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Is Liberal Enforcement of Noncompetes Still Good Policy?

To prompt discussion about the economic impact of Georgia's noncompete law, this article discusses policy considerations and gives practical suggestions for how Georgia's noncompete law might be amended to effectively support employers without unnecessarily burdening employees.

BY BENJAMIN I. FINK

In 2011, the law in Georgia relating to enforcement of noncompetes and other restrictive covenants changed significantly as a result of the passage of the statute that is commonly referred to as the "Restrictive Covenant Act" or "RCA."[1] Prior to that time, the Georgia Constitution prohibited contracts that had the effect of or were intended to defeat or lessen competition.[2] That prohibition resulted in a long line of case law in Georgia that was hostile to enforcement of restrictive covenants, particularly in the employment context.

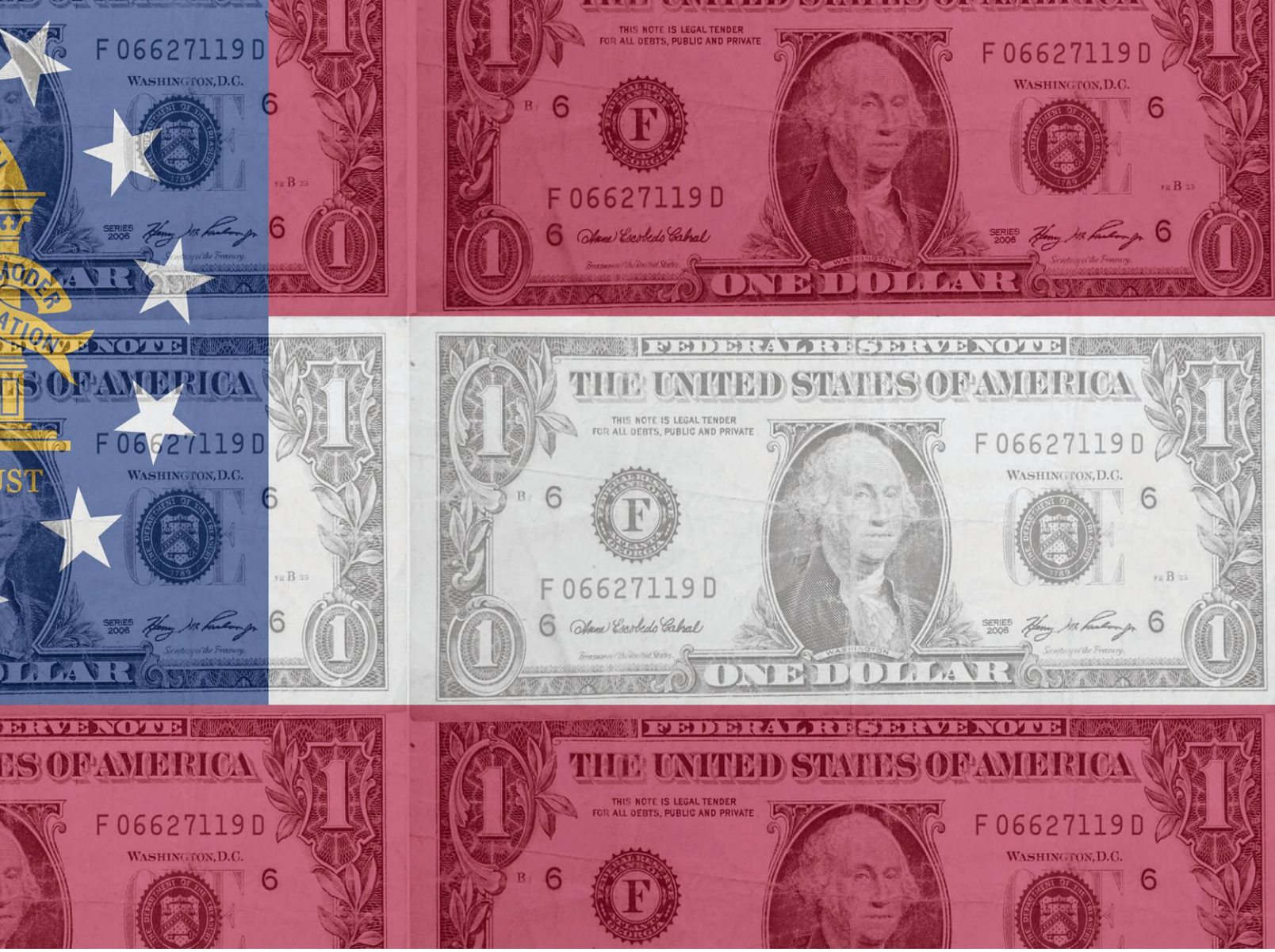
The RCA made it much easier for companies to enforce noncompetes, especially against former employees. In passing the law, the General Assembly found that "reasonable restrictive covenants contained in employment and commercial contracts serve the legitimate purpose of protecting legitimate business interests and creating an environment that is favorable to attracting commercial enterprises in Georgia and keeping existing businesses within the state."[3]

