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## No Exit: Understanding Employee Non-Competes and Identifying Best Practices to Limit Their Overuse

Jane Flanagan

Judges and policy makers have long struggled with what to do with restrictive covenants not to compete (“non-competes”) that limit an employee’s ability to work for a competitor employer for a certain amount of time after they leave a job. Employers as far back as the medieval guild system have, as Harlan Blake put it, viewed these kinds of post-employment restraints “as perhaps the only effective method of preventing unscrupulous competitors or employees from appropriating valuable trade information and customer relationships for their own benefit.”<sup>1</sup> From this view, non-competes should be permitted and protected because otherwise businesses will not invest in training and research. The opposite view is that non-competes should be severely limited or banned because, taken in the aggregate, they diminish competition and entrepreneurship by “intimidating potential competitors and by slowing down the dissemination of ideas, processes, and methods” and lower wages and working conditions by “unfairly weaken[ing] the individual employee's bargaining position vis-à-vis his employer.”<sup>2</sup>

Courts have generally attempted to strike a balance between these interests by allowing and enforcing non-competes for those employees—typically highly skilled and highly compensated employees—for whom the employer has a legitimate business reason, such as protection of trade secrets or customer goodwill.

Yet recent evidence in both academic literature and the popular press suggests that this balance is off. Research shows that two in five workers, or 40 percent of the U.S. labor force, has been bound by a non-compete at some point in their careers.<sup>3</sup> It is estimated that in 2014, for example,

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<sup>1</sup> Harlan Blake, *Employee Agreements Not to Compete*, 73 HARV. LAW REV. 625, 627 (1960).

<sup>2</sup> *Id.*

<sup>3</sup> Evan Starr et al., *Non-competes in the U.S. Labor Force* (Univ. of Mich. L. & Econ., Research Paper No. 18-013, 2019). This amounts to about 60 million people. Around one in five labor force participants are currently working under a non-compete.

some 28 million Americans were working under a non-compete.<sup>4</sup> From the now infamous non-compete that sandwich chain Jimmy John's imposed on all of its employees, including minimum-wage sandwich makers and delivery drivers,<sup>5</sup> to stories of employers using non-competes for janitors,<sup>6</sup> manual laborers,<sup>7</sup> security guards,<sup>8</sup> and even unpaid summer interns,<sup>9</sup> the news is replete with examples of non-competes gone wild. These non-competes are limiting the outside job options for employees who, practically by definition, could not possess highly sensitive confidential information or trade secrets about their employers. Taken in the aggregate, such widespread limitations on employee mobility have demonstrable, negative consequences for wages<sup>10</sup> and innovation.<sup>11</sup>

This Issue Brief seeks to understand the recent growth of non-competes and to explore legal and policy responses to limit their usage. Part I provides a basic primer on the traditional legal framework governing non-competes. Part II explores why, despite a legal framework that disfavors non-competes, an increasing number of workers are subject to them. Part III summarizes recent legislative responses, drawing out commonalities, strengths, and weaknesses in the various approaches. Part IV explores non-legislative approaches to combatting overuse of non-competes, including public enforcement, education, and organizing. Throughout this Issue Brief, I attempt to contextualize employers' use of overbroad, unenforceable non-competes within an overall rise in boilerplate employment contracts that seek to modify or supplant the rights workers have at work and after they leave a job. I argue that best practice responses will address this overall trend and not just non-compete usage.

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<sup>4</sup> Starr, *supra* note 3, at 2.

<sup>5</sup> Samantha Monkamp, *Illinois AG Sues Jimmy Johns Over Non-competes Pact; Chain 'Disappointed'*, CHI. TRIB., June 9, 2016. Full disclosure: the author was one of the attorneys representing the State of Illinois in this lawsuit.

<sup>6</sup> Sophie Quinton, *These Days, Even Janitors Are Being Required to Sign Non-Compete Clauses*, U.S.A. TODAY (May 27, 2017).

<sup>7</sup> Conor Dougherty, *How Non-compete Clauses Keep Workers Locked In*, N.Y. TIMES (May 13, 2017).

<sup>8</sup> Stacey Vanek Smith, *In Tight Labor Market, Blue Collar Employers Turn to Non-Compete Clauses*, NAT'L PUB. RADIO (June 27, 2019).

<sup>9</sup> Harriet Torry, *Interns' Job Prospects Constrained by Non-compete Agreements*, WALL STREET J. (June 29, 2019).

<sup>10</sup> OFFICE OF ECON. POLICY, U. S. DEP'T OF THE TREASURY, NON-COMPETE CONTRACTS: ECONOMIC EFFECTS AND POLICY IMPLICATIONS (Mar. 2016).

<sup>11</sup> Orly Lobel, *Talent Wants to Be Free: Why We Should Learn to Love Leaks, Raids, and Free Riding* (2013); Orly Lobel, *The Spinoff Advantage: Human Capital Law and Entrepreneurship*, in *ENTREPRENEURSHIP AND THE LAW* (Brian Broughman & Gordon Smith eds., forthcoming 2019).

## I. The Traditional Legal Framework Views Non-Competes as Exceptions

Employment law in the United States is premised upon the idea of a free labor market. Employment relationships are presumed to be “at will,”<sup>12</sup> meaning that the great majority of Americans can be fired from their jobs at any time so long as the reason for the termination is not discriminatory or contrary to public policy.<sup>13</sup> What we get in return, so the reasoning goes, is an ability to use skills attained at one job to move to a better job. If the job conditions are bad, we can quit. If our skills could earn us more at another employer, we can quit. Taken in the aggregate, this free movement of workers is thought to build overall economic growth and entrepreneurship as employers compete for the best workers.<sup>14</sup>

Employers and employees can enter into contracts that modify the terms of the employment relationship. Union negotiated collective bargaining agreements, for example, may override the presumption of at will employment and provide that employees may only be terminated for “just cause.”<sup>15</sup> Conversely, non-competes and other post-employment restraints may limit a workers’ ability to quit and dictate where and for whom they can work after leaving their job.

