D R A F T

FOR DISCUSSION ONLY

Covenants Not to Compete Act

[Tentative new name: Noncompete Agreement Act]

Uniform Law Commission

May 5, 2021 Drafting Committee Video Conference

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May 4, 2021

Covenants Not to Compete Act

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Covenants Not to Compete Act

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Covenants Not to Compete Act

Section 1. Title

This [act] may be cited as the Covenants Not to Compete Act. [Tentative new name: Noncompete Agreement Act.]

Section 2. Definitions

In this [act]:

(1) "Apprentice" means an individual who is in an apprenticeship program registrable under [state or] federal law to learn a skilled occupation.

(2) "Confidentiality agreement" means an agreement that expressly prohibits a worker from disclosing or using information, and is not entered into as a condition of settlement or other resolution of an employment dispute.

(3) "Electronic" means relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities.

(4) "Employer" means an individual or entity who hires or contracts with a worker.

(5) "Entity":

(A) means:

(i) a business corporation;

(ii) a nonprofit corporation;

(iii) a general partnership, including a limited liability partnership;

(iv) a limited partnership, including a limited liability limited partnership;

(v) a limited liability company;

[(vi) a general cooperative associate;]

(vii) a limited cooperative association;

(viii) an unincorporated nonprofit association;

(ix) a statutory trust, a business trust, or common-law business-trust; or

(x) any other person that has:

(I) a legal existence separate from any interest holder of that person; or

(II) the power to acquire an interest in real property in its own name; and

(B) does not include:

(i) an individual;

(ii) a trust with a predominately donative purpose or a charitable trust;

(iii) an association or relationship that is not listed in subparagraph (A) and is not a partnership under the rules stated in Section 3-202(c) or a similar provision of the law of another jurisdiction;

(iv) a decedent's estate; or

(v) a government or governmental subdivision, agency, or instrumentality.

(6) "Forfeiture-for-competition agreement" means an agreement that by its terms or its manner of enforcement imposes adverse financial consequences on a worker for work-related activities elsewhere.

(7) “Intern” means an individual who performs uncompensated service to earn credit awarded by an educational institution, learn a trade or occupation, or gain work experience.

(8) “Less restrictive agreement” means an agreement that limits but does not expressly prohibit, except for a no-business agreement, the worker from some work, including a confidentiality agreement, a forfeiture-for-competition agreement, a no-business agreement, a no-recruit agreement, a non-solicit agreement, and a training-reimbursement agreement.

(9) “Noncompete agreement” means an agreement that expressly prohibits a worker from some work.

(10) “No-business agreement” means an agreement that expressly prohibits a worker from working for a client or customer of the employer.

(11) “No-recruit agreement” means an agreement that expressly prohibits a worker from hiring or recruiting another worker of the employer.

(12) “No-solicit agreement” means an agreement that expressly prohibits a worker from soliciting a client or customer of the employer.

(13) “Record” means information:

(A) inscribed on a tangible medium; or

(B) stored in an electronic or other medium and retrievable in perceivable form.

(14) “Restrictive employment agreement” means an agreement, whether alone or part of an agreement between an employer and worker or potential worker, that prohibits or requires an action after the work relationship ends or a sale of business is consummated, including a noncompete agreement and a less restrictive agreement.

(15) “Sale of business” means sale or merger of an entity or its subdivision or substantially all of the operating assets or ownership interest of an entity.

(16) “Sign” means, with present intent to authenticate or adopt a record:

(A) execute or adopt a tangible symbol; or

(B) attach to or logically associate with the record an electronic symbol, sound, or process.

(17) “Special training” means instruction, teaching, or other education received by a worker from a source other than the employer that is designed to enhance the ability of the worker to perform the worker’s work, is not normally received by other workers, and is a significant cost to the employer.

(18) “Stated rate of pay” means the definite and agreed upon annual compensation, including wage, salary, professional fee, and other amount received as compensation for personal service actually rendered, including the fair market value of all remuneration paid in any medium other than cash. The term does not include a healthcare benefit, severance pay, retirement benefit, expense reimbursement, amount paid by a person that represents a distribution of earnings and profit rather than as compensation for personal service, or anticipated but indeterminable compensation such as tips, bonuses, and commissions.

