

CONTENTS EMBARGOED FOR 6:00 A.M., May 5<sup>th</sup>, 2016

# Non-Compete Agreements: Analysis of the Usage, Potential Issues, and State Responses

May 2016



The U.S. economy has experienced a historic turnaround since the depths of the Great Recession. The unemployment rate has fallen by half since its peak in 2009, and over the last six years, American businesses have created more than 14 million new jobs, the longest streak on record. Despite this remarkable progress, the U.S. economy faces a number of longer-run challenges, some of which go back several decades. In at least part of the economy, evidence suggests that competition for consumers and workers is declining, and the number of new firms each year is experiencing a downward trend. In addition to this trend, there has been a decrease in ‘business dynamism’—the so-called churn of firms and who is working for whom in the labor market—since the 1970s.

One factor driving these issues may be institutional changes in labor markets, such as greater restrictions on a worker’s ability to move between jobs. To address these and other issues that limit competition in the marketplace, the President has directed executive departments and agencies to propose new ways of promoting competition and providing consumers and workers with information they need to make informed choices, in an effort to improve competitive markets and empower consumers’ and workers’ voices across the country.

Building on these efforts, this document provides a starting place for further investigation of the problematic usage of one institutional factor that has the potential to hold back wages—non-compete agreements. These agreements currently impact nearly a fifth of U.S. workers, including a large number of low-wage workers. This brief delineates issues regarding misuse of non-compete agreements and describes a sampling of state laws and legislation to address the potentially high costs of unnecessary non-competes to workers and the economy. It draws on a recently released report from the U.S. Treasury Office of Economic Policy--[\*Non-Compete Contracts: Economic Effects and Policy Implications\*](#)—which provides an overview of the nascent research on non-competes’ prevalence, enforcement, and effects.

## Introduction

Non-compete agreements, or “non-competes,” are contracts that ban workers at a certain company from going to work for a competing employer within a certain period of time after leaving a job. The main rationale for these agreements is to encourage innovation by preventing workers with ‘trade secrets’ from transferring technical and intellectual property of companies to rival firms, even when there are trade secret laws to protect companies. These agreements may also encourage greater employer investments in worker training because they may reduce fear that workers will take skills gained to a competitor.

Workers’ value comes in part from the skills and experiences gained on the job. Non-competes can reduce workers’ ability to use job switching or the threat of job switching to negotiate for better conditions and higher wages, reflecting their value to employers. Furthermore, non-competes could result in unemployment if workers must leave a job and are unable to find a new job that meets the requirements of their non-compete contract.

In addition to reducing job mobility and worker bargaining power, non-competes can negatively impact other companies by constricting the labor pool from which to hire. Non-competes may also prevent workers from launching new companies. Some critics also argue that non-competes can actually stifle innovation by reducing the diffusion of skills and ideas between companies within a region, which can in turn impact economic growth. Non-compete agreements may also have a detrimental effect on consumer well-being by restricting consumer choice.

Research suggests that 18 percent, or 30 million, American workers are currently covered by non-compete agreements. Even more workers, roughly 37 percent, report having worked under a non-compete agreement at some point during their career. A 2013 study commissioned by the Wall Street Journal signals either a rise in the prevalence of non-competes, or significant growth in their enforcement. The law firm Beck Reed Riden LLP found a 61 percent rise from 2002 to 2013 in the number of employees getting sued by former companies for breach of non-compete agreements.<sup>1</sup>

Non-compete clauses are found not only in the contracts of senior executives or other highly compensated employees, but also for comparatively low-skill occupations. Approximately 15 percent of workers without a college degree are currently subject to non-compete agreements, and 14 percent of individuals earning less than \$40,000 are subject to them. Recent media coverage has raised awareness of the usage and enforcement of non-competes among low-wage occupations including fast-food employees, warehouse workers, and camp counselors.

Based on the impacts of unnecessary non-competes for workers, consumers, and the broader economy, several states have passed, and many others are currently weighing reforms to the ways non-compete agreements are regulated. Federal legislation has also been proposed to limit the use of non-compete agreements in low-wage fields where they are less likely to have valid uses. Continued state interest and a growing understanding of the prevalence of non-compete agreements suggest that the time is ripe to consider how government can best ensure these agreements are used appropriately.

