Non-Compete Reform: A Policymaker's Guide to State Policies

This report provides information on state policies related to non-compete agreements as of October 2016. It is intended as a contextual guide for state policymakers, advocates, and students who are considering non-compete reform and/or interested to learn more about key dimensions of the current policy debate.

Introduction

Non-compete clauses ("NCC") have traditionally been used to protect trade secrets by maintaining a "buffer" time period before a departing employee may take a job with a competitor.

Evidence shows that non-compete clauses, once linked with highly compensated managerial and executive talent, have become more widespread and are shifting to affect more workers. A 2016 U.S. Treasury Department report cited research indicating that 18 percent of all workers and 15 percent of employees without a college degree are currently covered by a non-compete agreement.[1]

In recent years, these clauses have also become more common in low-wage, low-skilled professions like sandwich makers, temporary warehouse staff, and hairstylists–all of whom are unlikely to possess sensitive information or have access to trade secrets.[2] The Treasury report found that 14 percent of workers earning $40,000 or less per year are under non-competes. Due to increased media attention regarding the unfair use and proliferation of non-compete agreements in employment contracts, state laws governing these agreements have come under greater scrutiny.

Earlier this summer, following an investigation by the New York State Attorney General, the sandwich chain Jimmy John's agreed to stop using non-compete clauses in its hiring documents, which had barred departing employees from taking jobs with competitors of Jimmy John's for two years after leaving the company, as well as from working within two miles of a Jimmy John's store that made more than 10 percent of its revenue from sandwiches.[3] In a statement released by New York State Attorney General Eric Schneiderman, "Non-compete agreements for low-wage workers are unconscionable. They limit mobility and opportunity for vulnerable workers and bully them into staying with the threat of being sued."[4]

A growing number of state legislators are concerned about the spread of non-compete agreements and their potential impact on worker morale, wage growth, job mobility and career development, labor turnover, and economic development.[5] While only three states (California, North Dakota and Oklahoma) generally prohibit non-compete agreements, of the remaining 48 (including the District of Columbia), as of August 2016, only 26 have statutes on the books that govern such agreements in whole or in part, and these statutes vary considerably from state to state. For the 23 states that

[1] https://www.treasury.gov/resource-center/economic-policy/Documents/UST%20Non-competes%20Report.pdf
[2] https://onlabor.org/2016/05/03/use-and-abuse-of-the-non-compete-when-employers-utilize-non-compete-clauses-to-undercut-vulnerable-workers/
[3] http://www.cnbc.com/2016/06/22/jimmy-johns-drops-non-compete-clauses-following-settlement.html
[4] http://www.ag.ny.gov/press-release/ag-schneiderman-announces-settlement-jimmy-johns-stop-including-non-compete-agreements
[5] https://www.biztimes.com/2016/08/26/milwaukee-biz-blog-how-to-improve-wisconsins-dismal-startup-economy/ - http://www.seattletimes.com/nwshowcase/careers/shackled-to-an-old-job-by-a-noncompete-clause/ http://patch.com/massachusetts/stoneham/letter-why-non-compete-agreements-are-unfair-workers-bad-our-economy

permit non-compete clauses but currently lack governing statutes, there is a complex web of federal and state court decisions to navigate.

Recent reform efforts have focused on several policy areas including:

(a) Limiting the scope of non-compete clauses (e.g. duration, geographic range);
(b) Creating occupation-specific exemptions (e.g. physicians, broadcasters);
(c) Eliminating non-competes for low-wage workers by establishing wage thresholds;
(d) Specifying methods to limit enforcement of non-competes in cases where the terms are overly broad (i.e. red pencil, blue pencil, and reformation enforcement doctrines); and
(e) Providing more transparency for employees around non-compete clauses, such as guaranteeing prior notice.

