Comments of the International Center for Law & Economics Regarding Contract Terms That May Harm Fair Competition

FTC Docket No. 2021-0036

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Authored By:

Geoffrey A. Manne, President
Dirk Auer, Senior Fellow

I. Introduction

Petitioners in this proceeding have called for the FTC to use its rulemaking authority pertaining to unfair methods of competition to prohibit employee non-compete clauses and various forms of exclusive dealing. These rulemaking proposals are deeply misguided from both a procedural and substantive standpoint, however.

Bright-line competition rules, as opposed to broader judicially enforced standards, are appropriate only when it is possible to isolate a category of identical practices that routinely harm competition. This is not the case for the categories of conduct currently under consideration. More fundamentally, these calls ignore positive and significant consumer benefits generated by vertical agreements, in general, and exclusive dealing and non-competes, more specifically. Critics seem to assume that powerful firms foist these exclusive agreements upon their helpless commercial partners (whether employees or other companies). Yet a vast body of economic literature clearly rejects this premise. Instead, it shows that these clauses entail costs and benefits that each party must carefully weigh when they a enter into a commercial relationship.

Of course, this does not mean that non-compete clauses or exclusive dealing should be categorically out of bounds for antitrust authorities. Rather, they should be assessed on a case-by-case basis (i.e., under the rule of reason), accounting for both their pro- and anti-competitive potential. This would limit enforcement efforts only to the limited instances where those clauses harm consumers, thereby preserving the tremendous aggregate benefits they generate.

II. The pitfalls of rulemaking as opposed to the rule of reason

Bright line rules are unfit to address conduct that is highly heterogeneous in both the shape that it takes and its effects on competition. Yet the behavior the Petitioners seek to address exhibits great variation on both counts.

Antitrust problems (at least those assessed under the rule of reason) are defined by their anticompetitive effect and are highly fact specific. They are not readily susceptible to broad, preemptive, ex ante rules.[1] Rulemaking, by contrast, is appropriate only where harm can be properly addressed by rules proscribing specific conduct across the board. As the Commission itself has said, "where the legality of *identical, similar, or related practices of an anticompetitive nature* may be addressed responsibly and more efficiently in a single proceeding than in a case-by-case adjudication, law enforcement by rulemaking would be considered more favorably."[2] That is simply not the case for conduct that is broadly procompetitive and causes anticompetitive harm only in specific, varied circumstances.

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[1] *See, e.g.*, Isaac Ehrlich & Richard A. Posner, *An Economic Analysis of Legal Rulemaking*, 3 J. LEGAL STUD. 257, 277 (1974); Eric A Posner, *Standards, Rules, and Social Norms*, 21 HARV. J. L. & PUB. POL'Y 101 (1997); Louis Kaplow, *Rules Versus Standards: An Economic Analysis,* 42 DUKE L.J. 557 (1992).

[2] H. Rep. No. 93-1107, at 57 (1974) (emphasis added).

As explained below, exclusive contracts are well understood to raise competitive concerns only in very particular circumstances and under very particular conditions. They are quintessentially ambiguous conduct that are generally procompetitive and create anticompetitive concerns only rarely. They are not appropriate for preemptive rulemaking. For non-competes, the issue is even more problematic, because the concern is often more driven by concerns about "unfairness" under the Commission's UMC authority than it is anticompetitiveness, and rulemaking is starkly "ill-suited for the exploration of broad and largely normative issues."[3]

Further complicating matters is the fact that exclusive dealing and non-compete clauses can take widely varied forms. Any rulemaking initiative would thus struggle to isolate the problematic forms of such conduct—even on critics' own terms for what constitutes harmful conduct—from those that are perfectly benign. A rulemaking undertaking under these conditions would immediately be confronted with the following vexing questions, among many others: Should a ban on exclusive dealing concern both exclusive distribution *and* exclusive supply? What market coverage amounts to exclusivity? What is the minimum duration for a contract to fall under the exclusive dealing ban? Does the ban concern only explicit exclusivity, or also *de facto*?[4] What about obvious alternatives such as exclusive territories? What extent of competition in upstream and/or downstream markets would be required to obviate an anticompetitive concern, and how would it be measured? And much of the same applies to non-compete clauses. For instance, a key question is the extent to which a ban on non-competes would apply to high-level personnel who acquire highly confidential information—a situation that would otherwise be almost impossible to account for without a non-compete.

At the same time, as one of the Petitions for Rulemaking to which this Request for Comments is addressed itself notes, "[i]n the past two decades, the FTC, the Department of Justice ("DOJ"), and private antitrust enforcers have successfully litigated and settled many monopolization suits alleging improper exclusionary contracts, including against dominant firms in credit card networks, hospitals, iron pipe fittings, microprocessors, personal computer operating systems, pet diagnostic equipment, and transmissions for large trucks."[5] No one argues that exclusive contracts can *never* be anticompetitive. But to the extent they are, there is also no evidence to suggest that traditional antitrust enforcement is incapable of addressing and deterring those situations.

