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Note

The Antitrust Implications of Employee Noncompete Agreements: A Labor Market Analysis

I. INTRODUCTION

Employers often require workers in many occupations, particularly those requiring a high degree of specialized training, to enter into postemployment noncompetition agreements. The noncompete agreements commonly restrain such employees from carrying on their vocations within a prescribed geographic area, for a specific length of time, after ending their current employment. Although the common law offers some protection of employer interests, noncompete agreements have provided employers with a heightened level of protection that, in their view, more adequately guards their interests. While most former employees do not contest these agreements, their wide-ranging effects have given rise to frequent challenges.

Courts currently analyze the validity of noncompete agreements almost exclusively under state contract law, largely fail-

1. One commentator has observed that, although empirical data on usage of noncompete agreements seems to be lacking, an "armchair survey of the state cases decided each year reveals extensive use. Furthermore, reason exists to believe that the number of decisions reported constitutes only the proverbial iceberg's tip." Sullivan, Revisiting the "Neglected Stepchild": Antitrust Treatment of Post Employment Restraints of Trade, 1977 U. Ill. L.F. 621, 622-23. "For every covenant that finds its way to court, there are thousands which exercise an in terrorem effect on employees who respect their contractual obligations . . ." Blake, Employee Agreements Not to Compete, 73 HARV. L. REV. 625, 682 (1960). See, e.g., SCM Corp. v. Xerox Corp., 463 F. Supp. 983, 1008 (D. Conn. 1978). Dissatisfied employees may be faced with the prospect of moving beyond the agreement's geographic reach, switching occupations, or never leaving their employment.


Goldschmid notes:
[F]ederal antitrust laws, with rare and tangential exceptions, have not been applied to restrictive covenants. The modern citations . . . are to
ing to consider the antitrust implications of these agreements, either as affirmative defenses in suits to enforce the covenants, or as independent actions. The few courts that have considered the validity of these restrictive covenants under the antitrust laws have held them enforceable. Since courts have not conducted a complete antitrust analysis, they may have enforced illegal restrictions. The decisions have erroneously focused on the agreements' anticompetitive impacts on the market for the employer's product instead of on the market for the employee's labor, where the major antitrust effects occur.

This Note examines the traditional legal analysis of noncompete agreements under state contract law, and the currently limited application of federal antitrust law. An analysis of the cases shows that state contract law inadequately protects both employee and public interests, and that the courts, by focusing antitrust protection on the product market, have rendered its protection ineffective. This Note proposes that courts should apply antitrust law instead of state contract law in their analysis of noncompete agreements, and that courts should consider the anticompetitive effects of such agreements on the labor market instead of on the product market. This shift in emphasis will allow a more complete assessment of the advantages and disadvantages of noncompete agreements.

II. TRADITIONAL LEGAL ANALYSIS OF NONCOMPETE AGREEMENTS

Noncompete agreements ancillary to legitimate employment or sale of business contracts have been held valid under state contract law if "reasonable" in light of the circumstances. This test requires courts to weigh three factors: the restraint

... cases decided under state—not federal—law. It appears that federal enforcement agencies and private litigants have either concluded that state law is adequately policing the area or that federal antitrust statutes are not applicable to this field. ... [T]here is little basis for either view. Goldschmid, supra, at 1193.

4. See note 25 infra and accompanying text.
5. See notes 27, 48-63 infra and accompanying text.
6. The rule is that a mere covenant not to compete is an invalid restraint of trade. A valid covenant must be made in conjunction with a lawful contract, such as an employment or sale of business contract, where it is more likely to be necessary to protect legitimate business interests. See United States v. Adyston Pipe & Steel Co., 85 F. 271, 281-82 (6th Cir. 1899), aff'd as modified, 175 U.S. 211 (1899).
7. See note 23 infra.
must be no greater than is required to protect the employer;\(^8\) it
must not impose undue hardship on the employee;\(^9\) and it must
not be injurious to the public.\(^10\)

Courts use many criteria to decide the extent of the em-
ployer’s interest. The employee’s departure must present a
substantial risk either to the employer’s customer relations or
to the employer’s confidential business information.\(^11\) In as-
sessing the risk to customer relations, courts consider the fre-
cuency of the employee’s customer contact, whether the
employer has any contact with the customers other than
through the employee, the locale of the contact, and the nature
of the employee’s activity.\(^12\) The strength of the employer’s in-
terest in confidential business information depends on the na-
ture of the information and on the reasonable protective
measures the employer already has taken.\(^13\)