These policy responses are not mutually exclusive, nor are they independent of each other; states generally approach reform by using a combination of policies that complement one another.[6]

This paper will present the current "state of play" among states regarding the use of non-compete agreements along key policy dimensions in the context of enacted and recently proposed statutory reforms and judicial enforcement doctrines.

Data sources: This paper relies primarily on two existing and comprehensive state-by-state comparisons prepared by law firms, one by Beck Reed Riden and the other by Seyfarth Shaw.[7] Independent research was also conducted to present the analysis of several policy dimensions that are not covered in the two secondary sources cited herein (on topics such as garden leave, wage thresholds, prior notice, and durational limitations).

Methodology: This paper presents a state-by-state comparison of current state laws governing non-compete clauses with respect to the following dimensions:

1. Current statutes governing non-compete agreements. Which states currently have a statute governing non-compete agreements?

2. Enforceability of non-compete clauses. Which states enforce non-compete clauses?

3. Exempt occupations. Which occupations are exempted from non-compete enforcement, and in which states?

4. Enforcement doctrines. Which enforcement doctrines do states apply when a court finds a particular non-compete clause unlawful: reformation, blue pencil, or red pencil?

5. Garden leave. Which state laws require garden leave (a practice where an employee leaving a job agrees not to work for a competitor in exchange for continued compensation for a period of time)?

[6] http://www.tradesecretsnoncompetelaw.com/2016/08/articles/non-compete-agreements/connecticut-and-rhode-island-enact-statutes-restricting-physician-non-competes/ https://www.whitehouse.gov/sites/default/files/non-competes_report_final2.pdf
[7] http://www.beckreedriden.com/wp-content/uploads/2016/07/Noncompetes-50-State-Survey-Chart-20160731.pdf http://www.seyfarth.com/uploads/siteFiles/practices/141926_ChartofTradeAgreementsbyState_FINAL.pdf

6. Consideration. Is continued employment sufficient consideration to allow employers to bind employees to a restrictive covenant?

7. Wage threshold. Which states have a wage threshold below which NCCs are not enforceable or effective?

8. Durational limits. Which states impose durational limits on NCCs?

9. Prior notice. Which states have a "prior notice" policy requiring employers to give advance notice of a NCC to a prospective employee before they accept a job offer or promotion?

1. Current statutes governing non-compete agreements.

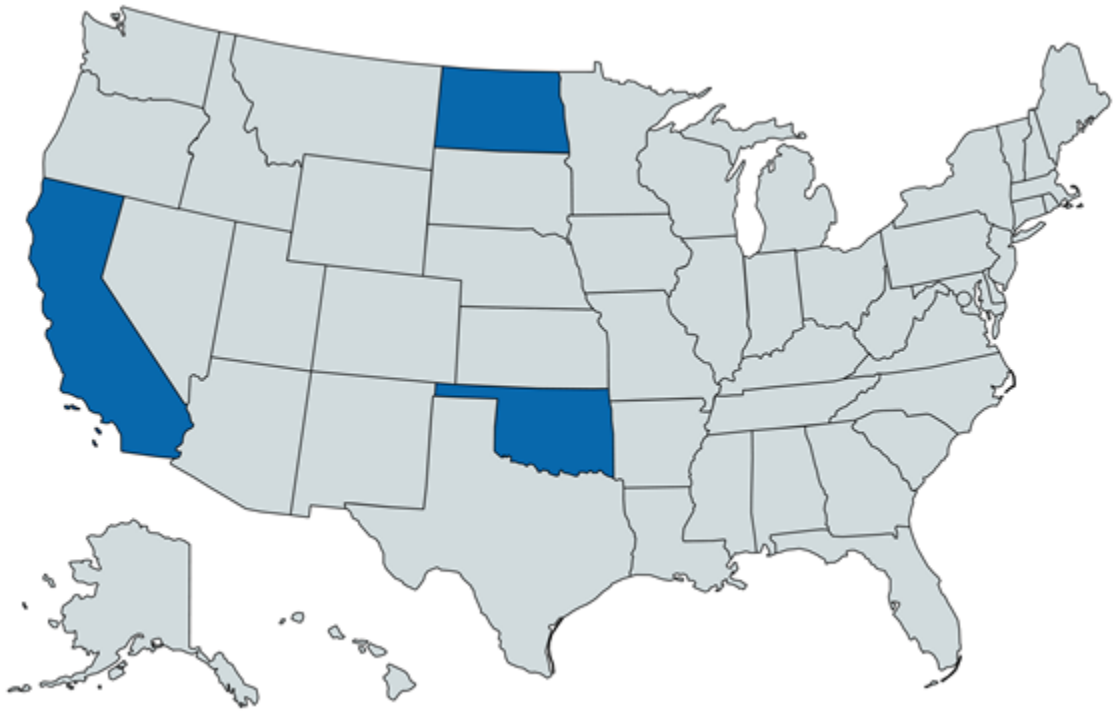
Currently, 26 states have a statute governing the enforcement of non-compete agreements (see table below). Existing state statutes address several aspects of non-compete agreement enforceability, including but not limited to: durational limitations; occupation/industry-specific exemptions; wage thresholds; "garden leave;" enforcement doctrines; and prior notice requirements.

