11KBW

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Dear Sir,

Consultation on measures to reform post- termination non-compete clauses in contracts of employment

This is the response of 11KBW to your Consultation. 11KBW is a leading set of Barristers' Chambers, which is widely recognised for its longstanding expertise in Employee Competition issues. In our work, we frequently litigate and advise in relation to the enforcement of post-termination restrictions in employment (and business) contracts including non-compete clauses. We represent both employers and employees.

OPTION 1: MANDATORY COMPENSATION

1. Do you think the Government should only consider requiring compensation for non-compete clauses or do you think the Government should consider requiring compensation where other restrictive covenants are used? Please indicate below.

- ***Non-competes only***
- ***Non-compete clauses and other restrictive covenants***

We do not agree with the approach of requiring compensation for non-compete clauses and nor do we think that compensation should be required where other restrictive covenants such as non-solicitation and non-dealing clauses are used. For the most part, the use of such clauses does not have a material impact on employees' ability to work, and thus deploy their skills, elsewhere in the market place. Those other clauses, where used properly, are necessary to protect the legitimate business interests of employers in their goodwill, confidential information and established workforce and it would not be equitable (particularly for small businesses) to have to pay employees to benefit from such protection.

2. If you answered 'non-compete clause and other restrictive covenants', please explain which other restrictive covenants and why.

N/A

3. Do you foresee any unintended consequences of limiting the scope of reform to non-compete clauses? If yes, please explain your answer.

While we would not welcome the expansion of the scope of reform for the reasons we have set out above, we do see some scope for unintended consequences. These include:

(i) The difficulties of defining what precisely amounts to a non-compete clause may lead to uncertainty and thus litigation. The current law on post termination restrictions is relatively well established over many years of consideration by the courts. By contrast, the proposed reform would be likely to involve novel issues that would need to be litigated afresh;

(ii) Employers may well restructure remuneration packages to take account of the requirement for post-termination compensation for non-competes, such that employees will receive less remuneration whilst in employment. An employee could lose remuneration where the employer decides not to enforce the non-compete. Conversely, it would not seem fair to require employers to pay an employee not to compete if they have no interest in preventing that competition. (As to this, see further the answer to question 8 below);

(iii) Employers are likely to considerably expand the scope of non-soliciting and non-dealing clauses for which they would not have to pay and this may increase complexity and reduce clarity.

4. Do you agree with the approach to apply the requirement for compensation to contracts of employment?

We do not agree with the approach of requiring compensation for non-compete clauses. We consider that requiring compensation may in fact run counter to the expressed aims of the consultation. There is a very real risk, in our view, that where employees are paid not to compete, it may act to keep them and their skills out of the workplace for longer. The payments could serve to disincentivise employees from taking any active part in the economy during the period of the restraint (in addition, most probably, to an earlier period of garden leave), leading to periods of idleness.. This could lead to employees' skills atrophying as they remain out of the market and be detrimental to the economy.[1]

[1] The risk of skills atrophying during periods of 'enforced idleness' has been recognized in the case law. See, for example, ***Provident Financial Group Plc v Hayward*** [1989] ICR 160 at 168 per Dillon LJ, ***Elsevier Ltd v Munro*** [2014] EWHC 2648 (QB), [2014] IRLR 766 at [58] per Warby J, ***ICAP Management Services Limited v Dean Berry and BGC Services (Holdings) LLP*** [2017] EWHC 1321 (QB), [2017] IRLR 811 at [110] per Garnham J.

Further, the effect of such a change is likely disproportionately to affect small businesses, such as start-ups, thus stifling innovation and even potentially preventing their establishment in this jurisdiction. Such companies may well have particular business needs to protect the confidential information of their fledgling enterprises, while not being in a position to pay former employees not to compete with them.

Conversely, well established, wealthy and large organisations will have no trouble paying employees not to compete with them (as a number of them do now).

5. Do you think the Government should consider applying the requirement for compensation to wider workplace contracts?

We consider that there is no reason to treat employees differently from workers who are similarly situated, such as consultants. If they are treated differently, that might simply incentivise businesses to prevent relevant individuals being considered employees.

We do not consider that the proposed reforms should have any application to contracts where the covenantor has a share in the goodwill which the restrictions aim to protect, such as partnership agreements, shareholder agreements, share schemes and joint investment arrangements (which we will call for convenience "business contracts").