Because non-competes limit workers’ free movement in the labor market, the law has traditionally viewed them with suspicion as disfavored restraints of trade and permitted them only in limited circumstances.<sup>16</sup> California, Montana, and Oklahoma do not recognize or enforce non-competes at all. The majority of states will, however, recognize and enforce a non-compete if it meets some variation of a balancing test developed by courts to weigh the interests of the employer and employee (hereinafter “the common law test”). This common law test generally looks at whether (1) the non-compete is used to protect a legitimate business interest of the employer; and (2) the restrictions it imposes are reasonable and not otherwise harmful to the public.<sup>17</sup> Discouraging employee turnover, for example, is not a legitimate business reason, but

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<sup>12</sup> James J. Brudney, *Reluctance and Remorse: The Covenant of Good Faith and Fair Dealing in American Employment Law*, 32 COMP. LAB. L. & POL’Y J. 773, 778 (2011). The State of Montana does not recognize the at will employment doctrine. See MONT. CODE ANN. §§ 39-2-901 through 39-2-915.

<sup>13</sup> Federal, state, and local civil rights laws have made it illegal to fire an employee on the basis of a protected category, such as their race, gender, national origin, age, or disability. See, e.g., 42 U.S.C. § 2000e-2(a). Employees also cannot be legally fired for exercising their workplace rights. See, e.g., 29 U.S.C. § 215.

<sup>14</sup> See Cynthia L. Estlund, *Between Rights and Contract: Arbitration Agreements and Non-Compete Covenants as a Hybrid Form of Employment Law*, 155 U. PA. L. REV. 379, 407-408 (2006) (describing how the “right to quit” has been tied to both freedom of labor markets and individual economic welfare and citing cases).

<sup>15</sup> Lawrence E. Blades, *Employment at Will vs. Individual Freedom: On Limiting the Abusive Exercise of Employer Power*, 67 COLUM. L. REV. 1404, 1410 (1967). Just cause provisions in collective bargaining agreements and other employment contracts protect employees from termination for no reason, reasons “erroneously believed by the employer to be justified,” or ulterior or unlawful reasons.

<sup>16</sup> See RESTATEMENT (SECOND) OF CONTRACTS §186 & ch. 8, topic 2, intro note (1981).

<sup>17</sup> This test was originally articulated in the seminal case *Mitchel v. Reynolds*, 24 Eng. Rep. 347 (Q.B. 1711), and later incorporated into most states’ common law. See, e.g., *Reliable Fire Equip. Co. v. Arredondo*, 965

courts do generally recognize an employer's interest in protecting things like trade secrets and customer goodwill as legitimate. If the court finds a legitimate reason for the non-compete, it will then seek to determine whether the restrictions are reasonable and do not impose an "undue hardship" on the employee by looking at factors such as the duration of the non-compete, the geographic area it applies to, the scope of the activity restrained, and whether there are other means of protecting the employer's legitimate interest. Some state courts will also look to see if a non-compete is supported by adequate "consideration" – money or something else of value to compensate the employee for limiting their future job prospects.<sup>18</sup>

While the legal doctrine views non-competes as exceptions to the general rule, permissible only when narrowly tailored and used for a legitimate reason, evidence suggests that particularly in the last decade, employers actual non-compete usage has been far broader than is necessary or legally permissible. As stated above, two in five workers, or a full 40 percent of the workforce report having signed a non-compete at some point in their career.<sup>19</sup> Nearly 30 million Americans are estimated to be presently working under a non-compete.<sup>20</sup> Non-compete usage is not limited only to high wage earners. Approximately 12 percent of workers earning less than \$40,000 a year and without a college degree are subject to non-competes.<sup>21</sup> Thus, a significant number of employees appear to be working pursuant to a non-compete that, if reviewed by a court, would likely be struck down as "unreasonable" and therefore legally unenforceable.

## II. How We Got Here: Why the Traditional Legal Framework Isn't Working

So how did we get here? Why does there seem to be such a disconnect between the legal regime governing non-competes and employers' actual usage?

### A. Employer Motivation for Non-Competes

One explanation for the apparent rise in employers' non-compete usage is that information and trade secrets have become more important and more portable. In the contemporary business world "where knowledge and the individuals who create and use that knowledge are key sources of competitive advantage," employers may feel a greater need to lock down these

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N.E.2d 393, 396-97 (Ill. 2012). Some states have incorporated elements of it into state statute as well. For an in-depth history of the legal treatment of non-competes from the middle ages through 1960, see Blake, *supra* note 1. One law firm's chart summarizing each states' regime as to non-competes is available [here](#).

<sup>18</sup> See e.g., *Fifield v. Premier Dealer Servs., Inc.*, 993 N.E. 938, 942 (Ill. App. Ct. 2013).

<sup>19</sup> OFFICE OF ECON. POLICY, *supra* note 10, at 6; Starr, *supra* note 3.

<sup>20</sup> OFFICE OF ECON. POLICY, *supra* note 10.

<sup>21</sup> Starr, *supra* note 3, at 3.

competitive assets.<sup>22</sup> Some scholars point to the overall rise in litigation over restrictive employment contracts as evidence of the value employers place on the intellectual property, trade secrets, and training an employee may take with them when leaving a job.<sup>23</sup> Under this theory, because information matters more, employers will take greater steps to protect it.

Another explanation for the rise in non-competes is that the nature of work has become far more short-term and contingent. Rather than rising through the ranks at a single employer, both employers and employees now expect that workers will move and switch jobs multiple times in the course of a career.<sup>24</sup> Yet while fewer employers are structuring jobs in such a way to incentivize employees to stay long-term, they also believe that they will lose a competitive advantage when those employees leave with skills, training, or actual information acquired on the job. Unilateral non-competes and other restrictive contract terms theoretically allow employers to have their cake and eat it too by restricting where employees can go and what they can do after leaving employment, without giving them very much (other than an at will job) in return. An anecdote reported in *Forbes* is illustrative of this point: a hospital executive was interviewed about the challenges of keeping doctors at independent clinics on staff once the hospital acquired the clinics. When the reporter asked what retention tools the hospital had used, the executive “sheepishly replied, ‘A whopper of a non-compete clause!’”<sup>25</sup> In other words, the employer’s primary retention tool was making it harder for employees to leave as opposed to offering incentives to stay.