(19) “Trade secrets” are as defined by the [cite to Uniform Trade Secrets Act].

(20) “Training-reimbursement agreement” means an agreement whereby the employer requires a worker to repay the employer for training expenses incurred by the employer.

(21) “Volunteer” means an individual who, of the individual's own free will, provides services without any financial gain.

(22) “Work” means providing service to an employer.

(23) “Worker” means an individual who works. The term includes an employee, independent contractor, partner, intern, volunteer, and apprentice. The term does not include a member of a board of directors or other governing board, investor, or vendor of goods.

Section 3. Scope

(a) This [act] applies to a restrictive employment agreement. To the extent a restrictive employment agreement is part of an agreement, the restrictive employment agreement is subject to this [act], and the rest of the agreement is not affected by this [act].

(b) This [act] supersedes the statutory and common law of a restrictive employment agreement but does not affect:

(1) the common law of contract;

(2) the common law of agency;

(3) any law or regulation that restricts an attorney's ability to enter into a restrictive employment agreement; and

(4) [cite to other state law that prohibits or limits enforceability of a restrictive employment agreement.]

Legislative Note*: The state should identify pre-existing statutes that prohibit or limit the enforceability of a specific type of restrictive employment agreement that are consistent with this [act] and can remain in force. [To the Drafting Committee only: For example, many states, such as Arizona, Connecticut, and Illinois, prohibit the use of noncompete agreements in the broadcasting industry.]*

Section 4. Notice Requirements

A restrictive employment agreement is prohibited and unenforceable unless:

(a) a copy of the proposed agreement is provided in a record to:

(1) a prospective worker before the worker’s acceptance of employment or

10 business days before the commencement of employment, whichever is earlier; or

(2) a current worker who receives a material increase in earned income before the worker's acceptance of a change in job status or responsibilities or 10 business days before the increase, whichever is earlier;

(b) in conjunction with a copy of the proposed agreement, the employer:

(1) notifies the worker in a record of the worker's right to consult with an attorney prior to signing the agreement; and

(2) gives the following notice in a record:

Notice Required by the Noncompete Agreement Act

You may be prevented from some future work if you sign this agreement

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1. Why am I getting this notice?

You are getting this notice because your employer is proposing that you sign an agreement that limits your ability to work after your work relationship ends. The law requires your employer to provide you with this notice, which will help you understand whether your employer may or may not impose post-employment restrictions.

2. What documentation must your employer provide?

Your employer must give you a copy of the proposed restrictive agreement as well as a copy of the final signed agreement. You may also request at any time during your employment a copy of the restrictive agreement which your employer must give to you within 10 business days of your request. You have 10 business days before starting work to review the agreement unless you decide to start work earlier or you have been working for your employer, in which case you have 10 business days after receiving the agreement to review the agreement.

3. Are restrictive employment agreements prohibited and unenforceable against some workers?

Yes. Most restrictive employment agreements will not be enforceable against physicians, volunteers, apprentices, interns, workers below 18 years old, workers terminated without good cause, and workers earning less than the state's annual mean wage, which can be found at https://www.bls.gov/oes/current/oessrcst.htm.

4. In what ways will I be restricted from work if I sign the agreement?

Your employer has proposed a [noncompete agreement], [confidentiality agreement], [forfeiture-for-competition agreement], [no-business agreement], [no-recruit agreement], [and] [or] a [no-solicit agreement]. *Your employer will highlight which of the agreements it is proposing.* These agreements restrict what you can do after your work ends and must be reasonable.

- a noncompete agreement restricts you from working for a competitor for up to 1 year and is only enforceable your employer has a valid reason for requesting the noncompete and its restrictions are as limited as possible
- a confidentiality agreement prevents you from disclosing information, and is only valid if it covers non-public and business-related information
- a forfeiture-for-competition agreement imposes financial consequences which must be proportional to your activity
- a no-business agreement prevents you from doing any business with certain clients for up to 6 months
- a no-recruit agreement prevents you from recruiting some of your former co-workers for up to 6 months
- a no-solicit agreement prevents your reaching out to former clients for up to 1

year

5. What options do I have?

You have three options:

a. Talk with a lawyer. A lawyer can explain the situation to you and help you decide whether to sign the agreement.

b. Contact the [Department of Labor]. The [Department of Labor] has the authority to seek a penalty from your employer for requesting that you sign a prohibited agreement.

c. Negotiate with your employer. Even if the agreement is enforceable under the [law of your state], you can ask your employer to reduce the post-employment work restrictions in the proposed agreement.

