March 4, 2010

The Wrong Tool for the Job: The IP Problem with Non-Competition Agreements

Viva R. Moffat

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INTRODUCTION

As intangible assets become more valuable and increasingly difficult to control, business owners have turned to a variety of mechanisms to protect those assets. Employee non-competition agreements are one of the tools that have been employed in a multi-pronged – or belt-and-suspenders – approach, and firms increasingly have been wielding them.[1] As the use of non-competes has become more widespread, controversy over these post-employment contractual restraints has also increased. In the last few years, at least six states have reconsidered the doctrine concerning enforceability of the agreements.[2] Currently, non-competes are enforceable in the majority of states, but a few states refuse to enforce the agreements entirely. These differences in state law have permitted a number of studies examining the effects of the differing legal rules, and

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1. *See* Rachel Arnow-Richman, *Cubewrap Contracts and Worker Mobility: The Dilution of Employee Bargaining via Standard Form Noncompetes,* 2006 MICH. ST. L. REV. 963, 981 n.59 [hereinafter Arnow-Richman, *Dilution*] ("While there is a dearth of statistical research on this issue, commentators generally agree based on anecdotal evidence and informal studies that employers' use of noncompetes and pursuit of claims for breach of such agreements are on the rise.") and *see* sources cited therein. *See also* Christine M. O'Malley, Note, *Covenants Not to Compete in the Massachusetts Hi-Tech Industry: Assessing the Need for a Legislative Solution,* 79 B.U. L. REV. 1215, 1216 (1999) (" . . . hi-tech companies have increasingly relied on broad non-compete clauses in employment agreements.") (citing Hanna Bui-Eve, Note, *To Hire or Not to Hire: What Silicon Valley Companies Should Know About Hiring Competitor's Employees,* 48 HASTINGS L.J. 981, 985 (July 1997) ("discussing the relationship between increased demand for technically skilled employees and the corresponding increased use of non-competition agreements").

2. *See, e.g.,* IDAHO CODE § 44-2701 (2008) (new statute took effect July 1, 2008, validating non-competes between employers and "key employees" or "key independent contractors."); Ill. House Bill 4040 (pending) (bill would restrict, but not eliminate, non-compete enforcement); Georgia House Bill 173 (legislation would expand enforceability of non-competes); OR. REV. STAT. § 653.295 (2009) (statute presumes non-competes void, but enforces agreements under some circumstances); posting by Massachusetts Representative Brownsburger, available at http://willbrownsberger.com/index.php/archives/tag/stag-non-competes (discussing proposed legislation to ban non-competes in Massachusetts); N.Y. LABOR LAW § 202-k (2008) (restricting enforcement of non-competes). In addition, the ALI is in the midst of drafting the Restatement (Third) of Employment Law, and the draft includes a provision permitting enforcement of non-competes. REST. (THIRD) OF EMPLOYMENT LAW (draft) § 8.06 ("a covenant in an employment agreement restricting a former employee's activities that is no broader than necessary in scope, geography, and time to further a protectable interest of the employer . . . is enforceable . . .").

those studies do not provide support for continued use of the agreements.[3] The California Supreme Court has roundly condemned non-competes on public policy grounds in a recent opinion reaffirming that state's rule against enforceability.[4] Although concerns about non-competes have been voiced for years, the time is ripe for a thorough re-examination of the use of and justifications for non-competition agreements.

Employment law scholars have explored some of the problematic aspects of imposing post-employment restrictions on individuals. In particular, they point to the fact that non-competes result from a deeply flawed bargaining process and impose significant restrictions on employee mobility, and they have advocated a variety of doctrinal fixes. Given the power of these critiques, the justifications for the use of non-competes should be quite powerful, but few scholars have examined, much less challenged, the justifications put forth.

In this Article, I undertake that task, and I argue not for reform of the doctrine but for elimination of non-compete enforcement entirely. The most problematic and least scrutinized of the justifications is the IP justification, which proceeds as follows: non-competes are necessary to protect trade secrets or other IP assets, or they are necessary to provide an incentive for firms to invent and invest. This IP justification, whether explicit or implicit, fails in the context of employee non-competes. The main thrust of the justification is that other forms of protection, primarily trade secrets law, are too weak and that non-competes are necessary to supplement that protection or as an alternative to it.

This argument ought to be rejected because, to some extent at least, trade secret law (and other forms of protection for intangibles) is *intentionally* limited, performing a channeling function by directing some inventions to the patent regime and others to the public domain.[5] Even to the extent that trade secret law is *unintentionally* weak, the IP justification for non-competes is not compelling. In that circumstance, non-competes are not a good tool for achieving the purposes of intellectual property protection. In either event, a refusal to enforce non-competes would serve a channeling function, directing efforts to protect intangibles

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3. *See infra* Part III.

4. Edwards v. Arthur Anderson, 189 P.3d 285, 291 (Cal. 2008). *See* CAL BUS. & PROF. CODE §16600 (2009). A few other states take the same position, rendering employee non-competition agreements unenforceable, with just a few narrow exceptions. *See, e.g.,* N.D.C.C. § 9-08-06 (containing language identical to California's statute). The North Dakota statute reflects North Dakota's "long-standing public policy against restraints upon free trade." Warner & Co. v. Solberg, 634 N.W.2d 65, 71 (N.D. 2001). In California, those exceptions are non-competes in the context of a sale of a business, to protect goodwill, and partnership arrangements. CAL BUS. & PROF. CODE §§ 16601, 16602 (2009).

5. This is not to say that trade secret law is perfectly calibrated, but only that it, like other areas of IP protection, entails some effort to balance the rights of owners with other interests, as well as with other forms of IP protection. *See infra* Part II.

to the IP regimes, rather than allowing an end run around those regimes with a tool that is so problematic in other ways.

Two other justifications for non-competes are regularly put forth: a general "business necessity" or need to protect "legitimate interests" claim, and the freedom of contract rationale. As with the IP justification, neither of these is compelling upon closer examination. The business necessity claim is quite often conclusory and unsupported; when it does have content it tends to collapse into an IP justification and is similarly problematic. The freedom of contract rationale, while rhetorically powerful, is at odds with the realities of employment contracting and with non-compete bargaining in particular.

Neither employment law scholars nor intellectual property scholars have explored or challenged this understanding of non-competes as an IP tool. When it becomes clear that non-competes are not just a deeply problematic aspect of the employment relationship, but also an effort to protect intellectual property in a way that interferes with the purposes of the IP regimes, the logical conclusion is that non-competes should simply be unenforceable.

This article proceeds as follows: In Part I, I describe some of the problematic aspects of non-competition agreements – the flaws in the bargaining process and the restrictions on employee mobility – and review the employment law literature discussing these concerns. In Part II, I turn to the largely-unexamined justifications for non-competes and argue that they are less than compelling. In particular, non-competes should be – but have not in the past been – understood as used primarily to protect intangible assets, and they fail at that task. Finally, in Part III, I conclude by arguing that the balance weighs heavily against the enforceability of non-competes but that, because of the fundamental nature of the freedom of contract rationale, courts should not generally find non-competes unenforceable. Instead, the public policy concerns described in this article call for a legislative solution.

I THE CLASSIC PROBLEMS WITH NON-COMPETES

As suggested in the Introduction, the time is ripe for a re-evaluation of the use and enforceability of non-competition agreements. Non-competes are used regularly and, it appears, increasingly by firms to restrict the post-employment activities of current employees, limiting the type, location, and extent of subsequent employment. They can be stand-alone agreements or part of a broader employment agreement, and they may be entered into at the outset of the employment relationship, in the midst of it, or at the termination of employment. In most states the agreements are enforceable if necessary to protect an employer's "legitimate interests" and are "reasonable" in terms of the restrictions im-

posed upon the employee, although the agreements are simply unenforceable in a few states.[6]

Employment law scholars have identified two primary concerns with non-competes: first, they result from a deeply flawed bargaining process; and, second, they restrict employee mobility. The bargaining process concerns are multifaceted but exemplified by the fact that the agreements are rarely negotiated and, indeed, are often entered into well after the employment relationship has begun. An agreement might state, for example, in its preamble: "In consideration of my employment or *continued employment*, [employee] agrees with the Company as follows . . ."[7] Non-competes are, of course, designed to restrict employee mobility, regularly limiting the types of future employment that could be accepted for a year or more. The same agreement provides that the employee "*will not,* during the period of [her] employment by the Company and in the event that my employment with the Company is terminated for any reason whatsoever and whether such termination be voluntary or involuntary, *for a period of three years (3) years following such termination, (i) directly or indirectly engage in any competitive business. . .*"[8] In this section, I elaborate on these two concerns and incorporate the results of several recent empirical studies that confirm some of the theoretical critiques.

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6. While California and a few other states currently have strong rules prohibiting enforcement of non-competes, the agreements are generally enforceable in most states. No jurisdiction takes a pure private ordering approach, however. *See* Cynthia Estlund, *Between Rights and Contract: Arbitration Agreements and Non-Compete Covenants as a Hybrid Form of Employment Law,* 155 U. PA. L. REV. 379, 395 (2006) [hereinafter Estlund, *Between Rights*] ("Across the country, however, postemployment covenants not to compete are subject not merely to the ordinary requirements of contract law but to additional substantive conditions that external law imposes on these agreements in particular."). In most states, courts apply some variation on the common law "rule of reason," examining the effects on the employee, the needs or interests of the employer, and the public interest to evaluate whether a given restriction is reasonable. *See, e.g.,* RESTATEMENT (SECOND) OF CONTRACTS § 188 (a court must consider: (1) whether "the restraint to greater than is needed to protect the [employer's] legitimate interest;" (2) the hardship to the employee; and (3) "the likely injury to the public."); Roanoke Eng'g Sales Co., Inc. v. Rosenbaum, 290 S.E.2d 882, 884 (Va. 1982) (applying a three-part balancing test, assessing whether the restraint is reasonable (1) "from the standpoint of the employer . . . in the sense that it is no greater than is necessary to protect the employer in some legitimate business interest . . . (2) . . . from the standpoint of the employee . . . in the sense that it is not unduly harsh and oppressive in a three-part balancing test in which the court asks whether the restraint is reasonable (1) "from the standpoint of the employer . . . in the sense that it is no greater than is necessary to protect the employer in some legitimate business interest . . . (2) . . . from the standpoint of the employee . . .in the sense that it is not unduly harsh and oppressive in curtailing his legitimate efforts to earn a livelihood; [and] (3) . . . from the standpoint of a sound public policy.").

7. http://contracts.onecle.com/gt-solar/woodbury-non-competition-2008-01-07.shtml (last visited March 4, 2010).

8. Some other significant aspects of this sample agreement will be addressed in Part II, *infra.* For now, it is sufficient to keep in mind that (1) the agreement makes explicit that its purpose is to protect the employer's intellectual property; (2) the employer's "Proprietary Information" is defined very broadly to include everything from systems and formulae to price and customer lists; and, finally, (3) the agreement references the "highly competitive nature of the business of the Company" and states that the purpose of the agreement is to "prevent any competitive business from gaining any unfair advantage from [the employee's] knowledge of Proprietary Information."

A. *Non-Competes are the Product of an Inherently Flawed Bargaining Process*

Given the fairly obvious negative consequences for an employee of entering into a non-compete – the inability to work for certain employers, in certain places, for some extended period of time – the logical question is *why* employees do so? Commentators have discussed the systematically unequal bargaining power between employees and employers in general, and the extent to which that plays out in the drafting, negotiation, and enforcement of non-competition agreements.[9] Non-competes result from a flawed bargaining process that departs substantially from the neo-classical bargaining model. Not only do non-competes generally operate in a unilateral way that adversely affects employees, but employers, as a general matter, have vastly disproportionate power in the bargaining process that results in a non-competition agreement. This means that, as a practical matter, non-competes are very often presented in a manner and form that makes it extremely unlikely that they will be negotiated.[10] In addition, the process is heavily influenced by cognitive and behavioral biases that make it less likely that employees will understand, negotiate, or challenge the agreements. These factors provide perhaps the best explanation for the fact that employees routinely enter into non-compete agreements, and together these factors erode – although they do not completely undermine – the freedom of contract rationale proferred by the proponents of such agreements. In arguing for the reform of non-compete doctrine, many scholars have focused on these arguments. I bring those arguments together in this section, along with the results of some empirical work, and conclude that these remain powerful critiques of non-competes.

Employee-employer relations are characterized by unequal bargaining power; as a general matter, employers have vastly more power in the negotiation and performance of the employment relationship.[11] This asymmetrical relationship heavily influences the existence and character of employee non-competition agreements. They are uniformly drafted by the employer and only rarely negotiated by the employee. As such, they nearly always favor the employer.[12] The comments to the Restate-

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9. *See infra* notes __ to __ and accompanying text.

10. *See infra* notes __ and __.

11. This subject has been explored in-depth, particularly by employment law scholars. *See, e.g.,* Arnow-Richman, *Dilution, supra* note 2, at 963 ("Employment relationships are perhaps the paradigmatic example of inequality of bargaining power in contract law."); Mayer G. Freed & Daniel D. Polsby, *Just Cause for Termination Rules and Economic Efficiency*, 38 EMORY L.J. 1097, 1099 (1989) ("The most commonly encountered market failure idea is the inequality of bargaining power that supposedly subsists between the employer and employee. This notion of inequality of bargaining power pervades discussions about regulation of the employment relationship.") *See also* Daniel D. Barnhizer, *Inequality of Bargaining Power*, 76 U. COLO. L. REV. 139 (2005) (discussing the concept of inequality of bargaining power in contract law generally).