If the courts find a protectible employer interest, they next
examine the hardship the restraint imposes on the employee.
Recognizing that persons should not be able to deprive them-
selves of all employment opportunities, courts consider

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\(^8\) See, e.g., Arthur Murray Dance Studios of Cleveland, Inc. v. Witter, 62 Ohio L. Abs. 17, 20, 105 N.E.2d 685, 687, 691 (C.P. Cuyahoga County 1952) (pro-


\(^12\) See Truly Nolen Exterminating, Inc. v. Blackwell, 125 Ariz. 481, 482, 610 P.2d 483, 484 (Ct. App. 1980); Captain & Co. v. Towne, 404 N.E.2d 1159, 1162 (Ind. Ct. App. 1980) (“employer is not en-
titled to protection from an employee’s use of his knowledge, skill or general in-
formation . . . .” (citation omitted)).
whether enforcing the agreement will eliminate all opportunities to find work. Noncompete agreements may severely restrict an employee's job opportunities within a particular market. Employers may also view job applicants subject to such agreements as less attractive potential employees. Courts use no specific tests in evaluating these considerations, but their analyses often follow a general guideline that covenants are invalid if too broad in prohibition of employee activities, too long in duration, or too wide in geographical restraint.

After consideration of employer and employee interests, courts next examine the agreement's effect on public interests. The agreement's adverse effect on the provision of services and its beneficial effect on the creation of employment opportunities are two of the few public impacts that courts consider.
consider. Courts have also used the public interest component to examine whether a noncompete agreement that is otherwise reasonable between an employer and an employee may nonetheless be invalid because it creates, or threatens to create, a monopoly.\textsuperscript{19} The courts have used a stringent standard in considering whether a restraint's effect on competition in the employer's industry amounts to a monopoly.\textsuperscript{20} Of the courts addressing the monopoly argument, only one found a restraint partially unenforceable because of its impact on competition,\textsuperscript{21} while others found no threatening monopoly and thus no impact on competition.\textsuperscript{22}

Although the public interest in preventing restraints on competition is reflected in the antitrust laws, courts have rarely applied antitrust law to noncompete agreements.\textsuperscript{23} Section 1 of the Sherman Act proscribes "every contract . . . in restraint of
Although the language of the Act clearly supports an argument that enforcement of noncompete agreements violates the antitrust laws, all postemployment restraints litigated under that section have been eventually upheld.\textsuperscript{25}

Courts have construed section 1 of the Sherman Act to prohibit agreements that "unreasonably" restrain trade; to be "unreasonable" under section 1, the restraint must adversely affect competition in the relevant market.\textsuperscript{26} The market traditionally analyzed in antitrust cases is the market for the employer's goods and services—that is, the product market, not the labor market.\textsuperscript{27} Because courts are accustomed to examining the product market, an employee subject to a noncompete agree-


To the extent that these statutes are part of the state's antitrust laws, noncompete agreements are subject to state antitrust law analysis. Like courts interpreting the federal antitrust laws, courts interpreting state antitrust laws have often relied on a common law contract analysis to determine reasonability. \textit{See} Miller Mechanical, Inc. v. Ruth, 300 So. 2d 11, 12 (Fla. 1974); Availability, Inc. v. Riley, 336 So. 2d 668, 670 (Fla. Dist. Ct. App. 1976). Consequently, the analysis under these state statutes does not radically depart from the traditional state common law test described above.


\textsuperscript{26} See Standard Oil Co. v. United States, 221 U.S. 1, 57-60 (1910). This rule developed because, early in the history of the Act, courts recognized that restraint was the essence of every contract. If the Act were read literally to prohibit every contract that restrained trade, it would outlaw the entire body of contract law. \textit{Id.} at 59-60. Mr. Justice Brandeis once stated the rule incisively:

The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable.

ment must prove that his exclusion from the labor market adversely affected competition in the sale of the employer's product or service. 28 Although individual noncompete agreements have some adverse impact on the product market, the effect will never be great enough in individual cases to cause a court using this analytical approach to hold a postemployment restraint invalid. 29 Bereft of the requisite adverse product market impact, noncompete agreements have been held not to violate section 1 of the Sherman Act. 30

III. THE CASE FOR A BROADER APPLICATION OF ANTITRUST LAW

A. INADEQUACY OF STATE LAW

State law inadequately protects employee and public interests for at least three reasons. First, the remedy for an employee whose noncompetition agreement is held invalid generally is to allow the employer to enforce only the reasonable terms of the agreement, or to apply the "blue-pencil" doctrine, severing the "unreasonable" terms, if distinctly severable, and enforcing the remainder. 31 This practice encourages employers to draft overly broad agreements in the belief that most employees will not challenge the agreement, and that if they do, the terms will simply be judicially narrowed. 32

