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March 22, 2023

Via Web Submission

Federal Trade Commission (the "***Commission***")
Office of the Secretary
600 Pennsylvania Avenue NW, Suite CC-5610 (Annex C)
Washington, DC 20580

Re: Non-Compete Clause Rulemaking, Matter No. P201200

Dear Commission and Commission Staff:

We applaud the Commission's attention to the role and use of non-compete clauses and the consideration of their effects on labor markets, as well as on product and service markets. As the Commission's January 2023 Notice of Proposed Rulemaking ("***NPRM***")[1] notes, non-compete clauses affect an estimated tens of millions of workers and companies in the aggregate in the United States.[2] We agree with the Commission that assessing the market impact of non-compete clauses is difficult, given the private nature of most such arrangements, but we appreciate the Commission's thorough review of literature on the subject and its engagement with market participants and their advisors about this important topic.

About Us

Before offering our comments and recommendations, we would like to provide the Commission with background about Moulton | Moore | Stella LLP (our "***Firm***"). We are an executive compensation and corporate boutique law firm headquartered in Santa Monica, California, with attorneys located in the following metropolitan areas: Los Angeles, California; Denver, Colorado; Washington, D.C.; Austin, Texas; and Boston, Massachusetts. Prior to joining our Firm, each of our attorneys worked at large, sophisticated law firms servicing primarily large companies and their investors. A significant part of our Firm's practice involves representing founders, co-founders, chief executive officers ("***CEOs***"), senior executives and management teams in connection with mergers and acquisitions ("***M&A transactions***"), initial public offerings and similar public-market transactions like direct listings and "de-SPAC" mergers (collectively, "***IPOs***"), capital-raise transactions, hirings, separations, promotions, incentive compensation package

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[1] Found at https://www.ftc.gov/system/files/ftc_gov/pdf/p201000noncompetenprm.pdf (last visited March 21, 2023).

[2] *See* NPRM at 15.

negotiations and other similar events, including with employers of all types and sizes — from public companies, to private-equity-backed portfolio companies, to Silicon Valley "unicorns," to pre-IPO emerging growth companies, to start-up entities of all types and to corporations, limited liability companies and partnerships across numerous industries, business verticals and contexts. We also regularly represent companies, in addition to executives, which gives us a balanced perspective on these matters. We frequently see how non-compete clauses affect these parties both at the time of negotiation and execution of the agreement containing a non-compete clause and at the time of a down-stream separation from service or transactional event (*e.g.*, an M&A transaction or equity-repurchase transaction) in connection with which such non-compete clauses become operative under their terms.[3] Our comments and recommendations as to the Commission's final non-compete clause rule (the "***Final Non-Compete Clause Rule***") are offered based on our experience representing "workers" (as defined in the NPRM)[4], employers and investors in the above contexts.

Our commentary focuses on certain background dynamics relating to the Commission's reasoning for the Final Non-Compete Clause Rule and we provide certain recommendations regarding the Final Non-Compete Clause Rule that, if implemented by the Commission, would, in our view, increase the effectiveness of the Final Non-Compete Clause Rule in advancing competition in the marketplace while also protecting the interests of employers attempting to impose, and certain classes of workers (described herein) willing to agree to, non-compete clauses under appropriate, pro-market circumstances.

Executive Summary

For the reasons discussed in detail in the following sections of this comment letter, our recommendations regarding the Final Non-Compete Clause Rule are as summarized below. Further details with respect to each recommendation are offered in the applicable section of this comment letter. We recommend the Final Non-Compete Clause Rule:

1. Definition of Non-Compete Clause. Clarify that a "non-compete clause" additionally includes (i) a non-compete clause based on a worker's direct or indirect equity or other interest in the employer, rather than based solely on the service relationship as such; and (ii) any clause that prohibits a worker holding a direct or indirect equity or other interest in a business (*e.g.*, a subsequent employer).[5]

2. Definition of Employer. Clarify that an "employer" includes parent, subsidiary and affiliate entities in addition to a worker's common law employer.[6]

3. Definition of Worker. Clarify that a "worker" additionally includes (i) an owner who provides services to or for the benefit of a business; and (ii) a person who provides services through

[3] When representing individuals, our Firm generally represents only key personnel (*see infra* "**How Employment Non-Compete Clauses Affect Key Personnel**"). However, we also have an informed view as to how non-compete clauses are applied to other workers as well, as those issues are often collateral to, or piggyback on, non-compete clause usage affecting key personnel.

[4] NPRM at 212.

[5] *See infra* "**How Non-Compete Clauses Are Used Generally**."

[6] *See id.*

an indirect contract relationship such as a professional employer organization or loan-out arrangement.[7]

4. Examples of *De Facto* Non-Compete Clauses. Include additional examples of contractual terms that may be *de facto* non-compete clauses, such as (i) certain types of non-solicitation provisions; (ii) forfeiture, disgorgement or "penalty price" repurchase provisions; and (iii) fee-shifting provisions.[8]

5. No Separate Standard for Key Personnel. Prohibit employment non-compete clauses (as defined further below in this comment letter) for "senior executives" and other key personnel on the same basis as other workers, as provided in the NPRM.[9]

6. No Agreements to Enter into Non-Compete Clauses in the Future. Prohibit contract terms that require a worker to enter into a non-compete clause following the date of the initial contract.[10]

7. Definition of Substantial Owner, Substantial Member and Substantial Partner. Define a "substantial owner," "substantial member" or "substantial partner" as a person holding direct or indirect beneficial ownership having an aggregate value of at least five percent (5%) of the total value of the equity of the target company at the time of the applicable transaction.[11]

8. Deemed Substantial Ownership. Provide that a worker, nevertheless, may be deemed to be a "substantial owner," "substantial member" or "substantial partner" in connection with an M&A transaction, for purposes of the exception permitting certain deal-related non-compete clauses (as defined further below in this comment letter), if the worker (i) is a founder, co-founder or executive officer of the employer; (ii) receives reasonably detailed advance written disclosure regarding the non-compete clause; and (iii) receives non-repayable, liquid consideration for the non-compete clause at a rate equal to at least one twelfth (1/12) the worker's target annual cash compensation for each month in which the non-compete clause is in effect.[12]

9. Manner of Rescission Notice to Workers. Require employers to provide written notice regarding the Final Non-Compete Clause Rule to current and former workers by way of both (i) individualized communication to workers; and (ii) posting notice to a physical or virtual space to which current workers have access and where workers would expect to find employment-related information. If the employer provides individualized notice by text message, the text message should instruct the worker to reference another, primary form of written notice (*e.g.*, email).[13]

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[7] *See id.*

[8] *See infra* "**Provisions Closely Related to Non-Compete Clauses**."

[9] *See infra* "**How Non-Compete Clauses Affect Key Personnel**." *See also* Recommendation #11, *infra*.

[10] *See infra* "**Deal-Related Non-Compete Clauses**."

[11] *See id.*

[12] *See id.*

[13] *See infra* "**Rescission of Existing Non-Compete Clauses**."

10. Translation of Rescission Notice. Require certain larger employers to provide the Rescission Notice (as defined further below in this comment letter) in another language, in addition to English, if such other language is the primary language of at least ten percent (10%) of the employer's workforce.[14]

11. Alternative Proposal for Commission's Consideration. Only in the event the Commission determines to provide a separate standard for certain key personnel as compared to other workers with respect to employment non-compete clauses: (i) apply the separate standard only to founders, co-founders and executive officers; (ii) require the employer to provide reasonably detailed advance written disclosure regarding the non-compete clause; and (iii) require the worker to receive non-repayable, liquid consideration for the non-compete clause at a rate equal to at least one twelfth (1/12) the worker's target annual cash compensation for each month in which the non-compete clause is in effect.[15]

How Non-Compete Clauses Are Used Generally

Non-compete clauses between an employer and a worker typically arise in any of three contexts:

- Non-compete clauses based on the service relationship (including termination of the service relationship), often extending for the term of the service relationship and for a certain period of time thereafter ("***service-based non-compete clauses***");

- Non-compete clauses based on equity ownership, which apply in connection with the grant of incentive equity awards or a worker's purchase of employer equity, and can extend for the duration of the period in which the worker holds the equity interest ("***ownership-based non-compete clauses***" and, together with service-based non-compete clauses, "***employment non-compete clauses***");[16] and

- Non-compete clauses based on a sale of all or a part of the employer's equity or assets (including to a new investor in an M&A transaction or a sale of the employer's equity back to the employer or to existing equity holders of the employer as part of a buyout transaction), which extend for a certain period of time following the closing of the transaction ("***deal-related non-compete clauses***").

As the Commission has observed, deal-related non-compete clauses raise unique considerations as they are often negotiated by the purchaser in a transaction as a means of protecting the value or goodwill of the acquired business (and thereby supporting the purchase

[14] *See id.*

[15] *See infra* "**Alternative Proposals**."

[16] Alternatively, the restriction under an ownership-based non-compete clause sometimes falls away at a defined point in time following termination of the worker's service relationship with the employer, regardless of whether the worker continues to hold the equity interest. In our experience, while the duration of an ownership-based non-compete clause often is not linked directly to the service relationship, ownership-based non-compete clauses typically are applied only to workers, as a separate tack for applying an additional employment non-compete clause, and not applied to outside investors. Consequently, we discuss ownership-based non-compete clauses in this comment letter as a type of employment non-compete clause generally.

price paid in the transaction).[17] These considerations, and the Commission's proposed exception to the prohibition on non-compete clauses generally in the Final Non-Compete Clause Rule, are discussed in detail under "**Deal-Related Non-Compete Clauses**" below.

With respect to employment non-compete clauses, the operative provisions of the non-compete clause (and important provisions relating to the application or effect of the non-compete clause) may be "housed" in any, or more than one, of the following contracts or arrangements that may apply to a worker:

- Offer letter or employment agreement;
- Standalone restrictive covenant agreement, which might be titled, for example, a "proprietary information and inventions assignment agreement," a "confidential information and inventions assignment agreement," an "employee confidentiality and inventions agreement," an "employee non-disclosure agreement," a "restrictive covenant agreement" or some variation or combination of these terms;
- Incentive compensation arrangements, such as a management incentive plan, long-term incentive plan, equity incentive plan, stock option plan, bonus plan or an individual grant notice, award letter or award agreement relating to an incentive equity or other compensation arrangement;
- Separation arrangements, including under a severance policy applicable to all or a subset of the employer's workers or under an individual separation agreement, change of control agreement, severance agreement or release of claims agreement;
- Equity holder agreements, such as a shareholders' agreement, limited liability company operating agreement or partnership agreement; and/or
- Other agreements, arrangements or policies setting out conditions of the worker's employment, compensation or equity interests, such as an employee handbook or employee manual, or standalone policy documents issued by the employer from time to time.

