Uniform Law Commission
Drafting Committee on Restrictive Employment Agreement Act
Memorandum on Drafting Options
Draft of August 22, 2020

Invitation: In August 2020 the Uniform Law Commission formed a drafting committee to draft a possible Uniform Restrictive Employment Agreement Act. This follows two years of study and recommendation by a study committee. The Drafting Committee is chaired by ULC Commissioner Rich Cassidy of Vermont, with Commissioner Clay Walker of South Carolina as vice-chair. Professor Stewart Schwab of Cornell Law School is the reporter for the Drafting Committee.

The drafting committee is soliciting participation of interested stakeholders and thought leaders, with the goal of proposing a statute for consideration and possible promulgation by the Uniform Law Commission in summer 2021 for adoption by the various states. Anyone interested in being included as an observer to the drafting committee may contact chair Rich Cassidy at rich@richcassidylaw.com; vice-chair Clay Walker at cwalker@hsblawfirm.com; or reporter Stewart Schwab at sjs15@cornell.edu for further information.

Overall Rationale for a Uniform Act: State legislatures have shown considerable interest in employee noncompetes and other restrictive agreements, with nearly a dozen states enacting legislation in the last few years and many more states considering a bill. Illustrating the continuing interest is Virginia's passage in April 2020, during the height of the coronavirus pandemic, of a statute banning noncompetes for low-wage workers. Still, most states rely on the common law to regulate restrictive employment agreements, and the recent statutes show considerable variety.

In appropriate circumstances, noncompetes and other restrictive employee agreements such as non-solicitation and non-disclosure agreements can be useful tools in facilitating sales of businesses, protecting trade secrets and customer relationships, and encouraging employee training. But recent studies demonstrate the widespread use of restrictive agreements among rank-and-file workers, where they can inhibit robust competition and impede workers from finding jobs most suited to their talents.

A Uniform Act could provide real value to state legislatures. Business-community and employee-advocate groups are frustrated with the lack of clarity within most states on when noncompetes are enforceable or unenforceable, and they are frustrated with the variety of approaches among states. The variety among states makes it difficult for national employers to apply consistent policies within their companies, and makes it hard for workers to know their rights and obligations under a noncompete.

Importantly, unlike many employment-law topics, stakeholders do not divide cleanly on pro-employer/pro-employee lines. Employers want both to keep current workers from leaving and to hire experienced workers from other firms. The drafting committee is eager to solicit views from a variety of stakeholders interested in this issue.

ISSUES for the DRAFTING COMMITTEE TO CONSIDER

Issue 1: Low-Wage Workers. Should the Act declare that noncompetes are unenforceable against low-wage workers, and how should low-wage be defined?

Most commentators believe that noncompetes are inappropriate for low-wage workers. The Act could provide crucial clarity here because the common law has extreme difficulty categorically distinguishing high-wage from low-wage workers. The recent statutes that void noncompetes for low-wage workers take a variety of approaches. Some statutes define low-wage with various multiples of a minimum wage, median wage, or poverty level, while others use the FLSA test for non-exempt workers. Perhaps the clearest definition would be a specific dollar amount, pegged so that it excludes workers likely to have access to trade secrets or major customers.

Sample statutory language: *A restrictive employment agreement is unenforceable unless the worker has earned income from this employer at a rate of at least $50,000 per year. [This amount can be adjusted annually for inflation.]*

Issue 2: Notice Requirements. Should the Act require that an employer notify the worker, at the time of initial hire or promotion into a sensitive position, that a noncompete or other restrictive agreement is part of the job?

Recent empirical studies suggest that workers who are given advance notice of a noncompete may get higher wages and more training than workers without a noncompete, but that workers without notice may get no offsetting benefits.

Sample statutory language: *A restrictive employment agreement is unenforceable unless*

(a) The agreement is in a record signed by the worker.

(b) The employer has provided a copy of the agreement to the prospective worker in a record by the earlier of a formal offer of employment or 10 business days before the commencement of the worker's employment. If the noncompete agreement is entered into after the commencement of the worker's employment, it must be entered into upon a subsequent bona fide advancement of the worker by the employer and the employer must provide a copy of the agreement to the worker in a record, and give the worker 10 business days to review and sign the agreement. The agreement must expressly state that the worker has the right to consult with an attorney prior to signing the agreement.

Issue 3: Enforceability standard. Even if a noncompete satisfies any wage-level and notice requirements, to be enforceable it must be narrowly tailored to protect a legitimate employer interest. Preventing competition by a former worker, standing alone, is not a legitimate interest. How should the Act articulate the legitimate interests and narrowly tailored requirements?

Sample statutory language: *A restrictive agreement is unenforceable unless its purpose and effect is to protect one or more of the following legitimate business interests:*

(1) the sale of a business;

(2) the employer's trade secrets or other confidential business information;

(3) the employer's customer relationships; or

(4) the employer's recovery of expense in providing special training to a worker who has worked for the employer for less than two years after the training is completed.

The agreement must be narrowly tailored in duration, geographical area, and scope of business to further one or more of these interests, and that interest cannot be substantially protected by a less restrictive agreement.

Issue 4: No-solicits and other partially restrictive employment agreements: In addition to regulating noncompete agreements that completely prohibit former workers from competing, should the statute regulate less restrictive employment agreements such as no-solicits, confidentiality or non-disclosure agreements, and clawback or financial-penalties-for-competing agreements?

The argument for inclusion is that this would clarify the legal treatment of all agreements that restrict a departing employee's ability to compete against a former employer.

