MEMORANDUM

To: **Uniform Law Commission**

From: **Rich Cassidy, Chair; Stewart Schwab, Reporter**

Re: **Draft of the Uniform Covenants Not to Compete Act Presented for July 9-14 Annual Meeting**

Date: **June 28, 2021**

A Prefatory Note precedes the draft of the Uniform Covenants Not to Compete Act to be presented for a single reading at the annual meeting of the Uniform Law Commission taking place in Madison, Wisconsin and via zoom on July 9-14, 2021. The Prefatory Note highlights the significant flurry of legislative activity in the last few years, which explains the desire to issue a Uniform Act as soon as possible, and details the policy issues and empirical evidence behind the act. This memorandum will not repeat that discussion.

This memorandum discusses the significant issues in each section of the act, highlighting changes made since the informal commissioner zoom meeting on June 8.

Section 1. Title

The drafting committee is returning to the original title--Covenants Not to Compete Act. Comments at the informal commissioner meeting convinced the drafting committee that a familiar name that flags the core topic of the act is better than alternative suggestions. The act goes beyond covenants not to compete (aka noncompete agreements) and covers other restrictive post-employment agreements as well, but the proposed alternate titles of "Uniform Restrictive Employment Agreement Act" or "Uniform Employee Noncompetition Act" were rejected as cumbersome or unfamiliar.

Section 2. Definitions

Definitions for "apprentice" and "intern" have been deleted because the substantive section singling them out for special treatment has been deleted. Most apprentices and virtually all interns make below the average mean wage, and Section 5 prohibits noncompete and nonsolicitation agreements against low-wage workers. Therefore, separately prohibiting these agreements against apprentices and interns was a belt-and-suspenders approach that the committee decided was not worth the extra complexity.

Thanks to discussion at the informal commissioner meeting, the key definition of "restrictive employment agreement" has been tightened and the confusing term "less restrictive agreement" has been eliminated. In the earlier draft a restrictive employment agreement meant any agreement that "prohibits or requires and action" after the work relationship ends or a sale of business is consummated. It now is defined as an agreement that "prohibits, limits, or sets a condition on working elsewhere" after the work relationship ends or a sale of a business is consummated. The focus now is on a restriction on working elsewhere after work ends, rather than a restriction on any action after work ends. For example, as the comments discuss, an

agreement whereby "the departing worker agrees to return a computer within seven days after leaving" is not a restrictive employment agreement, because it does not restrict working elsewhere. The definition "includes" the seven enumerated types of agreement that have a separate substantive section regulating their use. But an agreement that meets the general definition of restrictive employment agreement, even if not one of the seven enumerated types, is covered by the act.

The term "worker" retains its definition as an individual who provides services, rather than someone who is solely an investor or vendor of goods. The current draft now adds a definition of "work" as meaning "providing service," and the definition of work is clarified to explicitly include "a sole proprietor who provides service to a customer."

Section 3. Scope

The basic structure of this section from the earlier draft is retained. The act applies to a restrictive employment agreement, but not other parts of a larger agreement. Section 3(b) was altered to clarify that the act retains all other parts of the common law other than that specifically applying to restrictive employment agreements. The earlier draft had retained the common law of contract and agency (which are the major areas of common law with relevance here), but the current draft now more broadly retains "principles of law and equity consistent with this act." This latter formulation is adapted from the ULC Drafting Rules and Style Manual Rule 602(b) (2021). Section 3(d) notes that an agreement about patent or copyright rights is beyond the scope of this act.

Section 4. Notice Requirements

The final draft retains the basic structure of the earlier draft with helpful clarifying changes from the informal meeting. Subsection (a) requires the employer to give advance notice of the restrictive agreement to (A) a prospective worker 14 days before acceptance or the start of work; (B) a current worker 14 days before a change in job duties and a material increase in compensation; and (C), to a departing worker 14 days before signing. The latter subsection was added on recommendation of the informal meeting discussion to explicitly address the situation where a restrictive agreement is entered by a departing worker, usually as part of a severance package. The core requirements here are 14 days' notice and consideration. Other paragraphs of subsection (a) require the employer to "clearly specify" the restrictions, that the agreement be in a record and separately signed, and that the employer also give notice about the act as prescribed by the state department of labor.

