



November 13, 2019

Dear Members of the Subcommittee on Antitrust, Commercial, and Administrative Law of the House Judiciary Committee,

As a non-profit research and advocacy organization focused on promoting pro-innovation policies that advance the interests of startups, we appreciate your interest in labor mobility and the effects of non-compete agreements in the labor market. Many of the companies Engine works with launch with thin margins and almost-insurmountable challenges that are compounded by difficulties meeting one of their greatest needs—access to skilled, qualified talent. Many individuals who seek to start their own ventures or take a risk in working for an innovative, new company, are unable to do so because they are hamstrung by restrictive non-compete agreements, which only serve to stifle innovation out of a misguided fear that non-competes prevent a loss of trade secrets and foster job loyalty. Economies of scale are real and significant in disruptive industries like tech; non-compete agreements just make those economies that much steeper.

In order to launch, startups must navigate complicated circumstances—beginning with accessing capital—that could very easily lead to their failure. Beyond the need for capital to start a venture, businesses need to acquire the best and brightest talent to compete and be successful. Startups rely on the ability to hire individuals who can take the skills and knowledge they have developed working for other companies and use them to foster innovation and growth at emerging businesses. These companies often succeed because employees at existing tech companies have the ability to leave and start their own ventures—a 2016 report from the Treasury Department indicated that “[j]ob churn helps to raise labor productivity by achieving a better matching of workers and firms, and may facilitate the development of industrial clusters like Silicon Valley.”¹

Startups represent a driving force within the American economy. Studies show that small businesses account for almost 50 percent of employment, and are largely responsible for net job growth in the United States.² Unfortunately, over the past several years, the rate of new startup

¹ U.S. Department of the Treasury: Office of Economic Policy, *Non-compete Contracts: Economic Effects and Policy Implications*, (2016), available at:

<https://www.treasury.gov/resource-center/economic-policy/Documents/UST%20Non-competes%20Report.pdf>.

² Engine Advocacy, *Financing the New Innovation Economy: Making Investment Crowdfunding Work Better for Startups and Investors* (Oct. 14, 2015), available at:

<https://www.engine.is/news/issues/making-investment-crowdfunding-work-better-for-startups-and-investors/5992>.

formation has slowed, wages are stagnant, and U.S. job mobility is down more than 20 percent.³ While many economic factors impact the growth of businesses in the United States, the stifling of job mobility, innovation, and new business establishment can be tied to the proliferation of non-compete agreements. Moreover, job mobility is generally an indicator of a nation's economic health.

Non-compete agreements prevent employees from accepting new opportunities at startups and starting their own firms using the skills they developed in the job market—all out of fear of legal repercussions from provisions in non-compete agreements that often have little to do with protecting legitimate employer interests. These agreements are ubiquitous across the United States. A study by the Economic Innovation Group found that, as of 2014, roughly one in five workers was subject to a non-compete agreement, and about 60 percent of major franchises used no-poach agreements.⁴ Another study found that roughly 40 percent of Americans have been subject to non-compete agreements at some point in their careers.⁵ Non-compete agreements are also found at a higher rate within certain industries that largely have an overly burdensome impact on the startup community. One study found that while some lower wage earners were subject to non-compete agreements, roughly 50 percent of those workers making over \$150,000 per year were subject to non-compete agreements.⁶ This data suggests that industries employing highly-skilled workers, which are often needed in the startup community, are disproportionately impacted by non-compete agreements. These agreements further restrict the pool of talent available to startup founders, who already face steep enough challenges in launching their ventures and turning a profit.

Employers that use non-compete agreements list a variety of reasons to justify their restrictions on employee mobility. These companies often argue that non-compete agreements in employment contracts are needed to protect trade secrets and other intellectual property. This assertion, however, is abjectly false. Instead, these agreements are used for one glaring purpose—to stifle potential competition. A Treasury Department report found that only 24 percent of workers indicated they had access to trade secret information and fewer than 50 percent of workers subject to non-competes reported to have knowledge of trade secrets.⁷

³ Evan Starr, Economic Innovation Group, *The Use, Abuse, and Enforceability of Non-Compete and No-Poach Agreements: A Brief Review of the Theory, Evidence, and Recent Reform Efforts* (2019), available at: <https://eig.org/wp-content/uploads/2019/02/Non-Competes-2.20.19.pdf>.

⁴ Id.

⁵ Evan Starr, J.J. Prescott, and Norman Bishara, *Noncompetes in the U.S. Labor Force*, University of Michigan Law & Econ Research Paper No. 18-013 (Aug. 30, 2019), available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2625714.

