Non-Competition Agreements:

A Discussion to Eliminate Their Use

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Table of Contents

Abstract

This paper examines non-competition clauses and makes the case for their elimination in the course of conducting business. The main purpose of non-competition clauses is for the business entities, since it reduces the amount of competition they face. However, the burden placed on the worker outweighs the advantages for the businesses. The degree of enforceability of non-competition clauses will be explored in Massachusetts, Colorado, and California. This paper analyzes cases regarding non-competition agreements that pertain to each state. Finally, the case will be made that non-competition clauses should be eliminated and instead further enforce current trade secret statutes in addition to the creation of statutes that protect trade secrets on a state level.

Introduction:

It was in 2005 when one of the biggest court cases occurred; it was a clash of the titans. Google versus Microsoft, with Dr. Kai-Fu Lee in the center of it all. Originally, Lee was employed by Microsoft and became Vice President of Interactive Services in 2000. In 2005, Lee was offered a position at Google. After accepting this new position, Microsoft quickly filed a lawsuit, stating Lee breached a one-year non-competition agreement. Microsoft was granted a preliminary injunction to have Lee prohibited from working at Google. However, two months later, the court allowed Lee to work for Google with restrictions on what he would be allowed to do at the job. Before reaching the trial date, Google and Microsoft reached a confidential settlement on December 22, 2005. This is one of the more publicized cases dealing with non-competition clauses. Lee, Microsoft, and Google shed new light on non-competition agreements and the debate that surrounds it (Sandoval, 2005).

Non-competition agreements are commonly used throughout business. Usually, they are lumped with non-solicitation and non-disclosure agreements or within a restrictive covenant for an employee-employer relationship. It appears that primarily the businesses have the majority of advantages when a non-competition agreement is signed. By signing the agreement, employees have less of an incentive to leave (since there are now restrictions on their future job opportunities) and companies have less future competition. However in today's society with the current economy, unnecessary burden is added to the worker. Now, the worker is not allowed to take any perspective job offer

or risk a law-suit—which can be time consuming and costly. In essence, the worker becomes more limited, while the companies gain more power.

It will be argued that all non-competition agreements should be unenforceable throughout the United States. The common law of Massachusetts and state statures of Colorado and California are examined to better understand how non-competition agreements are enforced in situations. Further, the main arguments will be identified and discussed. Finally, the main arguments against the enforcement of non-competition agreements will be discussed and a solution will be proposed. Ultimately, the use of a non-competition agreement hinders the employee—benefiting solely the employer—when it is the responsibility of the government to create and enforce statutes that will protect trade secrets on a national and state level.

Background and History:

Non-competition agreements or non-competition covenants are used in two specific cases; for employee to employer relationships and seller and buyer relationships—for the sale of a business. These agreements must be ancillary to another contract, such as an employment agreement. The contract outlines restrictions on the employee should his/her current employment terminate. The restrictions may vary based on the competitive market for the industry of the employer. The contract can outline a designated geographic location and time period restriction on the former employee. The ultimate objective of a non-compete agreement is to help eliminate the risk of confidential information becoming available to the competition. A main example of this

occurs when a current employee who gains confidential company information leaves the company and gains employment with a competing company—inevitably discussing the confidential information in an intentional or unintentional manner.

The earliest recorded case of non-compete agreements occurred in England in 1414. During this time, the bubonic plague had occurred about 30 years prior, causing a massive shortage in the labor force. The case consisted of a plaintiff requesting that his previous employee, a clothes dyer, be restricted from working in the same town for six months. The judge for the case showed utter disgust and threatened the plaintiff with jail time for requesting such an act. The judge at the time believed that it would be outrageous for one party to restrict another from practicing his chosen professional trade. As a result, the Ordinance of Labourers was enacted; this act in essence prohibited unemployment in post-medieval England. This way of thinking continued through the 16th century. It was not until the Industrial Revolution that the courts began enforcing non-compete agreements to which employees voluntarily entered into with an employer. Similar to today's courts, the stipulation based on "reasonableness" limits the geographic scope and duration. Today, the enforceability of non-compete agreements vary based on statutes and common law set by each individual state (Marx, M., Strumsky, D., & Fleming, L. 2009). As stated by Marx, Strumsky, and Fleming (2009), "firms use non-competes to protect their interests: to prevent the disclosure of trade secrets, to honor customer confidentiality, and to guard against competitors appropriating the specialized skills and knowledge of its employees." In sum, a non-compete serves as added protection for a business' customers and interest.