In the large majority of states, non-compete agreements are enforceable for workers across all income brackets, and many states do not have restrictions around the geographic or temporal limitations of non-competes. Non-compete agreements are also prevalent in states where the courts generally do not enforce them. For example, in California, which does not generally enforce non-compete agreements, 22 percent of workers report that they have signed a non-compete. Survey research shows that many workers are not aware of the lack of enforcement in these states, suggesting that even unenforced non-compete agreements may have deleterious effects.

In the coming months, as part of the Administration's efforts to support competition in consumer product and labor markets, the White House, Treasury, and the Department of Labor will convene a group of experts in labor law, economics, government and business to facilitate discussion on non-compete agreements and their consequences. The goal will be to identify key areas where implementation and enforcement of non-competes may present issues, to examine promising practices in states, and put forward a set of best practices and call to action for state reform. By facilitating a dialogue between academic experts and those with practical expertise, we aim to identify policies that could be used to promote a fair and dynamic labor market, while remaining cognizant of real world challenges to reform. We also aim to prompt further research exploring the use and the effects of non-compete agreements.

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<sup>1</sup> Wall Street Journal. "Litigation Over Noncompete Clauses Is Rising."  
<http://www.wsj.com/articles/SB10001424127887323446404579011501388418552>

# Summary of US Treasury Department Report on Non-Compete Contracts Prevalence and Economic Effects

## Use and Misuse of Non-Compete Contracts

The main economically and societally beneficial uses of non-competes are to protect trade secrets, which can promote innovation, and to incentivize employers to invest in worker training because of reduced probability of exit from the firm.

However, evidence indicates that non-competes are also being used in instances where the benefit is likely to be low (e.g., where workers report they do not have trade secrets), but the cost is still high to the worker. For example:

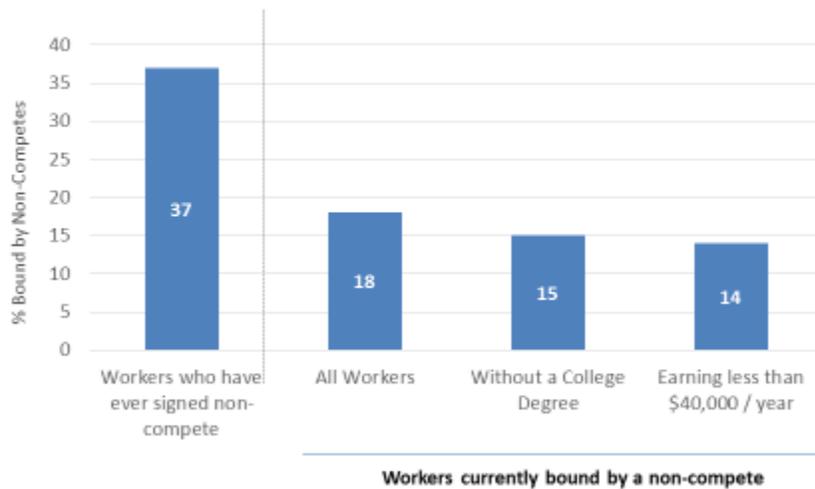
- Only 24 percent of workers report that they possess trade secrets. Moreover, fewer than half of workers who have non-competes report possessing trade secrets, suggesting that trade secrets do not explain the majority of non-compete activity.<sup>2</sup>
- If protection of trade secrets were the main explanation for non-compete agreements, then one would expect such agreements to be highly concentrated among workers with advanced education and occupations entrusted with trade secrets. However, 15 percent of workers without a four-year college degree are subject to non-competes, and 14 percent of workers earning less than \$40,000 have non-competes. This is true even though workers without four-year degrees are half as likely to possess trade secrets as those with four-year degrees, and workers earning less than \$40,000 possess trade secrets at less than half the rate of their higher-earning counterparts.<sup>3</sup>
- While engineering and computer/mathematical occupations have the highest non-compete prevalence at slightly more than one-third, occupations like personal services and installation and repair also include many workers with non-competes, at about 18 percent.

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<sup>2</sup> US Treasury Department, “Non-compete Contracts: Economic Effects and Policy Implications”, March 2016.

<sup>3</sup> Starr, Evan, Norman Bishara and JJ Prescott. 2015. “Noncompetes in the U.S. Labor Force.”

### Nearly 1/6 of workers earning less than \$40,000 per year are bound by non-competes



When entry-level workers in low-wage jobs are asked to sign two-year non-competes, the distributional impacts are particularly concerning.<sup>4</sup> Non-competes can also become overly burdensome when they apply too broadly in terms of geography or time. Without restricting non-competes to only apply in a specific region, or for a limited time period, job-seekers may be forced to leave their industry in order to make a living in a way that does not conflict with their non-compete agreement.