Second, state law provides inadequate protection because many courts have not considered all three prongs of the common law "reasonableness" test. Often, if a court has found a protectible employer interest, its analysis has not proceeded to the issue of employee hardship. 33 Moreover, of those courts that have balanced both employer and employee interests, most have ignored the public's interest. 34

28. See cases cited in note 94 infra.
29. See notes 94-95 infra and accompanying text.
30. See note 25 supra and accompanying text.
31. See Wetzel, supra note 3, at 66. See generally 6A CORBIN, CONTRACTS § 1390 (1962).
33. Professor Blake observed that once courts complete their analysis of the protectible employer interest, they usually find the relevant considerations exhausted. The employee interest and public interest branches of the test are seldom given separate attention. "This does not mean that the interests of the employee and the public are necessarily slighted, but only that 'undue hardship' to the employee and 'injury' to the public are measured against the urgency of the employer's claim to protection . . . ." Blake, supra note 1, at 649-50.
34. See note 16 supra.
Most importantly, courts that have employed a contract law analysis have not considered the crucial antitrust issues. At best, courts have questioned whether the noncompete agreement created or threatened to create a monopoly under a stringent standard.\textsuperscript{35} They have not considered the broad goals of federal antitrust law, nor have they thoroughly analyzed whether the agreement violates the requirements of section 1 of the Sherman Act.

B. INTERESTS PROTECTED BY ANTITRUST LAW

1. Sherman Act Objectives

The Sherman Act was enacted to preserve competitive markets,\textsuperscript{36} which economists believe promote well-being by maximizing consumer satisfaction and minimizing maldistributions of wealth that occur when prices are unrelated to costs.\textsuperscript{37} The Act reflects congressional judgment that competition is the best method of allocating resources, producing lower prices, and concomitant higher quality. Congress believed that a better bargain results from the free opportunity to choose among alternatives.\textsuperscript{38}

Economic efficiency, however, is not the sole aim of antitrust policy. This "comprehensive charter of economic liberty" also advanced important political objectives.\textsuperscript{39} Among these objectives were the achievement of a viable economy with a minimum of political interference and the protection of individ-

\textsuperscript{35} See note 19 supra and accompanying text.

\textsuperscript{36} See American Column & Lumber Co. v. United States, 257 U.S. 377, 400 (1921); United States v. Union Pac. R.R. Co., 226 U.S. 61, 67 (1912).


\textsuperscript{38} The Act "rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress." Northern Pac. Ry. v. United States, 356 U.S. 1, 4 (1958). See also Connell Const. Co. v. Plumbers & Steamfitters Local No. 100, 421 U.S. 616, 623 (1975); Shapiro v. General Motors Corp., 472 F. Supp. 636, 648 (D. Md. 1979).

\textsuperscript{39} Northern Pac. Ry. v. United States, 356 U.S. 1, 4 (1958). Professors Blake and Jones maintain that the Act was to be a "bulwark against arbitrary action and oppression at the hands of the economically powerful ...." Blake & Jones, supra note 37, at 384. They believe Americans favor freedom of action and the wide range of choices that freedom implies; competition maximizes freedom of opportunity for consumers and businessmen. But see Bork, Contrasts in Antitrust Theory: I, 65 COLUM. L. REV. 401 (1965). "Early antitrust policy developed almost entirely as economic regulation." Id. at 413. "[T]he political and social values mentioned in connection with antitrust usually turn out to be either mere rhetorical reinforcement of results arrived at on grounds of economic analysis or else unstructured mush." Id. at 415.
ual freedom and opportunity.\textsuperscript{40} Maintenance of competitive markets facilitates the attainment of society's political as well as economic objectives; thus, faith in the value of competition has long been the heart of our national economic policy.\textsuperscript{41} Congress intended courts to interpret the Sherman Act in light of these multiple economic and political policy objectives.\textsuperscript{42} By its deliberately broad language,\textsuperscript{43} the Act retains the flexibility to encompass newly devised restraints on competition and opportunity.\textsuperscript{44}

In addition to restricting an individual employee's mobility, noncompete agreements interfere with society's broad interest in unfettered labor mobility.\textsuperscript{45} That interest is reflected in the political antitrust objective of protecting individual freedom and opportunity. By definition, noncompete agreements hamper the economic mobility of employees and impair their ability to practice their livelihoods,\textsuperscript{46} impinging on both the individual's personal interest in freedom of employment and on society's interest in protecting that freedom for the greater public

\textsuperscript{40} See Blake & Jones, supra note 37, at 383.