Invidia, LLC. v. Maren DiFonzo:

The case pertains to Maren DiFonzo, a hairdresser, who signed a non-competition agreement with a local hair salon, Invidia. The company argued that the entire basis for the success of the business was the clientele. DiFonzo argued that that the contract was signed six days after employment and that the terms of employment changed after six months, when she became a full time employee. This case specifically dealt with the Invidia seeking an injunction against DiFonzo. The injunction would be granted as long as Invidia could prove the following: that success is likely, irreparable harm will occur should the injunction not be granted, and potential harm to the plaintiff part outweighs the harm to the defendant. Ultimately, Invidia was not granted the injunction due to the inability to prove that DiFonzo was soliciting clients. The case of Invidia and DiFonzo demonstrated the particular difficulty that a company can face when dealing with the court system. The company invested time and money seeking an injunction when ultimately the courts ruled in favor of the defendant. When seeking damages from a breach of contract, it can be extremely difficult and sometimes unsuccessful (Invidia, LLC v. DiFonzo, 2012).

Electrical Products Consolidated v. Howell:

This case chronicles Electrical Products Consolidated seeking an injunction against Howell. Howell was employed by the company and during that time he gained access to confidential information. Upon leaving the company, Howell created a

competing company and conducted business with a customer with whom he became acquainted during his employment with Electrical Products Consolidated. Initially, the courts did not grant the injunction to the company, based on prima facie case. Upon further investigation, the case lead to the reversal of the original ruling. This case, similar to the previous case, proved to be difficult. After initially seeking an injunction and its denial from the court, the company remained persistent. According to the state statutes, and with further analysis it became evident that the violation of trade secrets was imminent. It was for this reason that the injunction was granted (Electrical Products Consolidated v. Howell, 1941).

Massachusetts Non-Compete Agreement Common Law:

In Massachusetts, non-compete agreements are enforceable in court. The main exceptions are to physicians, nurses, social workers, and the broadcasting industry which are dictated by public policy. The courts will balance the needs of the former employee's ability to earn a living with the concerns of a business. According to Secretary Galvin of Massachusetts (2012), "generally, Massachusetts courts have enforced such covenants where necessary to protect trade secrets, confidential data, or the employer's good will." Therefore, Massachusetts believes that companies should be able to have the added protection against the threat that former employees pose to the business (Galvin 2012). A key argument that could be made against the use of non-compete agreements, based on the Secretary's statement, is that each of the components mentioned fall under federal statutes already set in place to protect a company's trade secrets.

Common Law:

Since, Massachusetts does not have a set statute for the enforceability of non-competition clauses, common law is used to analyze cases. Common law evolves with each new case that the state encounters. It is prescriptive rather than statutes which are instructive. Previous court rulings in similar cases will influence the decisions on new non-competition agreement cases. Many factors are taken into account when making the determination on non-compete agreements' enforceability. If a company were to pursue a former employee for breach of contract, the company would seek an injunction in order to prevent the employee from working and then pursue further legal action in court. In order for a court to rule in favor of the business certain criteria must be met. Legitimate business interests and scope of the contract are two factors that will be considered in a non-competition case (Goodof, 2005). With common law, non-compete agreement cases can be difficult to interpret because there are numerous cases, each with differing circumstances and rulings.

