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Non-compete clauses in employment contracts: The case for regulatory response

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Abstract

In the employment context non-competes are contractual terms which provide that once the employment ends the employee cannot work for another employer in the same industry or field (ie a competitor), within a specified geographic area, for a specified time. The use of non-competes by Australian business has increased over the past 5 years and this trend is likely to continue. Non-competes are no longer limited to highly paid executives but now apply to about 1 in 5 Australian workers, across income, age, occupational and education groups. The existing law and practice regarding non-competes in Australia is plagued with confusion and uncertainty. Non-competes also have adverse economic consequences; they are associated with reduced employee mobility and consequent negative impacts on wages and productivity. The distribution and prevalence of non-competes in Australia are broadly consistent with data in other developed economies. A number of jurisdictions within the OECD have imposed restrictions on the use of non-competes. The US Federal Trade Commission is considering a ban on the use of non-competes and in the UK the government has announced its intention to limit the term of non-competes to 3 months. In Australia the Competition Minister has recently asked the ACCC and Treasury for advice on the competitive aspect of non-competes. After reviewing the arguments for and against restricting the 'reach' of non-competes I conclude that the weight of the evidence favours a regulatory response to ameliorate the unfairness inherent in the existing law and practice. A number of possible regulatory responses are considered.

Keywords: Non-competes, post-employment restraints, regulatory response

* *Views expressed in this paper are those of Iain Ross and not necessarily those of the RBA. I would like to thank James Bishop for reviewing an earlier draft.*

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NON-COMPETE CLAUSES IN EMPLOYMENT CONTRACTS: THE CASE FOR REGULATORY RESPONSE

Dr Iain Ross*

1. Introduction

The Competition Minister, the Hon Dr Andrew Leigh, recently asked the ACCC and Treasury for advice on the competitive impacts of non-competes. This paper is about a particular form of non-compete, namely contractual terms that seek to limit what an employee can do after their employment ends. A non-compete usually provides that once the employment ends the employee cannot work for another employer in the same industry or field (ie a competitor), within a specified geographic area, for a specified time.

About 1 in 5 Australian workers are covered by a non-compete. They are no longer confined to highly paid executives but now apply across income, age, occupational and education groupings. There has also been an expansion in the type of interests which may be legitimately protected by a non-compete, to include an interest in a stable workforce – which has provided the legal rationale for employment terms prohibiting the solicitation of former co-workers (sometimes referred to as 'no poaching' terms). The prevalence of non-competes in Australia is broadly consistent with data in other developed economies.

The existing law and practice in respect of the use of non- competes in Australia is manifestly unfair and contrary to the public interest. In most cases the parties to a non-compete cannot be certain of enforceability without a judicial determination and such uncertainty weighs more heavily on employees than employers. For many employees the mere threat of litigation is enough to secure compliance, irrespective of the enforceability of the non-compete. Further, the research literature suggests that non-competes are associated with the reduced employee mobility, with consequential negative impacts on wages and productivity.

The use of non-competes by Australian business has increased over the past 5 years and, absent a policy response, this trend is likely to continue.

The arguments in favour and against a regulatory response are considered and a number of possible regulatory responses are canvassed.

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2. About Non-Competes

2.1 Background

Non-competes have become increasingly common, in part, because they are easier to enforce than other post-employment restraints dealing with confidential information and customer solicitation. Further, as noted by Stewart et al (2016) 'This is a strategy that has been overtly encouraged by courts in recent years'[1].

Like other post-employment restraints, non-competes are subject to the common law doctrine of restraint of trade[2] and as such are presumptively invalid on the basis that they are contrary to the public interest. To rebut that presumption, the employer benefiting from the non- compete must establish that the restriction imposed is no wider than is reasonably necessary to protect a legitimate interest.

In theory, the practical application of the doctrine should seek to balance three overlapping and competing interests:

1. Employers have an interest in protecting their businesses.
2. Former employees have an interest in plying their profession or trade.
3. The public has an interest in the promotion of competition and the efficient allocation of economic resources.

As to the employers' interest, a non-compete which does nothing more than protect the original employer from competition from a former employee is unenforceable as it is the very thing the doctrine prohibits.[3] However, a non-compete is lawful if the employer can point to an interest that the employer is entitled to protect, such as confidential information or customer connections *and* if the restraint goes no further than is reasonable to protect that interest. It must, to use Lord Parker's words in *Herbert Morris Limited v Saxelby*[4] (Herbert Morris) 'afford no more than adequate protection to the party in whose favour it is imposed'.[5]

The interests of the former employee are generally not a significant consideration in assessing the validity of a non-compete. In practice, the common law's primary concern is to assess whether the employer has a legitimate interest and to determine if the non-compete[6] is commensurate with that interest. The employees' position is generally treated as irrelevant,[7] and consequently the majority of non-competes are upheld.[8] As Stewart notes, 'it is rare for a court to concern itself in any detail with the relative bargaining power of the parties; or with the overall 'fairness' of the agreement; nor is it necessary that the employee receive any additional consideration for entering into the restraint'.[9]

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[1] Stewart et al (2016) at 516, citing *Printers and Finishers Ltd v Holloway* [1964] 3 ALL ER 731 at 736; *Rentokil Pty Ltd v Lee* (1995) 66 SASR 301 at 340; *Woolworths Ltd v Olsen* [2004] NSWCA 372 at 67.
[2] *Linder v Murdock's Garage* (1950) 83 CLR 628 and 645 per McTiernan J.
[3] See *Marlov Pty Ltd v Murat Col* [2009] NSWSC 501 (5 June 2009).
[4] [1916] 1 AC 688.
[5] Ibid at 707.
[6] See *Brightman v Lamson Paragon Ltd* (1914) 18 CLR 331 at 337-8; *Lindner v Murdock's Garage* (1950) 83 CLR 628 at 633; though *cf Adamson v NSW Rugby League Ltd* (1991) 31 FCR 242.
[7] Stewart (1997) at 184.
[8] Arup et al found that 63% of post-employment restraints were upheld by courts between 1989 and 2012, see Table 1 infra.
[9] Stewart (1997) at 184 citing *Herbert Morris Ltd v Saxelby* [1916] 1 AC 688 at 707-8; *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd* (1973) 133 CLR 288 at 316. See generally Stewart (1997) at 184.

The doctrine of restraint of trade is intended to protect the public from the anti-competitive consequences of private contractual arrangements. As the court said in Herbert Morris:

> 'The general public suffers with [the worker who is restrained], for it is in the public interest that a man should be free to exercise his skill and experience to the best advantage for the benefit of himself and all those who desire to employ him.'[10]

Yet the public interest is often forgotten in contemporary judgments where the central focus is on the interests of the employer seeking to enforce the non-compete[11] and 'in practice, reasonableness in the public interest is almost never considered as a distinct issue and it is hard to find a single case in which a restraint has been struck down on that ground'.[12]

Even those who contend that the common law, if properly applied, strikes an appropriate balance between the post-employment interests of employers and their former employees acknowledge that 'there is a tendency in some recent cases to give greater weight to the terms of the contract as opposed to the public policy that militates against enforcement'.[13]

The critique of non-competes can be reduced to four broad issues:

(i) the confusion and uncertainty created by the use of overly broad non-competes, particularly the use of 'stepped' or 'laddered' clauses (Confusion and Uncertainty);

(ii) the ready access to injunctive relief disadvantages employees and fails to take sufficient account of the public interest (Injunctive Relief);

(iii) the use of non-competes has become widespread including low-wage occupations, such as hairdressers and the types of interests protected by a non-compete have expanded (Proliferation of Non-competes); and

(iv) non-competes reduce competition and job mobility and have consequential negative impacts on wages and productivity (Economic Consequences).

2.2 Confusion and Uncertainty

To enforce a non-compete the employer must show that the restraint is reasonable in the sense that it is commensurate with a legitimate interest and is no wider than strictly necessary to protect that interest. The 'reasonableness' of a non-compete is assessed having regard to the three elements common to such terms:

- the nature and extent of the particular activities sought to be restrained;
- the geographic area in which those activities must not occur; and
- the duration of the restraint.

There are no set rules about what constitutes a 'reasonable' geographic area or a 'reasonable' duration and the scope of each element is considered having regard to the other elements of the

[10] *op cit* 699.
[11] Riley (2012) at 632.
[12] Stewart (1997) at 182.
[13] Neil and Saady (2018) at 118.

non-compete. Each non-compete must also be assessed with particular reference to the legitimate interest the employer is seeking to protect. Further, the assessment of reasonableness is made by reference to the circumstances which obtained at the time the parties agreed to the non-compete, not the time of any alleged breach by the employee.[14]

Whether a court upholds the validity of a non-compete is dependent on the facts in each case and past cases provide little guidance. As Harman LJ put it in *GW Plowman & Sons Ltd v Ash*:

> 'the limits of the [restraint of trade] doctrine are very widely set out and differ a good deal as it seems to me, from case to case, so that no one is binding authority for any other because the circumstances differ'.[15]

The subjective nature of the test has been the subject of academic criticism; for example, Riley describes it as a 'very flabby test'[16] and Pivateau (2007) describes the test as 'a standard [that] holds minimal value in the construction of non-compete agreements'.[17] One court characterised the task of assessing the reasonableness of a non-compete as 'a swampy morass of conflicting interests and policies into which a court may eventually need to plunge to resolve the problems these covenants present'.[18]

The fact-dependent nature of the proceedings and the general nature of the test give rise to a diversity of judicial opinion. An authority can usually be found to support any particular point of view; as is apparent by comparing the cases relied on by Riley (2012) and Stewart (1997), as opposed to Neil and Saady (2018).

In addition to the uncertainty generated by the very nature of the test and its application in particular cases, the ability of courts to 'sever' offending aspects of a non-compete creates an additional layer of uncertainty.

At common law, an invalid part of a non-compete may be severed if a 'blue pencil' can be run through the offending part without affecting the original nature of the clause and contract.[19] The 'blue pencil' doctrine applies in all Australian States; further, in New South Wales, s 4(3) of the *Restraints of Trade Act 1976 (NSW)* (Restraint of Trade Act) statutorily extends the courts' power of severance, enabling the "beneficial surgery" of a restraint to "attempt to make it reasonable".[20]

The capacity to sever offending clauses encourages employer overreach in drafting non-competes and increases the use of overly broad clauses which, absent the blue pencil doctrine or in NSW the Restraints of Trade Act, would be unenforceable.

