TESTIMONY BEFORE THE SENATE STANDING COMMITTEE ON Labor and SENATE STANDING COMMITTEE ON Commerce, Economic Development, and Small Business

NEW YORK STATE SENATE

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Joint Hearing on S.3100, An act to amend the labor law, in relation to prohibiting non-compete agreements and certain restrictive covenants

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My name is Brian Callaci. I am Chief Economist at the Open Markets Institute. We are a research and advocacy organization focused on antimonopoly policy headquartered in Washington, DC. My PhD in economics is from the University of Massachusetts Amherst, and my research focuses on the effects of restrictive contracts imposed on workers and small businesses. I would like to thank Chair Ramos, Chair Ryan, and the other members of the Committees for the opportunity to participate in this hearing.

We support S.3100 for enacting a ban on non-compete clauses and other similar provisions in labor contracts, which prevent workers from changing jobs to work for the employer of their choice or to start their own business. By limiting worker mobility, non-compete clauses drive down wages, reduce the formation of new businesses, and trap workers in jobs where they may be subject to unsafe working conditions, discrimination, and abuse. The bill would eliminate these pernicious contracts for all workers, irrespective of their income, line of work, or employment classification.

In March 2019, the Open Markets Institute led a coalition of civil society organizations, labor unions, legal experts, and economists that formally petitioned the Federal Trade Commission to use its authority under the FTC Act to issue a rule prohibiting non-compete clauses in labor contracts as an unfair method of competition that is *per se* illegal.[1] The petition called for an FTC rule that would make non-compete clauses illegal for all workers.

In January of this year, the FTC proposed a rule that would do just that. With S.3100, New York is poised to also protect workers, consumers, and small businesses from these coercive contracts, giving workers important additional protections under state law, and safeguarding the rights of workers, consumers, and small business owners in the event the FTC's final rule has any gaps or

[1] Open Markets Inst. et al., Petition for Rulemaking to Prohibit Worker Non-Compete Clauses (March 20, 2019), https://www.openmarketsinstitute.org/publications/open-markets-afl-cio-seiu-60-signatories-demand-ftc-ban-worker-non-compete-clauses.

is struck down by a court. Further, unlike the FTC rule, which only the FTC would be able to enforce, workers, under S. 3100, would be able to bring private lawsuits against employers who use non-compete clauses.

The economic research is very clear: evidence strongly supports the need for a ban on non-compete clauses. The use of non-compete clauses reduces labor market mobility and generally depresses wages, wage growth, and small business formation.[2] These contracts are in wide use, affecting as many as 60 million private-sector workers nationwide.[3] The FTC estimates that non-competes cost workers $300 billion per year.[4] These contracts are imposed on workers, not negotiated: a national survey study found that only 10% of employees negotiate over their non-competes, and one-third are presented with them after only accepting their job offers.[5]

Non-compete contracts, and similar contracts that limit worker mobility, suppress wages. A recent study exploring the 2008 Oregon ban on non-compete clauses found that banning non-competes increased wages by as much as 14%-21%.[6] Another study found that wages of technology workers rose 4% after non-competes were made non-enforceable in that sector in Hawaii.[7] The adverse effects of restrictions on labor mobility appear to be especially pronounced for women and people of color. Research has found that stronger enforcement of non-compete clauses "reduces earnings for female and for non-white workers by twice as much as for white male workers."[8]

It is not just workers who are harmed by non-competes. Employers' use of non-compete clauses also has adverse effects on competitors and consumers in product and service markets. Using non-compete clauses, employers can foreclose competitors in downstream markets. By tying up specialized workers with non-compete clauses, dominant firms can prevent new entrants and small rivals from hiring the labor they need to compete effectively and grow.[9] In other words,

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[2] *See, e.g.*, U.S. Dep't of Treasury, Non-Compete Contracts: Economic Effects and Policy Implications 20 (2016), https://home.treasury.gov/system/files/226/Non_Compete_Contracts_Econimic_Effects_and_Policy_Implications_MAR2016.pdf; Evan Starr, *Consider This: Training, Wages, and the Enforceability of Covenants Not to Compete* 17 (2018); Toby E. Stuart & Olav Sorenson, *Liquidity Events and the Geographic Distribution of Entrepreneurial Activity*, 48 ADMIN. SCI. Q. 175, 197 (2003).

