MEMORANDUM

To: Noncompete Drafting Committee Members and Observers

From: Stewart Schwab, Reporter

Date: November 2, 2020

Re: Drafting notes for §§1-2

Below are the drafting notes my research assistants compiled for me to explain the choices made and sources used. Clicking on the underlined words takes you to the state statute on point.

SECTION 1. This [act] may be cited as the Uniform Restrictive Employment Agreement [Act].

Notes: Other options include (1) Uniform Restrictive Covenants [Act] (2) Uniform [Act] Relating to Restrictive Covenants (3) Uniform [Act] Relating to Restrictive Employment Agreements.

Originally the Act was drafted to focus exclusively on noncompete agreements and the name was something along the lines of "Uniform Noncompete Agreement Act." However, after the Scope Committee suggested we include standards for lesser restrictive agreements, we changed the name.

SECTION 2. DEFINITIONS. In this [Act]:

(1) "Apprentice" is a worker participating in an apprenticeship program registered by the Office of Apprenticeship of the U.S. Department of Labor and meeting the standards established by the office, or registered in any state apprenticeship agency recognized by the office.

Notes: This is the definition of apprentice exemption set forth in Section 3(f) of this Act. This definition is identical to that found in New Jersey's pending restrictive covenant statute.

(2) "Confidential information" means valuable information about the employer's business not known to competitors, whether or not it is a trade secret, that a worker receives because of the worker's relationship with the employer.

Notes: Generally speaking, states have tackled confidential information in one of three ways.

The laundry list, when a state lists many different types of confidential information and declares that confidential information "includes, but is not limited" to these examples: Laundry lists are found in both the Alabama and Oregon statutes, which define confidential information with reference to more than ten different types of information.

We chose not to adopt the laundry list for several reasons. First, it looks messy and cluttered. Second, it might suggest that other types of information were considered and deliberately excluded as exemplars, which might lead to an otherwise protectable piece of information not being considered as "confidential information." Conversely, the "includes but not limited to" language might suggest that virtually any private information can be protected as confidential information, which goes against the ethos of the Act, which is to limit the use of restrictive covenants to situations where an employer's legitimate interests (other than limiting competition) need protection.

Confidential information means...confidential information?: This conclusory approach merely delegates to courts the task of defining confidential information. We opted against this vague definition because it directly counters a goal of uniform statute writing; the statute should provide clarity beyond what the common law can give. The uniformity goal of the act means that a national employer should not have to look at fifty state court precedents to determine the standards of protectable confidential information.

The Test: Georgia is one of only a few states that provides significant qualifications in its definition of confidential information. Additionally, the Arkansas statute (see also Florida unenacted) offers a value-based test. Georgia's test requires that the information have value and be learned by the worker during employment. For the reasons that the other options were not chosen, the test-based version succeeds. It

does not allow employers to rampantly use confidential information as an excuse to require a worker to enter a restrictive covenant. It provides greater certainty, but with the caveat that employers might try to litigate whether something is valuable to the business. Lastly, it does not presuppose that certain types of information will always, or will never, be protectable as confidential.

Also of note: Some states, such as Florida , Maine, and Massachusetts (see also New Jersey unenacted), note that confidential information does not need to be a trade secret. It's possible that trade secrets would become redundant with this definition, as trade secrets are a subspecies of confidential information. However, given the added protections specifically afforded to trade secrets and the inherent synergy that such information has with the 48 versions of the UTSA, it seems wise to separate the two terms.

(3) "Confidentiality agreement" means an agreement between an employer and worker restricting the worker from disclosing or using trade secrets or confidential information.

Notes: The main issue in drafting this paragraph was whether it would be wise to have separate definitions of confidentiality agreements and non-disclosure agreements in the Act, or at least whether to say "also known as a non-disclosure agreement" in our definition of confidentiality agreement. After researching the two types of agreements, we concluded that both serve the same purpose. We used the actions "disclosing" and "using" the information (which are used by the Uniform Trade Secrets Act in its definition of misappropriation) to highlight that confidentiality agreements include non-disclosure or non-use agreements as well. Given the interchangeability of non-disclosure agreements and confidentiality agreements, it is possible to exchange the current definition to an NDA-centric definition.