6. Do you think the proposed reform to non-compete clauses in contracts of employment could have an impact on the use of, and/or the enforceability of, non-compete clauses in wider contract law? If yes, please explain why and how.

We consider that, so long as the relevant legislation is carefully drafted, there are unlikely to be any effects on wider contract law.
Areas to which the draftsman may need to give careful consideration are:

- the situation where the employee has agreed both employment covenants and covenants in a business contract[2];
- where the employer company is part of a wider group and the covenant aims to protect the interests of more than the employer.

7. Please indicate the level of compensation you think would be appropriate.

- ***60% of average weekly earnings***

[2] At common law, in this situation, the court looks at the substance of the transaction to determine whether to apply the employment or less rigorous business sale approach to reasonableness, see ***Alliance Paper Group v Prestwich*** [1996] IRLR 25; ***Allied Dunbar v Weisinger*** [1988] IRLR 60; ***TSC Europe v Massey*** [1999] IRLR 23; ***Cyrus Energy v Stewart*** [2009] CSOH 53 at [25]; ***Kynixia v Hynes*** [2008] EWHC 1495 (QB).

- ***80% of average weekly earnings***
- ***100% of average weekly earnings***
- ***Other (please specify and explain why)***

The most important issue here is not so much the percentage of "*average weekly earnings*" but how that term is defined. In our experience, in many areas of the economy, large amounts of remuneration are paid as lump sums on particular days (for example bonuses or commissions). In many areas of employment law, this can massively skew the amount payable to an employee either up or down depending on timings.[3]

The difficulty is to define both the length of the period over which average earnings are to be calculated, and when that period is to take place. As to the length, a year would be likely to capture the vagaries of most compensation structures but is a long period to evidence. (It would be possible to make provision for a pro rata calculation where the employment has not lasted this long). It would seem fair that the period should capture the time frame up to the end of employment.

We also note that post termination restrictions are often agreed at the beginning of the period of employment. At that time, neither party will be in a position to know what the employee's final remuneration is likely to be.

We do not have strong views on the percentage amount but consider that it should be less than 100% of average weekly earnings as the consideration provided for it by the employee represents only a part of the consideration provided during employment. The employee ought not to receive full pay when the employer is not receiving the full services of the employee We believe this should be so, on balance, even in the rare case where the non-compete effectively acts to prevent the employee taking up any employment during the period of restraint. We also believe that that the higher the compensation, the greater the incentive on the employee to remain idle throughout the period of the restraint.

8. Do you think the employer should have the flexibility to unilaterally waive a non-compete clause or do you think that waiving a non-compete clause should be by agreement between the employer and the employee? Please indicate your answer below.

- ***Employer decision only.***
- ***Agreement between employer and employee.***
- ***Not sure/Don't know***

Please explain your answer.

On balance, and consistently with contractual principle, we think that the employer should be able to decide to waive a non-compete clause unilaterally. Otherwise, the employee will be incentivised not to work for the relevant period even where the employer does not wish to enforce the non-compete.

[3] For a vivid example see ***Geys v Societe Generale*** [2012] UKSC 63, [2013] 1 AC 523

We appreciate that most employers would be unlikely to enforce the non-compete in such circumstances but nevertheless the money received by the employee will disincentivise work. Also, even if the employer does not in fact enforce the provision, the very fact that it could do so would be likely to keep the employee outside the workforce even when that is not in the interest of either party, or in the public.

It also seems odd that the employer would be required to pay for something that it simply does not want.

9. Do you agree with this approach? If not, why not?

No, we do not agree with this approach. We do not see how it is realistic in most cases for an employer to decide whether or not they intend to enforce a non-compete at a particular time prior to the employee's termination, when this is likely to be before the employer is aware that the employment is likely to terminate.

The employment relationship is fluid and the decision will involve a developing consideration of whether or not that employee is likely to be a sufficient competitive threat to the business such that it would be worth paying what is likely, at least in many cases, to be a considerable sum. Employers will be likely to take into account both the nature and the quality of the employee's work as well as the future business plans of their own enterprise. A fixed statutory period within which an employer could waive a future contractual right without penalty seems to us to introduce a type of formulaic rigidity which would be highly undesirable. If the intention of this proposal is to dissuade employers from inserting non-competes on which they never intend to rely, then we think the cure might be worse than the disease.

