WHY WE NEED A NATIONAL ABSOLUTE NONCOMPETE BAN: RESTRICTIVE COVENANTS FROM INNOVATION, ANTIDISCRIMINATION & COMPETITION POLICY PERSPECTIVES

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Abstract

Noncompete law stands at the intersection of competition, equality, innovation, and employment policy. While the Uniform Restrictive Employment Agreements Act (UREAA or the Act) is a positive step forward in curtailing the use of restrictive covenants, the Act is limited in its scope because it adopts a partial noncompete ban rather than a comprehensive ban. Because noncompetes harm not only workers by suppressing mobility and wages but also innovation, entrepreneurship, competition, equality, and market growth, enforcing noncompetes for higher-skilled workers can be particularly harmful from an economic policy perspective.

The research on noncompetes—which has become robust in recent years—supports a national, absolute ban on all noncompetes at all employment levels. This Article, written for the University of Florida Levin College of Law's Journal of Law & Public Policy symposium on UREAA, argues that an absolute ban on noncompetes is superior to the standard of reasonableness that the UREAA would adopt for higher-skilled employees. At the same time, it explains why the Act rightfully tackles not only noncompetes but also the family of restrictive covenants that limit workers' ability to compete post-employment. This Article describes a growing body of academic, empirical, experimental, and theoretical research that demonstrates that the common use of boilerplate employment contracts, which bundle restrictive clauses—including noncompete, non-disclosure, non-solicit, non-poaching, non-dealing, and non-disparagement clauses, with choice-of-law, choice-of-forum, and severability clauses—have detrimental effects on mobility and innovation. This Article concludes that a national solution is superior to a uniform act adopted by states because the research shows that state variation, choice-of-law and choice-of-forum clauses, and misinformation among workers have led to noncompetes and other restrictive covenants being highly prevalent even in states that do not enforce them. Therefore, this Article commends the Federal Trade Commission's recent action in implementing the rule to ban all noncompetes and de facto noncompetes in the United States.

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INTRODUCTION

Noncompete law stands at the intersection of competition, equality, innovation, and employment policy. While the Uniform Restrictive Employment Agreements Act (UREAA or the Act)[1] is a positive step forward in curtailing the use of restrictive covenants, the Act is too limited in its scope because it adopts a partial noncompete ban rather than a comprehensive ban.[2] The UREAA adopts an employment law contract perspective while neglecting the other policy aspects of innovation, equality, and competition that are inherently part of restrictive covenants law.[3] The Act would make noncompetes unenforceable only for low-wage workers while allowing "reasonable" noncompetes in the higher-skilled, higher-paid labor market.[4] Because noncompetes suppress workers' mobility and wages and reduce innovation, entrepreneurship, competition, equality, and market growth, enforcing noncompetes for higher-skilled workers can also be particularly harmful from an economic policy perspective. The research on noncompetes—which has become robust in recent years—supports a national, absolute ban on all noncompetes, not just for low-wage workers but at all levels of employment.[5]

This Article argues that an absolute ban on noncompetes is superior to the standard of reasonableness that the UREAA would adopt for higher-skilled employees. At the same time, it explains why the Act rightfully tackles not only noncompetition but the entire family of restrictive covenants that limit workers' ability to compete post-employment. This Article presents a growing body of academic research,

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1. UNIF. RESTRICTIVE EMP. AGREEMENT ACT (UNIF. L. COMM'N 2021).
2. *See id.* § 3.
3. *See id.*
4. *Id.* § 7.
5. Evan Starr, *Noncompete Clauses: A Policymaker's Guide through the Key Questions and Evidence*, ECON. INNOVATION GRP. (Oct. 31, 2023), https://eig.org/noncompetes-research-brief/ [https://perma.cc/8TEB-8GAT].

empirical, experimental, and theoretical, which demonstrates that the common use of boilerplate employment contracts, which bundles restrictive clauses—including noncompete, non-disclosure, non-solicit, non-poaching, non-dealing, and non-disparagement clauses, with choice-of-law, choice-of-forum, and severability clauses—have detrimental effects on mobility and innovation. New empirical research shows that this type of bundling of restrictive provisions in employment contracts is exceedingly common, covering over eighty percent of workers and seventy percent of firms.[6] Moreover, because it is well documented that employers often require employees to sign noncompetes in jurisdictions with noncompete bans, the Act rightfully provides an enforcement mechanism and remedies for inserting invalid clauses into employment contracts.[7] Finally, this Article argues that a national solution is superior to a uniform act adopted by states because the research shows that state variation, choice-of-law and choice-of-forum clauses, and misinformation among workers have led to noncompetes and other restrictive covenants being highly prevalent even in states that do not enforce noncompetes.