Indeed, there is every reason to believe that addressing such conduct under the rule of reason is preferable to the adoption of ex ante rules. As the evolution of the judicial approach to exclusivity (and other contractual restraints) demonstrates, courts, enforcers, and economic actors learn over time, and this affects the types of conduct in the economy, the cases chosen by enforcers, and the accuracy of decisions by judges. Courts regularly adjust their rules and how they are enforced to

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[3] Richard K. Berg, *Re-Examining Policy Procedures: The Choice Between Rulemaking and Adjudication*, 38 ADMIN. L. REV. 149, 166 (1986).

[4] *See, e.g.*, Sela Stroud, *Non-Compete Agreements: Weighing the Interests of Profession and Firm*, 53 ALA. L. REV. 1023 (2001) (showing that law firm partners often agree to contractual terms that, by making it harder for a partner to exit a practice, effectively amount to *de facto* non-compete clauses).

[5] Petition for Rulemaking to Prohibit Exclusionary Contracts by Open Markets Institute, *et al.*, File No. FTC-2021-0036-0002 (Jul. 20, 2021) at 1-2, in FTC Docket No. 2021-0036.

reflect degrees of ambiguity, and economic actors adjust their conduct in response to the courts. The rule of reason is key to this discovery procedure.[6]

The rule of reason has another key strength as far as this discovery procedure is concerned: it is more susceptible to change. By adopting less precise rules of reason, the courts render the relative changeability of the rule less difficult. This has important implications for the overall accuracy and optimality of the legal regime. Unless you assume infallibility on the part of agencies and courts, the ease with which rules can change may be the most significant aspect of an optimal antitrust regime. Because of defendant heterogeneity, evolving economic understandings, and the inherent competitive ambiguity of novel conduct or novel circumstances, the optimal rule is likely not a single rule, but a dynamic one that continually (but not drastically) evolves over time.

> [A]nticompetitive conduct that is erroneously excused may be subsequently corrected, either by another enforcer, a private litigant, or another jurisdiction. An anticompetitive merger that is not stopped, for example, may be later unwound, or the eventual anticompetitive conduct that is enabled by the merger may be enjoined . . . . By contrast, procompetitive conduct that does not occur because it is prohibited . . . has no constituency and no visible evidence on which to base a case for revision.[7]

Like per se prohibitions, ex ante rules deter all relevant conduct, while the rule of reason encourages experimentation. Under a rule of reason approach, firms self-assess their behavior and proceed if they think it is not harmful; plaintiffs and courts are then free to challenge this assessment. The retort that this feedback loop is merely hypothetical because, in practice, anticompetitive harm is nearly impossible to prove is not a persuasive argument in favor of ex ante prohibitions. Can it possibly be justified to outlaw entire categories of conduct despite plaintiffs being unable to show that such conduct is harmful in individual cases?

The critical question is whether perceived low levels of enforcement are caused by the rule of reason, or whether they are a function of the behavior that is currently prosecuted under this rule. In other words, it is plausible that rule of reason cases are rare and difficult to prove because the most egregious practices are being effectively deterred. The marginal cases that face prosecution under the rule of reason might thus be those that are least likely to harm consumers. The eventual number of cases both brought and won would be extremely low in both a system with *under*-enforcement as well as one with *optimal* enforcement.[8] Telling the difference between them is

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[6] As the Supreme Court has often noted (in comparing the rule of reason to the adoption of per se rules). *See* United States v. Topco Assocs., Inc., 405 U.S. 596, 607–08 (1972) ("It is only after considerable experience with certain business relationships that courts classify them as per se violations of the Sherman Act."). Justice Marshall's reasoning in *Topco* was repeated in both the *Broadcast Music* and *Leegin* majority opinions. Broadcast Music, Inc. v. CBS, Inc., 441 U.S. 1, 2 (1979); Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877 (2007). Note that European competition law also relies upon this learning process. *See, e.g.*, Dirk Auer & Nicolas Petit, *CK Telecoms v Commission: The Maturation of the Economic Approach in Competition Case Law*, 11 J. EUR. COMPETITION L. & PRACTICE 225 (2020).

[7] Geoffrey A. Manne, *Error Costs in Digital Markets*, in THE GLOBAL ANTITRUST INSTITUTE REPORT ON THE DIGITAL ECONOMY 3, 64–65 (2020).

[8] The number of cases could be extremely low in a system with massive *over*-enforcement, too. Such a system would dramatically curtail all conduct, thus indirectly curtailing enforcement. Indeed, the argument that an optimal enforcement

difficult, at best. The proper litmus test is whether *widely detrimental practices*—such as cartels or mergers to monopoly—are hard or impossible to bring successfully under the rule of reason, not whether *ambiguous practices* are.