It is undoubtedly true that more liberal enforcement of noncompetes helps many employers; however, there is little evidence that proponents of the RCA considered the negative effects the law could have on Georgia's economy as a whole. For example, while the law was being debated in the Legislature, a few members of the public, including this author, called upon Georgia lawmakers to consider studies that suggest greater enforcement of noncompetes can hinder overall economic development and entrepreneurial activity.[4] These recommendations for further research and analysis were largely ignored.

Much has changed in the national noncompete landscape since 2011 and many of the policies commonly cited as the basis for strict enforcement of noncompetes are now being heavily scrutinized by state legislatures.[5] The massive job losses resulting from the coronavirus pandemic may accelerate this trend, especially with respect to lower wage workers.

In October of 2016, in response to a report released by the U.S. Department of Treasury, President Obama issued a call to action on "unnecessary" noncompete agreements.[6] This call to action received support from elected officials in a few states, as well as from prominent social scientists who study noncompetes.[7] The Trump administration has continued to scrutinize noncompete agreements and various bills have been introduced by Congress seeking to curtail the use of noncompetes.[8]

In addition, the Federal Trade Commission (FTC) has been pulled into the national reassessment of noncompetes.[9]



Earlier this year, the FTC held a public workshop on possible rulemaking to determine whether there is sufficient legal and empirical support to promulgate a rule restricting the use of noncompetes.[10]

These developments demonstrate a growing national interest in reassessing noncompetes. This interest is perhaps partially fueled by a number of economic and social studies that support some of the cautionary pleas made by this author in 2011. Considering the recent national trend toward reevaluating noncompetes, as well as the introduction of new empirical data related to noncompetes, the time may be ripe for Georgia lawmakers to revisit Georgia's noncompete law and its impact on economic development in Georgia. To prompt discussion about the economic impact of Georgia's noncompete law, this article discusses some of these policy considerations. Additionally, this article gives practical suggestions for how Georgia's noncompete law might be amended to effectively support employers without unnecessarily burdening employees.

Background

In most states, except those most hostile to noncompetes, the law typically allows for the enforcement of noncompetes as long as they are reasonable, requiring courts to balance the interests of employers, employees and society as a whole in making a reasonableness determination.[11] This approach typically provides the courts with wide discretion in determining on a case-by-case basis whether a noncompete should be enforced, allowing increased flexibility in the law. Following enactment of the RCA, Georgia follows this approach.