This Article proceeds as follows. Part I presents contemporary research on restrictive covenants and explains why an absolute ban on noncompetes at all levels of employment is the optimal policy. Part II argues that a ban focused solely on prototypical noncompetes fails to address how other restrictive covenants operate as de facto noncompetes to suppress talent mobility. Part III describes the 2024 Federal Trade Commission's (FTC) rule banning all noncompetes and de facto noncompetes in the United States and explains why this national ban is superior to a uniform state law.

I. THE HARMS OF RESTRICTIVE COVENANTS & WHY AN ABSOLUTE BAN IS NEEDED

An estimated thirty million American workers are bound by noncompetes, ranging from volunteers to executives.[8] These restrictions on mobility not only harm workers but also have adverse effects on our entire economy and society. When workers can move between jobs easily, the economy performs better, as employees are permitted to find employers that most value their skills (and vice versa). Noncompetes

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6. *See* Natarajan Balasubramanian et al., *Bundling Postemployment Restrictive Covenants: When, Why, and How It Matters* (Mar. 2021) (unpublished manuscript at 1), https://extranet.sioe.org/uploads/sioe2021/balasubramanian_starr_yamaguchi.pdf [https://perma.cc/VA7Q-SDTN].

7. *See* UNIF. RESTRICTIVE EMP. AGREEMENT ACT § 16(e) (UNIF. L. COMM'N 2021).

8. *Fact Sheet: FTC Proposes Rule to Ban Noncompete Clauses, Which Hurt Workers and Harm Competition*, FTC, https://www.ftc.gov/system/files/ftc_gov/pdf/noncompete_nprm_fact_sheet.pdf [https://perma.cc/B5AB-27MN] (last visited Feb. 18, 2024).

hinder competition, innovation, wages, and equality. Noncompetes and related restrictive agreements have been found to negatively impact employees, entrepreneurial activities, and the growth of industries and regions.[9]

Implementing and enforcing noncompetes results in (1) decreasing general worker mobility; (2) steering outgoing employees away from competitors and directing them to non-competing sectors in varied industries; (3) diminishing entrepreneurship, stifling innovation in startups, slowing job growth; and (4) constricting the job market, pushing down salaries, and perpetuating gender and racial wage disparities. In my book, *Talent Wants to be Free*, and a series of research articles, I argue that regions that care about innovation and growth should adopt policies that ensure all employees—whether low-skilled or high-skilled—can transition between competitors.[10] This approach promotes various interconnected objectives of economic progress, encompassing the spread of knowledge, robust networks, job matching quality, benefits of business clusters, employee motivation and behaviors, reward and punishment systems, entrepreneurial spirit, attracting talent, wage-setting monopolies and wage dynamics, and fostering equality.[11] Noncompetes stifle workforce movement, impede the spread of knowledge, monopolize markets, and diminish workers' motivation to bolster their professional skills. Furthermore, noncompetes hinder the emergence of new businesses. Owing to curtailed mobility, salaries in regions upholding noncompete agreements tend to plateau or even diminish.[12] Contrarily, states that void noncompetes attract skilled professionals because these states value experience, expertise, and the freedom to transition between jobs.

Empirical research on labor market concentration and the behavioral effects of post-employment restrictions also suggests that restrictive

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9. *See id.*

10. *See* ORLY LOBEL, TALENT WANTS TO BE FREE 5 (2013); *see also* Orly Lobel, *Non-Competes, Human Capital Policy & Regional Competition*, 45 J. CORP. L. 931, 947 (2021) (describing ten distinct benefits in regions that ban noncompetes).

11. *See generally* On Amir & Orly Lobel, *Driving Performance: A Growth Theory of Noncompete Law*, 16 STAN. TECH. L. REV. 833 (2013) (finding behavioral and dynamic growth effects that explain the advantage of regions with fewer restrictions on human capital); On Amir & Orly Lobel, *How Noncompetes Stifle Performance*, HARV. BUS. REV. (Jan.–Feb. 2014), https://hbr.org/2014/01/how-noncompetes-stifle-performance [https://perma.cc/3FCP-7KPH] (explaining study findings that workers exhibit less motivation and worse performance under noncompete conditions).