Yet another explanation for employers’ increasing use of non-competes is that this is but one measure of a larger trend towards employers using employment contracts as a way of ordering the employment relationship. The widespread accessibility of boilerplate employment contracts from websites like rocketlawyer.com or lawdepot.com has facilitated the rapid expansion of contracts “unilaterally drafted by the employer and presented as a condition of employment . . . .”<sup>26</sup> These documents tend to include several problematic elements such as non-competes, shortened statutes of limitations, non-disparagement clauses, and “loser pay” provisions that

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<sup>22</sup> Norman D. Bishara & Michelle Westermann-Behaylo, *The Law and Ethics of Restrictions on an Employee’s Post-Employment Mobility*, 49 AM. BUS. L.J. 1, 10 (2012).

<sup>23</sup> Katherine V.W. Stone, *Knowledge at Work: Disputes Over the Ownership of Human Capital in the Changing Workplace*, 34 CONN. L. REV. 721, 739 (2002).

<sup>24</sup> *Id.* at 726-29.

<sup>25</sup> Steve Parrish, *Unexpected Outcomes that Can Come from Non-Compete Agreements*, FORBES (July 19, 2014).

<sup>26</sup> Rachel Arnov-Richman, *Cubewrap Contracts: The Rise of Delayed Term, Standard Form Employment Agreements*, 49 ARIZ. L. REV. 637, 639 (2007).

shift costs to the losing party in the case of an employment dispute. In the past several decades these boilerplate contracts have also enabled an explosion in employer reliance on mandatory arbitration clauses to keep employment disputes out of court. In 1992, only 2 percent of private sector non-unionized employees were covered by an employment contract that contained a mandatory arbitration requirement; by 2018, that number had risen to 56.2 percent of private sector nonunion employees or 60.1 million American workers.<sup>27</sup> While I am unaware of scholarship definitively linking the rise of mandatory arbitration clauses with that of non-compete clauses, given that they both live in the same employment document, it seems unlikely that their usage is entirely disassociated.

## B. Existing Legal Frameworks Are Insufficient to Deter Overuse of Non-Competes

More important than the question of *why* employers are increasingly using non-competes is the corollary question: Why not? Given power imbalances in the employment relationship, workers rarely negotiate the terms of their employment contracts including non-competes and, under the traditional legal framework, there are few real disincentives to overuse them.

### 1. Non-competes Are Rarely Negotiated and Rarely Judicially Enforced

The notion that individual non-compete contracts are negotiated between two parties with legal counsel is largely legal fiction. In reality, most employees are unrepresented by counsel and are handed an employment agreement containing any number of provisions to sign or initial as part of their “on boarding” process.<sup>28</sup> A full third of employees only learn they are required to sign a non-compete *after* accepting a job,<sup>29</sup> at which point they have presumably already given notice at their old job and are in no position to bargain, let alone walk away.<sup>30</sup> Indeed, less than 10 percent of employees report negotiating the terms of their non-compete before “agreeing” to it.<sup>31</sup>

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<sup>27</sup> ALEXANDER J.S. COLVIN, ECON. POLICY INST., THE GROWING USE OF MANDATORY ARBITRATION, (Apr. 6, 2018). Note that this study was conducted prior to the U.S. Supreme Court’s decision in *Epic Systems Corp. v. Lewis*, 138 S. Ct. 1612 (2018), which affirmed employers’ ability to require employees to arbitrate claims individually, thereby avoiding classwide arbitrations, and presumably making arbitration even more attractive to employers.

<sup>28</sup> Arnow-Richman, *supra* note 25, at 639.

<sup>29</sup> Starr, *supra* note 3.

<sup>30</sup> Arnow-Richman, *supra* note 25, at 655. (“Indeed, the timing of cubewrap contracts appears expressly designed to capitalize on preexisting imbalances, delaying what might otherwise be deal breaking terms until it is impossible for even a resilient worker to carefully evaluate them and ultimately refuse.”)

<sup>31</sup> Starr, *supra* note 3.

This same power imbalance and lack of legal advice may also shape employee behavior on the other end of the employment relationship. An employer may, for example, remind an employee planning to leave that they have a non-compete.<sup>32</sup> Or they may mention it to a prospective employer during a reference check. Both can have an informal enforcement effect, as the employee may decide not to leave the job or the competitor may decide not to hire them out of fear of being sued. As such, as Harlan Blake wrote, “[f]or every covenant that finds its way to court, there are thousands which exercise an *in terrorem* effect on employees who respect their contractual obligations and on competitors who fear legal complications if they employ a covenantor, or who are anxious to maintain gentlemanly relations with their competitors.”<sup>33</sup>

Research shows that the very presence of a non-compete in an employee’s agreement chills worker mobility, regardless of whether it is enforceable in court.<sup>34</sup> In one study of automated speech experts (an industry with a high incidence of non-compete usage), around 30 percent of employees surveyed had temporarily left the automated speech field at some point to wait out a non-compete before switching jobs, but not a single person had actually been sued.<sup>35</sup> Rather, these employees changed their behavior based on “the expectation of what might happen if they refused to act in accordance with the employment agreement they had signed.”<sup>36</sup> This same chilling effect has been documented in the analogous consumer contract context where the very presence of boilerplate contract language discourages consumers from complaining about being cheated or trying to avoid enforcement of a fraudulent contract.<sup>37</sup> This very real effect on behavior makes employers more likely to “overreach under the radar” based on the logical assumption that doing so “might have the benefit of keeping employees from leaving and moving to competitors [even] when they are [legally] entitled to do so.”<sup>38</sup>

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<sup>32</sup> LISA MADIGAN & JANE FLANAGAN, OFFICE OF THE ATTORNEY GEN., STATE OF ILL., OVERUSE OF NON-COMPETITION AGREEMENTS: UNDERSTANDING HOW THEY ARE USED, WHO THEY HARM, AND WHAT STATE ATTORNEYS GENERAL CAN DO TO PROTECT THE PUBLIC INTEREST (June 13, 2018).

<sup>33</sup> Blake, *supra* note 1, at 682.

<sup>34</sup> This research finds that employees working under a non-compete are 11 percent less likely to switch jobs, regardless of whether they live in a state where their agreement would be enforceable in court. Starr, *supra* note 3.

<sup>35</sup> Matt Marx & Lee Fleming, *Non-Compete Agreements: Barriers to Entry . . . and Exit?*, 12 INNOVATION POL’Y & ECON. 39, 49 (2012).

