenged conduct.[86] The coexistence assumption makes perfect sense when assessing a horizontal merger that might produce technological efficiencies, the exemplar that motivates the PET model.[87]

Assume, however, that the challenged restraint survives per se condemnation because atomistic competition could produce a market failure and misallocation of resources, while the restraint might prevent that failure.[88] Here the PET model, which assumes away market failures, may prove less useful.[89] In such cases, proof that the restraint results in higher prices *could* indicate one of two things: (1) the agreement exercised market power; (2) the restraint overcame a market failure that had manifested itself as sub-optimal prices before the agreement, by inducing additional advertising and increased demand for the defendant's product.

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85 *See* NCAA v. Univ. of Oklahoma, 468 U.S. 85, 105-06 (1984) (finding that plaintiffs had established prima facie case by demonstrating that restraints had increased prices and reduced output compared to nonrestraint baseline).

86 *See* Meese, *Transaction Costs in Rule of Reason Analysis*, *supra* note 74, at 460.

87 *Id.*

88 *Cf.* Continental T.V. v. GTE Sylvania, 433 U.S. 36, 55 (1977) (rejecting per se condemnation of restraint because agreement might improve a "purely competitive" situation).

89 *See* Meese, *supra* note 41, at 162 (contending that proof that a restraint overcomes a market failure undermines price-based prima facie case); Meese, *Transaction Costs in Rule of Reason Analysis*, *supra* note 74, at 470 n.58 (explaining that PET model embraces most assumptions of pre-1960 perfect competition model including absence of externalities). *Cf.* R.H. Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1, 2-15 (1960) (explaining that where "the operation of a pricing system is without cost" voluntary contracting will "maximise the value of production" regardless of the initial assignment of legal entitlements); *id.* at 8 ("[T]he ultimate result (which maximises the value of production) is independent of the legal position if the pricing system is assumed to work without cost."); *id.* at 15 ("[I]f . . . market transactions are costless, such a rearrangement of rights will always take place if it would lead to an increase in the value.")

Exclusive dealing agreements exemplify such ambiguity. Such agreements can help manufacturers capture the benefits of advertising expenditures that drive consumers to dealers that display the manufacturer's trademark.[90] Once consumers arrive, dealers may enhance their own markups by steering customers to products supplied by other manufacturers who do not advertise and therefore charge lower wholesale prices.[91] These manufacturers that refuse to advertise free ride on the first manufacturer's advertising, attenuating incentives to advertise in the first place. By preventing dealers from selling products of competing suppliers, exclusive dealing restores the manufacturer's incentives to advertise its products.[92]

Assume that a plaintiff establishes a prima facie case by proving that retail prices for the manufacturer's product rose after adoption of the agreement. Assume further that the manufacturer proves that exclusive dealing protects it from free riding as described above. Should a tribunal balance harms and benefits or ask whether there is a "less harmful" way to achieve these benefits?

No. Both inquiries assume that the restraint's benefits coexist with harms. However, given how the plaintiff has established a prima facie case, proof of such benefits undermines any presumption of harm. The only data supporting the prima facie case—increased post-restraint prices—are equally consistent with a beneficial account of the agreement, namely, that pre-agreement prices reflected market failure that the agreement corrects. After all, additional advertising, if successful, will increase demand and therefore price for the manufacturer's product.[93] Thus, evidence before the tribunal is equally susceptible to two interpretations, one beneficial and one harmful. The plaintiff bears the burden of proof, and such evidence cannot support a presumption of harm.[94] The only unambiguous evidence before the tribunal

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90 *See* Howard Marvel, *Exclusive Dealing*, 25 J. L. & ECON. 1, 1 (1982).

91 *Id.* at 7-8.

92 *Id.* at 8-11.

93 *See* Alan J. Meese, *Exclusive Dealing, the Theory of the Firm, and Raising Rivals' Costs: Toward a New Synthesis,* 50 ANTITRUST BULL. 371, 427 (2005) (exclusive dealing agreement that prevents interbrand free riding will increase manufacturer's advertising and demand for the manufacturer's product, thereby resulting in higher prices).