12. *See* EVAN STARR, THE USE, ABUSE, AND ENFORCEABILITY OF NON-COMPETES AND NO-POACH AGREEMENTS 7 (2019); Natarajan Balasubramanian et al., *Locked In? The Enforceability of Covenants Not to Compete and the Careers of High-Tech Workers*, 57 J. HUM. RES. 349, 349 (2020); Hyo Kang & Lee Fleming, *Non-Competes, Business Dynamism, and Concentration: Evidence from a Florida Case Study* (Aug. 5, 2020) (unpublished manuscript at 8), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3172477 [https://perma.cc/2Y69-86YC].

covenants have a disproportionate effect on certain protected identities, primarily women, minorities, and older workers.[13] These protected identities often already have greater employment search friction—their geographic constraints are, on average, greater, and noncompetes artificially add to these frictions.[14] Women, for example, more frequently face the burdens of coordinating dual careers, considering family geographical ties, and navigating job market re-entry after family leave.[15] The vicious circle of a gender pay gap means that the wife—often the lower earner—makes her search secondary to the husband's primary job search.[16] Moreover, women and minorities have disproportionate non-monetary preferences about workplace culture, such as working in a diverse, harassment-free, and equal-opportunity corporate environment.[17] Post-employment restrictions foreclose this valuable competition over corporate culture preferences. A recent analysis has shown that noncompetes affect women more severely than men by more substantially curbing their mobility, reducing their pay, and postponing their ambitions to establish and lead their businesses.[18]

Debates about noncompetes are often distorted through the lens of labor versus business.[19] The benefit of employee mobility has been framed as a worker's right to pursue her profession, while the benefit of restriction is framed as a corporation's right to protect its investment in intangible property and training.[20] A better framing is that mobility benefits regions, including firms, but without a mobility policy, firms will attempt to prevent their employees from moving to competitors.[21] In optimal competitive market equilibrium, every firm should eschew this anti-competitive impulse in advance so everyone can benefit from a continuous, high-quality labor pool over time. The individual desires of

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13. Orly Lobel, *Exit, Voice & Innovation: How Human Capital Policy Impacts Equality (& How Inequality Hurts Growth*, 57 HOUS. L. REV. 781, 806 (2020).

14. *See id.* at 801.

15. *See id.*

16. Orly Lobel, *Gentlemen Prefer Bonds: How Employers Fix the Talent Market*, 59 SANTA CLARA L. REV. 663, 688 (2019).

17. *See* Emily Field et al., *Women in the Workplace 2023*, MCKINSEY & COMPANY (Oct. 5, 2023), https://www.mckinsey.com/featured-insights/diversity-and-inclusion/women-in-the-workplace# [https://perma.cc/MZ74-H2AM].

18. *See* Matt Marx, *Employee Non-compete Agreements, Gender, and Entrepreneurship*, 33 ORG. SCI. 1756, 1756 (2021).

19. Mark Lemley & Orly Lobel, *Banning Noncompetes is Good for Innovation*, HARV. BUS. REV. (Feb. 6, 2023), https://hbr.org/2023/02/banning-noncompetes-is-good-for-innovation [https://perma.cc/G4RU-9M8J].

20. *See* Kathryn Anne Edwards, *Worker Mobility in Practice: Is Quitting a Right, or a Luxury?* ECON. POL'Y INST. (May 12, 2022), https://www.epi.org/unequalpower/publications/worker-mobility-in-practice/ [https://perma.cc/Y994-YJ7X].

21. *See* Ronald J. Gilson, *The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete*, 74 N.Y.U. L. REV. 575, 578 (1999).

companies to limit competition create a collective-action issue. Therefore, a law is needed to address this collective action failure, banning noncompetes from fueling competition and growth across all industries and all employment levels.

II. DE FACTO NONCOMPETES

A formal noncompete clause hinders an employee's ability to engage (1) in competitive work; (2) in a geographic area; and (3) for a period of time following their departure from a current employer.[22] Notably, other restrictive covenants that frequently appear in conjunction with a formal noncompete in an employment contract can also prevent former employees from competing with their employer.[23] These include non-solicitation clauses, which prohibit former employees from soliciting an employer's customers; non-poaching clauses, which prohibit the hiring of former co-workers; broad non-disclosure agreements (NDAs), which claim much of the employee's knowledge and skills as proprietary information; and broad pre-innovation assignment clauses, which transfer all of an employee's inventions and creativity back to the employer, sometimes even after the employee has left.[24]

The UREAA covers any agreement between an employer and worker that "prohibits, limits, or sets a condition on" working after the relationship ends, including noncompetes, nonsolicitation agreements, no-business agreements, no-recruit agreements, confidentiality agreements, payment-for-competition agreements, and training-reimbursement agreements.[25] The UREAA provides that a confidentiality agreement is "prohibited and unenforceable" *unless* the worker may use and disclose information that: "(1) arises from the worker's general training, knowledge, skill, or experience, whether gained on the job or otherwise; (2) is readily ascertainable to the relevant public; or (3) is irrelevant to the employer's business."[26] This requirement is an important move toward banning noncompetes and any arrangement designed or used to suppress competition in the talent market.