We also envisage that there could be any number of disputes surrounding such notices from whether the giving of a notice (which would sound in financial loss) might constitute discrimination or detriment for making a protected disclosure. Possibilities might be age discrimination if employees considered to be near retirement were more likely to be given notices. In other cases, employers might seek to reimpose non-competes that have been waived if and when circumstances change. We can see the possibility for litigation here.

10. How long do you think the time period within which the employer must waive the restriction before the termination of employment should be?

- ***3 months***
- ***6 months***
- ***12 months***

Since we do not agree with this approach, we would suggest the minimum possible period if this is to be considered.

Questions 11 to 17

We have not answered these questions which are directed specifically at employers.

18. Would you support this measure to improve transparency around non-compete clauses? If not, please explain why not.

Yes, we would tentatively support a requirement for employers to draw employees' specific attention to the exact terms of the non-compete agreement in writing before entering the employment relationship. This would prompt awareness of "hidden" clauses in long contracts for both employees and for employers using standard term contracts without adequate forethought. It would not be particularly onerous on employers, and would aid clarity. We have experience of numerous cases where there has been a dispute as to whether and when a post-termination restriction was agreed.[4] We consider that consideration should also be given to this requirement being accompanied by an obligation on the employer to afford the employee an opportunity to take legal advice. We return to this below.

We assume that what is meant by "before entering the employment relationship" means the relationship described in the latest employment contract even where there is a continuous employment. We say so because it is generally appropriate that non-competes are only included in the contracts of employees in senior positions including upon promotion.

We also consider that the statutory requirement to impose a notice provision ought to address the adequacy of the form of notice[5] and the consequences of a failure to give adequate notice.

19. Have you ever been subject to a non-compete clause as an employee or limb(b) worker? If yes, were you aware of the non-compete clause before you accepted the offer of employment.

N/A

20. Has a non-compete clause ever prevented you from taking up new employment in the past and/or prevented you from starting your own business. Please explain you answer.

N/A

21. Do you have any other suggestions for improving transparency around non-compete clauses?

As we have suggested above, it seems to us that a sensible reform would be that non-competes could only be enforceable against employees if they had been given the opportunity to receive legal advice, or had actually received legal advice, at the time that they were entered into. A

[4] See, for example, ***Pat Systems v Neilly*** [2012] EWHC 2609 (QB), [2012] IRLR 979 and ***Tenon FM Ltd v Cawley*** [2018] EWHC 1972 (QB), [2019] IRLR 435.

[5] Compare, for example, the common law test of adequate notice for onerous terms in ***Interfoto Picture Library v Stiletto*** [1989] QB 43 in which it was said that the guiding principle was that "*the more outlandish the clause the greater the notice which the other party, if he is to be bound, must in all fairness be given*" (at 443).

possible model for this would be the legislation surrounding settlement agreements, such as in s.203 of the *Employment Rights Act 1996*.

22. Would you support the inclusion of a maximum limit on the period of non-compete clauses?

On balance, we do not consider a maximum limit on the period of non-compete clauses is a good idea. This is because:

(i) In our experience, the circumstances of different businesses are very different and it is difficult to legislate to cover all scenarios. We can imagine that there could be some very particular circumstances relating to very senior employees who have sold their business and have significant confidential information where a year, for example, may not be enough;

(ii) A maximum would be likely to encourage all employers (who were able to pay) to impose that maximum, even in cases where that would not currently be allowed.

We can envisage drafting that might minimise the potential problems, such as: "*such period to last no longer than reasonably necessary but in any event no longer than 12 months unless justified by exceptional circumstances*". However, such drafting would perhaps negate the object of imposing a maximum period at all and statutory references to 'exceptional circumstances' are often unhelpful and generative of litigation.

The treatment of periods of garden leave and the thorny issue of "set-off"[6] would also have to be considered.

23. If the Government were to proceed by introducing a maximum limit on the period of non-compete clause, what would be your preferred limit?

- ***3 months***
- ***6 months***
- ***12 months***
- ***Other (please specify)***

Please explain in further detail the reasoning behind your preferred limit.

If a maximum limit is to be imposed, we consider that 12 months would be the appropriate amount as we relatively often encounter circumstances in which such periods are appropriate.

24. Do you see any challenges arising from introducing a statutory time limit on the period of non-compete clauses? If yes, please explain.

Yes, see the answer to question 22 above.

[6] ***Credit Suisse Asset Management Ltd v Armstrong*** [1996] ICR 882

OPTION 2: BAN NON-COMPETES

25. What do you think could be the benefits of a ban on non-compete clauses in contracts of employment? Please explain your answer.

