SB3126
SD1

Date: 02/20/2014
Time: 10:30 AM
Location: Conference Room 016
Committee: Senate Judiciary and Labor

Department: Education

Person Testifying: Kathryn S. Matayoshi, Superintendent of Education

Title of Bill: SB 3126, SD1(sscr2425) RELATING TO EMPLOYMENT AGREEMENTS.

Purpose of Bill: Prohibits noncompete agreements and restrictive covenants that forbid post-employment competition of employees of a technology business or licensed physicians. (SD1)

Department's Position:
The Department of Education supports this measure. As one of the largest technology employers in the state, finding talented, experienced individuals to fill our openings is a challenge for a number of reasons. One being that there appears to be a lack of available individuals either qualified or available to work in this state. In some cases, we are unable to approach or attract candidates working for large mainland technology companies because their noncompete agreements prevent them from seeking subsequent employment at organizations their current employer does business with. This may not be difficult for individuals working for small employers, but for employees of companies like Apple, Microsoft, or IBM, a noncompete agreement effectively prevents them from working in any technology capacity in the state, and certainly at the Department of Education, where we do business with numerous technology vendors (local and mainland based). Noncompete agreements tend to encourage technology workers to move out of state to secure employment in their chosen field, thus reducing the available candidate pool to fill our most experienced positions.

We believe that limiting the use of noncompete agreements would help to increase the pool of technology employees in the state of Hawaii, and encourage innovation and growth in the technology industry as a whole.

HTDC Cultivating Hawaii's tech sector
HIGH TECHNOLOGY DEVELOPMENT CORPORATION

Written Statement of
ROBBIE MELTON
Executive Director & CEO
High Technology Development Corporation
before the
SENATE COMMITTEE ON JUDICIARY AND LABOR

Thursday, February 20, 2014
10:30 a.m.
State Capitol, Conference Room 16
In consideration of

SB 3126 SD1 RELATING TO EMPLOYMENT AGREEMENTS.

Chair Hee, Vice Chair Shimabukuro, and Members of the Committees on Judiciary and Labor.

The High Technology Development Corporation (HTDC) offers **comments** on SB 3126 SD1 relating to Employment Agreements. SB3126 SD1 adds specific language to invalidate non-compete agreements for technology businesses or licensed physicians. Technology businesses are defined as businesses that rely on software development, information technology, or both. HTDC comments this is a broad definition which may be applicable to many modern businesses yet may be ambiguous for some businesses conducting research and development. HTDC comments that the bill favors employee mobility which can provide benefits of retaining spin-off companies and entrepreneurial employees within the state. HTDC also comments that the "reasonable" non-compete agreement currently afforded to employers can be essential for certain technology companies in building a globally competitive business. HTDC does not offer comments on the inclusion of physicians in SD1.

Thank you for the opportunity to offer these comments.

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Jeffrey D. Hong
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Honolulu, HI, 96813

SENATE COMMITTEE ON JUDICIARY & LABOR

Thursday, Feb 20, 2014, 10:30 AM
State Capitol Conference Room 016

Aloha Chair Hee, Vice Chair Shimabukuro, Members of the Committee on Judiciary & Labor:

As the Chief Technology Officer of a local software company I strongly support SB3126-SD1. The Bill provides better opportunities for technology professionals to call Hawaii home. I have personally seen how noncompetition agreements are used in the technology industry with detrimental effects to employees and Hawaii's business community.

Academic studies have concluded that public policy supporting employee mobility encourages the innovation economy. California has an over 100 year old policy of barring non-competes with limited reasonable exceptions. The studies indicate California's policy has helped sharpened the cutting edge of her business regions by providing a ready pool of qualified talent. The Governor of Massachusetts called for a similar elimination of covenants not to compete in his State to make it more competitive.

A concern for owners of innovation businesses is protecting their intellectual property. Hawaii has adopted the Uniform Trade Secret Act to provide a legal framework for protecting trade secrets. The current use of noncompetition agreements to protect trade secrets encourages and discourages behavior that inhibits our technology and other industries:

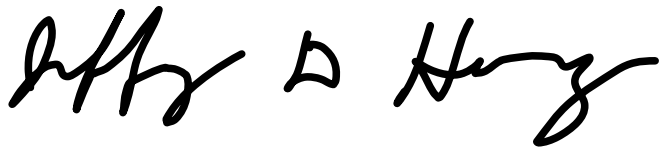
- Encourages broad and indiscriminate use across many industries. This causes kama'aina to leave the State if they want to remain employed in their field. The alternative is to work a "penalty box" job for up to 3 years with underutilized skills.
    - Our supreme court has upheld barring a Japanese tour "briefer" from her job. One of her 3 year penalty box professions was driving a bus.
    - Almost half of technology professionals surveyed are subject to these agreements.
- Discourages the formation of new businesses and competition in an already small and isolated marketplace.