States where all non-competes are unenforceable are not included in the tabulation below and will be discussed in the following section.

State	Statutory Citation	State	Statutory Citation
Alabama	Ala. Code §§ 8-1-190-197 (Sec. 8-1-1 repealed effective 1/1/2016)	Michigan	Mich. Comp. Laws § 445.774a.
Arizona	ARS Sect. 23-494 refers to exemptions	Missouri	28 Mo. Stat. Ann. § 431.202 (related)
Arkansas	SB 998 (3/20/15 Engrossed)	Montana	Mont. Code Ann. §§ 28-703-05
Colorado	Colo. Rev. Stat. § 8- 2-113	North Carolina	N.C. Gen. Stat. sec. 75-4
Connecticut	CT Gen Stat § 31-59b (2012)	New Hampshire	RSA 275:70
Delaware	Title 6, Chapter 27, Section 2707 refers to exemption	New Mexico	N. M. S. A. 1978, §§ 24-11-1-5
Florida	Fla. Stat. Ann. § 542.335	Nevada	Nev. Rev. Stat. § 613.200(4)
Georgia	Ga. Const., Art. III, Sec. VI, Par. V(c), as amended. [NOTE: Does not apply to pre-amendment clauses]	Oregon	Or. Rev. Stat. § 653.295
Hawaii	Haw. Rev. Stat. § 480-4.	South Dakota	S.D. Codified Laws sec. 53-9-8, et seq .
Idaho	Idaho Code §§ 44-2701-2704.	Texas	Tex. Bus. & Com. Code §§ 15.50-.52
Illinois	SB 3163 signed by Governor 8/19/2016	Utah	Utah Code Ann. §§ 34-51-101-301 [Effective for agreements on or after 5/10/2016]
Louisiana	La. Rev. Stat. Ann. Sec. 23:921	Vermont	Exemption in Title 26, Chapter 6, Section 281C
Maine	Title 26, Chapter 7, Section 599(b)	Wisconsin	Wis. Stat. Ann. § 103.465

2. Enforceability of non-compete clauses.

Of the 50 states and the District of Columbia, NCCs are permissible in all but three states: California, North Dakota and Oklahoma. These states are highlighted in blue in the map below. The remaining states rely on state courts and existing statutes, where applicable, to determine the legality of non-compete agreements.



The 22 states that currently have no explicit statutory references are: Alaska, District of Columbia, Iowa, Indiana, Kansas, Kentucky, Massachusetts, Maryland, Minnesota, Mississippi, Nebraska, New Jersey, New York, Ohio, Pennsylvania, Rhode Island, South Carolina, Tennessee, Virginia, Washington, West Virginia and Wyoming.

