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# States Take Lead Role in Protecting Employee Rights

Kurt Stanberry[1]

***Abstract***
*This paper examines a controversy in U.S. employment regulation. Employers in the U.S. are using two techniques, no poach and non-compete agreements, to prevent employees from leaving for better paying jobs. This has a potentially negative effect on employee wages and on the economy as a whole, leading to stagnation in wage growth. Furthermore, it is a debatable ethical practice because it interferes with an employee's right to choose for whom they will work. Multiple states in the U.S. have begun to take action to prevent the use of these employment techniques, especially as applied to low-wage employees.*

**Key words:** non-compete, no poach, employment regulation

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## INTRODUCTION

Workplace regulation is going through a metamorphosis, as leadership shifts from the federal government to the states. This article examines the new leadership role of the states, specifically with regard to the issue of employees and the freedom to change jobs under 'no poaching' and 'non-compete' agreements.

The 1930's saw the birth of employment laws designed to protect American workers, part of the New Deal under FDR. The federal government played the lead role in creating and enforcing worker rights in an era that stretched over eighty years. Today however, in the 21st century version of the 'new deal', states are now filling a void created at the federal level as regulation falls out of favor in Washington, D.C.

For decades, the cascading array of federal employment laws, and the agencies that enforced them, were so strong that it minimized the role of state legislatures. However, that era of strong central government regulation appears to be ending, as the federal government cedes responsibility for employee protection to state governments. This is true on a wide range of issues from minimum wage to the gender pay gap to the legality of 'non-compete' and 'no poaching' agreements.

## STATEMENT OF THE PROBLEM

A key issue in the area of labor economics and employment regulation is employee freedom, or the lack thereof, as it relates to the right to choose where and for whom they want to work. When one describes the attributes of a system of democratic capitalism, in its purest form, a free marketplace for all is a foundational principle. As applied to the concept of employment, this means that a worker should have the right, the freedom, to work for whomever offers them the best job, seeking the highest compensation and best working conditions possible. The problem is that, due to the extensive use of no poaching and non-compete agreements, this is not true for many American workers, and it has a potentially adverse effect on workers and the economy.

## BRIEF HISTORY OF THE PROBLEM

For the past two decades, many U.S. businesses have increasingly turned to the use of two techniques, both of which have a dubious ethical basis, to prevent workers from seeking better jobs: 1) 'no poaching' agreements between competitors, and 2) 'non-compete' agreements with employees. In what is essentially an attempt to keep the wages of ordinary rank-and-file workers artificially low, thus keeping employer labor costs down, employers have these two methods to accomplish what amounts to, in many circumstances, unregulated anticompetitive practices. It is not consistent with basic American economic values; rather it is an example of just the opposite. It is, at its foundation, what many would term anti-

[1] *University of Houston-Downtown, Davies College of Business, PLM Endowed Professor of Business*
*E-mail: stanberryk@uhd.edu*

American. It locks low-wage workers in place, essentially forcing them to stay in their current job, unable to seek a similar job for better wages and pursue opportunities to get ahead.

While it is understandable that employers want to keep their cost of labor as low as possible, when companies try to accomplish that goal artificially by controlling employee freedom of choice and mobility, it becomes problematic. Now in some states, it is illegal. The federal government, in keeping with a recent trend, has remained inactive in terms of passing any laws, or promulgating any regulations, to address the overuse of non-compete clauses or the overreaching use of no poaching clauses. Instead, it is action by state legislatures, and state attorneys general, which is leading the way in protecting employee rights

**CASE EXAMPLES**

Many major restaurant chains, including Arby's, Carl's Jr., McDonald's, Jimmy John's, Auntie Anne's, Buffalo Wild Wings, Cinnabon, Applebee's, Church's Chicken, Five Guys, IHOP, Jamba Juice, Little Caesars, Panera Bread and Sonic have all used a combination of two repressive employment techniques. More broadly, hundreds of other businesses use them across the nation.

As a specific example, the Jimmy John's company routinely mandated that franchisees purchasing their sandwich shop franchises agree to a contract that contained a no-poach clause. Additionally, Jimmy John's would mandate that all employees hired had to sign a non-compete agreement. Of course, this benefitted the franchisees, so Jimmy John's did not receive push back on the no poaching clauses from that group. Employees had no bargaining power; they had to sign them to get a job, even as a sandwich maker.