    - Non-competes prevent innovators from creating businesses.
    - Non-competes and non-solicitation agreements prevent entrepreneurs from staffing businesses.
- Discourages the formation of a critical mass of technology professionals in Hawaii
    - Discourages technology professionals from moving to a place of limited employment mobility.
    - Encourages the best to leave because they are driven out by a covenant not to compete.
- Forces Hawaii employers to make expensive searches outside the State to fill a talent void.
    - Discourages the fruits of these searches from creating local roots.

I thank you for the opportunity to testify. Please support this bill and encourage Hawaii's technology community.

I have attached relevant articles and academic studies for your review.

Mahalo,



Jeffrey D. Hong
Chief Technology Officer
TechMana LLC

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- **Testimony: Massachusetts Governor's Office 2013** – Statement of support for eliminating the enforceability of noncompetition agreements in Massachusetts.
    - *http://www.boston.com/business/technology/innoeco/9-10-2103Testimony.pdf*
- **Article: WSJ Noncompete Employees -** Comments on studies indicating the best employees will emigrate from noncompete jurisdictions. Remaining employees may not be the ones an employer wants to keep.
    - *http://blogs.wsj.com/accelerators/2014/01/22/orly-lobel-why-non-competes-may-give-you-the-least-desirable-employees/*
- **Article: Non-compete provisions in California: -** Describes a recent US District Court ruling invalidating an Illinois company's non-compete from enforcement in California.
    - *http://www.dorsey.com/eU_LE_noncompete_california_072612/*
- **Study: University of Minnesota –** Proposes the Uniform Trade Secrets Act as a modern way of protecting trades secrets and decoupling non-competition agreements. "The Evolving Law of Employee Noncompete Agreements: Recent Trends and an Alternative Policy Approach"
    - *http://papers.ssrn.com/sol3/papers.cfm?abstract_id=124508*
- **Study: Stanford Law School** – Compares the legal framework of covenants not to compete in California and Massachusetts. It describes the effect of enforcement on the rise of high technology industrial districts in California over Massachusetts. "The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete"
    - *http://papers.ssrn.com/sol3/papers.cfm?abstract_id=124508*

Edward Pileggi
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February 19, 2014

Chair Hee, Vice Chair Shimabukuro, and Members of the Committee on Judiciary & Labor:

As a technology professional with over 15 years of experience, I'm strongly in favor of SB3126 because it would help create employment opportunities in the technology sector and ultimately encourage technology professionals to remain in Hawaii.

I have first-hand experience with the negative impacts of non-compete agreements. The most recent incident is one that I'm currently going through as a software consultant with Hawaiian Airlines. While I do enjoy working for Hawaiian Airlines, there is a staffing agency between myself and Hawaiian Airlines that has not been treating me fairly. Most importantly, they have not been paying me on time. Unfortunately my options are limited due to the non-compete clause put in place by the staffing agency and as a result I'm faced with either accepting the unfair treatment or moving back to California.

I believe that Hawaii does an excellent job of attracting talented technology professionals from all over the world, but it has a difficult time retaining these individuals due in large part to non-compete agreements. Supporting SB3126 will help alleviate the need for technology professionals to seek employment opportunities outside of Hawaii.

Mahalo,

Edward Pileggi
Owner & Founder
Lunasoft LLC

Hazel Glenn Beh
Professor of Law and Co-Director, Health Law Policy Center

February 4, 2014

The Senate
The Twenty-Seventh Legislature
Regular Session of 2014
Committee on the Judiciary and Labor

Dear Senators Clayton Hee, Chair and Maile Shimabukuro, Vice Chair and Committee Members:

This testimony is submitted in strong support of SB3126 SD1.

I am a Professor of Law at the William S. Richardson School of Law; I have taught Contract law here since 1995. I am writing in my personal capacity; however, this testimony is based on my professional research on the effects of non-compete clauses in Hawaii. I am the co-author (with student H. Ramsey Ross) of Non-Compete Clauses in Physician Employment Contracts Are Bad for Our Health, 14 Haw. Bar J. 79 (2010).

Senate Bill 3126 SD1 wisely prohibits non-competition agreements between employer and employees in two important fields where Hawai‘i must be keenly competitive. My personal belief is that non-competition clauses should be prohibited in all classes of employment contracts. This Bill represents a modest first step.