94 *See e.g.* Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 587-88 (1986) (noting that evidence that is as consistent with procompetitive as with anticompetitive objectives cannot, without more, support inference of anticompetitive conduct); Meese, *Price Theory, Competition, and the Rule of Reason*, *supra* note 41, at 100 n.111 (collecting other citations).

shows that the NCA produces benefits. Application of Price Theory's PET model, including its "coexistence assumption," would produce misleading results, here condemnation of some beneficial restraints.

B. TCE and Antitrust Balancing

Let us apply these considerations to nonexecutive NCAs, the vast majority of such agreements.[95] The Commission attributed three independent harms to these contracts. The first, restrictiveness, entailed the reduction of aggregate wages.[96] This harm fits comfortably within the PET framework. The second and third were procedural and substantive coercion and entailed no independent economic harm. The supposed presence of such coercion justified a "high bar" that justification(s) for such NCAs had to overcome.[97]

As explained earlier, "procedural coercion" entails employers' use of overwhelming bargaining power to impose NCAs.[98] Substantive coercion entails (1) procedural coercion and (2) a significant limitation of employee autonomy at the time of potential departure from the employer.[99] NCAs entered by senior executives produce neither harm.[100]

Still, the same Price Theory that informs the PET model describes how firms with market power can use such power to coerce acceptance of onerous contractual terms.[101] One can imagine a Rule of Reason framework analogous to the Commission's approach that treats "coercion" as an independent antitrust harm, allowing defendants to adduce rebuttal evidence. Some lower courts have done exactly that in the tying context, where the gravamen of the offense under Section 1 is the use of economic power to "force" purchasers to buy a tied product against their will.[102] While the Supreme Court has found that such forcing establishes a per se violation,[103] lower courts have recognized business justifications for such agreements, subject to a plaintiff's proof that "less restrictive means" will achieve the same benefits.[104]

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95 *See supra* note 31 and accompanying text.
96 *See supra* notes 15-16 and accompanying text.
97 *See supra* notes 66-67 and accompanying text.
98 *See supra* notes 20-22 and accompanying text.
99 *See supra* notes 23, 28-29 and accompanying text.
100 *See supra* notes 25-28 and accompanying text.
101 *See supra* notes 42-44 and accompanying text.
102 *See* Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 12-13 (1985).
103 *Id.* at 9-11.
104 *See* Mozart v. Mercedes-Benz of N. Am., 833 F.2d 1342, 1349-1351 (9th

Such a balancing approach raises vexing questions. For instance, tying jurisprudence requires plaintiffs to show that sellers possesses power in the tying product market and thus the ability to "force" purchasers to take a tied product they otherwise would not purchase.[105] However, the NPRM ignored evidence suggesting that most employers lack such power.[106] Moreover, the Commission did not explain how to assess the magnitude of "coercive harm," apart from the economic impact on wages already incorporated in the NPRM's "restrictiveness" finding.

Fortunately, there is no need to address these questions. Instead, given the Commission's determination that "coercion" establishes a prima facie case and the nature of benefits sometimes produced by NCAs, the PET model's coexistence assumption has no place when assessing the net impact of such agreements. Instead, proof that a fully-disclosed NCA produces benefits undermines any presumption that the agreement is procedurally or substantively coercive.

As explained earlier, the PET model treated the acquisition of market power and resulting misallocation of resources as the sole antitrust harm.[107] Echoing NeoBrandeisian commitments, the NPRM recognized two additional harms, namely, procedural and substantive coercion. However, the Commission, echoing TCE, also recognized that NCAs can overcome market failures and thereby enhance social welfare. Under the PET approach, such benefits would be deemed "productive efficiencies" and thus balanced against the harms (however measured) of coercion.

However, TCE did more than reject Price Theory's substantive account of nonstandard agreements. TCE also offered a new explanation of how parties create such obligations, an account with implications for the coexistence assumption in this context. This account rejected the view that firms necessarily employed overwhelming bargaining power to impose such agreements.[108] Instead, TCE asserted that fully-disclosed nonstandard agreements that produce

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Cir. 1987) (accepting business justification after rejecting plaintiff's contention that less restrictive means would have achieved same benefits).

