



# Non-Compete Agreements Under State Law

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## Some context ...

- In this section of the course, we are talking about the background common law, as opposed to the Sherman Act and federal statutes.
- Under Sherman Act § 1, we will generally be concerned with whether the existence of an agreement exposes the agreeing parties to liability.
- Here, considering non-compete agreements under state law, we are concerned with whether the contracts are legally enforceable.

## **Non-Compete Agreements, in General**

- Non-compete agreements are sometimes called “covenants not to compete,” “non-competes,” “restrictive covenants,” or similar.
- At least as far back as the 1400s, common law courts considered the enforceability of contracts in which one party agreed not to compete with another party.
- Early on, courts considered these agreements void per se. As the years went by, courts began allowing restraints as long as they were “reasonable,” taking into account things like whether the restraint was ancillary to an otherwise lawful agreement, whether it was reasonably limited in geographic scope, subject matter scope, and time.

## **Modern State Law on Enforceability of Non-Competes**

- A non-compete is a type of restraint of trade.
- “A bargain is in restraint of trade when its performance would limit competition in any business or restrict a promisor in the exercise of a gainful occupation.” - Restatement 2d of Contracts.
- Under the modern common law, unreasonable restraints of trade are unenforceable.
- In many states, statutes have been enacted along these lines.

## Any of the following makes a restraint of trade “unreasonable”:

- It is not ancillary to a legitimate transaction (contract of employment, sale of a business, sale of property).
- It is greater (more restrictive) than necessary to advance a legitimate business need.
- It imposes an undue hardship on the restricted person.
- It has the purpose of creating or tends to create control of prices, restriction of output, or a monopoly.

## Consider whether non-competes are in the public's interest:

### Potentially bad

- Eliminates competition, and thus increases prices and stops otherwise mutually beneficial deals from happening (deadweight loss)
- Causes people to be unemployable, which means they might go bankrupt, require public assistance, etc.

### Potentially good

- Allows efficient sales of businesses (without a covenant, it might be impossible to sell a business for what it's worth)
- Allows protection of trade secrets, investments in employee training, etc.

**Let's look at  
*Ortega v. Abel...***