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Is Strict Enforcement of Non-Competes Good Policy?

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Introduction

The use of noncompetes in the employment context has long been the subject of controversy in the United States. On the one hand, there are states in which noncompetes are liberally enforced against employees. On the other hand, there are states that have historically been hostile to employment noncompetes. And a fair number of states fall somewhere in the middle. In the majority of states, except the ones most hostile to noncompetes, the law typically allows for the enforcement of noncompetes as long as they are reasonable. When making a reasonableness determination, courts are required to balance the interests of employers, employees, and society as a whole.

This approach typically provides the courts with wide discretion to determine on a case-by-case basis whether a noncompete should be enforced, allowing increased

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flexibility in the law. However, scholars and researchers have argued that this reasonableness test for enforceability, which has been adopted in the majority of states, leads to inconsistent outcomes,[1] the misallocation of scarce human resources, and reduced economic growth, innovation, and employee performance.[2]

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 new realities of the employment model in the United States, including the shift from employers promising long-term job stability in exchange for employee loyalty to an industrial model comprised of job instability and increased employee mobility.[3]

The purpose of this article is to examine noncompetes from a historical perspective, providing insight as to why noncompete law has developed in the United States in the way that it has. The article will also examine the uses of noncompetes in the employment context and whether they are effective in achieving their purported goals.

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[1] Daniel P. O'Gorman, *Contract Theory and Some Realism About Employee Covenant Not to Compete Cases*, 65 SMU L. REV. 145, 185 (2012).

[2] *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).

[3] *See* Garrison &Wendt, *supra* note 2, at 166-167.

Historical Perspective

The laws relating to the use of noncompetes in the employment context are rooted heavily in English common law beginning in the seventeenth century guild system.[4] An oft-cited hornbook, *Clark on Contracts*, states that a contract in unreasonable restraint of trade is contrary to public policy and void.[5] The rationale for the historical hostility toward employment noncompetes is set forth in this treatise:

> The unreasonableness of contracts in restraint of trade and business is very apparent from several obvious considerations: (1) Such contracts injure the parties making them, because they diminish their means of procuring livelihoods and a competency for their families[;] (2) They tend to deprive the public of the services of men in the employments and capacities in which they may be most useful to the community as well as to themselves[;] (3) They discourage industry and enterprise, and diminish

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[4] *See* O'Gorman, *supra* note 1. As noted in Mr. O'Gorman's work, the move toward enforcement of noncompetes in the employment context was seen in nineteenth century English courts when the courts began to cite *Mitchel v. Reynolds*, an eighteenth-century case which upheld a noncompete included in a contract ancillary to the sale of a business because it was "reasonable." Specifically, while there is a presumption that any restraint of trade is invalid because such agreements may cause hardship on the seller of the business resulting from an inability to earn a livelihood, cause harm to society from losing the seller's services, and enable a business to develop a monopoly, in *Mitchel*, the noncompete was reasonable because the agreement was ancillary to the sale of a business, not employment, and would result in hardship to a businessperson who wanted to retire but could not obtain an acceptable price because the buyer could not be assured the seller would not compete against him. The Court in *Mitchel* stated there may have been a difference had the noncompete been ancillary to an employment agreement but also noted there is a distinction between "general" and "partial" restraint, the former being invalid as a matter of law. This reasonableness approach to determining the validity of a noncompete influenced much of the law in the United States as it relates to noncompetes in the employment context.

[5] WILLIAM LAWRENCE CLARK, HANDBOOK OF THE LAW OF CONTRACTS 304 (2d ed. 1914).

> the products of ingenuity and skill[;] (4) They prevent competition and enhance prices[; and] (5) They expose the public to all the evils of monopoly.[6]

Courts have also been suspicious of employment noncompetes because they are often considered to be the result of unequal bargaining power and constitute contracts of adhesion.[7]

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[6] These justifications for invalidating contracts in unreasonable restraint of trade are cited in a number of cases since the late 1800s and early 1900s, including: Rakestraw v. Lanier, 104 Ga. 188, 194 (1898); Freudenthal v. Espey, 45 Colo. 488 (1909); Arthur Murray Dance Studios of Cleveland v. Witter, 105 N.E.2d 685, 62 Ohio Law Abs. 17 (Ohio Ct. Common Pleas 1952).