The Michigan Antitrust Reform Act (House bill 4198) proposed in February 2015 would have banned non-compete agreements, except in cases where there is a sale of a business.

3. Exempt occupations.

Half of the states that permit NCCs exempt certain occupations. The most frequently exempted occupations are broadcasters (Arizona, Connecticut, District of Columbia, Illinois, Massachusetts, Maine, and Washington) and physicians and other medical practitioners (Arizona, Connecticut, Delaware, New Mexico, Rhode Island, Tennessee, and Texas).

The following table summarizes the exempted occupations by state.

State	Exempted occupations
AL	Professionals
AR	Various professionals (medical, veterinary, social workers, others)
AZ	Broadcasters; maybe Physicians
CO	Physicians (damages not barred)
CT	Broadcasters; Security Guards; Physicians
DC	Broadcasters
DE	Physicians
FL	Mediators
HI	Employees in a technology business
IA	Franchisees (where franchisor does not renew)
ID	Non-key employees
IL	Broadcasters; Government Contractors; Physicians
KS	Accountants (limited)
LA	Automobile Salesman; Real Estate Broker's Licensees (procedural requirements)
MA	Broadcasters; Physicians; Nurses; Social Workers; Psychologists
ME	Broadcast Industry (presumption)
MO	Secretaries (limited); Clerks (limited)
NC	Possible limits on use with locksmiths.
NJ	In-House Counsel; Psychologists.
NM	Healthcare practitioners (Exemption has limits; including that it does not apply to any covered medical professional if they are a shareholder, owner, partner, or director of a health care practice)
TN	Physicians (in certain circumstances).
CT	Physicians (in certain circumstances)
TX	Physicians (in certain circumstances).
VT	Beauticians and Cosmetologists (by their school)
WA	Broadcasters (under certain circumstances)

Occupational exemptions are the most common limitation on non-competes in state law today. They generally address those occupation-specific cases where: (1) the existence of a non-compete agreement would be unduly burdensome to the employee; (2) less-competitive markets have the potential to hurt consumers; and/or (3) sectors where legislators are focused on encouraging innovation and economic growth. For example, broadcasters working in a rural setting may only have one or two options for employment in their job market area. Recognizing the harm that these agreements pose to employees in the broadcasting industry, seven states have exempted them from state non-compete laws.

The case for reforming non-compete law by exempting physicians, nurses, psychologists, social workers, and other medical professionals has a strong policy basis because enforcing non-compete clauses could further limit patients' access to medical providers in areas where only very few are available. The American Medical Association has recognized that physicians have an obligation to support the continuity of care (AMA Code E.8.115), that free choice is the right of every patient (AMA Code E.9.06), and that physicians have an ethical commitment to place the patient's welfare above the interests of self or other groups (AMA Code 10.015).

Recently enacted statutes in Rhode Island (R.I. Gen. Laws §5-37-33) and Connecticut (Public Act No. 16-95) limit the enforceability of non-competes for physicians. The Rhode Island statute renders invalid "any restriction on the right to practice medicine" in the state, whereas the Connecticut bill limits non-competes for physicians to one-year and allows for a maximum geographic restriction of 15 miles. Legislators in Connecticut specifically cited the AMA principles regarding the importance of patient choice and continuity of care in the debate on the Connecticut bill limiting non-compete agreements for physicians.[8]

Another occupation-specific exemption is for information technology professionals; which states have passed with the goal of promoting innovative activity. IT workers who are free to switch from one job to the next will carry a more diverse set of skills and knowledge, which in turn complements innovation. Hawaii recently reformed their non-compete laws to exempt information technology workers, citing that "[e]liminating restrictive covenants for employees of technology businesses will stimulate Hawaii's economy by preserving and providing jobs for employees in this sector and by providing opportunities for those technology employees to establish new technology companies and new job opportunities in the State." Similar policy justifications were cited in recent reform attempts in Massachusetts by members of the venture capital and tech communities.[9]