While some might believe that a large corporation would not really bother to enforce such a clause against mere sandwich makers, that has not been the case. Jimmy John's has maintained a policy of routinely enforcing such agreements at all levels. This case demonstrates the ripple down effect of non-competes on low-level workers. Jimmy John's company policy prohibited all departing employees from taking jobs with competitors for two years after leaving the company, and/or from working within a minimum two-mile radius of a Jimmy John's store. (Whitten 2016).

Some of the companies mentioned above did not go quite as far as did Jimmy John's. For example, while Carl's Jr. franchisees were prohibited from poaching workers from another Carl's Jr., they do not stop those workers from taking jobs at restaurants run by a different chain.

Many types of franchise businesses impose these clauses, but they are especially prevalent in the restaurant and fast food industry, which relies overwhelmingly on independently owned and operated franchise stores. These are the very businesses that employ a large number of low-wage workers, exactly the type of employee that might benefit from even a fifty cent per hour increase in pay. However, many of these lower-wage workers may find that seeking a raise by changing jobs is impossible because there is a contract that prevents it. Such employment practices adversely affect many tens of thousands of workers nationwide.

Furthermore, it is not only in industries such as fast food where there has been an increase in the use of non-competes, junior level employees in Wall Street and Silicon Valley have felt the ramifications of this as well. (Visnawatha 2016). Employees at levels in all types of companies are frequently being required to sign them.

**THE ANTICOMPETITIVE NATURE OF NO POACH AGREEMENTS**

No poach clauses tend to hold down pay. This is particularly true for restaurant employees, a very large segment of the lower end of the work force, which has a negative impact on not only the individual worker, but likely also contribute to a broader national economic problem. Some experts worry that wage stagnation that has continued to plague the economy is due in part to these types of clauses that artificially hold down wages. A new job offer from a prospective employer is often the only advantage an employee can use to negotiate a raise, and thus many economists are concerned that these agreements hinder workers' ability to level the playing field.

In 2017, two Princeton economists, Ashenfelter and Krueger, published a study in which they estimated that no-poach clauses affected about 70,000 individual restaurants in the United States, or more than a quarter of all fast-food outlets. Extrapolating the data, if an average fast-food franchise employs about 50 workers, that brings the total to 3.5 million adversely affected workers. After examining the franchise deals of 40 of the country's largest chains, Professors Krueger and Ashenfelter concluded that no-poach restrictions appeared to exist mainly to limit competition and turnover, possibly depressing wages in the process.

**STATE ACTION ON NO POACH AGREEMENTS**

Several states have taken the lead on regulating and/or prohibiting the use of no-poaching agreements. A leading example is the state of Washington, where under a settlement agreement with the state, the seven companies referenced above have pledged to remove no-poaching clauses from their contracts with franchisees. In addition to stripping the clauses from existing franchise contracts in Washington, the seven chains have also vowed not to enforce them nationwide. The clauses cannot be included in new and renewed contracts either.

The attorney general in the state of Washington, whose office reached legally binding agreements with the seven chains, has indicated that his goal is to eliminate these provisions in all fast-food contracts in the state. His office began investigating the issue after The New York Times published an article exploring how the clauses limit workers' mobility. Unlike non-compete clauses, which job-seekers can at least in theory review before signing hiring documents, no-poach provisions are third party agreements in contracts between restaurant chains and franchisees, which independently own and operate the majority of stores. Workers hired at such fast food franchises may not even know they are bound by the restrictions until they try to land new jobs.

McDonald's, the largest fast-food chain in the country (by revenue), finally removed the clause in its franchise contracts in 2017, and announced that it would not enforce them in existing contracts. Nevertheless, some workers' rights advocates have said McDonald's did not always keep that promise. The company's new agreement with the Washington AG's office makes it legally binding.

In all, over 15 major companies including Arby's, Carl's Jr., McDonald's, Jimmy John's, Auntie Anne's, Buffalo Wild Wings, Cinnabon, Applebee's, Church's Chicken, Five Guys, IHOP, Jamba Juice, Little Caesars, Panera Bread and Sonic have agreed to halt the practice. Additionally, the companies may still have to contend with other states. More than ten other attorneys general announced their own inquiry into hiring at major fast-food chains, including Arby's, to determine whether their no-poach clauses broke any laws.

