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Volume 10 | Issue 1

Article 10

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10-1-2003

## Noncompetes, Human Capital, and Contract Formation: What Employment Law Can Learn From Family Law

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### Recommended Citation

Rachel Arnow-Richman, *Noncompetes, Human Capital, and Contract Formation: What Employment Law Can Learn From Family Law*, 10 Tex. Wesleyan L. Rev. 155 (2003).

Available at: <https://doi.org/10.37419/TWLR.V10.I1.8>

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# NONCOMPETES, HUMAN CAPITAL, AND CONTRACT FORMATION: WHAT EMPLOYMENT LAW CAN LEARN FROM FAMILY LAW

*Rachel Arnow-Richman*<sup>†</sup>

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## I. INTRODUCTION

Despite the nettlesome policy issues that plague noncompete law, there is one thing everyone can agree on—the current law is in a state of near chaos. Years upon years of seemingly inconsistent enforcement decisions have provided little concrete guidance as to what constitutes an enforceable agreement.<sup>1</sup> Parties, lawyers, and judges are consequently at a loss in making decisions about whether to request, sign, litigate, or enforce such agreements.<sup>2</sup> In this Essay, I query

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1. See, e.g., *Arthur Murray Dance Studios of Cleveland, Inc. v. Witter*, 105 N.E.2d 685, 687 (Ohio Ct. Com. Pl. 1952) (describing the body of noncompete case law as “a sea—vast and vacillating, overlapping and bewildering. One can fish out of it any kind of strange support for anything, if he lives so long.”).

2. See Stewart E. Sterk, *Restraints on Alienation of Human Capital*, 79 VA. L. REV. 383, 404 (1993) (noting that uncertainty as to the scope of protection afforded by noncompete law leads to the “inefficient waste of judicial resources” and consequent social costs); Peter J. Whitmore, *A Statistical Analysis of Noncompetition Clauses in Employment Contracts*, 15 J. CORP. L. 483, 485 (1990) (“Despite [the] abundance of legal precedent, it still is difficult for lawyers to predict confidently how a court will react to any given noncompetition clause.”). Scott McDonald, in his insightful contribution to this Symposium, provides an array of real world examples illustrating how the uncertainty surrounding noncompete enforcement creates a “Catch-22” for employers and employees, resulting in extensive costs to all involved.

whether greater attention to contract formation principles can bring at least some uniformity to this troubled area of law. Specifically, I will consider the extent to which basic pillars of contract law—consideration, unconscionability, and assent—can be modified and applied to better police contractual restraints on employee mobility.

To some extent, this project involves treating noncompetes more like contracts. Such an undertaking may seem unusual given modern de-emphasis on contract formalities, particularly in the area of employment. Earlier in this conference, Richard Carlson referred to the employment relationship as “the penultimate relational contract,” second only to the marriage contract.<sup>3</sup> Indeed, long before the “relational contract” movement in contracts scholarship, courts recognized that noncompetes were special and should not be enforced as a matter of course like other agreements.<sup>4</sup> Since the early 1700s, courts assessing such restraints have attempted to balance the interests of the parties in light of both the nature of their relationship and the concerns of society.<sup>5</sup> Under the modern rule, a court will enforce a non-compete only if it satisfies a two-part “rule of reasonableness”: The restraint must be both reasonable in scope and necessary to protect a legitimate interest of the employer.<sup>6</sup>

Despite historical attention to such issues, the current approach to noncompete enforcement has been consistently criticized from a range of perspectives for not appropriately protecting the interests of either party.<sup>7</sup> In Part II of this Essay, I take those criticisms as my

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See M. Scott McDonald, *Noncompete Contracts: Understanding the Cost of Unpredictability*, 10 TEX. WESLEYAN L. REV. 137 (2003).

3. See Audio tape: Employment Law Conference, held by Texas Wesleyan School of Law (Mar. 7, 2003) (on file with the Texas Wesleyan Law Review).

4. Relational contract theory refers principally to the idea that the behavior and expectations of contracting parties are heavily influenced by the desire to preserve their existing relationship and foster cooperative behavior. See generally IAN R. MACNEIL, *THE RELATIONAL THEORY OF CONTRACT* (2001); Jay M. Feinman, *Relational Contract Theory in Context*, 94 NW. U. L. REV. 737 (2000); Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089 (1981); Paul J. Gudel, *Relational Contract Theory and the Concept of Exchange*, 46 BUFF. L. REV. 763 (1998).

5. See *Mitchel v. Reynolds*, 24 Eng. Rep. 347, 349 (Q.B. 1711). For an extensive discussion of the history of noncompete law and the significance of the *Mitchel* decision, see Harlan M. Blake, *Employee Agreements Not to Compete*, 73 HARV. L. REV. 625, 631–32 (1960).

6. According to the Restatement articulation of the test for enforcement, a promise to refrain from competition is “unreasonably in restraint of trade if the restraint is greater than is needed to protect the promisee’s legitimate interest, or the promisee’s need is outweighed by the hardship to the promisor and the likely injury to the public.” RESTATEMENT (SECOND) OF CONTRACTS § 188(1) (1981). For a more detailed discussion of how modern courts have applied the two-part test, see Arnor-Richman, *Bargaining for Loyalty*, *supra* note 1, at 1173–80.