4. Enforcement doctrines.

There are three primary non-compete enforcement doctrines in use by states: *reformation; blue pencil; and red pencil*. These doctrines provide courts with the discretion to determine the impact

[8] https://www.cga.ct.gov/2016/PHdata/Tmy/2016SB-00351-R000307-Senator%20Leonard%20A.%20Fasano-TMY.PDF; https://www.cga.ct.gov/2016/PHdata/Tmy/2016SB-00351-R000307-Senator%20Martin%20M.%20Looney%20President%20Pro%20Tempore-TMY.PDF

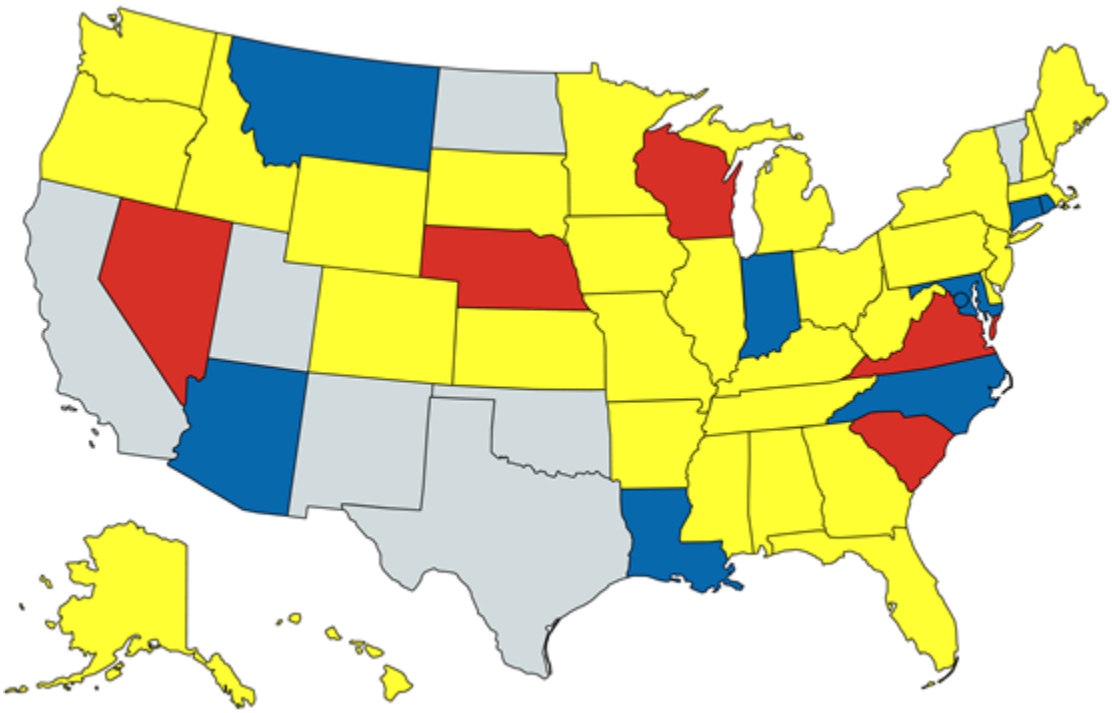
[9] http://www.newenglandvc.org/an-important-update-on-noncompete-reform-2/ & https://www.noncompetes.org/tee/

on the enforceability of a non-compete provision that includes elements that contravene state law, as outlined below:

- In *reformation* states, courts can use discretion to rewrite offending provisions so that they conform to state law.
- Under the *blue pencil* doctrine, courts may strike the unenforceable provision(s) of the contract and hold that the remainder of the contract remains in effect.
- Under the *red pencil* doctrine, courts can nullify the *entire non-compete agreement* if one of the provisions does not comply with existing statute and/or case law standards.