[3] ALEXANDER J.S. COLVIN & HEIDI SHIERHOLZ, NONCOMPETE AGREEMENTS 2 (2019), https://www.epi.org/publication/noncompete-agreements/.

[4] Non-Compete Clause Rule, 88 Fed. Reg. 3482 (proposed January 19, 2023) (to be codified at 16 C.F.R. pt. 910).

[5] Evan Starr, Justin Frake & Rajshree Agarwal, *Mobility Constraint Externalities*, 30 ORGAN. SCI. 961 (2019).

[6] Michael Lipsitz & Evan Starr, *Low-Wage Workers and the Enforceability of Noncompete Agreements*, MANAG. SCI. (2021).

[7] Natarajan Balasubramanian et al., *Locked In? The Enforceability of Covenants Not to Compete and the Careers of High-Tech Workers*, 57 J. HUM. RESOUR. S349 (2022).

[8] MATTHEW S. JOHNSON, KURT LAVETTI & MICHAEL LIPSITZ, *The Labor Market Effects of Legal Restrictions on Worker Mobility*, (2020), https://papers.ssrn.com/abstract=3455381

[9] *See, e.g.*, BRFHH Shreveport, LLC v. Willis Knighton Med. Ctr., 176 F. Supp. 3d 606, 625 (W.D. La. 2016) ("Vantage also asserts that its allegations of Willis-Knighton's non-compete agreements with its physicians and its control of physician referrals are anticompetitive under section 2 of the Sherman Act."); Warren Greenberg, *Marshfield Clinic, Physician Networks, and the Exercise of Monopoly Power*, 33 HSR: HEALTH SERVS. RSCH. 1461, 1470 (1998) ("The Marshfield Clinic also enforced a non-compete clause with physicians who were formerly

non-competes can be used as a tool to foreclose critical inputs and cement monopoly power and market dominance.[10] This fortification of monopoly and oligopoly power can inflict significant and durable injuries on consumers who pay higher prices and are deprived of higher quality goods and services. More generally, the use of non-compete clauses by incumbent corporations for specialized workers can slow the entry and growth of new firms.[11]

It is important to ban non-competes outright, not merely make them unenforceable. S.3100, crucially, does enact such a ban. Research has found that non-competes discourage workers from leaving, even when employers cannot or do not enforce them in court.[12] This tells us that the existence of non-competes—regardless of whether employers can, or seek to, enforce them—is enough to harm workers. Employers recognize this fact and use non-competes even when they cannot enforce them through litigation.

Because many workers fear the cost and stresses of litigation and the risk of being liable for damages to their employers,[13] comparatively few non-compete clauses are tested in court. Thus, these contracts inflict harm on workers through their mere existence. As legal scholar Harlan Blake wrote, "For every covenant [not to compete] that finds its way to court, there are thousands which exercise an *in terrorem* effect on employees who respect their contractual obligations[.]"[14] This chilling effect on labor market mobility may be especially strong for women.[15]

California's experience is revealing. Under California law, employers cannot enforce non-compete clauses against workers in court.[16] This has been the law for more than 150 years.[17] Nonetheless, nearly 30% of workplaces still impose non-compete clauses on *all* employees and approximately 45% use these contracts with some of their employees.[18] Anything short of a complete ban on non-compete clauses and similar contracts is an invitation to employers to continue including these restraints in employment agreements and employee handbooks.

Whereas the harms from non-competes are real and well documented, the justification for these contracts is unpersuasive. Employers and their representatives assert that non-competes are

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employed by Marshfield. Such physicians could not practice within 30 miles of Marshfield for three years after termination from the Clinic, resulting in less competition to the Marshfield Clinic.")

[10] Jonathan B. Baker, *Exclusion as a Core Competition Concern*, 78 ANTITRUST L.J. 527, 540 (2012).

[11] Benjamin Glasner, *The Effects of Noncompete Agreement Reforms on Business Formation: A Comparison of Hawaii and Oregon*, (2023), https://eig.org/noncompetes-research-note/ (last visited Apr 5, 2023).

[12] Evan Starr, J.J. Prescott & Norman Bishara, *Noncompetes and Employee Mobility*, 2019 ACAD. MANAG. PROC. 13874 (2019).

[13] Matt Marx, *Employee Non-compete Agreements, Gender, and Entrepreneurship*, 33 ORG. SCI. 1756, 1760 (2022).