**NON-COMPETE AGREEMENTS**

The use non-compete clauses has become much more widespread over the past two decades, applying not only to executives, but to mid-level and lower-level workers as well. A U.S. Treasury Department report indicates that a rapidly growing number of workers at all levels are being required to sign non-compete agreements, which now control the movement of approximately one-fifth of the workers in the US. (Treasury 2016).

This constitutes a significant portion of the workforce, and is a significantly higher percentage than is necessary in order to protect the good will and intellectual/proprietary property of US companies. (Stanberry & Aven, 2017). Non-compete agreements are used in many employment situations when there is no need for them, with an underlying motive of restricting employee movement at all levels. This increase in the use of non-competes has led to widespread debate among academics, business executives, human resource departments, employment law attorneys, and politicians about the appropriateness and legality of non-compete clauses.

The most rapid area of growth in the use of non-compete agreements is in low-wage, low-skilled occupations, such as the fast food industry. Ordinary employees, such as those frying chicken, or making sandwiches, or throwing pizzas, are now being required to sign contractual agreements to refrain from changing employers within the industry. Non-compete clauses are now used in virtually all industries,

ranging from hairstylists to secretaries to nurses. The US Treasury report contains data indicating that about 1 in 6 workers earning below $40,000/year are under non-compete contracts of some sort, meaning that over 30 million American workers are currently covered by non-compete agreements. (Treasury 2016).

There is a clear anticompetitive problem with the overuse of unnecessary non-competes. Anything that reduces competition in the labor market has potentially negative impacts on the economy. (Stanberry & Aven, 2017). Non-compete clauses can, and do, result in a reduction in employee movement. This in turn can, and does, result in lower wages. Ultimately, this has the possibility of affecting the economy in a negative way. (DOJ 2016).

Recent studies indicate that food workers today are less mobile, and less likely to switch jobs, than they were 25 years ago, due in part to the significantly expanded use of non-compete agreements. (Treasury 2016). The resulting lower wages due to inability to move upward has the potential to reduce the number of employees classified as middle class, a long-term hallmark of the US economy. In contrast, if there were fewer non-compete clauses in use at the lower-levels of employment, and competitors could hire workers from other companies in the same industry, it has the potential to create a benefit for both the worker and the prospective new employer.

**ARE NON-COMPETE AGREEMENTS ALWAYS NECESSARY?**

Many of the employees now covered by non-compete clauses do not possess sensitive proprietary information, and nor are they in a position to be able to lure away lucrative client accounts. In fact, most studies indicate that of all workers covered by non-compete restrictions, fewer than 50% have access to any information that might possibly need protection (White House 2016). The White House under President Obama issued a report entitled, "Non-Compete Agreements: Analysis of the Usage, Potential Issues, and State Responses", analyzes the issue from both perspectives, that of the employer and of the employee. (White House 2016). This report details not only the growing use of non-compete agreements in employee contracts, but also identifies the potential for abuse and misuse, and the potentially negative effects on the economy.

Experts acknowledge that non-compete agreements are legitimate and necessary to protect valuable proprietary information in the hands of upper-level employees. (Fisk 2001). However, since the data indicates that fewer than half of workers who have non-compete agreements possess trade secrets or other such important information, it seems clear that new laws are necessary to limit the use of non-compete clauses. (White House 2016).

**ARE NON-COMPETE AGREEMENTS ENFORCEABLE?**

Some employers have tried to justify the use of non-compete agreements by claiming that such clauses are not always enforced, thus the potential for abuse is not as great as it might appear. However, the data indicates that is not the case at all. The White House report noted that the number of employees being sued by their former employer for breach of non-compete agreements over the past decade has almost doubled. (White House 2016). Furthermore, the reality is that very few of the lower-level employees can afford an attorney or the cost of litigation. It is difficult to estimate the additional number of employees who are discouraged and simply give in to the pressure of potential litigation. (Ayres & Speidel 2008). Non-competes serve as a detriment to employee mobility.