In addition, regardless of whether they promote the protection of trade secrets, the agreements can sometimes be implemented in ways that create confusion or lack of transparency for workers.

- Many workers do not realize when they accept a job that they have signed a non-compete, or they do not understand its implications.
- Many workers are asked to sign a non-compete only after accepting a job offer. One lower-bound estimate is that 37 percent of workers are in this position.
- Many firms ask workers to sign non-competes that are entirely or partly unenforceable in certain jurisdictions, suggesting that firms may be relying on a lack of worker knowledge. For instance, California workers are bound by non-competes at a rate slightly higher than the national average (19 percent) despite the fact that, with limited exceptions, non-competes are not enforced in that state.

### Evidence on the Effects of Non-Compete Contracts

Although non-competes can play a beneficial role when used in a limited way, evidence suggests that in certain cases, non-competes can reduce the welfare of workers and hamper the efficiency of the economy as a whole by depressing wages, limiting mobility, and inhibiting innovation.

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<sup>4</sup> US Treasury Department, see 1.

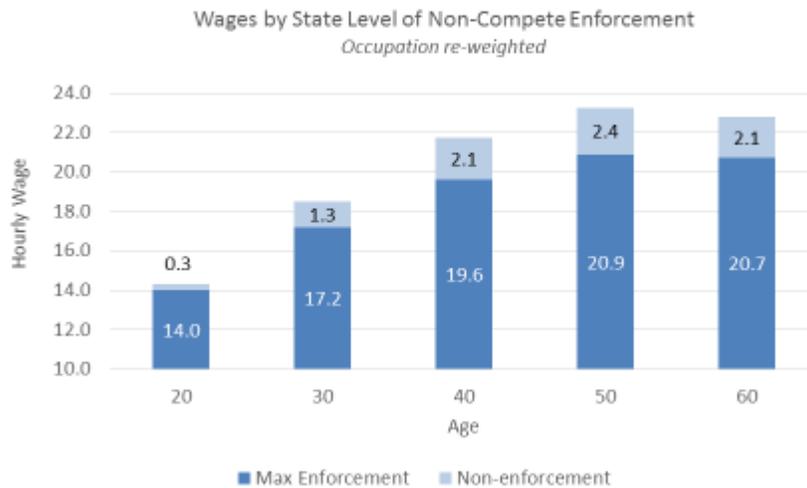
### ***Effects of non-competes on wages***

Worker bargaining power is reduced after a non-compete is signed, possibly leading to lower wages. When workers are legally prevented from accepting competitors' offers, those workers have less leverage in wage negotiations and fewer opportunities to develop their careers outside of their current firm.

The Treasury report indicates that stricter non-compete enforcement is associated with both lower wage growth and lower initial wages, finding that an increase in one standard deviation in non-compete enforcement reduces wages by about 1.4 percent. Recent work by Starr and coauthors finds broadly similar results.<sup>5</sup>

Given the potential for interaction between non-competes and on-the-job training, Treasury also analyzes the impact of stricter non-compete enforcement as workers age. If non-competes promote training, one would expect states with stronger enforcement to see faster wage growth as workers age and gain the tenure and experience that is typically associated with higher rates of training. As shown in the charts below, the analysis suggests that states with higher levels of non-compete enforcement see lower wages in general, and that wage disparities between high and low enforcements states actually grow as workers age.<sup>6</sup>

### **Workers in states with lower levels of non-compete enforcement on average have higher wages**



Source: 2014 Current Population Survey, Starr et al. (2015), and Treasury calculations. All variables, with the exception of enforcement index and age, are held constant at their means

<sup>5</sup> Treasury uses the 2014 merged outgoing rotation groups of the Current Population Survey (CPS), which provide a cross section of population-representative workers. Merged with this data is the Starr-Bishara index of non-compete enforceability by state (generously provided by Evan Starr), as well as the fraction of workers with non-competes by major occupation from Starr, Bishara, and Prescott (2015).

<sup>6</sup> When interpreting any of the results just described, it should be remembered that we are not exploiting variation over time in non-compete enforcement; rather, the wage estimates are derived from variation across states. Even after controlling for available worker-level variables, states may differ in ways that are both relevant to wage growth and non-compete enforcement. As such, the results shown here should be seen as merely suggestive.

