

SB1279

Measure Title: RELATING TO EMPLOYMENT AGREEMENTS.
Report Title: Technology; Employment Covenants or Agreements
Description: Prohibits noncompete agreements and restrictive covenants that forbid post-employment competition of employees of a technology business.
Companion:
Package: None
Current Referral: EDT/CPN, JDL
Introducer(s): WAKAI, CHUN OAKLAND, INOUYE, NISHIHARA, Espero, Galuteria, Harimoto, Slom

Written Statement of
ROBBIE MELTON
Executive Director & CEO
High Technology Development Corporation
before the
**SENATE COMMITTEES ON
ECONOMIC DEVELOPMENT & TECHNOLOGY
AND
COMMERCE AND CONSUMER PROTECTION**

Friday, February 6, 2015
9:45 a.m.
State Capitol, Conference Room 229
In consideration of

SB1279 RELATING TO EMPLOYMENT AGREEMENTS.

Chairs Wakai and Baker, Vice Chairs Slom and Taniguchi, and Members of the Committees on Economic Development & Technology and Commerce and Consumer Protection.

The High Technology Development Corporation (HTDC) **respectfully offers comments** on SB1279 relating to employment agreements.

HTDC comments that the bill favors employee mobility which can provide benefits of retaining spin-off companies and entrepreneurial employees within the state. HTDC comments that eliminating all non-compete agreements also reduces a small business's ability to protect its corporate knowledge, business strategy, and customers. HTDC suggests that companies should have the right to protect their client base and intellectual property.

Thank you for the opportunity to offer these comments.

SB 1279

RELATING TO EMPLOYMENT AGREEMENTS

**KEN HIRAKI
VICE PRESIDENT – GOVERNMENT & COMMUNITY AFFAIRS
HAWAIIAN TELCOM**

February 6, 2015

Chairs Wakai, Baker and members of the Committees:

I am Ken Hiraki, testifying on behalf of Hawaiian Telcom on SB 1279 - Relating to Employment Agreements.

Hawaiian Telcom opposes SB 1279 which prohibits the use of noncompete and nonsolicit clauses in any employment contract, post-employment contract, or separation agreement relating to an employee of a technology business.

The use of such clauses are designed to protect employers by prohibiting former employee from freely sharing with competitors confidential information about a former employer's operations, customer/client lists, business practices, upcoming products, and/or marketing plans.

Inclusion of such clauses encourage companies to hire more employees because employers are provided some protection to hire, contract and otherwise operate a business without the fear that confidential business knowledge will be passed on to a competitor without any limits or consequences. Imagine a scenario where an employee joins the company for several months and has access to confidential information, then immediately leaves to work for a direct competitor in the same capacity and is allowed to freely share such information with his new employer. This type of scenario can be devastating to a company and may lead to greater instability in the already competitive field of technology.

Finally, we believe that SB 1279 is discriminatory in effect because it only applies to employees of a technology business. There is no evidence to show that the technology business is particularly unique requiring discriminatory treatment not afforded to other job specialties such as insurance, banking, education, engineering, electric etc.

Based on the aforementioned, Hawaiian Telcom respectfully requests that this measure be held. Thank you for the opportunity to testify.



SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TOURISM

SENATE COMMITTEE ON COMMERCE AND CONSUMER PROTECTION

Friday, February 06, 2015

9:45 a.m.

State Capitol, Conference Room 229

Greetings Chair Wakai, Vice Chair Slom, Members of the Committee on Judiciary & Labor, Chair Baker, Vice Chair Taniguchi, and Members of the Committee on Commerce and Consumer Protection:

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 1279, as a means for Hawaii to retain its top talent.

2014 marked 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. Just to summarize a few points:

- 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 the 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 can rely on employees not leaving for rivals thanks to the non-compete they were required to sign. 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 holds 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 1279 would promote the retention of top talent in Hawaii.



References

Fallick, Bruce, Charles Fleischman, and James Rebitzer, "Job-Hopping in Silicon Valley: Some Evidence Concerning the Micro-Foundations of a High Technology Cluster," *The Review of Economics and Statistics*, 88 (2006), 472-481.

