Intelligence MEMOS

From: Matt Malone

To: Canadians Concerned about Employment Law

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Re: NON-COMPETES ARE HOLDING CANADA BACK – SO LET'S BAN THEM

Canadian political leaders often talk about unleashing innovation. California did it with just 24 words.

"Every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void," says the state's Labor Code.

The federal government and every province should be copying it.

This prohibition on non-compete clauses has done more to foster economic prosperity, growth, and innovation than any government subsidy or handout. That's not surprising. Knowledge spillovers are a critical factor in building vibrant and prosperous economies where innovation occurs. That requires letting employees job hop – something they cannot do when they're shackled by restraints which prevent them from working.

In Canada, such restrictions are perfectly legal. They are routinely inserted in employment contracts, often without employees even realizing it, and have long-lasting effects on job mobility. In the US, President Joe Biden has recently said he will attempt to ban them. Canada and the provinces should be doing the same by amending their labor codes and employment standards laws.

As a general matter, why do we have non-competes? The answer is simple. No company wants to see its talent poached by a competitor (or turned into a competitor) when it can prevent that from happening.

But hindering employee mobility hurts everyone, and here are six reasons why.

First, jurisdictions that allow non-competes have lower wages than those that prohibit them. This makes sense. Employees who can easily change jobs demand higher wages, driving up salaries. When Hawaii banned non-compete agreements for tech workers in 2015, wages in that sector increased 11 percent in three years. Conversely, when Michigan went from banning non-competes to enforcing them in the mid-1980s, job mobility rates decreased and wages stagnated.

Second, jurisdictions that prohibit non-competes appear most successful in attracting workers. Consider that in the most recent University of Waterloo software engineering class, 84 percent of graduates planned to move the US, and almost half were headed to California, which bans non-competes.

Third, non-competes don't do what employers say they do in lawsuits when they defend them. Employers like to say non-competes are justified because they protect trade secrets. But that's not what non-competes do. They prevent people from working. Moreover, we have laws to prohibit stealing trade secrets, including a Criminal Code section that makes theft of trade secrets punishable by up to 14 years in prison.

Fourth, the bargaining power of employees has changed considerably since 1711, when British case law first tolerated non-compete agreements. Many employees' ability to negotiate the terms of their employment agreements is minimal, or even illusory, now that the market cap of companies like Apple is bigger than the GDP of Canada or Alphabet, the GDP of Ontario.

Fifth, at a cognitive level, most employees do not likely understand these agreements due to the lack of requisite legal knowledge and are not contemplating end of employment as they sign.

Sixth, the vast majority of non-competes go unchallenged, even when they are legally unenforceable. This is because courts can only review them on a one-by-one basis. They are not easily susceptible to systemic review.

This is hobbles innovation in Canada. Some might argue that with restrictive covenants, employers will not be incentivized to educate and invest in training their employees. Yet these arguments lack force, especially when one considers that the region that is most synonymous with innovation over the last three decades – Silicon Valley – is located in a region that prohibits non-competes and has done so since the 19th century. Firms have always been free to opt out of California's prohibition against restrictive covenants by moving to a jurisdiction that enforces them – and they haven't.

In jurisdictions that ban non-competes, employers have to work hard to attract and keep their best and brightest employees. They do so by raising wages, giving employees ownership in companies, and offering other perks. They are forced to make work attractive and alluring, which has many positive spinoff effects. These actions raise wages and improve standards of work, and they make employment more attractive not only to Canadians but people everywhere. The best employees want to work in these places.

For all these reasons, Canada and the provinces should move to pass a bright line rule prohibiting non-competes. If they need inspiration, they should look to where those University of Waterloo software engineering graduates are fleeing –California has banned non-competes since 1872.

Instead of making their economies more attractive for innovative workers, Canadian governments let their most intelligent and innovative workers languish behind non-competes – and lose others to regions that ban them.

Twenty four words in a labour code is all it takes.

Matt Malone is a Research Associate at the Centre for Law, Technology, and Society at the University of Ottawa.

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