[7] *See* Buffkin v. Glacier Grp., 997 N.E.2d 1, 10 (Ind. Ct. App. 2013) (citing RESTATEMENT (SECOND) OF CONTRACTS § 188, cmt. g (1981) ("Post-employment restraints are scrutinized with particular care because they are often the product of unequal bargaining power and because the employee is likely to give scant attention to the hardship he may later suffer through loss of his livelihood."); Ultra Lube, Inc. v. Dave Peterson Monticello Ford-Mercury, Inc., 2002 WL 31302981, at *6 (Minn. Ct. App. Oct. 15, 2002) (The Supreme Court expressed concern about unequal bargaining power between employee and employer because "it may well be surmised that such a covenant finds its way into an employment contract not so much to protect the business as to needlessly fetter the employee, and prevent him from seeking to better his condition by securing employment with competing concerns. One who has nothing but his labor to sell, and is in urgent need of selling that, cannot well afford to raise any objection to any of the terms in the contract of employment offered to him, so long as the wages are acceptable."); Johnstone v. Tom's Amusement Co., Inc., 228 Ga. App. 296, 299 (1997) ("The rationale behind the distinction in analyzing covenants not to compete is that a contract of employment inherently involves parties of unequal bargaining power to the extent that the result is often a contract of adhesion…"); Sentry Ins. Co. v. Firnstein, 14 Mass. App. Ct. 706, 707 (1982) ("[Non-competes in the employment context] are scrutinized with particular care because they are often the product of unequal bargaining power and because the employee is likely to give scant attention to the hardship he may later suffer through the loss of his livelihood.").

Despite this historical hostility to noncompetes, many states enforce them where they are deemed to be reasonable.[8] In making a reasonableness determination, courts typically consider the nature and extent of the trade or business and the situation of the parties.[9] Specifically, the courts will normally analyze

> whether the restraint is such only as to afford a fair protection to the interests of the party in favor of whom it is given, and not so large as to interfere with the interests of the public. Whatever restraint is larger than the necessary protection of the party can be of no benefit to either. It can only be oppressive, and, if oppressive, it is, in the eye of the law, unreasonable. Whatever is injurious to the interests of the public is void on the ground of public policy.[10]

This type of determination requires the courts to balance the interests of employers, employees, and the public in enforcing a noncompete in the employment context, while acknowledging that such agreements are generally heavily scrutinized.[11]

In October 2016, then President Obama issued a call to action on "unnecessary" noncompete agreements[12] urging Congress to pass federal legislation to eliminate

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[8] This is arguably consistent with *Clark on Contracts*, in which Mr. Clark states that "[p]ublic policy requires…that the freedom of persons to enter into contracts shall not be lightly interfered with. Some restraint of trade, therefore, must be permitted, [but the agreement] must not be unreasonable." CLARK, *supra* note 5, at 305.

[9] *Id.*

[10] *Id.* (citing Horner v. Graves, 7 Bing. 735, 131 Eng. Rep. 284 (1831)).

[11] *See* Garrison & Wendt, *supra* note 2 (noting the expansion of enforcing noncompetes where the alleged employer's interests related to generalized training rather than solely unique or specialized skills in certain jurisdictions, as well as the move to reformation and modification of noncompetes in certain jurisdictions, which allow the courts to modify noncompetes in order to make them reasonable rather than striking the noncompete as invalid as a whole).

[12] From 2016 to 2020, a handful of states have since followed the Obama Administration's lead regarding the call to action and amended their noncompete laws for workers under certain wage thresholds. These states include Illinois in 2016; Massachusetts in 2018; Maine, also adding advance notice procedural requirements, in 2019; Maryland in 2019; New Hampshire, also making noncompetes "void and unenforceable" between employer and

noncompete agreements for workers under a certain salary threshold and set forth best practices for states that choose to enforce noncompetes.[13] This call to action was issued in response to a report released by the U.S. Department of Treasury's Office of Economic Policy a few months earlier. The Treasury Department reported that employers use noncompetes to protect trade secrets, to reduce labor turnover, to impose costs on competing firms, and to improve employer leverage in future negotiations with workers, but that these benefits come at the expense of workers and the broader economy.[14] The call to action received support from elected officials in a few states, as

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employee, in 2019; Rhode Island, creating its first yet robust statute regarding noncompete law, in 2019; Virginia, enacting their first law banning noncompete agreements for low-wage employees, in 2020; and Washington in 2020. *See generally* Russell Beck, *"Low-Wage" Employees Are Exempt from Nine Noncompete Laws. But, Who Is a Low-Wage Employee?* FAIR COMPETITION LAW (Dec. 6, 2020), https://faircompetitionlaw.com/2020/12/06/low-wage-employees-nocompete-exemption/.

[13] The White House, Office of the Press Sec'y, FACT SHEET: The Obama Administration Announces New Steps to Spur Competition in the Labor Market and Accelerate Wage Growth (Oct. 25, 2016), https://obamawhitehouse.archives.gov/the-press-office/2016/10/25/fact-sheet-obama-administration-announces-new-steps-spur-competition. Best practices identified were (1) "Ban non-compete clauses for categories of workers, such as workers under a certain wage threshold; workers in certain occupations that promote public health and safety; workers who are unlikely to possess trade secrets; or those who may suffer undue adverse impacts from noncompetes, such as workers laid-off or terminated without cause"; (2) "Improve transparency and fairness of non-compete agreements by, for example, disallowing non-competes unless they are proposed before a job offer or significant promotion has been accepted (because an applicant who has accepted an offer and declined other positions may have less bargaining power); providing consideration over and above continued employment for workers who sign non-compete agreements; or encouraging employers to better inform workers about the law in their state and the existence of non-competes in contracts and how they work"; and (3) "Incentivize employers to write enforceable contracts, and encourage the elimination of unenforceable provisions by, for example, promoting the use of the 'red pencil doctrine,' which renders contracts with unenforceable provisions void in their entirety."