7. See, e.g., Ronald J. Gilson, *The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete*, 74 N.Y.U. L. REV. 575, 602–09 (1999) (suggesting that jurisdictions that favor enforcement of noncompetes may impede the type of informational spillover between firms that is

starting point, discussing contemporary changes in the labor economy and in the popular expectations surrounding employment relationships that challenge the existing doctrinal test. In Parts III and IV, I consider possible changes to the doctrine, focusing primarily on the trend toward greater recognition of the contractual force of premarital agreements between spouses. In so doing, I use the “ultimate relational contract” to advocate for greater attention to formalities in the “penultimate relational contract.”<sup>8</sup>

## II. THE “RULE OF REASON” IN A “ME, INC.” WORLD

A critical examination of any employment law rule cannot proceed without considering its social context, namely, the state of the labor economy and workplace culture. In the area of noncompete enforcement, two trends have import: first, the increased mobility of employees within a national and sometimes international market; and second, the decline of the manufacturing economy and corresponding rise in information dependent industries. In my writing elsewhere, I have described these trends as contributing to the emergence of a “Me, Inc.” work world—an employment environment where workers are considered autonomous and valued according to their human capital.<sup>9</sup> With respect to noncompetes, the “Me, Inc.” world affects the application of the modern “rule of reason” in two different and competing ways, pulling the doctrine in opposite directions.

From one perspective, recent increases in employee mobility provide a rationale for limiting noncompete enforcement. In the last quarter century, there has been a decline in the classic “social contract” of employment, under which work was viewed as a semi-permanent relationship of mutual dependence.<sup>10</sup> In contrast to the long-

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necessary for healthy economic growth); Gillian Lester, *Restrictive Covenants, Employee Training, and the Limits of Transaction-Cost Analysis*, 76 IND. L. J. 49, 65–71 (2001) (suggesting that fact-specific rules of noncompete enforcement may be hopelessly under and over-inclusive in protecting against opportunism); Sterk, *supra* note 2, at 386–412 (suggesting that restrictions on noncompetes impede workers’ ability to sell their labor and create disincentives to optimal investment in employee skill development by employers); Katherine V.W. Stone, *The New Psychological Contract: Implications of the Changing Workplace for Labor and Employment Law*, 48 UCLA L. REV. 519, 586–92 (2001) (suggesting that current enforcement rules allow employers to renege on implied promises to provide workers with skills that they can use to market themselves after departure).

8. See *infra* Part IV.B.

9. See Rachel Arnow-Richman, *Accommodation Subverted: The Future of Work/Family Initiatives in a “Me, Inc.” World*, TEX. J. WOMEN & L. (forthcoming 2003) (manuscript at 32, on file with author).

10. I use the term “social contract” to refer to the mutual expectations of the parties, as distinct from their legally enforceable obligations to one another, and the term “classic social contract of employment” to refer to the prevailing expectations of workers and employers during the early to mid-20th century. For an explanation of the organizational psychology that affects such understandings, see Denise M. Rousseau, *Psychological and Implied Contracts in Organizations*, 2 EMPLOYEE RESPS. &

term jobs of the past, many contemporary employees have “boundaryless careers,” over the course of which they work for multiple employers or experience frequent lateral moves within a single organization.<sup>11</sup> The question is how such changes in parties’ expectations about the duration of their commitment should affect whether a noncompete is deemed enforceable. On a doctrinal level, this issue implicates the first prong of the two-part “rule of reason” test: the requirement that the restraint be reasonable in scope.<sup>12</sup> In the spot market for labor, implicit promises of long-term employment have been replaced by implicit promises of long-term employability.<sup>13</sup> While an employee often does not expect permanent employment at his or her current place of work, the employee legitimately expects that he or she can successfully market the skills acquired in that position once the relationship ends.<sup>14</sup> If the employer encourages that expectation, it would be unfair for the employer to enforce a noncompete against the departing worker.<sup>15</sup> For instance, in the current economic climate it would seem unreasonable for an employer to restrict the opportunities of a neophyte software developer, who, after spending a few years with one technical company, moves on to a competitor at a point of natural turnover in the organization.

That same mobility, however, supports increased use and enforcement of noncompetes in instances where the employer reasonably fears a worker will defect to a competitor after the company has invested in his or her training and development. With the movement from an industrial economy to an information-based one, corporate value is increasingly dependent on human capital, making employers more vulnerable to opportunistic employee departures. This trend implicates the second prong of the two-part “rule of reason”: the requirement that the employer have a “legitimate” or “protectable” in-

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RTS. J. 121, 123–29 (1989). For a more detailed account of the evolution of the classic social contract of employment and its implicit terms, see PETER CAPPELLI, *THE NEW DEAL AT WORK: MANAGING THE MARKET DRIVEN WORKFORCE* 57–68 (1999); Stone, *supra* note 7, at 526–39.

11. See Stone, *supra* note 7, at 553–56. An inter-related development discussed earlier in this Symposium by Orly Lobel is the rise in temporary labor and the emergence of employment agencies as significant third party players in establishing terms of employment. See Orly Lobel, *The Slipperiness of Stability: Contracting for Flexible and Triangular Employment Relationships in the New Economy*, 10 TEX. WESLEYAN L. REV. 109, 110 (2003) (describing how desire for numeric flexibility in a dynamic market leads employers to rely increasingly on contingent labor).

12. See RESTATEMENT (SECOND) OF CONTRACTS § 188(1) (1981); *infra* note 6 and accompanying text.

13. See Stone, *supra* note 7, at 569.

14. See CAPPELLI, *supra* note 10, at 29–30; Arnow-Richman, *Bargaining for Loyalty*, *supra* note 1, at 1200–02; Stone, *supra* note 7, at 568–72.