12. *See Estlund, Between Rights*, *supra* at 384 ("Most employment contracts arise between individuals who are more or less dependent on a single job and comparatively large organizations

ment of Contracts provision on non-competes put it succinctly: "Postemployment restraints are scrutinized with particular care because they are often the product of unequal bargaining power and because the employee is likely to give scant attention to the hardship he may later suffer through loss of his livelihood."[13] Commentators have noted the increased use of boilerplate agreements,[14] and the one-sided nature of those agreements. In many instances, the purpose "is not to memorialize a negotiated set of terms, but to extract waivers of rights, thus realigning statutory and default rules to better reflect employers' interests."[15]

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that are repeat players with diversified investments in the labor market. Most contract terms are offered by employers on a take-it-or-leave-it basis, and are set under the shadow of employment at will – the employer's presumptive power to fire employees for any reason at all, including refusal to accept the employer's proferred or modified terms of employment."). *See also* Griffin Toronjo Pivateau, *Putting the Blue Pencil Down: An Argument for Specificity in Noncompete Agreements,* 86 NEB. L. REV. 672, 676 (2008) ("non-compete agreements are almost invariably drafted in favor of the employer"), *citing* Kenneth J. Vanko, *You're Fired! And Don't Forget Your Non-compete . . ." The Enforceability of Restrictive Covenants in Involuntary Discharge Cases,* 1 DEPAUL BUS. & COM. L.J. 1, 1 (2002). *See also* O'Malley, *supra* note 2, at 1216 ("In a typical situation, the hi-tech employer drafts a non-competition agreement and compels the prospective employee, who lacks bargaining power and legal sophistication, to sign it as a condition of employment. As a result, most non-competition agreements contain a strong bias in the employer's favor."). Law and economics scholars, on the other hand, have pushed back against the notion that employees are systematically disadvantaged in bargaining with their employers or potential employers. *See, e.g.,* Estlund, *Between Rights, supra* note __ at 388 n.18 ("Law-and-economics scholars have repeatedly criticized the 'unequal bargaining power' claim and argued for greater deference to contracts.") (citing STEWART J. SCHWAB, THE LAW AND ECONOMICS APPROACH TO WORKPLACE REGULATION, IN GOVERNMENT REGULATION OF THE EMPLOYMENT RELATIONSHIP 91, 111-13 (Bruce E. Kaufman ed., 1997) and Michael L. Wachter & Randall D. Wright, *The Economics of Internal Labor Markets,* 29 INDUS. REL. 240, 260 (1990)). *See, e.g.,* Michael H**.** Gottesman, *Wither Goest Labor Law: Law and Economics in the Workplace,* 100 YALE L.J. 2767, 2770-71 (1991) (book review) (discussing the debate between "adherents of neoclassical economics who contend that there is no reason for the law to treat the sale of labor differently from the sale of products" and those who, for example, argue that "collective bargaining . . . truly is the most effective ordering principle for the workplace . . .").

13. RESTATEMENT (SECOND) OF CONTRACTS § 188 cmt. g. (1981) The drafters of the Restatement of the Law Third (Employment Law) have apparently struggled with the proper approach to take. The draft provision permits limited enforcement of non-competes, and it does not appear to acknowledge the bargaining process concerns. RESTATEMENT (THIRD) OF EMPLOYMENT LAW (draft) § 8.06.

14. There is limited empirical work concerning the frequency with which employees enter into non-competes. There is surely variation by jurisdiction by industry, by type of employer, and by type of employee. Commentators seem to assume that the use of non-competes is increasing, but there is little data. Toby E. Stuart & Olav Sorenson, *Liquidity Events and the Geographic Distribution of Entrepreneurial Activity*, 48 ADMIN. SCI. Q. 175, 182 (2003) ("The prevalence of non-compete covenants in employment contracts remains unknown, but available data suggest that they may be nearly ubiquitous in employment contracts in high technology businesses. Kaplan and Stronberg (2000), for example, found that venture capital firms required 90 percent of the founders of the companies they financed to sign non-compete agreements. In a broader survey, Leonard (2001) reported that 88 percent of companies with less than $50 million in sales require employees to sign non-compete covenants."). Another study, citing many of the same sources, states that "[n]on-competes appear to be nearly universal in employment contracts." Matt Marx, Deborah Strumsky, & Lee Fleming, *Mobility, Skills, and the Michigan Non-Compete Experiment,* 55 MGMT. SCI. 875, 876 (June 2009).

15. Arnow-Richman, *Cubewrap Contracts: The Rise of Delayed Term, Standard Form Employment Agreements*, 49 ARIZ. L. REV. 637, 639 (2007) [hereinafter Arnow-Richman, *Delayed Term*].

Under a freedom of contract rationale, one might expect that employees take on non-competition restrictions in exchange for something: higher salaries or additional responsibilities or greater benefits.[16] This is theoretically compelling, but some evidence indicates that the contrary might, in fact, be true: employees subject to non-competes may receive *less* in the employment bargain. One study has found "that tougher non-competition enforcement promotes executive stability" (i.e., decreased mobility) as well as "*reduced* executive compensation . . ."[17] While this undercuts the standard freedom of contract view of bargaining, it is upon further reflection not entirely surprising. In jurisdictions in which non-competes are enforced, an employee's market power, and therefore ability to negotiate for better terms, is reduced.

Perhaps because non-competes are rarely negotiated and rarely challenged in court, employers have a tendency to overreach, drafting non-competes that are quite broad and possibly unenforceable. This issue is obviously subject to empirical proof, but many courts and commentators believe that employer overreach is a significant problem,[18] and anecdotal evidence supports this view.[19] This tendency to overreach creates *in terrorem* effects: employees will refrain from lawful, permissible behavior out of concern for complying with the contract and avoiding litigation.[20]

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16. *See, e.g.,* Stewart E. Sterk, *Restraints on the Alienation of Human Capital,* 79 VA. L. REV. 383, 408 (1993) (". . . denying the monopsonist power to enforce restrictive covenants would simply cause the monopsonist to exercise that power in a different way – for instance, by offering lower wages. Refusing to enforce restrictive covenants would not reduce the monopsonist's power."). The same argument is made concerning standard form consumer contracts: "If one seller offers unattractive terms, a competing seller, wanting sales for himself, will offer more attractive terms." RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW, 114 (4th ed. 1992).

17. Mark J. Garmaise, *Ties That Truly Bind: Non-competition Agreements, Executive Compensation and Firm Investment,* working paper, available at http://personal.anderson.ucla.edu/mark.garmaise/noncomp7.pdf (last visited February 26, 2010).

18. Although empirical evidence may be hard to come by "[c]oncerns about the *in terrorem* effects of [non-competes] . . . have been voiced with frequency." Arnow-Richman, *Dilution, supra* note 2, at 966 n.10 (and see sources cited therein). "In both [non-competes and arbitration agreements], employers have an incentive to overreach – to use these agreements to impair employees' inalienable rights, injure the public interest, or both. The loss of a valued employee, especially to a competitor, is undesirable; the employer may be tempted to secure as much insulation from that loss, and from that future competition, as its market power will permit." *Estlund, Between Rights*, *supra* note __, at 412. S*ee also* Rachel Arnow-Richman, *The Role of Contract in the Modern Employment Relationship,* 10 TEX. WESLEYAN L. REV. 1, 5 (2003).

19. One anecdotal piece of evidence: During my time in practice, I was asked by one client to draft a non-compete for all employees in a small company. I responded that the terms suggested by the client would be unenforceable. The client responded: "I don't care. I just don't want them to leave."

20. *See Estlund, Between Rights*, *supra* note __, at 406 ("An overbroad non-compete – one that lasts too long or that covers activities that do not threaten the employer's legitimate interests – may deter the employee from quitting and competing even when she has a right to do so, or it may deter a competitor from hiring the employee."). *See also* Richard P. Rita Pers. Svcs. Int'l, Inc. v. Kot, 191 S.E.2d 79, 81 (Ga. 1972) ("For 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. Thus, the mobility of untold numbers of

The *in terrorem* effects are magnified – because employers are more likely to overreach – in jurisdictions that allow "blue penciling," or reformation of the contract to make it reasonable.[21] Both commentators and courts have noted the incentive to overreach when blue penciling may occur.[22] A Georgia court described the dynamic as follows:

> Employers covenant for more than is necessary, hope their employees will thereby be deterred from competing, and rely on the courts to rewrite the agreements so as to make them enforceable if their employees do compete. When courts adopt severability of covenants not to compete, employee competition will be deterred even more than it is at present by these overly broad covenants against competition.[23]

The *in terrorem* effects may even extend to other employers, reducing employee mobility further. For example, in a case in which a federal court applying Indiana law refused to blue pencil a non-compete covenant, the court stated that "A prospective new employer . . . could not read the . . . [non-compete provision] and know what sorts of activity would be prohibited and what would not . . . A current employee may be frozen in his or her job by an unreasonably broad covenant. Even if the employee believes the covenant is too broad, she may be able to test that proposition only through expensive and risky litigation."[24]

Another manifestation of the asymmetrical bargaining power in the process is the fact that non-compete provisions are regularly presented after the employee has already accepted the position, and sometimes

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employees is restricted by the intimidation of restrictions whose severity no court would sanction."), *quoting* Harlan M. Blake, *Employee Agreements Not to Compete,* 73 HARV. L. REV. 625, 682-83 (1960). *See also* Reddy v. Community Health Foundation of Man, 298 S.E.2d 906, 916 (W.Va. 1982) (describing broad non-compete provisions in employment agreements "where savage covenants are included in employment contracts so that their overbreadth operates, by *in terrorem* effect, to subjugate employees unaware of the tentative nature of such a covenant.").Even those commentators who generally support the enforceability of non-competes concede that overreaching – and its effect on employees – may occur. *See, e.g.,* Stewart E. Sterk, *supra* note __, at 410 ("by limiting the number of attractive alternatives available to an employee, a restrictive covenant may in some sense 'coerce' that employee to remain with his initial employer.").

21. Pivateau, *supra* note __, at 690-91 ("In those states employing the [blue pencil] doctrine, employers are effectively encouraged to enter into otherwise unenforceable agreements."). *See also* Rita Pers. Svcs. v. Kot, 191 S.E.2d at 81 ("[i]f severance is generally applied, employers can fashion truly ominous covenants with confidence that they will be pared down and enforced when the facts of a particular case are not unreasonable."); Valley Medical Specialists v. Farber, 982 P.2d 1277, 1286 (Ariz. 1999) ("employers may therefore create ominous covenants, knowing that if the words are challenged, courts will modify the agreement to make it enforceable.").

22. *See, e.g. Estlund, Between Rights*, *supra* note __, at 405 ("[j]udicial willingness to edit or reform agreements . . . may invite employers to overreach." Philip J. Closius & Henry M. Schaffer, *Involuntary Nonservitude: The Current Judicial Enforcement of Employee Covenants Not To Compete – A Proposal for Reform,* 57 S. CAL. L. REV. 531, 547 (1984) ("the 'blue pencil rule' and the 'rewriting' of offending covenants illustrate another defect in the reasonableness approach. These practices encourage employers to be 'unreasonable' in drafting covenants not to compete because there is, in effect, no sanction for being unreasonable.").

23. Howard Schultz & Assocs., Inc. v. Broniec, 236 S.E.2d 265, 269 (Ga. 1977).

24. Produce Action Int'l, Inv. v. Mero, 277 F. Supp. 2d 919, 930-31 (S.D. Ind. 2003).

months or years later. The rise of standard form, adhesive agreements in the private employment context has only exacerbated this dynamic, resulting in employment agreements that are presented in a "delayed terms" manner, much the way shrinkwrap and clickwrap contracts have presented a "pay now, terms later" situation.[25] While employees often negotiate salary and benefits before accepting a job, non-competition provisions regularly are not discussed but instead presented on the first day on the job or sometime thereafter. Delayed terms – those presented after an employment agreement has been negotiated, and often after the employee has begun work – give rise to a host of problems in the employment context, and with respect to non-competition provisions in particular.

Professor Arnow-Richman describes the context in which non-competes are often presented, likening the presentation to that of shrinkwrap contract:

> The use of boilerplate language in any context has long raised questions about the validity of assent and the risk of overreaching by the drafter, concerns that are heightened where a delay in providing terms impedes a party's ability to consider the transaction as a whole. In the employment context, such concerns redouble given the nature of both the relationship and the market. As compared with a purchase of goods, the individual employee is likely to have much more at stake in any one 'sale' and ultimately has very limited ability to reject or 'return' the job once accepted. These limitations allow cube-wrap contracts to operate underground as a form of private legislation, rewriting the baseline common law and statutory rules that protect employee rights and society generally.[26]

As Arnow-Richman suggests, there are a variety of cognitive and behavioral mechanisms at work in the negotiation of employment and within the employment relationship itself that explain the fact that employees rarely negotiate non-competes.[27] People are not particularly

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25. Arnow-Richman, *Delayed Term*, *supra* note __, at 640 ("What has escaped wide notice in the employment law literature is that standard form employment agreements frequently follow this agreement-now-terms-later model of contracting.").