Non-compete clauses hurt Hawaii businesses and consumers and contribute to our "brain drain" and skilled workforce shortages. Under current case law in Hawaii, employer imposed non-competition agreements of three year duration and state-wide scope have been upheld. This means that a departing worker has three choices: leave the state, change careers, or remain in an unhappy job. If the worker defies the non-compete, they can be sued and forced to pay damages well beyond what they might have earned.

Hawai‘i has lost doctors, skilled workers, and inventors to other states, because these non-compete clauses are so liberally upheld by our courts. Most of these valuable employees leave silently, choosing to go elsewhere rather than endure challenging these clauses and risking a lawsuit.

Non-compete clauses are costly and unfair to workers, to our consumers, and to our state economy. In the case of doctors, enforcement of a non-compete is particularly unfair to patients and patient communities who lose choice and expertise. Our taxpayers lose the investment we made through subsidized medical education and residency when we allow employers to enforce non-compete clauses that drive doctors from our state. Likewise, in the tech industry, all the incentives we give to the high tech industry to attract and recruit inventors to our state are lost each time a worker leaves the state because of an employer imposed non-compete.

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Other states have already banned non-compete clauses and are reaping economic benefits all around. Most notably, California bans almost all non-compete clauses in employer agreements, allowing them only in conjunction with the sale of goodwill of a business. Studies examining why and how Silicon Valley became ground zero for the high tech revolution have found that other regions failed in part because non-compete clauses drive away inventors, and do not foster the development of a synergistic community needed to advance tech industries. You cannot build a community of entrepreneurs if you do not allow them mobility within that community. In order to succeed, Hawaii needs to learn this lesson: our regional success depends on a mobile workforce that remains wedded to our community.

No one wants employees to steal trade secrets, secret recipes, client lists, or other intellectual property. Our existing laws adequately protect those legitimate concerns without enforcement of non-compete clauses. But employers should not be able to stagnate our state by preventing fair competition among those who brought their own skills, education, and entrepreneurial drive to their work.

Thank you for your consideration of this important matter.

Sincerely,

/s/Hazel Beh
Co-Director
Health Law Policy Center

SENEATE COMMITTEE ON JUDICIARY & LABOR

Thursday, February 20, 2014

10:30 a.m.

State Capitol, Conference Room 016

Greetings Chair Hee, Vice Chair Shimabukuro, and Members of the Committee on Judiciary & Labor:

My name is Matt Marx. I am the Assistant Professor of Technological Innovation, Entrepreneurship, and Strategic Management at the MIT Sloan School of Management. My research, supported by others in my field, concludes regional "brain drains" are directly related by public policy affecting employee mobility. I strongly support SB 3126, SD 1 as a means for Hawaii to retain its top talent.

2014 marks an inauspicious anniversary: 600 years since the first employee non-compete lawsuit was filed. It was in northern England, in the very high-tech industry of clothes-dyeing. An apprentice was sued by his master for setting up his own clothes-dyeing shop in the same town in 1414. The judge, appalled that the master would try to prevent his own apprentice from practicing his profession, threw out the case and threatened the plaintiff with jail time.

Much has changed in 600 years, but employee non-compete agreements still bear painful resemblance to Medieval practices. As a professor at the MIT Sloan School of Management, my research focuses on the implications of non-competes for individuals, firms, and regions. I am not alone in this effort; during the last ten years, several scholars have contributed to a body of work including

- Toby Stuart of the University of California at Berkeley
- Olav Sorenson of Yale University
- Mark Garmaise of UCLA
- Mark Schankerman of the London School of Economics
- Lee Fleming of the University of California at Berkeley
- Jim Rebitzer of Boston University
- April Franco of the University of Toronto
- Ronald Gilson of Stanford University
- Ken Younge of Purdue University
- Sampsa Samila of the National University of Singapore
- Ivan Png of the National University of Singapore

My work, as well as that of those of these scholars, has almost universally found non-competes to be detrimental to individual careers and regional productivity. Non-competes, do not, as is often claimed, spur R&D investment by companies. I enclose a summary of this research and an

article with Lee Fleming from the 11th volume of the Innovation Policy and the Economy series by the National Bureau of Economic Research and which was presented in April 2012 at the National Press Club. Just to summarize a few highlights of this article:

- Although it is frequently claimed that non-competes are usually only a year in duration, a survey I conducted of more than 1,000 members of the IEEE engineering organization revealed that fully one-third of these are longer than one year and 15% are longer than two years.
- An article of mine in the American Sociological Review reveals that firms rarely tell would-be employees about the non-compete in their offer letter. Nearly 70% of the time, they wait until after the candidate has accepted the job and, consequently, has turned down other job offers. Half the time the non-compete is given on or after the first day at work. At this point it is too late for the employee to negotiate—indeed, I found that barely one in ten survey respondents had a lawyer review the non-compete.
- Several articles including my own with Lee Fleming and Debbie Strumsky in Management Science, by Jim Rebitzer and two Federal Reserve economists in the Review of Economics and Statistics, by Mark Garmaise in the Journal of Law, Economics, and Organization find that non-competes make it difficult for employees to change jobs. Instead, workers are trapped in their jobs with little possibility of moving elsewhere.

In the remainder of my testimony I wish to comment on the "chilling effect" non-competes can have regardless of the best intentions of judges and the possible implications for regional economic performance.

Jay Shepherd of the Shepherd Law Group reports that there were 1,017 published non-compete decisions in 2010. The Bureau of Labor Statistics reported that there were 154,767,000 workers in the U.S. as of June 2010. If the effect of non-competes were limited to the courtroom, simple math would suggest that 0.0007% of workers were affected by non-competes. Yet data from my IEEE survey indicate that nearly half of engineers and scientists are required to sign non-competes (including states where they are unenforceable). Why are 50% of workers asked to sign non-competes when barely a thousandth of a percent of them ever involve a court case? It is because of *the chilling effect*—because non-competes affect worker behavior even in the absence of a lawsuit. Thus it is essential to account for and anticipate how non-competes affect workers outside the courtroom.

In my own research including interviews with dozens of workers, I have rarely if ever come across an actual lawsuit. However, I have seen several instances where workers have taken a *career detour*, leaving their industry for a year or longer due to the non-compete. They took a pay cut and lost touch with their professional colleagues—not because they were sued, but for other reasons. They may have been verbally threatened by their employer; they may not have been threatened but have assumed that if they were sued, they would lose due to the expense of defending themselves; in some cases they felt that they were under obligation to honor the agreement they had signed—no matter how overreaching it might have been.

Non-compete reform is not just about protecting workers; it is also about growing the economy. Some will say it is impossible to operate their business without non-competes. Perhaps it is easier not to worry about people leaving, but one need look no further than California's Silicon Valley or San Diego biotech cluster for proof that a thriving economy does not depend on non-competes. Non-competes have been banned in California for more than 100 years. Again, I acknowledge that as a manager life is easier when you have non-competes. When I was managing a team of engineers in Boston, I never really worried about people quitting. Whereas when I managed a team in Silicon Valley, I realized that we as a company had to keep them engaged. We had a saying: "you never stop hiring someone." I think it made us a better company, and it made me a better manager.

Non-competes hurt the economy because it is more difficult to start new companies and also to grow those companies. Professors Olav Sorenson of Yale University and Toby Stuart of the University of California at Berkeley published a study in 2003 showing that the spawning of new startups following liquidity events (i.e., IPOs or acquisitions) is attenuated where non-competes are enforceable. Professor Sorenson followed up this study with a more recent article, coauthored with Professor Sampsa Samila at the National University of Singapore. They show that a dollar of venture capital goes further in creating startups, patents, and jobs where non-competes are not enforceable. Their finding is moreover is not just a Silicon Valley story but hold when Silicon Valley is excluded entirely.

Non-competes not only make it more difficult to start a company; they make it harder to grow a startup. One of the randomly-selected interviewees in my American Sociological Review article said that he "consciously excluded small companies because I felt I couldn't burden them with the risk of being sued. [They] wouldn't necessarily be able to survive the lawsuit whereas a larger company would." Also, whereas large companies are able to provide a holding-tank of sorts for new hires to work in a different area while waiting for the non-compete to expire, this is more difficult for smaller firms.

Finally, and perhaps of even greater concern, is that non-competes chase some of the best talent out of a region. I have included my research on a 1985 change in public policy in Michigan to start enforcing noncompetition agreements. My research indicated that the change accelerated the emigration of inventors from the state and moreover to other states that continued not to enforce non-compete agreements. This finding is not simply an artifact of the automotive industry or general westward migration; in fact, it is robust to a variety of tests including pretending that the policy change happened in Ohio or other nearby, mid-sized Midwestern states. Worse, this "brain drain" due to non-compete agreements is greater for the most highly skilled workers. It stands to reason that a change in public policy like SB 3126, SD 1 would promote the retention of top talent in Hawaii.

References

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