EIG

To: Connecticut State Legislature's Labor and Public Employees Committee
From: John Lettieri, President & CEO, Economic Innovation Group
Subject: Written Testimony on Raised Bill 906
Date: March 4, 2021

Introduction

Co-chairs Kushner and Porter, Ranking Members Sampson and Arora, Vice Chairs Cabrera and Sanchez, and members of the Labor and Public Employees Committee, thank you for inviting me to submit written testimony for Raised Bill No. 906, concerning non-compete agreements.

Simply put, non-compete agreements limit worker mobility and dampen the dynamism of the U.S. economy. Once reserved for senior executives and those possessing valuable trade secrets, these provisions are now used extensively throughout the labor market and affect millions of low-wage and highly-skilled workers alike—with profoundly detrimental results for the broader economy.

Fortunately, there is growing bipartisan consensus on the urgent need for non-compete reform. Last week, members of the U.S. Senate and House of Representatives reintroduced the bipartisan *Workforce Mobility Act*, which would essentially ban the use of non-competes in most circumstances. And at the state level, 17 state legislatures (including Connecticut) introduced or passed legislation reforming the use of non-compete agreements in 2020 alone.[1] The Economic Innovation Group (EIG) strongly supports these efforts and is pleased to offer testimony in favor of Raised Bill 906.

How Non-competes Hurt Workers and Contribute to a Less Dynamic Economy

Non-competes hurt workers and the broader economy primarily through reduced wages and less entrepreneurship, respectively. Research finds that roughly 20 percent of U.S. workers are bound by a non-compete agreement, and nearly twice as many have signed one at some point in the past.[2] Although their use among senior executives is ubiquitous, a sizable portion of the lower-wage workforce is covered by non-competes as well. Healthy labor markets depend on both vigorous competition for talent between firms and the ability of workers to freely market their skills to interested employers. Yet, non-competes bluntly restrict workers' ability to pursue good jobs in their area of expertise. Here is an overview of the effects of non-compete agreements on workers:

- **Non-compete enforcement hurts worker wages:** Across industries and states, a growing abundance of empirical evidence finds negative effects of non-competes on wages.[3]
- **These negative wage effects are worse for historically marginalized workers:** New research has found that stricter non-compete enforceability lowers earnings for female and nonwhite workers by twice as much as for white male workers.[4] Other studies

[1] John Lettieri, "A Better Bargain: How non-compete Reform Can Benefit Workers and Boost Economic Dynamism." American Enterprise Institute (2020).
[2] Ibid.
[3] Evan Starr "The Use, Abuse, and Enforceability of Non-Compete and No-Poach Agreements." Economic Innovation Group (2019).
[4] Matthew Johnson, Kurt Lavetti, and Michael Lipsitz "The Labor Market Effects of Legal Restrictions on Worker Mobility." Available online at SSRN (2020).

have shown that workers with less education experience larger negative wage impacts from non-competes.[5]

- **Non-competes deter workers from finding better opportunities:** Workers bound by a non-compete stay in their jobs 11 percent longer.[6] Since job mobility is key for boosting earnings, these longer tenures reinforce the negative earnings effects of non-competes.

More generally, non-competes pose threats to the broader economy. A dynamic economy depends upon knowledge spillovers—the productivity-boosting exchanges that happen when individuals collaborate, start new enterprises, or take the body of their lifetime experiences and apply them in new contexts. Non-compete agreements undermine the diffusion of expertise and know-how that is integral to a dynamic, innovative, and inclusive economy:

- **Non-competes reduce entrepreneurship:** Greater enforceability of non-competes reduces new firm entry by 18 percent. The firms that do start tend to have fewer employees at launch and are more likely to die in their first three years. The ones that survive still tend to remain smaller for their first five years.[7]
- **Negative effects on new business growth are worse for underrepresented entrepreneurs:** The threat of non-compete enforcement appears to particularly dampen entrepreneurship among women.[8]
- **Non-competes likely slow the pace of innovation:** Non-competes obstruct the flow of knowledge by restricting the churn of workers among firms. They make venture capital less effective in spurring new patents and job growth.[9]

What Should Policymakers Do?

The need for reform is urgent. While we believe the most beneficial policy would be a nearly universal ban on non-competes, there are a wide variety of options from which state policymakers can choose. Raised Bill 906 hits on many of the essential ingredients of reform:

- Limit the Pool of Eligible Workers: Many states currently have no restrictions on the kinds of workers that can be bound by a non-compete. Several options exist to narrow the eligible pool of workers—by industry, by wage level, or by education attainment—such that the most vulnerable workers are never presented with a non-compete. Raised Bill 906 sets important income minimums (employees earning 3 times the minimum fair wage and independent contractors earning 5 times the minimum fair wage)—below which workers are protected from non-competes. While best practice would have states push as far up the income ladder as possible—ideally toward outright ban, as the District of Columbia just passed—in order to derive all of the economic benefits possible from reform, the Raised Bill 906 would be a major step in protecting the state's most vulnerable workers.

- Limit the Scope: Non-compete agreements should be as narrowly scoped as possible in duration and geography. In this vein, Raised Bill 906 limits the term of the agreement to a maximum of one year after the employee leaves the firm. Geographically, it places

[5] Evan Starr "Consider This: Training, Wages, and the Enforceability of Covenants Not to Compete." Available online at SSRN (2018).
[6] Starr "The Use, Abuse, and Enforceability of Non-Compete and No-Poach Agreements."
[7] Ibid.
[8] Matt Marx "Punctuated Entrepreneurship (Among Women)." U.S. Census Bureau (2018).
[9] Starr "The Use, Abuse, and Enforceability of Non-Compete and No-Poach Agreements."

further limitations on valid non-competes, restricting their scope only to areas where the worker either did business or had a "material influence" in the last two years, as opposed to any location where the employer has a presence. This difference is significant because non-compete agreements are often written to encompass the entirety of the firm's economic reach, making them far more harmful for workers. By centering the geographic scope on the worker's territory, valid non-compete agreements will likely cover less area and thus be less restrictive for workers.

- Require Transparency: Workers are at a disadvantage when they lack the necessary information to evaluate a proposed agreement. Employers knowingly exploit this disadvantage, often by requesting employees to sign non-competes on their first day of work when other job options have been foreclosed. By requiring employers to provide a 10-day window for workers to review and sign a valid non-compete agreement and giving workers' the explicit right to review with counsel, Raised Bill 906 is an important step in the right direction of balancing the power dynamics between employers and workers.

- Create Disincentives for Overuse: There are currently few downsides for an employer to require non-competes of their employees—even when an agreement is written so broadly as to be unenforceable or when it covers employees who have no specialized skills or trade secrets. States should seek to discourage such overuse wherever possible. Raised Bill 906 provides the Attorney General the ability to bring civil suits against employers and allows for civil penalties when employers are found to have used unlawful non-competes. Furthermore, in the case where an employer is trying to enforce a non-compete against a worker, the Bill places the burden of proof on the employer to show that their non-compete agreement is valid. Lastly, the requirement to provide "garden leave" (i.e., compensation for a former employee while a non-compete is being enforced) adds another important layer of financial disincentive for overuse. All three of these provisions move Connecticut in the right direction with regards to limiting how employers may use these agreements.

Conclusion

Workers should be free to seek better jobs and compete in the marketplace without needing permission from their former employers. While we encourage Connecticut lawmakers to consider going even further in restricting the use of non-competes, Raised Bill 906 embraces many best practices of non-compete reform and would result in a state economy that is friendlier to workers and entrepreneurs and better able to achieve its full potential. EIG urges swift passage of this legislation.