105 *See Jefferson Parish*, 466 U.S. at 15.

106 *See* Meese, *Are Employee Noncompete Agreements Coercive, supra* note 13, at 284-293 (describing evidence establishing that most or nearly all employees bargain in unconcentrated labor markets).

107 *See supra* notes 74-77 and accompanying text.

108 *See supra* notes 42-44 and accompanying text (describing Price Theory's assertion that firms coercively impose nonstandard agreements).

cognizable benefits are voluntary, because firms will obtain them regardless of whether they possess market power. For instance, Ronald Coase asserted that his 1930s TCE account of vertical integration explained such conduct independent of any monopoly considerations.[109] Benjamin Klein opined that restraints preventing franchisee opportunism are "voluntary" as between franchisor and franchisee.[110]

Oliver Williamson offered a more precise account, explaining how a firm might induce trading partners to accept contractual safeguards that prevent opportunism.[111] Williamson explained that a seller could offer trading partners two options: sale of the product, plus the counterparty's agreement to a safeguard, at one price, or sale with no safeguard, at a higher price.[112] This approach entails the threat to charge higher prices to those who reject the safeguard and choose the second option.

Of course, as price theorists explained, firms with market power *can* use differential pricing to exercise such power and impose onerous terms.[113] However, the price differential Williamson invoked does not reflect an exercise of market power. Unlike Price Theory's differential, which includes a price above cost, Williamson's differential reflects the different costs the seller would incur under each option. That is, the second option incorporates the anticipated costs of counterparty opportunism that will occur absent some safeguard.[114] Because the price differential reflects differential costs, it is not an exercise of market power.[115]

Firms that employ such differentials may *possess* market power. Still, such power is incidental to a cost-based differential. Firms will instead exercise any power by charging higher prices for the underlying product than the corresponding prices charged by firms without such power.

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109 *See* Ronald H. Coase, *The Nature of the Firm: Meaning*, 4 J. L. ECON. & ORG. 19, 26-27 (1988).

110 *See* Klein, *supra* note 57, at 356 (promising to "explain the voluntary adoption of contractual provisions . . . that have been under legal attack.")

111 *See* WILLIAMSON, ECONOMIC INSTITUTIONS, at 32-35 (describing "contracting schema" whereby seller adjusts prices depending on whether buyer accepts contractual safeguard).

112 *See id.*

113 *See supra* notes 42-44 and accompanying text.

114 *See* WILLIAMSON, ECONOMIC INSTITUTIONS, at 33; Coase, *Origin*, 4 J. L. & ECON. at 15 (explaining that suppliers will increase prices to reflect risk of opportunism arising from relationship-specific investments).

115 *See* A.P. Lerner, *The Concept of Monopoly and the Measurement of Monopoly Power*, 1 REV. ECON. STUD. 473, 473–74, 484–85 (1934) (defining market power in this manner).

Both types of firms will rely upon cost-based price differentials to induce acceptance of nonstandard agreements.[116] However, each of the prices (low and high) charged by firms *with* market power will exceed the corresponding prices (low and high) charged by firms without such power. This non-coercive contract formation process is indistinguishable from the process that offers consumers two warranty options at different cost-based prices, inducing each to choose that option which maximizes the net benefits each derives from the product.[117]

In the same way, employers with labor market power will not use such power coercively to impose fully-disclosed NCAs that produce cognizable benefits.[118] In competitive markets, employers will offer potential employees wage premia as compensation for entering NCAs, just as the NPRM hypothesized that firms would do for senior executives.[119] These premia will reflect and share the benefits employers derive from enhanced productivity. Potential employees who consider the premium sufficient compensation will accept the offer.[120] Those who reject the NCA will receive non-premium wages or reject the employer's offer. Public comment in response to the Commission's 2021 request for comment on the 2019 Petition explained this voluntary process of contract formation.[121]

Here again, employers will use any labor market power to

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116 *See* Meese, *supra* note 42, at 1354 nn.288-291 (collecting sources for this proposition). Indeed, an article the NPRM cited for other propositions concurs. *See* Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. CHI. L. REV. 1203, 1211-12, n.33 (2003) (citing several sources supporting this assertion). *See also* Alan J. Meese, *Price Theory and Vertical Restraints: A Misunderstood Relation*, 45 UCLA L. REV. 143, 189 (1997) ("No market power is necessary to the negotiation of any of these provisions . . . [and] the presence of such power is simply coincidental.").