\textsuperscript{42} "This . . . has for its single object to invoke the aid of the courts . . . to supplement the enforcement of the . . . common and statutory law . . . in dealing with combinations that affect injuriously the industrial liberty of the citizens of these States." 51 CONG. REC. 2457 (1890) (remarks of Sen. Sherman).

\textsuperscript{43} The Senate Finance Committee, of which Sherman was a member, initially amended the original language to provide more detail. A number of amendments were also proposed when the bill reached the floor; one specifically defined terms such as trust, combination, and monopoly. See generally 51 CONG. REC. 2455-731 (1890). Despite these options, the original, more general language was adopted. See Standard Oil Co. v. United States, 221 U.S. 1, 60 (1910).


\textsuperscript{45} This societal interest was recognized in Deuerling v. City Baking Co., 155 Md. 280, 284-85, 141 A. 542, 543-44 (1928), though the noncompete agreement was enforced. Society's interest in the unrestricted movement of labor is analogous to its interest in free alienability of property. The court in Deuerling emphasized that "it is just as essential that men's services be freely for sale as that property should not be allowed to be withdrawn from the market for an indefinite length of time," and that both principles were based on sound public policy. Id. at 284, 141 A. at 544.

\textsuperscript{46} See Blake, supra note 1, at 646-51. A commentator has observed several effects of nondisclosure agreements that are also likely to occur from use of noncompete agreements. First, the covenants tend to discourage employees from actively seeking new positions. Second, the covenants diminish an employee's value to the new employer because the agreements tend to restrict the employee from using whatever was learned in the prior employment. Third, employers may be reluctant to hire employees of competitors, fearing a suit to enforce the restraint. Note, Employee Nondisclosure Covenants and Federal Antitrust Law, supra note 14, at 426-27. This reluctance also impedes employee mobility.
good. Thus, noncompete agreements contravene an important political antitrust goal.

2. Product Market Impact

There is a direct impact on competitive markets that state law currently does not consider. Even when noncompete agreements do not suppress competition to the extent that their enforcement threatens to promote a monopoly, they harm interests protected by the antitrust laws by decreasing competition in the market of the employer's product. Noncompete agreements prohibit employees from setting up businesses against their former employers or from competing against them in a rival's employ. Consequently, for each ex-employee who honors a noncompetition agreement, the employer faces one less potential competitor in the marketplace. The employer's competition is further reduced by the absence in the marketplace of employees who, but for the deterrence of postemployment restraints, might consider leaving their employment. Employers need not fear that rivals will be able to acquire and exploit their new processes, confidential information, and customer relationships by hiring a former employee. In this sense, noncompete agreements restrain competition in the market for the employer's product or service, and thus impair the antitrust objective of promoting competitive markets.

3. Labor Market Impact

In addition to their product market impact, noncompete agreements have a strong impact on the labor market. Although some courts have felt that noncompete agreements could benefit the public by creating employment opportunities for employees not subject to such restraints, the courts have overlooked the possibility that noncompete agreements actually reduce competition in the labor market. In a perfectly competitive labor market, each firm is too small to affect the wage rate by changing its use of labor. Therefore, the supply of labor curve confronting each producer is a horizontal, perfectly

47. Professor Blake notes: "For every covenant that finds its way to court, there are thousands which exercise an in terrorem effect on employees who respect their contractual obligations and on competitors who fear legal complications if they employ a convenantor, or who are anxious to maintain gentlemanly relations with their competitors." Blake, supra note 1, at 682-83.

48. See note 18 supra and accompanying text.
elastic line at the market wage rate. A profit maximizing entrepreneur will employ units of labor until the value of the marginal product of labor, the addition to total production for each additional unit of labor employed, multiplied by the market price of the commodity produced is equal to the price of labor, the wage rate.

An employer's interference with free competition for one of its former employee's services, therefore, impairs the market's ability to achieve the most economically efficient allocation of labor. A noncompete agreement that prevents an employee

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50. Id. at 369-70. This analysis is analogous to that in the product market, where the profit maximizing entrepreneur produces when marginal revenue equals marginal cost, which equals price. See note 82 infra.

Individual Producer Labor Demand & Supply

<table>
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<tr>
<th>Wage</th>
<th>Value of Marginal Product</th>
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<tbody>
<tr>
<td>Supply of Labor</td>
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Quantity of Labor

The individual producer's demand for labor curve, then, is equivalent to the value of the marginal product (VMP) curve.