Colorado Non-Compete Agreement Statutes:

According to Colorado statutes, "any covenant not to compete which restricts the right of any person to receive compensation for performance of skilled or unskilled labor for an employer shall be void (Colo. Rev. Stat. § 8-2-113 (2), 2013)." The following exceptions are applied to the statute: contracts for the purchase and sale of a business,

contracts for the protection of trade secrets, contracts for provision providing for recovery of the expense of educating and training any employee who served an employer for a period of less than two years, and executive and management personnel. Colorado courts have a different perspective on the need for non-compete agreements. In contrast to Massachusetts, Colorado has outlined the specific cases of when a non-compete agreement is permissible. However, the restriction for the protection of trade secrets is repetitive with the federal statute already in place.

California Non-Compete Agreement Statutes:

California does not enforce any types of non-compete agreements. According to the California Business and Professions Code § 1600 (2008), "except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void." The exceptions to this code include: when a buyer of a business prohibits the seller of the business from competing with the newly acquired business and when there is a dissolution of a business partnership or the dissociation of a partner from a partnership. California's view on non-compete agreements is similar to the judge's distain against the defendant in one of the earliest court hearings on this issue. California created a very broad statute for which they have few restrictions, allowing greater freedom to the employee.

California Business and Professions Code 16600:

As stated previously, Code 16600 restricts any type of non-compete agreement. The code is extremely broad and has caused much debate over how it should be interpreted. As a result, many cases involving non-compete agreements have been dismissed. The code also extends the jurisdiction to void any non-compete agreements outside of the state of California. As stated in Tedesco (2011), "the court interpreted 'employment in California' to mean: (1) employees living in state; (2) employees living out of state, but hired by California employers; (3) employees living out of state but performing services in state." In other words, even though an employee many live in another state where non-compete agreements are enforceable, if the company is based out of California then the non-competition clause becomes void. The opposite is also true, if a company is based out of another state where non-compete agreements are valid contracts, but the employee with whom the contract is held resides in California, then the contract becomes void. The code is very expansive, allowing employees more independence in the job market.

Edwards II v. Arthur Anderson, LLP:

Edwards v. Anderson (2008) is a well-known case that displayed the power and breadth that the Business and Professions Code 16600 carried. The case detailed Edwards, a tax manager, at an accounting firm, Arthur Anderson LLP. Upon employment with the firm, Anderson drafted a non-compete agreement that prohibited Edwards from performing services or soliciting any of the clients from the Anderson firm for eighteen months after the termination of employment with the firm. Events developed that led to

Anderson selling portions of its company. HSBC, USA decided to purchase the portion of the company that Edwards managed. Edwards decided to accept employment from HSBC, USA but refused to execute his non-compete agreement. After an initial ruling in favor of Anderson, an appeal overturned the ruling under the code 16600 policy. As stated in Wikham and Sims (2008), "This broad prohibition on covenants not to compete is intended to foster the dual interests in protecting employee mobility and open competition" The case exemplifies California's stance on non-competes. The state favors the interest of the employees, taking into account the need to earn income in one's chosen profession and the increasing mobility of the modern day employee.

Latona v. Aetna U.S. Healthcare Inc.:

In the Latona v. Aetna (1999) case, the plaintiff was terminated for failure to sign a non-compete agreement. As an existing employee, Latona was requested by Aetna to sign a non-compete and confidentiality agreement. When she refused the company decided to terminate her employment. As a result, Latona filed a lawsuit against the company stating a violating of the Business and Professions Code 16600. The court ruled in favor of Latona. This cases demonstrated the breadth that the code carries. The code not only dealt with the post-employment implications, but also the immediate signing of the agreement. Until this case, many employers were unaware of this type of implication of the code.

Main Opposing Arguments:

One of the main arguments for non-competition clauses is the proactive approach that the document takes in employment. Although, there are many laws that protect against the exposure of trade secrets, these measures are reactive to the situation. The main component of a trade secret is the "secret" portion. Once a former employee exposes the information; it is no longer valuable to the former company. The trade secret is no longer valuable and therefore the company loses one competitive factor. The company would be in the reactive mode, attempting to rebuild while also seeking monetary relief for the crime committed. Non-competition clauses hinder an employee before the opportunity presents itself to divulge the secrets. Furthermore, non-competes also are one of the few instruments that a company can utilize to protect their company against former employees that is within their full control as a preventative measure.