### ***Effects of non-competes on labor market dynamism***

The broad geographic and time scope of non-compete contracts can limit the mobility of workers in a long-lasting way, harming both the workers and the overall efficiency of labor markets. When lower paid, entry-level workers are prohibited from taking related employment for some time, they may lack the necessary skills to apply for other jobs, weakening their prospects for future employment and even their labor force attachment.

A study from Marx, Strumsky, and Fleming shows that worker job mobility fell by 8 percent when non-competes were made enforceable, with the effect even larger for workers with more narrowly-focused skills. However, other authors dispute these findings, arguing that the inadvertent legalization was not retroactive and that some states were inappropriately labeled as “non-enforcing.” In separate work, Marx finds that workers who do switch jobs are more likely to leave their industry if they are covered by a non-compete, with the attendant “reduced compensation, atrophy of their skills, and estrangement from their professional networks” that would be expected to occur.<sup>7</sup>

### ***Effects of non-competes on innovation, entrepreneurship, and regional economic growth***

When firms in a given industry are clustered, it makes it easier for their workers to share expertise and discoveries, some of which may not be protected by trade secret or intellectual property legal provisions. Economists refer to geographic clustering effects of factors like a large, deep pool of skilled workers, a more competitive market of suppliers, and information spillovers across workers and firms as “agglomeration effects.”

While not necessarily in the interest of an individual firm, more rapid dissemination of ideas and technology improvements can have significant positive impacts for the larger regional economy in terms of innovation, entrepreneurship, and attracting more businesses and jobs to a region. Non-competes that stifle mobility of workers who can disseminate knowledge and ideas to new startups or companies moving to a region can limit the process that leads to agglomeration economies. Overly broad non-compete provisions could prevent potential entrepreneurs from starting new businesses in similar sectors to their current employer, even if they relocate.

## **Potential issues presented by non-compete agreements**

While we are still learning more about non-competes and their impact, the available evidence suggests that they can be used or enforced in ways that favor the interests of the firm over the worker.

Because of the potential issues presented by some non-competes, there is a growing movement in states to take action to limit the misuse of non-compete agreements. Several states are banning non-compete agreements outright for certain sectors and occupations. This year, Hawaii banned non-compete agreements for technology jobs, and New Mexico banned them for health care jobs. Others have taken steps to limit the scope of non-competes. Oregon recently banned non-compete agreements longer than 18 months, while Utah limited the agreements to one year.

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<sup>7</sup> See Marx, Strumsky, and Fleming (2009) and Marx (2011).

California's legislature has rendered non-compete contracts generally unenforceable in their state. Some researchers have suggested that California, and Silicon Valley in particular, have benefited from this action, though compelling evidence is difficult to obtain<sup>8</sup>.

At the federal level, legislation has been proposed to limit the use of non-compete agreements below a certain income threshold where they are less likely to have valid uses.

Over the coming months, the White House, Treasury and Labor will continue to explore these areas and possible solutions in engagement with states, businesses and experts. Below, we have listed seven areas that highlight how workers may be disadvantaged by non-competes, and how some states and state legislatures are attempting to address this issue.

### **1. Workers who are unlikely to possess trade secrets (in particular, low wage workers) are nonetheless compelled to sign non-competes.**

Fourteen percent of workers earning less than \$40,000 have signed non-competes, although those workers possess trade secrets at less than half the rate of their higher-earning counterparts.<sup>9</sup> When an employer requires low-wage employees to sign non-competes, it can effectively limit the ability of their workers to bargain for higher pay by making it harder for them to find new jobs. This can cause particular hardship for lower-skill workers who may not have marketable skills outside of their past employment. For example, a national sandwich chain required its employees to sign an expansive non-compete agreement that would ban them from working at just about any other fast-food restaurant.

***Examples of Actions States or State Legislators Have Taken to Address this Issue:*** Because non-competes are less likely to have the social benefit of protecting trade secrets when applied to low-wage workers, some states have proposed, and Oregon has passed, legislation restricting the enforceability of non-competes for employees under a certain income threshold. In New Jersey and Maryland, bills were proposed, although they did not make it out of committee, that would render non-competes unenforceable for any workers eligible to receive unemployment compensation.<sup>10</sup>

State legislators in Washington and Idaho have introduced bills that would limit the reach of non-competes by designating certain workers who are more likely to have inside knowledge and trade secrets given their positions as “key employees,” or by rendering void “unreasonable” competition agreements.