<sup>36</sup> *Id.*

<sup>37</sup> Meirav Furth-Matzkin & Roseanna Sommers, *Consumer Psychology and the Problem of Fine Print Fraud*, 72 STAN. L. REV. (forthcoming).

<sup>38</sup> Estlund, *supra* note 14, at 423.

## 2. Even When Non-Competes are Challenged in Court, They Often Avoid Scrutiny

On those rare occasions when an employee challenges a non-compete in court, the employer can always decline to enforce that particular employee's claim, thereby mooting out the challenge. For example, when a former Jimmy John's employee filed suit seeking, among other things, a declaratory judgment that his and other employees' non-competes were unenforceable, the company responded by filing affidavits saying that it would not enforce the plaintiff's individual non-compete, and the court dismissed the claim.<sup>39</sup> This avoided a judicial decision on the legality of the non-compete for other employees. Nordstrom's Trunk Club adopted a similar strategy in response to a suit filed by a former employee who had worked as a personal shopper for the high-end retail store and sought to leave to go work for a children's boutique.<sup>40</sup> Although Trunk Club had threatened to sue the plaintiff for violating the terms of her non-compete if she took the new job, the company quickly changed its tune and promised not to enforce the employee's non-compete when she challenged it in court. Again, this strategy allowed Trunk Club to evade judicial scrutiny of identical agreements for other Trunk Club sales employees.<sup>41</sup>

## 3. Reformation and "Blue Penciling" are Insufficient Deterrents

For those non-competes that do make it to court, judges in the majority of states<sup>42</sup> have the option of "reforming," i.e. rewriting the provision to make it reasonable, or using the "blue pencil" doctrine to strike the offending provision and allowing the rest of the agreement to stand.<sup>43</sup> Although judges generally may exercise discretion over when to strike or reform a particular provision (for example, shortening the length of time it applies or limiting the geographic scope) and when to invalidate the whole contract,<sup>44</sup> there are some states that *require*

<sup>39</sup> *Brunner v. Liautaud*, No. 14-c-5509, 2015 WL 1598106, at \*10 (N.D. Ill. Apr. 8, 2015).

<sup>40</sup> Becky Yerak, *Nordstrom's Trunk Club Ordered to Drop Ex-Worker's Non-Compete Agreement*, CHI. TRIB. (Aug. 8, 2017).

<sup>41</sup> See Agreed Order of Dismissal with Prejudice, *Molly Christine Dowell v. Trunk Club, Inc.*, No. 17-CH-09876 (Cook Cty. Cir. Ct. Feb. 5, 2018).

<sup>42</sup> Georgia, Virginia, and Wisconsin are states that do not permit judicial blue penciling. See Griffin Toronjo Pivateau, *Putting the Blue Pencil Down: An Argument for Specificity in Non-Compete Agreements*, 86 NEB. L. REV. 672, 682 (2008).

<sup>43</sup> See, e.g., *Booker v. Robert Half Int'l, Inc.*, 413 F.3d 77, 79 (D.C. Cir. 2005); *Bynum v. Maplebear Inc.*, 160 F. Supp. 3d 527, 537 (E.D.N.Y. 2016); *McLaurin v. Russell Sigler, Inc.*, 155 F. Supp. 3d 1042, 1044 (C.D. Cal. 2016); *Pollard v. ETS PC, Inc.*, 186 F. Supp. 3d 1166, 1178 (D. Colo. 2016); *Coronado v. D N. W. Houston, Inc.*, No. H-13-2179, 2015 WL 5781375, at \*11 (S.D. Tex. Sept. 30, 2015).

<sup>44</sup> See, e.g., *Marvin Lumber & Cedar v. Severson*, No. 15-1869, 2015 WL 5719502, at \*8-10 (D. Minn. Sept. 28, 2015) (weighing factors and declining to blue pencil an unenforceable non-compete).

judicial contract reformation. For example, Nevada law states that if a court finds a non-compete covenant unenforceable, the court “shall revise the covenant to the extent necessary and enforce the covenant as revised.”<sup>45</sup> These doctrines create little-to-no disincentive for the employer to overreach in contract drafting; the worst that can happen is that the offending provision will be struck or rewritten with no further consequences. Moreover, such doctrines discourage judges from looking at questions of fairness in the employment contract as a whole.

### III. Legislative Approaches to Limiting Non-Competes

Recent years have seen a flurry of policy activity related to non-competes. The outgoing Obama administration did much to highlight and elevate concerns about the impacts of non-competes. In March 2016, the U.S. Treasury Department issued a report finding greater enforcement of non-competes to be associated with slower earnings and growth and recommending initial policy proposals to limit their use.<sup>46</sup> This report was followed by an Obama White House initiative on non-competes and a subsequent “State Call to Action,” which specifically called on states to pass legislation to (1) ban non-compete clauses for certain categories of workers; (2) require non-competes to be disclosed before a job offer has been accepted; and (3) incentivize employers to write enforceable contracts through the use of “red pencil doctrine” and other penalties for non-compliance.<sup>47</sup>

Since then, several federal proposals, including a recent bipartisan bill, have been introduced,<sup>48</sup> and a number of states have passed laws that contain some elements outlined in the “State Call to Action.” During the 2019 state legislative sessions alone, reforms passed in Maine, Maryland, New Hampshire, Rhode Island, and Washington state. These joined other state reforms in Massachusetts (2016), Illinois (2015), and Oregon (2008).<sup>49</sup> Most of these laws take a fundamentally similar approach to non-competes, either banning or rendering them

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<sup>45</sup> NEV. REV. STAT. § 613.195.

<sup>46</sup> OFFICE OF ECON. POLICY, *supra* note 10.

<sup>47</sup> STATE CALL TO ACTION ON NON-COMPETE AGREEMENTS, OFFICE OF THE PRESIDENT (2016), <https://obamawhitehouse.archives.gov/sites/default/files/competition/noncompetes-calltoaction-final.pdf>

<sup>48</sup> Senator Chris Murphy (D-CT) has introduced several federal bills to limit or ban non-compete use: the Mobility and Opportunity for Vulnerable Employees (MOVE) Act, S. 1504, 114th Cong. (2015), co-sponsored with Senator Al Franken (D-CT); the Workforce Mobility Act of 2018, S. 2782, 115th Cong. (2018), co-sponsored by Senators Warren (D-MA) and Wyden (D-OR); and The Workforce Mobility Act of 2019, S. 2614, 116th Cong. (2019), co-sponsored by Senator Young (R-IN).