Another point to be aware of is the level of difficulty that a business can face when attempting to make a case for stolen trade secrets. The current statute is a federal statute, therefore the theft of trade secrets on a small business level will most likely never make it to federal court. The amount of money and time that would be required of a small business owner would be too great and could ultimately force the owner out of business. Also noted that the business could withdraw due to the origin of trade secrets; therefore, non-competes are an inexpensive way to prevent a potentially costly battle for business owners.

Finally, non-competes are also used in the sale of a business. This situation is also a strong case for the use of non-competition clauses. In the event of one business owner selling an established business to another person, it is believed that there should be

protection for the new owner who just made the purchase. This is because there is a distinct possibility that the previous owner could open a similar small business in close proximity of his old business. This can lead to the new owner losing his customer base to the old owner's reputation and new business, which could negatively impact the new owner immensely.

Employee Mobility:

In today's society the average worker stays at a job for about 4.4 year, and that number is only expected to decrease as the younger generation of workers starts to increase. The millennial generation is expected to have an average of 15-20 jobs during their working lives (Meister, 2012). With these facts, it is clear that non-compete agreements could hinder the future working class. The impact of non-compete agreements, could slow down the work force and hinder productivity. By forcing employees to stay confined to a job, productivity could decrease as well as morale.

Economic Instability:

Today's economy is in recovery mode from the most recent economic depression and the unemployment rate is still 7.3% as of August (n.d., 08/31/2013). Although, employers are starting to hire again, the economy has not recovered completely. The struggles of unemployment weigh heavily on Americans still. Some of the employees who are committed to these types of agreements may be forced to have a gap in their

work experience. Those who sign non-competition agreements do not anticipate the future implications that they bring. Imagine the stress of leaving a familiar position. Then, imagine during this incredibly stressful period that restrictions are being placed on future employment for the next 2 years. The problem lies here, the employee has lost his freedom in the job market. The only party in this transaction that benefits from this is the company. They do not have to worry about any increased competition from their old employees. The company has no consequences in this situation, while the employee faces a difficult perhaps limited job search.

Labor Market:

The labor market should be treated similar to any other type of free market, in that if a company values an employee then the company should in turn analyze the measures that should be taken to ensure that that employees stay with the company. In California, there are thousands of skilled and knowledgeable workers at various companies. Since the state does not enforce non-compete agreements, how have those companies remained successful? Wouldn't employees constantly be leaving and taking sensitive company information with them each time? The combination of federal statutes and attractive employee benefits have persuaded employee to stay. The company should provide benefits and compensation to its most valuable employees to convince them to stay, rather than resort to "hostage-like" tactics. A non-compete agreement creates a requirement to stay at a current position. However, companies should want employees to stay out of choice rather than fear—this is not an implication that all employee who stay

are being forced. Companies should create an attractive environment that will engage, encourage, and nurture employees and loyalty will transpire.

Trade Secrets:

The main reason why non-compete agreements are utilized is because of the risk of exposing trade secrets. As mentioned in previous sections, non-compete agreements are also responsible for protecting confidential data and good will. One thing that should be noted here is that confidential data and good will can both be classified as trade secrets. As stated by Png (2012), "[trade secrets] consist of any formula, pattern, device or compilation of information which is used in one's business, and which gives him an opportunity to obtain an advantage over competitors who do not know or use it." Good will is classified as a prosperous or beneficial relationship between a business and its customers. This is threatened when the former employee has drawn from a customer list that was provided by the former employer. Therefore many of the reasons for using a non-compete agreement fall under the category of a trade secrets. Moreover, there are already federal statutes that protect against the divulgence of trade secrets.