The market demand for labor, like the market demand for a product, is the horizontal sum of the constituent individual demand curves. See C. Ferguson & J. Gould, supra note 49, at 371. Note, however, that a change in the product price or demand will also affect the demand for the input, or labor. Id. at 375.

The supply of labor that individual workers offer depends on their preference for work versus their preference for leisure. The supply curve for individuals is positively sloped because an increase in wage rates results in an increase in the number of hours they will work and a decrease in the amount of leisure they prefer. Id. at 381. The market supply of labor, just like the market supply of a product, is the summation of all of these individual supply curves. After deriving the market demand and supply for labor, one can determine the market equilibrium price or the market wage rate by finding the intersection of supply and demand, just as one determines the price of a commodity in the product market.

51. See Newburger, Loeb & Co. v. Gross, 563 F.2d 1057, 1082 (2d Cir. 1977), cert. denied, 434 U.S. 1035 (1978). The Ninth Circuit found, in Winston Research Corp. v. Minnesota Mining & Mfg. Co., 350 F.2d 134 (9th Cir. 1965), certain restrictions on the disclosure of trade secrets to "limit the employee's employment opportunities, tie him to a particular employer, and weaken his bargaining power with that employer. [They] interfere with the employee's movement to the job in which he may most effectively use his skills." Id. at
from competing against a former employer artificially decreases the supply of that particular type of labor in the geographic area for the time that the covenant is in force.\textsuperscript{52} If an agreement, for example, prevented a computer programmer from competing in a five-state territory for a period of two years, there would be one less computer programmer available to other firms in the area for two years. If an employer, or several employers, enforced a number of such agreements, the supply of available programmers could decrease significantly.\textsuperscript{53} Given this decrease in supply, and assuming that demand for labor remained constant,\textsuperscript{54} the wage commanded by the remaining available programmers not subject to noncompete agreements would be artificially inflated.\textsuperscript{55}

Noncompete agreements sustain this artificially high price by inhibiting the market's normal response to an increased wage rate. Absent market imperfections, an increase in the wage rate would normally begin to attract new workers to the market from other occupations or from other localities. These workers would increase the available supply of labor, and in the long run the market would reach a new equilibrium.\textsuperscript{56} Labor markets are not, however, perfectly competitive.\textsuperscript{57} Market imperfections in the form of various immobilities inhibit the

\begin{footnotesize}
\begin{enumerate}
\item Such restrictions harm the public because "[t]hey inhibit an employee from either setting up his own business or from adding his strength to a competitor of his employer, and thus they diminish potential competition. Such restrictions impede the dissemination of ideas and skills throughout industry." \textit{Id.} at 137-38. The court thus recognized both labor and product market effects. \textit{See also} Note, Employee Nondisclosure Covenants and Federal Antitrust Law, \textit{supra} note 14, at 426-27 (discussing anticompetitive labor effects of nondisclosure agreements). Professor Blake observes that "[a]nything that impedes an employee's freedom of access to a job in which his productivity (and wages) would be higher, involves a cost in terms of the economy's welfare." Blake, \textit{supra} note 1, at 650.
\item This supply shift would occur once an employee subject to a noncompete agreement left his or her employment. If the employee remained with the employer, this shift would not occur, but the agreement would nonetheless have anticompetitive effects; the free mobility of resources necessary to perfect competition remains impaired.
\item An increase in the price of the input would probably result in lowered demand for labor, moderating the wage increase.
\item This analysis is similar to the analysis of the effect of exclusive or craft unionism. \textit{See} C. McConnell, \textit{Economics} 612 (8th ed. 1981).
\item For a general analysis of equilibrium, employing both a product and labor market, see \textit{id.} at 645-48.
\end{enumerate}
\end{footnotesize}
ability of the system to reach long-run equilibrium.\textsuperscript{58} Some of these immobilities are sociological,\textsuperscript{59} others are geographical,\textsuperscript{60} and still others are institutional.\textsuperscript{61} Noncompete agreements are a form of institutional restraint, preventing workers subject to their terms from entering the available pool of a particular type of labor.