[14] *See* U.S. Dep't of the Treasury Office of Econ. Pol'y, *Non-compete Contracts: Economic Effects and Policy Implications* (March 2016), https://home.treasury.gov/system/files/226/

well as from prominent social scientists who study noncompetes.[15] The Trump administration, including the Department of Justice and the Federal Trade Commission, also scrutinized noncompete agreements and no-poach agreements between large employers, and various bills were introduced by Congress seeking to curtail the use of noncompetes, particularly for low-wage workers.[16]

Non_Compete_Contracts_Econimic_Effects_and_Policy_Implications_MAR2016.pdf. Social benefits that can be derived from noncompetes include promotion of innovation through protection of trade secrets, increased incentive to provide costly training to employees, and discouraging workers from leaving jobs that have a high turnover cost. Employee costs include weakened bargaining power after signing a noncompete—leading to lower wages and inducement to leave occupations in which they have already acquired training and significant experience.

[15] *See id.*; *see also* Olav Sorenson & Matthew Marx, *Restricting Employment Restrictions*, YALE INSIGHTS (Nov. 16, 2016), http://insights.som.yale.edu/insights/restricting-employment-restrictions. The noncompete President Trump had campaign employees, contractors, and volunteers sign was an indication that the Trump administration would not support noncompete reform and instead would leave enforcement issues to the state level. Although it is not unusual for presidential candidates to restrict employees from working for their opponents, Trump's noncompete included a blanket prohibition restricting contractors' *employees* from working for a rival campaign. Even Mark Braden, former chief counsel of the Republican National Committee, thought that this extra layer of protection was unimaginable. *See* Marianne Levine & Kyle Cheney, *Trump Campaign Contract Has Unusually Broad Non-Compete Clause*, POLITICO (Sept. 9, 2016), http://www.politico.com/story/2016/09/trump-campaign-non-compete-clause-227967.

[16] 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*, ECONOMIC INNOVATION GROUP, at 2-3 (Feb. 2019), https://eig.org/wp-content/uploads/2019/02/Non-Competes-Brief.pdf. The Federal Trade Commission agreed to meet on January 9, 2020 "to examine whether there is a sufficient legal basis and empirical economic support to promulgate a Commission Rule that would restrict the use of noncompete clauses in employer-employee employment contracts." U.S. Fed. Trade Comm'n, *Non-Competes in the Workplace: Examining Antitrust and Consumer Protection Issues* (Jan. 9, 2020),

More recently in 2020, then President-elect Joe Biden addressed noncompete agreements in his "Plan for Strengthening Worker Organizing, Collective Bargaining, and Unions," which stated that President "Biden will work with Congress to eliminate all non-compete agreements, except the very few that are absolutely necessary to protect a narrowly defined category of trade secrets, and outright ban all no-poaching agreements."[17] Once in office, on July 9, 2021, President Biden issued his Executive Order on Promoting Competition in the American Economy.[18] The Order encourages the Chair of the FTC "to curtail the unfair use of noncompete clauses and other clauses or agreements that may unfairly limit worker mobility." While the Biden Administration addressed the Plan through this Order, Biden's call to the FTC does not change the law of noncompetes; however, it arguably goes far beyond President Obama's "Call to Action."

Just this year, on February 25, 2021, a new version of the Federal Workforce Mobility Act was introduced with the intent to limit the use of noncompete agreements and arguably would result in a complete ban on all employee noncompete

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https://www.ftc.gov/news-events/events-calendar/non-competes-workplace-examining-antitrust-consumer-protection-issues.

[17] *See* Brooke Razor & Jill A. Zender, *Biden Proposes Nationwide Non-Compete Ban*, NAT'L L. REV. (June 3, 2021), https://www.natlawreview.com/article/biden-proposes-nationwide-non-compete-ban. Change is also coming from more places than just the White House and Capitol Hill. State laws surrounding noncompete agreements vary drastically and are changing rapidly. As of February 7, 2022, sixty-six non-compete bills were pending across twenty-one states: Florida, Hawaii, Illinois, Indiana, Iowa, Kentucky, Massachusetts, Missouri, New Hampshire, New Jersey, New York, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, Tennessee, Vermont, Virginia, West Virginia, and Wisconsin. *See* Russell Beck, *21 States with 66 Pending Noncompete Bills: Florida*, FAIR COMPETITION LAW (Feb. 7, 2022), https://faircompetitionlaw.com/2022/02/07/21-states-with-66-pending-noncompete-bills-florida/.

[18] Exec. Order No. 14036, Promoting Competition in the American Economy, 86 Fed. Reg. 36987 (July 9, 2021).

agreements.[19] This "bill pairs a non-compete ban with three critical elements: education, investigation, and enforcement" in attempt to provide infrastructure to address violations rather than just a ban.[20] These recent events reflect the trend of reevaluating noncompete laws across the country.