Furthermore, the assumption that counting cases or wins provides evidence that the current enforcement regime and legal standards that influence it are improper is unfounded. But it is endemic. For example, the Petition for Rulemaking asserts that "an antitrust lawsuit under the rule of reason is extraordinarily difficult to prosecute and win. Indeed, the record suggests that the rule of reason approximates a standard of practical legality."[9] In reality, this proves nothing because the cause of this result could be that none of the conduct was actually anticompetitive, rather than that it is too difficult to prove that anticompetitive conduct is, in fact, anticompetitive. Indeed, with a mature legal system and relatively clear rules, one should expect relatively few instances of marginal conduct giving rise to cases that present truly novel problems. It is entirely predictable that firms would, for the most part, be accurately guided in their affairs by the law and would largely avoid offending well-established competition principles.

Moreover, it is insufficient to judge the quality of an antitrust regime by considering only the direct effects of enforcement actions, rather than also considering their broader deterrent effect. As Douglas Melamed puts it, antitrust law's "principal value is found, not in the big litigated cases, but in the multitude of anticompetitive actions that do not occur because they are deterred by the antitrust laws, and in the multitude of efficiency-enhancing actions that are not deterred by an overbroad or ambiguous antitrust law."[10]

Against this backdrop, it is wholly inappropriate to address exclusionary contract terms with a blanket, ex ante prohibition. As Justice O'Connor noted in her celebrated concurrence in *Jefferson Parish*:

> In determining whether an exclusive-dealing contract is unreasonable, the proper focus is on the structure of the market for the products or services in question—the number of sellers and buyers in the market, the volume of their business, and the ease with which buyers and sellers can redirect their purchases or sales to others. Exclusive dealing is an unreasonable restraint on trade only when a significant fraction of buyers or sellers are frozen out of a market by the exclusive deal.[11]

The significant heterogeneity exhibited by exclusive dealing and non-compete clauses and the widely divergent circumstances and market structures in which they are implemented make them extremely poor candidates for regulation by rulemaking.

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regime would tend toward little enforcement rests in part on this same dynamic, only in that case it is harmful conduct that is deterred, leading to decreased enforcement, while in the excessive-deterrence case it is all conduct that is deterred.

[9] Petition for Rulemaking to Prohibit Exclusionary Contracts, *supra* note 5, at 72-73 (*citing* Michael A. Carrier, *The Rule of Reason: An Empirical Update for the 21st Century*, 16 GEO. MASON L. REV. 827 (2009)).

[10] A. Douglas Melamed, *Antitrust Law and Its Critics*, 83 ANTITRUST L.J. 269, 285 (2010).

[11] Jefferson Parish Hospital Dist. No. 2 v. Hyde, 466 U.S. 2, 35, 45 (1984) (O'Connor, J., concurring).

III. Vertical agreements generally benefit consumers

More fundamentally, both exclusive dealing contracts and non-compete clauses generally lead to significant consumer benefits. Indeed, they are both forms of vertical restraints. Economic science has analyzed these agreements in great detail, both from theoretical and empirical viewpoints. On both fronts, the bottom line is that vertical agreements can harm competition and consumers only in exceptional circumstances. There is thus broad consensus among economists that these restraints should not be subjected to *per se* prohibitions,[12] and that rule of reason analysis (or even, according to some, *per se* legality[13]) is appropriate in these settings.

At their core, vertical agreements are designed to solve principal-agent problems that might otherwise hinder distribution via the market (as opposed to that which takes place within the firm). Indeed, vertical distribution creates several opportunities for opportunistic behavior,[14] such as freeriding,[15] double marginalization,[16] and holdup.[17] Vertical distribution can also entail other significant transaction costs, notably those that stem from parties' incomplete information.[18] Firms

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[12] *See, e.g.,* Patrick Rey & Jean Tirole, *The Logic of Vertical Restraints*, 76 AM. ECON. REV. 921, 937 (1986) ([Speaking of retail price maintenance and exclusive territories, in particular]: "Another major contribution of the earlier literature on vertical restraints is to have shown that per se illegality of such restraints has no economic foundations. . . . So at the current stage of research, the rule of reason seems safer."). *See also* Lester G Telser, *Why Should Manufacturers Want Fair Trade?*, 3 3 J. L. ECON. 86, 104 (1960) ("[A] single manufacturer producing a differentiated product over which he possesses some degree of monopoly power may find it advantageous to establish minimum retail prices in order to induce those retailers who handle his product to offer special services jointly with it thereby increasing total sales.").