117 *See* George L. Priest, *A Theory of the Consumer Product Warranty*, 90 YALE L. J. 1297, 1313 (1981) (explaining that well-informed consumers will choose warranties that minimize the sum of warranty price and product maintenance costs).

118 *See* Meese, *Don't Abolish Employee Noncompete Agreements*, *supra* note 13, at 690-91. This model of contract formation would also apply, it seems, to NCAs that encourage capital investment, even though the literature describing this benefit does not invoke TCE. *See supra* notes 52-53 and accompanying text.

119 *See* Rubin & Shedd, *supra* note 55, at 95-100; *supra* notes 25-27 and accompanying text (describing NPRM's conclusion that senior executives would receive compensation for entering NCAs).

120 *See* 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).

121 *See e.g.*, Alan J. Meese, Response to Request for Public Comments on Contracts That May Harm Competition, 17-19 (Sept. 30, 2021).

reduce wages, whether premium or non-premium.[122] Thus, employers without power will pay higher non-premium and premium wages, respectively, than those with power. While employers' exercise of power to reduce wages constitutes economic harm, this exercise does not impose beneficial NCAs.

Such voluntary contractual integration can occur without individualized, dual offers. Two scholars have explained how parties would enter beneficial NCAs independent of any bargaining power. If the employer offers only one option—a disclosed employment agreement including the NCA—some individuals will exit from negotiations, reducing the pool of potential employees, forcing employers to increase wages (or abandon NCAs) to induce remaining potential employees to accept such offers. The result would replicate the premium wage of a two-option offer. Indeed, an article the NPRM cited for other propositions describes such a formation process, whereby "sufficiently observable" NCAs create "pressure" for employees to "receive compensation for their post-employment concessions."[123] Employers can respond by including "a compensating [wage] differential," thus "*rendering bargaining unnecessary*."[124]

C. Voluntary Integration and the Coexistence Assumption

TCE predicts that employers will obtain voluntary agreement to beneficial NCAs they disclose in advance, sharing, via higher wages, some of the benefits the employer expects from investments that such agreements facilitate.[125] Ordinarily the fact that a restraint is voluntary does not rebut a prima facie case. Thus, proof that a cartel agreement is voluntary is entirely consistent with a conclusion that the agreement exercises market power, reducing consumer welfare. Moreover, the horizontal merger that motivates the PET model is a voluntary transaction, and this does not refute a prima facie case of harm.

However, the Commission rejected the traditional approach, in favor of its NeoBrandeisian vision. Coercion as

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122 *See* Rubin & Shedd, *supra* note 55, at 100 ("[B]oth parties must prospectively expect to benefit from the agreement, independently of their respective bargaining power"); Meese, *Don't Abolish Employee Noncompete Agreements*, *supra* note 13, at 690.

123 *See* Donna Rothstein & Evan Starr, *Noncompete Agreements, Bargaining, and Wages: Evidence from the National Longitudinal Survey of Youth 1997*, MONTHLY LAB. REV. (June 2022); NPRM, *supra* note 11, at 3485 n.48 (discussing this study).

124 *Id.* (emphasis added).

125 *See supra* notes 119-121 and accompanying text.

such—which entailed a particular process of contract formation—established a prima facie case, independent of economic harm. Moreover, unlike the cartel or merger context, where high transaction costs prevent victims from bargaining to prevent output reduction, the employment relationship is potentially a low transaction cost setting, with employer and employee jointly internalizing NCAs' benefits.[126] Finally, TCE's account of NCAs refutes Price Theory's assumption that firms necessarily employ bargaining power to impose such agreements.

