Uniform Law Commission

Study Committee on Covenants Not to Compete

Final Report and Recommendation to Scope & Program Committee

May 28, 2020

***Progress to Date***: The Study Committee was formed in August 2018 and had an initial conference call on September 17, 2018. Reporter Stewart Schwab drafted a report that was circulated and discussed by the Study Committee by conference call on September 25, 2019. A third conference call was held December 10, 2019. In January 2020, informed by an extensive email exchange that followed up on the December conference call, the Study Committee submitted to the Scope and Program Committee a report and recommendation that a drafting committee be formed. That recommendation endorsed a "building block" approach of possible topics to include in the uniform act. The Scope and Program Committee found the building-block approach to be confusing and asked the Study Committee to provide a specific outline of issues to be included in any draft act, as well as a report on stakeholder sentiment. Reporter Schwab drafted a revised report as well as a memorandum on interest-group positions, which was circulated to the Study Committee and discussed during a Zoom conference on May 14, 2020. Reporter Schwab and co-chairs Keith Rowley and Steve Willborn further revised the report and recommendation in light of the May 14 discussion and subsequent emails. The Study Committee now submits this Final Report and Recommendation to the Scope and Program Committee, along with the memorandum on interest-group positions.

***Recommendation***: The Study Committee, including its ABA advisor and participating stakeholder observers, unanimously recommends that a drafting committee be appointed to draft a Uniform Act on Covenants Not to Compete (exact title to be left to the discretion of the drafting committee).

***Overall Rationale for a Uniform Act***: The Study Committee is convinced that state legislatures have considerable interest in employee noncompete covenants, with nearly a dozen states enacting legislation in the last couple of years, and many more states considering legislation. 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 noncompetes, and the recent statutes show considerable variety.

A Uniform Act could provide real value to legislatures. Business-community and employee-advocate groups are frustrated both with the lack of clarity within most states on when noncompetes are enforceable or unenforceable and with the variety of approaches among states. State-to-state and within-state variations make it difficult for national employers to adopt consistent policies for the various jurisdictions in which they do business and for workers to know their rights and obligations under a noncompete. A detailed assessment of stakeholder positions is included in the accompanying memorandum on interest-group positions.

Importantly, unlike most 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. For example, Study Committee Member David Jensen reports that Idaho's recent legislative experience shows the split interests on the employer side. In 2016, the Idaho legislature added a provision to the state's codification of the common law that made it much easier for employers to enforce noncompete agreements against key employees and independent contractors. Idaho soon received bad national press about its employer-friendly law. One example was an Inc.com article headlined: "Have a great startup idea? Don't move to Idaho." As a result, in December 2017, more than 100 Idaho business leaders, ranging from high-tech CEOs to small-business owners to engineers, signed a letter to Idaho's Governor and the Idaho Legislature calling for the repeal of the 2016 law. The Idaho legislature repealed the 2016 law during the 2018 session and the Governor allowed the repeal bill to become law without his signature. In his statement, the Governor urged the legislature to take up the issue again in 2019 and look for a middle ground. So, if a conservative state like Idaho is interested in finding a "middle ground," David Jensen concludes, perhaps there are prospects for the product of a drafting committee.

## TOPICS TO INCLUDE IN A UNIFORM EMPLOYEE NONCOMPETE ACT

The Uniform Act should include the following issues or topics:

**Topic 1: Coverage of Noncompetes and other Restrictive Covenants**. The Act should define and regulate covenants not to compete ("noncompetes"). The drafting committee should also consider the regulation of other restrictive employment covenants such as non-solicitation, confidentiality, and nondisclosure covenants, because they also impact a departing employee's ability to compete against a former employer.

The Act should not cover no-poach agreements. Unlike noncompetes and other restrictive employment covenants, all of which are agreements between an employer and employee, no-poach agreements are between two employers not to hire each other's employees. Such clauses between competing employers almost certainly violate antitrust laws, while the wisdom and legality of no-poach agreements among franchisees of the same brand is more debatable.

While a few state noncompete statutes regulate no-poach agreements, most do not. The Study Committee recommends that the Uniform Act avoid the topic as raising antitrust issues tangential to the core issues of noncompetes.

**Topic 2: Exempting Low-Wage Workers**. The Act should declare that noncompetes are not enforceable against low-wage workers (including low-salaried workers), defining low-wage workers in an appropriate way that takes into account wage inflation.

Most states would support this provision. Most commentators believe that noncompetes are inappropriate for low-wage workers, and indeed current common law makes them generally unenforceable, albeit on a case-by-case basis. One of the most knowledgeable observers on the Study Committee said he knew of only one or two people among the hundreds he has dealt with on this issue that argued that a noncompete was appropriate for low-wage workers. Most of the recent statutes have focused on exempting low-wage workers. A statute can provide crucial clarity here because the common

law has extreme difficulty in expressly or categorically distinguishing high-wage from low-wage workers and the recent statutes have considerable variation.

Key tasks for the drafting committee here would include: (1) defining "low-wage" with care, and in particular assessing whether a low-wage level can be determined that correlates with the likelihood of an employee possessing trade secrets; (2) deciding whether to use a monetary cutoff as most recent statutes have done (and if so, at what level), use the exempt/non-exempt employee categories of the Fair Labor Standards Act, as a couple of states have done, or perhaps use both; and (3) deciding how the low-wage definition should be indexed for inflation. In making these decisions, the drafting committee should be mindful of the value of a clear rule and that many have criticized the FLSA exempt/non-exempt test as lacking clarity and as being a headache for employers.