Current State of Noncompete Laws in the United States

As Norman D. Bishara illustrates in his work, "Fifty Ways to Leave Your Employer: Relative Enforcement of Covenants Not To Compete, Trends, and Implications for Employee Mobility Policy," noncompete laws across the nation fall on a spectrum, and there are numerous subtleties in the laws of each jurisdiction.[21] Nevertheless, the states generally align into two different camps: (1) those laws which provide that noncompetes are *per se* invalid[22]; and (2) those laws which provide that noncompetes may be enforced if they are reasonable.

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[19] David J. Clark, *Another Bill in Congress Seeks to Limit Non-Competes—Will This One Go Anywhere?* NAT'L L. REV. (Mar. 1, 2021), https://www.natlawreview.com/article/another-bill-congress-seeks-to-limit-non-competes-will-one-go-anywhere. This Act represents one of the latest of multiple attempts to restrict noncompete agreements through federal legislation.

[20] Emma Hecker, *The Case for Non-Compete Reform*, ECONOMIC INNOVATION GROUP (Apr. 30, 2021), https://eig.org/news/eig-american-dynamism-series-the-case-for-non-compete-reform (citing Rachel Arnow-Richman).

[21] Bishara, *supra* note 2. Bishara notes from 2009 ranking data that on a spectrum of weak to strong enforcement of noncompetes, 96% of states (forty-nine states and the District of Columbia) allow some type of noncompete enforcement, with twelve states (20%), including Florida and New Mexico, strongly enforcing noncompetes, nine states (18%), including Arkansas and Alaska, weakly enforcing noncompetes, and thirty states (60%) moderately enforcing noncompetes.

[22] There are also states which will typically not enforce noncompetes except under limited circumstances, such as the exception in Colorado where a noncompete will only be enforced if it applies to a highly compensated employee, if it is for the protection of trade secrets, and if it is no broader than is reasonably necessary to protect the employer's legitimate interest in protecting trade secrets. C.R.S. § 8-2-113(2)(c)-(d), (2018). In fact, Colorado approved significant changes to C.R.S. § 8-2-113 that will take effect August 10, 2022. The new law

California is probably the most well-known state that outlaws noncompetes in the employment context. Under California Business and Professions Code Section 16600, with certain exceptions,[23] "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void."[24]

Conversely, Ohio's noncompete laws mirror those typically seen throughout the country. Under Ohio law, a covenant not to compete is enforceable if it is reasonable;

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removes the exception for executive and management personnel and professional staff. Instead, the new law allows noncompete agreements to be enforceable for a highly compensated employee, for the protection of trade secrets, and provided the noncompete is no broader than is reasonably necessary to protect the employer's legitimate interest in protecting trade secrets.

[23] These exceptions generally include restrictions on employment choice related to the sale of the goodwill of a business and partnership dissolution.

[24] While California will not ordinarily enforce noncompetes in the employment context, if a noncompete is necessary to protect the employer's trade secrets, Section 16600 will not invalidate such noncompete. *See* Loral Corp. v. Moyes, 174 Cal. App. 3d 268, 276 (1985); D'sa v. Playhut, Inc., 85 Cal. App. 4th 927, 934 (2000); Muggill v. Reuben H. Donnelley Corp., 62 Cal. 2d 239, 242 (1965). Only two other states currently have a wholesale ban on noncompete agreements in the employment context, including Oklahoma and North Dakota. Washington, D.C. may be enacting a similar ban on noncompetes in October of 2022. Oregon, although it does not wholly ban noncompetes, added requirements in 2021, making the existing restrictions much more aggressive and closer to California on the spectrum. Specifically, Oregon now deems noncompete agreements as "void and unenforceable" and also now requires a shorter time restriction, an increase in income threshold, and other procedural and writing requirements. *See* Russell Beck, *20 States with 59 Noncompete Bills: Oregon – Update – One Bill Becomes Law*, FAIR COMPETITION LAW (May 27, 2021), https://faircompetitionlaw.com/2021/05/27/20-states-with-59-noncompete-bills-oregon-update-one-bill-becomes-law/. Oregon's law can be compared to Washington D.C.'s new law that took effect in early 2021, which is the most all-encompassing and pro-employee noncompete law in the nation, as well as one of the broadest bans on these agreements. *See* Jenna G. Crawford, *Employment Agreements: DC's Recent Ban on Non-Competes is One of the Broadest in the Country*, NAT'L L REV. (Mar. 23, 2021), https://www.natlawreview.com/article/employment-agreements-dc-s-recent-ban-non-competes-one-broadest-country.

and Ohio courts will deem a noncompete reasonable "if the restraint is no greater than is required for the protection of the employer, does not impose undue hardship on the employee, and is not injurious to the public."[25]