It has also become common for non-competes to be drafted to facilitate the process of severance by the adoption of 'cascading' or 'laddered' non-competes. Such terms set out a series of overlapping or cumulative restraints comprising multiple versions of different non-competes

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[14] *Lindner v Murdock's Garage* (1950) 83 CLR 628 at 638, 647-8, 653; *Amoco Australia Pty Ltd v Rocca Bros Motor Engineering Co Pty Ltd* (1973) 133 CLR 288 at 318; *Gerahty v Minter* (1979) 142 CLR 177 at 181, 188.
[15] [1964] 1 WLR 568 at 571.
[16] Riley (2012) at 619.
[17] Pivateau (2007) at 677.
[18] *Reddy v Cmty. Health Found. Of Man,* 298 S.E. 2d 906, 917 (W. Va. 1982), cited in Pivateu (2007) at 675.
[19] *Del Casale v Artedomus (Aust) Pty Ltd* (2007) 165 IR 148, 132; *Attwood v Lamont* [1920] 3 KB 571, 578; SST *Consulting Services Pty Ltd v Rieson* (2006) 225 CLR 516, 44–48.
[20] *Wright v Gasweld Pty Ltd* (1999) 22 NSWLR 317, 339.

which vary as to geographic breadth, duration and/or activities affected. Any restraint that is too wide can be severed, leaving what remains enforceable. An example of such a clause, taken from *JQAT Pty Ltd v Storm*,[21] is set out below:

> 6.2 In the event that his Employment hereunder is terminated the Employee shall not, without the prior written consent of the Company, from the date of such termination for the period hereinafter specified be as principal interested, engaged or employed or act as an adviser or consultant in, or be an employee, agent or officer of, or an adviser or consultant to, any person, firm or corporation interested or engaged in:
>
> (a) (i) the provision of personnel/Human Resource services;
>
> (ii) any activity of a like or similar kind to that in which the Employee was interested or engaged during the course of his employment hereunder;
>
> (iii) any business of a like or similar kind to that engaged in by the company:
>
> (b) (i) for a period of one (1) month;
>
> (ii) for a period of two (2) months;
>
> (iii) for a period of three (3) months;
>
> (c) (i) in the State of Queensland;
>
> (ii) in the State of New South Wales.
>
> 6.3 The preceding sub-clause 6.2 of this Clause 6 shall be construed and have effect as if it were the number of separate sub-clauses which results from combining the commencement of sub-clause 6.2 with each sub-paragraph of paragraph (a) and combining each such combination with each sub-paragraph of paragraph (b) and combining each such combination with each sub-paragraph of paragraph (c), each such resulting sub-clause being severable from each other such resulting sub-clause, and it is agreed that if any of such separate resulting sub-clauses shall be invalid or unenforceable for any reason, such invalidity or unenforceability shall not prejudice or in any way affect the validity or enforceability of any other such resulting sub-clause.

Some judges have held certain cascading non-competes to be unenforceable on the basis of uncertainty[22] and others have suggested that they should only be enforceable if the employer has made a genuine attempt to draft a valid non-compete.[23] But the weight of authority supports the view that there is nothing inherently wrong with a cascading non-compete, provided the drafting is sufficiently precise.[24]

Cascading or laddered non-competes have been the subject of judicial[25] and academic[26] criticism for creating uncertainty. For example, Stewart argues:

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[21] [1987] 2 Qd R 162 at 162-3.
[22] Eg see *Austra Tanks Pty Ltd v Running* [1982] 2 NSWLR 840.
[23] Eg *Workpac Pty Ltd v Steel Cap Rcruitment* (2008) 176 IR 464 at 46.
[24] Eg *Hanna v OAMPSA Insurance Brokers Ltd* (2010) 202 IR 420.
[25] *Schindler Lifts Australia Pty Ltd v Debelak* (1989) 15 IPR 129; *Brendan Pty Ltd v Russell* (1994) 11 WAR 280; *Tyser Reinsurance Brokers v Cooper* [1998] NSWSC 689.
[26] Arup et al,at 3, 13–14; Stewart (1997) at 218.

> 'Employers and other covenantees should be compelled to be clear as to what activities they wish to restrain, in what location and for what period. If they exceed the limits set by the law, and find that they cannot enforce the restraint in the face of conduct that could on any basis have been the subject of a reasonable covenant, then so be it. That is the price to be paid for taking insufficient care or being overly ambitious as to the scope of the restraint. The risk of losing out in that way surely does no more than balance the natural advantage that most employers enjoy through superior resources, access to legal advice and the intimidatory effect of the mere presence in a contract of a restraint, valid or not.'[27]

The problem for an employee bound by a laddered non-compete is that, absent a judicial determination, they have no way of knowing which of the restraints will be found to be reasonable and which go too far and be unenforceable. The impact of such uncertainty is amplified by the inequalities between the employer and employee.

Arup et al conducted an empirical study of the practice regarding the enforcement of post-employment restraints. Some 24 legal practitioners were interviewed for the study. Two-thirds of those practitioners were employment law specialists, some of whom acted for employers, some for employees; some had a mixed clientele. Barristers in several jurisdictions and some judges were also interviewed.[28] The authors observed that uncertainty 'is a greater burden for the party, without inside knowledge (of proceedings, courts and decisions), and without resources (financial, psychological, relational and reputational) to bargain hard and maintain litigation' and concluded:

> 'The empirical research reported here demonstrates that there is much uncertainty in the operation of the law around the use of restraint of trade clauses in employment contracts ... the evidence suggests that to a significant extent, this uncertainty weighs more heavily on the side of any dispute that is least able to bear it – the employee.'[29]

Neil and Saady (2018) take a contrary view, arguing that the uncertainty inherent in the current law is a testament to its fairness:

> 'The lack of uniformity in enforcing restraints illustrates the fairness of the test, as it ensures restraints are enforced in a manner that balances employer and employee interests in each case. While some judgments may give the impression of "elasticity", most differences of approach result from judges attempting to apply the law to the commercial context of each case. No result will ever be the same because the facts of each case are unique.'

But this view ignores the chilling effect created by the uncertainty inherent in the application of the current law. The cost of legal proceedings, in financial and emotional terms, presents a significant deterrent to employees seeking to challenge the validity of a non-compete[30]. In terms of the financial cost, the legal practitioners interviewed by Arup et al, in 2013, put the cost of opposing an application for an interlocutory injunction at between $20,000 and $100,000. Such costs are a significant disincentive for most employees.

For many employees, the mere threat of legal action by the employer is enough to secure compliance, whatever the lawfulness of the non-compete, as Stewart has observed:

> 'One should not underestimate the *in terrorem* impact of invalid covenants on employees

[27] Stewart (1997) at 218.
[28] Arup et al (2013) at 5.
[29] Arup et al 'Restraints of Trade: The Legal Practice', *UNSW Law Journal*, Vol 36(1) at 29.
[30] Arup et al at 18.

> who, even if they have access to legal knowledge or advice, possess insufficient resources to pursue a legal challenge to those restrictions.'[31]

An *in terrorem* effect occurs when individuals adhere to a contractual term in anticipation of legal action if they choose not to comply. In the case of non-competes, the *in terrorem* effect is such that former employees comply with more non-competes than would be upheld if they went to trial[32] and settlements are generally made before proceedings are issued.[33]

The reported cases are replete with judicial comments on the *in terrorem* effect of invalid non-competes[34]. The court in *Rita Personnel Services International v Kot*[35] captured the essence of the problem:

> 'For every covenant that finds its way to court, there are thousands which exercise an *in terrorem* effect on employees who respect their contractual obligations and on competitors who fear legal complications if they employ a covenantor, or who are anxious to maintain gentlemanly relations with their competitors. Thus, the mobility of untold numbers of employees is restricted by the intimidation of restrictions whose severity no court would sanction.'

A US study by Starr et al (2020) provides empirical evidence of an *in terrorem* effect, including with respect to unenforceable non-competes. Using nationally representative data for 11500 labour force participants, the authors found that non-competes are associated with reductions in employee mobility and changes in the direction of that mobility (ie towards non-competitors) in *both* States that do and do not enforce non-competes. Indeed, they found no statistical differences in mobility patterns between States where non-competes are enforceable and States where they are not.[36] When asked how important their non-compete was in determining whether or not to leave their employment and go to work for a competitor, some 58.1 per cent of respondents in States that do *not* enforce non-competes answered that it was 'somewhat, very or extremely important', compared to 53.5 per cent of respondents from states that *do* enforce non-competes. Starr et al (2020) conclude: 'a non-compete is associated with both a longer tenure and a reduced propensity to leave for a competitor even when the non-compete in question is unenforceable under state law'.[37]

Similarly, Colvin and Shierholz (2019) found that non-competes are widely used in the US including in California, where 45.1 per cent of private sector businesses with 50 or more employees had at least some employees covered by a non-compete, despite non-competes being unenforceable under California state law.

In a later study, Prescott and Starr (2022) show that workers tend to believe their non-competes are enforceable, even when they are not, and that their beliefs about the law— rather than the actual law—matter to their actions.

In sum, uncertainty is an inherent by-product of the current legal framework for assessing the validity of non-competes. The generality of the legal test and the fact-dependent nature of the

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[31] Stewart (1988):15.
[32] Arup et al at 24.
[33] Arup et al at 10.
[34] See eg, *Mason v Provident Clothing & Supply Co* [1913] AC 724 at 745; *Lindner v Murdock's Garage* (1950) 83 CLR 628 at 644-5; *Drake Personnel Ltd v Beddison.*
[35] 191 S.E. 2d 79 at 81 (Ga 1972).
[36] Starr et al (2020) at p 637.
[37] Starr et al (2021) at 665.

proceedings leads to a diversity of judicial opinion. This uncertainty is compounded by the 'blue pencil' approach to severance and the operation of the Restraint of Trade Act, which encourage employer overreach in drafting non-competes and have given rise to cascading non-competes. Consequently, in most cases, the parties cannot be certain that their particular non-compete will be enforceable; absent a judicial determination. This uncertainty weighs more heavily on employees and, for many, the mere threat of legal action is enough to secure compliance, irrespective of the legal merits or enforceability of the particular non- compete. The US evidence suggests that in States where non-competes are unenforceable employers still use them; they have an *in terrorem* effect on employees and are associated with reduced employee mobility. The unfairness of such an outcome is manifest and is contrary to the public interest.

2.3 Injunctive Relief

The initial enforcement action in respect of a non-compete is typically an interlocutory proceeding for injunctive relief. The interlocutory decision effectively determines the matter as very few cases proceed from the interlocutory to the trial stage.[38] This is particularly problematic for defendants, as a former employer need only show that it has an arguable case and the balance of convenience favours injunctive relief.[39] Few cases give serious consideration to whether damages would constitute an adequate remedy such that injunctive relief ought not be granted.[40]

As to the practical operation of the legal test in respect of injunctive relief, Arup et al conclude that:

> 'If the court considers that an arguable case is made out, it is rare to see a decision in which the hardship to the employee tips the balance of convenience against granting the employer the injunction. Generally, the balance of convenience is weighed in the employer's favour. The court is more concerned about the threat of an immediate injury to the employer's interest. The courts take the view that damages awarded after the event would not be an adequate remedy; for instance, they would be hard to estimate.[41] Yet the courts will want to create the least amount of hardship possible. An interlocutory injunction might not be granted if it would prevent the employee from earning a living.[42] However, to add to the uncertainty, the court may be sceptical of this claim or take the view the employee has brought the hardship upon himself or herself.'[43]

The role of injunctive relief in the enforcement of non-competes has been the subject of academic criticism. For example, Riley[44] argues:

> 'There is an argument for introducing more rigid requirements for assessing the balance of convenience in these cases. In defamation cases, where the policy of the law is to guard freedom of speech jealously, courts have had no difficulty in finding that the balance of convenience almost invariably favours refusal of an injunction restraining the allegedly

[38] Arup et al at 12.
[39] *American Cyanamid Co v Ethicon Ltd* [1975] AC 396.
[40] Riley (2012) at 619.
[41] See *OAMPS Gault Armstrong Pty Ltd v Glover* [2012] NSWSC 1175; *BDO Group Investments (NSW– Vic) Pty Ltd v* Ngo [2010] VSC 206; *FNET Pty Ltd v Laksanabencharong* [2009] NSWSC 708.
[42] See *Reed Business Information v Seymour* [2010] NSWSC 790; *Think: Education Services Pty Ltd v Lynch* [2011] NSWSC 984.
[43] Arup et al at 10.
[44] Riley (2012) at 633 and 634.

defamatory imputation.[45] Perhaps it is time to identify a similar presumption that applies in cases where the enforcement of a negative covenant would prevent an individual from pursuing a chosen career. At least our courts might adopt the approach taken by courts in New York faced with similar questions:

> "A party seeking the drastic remedy that a preliminary injunction confers must establish a clear legal right to that relief under the law and upon undisputed facts set forth in the record
> … To prevail on a motion for preliminary injunction relief, the movant must clearly demonstrate a likelihood of success on the merits, the prospect of irreparable harm or injury if the relief is withheld and that a balance of the equities favours the movant's position.'"[46]

Arup et al make a similar point, proposing that 'it would be preferable for the courts to require the employer to make out a stronger case before an interlocutory injunction is granted'.[47]

In sum, injunctive relief is typically used to enforce non-competes and few cases proceed to the trial stage, in which the merits of the employer's case can be fully tested. In interlocutory proceedings, the employer need only establish an arguable case on the merits and that the balance of convenience favours injunctive relief. A review of the relevant cases suggests that the balance of convenience is weighed in the employer's favour.