15. See Stone, *supra* note 7, at 590–91 (noting that in such situations it cannot be said the employer paid for the training of the worker and the employee should have the right to use the knowledge received on the job in his or her subsequent position).

terest underlying its use of a noncompete.<sup>16</sup> Historically, this requirement served to distinguish between permissible and impermissible restraints by sanctioning those designed to protect distinct business interests, such as trade secrets, and prohibiting those designed to indenture workers.<sup>17</sup> As a consequence, the employer's interest in human capital, which closely approximates an interest in retaining the worker, has largely gone unrecognized by courts.<sup>18</sup> While such an approach may have been appropriate in an economy that thrived on "hard" trade secrets, such as secret recipes, chemical formulae, and production processes, its relevance is questionable in contemporary situations where employers seek to protect business assets that lack the discrete quality of transportable information, but are of equal or greater worth.<sup>19</sup> Indeed, if one reconsiders the example of the neophyte software developer with some additional facts, the noncompete

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16. See RESTATEMENT (SECOND) OF CONTRACTS § 188(1) (1981); *infra* note 6 and accompanying text. Most jurisdictions recognize only two bases for an employer's enforcement of a noncompete: (1) customer relationships and business goodwill, and (2) trade secrets and proprietary information. See, e.g., BDO Seidman v. Hirshberg, 712 N.E.2d 1220, 1225 (N.Y. 1999) ("The employer has a legitimate interest in preventing former employees from exploiting or appropriating the goodwill of a client or customer, which had been created or maintained at the employer's expense, to the employer's competitive detriment."); *Comprehensive Techs. Int'l, Inc. v. Software Artisans, Inc.*, 3 F.3d 730, 739 (4th Cir. 1993) ("When an employee has access to confidential and trade secret information crucial to the success of the employer's business, the employer has a strong interest in enforcing a covenant not to compete . . ."); see generally Rachel S. Arnow-Richman, *Bargaining for Loyalty in the Information Age: A Reconsideration of the Role of Substantive Fairness in Enforcing Employee Noncompetes*, 80 OR. L. REV. 1163, 1176-77 (2001) [hereinafter Arnow-Richman, *Bargaining for Loyalty*] (discussing contemporary doctrinal requirements for these categories).

17. See *Reed, Roberts Assocs., Inc. v. Strauman*, 353 N.E.2d 590, 594 (N.Y. 1976) (declaring that non-compete "savored of servitude" where employer's "real purpose" was to "compel . . . partners . . . to remain with the firm indefinitely"); Arnow-Richman, *Bargaining for Loyalty*, *supra* note 16, at 1179-80 (suggesting that historically-recognized employer interests were perceived as coextensive with employer property rights and that in the absence of such interests courts feared the agreement's purpose was to indenture or exploit the employee).

18. For instance, courts have traditionally held that the provision of training, however costly, does not give rise to a protectable interest absent the transmission of some proprietary information during the training process. See, e.g., *Kelsey-Hayes v. Maleki*, 765 F. Supp. 402, 407-08 (E.D. Mich. 1991) (declining to enforce non-compete against neophyte engineer trained by employer in generic computer programming language where employer training transmitted only skills and no trade secrets); cf. *Hasty v. Rent-A-Driver, Inc.*, 671 S.W.2d 471, 473-74 (Tenn. 1984) (noting in declining to enforce noncompete that "the loss of employees to competitors is the type of injury which results from ordinary competition and which cannot be restrained by contract" despite employer investments in identifying and hiring highly qualified workers). Other cases suggest this rule may be eroding in response to the trends described above. See, e.g., *Borg-Warner Protective Servs. Corp. v. Guardsmark, Inc.*, 946 F. Supp. 495, 501-02 (E.D. Ky. 1996) (finding that employer had legitimate interest supporting the use of a noncompete after engaging in selective hiring process and providing new guards with weeks of non-proprietary security training).

19. See Arnow-Richman, *Bargaining for Loyalty*, *supra* note 16, at 1189-91.

seems less objectionable. If the employee was trained by the company for purposes of producing a particular product, about which she had no prior knowledge, and she defects to a competitor just before its completion, it might be appropriate to restrain her in order to compensate the employer for its lost investment in her human capital, which is essential to timely production.

### III. TWEAKING THE "RULE OF REASON"

Thus, emerging trends in the labor market have conflicting effects on the current doctrinal rule, urging on one hand greater protection of human capital as a legitimate employer interest and, on the other, greater respect for the short-term nature of most employment relationships in assessing a noncompetitor's reasonableness.<sup>20</sup> Such observations do not necessarily imply that the current test should be dismantled. To the contrary, the hallmark of the "rule of reason" is that it permits judicial discretion in enforcement. The developments described above are consistent with continued flexibility because the appropriateness of enforcement depends on a multitude of circumstances unknown at the time of contract formation. These include the value of employer inputs in the worker, the productivity of the worker, his or her value on the external market, the duration of the employment relationship, and the timing of the worker's departure. Such concerns could be incorporated within the analysis of the employer's protectable interest and the scope of the restraint upon enforcement under the two-part "rule of reason."

Yet, I pause when I consider both the practical and theoretical implications of complicating the current test with additional factors for courts to consider. Certainly the administerability of such an approach is questionable.<sup>21</sup> More importantly, even if courts could be trusted to competently account for such factors in a fair and consistent manner, no amount of embellishing the "rule of reason" will protect employees whose noncompetes do not come before a court. I am concerned about the *in terrorem* effects of noncompete agreements, not only on employees whose cases settle, but also on those who are discouraged from leaving their employer altogether.<sup>22</sup> Particularly in jurisdictions that "blue pencil," that is, reduce the scope of overbroad

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20. See *supra* Part II.

21. See Lester, *supra* note 7, at 72 (observing that "a discretionary rule [of noncompete enforcement] depending on which party has paid for an investment in human capital would demand difficult empirical judgments that may exceed the capacity of judges").