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<sup>8</sup> For example, see Gilson, Ronald J. 1999. “The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete.” *New York University Law Review* 74 (3): 575–629.

<sup>9</sup> See Starr, Bishara and Prescott (2015).

<sup>10</sup> [http://www.njleg.state.nj.us/2012/Bills/A4000/3970\\_11.HTM](http://www.njleg.state.nj.us/2012/Bills/A4000/3970_11.HTM);  
[http://mgaleg.maryland.gov/2013RS/fnotes/bil\\_0001/sb0051.pdf](http://mgaleg.maryland.gov/2013RS/fnotes/bil_0001/sb0051.pdf)

### ***State Examples***

- **Oregon.** (*Rev. Stat. 653.295*): Non-competes are voidable and may not be enforced by Oregon courts unless several conditions are met. Examples of those conditions include, with limited exceptions, (1) when the employee's gross salary and commissions, calculated on an annual basis, at the time of the employee's termination equal more than the median family income for a family of four as calculated by the Census Bureau for the most recent year available at the time of the employee's termination, and (2) when particular compensation is paid to the employee during the period in which the employee is restricted from working.
- **Washington.** Proposed House Bill 2931 would render "unreasonable and void" employment noncompetition agreements if the employee is a seasonal or temporary employee, if the employee was terminated without just cause or laid-off by action of the employer, The bill also would also render void and unenforceable non-compete agreements that restrict employees from competing for more than one year after termination of employment, and those that apply to employees who are not executives. In addition, the bill would make noncompetition agreements involving independent contractors void and unenforceable. However, the bill is delayed for legislative consideration until at least next year.
- **Idaho.** (*Idaho Code Section 44-2701*): In 2008, Idaho passed a law that restricts non-competes to "key employees." "Key employees" are those who "by reason of the employer's investment of time, money, trust, exposure to the public, or exposure to technologies, intellectual property, business plans, business processes and methods of operation, customers, vendors or other business relationships during the course of employment, have gained a high level of inside knowledge, influence, credibility, notoriety, fame, reputation or public persona as a representative or spokesperson of the employer, and as a result, have the ability to harm or threaten an employer's legitimate business interests."

## **2. Workers are asked to sign a non-compete only after accepting a job offer, when they have already declined other offers and thus have less leverage to bargain.**

The Treasury report notes that at least 37 percent of workers are asked to sign non-compete agreements after accepting a job offer. In cases where job offers have already been accepted, workers often have less leverage to bargain, in part because they may have already turned down other job offers. However, in many states, even if a worker was not made aware of a requirement to enter a non-compete agreement when she was hired, courts have enforced a covenant signed after employment commenced.

A separate survey, exclusively focused on members of the Institute of Electrical and Electronics Engineers, reports that “...barely 3 in 10 workers reported that they were told about the non-compete in their job offer. In nearly 70% of cases, the worker was asked to sign the non-compete after accepting the offer – and, consequently, after having turned down (all) other offers. Nearly half the time, the non-compete was not presented to employees until or after the first day at work.”<sup>11</sup>

**Examples of Actions States or State Legislators Have Taken to Address this Issue:** In New Hampshire and Oregon, non-compete agreements may be rendered void for lack of consideration when employers fail to include them in the original terms of employment. Requiring that non-compete contracts be provided along with job offers and not after an offer is one possible solution to protect workers. In the case of internal promotion, states could require that employers provide employees with non-competes before the employee begins the new position.

#### **State Examples**

- **Oregon.** (*Rev. Stat. 653.295*): In 2015, Oregon passed a law requiring firms to make clear in offer letters if employees will be expected to sign non-compete agreements. The non-compete must be provided at least 2 weeks before employment or with bona fide advancement.
- **New Hampshire.** (*Senate Bill 351*): In 2014, New Hampshire passed a law that requires that non-compete agreements that are executed as a condition of employment should be provided to potential employees prior to the acceptance of an offer of employment. Otherwise, the non-compete will not be enforceable against the employee.

### **3. Non-Competes, Their Implications, And Their Enforceability Are Often Unclear To Workers**

Many workers report that they do not realize when they accept a job that they have signed a non-compete, or that they do not understand its implications.<sup>12</sup> Workers are often poorly informed about the existence and details of their non-competes, as well the relevant legal implications. Additionally, in states like California where non-competes are unenforceable, workers may be unaware about their legal enforceability. States could consider taking steps to ensure that important details on non-competes, like the duration and geographic scope of the contract, be clearly explained to workers.