Moreover, an important strength of the UREAA is that it includes an enforcement mechanism. The Act establishes statutory damages of $5,000 per worker per agreement for an employer who knows or

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22. Lobel, *supra* note 13, at 791.

23. *See* Orly Lobel, *Boilerplate Collusion: Clause Aggregation, Antitrust Law & Contract Governance*, 106 MINN. L. REV. 877, 893 (2021).

24. *See id.* at 894; Orly Lobel, *Enforceability TBD: From Status to Contract in Intellectual Property Law*, 96 B.U. L. REV. 869, 875 (2016); Orly Lobel, *The New Cognitive Property: Human Capital Law and the Reach of Intellectual Property*, 93 TEX. L. REV. 789, 813 (2015).

25. UNIF. RESTRICTIVE EMP. AGREEMENT ACT § 2 (UNIF. L. COMM'N 2021).

26. *Id*. § 9.

reasonably should know the Act prohibits the agreement.[27] It also allows for an action by the state attorney general or a private right of action (with attorney's fees if successful).[28] The availability of action is vital because empirical findings suggest the importance of understanding mobility-in-action and how noncompetes and other restrictive covenants extend beyond what the law currently allows.[29] California's policy of non-enforcement of noncompetes, for example, is underenforced. California employers insert noncompetes into their employment contracts at rates similar to those of non-California employers.[30] Unenforceable noncompetes still chill the movement of employees. Most invalid contracts will not be tested in court. Instead, they will have a terrorem effect on employees. Evan Starr and his collaborators have found, after surveying 11,500 labor force participants, that signing a noncompete results in less mobility and redirects mobility away from competitors to noncompetitors whether or not the noncompete was signed in a state that enforces noncompetes.[31] A private right of action and a public proactive enforcement mechanism with real remedies for inserting unlawful clauses into employment contracts are important steps to reducing such noncompliance harms.

III. THE FTC RECENTLY IMPLEMENTED RULE AS SUPERIOR TO A UNIFORM STATE LAW

In the recent past, the use of noncompetes was regulated by a confusing and inconsistent patchwork of state laws. Most states enforced noncompetes based on a vague "reasonableness" standard, leading to uncertainty and legal disputes.[32] Even in states where noncompetes were categorically banned, some employers employed unlawful noncompetes as a scare tactic.[33] Moreover, employers in noncompete-banning states may have used a choice-of-law provision in contracts to impose the law of a noncompete-enforcing state, effectively bypassing their state's regulation. This complexity added to the overall problem, discouraging workers from challenging unreasonable noncompetes and restricting

27. *Id*. § 16(e).

28. *Id*.

29. *Id.* at prefatory note.

30. Norman Bishara et al., *An Empirical Analysis of Noncompetition Clauses and Other Restrictive Postemployment Covenants*, 68 VANDERBILT L. REV. 1, 34 (2015).

31. *See* Evan Starr et al., Noncompetes in the U.S. Labor Force (Oct. 12, 2020) (unpublished manuscript at 7) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2625714 [https://perma.cc/2ZTF-XEZ6].

32. *See* Sterling Miller, *Ten Things: Drafting an Enforceable Non-Compete Agreement*, TEN THINGS YOU NEED TO KNOW AS IN-HOUSE COUNS. (Feb. 13, 2019), https://tenthings.blog/2019/02/13/ten-things-drafting-an-enforceable-non-compete-agreement/ [https://perma.cc/D5KX-UREE].