For the reasons given below, we do not presently support a ban on non-compete clauses in contracts of employment. Whilst we recognize that it is possible that a ban on non-competes might promote greater employee mobility and foster increased competition and innovation (the principal benefits cited in the consultation paper), (i) we are not aware of any empirical evidence which would justify such a conclusion, particularly in the specific economic and social context of the UK, and (ii) our collective professional experience does not lead us to think that such a radical change in the law is necessary or desirable. Moreover, whilst we would (as interested citizens) generally support policy measures designed to strengthen the UK economy, we do not understand there to be a particular problem at present with innovation. In the *Global Innovation Index 2020* produced by the World Intellectual Property Organization, the UK ranks 4th amongst high-income economies, and 3rd in Europe (after Switzerland and Sweden).[7]

In our view, the non-compete performs an important role in protecting employers who have lost a senior executive or senior technical employee to a rival in trade seeking to exploit the former employee's recent insights into the ex-employer's strategies and innovation. In our experience, the employer seeking to use the shield of a non-compete to protect it from the exploitation of its strategic or technical information by a rival in trade can just as much be a small innovative start-up seeking to defend itself from the predations of a major corporation as a major corporation perceived to be using a non-compete to shackle an innovative employee. We are also concerned that banning the use of non-competes in employment contracts could act to dissuade venture capitalists from investing seed capital in innovative start-up companies at a time when confidential information is the start-up's core asset.

The consultation paper also mentions increased certainty as another potential benefit of a ban. Although we agree that bright-line rules can promote legal certainty, in the present context we consider that the loss of nuance and flexibility which would follow from an outright ban is too high a price to pay for a marginal gain in certainty and clarity. In our experience, the court's regulation of non-competes at common law is sophisticated, searching and case sensitive.[8] That is not to say, however, that we are opposed to some modification and clarification of the existing law by means of statutory intervention. We have made some suggestions above (under 'Option 1') and below as to potential reforms to the existing law, and we would envisage that any such reforms would, if implemented by a carefully-drafted statute, contribute to greater certainty for employers, employees and advisers.

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[7] Cornell University, INSEAD, and WIPO (2020), *The Global Innovation Index 2020: Who Will Finance Innovation?* Available at https://www.wipo.int/edocs/pubdocs/en/wipo_pub_gii_2020.pdf. It is our understanding that both Swiss and Swedish law allow employee non-competes where they are reasonable.

[8] See, for example Gloster J's exposition of the relevant considerations in ***Brake Bros v Ungless*** [2004] EWHC 2799 at [15].

Notwithstanding our opposition to a ban, we have also briefly considered whether there might be any other benefits beyond those mentioned in the consultation paper. We are aware that President Biden's administration has proposed a Federal ban on non-compete covenants as part of a package of strengthening employees' rights and raising wages.[9] It is possible that a ban on non-competes in the UK could have some similar benefits. However, (i) we do not know whether there is empirical evidence and/or economic modelling which suggests that wages are/would be higher in the absence of non-competes; (ii) our view, based on our collective professional experience, is that the current substantive law[10] of the UK has evolved so as to ensure that such covenants cannot be used to oppress junior or low-paid employees, or to restrict mobility *per se*[11] (though we recognise employees face economic and procedural hurdles to legal challenges); however (iii) we do not have a sufficiently global view of the UK labour market to know to what extent restrictive covenants are nevertheless being 'abusively' inserted into contracts in circumstances where they would clearly be unenforceable (which seems to have been the driving force behind many of the efforts to reform the law at the federal level in the US).

26. What do you think might be the potential risks or unintended consequences of a ban on non-compete clauses? Please explain your answer.

Our collective experience as a group of barristers litigating and advising on cases involving employee-mobility issues is that employers are acutely concerned to protect their confidential commercial information and trade secrets from unfair exploitation by former employees and competitors and view the non-compete as an essential shield to fill a hole in the wall of protection caused by the uncertainties of defining what are trade secrets.[12] We suspect that a ban on non-competes would encourage businesses and their advisers to find alternative routes to target those who they perceive to be endangering their confidential information. This could lead to:

- Growth in litigation in which an employer asserts a claim against an ex-employee and/or their new employer for breach of confidence (or a related remedy, or potentially, an intellectual property-based claim).[13] Indeed, we are aware of some evidence, both empirical and anecdotal, to suggest that the unavailability of non-

[9] See https://joebiden.com/empowerworkers/

[10] Elsewhere in this response we have made some suggestions for how procedural law could be reformed so as to redress the present imbalance between Claimants and Defendants in injunctive proceedings.