Proof that a fully-disclosed NCA prevents opportunistic exploitation of employer investments in training or information undermines any presumption that the agreement resulted from a coercive process of contract formation.[127] Any assumption that such benefits coexist with procedural coercion is therefore erroneous. Such proof also undermines any assumption that benefits coexist with "substantive coercion," given that procedural coercion is a necessary condition for such coercion. Proof that disclosed NCAs produce the sort of benefits the Commission recognized thus extinguishes any prima facie case of coercion of either variety.

This insight only applies to beneficial NCAs that employers disclose before the employee accepts the offer. If the employer defers such disclosure until *after* acceptance, transaction costs rise, and the resulting NCA is not voluntary. To be sure, the agreement produces the same benefits it would produce if disclosed in advance. Perhaps the employee *would have* accepted the NCA if given the opportunity. However, it is also

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126 *See* Krattenmaker & Salop, *Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power Over Price,* 96 YALE L. J. 209, 268-70 (explaining how transaction costs prevent parties from investing sufficiently in preserving competition).

127 *Id.* at 278. The Final Rule omitted reference to a "high bar" governing assessment of business justifications. *See* Non-Compete Clause Rule, 89 Fed. Reg. 38342, 38372 (May 7, 2024) (to be codified at 16 C.F.R. pts. 910, 912). At the same time, the Commission did not address the possibility that fully disclosed and beneficial NCAs are the result of voluntary integration, regardless of the existence of labor market power and/or whether the employee is a senior executive. The Commission, which bears the burden of proving that nonexecutive NCAs are always coercive, made no effort to identify the proportion of such agreements that are the result of voluntary integration, despite comments that expressly explained that: (1) a majority of NCAs are disclosed in advanced and (2) fully disclosed and beneficial NCAs are presumptively the result of voluntary integration. *See* Alan J. Meese, Comment Letter on Non-Compete Clause Rulemaking, Matter No. P201200, 6-13, 22, & 31 (Apr. 19, 2023). Thus, the Commission's finding that such NCAs sometimes produce benefits would seem to call into question the Final Rule's finding that nonexecutive NCAs are necessarily coercive.

possible that the employee would have rejected the offer or demanded increased wages in return for such agreement.[128] Either way, the NCA cannot be presumed voluntary, as employees bound by the agreement did not consent to the uncompensated restriction on post-employment autonomy.

The Commission's assessment of possible business justifications exaggerated NCAs' harms and was thus badly biased against fully-disclosed NCAs that produce cognizable benefits. For instance, when comparing the harms and benefits of such NCAs, the Commission erroneously included both forms of coercion on the "harm" side of the ledger. Moreover, the Commission expressly invoked these two harms to justify imposing a "high bar" on justifications for nonexecutive NCAs.[129] The resulting comparison of benefits with harms was thus badly distorted and biased in favor of rejecting such justifications.

To be sure, not all NCAs produce such benefits. Some that do might not be disclosed in advance. In both cases, the prima facie case of coercion stands. However, the Commission—which must adduce evidence to support its claim that *all* nonexecutive NCAs are coercive—did not estimate what proportion of NCAs produce benefits.[130] Moreover, as explained below, the Commission misstated the extent of pre-contractual disclosure.[131] Simply put, the Commission did not do the work necessary to determine how many nonexecutive NCAs are entirely voluntary and thus produce no coercive harms. Instead, the Commission implicitly relied upon the "output" of the inapplicable PET model, thereby producing a misleading evaluation of NCAs. An unbiased approach to assessing possible business justifications could have produced a different result.

IV
POTENTIAL COUNTERARGUMENTS

The NPRM's defenders may make two counterarguments.

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128 *See* Evan P. Starr, J.J. Prescott & Norman D. Bishara, *Noncompete Agreements in the US Labor Force*, 64 J.L. & ECON. 53, 69 (2021) (finding that pre-contractual disclosure almost doubles such negotiation); Matt Marx, *The Firm Strikes Back: Non-compete Agreements and the Mobility of Technical Professionals*, 76 AM. SOCIO. REV. 695, 706 (2011) (finding that such disclosure tripled individual negotiation).