Garmaise, Mark, "The Ties That Truly Bind: Noncompetition Agreements, Executive Compensation, and Firm Investment," *Journal of Law, Economics, and Organization*, 27(2):376-425.

Gilson, Ronald, "The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete," *New York University Law Review*, 74.

Marx, Matt, Deborah Strumsky, and Lee Fleming, "Mobility, Skills, and the Michigan Non-Compete Experiment," *Management Science*, 55 (2009), 875-889.

Marx, Matt, "The Firm Strikes Back: Non-compete Agreements and the Mobility of Technical Professionals." *American Sociological Review* 76(5):695-712.

M. Marx and L. Fleming. "Non-compete Agreements: Barriers to Entry...and Exit?" in J. Lerner and S. Stern, eds., *Innovation Policy and the Economy* 12. (2012)

Samila, Sampsa, and Olav Sorenson. "Noncompete covenants: Incentives to innovate or impediments to growth." *Management Science* 57.3 (2011): 425-438.

Stuart, Toby E., and Olav Sorenson. "Liquidity events and the geographic distribution of entrepreneurial activity." *Administrative Science Quarterly* 48.2 (2003): 175-201.

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SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TOURISM

SENATE COMMITTEE ON COMMERCE AND CONSUMER PROTECTION

Friday, Feb 06, 2015, 09:45 AM
State Capitol Conference Room 229

Aloha Chair Wakai, Chair Baker, Vice Chair Slom, Vice Chair Taniguchi, and Members of the Committees:

As the Chief Technology Officer of a local software company I strongly support SB1279. 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. For over 100 years, California has policy of generally barring non-competes with limited reasonable exceptions. Academic studies have concluded California's policy has helped sharpened the cutting edge of her business regions by providing a ready pool of qualified talent.

A legitimate 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 in Hawaii drives behavior that inhibits our technology and other supported industries:

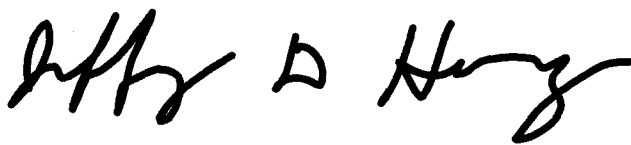
- Encourages broad and indiscriminate use of non-competes across many industries. This causes kama'aina to leave the State if they want to remain employed in their field. The alternative is to work a "penalty box" job for up to 3 years with underutilized skills.
 - Our supreme court has upheld barring 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 locally.
- 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 our best local talent 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 to grow.

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

Mahalo,



Jeffrey D. Hong
Chief Technology Officer
TechMana LLC

References

- **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

Strong Support SB 1279

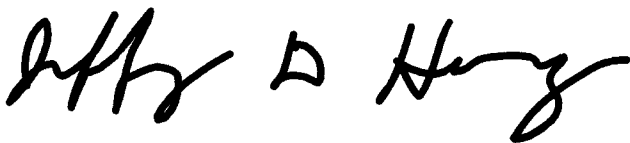
Supporting Hawaii's Technology Community

Hawai'i courts have enforced statewide, multi-year non-compete clauses on employees. These provisions forces our citizens to leave the state in order to continue advancing in their fields. Although many professions would benefit from the elimination of covenants not to compete, the unique damage to Hawai'i from enforcement of these contracts to technology professionals merits special consideration.

Protecting intellectual property is vital to growing Hawaii's innovation economy. The adoption of the Uniform Trade Secret Act in Hawai'i provides a means for protecting the legitimate trade secrets of innovation businesses. Covenants not to compete are an obsolete approach to protecting trade secrets. It drives local technology innovators from Hawai'i and forces businesses into expensive searches for talent from outside the State.

In founding Techmana LLC, a Hawaii based travel technology company, I have personally experienced the subtle and explicit barriers non-compete agreements create for businesses. Advocating for SB 1279 has brought together a broad coalition of support for eliminating an avoidable cause of brain drain from our State. We ask your positive consideration of SB 1279.