Because businesses frequently operate through one or more affiliated legal entities, with the legal structure and relationship of the various entities being driven by various tax, regulatory and other corporate and legal considerations, these contracts may be with the worker's common law employer or with one or more affiliated entities.[18] Relevant terms, set forth in one or more (or a combination) of the foregoing, may provide that an employment non-compete clause applies during a specified period of time, with respect to a specified business (or an entire industry or profession) and/or within a specified geographic region. They may also, and frequently do, provide more broadly that the non-compete clause applies with respect to any business the employer may conduct or plan to conduct from time to time, in any geographic area (*e.g.*, a whole

[17] NPRM at 129.

[18] In certain cases, workers also may be employed indirectly, by way of a contract relationship with a "professional employer organization" (or "PEO," an independent business that provides payroll management, employee benefits, human resources services and similar offerings, generally targeted at small to mid-size companies) or under a "loan-out" arrangement (in which the employer contracts for a worker's service through a legal entity wholly owned or otherwise controlled by the worker and of which the worker is the sole or principal employee or service provider).

country or certain sub-regions thereof, such as the entire U.S. or certain U.S. states, metropolitan areas or anywhere within a certain radius of a specific location) in which the employer and its affiliates do business or plan to do business, and that the time period during which the restriction applies may be further extended in the event of a breach (or dispute regarding an alleged breach). The terms might also provide that a worker will be required to agree to a non-compete clause, on unspecified terms, that may be provided in the future (*e.g.*, as a condition of severance arrangements entered into upon termination of employment, or in connection with a sale of the employer's equity or assets).[19] Further, the applicable contracts and arrangements might provide, including in a section separate from the non-compete clause itself or in an entirely separate document, for the application of certain economic penalties upon the worker's breach (or alleged breach) of the terms of the non-compete clause or any other applicable restrictive covenant. In our experience, taken together, these practices can, and often do, result in a worker not knowing that a non-compete clause applies or, even if the worker does know that a non-compete clause applies, not understanding the full extent or effect of the restriction.

The scope of the most typical form of employment non-compete clause, in our experience, is substantially broader than suggested by the Commission's description in the NPRM.[20] In the NPRM, the Commission generally focuses on employment non-compete clauses that prohibit a worker from *being employed by* or *operating* a competitor. However, in our experience, an employment non-compete clause often limits the worker more broadly, including by prohibiting working for, consulting for, advising or otherwise assisting, in any capacity (and in each case, whether on a paid or unpaid basis), a competing business, starting a competing business or otherwise holding any direct or indirect equity or other interest in a competing business, in each case, anywhere within a broadly defined restricted geographic area. The restricted business is frequently defined to include any type of business in which the employer (or any of its affiliates) engages or plans to engage from time to time, or even any business within an entire industry or segment, and the restricted geographic area is frequently defined to include any country in which the employer (or any of its affiliates) engages or plans to engage in any business from time to time. In short, the restriction is often made as broad as possible, intending to cover any and all possible relationships (whether as a worker, as an owner or otherwise) with any and all possible competitors. Sometimes a contract may provide certain narrow exceptions, such as permitting a worker to hold a small minority stake in a publicly traded company whether or not that company is a competitor (*e.g.*, up to one percent (1%) of the publicly traded company's equity), insofar as the worker is not actively involved in the governance or operations of the company. Most typically, however, an employment non-compete clause is scaled back from this broad-as-possible starting position only where the law of the applicable state or states where the workers are located sets out specific limits that must apply for a non-compete clause to be enforceable.

Notably, although the NPRM proposes to define "non-compete clause" only as a clause that prevents seeking or accepting employment or operating a business, as such, this definition would not cover a critical element of most non-compete clauses used in the market, by omitting to mention clauses that prohibit holding an interest in a business (as described in the immediately preceding paragraph). Because equity and equity-based compensation often is the most valuable part of an employment package for executives and other key personnel — or in certain contexts, such as startups, for all or substantially all workers — a clause prohibiting holding an interest in a

[19] A provision in a current contract requiring the worker to enter into a non-compete clause, on unspecified terms, in the future is most common in connection with "drag-along" provisions in an employer's equity holder agreements (*see infra* note 61).

[20] *See* NPRM at 6–7.

business would almost certainly operate as a *de facto* non-compete clause, even if employment with or operation of a business, as such, is otherwise permitted. This is an important nuance to address in the Final Non-Compete Clause Rule to fully cover key elements of existing market practice with respect to non-compete clauses. Rather than relying on a less clear, fact-based functional test for whether such a provision constitutes a *de facto* non-compete clause, which inevitably would generate wasteful costs related to interpretation, negotiation and litigation, the Commission should clarify in the Final Non-Compete Clause Rule that a prohibition on direct or indirect ownership also constitutes a prohibited non-compete clause.

As the Commission has observed, employment non-compete clauses are typically presented to workers as "take it or leave it" propositions as part of "standard form" or "program" contracts or "boilerplate provisions" that all workers must sign.[21] The same holds true for key personnel, in addition to other workers. Moreover, as noted above, employers typically do not tailor their broadly stated non-compete clauses other than (sometimes) to meet minimum requirements of applicable state law, as described above.[22] Although an employer may have materially different interests with respect to differently situated workers (*e.g.*, competition by one worker may imply a greater risk to the employer's trade secrets than competition by another worker) and a non-compete clause may be materially more restrictive with respect to one worker compared to another (*e.g.*, a worker with a technical or industry-specialized role may be meaningfully less able to secure reasonably suitable future employment, under a non-compete clause, than a worker with more generic or more easily translatable skills), these differing interests are, in our experience, rarely fully (if at all) taken into account or compensated for by employers. As noted by the Commission, workers' earnings are generally lower, not higher, in geographic areas where non-compete clauses are more readily enforceable.[23] And in our specific experience, we generally do not see employers specifically compensating for the non-compete clauses they require from their workers. Rather, employers establish workers' compensation based on role, experience, perceived contribution or potential contribution to the business and other more general factors — and if the worker happens to live in a state where employment non-compete clauses generally are enforceable, they will be required to agree to such a non-compete clause (stated as broadly as possible), while their colleagues who happen to live in a state where employment non-compete clauses generally are not enforceable (or generally are less enforceable) will not face the same restrictions. But the workers who are required to agree to an employment non-compete clause do not, solely by reason of agreeing to the non-compete clause, receive any greater compensation, and the workers who are not required to agree to an employment non-compete clause do not receive any less.[24] Overall, the typical approach of employers to employment non-compete clauses is to default to the most employer-favorable position possible, as a matter of policy, often believing that they will receive little or no meaningful pushback due to the lesser sophistication and leverage of workers compared to the employer.[25]

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[21] *See* NPRM at 85.

[22] There are, of course, often good practical reasons (*e.g.*, time, cost and administrative ease) for employers to strive for maximal uniformity of arrangements across their workforce.

[23] *See* NPRM at 104.

[24] The lack of specific compensation for employment non-compete clauses is discussed further under "**Employment Non-Compete Clause Practice in California**" below.

[25] To some extent, there is a collective action problem informing this approach, as employers believe they would be disadvantaged, in the market for talent, by eliminating or scaling back employment non-compete clauses if their competitors do not do the same.

Because we generally do not see employers assign specific value to, or otherwise adjust or compensate for, employment non-compete clauses, among other reasons, we do not believe that the Final Non-Compete Clause Rule will, in any material respect, reduce the investments employers make in workers, whether by way of training or otherwise, despite the works cited by the Commission that suggest a theoretical effect based on differences in local rules.[26] While there may be limited exceptions, it certainly does not seem to be the case, for example, that employers in California, as a whole, invest less in their workers than employers in Nevada or Arizona.

Recommendations. Based on the foregoing, and additional factors discussed further below in this comment letter, we offer the following recommendations:

1. Definition of Non-Compete Clause. The definition of "non-compete clause" in the Final Non-Compete Clause Rule should clarify that both ownership-based non-compete clauses, as well as any clause that prohibits holding a direct or indirect equity or other interest in a business, are prohibited, to more fully address the way non-compete clauses typically are used in the market today. We recommend the following definition:

   "***Non-compete clause*** means a contractual term between an employer and a worker that prevents or otherwise materially limits the worker from (i) (A) seeking, accepting or performing the duties of employment or other service with any business, (B) operating a business or (C) holding any direct or indirect equity or other interest in a business, (ii) in each case, after the conclusion of the worker's employment or other service with the employer and (iii) whether as a result of (A) the conclusion of the worker's employment or other service with the employer, (B) the worker holding or having previously held any direct or indirect equity or other interest in the employer or (C) any other reason."

2. Definition of Employer. The definition of "employer" in the Final Non-Compete Clause Rule should clarify that affiliated entities are considered employers for purposes of the Final Non-Compete Clause Rule, as businesses often are structured with multiple affiliated legal entities. We recommend the following definition:

   "***Employer*** means a person, as defined in 15 U.S.C. 57b-1(a)(6), that, directly or indirectly, hires or contracts with a worker to work for such person. The term employer also means any parent, subsidiary or affiliate of such person."

3. Definition of Worker. The definition of "worker" in the Final Non-Compete Clause Rule should clarify that the term also applies to an owner who provides services to or for the benefit of the business (to avoid any ambiguity that otherwise might arise as a result of incentive equity, partnership or similar arrangements) and to a person who provides services under an indirect contract relationship (to capture certain contract-based arrangements between employers and workers seen in the market). We recommend the following definition:

   "***Worker*** means a natural person who works, directly or indirectly, whether paid or unpaid, for an employer. The term includes, without limitation, an employee, individual classified as an independent contractor, extern, intern, volunteer, apprentice or sole proprietor who provides a service to a client or customer; a person who holds a direct or indirect equity

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[26] *See* NPRM at 45.

or other interest in the employer and who provides services to or for the benefit of the employer; and a person who works for the employer under an arrangement with a professional employer organization, statutory employer, wholly owned entity of which the person is the sole or principal employee or service provider, loan-out arrangement or similar arrangement. The term worker does not include a franchisee in the context of a franchisee–franchisor relationship; however, the term worker includes a natural person who works for the franchisee or franchisor. Non-compete clauses between franchisors and franchisees would remain subject to Federal antitrust law as well as all other applicable law."

Provisions Closely Related to Non-Compete Clauses

Of course, as the Commission has recognized, employers use a variety of means to protect their trade secrets and other business interests other than, or in addition to, non-compete clauses.[27] Common contract provisions that can overlap, to a lesser or greater extent, with a non-compete clause include, without limitation, provisions relating to:

- Non-disclosure and non-use of confidential information;
- Non-recruitment and/or no-hire of current and/or former employees and other service providers ("***non-recruitment clauses***");[28]
- Non-solicitation of current, former and/or prospective clients or customers ("***client non-solicitation clauses***");
- Non-solicitation of current, former and/or prospective vendors, suppliers, distributors and similar business partners ("***business partner non-solicitation clauses***" and together with client non-solicitation clauses, "***non-solicitation clauses***"); and
- Non-disparagement of the employer and its business, owners, employees, affiliates and other related parties.