However, some scholars have argued that this reasonableness test for enforceability leads to inconsistency in enforcement,[12] as well as the misallocation of human resources, reduced economic growth, innovation and even employee performance.[13] Further, some scholars have argued that a legal regime in which noncompetes are strictly enforced is inconsistent with the current state of the economy and the realities of the current employment model in the United States, including the shift from employers promising long-term job stability in exchange for employee loyalty to a model comprised of job instability and increased employee mobility.[14] Noncompetes "may also serve anticompetitive ends, including limiting wage growth by restraining labor-market competition from product-market competitors, retarding product-market competition by reduc-

ing information flows to competitors and preempting future competition from departing employees."[15]

The Policy Considerations

The Use of Noncompetes to Protect Trade Secrets

One of the primary arguments for the use of noncompetes in the employment context by employers is that they are necessary to prevent unfair competition through an employee's misappropriation of confidential information, trade secrets or other key competitive knowledge learned through employment or as a result of training.[16] While trade secrets statutes provide for injunctive relief for actual or threatened misappropriation of trade secrets, as well as potential damages for actual misappropriation, this type of protection may sometimes be insufficient for employers as the damage may already be done by the time they are able to obtain an injunction.[17] There is certainly a valid concern that neither trade secret law nor nondisclosure agreements provide the level of protection offered by noncompetes. Noncompetes can prevent an employee from taking a role with a competitor that would put the former employer's trade secrets and other confidential business information at risk of being used or disclosed. On the other hand, based on studies suggesting the availability of other legal mechanisms such as nondisclosure agreements, confidentiality agreements and trade secrets statutes, as well as the inability of noncompetes to adequately protect trade secrets without overreaching to cover non-protectable information and without overly restricting job mobility, policy-makers should at least consider whether noncompetes are the most appropriate way in which to protect an employer's trade secrets from former employees' improper use or disclosure.[18]

Researchers at MIT and Harvard have concluded that states that enforce noncompetes tend to experience lower venture capital investment than states that proscribe enforcement, and that the strict enforcement of noncompetes drives away some of the "best and brightest."

What Impact do Noncompetes have on Economic Development?

Proponents of noncompetes argue that businesses are less likely to open offices or locate in jurisdictions where courts frequently strike down noncompetes and that this stems from concerns about their ability to restrict their employees from leaving to join competitors. Yet, some studies suggest that strict enforcement of noncompetes may not be in the best interest of all businesses or overall economic development.[19] Researchers at MIT and Harvard have concluded that states that enforce noncompetes tend to experience lower venture capital investment than states that proscribe enforcement,[20] and that the strict enforcement of noncompetes drives away some of the "best and brightest."[21] Thus, highly accomplished executives may be more likely to locate in states that do not favor enforcement of noncompetes as they may believe they can maximize their compensation in those states. In addition, several studies suggest that enforcing noncompetes may inhibit entrepreneurs from starting new businesses.[22] These studies at least suggest that the historical rationale for noncompete enforcement should be reexamined.

What Impact Do Noncompetes Have on Innovation?

Proponents of noncompetes have also traditionally argued that they give businesses an incentive to engage in costly research and development activities, which lead to innovations in products

and services, thereby making businesses more competitive.[23] Without such protections, employers may be less likely to spend money on research and development because employees could more easily walk away from the business and take their knowledge to a competing business.

Conversely, one study has found that stricter enforcement of noncompetes reduces research and development spending and capital expenditures per employee.[24] Other studies conclude that the enforcement of noncompetes may actually reduce technological advancement, innovation and economic growth for businesses due to the lack of information spillover created by employee mobility.[25] Further, one scholar has concluded that the use of noncompetes as protection for intellectual property rights such as trade secrets may inhibit downstream innovation because former employees may be sufficiently afraid of becoming "enmeshed in litigation" as a result of using such information to engage in competitive activities, such as creating a competing enterprise.[26]

What Impact Do Noncompetes Have on Employee Performance?

A newer argument against the strict enforcement of noncompetes in the employment context is that such enforcement stifles employee performance. In a recent study, researchers found that subjects in simulated noncompete conditions showed significantly less motivation in their jobs and got worse results on effort-based tests. They conclude that restrictions on an employee's future employment not only dim the employee's later employment prospects, but also "decrease their perceived ownership of their jobs, sapping their desire to exert themselves and develop their skills."[27]