Enforcement doctrines provide an incentive for employers considering the use of non-competes to use language and terms that are less restrictive and more likely to stand up to judicial review. Because the red pencil doctrine goes furthest in limiting the use of non-competes, employers in red pencil states have the strongest incentives to write contract language narrowly and carefully.

Of the 48 jurisdictions where non-compete clauses are permissible, three of them do not specify an enforcement doctrine in state law (Vermont, New Mexico and Utah). Reformation (yellow-colored states in the map below) is specified in Alaska, Alabama, Arkansas, Colorado, DC (reformation or blue pencil), Delaware, Florida, Georgia, Hawaii, Iowa, Idaho, Illinois, Kansas, Kentucky, Massachusetts, Maine, Michigan, Minnesota, Missouri, Mississippi, New Hampshire, New Jersey, New York, Ohio, Oregon, Pennsylvania, South Dakota, Tennessee, Texas, Washington, West Virginia and Wyoming. Red pencil (red-colored states in map below) applies in Nebraska, Nevada, South Carolina, Virginia and Wisconsin. Blue pencil (blue-colored states in map below) is specified in Arizona, Connecticut, Indiana, Louisiana, Maryland, Montana, North Carolina and Rhode Island.



5. Garden leave.

Post-employment compensation during the restricted period of a non-compete agreement, or what is more commonly referred to as a "garden leave" provision, creates an incentive for employers to require non-competes only for those employees who pose a risk to the firm's legitimate business interests. Because "garden leave" constitutes a direct cost, employers are likely to be more cautious when deciding to include them in an employment contract.

Oregon is currently the only state that has some form of a "garden leave" requirement. The statute "[p]rovides the employee, for the time the employee is restricted from working, the greater of compensation equal to at least 50 percent of the employee's annual gross base salary and commissions at the time of the employee's termination or 50 percent of the median family income for a four-person family, as determined by the United States Census Bureau for the most recent year available at the time of the employee's termination."

Recent reform efforts in Massachusetts (H.4434 & S.2418) proposed garden leave provisions that would have required employers to compensate departing employees bound by a non-compete agreement. The House proposal would have required employers to pay 50 percent of the discharged employee's base salary, or another mutually agreed upon amount within the 2 years preceding the employee's termination.[10] The Senate proposal went further by requiring a "garden leave clause or other mutually agreed upon consideration" between the firm and the worker equal to or greater than 100 percent of the employee's highest annualized salary for the 2 years preceding termination. This relatively new policy approach could offer options for state legislatures to create a cost mechanism that reduces the likelihood that non-compete agreements will be used unnecessarily.

[10] https://malegislature.gov/Bills/189/House/H4434/

6. Consideration.

State courts have weighed the question of whether continued employment is sufficient consideration by the employer to bind employees to a non-compete agreement—that is, whether a non-compete agreement is enforceable if the only thing an employee receives in return for signing it is continued employment.

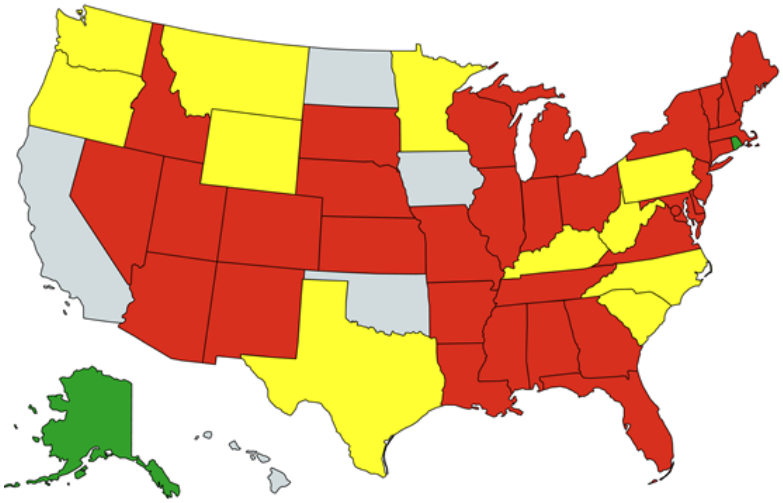
Thirty-five states have, either through statute or case law, decided that continued employment is sufficient consideration to bind employees to a non-compete agreement. Of these 35 states, Tennessee, Illinois, and the District of Columbia courts will generally hold that sufficient consideration has been provided, so long as the employment continued for an "appreciably long" time or continued for a "sufficient duration" prior to termination. Likewise, Mississippi has reserved the right to consider whether a non-compete agreement is enforceable if the employee is terminated shortly after being hired.