129 *See supra* notes 65-67 and accompanying text.

130 *See* 5 U.S.C. § 706(2)(e) (agency action unsupported by substantial evidence is invalid); *see also* Universal Camera Corp. v. Nat'l Lab. Rels. Bd., 340 U.S. 474 (1951) (invalidating the NLRB's order for this reason).

131 *See infra* notes 135-139 and accompanying text.

First, they may characterize this Essay's critique as hypothetical, given the Commission's finding that employees rarely have pre-contractual knowledge of NCAs. Second, defenders may invoke the Commission's finding that NCAs are not narrowly tailored to achieve legitimate objectives, because there are less restrictive means of achieving such benefits. Neither counterargument withstands scrutiny.

A. Supposed Ignorance of NCAs

The Commission's finding that all nonexecutive NCAs are procedurally and substantively coercive depends partly upon its determination that potential employees rarely learn of NCAs before accepting the employment offer.[132] If true, it makes sense, as explained earlier, to treat even beneficial NCAs as coercive, and to assume that benefits coexist with coercive harm.[133]

However, as several public comments explained, the Commission itself could require pre-contractual disclosure of NCAs, thereby increasing the proportion of disclosed NCAs.[134] In any event, the record contradicted the Commission's assumption of pre-contractual ignorance.[135] A 2014 survey asked whether respondents were subject to NCAs and, if so, when they learned of such agreements.[136] 61 percent of respondents subject to NCAs replied that they knew of the agreement before accepting the employment offer.[137] The Commission invoked this survey for other purposes,[138] calling it "likely the most representative coverage of the U.S. labor force."[139]

These results, which the Final Rule also ignored, might *understate* the current proportion of individuals with pre-contractual knowledge of NCAs. The survey predated several state enactments *requiring* such pre-agreement disclosure.[140] Presumably the proportion of pre-contractual

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132 *See supra* note 24 and accompanying text. *See also* NPRM, *supra* note 11, at 3503.

133 *See supra* note 128 and accompanying text.

134 *See* Meese, *Are Employee Noncompete Agreements Coercive, supra* note 13, at 303 n.295 (collecting examples of such comments).

135 *Id.*

136 *See* J.J. Prescott, Norman D. Bishara & Evan Starr, *Understanding Noncompetition Agreements: The 2014 Noncompete Survey Project*, 2016 MICH. ST. L. REV. 369, 397-455 (describing survey methodology).

137 *See* Starr, Prescott & Bishara, *supra* note 128, at 69.

138 NPRM, *supra* note 11, at 3485; *id.* at 3503, n.277.

139 *Id.* at 3485.

140 *See* Meese, *Are Employee Noncompete Agreements Coercive, supra* note 13,

disclosure has risen in such states, increasing the overall national proportion. Second, some attorneys now treat such disclosure as a "best practice," even in states that have not adopted such requirements.[141]

Let us assume that 61 percent of NCAs are disclosed in advance. This data raises the possibility that (1) some NCAs produce cognizable benefits (as the Commission found) and (2) employers disclose a significant majority of such beneficial agreements before employees accept the employment offer. If both such conditions are present, the Commission's finding that all nonexecutive NCAs entail two forms of coercion is erroneous. Unfortunately, the Commission did not estimate what proportion of NCAs produce such benefits. There is thus no basis for assuming that only a small proportion of NCAs are both fully disclosed, beneficial and therefore voluntary. If the Commission wishes to stand upon its contention that beneficial NCAs are always coercive, it must adduce actual evidence to this effect instead of relying upon the PET model's outdated and inapplicable coexistence assumption.

B. The Commission Misapplied the Narrow Tailoring Test

The NPRM rejected business justifications for two reasons. First, there was no showing that benefits of NCAs outweigh harm. Second, regardless of such a showing, there are alternative means of achieving the legitimate objectives of NCAs, with the result that NCAs are not "narrowly tailored" to achieve cognizable benefits. This latter argument seemed to echo the Rule of Reason's less restrictive alternative test, under which courts condemn restraints that produce significant benefits if a plaintiff can establish that defendants could achieve the same benefits by means producing less anticompetitive harm.[142]

As I have explained elsewhere, the less restrictive alternative test assumes that the restraint's benefits coexist

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at 302 nn. 283-84 (collecting such enactments).