Subsection (b) allows the worker to waive the 14 days requirement if the worker wants to begin work earlier.

Subsection (d) requires the state department of labor to prescribe the notice about the act that the employer must give the worker along with the proposed restrictive agreement. The act gives the department of labor some discretion how to prescribe the notice, and the comments suggest draft notices for a couple of restrictive agreements that the department might use.

Overall, the section requires that the worker receive both general notice of the act's requirements and bespoke notice of the specific restrictions of the proposed agreement.

Section 5. Worker Not Subject to Restrictive Employment Agreement

Paragraph 5(1) is the low-page provision. It declares that the restrictive employment agreement (other than a confidentiality agreement or training-repayment agreement) is prohibited and unenforceable unless the worker has a stated rate of pay greater than the state's annual mean wage. As the comment discusses, using the stated rate of pay has the advantage that it is known at the time the agreement is entered, so the parties should know whether the agreement is prohibited or not. Other advantages of this measure are that it adjusts for inflation, is easily accessible, varies by state, and is a core aspect of the labor market related to workers that might have access to a trade secret or significant customer relationship.

Paragraph 5(2) declares that an agreement is prohibited and unenforceable against a worker who is laid off (revealing the employer no longer needs the worker) or terminated without good cause.

As discussed earlier in this memo, the current draft deletes the earlier requirement (in old paragraph 5(3)) that an agreement is unenforceable against a minor, apprentice, intern, or volunteer. This was a belt-and-suspenders requirement largely covered by paragraph 5(1)'s low-wage provision.

Section 6. Restrictive Employment Agreement

This is a new section requiring that every restrictive employment agreement be reasonable. The reasonableness requirement was already imbedded in various sections in the earlier draft, so substantively this is not a new requirement, but is now given its own section. As the comment explains, the reasonableness requirement is in addition to the specific requirements for each particular type of restrictive agreement, and applies to a restrictive employment agreement that may not meet the definition of a particular type of agreement.

Section 7. Noncompete Agreement

Regulation of a noncompete agreement is at the core of the act. This section follows standard common law by requiring that a noncompete: (1) further a legitimate business interest, and (2) be narrowly tailored to protect that interest. Paragraph (1) specifies three legitimate interests. As the comment explains, these cover most of the legitimate interests recognized by courts, although the terminology varies extensively among the states. Paragraph (2) articulates the standard narrowly tailored requirements of duration, geography, and scope of actual competition, and also clarifies that a noncompete is not narrowly tailored if another restrictive agreement (such as a confidentiality or nonsolicitation agreement) would adequately protect the trade secret or customer interest. Paragraph (3) adds clarity that the common law cannot with a clear rule: a noncompete cannot restrict competition for more than a year (or, in connection with the sale of a business, five years).

Section 8. Confidentiality Agreement
Section 9. No-Business Agreement
Section 10. Nonsolicitation Agreement
Section 11. No-Recruit Agreement
Section 12. Payment-for-Competition Agreement
Section 13. Training-Repayment Agreement

Each of these sections promulgates the specific requirements for the particular type of agreement. This structural change to the draft was suggested in the informal-meeting discussion as a replacement to the confusing umbrella term "less restrictive agreement." In general, these agreements have an outer duration of one year. The exceptions are: (1) confidentiality clause, which has no maximum duration because information can remain confidential indefinitely; (2) no-business agreement, which is six months to reflect that it is more onerous than the structurally similar nonsolicitation agreement; and (3) training-repayment agreement, which can last for two years after employment ends to encourage employers to pay for specific training.

Section 14. Nonwaivability

In general, the requirements of this act are nonwaivable, except for section 4(b)'s rule that the employer give a worker 14 days' notice of an agreement. The wording has been changed to clarify that a party can stipulate to a fact "in the context of resolving an issue in litigation or other dispute resolution."

Section 15. Enforcement and Remedy

This is a critical section. The current draft deletes parts of the earlier draft that simply restated standard civil procedure.

Subsection (a) covers the controversial issue of colored pencil and gives a state two alternatives. Alternative A is the red pencil, whereby a court will not enforce any part of an overbroad agreement. Alternative B is a type of purple pencil. If the agreement violates a specific durational requirement of the act (e.g., a nonsolicitation agreement exceeding one year), the court will not enforce it. Otherwise, the court may modify an overbroad agreement if the employer reasonably and in good faith believed the agreement complies with the act.