The Idaho statute (Idaho Code 44-2701 – 2704) states that if a non-compete agreement has been signed but no "additional consideration" has been provided, the non-compete agreement shall not exceed 18 months. Of the remaining 13 states, continued employment is either *not* sufficient consideration or the law/courts are undecided. The following table and map present the categorization graphically. In the map below, states where continued employment is sufficient consideration to bind an employee to an non-compete clause are coded in red; states that do not are coded in yellow; and undecided states are coded in green.

State law: Continued employment as sufficient consideration?	Number of states	Percent of states (N=48)
Not a sufficient consideration	11	22.9%
Undecided (or undecided and likely)	2	4.2%
Yes, with or without conditions	35	72.9%

The House (H.4434) and Senate (S.2418) proposals in Massachusetts would have required employers to provide current employees with independent consideration, beyond continued employment, in order for the non-compete agreement to be enforceable.

Much like the "garden leave" policy proposal, requiring employers to provide sufficient consideration above continued employment creates a cost incentive for firms to only bind essential staff to non-compete agreements, instead of using them as a blanket on-boarding practice.



7. Wage threshold.

Wage thresholds are used to make non-compete agreements unenforceable for a subset of workers in settings where the likelihood of possessing sensitive firm-level information is highly unlikely and for workers in cases where a wide disparity in bargaining power exists.

At present, four states – Oregon, Colorado, Washington, and Illinois (effective January 1, 2017) – have some form of threshold.

The Oregon statute (§ 653.295) stipulates that upon termination, the employee's salary and commissions must exceed the median family income for a family of four as determined by the U.S. Census Bureau. This is the most expansive wage threshold in state law to date. With respect to Colorado and Washington, existing state laws can more accurately be described as a "quasi-threshold," where the law only applies to "executive and management" personnel and does not specify a dollar threshold.

The recently enacted Freedom to Work Act (Public Act 099-0860), passed by both houses of the Illinois legislature and signed by Governor Rauner, created a low-wage worker threshold that no longer permits employers to bind employees making below $13/hour to a non-compete agreement. The unsuccessful reform efforts in Massachusetts proposed to set wage thresholds for enforceability of non-compete agreements at $130,000 per year in the Senate proposal (S.2418) and $47,476 per year in the House proposal (H.4434).

On the federal level, the Mobility and Opportunity for Vulnerable Employees Act (MOVE Act S. 1504), introduced in June 2015 by Senators Al Franken of Minnesota and Chris Murphy of Connecticut, proposes a federal wage threshold for "low wage employee[s]" making below the "livable hourly rate," defined by the Act as $31,200 per year (about $15 per hour). The LADDER Act (H.R. 2873), introduced also in June 2015 by Representative Joseph Crowley of New York, prohibits employers from requiring low-wage employees to sign non-compete agreements. Both bills define low-wage workers as individuals who make below $15 an hour or the hourly rate equal to the minimum wage required by state/local law, or who are classified as non-exempt under the Fair Labor Standards Act.

8. Durational limits.

Only 10 of the 48 states that permit non-compete clauses specify by statute a time limit on the allowable duration of restricted employment options. State courts vary considerably on what constitutes a "reasonable" length of time for which a non-compete agreement would be enforceable and differ on the factors used to weigh the appropriate length of the contract. State courts vary but have generally held that one to two years is a reasonable timeframe for a non-compete agreements to restrict a departing employee's ability to work for a competitor.[11] Some states have gone further and enacted durational limitations for post-employment restrictions that are narrower than what courts have traditionally allowed.