6. What if I sign an agreement that is prohibited by law?

If you sign an agreement that is prohibited under the [act], then the agreement will be unenforceable. If your employer takes you to court and you win, you may be entitled to the costs of litigation and damages. In some situations, you may also sue your employer.

(c) the proposed agreement and the agreement clearly specify the information, type of work, or competitive activity that is restricted or prohibited after the work relationship ends.

(d) the agreement is in a record separately signed by the worker and an agent of the employer and a copy of the agreement is given to the worker promptly after signing.

(e) the employer gives a copy of the agreement to the worker within [10] business days of a worker's request in a record for a copy, unless the employer when acting in good faith is unable to provide the record within [10] business days and the worker is not prejudiced by the delay.

Comment

The separately signed requirement is included for those situations where the restrictive employment agreement is part of a larger work agreement. In this situation, the worker and agent of the employer are specifically required to sign the restrictive employment agreement on its own whether or not they sign the larger work agreement.

Section 5. Worker Not Subject to Restrictive Employment Agreement

A restrictive employment agreement, except for a confidentiality agreement, is prohibited and unenforceable unless:

(a) the worker has, when accepting the restrictive employment agreement and throughout employment, a stated rate of pay greater than the annual mean wage of employees in [State] as determined by [State Department of Labor] [U.S. Department of Labor, Bureau of Labor Statistics];

(b) The worker voluntarily quits without good cause attributable to the employer or is terminated for individual performance-related cause; and

(c) The worker is at least 18 years of age and is not an intern, volunteer, or apprentice when the agreement is signed.

Comment

Subsection (a) is a core part of the act. It prohibits and makes unenforceable a restrictive employment agreement (other than a confidentiality agreement) unless the worker has an annual rate of pay above the threshold amount. The state annual mean wage has several desirable features for being this threshold figure. First, it automatically adjusts for inflation. Second, the figure is easily accessible. The U.S. Department of Labor Bureau of Labor Statistics tracks this number on a state-by-state basis and updates its database yearly.[1] Thus, even if a state does not collect or publish its own annual wage data, it can refer to an easily accessible federal source. Third, the figure varies by state, reflecting the particular economic status of each state. Fourth, the figure is not based on an arbitrary multiple of some other statistics. Fifth, the figure is a core aspect of the labor market rather than tangentially related.

Other possible thresholds lack one or more of these characteristics. For example, a fixed dollar amount does not adjust to inflation and, unless each state separately picks a number, it is not tailored to local labor conditions. A multiple of the minimum wage does not change readily

[1] https://www.bls.gov/oes/current/oessrcst.htm.

with inflation and requires an arbitrary multiple to be meaningful. A threshold based on the poverty level requires an arbitrary multiple and the base number is not directly related to the labor market.

A major feature of the annual mean wage threshold is that it roughly corresponds to workers whose restrictive covenants would typically be unenforceable on common-law trade-secrets criteria anyway. It thus adds clarity and certainty to the question of enforceability without greatly altering the validity of a restrictive agreement for which the employer has a legitimate interest. Few workers making less than the annual mean wage have meaningful access to trade secrets. In 2020, the annual mean wage nationwide was $56,310, ranging from $41,600 in Mississippi to $70,010 in Massachusetts (with greater ranges in U.S. territories). Workers making more than the annual mean wage typically have a college degree, while those making less than the annual mean wage have less education. Having a college degree, in turn, makes it twice as likely the worker has a trade secret.[2]

While empirical data are somewhat less clear for customer relationships than trade secrets, the annual mean wage threshold likely gives a rough correspondence with an unenforceable interest in customer relationships as well. A worker making less than the average mean wage rarely has enough star power or is engaged in a near-permanent customer relationship such that the customer will follow the worker to a new employer. Higher-paid customer representatives may have such power, and thus the employer is more likely to have a protectable interest in the customer relationships enjoyed by a worker paid more than the annual mean wage.