<sup>49</sup> This paper does not focus on industry-level non-compete reforms. Although, in recent years, some states have also passed bans or limitations on non-compete use in certain professions like, for example, broadcasters or doctors.

unenforceable for some subset of mostly low-wage workers and, in some cases, defining reasonable use of non-competes for those employees who may still be bound by them.

## A. State-Level Reforms

### 1. Prohibit Non-Competes for Certain Categories of Employees

All of the recent state legislation limiting non-competes set an earnings threshold below which the state will not uphold a non-compete. Some states set this threshold based on an hourly wage rate,<sup>50</sup> other states have pegged the threshold to the federal poverty level<sup>51</sup> or the Fair Labor Standards Act (FLSA),<sup>52</sup> but the approach—making non-competes unenforceable for low-wage workers—is fundamentally the same. Washington State’s new law sets a much-higher earnings threshold, banning non-competes for all employees’ earning an annual salary of less than \$100,000 and independent contractors earning less than \$250,000 a year.<sup>53</sup> Washington appears to have set these income thresholds based on an explicit policy judgment that, for the vast majority of the state’s wage earners, the harms to wages, mobility, and innovation posed by non-competes outweigh employer interests in using them.<sup>54</sup>

Regardless of where the threshold is set, bans on non-competes for low-wage workers provide clear bright-line rules for employers and help protect employees with the least bargaining power. The preliminary evidence shows that they have their intended effect. A new study found that Oregon’s 2008 low-wage worker non-compete ban has increased hourly wages by 2.2-3.1 percent on average and has increased employee mobility by 12-18 percent.<sup>55</sup>

### 2. Set Limits On What Is “Reasonable”

As discussed in Section II, most states impose a common law test to determine if a non-compete is valid and may be enforced. The majority of states that have regulated in this area have left the common law test intact for those employees whose earnings are above the threshold and may be asked to sign a non-compete. However, some of the new state laws have also chosen to place statutory definitions or limits on what a court may consider “reasonable” when reviewing a

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<sup>50</sup> In Illinois, non-competes are banned for workers earning less than \$13 an hour (which will be the City of Chicago minimum wage by 2020). 820 ILL. COMP. STAT. 90/5(c). In Maryland, the threshold is workers earning \$15 an hour or less. MD. CODE ANN., LAB. & EMP. § 3-716(A)(1). New Hampshire is set at 200 percent the federal hourly minimum wage, or \$14.50 an hour. N.H. REV. S. ANN. § 275:70-a(I)(b).

<sup>51</sup> 28 R.I. GEN. LAWS ANN. § 28-58-2; ME. REV. STAT. ANN. tit. 26, § 880(2).

<sup>52</sup> Both Massachusetts and Oregon exempt workers covered by the FLSA overtime provisions. OR. REV. STAT. §653.295(d). Executive, administrative, and most professional employees who earn at least \$455 a week are exempt from the minimum wage and overtime requirements of the FLSA. 29 U.S.C. §§ 201-219; 29 C.F.R. Part 541.

<sup>53</sup> WASH. REV. CODE § 49.62 *et seq.*

<sup>54</sup> *See, e.g.,* STAFF SUMMARY OF PUBLIC TESTIMONY, H.B. REP., ESHB 1450 (2019).

<sup>55</sup> Michael Lipsitz & Evan Starr, *Low-Wage Workers and the Enforceability of Non-Compete Agreements*, SSRN (Sept. 10, 2019).

non-compete by placing guardrails on the geographic areas<sup>56</sup> or the allowable duration of a non-compete.<sup>57</sup> Whether and how much of an effect these kinds of limitations will have is yet unknown, but it is one means of providing outside limits for contract drafters and limiting judicial discretion.

### 3. Impose Notice Requirements

Another common feature of some of the recent state legislation is a requirement that workers receive notice that they will be asked to sign a non-compete. In Maine, for example, employers are required to specify in any job advertisement if a non-compete is required and employees must be given a copy of the agreement to review at least three business days before it must be signed.<sup>58</sup> In Washington, employers are required to disclose the non-compete in writing at the time of the job offer.<sup>59</sup> These notice features are intended to limit the boilerplate nature of many non-competes. While they do not eliminate inequality of bargaining power between an employer and an employee asked to sign an employment contract, such requirements do at least put employees in a better position to negotiate the terms of their non-compete or factor it into their decision-making about whether to accept a job.

### 4. Disincentivize the Overuse of Non-Competes

It is important to note that most of the recent state-level reforms to non-competes neither outlaw them nor provide penalties for their use. Rather, they make non-competes unenforceable, meaning that, if challenged in court, they would be struck down. This is an important distinction. These laws do not protect or incentivize employers that use non-competes for low-wage workers, but they also do not create strong disincentives for employer overreach. However, a few states have taken innovative measures to impose some costs on employers for using illegal non-competes or to make them think more critically about for whom they can and should be used.

#### a. Public Enforcement and Civil Penalties

A few states have public enforcement schemes that allow employees who are asked to sign an illegal non-compete to file a complaint with a state agency, much like a wage and hour complaint. In Maine, workers may complain to the state Department of Labor, which is charged with enforcing the law and, if the Department finds that the complaint is warranted, it may impose a civil penalty of not less than \$5,000.<sup>60</sup> Washington also provides that workers may,

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<sup>56</sup> MASS. GEN. LAWS ch. 149, § 24L(b).

<sup>57</sup> MASS. GEN. LAWS ch. 149, § 24L(b)(iv)-(v); WASH. REV. CODE. § 3(b)(2).

<sup>58</sup> ME. REV. STAT. ANN. tit. 26, § 599-B.3.