We expect that, when and if the Final Non-Compete Clause Rule becomes effective, employers will increasingly focus on the use and enforcement of these and similar provisions. Because these provisions are closely related to direct non-compete clauses, it is worth reviewing more closely some common circumstances in which one of these alternative restrictive covenants, or other related contract provisions, may rise to the level of a *de facto* non-compete clause, as

[27] *See* NPRM at 10–11 (providing a similar list); NPRM at 93–101 (discussing the use of trade secret law, non-disclosure agreements, the use of fixed-term employment contracts and "clawback"-style penalties); and NPRM at 108–111 (discussing non-disclosure provisions, non-solicitation agreements and other potential *de facto* non-compete clauses).

[28] Contracts in the market often use "non-solicitation" terminology in connection with non-recruitment clauses. In this comment letter, however, we distinguish for clarity between non-solicitation provisions relating to employees and service providers (which we refer to as non-recruitment clauses) and non-solicitation provisions relating to clients, customers, vendors, suppliers, distributors and other business partners (which we refer to as non-solicitation clauses).

described in the NPRM,[29] including in cases where an express non-compete clause does not apply.

The alternative restrictive covenant most closely related to an express non-compete clause is a non-solicitation clause.[30] The Commission suggests in the NPRM that a client non-solicitation clause generally does not prevent a worker from competing with a former employer, but only affects the manner in which the worker may compete.[31] A different view, however, is that a client non-solicitation clause is, precisely, a non-compete clause — after all, a client non-solicitation clause is nothing more than a bar on competition, only differing from an express non-compete clause in that it operates on the basis of a set of specific clients or customers, rather than on the basis of a line or type of business. For example, California generally prohibits client non-solicitation clauses as well as express non-compete clauses, both as forms of unlawful restraint on trade.[32] Any distinction between an express non-compete clause and a client non-solicitation clause can become even less clear in certain cases, such as personal services contexts; where the clause in question bars solicitation not only of the employer's actual clients, but even of its former or prospective clients (particularly if there is a low barrier to soliciting prospects in context of the business, or if the contract defines prospective clients, for purposes of the non-solicitation clause, broadly); in contexts involving the solicitation by investment professionals of large institutional investors (in which case a relatively small number of clients represent a relatively outsized portion of the market, and the investors have an independent interest in maintaining a complex and diversified portfolio); or in contexts such as end-point industries where a business's customers or clients are relatively concentrated or a monopsony or pseudo-monopsony exists (*e.g.*, businesses that offer goods or services to U.S. automotive manufacturers, U.S. telecommunications conglomerates or U.S. media and entertainment studios). Similar dynamics can apply, as well, with respect to business partner non-solicitation clauses (*e.g.*, where product makers use common retail distribution channels, or a limited number of specialized, outsourced manufacturers or vendors provide the bulk of certain goods or services within an industry or segment). For these reasons and in connection with the other points discussed below, we have suggested that the Final Non-Compete Clause Rule define "non-compete clause" to include provisions that *materially limit* a worker from seeking, accepting or performing the duties of employment or other service with any business, or operating any business, in addition to provisions that expressly prohibit the same.[33]

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[29] NPRM at 11.

[30] *See supra* note 28 (distinguishing non-recruitment clauses and non-solicitation clauses).

[31] NPRM at 108. The NPRM does not discuss business partner non-solicitation clauses, which are common in the market and which raise many of the same considerations that apply with respect to client non-solicitation clauses.

[32] *See* Cal. Bus. & Prof. Code, § 16600 ("Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void."). *See also Edwards v. Arthur Andersen LLP*, 44 Cal. 4th 937, 948, 189 P.3d 285, 290 (2008) ("We conclude that Andersen's noncompetition agreement was invalid. As the Court of Appeal observed, 'The first challenged clause prohibited Edwards, for an 18-month period, form performing professional services of the type he had provided while at Andersen, for any client on whose account he had worked during 18 months prior to his termination. The second challenged clause prohibited Edwards, for a year after termination, from "soliciting," defined by the agreement as providing professional services to any client of Andersen's Los Angeles office.' The agreement restricted Edwards from performing work for Andersen's Los Angeles clients and therefore restricted his ability to practice his accounting profession.")

[33] *See supra* "**How Non-Compete Clauses Are Used Generally**."

In addition to "non-compete-like" provisions, a number of other common contract provisions are important in the application or enforcement of non-compete clauses and other restrictive covenants. In addition to the training repayment agreements specifically described in the NPRM, these can include, without limitation, contract terms providing for:

- Forfeiture, disgorgement or other economic penalties applied with respect to cash bonus or equity or equity-based incentive compensation arrangements, which may include, for example, a requirement that a worker repay compensation previously earned by the worker or proceeds from distributions made to the worker as an equity holder, forced forfeiture of previously vested incentive equity or a forced repurchase by the employer of a worker's rollover or purchased equity at a penalty price less than then-current fair market value;[34]

- Forced sale by the worker to the employer (or other designated parties) of the worker's vested incentive, rollover or purchased equity at a price equal to then-current fair market value;

- One-way fee shifting provisions requiring the worker to pay the employer's attorneys' fees and other costs in connection with any enforcement or attempted enforcement of a non-compete clause or other restrictive covenant provision (but, on the other hand, *not* requiring the employer to reimburse the worker's costs if a court or arbitrator decides in favor of the worker);[35] or

- Notice to the employer of the worker's subsequent employment or other business activities, and/or notice to a subsequent employer or business partner of the non-compete clause or other restrictive covenant provisions applicable to the worker.

Although some of these provisions are more benign than others (*e.g.*, a notice provision, or a requirement that the worker sell back to the employer the worker's equity interests in the employer at then-current fair market value, so long as fair market value is reasonably determined), altogether, these and similar contract provisions generally operate in concert to create an environment in which the worker faces the possibility of severe, direct (and even, in some cases, ruinous) economic penalties if the worker engages in any level of actual or perceived competition with the employer during the term of a non-compete clause or other restrictive covenant provision. For workers seeking new employment under the shadow of these contract terms, even in circumstances where a potential position may be competitive only in a remote sense or where the applicable non-compete clause or other restrictive covenant provision is not clearly enforceable (or even if it is clearly *unenforceable*), in our experience, in many cases the worker decides that taking a potentially competitive position is simply not worth the risk (whether that is the risk of the penalty itself, or even solely the risk of the potential costs involved in disputing application of the penalty). Workers often are, quite rationally, sensitive to an employer's "power of the purse," and are reluctant to engage in conduct that could risk the employer wiping out vested incentive compensation the worker has earned over years of service (forcing the worker to sue the employer to honor or recover the vested amounts, if the worker disagrees with the employer's determination of whether a breach has occurred, potentially paying substantial costs for an uncertain return), suing the worker for repayment of substantial portions of the worker's prior earnings or otherwise sticking the worker with the bill for the employer's attorneys in connection with attempted

[34] *See infra* "**Employment Non-Compete Clause Practice in California**."

[35] *See infra* "**How Employment Non-Compete Clauses Affect Key Personnel**."

enforcement of the contract term. Employers can leverage this dynamic, on the one hand, using their generally greater legal sophistication and economic position to impose one-sided contract terms on workers, and on the other hand, expecting that if the workers make a relatively rational analysis of risk and reward then even the most onerous non-compete clause or other restrictive covenant provision is unlikely, in practice, to face serious challenge.

The Commission states in the NPRM that liquidated damages provisions, requiring a worker to pay damages to an employer if the worker competes with the employer, would be considered non-compete clauses because the penalty would have the effect of prohibiting the worker from seeking or accepting new employment.[36] For clarity and to better facilitate compliance, we recommend providing in the Final Non-Compete Clause Rule additional, specific examples of provisions that could constitute a *de facto* non-compete clause.

Recommendation. Based on the foregoing, and additional factors discussed further above in this comment letter, we offer the following recommendation:

4. Examples of *De Facto* Non-Compete Clauses. Section 910.1(b)(2) of the Final Non-Compete Clause Rule should include the following additional examples of types of contractual terms that may be *de facto* non-compete clauses:

    (i) A contractual term between an employer and a worker that prevents the worker from directly or indirectly soliciting the business of, or engaging in business with, current, former or prospective clients or customers of the employer without the use of the employer's trade secrets or other confidential information.

    (ii) A contractual term between an employer and a worker that prevents the worker from directly or indirectly soliciting the business of, or engaging in business with, current, former or prospective vendors, suppliers, distributors or other business partners of the employer without the use of the employer's trade secrets or other confidential information.

    (iii) A contractual term between an employer and a worker that provides for the forfeiture or disgorgement of cash, equity or equity-based compensation, or the forced sale by the worker of any equity or equity-based interests at a price less than then-current, reasonably determined fair market value, in each case, as a result of the worker's employment or other business activity after the conclusion of the worker's employment with the employer without the use of the employer's trade secrets or other confidential information.

    (iv) A contractual term between an employer and a worker that requires the worker to pay or reimburse the costs and expenses (including, without limitation, attorneys' fees) of the employer in connection with the employer's enforcement of any contract term between the employer and the worker, other than payment or reimbursement of the employer's reasonable, documented costs and expenses pertaining to a dispute in which the employer prevails, in the final and non-appealable judgment, in enforcing the applicable contract term.

[36] NPRM at 107.

How Employment Non-Compete Clauses Affect Key Personnel

Compared with deal-related non-compete clauses, employment non-compete clauses can, and often do, more readily present opportunities for employers to "exploit" and "coerce" workers at the expense of market competition and commerce generally.[37] We agree with the Commission's scrutiny of employment non-compete clauses: Such clauses are an unfair method of competition and are exploitative and coercive both at the time of contracting and at the time of a worker's potential departure from the employer, in each case, while burdening a significant volume of commerce. Although the Commission posits in the NPRM that "exploitation" and "coercion" at the time of contracting and at the time of a worker's potential departure from an employer do *not* apply to "senior executives," in our experience, negotiating and contracting inequities can, and often do, apply in these circumstances (as described further below in this section).[38]

Before sharing our experience regarding whether "senior executives" may be susceptible to negotiating and contracting inequities as related to employment non-compete clauses, we first address the Commission's request to comment on whether, and how, to define "senior executives." Although the Commission characterizes "executives" as a single occupation, it is important to recognize that "executives" as a group are not a monolith.[39] In this comment letter, we use and refer to the terms "***key personnel***" and "***key person***" in lieu of "senior executives." The group of individuals who may be key personnel varies from company to company. Examples may include founder- and co-founder-employees, CEOs, "C-suite" executives more broadly, key technical talent, key revenue-driving personnel (*e.g.*, high impact individual contributors in a service business, such as media personalities, money managers or talent agents) and other "high performing" employees or service providers who are deemed to be able to provide relatively significant contributions to a company's success.