2.4 Proliferation of Non-competes

The 'reach' of non-competes has expanded in recent times, both in the number and type of employees covered; and the type of interest said to be protected by a non-compete.

Australian Data

In 2023 e61, an economic research institute, leveraged an online survey of 3000 respondents to obtain data on the prevalence of non-competes in Australia.[48] The questions on non-competes were drawn from an American online poll in 2014, which revealed that 18 per cent of the US workforce were subject to non-competes,[49] an estimate replicated by a Bureau of Labour Statistics survey in 2017.[50]

The results suggest that a substantial proportion of the Australian workforce are subject to a post- employment restraint: 22 per cent had a non-compete; 26 per cent had signed a non-disclosure of confidential information covenant, 16 per cent had agreements restricting the poaching of clients and 7 per cent had agreements restricting the poaching of co-workers.

Importantly, e61 found that non-competes covered workers in a range of different income, age, education and occupational groups, including a significant proportion of workers with a household income of less than $100,000 per annum.

The most recent Australian data on the use and prevalence of employment restraints is from the 'Short Survey of Employment Conditions' (the short survey) conducted by the ABS in late

[45] *Australian Broadcasting Corporation v O'Neill* (2006) 229 ALR 457. For commentary, see Rolph (2009).
[46] *Jacobi Tool & Die Manufacturing Inc v Mondi* 2007 WL 3325854 (NY Supp), 3.
[47] Arup et al at 228.
[48] Andrews and Jarvin (2023).
[49] Starr et al (2021).
[50] Rothstein & Starr (2022).

2023. Utilising the Employee Earnings and Hours (EEH) responding sample, about 7000 businesses were invited to answer a series of questions on employment restraint clauses. While not compulsory, the survey achieved a relatively high response rate of around 70 percent.

The results of the short survey were released on 21 February 2024[51], revealing that about half (46.9 per cent) of Australian businesses reported using at least one type of restraint clause in their employment contracts; with 20.8 percent using non-competes and 18 percent using clauses prohibiting the solicitation of co-workers.
Non-competes were used across all industry sectors with the highest use in the services sector, in particular, financial and insurance services; rental, hiring and real estate services; electricity, gas, water and waste services; and administrative support services.

The results also suggested that the use of restraint clauses was not limited to highly paid executives; rather they were used somewhat indiscriminately. Most businesses that used non-competes (68.2 percent) or an employment term prohibiting the solicitation of co-workers (67.2 percent) reported that the clause applied to between 76 and 100 percent of their employers.

The data suggests there is an increasing tendency to use restraints and that this trend is likely to continue. While the majority of businesses reported that their use of non-competes and terms prohibiting the solicitation of co-workers had generally remained the same over the past 5 years, a higher proportion of employers reported an increased use than a decrease. Of businesses currently using non-competes, 9.3 percent reported an increase in the use of such terms over the previous 5 years and only 1.9 percent reported a decrease. Of businesses currently using non-solicitations of co-worker restraints, 8.4 percent reported an increase and only 1.1 percent reported a decrease. Further, in response to a question regarding the expected future use of restraint clauses, about 1 in 5 businesses (19.9 percent) who do not currently use a non-compete reported that they would include such a term in future employment contracts. There was a similar response (22.5 percent) in respect of terms prohibiting the solicitation of co-workers.

The ABS short survey does not report the proportion of employees bound by non-competes or terms prohibiting the solicitation of co-workers; it only provides data on the proportion of businesses using such restraints. A subsequent e 61 publication[52] uses ABS data to provide a lower, central and upper estimate of the proportion of employees subject to particular restraint clauses. The authors estimate that roughly 20 to 25 percent of Australian workers are subject to non-compete and non-solicitation of co-worker terms, with a central estimate of 21 and 23 percent, respectively.

It is worth noting that in releasing the short survey results the ABS cautioned that ‘the data and insights should be considered experimental and exploratory’, as this was the first attempt at collecting such information and the survey used simple questions to minimise reporting effort for businesses.

The Arup et al study is broadly consistent with the results reported by e61 and the ABS, and notes that:[53]

> ‘Some sectors of the economy are more strongly represented than others. The interviewees

[51] Restraint Clauses, Australia 2023, Cat. No. 6306.0
[52] Andrews D, M Bennan and J Buckley (2024).
[53] For example, L5, L9, L10, L12, L21.

> suggested that the financial services sector has figured most prominently in recent years, as well as other service sectors including real estate, recruitment, retail, distribution, medical services, information, insurance, media and hairdressing.[54]

To that list one could add horticulture workers. A standard form contract used by labour hire firms to engage 'contractors' to perform work (such as strawberry picking) in the horticulture industry in Victoria contains the following term:

> **Post-agreement restraints non-compete**[55]
>
> **13.**
>
> **(a)** For a period of 1 month after the Contractor's engagement with the Company has been terminated for whatever reason, the Contractor agrees that it will not, within Victoria, be engaged as an employee, independent contractor, adviser or in any other capacity in any business which, in the reasonable opinion of the Company, is in competition with the Company.
>
> **(b)** The Contractor acknowledges that any breach by the Contractor of this clause would cause irreparable harm and significant damage to the Company and accordingly that the Company has the right to seek and obtain immediate injunctive relief in relation to any such breach.
>
> **(c)** The Contractor acknowledges that the covenants in respect of non-competition contained in this clause are fair and reasonable and that the Company is relying upon this acknowledgement in entering into this agreement.

Plainly, non-competes are no longer confined to highly paid senior executives, as Riley (2012) observes:

> 'By the power of the word-processed precedent document, restraints that were once considered appropriate only to preserve the value of goodwill purchased from a business owner are now appearing in contracts for moderately paid salary earners.'[56]

The number of court judgments dealing with non-competes has also increased over time, supporting the proposition that non-competes are becoming more prevalent.

A study by Chia and Ramsay[57] analysed Australian restraint of trade judgments over a 24-year period from 1989 to 2012. They found that employment restraints were the most common type of restraint of trade litigation and that employment restraints are increasing as a proportion of all restraint of trade cases and are found most frequently in the financial services and professional services industries.

Enterprise Agreements and Non-competes

It is important to note that non-competes are not confined to individual employment contracts – they are also a feature of a number of enterprise agreements approved under the *Fair Work Act 2009* (Cth) (the FW Act). The 1070 single employer enterprise agreements approved between 1 July and 30 September 2023 were searched using the following key words and

[54] Arup et al (2013) at 8.
[55] Provided by the Victorian Labour Hire Licensing Authority.
[56] Riley (2012) at 620.
[57] Chia and Ramsay (2016).

phrases: ‘confidentiality’; intellectual property’; ‘restraint’; ‘restraint of trade’ and ‘restriction of trade’. Only the first 100 results were examined in detail and post-employment restraints were found in 8 of those 100 agreements. Two of these agreements contained non-competes.

Clause 25 of the SCAF-West Pty Ltd Enterprise Agreement 2023 provides:

> ‘Both during employment and following the cessation of employment, an employee will not… undertake work that might be construed as being in competition with that of the work undertaken by SCAF-West without the written consent of the Company. Employees acknowledge and agree that the company is entitled to take action as necessary to enforce the above provisions. These restraint provisions shall apply for a period of 3 months in those circumstances where an employee seeks to work for a company that has won a contract that SCAF-West was unsuccessful in re-obtaining. This provision may be amended by written agreement between the parties.’

Clause 36 of the Pyramid Group Employee Enterprise Agreement 2023 provides:

> (a) In order to reasonably protect the goodwill of the Employer … for a period of 12 months following the date of termination of employment an Employee must not either alone or in company with a third party…
>
> (ii) Undertake any work on behalf of any Client who had engaged with the Employer in the 12 months immediately preceding the termination date and with who the relevant Employee had engaged with;
>
> …
>
> (iv) Seek to encourage any Employee of the Employer to leave their employment.
>
> (b) The Employee agrees that any combination of the acts referred to in clause 35(a) for the period referred to would be unfair to the Employer, would have the potential to damage the Employer and would lead to substantial loss to the Employer.

Further, clause 33.1 of the Attitude Group Pty Ltd Enterprise Agreement 2023-2027 contains a prohibiting the solicitation of former co-workers term:

> ‘Employees agree that in consideration of their remuneration and to protect the goodwill of the Company, they will not while employed by the Company, or for one (1) year after such employment ends, induce, encourage, or solicit any of the Company’s employees to resign.’

The inclusion of non-competes in enterprise agreements is an important development as they provide a mechanism for expanding the number of employees covered by non-competes. Some 3993 agreements, covering 700,000 employees, were approved by the Fair Work Commission (FWC) in 2022/23.[58]

Further, unlike employment contracts, enterprise agreements do not require the consent of each employee covered by the agreement. An agreement is ‘made’ when a majority of the employees who will be covered by the agreement cast a valid vote to approve the agreement. Further, once an agreement is approved by the FWC, it applies not only to those employees who had an opportunity to vote on the approval of the agreement, but to all future employees who fall within the scope of the agreement.[59] Such ‘future employees’ will have no say in whether they

[58] DEWR (2023) Historical Trends Data, Department of Employment and Workplace Relations, Australian Government 2023.

[59] An enterprise agreement does not impose obligations on a person, or give a person an entitlement, unless the agreement

agree to be bound by the non-compete term.

Despite the presence of post-employment restraints (such as non-competes) in enterprise agreements, there is considerable doubt about the enforceability of such terms.

In order to be approved by the FWC, an agreement must be about 'permitted matters'. Relevantly, 'permitted matters' include 'matters pertaining to the relationship between an employer that will be covered by the agreement and the employer's employees who will be covered by the agreement' (s.172(1)(a)). Each substantive term of an enterprise agreement must be about a permitted matter.

As the Full Court of the Federal Court observed in *Australian Maritime Officers Union v Sydney Ferries Corporation*[60] 'there are few hard and fast rules about what does, and what does not, pertain to an employment relationship'. The question of whether a post-employment restraint is a matter pertaining to the relationship between an employer and employee does not appear to have been the subject of judicial determination. There has been some, albeit limited, consideration of the issue in decisions of individual members of the FWC.