22. See Charles A. Sullivan, *Revisiting the "Neglected Stepchild": Antitrust Treatment of Postemployment Restraints of Trade*, 1977 U. ILL. L. REV. 621, 622-23 (noting that the number of reported noncompete decisions "constitutes only the proverbial iceberg's tip" and speculating that "the mere existence of such clauses must also induce many employees—unwilling to choose among changing careers, moving to a new location, or litigating—not to leave their employment to begin with").

noncompetes, there is every reason to fear that employers will draft these agreements as expansively as possible, in ways that will significantly impact the choices of those who sign them.<sup>23</sup>

Adding bases for reviewing the enforceability of noncompetes also begs important policy questions about the binding nature of contractual agreements and the impact of bargaining power on consent. Uncertainty as to the nature or progression of a contractual relationship is generally not a basis for post-hoc assessments of reasonableness. Indeed, the law ordinarily deems the contract to be the appropriate vehicle for allocating such future risks. To the extent the law is otherwise in the noncompete context, it is typically attributed to employees' lack of bargaining power.<sup>24</sup> While I am convinced that as much may be said of many individuals, the generalization that employees are unable to demand or even to question the terms of their employment remains precisely that.<sup>25</sup> The rhetoric of limited bargaining power often falls short in modern cases involving employer investment in the human capital of its work force. There is a certain inconsistency in recognizing the value of employees' human capital as potentially worthy of restraint, while simultaneously asserting that the employee lacks power to contract regarding the sale of his or her labor.<sup>26</sup> More

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23. Courts follow one of three approaches to overbroad noncompete agreements: (1) enforce the agreement provided the court can sever (or "blue pencil") the offending portions; (2) enforce the agreement subject to judicial redrafting; or (3) void the agreement as overbroad. See Maureen B. Callahan, Comment, *Post-Employment Restraint Agreements: A Reassessment*, 52 U. CHI. L. REV. 703, 710 (1985) (discussing distinctions between the approaches). The majority of jurisdictions revise rather than void overbroad noncompetes, creating incentives for employers to overreach in the drafting stage. See Phillip J. Closius & Henry M. Schaffer, *Involuntary Nonservitude: The Current Judicial Enforcement of Employee Covenants Not to Compete—A Proposal for Reform*, 57 S. CAL. L. REV. 531, 547 (1984) (suggesting that judicial redrafting "encourage[s] employers to be 'unreasonable' in drafting covenants not to compete because there is, in effect, no sanction for being unreasonable").

24. Concern over employees' limited bargaining power predates modern noncompete jurisprudence. Danger of exploitation was the core rationale for treating noncompetes as void against public policy under English common law prior to the landmark *Mitchel v. Reynolds* decision permitting such agreements in limited circumstances. See Blake, *supra* note 5, at 632–37 (discussing early history of noncompete use and enforcement under British law). In providing limited sanction to noncompetes in *Mitchel*, which involved a covenant incident to a sale of business, the British court sounded a cautionary note with respect to the use of noncompetes in the employment context, noting that masters were likely to "give their apprentices much vexation on this account, and to use many indirect practices to procure such bonds from them." *Mitchel v. Reynolds*, 24 Eng. Rep. 347, 350 (Q.B. 1711).

25. See Marlize Van Jaarsveld, *The Validity of a Restraint of Trade Clause in South Africa as a Contractual Term in an Employment Contract*, 10 TEX. WESLEYAN L. REV. 171, 177–78 (2003) (discussing view that employees may in some instances "be in a stronger [bargaining] position than employers due to factors such as" labour legislation, the growth of trade unions, economic development and other modern phenomena).

26. See Arnow-Richman, *Bargaining for Loyalty*, *supra* note 16, at 1213 (suggesting that an assessment of employee bargaining power cannot be made without taking account of the market for the employee's skills); Callahan, *supra* note 23, at



importantly, if bargaining power concerns are compelling in the majority of cases, it would make sense to consider this issue expressly rather than using the effects of the agreement as a proxy for assessing fairness. Given the fact-specific nature of the current doctrinal rules, it is surprising that the current approach calls for no investigation into the quality of consent in individual cases.<sup>27</sup>

In sum, tweaking the existing “rule of reason” to specifically account for contemporary concerns may provide better results in some cases. It does not, however, eliminate employer incentives to overuse noncompete agreements, and it does continued injustice to principles of freedom of contract.<sup>28</sup>

#### IV. CONTRACT-BASED ALTERNATIVES

##### A. *Marriage: Formation Analysis in the “Ultimate” Relational Contract*

The next question is what alternatives are there for policing noncompete enforcement? One model for a new rule can be found in the law of domestic relations, specifically in the rules governing enforcement of premarital agreements. Premarital agreements are an appropriate source for analogy for several reasons. Both family and employment relationships are fundamental, life-ordering institutions that raise important questions about the viability of contractual rights within a status-oriented relationship. Like noncompetes, premarital agreements represent an effort by parties invested in a personal relationship to dictate by contract the consequences of a possible dissolution, and like noncompetes, their use is on the rise in response, at least in part, to changing expectations about the durability of marriage that

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721–22 (reasoning that most proprietary information sought to be protected through noncompetes is held by upper-level employees who have alternative employment opportunities); cf. Sterk, *supra* note 2, at 411 (“By protecting an employee’s freedom to leave his employer without serious consequences, courts impose a corresponding restriction on an employee’s freedom to contract about future use of his ‘own’ human capital.”). *But see* Stone, *supra* note 7, at 586 (noting increased tendency of employers to demand noncompetes from lower-level and low-skill employees who are less likely to have information worthy of protection).