141 *See* Fisher Phillips, *Do You Need to Give Notice to Employees About Signing a Non-Compete or Other Restrictive Covenant?* (July 6, 2023), https://www.fisherphillips.com/en/news-insights/do-you-need-to-give-notice-to-employees.html [https://perma.cc/KGB2-58PZ] ("Even if a state's law does not specifically require it, companies would benefit by providing restrictive covenants to employees and potential employees in advance, as it is a good practice that may be viewed favorably by a court considering the restriction.").

142 *See* C. Scott Hemphill, *Less Restrictive Alternatives in Antitrust Law*, 116 COLUM. L. REV. 927, 929 (2016) (noting that courts ask "whether the alternative action is less harmful"); *id.* at 937 ("[C]ourts ask whether an alternative exists that serves the same beneficial goal with less anticompetitive effect.").

with harms presumed from the plaintiff's prima facie case.[143] Otherwise, it makes no sense to ask whether there is a *less* anticompetitive way to achieve such benefits.[144] Moreover, proof that a disclosed NCA produces such benefits rebuts the prima facie case of procedural and substantive coercion, thereby undermining any coexistence assumption *to that extent*.[145]

At the same time, such proof does *not* undermine the Commission's finding that nonexecutive NCAs are "restrictive" and reduce aggregate wages for employees. Hence, benefits of NCAs *would* coexist with this subset of harm recognized by the PET model and the Rule of Reason. As a result, proof that a less restrictive means would produce the same benefits as NCAs would require rejection of any justification under the ordinary Rule of Reason framework.[146]

However, the Commission did not apply the Rule of Reason's less restrictive alternative test. According to a unanimous Supreme Court, plaintiffs who invoke less restrictive alternatives must establish that the proffered alternatives will produce "the same" benefits as the challenged restraint.[147] The leading antitrust scholar, Herbert Hovenkamp, has opined that plaintiffs should prevail if the alternative produces the "same" or perhaps "nearly the same" benefits.[148]

The NPRM did not cite either articulation of the less restrictive alternative standard. Nor did it purport to find that the alternatives it identified produced "the same" or "nearly the same" benefits as NCAs. Instead, the Commission stated that various alternatives were "viable," without addressing record comments explaining why such alternatives were significantly inferior to NCAs.[149] The NPRM did emphasize that California, Oklahoma, and North Dakota had banned such agreements

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143 Meese, *supra* note 41, at 112-13, 169.

144 *See id.*

145 *See supra* note 128 and accompanying text.

146 *See supra* note 142 and accompanying text; NCAA v. Alston, 141 S. Ct. 2141, 2162 (2022).

147 *See Alston*, 142 S. Ct. at 2162 (describing "the key question at the third step [of rule of reason analysis]" as "whether the student-athletes could prove that substantially less restrictive alternative rules existed to achieve the same procompetitive benefits" the defendants had proved).

148 *See* PHILLIP E. AREEDA & HERBERT HOVENKAMP, 7 ANTITRUST LAW, ¶ 1507c (Wolters Kluwer 4th ed. 2017) (articulating the test as whether "the objective can be achieved (nearly?) as well by a significantly less restrictive alternative.").

149 *See, e.g.*, Meese, *Comment Letter on Request for Public Comment Regarding Contract Terms That May Harm Fair Competition,* at 35-37.

but were nonetheless prosperous.[150] However, the Commission did not mention that California has the nation's highest poverty rate or ask whether the Golden State would be *more* prosperous if it enforced reasonable NCAs.[151] Indeed, the NPRM conceded that, compared to alternatives, NCAs would induce "increased training" and "increased capital investments."[152] The Commission also asserted that the alternatives would "*reasonably* accomplish the same purposes" as NCAs, without offering a citation for this standard or explaining how "reasonably" modifies "accomplish."[153]