[13] *See, e.g.,* Richard A Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6, 6 (1981) ("The Supreme Court's standard for evaluating the legality of restricted distribution has oscillated from the Rule of Reason to per se illegality and back. I argue in this article that it is time to adopt an entirely new standard, namely, per se legality."). It should be noted, however, that, while strongly repudiating per se illegality, Rey and Tirole also disclaim Posner's per se legality argument. *See* Rey & Tirole, *id.*, at 937.

[14] *See, e.g.*, Benjamin Klein, Robert G. Crawford & Armen A. Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J. L. ECON. 297, 298 (1978) ("The particular circumstance we emphasize as likely to produce a serious threat of this type of reneging on contracts is the presence of appropriable specialized quasi rents. After a specific investment is made and such quasi rents are created, the possibility of opportunistic behavior is very real. Following Coase's framework, this problem can be solved in two possible ways: vertical integration or contracts.").

[15] *See, e.g.,* Ralph A. Winter, *Vertical Control and Price Versus Nonprice Competition*, 108 Q. J. ECON. 61, 61 (1993) ("In considering customers on the wrong margin, retailers are therefore biased toward price competition. This distortion that can be corrected with vertical restraints.").

[16] *Id.* at 921 ("To cite only two well-developed examples, a franchise (or RPM) can solve the double marginalization problem; while ET or RPM (together with a franchise) can eliminate promotional externalities"). See also Joseph J. Spengler, *Vertical Integration and Antitrust Policy,* 58 J. POL. ECON. 347, 352 (1950) ("Of great importance is the conclusion, developed earlier, that in an imperfectly competitive world vertical integration enables the higher-stage producer to evade "monopolistic" surcharges imposed by suppliers in lower stages, thus putting him in a position where he finds it advantageous to ask lower prices than would be asked in the absence of vertical integration and in the presence of existing horizontal integration.").

[17] *See* Benjamin Klein, *Transaction cost determinants of" unfair" contractual arrangements*, 70 AM. ECON. REV. 356, 362 (1980) ("I have argued that a particular form of transaction cost based upon the existence of incomplete contracts (due to uncertainty and measurement costs)—a transaction cost I have called the hold-up problem—may be an important reason in many cases for termination-at-will and exclusive-dealing contractual arrangements.").

[18] *See, e.g.*, Rey & Tirole, *supra* note 12, at 937 ("Alternatively, one could assume that the manufacturer is able to monitor the consumer price, but not some selling effort levels exerted by the retailers. The manufacturer then faces the same tradeoff between an efficient, because unconstrained by product competition, use of de- centralized information (ET), and an

routinely rely on vertical agreements to solve these problems. These agreements thus play a critical role in ensuring that firms can, if they so choose, rely on the market to distribute their goods.

And because vertical integration or internal growth are, at the margin, substitutes for vertical agreements, it is important to note that any significant prohibitions on the use of vertical restraints would incentivize vertical consolidation.[19]

While the theoretical literature suggests that firms *can* engage in anticompetitive vertical conduct, the empirical evidence suggests that, even though firms do impose vertical restraints, it is exceedingly rare that they have net *anticompetitive* effects. Nor is the relative absence of such evidence for lack of looking: countless empirical papers have investigated the competitive effects of vertical integration and vertical contractual arrangements and found predominantly procompetitive benefits or, at worst, neutral effects.

In their seminal metanalysis of this topic,[20] Professors Lafontaine and Slade show that vertical restraints generally increase consumer welfare, thereby justifying the relatively circumspect approach taken by the U.S. Supreme Court toward challenges to such restraints, as well as those of antitrust authorities around the world.[21] Empirical research also confirms the intuition that vertical restraints are primarily used to avoid free-riding and other issues related to vertical distribution.[22]

Although critics have been quick to attempt to refute these findings, at the very *worst* their criticisms show that the competitive effects of vertical restraints are uncertain, and wholly

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efficient provision of insurance, that is, a better capture of the retailers' informational rent (product competition)."). *See also* B. Douglas Bernheim & Michael D. Whinston, *Exclusive Dealing*, 106 J. POL. ECON. 64 (1998); David Martimort, *Exclusive Dealing, Common Agency, and Multiprincipals Incentive Theory*, RAND J. ECON. 2 (1996).

[19] *See* Ronald H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937).