While individual circumstances vary, there are certain distinctions between key personnel we commonly find in our practice. For instance, key personnel, for purposes of assessing non-compete clauses, often can be divided into two groups: (i) individuals who, notwithstanding the existence of a non-compete clause, likely would be able to secure gainful, reasonably suitable employment following the termination of their current employment; and (ii) individuals who, as a result of the existence of a non-compete clause, would be at serious risk of not being able to secure gainful, reasonably suitable employment following the termination of their current employment. The first group encompasses key personnel whose talents and expertise are not

[37] Deal-related non-compete clauses, with which a buyer in an M&A transaction or the employer in an equity buyout transaction of a significant equity holder seeks legal protection from a seller and, frequently, its key personnel (as applicable) to preserve the value of the business or equity purchased in the transaction, are discussed in detail under "**Deal-Related Non-Compete Clauses**" below.

[38] In the NPRM, the Commission uses the words "exploitative" and "coercive" (NPRM at 71–72, 81, 86, 137) and has invited comment on whether employment non-compete clauses are susceptible of exploitation and coercion as related to "senior executives" (NPRM at 72). In this comment letter, we address this aspect of the NPRM and respond directly to the Commission's request for comment. However, we appreciate — and agree — that "senior executives" (or "key personnel," as we define the applicable group for purposes of this comment letter), compared to other classes of workers, are not as susceptible to exploitation or coercion because of generally greater access to resources and advisory services.

[39] *See* NPRM at 17.

limited to a single industry or type of business (*e.g.*, individuals in finance, legal and human resources functions, such as a chief financial officer, general counsel or chief human resources officer). The second group encompasses individuals whose entire training and expertise are limited to a specific industry or type of business (*e.g.*, certain CEOs, chief product officers, chief operating officers, chief business officers, certain sales positions or technical experts).

Further, there are important differences in how employment non-compete clauses affect key personnel at different stages in their careers. Although it is true that certain key personnel have a significant amount of leverage when negotiating their employment non-compete clauses (such leverage is typically a function of context), many key persons do not (at least relative to their employers). Of course, most key personnel are not senior, "C-suite" executives at Fortune 500 companies, who are more likely to have more personal resources and more coveted business experience. Many startups and emerging companies (in a variety of sectors, but particularly in technology) are led by founder-executives or other key personnel in the relatively early stages of their careers; indeed, many of them take outsized career risks (relative to other tracks available to them) to pursue those opportunities. While those individuals may occupy key roles, they often are not similarly situated to more-established executives described above. Consequently, in these and similar cases, title or position notwithstanding, an employment non-compete clause may be relatively market-damaging and a key person bound by an employment non-compete clause may be compelled to transition into adjacent positions that do not always maximize their particular skills, knowledge and experience (which can be damaging to the labor market as well as the applicable product and/or service markets).

In our experience:

- Key Personnel Are Susceptible to Negotiating & Contracting Inequities. While key personnel are relatively more sophisticated than other workers in their respective lines of businesses, and many key personnel have at least some experience navigating legal issues in career milestone events and prior transactional contexts (*e.g.*, hirings, separations and promotions), key personnel nevertheless frequently, if not more often than not, are at a significant disadvantage compared to employers in negotiating employment non-compete clauses, and are susceptible to negotiating and contracting inequities at the time of contracting or at the time of potential departure from an employer. As described above in this comment letter, employment non-compete clauses often are interlaced in a packaged suite of documents prepared by an employer that are part of a program offered to workers — expressly or implicitly — on a "take it or leave it" basis (*e.g.*, as "standard forms" and "part of the program").[40] Frequently, an employment non-compete clause is not brought "front and center" to a worker's attention, whether the worker is a key person or otherwise. Rather, employment non-compete clauses, depending on the context, frequently are housed in what is presented as the "boilerplate" of an employment agreement, offer letter, incentive plan document or incentive grant agreement, or in a hard-to-find, back-paged section of a long and complex shareholders', partnership or operating agreement (most of which is unrelated to employment matters). For these reasons and others discussed in more detail above in this comment letter, key personnel, like non-key personnel, often are not even aware that an employment non-compete clause is part of "the program" or, even if they are aware of the employment non-compete clause, they do not understand its full extent or effect.

[40] *See supra* "**How Non-Compete Clauses Are Used Generally**."

Furthermore, as the Commission notes in the NPRM, workers often are reluctant to file lawsuits against employers to challenge the application or enforcement of employment non-compete clauses, even in cases where there could be a high probability of success.[41] In our experience, this is true of key personnel in addition to other workers. And fee-shifting provisions included in the operative agreements or arrangements can create additional, strong disincentives for workers (including key personnel) to pursue litigation or claims in other dispute resolution forums related to the enforceability of employment non-compete clauses. Because employers, when compared to workers (including key personnel), more often than not have "deeper pockets" and better access to counsel to aid enforcement of employment non-compete clauses, key personnel assessing whether to engage in a legal dispute relating to such topics may be reluctant to "fight an uphill battle," at a relatively substantial and certain cost and for a relatively uncertain benefit, particularly in cases where a fee-shifting provision could require the worker to reimburse the employer for all litigation or dispute resolution fees and costs (including attorneys' fees) in the event the employer is meritorious in the dispute (or simply meritorious on a single claim or cause of action). Workers (including key personnel) are often also highly sensitive to reputational risks that might come from being in a public dispute with a former employer. The above dynamics can create a deep "chill" on worker (including key personnel) mobility, including in cases where the worker is confident that an existing employment non-compete clause is unenforceable on the legal and factual merits.

- Key Personnel Often Do Not Access Representation; Employers Almost Universally Do. Key personnel often decide not to retain counsel to represent their interests in the negotiation of an employment non-compete clause. In our experience, based on conversations with clients and prospective clients, key personnel often do not retain counsel because the perceived utility or upside of retaining counsel is outweighed by the perceived costs of such representation (in terms of the key person's own time commitment, their expenditure of legal fees for the engagement and, sometimes, a perceived potential reputational risk involved in negotiating these types of issues). This dynamic is not unique to employment non-compete clauses. Rather, this dynamic often underpins how key personnel approach negotiations with a current, former or prospective employer regarding the terms of their employment generally and/or the termination thereof. Large, established or sophisticated employers (including well capitalized startups and emerging growth companies) almost always retain sophisticated counsel (including executive compensation, labor and employment, corporate, securities law, corporate tax and other related practitioners) to represent their interests in these and other matters. And when compared to workers (including key personnel), employers generally, including across industries and contexts, more often than not have significantly more resources at their disposal to retain counsel.

- Underrepresented Groups May Be Particularly Susceptible to Negotiating & Contracting Inequities. Key personnel from underrepresented groups (*e.g.*, women and racial and ethnic minorities) may be even more susceptible to negotiating and contracting inequities at the time of contracting and at the time of a potential departure from an employer.[42] In our experience, key personnel from underrepresented groups appear to be less likely to engage counsel to review or negotiate employment, compensation and separation terms,

[41] NPRM at 195.

[42] *See* NPRM at 27–28, 40 and 194–195 (citing differential effects of non-compete clauses on underrepresented groups).

including in connection with "milestone" events like M&A transactions, IPOs, capital-raising transactions, buyout transactions and similar events. Based on conversations with clients and prospective clients, this may be due, in part, to an express or implicit desire to avoid being perceived by a prospective, current or former employer as "difficult," "aggressive" or "ungrateful" (these are actual terms we have heard from multiple clients and prospective clients, including founders, co-founders and CEOs of large, established and sophisticated employers). Additionally, key personnel from underrepresented groups may have less access to professional channels or networks that may be more readily available to or more customarily leveraged by key personnel from non-underrepresented groups for resources and support during employment, compensation, separation and milestone-event negotiations with employers.

We share the above to illustrate some important ways we observe, in our practice, actual or potential negotiating and contracting inequities affecting key personnel in the market, both at the time of contracting and at the time of potential departure from the employer. Although key personnel generally may be *less* susceptible to such inequities compared to other classes of workers, any such distinction is a matter of degree rather than of kind — and, as noted above, any such distinction may be much greater for some key personnel than for others, depending on the specific situation. A key person very well may experience unequal bargaining power compared to an employer and be burdened by an employment non-compete clause in the ability to quit a job, including to pursue more suitable opportunities, just the same as any other worker.[43] Based on our experience working with key personnel clients over the last decade, we believe these factors, among others, contribute to the manner in which, and extent to which, employment non-compete clauses applied to key personnel (in addition to other classes of workers) create externalized costs at the expense of market competition and commerce generally.

In considering in the NPRM the potential difference in circumstances between key personnel and other classes of workers, the Commission appropriately raises the potential that key personnel may bargain for more generous severance packages in exchange for agreeing to employment non-compete clauses.[44] As a general matter, it is correct that the applicable arrangements of key personnel, compared to other workers, generally are more likely to include severance terms. However, there are many situations in which key personnel do not receive substantial severance terms (for example, and without limitation, startups in many cases do not offer severance, or severance may not be offered if the employer otherwise is cash constrained).[45] Even if an employer does provide severance terms, the amount of severance often does not fully replace the compensation that a worker otherwise could have earned during the period in which an employment non-compete clause applies, whether because the restricted period under the employment non-compete clause is longer than the severance period or because the severance terms omit paying certain components of "run-rate" compensation during the severance period.

[43] *Cf.* NPRM at 81–88 (positing generally that since certain executives, in certain circumstances, may be able to negotiate fulsomely the terms of their employment, compensation and separation packages, consequently "senior executives" as a group are not subject, in any case, to negotiating and contracting inequities compared to employers).

[44] NPRM at 88.

[45] There are also other reasons, of course, beyond cash constraints, why an employer may not provide severance terms. Even in cases where an employer's financial circumstances do not categorically preclude the possibility of making severance payments, a common negotiating tactic from employers and their advisors is to resist agreeing to severance terms on the basis that severance is "not market" or because the employer does not offer severance to other workers (including key personnel).

While these elements are negotiable in some cases, for a variety of reasons it is common for certain gaps to remain. And, critically, severance typically is paid only in a limited subset of cases (*e.g.*, upon termination by the employer without "cause," as defined in the applicable contract), while, with limited exceptions, employment non-compete clauses typically apply in all cases (*i.e.*, regardless of the reason for which the worker's employment ends), whether or not severance is paid. From an employer's perspective, severance is offered (if at all) for a number of reasons, including, without limitation, to create attractive and competitive compensation packages, to retain key personnel, to secure releases of claims from departing workers, in addition to compensating in certain cases for employment non-compete clauses and other restrictive covenants.[46] In short, for a variety of reasons, the Commission should not over-rely on the fact that key personnel may have severance entitlements to conclude that employment non-compete clauses do not adversely affect the labor market for key personnel.