<sup>59</sup> WASH. REV. CODE § 3(1)(a)

<sup>60</sup> ME. REV. STAT. ANN. tit. 26, § 599-B.3.

through a private action or complaint to the Attorney General, recover actual damages plus a statutory penalty of \$5,000 and attorney's fees.<sup>61</sup> A free complaint to a public agency is comparatively less burdensome than private litigation, helps encourage workplace-wide review of an employer's non-compete practices, and can improve enforcement of the new non-compete statutes. Furthermore, given the unlikelihood of a lawyer representing a single aggrieved individual, it also provides meaningful recourse where previously there was none.

### **b. Require Payment in Exchange for Time Out of the Labor Market**

The Oregon and Massachusetts laws disincentivize overuse of non-competes by making it more costly for employers to impose them at the outset. In these states, there is a requirement that a non-compete be supported by some monetary payment or "garden leave" to be enforceable. Garden leave, originally a concept in British law, is a time period during which an employer pays an employee's salary or portion thereof in exchange for their sitting out of the labor market.<sup>62</sup> Because of the obvious expense associated with it, garden leave helps clarify which employees possess information or relationships valuable enough to the employer that they are willing to pay their salary (or some portion of their salary) in order to keep them from going to a competitor.<sup>63</sup>

The required amount of compensation to constitute a garden leave clause under the Massachusetts or Oregon laws is at least 50 percent of the employee's annualized salary,<sup>64</sup> although both states provide an alternative. In Oregon, an employer may pay the employee the greater of 50 percent of their annual salary or 50 percent of the median income for a family of four, as calculated by the U.S. Census Bureau,<sup>65</sup> whereas Massachusetts permits employers to provide any "other mutually-agreed upon consideration," so long as it is specified in writing in the agreement.<sup>66</sup> Yet, the requirement that a non-compete be supported by consideration or

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<sup>61</sup> WASH. REV. CODE § 9.

<sup>62</sup> Bishara & Westermann-Behaylo, *supra* note 21, at 25.

<sup>63</sup> *Id.* at 26.

<sup>64</sup> OR. REV. STAT. § 653.295(1)(c)(ii).

<sup>65</sup> *Id.* (the median household income for a family of four in Oregon is currently \$56,119).

<sup>66</sup> MASS. GEN. LAWS ch. 149, § 24L(b)(vii). The law does not define what constitutes adequate consideration, but Massachusetts courts have upheld non-competes where the "consideration" provided is simply continued employment at the agreed-upon salary. *See, e.g., Mancuso-Norwak Ins. Agency, Inc. v. Rogowski-Verrette Ins. Agency, LLC*, No. WOCV201201054C, 2012 WL 6629644, at \*3 (Mass. Super. Nov. 8, 2012) ("It is well settled under Massachusetts law that an employer may utilize a non-competition agreement as a condition of hiring or retaining an employee and that continued employment is sufficient consideration to enforce such a covenant.")

something of value is already a feature of many states' common law, and it has not ensured that employees are adequately compensated for signing non-competes.<sup>67</sup> Thus, true garden leave requirements and more narrowly drawn approaches, such as Oregon's, are more likely to ensure that workers will receive a meaningful payment in exchange for their non-compete than vague requirements of some consideration.

### c. Discourage Use of Blue Pencil

Washington law creatively discourages employer overuse of non-competes by imposing monetary costs whenever a court has to modify a non-compete to make it reasonable. In Washington, "[i]f a court or arbitrator reforms, rewrites, modifies, or only partially enforces a noncompetition covenant, the party seeking enforcement must pay the aggrieved person the greater of his or her actual damages or a statutory penalty of \$5,000 plus reasonable attorney's fees."<sup>68</sup> This allows employers to have some certainty in contracting while also incentivizing them to only use reasonable non-competes because they may be on the hook for the workers' fees if they overreach. Unfortunately, several states have moved in the opposite direction, statutorily protecting blue penciling<sup>69</sup> or requiring judicial reformation of unenforceable non-competes without any penalties.<sup>70</sup> In these states, the worst that can happen to the overreaching employer is a judge striking or rewriting the non-compete provision of the employment agreement.

### d. Ban Contracts that Limit Worker Mobility

Finally, it is worth noting an important, emerging trend in these recent state bills to look beyond non-competes and more generally limit or ban employment contracts that impact workers' job mobility. For instance, the Maine non-compete law bans not only non-competes but all "restrictive employment agreements," which are defined to include any agreement that "prohibits or restricts one employer from soliciting or hiring another employer's employees or former employees."<sup>71</sup> This measure is an important recognition—and one that should be considered by other policymakers—that contracts that restrict worker mobility are not always explicitly labelled "non-compete" and are not always entered into by an employer and an employee. Rather, various clauses in an employment contract can have the effect of a non-compete, moreover contracts between employers in a variety of contracted relationships

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<sup>67</sup> In Illinois, for example, where courts have held that the promise of an at will job alone is insufficient consideration to support a non-compete, investigations by the state attorney general revealed multiple instances of broad non-competes signed by an entire workforce supported by no consideration or very nominal consideration (i.e. a one-time payment of \$15 ostensibly in exchange for signing a two-year non-compete). See Madigan & Flanagan, *supra* note 31.

<sup>68</sup> WASH. REV. CODE § 9(2).

<sup>69</sup> MASS. GEN. LAWS ch. 149, § 24L(c); 28 R.I. GEN. LAWS § 28-53-3(b).

<sup>70</sup> MASS. GEN. LAWS ch. 149, § 24L(d).

<sup>71</sup> ME. REV. STAT. ANN. tit. 26 § 599-B.

(franchisees, subcontractors, other firms in a supply chain) may also impact worker mobility. Broader definitions and understandings will help effectively address the harms.

## B. Proposed Federal Reforms

Non-competes have traditionally been a matter of state law but recent initiatives to address them federally bear mention and could change the entire way such contracts are analyzed and enforced.

The Workforce Mobility Act of 2019, a recently proposed federal bill sponsored by Senators Tod Young (R-IN) and Chris Murphy (D-CT), would ban the use of non-competes for any individual engaged in commerce or the production of goods in commerce.<sup>72</sup> It does contain limited exceptions, permitting non-competes with regards to owners or senior executives in the sale of a business or the dissolution of a partnership. As such, the proposed legislation effectively bars non-competes in employment relationships where there is an inequality in bargaining power but permits them in business-to-business transactions where both parties are more likely to be sophisticated and represented by counsel.