Arguably, the unenacted Minnesota noncompete statute is consistent with our approach, as it refers to confidentiality agreements while remaining silent on NDAs. However, this confidentiality agreement definition was chosen because of the obvious synergy between that and the definition of confidential information.

It is important to note that most states that include language relevant to nondisclosure or confidentiality agreements almost always state the two in the disjunctive. Some states, like Arkansas, Maine, Massachusetts, Rhode Island, and Utah (see also Tennessee, Missouri, and New Jersey unenacted), use language such as "...nondisclosure agreement or confidentiality agreement."

(4) "Earned income" means the amount of, for an employee, wages, salaries, tips, and other employee compensation; for an independent contractor, the amount of net earnings from self-employment; and for a partner, the amount of the partner's salary, equity, dividends, percent of profits, benefits, and other compensation for the taxable year; but only if such amounts are includible in gross income for the taxable year.

Notes: "Earned income" is drawn from Washington's statute, which we used as an example because it simply provides a single number that captures all of an employee's annual compensation. We also considered following New Jersey's unenacted statute, which took a more narrative approach in defining "pay." While New Jersey's approach of explicitly listing the components of pay facially provides some clear guidance, generating such a list suggests that other types of compensation were considered and deliberately excluded, which we sought to avoid.

We also considered including the value of stock that employees hold in the employer as part of "earnings." Our aim would have been to include a group of employees, such as those of startup companies in Silicon Valley, who otherwise fall below the wage threshold because their compensation is almost exclusively in stock options. However, while employees are not always required to report stock options for tax purposes, when they are required to do so, they typically must report their stock options in box one of the Form W-2. This added language, therefore, would likely have done little additional work, while potentially causing great confusion.

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

Notes: This definition of "electronic" is a standard ULC definition and is taken from Section 2(5) of the Uniform Electronic Transactions Act.

(6) "Employer" means a legal or natural person who hires an individual for services in exchange for earned income.

Notes: There are generally three ways that existing statutes define "employer."

Reference method: First, some states, like Illinois, New Hampshire, Oregon, and Washington, refer to other enacted statutes that already contain a definition of employer. For states that already define "employer", this is a nice method of maintaining uniformity across state law. However, if we look at the Uniform Wage Garnishment Act, for example, which obviously has a different goal than a restrictive covenant act, we note that the definition for employer focuses on owing earnings to an employee. If we were to insert this definition into the Act, then interns could be subject to a noncompete, as they are not paid and therefore the Act would not cover their employer. Also, it is worth pointing out that this definition does not include a partnership where the only people working for the entity are partners. However, in this case, the "sale of business" noncompete should suffice to cover a partner who leaves the partnership.

Laundry List: Second, some states, like Georgia, Rhode Island, and Washington, attempt to define an employer by using an exhaustive list of potential employer classifications. For the reasons previously mentioned, we prefer not to use the laundry list approach.

Basic and Conclusory: Lastly, Nevada and West Virginia (see also Texas unenacted) define employer by using a circular formula similar to the Fair Labor Standards Act, such as an employer is someone who hires an employee.

Our Differing Approach: We defined the employer in a way that differs from current statutory approaches, but is also very broad.

1. "a legal or natural person": We have avoided the laundry list approach in the statute in favor of definitions. We want to emphasize that employers can be (and usually are) legal persons as well as natural persons.

2. "who hires an individual for services": Many statutes make the conclusory definition that an employer employs. Our alternative definition specifically focuses on the relationship wherein the worker provides services. Also, this definition is useful because it is not limited by a timeframe. In other words, the requirement of merely "hiring" a worker results in coverage of former, current, and even in some cases, future employers.

3. "in exchange for earnings": This component of the definition serves to limit the otherwise conceptually broad “employer” (e.g., is an individual an employer if they give a worker a DVD player to mow a lawn?). It also plays off the existing definition of earned income and seems to neatly tie together “worker” and “employer.”