There is some evidence to suggest that restricted employees' negative perceptions of their future market opportunities may be justified. According to another recent study, employees who work in states where noncompetes are enforced generally accumulate less income than employees who live in states where noncompetes are not enforced.[28] Scholars suggest that this is because the restricted employees are not free to pursue higher-paying opportunities when they come along.[29] Similarly, some studies suggest that in areas where noncompetes are regularly enforced, even employees who are not bound by noncompetes see reduced wages and employment opportunities.[30]

Suggestions for Reforming Georgia's Noncompete Law

Given the state of the research, the question that should be asked is whether the law surrounding noncompete agreements needs wholesale change or whether the occasional abuse of noncompetes is what really creates the problems (like unpaid interns and minimum wage sandwich makers). While abuses certainly exist and should be curbed, the studies referenced above suggest that Georgia's noncompete law could be reformed to enhance the benefits of noncompetes while reducing the burden they place on Georgia's employees. The reformation could include at least four major components.

First, Georgia should consider expressly banning noncompetes for low-wage workers. Georgia's current noncompete law does not clearly delineate which employees may be subjected to a noncompete.[31] While the drafters may not have intended for the statute to allow noncompetes against low-wage employees, there is enough room in the statute's language to argue that these employees may be restricted by a noncompete in certain circumstances. However, low-wage workers typically are not privy to the type of information noncompetes are meant to protect, and even if they are, there are other less burdensome legal mechanisms employers may use to protect their information. This rationale prompted several states to ban noncompetes for low-wage workers in 2019.[32] Georgia should consider following suit.

Second, Georgia should consider requiring employers to give employees and job candidates advance notice that they will be asked to sign a noncompete. Requiring employers to give employees advance notice would prevent the common scenario of new employees hastily signing a noncompete on their first day of work and would give employees a chance to consider the implications of signing a noncompete before accepting employment.[33] Relatedly, consideration should be given to offering existing employees something more than continued employment as consideration in support of a noncompete. This consideration might include a one-time payment, equity incentives, additional paid time off or something else of value.

Third, Georgia should consider adopting a relatively new approach, called "purple penciling" by some experts,[34] when evaluating the enforceability of noncompetes. The purple pencil approach is a combination of a judicial modification approach, in which courts may "modify" a noncompete by rewriting its language, and a red pencil approach, in which courts simply void an overly broad noncompete. Under the purple pencil approach, courts must void a noncompete entirely unless the document shows an unambiguous intent to draft narrow restrictions on the employee, in which case, a court may modify the noncompete.

Finally, Georgia should consider expressly empowering courts to craft broad remedial measures when an employee intentionally violates other legal obligations, such as a non-disclosure covenant or customer non-solicitation covenant, including, when appropriate, prohibiting the employee from working for a competitor for a limited period of time. Some have referred to this as a "springing" or "time-out" noncompete.[35] A springing noncompete is one that an employee is not initially subjected to by an employer, but may be imposed on an employee by a court if the employee violates another less restrictive covenant. By allowing courts to impose springing noncompetes, Georgia employers will be encouraged to use less restrictive covenants with the assurance that courts can impose more substantial protective remedies on dishonest and non-compliant employees.

Conclusion

The question of the extent to which noncompetes should be enforceable in the employment context appears to have no clear answer. On the one hand, em-

ployers have a very legitimate interest in protecting their business assets from unfair competition by former employees and their new employers. On the other, employees, and the greater economy as a whole, have a legitimate interest in having the ability to change jobs and not being chained to a specific job as a result of their knowledge of information that may be used in a new position. The public also has a legitimate interest in a competitive marketplace. Accordingly, as a starting point, Georgia lawmakers should consider taking steps to reduce the use of noncompetes against low-wage employees, to ensure employees are aware they may be asked to sign a noncompete and to encourage employers to use less restrictive covenants by empowering courts to more effectively deal with over broad noncompetes and, on the other hand, with dishonest or non-compliant employees. ●

Thank you to Lauren Frisch and Ben Perkins, associates at Berman Fink Van Horn, for their assistance with this article.