Uniform Trade Secrets Act:

The Uniform Trade Secrets Act (UTSA) was drafted in 1979 in the Uniform Law Commission, and later amended in 1985. This was to improve the trade secret protection in all 50 states. Currently it has been enacted in 47 states, District of Columbia, Puerto

Rico, and the U.S. Virgin Islands as of May 2013. This is just one of the many laws that help protect the trade secrets of companies. Since most of the issues that the non-compete agreement address fall into the category of trade secrets. Therefore, non-competes are a supplement to the federal statutes already set in place.

Espionage Act:

The Economic Espionage Act was passed in 1996 and it made the theft of trade secrets a federal crime. Currently the threat the penalties for offenders are $500,000 with the possibility of 15 years in jail; and up to $10 million for organizations (each penalty is subject to the severity of the crime). The EEA also protects internationally as well. This measure, unlike the previous act, includes all of the United States; in essence all businesses are protected against the misappropriation of trade secrets. Furthermore, the use of non-competition clauses in effect reiterate this law, rather than introduce anything new to the employee. Herein lies the redundancies of non-competition clauses, there is already a federal law (in addition to the UTSA that covers the majority of the U.S.) that protects trade secrets. The non-compete agreement in hence reiterates these laws, while also adding a new layer that impinges upon an employee's freedom in the job market (Minott, 2011).

Creativity:

One of the most interesting facts that keeps presenting itself in past research is the difference between the east and west coast, especially in terms of how the technology industry stands. The west coast has boomed in recent decades with the technological advances. With technology giants such as Google, Apple, Microsoft, etc. the west coast has dominated in the technology industry. The number of advancements that has developed from these companies is overwhelming not to mention their impact they have made to the everyday life of consumers. It is noteworthy to see the success that the west coast has had without the use of non-compete agreements. Although it should not be deduced that the success of the Silicon Valley is due solely in part to the lack of enforceability of non-compete agreements, it should be noted that one of the differences between the two regions is non-competes and therefore should be taken into account.

Solution:

The solution that is being proposed is to eliminate the use of non-competition clauses throughout the nation. Any state that enforces them should instead enforce the laws that protect a company. The states should increase the penalties that result from the exposure of trade secrets and other confidential information. The fines should balance between significant and detriment to a business. Fines need to be significant to signal the company to wrong-doing. The penalties to former employees should be stressed by previous employees before they leave the company to ensure that ignorance is not a factor. Companies should be aware of the rights that they possess and when they can exercise them against a former employee. Companies should also be made aware of the

laws that could be violated if they hire a former employee of another company. Understanding the law and its implications will help businesses and workers behave ethically. The country should avoid companies from micromanaging its people. In addition, state statutes should be enacted to help provide security of trade secrets. For the small businesses who have had trade secrets exposed, their cases will most likely not go to court. The money and burden of proof required in these cases would be too great of the business owner. State level statutes would be more beneficial to these individuals rather than federal statutes. In essence, if the government were to enforce statutes that protect trade secrets, then it would help reduce the need for the non-competition clauses.

Although non-competition clauses serve a purpose, it seems apparent that the government has also implemented legislation that already protects these companies. It seems redundant and inconvenient to the work force to have multiple routes to the same goal. By eliminating non-compete clauses workers will gain more freedom within an already difficult labor market. The power will be reinvested back into the workers rather than the big corporations.

Conclusion:

It is clear that non-competition agreements serve a purpose for companies. They provide a proactive and inexpensive method of protecting sensitive and important information from interested parties. However, the fact still remains that the non-competition clauses benefit the companies rather than the workers. The company is able to safeguard its information while reducing competition. Those who need protection are not so much the big wealthy companies as it is the employees who work for them. The

employee must promise to limit one's own potential future job market availability or face potential legal action. In today's society, non-competition agreements should not be enforced based on the economy and the idea of a free labor market. In addition it should be the responsibility of the country and states to enact statutes that protect against divulgence of trade secrets. Furthermore, the use of non-competition agreements are detrimental to a healthy labor market as well as the overall advancements made within industries; therefore, it is the responsibility of the government to protect workers and companies—rather than the companies creating burdens for their employees only for the protection of their own interests.

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