(7) “Forfeiture for competition agreement” means an agreement that by its terms or its manner of enforcement imposes adverse financial consequences on a former worker if the worker engages in competitive activities.

Notes: This type of agreement began with conversations regarding clawback agreements and whether they should be included as a lesser restrictive agreement. However, given the varied types of agreements that impose financial penalties on workers or allow for the employer to recover its expenses under specific circumstances, the language and meaning of a clawback agreement ceases to make sense. In searching for a definition that would more accurately reflect the various types of these agreements, we found the “forfeiture for competition” clause in Rhode Island’s noncompete statute. Section 3(f) of the act established the enforceability of the various types of forfeiture agreements.

(8) “Intern” is [Look to FLSA Fact Sheet 71]

Notes: This is the definition of the Intern exemption set forth in Section 3(f). The FLSA Fact Sheet can be found **here**.

(9) "Less restrictive agreement" is an agreement between an employer and worker that does not completely forbid the worker from competing within the worker's profession, trade, or business after the working relationship has ended, and includes a non-solicitation agreement, a confidentiality agreement, and a forfeiture for competition agreement.

Notes: The main point of tension here is whether the Act should include lesser restrictive covenants. We include them because a purpose of this statute is to be as comprehensive as possible, and if there is a requirement that a valid noncompete only be used when a lesser restrictive covenant will not substantially protect the legitimate interest, then not to delve deeper into these lesser covenants would create a vacuum of uncertainty. Several states such as Alabama, Missouri, Oregon, and Rhode Island include less restrictive agreements in their statute (for specific examples, please see Notes in Section 3(h) as well as the definitions of the various lesser restrictive agreements). On the other hand, many states, including Washington, Utah, and Arkansas (see also Tennessee unenacted), specifically note that the statute only covers noncompete agreements. Many other states, however,

(10) "Noncompete agreement" means an agreement between an employer and worker arising out of an anticipated or existing work relationship under which the employer prohibits the worker from competing within the worker's profession, trade, or business after the work relationship has ended.

Notes: This section's definition of a "noncompete agreement" is an amalgamation of several states' definitions. Rhode Island and Massachusetts use the basic language "arising out of an existing or anticipated employment relationship" (see also New Jersey unenacted). Multiple states, such as Alabama, California, Montana, and Washington, define a noncompete agreement as a contract that restrains employees from engaging in a lawful profession, trade, or business. Virginia defines a covenant not to compete as a contract that restricts an individual's ability to compete with his former employer. To achieve more precision, this section's definition merges each of these approaches.

(11) "Non-solicitation agreement" means an agreement between an employer and worker prohibiting the worker from soliciting the employer's workers, customers, or clients after the work relationship has ended.

Notes: This definition is drawn from Washington's definition of "non-solicitation agreement." Like the Washington statute, this definition only applies to agreements prohibiting solicitation after the work relationship has ended (and section 3(h)(2) will limit enforceability to persons with whom the worker personally worked). An agreement prohibiting solicitation while employed, as opposed to after the work relationship has ended, is outside the definitional scope of the act and thus is enforceable without the limitations of the act.

(12) "No-business agreement" means an agreement between an employer and worker prohibiting the worker from doing business with the employer's workers, customers, or clients after the work relationship has ended.

Notes: Only a few states, such as Massachusetts, Oregon, Rhode Island (see also New Jersey and Vermont unenacted). explicitly acknowledge no-business agreements as distinct from non-solicitation agreements. They are similar agreements, with the no-business agreement restricting the former worker more tightly than the no-solicit, but no-solicit seems more visible in the legal Notes. One option would be to include no-business agreements in the definition of no-solicit (or vice versa). We opted for separate definitions because a no-business agreement is more restrictive than a no-solicit, and in section 3(h) will treat the two agreements differently.

(13) "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

Notes: This definition of "record" is a standard ULC definition and derives from Section 2(13) of the Uniform Electronic Transactions Act.