Benjamin I. Fink is a shareholder in the Atlanta law firm Berman Fink Van Horn P.C. where his practice focuses on noncompete, trade secret and other competition-related disputes. In recognition of his thought leadership in the trade secrets arena, he was invited to serve on the Sedona Conference drafting team for Principles/Best Practices Commentary on Protecting Trade Secrets in Litigation as part of Working Group 12 on Trade Secrets.

Endnotes

1. HB 30, 151st Leg., Reg. Sess. §1 (Ga. 2011).
2. Ga. Const. art. III, § VI, para. V(c) (*amended by* Ga. Const. art. III, § VI, para. V(c)(1)-(3)).
3. HB 173, 150th Leg., Reg. Sess. §3 (Ga. 2009).
4. Ga. State Univ. Law Review, *Contracts HB 30,* 28 Ga. St. U. L. Rev. 21, 29 (2012).
5. Over the last few years, Massachusetts, Washington, Maryland and Oregon have imposed new limits on employers' use of non-competes. Bills to modify non-compete laws have been introduced in over 30 states, with 37 bills pending in 18 states (plus Washington D.C.). Nineteen of those states have enacted legislation modifying their preexisting non-compete laws, some strengthening non-competes, but most making it harder to enforce them. *See The Changing Landscape of Trade Secrets Laws and Noncompete Laws Around the Country*, https://www.faircompetitionlaw.com/changing-landscape-oftrade-secrets-laws-and-noncompete-laws/.
6. *See* Office of Economic Policy, U.S. Department of Treasury, *Non-compete Contracts: Economic Effects an, Policy Implications* (March 2016); White House, Office of the Press Secretary, FACT SHEET: The Obama Administration Announces New Steps to Spur Competition in the Labor Market and Accelerate Wage Growth (October 25, 2016).
7. *See id. See also* Olav Sorenson & Matthew Marx, *Restricting Employment Restrictions* (November 16, 2016), http://insights.som.yale.edu/insights/restricting-employment-restrictions.
8. Evan Starr, *The Use, Abuse, and Enforceability of Non-Compete and No-Poach Agreements: A Brief Review of the Theory, Evidence, and Recent Reform Efforts*, Econ. Innovation Group, 2-3 (Feb. 2019), https://eig.org/wp-content/uploads/2019/02/Non-Competes-Brief.pdf; David M. Walsh & Colin A. Thakkar, *A Renewed Attempt in Congress to Eliminate Non-Compete Agreements*, The Nat'l L. Rev. (Nov. 24, 2019); Workforce Mobility Act of 2020, H.R. 5710, 116th Cong. (2020).
9. Russell Beck & Erika Hahn, *Noncompete Misconceptions May Be Inhibiting Reform*, Law 360 (Dec. 17, 2019), https://www.law360.com/articles/1228569/noncompete-misconceptions-may-be-inhibiting-reform.
10. *FTC to Hold Workshop on Non-Compete Clauses Used in Employment Contracts*, Fed. Trade Commission (Dec. 5, 2019), https://www.ftc.gov/news-events/press-releases/2019/12/ftc-hold-workshop-non-compete-clauses-used-employment-contracts. At the workshop, the FTC asked stakeholders what effect noncompetes have on the labor market, how businesses justify them, and whether the federal government should address "potential harms" not addressed by current law and regulation.
11. The 1711 case of *Mitchel v. Reynolds*, 24 Eng. Rep. 347 (Q.B. 1711) established the modern reasonableness framework. *See* Catherine L. Fisk, *Working Knowledge: Trade Secrets, Restrictive Covenants in Employment, and the Rise of Corporate Intellectual Property, 1800–1920*, 52 Hastings L.J. 441, 453–54 (2001); Alger v. Thacher, 36 Mass. 51, 53 (1837).
12. Daniel P. O'Gorman, *Contract Theory and Some Realism About Employee Covenant Not to Compete Cases*, 65 SMU L. Rev. 145, 185 (2012).
13. *See* Michael J. Garrison & John T. Wendt, *The Evolving Law of Employee Noncompete Agreements: Recent Trends and an Alternative Policy Approach*, 45 Am. Bus. L.J. 107, 168-69 (2008); Norman D. Bishara, *Fifty Ways to Leave Your Employer: Relative Enforcement of Covenants Not to Compete, Trends, and Implications for Employee Mobility Policy*, 13 U. PA. J. BUS. L. 751, 761 (2011); Katherine V.W. Stone, *Knowledge at Work Disputes Over the Ownership of Human Capital in the Changing Workplace*, 34 Conn. L. Rev. 721, 723 (2002); Ronald J. Gilson, *The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete*, 74 N.Y.U. L. Rev. 575, 578 (June 1999); On Amir & Orly Lobel, *Driving Performance: A Growth Theory of Noncompete Law*, 16 Stan. Tech. L. Rev. 833, 836 (2013).
14. *See* Garrison & Wendt, *supra* note 13, at 166-167.
15. Starr, Evan, et al., *Noncompetes in the U.S. Labor Force*, U. of Mich. Law & Econ. Research Paper No. 18-013 (May 7, 2020).
16. Garrison & Wendt, *supra* note 13, at 166-167.
17. *See* Randy Burton, et al., *The Sound of Inevitability: The Doctrine of Inevitable Disclosure of Trade Secrets Comes to Texas*, 44 SPG Tex. J. Bus. L. 103, 123 (2012).