26. Arnow-Richman, *Delayed Term*, *supra* note __, at 641.

27. For a discussion of these cognitive and behavioral biases that place employees in a particularly bad bargaining position vis-à-vis employers, *see, e.g.,* Cass R. Sunstein, *Human Behavior and the Law of Work,* 87 VA. L. REV. 205, 240-43 (2001) (discussing the fact that people tend to have "excessive optimism" and "inadequate foresight" about future risk, and that they "edit out" low probability events); Samuel Issacharoff, *Contracting for Employment: The Limited Return of the Common Law,* 74 TEX. L. REV. 1783, 1794 (1996) (analogizing the hiring stage to a first date, in which one would not raise questions about dissolution of the relationship. "The inherent difficulty in discussing end-term arrangements at the point of initial courtship is compounded by the general presumption to bargaining inequality for all but the most select employees."); Walter Kamiat, *Labor and Lemons: Efficient Norms in the Internal Labor Market and the Possible Failures of Individual Contracting,* 144 U. PA. L. REV. 1953, 1955-56 (1996) (describing difficulties on both sides of the employment bargain: "An employee and employer contracting for employment fits Akerlof's model: each possesses unique access to information – information regarding the quality of their offers – that

good at estimating the risk that something may go wrong. At the outset of an employment relationship in particular, prospective employees are unlikely to dwell upon the possibility of negative outcomes that might or might not occur in the relatively distant future.[28] "Indeed, the period immediately following hire is likely to be the one in which employees are most optimistic about their future employment. Beliefs about the quality and duration of employment may even be explicitly reinforced by management personnel who reassure the workers about their prospects and treat the required written documents as 'routine paperwork.'"[29] Even assuming that a non-compete provision is presented to the employee before she begins work (which is often not the case), the issue is unlikely to be salient to the employee at that point in the employment relationship. Unlike salary, hours, or benefits, a non-compete provision takes effect, if at all, at a point much later in time. "[N]on-compete agreements constrain employees only in a fairly remote and uncertain future event; and we may expect employees to overdiscount the likelihood of these events or the importance of the rights at stake."[30]

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the other party would find highly relevant, but which neither party can easily discover from the other."); Pauline T. Kim, *Bargaining with Imperfect Information: A Study of Worker Perceptions of Legal Protection in an At-Will World,* 83 CORNELL L. REV. 105, 106 (1997) ("workers appear to systematically overestimate the protections afforded by law, believing that they have far greater rights against unjust or arbitrary discharges than they in fact have under an at-will contract."). *See also* Cass R. Sunstein, *Switching the Default Rule*, 77 N.Y.U. L. REV. 106, 108 (2002) (discussing the "endowment effect" in the employment relationship); Cynthia L. Estlund, *How Wrong Are Employees About Their Rights, And Why Does It Matter?*, 77 N.Y.U. L. REV. 6, 8 (2002) [hereinafter Estlund, *How Wrong*] ("In the context of a contract between a more- and a less-sophisticated party, in which the former directly benefits from the misconceptions of the latter, a case can be made for bringing the law into line with the optimistic beliefs of the less-sophisticated party."). Even those scholars who urge enforcement of non-competes recognize some of the problematic aspects of the bargaining process. *See, e.g.,* Sterk, *supra* note __, at 408 ("Deficiencies in information or imagination, however, might lead employees to sign restrictive covenants that are not in their interest."), *citing* Lea S. VanderVelde, *The Gendered Origins of the* Lumley *Doctrine: Binding Men's Consciences and Women's Fidelity,* 101 YALE L. J. 775, 852 (1992) ("Most individuals enter into employment contracts with hopes and dreams. Few enter with the end of the relationship clearly in mind"); and Mayer G. Freed & Daniel D. Polsby, *Just Cause for Termination Rules and Economic Efficiency*, 38 EMORY L.J. 1097, 1105-07 (1989).

28. *Arnow-Richman, Delayed Term*, *supra* note __, at 653. For more general discussions of this topic s*ee* Jean Braucher, *Amended Article 2 and the Decision to Trust the Courts: The Case Against Enforcing Delayed Mass-Market Terms, Especially for Software*, 2004 WISC. L. REV. 753 (2004); Melvin Aron Eisenberg, *The Limits of Cognition and the Limits of Contract,* 47 STAN. L. REV. 211 (1995). *See also* Sterk, *supra* note __, at 408-09 ("Deficiencies in information or imagination, however, might lead employees to sign restrictive covenants that are not in their interest. . . . An employee beginning a new job may discount or overlook the possibility that she will later want to compete with her employer."); Rena Mara Samole, Note, *Real Employees: Cognitive Psychology and the Adjudication of Non-Competition Agreements*, 4 WASH. U. J.L. & POL'Y 289, 307-08 (2000) (". . . cognitive psychologists suggest that because neoclassical economics ignores important limits on human cognition in situations involving risk or uncertainty, it relies on an idealized and impossible view of human behavior.").

29. *Arnow-Richman, Delayed Term*, *supra* note __, at 654.

30. *Estlund, Between Rights*, *supra* note __, at 413 ("Cognitive biases or informational asymmetries might thus aggravate concerns about the fairness of bargains struck at an earlier point, especially at the outset of employment, when questions about the forum in which one might later sue the employer, or about one's ability to compete with the employer after termination, are likely to

The combination of asymmetrical bargaining power, the form and presentation of many non-competes, and the cognitive biases involved in the negotiation of non-competes means that the bargain struck between the parties rarely conforms to the neoclassical vision of a freely negotiated contract. Many commentators have questioned the approach to evaluating non-competes based on these bargaining power issues, but few have suggested an absolute rule of unenforceability.[31] I do not argue that non-competes should be unenforceable for this reason alone, but this constellation of factors undermines the freedom of contract rationale set forth by proponents of non-competition agreements and weighs heavily in the balance.[32]

B. *Employee Non-Competes Restrict Employee Mobility and the Free Flow of Labor*

At the risk of stating the obvious, non-competes are problematic because they restrict employee mobility, generally considered to be a matter of public policy, both in theory and as a practical matter. At its extreme, a non-competition agreement would violate the Thirteenth Amendment. That is, a complete restriction on postemployment labor is tantamount to involuntary servitude.[33] It goes without saying that such an agreement violates public policy concerning slavery, the importance of the alienability of labor and "the right to quit."[34]

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tarnish the appeal of an applicant or new employee. All of this might make it easier for employers to overreach and invade employee rights.").

31. Arnow-Richman concludes that "no doctrinal fix will fully solve the problem of employer overreaching or employee oppression, because it does not alter the fundamental imbalance that exists whenever a single individual deals with a larger entity . . ." Arnow-Richman, *Dilution, supra* note 2, at 992. Many employment law scholars have suggested various doctrinal fixes. *See, e.g.,* Arnow-Richman, *Dilution, supra* note__, at 984 (suggesting doctrinal changes that would "encourag[e] disclosure on the front end of the employment relationship by refusing enforcement of cubewrap terms and discourage[e] overbroad agreements by refusing judicial redrafting . . ."); KATHERINE V.W. STONE, FROM WIDGETS TO DIGITS: EMPLOYMENT REGULATION FOR THE CHANGING WORKPLACE 156 (2004) (arguing that courts should "limit enforcement of noncompete covenants to the protection of trade secrets narrowly defined . . ."); Philip Closius & Henry M. Schaffer, *Involuntary Nonservitude: The Current Judicial Enforcement of Employee Covenants Not to Compete – A Proposal for Reform*, 57 S. CAL. L. REV. 531, 548-49 (1984); Gillian Lester, *Restrictive Covenants, Employee Training, and the Limits of Transaction-Cost Analysis*, 76 IND. L.J. 49, 72-74 (2001) (considering various alternative approaches); Sterk, *supra* note __, at 387 (arguing that all non-competes, not just "reasonable" non-competes ought to be enforceable). *See also* Katherine V.W. Stone, *The New Psychological Contract: Implications of the Changing Workplace for Labor and Employment Law*, 48 UCLA L. REV. 519, 590 (2001) (critiquing non-compete doctrine, particularly as applied in a very mobile economy with limited employment security).

32. *See infra* Part II.

33. *See* Blake, *supra* note __, at 77.

34. *Estlund, Between Rights*, *supra* note 18, at 408 ("An extremely broad waiver of the right to work elsewhere after quitting, such as would be permitted under and ordinary contractual treatment of [non-compete] agreements, comes very close in effect to contracting away one's inalienable right to quit. So the pall of the Thirteenth Amendment and its ban on involuntary servitude hangs over these agreements."). *See also* Oren Bar-Gill & Gideon Parchomovsky, *Law and the Boundaries of Technology-Intensive Firms,* 157 U. PA. L. REV. 1649, 1667 (2009) ("Of course, the reach of these contractual restrictions and, correspondingly, the extent of control that they provide are not

Given this history, even moderate restraints on postemployment activity have been viewed with suspicion.[35] Although employee non-competes are enforceable in many states,[36] the law, both common law and statutory, evolved from this historical perspective, which means that such agreements are examined more closely than many other commercial agreements.[37] Moreover, even in the most permissive states, non-competition agreements are unenforceable if they prevent an employee from making a living or engaging in his or her profession of choice entirely. To be enforceable, a non-competes must be limited in geographic scope, temporal scope, and in restrictions on future employment.[38] Most, but not all, non-competes must be supported by consideration so that in theory the employee receives some kind of benefit.[39] Functionally, however, non-competes operate unilaterally in that the employee is burdened by postemployment restrictions but the employer may fire the employee at any time (assuming at will employment) and is not required to pay the employee during the restricted period.[40]

As a practical matter, non-competes are certainly meant to limit employee mobility. An agreement might state, for example, that the employee "will not, during the period of my employment by the Company and in the event that my employment with the Company is terminated for any reason whatsoever and whether such termination be voluntary or involuntary, for a period of three years (3) years following such termina-

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unlimited. And it is the law that sets the limits – limits that echo the slavery concerns raised by Hart."), *citing* Oliver Hart, FIRMS, CONTRACTS AND FINANCIAL STRUCTURE 29 (1995).

35. Sterk, *supra* note __, at 411 ("When courts express hostility to restrictive covenants in employment on involuntary servitude grounds, they suggest in effect that the right to choose how to use one's 'own' human capital is an important element of personal freedom."); *see generally* Harlan M. Blake, *supra* note __, at 629-37 (discussing the common law's suspicion of restraints on trade).

36. Non-competes are unenforceable in a few states, including California. *See* CAL BUS. & PROF. CODE § 16600.

37. *See* Sterk, *supra* note __, at 395 ("For centuries, English and American courts have carefully scrutinized restrictive covenants between employers and employees as 'restraints on trade.'"). In the majority of states, the approach varies in its details but is generally consistent. By the common law or by statute, many states apply a "rule of reason" in which the employee's interest in being free of the restriction is balanced against the employer's "protectable interest." The "public interest" is also often part of the calculation. *See, e.g.,*

38. *See, e.g.,* V.T.C.A., BUS. & C. § 15.50 (". . . a covenant not to compete is enforceable if it is ancillary to or part of an otherwise enforceable agreement at the time the agreement is made to the extent that it contains limitations as to time, geographical area, and scope of activity to be restrained that are reasonable and do not impose a greater restraint than is necessary to protect the goodwill or other business interest of the promisee.").

39. The law in many states is in flux on this point. In some jurisdictions, at will employment (or continued at will employment is deemed sufficient consideration), while in other states the law requires some additional consideration. *See, e.g.,*Lucht's Concrete Pumping, Inc. v. Tracy Horner and Everist Materials, -- P.3d --, 2009 WL 1621306 (Colo.App. 2009), at 3 ("We are persuaded by the rationale in these cases and in others that have similarly held that continued employment does not create consideration for a noncompete agreement once an employee has begun working for an employer."), cert. granted, Feb. 1, 2010, 2010 WL 341383 (Colo.).

40. In England, noncompetition agreements are enforceable, but the employer must pay the employee during the postemployment restricted period. This is called "gardening leave."

tion, (i) directly or indirectly engage in any competitive business . . ."[41] This kind of contractual language is obviously intended to have an effect on the individual employee bound by the agreement. To state the obvious, the agreement seeks to limit, though not eliminate, the employee's ability to terminate her employment and secure another job.[42] It also seems obvious that – all things being equal – it is in the employee's interest to be free of such restrictions.

The actual effects of the agreement on the individual employee will certainly vary. The employee might not have read or understood the agreement, and it might for that reason have no effect whatsoever on the employee's behavior. If the employee has read the agreement or is otherwise aware of the non-compete, the agreement might make it more likely that the employee will stay with the employer, rather than leaving to take advantage of other opportunities. This of course is precisely the point of a non-compete, from the employer's perspective: retaining the employee and the investment the employer has made in that employee while, at the same time, preventing a competitor from gaining access to the skills, knowledge or information possessed by the employee. One recent study supports the intuition that non-competes might make retention of the employee more likely. It concludes that "workers subject to non-competes [tend] to stay with their employers."[43] This is one way, then, in which non-competes limit employee mobility.

Non-competes might affect employee mobility in other ways. If the employee decides, notwithstanding the non-compete agreement, to terminate her employment with this employer (or if the employee is fired or laid off[44]), the employee might seek employment that conflicts with the terms of the agreement, risking a lawsuit, or might accept employment in another field to avoid breaching the agreement. Marx's study concludes that these effects are real. Workers subject to non-competes often take

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41. Sample contract available at http://contracts.onecle.com/gt-solar/woodbury-non-competition-2008-01-07.shtml (last visited March 4, 2010).

42. Sterk describes this situation as the epitome of the alienability of labor, and he views that as a good thing, arguing that virtually all non-competes – not just "reasonable" non-competes – ought to be enforceable. Sterk, *supra* note __, at 412 ("These restrictions on a person's ability to alienate his own human capital have been justified in part by the need to discourage anticompetitive behavior, in part by the need to protect employees from the greater bargaining power of employers, and, most significantly, by the need to protect individual freedom. None of those justifications, however, is entirely persuasive.").

43. Matt Marx, *Good Work if You Can Get It . . . Again: Non-Compete Agreements, "Occupational Detours," and Attainment,* 3 (Mass. Inst. of Tech. Working Paper Series, August 17, 2009), *available* at http://ssrn.com/abstract=1456748. [hereinafter Marx, *Good Work*]. *See also* Bruce Fallick, Charles A. Fleischman, and James B. Rebitzer, *Job-Hopping in Silicon Valley: Some Evidence Concerning the Microfoundations of a High-Technology Cluster*, REV. OF ECON. & STAT. 472 (Aug. 2006) ("Our finding of a California effect on mobility lends support to Gilson's hypothesis that the unenforceability of noncompete agreements under California state law enhances mobility and agglomeration economies in IT clusters.").

44. Note that in the illustrative agreement the post-employment restrictions are in force regardless of the reason the employment relationship terminated.