Recommendation. Based on the foregoing, in addition to the other good reasons cited by the Commission at Part IV.A.1.a and Part VI.A.2 of the NPRM and other reasons discussed further below in this comment letter, we offer the following recommendation:

5. No Separate Standard for Key Personnel. The Final Non-Compete Clause Rule should prohibit employment non-compete clauses for "senior executives" and other key personnel on the same basis as for other workers, as provided in the NPRM, rather than adopting an alternative, separate standard as discussed at Part VI.B and Part VI.C of the NPRM.[47]

Employment Non-Compete Clause Practice in California

The Commission's focus on states (California, North Dakota and Oklahoma) that have rendered service-based non-compete clauses void for nearly all workers, including key personnel, is both appropriate and instructive.[48] The Commission points out that there are other means through which businesses are able to protect their investments and that the experience of each of the aforementioned states suggest that these alternatives are effective.[49] We agree. In addition to the Commission noting that California is a state where large companies have succeeded — being home to four (4) of the world's ten (10) largest companies by market capitalization as of the date of the NPRM — and being the global center of the technology sector, we also think it is important to point out that, as of October 2022, California was on the cusp of overtaking Germany as the world's fourth largest economy.[50]

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[46] *See also infra* "**Employment Non-Compete Clause Practice in California**" (discussing related points in connection with severance terms offered to California-based workers).

[47] *See also infra* "**Alternative Proposals**."

[48] NPRM at 49, 100–101.

[49] NPRM at 99–100.

[50] NPRM at 100–101; Office of Governor, Gavin Newsom, "ICYMI: California Poised to Become World's 4th Biggest Economy," published October 24, 2022 at https://www.gov.ca.gov/2022/10/24/icymi-california-poised-to-become-worlds-4th-biggest-economy/ (last visited March 15, 2023).

As noted above, our Firm is headquartered in California and, since its inception, has represented numerous key personnel based in California *vis-à-vis* their California-headquartered and non-California-headquartered employers. These key personnel have worked for both well-established, publicly traded and privately held companies and for the "vibrant startups" that the Commission references in the NPRM.[51] In addition, our California clients have been employed in various dynamic industries and sectors, including technology, electric vehicles, healthcare, finance and investment, real estate, industrials and energy. Indeed, those who believe that a nationwide ban on non-compete clauses might adversely affect businesses and the economy need only look to California's economy as a shining example of why that may not actually be true.

Further, in light of our Firm's experience representing key personnel in large markets inside and outside of California, we think it is also revealing to share our experience negotiating employment, compensation and separation packages in California as compared to jurisdictions where employment non-compete clauses are generally permitted and may be enforced. One might think that an employer that is permitted to use employment non-compete clauses in its employment contracts would, at least partially, share the economic benefit (to the employer) of those clauses in the compensation terms it offers to key personnel (*e.g.*, in the form of increased base salary, bonuses, equity and equity-based incentives and severance packages), and that California employers would pay less on average, compared to employers in jurisdictions where employment non-compete clauses are permitted and enforced, because California employers are unable to enjoy the benefit of such clauses in comparison to their out-of-state competitors. This generally has not been our experience. We have not seen an appreciable difference in compensation packages for California workers when compared to similarly situated personnel in other large markets, whether with respect to base compensation, bonus or other incentive compensation or severance terms, solely as a result of the application or absence of an employment non-compete clause in the applicable contracts. To focus on one element of compensation packages referenced by the Commission, the provision of severance to key personnel is common among employers even in California, despite the limitations on enforcing employment non-compete clauses under California law. As noted above, severance terms are provided for multiple reasons beyond compensating for employment non-compete clauses, and in many cases do not compensate for employment non-compete clauses at all, in practice, if severance is not paid in connection with the actual termination of employment based on the circumstances that apply at the time. In our experience, compensation and other commercial and legal terms for workers, across regions and industries, reflect an employer's and worker's assessment and mutually agreed "landing place" for a variety of factors, including, without limitation, macro-economic factors, industry-specific factors, employer-specific factors and precedent, worker-specific incentive and retention considerations, the views and advice of counsel and other advisors (in each case, where applicable) and other factors, but employers rarely compensate for employment non-compete clauses, where enforceable.[52]

Notwithstanding the foregoing, it is also important for us to point out that many employers with significant operations in California (particularly, employers that are incorporated in a state outside of California) *do*, in fact, attempt to impose employment non-compete clauses on their California workers (including key personnel), under a relatively recent law that, as of the date of

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[51] NPRM at 101.

[52] Across industries and market segments, there also are meaningful differences in common practice that may manifest as geographical differences. For example, pre-revenue high-growth technology startups (many of which are headquartered in California) typically do not offer the same severance packages as mature financial services companies (many of which are based in New York).

this comment letter, provides an unsettled potential exception to California's otherwise broad prohibition of all employment non-compete clauses. California Labor Code Section 925(a) provides as a general matter that an employer may not require a California worker, as a condition of employment, to agree to a provision that would require the worker to adjudicate outside of California a claim arising in California or deprive the worker of the substantive protection of California law in relation to any such claim. California Labor Code Section 925(e), however, provides an exception, pursuant to which Section 925(a) does not apply to a contract with a worker who is represented by counsel in negotiating the terms of an agreement to designate a non-California choice of law, venue or forum. Whether based on California Labor Code Section 925(e) or otherwise, we have seen some employers with significant operations in California include employment non-compete clauses in their contracts with California workers along with choice of law provisions that provide the law of a state other than California (and which permits employment non-compete clauses) will apply with respect to the interpretation and application of the contract terms. In some cases, the hope appears to be that, if the employment non-compete clause ever were challenged, the enforceability of the choice of law provision, and consequently that of the employment non-compete clause, would be upheld.

Indeed, we recently represented a California-based worker who was presented with an offer letter by a potential employer with significant operations in California where the offer letter stated that (i) the law of a state other than California (and which permits employment non-compete clauses) would govern the terms of the offer letter; and (ii) the worker was *required* to engage independent legal counsel to review the restrictive covenants (including the employment non-compete clause) and that the worker would be reimbursed up to a certain limited amount for the legal counsel's review. This was most certainly a tactic to increase the likelihood that the non-compete clause in the contract might be held to be enforceable if it ever became subject to a dispute. Notwithstanding these approaches, there is nothing in California Labor Code Section 925 that indicates it was intended to serve as an exception to the independent prohibition on service-based non-compete clauses under California Business & Professions Code Section 16600 (furthering California's general public policy against enforcement of non-compete clauses).[53] Courts are gradually starting to grapple with this issue, but there is more uncertainty than clarity regarding the enforceable application of California Labor Code Section 925(e), and it will likely be some time before this landscape becomes clearer under California law.[54]

In addition to employers relying on California Labor Code Section 925(e), it is also common, as described further above in this comment letter, for California employers to attempt to tether employment non-compete clauses to a repurchase of equity held by workers (*i.e.*, if the worker breaches an employment non-compete clause, then the worker can be forced to sell any equity in the employer held by the worker at a so-called "bad leaver" price, often the lesser of then-current fair market value and the price the worker originally paid for the equity). We have

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[53] *See* Debra Fischer and Adam Wagmeister, "Does Section 925 reinforce or weaken policy against noncompetes?", Los Angeles & San Francisco Daily Journal, Jan. 7, 2019.

[54] *See id.* (discussing *Nuvasive, Inc. v. Patrick Miles*, C.A. No. 2017-0720-SG (Del. Ch. Sept. 28, 2018) (in *Nuvasive*, the Delaware Chancery Court held that the Delaware governing law provision in the employment agreement between an employer and its former employee, who was also a California resident, would apply because the former employee was represented by counsel when entering into the agreement, and therefore, the former employee would be bound by the non-compete clause within the agreement)). However, the Delaware Chancery Court later reversed itself when Mr. Miles presented "persuasive evidence of record that he had not been represented by counsel during negotiation of the [a]greement, and that therefore the statutory exception in California law [*i.e.*, Cal. Labor Code Section 925(e)] had not in fact been implicated." *Nuvasive, Inc. v. Patrick Miles*, C.A. No. 2017-0720-SG (Del. Ch. Aug. 26, 2019).

also seen California employers attempt to limit potential competition from workers by including “forfeiture for competition” provisions and other economic penalty provisions in their contracts.

Whether or not the practices that we have described above would be enforceable in a judicial forum, it is our experience that in certain cases they can be economically effective deterrents to competition in California as workers (including key personnel) often do not have the financial means or incentives to “test” enforceability of an employment non-compete clause in court. Although, in our experience, most California employers do not represent to California-based workers that the workers are subject to employment non-compete clauses, the attempted “workarounds” of some employers serve to illustrate the benefit of providing in the Final Non-Compete Clause a clearly stated, uniform standard that is appropriately informed by the manner in which employment non-compete clauses are drafted and applied in practice in the market today.

Deal-Related Non-Compete Clauses

Deal-related non-compete clauses often are viewed as a critical legal protection negotiated by buyers and sellers in the context of M&A transactions. To protect their investments (in a context where there is generally no existing track record of working together on which trust can be built), buyers often want the assurance that sellers (often including, in particular, the target company’s equity-holding key personnel) will, as a condition to the transaction, covenant to avoid competing with the acquired company for some period (generally, up to five (5) years) after the acquisition. Buyers are also often concerned that numerous key personnel may be receiving material payments that make it harder to retain them after such a transaction. Against this backdrop, deal-related non-compete clauses and other restrictive covenants can facilitate transactions that create substantial value for selling equity holders (including key personnel).[55] In many cases, key personnel are amenable to signing deal-related non-compete clauses because

[55] To some extent, similar arguments can be made about an employer’s interest in protecting goodwill through an “employment non-compete clause” (including an "ownership-based noncompete clause”) or a “deal-related noncompete clause” outside the context of an “M&A transaction” (in each case, as such terms are defined above for purposes of this comment letter). However, there are several factors that we think generally distinguish entry into a deal-related non-compete clause in the context of an M&A transaction from entry into non-compete clauses in other contexts. First, an M&A transaction often gives rise to material liquidity to a group of key personnel at the same time, creating a natural “inflection point” for separations and often raising the stakes for a potential buyer compared to a “one-off” departure of key personnel. Second, as noted above, because of the dynamics of an M&A transaction, key personnel and buyers may have little built up trust before the transaction is consummated, making departures (including departures to competitors) more likely. Third, M&A transactions are often associated with significant changes to business operations and governance practices, which make departures of key personnel more likely. Finally, publicity associated with an M&A transaction often leads executive recruiters to aggressively court key personnel (thus making it more likely that they will be aware of alternative opportunities and pursue them).