Recent legislative reforms/proposals have been trending toward the lower bound of what state courts have generally upheld. Last year, Oregon Governor Brown signed H.B. 3236, which limited post-employment restrictions to 18 months. Earlier this year, Utah Governor Herbert signed the Post-Employment Restrictions Act (H.B. 251) into law that limits non-compete agreements to one year.[12] During the 2016 legislative session, Washington State considered a bill (H.B 2931) that would have limited the use non-compete agreements to one year In Massachusetts, the legislature proposed durational limits of one year in the House bill (H.4434) and three months in the Senate bill (S.2418).[13]

[11] https://www.fenwick.com/FenwickDocuments/RS_Summary-of-Covenants.pdf
[12] http://le.utah.gov/~2016/bills/static/hb0251.html
[13] [13] http://lawfilesext.leg.wa.gov/biennium/2015-16/Pdf/Bills/House%20Bills/2931.pdf

9. Prior notice.

It is not uncommon for employees to learn that they are bound by a non-compete agreement only after they have left their employer. One University of Michigan study found that more than 40 percent of those who had signed an agreement read it quickly or not at all.[14] Moreover, recently-hired employees who are asked to sign a non-compete agreement *after* being hired have to choose between quitting their job or signing an agreement under circumstances where their bargaining power is sharply reduced from the time of the job offer. The U.S. Treasury reported one lower-bound estimate that 37 percent of workers who sign non-compete clauses are asked to sign *after* they accept an offer of employment, when it may be too late to negotiate. Two state laws, in New Hampshire and Oregon, currently have a "prior notice" policy, reflected below:

State	Prior notice requirement, job offer or meaningful promotion
NH	Disclose non-compete [...] prior to making an offer of employment or an offer of change in job classification
OR	2 weeks prior notice

Recent reform attempts in Massachusetts (H.4434 & S.2418) and Connecticut (Public Act No. 13-309) signaled perhaps a shifting focus on increasing transparency by requiring employers to give prior notice either when an employment offer is made or at the time the employee accepts the job, but no later. The proposed Massachusetts House and Senate bills would have required prior notice when the formal offer is made or within ten business days before the commencement of employment, whichever is sooner. The 2013 Connecticut proposal, vetoed by Governor Malloy, would have required employers to provide employees with a written copy of the agreement and a "reasonable period of time, of not less than seven calendar days" to consider before accepting a job.[15]

[14] http://www.wsj.com/articles/noncompete-agreements-hobble-junior-employees-1454441651
[15] https://www.cga.ct.gov/2013/ACT/PA/2013PA-00309-R00HB-06658-PA.htm

Conclusion

Notwithstanding the complexity of state legislation and case law, there are several common themes of state approaches to non-compete reform, as listed in this report. Most states have adopted or are considering a *combination* of reform measures to balanced options, including policies that increase transparency for workers (e.g. prior notice) or limit the application of non-compete clauses only to situations where a legitimate interest needs to be protected (e.g. wage thresholds, durational limits and exemptions).

Furthermore, increasing incentives for firms to require non-compete agreements only when they believe they are truly necessary by changing the way non-compete agreements are enforced is also growing in popularity. Enabling courts to nullify non-compete agreements that fail to adhere to state laws, may encourage employers and their legal teams to more carefully craft narrow, enforceable language. Likewise, efforts to increase the cost to employers of unlawful non-compete agreements ("garden leave") may deter overbroad application of non-compete agreements.

While there may be a common menu of options when it comes to best-practice policies for limiting non-compete use, no universal formula for reform exists; political dynamics, market conditions, and economic characteristics all play a role in shaping the appropriate strategy.