[11] A covenant against competition *per se* has been regarded as void at least since the decision of the House of Lords in ***Herbert Morris v Saxelby*** [1916] 1 AC 688. For a recent example of a finding that a non-compete covenant was unreasonable and therefore void in respect of a relatively junior employee see ***Quilter Private Client Advisers Limited v Emma Falconer Continuum (Financial Services) LLP*** [2020] EWHC 3294 (QB)

[12] In ***Littlewoods v Harris*** [1977] 1 WLR 1472 at 1479A-E, Lord Denning defined the legitimate purpose of a non-compete as being to protect the employer's confidential information from being passed to its rival in trade where an ordinary confidentiality clause would not be sufficient because: (a) it is difficult to draw the line between information which is or is not confidential; and (b) it is difficult to prove a breach when the information is of a character which the employee can carry away in his head. In our experience, that definition remains true.

[13] For example, under the *Trade Secrets (Enforcement, etc.) Regulations 2018 (SI 2018/597)*, or for breach of copyright, under the 'Database right' in Directive 96/9/EC or for breach of fiduciary duty, or in conspiracy and the other economic torts.

compete covenants in California has driven a significant increase in trade secrets litigation in that jurisdiction.[14]
We make three further comments about this potential phenomenon:

(i) Trade Secrets and intellectual property-based litigation has the potential to be considerably more intrusive into the private lives of individual employees. If an employer cannot rely on a non-compete covenant to protect its confidential information then it may resort to increased workplace monitoring during the currency of the employment, and may seek extraordinary injunctive relief from the court after the employment has ended (such as search and seizure orders, computer imaging orders and orders for delivery up or destruction);

(ii) Because it is more legally and procedurally complex, trade secrets litigation tends to be more expensive and may take more court time than litigation to enforce a restrictive covenant;

(iii) Not least because of the preceding two points, we would not regard the availability of trade secrets and intellectual property-based litigation as a satisfactory substitute for the existence of non-compete covenants. We would also caution against the conclusion that the California experience shows that trade secrets litigation provides a sufficient alternative means for employers to protect their legitimate business interests. There are many procedural differences between Californian and English law, but one significant advantage available to litigants in California is the ability to take depositions from (i.e. cross-examine) defendants at an early stage of the litigation.[15] No equivalent procedure exists for litigants in England under the Civil Procedure Rules.

- Growth in the use of garden leave as a substitute for a non-compete covenant. The common assumption that garden leave provides a more flexible and more reasonable restriction than a non-compete is not necessarily true. Garden leave can be "more onerous" than a post-termination restriction because it may stop an employee from exercising his skills, and contributing to the economy, entirely for 6 months or so where a non-compete would only restrict competitive employment.[16] This would appear to be contrary to the aims of this consultation;

- *In extremis*, anti-competitive behaviour by employers acting in concert by, for example, agreeing not to offer employment to each other's employees (which is likely to be

[14] See for example: https://www.faircompetitionlaw.com/2017/06/25/california-trade-secrets-litigation-supplants-noncompete-litigation/ noting a 4 to 5-fold increase in trade secret litigation in California following the California Supreme Court's decision in ***Edwards v Arthur Andersen*** 44 Cal. 4th 937 (2008) (referred to further below).
[15] Depositions are available under rule 30 of the *Federal Rules of Civil Procedure* and §2025.010ff of the California Code of Civil Procedure. Courts often order expedited discovery in trade secrets litigation which can allow a plaintiff to depose a defendant before a preliminary injunction hearing.
[16] See the remarks of Cox J in ***TFS Derivatives v Morgan*** [2004] EWHC 3181 (QB), [2005] IRLR 246 at [76]-[84].

unlawful on the current state of English law).[17] This happened in the high-tech industry in California and was the subject of an antitrust investigation by the US Department of Justice, subsequent proceedings brought in 2010, and a substantial settlement in 2011.[18]

27. Would you support a ban on non-compete clauses in contracts of employment? Please explain your answer.

No, we would not at present support a ban on non-compete clauses in contracts of employment. The reasons for our view are as follows:

(i) Banning non-compete clauses in contracts of employment would constitute a very significant change to English law. Reasonable non-competition covenants designed to protect an employer's legitimate business interests have been upheld at common law in this jurisdiction probably since the decision in ***Mitchel v Reynolds*** (1711) 1 P Wms 181 and at least since the decision of the House of Lords in ***Nordenfelt v Maxim Nordenfelt Guns & Ammunition Co Ltd*** [1894] AC 535. It is reasonable to infer that they have therefore been fairly consistently viewed by litigants, lawyers and judges as something worth retaining in English law;

(ii) Whilst the sanction of historical practice is certainly not conclusive, in light of the historical position we would expect there to be a robust body of evidence justifying a radical departure from the current law. As we have stated above, we are not aware of any body of empirical evidence demonstrating a link between the common law approach to non-competes in employment agreements and a lack of innovation, or a problem with labour mobility, in the UK economy (we deal below with the particular analogy of California). Indeed, we are not aware of evidence which suggests that the UK economy lacks innovation at all;

(iii) In the absence of empirical evidence, we would expect there either to be a strong theoretical basis for the proposed change in law, and/or significant public support for it. We are not aware of either. Indeed, the majority of responses to the then Government's 'Call for Evidence' on non-compete clauses in 2016 were to the effect that the law worked well and was not in need of change. As the Government stated on 25 May 2016: "*The common view across the majority of responses was that restrictive covenants are a valuable and necessary tool for employers to use to protect their business interests and do not unfairly impact on an individual's ability to find other work. Common law has developed in this area for over a century and is generally acknowledged to work well*";

[17] See ***Kores Manufacturing Co Ltd v Kolok Manufacturing Co Ltd*** [1959] Ch 108, ***Hanover v Schapiro*** [1994] IRLR 82 per Dillon LJ at [15], ***Eastham v Newcastle United*** [1964] 1 Ch 413 at 442–443 per Wilberforce J and ***Cantor Fitzgerald v Bird*** [2002] IRLR 867 at [137] and [142]. Such an agreement might also be void under s.2 *Competition Act 1998*.

[18] See https://www.justice.gov/atr/case/us-v-adobe-systems-inc-et-al. Subsequent to the proceedings brought by the DoJ there was a class action which also subsequently settled. See: https://www.cand.uscourts.gov/judges/koh-lucy-h-lhk/in-re-high-tech-employee-antitrust-litigation/

(iv) We are of the view that, for the most part, the current substantive law on non-competes works well. Applying a judicial standard of reasonableness provides for flexibility and a context-sensitive approach to enforcement, and the accretion of case law across a wide-range of industries allows experienced advisers to advise their clients with confidence. If reform is needed in this area of the law, then banning non-competes is not it.

The consultation paper refers to California as a jurisdiction which "*is home to some of the world's most innovative organisations and tech clusters, where non-compete clauses are void, regardless of whether they are reasonable.*" It acknowledges that "*the success of* [California] *is based on a host of factors*" but says that its "*innovative approach to non-compete clauses should not be discarded as playing a part.*" Whilst we welcome the consultation paper's consideration of international comparators, we do not think that the example of California by itself provides sufficient justification for the abolition of non-competes in English law. We make the following observations:

(i) It is not strictly accurate to refer to California's approach to non-competes as 'innovative'. There has been a statutory ban on non-compete clauses in California since 1872.[19] This is significant, because it means that it is not possible to assess whether California's economic success, particularly in the high-tech industry, was caused or contributed to by a *change* in the law;

(ii) Whilst it has been hypothesised that the success of Silicon Valley is due in significant part to the absence of non-competes in the employment contracts of tech workers,[20] that hypothesis is far from universally accepted amongst scholars and practitioners in the United States;

(iii) There is, in fact, a lively debate in the scholarly literature about the contribution of California's non-compete ban to the success of California's high-tech economy. Our understanding is that although there is a growing body of empirical research (some of which we have referred to in our answer to question 33 below), it has not been possible to demonstrate that there is a definite causal link between California's ban and its economic success;

(iv) Many other candidates for California's success have been put forward – the close relationship between Stanford University and tech companies, the early presence of venture capital firms in Menlo Park, and the compounding effects of early tech success among others. A combination of all of these seems to us to be plausible, but none can easily be analogised to the UK situation;

(v) California is one of only three states (along with Oklahoma and North Dakota, neither of which has a thriving tech industry) which completely ban non-competes in employment agreements.[21] The rest of the 47 states have laws which are essentially