The proposed bill contains multiple avenues for enforcement. It would require (1) that employers post a notice highlighting the Act's prohibition on non-competes for individuals engaged in commerce and (2) that the U.S. Department of Labor enforce the notice provisions and investigate complaints from individual workers illegally asked to sign a non-compete. It also provides for a private right of action as well as Federal Trade Commission (FTC) scrutiny by making the use of a non-compete agreement an unfair or deceptive practice under the Federal Trade Commission Act.<sup>73</sup> In this way, the legislation addresses both the harms to individual workers as well as the aggregate harms to free labor market mobility. If passed, it would comprehensively alter the national landscape for non-competes. However, in part because of the sweeping and comprehensive nature of the proposed reform, the passage of the Workforce Mobility Act of 2019 seems far from assured, even with some bipartisan support.

## IV. Non-Statutory Approaches: Education, Public Enforcement, and Ethics

It would be a mistake to think that the overuse of non-competes and boilerplate contract terms can *only* be addressed through statutory bans. Indeed, while there has not traditionally been significant public enforcement in this area, both state and federal actors have tools to address the harms of overuse of boilerplate non-competes and other restraints on employee mobility. Additionally, because so much of non-competes usage, negotiation, and enforcement happens informally and without court scrutiny, extra-judicial responses that address or impact employee behavior such as education and organizing can also be effective in addressing their harms.

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<sup>72</sup> The Workforce Mobility Act of 2019, S. 2614, 116th Cong. (2019).

<sup>73</sup> 15 U.S.C. 57(a)(1)(B).

### A. Use Existing Public Enforcement Authority to Challenge Non-Competes

State attorneys general are well positioned to address the broad overuse of non-competes. Whether addressing the overall impact of an unenforceable term in a consumer privacy policy or the market harms that result from collusive behavior between competitors, state attorneys general are accustomed to combatting and remedying illegal policies and practices on behalf of their constituents and typically have a variety of legal tools at their disposal to do so.

While the precise statutory authority granted to state attorneys general varies from state to state, all state attorneys general act to some extent in a *parens patriae* capacity to defend and represent the public interest.<sup>74</sup> *Parens patriae* authority may be used to file suit and seek relief in a case where the violation is one of common law (as opposed to statutory law). Thus, for example, the Office of the Illinois Attorney General has filed suit pursuant to its *parens patriae* authority to enjoin the use of non-competes that would violate the state common law test.<sup>75</sup> State attorneys general may also have general statutory authority to address unlawfulness committed within their state. The New York Attorney General, for one, is authorized to enjoin any “repeated fraudulent or illegal acts . . . or persistent fraud or illegality in the carrying on, conducting, or transaction of business”<sup>76</sup> and has relied on this authority to initiate and conduct investigations into non-compete usage and other workplace practices.

The anti-competitive harms of non-competes and other restrictive employment contracts may also provide a separate basis for state attorneys general to challenge them under consumer or anti-trust laws. While consumer laws generally cannot be applied to remedy individual employment situations, they may provide a basis to address the broader impacts of non-compete overuse which can harm competitor businesses and state economies generally by lowering wages or binding workers from moving freely to new jobs within the labor market. Moreover, in states that have them (like California), state attorneys general may be able to address these harms using statutes that expressly ban unfair methods of competition.<sup>77</sup>

Similarly, and as mentioned above, there are those who have argued that the FTC could address the anti-competitive harms of non-competes using its existing rulemaking authority.<sup>78</sup> Thus far,

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<sup>74</sup> The doctrine of *parens patriae* provides that a state can act in its capacity as provider of protection to those unable to care for themselves. See, e.g., *Parens Patriae*, BLACK’S LAW DICTIONARY (10th ed. 2014); *Louisiana v. Texas*, 176 U.S. 1, 19 (1900) (holding that the State of Louisiana had standing to pursue claims against the State of Texas to safeguard the health of its citizens).

<sup>75</sup> See *People v. Check Into Cash of Ill., LLC*, No. 2017-CH-14224 (Cook Cty. Cir. Ct., filed Oct. 25, 2017); *People v. Jimmy John’s Enters., LLC*, No. 2016-CH-07746 (Cook Cty. Cir. Ct., filed June 8, 2016).

<sup>76</sup> N.Y. EXEC. LAW § 63(12).

<sup>77</sup> CAL. BUS. & PROF. CODE § 17200.

<sup>78</sup> See Petition for Rulemaking by Open Markets Inst. et al. for Rulemaking to Prohibit Worker Non-Compete Clauses, Fed. Trade Comm’n (Mar. 20, 2019). Full disclosure: the author is a signatory to this petition.

the FTC has declined to do so, although it has been exploring issues of labor market competition, including non-competes, in the 21<sup>st</sup> century economy.<sup>79</sup>

Whether state or federal, public enforcers are in many ways better positioned to attack widespread boilerplate non-compete usage than individual employees because they are not limited to individual remedies and their claims cannot be mooted by an employer's decision not to enforce a particular individual's non-compete. Rather, government agencies may seek injunctive relief and other remedies for the harms to earnings, innovation, and entrepreneurship experienced generally by the people of their states. These tools are particularly useful to consider in states that lack statutory prohibitions or any realistic hope of passing them, as well as in those states where the statutory ban applies only to very low-wage workers. In those circumstances, these tools could still help a worker who is above the statutory income threshold of a state statute but the non-compete is nonetheless unenforceable under common law standards.<sup>80</sup>

### B. Conduct Outreach, Education, and Organizing

Government agencies, workers' centers, law school clinics, community groups, legal aid organizations, unions, and labor education centers, among others, routinely engage in education and community outreach geared at educating workers, particularly low-wage and vulnerable workers, about their rights at work. Traditionally, these efforts have focused on issues like minimum wage, overtime, and meal/rest break laws and not on contractual employment issues, which were thought to be of more concern for higher-wage workers. However, as contractual issues gain practical importance for all workers, outreach and education efforts need to adjust, particularly given employees' documented misperceptions about their legal rights<sup>81</sup> and the chilling effect that non-competes can have on their behavior, regardless of their enforceability.<sup>82</sup> New state-level non-compete laws present an opportunity for worker advocates and government agencies to provide training and materials in those states

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<sup>79</sup> See Fed. Trade Comm'n, Comment of Commissioner Rohit Chopra on Hearing #1 on Competition and Consumer Protection in the 21st Century (Sept. 6, 2018).