"occupational detours," which may not redound to their benefit.[45] The "results suggest that those who change jobs while subject to non-competes may actually be taking a step back in their careers."[46] Together, the implications are significant: "Not only do non-competes discourage individuals from changing jobs to take advantage of attractive opportunities . . . when workers subject to non-competes nonetheless leave their jobs, their next step often becomes decidedly unattractive: working surreptitiously within their field, leaving their field, or not working at all."[47]

Studies have demonstrated not just the individual effects of non-competition agreements but the effect on the flow of labor in particular markets. In a very interesting study involving Michigan law on non-competes, Matt Marx, Deborah Strumsky, and Lee Fleming concluded that employee mobility is in fact tied to the rule concerning the enforceability of non-competes.[48] Michigan created a perfect setting for a study concerning the effect of the legal rule on non-competes:[49] the state legislature inadvertently (strange, but true, apparently) changed the rule on non-competes.[50] They were unenforceable before 1985[51] and enforceable thereafter.[52] Drawing on information contained in patent applications, the researchers found that "the job mobility of inventors in Michigan fell 8.1% following the policy reversal compared to inventors in other states that continued to proscribe non-competes, and these effects were ampli-

45. Marx, *Good Work, supra* note 49, at 3.

46. Id. at 4. Marx concludes that "[k]knowledge workers subject to non-competes find it difficult to continue in their chosen profession when changing jobs, often leaving their field." Id. at 44.

47. Id. at 46.

48. Matt Marx, Deborah Strumsky & Lee Fleming, *Mobility, Skills, and the Michigan Non-Compete Experiment*, 55 MGMT. SCI. 875, 876 (2009).

49. Marx, Strumsky & Fleming, *supra* note __, at 878 ("Michigan is the only state we know to have clearly and inadvertently reversed its enforcement policy in the last century. Given that Michigan's shift in non-compete enforcement appears to have been exogenous, we propose that Michigan affords a 'natural experiment' with which to directly test the impact of non-competes on worker mobility.").

50. In 1985, the legislature passed the Michigan Antitrust Reform Act, which repealed a large section of the state's code, including the provision holding non-competes unenforceable. The abolition of that provision was apparently not the purpose of the statutory repeal and was, evidently, neither intentional or even noticed at the time. *See* Marx, Strumsky, Fleming, *supra* note __, at 877 ("Given that the impetus for the change in law appears to have been general antitrust reform and not specifically altering non-compete enforcement, it appears that the 1905 statute prohibiting non-competes was inadvertently repealed as part of the antitrust reform.").

51. MICH. COMP. LAWS SERV. § 445.761 (1905) ("All agreements and contracts by which any person . . . agrees not to engage in any avocation or employment . . . are hereby declared to be against public policy and illegal and void.").

52. The provision prohibiting the enforcement of non-competes was repealed, and lawyers and employers in Michigan soon realized that they could impose such terms on employees. Marx, Strumsky & Fleming, *supra* note __, at 877.

fied for those with particular characteristics."[53] Other studies have documented similar effects.[54]

It is beyond doubt that non-competes are intended to restrict the free flow of the labor market, and it appears that they succeed. While employers (and courts) often justify the imposition of non-competes, in part, on a free market, freedom of contract rationale, these agreements exist in some tension with those theories. Given that non-competes interfere in the market for labor and are the product of a deeply flawed bargaining process, the arguments in favor of non-competes would have to be quite powerful to justify their imposition. As we shall see in the next Part, that is hardly the case. Upon closer examination, the justifications for non-competes are surprisingly weak, and thus the balance tips heavily toward an absolute rule of unenforceability.

II THE UNEXAMINED AND PROBLEMATIC JUSTIFICATIONS FOR NON-COMPETES

While many scholars have persuasively argued that non-competes are bad for employees and problematic in a variety of ways, few have addressed head on the justifications in support of the agreements. Upon closer examination, these justifications – which fall into three general categories – turn out to be surprisingly weak. The least examined and most problematic of these is that non-competes are necessary to protect intellectual property or IP-like intangibles.[55] This argument is often explicit: non-competes are necessary to protect a firm's trade secrets, for example. Even when it is not explicit, the IP justification emerges implicitly when proponents argue that non-competes are necessary to encourage investment in employees, in invention, and in disclosure of information. Employers and courts also put forth a more general argument about the "business necessity" served by non-competes, contending that they are necessary to protect the employer's "legitimate interests." Finally, and most broadly, the freedom of contract principle is used to justify the imposition of non-competes.

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53. Marx. Strumsky & Fleming, *supra* note __, at 876 ("Michigan inventors with skills one standard deviation above the mean in their firm-specificity experienced a decrease in their job mobility of 15.4% . . .").

54. Bruce Fallick, Charles A. Fleischman, and James B. Rebitzer, *Job-Hopping in Silicon Valley: Some Evidence Concerning the Microfoundations of a High-Technology Cluster,* 88 REV. OF ECON. & STAT., 472, 481 (Aug. 2006) ("Our finding of a California effect on mobility lends support to Gilson's hypothesis that the unenforceability of non-compete agreements under California state law enhances mobility and agglomeration economies in IT clusters."). For a discussion of Gilson's argument, *see infra* Part __.

55. Intellectual property scholars have assumed that non-competes operate as a form of IP protection, *see, e.g.,* Bar-Gill & Parchomovsky, *supra* note __, at 1655 (discussing covenants not to compete as a "nonproperty source of control" over intellectual property); Jonathan Barnett, *Is Intellectual Property Trivial?*, 157 U. PA. L. REV. 1691, 1706 (2009) (discussing non-competes as an alternative method of intellectual property protection), but few, if any have challenged the justification.

Each of the arguments used to support non-competes is less compelling than its rhetoric implies, but these arguments have rarely been challenged by either employment law or IP scholars. The IP justifications are misplaced but telling. They reveal that the primary motivations for the use of non-competes revolve around attempts to protect IP or IP-like assets ("confidential business information" "proprietary information" "confidential information" and so on), but the justifications point in another direction. IP law, rather than contract law, is the proper tool, and a refusal to enforce non-competes would properly channel protection to the IP regimes. The "business necessity" justification is often unsupported. When it does have some content, it collapses into an IP justification. Finally, as discussed above in Part __, the freedom of contract rationale is undermined by the realities of the relationship between employee and employer and by the anti-competitive aspects of the agreements.

A. *The Misplaced IP Justification*

Perhaps the least examined and most problematic argument made in support of non-compete enforcement is the IP justification. Firms and courts regularly justify non-competes on the need to protect intellectual property (IP) or IP-like assets. The IP justification for non-competes is not necessarily wrong,[56] but it is certainly misplaced. Non-competes agreements are simply not a good tool for protecting IP rights. First, to the extent that non-compete agreements are used as a supplement or as an alternative to IP protection, we ought to be concerned that they might upset the balance struck by the IP regimes between protection and disclosure; between private rights and the public availability of inventions, information, and creations. Second, even if there is a need for additional protection, consistent with IP policy, non-competes are not the solution to that problem as they fail to address the public goods problem that IP rights are generally meant to solve. In this section, I demonstrate that the asserted need to protect intellectual property is the primary purpose for the use of non-competes, provide a brief background on the policies and goals of IP protection, and argue that non-competes fail to serve any of those goals and in some ways conflict with them.

1. The IP Justification for Non-Competes

There are at least two versions of the IP justification. Sometimes the justification is made explicitly.[57] Other times, the argument is im-

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56. That is, there may be a need for IP protection, but I argue in this Part that non-competes are not a good method of IP protection, particularly because the other effects of the agreements, on individual employees and the labor market, are so problematic. *See supra* Part I.

57. *See* Katherine Stone, *Knowledge at Work: Disputes Over the Ownership of Human Capital in the Changing Workplace*, 34 CONN. L. REV. 721, 746 (2002) [hereinafter Stone, *Knowledge at Work*] ("A court will not enforce a covenant if it is solely a means to restrain trade. Rather, the long-standing view has been that to be enforceable, a covenant not compete must protect an employer's interest in a trade secret or in other 'confidential information.'").

plicit or attenuated, but should be understood as another version of the IP justification. In any event, upon closer examination, it becomes obvious that non-competes are used primarily to protect IP or IP-like assets.

The explicit IP justification appears regularly and appears to be widely accepted and generally uncontroversial. It is often asserted that non-competition agreements are necessary for the protection of trade secrets and other forms of intellectual property.[58] Non-compete agreements regularly cite trade secrets or confidential information as the "protectable interest" sought to be guarded with the contract.[59] An agreement might state, for example: "I understand that this Section is not meant to prevent me from earning a living or fostering my career. It does intend, however, to prevent any competitive business from gaining any unfair advantage from my *knowledge of Proprietary Information*."[60] Proprietary information is defined quite broadly, but includes primarily intellectual property or IP-like intangibles.[61] Courts justify non-compete agreements by reference to the need to protect trade secrets.[62] State law sometimes makes explicit the connection. Colorado law, for example, provides that non-competes are unenforceable except in a few circumstances, one of which is a contract for the purpose of protecting trade secrets.[63] In California, notwithstanding a recent ruling reaffirming California's prohibition on non-competes,[64] firms continue to assert that such agreements are necessary to protect their trade secrets and that a common law "trade secrets" exception applies to the California rule.[65] And com-

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58. Although there is some dispute about this, trade secrets are generally deemed to be a form of intellectual property. On the varying descriptions of and justifications for trade secrets law, *see* Mark A. Lemley, *The Surprising Virtues of Treating Trade Secrets as IP Rights*, 61 STAN. L. REV. 311, 319-329 (2008) [hereinafter Lemley, *Surprising Virtues*]. Lemley argues "that trade secrets are best conceived as IP rights, and that, as IP rights, they work – they serve the basic purposes of IP laws." Lemley, *Surprising Virtues*, *supra* note 64, at 329. *See also* Bar-Gill & Parchomovsky, *supra* note __, at 1676 ("Despite their weak proprietary status, the protection afforded to trade secrets is broad and strong . . .).

59. *See, e.g.,* Comprehensive Technologies Int'l v. Software Artisans, Inc., 3 F.3d 730 (4th Cir. 1993) ("When an employee has access to confidential and trade secret information crucial to the success of the employer's business, the employer has a strong interest in enforcing a covenant not to compete because other legal remedies often prove inadequate.").

60. Note that this agreement acknowledges the tensions created by non-competes and asserts that it is not intended to be overly restrictive.

61. *See supra* note __.

62. *See* Nolo Press, *Noncompete Agreements: How to Create an Agreement You Can Enforce*, available at http://www.nolo.com/legal-encyclopedia/article-29784.html (last visited February 27, 2010) ("Use a noncompete agreement to prevent losing valuable trade secrets and employees.").

63. COLO. REV. STAT. § 8-2-113 (non-competes for the purpose of protecting trade secrets may be enforceable).

64. Edwards v. Arthur Anderson, 189 P.3d 285 (Cal. 2008).

65. *See, e.g.,* Dowell v. Biosense Webster, Inc., 179 Cal. App. 4th 564, 577 (Cal. Ct. App. 2009) ("Biosense argues that the [non-compete] clauses in the agreements are narrowly tailored to protect trade secrets and confidential information because they are 'tethered' to the use of confidential information, and are triggered only when the former employee's services for a competitor implicate the use of confidential information.) It should be noted that the non-compete agreements signed by these California employees contained New Jersey choice of law and consent-to-venue clauses. *Id.* at 568. The Court did not address these provisions or explain why it was applying California law.

mentators agree that employers regularly use non-competes to protect IP or IP-like assets.[66]

The Fourth Circuit provides a classic example in its opinion in *Comprehensive Technologies Int'l v. Software Artisans, Inc.*[67] In that case, CTI sued a former employee, Dean Hawkes for, among other claims, copyright infringement, trade secret misappropriation, and breach of a non-compete. As part of his termination agreement when he left CTI, Hawkes signed a one-year non-compete.[68] When Hawkes started a new, competing business before the expiration of the non-compete, CTI sued him (and others) for copyright infringement, trade secret misappropriation, and breach of the non-compete. The Fourth Circuit upheld the trial court's decision rejecting the copyright claim[69] and the trade secret claim,[70] on the grounds that there were no trade secrets and, even if there were, that they were not misappropriated. The court went on, however, to permit CTI to pursue its non-compete claim, stating that the non-compete was necessary in order to protect CTI's trade secrets and other confidential information.[71] In other words, the court accepted the IP justification despite concluding that the employer did not prevail on either IP claim! Thus, the IP justification may prevail even when untethered from trade secret or other intellectual property concerns.

A common corollary to this argument is that trade secret law on its own is too limited and thus insufficient to protect the employer's information.[72] In other words, it is easier to prevent an employee from work-

66. Arnow-Richman, *Delayed Term, supra* note 21, at 639 (concluding that employers regularly use standard-form agreements for, among other reasons, "augmenting their trade secret rights."). *See also* Michael V. Risch, *Comments on Trade Secret Sharing in High Velocity Labor Markets*, 12 Emp. Rts. & Emp. Pol'y J. 339, 340 n. 43 (2009); Estlund, *Between Rights, supra* note 18, at 416 ("Some non-competes – those that protect employers' trade secrets – may thus be justified as necessary to protect independently recognized employer rights.").

67. Comprehensive Techs. Int'l v. Software Artisans, 3 F.3d 730 (4th Cir. 1993) (rejecting the employer's trade secrets claim because of a lack of trade secrets but upholding the noncompete on the basis of protecting trade secrets and other confidential information). I call this a classic example because it is one that has been used by regularly in discussions of non-competes. *See, e.g.,* Rachel S. Arnow-Richman, *Bargaining for Loyalty in the Information Age: A Reconsideration of the Role of Substantive Fairness in Enforcing Employee Noncompetes,* 80 OR. L. REV. 1163, 1184 (2001); ROBERT P. MERGES, PETER S. MENELL, AND MARK A. LEMLEY, INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE 96 (5th ed. 2010).

68. CTI v. Software Artisans, 3 F.3d at 733-34.

69. Id. at 735.

70. Id. at 737.

71. Id. at 739 ("When an employee has access to confidential and trade secret information crucial to the success of the employer's business, the employer has a strong interest in enforcing a covenant not to compete because other legal remedies may prove inadequate . . . On the facts of this case, we conclude the scope of the employment restrictions is no broader than necessary to protect CTI's legitimate business interests.").