Instead of applying the less restrictive alternative standard, then, the Commission seems to have engaged in what one leading scholar calls assessment of "balanced alternatives."[154] This approach entails comparing the net competitive effects of the challenged restraint with the net effects of admittedly inferior alternatives.[155] While conceding that NCAs produce more benefits than alternatives, the Commission also contended that NCAs produce more harms as well.[156] The Commission seems to have concluded that the net impact of NCAs was negative compared to the net impact of (less effective) alternatives.[157]

A determination that many nonexecutive NCAs are the result of voluntary integration would undermine this analysis, however. After all, the Commission's estimate of the harm produced by NCAs included the harms of "procedural" and "substantive" coercion that all nonexecutive NCAs supposedly produce.[158] A finding that a sizable proportion of such NCAs instead constitute voluntary integration would to that extent reduce the gross magnitude of harm that NCAs create. Such a sizable reduction could very well result in a conclusion that

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150 NPRM, *supra* note 11, at 3507.

151 *See* Dan Walters, *What Should Be Done to Lower California's Highest-in-Nation Poverty Rate?*, CALMATTERS (Nov. 6, 2023), https://calmatters.org/commentary/2023/11/lower-california-highest-poverty-rate/ [https://perma.cc/V85L-C2PX].

152 NPRM, *supra* note 11, at 3508 (NCAs' harms are not outweighed "because the worker is receiving increased training, or because the firm has increased capital investments."); *id.* at 3505 (conceding that alternatives "may not be as protective as employers would like").

153 *Id.* at 3505.

154 *See* Hemphill, *supra* note 142, at 955-59 (describing such an approach as assessing "balanced alternatives").

155 *See id.* (describing this approach as "[b]alancing within the LRA test" and "a rough cost-benefit analysis between the conduct and the alternative.").

156 *See* NPRM, *supra* note 11, at 3507-08.

157 *Id.*

158 *See supra* notes 20-35, 66-67 and accompanying text.

the benefits of NCAs exceed the harms and that the net impact of such agreements is superior to the net impact of alternatives.[159]

CONCLUSION

The Commission found that NCAs reduce aggregate wages, offending traditional antitrust standards. But the Commission also expanded the definition of harm, to include procedural and substantive coercion. The NPRM finds that nearly all NCAs entail both types of coercion, treating the former as a necessary condition for the latter. At the same time, TCE compels recognition that such agreements can overcome market failures and produce cognizable benefits. This combination of normative and theoretical change requires some methodology for assessing business justifications for agreements that purportedly produce three different harms.

Ambitious normative change does not itself generate the analytical tools necessary to implement new standards. Unfortunately, the Commission ignored TCE's account of contract formation, an account that explains how employers can obtain voluntary agreement to beneficial NCAs. Application of this model undermines any presumption that fully-disclosed NCAs that produce cognizable benefits are the result of procedural coercion and thereby undermines any presumption of substantive coercion as well. Instead, the Commission improperly assumed that the benefits of fully-disclosed NCAs necessarily coexist with both coercive harms, an assumption that echoed Price Theory's PET model. Because the PET model's coexistence assumption is erroneous in this context, the Commission's assessment of possible business justifications for NCAs was unduly biased against such agreements, depending as it did upon an exaggeration of NCAs' harms and a "high bar" resulting from presumed but sometimes illusory coercion.

The Commission's erroneous exaggeration of harms highlights the perils of abrupt and ill-considered normative change. The Commission developed its Section 5 enforcement policy without public input and ignored public comment and academic literature explaining TCE's account of voluntary

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159 The Commission also invoked evidence that wages are lower in states that enforce NCAs more robustly. However, as explained earlier, wages only reflect the benefits produced by NCAs when NCAs are fully disclosed before employees accept such agreements. *See supra* notes 68-72 and accompanying text. However, the Commission made no findings regarding what proportion of beneficial NCAs are disclosed.

contract formation. Instead of adapting its methodology of assessment to a new normative account of Section 5, the Commission implicitly fell back on the PET model—developed to assess entirely different economic phenomena. The Commission should reconsider its new normative account of antitrust harm or revise its methodology of assessing business justifications to reflect the best economic account of the formation of NCAs.