[20] *See* Francine Lafontaine & Margaret Slade, *Vertical Integration and Firm Boundaries: The Evidence*, 45 J. ECON. LIT. 629 (2007); Francine Lafontaine & Margaret Slade, *Exclusive Contracts and Vertical Restraints: Empirical Evidence and Public Policy*, in HANDBOOK OF ANTITRUST ECONOMICS (Paolo Buccirossi ed., 2008). *See also* James C. Cooper, et al., *Vertical Antitrust Policy as a Problem of Inference*, 23 INT'L. J. INDUS. ORG. 639, 648 (2005) ("In reviewing this literature, two features immediately stand out: First, there is a paucity of support for the proposition that vertical restraints/vertical integration are likely to harm consumers. . . . Second, a far greater number of studies found that the use of vertical restraints in the particular context studied improved welfare unambiguously . . . ."); Daniel P. O'Brien, *The Antitrust Treatment of Vertical Restraints: Beyond the Possibility Theorems*, in THE PROS AND CONS OF VERTICAL RESTRAINTS 40, 76–81 (Konkurrensverket Swedish Competition Authority ed., 2008); Margaret E. Slade, *The Effects of Vertical Restraints: An Evidence Based Approach*, in REPORT: THE PROS AND CONS OF VERTICAL RESTRAINTS 12, 22 (2008) ("[Table 1 in this paper] indicates that voluntarily adopted restraints are associated with lower costs, greater consumption, higher stock returns, and better chances of survival.").

[21] *See* Nw. Wholesale Stationers, Inc. v. Pac. Stationery & Printing Co., 472 U.S. 284, 294-96 (1985) (instructing that the per se rule should not be applied to "cooperative activity involving a restraint or exclusion" where there are even "plausible arguments that [the activities] were intended to enhance overall efficiency and make markets more competitive"). *See also* Cal. Dental Ass'n v. FTC, 526 U.S. 756, 771 (1999).

[22] *See, e.g.,* Giorgio Zanarone, *Vertical Restraints and the Law: Evidence From Automobile Franchising*, 52 J. L. ECON. 691, 699 (2009) ("Taken together, these results are consistent with the view, shared by a broad range of economic theories, that vertical restraints are used to control horizontal and vertical externalities and to coordinate the price and service decisions of independent dealers.").

inappropriate for condemnation through rulemaking.[23] The reality is that the hundreds of studies canvassed by Lafontaine and Slade still constitute the overwhelming majority of the evidence we have; and many, if not most, of the studies are perfectly well done, even by modern standards. Indeed, Professor Lafontaine—formerly Director of the Bureau of Economics at the FTC—recently reiterated the relevance of the studies and restated the overall conclusions of the literature:

> We were clear that some of the early empirical evidence is less than ideal, in terms of data and methods.
>
> But we summarized by saying that the empirical literature reveals consistent evidence of efficiencies associated with the use of vertical restraints (when chosen by market participants) and, similarly, with vertical integration decisions.[24]

Again, it is of course true, as the Petition for Rulemaking asserts, that some vertical restraints, "by stifling or reducing business rivalry on the merits, can inflict substantial injury on consumers and sellers, in the form of higher prices, lower quality products for purchasers and lower prices and other less favorable terms of trade for suppliers."[25] But it is simply inaccurate to claim, as the Petition also does, that the "justifications for exclusivity are unpersuasive."[26] Rather, the vast weight of economic evidence and theory supports the competitive benefits of exclusivity in a multitude of circumstances. And to the extent that theoretical scholarship suggests possible harms, an honest assessment of this literature renders no clear policy prescription:

> While the analysis vindicates the leverage hypothesis on a positive level, its normative implications are less clear. Even in the simple models considered here, which ignore a number of other possible motivations for the practice, *the impact of this exclusion on welfare is uncertain*. This fact, combined with the difficulty of sorting out the leverage-based instances of tying from other cases, *makes the specification of a practical legal standard extremely difficult*.[27]

To dismiss this scholarship as "unpersuasive" in order to justify a blanket rule prohibiting exclusivity would be inconsistent with the FTC's "dual mission to protect consumers and promote competition."[28]

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[23] *See, e.g.*, Marissa Beck & Fiona Scott Morton, *Evaluating the Evidence on Vertical Mergers* 2 (Working Paper, Feb. 26, 2020), https://ssrn.com/abstract=3554073 ("*[M]any vertical mergers are harmless or procompetitive*, but that is a far weaker statement than presuming every or even most vertical mergers benefit competition *regardless of market structure*.") (emphasis added).

[24] Fed. Trade Comm'n, *Hearings on Competition and Consumer Protection in the 21st Century: FTC Hearing #5: Vertical Merger Analysis and the Role of the Consumer Welfare Standard in U.S. Antitrust Law*, Presentation Slides, at 93 (Nov. 1, 2018) (slides by Francine Lafontaine, Professor, Michigan-Ross), https://www.ftc.gov/system/files/documents/public_events/1415284/ftc_hearings_5_georgetown_slides.pdf.

[25] Petition for Rulemaking to Prohibit Exclusionary Contracts, *supra* note 5, at 1.

[26] *Id.* at 2.

[27] Michael D. Whinston, *Tying, Foreclosure, and Exclusion*, 80 AM. ECON. REV. 837, 855-56 (1990).