18. *See* Viva R. Moffat, *Making Non-Competes Unenforceable*, 54 Ariz. L. Rev. 939, 980 (2012); Garrison & Wendt, *supra* note 13, at 116, 178.
19. *See* April Franco & Matthew Mitchell, *Covenants Not to Compete, Labor Mobility and Industry Dynamics*, 44 – 46 (Mar. 21, 2005), http://www.lse.ac.uk/fmg/research/RICAFE/pdf/Franco_April.pdf; *see also* Richard A. Booth, *Hurd on the Street?* The National Law Journal (Oct. 25, 2010) (California law against non-competes is good for business, particularly the technology business, as it seemed to have led to the rise of Silicon Valley and increased innovation by allowing information sharing that would otherwise not have been possible; further, without the restrictions of non-competes, employees are free to leave less productive companies whenever they so choose, which helps to create a more efficient marketplace and allows the best employees to be hired by the best businesses); Matt Marx & Lee Fleming, *Non-compete Agreements: Barriers to Entry... and Exit?*, 12 Innovation Policy and the Economy 39 – 64 (2011), http://funginstitute.berkeley.edu/sites/default/files/Non-compete%20agreements%20barriers%20to%20exit.pdf; Ronald J. Gilson, *The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete*, 74 N.Y.U. L. Rev. 575, 578 (June 1999); John Krafcik, *A Little-Known California Law is Silicon Valley's Secret Weapon*, p. 6 (2017), http://www.vox.com/new-money/2017/2/13/14580874/google-self-driving-noncompetes.
20. Sampsa Samila & Olav Sorenson, *Non-compete Covenants: Incentives to Innovate or Impediments to Growth,* Danish Research Unit for Industrial Dynamics Working Paper No. 10-02, (2011), https://pdfs.semanticscholar.org/609e/74a33834304a4dcf39c2321f601c37935334.pdf?_ga=2.101460673.1105628633.1592400522-1801095256.1592400522.
21. *See* Marx & Fleming *supra* note 19, at 55; *see also* Matt Marx, et al., *Regional Disadvantage? Non-compete Agreements and Brain Drain*, p. 19 (2012), https://faculty.insead.edu/jasjit-singh/documents/marx_singh_fleming_regional-disadvantage.pdf; Matt Marx, et al., *Mobility, Skills, and the Michigan Non-Compete Experiment*, 55 Mgmt. Sci. 875(2009) (finding that "[t]he job mobility of inventors in Michigan fell 8.1% following the policy reversal compared to inventors in other states that continued to proscribe non-competes, and these effects were amplified for those with particular characteristics"); Matt Marx, et.al., *Noncompetes and Inventor Mobility: Specialists, Stars, and the Michigan Experiment*, Working Paper No. 07-042 (2007), http://www.hbs.edu/faculty/Publication%20Files/07-042.pdf.
22. Starr, *supra* note 8.
23. Garrison & Wendt, *supra* note 13, at 168.
24. Mark J. Germaise, *Ties that Truly Bind: Non-Competition Agreements, Executive Compensation and Firm Investment* (2009), http://personal.anderson.ucla.edu/mark.garmaise/noncomp7.pdf.
25. Garrison & Wendt, *supra* note 13 at 169-70; *see also* Moffat, *supra* note 18, at 979; Anna Lee Saxenian, *Regional Advantage: Culture and Competition in Silicon Valley and Route 128*, Cambridge, Massachusetts: Harvard University Press (1994).