27. See Lester, *supra* note 7, at 60–61 (discussing this inconsistency).

28. On the latter point, I acknowledge Frank Snyder’s contribution to this Symposium cataloguing the dangers of manipulating contract law to achieve fairness in employment relationships. See Franklin G. Snyder, *The Pernicious Effect of Employment Relationships on the Law of Contracts*, 10 TEX. WESLEYAN L. REV. 33 (2003). Noncompete law is one area in which there does not appear to be any spillover into the general law of commercial contracting. However, I am mindful of the risks Professor Snyder identifies and favor maintaining doctrinal consistency to the extent possible while taking account of the unique questions posed by employment relationships even if only for the sake of theoretical integrity within contract law. *Id.*

could be said to parallel changing expectations about the durability of employment relationships.<sup>29</sup>

The law of premarital agreements aims to achieve substantive fairness for the parties involved and is markedly similar to the law of noncompetes both in its doctrinal rules and underlying policy concerns. To be enforceable, premarital agreements must be reasonable.<sup>30</sup> Courts consider such an inquiry necessary due to the likelihood of unequal bargaining power (historically the wife's), much in the way courts reviewing noncompetes have expressed concern about the bargaining power of employees.<sup>31</sup> However, a key difference in the law of premarital agreements is that the judicial inquiry incorporates a procedural component. In addition to examining the agreement's substantive terms, courts consider the quality of the consent of the party waiving rights under the agreement. This may take into account the waiving party's access to information about spousal rights and the implications of the agreement, his or her knowledge of the extent of the opposing party's financial assets, whether he or she had the opportunity to review the agreement and seek counsel, and the relative sophistication of the parties.<sup>32</sup>

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29. Cf. CAPPELLI, *supra* note 10, at 2-3 ("If the traditional, lifetime employment relationship was like a marriage, then the new employment relationship is like a lifetime of divorces and remarriages, a series of close relationships governed by the expectation going in that they need to be made to work and yet will inevitably not last."). The increase in the rate of marital dissolution is generally attributed to the advent of no-fault divorce in the 1970s. See June Carbone, *Economics, Feminism, and the Reinvention of Alimony: A Reply to Ira Ellman*, 43 VAND. L. REV. 1463, 1493 (1990); Raymond C. O'Brien, *The Reawakening of Marriage*, 102 W. VA. L. REV. 339, 354 (1999).

30. See *Newman v. Newman*, 653 P.2d 728, 736 (Colo. 1982); *Scherer v. Scherer*, 292 S.E.2d 662, 666 (Ga. 1982); *Osborne v. Osborne*, 428 N.E.2d 810, 816 (Mass. 1981).

31. The rule also reflects the belief that soon-to-be marital partners owe one another an obligation of fairness. See Arnow-Richman, *Bargaining for Loyalty*, *supra* note 16, at 1227-29 (discussing historical rationales for limiting enforceability of premarital agreements and their modern legacy).

32. See, e.g., *In re Marriage of Bonds*, 5 P.3d 815, 824-25 (Cal. 2000) (noting that in assessing voluntariness of a prenuptial agreement courts should consider *inter alia* surprise in the presentation of the agreement, the presence or absence of independent counsel, inequality of bargaining power, whether there was full disclosure of assets, and whether the adversely affected party understood the effect of the agreement); *Fletcher v. Fletcher*, 628 N.E.2d 1343, 1348 (Ohio 1994) ("[W]hen an antenuptial agreement provides disproportionately less than the party would have received under an equitable distribution, the party financially disadvantaged must have a meaningful opportunity to consult with counsel."); *Stoner v. Stoner*, 819 A.2d 529, 533 (Pa. 2003) (noting that "full disclosure of the parties' financial resources is a mandatory requirement" for an enforceable marital agreement); cf. *Hengel v. Hengel*, 365 N.W.2d 16, 20 (Wis. Ct. App. 1985) (noting that the wife was "moderately sophisticated in financial matters, that she was made aware of the contents of financial statements and, that she had independent knowledge of the substantial size of [husband's] estate before the marriage" in finding premarital agreement enforceable); AM. LAW INST. PRINCIPLES OF THE LAW OF FAMILY DISSOLUTION: ANALYSIS AND RECOMMENDATIONS § 7.04(3) (2002) [hereinafter A.L.I. PRINCIPLES] (creating a rebuttable presumption of validity

Indeed, the current trend in premarital agreement enforcement inclines toward greater attention to procedural concerns rather than concern with substance. In the last decade, a small majority<sup>33</sup> of states have adopted some form of the Uniform Premarital Agreement Act (UPAA), which provides for enforcement of premarital agreements absent involuntariness or unconscionability at the time of drafting.<sup>34</sup> As a result, contractual issues such as assent have come to the forefront of premarital agreement jurisprudence.<sup>35</sup> I do not mean to suggest that such agreements have become a simple matter of contract law, for they surely have not given the expanded consent inquiry I have just described.<sup>36</sup> Rather, we see a more nuanced approach to

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where premarital agreement was entered into in accordance with procedural safeguards, including the presence of counsel and execution at least thirty days prior to marriage).

33. Currently twenty-five states and the District of Columbia have adopted some form of the UPAA law. See The Nat'l Conference of Comm'rs on Unif. State Laws, *A Few Facts About the Uniform Premarital Agreement Act*, available at [http://www.nccusl.org/nccusl/uniformact\\_factsheets/uniformacts-fs-upaa.asp](http://www.nccusl.org/nccusl/uniformact_factsheets/uniformacts-fs-upaa.asp) (last visited Sept. 25, 2003) (on file with the Texas Wesleyan Law Review).

34. UNIF. PREMARITAL AGREEMENT ACT § 6(a) (1983), 9C U.L.A. 48, 48–49 (2001).

A premarital agreement is not enforceable if the party against whom enforcement is sought proves that that party did not execute the agreement voluntarily or the agreement was unconscionable when it was executed and, before execution of the agreement, that party was not provided a fair and reasonable disclosure of the property or financial obligations of the other party, did not voluntarily and expressly waive . . . any right to disclosure . . . and did not have . . . adequate knowledge of the property or financial obligations of the other party.

*Id.*; cf. A.L.I. PRINCIPLES § 7.05(2) (limiting review of substantive effects of premarital agreements to situations where there has been a substantial change in circumstances, such as the birth of a child, or the passage of a statutorily fixed number of years between contract formation and enforcement).