Subsection (a) uses "stated rate of pay" (as defined in Section 2(18)) as the figure to compare to the annual mean wage, rather than all earnings or amount earned in the prior year. This figure is used to add clarity at the moment of contracting. Both worker and employer should know the definite amount the worker will be making, based on the rate of pay and the expected hours, and thus should be able to easily determine whether it is more or less than the annual mean wage. Annual earnings, particularly when they depend on commissions, bonuses, or premium pay, would be much less certain at the time of hiring, and thus create ambiguity in enforcement at this critical time in the employment relationship.

This subsection requires that the stated rate of pay must remain above the annual mean wage throughout the employment relationship, as well as at the initial acceptance of the restrictive agreement. For example, if the stated rate of pay barely exceeds the annual mean wage at acceptance and does not rise as much over the year as the annual mean wage, the restrictive

[2] For details see, U.S. Dep't of Treasury Office of Economic Policy, Non-Compete Contracts: Economic Effects and Policy Implications 4, https://www.treasury.gov/resource-center/economic-policy/Documents/UST%20Non-competes%20Report.pdf (Mar. 2016); Elka Torpey, *Education Pays*, U.S. Bureau of Labor Statistics, https://www.bls.gov/careeroutlook/2019/data-on-display/education_pays.htm (Feb. 2019); According to a 2016 Report on Non-Compete Contracts by the Treasury Department, workers with four-year degrees are twice as likely to possess trade secrets as those without four-year degrees. In 2018, the median annual earnings corresponding to educational attainment was approximately as follows: bachelor's degree-$62,000, associate's degree-$45,000, and less than an associate's degree-$40,000 or less. Generally in line with these statistics, the Treasury Department Report also showed that workers earning less than $40,000 possess trade secrets at less than half the rate of their higher-earning counterparts.

agreement may become prohibited and unenforceable over time.

Section 6. Requirements for Noncompete Agreement

A noncompete agreement is prohibited and unenforceable unless:

(a) the agreement protects one or more of the following legitimate business interests:

(1) the sale of a business in which the worker is a substantial owner and consents to the sale;

(2) the employer's trade secrets; or

(3) the employer's current and ongoing customer relationships;

(b) the agreement, at the time it is entered and through the time of enforcement, is reasonable and narrowly tailored in duration, geographical area, and scope of actual competition to further an interest of subsection (a), and the interest cannot be substantially protected by a less restrictive agreement;

(c) the agreement lasts no longer than:

(1) five years when furthering an interest under subsection (a)(1);

(2) one year when furthering an interest only under subsection (a)(2) or (a)(3).

Section 7. Requirements for Less Restrictive Agreement

A less restrictive agreement is prohibited and unenforceable unless the agreement is reasonable. An agreement is not reasonable, if in the case of:

(a) a confidentiality agreement, it prohibits the worker from using or disclosing:

(1) the worker's general training, knowledge, skill, or experience gained on the job or otherwise; or

(2) information that is;

(A) readily accessible to the relevant public; or

(B) not relevant to the employer's business;

(b) forfeiture-for-competition agreement, the financial consequence exceeds the actual harm to the employer cause by the worker or lasts longer than one year after termination of employment.

(c) a no-business agreement, it extends beyond a current and ongoing client or customer of the employer with whom the worker had personally worked or lasts longer than six months after termination;

(d) a no-recruit agreement, it extends beyond a fellow worker currently working for the employer with whom the worker had personally worked or lasts longer than six months after termination.

(e) a no-solicit agreement, it extends beyond a current and ongoing client or customer of the employer with whom the worker had personally worked or lasts longer than one year after termination.

(f) a training-repayment agreement, it requires payment to the employer of greater than the cost of special training or requires repayment for longer than two years after the training is completed;

Section 8. Waivable and Nonwaivable Provision

(a) Except as provided in subsection (b), a party to a restrictive employment agreement may not waive or stipulate to a fact to avoid a requirement of this [act].