26. Viva R. Moffat, *The Wrong Tool for the Job: The IP Problem with Non-Competition Agreements*, 52 Wm. & Mary L. Rev. 873, 911 and n. 150 (2011). While there is no dearth of studies suggesting non-competes have the potential to stifle innovation, some authors suggest that the studies underlying this notion, like the comparison between Silicon Valley and Massachusetts, are not as impactful as many believe. *See, e.g.*, Jonathan Barnett & Ted Sichelman, *The Case for Non-Competes*, U. Chi. L. Rev. (forthcoming 2020).
27. On Amir & Orly Lobel, *How Noncompetes Stifle Performance*, Harvard Bus. Rev., Jan.–Feb. 2014, at 26.
28. Natarajan Balasubramanian, et al., *Locked In? The Enforceability of Covenants Not to Compete and the Careers of High-Tech Workers*, 28-29 (U.S. Census Bureau Ctr. for Econ. Studies, Paper No. CES-WP-17-09, 2018), https://ssrn.com/abstract=2905782.
29. Starr, *supra* note 8. Starr also concludes that because non-competes diminish employee wages and mobility and reduce new firm entry into the market, companies located in states that enforce non-competes are attractive acquisition targets. Starr also references studies that suggest non-competes raise hiring costs for firms that hope to acquire employees/other companies in states that enforce non-competes. *Id.* at 12.
30. Evan Starr, et al., *Mobility Constraint Externalities* 30 Org. Sci. 869 (2019). Yet, another recent study suggests that reducing use of non-competes, at least among low-wage employees, can increase employees' wages and mobility. Michael Lipsitz & Evan Starr, *Low-Wage Workers and the Enforceability of Non-Compete Agreements* (December 9, 2019), https://ssrn.com/abstract=3452240 or http://dx.doi.org/10.2139/ssrn.3452240. *Compare Study Finds Noncompete Clauses Affect How Employees Behave, To Benefit Of Employers*, https://news.ku.edu/2019/03/25/study-finds-non-compete-clauses-affect-how-employees-behave-benefit-employers.
31. *See* O.C.G.A. § 13-8-53(a); *see also* Blair v. Pantera Enters., Inc., 394 Ga. App. 846, 824 S.E.2d 711 (2019) (backhoe operator not an employee subject to a non-compete under the RCA); Kennedy v. Shave Barber Co., LLC, 348 Ga. App. 298, 822 S.E.2d 606 (Ga. Ct. App. 2018) (hair stylist is a key employee under the RCA); CSM Bakery Sols., LLC v. Debus, 1:16-CV-03723-TCB, 2017 WL 2903354 (N.D. Ga. Jan. 25, 2017) (non-compete not permitted against bakery manufacturer sales representative).
32. Benjamin I. Fink, *Employer Alert: Non-Competes Are Under Attack in Certain States*, BFVLaw.com: Georgia Non-Compete & Trade Secrets (Aug. 28, 2019), https://www.bfvlaw.com/employer-alert-non-competes-are-under-attack-in-certain-states/.
33. When employees are given advance notice that a non-compete will be required non-competes may have positive effects such as higher wages, more training, information and job satisfaction. *See* Starr, *supra* note 15, p. 15.
34. *See, e.g.*, Beck & Hahn, *supra* note 9.
35. *Id.*