Starr, Bishara, and Prescott (2015) find that only 10 percent of workers with non-competes report bargaining over their non-compete, with 38 percent of the non-bargainers not realizing that they could negotiate.

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<sup>11</sup> Marx, Matt, and Lee Fleming. 2012. “Non-compete Agreements: Barriers to Entry...and Exit?” In *Innovation Policy and the Economy*, Volume 12, 39-64. Chicago: University of Chicago Press.

<sup>12</sup> Starr, Evan, Norman Bishara and JJ Present. 2015. “Noncompetes in the U.S. Labor Force.”

#### 4. Employers Often Write Non-Compete Agreements That Are Overly Broad Or Unenforceable

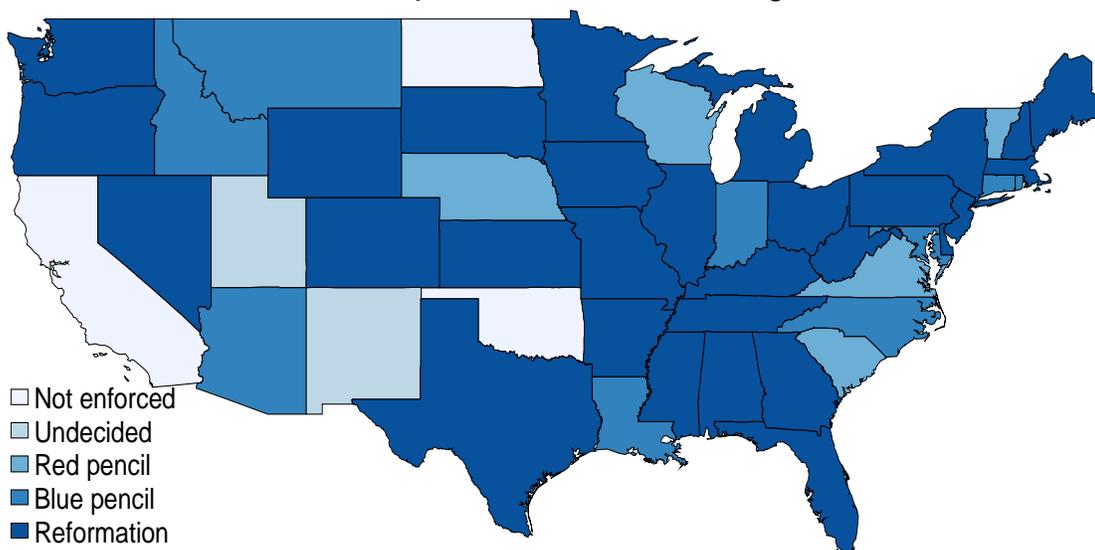
Some firms ask workers to sign non-competes that are entirely or partly unenforceable in certain jurisdictions. For instance, California workers are asked to enter into non-competes at a rate slightly higher than the national average (19 percent), despite the fact that, with limited exceptions, non-competes are not enforced in that state.

Given the well-documented worker confusion about these contracts (as stated in Starr, Bishara and Prescott's findings above), employers can exert a chilling effect on worker behavior even when their contracts are unenforceable.

There are three main approaches that states are taking to address unenforceable or overly broad contracts, which vary greatly in terms of the incentives they provide employers.

- *"Equitable Reform."* The majority (about 30) of states are implementing equitable reform approaches, which are the most lenient on employers that require workers to enter into partially unenforceable contracts. In these states, courts allow employers to rewrite non-compete contracts to bring the contracts in line with state law.
- *"Blue Pencil" Doctrine.* Some states are implementing a "blue pencil" doctrine, which entails striking offensive clauses from non-compete contracts if doing so renders the remaining language enforceable under the state's law.
- *"Red Pencil" Doctrine.* Lastly, some states provide disincentives for employers to write non-compete contracts that are unenforceable by refusing to enforce and making void a non-compete contract that contains any unenforceable provisions. This practice is known as "red pencil" doctrine, and it can have the effect of increasing employers' incentive to write a contract that is fully enforceable. Research from the litigation firm Beck, Reed, and Riden LLP's 50 state non-compete survey indicates that three states—Nebraska, Virginia, and Wisconsin—are using this approach.