(b) The worker may waive the 10-business-day time requirement of Section 4(a)(1) as long as the worker receives a copy of the proposed agreement before accepting employment. If

the worker so waives, the agreement is not enforceable unless the worker subsequently works at least 10 business days for the employer.

Section 9. Enforcement and Remedy

(a) A court may not modify a restrictive employment agreement [that restricts a worker beyond an enumerated maximum duration under this [act]] to make it enforceable. [A court may modify an agreement that otherwise violates this [act] only upon a finding that the employer reasonably and in good faith believed the agreement was enforceable under this [act] and only to the minimum restriction necessary to protect the employer's interest and render the agreement enforceable.]

(b) A court may remedy an actual or threatened breach of a valid agreement or a failure to comply with this [act] with injunctive relief, actual damages, legally enforceable liquidated damages specified in the agreement, and costs.

(c) A court may award reasonable attorney's fees, actual and liquidated damages, and costs to a party that successfully challenges the enforceability of an agreement.

(d) An affected worker or employer, including an employer not a party to the agreement who is considering hiring an affected worker, may seek a declaratory judgment that the agreement is unenforceable.

(e) The party seeking to enforce an agreement has the burden of proof on every element in any proceeding.

(f) An employer that requests that a worker sign an agreement that the employer knows or reasonably should know is unenforceable under this [act] commits a civil violation.

(g) The [Attorney General and Department of Labor] may bring an action on behalf of an affected worker, or an affected worker may bring a private action, against an employer to enforce

subsection (f), for which liquidated damages of not more than $[5,000] per worker per agreement may be adjudged for each violation.

Section 10. Healthcare Provider

A noncompete agreement, no-business agreement, no-recruitment agreement, or non-solicitation agreement is prohibited and unenforceable against a physician or other healthcare provider as defined by [state regulation of healthcare providers].

Comment

This section makes the listed agreements unenforceable against a healthcare provider even when ancillary to a sale of business. This is similar to the regulation of the equivalent lawyer agreements, which generally are not enforceable even ancillary to a sale of business. Just as the Rules of Professional Conduct allow for the enforceability of some forfeiture-for-competition agreements against lawyers, however, this section allows for the enforceability of forfeiture-for-competition agreements against a healthcare provider, so long as the agreement meets the other requirements of this [act].

Section 11. Choice of Law and Forum

A choice of law or forum provision is prohibited and unenforceable if it has the effect of causing a dispute arising out of a restrictive employment agreement to not be governed by the law of, or decided by a court or arbitrator in, the state where the worker works for the employer or, if the work relationship has ended, the state in which the worker worked at the time of termination.

Section 12. Uniformity of Application and Construction

In applying and construing this uniform act, a court shall consider the promotion of uniformity of the law among jurisdictions that enact it.

Section 13. Relation to Electronic Signatures in Global and National Commerce Act

This [act] modifies, limits, or supersedes the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 et seq.[, as amended], but does not modify, limit, or

supersede 15 U.S.C. Section 7001(c), or authorize electronic delivery of any of the notices described in 15 U.S.C. Section 7003(b).

Legislative Note: *It is the intent of this act to incorporate future amendments to the cited federal law. In a state in which the constitution or other law does not permit incorporation of future amendments when a federal statute is incorporated into state law, the phrase "as amended" should be omitted. The phrase also should be omitted in a state in which, in the absence of a legislative declaration, future amendments are incorporated into state law.*

Section 14. Saving Provision

Section 4 (e) and Section 5 of this [act] apply to every restrictive employment agreement regardless of the date in which it was entered. Otherwise, this [act] does not affect the validity of a restrictive employment agreement in effect before [the effective date of this [act]].

Section 15. Severability

If a provision of this [act] or its application to a worker or employer is held invalid, the invalidity does not affect another provision or application that can be given effect without the invalid provision.

Legislative Note: *Include this section only if the state lacks a general severability statute or a decision by the highest court of the state adopting a general rule of severability.*

Section 16. Repeals; Conforming Amendments

(a) . . .

(b) . . .

Legislative Note: *The state should examine its statutes to determine whether conforming revisions are required by provisions of this act relating to { }. See Section { }.*

Section 17. Effective Date

This [act] takes effect . . . .