**Topic 3: Notice and other Procedural Requirements for Transparency**. The Uniform Act should specify notice and other procedural requirements for an enforceable noncompete. These include that the noncompete must be in writing and signed by the employee before accepting a new job or a new position/promotion, and perhaps that the employer must give notice about the Act's restrictions on noncompetes. The drafting committee should also consider whether a noncompete upon separation from an employer in exchange for benefits conditioned on the employee's adherence to the noncompete is enforceable.

Many states would support notice provisions. Empirical evidence suggests that noncompetes work very differently for workers who had advance notice from workers who had a noncompete imposed after the employment relationship began.

Key tasks for the drafting committee here would include: (1) defining a limited number of procedural requirements for an enforceable pre-/intra-/post-employment noncompete; and (2) determining the relationship between procedural requirements and consideration requirements for at-will employees, for whom promise of continuing work is generally thought sufficient consideration for changes in the employment contract.

**Topic 4: Enforceability Standard**. The Uniform Act should make clear that a noncompete is unenforceable, even if it satisfies the wage-level and notice requirements of Topics 2 and 3 above, unless the noncompete protects a legitimate employer interest and is narrowly tailored in time, geography, and scope to protecting that interest. The drafting committee should be given some flexibility on the level of specificity in defining legitimate interests. For example, the Act could list some legitimate interests including sale-of-business, protecting trade secrets, and protecting customer relationships, and indicate this is not an exclusive list. The Act should make clear, however, that preventing competition by a former employee, standing alone, is not a legitimate interest. The Act could indicate that part of the narrowly tailored inquiry includes whether a less restrictive clause (such as a non-solicitation or confidentiality clause) would adequately protect the employer's legitimate interest.

This topic will require nuance by the drafting committee. While most states agree on the substance, if not the exact language, of the general standard that noncompetes are enforceable only if narrowly tailored to support a legitimate employer interest and not excessively burdensome to employee or public, there is more variation among states as one specifies particular employer interests. Still, the Act needs to articulate the enforceability standard with some degree of specificity.

**Topic 5: Choice of Law**. The Uniform Act should declare that, regardless of a choice-of-law provision in an employment contract, its enforceability should be determined by the law of the state where the employee works when hired, promoted, reassigned, separated, or otherwise subjected to the noncompete.

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 clause.

A key task for the drafting committee here would include getting clear, standard terminology that could be used consistently by many states.

Templates exist in current laws. For example, the Massachusetts 2018 law declares: "No choice of law provision that would have the effect of avoiding the requirements of this section will be enforceable if the employee is, and has been for at least 30 days immediately preceding his or her cessation of employment, a resident of or employed in Massachusetts at the time of his or her termination of employment." Washington state's 2019 law declares: "A provision in a covenant signed by an employee or an independent contractor who is Washington-based is unenforceable if it requires the employee to adjudicate a noncompetition agreement outside the state and to the extent it deprives the employee of the substantive protection of Washington law."

**Topic 6: Remedies and Penalties.** The Uniform Act should declare that courts may enforce actual or threatened breaches of a valid noncompete with injunctive remedies and damages. This is currently 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. The Uniform Act, therefore, should go beyond declaring that such noncompetes are unenforceable, and also address when, if at all, courts can narrow an overbroad rule and enforce it as narrowed (the so-called blue, red, or purple pencil rules). The drafting committee should also consider fines or penalties for noncompetes that violate the clearly defined requirements of Topic 2 (wage thresholds) or Topic 3 (notice and other procedural requirements), and authorize state attorneys general to enforce the fines and perhaps create a private right of action.

Several states have already authorized such enforcement mechanisms, or otherwise allowed challenges of clearly unenforceable noncompetes with private rights of action, attorneys fees, and similar measures. This topic becomes more controversial as the remedies and penalties increase.

**Topic 7: Exempting Physicians and other Healthcare Workers**. The Act should declare that noncompetes are not enforceable against physicians and perhaps other healthcare professionals.

About a dozen states exempt physicians from noncompetes. The American Medical Association strongly endorses such statutes, so including these exemptions would give the Uniform Act support from a powerful stakeholder.

**Topics that Should NOT Be Included**

The Study Committee recommends that the following topics NOT be included in a Uniform Act. While these topics may have merit, there is insufficient consensus on their wisdom or scope to ensure that many states will adopt them. Among the topics NOT to include are:

*No-poach agreements*. As discussed in Topic 1 above, antitrust statutes loom large for no-poach agreements and the issues they present tend to be tangential to the core issues of restrictive covenants between employer and employee.

*Garden leave*. In a garden-leave clause, an employer promises to pay an employee during the noncompete period. Massachusetts requires that a noncompete clause be supported by a garden-leave clause or other mutually-agreed upon consideration, and Washington requires compensation during the noncompete period for employees terminated by layoff. Other states are considering whether to require this so-called garden leave.

Study Committee members knowledgeable of the Massachusetts legislative experience report that garden leave was highly controversial there, and probably delayed passage of the bill for one or two years until a compromise was found. The Study Committee recommends avoiding this topic as too controversial.

*Exempting Tech Workers and other specific occupations*. A few states void noncompetes for tech workers, broadcasters, or other occupations. These exemptions involve competing interests, and there is not strong national consensus here. The Study Committee recommends that the Uniform Act not cover these specific occupations, but leave them to individual state law.

Why differentiate between physician/healthcare providers and professionals in other industries? First, physicians are comparable to lawyers in many contexts, and lawyer noncompetes are unenforceable in all states. Second, there is a growing consensus that healthcare noncompetes should be banned or heavily scrutinized (see the accompanying memo on interest groups). The Uniform Act may find powerful allies in the American Medical Association and other groups if the Act includes tight regulation or a ban on healthcare noncompetes. While the Study Committee is not sure a healthcare exemption should appear in the final draft of a Uniform Act, it feels the topic should not be excluded from the drafting committee at this point.