In *Re Glen Eden Thoroughbreds Pty Ltd (t/as Ray White Shailer Park)*[61] ('Glen Eden') Commissioner Asbury, as she then was, refused to approve an enterprise agreement containing post-employment restraints on the basis that they did not pertain to the employment relationship. The Commissioner later approved the agreement on the basis of undertakings given by the employer under s.190 of the FW Act[62]. One of the undertakings provided was that the employer would not 'refer to and/or rely on' the non-permitted matters in the agreement, including the post-employment restraint; a matter which is discussed below.

As stated in the Explanatory Memorandum to the *Fair Work Bill 2008* the 'matters pertaining to the employment relationship' formulation is of long standing:

> 'Although the precise words used have changed from time to time, the courts have construed each manifestation of the formula in a similar way. There is substantial jurisprudence about what the phrase means. It is intended that paragraph 172(1)(a) should be read in line with that jurisprudence.'[63]

In terms of the jurisprudence, *R v Portus; Ex parte City of Perth and Others*[64] (Portus) is particularly relevant. In Portus the High Court considered whether a dispute about the right of employees to challenge their dismissal in the then Conciliation and Arbitration Commission pertained to the relations of employers and employees. Justice Stephen, with whom Menzies J agreed, held:

> 'Because the demand does not seek to deprive an employer of its power to dismiss or terminate employment but seeks instead to legislate for what will only occur thereafter and then only because of an effective dismissal or termination, it follows that it is the relations of a former employer and its ex-employee that are in question rather than the relations existing between those occupying an existing employer-employee relationship... In the present case, the right or

'applies' to the person (s.51 of the FW Act). An enterprise agreement 'applies' to an employee if, relevantly, the agreement is in operation and it 'covers' the employee (s.52(1) of the FW Act). An enterprise agreement 'covers' an employee if the agreement is expressed to cover the employee (s.53(1) of the FW Act).

[60] [2009] FCAFC 145 at 200.

[61] [2010] FWA 7217.

[62] [2010] FWAA 8455.

[63] Explanatory Memorandum to the *Fair Work Bill 2008* at [670].

[64] (1973) 129 CLR 312.

> advantage sought by the Association is in no real sense the fruit of employment; what gives rise to it is the employee's dismissal from employment and the employee who is not dismissed never has occasion to enjoy it. Moreover, it is not some event occurring during employment, such as an industrial accident or the rendering of years of service, that gives rise to the right; instead it is the termination of employment, combined with a subsequent election by the ex employee, that would operate to vest in him for the first time the proposed right of appeal.'[65]

Further, in *Re Manufacturing Grocers' Employees Federation of Australia; Ex parte Australian Chamber of Manufacturers*[66] the High Court held:

> 'the expression "the relations of employers and employees" refers to the relation of an employer as such with an employee as such … a matter must be connected with the relationship between an employer in his capacity as an employer and an employee in his capacity as an employee in a way which is direct and not merely consequential.'[67]

While not free from doubt, it is likely that a court would find that a term seeking to impose a post-employment restraint (such as a non-compete or prohibiting the solicitation of former co-workers term) is *not* a matter 'pertaining to the relationship between an employer … covered by the agreement and the employer's employees … covered by the agreement', and hence is not a 'permitted matter'.

However, even if such a conclusion is correct, that is not the end of the matter. Section 186(1) of the FW Act provides that the FWC must approve an agreement if the requirements set out in ss 186 and 187 are met.[68] Sections 186 and 187 do *not* require that the FWC be satisfied that the substantive terms of the agreement relate to 'permitted matters'.

Section 186(4) provides that '[T]he FWC must be satisfied that the agreement does not include any unlawful terms'. The meaning of an 'unlawful term' is defined in s.194 and that definition does not refer to non-competes or indeed to any form of post-employment restraint.

Section 253 is also relevant, it provides:

> **253 Terms of an enterprise agreement that are of no effect**
>
> (1) A term of an enterprise agreement has no effect to the extent that:
>
> (a) it is not a term about a permitted matter; or
>
> (b) it is an unlawful term; or
>
> (c) it is a designated outworker term.
>
> Note 1: A term of an enterprise agreement has no effect to the extent that it contravenes section 55 (see section 56).
>
> Note 2: Certain terms of enterprise agreements relating to deductions, or requiring employees to spend or pay amounts, have no effect (see section 326).
>
> (2) However, if an enterprise agreement includes a term that has no effect because of subsection (1), or section 56 or 326, the inclusion of the term does not prevent the agreement from being an enterprise agreement.

In some cases s.186(2)(a) may also be relevant; it provides that before approving an agreement

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[65] [2010] FWA 7217 at [329]-[330].
[66] (1986) 160 CLR 341 at 353.
[67] Ibid at 353.
[68] *CFMMEU v Mechanical Maintenance Solutions Pty Ltd* [2022] FCAFC 15 (16 February 2022).

the FWC must be satisfied that it 'has been genuinely agreed to by the employees covered by the agreement'. Section 188(4A) provides that the FWC cannot be so satisfied unless it is satisfied that the employer has complied with s.180(5). Subsection 180(5) provides:

> **180 Certain pre-approval requirements**
>
> (5) The employer must take all reasonable steps to ensure that:
>
> (a) the terms of the agreement, and the effect of those terms, are explained to the employees employed at the time who will be covered by the agreement; and
>
> (b) the explanation is provided in an appropriate manner taking into account the particular circumstances and needs of those employees.

It is at least arguable that if the agreement contains a non-compete term, then the employer must explain to the employees who will be covered by the agreement that the term has no legal effect because it is not a 'permitted matter' and that a failure to provide such an explanation would be a failure to comply with s.180(5). On that basis the FWC would be obliged to decline to approve the agreement.[69] It should be noted that such an argument was rejected in *Glen Eden Thoroughbreds*[70], but that decision may need to be reconsidered in light of the subsequent judgment of the Full Court of the Federal Court in *One Key Workforce Pty Ltd v CFMMEU*.[71]

Assuming that a non-compete is not a permitted matter, then pursuant to s.253(1)(a) such a term will have no legal effect. It follows from this that it cannot be taken into account in the FWC's assessment of whether an agreement passes the Better Off Overall Test (the BOOT) (see ss 186(2)(d) and 188).[72]

Two other points also follow from this.

First, the FWC has no power to require an employer to give an undertaking in relation to a post-employment restraint term. This is so because a pre-condition to the approval of an agreement with undertakings is that 'the FWC has a concern that the agreement does not meet the requirements set out in sections 186 and 187'. As mentioned above, the FWC is not entitled to decline to approve an agreement simply because it includes a term which is not about a permitted matter. The inclusion of a non-compete in an agreement cannot, of itself, give rise to a concern that the agreement does not meet the requirements set out in sections 186 and 187.

It follows that the FWC has no power to require that an employer give an undertaking in respect of a non-compete (or any other type of post-employment restraint).

Second, the FWC may approve an agreement 'with amendments', under s.191A, but that provision only applies where the FWC has a concern that the agreement does not pass the BOOT (s.191A(1)(b)) and hence is not relevant for present purposes.

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[69] See *Lake Imaging Enterprise Agreement (Imaging Staff – Geelong) 2010* [2011] FWA 39 at [50]. Also see paras 8 to 14 of the Fair Work (Statement of Principles on Genuine Agreement) Instrument 2023 made pursuant to s.188(B) of the FW Act.
[70] [2010] FWA 7217 at [80].
[71] [2018] FCAFC 77 at [112]-[113].
[72] See *Armacell Australia Pty Ltd* [2010] FWAFB 9985 at [30]-[31] and *3D Earthmoving 2017 Pty Ltd* [2018] FWC 622 at [104] and [2018] FWCFB 2268. Further, s.192 provides that in certain limited circumstances the FWC may refuse to approve an enterprise agreement, none of those circumstances are relevant for present purposes.

On the understanding that post-employment restraints are not 'permitted matters' then the position in respect of enterprise agreements which include post-employment restraints may be summarized as follows:

1. The FWC is not entitled to refuse to approve an agreement merely because it includes a term that is not a 'permitted matter'.
2. A post-employment restraint is not relevant to the FWC's assessment of whether the agreement passes the BOOT.
3. The FWC has no power to require an employer to provide an undertaking in relation to the operation of a post-employment restraint, nor can the FWC require that an agreement be amended, under s.191A, to remove a post-employment restraint term.
4. As a post-employment restraint is not a permitted matter it will have no effect (ie it will be unenforceable), but the inclusion of the term in an enterprise agreement will not otherwise affect the validity of the enterprise agreement.

A consequence of the present legal framework is that a non-compete may be included in an enterprise agreement despite the fact that the term will likely have no legal effect. The potential for such a term to have an *in terrorem* effect on the employees covered by the agreement is obvious. There is nothing on the face of the agreement to indicate that the non-compete term has no legal effect. In all likelihood, the employees covered by such an agreement would assume that the non-compete term is valid. This is an entirely unsatisfactory state of affairs.

Data from other developed economies

The above observations about the distribution and prevalence of non-competes in Australia are broadly consistent with data in other developed economies.

A study by Colvin and Shierholz (2019) used data from a national survey of private sector US businesses with 50 or more employees, targeted at human resource managers or individuals responsible for hiring employees. About half, (49.4 per cent), of establishments responded that at least some of their employees were required to enter into non-competes and 31.8 per cent responded that *all* of their employees were required to enter into non-competes, irrespective of their pay level or the nature of their job. As to pay levels the use of non-competes tends to be higher in higher-wage workplaces, but more than a quarter—29.0%—of responding businesses where the average wage is less than $13.00 per hour used non-competes for all their workers.[73]

It was not possible to directly derive the proportion of employees covered by non-competes because the businesses who responded that they required *some* of their employees to enter into non-competes did not provide data on the proportion of employees subject to a non-compete. Colvin and Shierholz (2019) estimate that between 27.8 per cent and 46.5 per cent of private sector workers in the US are subject to non-competes.

Using nationally representative employee survey data, a US study by Starr et al (2021) found that non-competes are more likely to be found in high-skill, high-paying jobs but were also common in low-skill, low-paying jobs and in States where non-competes are unenforceable.

[73] Table 4 from Colvin and Shierholz (2019).

As to the prevalence of non-competes, Starr et al conclude that '38.1 per cent of US labour force participants have signed a non-compete at some point in their lives and that 18.1 per cent … currently work under one'.[74] These results may underestimate the prevalence of non-competes in the US as they are based on a survey of employees who may not know or recall if they are subject to a non-compete.

In the UK the Department for Business and Trade estimates that non-competes 'are widely used across the labour market, with around 5 million employees [out of a total workforce of 30 million; so about 17 per cent] subject to a non-compete clause in Great Britain with a typical duration of around 6 months'.[75]
Non-competes are also common in Europe. For example, in the Netherlands around 19 per cent of employees are covered by non-competes[76] and in Austria non-competes apply to over 35 per cent of private sector workers.[77]

The interests protected by non-competes

In addition to the increasing prevalence of non-competes there has been an expansion in the type of interests said to be legitimately protected by such restraints.