While the factors above apply specifically in the context of an M&A transaction, we believe there are pro-market considerations (such as facilitating the creation of partnerships and other new enterprises where co-founders and/or other equity holders hold meaningful stakes (relative to one another)) that support the ability of parties to agree to binding deal-related non-compete clauses outside the context of an M&A transaction (such as where an employer buys out a founder that is a significant equity holder). For this reason, we propose that the “substantial ownership” exception be available for all deal-related non-compete clauses (both in the M&A context and outside it) but that the “deemed substantial ownership” exception be available only within the context of an M&A transaction (which we believe warrants the most flexibility because of the factors described above).

they believe such transactions facilitate value creation for equity holders (key personnel often are informed by their fiduciary duties in such contexts) and personal value-realization events (whereas otherwise, the "paper" value of purchased and incentive equity may not be realizable, or at least not on the same timeframe).

While M&A transactions occur for many reasons, in our experience there are many M&A transactions that benefit product and service markets, such as (just as one example) where a buyer's existing distribution networks or other existing relationships can be used to expand the reach of a target company's product or service offering to meet market demand. To be fair, not every buyer would be unwilling to consummate an M&A transaction if deal-related non-compete clauses are not put in place. Other deal terms, such as earn-outs, contingent compensation, hold-backs and similar structures, may, in some cases, serve a similar function to a deal-related non-compete clause. However, deal-related non-compete clauses are important protections that are valued by buyers and sellers, and we would expect that a ban on deal-related non-compete clauses unless a seller is an owner, member or partner holding at least a twenty-five percent (25%) ownership interest in the business entity being sold may negatively impact the frequency and price at which M&A transactions are consummated in some markets.[56] Consummating fewer M&A transactions, or consummating M&A transactions at lower valuations, would (all else being equal) negatively impact the labor market for key personnel, who tend to have a substantial portion of their compensation linked to M&A transactions and other liquidity transactions that create value for selling equity holders more broadly.[57] In addition, more broadly speaking, liquidity through M&A transactions is a key channel through which innovation and entrepreneurship is rewarded in the market, and dampening that market could dampen incentives to entrepreneurship, which could negatively impact labor, product and service markets.[58]

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[56] If a threshold is retained in the Final Non-Compete Clause Rule, we strongly recommend clarifying that such threshold takes into account all direct and indirect beneficial ownership, to capture fully the fundamental economic interests of participating sellers.

[57] For privately held companies, it is often the case that key personnel have no ability, or limited ability, to get liquidity from their equity and equity-based interests outside the context of an M&A transaction, IPO or secondary market liquidity event. While private company equity is obviously valuable prior to a liquidity event, its value ultimately depends on the future occurrence of a liquidity event and therefore changes that negatively impact the M&A transaction market would tend to make private company equity less valuable.

We also recognize that in context of the "golden parachute" tax rules under Section 280G and Section 4999 of the Internal Revenue Code of 1986, as amended, the existence of enforceable non-compete clauses can assist in reducing or eliminating excise taxes on certain key personnel (generally, public company executives) relating to M&A transactions.

[58] On the other hand, there may be good reasons to believe that substantially limiting the use and application of deal-related non-compete clauses would *not* materially affect the market for M&A transactions or the market for entrepreneurship and business formation generally. In practice, deal-related non-compete clauses in connection with an M&A transaction often are applied only to key personnel of the acquired company, and not to sellers who are financial investors in the acquired company. Parties sometimes justify the distinction by citing a perceived difference in the threat presented by potential competition from operator executives compared to financial investors, but it is far from clear how much truth there is to this rationale. Financial investors obtain substantial amounts of confidential information relating to the business of companies they invest in, control and manage. In certain contexts, such as venture capital and private equity, investors can be materially involved in growth strategy and execution for the companies they control and build their own business plans (and sales pitch to limited partners) around being experienced, repeat players in specific industries and market segments. In that light, although market participants often maintain that deal-related non-compete clauses with key personnel are intrinsically necessary to support prices and retain goodwill in M&A transactions (and on that basis that they also are necessary to the broader cycle of

Restricting deal-related non-compete clauses based on a twenty-five percent (25%) ownership threshold may present too much risk to the M&A transaction market (which is important for entrepreneurship for the reasons noted above), as well as the market for entrepreneurship and new business formation generally. Sellers are best positioned to compete with the business they are selling when they have deep knowledge of the product, service, operations and/or strategy of the business, which is usually obtained through (i) access to non-public information or (ii) founder or similar executive-level service with the business. With respect to the first such consideration, it is often the case that minority investors in a business obtain contractual information rights, minority protection rights and/or rights to appoint board members or board observers when they own five to ten percent (5–10%) or more of a business, each of which may facilitate access to non-public information. With respect to the second consideration, we note that even founder-executives, in certain contexts (*e.g.*, later stage companies) very well may hold less than twenty-five percent (25%) of the business. In light of those market practices, but to balance the interests of the market generally and the interests of buyers and sellers in facilitating M&A transactions or the buyout of interests held by a founder or former business partner, we recommend setting the ownership threshold in the Final Non-Compete Clause Rule at a level such that the equity owner's equity interests must have an aggregate value of at least five percent (5%) of the total value of the equity of the target company at the time of the applicable transaction for the exception to apply.[59]

There are additional considerations that apply, in context of an M&A transaction, with respect to those equity holders providing (or having recently provided) executive-level services. As discussed above, M&A transactions often are key inflection points for key personnel to realize value from services rendered to an employer, often over a long period of time, and deal-related non-compete clauses are highly valued by buyers and sellers in M&A transactions and the availability of deal-related non-compete clauses may support the market for M&A transactions more generally. Consequently, it may be advisable to permit deal-related non-compete clauses in context of an M&A transaction, solely for key personnel, in a somewhat broader set of circumstances than suggested by a simple ownership threshold requirement. However, in our experience, key personnel can be disproportionately negatively affected by deal-related non-compete clauses in certain cases, including where either the circumstances under which the non-compete clause is entered into do not allow a reasonable opportunity to consider specific costs and benefits of the non-compete clause, or where the restrictions under the non-compete clause

new business establishment and growth), that may not be strictly true. There does not seem to be any discernible negative effect in specific M&A transactions, or any cooling effect in the market for transactions generally, as a result of non-operating financial investors generally being free to compete (*e.g.*, through investing in an existing competitor or seeding a new competitor) immediately with businesses they have sold, even where they were materially involved in the strategy and management of the business.

[59] We note that a simple percentage ownership requirement may be susceptible to some amount of distortion, as incentive equity and equity-based interests may be structured in a manner that provides less economic benefit than implied by the "top line" percentage ownership figure (*e.g.*, stock options and profits interests participate in equity value only to the extent of appreciation above grant-date value and, in some cases, only to the extent of appreciation above even greater performance-based hurdles). Indeed, if a simple percentage ownership requirement is used, it may be possible for buyers and sellers to circumvent the rule by issuing types of equity awards that only have value (or only vest) in far-fetched circumstances (*e.g.*, upon achievement of fifty (50) times' return to investors) but yet (as a technical matter) increase the key person's percentage of ownership interest in the target company. By applying a standard that looks to the percentage of total equity value received in liquid proceeds at the time of a relevant transaction, the Final Non-Compete Clause Rule could avoid opening that possibility.

are substantially disproportionate to the benefits provided to the affected person in the applicable transaction.[60]

One situation in which a deal-related non-compete clause can adversely affect key personnel is where the key personnel must "pre-agree," in an initial contract, to be bound by a deal-related non-compete clause in connection with some future M&A transaction, where the worker cannot know, at the time of entering into the initial contract, the context and terms of the M&A transaction (if any) that may actually occur.[61] Because these types of "springing" deal-related non-compete clauses are implemented at a time when a future M&A transaction, and the application of the non-compete clause, is theoretical, and because inclusion of these types of deal-related non-compete clauses is often insisted upon by large investors with substantially more resources and clout than key personnel, key personnel often find it difficult to avoid these commitments (if they understand they exist at all, which in many cases they do not).

Even when a deal-related non-compete clause is introduced and negotiated in connection with a specific M&A transaction, it is often the case that negotiating dynamics in that context effectively undercut an individual's ability to resist onerous restrictions under the deal-related non-compete clause. For commercial and practical reasons, one or a small group of key personnel (*e.g.*, a CEO, or a core group of top "C-suite" executives) typically lead negotiations in an M&A transaction, with respect to relevant employment matters, on behalf of a management team, senior leadership team or other broader group of workers. Frequently, however, all members of the group are not similarly situated and thus the impact of a deal-related non-compete clause can be significantly different for different members of the group (*e.g.*, a CEO nearing retirement who receives a substantial payout may find it quite easy to accept a five (5) year deal-related non-compete clause, whereas a recently promoted, early career operations executive receiving a far smaller payout may find the same restrictions unduly onerous).

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[60] There may be many reasons, even in cases where little or no liquid consideration is paid to sellers (including key personnel), that an M&A transaction may benefit product and service markets. For example, a transaction could allow a company with promising products or services that nevertheless has encountered difficulties surviving independently to recapitalize and/or continue as subsidiary of an acquiring company, or an "all stock" merger between two companies could enable the companies to improve their product or service offerings once combined. However, in these cases, an extensive deal-related non-compete clause, unsupported by any material amount of liquid consideration, can represent a substantial and unjustified burden for key personnel. Further, to the extent the illiquid consideration represents an equity interest in the continuing business, the key person would have at least some independent incentive not to compete against the business in which he or she continues to own an interest.

[61] This type of "pre-agreement" most typically occurs by way of a short reference included in a "drag-along" provision deep in a shareholders' agreement, limited liability company operating agreement or similar agreement. At a high level, a drag-along provision provides a particular party (often a large equity holder) with a right to require other equity holders (usually smaller equity holders) to agree to sell all or a portion of their equity in connection with an M&A transaction where the first equity holder (the "dragging" equity holder) sells all or a portion of its equity. While generally the terms that apply to the sale must be the same for the "dragged" equity holders as for the dragging equity holder, the dragged equity holder may not be similarly situated to the dragging equity holder in several important respects. For example, while the dragging equity holder may be willing to agree to a deal-related non-compete clause because the overall amount of consideration it receives in the transaction is substantial, a dragged equity holder may receive an amount that is far less significant. Further, in many cases drag-along provisions are crafted to include specific exceptions that undercut the general premise of equal treatment (including, in some cases, provisions under which key personnel are required to agree to deal-related non-compete clauses even where dragging equity holders do not so agree).

Accordingly, although we recommend permitting deal-related non-compete clauses negotiated in the context of a specific transaction in certain limited cases where the ownership threshold is not met, we recommend the additional exception apply only with respect to founders and top executives and only if there is sufficient disclosure relating to the transaction and the non-compete clause terms and liquid consideration at least equal to a reasonably sufficient minimum amount is paid to the worker.

Recommendations. Based on the foregoing, we offer the following recommendations:

6. No Agreements to Enter into Non-Compete Clauses in the Future. The Final Non-Compete Clause Rule should prohibit contractual terms in a precedent contract that require, or attempt to require, workers to enter into or agree to enter into non-compete clauses (including *de facto* non-compete clauses) at any future time following the date of such precedent contract, whether in connection with an M&A transaction or otherwise.