[28] What We Do, FEDERAL TRADE COMMISSION (last visited Sept. 30, 2021), https://www.ftc.gov/about-ftc/what-we-do.

IV. The value of exclusive dealing and non-compete clauses

Against this backdrop, a significant body of economic research shows that both exclusive dealing and non-compete clauses can generate significant benefits for consumers. This is further evidence that an outright prohibition on such clauses would be misguided.

For a start, exclusive dealing (i.e., "a contractual requirement by which retailers or distributors promise a supplier that they will not handle the goods of competing producers"[29]) can be used by manufacturers to intensify competition for distribution. As Benjamin Klein and Kevin Murphy explain: "exclusivity restrictions intensify competition by manufacturers for retail distribution, leading even retailers that do not possess any market buying power to receive substantially more favorable purchase terms from manufacturers, to the ultimate benefit of consumers."[30]

Likewise, exclusive dealing may align manufacturers' and retailers' incentives.[31] Indeed, retailers carrying goods from multiple manufacturers may have conflicting interests. By compensating retailers for discarding their outside option, exclusive dealing reduces moral hazard—both parties can thus more safely invest in the commercial relationship.[32] In other words, exclusive dealing arrangements prevent dealers from acting "opportunistically so as to avoid paying the manufacturer for valuable ancillary services provided in a tie-in to the product sold."[33]

Finally, along similar lines, it has been argued that exclusive dealing may be used to alleviate informational costs that would otherwise undermine commercial relationships. As David Martimort puts it, "[e]xclusive agents have few incentives to cheat when exposed to effective competition, and receive correspondingly lower informational rents. This benefit of competition as a retailer discipline device is the basic ingredient that favors exclusive dealing."[34] Martimort adds that exclusive dealing is thus often welfare-enhancing.[35]

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[29] Howard P. Marvel, *Exclusive Dealing*, 25 J. L. ECON. 1, 1 (1982).

[30] Benjamin Klein & Kevin M. Murphy, *Exclusive Dealing Intensifies Competition for Distribution*, 75 ANTITRUST L.J. 433, 437 (2008). Note that this may not be the only possible consequence of exclusive deals in every circumstance. *See, e.g.*, Jose Miguel Abito & Julian Wright, *Exclusive Dealing With Imperfect Downstream Competition*, 26 INT'L J. INDUS. ORG. 227, 227 (2008) ("An established upstream firm and competing downstream firms raise their joint profit by signing exclusive deals to protect the industry from upstream competition.").

[31] *See generally* Bernheim & Whinston, *supra* note 18.

[32] *See id.*

[33] Marvel, *supra* note 29, at 2.

[34] Martimort, *supra* note 18, at 28.

[35] *Id.* ("In markets where several manufacturers have chosen exclusive dealing, this vertical restraint may not be a sign that they are dominant firms which foreclose the market to potential rivals, but may instead be the outcome of effective competition. In fact, my welfare analysis characterizes some conditions under which the choice of this market structure, as opposed to a common agency one, is socially efficient.").

The economic literature on non-compete clauses is far less mature than that related to exclusive dealing. However, even at this relatively early stage, it is clear that the competitive impact of these clauses is markedly more ambiguous than some critics make it out to be.

First and foremost, non-compete clauses are substantively similar to exclusive dealing in that they compensate one party, in this case a supplier of labor activity, for eliminating, to some extent at least, its outside options. There is thus significant reason to believe that, just like exclusive dealing, these clauses can be used to align the incentives of a principal and an agent, thus reducing the scope for opportunistic behavior.

To wit, empirical research shows that *enforceable* non-compete clauses lead to higher CEO pay, and are more common when firms have intellectual capital that needs to be protected (and they thus stand to lose more if a CEO moves to a competitor).[36] This provides strong support to the idea that non-compete clauses are a means of alleviating principal/agent problems rather than a way for firms to anticompetitively reduce labor market competition.

Similarly, economists have shown that these clauses can encourage firms to invest in employee training programs and other forms of human capital, by eliminating the threat that either party may behave opportunistically after the fact.[37] These clauses might also enable firms to offer stable wages to employees who gain significant human capital on the job (*i.e.*, employees have a smoother salary progression than in the absence of such clauses).

Moreover, some have argued that non-compete clauses are a way of maintaining employee performance in the presence of minimum wage laws.[38] According to these authors, this has ambiguous welfare effects, as non-compete clauses can increase employment in industries that might otherwise be negatively affected by minimum wages.

