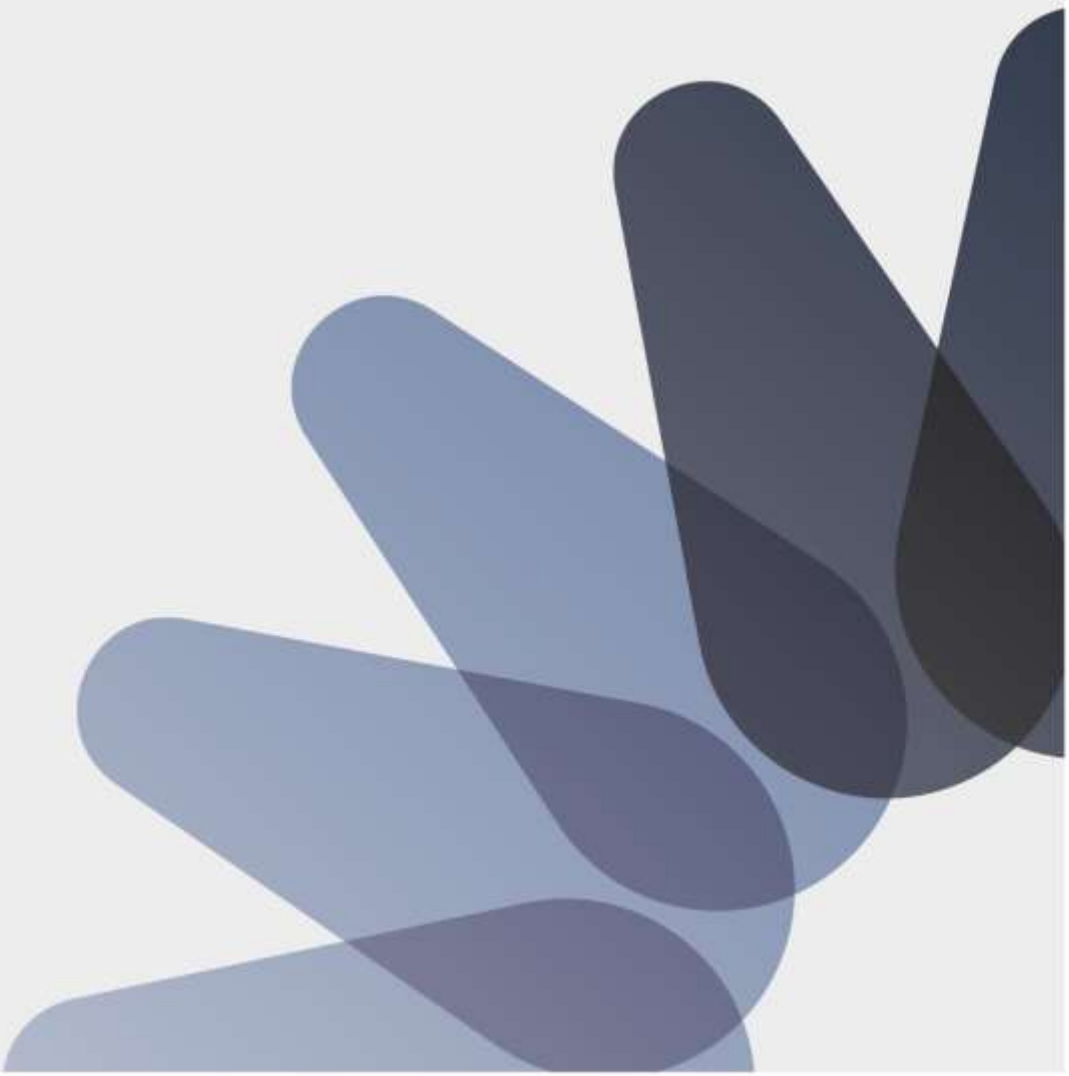
Australian Government
The Treasury

Competition Review

Non-compete clauses—prevalence, impact and policy implications

Summary of Treasury-e61 Institute Joint Webinar

Presented 18 October 2023



About the webinar

On 18 October 2023, the Competition Review hosted a joint seminar with the e61 Institute, bringing together local and international policymakers and researchers to discuss non-compete and related clauses.

The seminar was opened by the Hon Andrew Leigh MP, Professor Evan Starr provided the keynote address, and there were speakers from the OECD, US Federal Trade Commission, the US Department of Justice and the Australian Treasury.

What are non-compete clauses?

Non-compete clauses are conditions in employment contracts that restrict an employee from moving to a competitor. They usually define a specific period of time and/or geographic area over which the clause applies after the employee leaves the employer.

These clauses are traditionally justified to protect an employer's proprietary knowledge, client relationships and contacts, and to incentivise investments in developing workers' skills .

Non-compete clauses differ to and exist alongside other clauses that seek to protect an employer's information and business interests, including:

- Non-disclosure agreements: where workers are restricted from sharing certain information.
- Non-solicitation clauses: that prohibit a former employee from soliciting former clients/co-workers.
- No-poach agreements between employers: where businesses agree not to hire the current or former staff of another business.