(14) "Restrictive employment agreement" includes a noncompete agreement and lesser restrictive agreements.

Notes: The purpose of this definition is to clarify that, for provisions relating to restrictive employment agreements (e.g., choice of law), both noncompete agreements and lesser restrictive agreements are included in the term.

(15) "Sale of business agreement" means an agreement made in connection with the sale of a business or partnership or substantially all of the operating assets of a business or partnership, or with the disposal of the ownership interest of a business or partnership.

Notes: This definition is drawn from Massachusetts statute, which excludes sale of business agreements from its definition of noncompetition agreements. Although Massachusetts' definition includes further specificity, we split its definition between the broader definition of any "sale of business agreement" here, and what constitutes a narrowly tailored and therefore enforceable sale of business agreement in section 3(h) of the act.

(16) "Sign" means with present intent to authenticate or adopt a record:

(A) to execute or adopt a tangible symbol; or

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

Notes: This is a standard ULC definition of "sign" that has been used in statutes such as the Uniform Wage Garnishment Act and the Uniform Commercial Code.

(17) "Trade secrets" are as defined by the [Uniform Trade Secrets Act].

Notes: This is fairly straightforward as 48 states have enacted the UTSA and almost all statutes that list trade secrets as a legitimate interest refer to their respective state's version of the UTSA. Of note, New York, one of the remaining two states, currently has a pending modified UTSA bill. Some states define trade secrets within the legitimate interests, rather than the definitions section of an Act. Please refer to the states listed in the Notes for Section 3(g)(2) to preview this method.

(18) "Worker" means an individual who provides services in exchange for earned income. The term includes employee, independent contractor, partner, and an 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.

Notes: We use the term "worker" rather than "employee" for several reasons. Primarily, for reasons explained below, our act covers partners and independent contractors as well as employees. "Worker" is a better umbrella term than "employee," and avoids some of the controversial baggage surrounding "employee."

States define "employee" in a variety of ways in noncompete statutes. Our definition takes into consideration the approaches of several states, as well as the overarching considerations of simplicity and consistency with this Act's definition of "employer." States such as Rhode Island refer to an employee as an "individual who works for hire" (see also New Jersey unenacted). However, to add specificity to the definition and further connect it to the definition of "employer," we sought to tie it to the worker's provision of services to the employer. This also mirrors the approach of Louisiana.

Another approach that states like Georgia take is to limit the definition of employee based on the overarching noncompete policy rationale (see also Missouri unenacted). Although this approach initially seems appealing because it is narrowly tailored to the statute's objectives, ultimately we decided that such a definition was unnecessarily complicated and perhaps even inaccurate. For instance, if an "employee" is defined narrowly as an individual who possesses trade secrets, confidential information, or customer contacts that are important to the employer, then the implausible result is that someone on the first day of the job, not yet introduced to anyone or any thing, is not deemed an "employee."

Some states, like Georgia, include independent contractors in their definition of "employee," (see also Minnesota and Missouri unenacted), while Rhode Island explicitly excludes independent contractors from its definition. Other states remain silent on the issue. We chose to follow the approach of those states that include independent contractors as employees, because most of the policy reasons against enforcing noncompetes (e.g., enhancing worker mobility) apply to independent contractors as well as employees. In particular, policy speaks against enforcing a noncompete agreement against independent contractors with low net earnings, and when the employer has no legitimate business interest in the enforcement.

We also included partners in the definition of "worker." While states such as Alabama, California, Hawaii, and Louisiana recognize that there is good reason to allow partners to enforce noncompete agreements against one another, several of them also include some sort of reasonableness provision or other restraint in their statutes. For example, Alabama has a geographic restraint and Louisiana has a geographic and temporal restraint. Section 3 of this Act provides similar restraints, thus ensuring that partners can enforce restrictive agreements against one another only when necessary. In contrast, we exclude members of boards of directors from the definition of "employee," as boards of directors are of a wholly different nature than partnerships and their members are often outside experts and organizational leaders.