35. See *Bonds*, 5 P.3d at 823–24 (concluding that the intent of UPAA commissioners “was . . . to enhance the enforceability of premarital agreements and to convey the sense that an agreement voluntarily entered into would be enforced without regard to the apparent unfairness of its terms, as long as the objecting party knew or should have known of the other party’s assets”); *Simeone*, 581 A.2d at 165–66 (“Prenuptial agreements are contracts, and as such, should be evaluated under the same criteria as are applicable to other types of contracts . . . [T]he reasonableness of a prenuptial bargain is not a proper subject for judicial review.”); *Developments in the Law—The Law of Marriage and Family*, 116 HARV. L. REV. 1996, 2077 (2003) (noting that, due to the trend toward treating premarital agreements like ordinary contracts, even jurisdictions adopting a more cautious approach to reviewing premarital agreements are reluctant to decline enforcement solely on grounds of substantive unfairness).

36. Interestingly, the UPAA purports to adopt the same unconscionability standard that applies to commercial agreements. See UNIF. PREMARITAL AGREEMENT ACT § 6 cmt., 9C U.L.A. 49 (2001). This assertion, however, is belied by commentary indicating that unconscionability should be interpreted to protect parties from behavior that is “not consistent with the obligations of marital partners to deal fairly with each other.” *Id.*; see also A.L.I. PRINCIPLES § 7.02 cmt. c (“The distinctive expectations that persons planning to marry usually have about one another can disarm their capacity for self-protective judgment, or their inclination to exercise it, as compared to parties negotiating commercial agreements.”); *Bonds*, 5 P.3d at 825–26 (interpret-

basic contract principles in which courts carefully interpret concepts such as voluntariness and unconscionability in light of the existing and potential relationship of the parties.

B. *Employment: Formation Analysis in the “Penultimate” Relational Contract*

Many of the factual issues examined under the procedural component of the modern premarital agreement test, including the ability to review and consider the agreement, external pressures on consent, and the relative sophistication of the parties, are core concerns of noncompete law. All are circumstances that could be accounted for in an expanded contract-oriented analysis, like that espoused in the premarital agreement context, which closely examines contract formation issues in consideration of the special relationship of the parties. While a description of how such an approach would play out in individual cases is beyond the scope of this Essay, I will highlight three core principles of contract law—assent, unconscionability, and consideration—and identify how they might be used to account for some of these factual concerns either as supplements or alternatives to the current doctrinal inquiry.<sup>37</sup>

1. Assent

An expanded assent inquiry would allow courts to examine the procedural dimensions of an employee’s agreement not to compete in order to ensure meaningful consent. Courts could investigate many of the case-specific circumstances currently considered in the premarital agreement context, such as the timing of the agreement’s presentation to the party relinquishing rights and the presence or absence of real negotiation regarding its terms.<sup>38</sup> Taking into account how the agreement is executed is particularly appropriate in the noncompete context in which procedural defects are likely to be even more egregious than in the premarital agreement process. At a minimum, premarital partners deal one-on-one with an agreement drafted specifically for their relationship, albeit frequently on a take-it-or-leave-it basis. In

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ing UPAA to require consideration of factors “uniquely probative of coercion in the premarital context” in determining whether an agreement was entered into voluntarily).

37. For a more in-depth analysis of some of the concepts that follow, see Arnow-Richman, *Bargaining for Loyalty*, *supra* note 16, at 1234–43.

38. While these factors do not currently comprise part of the doctrinal inquiry, they often appear to influence court decisions. *See, e.g.*, *Flexcon Co. v. McSherry*, 123 F. Supp. 2d 42, 44 (D. Mass. 2000) (noting in refusing to grant preliminary injunction against competition that employee signed noncompete as part of “routine paperwork” three days after commencing employment); *Maltby v. Harlow Meyer Savage, Inc.*, 637 N.Y.S.2d 110, 111 (N.Y. App. Div. 1996) (finding agreement enforceable where employees had option to sign noncompete in conjunction with new job with higher salary and chose to do so after consultation with counsel). One goal of my proposal is to make such factually-specific considerations more explicit.

contrast, noncompetes are usually form documents presented bureaucratically. Within an expanded assent inquiry, form agreements distributed to mass numbers of employees could be presumed invalid, and agreements provided after hire, often amidst heaps of routine paperwork, could be unenforceable.<sup>39</sup>

Such explicit policing of the quality of consent to contract is by no means novel in employment law. Informed consent is already the touchstone for enforcement of waivers under the Age Discrimination in Employment Act (ADEA).<sup>40</sup> As discussed earlier in this Conference, it is also a core criterion in some jurisdictions for assessing the enforceability of agreements to arbitrate.<sup>41</sup> It would make sense to extend that inquiry to noncompetes and to determine whether the em-

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39. To be clear, I do not mean to suggest that the basic contractual doctrine of assent would require these results. Indeed it is an elementary principle of contract law that, absent duress, a signature evidences assent irrespective of whether the signing party read the underlying document. See *Upton v. Tribilcock*, 91 U.S. 45, 50 (1875) ("It will not do for a man to enter into a contract, and when called upon to respond to its obligations, to say that he did not read it when he signed it, or did not know what it contained. If this were permitted, contracts would not be worth the paper on which they are written."); *In re Greenfield's Estate*, 14 Pa. 489, 496 (1850) ("If a party who can read . . . will not read a deed . . . or if, being unable to read, will not demand to have it read . . . to him, he is guilty of supine negligence, which . . . is not the subject of protection, either in equity or at law."). Neither do I mean to suggest that the contractual doctrine of assent should be altered for the universe of contractual agreements. Cf. Snyder, *supra* note 28, at 33 (counseling against the generalized application of rules derived in employment cases to ordinary commercial contracts). Rather I am proposing requiring a higher standard of voluntariness similar to that required of parties to a premarital agreement in consideration of the unique aspects of family and employment relationships.