Prevalence of non-compete clauses

Participants noted that non-compete clauses are rising in prevalence and have become widespread in labour markets – not only in the US and EU but also Australia. Traditionally, non-compete clauses tended to be included in the employment contracts of higher-wage and senior roles to protect trade secrets and client relationships but have become increasingly common in the contracts of low-income workers such as those working in fast-food chains, childcare workers and security guards.

In Australia, a recent e61 Institute survey suggests around 1 in 5 workers have a noncompete clause in their employment agreement.

Participants also noted that these clauses are prevalent across a number of other OECD countries (see attached slides from OECD):

- United States (US): Around 18% of workers.
- Austria: Over 35% of private sector workers in 2006.
- Italy: Around 16% of private sector employees.
- Finland: Around 37% of high-skilled workers.
- The Netherlands: around 19% of employees.
- Denmark: around 20% of sales and marketing workers.
- United Kingdom (UK): around 5 million UK employees.

Non-compete clauses in practice – evidence from the US

While research on non-compete clauses is relatively limited in Australia, participants shared a growing body of evidence from the United States illustrating how they operate in practice and their impact on individuals and the broader economy (see attached slides from Evan Starr).

Use of non-compete clauses

- 50% of US firms use them.
- 30% of US firms use them for all workers.
- 30-50% of employees are asked to agree to a non-compete only after accepting job, without a change in responsibilities.
- Only 10% employees report negotiating over non-competes.

Effects on workers

- Ban on non-compete clauses for tech workers in Hawaii increased job mobility and new-hire wages for tech workers (see Balasubramanian et al. 2020).
- Non-competes are associated with reductions in employee mobility in both states that do and do not enforce non competes. This indicates "in terrorem effects" i.e., beliefs about the likelihood of a lawsuit or legal enforcement from an employer can limit mobility, regardless of actual enforcement.

Effects on markets and consumers

- Greater non-compete enforcement can contribute to higher prices for goods and services by increasing firm concentration (for example see Hausman and Lavetti 2019).
- Enforceability of non-competes in a state can also reduce job offers, mobility rates and wages for individuals *without* a non-compete provision in their contract.
- The welfare losses from preventing the reallocation of workers to more productive firms and inhibiting the entry of new firms are up to 2.25%.

Enforcement of non-compete clauses in Australia

Non-compete clauses in Australia are generally enforced under the common law.

The presumption at common law (outside of New South Wales) is that post-employment restraints including non-competes are void and unenforceable. However, a court may nonetheless find that the clause is valid and enforceable if it determines that the employer has a "legitimate protectable interest", and the restraint is no more than what is reasonably necessary to protect that interest (Heydon 2008).

Where a court determines the scope of a particular clause is unreasonable, it can "sever" this clause in a way that allows the reasonable aspects of the clause to still be applied. This has contributed to the presence of "cascading clauses" in employment contracts which frames restraints in descending ("cascading") restraints that apply to different geographical areas or time periods, such as being enforceable for either 12 months, 6 months, or 3 months (Arup et al. 2013).

NSW is the only jurisdiction in Australia to legislate in this area, with restraint of trade clauses subject to the operation of the Restraint of Trade Act 1976 (NSW). In NSW, this legislation provides that all restraints of trade are presumed valid and enforceable to the extent not against public policy. If there is a manifest failure to make the restraint reasonable, the court may actively re-work the restraint to render it 'reasonable'.

Participants discussed how the operation of the law in Australia introduces significant uncertainty for employees as to their legal rights, particularly when cascading clauses are used, and that the financial costs and uncertainty of a court decision can discourage many employees from challenging a non-compete clause in courts, even where it may be unreasonable.

Overseas examples of regulatory reform relating to non-compete clauses

Several jurisdictions overseas have taken action to limit or regulate the use of non-compete clauses. Other jurisdictions are considering options for doing so. Some of these options include:

- Banning non-competes: The US Free Trade Commission (FTC) proposed a rule in January 2023 that would ban non-compete clauses in employment agreements. The FTC estimates that without a non-compete restriction, American workers could earn nearly $300 billion more in wages.
- Selective or limited bans: A ban on non-compete clauses in employment agreements could be applied to employees below an income threshold (e.g., in Austria and Luxembourg). A ban could also be applied to specific sectors or occupations (e.g., in the US, Hawaii banned non-competes for technology jobs, and New Mexico banned them for healthcare jobs).
- Limiting duration of the non-compete: The UK proposed a restriction on the length of a non-compete clauses in employment agreements to 3 months.
- Mandatory Compensation: Firms wishing to impose a non-compete clauses in employment agreements would need to compensate workers for the duration of the non-compete (e.g., in Finland, Denmark, Portugal, Sweden, France).
- Enhancing transparency about non-compete clauses in employment agreements: This could be through public awareness campaigns or obligations on employers to improve transparency of the clause for workers (e.g., UK has, in addition to duration limits, proposed producing guidance on non-compete clauses).
- Controlling and monitoring the use of non-competes: This may involve registering the non-compete with the government and monitoring non-compete agreements, although this introduces a regulatory burden on employers and public authorities.

References

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