7. Definition of Substantial Owner, Substantial Member and Substantial Partner. The Final Non-Compete Clause Rule should define a "substantial owner," "substantial member" or "substantial partner" of a business based on a minimum beneficial ownership interest having an aggregate value of at least five percent (5%) of the total value of the equity of the target company at the time of the applicable transaction. We recommend the following definition:

   "***Substantial Owner***, ***substantial member*** and ***substantial partner*** mean, with respect to a business, an owner, member or partner who is, directly or indirectly, the beneficial owner of equity interests having an aggregate value of at least five percent (5%) of the total value of the equity of the target company at the time of the applicable transaction. For this purpose, (i) ***beneficial ownership*** means beneficial ownership within the meaning of Section 13(d) of the Securities Exchange Act of 1934, as amended, and the regulations and guidance promulgated thereunder (including, without limitation, Rule 13d-3(a)); (ii) ***business*** means a business entity together with its parent, subsidiary and affiliate entities; and (iii) ***target company*** means the business (on a consolidated basis) the equity or assets of which are being sold, whether the business operates through one or more entities, regardless of the specific form of the transaction (*e.g.*, including, but not limited to, mergers, equity sales, asset sales and combinations thereof)."

8. Deemed Substantial Ownership. The Final Non-Compete Clause Rule should provide that a worker who does not meet the foregoing ownership requirement nevertheless may be deemed to be a "substantial owner," "substantial member" or "substantial partner" of a business, for purposes of the exception provided at Section 910.3 of the Final Non-Compete Clause Rule, in certain limited cases, if the worker, in connection with an applicable M&A transaction:

   (i) Qualifies as a founder or executive officer of the business at the time of an applicable M&A transaction or within the twelve (12) month period immediately preceding the time of the applicable M&A transaction, for which purpose, (A) ***founder*** means a person who is, directly or indirectly, the beneficial owner of an ownership interest in the business and who has generally and continuously been identified by the business as a "founder" or "co-founder" for both external (*e.g.*, marketing or customer-facing) and internal (*e.g.*, worker-facing) purposes following such person's commencement of

employment or other service with such business, (B) ***executive officer*** means a person who qualifies as an "executive officer" of the business within the meaning of 17 C.F.R. Section 240.3b-7 (without regard to whether the business is subject to the reporting rules of the U.S. Securities & Exchange Commission (the "***SEC***")) and (C) ***M&A transaction*** means the sale of a majority of the equity interests or assets of a target company, whether by way of a sale of equity or assets, merger or otherwise;

(ii) Receives reasonably detailed advance written disclosure regarding the applicable M&A transaction, the non-compete clause and all material terms related to the non-compete clause that is written to be reasonably understandable without legal training, including, without limitation, disclosure as to:

(A) The identity of the counterparty or counterparties to the applicable M&A transaction including, if applicable, the identity of the person or persons with effective control of such counterparty or counterparties;

(B) A reasonable, good faith estimate (not including mere illustrative projections) of the consideration payable to the worker in connection with the applicable M&A transaction, as well as any material contingencies related to such payments;

(C) The identity of any other workers requested to enter into the non-compete clause or similar restrictions;

(D) The duration of the non-compete clause and its scope, including, without limitation, the specific activities prohibited and any specific exceptions, the definition of a competitor or competing business and the geographic area in which the restriction applies;

(E) Any forfeiture, disgorgement, repurchase or other penalty provisions that apply in relation to the non-compete clause;

(F) Any release of claims, alternative dispute resolution, jury trial waiver, class action waiver, fee-shifting or any similar provisions that apply in relation to the non-compete clause or otherwise in relation to the worker's receipt of consideration in connection with the applicable consideration; and

(G) Such other material terms that, in the good faith determination of the employer, a reasonable person would need to make an informed decision whether to agree to the non-compete clause; and

(iii) No less frequently than monthly, actually receives consideration in connection with the applicable M&A transaction in the form of cash and/or marketable securities that are freely tradeable without restriction (other than on account of applicable securities laws), for each month in which the non-compete clause is in effect, having an aggregate value at least equal to one twelfth (1/12) the worker's target annual cash compensation as of immediately prior to the applicable transaction (without regard to any reduction in the six (6) month period immediately preceding the applicable transaction) or, if the worker ceased to qualify as a founder or executive officer within the twelve (12) month period immediately preceding the applicable transaction, as of immediately prior to the worker ceasing to serve in such capacity (without regard to any reduction in the six (6) month period immediately preceding the date the worker ceased to serve in such

capacity), and provided that the worker may not be required to repay such consideration other than as a result of a material breach of the non-compete clause or as otherwise required by applicable law.[62] For this purpose: (A) the aggregate value of the consideration may take into account the payment of any holdback, escrow, vesting or other contingencies (in each case, to the extent actually paid to the key person) and the consideration may result from proceeds for the sale of securities, payments with respect to incentive equity or equity-based or other incentive awards, in each case, issued or granted by the acquired business or any other payment made in connection with the applicable M&A transaction (but excluding (1) severance payments and termination benefits to the extent they would otherwise be payable upon the same type of termination of service (*e.g.*, a termination of the key person's service by the employer without cause) without regard to the occurrence of the transaction (*i.e.*, there is no "enhancement" of the payment) and (2) any payments provided or made for service by the worker after the consummation of such transaction); (B) the consideration will be deemed to have been provided at a monthly frequency for each month in which the non-compete clause is in effect if, as of each applicable month, the total amount of consideration provided at any time prior to the end of such month (including payments made prior to the start of such month) equals or exceeds the ratable amount of consideration required to be paid for all periods through the end of such month; and (C) further, if payment of consideration is conditioned upon the worker providing a release of claims in favor of the employer, payments that commence no later than sixty (60) days following the date of the applicable transaction will be considered to have been provided at a monthly frequency for each month in which the non-compete clause is in effect so long as the first payment includes all amounts of consideration otherwise required to be paid had payments of consideration commenced immediately following the applicable transaction.

Rescission of Existing Non-Compete Clauses

The rescission of existing non-compete clauses that would be prohibited under the Final Non-Compete Clause Rule is an important and appropriate step to further the labor markets and product/service markets, as otherwise non-compete clauses may remain in effect for many years into the future. The mechanism to rescind existing non-competes should be practical, with a dual focus on: (i) minimizing the burden on employers who have not acted in bad faith when implementing (or attempting to implement) non-compete clauses prior to the compliance date for the Final Non-Compete Clause Rule; and (ii) creating general awareness among employers and workers of, and thereby facilitating compliance with, the Final Non-Compete Clause Rule.

With respect to the first principle, we note that employer compliance with any change in law often entails numerous logistical and operational hurdles. Employers acting reasonably and in good faith to comply with changes in law should not be penalized for technical failures that are corrected within a reasonable timeframe. Employers may not have comprehensive records of

[62] In our view payment at the rate of "one times" (1x) target cash compensation over the restricted period may provide a reasonable minimum for purposes of the proposed exception. However, as discussed further above in this comment letter, cash compensation often does not represent the principal value of a compensation package for key personnel, and it could be argued that a higher rate of payment should be required for a limited exception to the general prohibition on non-compete clauses under the NPRM (potentially much higher, such as three times (3x) target cash compensation).

which workers and former workers are subject to non-compete clauses (*e.g.*, due to personnel changes, the passage of time since relevant agreements were entered into, differing practices across jurisdictions, reliance on outside advisors and/or other factors) and in some cases may not have accurate and current contact information for personalized methods of electronic communication with former workers. While, ideally, employers should have this information, we do not believe these considerations should preclude employers from being able to rely on the safe harbor method of rescission provided in the NPRM.[63]

While we agree that the Recission Notice should be disseminated, where reasonably practicable, through individualized transmission methods (*e.g.*, sent via email), we recommend broadening the safe harbor in the Final Non-Compete Clause Rule so an employer is deemed to comply with the safe harbor where it has made certain good faith, reasonable attempts to disseminate the notice through individualized transmission methods and supported such efforts by general means of notice.[64] The NPRM provides that an employer would be able to rely on the safe harbor if the notice was provided to current workers and to those former workers for whom it has contact information "readily available," in each case, strictly within forty-five (45) days after rescinding non-compete clauses, with rescission required prior to the compliance date under the Final Non-Compete Clause Rule. We believe this may be too prescriptive for employers with smaller workforces in the U.S. We recommend the Commission implement a different safe harbor standard for smaller employers in the Final Non-Compete Clause Rule, based on factors as the Commission deems appropriate.

On the other hand, because the benefit of the Final Non-Compete Clause Rule would accrue to labor, product and service markets more generally, we believe there are several ways in which the dissemination of safe harbor notices can reach wider audiences and contribute to greater overall awareness of the Final Non-Compete Clause Rule in the market. We believe this can be done by requiring medium-size and larger employers with sufficiently large portions of their workforce that primarily speak non-English languages to translate notices into such non-English languages. Further, for larger employers, we believe written notices should be supplemented by video providing the same material information as the written notice, to facilitate awareness of the rescission of non-compete clauses.

Recommendations. Based on the foregoing, we offer the following recommendations:

9. Manner of Rescission Notice to Workers. The Final Non-Compete Clause Rule should provide that an employer will be deemed to comply with the safe harbor notice requirement if (i) it provides the otherwise compliant written notice through individualized transmission methods (such as email) to all workers employed on the date of transmission of the notice (or all such current workers with non-compete clauses) and all former workers for whom

[63] NPRM at 213–215.

[64] Although the Commission proposes in the NPRM that notice via text message may be acceptable, we do not believe that text messaging is appropriate as the primary vehicle for this type of communication, as the format is generally perceived as casual, does not easily support the conveyance of information in any material level of detail and is notoriously unreliable for record-keeping purposes (whether because of protocols that delete older text messages automatically, which are common, or because old text messages are not easily searchable or because key details, such as the actual sender, are not always readily verifiable). We do believe text messaging should suffice as a secondary communication vehicle as it may more readily reach certain workers.

it has contact information readily available; and (ii) it also posts a written notice of the Final Non-Compete Clause Rule and rescission of existing non-compete clauses to a physical or virtual place to which current workers have access and where which such workers would reasonably expect to find employment-related information (*e.g.*, an internal "intranet" or in a physical space commonly accessed by workers) or, with respect to both current workers and former workers for whom it has contact information readily available, provides secondary notice through a text message that (x) alerts the worker to the rescission and (y) instructs them to reference the primary written notice described in clause (i) (such notice described herein, the "***Rescission Notice***").