[14] Harlan M. Blake, *Employee Agreements Not to Compete*, 73 HARV. L. REV. 625, 682 (1960).

[15] Marx, *supra* note at 1769-70.

[16] CAL. BUS. & PROF. CODE § 16600.

[17] *See* Edwards v. Arthur Andersen LLP, 189 P.3d 285, 290 (Cal. 2008) ("[I]n 1872 California settled public policy in favor of open competition, and rejected the common law 'rule of reasonableness,' when the Legislature enacted the Civil Code.").

[18] Alexander J.S. Colvin & Heidi Shierholz, *Noncompete Agreements*, 6 (2019), https://files.epi.org/pdf/179414.pdf.

necessary for protecting trade secrets, customer lists, and other business information. According to this theory, restricting worker departure is necessary to prevent the appropriation of knowhow by rivals or workers who want to start competing businesses. However, to the extent employers do need to safeguard proprietary information, they have several less restrictive alternatives for preventing unauthorized disclosures. They can use copyright and trade secret law and targeted non-solicitation agreements to ensure that their valuable information is protected. Indeed, S.3100 makes explicit allowance for the use of such contracts. For high-level workers with regular access to sensitive business information, employers can also opt out of the default rule of at-will employment through fixed-term employment contracts that commit both parties (employer and employee) to the relationship for a period.[19] Such contracts characterize professional sports in the United States today. And S.3100 makes allowance for fixed-term contracts as well.

Another argument deployed by employers and the employer lobby to justify non-competes is that that they reduce employee turnover and promote employer investments in worker training, by barring workers from leaving and taking their skills to rival employers. Non-competes, in this view, give employers incentives to train workers, which ultimately benefits both parties.[20] However, by the same token, non-competes also lower workers' own incentives to invest in their own training: why try to learn new skills if you can't find a new job and get fair value for them?

The research suggests that when non-competes are banned, employers find other, better ways of retaining a loyal workforce and protecting mutual investments in training, such as higher wages, good working conditions, and the promise of future promotion and raises contingent on good performance. In other words, when prevented from using the cheap stick of non-competes, employers turn to less coercive carrots. The evidence cited earlier, showing that wages rise when employers cannot impose non-competes, suggests that turning from sticks to carrots is precisely how employers respond to noncompete bans. Indeed, research shows that employers do not even value their own non-competes very much: when Washington State banned non-competes for employees earning less than $100,000 per year, employers who really valued non-competes would have given workers just below the threshold tiny raises to make them exempt from the ban. Few did so.[21]

In contrast to these other methods of protecting proprietary information, non-competes are, in the words of University of Denver law professor Viva Moffat, "the wrong tool for the job."[22] They are overbroad. Non-competes restrain worker mobility with the purported aim of protecting business information even if it is dated or trivial. For instance, a worker who has been with an employer for ten years and generated substantial revenues and profits for the company can be locked into place by a non-compete because the employer wants to guard job training materials

[19] Nickens v. Labor Agency of Metropolitan Washington, 600 A.2d 813, 816 (D.C. 1991).
[20] United States Chamber of Commerce, Comment on FTC Non-Compete Notice of Propose Rulemaking. https://www.uschamber.com/assets/documents/FTC-Noncompete-Comment-Letter_FINAL_04.17.23.pdf
[21] Takuya Hiraiwa, Michael Lipsitz & Evan Starr, *Do Firms Value Court Enforceability of Noncompete Agreements? A Revealed Preference Approach*, (2023), https://papers.ssrn.com/abstract=4364674
[22] Viva R. Moffat, *The Wrong Tool for the Job: The IP Problem with Noncompetition Agreements*, 52 WM. & MARY L. REV. 873 (2010).

provided to the worker years earlier. At the same time, non-competes are too narrow. For example, they do not prevent the unauthorized, covert disclosure of trade secrets to competitors. They are poorly targeted for their ostensible purpose.[23]

Given the documented injuries to workers from non-competes and the specious employer justifications for their use, a categorical ban on these contracts is the correct policy. S.3100 does this. It should maintain this universal approach and not include any carveouts tied to income, line of work, or employment status.

Thank you for your time.

[23] Sandeep Vaheesan, *The Bogus Justification for Worker Non-Compete Clauses*, ON LABOR, Apr. 24, 2019, https://onlabor.org/the-bogus-justification-for-worker-non-compete-clauses/.