<sup>80</sup> See, e.g., *People v. Check Into Cash of Ill., LLC*, No. 2017-CH-14224 (Cook Cty. Cir. Ct., filed Oct. 25, 2017) (asserting statutory claims for those employees earning below \$13 an hour and separately alleging that non-competes were used in violation of common law for employees earning higher wage rates but for whom the employer had no legitimate business reason for a non-compete); see also Eliot Brown, *WeWork Reaches Settlement on Non-compete Pacts*, WALL STREET J. (Sept. 18, 2018) (announcing a settlement in which almost all but around 100 of WeWork's 3,300 employees nationwide, would be released from their non-compete or have the terms of their non-competes significantly limited).

<sup>81</sup> See, e.g., Cynthia L. Estlund, *How Wrong Are Employees About Their Rights, and Why Does it Matter?*, 77 N.Y.U. L. Rev. 6, 7-8 (Apr. 2002).

<sup>82</sup> See Starr, *supra* note 3; Marx & Fleming, *supra* note 34; Estlund, *supra* note 14.

where they are effective. If workers don't know what a non-compete is or whether they have one, these agreements will continue to exercise a chilling effect on their behavior, regardless of their enforceability. As such, these new laws will not have their intended effect. Moreover, for workers' centers and worker organizers, talking to workers about non-competes, forced arbitration, and other contractual issues may also lead to broader worker organizing.<sup>83</sup>

### C. Investigate Ethical Implications of Attorneys Drafting Unenforceable Contracts

Finally, a less explored angle for limiting non-competes is to focus on the attorneys who draft employment contracts. Particularly given the new state laws, there is a question of whether an attorney violates his or her professional ethical responsibilities if he or she, for example, drafts an employment contract for a low-wage worker that includes a non-compete provision in a state where they are banned. The Center for Public Interest Law at University of San Diego recently requested an opinion from the State Bar of California's Committee on Professional Responsibility and Conduct (COPRAC) on this very point, asking the Bar to opine on whether "an attorney's participation in the drafting, review (without objection), approval, or execution of contractual language in an employment agreement that is unambiguously illegal or unenforceable" violates the California Rules of Professional Conduct.<sup>84</sup> The request cites academic research showing that about 19 percent of all California workers have signed a non-compete agreement, although such agreements are never recognized in the state, strongly suggesting that attorneys are including terms they know to be unenforceable in the contracts they draft without any consequences.<sup>85</sup>

A recent case in Illinois involving a different illegal contractual term demonstrates just how unusual it is for attorneys to face consequences for their contract drafting. In this case, an attorney drafted an employment contract for his client, an ultrasound facility. The contract (which also contained a broad non-compete) was unilaterally imposed on a part-time employee making \$10 an hour. It required, among other things, that the employee agree to pay back all earned wages plus additional fees if she left the job before having worked there for a year, despite state and federal laws requiring payment of minimum wages for all hours worked.<sup>86</sup>

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<sup>83</sup> For example, in the past year, Google eventually acceded to demands from employees (both direct and temporary employees) who staged walkouts and very public campaigns asking the company to stop requiring employees to arbitrate sexual harassment claims. Jeanna McGregor, *Google and Facebook Ended Forced Arbitration for Sexual Harassment Claims. Why More Companies Could Follow*, WASH. POST (Nov. 12, 2018).

<sup>84</sup> Letter from Robert C. Fellmeth, Exec. Dir., Center for Public Interest Law, to Andrew Tuft, Staff Counsel, State Bar of California, and the Committee on Professional Responsibility and Conduct (June 5, 2019).

<sup>85</sup> Starr, *supra* note 3.

<sup>86</sup> *First Peek Ultrasound L.L.C. v. Weideman*, No. 1-18-0858, 2018 WL 6438309 (Ill. App. Ct. Dec. 5, 2018)

The Court of Appeals agreed with the trial court that the agreement was procedurally unconscionable and voided the contract, writing that for this low wage employee “such a provision is tantamount to forced labor as it discourages her from quitting . . . by impressing on her the gargantuan burden of having to repay all of her hard earned wages.”<sup>87</sup> Nonetheless, it declined to impose any additional sanctions on the attorney who drafted the illegal contract or his client. Attorneys and bar associations need to take a hard look at their own role in the proliferation of unenforceable contract terms and provide more clarity, particularly to employer-side counsel.

## V. Conclusion

In recent years there have been significant developments in understanding how overuse of non-competes lowers workers’ wages and labor market mobility and identifying effective tools to curb this overuse. In those states that have recently passed non-compete laws there is more to be done to ensure that these reforms have practical effect. In the vast majority of states where non-compete use is still governed almost exclusively by the common law, policymakers should consider adopting stronger measures to discourage employer overuse of non-competes. Public agencies and enforcers at the state and federal level should undertake public enforcement and education efforts around boilerplate non-compete use, whether in the absence of or as a supplement to legislative reforms. Moreover, while research and policy responses to date have been narrowly focused on non-competes, we must move towards broader understanding of how widespread use of employment contracts impacts workers’ bargaining power and restrains the labor market if we are to meaningfully address these concerns. Effective solutions will recognize that, so long as employers can ask workers to sign away their workplace rights, contract issues are intertwined with labor issues.

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<sup>87</sup> *Id.*

## About the Author

Jane Flanagan is a Leadership in Government Fellow with the Open Society Foundations and a Visiting Scholar at IIT Chicago-Kent College of Law. Flanagan is the former chief of the Workplace Rights Bureau within the Illinois Attorney General's Office, a bureau she founded and led from November 2015 through December 2018. Under her leadership, the bureau brought national attention to the increasing use of illegal non-compete agreements for low-wage workers and negotiated settlements to release thousands of such workers nationwide from those agreements. She also served as labor counsel in the Attorney General's office. Previously, Flanagan was an assistant attorney general in Maryland, where she served as counsel to Maryland's Division of Labor and Industry. She began her career litigating wage and hour collective action cases on behalf of employees. Flanagan earned a B.A. with honors from Wesleyan University and a J.D. from Northeastern University School of Law.

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