10. Translation of Rescission Notice. The Final Non-Compete Clause Rule should require that if an employer with one hundred (100) or more workers in the U.S. in the most recent twelve (12) month period (calculated reasonably by the employer)[65] has reasonable cause to believe that at least ten percent (10%) of the employer's workers or former workers receiving a Rescission Notice speak a language other than English as their primary language, the Rescission Notice must also be translated into such other language.[66]

Other Comments on Proposed Non-Compete Clause Rule

The Commission also invited comment regarding whether small employers should be exempt from the Final Non-Compete Rule or be subject to different requirements than larger employers.[67] We concur with the NPRM that small employers should be subject to the same requirements as larger employers under the Final Non-Compete Clause Rule.[68] In addition to the reasons cited by the Commission, we note, in particular, that there are no significant recurring compliance costs with respect to the Final Non-Compete Rule that would create undue burdens on small employers compared to larger employers, and that there is a material possibility that an exemption for small employers would create inefficient "cliff" effects, where small employers that grow past the specified threshold suddenly would need to shed their employment non-compete clauses (or, on the other hand, would potentially be able to impose new employment non-compete clauses if the workforce is reduced below the threshold). A small employer exemption likely would create more problems than it would solve.

[65] We encourage the Commission to assess whether the proposed one hundred (100) worker threshold is appropriate to implement the intent of our recommendation (namely, to require only medium-size and larger employers to comply with this aspect of the Final Non-Compete Clause Rule, if implemented by the Commission).

[66] This translation requirement would be applied separately based on each sub-population of language speakers. For instance, if five percent (5%) of the employer's population's primary language is Spanish and five percent (5%) of the employer population's primary language was Vietnamese, no translation requirement would apply.

[67] *See* NPRM at 204.

[68] *See id*.

Alternative Proposals

In response to the Commission's invitation to submit commentary and recommendations on whether an alternative framework for employment non-compete clauses should be considered, as noted above, we concur with the approach set out in the NPRM — namely, that the Final Non-Compete Clause Rule should provide a categorical ban on non-compete clauses (subject to a limited exception for deal-related non-compete clauses), rather than creating a rebuttable presumption of unlawfulness, and that the same standard should apply with respect to senior executives and other key personnel as applied to other workers.[69]

However, in the event the Commission determines to provide a separate standard for key personnel as compared to other workers in the Final Non-Compete Clause Rule, we propose below a reasonably balanced exception for certain key personnel, in line with our proposal above relating to an exception for certain deal-related non-compete clauses that we believe would reduce, to the extent possible, the occurrence of market-limiting externalities and negotiating and contracting inequities that otherwise might arise. This proposal would fall into the Commission's potential Alternative #1 ("*Categorical Ban Below Threshold, Rebuttable Presumption Above*").[70] If any alternative to a categorical ban is implemented, in our view it will be important to provide "bright line" standards in the Final Non-Compete Clause Rule to reduce or eliminate ambiguity and confusion among employers and workers. Counterparties to an employment non-compete clause should be reasonably able to identify both whether a worker qualifies as a key person for whom an employment non-compete clause may be permitted in certain circumstances and, if so, under what terms an employment non-compete clause would be valid and enforceable under the terms of the Final Non-Compete Clause Rule.

Additionally, in response to the Commission's invitation to submit commentary and recommendations on whether disclosure and reporting obligations should apply to the extent non-compete clauses are permitted under the Final Non-Compete Clause Rule, we have suggested disclosure requirements in connection with the potential, limited exceptions set out here and further above in this comment letter.[71] A separate reporting obligation might assist the Commission in enforcing the Final Non-Compete Clause Rule by enabling easier identification of employers whose practices with respect to non-compete clauses do not comply with the Final Non-Compete Clause Rule, or it might, over time, serve to generate quantitative data sets and information to assess the impact of the Final Non-Compete Clause Rule (potentially informing amendments thereto that further protect and improve the applicable labor, product and/or service markets based on information and data provided to the Commission by employers over time). However, these factors are less important if the Final Non-Compete Clause Rule clearly and broadly prohibits non-compete clauses as a general matter, as set forth in the NPRM and as we recommend (compared to a more mixed alternative approach), and a reporting obligation otherwise would generate recurring compliance costs and related burdens on employers.[72] On

[69] *See* NPRM at 142, 145–146.

[70] NPRM at 148.

[71] As described further above in this comment letter, in our experience, workers often do not know they are subject to a non-compete clause or, if they are aware of the non-compete clause, do not understand its full scope and effect. *See* NPRM at 154–155 (discussing disclosure requirements).

[72] *See* NPRM at 156. On the other hand, despite the Commission's concern regarding the potential of ongoing compliance costs involved in a reporting requirement, we believe that, like other recurring reporting and compliance obligations of employers, employers and third-party service providers over time would

balance, we do not believe a reporting obligation would meaningfully add to the net beneficial effect of the Final Non-Compete Clause Rule.[73]

Recommendation. Based on the foregoing, we offer the following recommendation:

11. Alternative Proposal for Certain Key Personnel. Only in the event the Commission determines to provide a separate standard for certain key personnel as compared to other workers (which we do not recommend — see Recommendation #5, *infra*, in this comment letter), the Final Non-Compete Clause Rule should provide that an employer may rebut a presumption of unlawfulness with respect to a non-compete clause (including a *de facto* non-compete clause), in certain limited cases, if the worker:

(i) Qualifies as a founder or executive officer of the business (as such terms are defined further above in this comment letter) at the time the non-compete clause is entered into, or, solely in relation to non-compete clauses entered into in connection with the worker's separation from service, qualified as such within the twelve (12) month period immediately preceding such separation from service, for which purpose, a ***separation from service*** means a "separation from service" within the meaning of Section 409A of the Internal Revenue Code of 1986, as amended, and the regulations and guidance promulgated thereunder;

(ii) Receives reasonably detailed advance written disclosure regarding the non-compete clause and all material related terms that is written so as to be reasonably understandable without legal training, which written disclosure must delivered no later than the time as of which the applicable agreement or arrangement containing the non-compete clause is provided to the worker or, with respect to any non-compete clause entered into in connection with the worker's commencement of employment or other service with the employer and/or as part of the initial compensation arrangements (whether under an offer letter, employment agreement, restrictive covenant agreement, incentive compensation arrangement, equity holders' agreement or otherwise), not later than the time of the offer of employment, and which written disclosure must include, without limitation, disclosure as to:[74]

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standardize and routinize procedures in a manner that effectively decreases the practical costs and operational burdens imposed by such an obligation.

[73] As an alternative to creating an employer reporting obligation, the Commission could consider requiring employers, in the limited cases where a non-compete clause is permitted under the Final Non-Compete Clause Rule, to provide a notice of the Final Non-Compete Clause Rule in the text of the applicable contract along with information to facilitate the worker reporting the contract to the Commission if the worker believes it does not comply with the Final Non-Compete Clause Rule, similar to other "tuck in" notice requirements that sometimes apply, such as under the Defend Trade Secrets Act (18 U.S.C. § 1833(b)(3)) or California's law relating to invention assignment agreements (Cal. Lab. Code § 2872). In general, however, we believe the separate notice we have suggested in this comment letter would be much more effective in promoting the purposes of the Final Non-Compete Clause Rule.

[74] *See* NPRM at 85, 154–155. In our experience, non-compete clauses may not be disclosed or summarized "up front" with the offer and high-level compensation proposal, a tactic that disadvantages workers (including key personnel) and facilitates employers imposing market-limiting non-compete clauses

(A) Whether and to what extent similarly situated workers of the employer are subject to the same non-compete clause or similar restrictions;

(B) The circumstances in which the non-compete clause would become effective (*e.g.*, upon any separation from service, or in more limited circumstances, such as if the employer pays severance);

(C) The duration of the non-compete clause and its scope, including, without limitation, the specific activities prohibited and any specific exceptions, the definition of a competitor or competing business and the geographic area in which the restriction applies;

(D) Any forfeiture, disgorgement, repurchase or other penalty provisions that apply in relation to the non-compete clause;

(E) Any release of claims, alternative dispute resolution, jury trial waiver, class action waiver, fee-shifting or any similar provisions that apply in relation to the non-compete clause or otherwise in relation to the worker's receipt of severance; and

(F) Such other material terms that, in the good faith determination of the employer, a reasonable person would need to make an informed decision whether to agree to the non-compete clause; and

(iii) No less frequently than monthly, actually receives consideration in connection with any period during which the employer does not affirmatively waive enforcement of the non-compete clause following the worker's separation from service in the form of cash severance and other termination benefits, for each month in which the non-compete clause is in effect following such separation from service, having an aggregate value at least equal to one twelfth (1/12) the worker's target annual cash compensation as of immediately prior to such separation from service (without regard to any reduction in the six (6) month period immediately preceding such separation from service) or, if the worker ceased to qualify as a founder or executive officer within the twelve (12) month period immediately preceding the termination date, as of immediately prior to the worker ceasing to serve in such capacity (without regard to any reduction in the six (6) month period immediately preceding the date the worker ceased to serve in such capacity), and provided that the worker may not be required to repay such consideration other than as a result of a material breach of the non-compete clause or as otherwise required by applicable law.[75] For this purpose: (A) the consideration will be

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in more circumstances than would be the case were non-compete clauses disclosed at the same time as other material elements of the worker's employment and compensation package.

[75] As noted further above in this comment letter, in our view payment at the rate of "one times" (1x) target cash compensation over the restricted period may provide a reasonable minimum for purposes of the proposed exception, although it could be argued that a higher rate of payment should be required for a limited exception to the general prohibition on non-compete clauses under the NPRM.

We also note the Commission's statements at pages 168–169 of the NPRM, which may justify a ten percent (10%) increase (relative to a founder or executive officer's target cash compensation as of immediately prior to such separation from service (without regard to any reduction in the six (6) month period immediately preceding such separation from service)) to the aggregate value of the applicable non-repayable cash severance and other termination benefits that must be provided to key personnel, in relevant part, to enforce an employment non-compete clause during the applicable restricted period (using the Commission's

deemed to have been provided at a monthly frequency for each month in which the non-compete clause is in effect if, as of each applicable month, the total amount of consideration provided at any time prior to the end of such month (including payments made prior to the start of such month) equals or exceeds the ratable amount of consideration required to be paid for all periods through the end of such month; and (B) further, if payment of consideration is conditioned upon the worker providing a release of claims in favor of the employer, payments that commence no later than sixty (60) days following the date of the worker's separation from service will be considered to have been provided at a monthly frequency for each month in which the non-compete clause is in effect so long as the first payment includes all amounts of consideration otherwise required to be paid had payments of consideration commenced immediately following the applicable transaction.

We offer these recommendations with respect to the Final Non-Compete Clause Rule for the reasons discussed above. Please do not hesitate to reach out if we can answer any questions regarding our recommendations or otherwise provide any further assistance to the Commission.

Sincerely,

Moulton | Moore | Stella LLP

identified CEO pay data as a proxy for all non-CEO key personnel employment non-compete clauses as well).