72. Arnow-Richman, *Dilution*, *supra* note __, at 983 n. 71 ("Indeed, it is widely assumed by lawyers that noncompetes can provide additional protection for intellectual property interests beyond what is afforded under common law."). *See, e.g.,* Stone, *Knowledge at Work, supra* note __, at 747 ("The historical link between noncompete covenants and trade secrets is somewhat paradoxical because disclosure of trade secrets and confidential information can be restrained in the absence of a covenant. However, it has been argued that, for procedural reasons, it is difficult to obtain enforce-

ing for Company X than it is to ensure that particular kinds of information will not be leaked from the employee's head to the new employer.[73] Employers thus use non-competes in part "to provide an extra layer of protection . . ."[74] For example, attorneys advise clients to use non-competes to "identify and correct potential holes in their trade secrets protection strategies."[75] A World Intellectual Property Organization commentary on "Trade Secrets and Employee Loyalty" has a subsection titled "Employees are the Biggest Threat" and suggests that contracts, including non-competition agreements, may be desirable because they "enhance legal protection of trade secrets."[76]

Even when the IP justification is not explicit, it is often implicit. Many justifications for non-competes are not framed in terms of IP protection, but they involve efforts to protect "confidential information," investments in "human capital," "proprietary information," and the like. Moreover, many argue that non-competition agreements are necessary to provide firms an incentive to invest in the training of employees and to encourage disclosure of information to employees that increases the efficiency and productivity of the firm. Sterk, for example, argues that non-compete enforcement is necessary to "assur[e] that employees acquire optimal levels of information and client contact."[77] "Confidential infor-

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ment of a trade secret, so that a restrictive covenant provides employers with important additional protection.").

73. Risch, *supra* note __, at 340 n.43 (2009) (With trade secret law "[e]mployers must prove that ex-employees misappropriated information . . . which is more difficult than simply proving that they are competing.").

74. Estlund, *Between Rights, supra* note __, at 416.

75. This language is from Seyfarth Shaw's website: http://www.seyfarth.com/index.cfm/fuseaction/practice_area.practice_area/practice_area.cfm (follow "Trade Secrets, Computer Fraud & Non-Competes" hyperlink) (last visited Feb. 24, 2010) (listing for strategies for compensating for the "holes" in trade secret protection). See also the Frost, Brown, Todd website: http://www.fbtemployerlaw.com/lande/ncts/NewsDetail.aspx?newsShortId=355 (last visited February 24, 2010) (indicating that non-competes may be the "best of all worlds" for a variety of reasons, including that other methods of protection, including non-disclosure agreements do not prevent the "competitive damage" from occurring). One Minnesota attorney stated, with respect to non-competes: "The nature of the modern economy means companies have to be service-oriented and idea-oriented, and many smaller companies are seeing the need to protect those ideas any way they can." Laurie & Laurie P.A. website: http://laurielaurie.com/noncompetes1.pdf (last visited February 11, 2010).

76. World Intellectual Property Organization website, available at http://www.wipo.int/sme/en/documents/trade_secrets_employee_loyalty.html (last visited February 24, 2010).

77. *See, e.g.,* Rubin & Shedd, *supra* note __, at 93 ("In particular, restrictive covenants were and are necessary in some circumstances to lead to efficient amounts of investment in human capital."). *See also* Sterk, *supra* note __, at 394 ("Long-term contracts, enforceable by restrictive injunction, provide a mechanism for insuring against such losses and thus for assuring that employees acquire optimal levels of information and client contact.") This argument focuses on the enforcement of and remedies for breach of employment contracts. It is unclear to me, however, that employers are interested in entering into long-term employment contracts with many employees. I have no beef with the contention that long-term contracts might well encourage optimal investment in employees and optimal disclosure of information to employees. I am not certain, however, that the argument translates perfectly to enforcement of noncompetes. Moreover, Sterk's assumptions do not, I think, apply broadly. It may well be true that "a legal regime that allows employers to use anticompetition covenants to reduce the risk that employees will breach long-term contracts operates

mation" and the like refer to intangible assets (as opposed to the tangible assets of a firm, such as computers or factories and so on), and it is intangibles that the IP regimes are designed to address. In addition, the incentive arguments are classic justifications for the grant of IP rights. These arguments for non-competes should thus be understood as another version of the IP justification.

2. Intellectual Property Policy

Given that both state and federal law provide for a variety of mechanisms for protecting intangibles, the IP justification for non-competes deserves much closer scrutiny than it has previously received. And to evaluate this justification, we must turn to IP law. Only by looking to the purposes of intellectual property protection can we determine whether and to what extent the IP justification for non-competes is persuasive.

Because the most common form of the IP justification refers to the limitations of trade secret law, I focus on that here. However, firms' IP and IP-like assets may be protected in a variety of ways, and employers have a number of legal mechanisms to protect against competition from former employees. Trade secrets are protected through a separate body of law: the Uniform Trade Secrets Act has been adopted by 45 states (and the U.S. Virgin Islands and the District of Columbia)[78] and operates generally to provide penalties for the misappropriation of trade secrets, as defined by the Act.[79] Patent and copyright law provide relatively robust protection for inventions and creations[80] (and employers tend not to argue that non-competes are necessary to protect their patents and copyrights). In addition, although state law obviously varies, employees generally have common law duties of confidentiality and loyalty;[81] even if information is not deemed a trade secret, an employee may not disclose confidential information of the employer.[82] Employees may not compete with their employers during the term of employment, though they may prepare to compete while employed and then compete following termination of the employment relationship (in the absence of a non-compete agreement, of course).[83] Moreover, a variety of contractual mechanisms exist to reinforce these common law duties: nondisclosure and confiden-

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to encourage optimal investment in employees." Sterk, *supra* note __, at 395. Most employment, however, is at will.

78. Uniform Law Commissioners, http://www.nccusl.org/Update/uniformact_factsheets/uniformacts-fs-utsa.asp (last visited February 24, 2010).

79. *See* U.T.S.A. §§ 1-4.

80. *See, e.g.,* Bar-Gill & Parchomovsky, *supra* note __, at 1672-1681 (discussing the role of patent law and copyright law in promoting and governing innovation).

81. RESTATEMENT (SECOND) OF AGENCY § 387 (1958)

82. Id.

83. Jet Courier Service v. Mulei, 771 P.2d 468, 492-93 (Colo. 1989).

tiality agreements are widely used and unquestionably enforceable.[84] Even with this briefest of overviews, it should be clear that employers are not without legal mechanisms for protecting their intangible assets and protecting against "unfair competition" from former employees.[85] It is from this perspective that the IP justification should be evaluated.

The primary justifications for granting intellectual property rights are the desire to provide an incentive to invent and create and an incentive for disclosing those inventions and creations.[86] The conferral of IP rights by the state is deemed necessary because intellectual assets are public goods; once they are disclosed they are nonrivalrous and nonexcludable – that is, once they exist, all may use them without affecting anyone else's enjoyment of them and access to them is difficult to restrict.[87] The concern is that in the absence of legal protection, insufficient investment will be made in the creation or invention of intangibles.[88] Thus the grant of property-like rights is thought necessary to encourage creation of those "goods."[89] This protection is expressly utilitarian: rights are granted to the extent that the benefits exceed the costs.[90] The utilitarian approach entails an attempt to confer only the type and strength of rights sufficient to encourage invention or creation and dissemination, and no more.[91]

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84. *See, e.g.,* IDX Systems Corp. v. Epic Systems Corp., 285 F.3d 581, 585 (2002) (holding that the reasons for limiting enforcement of non-competes do not apply to confidentiality agreements).

85. The law generally attempts to distinguish between "fair" and "unfair" competition. The cases distinguishing "preparing to compete" from "competing," for example, seek to draw that line. *See generally* Scott W. Fielding, *Free Competition or Corporate Theft?: The Need for Courts to Consider the Employment Relationship in Preliminary Steps Disputes*, 52 VAND. L. REV. 201, 206-07 (1999).

86. Lemley, *Surprising Virtues*, *supra* note __, at 329 (stating that IP rights "promote inventive activity and they promote disclosure of those inventions.").

87. *See* Merges, Menell & Lemley, *supra* note __, at 11-14 (discussing nonexcludability and nonrivalrousness).

88. *See* Lemley, *Surprising Virtues, supra* note __, at 329 (By providing exclusive rights, "patents and copyrights are generally acknowledged to serve a utilitarian purpose – the grant of that legal control encourages the development of new and valuable information by offering the prospect of supracompetitive returns, returns possible only if the developer does not face competition by others who use the same idea. In this way, patents and copyrights avoid the risk of underinvestment inherent with public goods, which are more costly to invent than imitate once invented."). For a more in-depth discussion of this issue, *see* Mark A. Lemley, *The Economics of Improvement in Intellectual Property Law*, 75 TEX. L. REV. 989, 993-1000 (1997).

89. Burk & McDonnell, *supra* note __, at 583 (". . . . private individuals will generally lack incentives to produce an adequate level of public goods. A key point of intellectual property is to help lessen the public good nature of new ideas by giving creators the ability to legally exclude others from using the ideas.").

90. *See* Barnett, *supra* note __, at 1699-1700 ("Virtually all students learn, many academic commentaries repeat, and countless judicial opinions state that stronger or weaker intellectual property always involves an unavoidable tradeoff between increasing innovation incentives (and resulting innovation gains), which result from stronger intellectual property, and reducing access costs, which result from weaker intellectual property.").

91. *See, e.g.,* Dan L. Burk and Brett H. McDonnell, *The Goldilocks Hypothesis: Balancing Intellectual Property Rights at the Boundary of the Firm*, 2007 U. ILL.L. REV. 575, 577 (considering a variety of forms of IP protection and arguing "that intellectual property rights that are improperly

For example, when a company seeks a patent for a new invention, the patent right operates as an incentive for the invention. In the absence of a patent right, we are concerned that companies or individuals will not invest in the research and development that leads to innovation, and we are concerned that the innovations will not be disclosed to the public. Thus we grant a patent right, even though it is a form of monopoly, to encourage the invention and its disclosure to the public.[92] Patent rights are relatively strong, providing a right to exclude for twenty years in exchange for disclosure to the public and the injection of the invention into the public domain once the patent term expires. Similarly, copyright law involves an effort to encourage the creation and dissemination of original expression, providing a long term of protection, but a fair number of exceptions and defenses that allow for various kinds of public uses.[93] Trade secrets law differs from patent and copyright in that it is state rather than federal law. It operates as an alternative or a supplement to the federal protections for intangibles, protecting all kinds of "valuable" and "secret" information.[94]

Broadly speaking, patent, copyright, and trade secret law each have their own internal balancing mechanisms (the strength of the rights granted versus the number and type of defenses, for example). The proper balance within each of the IP regimes is, of course, a matter of great dispute, but few would disagree that the IP regimes seek to find this balance.[95] Barnett describes the conventional wisdom concerning this

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calibrated, that are either too strong or too weak, will lead to inefficient firm and market structures."). *See also* Andrea Fosfuri and Thomas Ronde, *High-Tech Clusters, Technology Spillovers, and Trade Secrets Law,* available at http://www.krannert.purdue.edu/centers/ijio/Accepted/2200.pdf (last visited February 24, 2010) (concluding that "[t]rade secret protection based on punitive damages is, except in some extreme cases, beneficial for firms' profits, stimulates clustering, and is not an impediment to technology spillovers.").

92. *See* Graham v. John Deere Co., 383 U.S. 1, 9 (1966) (noting Thomas Jefferson's recognition of the difficulty of "drawing a line between the things which are worth to the public the embarrassment of an exclusive patent, and those which are not"), quoting letter from Thomas Jefferson to Isaac McPherson (Aug. 13, 1813), reprinted in 6 *Writings of Thomas Jefferson* 181 (H.A. Washington ed., New York, John C. Riker 1857).

93. 17 U.S.C. § 106 (rights of copyright owners) and § 107 (fair use).

94. U.T.S.A. § 4 (defining a trade secret as "information" that "derives independent economic value . . . from not being generally known to, and not being readily ascertainable by proper means by, other persons . . ."). On the differing and inconsistent justifications for trade secret law, *see* Mark Lemley, *Surprising Virtue*, *supra* note __, at 331 (". . . the additional incentive provided by trade secret law is important for innovation.").

95. Bonito Boats, Inc. v. Thunder Craft Boats, Inc., 489 U.S. 141, 146 (1989) ("From their inception, the federal patent laws have embodied a careful balance between the need to promote innovation and the recognition that imitation and refinement through imitation are both necessary for invention itself and the very lifeblood of a competitive economy."). *See also* Burk & McDonnell, *supra* note __, at 577 (positing a "'Goldilocks hypothesis' for intellectual property rights and the firm: like the size of a chair, the temperature of a porridge, or the firmness of a mattress, the provision of intellectual property rights should not vary too far to one extreme or another, but must be calibrated so that it is 'just right.'"). *But see ,e.g.,*,Edmund W. Kitch, *The Nature and Function of the Patent System*, 20 J.L. & ECON. 265, 290 (1977) (advocating relatively strong patent rights;

utilitarian approach: "This tradeoff assumes that more intellectual property generates social harm by reducing access to intellectual goods, but generates social benefits by enhancing anticipated profits and thereby enhancing innovation incentives. Conversely, less intellectual property generates social benefits by expanding access to intellectual goods but generates social harm by reducing anticipated profits and thereby reducing innovation incentives. Hence, the policy challenge lies in setting intellectual property coverage so as always to yield a net social gain."[96] Some argue for stronger IP rights while others contend that we have gone too far in terms of, for example, patent rights or copyright protection.[97]

It is also generally understood that the IP regimes do not operate in isolation.[98] Rather, the protections provided by each must be understood in terms of, and balanced against, the others. For example, and most pertinent here, some of the contours of trade secret law have developed and been interpreted by reference to other forms of IP protection. Taking this broader view, certain kinds of intangibles – valuable inventions that are self-disclosing, for example – are channeled to the patent system, which allows for, among other things, public disclosure of inventions.[99] Some inventions that are not patentable may be protected by other forms of legal protection, but some may receive no protection at all, as a matter

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"defined property rights in information significantly lower the costs of transactions concerning such information").