Historically the type of interests legitimately protected by a non-compete have been trade secrets, confidential information and 'customer connections'.[78] More recently, courts in England and Australia have also been willing to accept that an employer has an interest in a 'stable workforce' sufficient to justify a reasonable restraint prohibiting the solicitation of co-workers.[79]

In *Hartleys Ltd v Martin*[80] Gillard J granted an interlocutory injunction against two departing investment advisors preventing them from recruiting the services of their shared personal assistant, a Ms Briggs, without considering any argument about whether that aspect of the post-employment restraint was reasonable. The facts may be shortly stated. The two advisors decided to resign to go and work with ABN AMRO Morgan, a competitor operating in the same building as Hartleys. Ms Briggs resigned on the same day. In their contract of employment the two advisors had agreed to a post-employment restraint which prevented them, for three months, from performing any broking or investment advisory services for any client of Hartleys with whom they had direct dealings in the 12 months prior to leaving. They had also agreed 'not to employ, engage, solicit or entice away or endeavour to employ, engage, solicit or entire way from [Hartleys] any key employee'.[81]

Gillard J granted Hartleys an injunction preventing the two advisors from going to the rival firm for the three month period of the restraint and preventing them from offering a position to

[74] Starr et al (2021) at 60.
[75] Department for Business and Trade (UK) (2023) at 3.
[76] Streefkerk et al (2015).
[77] Young (2021).
[78] See *Heydon* above n 46, 115–32.
[79] For English authorities, see *Office Angels Ltd v Rainer-Thomas* [1991] IRLR 214; *Dawnay, Day & Co Ltd v De Braconier d'Alphen* [1998] ICR 1068; *TSC Europe (UK) Ltd v Massey* [1999] IRLR 22; *Alliance Paper Group plc v Prestwich* [1996] IRLR 25, these cases are discussed in Brooks (2001). For Australian authorities, see *Aussie Home Loans v X Inc Services* [2005] NSWSC 285 (7 April 2005) [26] (although ultimately White J did not uphold the particular restraint in this case); *Kearney Australia Pty Ltd v Crepaldi* [2006] NSWSC 23 (10 April 2006) [58]; *Cactus Imaging Pty Ltd v Peters* [2006] NSWSC 717 (18 July 2006) [55]; *Informax International Pty Ltd v Clarius Group Ltd* [2011] FCA 183 (4 March 2011) [50]–[54].
[80] [2002] VSC 301 (7 August 2002].
[81] Ibid at 71.

Ms Briggs. Ms Briggs was not a party to the proceedings and the order made entirely ignored her legal rights. As Riley (2005) notes:

> 'The doctrine of privity of contract – which ought to have protected her from being subjected to some burden as a result of a contract to which she was a stranger – was completely overlooked. Established guiding principles for the grant of an equitable injunction were ignored. The court gave no reasons justifying such a departure from fundamental doctrine.'[82]

In summary, the 'reach' of non-competes in the Australian workforce is extensive and is no longer confined to highly paid executives. Non-competes apply across income, age, occupational and education groupings. Further, a consequence of the present legal framework is that a non-compete can be included in an enterprise agreement, despite the fact that the term will likely have no legal effect; such a term will however have an *in terrorem* effect. The prevalence of non-competes in Australia is broadly consistent with data in other developed countries. There has also been an expansion in the type of interests which may be legitimately protected by a non-compete to include an interest in a stable workforce – which provides the legal basis for terms which prohibit the solicitation of former co-workers (sometimes referred to as no poaching restraints).

2.5 Economic consequences

A number of Australian labour law scholars have criticised non-competes as 'legal handcuffs' that reduce competitiveness, labour mobility and, hence, productivity.[83] The impact of non-competes on productivity is particularly important.

Productivity matters; labour productivity growth is the main driver of higher living standards over the medium term. It should concern all of us that in recent decades, in Australia and other advanced economies, growth in labour productivity has slowed markedly.

If sustained, lower productivity growth will negatively impact living standards and will mean lower potential growth and lower real neutral interest rates, making the conduct of monetary policy more difficult.

What then can be done to improve our productivity performance?

Most of the media commentary around productivity is narrowly focused; primarily on workplace relations and taxation reform. Regulatory burden and tax settings matter and affect productivity, but such a narrow focus ignores political reality and limits our ambition. A more useful starting point is to look at the causes of our recent slowdown in productivity growth, which can then inform potential policy choices.

The research literature consistently highlights two factors associated with Australia's productivity slowdown:

1. Non-mining investment was weaker than expected over much of the 2010s despite declines in interest rates and the end of the mining investment boom. The decline reflected a broad-based weakness in average investment across firms and industries (Hamber & Jenner, 2019). Generally speaking, if the amount of capital available to

[82] Riley (2005) at 6.
[83] Murphy, Arup et al (2013), Riley (2012), Stewart (2007). For a contrary view see Neil SC and N Saady (2018).

workers increases – capital deepening – they will be able to produce more output and hence be more productive.

2. There has been a decline in business and economic dynamism in Australia (Deutscher, 2019; Andrews & Hansell, 2021; Andrews et. al. 2022) and overseas (Calvino et. al. 2020), as evidenced by the slower adoption of new technologies (Andrews et. al., 2019; Akcigit & Ates, 2019) declining firm entry rates (Gutierrez & Phillippon, 2019) and a slowdown in resource allocation efficiency (Deeter et. al. 2020). Job mobility and labour reallocation rates have declined, 'trapping' scarce labour in lower productivity firms. Andrews & Hansell (2021) found that the pace of labour reallocation from low-to-high productivity firms has slowed since 2012, lowering labour productivity growth by around 0.15 percentage points per year in the mid 2010s compared to the early 2000s and accounting for about a quarter of the slowdown in non-mining non-financial private sector labour productivity growth from 2012 to 2014.

A recent paper by Hambur & Andrews (2023) brings these two factors together and found that 'declining competitive pressures appear to have contributed to a slower flow of investment and capital from low-to-high productivity firms and potentially weighed on aggregate investment'. The authors conduct a simple counterfactual exercise which suggests that, had the flow of labour and capital towards more productive firms not slowed since the mid-2000s, by 2017 the economy would have been $13 billion (or 0.75 percent of GDP) larger, roughly $550 per person or $1000 per worker. Indeed the impact is likely to be greater as the counterfactual only captures one channel through which weaker capital allocation and dynamism are likely to have affected incomes.

Non-competes are associated with reduced employee mobility and with changes in the direction of that mobility (ie towards non-competitors);[84] with consequential negative impacts on wages and productivity. A recent e61 research note[85] examined the relationship between job mobility and firm entry rates and the prevalence of employment restraints at an industry level in Australia. The authors found that:

1. Job mobility appears to be lower in industries where the use of restraint clauses is higher.
2. There is a negative correlation between the current prevalence of restraint clauses and the change in firm entry rates over the past 15 years.

Prohibiting or restricting non-competes enhances employee mobility and knowledge spillovers between firms. Gilson (1999) examined the economic effect of the law with respect to non-competes by comparing two high technology industrial districts, California's Silicon Valley and Massachusetts' Route 128. He contends that the differential performance of Silicon Valley and Route 128, the former has had continued success and the latter has declined, is due to the fact that California prohibits non-competes and Massachusetts enforces them.

A paper by Marx et al (2009) examines the impact of non-competes on employee mobility by using Michigan's 1985 reversal of its non-compete enforcement policy as a natural experiment. The authors found 'a strong decrease in average Michigan mobility once non-competes began

[84] Starr et al (2021).
[85] Andrews D, M Brennan and J Buckley (2024).

to be enforced'.[86]

Lipsitz & Starr (2022) considered the impact of Oregon's 2008 ban on non-competes for low skilled workers. Prior to the ban, 14 percent of employed low skilled workers were covered by a non-compete. The authors found that following the imposition of the ban, the average low-skilled wage increased by 2.2 to 3.1 percent and job mobility increased by 12 to 18 percent. Similarly, a study of a Hawaii ban on non-competes for tech workers found that the ban led to higher earnings (Balasubramanian et. al., 2022).

An outlier is Young (2021), who found that a ban on non-competes in Austria for low wage workers was associated with a 1.7 percent increase in annual job-to-job transition rate, disproportionally to higher quality and higher paying jobs but had limited effects on earnings. It is worth noting that the ban on non-competes in Austria only applied to those earning below the 52nd percentile of the earnings distributions.

A recent paper published by the US National Bureau of Economic Research (Gottfries & Jarosch, 2023) assessed the consequences of an outright ban on non-competes in the US labour market using a new model on wage-posting and on-the-job search, drawn from the Burdett-Mortenson model. The model used was validated by testing with existing empirical evidence on firm mergers and non-competes. The model predicts that wage gains are typically 2 to 6 percent but can be as high as 15 percent when non-competes are common and hiring costs are higher.

The baseline analysis by Gottfries & Jarosch (2023) suggests that a ban on non-competes between workers and firms in the US would increase wages by 4 percent as a consequence of the rise in competition, with strong wage spillovers to firms that did not initially use non-competes and a large increase in worker turnover. The authors also note that while a ban on non-competes is likely to increase wages and reduce labour misallocation, it also generates a sharp rise in worker churn, increased turnover costs and reduced labour demand.

Similarly, Johnson et. al. (2023) posit that average earnings of all US workers would likely increase by 3.2 percent to 11.2 percent (midpoint of the interval: 8.7 percent) nationally, if non-competes were made unenforceable.

As mentioned earlier, the slowing in Australia's productivity performance in recent decades has coincided with a decline in job-to-job transitions.[87] Job-to-job transition, sometimes referred to as job switching, occurs when a worker changes jobs without going through a period without paid employment. Andrews and Hansell (2021) suggest that the observed decline in productivity-enhancing labour reallocation is holding down overall productivity growth and is consistent with a rise in adjustment frictions. Non-competes are a source of friction in labour markets, creating a barrier to labour mobility.

International research suggests that job-to-job transitions can increase aggregate productivity by moving workers to more productive firms.[88] In the Australian context Buckley (2023) finds that the share of job switching that involves workers moving to higher productivity firms has fallen over time, from 54.2 per cent between 2003 to 2006 to 52.8 per cent between 2015 and

[86] Marx et al (2009) at 888.
[87] Andrews and Hansell (2021).
[88] Albagli et al (2021).

2019.[89] Buckley contends that making it easier for workers to switch jobs could boost productivity:

> 'Australian workers currently face a number of barriers when looking to move to a more productive firm. Some of these barriers have gotten worse in recent years. Non-compete clauses (NCCs), for instance, have become more prevalent over the last 15 years and are now a default option in many employment contracts. Removing or limiting the use of NCCs would help remove one source of friction behind the decline in job mobility.'[90] (citations omitted).

Competition among firms for employees, as reflected in higher job-to-job transition rates, is an important driver of higher wages. In the Australian context, Deutscher (2019) found that higher job-to-job transition rates are associated with higher wages and that a 1 percentage point increase in the rate at which workers switch jobs is associated with a 0.5 percentage point increase in growth in average wages.

A recent Australian study found that switching jobs is associated with pay increases that are nine percentage points higher on average than for non-switches and that the largest beneficiaries are workers aged between 21 and 34 years old. When such workers switch jobs they earn, on average $7,500 more per annum than 'job stayers'[91].

The next section considers whether a regulatory response is needed to address the deleterious impact of non- competes and, if so, what policy options are available.