Subsection (b) authorizes a worker to obtain a declaratory judgment that the agreement is unenforceable, and also authorizes this for a second employer who has hired or is considering hiring an affected worker. While the former is standard in most states, standing for the second employer to get a declaratory judgment is unclear in many states. This subsection makes clear the second employer has standing to get a declaratory judgment.

Subsection (c) allows a court the discretion to grant reasonable attorney's fees to a private party that successfully challenges or defends against the enforceability of a restrictive employment agreement. The policy goal here is that without access to attorney's fees, a worker often will be unable to contest the enforceability of the agreement, and a second employer may decline to hire a worker under the cloud of even a prohibited restriction. A state agency challenging an agreement on behalf of a worker cannot get attorney's fees. And while attorney's fees are covered, the act does not shift other reasonable litigation expenses such copying costs of depositions, travel expenses, and fees of an expert witness--additional options discussed in ULC Drafting Rules and Style Manual Section Rule 309(f)--leaving these to general state law.

Subsection (d) makes clear that the employer has the burden of proof in demonstrating compliance with the act, regardless of whether the employer is a plaintiff or defendant. The earlier draft placed on the employer the burden of proof for all elements of the claim, but the current draft more precisely places the burden on the employer only to show compliance. The act

leaves other aspects of the burden of proof to the ordinary operation of state procedure or evidence.

Subsection (e) creates a civil violation against an employer who knows or should know that the agreement is unenforceable. The penalty is in the form of statutory damages that will go to the affected worker. The amount is bracketed at $[5,000] per worker per agreement, allowing individual state discretion as to the dollar amount. The subsection creates a cause of action for the relevant state agency and for the affected worker to enforce the penalty.

[Old Section 10. Healthcare Provider]

As recommended by the discussion at the informal meeting, this section has been dropped. A healthcare provider is now treated like any other worker, not singled out for special treatment.

Section 16. Choice of Law and Venue

Subsection (a) declares that a choice-of-law provision must call for the law of the jurisdiction where the worker primarily works. The important goal here is uniformity and clarity, and the place of work almost always has the closest ties to the agreement. The comments discuss the complications that arise when the worker is transferred from state to state by an employer: here, the law where the worker last works controls.

Subsection (b) declares that the venue must be where the worker primarily works or last worked, or the worker's residence at the time of the dispute. The prior draft used the term "forum," but "venue" more accurately describes the issue here. The purpose here is to make the substantive provisions of the act a reality by requiring a venue where a worker can realistically challenge an improper restrictive employment agreement as a practical matter. A right to contest an agreement in a far-off jurisdiction is in many cases not of practical importance, because the logistics and costs are insurmountable. In this respect, the venue provision has a similar purpose to the attorney's fee provision of Section 15(c). Each is needed to give a worker a realistic opportunity to challenge a restrictive employment agreement that violates this act.

Section 17. Uniformity of Application and Construction

This is a boilerplate section of the ULC, but very important to this act.

Section 18. Saving Provision

With two exceptions (spelled out in Section 19), the act applies only to an agreement entered after the act's effective date.

Section 19. Transitional Provision

The act applies to existing as well as future restrictive agreements the requirement of Section (a)(5) that the employer give a copy of the agreement to a worker upon written request (but does not have to more than once a year). Retroactivity here is uncontroversial. It simply says

that the employer must timely give a copy to a worker upon request. Often the agreement was entered into years earlier and the worker may not have a good record-keeping system and know the terms of the agreement.

The act also applies Section 5 (containing the low-wage and no-layoff restrictions) to existing agreements. A prime policy goal of the act is to prohibit the enforcement of a restrictive agreement (other than a confidentiality or training-repayment agreement) against low-wage workers. Such enforcement is probably improper under current law, but there is much uncertainty here and the chilling effect deters worker mobility and the smooth operation of the labor market for low-wage workers. Ameliorating these problems should not wait until all current agreements run their course.

Section 20. Severability
Section 21. Repeals; Conforming Amendments
Section 22. Effective Date

These provisions are standard ULC boilerplate, albeit important.