⁶ Evan Starr, Economic Innovation Group, *The Use, Abuse, and Enforceability of Non-Compete and No-Poach Agreements: A Brief Review of the Theory, Evidence, and Recent Reform Efforts* (2019), available at: <https://eig.org/wp-content/uploads/2019/02/Non-Competes-2.20.19.pdf>.

⁷ U.S. Department of the Treasury: Office of Economic Policy, *Non-compete Contracts: Economic Effects and Policy Implications* (2016), available at: <https://www.treasury.gov/resource-center/economic-policy/Documents/UST%20Non-competes%20Report.pdf>.

Further, employers have a number of tools in their arsenal to protect against the divulgence of intellectual property. They can use non-disclosure agreements, various state trade secrets laws, and the Defend Trade Secrets Act to ensure that proprietary information is not shared outside their company walls. Established companies need not fear that departing employees will use sensitive information in founding their own ventures, since they are already prohibited from doing so. Instead, they will use the skills they've developed in the job market to advance innovative ideas and economic growth through the creation of a new venture.

While California courts have refused to enforce non-competes for some time, nationally, other states have begun to examine the effects of non-competes on their job markets. While California represents the gold standard in prohibiting non-competes, banning their enforcement entirely, the patchwork of state laws regarding the issue can actually make questions around mobility even more challenging. Even in states that do not enforce non-competes, employers still often include this language in employment contracts, which can still lead to employee fear in moving throughout the job market.⁸ Employers appear to be relying on their employees' lack of knowledge surrounding the enforceability of these agreements in certain states in order to dissuade them from leaving their positions for a new startup venture.

The growth of Silicon Valley represents perhaps the greatest example of the success of not enforcing non-compete agreements. California courts routinely find non-competes unenforceable, directly spurring new company formation and technological development. Conversely, other major metropolitan areas with highly trained and educated workers have not seen a similar boom in their tech centers. While several factors are likely at play in the inability to replicate the success of Silicon Valley, many people attribute California's success to its workers' ability to move from job to job with ease, preventing the stifling of innovation. The unenforceability of non-competes encourages an at-will movement of workers, allowing ideas to "naturally flow to whichever company can best put them to use."⁹

After access to capital, startups often say that the biggest challenge they face in establishing their businesses is access to talent. We must stop erecting barriers for new firms to acquire the talent they need. Research from witness Dr. Starr has shown that while non-competes do an excellent job of preventing employees with low likelihoods of success from branching out on their own, the true innovators will still eventually find a way to leave, and are often more likely to be successful in their future ventures.¹⁰ This means impeding their future success is ultimately unnecessary and counterproductive for economic growth in the United States. The United States

⁸ Id.

⁹ Timothy B. Lee, *A Little-Known California Law is Silicon Valley's Secret Weapon*, Vox (February 13, 2017), available at: <https://www.vox.com/new-money/2017/2/13/14580874/google-self-driving-noncompetes>.

¹⁰ Robert H. Smith School of Business, Management Science, *How Non-Compete Clauses can Backfire* (November 15, 2017), available at: <https://www.rhsmith.umd.edu/smithresearch/research/how-noncompete-clauses-can-backfire>.

needs to follow California's lead if we want to ensure that job growth surges and the startup ecosystem not only continues to thrive, but continues to spread outside the confines of states like California.

The government and industry leaders are starting to take notice of the possible harms of non-compete agreements. Several of the witnesses at the subcommittee's hearing on October 29, 2019, alluded to labor mobility as a critical factor for economic success, pointing to the prevalence of non-compete agreements as a possible barrier to economic success.¹¹

Commissioner Noah J. Phillips of the Federal Trade Commission indicated the FTC is establishing a workshop to examine the effects of non-competes on labor mobility. Dr. Evan Starr of the University of Maryland Robert H. Smith School of Business, who has undertaken extensive research on the effects of non-compete agreements, encouraged Congress to commission the FTC to further study the issue. Startups rely on talented, qualified workers to grow their nascent companies into successful enterprises. Even greater, the United States relies on entrepreneurs willing to take a chance on a risky venture—to bring innovation, jobs, and economic growth to the nation—but only if they aren't prohibited by an employment contract from launching their business in the first place.

Engine appreciates the opportunity to provide these comments and the Subcommittee's demonstrated interest in factors affecting labor mobility in the United States. We look forward to the Subcommittee's further efforts on this topic and remain committed to engaging with Members on how changes within the labor market, including on non-compete reform, affect the startup ecosystem.

¹¹ Testimony available at: <https://judiciary.house.gov/legislation/hearings/antitrust-and-economic-opportunity-competition-labor-markets>.