96. Barnett, *Is Intellectual Property Trivial?*, 157 U. PA. L. REV. 1691, 1693-94 (2009) (describing the standard explanation for the conferral of IP rights). Barnett argues, however, that IP rights don't tell the whole story. Instead, to understand and evaluate the IP regimes, one must look to nonproperty forms of protection as well. Id. at 1693 ("firms generally can – and *do* – exploit devices *other* than intellectual property to limit access to, and thereby appropriate returns from, innovation investments. Hence, intellectual goods that are unprotected by intellectual property may still be protected directly or indirectly by other legal or extralegal mechanisms, which broadly include technology, contract, organizational form, and various complementary assets.").

97. Lawrence Lessig, FREE CULTURE: HOW BIG MEDIA USES TECHNOLOGY AND THE LAW TO LOCK DOWN CULTURE AND CONTROL CREATIVITY xvi (2004) ("But just as a free market is perverted if its property becomes feudal, so too can a free culture be queered by extremism in the property rights that define it. That is what I fear about our culture today. It is against that extremism that this book is written.").

98. *See* Viva R. Moffat, *Mutant Copyrights and Backdoor Patents: The Problem of Overlapping Intellectual Property Protection*, 19 Berk. Tech. L.J. 1473, 1512 (2004) (arguing that "overlapping protection disrupts the federal intellectual property system, frustrates the patent and copyright bargains, and meddles with the incentive structures.").

99. *See* Lemley, *Surprising Virtues, supra* note __, at 341 ("Taken together, the secrecy requirement and the relative weakness of the trade secret law help ensure that the law protects those who would otherwise rely on secrecy without law, and encourages disclosure in those cases, while not displacing patent law as the means of protection for self-disclosing inventions. Put another way, the secrecy requirement channels particular inventors to the form of IP protection that best achieves the goals of society."). Merges, Menell, Lemley, *supra* note __, at 82 ("Reverse engineering may be explained as a legal rule designed to weaken trade secret protection relative to patent protection."). This is the theory, at least. It is an empirical question whether the weakness of state law actually propels inventors to the patent office. There is some reason to think that inventors may at times prefer trade secret protection even for patentable inventions. *See* Sharon K, Sandeen, Kewanee *Revisited: Returning to First Principles of Intellectual Property Law to Determine the Issue of Federal Preemption,* 12 MARQ. INTELL. PROP. L. REV. 299 (2009).

of public policy. For example, an invention that is not "novel" for the purposes of patent law is deemed part of the public domain and free for all to copy.[100]

This has been most clear in cases discussing the relationship between trade secret law and patent law. In *Kewanee v. Bicron*,[101] the Supreme Court held that Ohio's trade secret law was not preempted by federal patent law, emphasizing the narrowness of the state law.[102] If trade secret law were to provide more robust protection, by, for example, prohibiting reverse engineering or protecting against independent invention, under the reasoning in *Kewanee* it would likely be preempted because it would be too similar to the protections provided by federal patent law. "The Court reasoned that there was 'remote' risk that holders of patentable inventions would choose trade secret protection because trade secret law provides far weaker protection than patent protection . . ."[103] Trade secret doctrines – in particular the rule permitting reverse engineering – thus serve a channeling function, directing some inventions to the patent regime, some to trade secret protection, and acknowledging that some kinds of inventions are simply unprotectable. In other words, the specific contours of trade secret law are part of the utilitarian effort to balance the rights afforded in intangibles with the benefit to the public.

The channeling function provided by some aspects of trade secret law is not an anomaly. A variety of IP doctrines are deemed to be channeling rules, directing protection to one regime or the other, or to the public domain. Copyright law's useful article doctrine provides that "useful articles" may not be copyrighted because such items belong in the patent realm (or the public domain).[104] Similarly, trademark's functionality doctrine dictates that "functional" marks may not be protected by the trademark regime because to allow such protection would be, in essence, a backdoor patent achieved without satisfying the rigors of a patent examination.[105] A variety of subject matter rules perform similar channeling functions as well.[106] Just as there are disputes about the

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100. *See, e.g.,* Aronson v. Quick Point Pencil Co., 440 U.S. 257, 257 (1979) (one purpose of the patent system is "to assure that ideas in the public domain remain there for the free use of the public.").

101. Kewanee Oil Co. v. Bicron Corp., 416 U.S. 470 (1974).

102. The Court pointed out that Ohio's trade secret statute provided a cause of action only when there has been improper use of the trade secret under circumstances in which a duty existed not to so misuse the trade secret. Kewanee, 416 U.S. at 475-76. The Court also discussed the various circumstances in which discovery of a trade secret does not constitute misappropriation: independent invention, accidental disclosure, and reverse engineering. Id. at 476. The Court appears to have relied on the very weakness of trade secret law in determining that it could co-exist with federal patent law. For a thorough discussion of *Kewanee* and the relationship between state trade secret law and federal patent law, *see* Sandeen, *supra* note __, at 324-25.

103. Sandeen, *supra* note __, at 324-25.

104. Brandir Int'l Inc. v. Cascade Pac. Lumber Co., 834 F.2d 1142 (2d Cir. 1987).

105. TrafFix Devices, Inc. v. Marketing Displays, Inc., 523 U.S. 23 (2001).

106. Copyright's idea/expression dichotomy is one example. *See* Baker v. Selden, 101 U.S. 99 (1879) ("To give to the author of the book an exclusive property in the art described therein, when

proper balance within any one area of protection, one may of course dispute the proper balance between trade secret law and patent law, for example, or between copyright law and patent law, but there is no doubt that attempting to find this balance is fundamental to the intellectual property regime. In other words, one cannot evaluate any particular IP doctrine in a vacuum; some attention must be given to the broader picture. So, to the extent that non-competes are justified as a form of IP protection, that claim must be evaluated in light of the IP policy and other forms of IP protection.

3. Non-Competes Fail as an IP Tool

Employment law scholars have explicated a host of concerns about non-competes in the context of the employment relationship.[107] Viewed as an effort to protect IP, non-competes look even more problematic. Reviewing the variety of mechanisms that can be used to protect intangible firm assets, it becomes clear that using non-competes is part of a "belt-and-suspenders" approach to IP protection. This approach relies on the assumption that more protection is always necessary and better, but this assumption is faulty. First, it simply may not be true. As many observers have understood and described, upstream rights can inhibit downstream innovation. Second, as described above, private gain is not the primary purposes of providing IP protection. Instead, providing a sufficient, but not excessive, incentive to invent and create is the goal. Given this, the contours of trade secret and other IP protections make some sense, and the IP justification for non-competes starts to make no sense.

First, assuming that the existing IP regimes are proper and adequate, the use of non-competition agreements is likely to interfere with that system. In other words, IP law is in some ways *intentionally* limited. Indeed, if anything that was not protected by patent law (or copyright law) could be protected by some other mechanism, the balance struck by the federal IP statutes between protection and availability and between secrecy and disclosure would be destroyed.[108] There would be no reason for inventors or creators to go through the costly and expensive process of obtaining a patent. The Supreme Court's preemption jurisprudence in the IP area (conflicting and unsatisfactory though it is) recognizes as

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no examination of its novelty has ever been officially made, would be a surprise and a fraud upon the public. That is the province of letters-patent, not of copyright."). Patent law's refusal to protect abstract ideas is another example. Funk Bros. See Co. v. Kalo Inoculant Co., 333 U.S. 127, 130 (abstract ideas are "manifestations of . . . nature, free to all men and reserved exclusively to none."). Trade secret's requirement of secrecy performs a channeling function as disclosure is required in order to obtain a patent; thus an inventor must make an election between the two regimes.

107. *See supra* Part I.

108. Goldstein v. California, 412 U.S. 546, 559 (1973) (" . . . a conflict would develop if a State attempted to protect that which Congress intended to be free from restraint or to free that which Congress had protected.").

much.[109] Trade secret law plays a role in this balancing act. The contours of trade secret law perform a channeling function, directing some kinds of inventions to the patent system and others to the purview of state trade secret law – or to no protection at all. If non-competes are permitted to fill this state law hole, even partially, the channeling function performed by trade secret law is undermined.[110] A refusal to enforce non-competes would recognize that some of the limitations of trade secret law ought not to be remedied. It would, in other words, perform a channeling function of its own. The argument that non-competes are necessary as an alternative to or to supplement trade secret rights, then, collapses if the "weakness" in trade secret law is intentional, operating to direct certain inventions to the patent realm or dictating that the item not be protectable.

Even to the extent that trade secret law is *unintentionally* or improperly weak, the IP justification for non-competes is unpersuasive. If trade secret protection is insufficient on its own terms and within the larger scheme for protecting IP (that is, if it fails to achieve what it seeks to achieve), the solution to that problem lies more properly with the areas of law directed at protecting intangibles – trade secret law, non-disclosure agreements, duties of loyalty and confidentiality, doctrines governing the ownership of human capital – than with non-competition agreements. With this understanding, a refusal to countenance non-competes would serve a different kind of channeling function, encouraging development of trade secret law, whereas the continued use of non-competes discourages changes in trade secret (and other) law that might more effectively serve the IP justification.

The reason that the IP justification fails even when IP protection is deemed insufficient is that non-competes are simply not a good tool for addressing the purposes of IP protection. In other words, assuming that there is a need for a greater incentive to produce and invest in and dis-

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109. The Court is not entirely consistent in this regard, but overall the preemption cases make clear that the IP regimes cannot be viewed in isolation. While in *Kewanee* the Court stated that "the patent policy of encouraging invention is not disturbed by the existence of another form or incentive . . ." Kewanee, 416 U.S. at 484, the opinion also points to the limitations of trade secret law in reasoning that there is no conflict. And in other cases, the Court has struck down state laws as interfering with the incentive function provided by federal patent law. *See, e.g.,* Sears, Roebuck & Co. v. Stiffel Co., 376 U.S. 225, 232-33 (1964) ("But because of the federal patent laws a State may not, when the article is unpatented and uncopyrighted, prohibit the copying of the article itself or award damages for such copying. The judgment below did both and in so doing gave Stiffel the equivalent of a patent monopoly on its unpatented lamp."); Compco Corp. v. Day-Brite Lighting, Inc., 376 U.S. 234, 237 (1964) (For a state to "forbid copying would interfere with the federal policy, found in Art. I, s 8, cl. 8 , of the Constitution and in the implementing federal statutes, of allowing free access to copy whatever the federal patent and copyright laws leave in the public domain."); Bonito Boats Inc. v. Thunder Craft Boats, Inc., 489 U.S. 141 (1989) (preempting a Florida statute that prohibited copying of unpatented boat hulls).

110. Non-competition agreements are, of course, not a perfect substitute for a state-granted intellectual property right, and I do not contend that they serve the same function. The point is that to the extent that they are intended to protect intellectual property, one must look to the IP regimes to evaluate that justification.

close intangible, IP-like assets, non-competes are unlikely to provide that incentive (in addition to being so problematic from the employee perspective). First, they operate in bluntly and only indirectly to provide an incentive and to protect IP-assets. Second, the empirical work that has been done so far on the effects of non-competes on innovation indicates that the agreements simply do not provide much, if any, incentive to justify them on a utilitarian basis. Instead, studies indicate that firms may be better off overall under a regime in which non-competes are unenforceable.

As a method for protecting IP, non-competes work only indirectly. They are, in short, a "backdoor" – and therefore inappropriate – method of trade secret protection because contract law generally is not a good tool for addressing the concerns implicated by the IP justification.[111] IP rights operate against the world, while contract rights do not. Non-competes in particular do not address the public goods problem very well because they do not seek to control the *thing* we seek to incentivize. Rather, non-competes use control over people as a proxy for controlling *things.* A non-compete restricts not the use of a good or an invention, but the labor of the creator. Put simply (and borrowing the terminology from Matt Marx), non-competition agreements regulate the *inputs* to creation and invention, whereas IP rights regulate the inventive or creative *outputs.* [112] Because non-competes regulate the inputs to invention and creation, they are a blunt instrument for the IP task. As described in detail above,[113] there are a variety of collateral problems involved in enforcing non-competes: restrictions on employee mobility, broader effects on the labor market, and so on. Oddly, then, non-competes are both too broad, given their problematic aspects, but perhaps also too narrow – because they do not operate as rights against the world – if in fact there is an insufficient incentive for the kinds of intangibles employers seek to protect with non-compete.

This theoretical argument about the misfit between the IP justification and non-competes is buttressed by the empirical work that has been done on non-competes. The studies – limited though they are – indicate that non-competes simply may not provide much of an incentive to innovate and perhaps do not contribute to overall economic development.

The IP justification, and the related "business necessity" justification discussed below, must be based on the assumption that a firm is like-

111. It can, on the other hand, be very effective for the efficient transfer of IP rights.

112. Marx describes this as follows: In the case of IP rights, "the deadweight loss is often rationalized *ex ante* in that the good never would have been invented in the first place if not for the promise of a non-zero monopoly price. In the case of non-compete agreements, however, the deadweight loss bears a less direct relationship to the incentive to invest because . . . non-competes restrict access to the *inputs* of the innovative process instead of the *outputs.*" Marx, *supra* note __, at 48 (emphasis added).

113. *See supra* Part I.

ly to be harmed, presumably in terms of its growth, profitability, or productivity, if it cannot impose non-competes on its employees. This is another version of the incentive argument: there will not be sufficient investment in the absence of this form of protection. There is, however, some evidence that these assumptions do not hold up, and that, in fact, the free mobility of labor contributes to economic development of firms and to increased innovation because of the knowledge spillovers created by employees moving from one employer to another. Some studies do indicate that there are costs to firms associated with these knowledge spillovers (that is, that employers lose something when employees leave for a competing firm), but that those costs are outweighed by the benefits conferred by the spillovers received from other firms and the increased productivity of employees. Therefore, it may be that a firm's incentives to invest in employees to disclose information to employees and to innovate is not sharply reduced by a legal regime in which non-competes are unenforceable.[114] This evidence undermines – if it does not completely destroy – the IP and general "legitimate business need" justifications for the enforceability of non-competition agreements.