3. Policy Options

3.1 Is there a need for a regulatory response?

The case in favour of a regulatory response to curtail the use of non-competes rests on two broad propositions. The first is that the existing law and practice in respect of the use of non-competes in Australia is manifestly unfair and contrary to the public interest. In most cases the parties to a non-compete cannot be certain of its enforceability without a judicial determination and such uncertainty weighs more heavily on employees than employers. The uncertainty inherent in the application of the current law has a chilling affect and for many employees the mere threat of litigation is enough to secure compliance, irrespective of the enforceability of the non-compete. Further, employers have ready access to injunctive relief to enforce non-competes, to the disadvantage of employees and the public interest. Few cases proceed to the trial stage, where the merits of the non-compete can be fully tested.

The second proposition in favour of a regulatory response is that non-competes reduce employee mobility with consequential negative impacts on wages and productivity.

The case against any further limitation on non-competes, that is, in addition to the operation of the common law doctrine of restraint of trade, rests on four broad propositions.

(i) *Non-competes are necessary to protect trade secrets, particularly in high-skilled labour markets.*

Two points may be made in response to this proposition.

[89] Buckley (2023), Figure A.1, panel A.
[90] Buckle (2023) at 2.
[91] A Wong (2024).

First, the 'reach' of non-competes extends well beyond the highly skilled and highly paid. Starr et. al. (2021) report that 14.3 percent of US workers without a college degree and 13.3 percent of US workers with annual earnings of less than $40,000 are covered by a non-compete. A similar pattern emerges in Australia. About one in five Australian workers are subject to a non-compete and they are prevalent across different societal groups, including low-paid employees. In short, the 'reach' of non-competes is inconsistent with their stated justification; as Gottfries & Jarosch (2023) observe 'it seems hard to argue that the millions of low-skilled, low-pay workers have access to important trade secrets'(p22).

Second, there are other mechanisms to protect trade secrets. An employer wishing to restrain the post-employment use or disclosure of confidential information can rely on the common law duty of confidentiality and the equitable doctrine of breach of confidence. As Stewart (1997) points out (at p 188):

> 'the equitable obligation not to misuse information communicated or acquired in confidential circumstances falls upon any person into whose hands information comes as a result of another's breach of confidence. Hence the duty of confidentiality may be enforced not only against the ex-employee but also against any third party (such as another employee, or rival firm set up by the ex-employee) who acquires the information as a result of the ex-employee's breach'.

It is acknowledged that these alternate means have limitations. The duty of confidentiality is only breached by the misuse of 'secret' information and may not cover information which is only 'confidential'[92]. Further, an injunction will only be granted to restrain the use of trade secrets by a former employee if the precise material to be covered by the injunction can be specified[93] and to claim damages for such a breach the employer must show that any loss of business is attributed to the disclosure of the secret information[94].

As mentioned earlier, one of the reasons that non-competes have become more common is because they are easier to enforce than other post-employment restraints dealing with confidential information and customer solicitation. Indeed courts have encouraged this approach, for example in Littlewoods Organisation Ltd v Harris[95] the court said:

> 'experience has shown that it is not satisfactory to have simply a covenant against disclosing confidential information. The reason is because it is so difficult to draw the line between information which is confidential and information which is not and it is very difficult to prove a breach when the information is of such a character that a servant can carry it away in his head. The difficulties are such that the only practicable solution is to take a covenant from the servant by which he is not to go to work for a rival in trade'[96].

(ii) *Any further limitation on non-competes undermines the sanctity of contract.*

This argument is advanced by Neil and Saady (2018), who contend that employees 'consciously and freely chose to be bound' by non-competes when they entered into a contract

[92] *Faccenda Chicken Ltd* v *Fowler* [1986], All ER 617 at 625; and *Wright* v *Gasweld Pty Ltd* (1991) 22 NSWLR 317 at 333-4.
[93] *Lock International Plc* v *Beswick* [1989] 3 All ER 373.
[94] *Universal Thermosensors* v *Hibben* [1992] 3 All ER 257.
[95] *Littlewoods Organisation Ltd* v *Harris* [1997] 1 All ER 1472.
[96] Ibid at 1479 The same approach has been adopted in Australia, see *Woolworths Ltd* v *Olsen* [2004] NSWCA 372 and *Quantum Service and Logistics Pty Ltd* v *Schenker Australia Pty Ltd* [2019] NSWSC 2.

with their employer and refusing to enforce such a contractual obligation 'undermines the authority and sanctity of contract'.

There are two problems with this argument. The first is that the common law doctrine of restraint of trade already 'undermines the … sanctity of contract' as non-competes are invalid unless the non-compete is no wider than reasonably necessary to protect a legitimate interest. Further, both the common law and a range of statutory provisions routinely both imply and prohibit certain contractual terms.

The second, and more substantive point, is that the premise of the argument – that employees 'consciously and freely chose to be bound' by non-competes – ignores the inequality in bargaining power inherent in most employment relationships and is contrary to the available evidence.

Starr et al (2021) found that only 10 per cent of employees report attempting to negotiate over the terms of a non-compete or asking for additional compensation or benefits in exchange for agreeing to such a condition. When presented with a non-compete, most respondents report just reading and signing it, and some not even reading it.[97] Starr et al (2021) conclude that 'the evidence … indicates that employers present (or employees receive) non- compete proposals as take-it-or-leave-it propositions'.[98]

Further, as mentioned earlier, the proposition that employees 'consciously and freely chose to be bound' by non-competes is plainly wrong in respect of non-compete terms in enterprise agreements and their application to 'future employees'.

(iii) *Workers are better off being bound by a non-compete.*

There are two elements to this argument, namely that workers bound by non-competes earn higher wages and that they receive additional training.

Whether or not workers are better off being bound by a non-compete is somewhat contentious. A number of US studies have found that workers bound by non-competes earn higher wages than those without non-competes[99].

There is an obvious tension between these studies and those discussed earlier in section 2.5 of this paper which report an increase in wages following the banning of non-competes. This tension is discussed by Starr (2023) who observes that those asserting non-competes result in higher wages are 'confusing correlation with causation',:

> 'There are many reasons why workers with non-competes may earn more than workers without non-competes that have nothing to do with the noncompete. For example, non-competes are more common for more educated workers, and more educated workers tend to have higher earnings. So it's not surprising that non-competes are associated with higher earnings, but this may just have to do with the types of workers that agree to non-competes or the types of firms that deploy them'.

Similarly, Balasubramanian et al. (2023) find that positive wage relationships with non-competes are likely driven by selection and should not be interpreted causally and that a

[97] Starr et al (2021) Table 7 at 72.
[98] Starr et al (2021) at 72.
[99] See Starr, E., (2019) and Lipsitz, M. and Starr, E., (2022).

negative average wage effect is more likely.

Further, as Starr (2023) points out, if it is the case that enforcing non-competes is likely to lead to better outcomes for workers, we would expect non-competes to be associated with relatively higher wages where they are enforceable compared to where they are not. But this is the opposite of the results in Rothstein and Starr (2022) who find that the non-compete-wage differential in states that might enforce non-competes is 6 percent lower than in states that will not enforce them.

Starr (2023) convincingly concludes:

> 'Commentators suggesting that non-competes cause higher wages are largely misinterpreting cross-worker correlations. Rather, recent economic evidence suggests that the positive correlations between non-competes and wages is likely spurious and that non-competes (potentially alongside non-solicits and NDAs) likely reduce earnings by increasing retention and shielding firms from labor market competition. These findings align with studies of state policy shocks which cover state-level bans on non-competes for low-wage workers, high-tech workers, and a variety of other changes to state non-compete laws.'

The proposition that workers bound by non-competes receive more training is supported by two studies, which find that non-competes and their enforceability are associated with more training[100]. However, another study suggests that one reason there is more training in US states where non-competes are enforceable is because non-competes prevent firms from hiring experienced workers thus causing them to hire inexperienced workers who require more training[101].

While it may be accepted that non-competes are associated with the provision of additional training the reasons for that association are less clear. Further, the existence of such an association does not mean that imposing further restrictions on the use of non-competes will necessarily reduce the extent of training provided to employees.

(iv) *Non-competes foster innovation.*

A number of commentators have suggested that non-competes give firms incentives to develop and share valuable information with workers that may make those workers more productive, as they provide protection against their workers providing that information to a competitor.[102] However, the evidence from recent studies suggest that non-competes do *not* foster innovation.

A study by Johnson, Lipsitz, and Pei (2023), suggests that an average-sized increase in non-compete enforceability reduces patenting by 16-19 percent over the ensuing 10 years. Other recent studies report similar findings. Reinmuth and Rockall (2023) find that an average increase in the enforceability of non-competes[103] reduces patenting by 11.6 percent after 5 years.

In summary, there are factors weighing for and against curtailing the 'reach' of non-competes and the type of interest which may be protected by post-employment restraints, but the weight

[100] Starr (2019) and Starr, Prescott and Bishara (2021).
[101] Starr, E. M. Ganco and B. Campbell (2018).
[102] See e.g., Cowen (2023).
[103] An 'average' increase in enforceability is an increase of the size commonly observed in the authors sample of 26 changes in non-compete enforceability.

of the evidence favours a regulatory response to ameliorate the unfairness inherent in the existing law and practice with respect to the use of non-competes.

Despite the fact that the doctrine of restraint of trade is intended to protect the public from the anti-competitive consequences of non-competes and to take account of the interests of the affected worker, these considerations are often forgotten in contemporary judgments in which the central focus is on the interest of the employer. A regulatory response is required to correct this imbalance.

3.2 The Options

Australian labour law scholars have suggested a range of measures to mitigate the deficiencies in the current legal framework. For example, Arup et al suggest placing an upper limit on the duration of non-competes and requiring employers to pay their former employees for the period the non-compete operates.[104] They also propose a policy of 'no modification of restraints – or, at least only modification to make good the restraint if the parties can show they had genuine doubts about the appropriate restraint to apply in a particular position'.[105]

Riley (2005) argues that clauses which prohibit the solicitation of former co-workers be 'entirely unenforceable' and that more rigid requirements be introduced for assessing the balance of convenience in applications for injunctive relief to enforce non-competes. Arup et al (2013) suggest that a 'cleaner reform… would be to withhold interlocutory injunctive relief altogether from employers and require them to go to trial (on an expedited basis) to plead the merits of the restraint'.[106]

A number of jurisdictions within the OECD have imposed restrictions on the use of non-competes ranging from the general prohibition of such terms to more limited regulatory interventions, such as the payment of mandatory compensation to the former employee (by their former employer) while a non-compete operates to prevent them working for a competitor.[107]

A number of reforms have been proposed in the US, including banning non-competes for some or all employees and regulating the non-competes contracting process,[108] and in recent years, many States have passed laws limiting employers' ability to impose non-competes on their employees.[109]

At present, the restriction of non-competes across the US is under active consideration by the Federal Trade Commission (the FTC).

In January 2023 the FTC released a 'Notice of Proposed Rulemaking' (NPRM) to prohibit employers from imposing non-competes on workers. The proposed rule would:

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[104] Arup et al, at 26.
[105] Ibid at 27.
[106] Arup et al at 29.
[107] For example, articles 74, 74A and 74B of the German Commercial Code oblige an employer to pay the restrained employee 50% of their remuneration for the entire restraint period which can only operate for a maximum of two years. Similarly, under Art 2125 of the Italian Civil Code, a restrictive covenant must be written, limited in time, restricted to a specific activity and area, and provide financial compensation to the restrained employee.
[108] For a summary of non-compete policy proposals see Fair Competition Law, The Changing Landscape of Trade Secret Laws and Noncompete Laws around the Country (https://www.faircompetitionlaw.com/changing-landscape-of-trade-secrets-laws-and-noncompete-laws/
[109] For more on state action on non-competes, see Flanagan and Gerstein (2019).