Given these immobilities, a diminished supply caused by noncompete agreements is less likely to return to its original levels in response to the inflated wages. It is thus unlikely that the wage and the quantity of labor employed will remain at their original levels. The individual producer viewing a higher input price will still employ labor until the value of the marginal product equals the wage, but that equality will occur at a lower level of resource employment than before.\textsuperscript{62} Eventually, of course, market demand for labor would fall somewhat, causing the wage rate to decline. Employers are likely to employ fewer workers at the new lower wage level, however, than they originally employed.\textsuperscript{63} Noncompete agreements thus act to disturb present equilibrium in the labor market by artificially reducing the labor supply, as well as to impair the market's ability to achieve long-run equilibrium by hindering the normal adjustments a competitive market would make to eliminate disequilibrium. Because the agreements artificially inflate the price of labor, resources are not allocated in accord with economic efficiency; noncompete agreements thus cause society to pay more for a scarce resource than it would under competitive conditions, thereby thwarting the antitrust goal of preserving competitive markets.

\textsuperscript{58} See S. LEVITAN, G. MANGUM & R. MARSHALL, \textit{supra} note 57, at 134; C. McCONNELL, \textit{supra} note 55, at 619.

\textsuperscript{59} For example, employers may discriminate on the basis of race or sex. See C. McCONNELL, \textit{supra} note 55, at 619-20.

\textsuperscript{60} Some workers choose to remain in one geographic area and do not respond to attractive opportunities outside that area. \textit{Id}.

\textsuperscript{61} Union cards, licensing requirements, and advanced education requirements are all examples of institutional market imperfections. \textit{Id}.

\textsuperscript{62} This observation is a necessary corollary of the negative slope of the value of marginal product curve. See C. FERGUSON & J. GOULD, \textit{supra} note 49, at 370; note 50 \textit{supra} and accompanying text.

\textsuperscript{63} The labor market is originally at equilibrium where demand for labor \((D_1)\) intersects labor supply \((S_1)\). That intersection determines the quantity of labor employed \((Q_1)\) and the market wage rate \((W_1)\). As noncompete agreements are enforced, the supply of available workers \((S_1)\) decreases to \((S_2)\), establishing a new quantity employed \((Q_2)\) at a new higher wage rate \((W_2)\).
4. Oligopolistic Market Impact

So far, this Note has discussed anticompetitive impacts upon product and labor markets without reference to any particular industry. The factual proof of adverse competitive impact, in either the product or labor market, clearly would have to incorporate the characteristics of a given market and its participants. In a specific industrial structure, however, widespread use of noncompetition agreements has an additional antitrust implication for both product and labor market competition. In an oligopolistic industry, noncompete agreements could act as barriers to the entry of new firms.

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**Labor Market Effects**

[Diagram showing labor market with supply and demand curves, labeled as follows: Supply\(_1\), Supply\(_2\), Demand\(_1\), Demand\(_2\), W\(_1\), W\(_2\), W\(_3\), Q\(_1\), Q\(_2\), Q\(_3\).]

Market demand for labor will fall (to D\(_2\)) because as its price rises, users and firms, to the extent possible, will try to substitute other inputs for labor, reaching a new equilibrium (at Q\(_3\) and W\(_3\)). See C. Ferguson & J. Gould, supra note 49, at 112. This analysis assumes that the new equilibrium wage and quantity, W\(_3\) + Q\(_3\), will be respectively higher than and lower than the original wage and quantity, W\(_1\) + Q\(_1\), due to restraints on the substitution of capital for labor and to continued demand for the commodity produced. See C. McConnell, supra note 55, at 647-48.

64. An oligopolistic industry is a market structure where firms have some market power (and thus are not price takers as in perfect competition), but are subject to enough rivalry so that they cannot consider the market demand curve their own (as in monopoly). An oligopolistic industry consists of a few firms that are aware of their interdependence. See generally R. Lipsey & P. Steiner, Economics 252-53, 258-66 (5th ed. 1978).

65. One of the criteria that suggests an industry’s predisposition to forming cartels is its conditions of entry. “If entry can be effected rapidly and entrants have no higher long-run costs than the members of the cartel, the profit of cartelization will be small, and so also the incentive to cartelize.” R. Posner,
The computer industry in the United States, for example, is dominated by a few large firms. Economists have characterized the industry as oligopolistic or, at least, imperfectly competitive. The industry employs a large number of highly skilled and trained employees, among them computer programmers. Since computer technology develops rapidly and changes often, employers have sought to protect the advantages acquired by new processes and skilled employees. If many firms in the industry used noncompetition agreements to protect their positions, the cumulative impact would raise entry barriers to new firms by severely limiting the available labor supply.