## Non-compete Enforcement Regime



### ***State Examples of “Red Pencil” Doctrine***

- **Virginia.** Although the Supreme Court of Virginia has not expressly ruled on the courts’ power to “blue pencil” a non-compete agreement, several Virginia courts have declined to blue pencil non-compete agreements (*Lanmark Tech., Inc. v. Canales*, 454 F. Supp. 2d 524, 529 (E.D. Va. 2006); *Better Living Components, Inc. v. Coleman*, 62005 WL 771592, at \*5 (Va. Cir. Ct. Apr. 6, 2005)). In addition, some courts have found that blue pencil provisions permitting judicial modification in non-compete agreements are invalid or discouraged under Virginia law (*Lasership Inc. v. Watson*, 2009 WL 7388870, at \*9 (Va. Cir. Ct. Aug. 12, 2009); *Pace v. Ret. Plan Admin. Serv., Ltd.*, 2007 WL 5971432 (Va. Cir. Ct. Sept. 28, 2007)).
- **Nebraska.** The Nebraska Supreme Court has refused to “blue pencil” or reform non-compete clauses when certain elements are overly broad or vague. For example, in the 2015 case *Unlimited Opportunity, Inc. v. Waadah*, the Court found that the geographic scope of the non-compete was too broad, and thus refused to enforce it. (*Unlimited Opportunity, Inc. v. Waadah*, 290 Neb. 629 (2015)).

## **5. Employers Requiring Non-Competes Often Do Not Provide “Consideration” That Is Above And Beyond Continued Employment**

In the majority of states, when a non-compete is offered to an existing employee after the original offer of employment, continued employment is sufficient consideration for a non-compete to be enforceable. “Consideration” in this context refers to a benefit received by the signatory of a contract for a non-compete such as increased pay or more training.<sup>13</sup> Even for states that recognize continued employment, questions often arise about how long employment must continue to count as sufficient consideration. In addition, in the case where a worker with a non-compete is searching for a new job, the non-compete combined with a lack of severance pay can create hardship for that individual.

**Examples of Actions States are Taking to Address this Issue:** Currently, some states require that firms provide some “consideration” above and beyond continued employment such as pay raises, training, and promotions to workers who sign a non-compete after they have already worked for a firm for some amount of time. Just 11 states do not view continued employment as sufficient consideration” for the signing of a non-compete in this circumstance, and in DC, Illinois and Mississippi continued employment only counts as consideration if it is for a certain period of time.<sup>14</sup>

A study by Evan Starr finds that when states require firms to offer substantial consideration along with a non-compete (e.g., promotions, training, and higher wages), both training and wage outcomes for workers can be improved.

#### **State Examples**

- **Wyoming.** In Wyoming, a court found that continued employment alone does not provide the necessary consideration to support a covenant not to compete entered into after the employment relationship has already begun. Instead, separate consideration, such as a change in the terms and conditions of employment, must be given contemporaneously with the making of the covenant. This requirement apparently applies whether the employment is at-will or not (*Hopper v. All Pet Animal Clinic, Inc.*, 861 P.2d 531, 540 (Wyo. 1993)).
- **Illinois.** In Illinois, continued employment for a “substantial period of time” is sufficient consideration for a non-compete agreement. A substantial period of time is generally two years. For example, in the case of *Brown & Brown, Inc. v. Mudron*, the court held that seven months of continued employment was insufficient consideration for a non-compete agreement. (*Brown & Brown, Inc. v. Mudron*, 887 N.E.2d 437 (Ill. App. Ct. 2008)).

## **6. In Some Cases, Non-Competes Can Prevent Workers From Finding New Employment Even After Being Fired Without Cause**

In several states, non-competes are enforceable even for workers fired without cause (e.g., a layoff). Worker bargaining power can be particularly negatively affected when employers have the ability to unilaterally determine whether the worker may continue to be employed

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<sup>13</sup> See Beck Reed Riden LLP.

<sup>14</sup> See Beck Reed Riden LLP.

anywhere in his or her occupation. The requirement of having been fired “without cause” would prevent workers from easily evading a non-compete obligation through behavior calculated to force an employer to discharge them.

**Examples of Actions States are Taking to Address this Issue:** While very few states have legislation prohibiting the enforcement of non-competes when an employee is fired without cause, in some states, courts have found that there is no “legitimate business interest” in a non-compete when the employer initiates the termination without cause. In this case, the non-compete is rendered unenforceable.