- provide that non-competes are an unfair method of competition and would ban employers from entering non-competes with their workers, including independent contractors; and
- require employers to rescind existing non-competes with workers and actively inform their employees that the non-competes are no longer in effect.

The FTC estimates that the proposed rule would increase workers' earnings by nearly $300 billion per year. FTC staff are currently considering comments received on the proposed rule and will present any proposed revisions to the FTC for its determination.

The regulation of non-competes has also received attention in the UK where the government has announced its intention to introduce a statutory limit on the length of non-competes of 3 months.[110]

Some potential reform options in the Australian context are discussed below.

3.3 Monetary Thresholds

As mentioned earlier, non-competes often apply to low-wage employees. A common regulatory response is to render unenforceable non-competes with employees who earn less than a prescribed amount. The argument advanced in favour of such measures is that 'low-wage' non-competes are unfair, as Hiraiwa et al (2023) put it:

> 'low-wage workers typically do not benefit from the investments that firms use to justify [non-competes], often do not review their [non-compete] and may be unable to afford legal protection to defend against even frivolous [non-compete] lawsuits.'[111]

To these arguments one could add that 'low-wage' employees often lack the bargaining power to resist a non-compete or to negotiate its terms.

Non-competes with 'low-wage' employees are unenforceable in 11 States in the US.[112] There is no particular consistency in the threshold chosen or the method for determining that threshold. The criteria adopted in each state are summarised below:[113]

Non-competes limited by wages threshold

State	Wage Threshold (August 2022)
Colorado	$101,250
Illinois	$75,000
Maine	400% of the federal poverty level ($54,360 (est.))
Maryland	$15 per hour or $31,200 annually
Massachusetts	Nonexempt under the Fair Labor Standards Act
Nevada	Paid solely on an hourly wage basis, exclusive of tips or gratuities
New Hampshire	$14.50 per hour (2x federal minimum wage) or tipped minimum wage, whichever applies

[110] Department of Business and Trade (UK) 12 May 2023.
[111] Hiraiwa et al (2023) at 2; also see Krueger and Posner (2018).
[112] Beck (2022).
[113] Beck (2022).

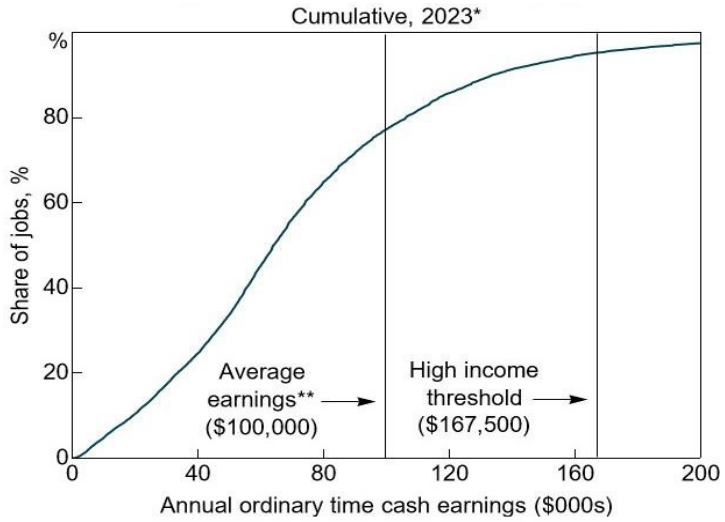
Oregon	$100,533
Rhode Island	250% of the federal poverty level for individuals $33,975 (est.)) or nonexempt under the Fair Labor Standards Act
Virginia	Average weekly wage in Virginia ($67,080 (est.))
Washington	$107,301.04 ($268,252.59 for independent contractors)

The selection of an appropriate non-compete enforcement threshold in the Australian context is a policy choice.

As shown in Chart 1 below the higher the threshold the more jobs affected.

Chart 1

Share of Australian jobs earning below any given level



* Based on 2021 Employee Earnings and Hours survey; assumes that earnings grew at the same rate as the WPI over 2022 and 2023

** Annual ordinary time cash earnings of full-time adult employees

Sources: ABS; RBA.

The 'high income threshold' is a concept used in the FW Act. If an employee (defined as a 'high income employee') has a guarantee of annual earnings which exceed the high income threshold, the unfair dismissal provisions of the FW Act do not apply to that employee (s.382). The high income threshold is indexed and is currently $167,500. If that figure was used as a non-compete enforceability threshold it would have the practical effect of prohibiting the enforcement of non-competes in over 90 per cent of Australian jobs. A threshold set at 'average earnings' covers just under 80 per cent of jobs.

The evidence from a US study by Hiraiwa et al (2023) suggests that a monetary threshold which covers about 80 per cent of workers does not reduce average firm value and firms do not appear to value the enforceability of non-competes for workers earning around the threshold. The authors expected that if firms valued the ability to enforce a non-compete they would give marginal workers earning just below the threshold a small wage increase to meet the enforceability threshold, which would be shown by a 'bunching' at the threshold and a missing mass below. The findings are summarised as follows:

> 'Using administrative data from Washington and a variety of difference-in-differences estimators, we find no evidence of excess mass just above the earnings threshold, and little to no evidence of missing mass below the threshold—including in industries where [non-competes] are most frequently used. To discern between potential interpretations of this evidence, we analyse data from a survey which asked employment attorneys in Washington about the 2020 law, and their experiences and perceptions related to giving marginal workers raises to reach the threshold. The survey data confirms a lack of bunching behaviour, and indicates that the most common reasons firms do not raise employee compensation to reach the necessary threshold are that they do not expect to need to enforce [non-competes] in court for such employees and because they have other tools to use to protect their resources…
>
> To examine whether banning [non-competes] for 79% of Washington workers destroys or enhances firm value, we follow Younge and Marx (2016) and study how, among publicly traded firms, Tobin's *q* changes following the [non-compete] ban. We find no evidence that firm value in Washington fell after "low-wage" [non-competes] were banned.'

In the event that an enforcement threshold is adopted, it should be indexed.

3.4 Term Limitations

Regulatory responses to non-competes can include the imposition of a limit on their duration; a requirement that the former employee be compensated for the duration that the non-compete applies; or a combination of these two measures.

As mentioned earlier, the UK has announced an intention to introduce a 3-month term limit to all non-competes. In Germany, employers are obliged to pay the restrained employee 50 per cent of their remuneration for the entire restraint period (a maximum of two years).

The advantage of a requirement that the former employee be compensated for the duration of the non-compete is that it, in effect, applies a market solution to the problem. The employer is required to place a value on the restraint and to pay that amount to the worker who is subject to the restraint.

What would be an appropriate term limit in the Australian context? It will be recalled that a non-compete is only lawful if the employer can point to a legitimate interest it is entitled to protect and the restraint goes no further than is reasonable to protect that interest. Neil and Saady (2018) – who argue that non-competes are both important and necessary to employment relationships – suggest that six months is the likely outer limit of reasonableness in this context, noting that:

> 'Courts have a tendency to refuse to enforce restraints of longer than six months, holding anything longer as intruding on employees' interests.'[114]

An appropriate policy intervention may be to introduce a non-compete term limit of up to six months subject to the restrained employee being compensated for the duration of the restraint.

The amount of compensation provided also presents a policy choice – ranging from the remuneration the employee would have received had the employment relationship continued (ie full compensation), to some proportion of that amount (partial compensation). Any determination of the appropriate amount of compensation should consider:

[114] Niel and Saady (2018) at 101.

- the fact that the former employee will not be performing any work for their former employer during the restraint period; and
- the former employee will not be able to commence working for a competitor (or to operate their own business) during the restraint period. Further, job switching usually results in higher remuneration and so the former employee will be denied access to that higher remuneration for the duration of the restraint.

Consideration should also be given to the interaction between the compensation paid during the restraint period and any payments in lieu of notice of termination or any 'gardening leave' arrangement.[115]

3.5 Injunctive relief

The criticism of the current law with respect to injunctive relief is that it is too readily available to employers seeking to enforce non-competes, to the detriment of the public interest and the employee to whom the non-compete applies.

The reform options range from prohibiting access to injunctive relief altogether, which would require employers to go to trial (on an expedited basis) where the merits of the non-compete can be fully tested; to 'lifting the threshold' for the grant of injunctive relief.

As Arup et al (2013) note, prohibiting access is a 'cleaner reform' but would be a much bigger step than requiring employers to make out a stronger case before injunctive relief is granted or 'tilting' the balance of convenience requirement towards the affected employee. Ultimately, Arup et al conclude:

> 'To remove interlocutory injunctive relief altogether … would also increase some pressures on the employee. So perhaps the right path is to improve the interlocutory procedure.[116]

A middle path may be to expressly require courts to take into account the public interest in the promotion of competition and the interests of affected employees in deciding whether the balance of convenience favours the grant of injunctive relief. There is, however, some complexity and risk in constraining judicial discretion. Depending on the other policy responses adopted, it may not be necessary to pursue this particular option.

3.6 Prohibition

There are a range of options within the prohibition policy mode, including:

- prohibiting *all* non-competes;
- prohibiting particular aspects of non-competes – such as terms prohibiting the solicitation of former co-workers;
- prohibiting the severance of unlawful aspects of non-competes by the courts; and
- prohibiting the inclusion of non-competes in enterprise agreements.

Each of these options is considered below.

(i) Prohibiting *all* non-competes

[115] As to 'gardening leave' see Coulthard (2009).
[116] Arup et al (2013) at 29.

Subject to limited exceptions, some States in the US provide that non-competes are unenforceable. For example, s.16600 of Californian Business and Professions Code states:

> 'Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade or business of any kind is to that extent void.[117]

The compete prohibition of non-competes may undermine the capacity of employers to take reasonable steps to legitimately protect their business and accordingly is likely to encounter strong resistance.

(ii) Prohibiting employee non-solicitation terms

Riley convincingly argues that such terms should be 'entirely unenforceable',[118] on the following basis:

> 'an employer has no legitimate interest in keeping staff. The case law (largely English single judge decisions[119]) holding that an employer has a legitimate interest in maintaining a stable workforce is misconceived. These cases focus - illegitimately - on the value of a stable and trained workforce as some kind of business 'asset', but forget that a workforce is not a thing of property. Staff are legal persons. They are subjects, not objects; they are owners, not owned. As independent legal actors they enjoy a liberty to receive, consider and should they so desire accept offers of employment. No contract made between other persons should be allowed to limit that liberty. To allow otherwise is to tolerate what the common law doctrine of privity of contract has always prohibited: burdening people behind their backs with the consequences of another's bargain.'

There is a strong case for prohibiting the use of terms which prohibit the solicitation of former co-workers.

(iii) Limiting judicial discretion

The common law approach to severance encourages employer overreach in drafting non-competes and has led to the adoption of cascading or laddered non-competes.