The Use of Noncompetes from the Perspective of Employees and Employers

The primary argument for employers to use noncompetes is that they are necessary to prevent unfair competition through an employee's misappropriation of "business assets," including confidential information, trade secrets, or other key competitive knowledge acquired through employee training or time spent on the job.[26] While liberal enforcement of noncompetes undoubtedly helps employers, some scholars have noted that employers now want employees to take an "entrepreneurial approach to their jobs…to exercise creativity on behalf of the [employer]…and [to] behave like owners" in order to allow the employer to remain competitive in this increasingly fast-paced, knowledge-centered industrial economy, all without making promises of job security or loyalty that were prevalent in the United States in the mid-twentieth century.[27]

As a result of this shift toward entrepreneurial innovation by employees in the workplace, some scholars have concluded that "the goal of today's management is to engender commitment without loyalty," which may be an unfair result for employees.[28] Undoubtedly, some companies use noncompetes as a means to retain employees almost involuntarily.[29] Some scholars argue that the restrictions noncompetes may place on

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[25] Raimonde v. Van Vlerah, 42 Ohio St. 2d 21, 325 N.E.2d 544, 545 (1975).

[26] Garrison & Wendt, *supra* note 2, at 166-167.

[27] Katherine V.W. Stone, *Knowledge at Work: Disputes Over the Ownership of Human Capital in the Changing Workplace*, 34 CONN. L. REV. 721, 733 (2002).

[28] *Id.*

[29] In June 2022, Microsoft announced that it was removing noncompetes from its employment agreements in the U.S. and would no longer enforce existing noncompetes. According to a company statement, Microsoft said its move was an effort to foster a workplace that "attracts and inspires world-class talent to unlock innovation aligned to our mission."

employee mobility and job marketability are overbroad and unreasonable, particularly if job security is a thing of the past.[30]

Do Noncompetes Negatively Impact Economic Development?

Proponents of noncompetes argue that businesses are less likely to open offices or locate in jurisdictions where courts frequently strike down noncompetes because of concerns about their ability to restrict their employees from leaving and joining competitors. This theory is certainly supported by anecdotal evidence, but it is difficult to find any empirical evidence supporting it. On the other hand, some studies suggest that strict enforcement of noncompetes may not be in the best interest of all businesses or overall economic development.[31] To this point, some argue that eliminating noncompetes aligns with American values because encouraging workers to leave one place of work and enter another enables them to contribute economic value and pursue their own passions.[32]

One researcher at New York University in 1999 suggested that California's ban on noncompetes is a "causal antecedent" for Silicon Valley's rise and thriving high-tech

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[30] Garrison & Wendt, *supra* note 2, at 115. *See also* Florence Shu-Acquaye, *The Effect of Non-Compete Agreements on Entrepreneurship: Time to Reconsider?* 10 U. PUERTO RICO BUS. L.J. 92 (2019).

[31] *See* April Franco & Matthew F. Mitchell, *Covenants Not to Compete, Labor Mobility, and Industry Dynamics*, 17 J. ECON. & MGMT. STRATEGY 581 (Aug. 2008), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1227202.; *see also* Richard A. Booth, *Hurd on the Street?* NAT' L. J. (Oct. 25, 2010), http://www.nationallawjournal.com/id=1202473700488?slreturn=20140116104553# (California law against noncompetes 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 noncompetes, 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 POL'Y & ECON. 39 (2012), https://www.journals.uchicago.edu/doi/full/10.1086/663155.

[32] Hecker, *supra* note 20 (citing Senator Young of Indiana).

industry.[33] Since that time, researchers at MIT and Harvard Business School have also concluded that states that enforce noncompetes tend to experience lower venture capital investment than states that proscribe enforcement,[34] and that the strict enforcement of noncompetes drives away some of the "best and brightest."[35]

For example, researchers at the Harvard Business School studying Michigan's inadvertent shift toward strict enforcement of noncompetes in the 1980's concluded that there is a much greater risk of emigration by highly cited inventors (i.e., those with more than the median number of citations per patent prior to the policy reversal) than

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[33] 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). The "unfair" advantage given to Silicon Valley companies due to California's ban on noncompetes can be most readily observed today among self-driving car startups. While many of these companies, like those started during dot-com boom, will ultimately fail, it is more probable than not that others will become industry leaders. *See* Timothy B. Lee, *A Little-Known California Law Is Silicon Valley's Secret Weapon*, VOX (Feb. 13, 2017), http://www.vox.com/new-money/2017/2/13/14580874/google-self-driving-noncompetes. More recently, Eli Lehrer noted during the Economic Innovation Group webinar that "at the societal level, non-competes keep innovators from turning new ideas into real products[,]" and thus "[t]here's a reason Silicon Valley is in Silicon Valley and not Boston." Hecker, *supra* note 20.

[34] According to a study completed by researchers Sampsa Samila and Olav Sorenson, the findings relating to venture capital within a region is an early indicator regarding regional productivity. The researchers acknowledged, however, that the impact of venture capital on an industry is only one component of research and development investments, and that venture capital may be more concerned with creating wealth in a small number of firms rather than creating more jobs and firms. Even with these caveats in mind, the researchers still concluded that such indicators do not appear to support the enforcement of noncompetes. Sampsa Samila & Olav Sorenson, *Non-compete Covenants: Incentives to Innovate or Impediments to Growth*, 57 MGMT. SCI. 425 (2011), https://www.jstor.org/stable/41060682 .