Finally, it is worth noting that a loss of employee mobility—the most commonly cited detrimental effect of non-compete clauses—is not in and of itself a *negative*.[39] Indeed, as the above

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[36] *See* Omesh Kini, Ryan Williams & Sirui Yin, *CEO Noncompete Agreements, Job Risk, and Compensation*, 34 REV. FIN. STUD. 4701 (2021). As noted, however, the scholarship is not unanimous. *See, e.g.*, Tai-Yuan Chen, Guochang Zhang & Yi Zhou, *Enforceability of Non-Compete Covenants, Discretionary Investments, and Financial Reporting Practices: Evidence from a Natural Experiment*, 65 J. ACCOUNTING & ECON. 41 (2018).

[37] *See* Paul H. Rubin & Peter Shedd, *Human Capital and Covenants Not to Compete*, 10 J. LEGAL STUD. 93, 99 (1981) ("Our explanation of covenants not to compete is in terms of human capital. We argue that such clauses are needed to lead to efficient levels of investment in training when the person receiving training is unable to pay for the human capital by accepting reduced wages. An alternative explanation may be that such contracts serve to smooth out lifetime earnings of employees. Employers might choose to pay employees more than their marginal product in early years of employment and less than their marginal product later, thus providing employees with a smoother income pat- tern than would payment according to marginal productivity.").

[38] *See* Thomas Kohler & Fabian Schmitz, *Do Non-Compete Clauses Undermine Minimum Wages?*, ECONtribute Discussion Paper No. 021 (Aug. 2020) at 24 ("Because money is a better means to transfer utility, the principal only uses NCCs if a minimum wage constrains her wage setting. This explains both why NCCs are prevalent in low-wage jobs and why an increase in the minimum wage leads to more NCCs.").

[39] *See, e.g.,* Matt Marx, Deborah Strumsky & Lee Fleming, *Mobility, Skills, and the Michigan Non-Compete Experiment*, 55 MGMT. SCI. 875, 875 (2009). ("Using a differences-in-differences approach, and controlling for changes in the auto industry central

paragraphs make clear, absent non-compete agreements, employee mobility, driven by ex post opportunism, could well be *excessive* compared to the social optimum. This is particularly true when (i) employees have access to significant intangible capital and their departure might thus lead to informational spillovers, and, more generally, (ii) if the relationship between the employer and employee entails important co-specialized investments that might be lost in the absence of a credible long-term commitment.

The upshot is that there are dispositive procompetitive justifications for both exclusive dealing and non-compete clauses that render *per se* prohibitions particularly costly to consumers and economic growth. This is particularly true in innovative industries where intangible assets and co-specialized assets are most common. Of course, this is not to say that these clauses can never restrain competition,[40] but rather that because they routinely increase consumer welfare, and their deleterious effects appear limited to certain factual situations that must be assessed on a case-by-case basis, the rule of reason is more apposite than *per se* prohibitions (or *per se* legality, for that matter).

V. The FTC lacks authority to promulgate the proposed rules

Although Section 6(g) of the FTC Act authorizes the FTC "to make rules and regulations for the purpose of carrying out the provisions of this subchapter,"[41] the structure of the Act and recent Supreme Court case law make clear that the FTC lacks the authority to promulgate an unfair methods of competition rulemaking to address exclusive contracts or non-compete agreements.

Nowhere does the FTC Act expressly give the FTC rulemaking authority to prohibit conduct that it deems anticompetitive. And the Act's structure confirms this lack of authority. As the ABA has noted in comments submitted to the FTC:

> [T]he Commission's [6(g)] rulemaking authority is buried in within an enumerated list of investigative powers, such as the power to require reports from corporations and partnerships, for example. Furthermore, the Act fails to provide any sanctions for violating any rule adopted pursuant to Section 6(g). These two features strongly suggest that Congress did not intend to give the agency substantive rulemaking powers when it passed the Federal Trade Commission Act.[42]

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to Michigan's economy, we find that the enforcement of non-competes indeed attenuates mobility. Moreover, noncompete enforcement decreases mobility more sharply for inventors with firm-specific skills and for those who specialize in narrow technical fields.").

[40] *See, e.g.*, Chiara Fumagalli & Massimo Motta, *Exclusive Dealing and Entry, When Buyers Compete*, 96 AM. ECON. REV. 785, 786 (2006) ("Our central result is, therefore, that the potential for using exclusive contracts in an anticompetitive way crucially depends on the intensity of competition in the downstream markets.").

[41] 15 U.S.C. § 46(g).

[42] Comments of the Antitrust Law Section of the American Bar Association in Connection with the Federal Trade Commission Workshop on "Non-Competes in the Workplace: Examining Antitrust and Consumer Protection Issues" (Apr. 24, 2020) at 54, FTC Docket No. FTC-2019-0093, *available at* https://www.americanbar.org/news/abanews/aba-news-archives/2020/04/aba-antitrust-law-section-releases-comments-to-ftc-on-non-compet/.