Pivateau (2007) proposes that 'courts put an end to the blue pencil doctrine… because it creates an agreement that the parties did not actually agree to [and] does nothing to address the underlying problems of non-compete agreements'.[120] Pivateau also contends that employers should be required to nominate precisely the position from which the employee would be barred, the interest that is worthy of protection, and the extent of the restraint that is considered reasonable.[121]

Some US states such as Georgia, Virginia and Wisconsin follow a 'no modification' approach to non-competes, also known as the 'all or nothing' rule. Under these provisions courts must refrain from either rewriting or striking out terms in non-competes which are wider than strictly

[117] Section 16600 has been upheld by the courts and re-affirmed by the Californian Supreme Court in *Edwards v Arthur Anderson*, 44 Cal. 4th 937 (2008).
[118] Riley (2005) at 3.
[119] See for example *Dawnay Day & Co Ltd*; *Wilcourt Investments Pty Ltd* [1997] EWCA Civ 17.53 (May 22, 1997); *TSC Europe (UK) Ltd v Massey* [1999] IRLR 22; *Alliance Paper Group plc v Prestwich* [1996] IRLR 25. For an analysis of these cases see Brooks (2001) at 42–49.
[120] Pivateau (2007) at 673-674.
[121] Pivateau (2007) at 674.

necessary to protect the employer's legitimate interest.[122]

There is a reasonable case for limiting the capacity of courts to sever unlawful aspects of non-competes, but such an approach brings with it some risk and complexity. It would, in effect, mean overriding parts of the Restraints of Trade Act and constraining the operation of a common law judicial discretion is not a task to be undertaken lightly.

Careful thought would need to be given to the drafting of such a provision. Depending on the other policy responses adopted it may not be necessary to pursue this option.

(iv) Prohibiting the inclusion of non-competes in enterprise agreements

As mentioned earlier, the inclusion of non-compete terms in enterprise agreements is an important development. It is likely that such terms have no legal effect, as they are not about a 'permitted matter', but they have an *in terrorem* impact. On the understanding that non-competes are not 'permitted matters' it follows that the FWC cannot refuse to approve an enterprise agreement merely because it includes a non-compete. Nor can the FWC require an employer to give an undertaking in relation to a non-compete or amend an agreement to remove a non-compete.

One means of addressing this unsatisfactory state of affairs is to amend the FW Act, as follows:

1. Amend s.194 to make a non-compete an 'unlawful term' (the FWC can only approve an enterprise agreement if it is satisfied that it does not contain any 'unlawful terms': s.186(4).
2. Amend s.191A (or insert a new section) to provide that the FWC *must* amend an enterprise agreement to remove a non-compete term as part of the approval process.

These amendments would remove the risk that employees may mistakenly believe that a non-compete term in an enterprise agreement is effective and enforceable.

The proposed amendments are predicated on the proposition that non-compete terms are not permitted matters and are of no effect. But what if that is not the case? What if a court were to find that non-competes are permitted terms? Well, in such circumstances, there is still a strong case for the amendments proposed.

If non-competes can be validly included in enterprise agreements, they would not be subject to the common law doctrine of restraint of trade because, upon approval, an enterprise agreement is a statutory instrument. Consequently, non-compete terms in enterprise agreements would not be constrained by the requirement that the restrictions imposed are no wider than reasonably necessary to protect a legitimate interest.

Further, enterprise agreements do not require the consent of each employee covered by the agreement at the time it was made (only a majority of those employees who cast a valid vote) and future employees have no say in whether they agree to be bound by the non-compete term.

True it is that in these circumstances a non-compete term can be weighed in the balance as part of the assessment of whether an agreement meets the BOOT. But how is the detrimental effect

[122] Pivateau (2007), at 674, argues that '[I]t is time to put the blue pencil down'.

of such a term to be assessed?

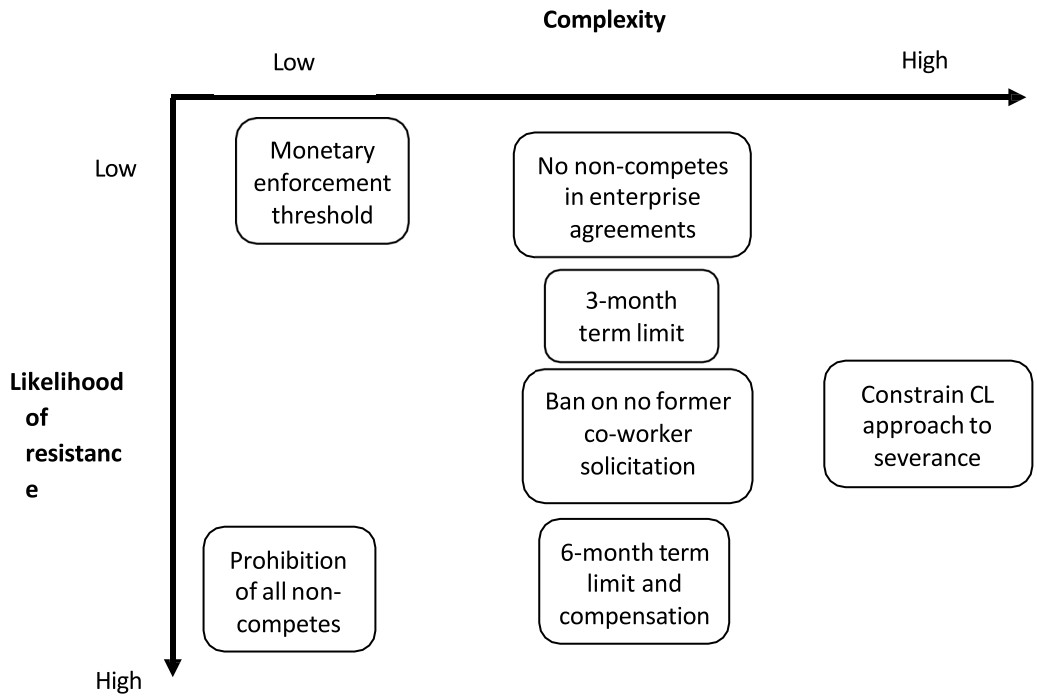
The better course is to simply make non-compete terms unlawful and require that they be removed from an enterprise agreement as part of the approval process.

4. Conclusion

The existing law and practice in respect of the use of non-competes in Australia is manifestly unfair and contrary to the public interest. Non-competes create a barrier to labour mobility. Prohibiting or restricting non-competes is associated with increases in workers' earnings and job switching. Job switching enhances knowledge spillovers between firms and is likely to increase labour productivity by moving workers to more productive firms. The weight of the evidence favours regulatory reform in respect of the use of non-competes in Australia.

The various policy options canvassed in this paper can be located on a two-axis matrix, depending on the complexity of the option and the extent to which it is likely to encounter resistance.

Policy options – complexity vs likelihood of resistance



Reasonable minds may differ about how a particular option is characterised and, of course, the devil is in the detail.

There is a strong case for prohibiting the use of non-competes in respect of low-paid workers. It is difficult to conceive of the 'legitimate interest' that would justify a non-compete in respect of a strawberry picker, or for that matter a hairdresser. To the extent that a non-compete with a hairdresser is directed at restricting the capacity of a former employee to solicit the customers of their former employer, that interest can be more directly protected by a post-

employment non-solicitation restraint. The use of a non-compete in such circumstances is akin to using a sledgehammer to crack a walnut. However, a 'very high' monetary enforcement threshold is likely to encounter significant resistance, particularly if it amounts to a de facto prohibition of all non-competes. The same observation may be made about the adoption of a very short term limit.

There is also a policy trade-off between simple/low resistance options and effectiveness. For example, adopting a monetary enforcement threshold at the level of the Federal minimum wage would be relatively simple and encounter little resistance; but it would cover very few employees.

Taking all of these matters into account, four particular policy interventions should be considered as an initial response to the issues with the current legal framework which have been identified in this paper.

1. The adoption of an indexed monetary threshold for non-compete enforceability.
2. Placing a term limit (up to six months) on non-competes in respect of employees who earn more than the monetary threshold, subject to the employer compensating the employee for the duration of the restraint.
3. Render unenforceable terms which prohibit the solicitation of former co-workers.
4. Amend the FW Act to provide that non-competes and terms which prohibit the solicitation of former co-workers in enterprise agreements are unlawful and require that they be removed as part of the approval process.

Consideration should also be given to extending the reforms beyond 'employees' to contractors and 'employee-like' workers given recent amendments to the FW Act.

The adoption of these policy responses would also address the problems inherent in 'laddered' non-competes. The imposition of a six-month term limit coupled with a requirement to compensate the worker subject to the restraint effectively removes the incentive for a 'laddered' restraint.

In implementing a policy response, five other matters should be considered.

First, the simplest mechanism for implementing any of the policy options mentioned above would be by an amendment to the FW Act.

It is generally accepted that the FW Act covers about 85 per cent of employees. In broad terms the employees not covered are:

- State government departments and (with a few exceptions) agencies in NSW, Queensland, SA and Tasmania
- State government departments and agencies (if unincorporated) in WA
- local government employers in NSW, Queensland, WA and SA, and
- sole traders, partnerships and non-trading corporations in WA.

There is no impediment to amending the FW Act to regulate individual employment contracts.

The FW Act was recently amended to insert provisions prohibiting employers from entering into a contract of employment or other written agreement which includes a pay secrecy term.

Second, the evidence suggests that employers regularly require employees to enter into non-competes that are unenforceable and that such (unenforceable) non-competes exert an *in terrorem* effect on employees and restrict mobility[123]. As Starr (2023) reports, nearly every nationally representative study of noncompete use finds that non-competes are found in approximately similar levels in states that will and will not enforce them, including studies of firms,[124] employees,[125] and in government-collected data.[126]

This suggests that it is not enough to merely restrict the *enforceability* of non-competes. A policy intervention must also limit the *use* of non-competes by increasing the 'cost' of using unenforceable non-competes.[127] One way of doing this would be to adopt a legislative response modelled on the pay secrecy provisions in ss 333B to 333D of the FW Act. There are two elements to such a model:

1. Provide that non-competes with employees who earn less than a prescribed amount (say $100 000 per annum) are unenforceable.
2. Expose employers to a civil penalty in the event that they enter into a non-compete with an employee who earns less than $100 000 per annum.

The same approach can be taken in respect of other policy options. For example, in respect of a term limit, any non-compete which purports to operate for longer than the prescribed limit would be unenforceable *and* employers entering into such-non-competes would be liable to a civil penalty.

Third, any regulatory response should consider providing an exemption in relation to the sale of a business or the dissolution of a partnership. Such exemptions are common in jurisdictions which limit or prohibit non-competes and recognise the fact that the purchaser in such transactions is often buying 'good will' and in such circumstances a reasonable non-compete is appropriate.

Fourth, depending on the regulatory responses adopted, some thought may need to be given to the interaction with relatively common contractual provisions, such as 'gardening leave' (Coulthard, 2009).

Finally, any regulatory response should be evaluated two years after implementation in order to assess its effectiveness and to determine if further measures are necessary.

[123] See [31]-[34] infra.
[124] See Balasubramanian, N, E Starr, and S Yamaguchi. "Employment Restrictions on Resource Transferability and Value Appropriation from Employees." Available at SSRN 3814403 (2023).
[125] Starr, Evan P., James J. Prescott, and Norman D. Bishara. (2021).
[126] Rothstein, D, and E Starr. (2022).
[127] A point made by Starr et al (2020) at 637.

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