In a well-known study comparing Silicon Valley in California with Route 128 in Massachusetts, two prominent high tech areas, AnnaLee Saxenian describes the divergent performances of the two regions: In 1965, Route 128 firms employed roughly three times as many people in the technology sector, but by 1990, Silicon Valley companies had many more people employed in that sector than Route 128.[115] Saxenian concludes that Silicon Valley's "culture of mobility" explains a great deal of the differential performance between the two industrial districts.[116] According to Saxenian, the transfer of knowledge by employees moving from one firm to another is conducive to technological innovation and economic growth.[117] In her view, Silicon Valley's "efficiency advantage,

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114. *See* O'Malley, *supra* note __, at 1230 ("The positive economic impact of employee mobility may suffice to override any policy concerns regarding the protection of an employer's interest in retaining its employees.").

115. ANNALEE SAXENIAN, REGIONAL ADVANTAGE: CULTURE AND COMPETITION IN SILICON VALLEY AND ROUTE 128, 3 (1994). *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, 587 (1999) ("In 1995, Silicon Valley reported the highest gains in export sales of any metropolitan area in the United States, an increase of thirty-five percent over 1994; the Boston area, which includes Route 128, was not in the top five.").

116. Saxenian, *supra* note __, at 128. Other research supports Saxenian's conclusion. *See, e.g.,* RICHARD GORDON, INNOVATION, INDUSTRIAL NETWORKS, AND HI-TECH REGIONS, IN INNOVATION NETWORKS: SPATIAL PERSPECTIVE (R. Camagni, ed., 1991) (arguing that employee mobility leads to increased innovation and economic growth because of the transfer of information among firms); *see also* Richard C. Levin, *Appropriability, R&D Spending, and Technological Performance,* 78 AM. ECON. REV. 424 (1988) (suggesting that information spillovers between firms do not negatively affect spending for research and development). There is no consensus on this issue, of course. Some have asserted that there can be *too much* employee mobility, arguing that employee mobility is beneficial to individuals but imposes costs on the economy as a whole. RICHARD L. FLORIDA & MARTIN KENNEDY, THE BREAKTHROUGH ILLUSION: CORPORATE AMERICA'S FAILURE TO MOVE FROM INNOVATION TO MASS PRODUCTION 91 (1990).

117. Saxenian, *supra* note __, at 34-37.

and the resulting performance gap" with Route 128 is attributable to differences between the business cultures in the two regions.[118] Notably, employees in California were significantly more mobile, changing jobs much more frequently, than employees in the Route 128 area.[119] Some have called this "high velocity" employment.[120]

In a 1999 article building on Saxenian's work, Ronald Gilson attributes Silicon Valley's high rates of employee mobility and Route 128's relatively lower rate to, most significantly, the difference in the two state's approach to non-competes.[121] Gilson describes the different legal rules – non-competes unenforceable in California, enforceable generally in Massachusetts – as providing for a "natural experiment"[122] the results of which he presents as quite clear: "Because California does not enforce post-employment covenants not to compete, high technology firms in Silicon Valley gain from knowledge spillovers between firms. These knowledge spillovers have allowed Silicon Valley firms to thrive while Route 128 firms have deteriorated."[123] Gilson concludes that the legal rule in California invalidating covenants not to compete was one of the operative mechanisms in increasing economic development and innovation in California. There is increased employee mobility in the absence of enforceable non-competes so that knowledge "spills over" to competing firms, leading to increased economic returns and innovation.[124]

The California rule concerning non-competes is crucial in this story because it solves a collective action problem.[125] According to Gilson, "[w]hile it would be in the interest of the region's firms collectively to facilitate employee mobility even at the expense of diluting the intellectual property of individual firms, it will be in the interest of any individual firm to impede the mobility of its own employees."[126] In other words, when non-competes are enforceable, firms will use them in an

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118. Gilson, *supra* note __, at 578.

119. Saxenian, *supra* note __, at 34 (In Silicon Valley, "engineers shifted between firms so frequently that mobility not only was socially acceptable, it became the norm.")

120. *See* Gilson, *supra* note __, at 591(defining "high velocity labor markets" as those with "rapid employee movement both between employers and in connection with founding start-ups").

121. Id. at 578. Gilson describes this as an "alternative explanation" though it seems to me entirely consistent with Saxenian's explanation. In fact, Saxenian herself pointed to the differential rules concerning non-competes as one of the factors influencing employee mobility and the resultant knowledge spillovers. Saxenian, *supra* note __, at __.

122. Gilson, *supra* note __, at 578.

123. Id. at 575. *See also* Pivateau, *supra* note __, at 692 (Because of non-competes, "employers may be deprived of access to well-trained employees, even those subject to otherwise unenforceable agreements.").

124. Gilson, *supra* note __, at 579 ("Knowledge, especially tacit knowledge, 'spills over' between firms through the movement of employees between employers and to start-ups.")

125. The rational actor argument would be that if knowledge spillovers brought about by employee mobility are value-enhancing, "[i]ndividual firms acting in their own self-interest will elect not to interfere with employee mobility . . ." Gilson, *supra* note __, at 595. This standard account does not, however, take account of the collective action problem.

126. Id. at 596.

individually rational but collectively irrational way. Gilson concludes that the California rule against the enforcement of non-competes serves a coordinating function, "solv[ing] the collective action problem associated with encouraging knowledge spillover through employee mobility."[127] According to Gilson, there is a causal connection in this case between the legal rule (non-competes unenforceable) and the high velocity employment in Silicon Valley, and it is high velocity employment that has led to better outcomes for the region as a whole.[128]

Gilson's view that that firms do not necessarily act irrationally, on an individual basis, in imposing non-competes is confirmed by some recent studies on non-competes. There are some demonstrated benefits for firms in binding its employees to non-competition agreements. They are more likely to retain employees (which is related to the employee mobility point discussed in Part __ above),[129] lower wages (which is related to the bargaining & consideration point made above in part ___), and reduced competition from others in the market. Notably, each of these is the flip side of the arguments against the enforceability of non-competition agreements. The benefits to individual firms appear to come at the cost of some other interest: employee mobility, commercial exchange, a competitive marketplace. As Gilson and others point out, this individual rationality may be collectively counter-productive. The evidence indicates that industrial sectors as a whole experience more growth and development when the legal regime prohibits non-compete enforcement. In such a situation, legal intervention makes sense.

Recent studies also support Gilson's conclusion that it is collectively irrational for firms to use non-competes, and these studies ought to be particularly persuasive to policymakers.[130] In another study based on the Michigan "natural experiment," Matt Marx, Jasjit Singh, and Lee Fleming conclude that non-competes play a role not just "within a region but *across regions* as well – with harmful implications where the use of such contracts is sanctioned."[131] They describe their findings in rather stark terms: "non-competes contribute to a 'brain drain' of the most valuable knowledge workers from regions that enforce them to those that

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127. Gilson, *supra* note __, at 579-80.

128. Id. at 596-97 ("the regime of high velocity employment appears to have resulted from the legal infrastructures' failure to provide complete protection for an important category of intellectual property.").

129. *See supra* note__.

130. *See, e.g.,* Fosfuri & Ronde, *supra* note __, at 22 ("A system of trade secret protection based on covenants not to compete or the possibility to seek an injunctive relief behave quite differently from one based on punitive damages. Indeed, stronger protection does not affect clustering. Instead, it prevents technology spillovers from arising when firms locate in the same region. In this sense, our model provides some support to Gilson's claim that the lack of enforceable covenants not to compete has spurred labor mobility and innovation in Silicon Valley.").

131. Matt Marx, Jasjit Singh & Lee Fleming, *Regional Disadvantage? Non-Compete Agreements and Brain Drain,* 2 [hereinafter Marx, et. al., *Regional Disadvantage*] *available at:* http://portale.unibocconi.it/wps/allegatiCTP/MarxSinghFleming2009.pdf (last viewed Feb. 24, 2010).

do not, driving away those with higher levels of human and social capital while retaining those who are less productive or connected. Over time, this process contributes to the accumulation of elite inventors in regions that prohibit enforcement."[132] The empirical work on non-competes thus demonstrates that in a variety of ways, non-compete agreements impose substantial costs and little demonstrated benefit.

Above, I have described the strong version of this argument: a legal rule permitting the enforcement of post-employment restraints hampers the economic development of firms and the regions in which those firms operate. The studies done to date have focused on just a few jurisdictions and on certain sectors of the economy. Virtually all of the studies have focused on higher-wage employees and on the technology sector. Even taking these limitations into account, however, it remains significant that no studies have concluded that non-competes are pro-competitive or substantially assist firms in protecting their assets. But even if one is unwilling to accept the strong version of the argument, the weak version undermines the IP justification. The weak version is that the rule against enforcement of non-competes does not hurt firms, at least not significantly, and is not, on balance, inefficient. Even in its weak form, this argument demonstrates the flimsiness of the incentive or "business interest" justification.

The notion that *less* protection – in this case, the unenforceability of non-competes – increases both economic growth and innovation contradicts some standard law and economics arguments about intellectual property assets. That argument proceeds as follows: "In the absence of complete protection, producers will not capture all of the gains resulting from their efforts, and too little intellectual property will be produced."[133] Similar arguments are made with respect to investments in "human capital." There is concern, for example, that "without some assurance that employees will perform long-term employment contracts, employers might well underinvest in development of firm-specific human capital."[134] The evidence on non-competes indicates that that more rights (contract rights, in this case) do not necessarily lead to greater economic returns.[135] I certainly do not intend to enter into that broader debate here, but there is sufficient evidence in the context of non-competition agree-

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132. Marx, et. al., *Regional Disadvantage, supra* note __, at 2.

133. Gilson, *supra* note __, at 620-21, *citing* Michael J. Trebilcock, THE COMMON LAW OF RESTRAINT OF TRADE: A LEGAL AND ECONOMIC ANALYSIS 152-53 (1986). *See also* Kitch, *supra* note __, at 710 (discussing the standard law and economics approach but also recognizing Silicon Valley's success in the absence of noncompetition agreements, citing it as "[a]nother bit of evidence that the real world does not operate as logic suggests . . .").

134. Sterk, *supra* note __, at 393.

135. Gilson, *supra* note __, at 621 ("the comparison is between the average per firm cost of diluted intellectual property protection and the average per firm benefit associated with the preservation of the high technology industrial district."). This is, obviously, an empirical matter, and one I cannot address here, but, as Gilson suggests, "the difference in performance of Silicon Valley and Route 128 is a little more than casual." Gilson, *supra* note __, at 621.

ments that cognitive and behavioral factors on the part of both employees and employers may well lead to the imposition of non-competition agreements that are not just unfair to employees but close to useless for employers.

In this section, I have argued that non-competes are used primarily as a tool for protecting IP or IP-like assets. Understood as an IP tool, non-competes are a failure. Some of the perceived weaknesses in trade secret are part of the larger regime for protecting (or not protecting) intellectual property. To the extent this is the case, the insufficiency or limitations of trade secret law do not justify the imposition of non-competes. To the extent that trade secret and other IP rules provide *unintentionally* insufficient protection, non-competition agreements do not serve the IP justification well in that they do not address the public goods problem and are unlikely to provide the incentive for invention that animates the IP justification.

In thinking about efforts to justify non-competition agreements as a form of intellectual property protection, a general refusal to enforce the agreements, in addition to benefitting employees as a class, would serve a channeling function, directing claims by employers toward intellectual property theories (such as trade secrets) and away from contract theories.[136] This would have a number of salutary effects: trade secret and other IP regimes might be changed in ways that would more appropriately allow for the protection of the things we think ought to be protected and at the same time leave in the public domain that that for IP-like reasons ought to be free for all. In addition, the problematic aspects of non-competes would be eliminated.

B. *The Conclusory and Misguided "Business Necessity" Justification*

Proponents of non-competes (courts and lawyers alike) often justify non-competes with general references to "legitimate business interests," "business necessity," and the need to prevent "unfair competition," often without more. An agreement might state, for example, that its purpose is "to prevent any competitive business from gaining any unfair advantage from [the employee's] knowledge of Proprietary Information." The "rule of reason" approach, applied in many states, requires employers to have a legitimate "protectable interest."[137] In non-compete agreements and in litigation, firms often use broad and conclusory language, merely assert-

136. *See* O'Malley, *supra* note __, at 1231-32 ("Limiting the enforcement of covenants not to compete would simply force employers to rely more heavily on statutory protection of trade secrets rather than on contractual solutions. Although the standard of proof in a trade secret dispute is often difficult and expensive to meet, this statutory scheme ensures that only the most legitimate business interests take priority over the important public policy concerns regarding employee mobility."). On the differing approaches to legal regulation of human capital, *see* Paul H. Rubin & Peter Shedd, *Human Capital and Covenants Not To Compete*, 10 J. LEGAL STUD. 93 (1981).

137. *See supra* notes __ & __.

ing that they have "protectable interests." A more specific claim might relate to "competitively sensitive information" or something of the like. These kinds of justifications, when put forth generally and without support, are clearly insufficient to justify the imposition of non-competes given the significant problematic aspects of the agreements from the employee perspective.