The aforementioned report also found that almost half of the workers who are asked to sign non-competes are asked to do so after already having already starting the job, which brings up the legal issue of consideration under contract law, a basic requirement under the law of every state. Employees often lack awareness of the agreement's legal implications, and are not aware that for a contract to be enforceable there must be an exchange of consideration. In addition, some employers write overly broad non-compete agreements knowing that employees are unlikely to question it because they are not aware of complex legal issues. (White House 2016).

## STATE ACTION ON NON-COMPETE AGREEMENTS

At the state level, where common law controls most of the contract issues involved in non-compete agreements, legislators are discussing the proliferation of non-compete agreements, especially as they apply to low paid workers. (Garrison & Wendt 2008). States are examining the effect on job mobility, wage growth, opportunities for promotion, and general economic opportunity. Some states, approximately 20, have current laws that address, to some degree, the use of non-competes. (White House 2016).

For example, the states of California, Oklahoma, Montana, and North Dakota completely prohibit use of non-competes. Likewise, the states of Georgia, Delaware, and Colorado hold that non-compete agreements are not enforceable, except with respect to employees in managerial or key positions. Additionally, multiple states including Virginia, Nebraska, Arkansas, and Wisconsin provide that the entire agreement is void if it contains restrictions on length and geographic range that violate the law. Finally, another group of states such as New Mexico, Oregon, Hawaii, and Utah do not go quite as far, but do at least moderately limit how long non-competes can enforced, and/or the geographic range of limitation.

Some states have no specific regulations, but handle the enforceability of non-compete clauses in a common law, case-by-case basis. For example Texas, where in a recent Texas Supreme Court case, (Mann, 2009), the Court had to decide the issue of the enforceability of non-competes. The decision held that "If the nature of the employment for which the employee is hired will reasonably require the employer to provide confidential information to the employee for the employee to accomplish the contemplated job duties…the covenant is enforceable." (Mann, 2009). In other words, the Texas court recognized the need to use a non-compete agreement only when the employee is given access to important confidential information. The clear implication of the majority opinion is that if an employee does not have access to important information, as is the case with fast food workers, there would be no reason to enforce the contract.

In New York State, Attorney General's Office got involved in the Jimmy John's case, after multiple employees complained about the company's use of non-competes. Through negotiation between the AG's office and the company, Jimmy John's agreed to stop using non-compete clauses in its original hiring documents in the state of New York.

## STATES COULD DO MORE

State law is the primary source of contract law governing non-compete clauses. Therefore, if reforms are to be considered, states would be the logical place to start. Assuming one concludes that this is an area in need of some basic reforms; possible state actions include a litany of options. For example, all states could and should limit the time and geographic region to which a non-compete applies, and set a wage floor below which an employee cannot be required to sign a non-compete agreement. Lastly, states could require an employer to pay additional consideration for a non-compete, because the worker is surrendering a right pursuant to a contract. (Stanberry & Aven, 2017).

## STILL ROOM FOR FEDERAL ACTION?

In addition to state action, the federal government could and should do more, though it seems against the odds in the current political climate. Congress could pass previously introduced legislation that failed, including the Limiting the Ability to Demand Detrimental Employment Restrictions Act, and the Mobility and Opportunity for Vulnerable Employees Act. It is also possible that, depending upon the outcome of the 2020 Presidential election, a new President could issue an Executive Order applying to all federal contractors that prohibits the use of non-competes for lower-wage workers employed by a government contractor. (Stanberry & Aven, 2017).

## CONCLUSION

The irony in the abuse of no poach and no compete agreements should not be lost on those who feign support of American ideals of a free market economy. In the current political climate, it is commonplace

to hear politicians touting wage growth and job creation. Yet they stand idly by as large companies use anticompetitive tactics that thwart those very objectives. This area is an example of a reform that could help address issues of wage stagnation and income inequality at lower levels, expand the middle class, and foster an atmosphere of competition. A recent Harvard Business Review article appropriately concluded,

> "Here's the real kicker about non-compete (and no poach) agreements. Most of the employers who impose them on their employees are or have tried to hire current employees from competitors. That does not mean they are trying to steal secrets, but it does mean they are engaged in a hiring practice that they are preventing their own employees from using. Employers who are going to court to enforce a non-compete and prevent an employee from leaving to work for a competitor are increasingly confronted by defense attorneys who outline for the judge all the recent hires the employer has poached from their competitors. This looks like hypocrisy to the judges." (Capelli 2014).

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