Due to artificially increased wages, existing firms that have not procured a "loyal" labor supply will experience rising costs of operation. New firms will have to pay more to hire programmers, or incur the costs of training employees new to the programming market. These high expenses may deter new firms from entering the industry, or cause those that do enter to be less successful. The lack of new firms entering the market is itself harmful because it perpetuates oligopoly, a form of imperfect competition. Although only expert economic witnesses can attest to the precise effects in specific industries, courts and litigants should become aware that increased entry barriers encourage exploitation and accumulation of market power.

ECONOMIC ANALYSIS OF LAW 214 (2d ed. 1977). Thus, high entry barriers may encourage exploitation and accumulation of market power.


67. While Brock denies that access to skilled personnel constitutes an important entry barrier, id. at 63, he concludes that current problems in the industry are primarily the result of the barriers to entry of new firms, contributing to the high degree of concentration. Id. at 230. Despite his underestimation of the importance of labor, Brock found that the area of the most substantial economies of scale was that of software (programming) and that one way a small company could overcome this barrier would be to employ highly skilled and able programmers. Id. at 38. Brock summarizes the disadvantages for new entrants in tabular form. See id. at 65.

68. The effect of noncompetition agreements on blocking new entries has been noted before. See Newburger, Loeb & Co. v. Gross, 563 F.2d 1057, 1082 (2d Cir. 1977), cert. denied, 434 U.S. 1035 (1978); Note, Antitrust Implications Arising From the Use of Overly Broad Restrictive Covenants for the Protection of Trade Secrets, supra note 14, at 315. See also Union Circulation Co. v. Federal Trade Comm'n, 241 F.2d 652, 658 (2d Cir. 1957); Blake, supra note 1, at 627.

[T]he courts should look to the general use of such restraints in the industry to determine whether the collective effect of such practices is to lock-in classes of key employees so as to create a general barrier to competition.

. . . [T]he existence of an oligopolistic market structure . . . should cut [against the employer], especially if the other firms in the industry also restrain key employees.

Sullivan, supra note 1, at 647-48.
ers are a potential anticompetitive effect of employee covenants not to compete.

C. Judicial Reluctance to Apply Antitrust Law

One explanation for the failure of courts to consider the antitrust implications of noncompete agreements may be their reluctance to interfere with state contract and trade secret law. Contract law governs the validity of restrictive covenants by weighing the employer, employee, and public interests. In addition, the law of trade secrets protects many of the same employer interests that noncompete agreements protect. Theft or disclosure of a trade secret is a competitive tort. An employee may also have a duty not to disclose information under either an express nondisclosure covenant or an implied term of the employment contract. Finally, disclosure of confidential information may be a violation of an employee's implied duty of loyalty or a breach of a fiduciary duty under state corporate law.


70. See notes 8-10 supra and accompanying text.

71. "[E]ven absent covenants not to compete, various doctrines of state trade secret law will protect the employer against egregious employee misconduct." Sullivan, supra note 1, at 640. Professor Blake notes that an employer is apt to regard his interests as inadequately protected by traditional remedies. Blake, supra note 1, at 657. Finding some merit in the employer's position, Professor Blake explains how noncompete agreements remedy the alleged deficiency:

In at least three different ways such covenants may provide protection beyond that which would otherwise be available. First, they may deter the employee from leaving his employment . . .; second, if the former employee violates the covenant, he may be ordered out of the business entirely rather than subjected only to the less effective order not to solicit; finally, an effective covenant may in some cases not only protect against solicitation of all the employer's actual customers but also guarantee his exclusive access to potential customers . . .

Id. Professor Sullivan observes that noncompetition agreements add only marginal legal protection at a high cost to competition. Sullivan, supra note 1, at 641 n.94. Some commentators have argued that even trade secret protection and nondisclosure covenants, both of which have narrower effects than noncompete agreements, restrain competition "by impeding the mobility and market value of individual employees." Note, Employee Nondisclosure Covenants and Federal Antitrust Law, supra note 14, at 424-27. See also Note, Antitrust Implications Arising From the Use of Overly Broad Restrictive Covenants for the Protection of Trade Secrets, supra note 14, at 307-08.