#### **State Examples**

- **Montana.** The Montana Supreme Court has found that it is difficult to establish a legitimate business interest for enforcement of a non-compete when the employer initiates the termination without cause. A 2011 Montana Supreme Court decision stated that a Montana employer— as in several other states — ordinarily will not be permitted to enforce a non-compete provision in an employment agreement where the employer was solely responsible for ending the employment relationship. Importantly, the court noted that circumstances may exist that could provide an employer with a legitimate business reason to enforce a non-compete such as in cases where the employee misappropriated trade secrets. *Wrigg v. Junkermier, Clark, Campanella, Stevens, P.C., Case No. DA 11-0147, 2011 MT 290 (Nov. 22, 2011).*
- **New York.** In *Arakelian v. Omnicare Inc.* 735 F. Supp. 2d 22, 41 (S.D.N.Y. 2010), the court affirmed that New York courts will not enforce non-compete agreements if the termination was involuntary stating that, “[e]nforcing a noncompetition provision when the employee has been discharged without cause would be ‘unconscionable’ because it would destroy the mutuality of obligation on which a covenant not to compete is based” (internal quotations omitted).

## **7. In Some Sectors, Non-Competes Can Have A Detrimental Effect On Health And Well-Being By Restricting Consumer Choice**

In some instances, non-competes through imposing a restriction on free trade can interfere with consumers ability to acquire critical goods and services. For example, in the case of consumer choice for health care services (i.e. physicians, nurses, psychologists, social workers and other medical professionals), non-competes have the potential to interfere with the quality of care.

Little is known regarding the ubiquity of non-competes throughout differing job categories within the health care service sector. For physicians, it is plausible that there may be “legitimate business interests” that hospitals and service providers seek to protect. However, more attention on lower-wage segments of the industry, particularly within the home health care workers space, may

provide much needed insight into a sub-sector that is poised to grow substantially over the next decade. These workers are less likely to possess knowledge of trade secrets and pose little to no competitive risk.

**Examples of Actions States Are Taking to Address this Issue:** Several states will not enforce non-competes where a “public interest” exists in the consumption of critical goods and services. Depending on the state, courts have recognized the importance of preserving the physician-patient relationship and have exempted them from being bound by a non-compete agreement (Delaware, Illinois, Tennessee, Texas, and Massachusetts). Yet in many states, no physician exemption exists. These states generally move toward limitations on enforceability, and in some cases, outright exemption.

#### **State Examples**

- **Delaware.** Delaware statute limits enforcement of non-competes against physicians, stating that “Any covenant not to compete provision of an employment, partnership or corporate agreement between and/or among physicians which restricts the right of a physician to practice medicine in a particular locale and/or for a defined period of time, upon the termination of the principal agreement of which the said provision is a part, shall be void...” The statute also expressly provides for reasonable damages provisions (*6 DEL. CODE § 2707*)
- **Colorado.** Colorado statute similarly states that, “Any covenant not to compete provision of an employment, partnership, or corporate agreement between physicians which restricts the right of a physician to practice medicine, as defined in section 12-36-106, C.R.S., upon termination of such agreement, shall be void...” (*COLO. REV. STAT. § 8-2-113(3)*)
- **Texas.** Texas code allows non-competes to be enforced against physicians only in narrow circumstances. Among other things, the covenant must (1) allow the physician access to his/her list of patients seen or treated within one year of termination of the contract or employment; (2) allow the physician access to patient medical records upon authorization of the patient; and (3) provide that the physician will not be prohibited from providing continuing care and treatment to a specific patient or patients during the course of an acute illness after the contract or employment has been terminated. (*TEX. BUS. & COM.CODE § 15.50(b)-(c)*).

## **Conclusion**

In some cases, non-compete agreements can play an important role in protecting businesses and promoting innovation. They can also encourage employers to invest in training for their employees. However, as detailed in this report, non-competes can impose substantial costs on workers, consumers, and the economy more generally. This report informs future discussions and potential recommendations for reform by providing an overview of the research on the prevalence of non-

competes, evidence of their effects, and examples of actions states are taking to limit the use and enforcement of unnecessary non-competes.

There is more work to be done. The Administration will identify key areas where implementation and enforcement of non-competes may present issues, examine promising practices in states, and identify the best approaches for policy reform. Researchers must continue to assess and identify promising policy reforms and the potential impact of those reforms including unintended consequences. Ultimately, most of the power is in the hands of State legislators and policymakers in their ability to adopt institutional reforms that promote the use and enforcement of non-competes in instances that appropriately weigh their costs and benefits and in ways that provide workers appropriate levels of transparency about their rights.