40. 29 U.S.C. § 626(f) (2003) ("[A]n individual may not waive any right or claim under [the ADEA] unless the waiver is knowing and voluntary."). In assessing whether the employee's consent is sufficiently informed, the Older Workers Benefit Protection Act (OWBPA) of the ADEA requires, among other things, that the waiver be drafted in understandable language, that it refer to the rights being waived, that the employee be advised to consult an attorney, and that the employee is given an opportunity to consider and revoke the agreement. See *id.*

41. See Prudential Insurance Co. of Am. v. Lai, 42 F.3d 1299, 1305 (9th Cir. 1994) ("[W]e conclude that a Title VII plaintiff may only be forced to forego her statutory remedies and arbitrate her claims if she has knowingly agreed to submit such disputes to arbitration."); Christine M. Reilly, *Achieving Knowing and Voluntary Consent in Pre-Dispute Mandatory Arbitration Agreements at the Contracting Stage of Employment*, 90 CAL. L. REV. 1203, 1215-20 (2002) (discussing current approaches to enforceability). Numerous commentators have urged adoption of strict consent requirements for enforcement of such agreements, which, like noncompetes, are generally provided to the employee at the outset of the relationship and prior to any employment dispute. See Ellwood F. Oakley, III & Donald O. Mayer, *Arbitration of Employment Discrimination Claims and the Challenge of Contemporary Federalism*, 47 S.C. L. REV. 475, 531 (1996); Eileen Silverstein, *From Statute to Contract: The Law of the Employment Relationship Reconsidered*, 18 HOFSTRA LAB. & EMP. L.J. 479, 484 (2001); Richard E. Speidel, *Consumer Arbitration of Statutory Claims: Has Pre-Dispute [Mandatory] Arbitration Outlived Its Welcome?*, 40 ARIZ. L. REV. 1069, 1087-92 (1998).

ployee had a real opportunity to consider and potentially reject the agreement.

## 2. Unconscionability

Substantive unconscionability is already at the heart of noncompete law and is primarily examined through the reasonableness prong of the current enforcement test. A key difference between that analysis and substantive review under modern premarital agreement law, however, is the timing of the inquiry, which occurs as of enforcement under noncompete law and as of formation under the UPAA in accordance with traditional contract doctrine.<sup>42</sup> While the former approach affords maximum protection to the employee of the moment, it creates tremendous uncertainty for both parties and encourages employers to draft noncompetes broadly. Employees as a whole might be better off if the inquiry were to shift back to the point of contract formation in the same way that the UPAA has refocused this inquiry in the premarital agreement context. This can be done without necessarily limiting the scope of the inquiry to what would constitute unconscionability under commercial law—certainly the threshold for what is enforceable is higher in the premarital agreement context than what is considered binding under the Uniform Commercial Code.<sup>43</sup> More importantly, if properly administered, such an approach could force employers to use noncompetes more sparingly and draft them more narrowly.

Whatever standard of unconscionability is adopted, it is crucial that the “blue pencil” rule, which permits courts to sever overbroad restraints, be eliminated.<sup>44</sup> Judicial redrafting rewards employers who overreach.<sup>45</sup> The law should not permit employers to demand noncompetes of any length as a matter of course without anticipating the nature and duration of the employee’s tenure and without supplying any reciprocal promise other than the mere opportunity to work. If the employer cannot draft a reasonably well-tailored noncompete at the outset of the relationship, it should not be able to rely on a court to do so in the future.<sup>46</sup>

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42. See RESTATEMENT (SECOND) OF CONTRACTS § 208 (1981) (“If a contract or term thereof is unconscionable *at the time the contract is made* a court may refuse to enforce the contract . . .”) (emphasis added); UNIF. PREMARITAL AGREEMENT ACT § 6(a) (1983), 9C U.L.A. 48, 48–49 (2001) (“A premarital agreement is not enforceable if . . . the agreement was unconscionable *when it was executed.*”) (emphasis added).

43. See *supra* note 40 and accompanying text.

44. For an explanation of the “blue pencil” rule, see *infra* note 23.

45. Blake, *supra* note 5, at 683 (“If severance is generally applied, employers can fashion truly ominous covenants with confidence that they will be pared down and enforced when the facts of a particular case are not unreasonable. This smacks of having one’s employee’s cake, and eating it too.”).

46. The Texas State Legislature has sought to address this problem creatively by permitting blue penciling, but requiring overreaching employers to pay the em-

### 3. Consideration

Here I depart from the law of premarital agreements, as well as the current law of noncompete enforcement, neither of which emphasizes consideration.<sup>47</sup> While I am reluctant to open this Pandora's box, I believe it is impossible to meaningfully opine on the appropriateness of a restraint without evaluating on some level the adequacy of the deal. Mindful of Frank Snyder's earlier warnings about manipulating contract law,<sup>48</sup> I think we do no injustice to the doctrine by adopting a special rule setting forth minimum terms necessary to support an employee's promise not to compete. Ideally, employers should be required to provide some form of job protection to the worker, such as a promise of term employment or of for-cause only termination in exchange for the noncompete. This rule would have the rather harsh effect, from the employer's perspective, of rendering unenforceable any restraint ancillary to a purely at-will relationship, but it would provide real protection to workers and be easy to administer.<sup>49</sup> At a