Similarly, the absence of any provision for sanctions in the Act for 6(g) rule violations indicates that Congress did not intend for the provision to authorize the promulgation of substantive rules.[43] And, indeed, FTC Commissioners and other commentators have long held this view. As one Commissioner wrote in 1964:

> [T]his much is clear: the object of the Commission's rulemaking and other administrative procedures in the administration of section 7 is not to promulgate per se rules or codes rigidly demarcating the lawful limits of merger activity. Rulemaking in this area should be regarded as primarily a method of inquiry—of finding the facts respecting specific market situations, appraising their significance, and making public the conclusions reached.[44]

By contrast, Congress expressly granted the FTC authority to promulgate rules relating to specific statutes and under the Commission's unfair and deceptive acts and practices authority through so-called "Magnuson-Moss" rulemaking procedures.[45] And where it did so, Congress clearly defined the scope of the FTC's authority, providing clear guidelines and limits on the Commission's authority. The absence of any such constraints on 6(g) rulemaking strongly indicates that Congress did not contemplate that the 6(g) authorizes substantive rulemaking. As the ABA comment aptly notes:

> Although Magnuson-Moss purported to leave the Commission's rulemaking power under Section 6(g) with respect to unfair methods of competition undisturbed, Congress did nothing to clarify the nature and extent of that authority. And given that Magnuson-Moss was enacted to address concerns raised by *National Petroleum Refiners* and similar cases, it's hard to see Section 6(g), with its vague and broad language, as providing a firm footing for informal antitrust rulemaking by the Commission. Accordingly, in 1980, the Section observed: "It clearly would be anomalous if the FTC could adopt an antitrust rule based simply on a notice and comment proceeding under the Administrative Procedure Act, while being required to follow the procedural guards Congress mandated for rules in the consumer protection area."[46]

The *National Petroleum Refiners* case did uphold the FTC's Section 6(g) authority, rejecting the argument that Section 6(g) "is limited to specifying the details of the Commission's nonadjudicatory, investigative and informative functions spelled out in the other provisions of Section 6 and should not be read to encompass substantive rulemaking in implementation of Section 5 adjudications."[47] But, as noted, Magnusson-Moss procedures were implemented precisely

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[43] *See* Thomas W. Merrill & Kathryn Tongue Watts, *Agency Rules with the Force of Law: The Original Convention*, 116 HARV. L. REV. 467, 504–05 (2002) ("The failure to provide any sanction for the violation of rules adopted under section 6(g), along with the placement of the rulemaking grant in section 6, which conferred the FTC's investigative powers, clearly suggests that Congress intended the rulemaking grant to serve as an adjunct to the FTC's investigative duties, regarding which Congress had not given the agency the authority to act with the force of law.").

[44] Philip Elman, *Rulemaking Procedures in the FTC's Enforcement of the Merger Law*, 78 HARV. L. REV. 385, 390 (1964).

[45] *See* Federal Trade Commission Improvements Act of 1975, § 202(b), Pub. L. No. 93-637, 88 Stat. 2183, 2198 (1975).

[46] Comments of the Antitrust Law Section, *supra* note 42, at 57 (*quoting* ABA SECTION OF ANTITRUST LAW, REPORT OF THE SECTION CONCERNING FEDERAL TRADE COMMISSION STRUCTURES, POWERS, AND PROCEDURES 340 (1980)).

[47] National Petroleum Refiners Ass'n v. F.T.C., 482 F.2d 672, 676 (D.C. Cir. 1973).

to address concerns raised by the case and then-recent FTC rulemaking practices, and it is extremely unlikely that it stands as good law today following the passage of the Antitrust Improvements Act of 1975.

This conclusion is only bolstered by the Supreme Court's recent (unanimous) holding in *AMG Capital v. FTC*.[48] Although *AMG Capital* relates directly to the FTC's 13(b) authority, the Court's holding is broadly indicative of its interpretation of the entirety of the FTC Act, and suggests a strong current of restraint on claims of implicit authority: "But to read those words as allowing what they do not say . . . is to read the words as going well beyond the provision's subject matter. In light of the historical importance of administrative proceedings, that reading would allow a small statutory tail to wag a very large dog."[49] Citing its holding in *Whitman v. American Trucking*, the Court made clear in *AMG Capital* that the absence of clear congressional authority would preclude finding such extensive powers by implication: "By contrast, the Commission's broad reading would allow it to use §13(b) as a substitute for §5 and §19. For the reasons we have just stated, that could not have been Congress' intent."[50]

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[48] AMG Capital Management, LLC, et al. v. Federal Trade Commission, 41 S. Ct. 1341 (2021)..

[49] *Id.* at 1348.

[50] *Id.* at 1349 (*citing* Whitman v. American Trucking Assns., Inc., 531 U. S. 457, 468 (2001) ("Congress . . . does not . . . hide elephants in mouseholes")).