Sample statutory language:

(*) a non-solicitation agreement is presumptively enforceable if it is limited to fellow workers, customers, or clients with whom the worker personally worked, and lasts no more than one year after termination;

(*) a confidentiality agreement is presumptively enforceable if it does not prohibit a worker from:

(A) using the worker's general training, skill, or experience gained on the job;

(B) reporting what the worker reasonably believes to be a violation of law; and

(C) disclosing sexual harassment;

(*) a forfeiture for competition agreement is presumptively enforceable if the financial consequence is reasonable and the agreement:

(A) compensates the employer for no more than the identifiable actual cost of providing special training to a worker who works for the employer for less than two years after the training is completed;

(B) applies only to clients or customers with whom the worker personally worked and was introduced to by the employer, and lasts no more than one year after termination;

(C) is limited to diminution or delay of non-vested retirement benefits, profit-sharing, or other bonus compensation because the worker is competing against the employer.

Issue 5: Independent Contractors and Partners. In addition to regulating noncompetes or other

restrictive agreements with employees, should the Act regulate restrictive agreements with independent contractors and partners as well?

Restrictive agreements with employees are the most prevalent, but restrictive agreements with independent contractors and partners have similar policy tradeoffs: they can protect trade secrets and customer relationships, and they can inhibit mobility and efficient job matching.

One way for the Act to cover these other employment relationships is to define worker as including an employee, independent contractor, or partner, and regulating restrictive agreements between an employer and worker.

Sample statutory language: *"Worker" means an individual who provides services in exchange for earned income. The term includes an employee, independent contractor, partner, and individual who works in a supervisory, managerial, or confidential position. The term does not include a member of a board of directors. The definition of worker set forth in this subdivision shall be applicable only with respect to this [Act]. The definition is not intended, and shall not be relied upon, to create, change, or affect the employment status of any natural person or the meaning of the terms employee, employment, or employer that may apply in any other context or pursuant to any other provision of law.*

Issue 6: Physicians and other Healthcare Workers. Should the Act make unenforceable restrictive agreements with physicians and other healthcare workers, except perhaps in connection with the sale of a business?

In recent years, many commentators and groups, including the American Medical Association, has urged that restrictive agreements against healthcare workers be unenforceable or, at a minimum, heavily scrutinized. About a dozen states have done so by statute. The core concern is that restrictive agreements constrain patient access to health care and restrict the overall supply of healthcare providers. Advocates of this position compare physicians to lawyers. Every state has adopted a version of the ABA Model Rules of Professional Conduct Rule 5.6, which prevents a lawyer from entering into a covenant that restricts the lawyer's ability to practice law (except in connection with the receipt of retirement benefits).

Sample statutory language: *Notwithstanding any other section of this [Act], a noncompete agreement, non-solicitation agreement, or no-business agreement is unenforceable against a physician or other healthcare provider as defined by [state regulation of healthcare providers] unless:*

(a) The agreement is made in connection with the sale of a physician practice; and

(b) The agreement of subsection (a) is narrowly tailored in duration, geographical area, and scope of business to protect a trade secret or customer relationship, and that interest cannot be substantially protected by a less restrictive agreement.

Issue 7: Choice of Law. Should the Act regulate choice-of-law provisions in restrictive agreements?

While relatively little public commentary has concerned choice of law, most states would welcome such a provision in a Uniform Act. A major rationale for a *uniform* act is the consistency and predictability it creates across jurisdictions, and this would be furthered by a choice-of-law provision. A key goal here is to establish clear, standard terminology that could be used consistently by many states. Most likely, the enforceability of a restrictive covenant should be determined by the law of the state where the worker works at the time they are hired, promoted, reassigned, or separated.

Sample statutory language: *Personal Jurisdiction; Choice of Law and Forum; Preemption of Other Law.*

(a) In a dispute arising under this [act], a court may exercise personal jurisdiction over any non-domiciliary who works for the employer in the state, or who worked for the employer in the state at the time of the work relationship's termination.

(b) A dispute arising out of or related to a restrictive employment agreement shall be exclusively:

1. decided by a court in the state in which the worker works for the employer or, if the work relationship has ended, the state in which the worker worked for the employer at the time of the employment relationship's termination; and

2. governed by the laws of that state.

(c) No choice of law provision that would have the effect of avoiding the requirements of this statute will be enforceable if the worker is, and has been for at least 30 days immediately preceding the worker's cessation of employment, a resident of or employed in this state at the time of his or her termination of employment. The criteria for enforceability of a noncompete agreement and the procedures and remedies in an action to enforce a noncompete agreement provided in this statute preempt any other criteria, procedures, and remedies under common law or otherwise.

Issue 8: Remedies and Penalties. What enforcement mechanisms should the Act contain?

Undoubtedly, the Act should empower courts to enforce actual or threatened breaches of a valid noncompete with injunctive remedies and damages. This is current standard law.

The empirical reality, however, is that many employment contracts contain noncompetes that are clearly unenforceable under current law but may chill workers from seeking other job opportunities. To address this reality, the Act may need to beyond declaring that such noncompetes are unenforceable, and also address (1) when, if at all, courts can enforce an overbroad clause (the so-called blue, red, or purple pencil rules); (2) what, if any, fines or penalties should be created; and (3) who may bring suits for enforcement, such as the state attorney general or private parties.

Sample statutory language:

(a) A court may enforce an actual or threatened breach of a valid restrictive employment agreement with injunctive remedies, damages, and costs.

(b) A court shall not modify a restrictive employment agreement in violation of this [Act] to make it enforceable.

(c) A worker or other employer may seek a declaratory judgment that a restrictive employment agreement is invalid. If the court so finds, it may award costs and attorney fees.

(d) An employer that requires a worker to sign an agreement in violation of this [Act] commits a civil violation for which a fine of not more than $5,000 per occurrence may be adjudged.

(1) The [Attorney General of this state] may bring an action against an employer to enforce this subsection.

(2) A worker or other employer has a private right of action to enforce this subsection.