[35] *See* Marx & Fleming, *supra* note 31, at 20.

similarly situated inventors in states that do not enforce noncompetes.[36] The researchers concluded that given the higher opportunity costs of highly cited and specialized inventors, such inventors may be more likely to emigrate and seek employment in less restrictive regions. They may also be more attractive to out-of-state employers than lower-value workers and more likely to be recruited.[37] As a result, the researchers concluded that "workers with higher levels of human capital may be at once more eager and more able to emigrate while lower-value workers are kept at their jobs—and thus in the region—by non-compete agreements."[38]

Similarly, another study found that while tougher enforcement of noncompetes promotes executive stability, increased enforceability also results in reduced executive compensation.[39] Thus, one could argue that 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. This same study

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[36] Matt Marx, Jasjit Singh, & Lee Fleming, *Regional Disadvantage? Non-Compete Agreements and Brain Drain*, p. 402 (2014), https://www.insead.edu/sites/default/files/assets/faculty-personal-site/jasjit-singh/documents/Personal/Marx_Singh_Fleming_RP_PRINT.pdf. *See also* Matt Marx, Deborah Strumsky, & Lee Fleming, *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"), http://dx.doi.org/10.1287/mnsc.1080.0985; Matt Marx, Deborah Strumsky, & Lee Fleming, *Noncompetes and Inventor Mobility: Specialists, Stars, and the Michigan Experiment* (Harv. Bus. Sch., Working Paper No. 07-042, 2007), http://www.hbs.edu/faculty/Publication%20Files/07-042.pdf.

[37] Marx, Strumsky & Fleming, *supra* note 36. As a further example, without the restrictions of noncompetes, employees are free to leave less productive companies whenever they choose to do so, which helps create a more efficient marketplace and allows the best employees to be hired by the best businesses. *See* Booth, *supra* note 31.

[38] Marx, Strumsky & Fleming, *supra* note 36.

[39] Mark J. Garmaise, *Ties that Truly Bind: Non-Competition Agreements, Executive Compensation and Firm Investment*, J.L. ECON. & ORG. (2009), https://www.anderson.ucla.edu/documents/areas/fac/finance/noncomp2.pdf.

also reported that stricter enforcement of noncompetes reduces research and development spending and capital expenditures per employee.[40]

In addition to affecting existing entities, several studies suggest that enforcing noncompetes may inhibit entrepreneurs from starting new businesses. In February of 2019, Dr. Evan Starr noted that "seven recent studies examined the relationship between non-compete enforceability and entrepreneurship, finding generally the enforceability of non-competes dampens new firm creation."[41] According to the studies cited by Dr. Starr, noncompetes inhibit firms from hiring new employees, thereby preventing the growth of the firms.[42] This inability to hire employees is apparently more strenuous on new companies, which, according to one at least one study, are more likely to go out of business in states where noncompetes are enforced.[43]

At a minimum, these aforementioned studies demonstrate the importance of examining the historical rationale for enforcing noncompetes in the U.S., but U.S.-based employers should also consider the global effects of such agreements. In countries such as China, India, and Brazil, where long-term economic development is dependent upon both domestic innovation and foreign R&D investments, enforcement of noncompetes can be a double-edged sword. These agreements may be beneficial for attracting foreign R&D investments; however, they may be a factor in stifling domestic innovation by limiting employee mobility.[44]

What Impact Do Noncompetes Have on Innovation?

Proponents of noncompetes traditionally argue that they give businesses an incentive to engage in expensive research and development activities, which lead to

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[40] *Id.*

[41] 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 (Feb. 2019), https://eig.org/wp-content/uploads/2019/02/Non-Competes-Brief.pdf.

[42] *Id.*

[43] *Id.*

[44] Grant R. Garber, *Noncompete Clauses: Employee Mobility Innovation Ecosystems and Multinational R&D Offshoring*, 28 BERKELEY TECH. L. J. 1079, 1079-80, 1102, and 1108 (2013).

innovations in products and services, thereby making businesses more competitive.[45] Without such protections, they say, employers will 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.

Nevertheless, researchers studying the rise of Silicon Valley in the high-tech industry during the 1980s and the lower growth of the high-tech industry in Massachusetts concluded that the enforcement of employee noncompetes may actually reduce technological advancement, innovation, and economic growth for businesses due to the lack of the information spillover created by employee mobility.[46] Senator Murphy of Connecticut recently reemphasized this point, noting that "[i]f you are tied to your place of employment, and you cannot leave to go bring an idea you have to fruition, it harms [everyone]."[47] Further, one scholar from the University of Denver concluded that using 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.[48] These studies appear then to show that enforcement of noncompetes has the potential to stifle innovation in former employees.