While in the majority of cases these claims as to business necessity are likely made in good faith, we ought to be suspicious of imposing restrictions on employee mobility based on such conclusory assertions. That is, if in fact there is no business necessity or legitimate interest, a non-competition agreement ought not to be countenanced. Indeed, the balancing tests used by many states to evaluate non-competes contemplates some proof of the employer's legitimate interest in imposing the non-compete.[138] As a practical matter, however, it appears that in many litigated cases there is little, if any, evidence presented concerning the actual scope and nature of the employer's interest.[139] More importantly, perhaps, the vast majority of non-competes are not litigated and subjected to the requirement of proof. There is thus little incentive for employers to carefully evaluate the "business necessities" motivating the use of the non-compete agreement as it will never be held to proof in court. To the extent that courts do not often require much specificity, the incentive is accordingly reduced even further. We should thus expect that non-competes are used more than is necessary – assuming they are necessary at all, a point I do not concede – and that they are overbroad in their operation.[140]

The general and conclusory nature of employers' assertions of "necessity" for non-competes points to flaws in the current approach many states take, but it is not sufficient on its own to tip the scale against non-compete enforcement generally. That is, one could counter this argument by urging courts to require greater indicia of actual, specific business necessity to allow an employer to prevail. To the extent there is any content to employer's claims in this regard, however, the general "business necessity" justification collapses into the IP justification. Firms will claim that the non-compete is necessary to protect its assets, or to encourage it to invest in human capital, or to protect against disloyal employees. These should all be seen as versions of the IP justification, and

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138. *See supra* Part I.

139. *See, e.g.,* Arnow-Richman, *Bargaining, supra* note __, at 1184-85 (discussing CTI v. Software Artisans: "Having dismissed the trade secret claim, however, the court went on to conclude that the employer had demonstrated a legitimate interest in confidential information justifying enforcement of the employee's noncompete . . . The only additional explanation or source proffered in the opinion to support this generalized conclusion was the fact that the employment agreement containing the noncompete recited that the employee would have access to confidential and secret information. Such rote conclusions are typical of many cases involving the assertion to confidential information as a protectable interest.").

140. *See supra* Part I.

are flawed for the same reasons. Thus the "business necessity" justification is both flimsy and misguided.

III OVERCOMING THE FREEDOM OF CONTRACT RATIONALE

In Part I, I sketched out the classic problems with non-competition agreements: they are the result of a flawed bargaining process and they represent a deviation from the presumption of employee mobility and the free flow of labor. These arguments weaken, but are not sufficient to dismantle, the freedom of contract rationale, which remains powerful notwithstanding these critiques. As a result, most of these critiques of non-competes have focused on reforming the doctrine rather than eliminating enforcement of non-competes entirely. In Part II, I examined the largely unchallenged justifications for non-competes and found them to be surprisingly weak. Given the myriad problems presented by the use of non-competes and the fact that they generally fail to achieve their purposes, rendering them unenforceable becomes the logical conclusion. But the freedom of contract rationale remains to be addressed, and in this final section, I briefly discuss the freedom of contract argument in the context of non-competes and conclude that the proper approach to eliminating enforcement of non-competes is through legislative action rather than judicial decision-making.

As with all contracts, a fundamental justification for non-competition agreements is the freedom of contract principle.[141] The principle is generally animated by a free market ethos: independent actors should be free to enter into any agreements they choose. Underlying this ethos is the assumption that market-based transactions will be more efficient. Thus the default rule is that agreements will be enforced and that courts will not interfere with the substance of those agreements, with exceptions for circumstances in which the voluntariness of the agreement is particularly suspect: misrepresentation, duress, or unconscionability, for example.[142] This is consistent with the neoclassical model of promoting bargained-for agreements but rejecting those agreements that are the product of a significantly flawed bargaining process.

In the non-compete context, the more specific version of the freedom of contract argument is that "human capital" ought to be fully alienable.[143] Professor Stewart Sterk has argued, for example, that "In justifying these restraints [on alienability], moreover, courts and scholars have

141. *See, e.g.,* Kitch, *supra* note __, at 686 ("The central issue is not the desirability of such contractual arrangements in particular cases but why employer and employee are not free to enter into arrangements that they consider desirable in light of the circumstances. Why doesn't the usual assumption that contracting parties can protect their own interests control here as elsewhere?").

142. RESTATEMENT (SECOND) OF CONTRACTS § 164 (misrepresentation); § 175 (duress); U.C.C. § 2-302 (unconscionability).

143. Note that the alleged need to protect or invest in "human capital" is another version of the IP justification. Human capital is perhaps the epitome of an intangible, and the various IP regimes and rules governing the workplace deal with who, if anyone, owns various aspects of human capital.

rarely considered an important distributional effect of these restraints on alienation: the persons most likely to benefit from rules that keep future earning capacity in the hands of its original holder are those persons best endowed with the talents, skills, and knowledge that contribute to that earning capacity."[144] This is, essentially, an efficiency-based argument, and Sterk describes a refusal to enforce non-competes as paternalistic: "courts or legislature[s] substitute social judgments about the appropriate trade-offs between compensation and future freedom for the decisions parties make by contract."[145] The freedom of contract rationale makes a strong case for robust and hands off contract enforcement in all but the most egregious cases.[146]

Non-compete agreements are generally at odds with both the efficiency and fair bargaining process underpinnings of the freedom of contract rationale.[147] As set forth in some detail above, there is vastly unequal bargaining power between employees and employers generally. As a result of this inequality of bargaining power, the terms uniformly favor employers; indeed, it is difficult to imagine an employee seeking to include a non-compete in her employment agreement. Also as a result of the inequality of bargaining power, the terms of a non-compete are rarely negotiated and are often presented only after (sometimes well after) the employee has accepted employment and started work.[148] Though one might imagine that employees receive something in exchange for the non-compete agreement (higher pay, for example), the evidence suggests that salaries are no higher, and possibly lower, for employees subject to non-competes.[149] Moreover, as a result of the bargaining power asymmetry, employers regular overreach in drafting non-competes to impose broad and sometimes unenforceable terms on employees. All of this represents a fairly radical departure from the neoclassical model of contract formation on which the freedom of contract principle is based.

The efficiency aspect of the freedom of contract rationale is similarly undermined by some of the evidence presented in Part III above concerning the effects of the rules concerning non-competes. Sterk ar-

144. Sterk, *supra* note __, at 385. This Article takes a position nearly diametrically opposed to Sterk's. Sterk contends that the arguments for limiting non-compete enforcement are particularly weak. "The principal justifications for refusing to enforce 'unreasonable' covenants not to compete, however, are insufficient." Id. at 387. Sterk "concludes that the existing doctrinal structure, which requires fact-specific judicial evaluation of covenants for reasonableness, rests on foundations that are problematic at best." Id.

145. Id. at 411-12.

146. Id. at 412 (" . . . if the owner of more traditional forms of property – as might be the case with a grant of an easement, for instance – courts are unlikely to invalidate the transfer years later unless presented with evidence of fraud or overreaching in the original bargain.").

147. Arnow-Richman, *Delayed Term, supra* note __, at 639. "The proliferation of cubewrap contracts poses a significant challenge to those who might otherwise support private ordering in setting and policing the terms of employment relationships." *See* id. at 641 (arguing for mandatory disclosure of standard form employment agreements).

148. *See supra* Part I.

149. *See supra* Part I.

gues that the "rule of reason" approach adopted by the majority of the states leads to inefficiency, however, by "replacing the contracting parties' judgment about the 'need' for the covenant with the judgment of courts removed from the problems faced by the particular employer and employee."[150] While this is quite logical in the abstract sense, the vision does not comport with either the realities of the contracting process or the evidence concerning non-competes and economic development. As discussed above in Part II, it appears that jurisdictions in which non-competes are unenforceable are at least not worse off, and may well be in a relatively better position, in terms of economic development and rates of innovation.[151]

Unlike the vast majority of contracts that are consistent with and promote market exchange – and thus efficiency – non-competes also operate as interventions in the market. By their very terms they seek to reduce competition in the market for labor, and it appears that they do have that effect.[152] As described above, non-competes significantly affect employee mobility and the free flow of the labor market. As suggested by their name, non-competes reduce competition in a way that has to be deemed an interference in the market. The intervention in the labor market appears to have broad ramifications. For example, there is some evidence that economic development is greater in jurisdictions in which non-competes are unenforceable.[153] To some extent, therefore, non-competes are at odds with the free market rationale that animates the freedom of contract rationale, rendering that rationale less compelling in this situation.

Notwithstanding these arguments, however, courts are unlikely to hold non-competition agreements unenforceable; nor should they. Although the arguments against enforceability are powerful, the issue is more amenable to the legislative process than the judicial decision-making.

Courts rarely will hold individual contracts unenforceable, much less *classes* of contracts. Standard-form consumer contracts, for example, have been roundly criticized on a variety of fronts, yet their continued use is certainly not in jeopardy.[154] Just as non-competes suffer from

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150. Sterk, *supra* note __, at 405.

151. *See supra* note __.

152. *See, e.g.,* Estlund, *Between Rights*, *supra* note __, at 411-12 ("Non-compete agreements obviously stifle competition; they run into the venerable public policy against contracts in restraint of trade.").

153. *See supra* Part II.

154. *See generally* Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1174 (1983) (setting forth the now-classic critique of contracts of adhesion, but also concluding that "If business firms play an important part in maintaining such a society, and if their ability to do so depends significantly on the use of standard forms, perhaps enforcement of the forms can be justified . . ."); Randy E. Barnett, *Consenting to Form Contracts*, 71 FORDHAM L. REV. 627 (2002) ("In practice, form contracts are ubiquitous."). Along with many others, I have argued that

a variety of defects, standard-form consumer contracts also depart fairly radically from the neoclassical model of contracting: they are the product of vastly unequal bargaining power, the terms generally favor the drafter,[155] in many circumstances there is slim possibility of opting out, and they are, as practical matter, never negotiated. But in the consumer contract context, the arguments in favor of enforceability – efficiency and practicality, primarily – retain a great deal of force. It is nearly impossible to imagine a world in which there are no consumer contracts, or in which every contract accompanying a camera or a computer or even a new pair of jeans bought online must be individually negotiated and discussed.[156] The same cannot be said of employee non-competition agreements.

Rather than asking courts to consider non-competition agreements on a one-off basis, the appropriate response to the concerns about non-competes is a legislative solution. The evidence concerning the effects of non-competes on employees and the arguments about the role of non-competes in the overall scheme for protecting IP are policy arguments that should be directed to policymakers and ought to be quite compelling to policymakers. [157] In other words, a legislative approach provides a substantially better solution than an incremental common law decision-making approach.

The arguments set forth above, both those developed by the employment law scholars and those flowing from an examination of the justifications for non-competes, lead to the conclusion not just that such agreements are problematic from an individual perspective but also from

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adhesion contracts ought to be policed more strictly. Viva R. Moffat, *Super-Copyright: Contracts, Preemption, and the Structure of Copyright Policymaking*, 41 U.C. DAVIS L. REV. 45 (2007) (arguing that adhesion contract terms limiting fair use ought to be preempted).

155. *But see* Florencia Marotta-Wurgler, *Are "Pay Now, Terms Later" Contracts Worse for Buyers? Evidence From Software License Agreements*, 38 J.Legal Stud. 309, 312 (2009) (Finding that "[a]t least with respect to software license terms, buyers do not, on average, receive more pro-seller contracts when the terms are disclosed only after purchase. Scholars and consumer advocates, then, should not be particularly concerned about rolling contracts. It is important to note, however, that the tests in this paper cannot answer the broader question whether all EULAs, or standard-form contracts in general, contain poor-quality terms according to some absolute standard.").

156. It is difficult to know how what percentage of consumer contracts are standard form agreements, but scholars agree that that they are very widely used. *See* Arnow-Richman, *Dilution, supra* note __, at 977 n.51 ("While there is little empirical evidence about the number of standard form contracts relative to the number of contracts generally, scholars agree that standardized forms are ubiquitous and represent the dominant mode of private ordering in the contemporary economy."), *citing* Russell Korbkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. CHI. L. REV. 1203, 1203 (2003) and W. David Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529, 529 (1971).

157. *See* Marx, et. al., *Regional Disadvantage*, *supra* note __, at 6 ("From a regional policymaker's perspective, the free flow of talent to the best opportunities is beneficial as long as it occurs locally; workers who take out of state jobs are a loss to the region. Prior work has shown that non-competes deter intra-regional mobility . . .; this article establishes that non-competes are responsible for a brain drain from enforcing states to non-enforcing states. Taken together, these results suggest that the state sanction of non-competes is a lose-lose proposition at the regional level, especially in light of recent evidence that R&D investment remains strong and effective in regions which prohibit enforcement.").

the policymakers' perspective. Non-competes result from a flawed bargaining process, they restrict the free flow of labor, and their operation conflicts with the policy goals of the IP regimes. The arguments in favor of non-competes, it turns out, are mostly empty. To the extent the arguments have some content – there are trade secrets to protect, or an incentive for investment is necessary – non-compete agreements are clearly not the proper tool for addressing those concerns. Those concerns ought, instead, to be addressed through other legal mechanisms: trade secret law, for example, or more widespread and robust use of non-disclosure agreements.

Simply suggesting that firms turn to other mechanisms will not address the broader policy concerns, however. As Gilson indicated, the possibility of non-compete enforcement creates a collective action problem: it is individually rational but collectively irrational for firms to impose non-competes on their employees. Gilson argues that the California rule prohibiting non-compete enforcement solves this collective action problem by operating as a binding mechanism. In other words, this is a situation in which regulation makes sense.

This is the approach that California has taken, and the arguments presented here make the case that the substantive law of many states ought to be changed. Currently, a few states employ a rule rendering non-competes unenforceable; the majority of states employ a "rule of reason" in which non-competes are scrutinized closely but are generally unenforceable; a minority of states provide that non-competes are unenforceable but then allow for a number of exceptions. As many employers operate in a number of states and as employees have become increasingly mobile, the variation in state law (along with sharply conflicting policy concerns inherent in the use of non-competes), interstate conflicts of law and jurisdictional disputes have increased. These factors all weigh in favor of a uniform rule to be adopted by all of the state prohibiting non-compete enforcement as California and a few other states currently do. In an article to follow this one, I will make the case for uniform act that would render non-competition agreements void and unenforceable.