Mahalo,



Jeffrey Hong
Chief Technology Officer
Techmana LLC

SB 1279 Supporters

Technology Industry:

Jacob Buckley-Fortin – CEO, eHana LLC
Matthew Douglass – Co-Founder, VP Platform, Practice Fusion
Jay Fidell – Founder, ThinkTech
Cort Fritz – Principle Program Manager, Microsoft
Jeffrey Hong – Chief Technology Officer, Techmana LLC
Chris Lee – Motion Picture Producer, Founder and Director, ACM System
Cinthia Miller – Owner – O&A Consulting
Jim Takatsuka – Hawaii Account Executive - Microsoft
Edward Pileggi – Owner – Lunasoft LLC
William Richardson – General Partner, HMS Hawaii Management Partners
Aaron Schnieder – Founder, Church Office Online
John Vavricka – Program Director, RTI International

Academic Faculty:

Professor Hazel Beh - University of Hawaii, Richardson School of Law
Professor Matt Marx – MIT, Sloan School of Management

Government:

Steven Levinson - Associate Supreme Court Justice, State of Hawaii, Retired
Mark Wong - CIO, City & County of Honolulu
David Wu - CIO, State of Hawaii Department of Education

** All individuals are expressing their personal views and not representing the views of their associated organizations. The views of their organizations are expressed in submitted testimony.*

February 4, 2015

Aloha Chair Wakai, Chair Baker, Members of the Commerce & Consumer Protection Committee, and Members of the Technology & the Arts Committee.

I am writing in strong support of SB1279 – a bill to invalidate restrictive employment covenants or agreements. Research has shown that restrictions on employee mobility can inhibit innovation in high-velocity industries like information technology (IT) and can lead to an exodus of skilled workers (and their important knowledge) to other regions.

I have been a part of Hawaii's IT sector for 25 years working for Apple, Sun Microsystems, and currently as the Enterprise Account Manager for Microsoft. I testify today in a personal capacity. Over this time, I have seen Hawaii companies struggle to find enough skilled IT workers to help them best leverage their investments in information technology. Although there are certainly many skilled technology workers here, we have never approached the critical mass of IT professionals needed to drive our businesses forward.

When compared to their mainland peers, many Hawaii companies are far behind in their use of information technology, simply because the skills to deploy hardware and software are difficult to find. It is not uncommon to find companies here running on software that is more than 10 years old – an eternity in the IT world. The need and the desire to modernize are certainly there, but because skilled labor is difficult to find, many companies simply make do with outdated technology.

When Hawaii businesses do decide they need to push forward and innovate, they are often forced to look outside the state, which of course means shipping dollars to the mainland and beyond. Two recent projects that I have been involved with illustrate this point well:

- A large local company needed to redesign and rebuild their company web site, not just to improve their ability to market their products, but also to serve as a platform to transact hundreds of millions of dollars' worth of business. Using the internet allowed them to increase their reach, reduce their costs, and accelerate their growth. Their finished project allowed them to reach their goals, but the site was designed and built almost exclusively using out-of-state contractors.
- Another large local company needed to build a new system for managing their customer activity. The new system would allow them not only to keep track of all customer interactions, but reveal new sales opportunities and help the company identify which products were successful and which were not. The system would allow the company to operate more efficiently (quicker, higher quality interactions) and effectively (the right product to the customer most likely to buy). This project was completed entirely by out-of-state contractors.

In both examples, the companies have strong ties to the Hawaii community and would very much have preferred to hire local and keep their spending in Hawaii (expenditures on the customer management project were well over \$1M and those for the web site were triple that). But in each case, the appropriate skills were not available locally and the companies were forced to import the technology skills required to meet their needs.

Of course, the paucity of skilled IT workers in Hawaii is not solely due to impediments to employee mobility. But in the technology industry, removing any restriction on employment would serve as an important step towards catalyzing growth in a sector that can have broad, meaningful impact in our community.

Thank you for your consideration,

A handwritten signature in black ink, appearing to read "Jim", with a large loop at the end.

Jim Takatsuka
Enterprise Account Manager
Microsoft Corporation