33. Starr et al., *supra* note 31, at 2.

mobility. As my co-author Mark Lemley and I recently argued in an article in the Harvard Business Review, a national solution was needed and has now since been implemented.[34]

On April 23, 2024, the FTC passed a new rule that effectively makes noncompetes nationally void and unlawful.[35] The rule enforces a comprehensive ban on new noncompetes—nationwide, in all industries, and for all levels of employment.[36] The final rule allows existing noncompetes involving senior executives to remain in effect, as these individuals are less likely to suffer the harms associated with noncompetes that affect other workers.[37] However, existing noncompetes for non-executive workers become unenforceable after the rule's effective date. [38]

The final rule also includes contractual terms in its ban, resulting in de facto noncompete clauses.[39] The FTC rule adopts a "functional" test for deciding what constitutes a noncompete.[40] Under this test, a "non-disclosure agreement" is possibly a de facto noncompete clause if it is so broadly worded "that it effectively precludes the worker from working in the same field after the conclusion of the worker's employment with the employer."[41]

The FTC also recognizes the need to address other restrictive covenants, such as unreasonable Training Reimbursement Agreements (TRAs), Nonsolicitation Clauses (NSCs), Nondealing Clauses (NDCs), and Nonpoaching Clauses (NPCs). These restrictive covenants may "function to prohibit" employees form pursuing or accepting other work or creating a business after their employment ends.[42] As a result, they

34. *See* Lemley & Lobel, *supra* note 19.

35. *See Chamber of Commerce of the United States v. FTC*, 2024 U.S. Dist. LEXIS 81436 at 3.

36. *See* Non-Compete Clause Rule, 88 Fed. Reg. 3482, 3482 (Jan. 19, 2023) (to be codified at 16 C.F.R. pt. 910) (proposing noncompete clauses be deemed an unfair and unlawful method of competition engaged by employers).

37. 1 Labor & Employment in California § 1-4 (2024) at 87.

38. *Id.*

39. Non-Compete Clause Rulemaking, 88 Fed. Reg. 3482, 3509 (proposed Jan. 19, 2023) (to be codified at 16 C.F.R. pt. 910).

40. *Id.*

41. *Non-Compete Clause Rulemaking*, FTC (Jan. 3, 2023), https://www.ftc.gov/legal-library/browse/federal-register-notices/non-compete-clause-rulemaking ("[Proposed rule § 910.1(2)(i) states:] Functional test for whether a contractual term is a non-compete clause. The term non-compete clause includes a contractual term that is a de facto non-compete clause because it has the effect of prohibiting the worker from seeking or accepting employment with a person or operating a business after the conclusion of the worker's employment with the employer. For example, the following types of contractual terms, among others, may be de facto non-compete clauses: . . . A non-disclosure agreement between an employer and a worker that is written so broadly that it effectively precludes the worker from working in the same field after the conclusion of the worker's employment with the employer.").

42. *See id.*

would satisfy the FTC's definition of a noncompete clause and would therefore be prohibited. [43] In upcoming legal challenges to the final rule, businesses will likely argue that noncompete clauses do not qualify as an "unfair method of competition" under the Federal Trade Commission Act.[44] Additionally, they will presumably contend that the FTC does not have the power to adopt the rule under the "major questions doctrine," which requires explicit statutory authority for agency rules with significant economic and political impacts or that interfere with areas traditionally governed by state law..[45]

Our national economy relies increasingly on a workforce that spans the entire country.[46] Many workers are employed by companies with a national presence, and the rise of remote work has made many jobs accessible from anywhere.[47] In this environment of growing opportunity, employees need the guarantee of labor mobility. The patchwork of state noncompete laws hinders our national labor force and economy. As illustrated above, noncompetes are unfair to workers, hinder competition, and suppress economic growth. A federal ban on noncompetes and addressing other restrictive covenants is necessary to alleviate the negative impact of these agreements and promote a more dynamic and equitable labor market. The FTC's recent implementation of this ban is a commendable step in the right direction.

CONCLUSION

This Article makes the case that although the UREAA is a step in the right direction and signals a new era of understanding the harms of noncompetes, it is insufficient. Banning restrictive agreements solely in low-wage employment markets ignores that these agreements harm workers at all levels and cause market-level economic harm. A national absolute ban is the superior solution to the sticky problem of anti-competitive post-employment restrictions to protect workers, fuel innovation, and support market competition and economic growth.

43. *See id.*

44. 1 Organizing Corp & Other Business Enterprises § 9.12 (2024) at 61.

45. *Id.*

46. *See* Nicholas Bloom et al., *Survey: Remote Work Isn't Going Away – and Executives Know It*, HARV. BUS. REV. (Aug. 28, 2023), https://hbr.org/2023/08/survey-remote-work-isnt-going-away-and-executives-know-it [https://perma.cc/P9VK-Z4RL].

47. *See id.*