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 joint study, researchers from the University of California at San Diego and the University of San Diego found that subjects in simulated noncompete conditions showed significantly less motivation in their jobs and scored worse on effort-based tests than study subjects who completed the simulation without restrictions. The researchers

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[45] Garrison & Wendt, *supra* note 2, at 168.

[46] *Id.* at 169-70. *See also* Viva R. Moffat, *Making Non-Competes Unenforceable*, 54 ARIZ. L. REV. 939, 979 (2012); ANNALEE SAXENIAN, REGIONAL ADVANTAGE: CULTURE AND COMPETITION IN SILICON VALLEY AND ROUTE 128 (Harvard Univ. Press 1994).

[47] Hecker, *supra* note 20.

[48] 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).

concluded 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."[49] The researchers noted that "although information leakage and job-hopping by talented employees may provide competitors with undue know-how, expertise, and technologies, constraining mobility may negatively affect employee performance [because an] employee who knows their market opportunities are significantly reduced due to an enforceable noncompete restriction will be less driven to perform well and to invest in his own human capital."[50]

There is some evidence to suggest that restricted employees' glum perceptions of their future market opportunities may be justified. According to a December of 2018 study, employees that work in states where noncompetes are enforced generally accumulate less income than employees who live in states where noncompetes are not enforced.[51] Scholars suggest that this is because the restricted employees are not free to pursue higher-paying opportunities when they come along.[52]

While it is unclear whether all employees are less motivated to perform when subject to enforceable noncompetes, when the vast majority of employment contracts are at-will and a decline in performance may lead to termination, it is possible that the strict enforcement of noncompetes may have a negative impact on employee performance.

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[49] On Amir & Orly Lobel, *How Noncompetes Stifle Performance*, HARV. BUS. REV., at 26 (Jan.–Feb. 2014), http://hbr.org/2014/01/how-noncompetes-stifle-performance/ar/1,

[50] *See* Amir & Lobel, *supra* note 2.

[51] 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://papers.ssrn.com/sol3/papers.cfm?abstract_id=2905782.

[52] Starr, *supra* note 41. Starr also concludes that because noncompetes diminish employee wages and mobility and reduce new firm entry into the market, companies located in states that enforce noncompetes are attractive acquisition targets. Starr also references studies that suggest noncompetes raise hiring costs for firms that hope to acquire employees/other companies in states that enforce noncompetes. *Id.* at 12.

Are Noncompetes Necessary to Protect Trade Secrets?

As indicated above, noncompetes may be used to protect against employees exiting a company and taking and using or disclosing trade secrets learned during their employment in their future employment or for creating a competing business. In fact, "[w]here courts have enforced covenants not to compete against 'common' employees, it has typically been to protect an employer's investment in training, development of customer goodwill, or to protect trade secrets or confidential information."[53] Typically, protecting trade secrets against future disclosure by a former employee is one of the more common rationales for enforcing covenants not to compete. But courts are often reluctant to enforce a covenant not to compete where the employee does not have access to trade secrets or other confidential or proprietary information, as the covenant may constitute an unlawful restraint of trade.[54]

When former employees will be or have been exposed to trade secrets in the course of their employment, employers may seek to protect against the disclosure of such trade secrets in subsequent employment by requiring the employees to sign a noncompete agreement which restricts the employees' ability to work for a competing company or start a competing business. While the Uniform Trade Secrets Act and similar state trade secrets statutes provide injunctive relief for actual or threatened misappropriation of trade secrets, as well as potential damages for actual misappropriation, this type of protection may be insufficient for employers as the damage may already be done by the time they are able to obtain an injunction and damages may not be enough to compensate the employer for the unauthorized disclosure of its trade secrets.[55] 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

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[53] Edward T. Ellis, *Non-Competition Agreements and Protection of Trade Secrets*, American Law Institute – American Bar Association Continuing Legal Education, Current Developments in Employment Law, CV001 ALI-ABA 1097, 1101 (2013).

[54] *Id.*

[55] *See* Randy Burton, Esq., Sam Johnson, Esq., & Cara Burton, Esq., *The Sound of Inevitability: The Doctrine of Inevitable Disclosure of Trade Secrets Comes to Texas*, 44 TEX. J. BUS. L. 103, 123 (2012) (Arguing that once trade secrets have been disclosed, the secrecy may be lost and the damage irreversible, thus it is better to have preventative measures such as noncompetes to help protect against the misappropriation of trade secrets rather than resorting to litigation).

employee from taking a role with a competitor that would put the former employer's trade secret and other confidential business information at risk of being used or disclosed. As a result, some employers use noncompetes as a prophylactic measure, to prevent former employees from disclosing trade secrets in the first place, and to avoid having to respond to misappropriation after the harm has already been done.[56]

Researchers from the University of St. Thomas reject such contentions, arguing that there are a number of other legal mechanisms by which employers can achieve the same results or, in other words, avoid misappropriation of trade secrets by former employees, and which would also allow former employees to have greater job mobility.[57] Further, these scholars argue that noncompetes used for the purpose of prohibiting the misappropriation of trade secrets or to prevent unfair competition are ineffective for their intended purpose for the following reasons:

(1) Noncompetes when used as a prophylactic measure to protect against *potential* trade secret misappropriation are necessarily overbroad with a near impossibility of being able to tailor a trade secret noncompete to only prohibit employees from using or disclosing trade secrets;

(2) Noncompetes used in this manner also come with the "serious risk of overdeterrence," which is "compounded by the *in terrorem* effect" of simply having a noncompete, as employees may not understand the nuances of the

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[56] Garrison & Wendt, *supra* note 2, at 117.