[19] Originally enacted in section 1673 of the Civil Code, now in § *16600 of the California Business and Professions Code.* The key recent decision is ***Edwards v Arthur Andersen*** 44 Cal. 4th 937 (2008) in which the California Supreme Court re-emphasised that there is no exception for narrowly drawn restraints.
[20] See in particular the article cited below by Professor Ronald Gilson
[21] See https://www.faircompetitionlaw.com/wp-content/uploads/2020/12/Noncompetes-50-State-Survey-Chart-20201218.pdf

very similar to English law (i.e. non-competes are generally enforceable only if narrowly tailored to serve a legitimate business interest).[22] Although the legislatures of many states have in recent years considered adopting the California model, only the District of Columbia has in fact done so – its ban comes into force in March 2021;[23]

(vi) There has recently been considerable reporting about the 'exodus' of tech companies from California, particularly in the wake of the Covid-19 pandemic.[24] Many of the companies who have left, or who have threatened to leave California, have done so in favour of Texas. Section 15.50 of the Texas Business & Commerce Code[25] provides "*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.*"

28. If the Government introduced a ban on non-compete clauses, do you think the ban should extend to wider workplace contracts?

As stated above, we do not presently support the introduction of such a ban. If the government were to proceed with a ban, however, careful thought would need to be given to the categories of worker to which it applied. As the law of England and Wales currently stands, the boundaries between the categories of (i) self-employed, (ii) so-called 'limb-b worker' and (iii) employee are not precise. Clearly the introduction of any ban affecting only employees (as defined) has the potential to lead to confusion about the application of the law to those in the other categories, abusive re-classification practices and other problems.

29. Do you think a ban should be limited to non-compete clauses only or do you think it should also apply to other restrictive covenants? If the latter, please explain which and why.

As stated above, we do not support the introduction of a ban on non-compete clauses. We do not see that there is a case for the introduction of a ban on other types of restrictive covenants in the employment context.

30. If the Government introduced a ban on non-compete clauses in contracts of employment, do you think there are any circumstances where a non-compete clause should be enforceable? If yes, please explain.

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[22] As reflected in the *Restatement of Employment Law* §8.06: "*a covenant in an agreement between an employer and a former employee restricting the former* employee's *working activities is enforceable only if it is reasonably tailored in scope, geography, and time to further a protectable interest of the employer*…" For an example comparative analysis of English law and the law of a US state regarding non-competes, see ***Duarte v Black & Decker*** [2007] EWHC 2720 (QB), [2008] 1 All ER (Comm) 401 (re. the law of Maryland, an economically successful state with defence, aerospace and bio-research industries).

[23] See https://lims.dccouncil.us/Legislation/B23-0494

[24] See, for example, https://www.sfchronicle.com/opinion/openforum/article/Silicon-Valley-s-exodus-Stop-blaming-tech-15928928.php and https://www.latimes.com/opinion/story/2021-01-03/tech-industries-california-exodus-tesla-oracle (referring to academic research on California's loss of market share in innovative industries).

[25] https://statutes.capitol.texas.gov/Docs/BC/htm/BC.15.htm

We do not presently support the introduction of such a ban, but we would observe that selectivity in its application might be a recipe for confusion, and litigation.

31. Are there options short of banning non-compete clauses which would limit their enforceability in the interests of spreading innovation? Please explain your answer.

We are aware of US jurisdictions which, after review, have decided to introduce bans on non-competes for certain categories of worker, defined either by reference to the industry in which they work, or the level of their gross pay. For example, Hawaii has banned non-competes for employees in a 'technology business' (that is "*a trade or business that derives the majority of its gross income from the sale or license of products or services resulting from its software development or information technology development, or both*")[26] and Illinois (amongst others) has banned non-competes for 'low-wage employees' (those who earn the greater of the local minimum wage or $13 per hour).[27] If there was evidence that there was a problem with non-competes in particular industries, or amongst particular types of workers in the UK, then one option might be some similar type of legislation. We would note, however, that any such legislation would need to be carefully drafted so as to adequately capture the intended group without resorting to undue complexity in the statutory language.