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ployee's attorney's fees. See TEX. BUS. & COM. CODE ANN. § 15.51(c) (Vernon 2002) ("If . . . the promisor establishes that the promisee knew at the time of the execution of the agreement that the . . . [noncompete] limitations imposed a greater restraint than necessary to protect the goodwill or other business interest of the promisee, . . . the court may award the promisor the costs, including reasonable attorney's fees, actually and reasonably incurred by the promisor in defending the action to enforce the covenant."). In practice, however, that portion of the statute is rarely applied to the benefit of employees. Because courts have interpreted the provision narrowly and imposed strict proof requirements on employees seeking fees, it is unlikely that the risk of paying attorney's fees has had any meaningful deterrent effect on broad drafting practices. See *Emergicare Sys. Corp. v. Bourdon*, 942 S.W.2d 201, 205 (Tex. App.—Eastland 1997, no writ) (affirming denial of recovery of attorney's fees for employee because awarding fees is a permissive rather than a mandatory component of the statute subject to review for abuse of discretion only); *Evan's World Travel, Inc. v. Adams*, 978 S.W.2d 225, 234 (Tex. App.—Texarkana 1998, no pet.) (reversing and remanding award of attorney's fees because record did not show alleged costs were actually and reasonably incurred); *Leon's Fine Foods, Inc. v. McClearin*, No. 05-97-01198-CV, 2000 WL 277135, at \*3 (Tex. App.—Dallas Mar. 15, 2000, no pet.) (not designated for publication) (holding that a noncompetition and non-disclosure promise is not an obligation "to render personal services" as required in section 15.51(c) to entitle employee to recovery of attorney's fees).

47. In general, premarital agreement law treats the proposal of marriage as sufficient consideration for the relinquishment of spousal support rights. See, e.g., *In re Marriage of Barnes*, 755 N.E.2d 522, 527 (Ill. App. Ct. 2001). Similarly, noncompete law treats the offer of employment as consideration for the employee's promise not to compete. See *Garcia v. Laredo Collections, Inc.*, 601 S.W.2d 97, 98-99 (Tex. Civ. App.—San Antonio 1980, no writ) ("When the execution of a covenant not to compete is contemporaneous with the acceptance of employment, the latter becomes the consideration for the covenant."); *McDonald*, *supra* note 2, at 147-48. The UPAA eliminates the requirement of consideration altogether. See UNIF. PREMARITAL AGREEMENT ACT § 2, 9C U.L.A. 41 (2001) ("A premarital agreement must be in writing and signed by both parties. It is enforceable without consideration.").

48. See *supra* note 30 and accompanying text.

49. The Texas Supreme Court came close to adopting such a rule in holding that a purely at-will employment relationship is not an "otherwise enforceable agreement" under the state noncompete statute, which requires, *inter alia*, that a noncompete be

minimum, we should eliminate the rule adopted by many jurisdictions that continued employment creates after the fact consideration for mid-term agreements.<sup>50</sup> In this way, we at least ensure that employees can consider the agreement as part of accepting the job and hence, exercise some form of actual assent to the package deal.

## V. CONCLUSION

To be sure, it is unlikely that a few doctrinal changes or additions can fully resolve the intractable problems presented by noncompete enforcement. It may be that the only way to adequately protect workers while maintaining consistency and predictability is to prohibit such contracts altogether. My point, however, is that if we assume noncompetes are here to stay—and at least some aspects of the new economy suggest they may be appropriate in particular cases—there are advantages to focusing more attention on the process by which those agreements are reached, as opposed to simply the substantive effect of their terms. Put simply, a core problem with noncompetes is that there are far too many of them; their presence in the workplace exceeds the presence of employees in whom employers have a legitimate interest in need of protection. While it is by no means easy to

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“ancillary to an otherwise enforceable agreement” to be valid. See *Light v. Centel Cellular Co. of Tex.*, 883 S.W.2d 642, 643 (Tex. 1994) (applying TEX. BUS. & COM. CODE ANN. § 15.50 (Vernon 2002)). It went on to hold, however, that an employer’s promise to provide trade secrets, training or confidential information, even to an at-will employee, could constitute the requisite “enforceable agreement.” See *id.* at 647–48. While I am receptive to the idea that such information and opportunities, at least on a theoretical level, could provide a fair exchange for the employee’s promise, see Arnow-Richman, *Bargaining for Loyalty*, *supra* note 16, at 1240–41, I have ultimately come to the conclusion that it is impractical to recognize such promises alone as sufficient consideration for a noncompete. In drafting noncompetes, employers routinely recite that they will provide the employee with proprietary information. See *McDonald*, *supra* note 2, at 148 & n.41. A substantive consideration analysis of the type advocated here would require courts to examine whether the promised information and training is valuable and whether it was in fact transmitted to the worker, in effect plunging courts into a difficult case-by-case assessment comparable to what they now undergo in determining the existence of a legitimate interest. Moreover, such an approach in effect treats the promise of training or information as an unconditional duty of the employer notwithstanding the at-will status of the employee. This could lead to the anomalous result of a terminated employee suing his or her employer for damages resulting from the failure to transmit promised information or training. Thus, I am inclined to think promises of this type are insufficient to support a noncompete absent an explicit promise by the employer (or a newly-created judicial default rule) that provides the employee with job security for the period of time necessary to acquire the valuable information or experience.

50. I refer here to case law holding that a noncompete signed by an at-will employee after the commencement of employment is enforceable, even if it was not accompanied by any additional consideration (such as a raise or promotion), simply because the employer elected to retain rather than terminate the employee. See *Abel v. Fox*, 654 N.E.2d 591, 593 (Ill. App. Ct. 1995); *Cent. Adjustment Bureau, Inc. v. Ingram*, 678 S.W.2d 28, 35 (Tenn. 1984); *Curtis 1000, Inc. v. Suess*, 24 F.3d 941, 947 (7th Cir. 1994).



enforce these agreements under current law, it is far too easy to request and obtain them, and the current judicial focus on substantive effects does little if anything to address this problem. My suggestion is that we enlist contract principles in order to help eliminate employers' latitude to demand noncompetes from their workforce. Hopefully the application of stricter formation rules will encourage employers to use these contracts sparingly and, ideally, only in the exceptional case of an especially valuable and truly negotiated employment relationship.