[57] *Id.* at 116. The authors point out that former employees are still under a continuing fiduciary duty not to disclose or use their prior employer's trade secrets, though it is unclear how much this fiduciary duty actually deters employees from disclosing or using trade secrets. The authors also suggest the use of nondisclosure and confidentiality agreements specifying the proprietary business information that is required to remain confidential in lieu of noncompetes. Further, injunctive relief may be sought to prevent the misappropriation of trade secrets or threat thereof under the Uniform Trade Secrets Act or similar state law. The authors also raised the controversial topic of "inevitable disclosure," which has been recognized in certain jurisdictions and rejected in others, under which a court could prevent an employee from working for a competitor if the disclosure of trade secrets will be virtually certain based on the knowledge base of the former employee and the position the employee secured with the competitor. *See also* Moffat, *supra* note 46, at 980.

noncompete and its enforceability and as a result may decide against engaging in competitive activity solely to avoid potential litigation;

(3) Relatedly, with the mere existence of a noncompete, prospective employers may be unwilling to "hire employees subject to such noncompetes" to avoid litigation based on alleged tortious "interference with contracts or unfair competition"; and

(4) Employers "have an incentive to draft overbroad noncompete[s]" because they are drafting for potential future disclosure of trade secrets, and it is difficult to guess what types of harmful competitive activity in which an employee may engage; additionally, many states will allow the modification and reform of an overbroad noncompete and will not invalidate the entire agreement.[58]

Based on the preceding arguments among scholars, policymakers should question whether noncompetes are absolutely necessary to prevent the misappropriation of trade secrets by former employees or whether such agreements are more restrictive on employees' job mobility than is necessary, given the existence of legal alternatives to noncompetes. One scholar from the University of Denver concluded that noncompetes do not work well to protect intellectual property assets such as trade secrets because they are simultaneously too narrow and too blunt: too narrow because they fail to protect the trade secrets (and other intellectual property) from the world, just from the employee and a competing business; too blunt because they are directed at people rather than the intangible intellectual property itself, unlike other forms of intellectual property.[59] This scholar similarly asserts that noncompetes may be used to protect information that could not ordinarily be protected by trade secret law, copyright law, or patent law, which would interfere with "the effort in the [intellectual property] regimes to work toward a balance [between protection and the public domain]."[60]

Based on studies suggesting the availability of other legal mechanisms—such as nondisclosure agreements, confidentiality agreements, and the Uniform Trade Secrets Act—as well as the purported inability of noncompetes to adequately protect trade secrets without overreaching to cover non-protectable information and without overly

[58] Garrison & Wendt, *supra* note 2, at 178.

[59] Moffat, *supra* note 46, at 980.

[60] *Id.*

restricting job mobility, policymakers should consider whether noncompetes are the most appropriate tool for protecting an employer's trade secrets from former employees' improper use or disclosure. However, while abuses certainly exist and should be curbed, noncompete laws in states that fall in the middle ground—where the law typically allows for the enforcement of noncompetes as long as they are reasonable—could be reformed to enhance the benefits of noncompetes while reducing the burden they place on employees.

Conclusion

The question of whether noncompetes should be enforceable in the employment context, particularly to protect the improper use and disclosure of trade secrets by former employees, appears to have no clear answer: employers have a legitimate interest in protecting their business assets from unfair competition by former employees and their new employers; employees have a legitimate interest in having the ability to change jobs and not be chained to a specific job as a result of knowing information they may potentially use in a new position, particularly where employer-employee contracts have fundamentally changed and job stability is no longer a guarantee; and the public has a legitimate interest in a competitive marketplace. In comparing these competing interests and attempting to balance them, researchers have begun to conclude that, despite justifications for strictly enforcing noncompetes, there are several reasons why such enforcement may not be beneficial for employees, employers, businesses, and the economy as a whole. For example, strict enforcement may reduce regional economic growth, innovation, and perhaps even employee performance and motivation.

When considering the use of noncompetes to protect against the improper use and disclosure of trade secrets by former employees engaging in competitive activities, a number of researchers have determined that while it is understandable that employers would default to using non-competes as a preventative measure to avoid potential misappropriation, the noncompete is actually an ineffective tool for achieving such goals in comparison to alternative legal mechanisms that may be used to achieve the desired objective. These scholars concluded that nondisclosure agreements and confidentiality agreements, which may be closely tailored to identify the specific information that is to be prohibited from use or disclosure, rather than identifying the individual who cannot use or disclose "trade secrets" to a competitor, may be a better option.

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