If there were empirical evidence that non-competes were being 'abusively' inserted into the contracts of UK employees in circumstances where they would clearly be unenforceable, and that employees were dissuaded from challenging their enforceability by the economic and procedural hurdles to accessing justice in such cases,[28] we would favour reform aimed at ensuring a greater equality of arms and level playing field for employees challenging enforceability. Some ideas might include the imposition of a higher threshold for granting interim relief in non-compete cases (higher, that is, than the *American Cyanamid* 'serious issue to be tried' test),[29] or a relaxation of the 'loser pays' principle. However those subjects lie beyond the ambit of the present consultation.

32. Are you aware of any instances where a non-compete clause has restricted the spread of innovation/innovative ideas? Please explain your answer.

We are aware of a few extreme cases where attempts have been made to use non-competes to stifle the innovative ideas of inventors, for example, of a new type of medical ventilator,[30] or of a type of wound dressing able to stimulate cell growth. However, these types of cases in our experience generally occur in contracts involving the sale of goodwill or in the nature of a joint investment towards a future sale of goodwill (private equity or venture capital

[26] Haw. Rev. Stat. § 480-4. See https://www.capitol.hawaii.gov/hrscurrent/Vol11_Ch0476-0490/HRS0480/HRS_0480-0004.htm

[27] 820 I.L.C.S. §§ 90/1-90/10. See https://www.ilga.gov/legislation/ilcs/ilcs3.asp?ActID=3737&ChapterID=68

[28] These hurdles have been the subject of judicial comment. In ***Caterpillar Logistics Services v Huesca de Crean*** [2012] EWCA Civ 156, [2012] ICR 981 (a trade secrets case) Stanley Burnton LJ observed at [71] that in a situation where an employee "*whose annual salary would be a small fraction of the costs of litigation*" is sued by a large corporation "*Many defendants… would simply concede rather than risk bankruptcy.*"

[29] Some judicial modification has been made to the *American Cyanamid* test in circumstances where the grant of an injunction will be conclusive of the litigation, see ***NWL Limited v Woods*** [1979] 1 WLR 1294, at 1307 per Lord Diplock, and ***Lansing Linde v Kerr*** [1991] 1 WLR 251, at 258A-D per Staughton LJ. For a recent example of the principle's application see ***P14 Medical Ltd v Mahon*** [2020] EWHC 1823 (QB), [2021] IRLR 39 at [16]-[25] per Cavanagh J. Consideration could be given to codifying and extending this principle.

[30] See ***Dranez Anstalt v Hayek*** [2002] EWCA Civ 1729, [2003] 1 BCLC 278

investment arrangements) rather than in employment cases. Also, the common law already, theoretically, has the means to address this vice because the test of enforceability is one encompassing not only reasonableness in the interests of the parties but also reasonableness in the interests of the public at large.

33. If you are aware of any literature, research, or evidence from your own business experience that looks at the impact of non-compete clauses on competition, innovation, or economic growth please list the publications below.

There is a very extensive literature in law reviews and other publications in the United States. We are aware of and have considered only a small fraction of this. We refer to the following brief list of sources:

- Ronald J Gilson, *The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete*, 74 NYU Law Review, 575 (1999)
- Michael J. Garrison & John T. Wendt, *The Evolving Law of Employee Noncompete Agreements: Recent Trends and an Alternative Policy Approach*, 45 American Business Law Journal 107 (2008).
- Robert W Gomulkiewicz, *Leaky Covenants-Not-to-Compete as the Legal Infrastructure for Innovation*, 49 UC Davis Law Review 251 (2015)
- Norman D. Bishara, Kenneth J. Martin & Randall S. Thomas, *An Empirical Analysis of Noncompetition Clauses and Other Restrictive Postemployment Covenants*, 68 Vanderbilt Law Review 1 (2015)
- Norman D. Bishara & Evan Starr, *The Incomplete Noncompete Picture*, 20 Lewis & Clark Law Review, 497 (2016)
- Office of Economic Policy, US Department of the Treasury *Non-compete Contracts: Economic Effects and Policy Implications* (2016) Available at: https://home.treasury.gov/system/files/226/Non_Compete_Contracts_Econimic_Effects_and_Policy_Implications_MAR2016.pdf
- Eric A Posner, *The Antitrust Challenge to Covenants Not to Compete in Employment Contracts*, 83 Antitrust Law Journal, 165 (2020)

There is also a great deal of useful information on the law of the US in this area on the blog maintained by the law firm Beck Reed Riden LLP: https://www.faircompetitionlaw.com/

Questions 34 to 37

We have not answered these questions which are directed specifically at employers.

Yours faithfully,

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