73. Id.

Because of this complex overlap in applicable law, courts may fear that analyzing noncompete agreements under federal antitrust law will conflict with analysis of such covenants under state law.\textsuperscript{75} This fear is unfounded. State contract common law does not establish that "reasonable" restraints are desirable, it merely declares that such restraints are not contrary to public policy.\textsuperscript{76} Thus, even if a court finds a restraint "reasonable" under contract law, but finds it "unreasonable" under federal antitrust law, the court does not necessarily intrude upon any affirmative state policy.\textsuperscript{77}

State trade secret law poses no greater problem. An antitrust challenge to a contract that merely duplicates state trade secret protection should result in a finding that the restraint is reasonable. Most noncompetition contracts, however, provide more protection than does state trade secret law.\textsuperscript{78} This additional protection is, of course, the very purpose of the agreement. Subjecting the excess protection to antitrust scrutiny does not infringe on any affirmative state policies because, by definition, the "excess" of the restraint is beyond the scope of state trade secret law.\textsuperscript{79} As a result of this mistaken and excessive judicial deference to state law, courts have ignored the public interest reflected in the federal antitrust laws.\textsuperscript{80}

Another explanation of the judicial reluctance to apply antitrust analysis and to ignore "public interest" issues is the misperception by the courts that public and private interests are congruent. Courts seem to have assumed that the balancing of employer and employee interests will maximize both societal

\textsuperscript{75} See Goldschmid, supra note 3, at 1193, 1204; Sullivan, supra note 1, at 662-63.

\textsuperscript{76} See tests for analyzing restraints under state contract law, notes 6-22 supra and accompanying text.

\textsuperscript{77} See Sullivan, supra note 1, at 662, 663 & n.181.

\textsuperscript{78} See Note, Employee Nondisclosure Covenants and Federal Antitrust Law, supra note 14, at 431-32.

\textsuperscript{79} One commentator has argued that courts should balance the state policy of protecting trade secrets that supports reasonable nondisclosure covenants against the anticompetitive effect, and should refuse to enforce the agreement if competition is substantially impaired. See id. at 432. See also Sullivan, supra note 1, at 666.

\textsuperscript{80} Sullivan, supra note 1, at 639, maintains that state restraint of trade contract common law is overly concerned with the employer's interests, and thus that undue deference to state law has distorted the appropriate Sherman Act approach. \textit{Id.} at 643. "[T]he antitrust law, if it is to be applied to employer agreements not to compete, must treat common law precedents with a so-far unaccustomed suspicion." \textit{Id.} at 634. See also Goldschmid, supra note 3, at 1194, 1196.
and individual interests. It is true that in an efficient market the social cost of preventing employees from accepting new employment where they would be more productive is equal to the individual's economic loss. In the real economic world where the relevant market is not perfectly efficient, however, it is erroneous to assert that public and private interests converge and that, therefore, the court need not consider public interests separately. In an imperfectly competitive market, the

81. See Blake, supra note 1, at 687. The current practice of ignoring the public interest factor in the three part test for noncompete clauses supports this analysis. See note 16 supra and accompanying text. If courts felt there were no public interests in enforcement or nonenforcement of restrictive covenants, it would seem logical for them to ignore the public interest component in announcing the test, as a few courts have done. See Dixon v. Royal Cup, Inc., 386 So. 2d 481, 482 (Ala. Civ. App. 1980). Those courts that retain the requirement, yet ignore it, apparently believe that employer and employee interests adequately assess the public interest. This approach makes sense if there are no specific public interests and harms. A court unaccustomed to considering the public interest in preserving competitive markets and the unfettered movement of labor would tend to view a public harm of a postemployment restraint as identical to its harm to the employee. Furthermore, the only interests actually presented by litigants to the court appear to be those of the employer and employee.

82. See Blake, supra note 1, at 687. An efficient market, defined in economic terms, is perfectly competitive. A perfectly competitive market meets four conditions: each seller's product is homogeneous; each market participant is a price-taker (unable to affect the price because each occupies such a small part of the market); all resources are completely mobile (able to enter the market, leave it, or switch uses readily); and all market participants have perfect knowledge. E. Mansfield, Microeconomic Theory and Application, 223-24 (1970). Absent externalities, marginal private cost equals marginal social cost in perfect competition. C. Ferguson & J. Gould, supra note 49, at 455-57, 472-73. The social cost of the restrictive covenant is reduced efficiency, stemming from the allocation of resources to a less productive use; the private cost, if one assumes a constant labor supply, is the loss to the individual of the potential increase in his wage, measured by the value of the marginal product of labor (marginal product of labor times price of the product). See id. at 365-71.

83. Perfect competition requires that each supplier be a price-taker and that the industry has freedom of entry and exit. In a simplified labor market, workers are the suppliers, and companies are the consumers. Each laborer is a wage-taker (i.e., cannot alter the going price but must passively accept it) and any worker can leave or enter the labor market at any time. See P. Samuelson, supra note 37, at 540.

84. Public and private interests, for example, are not equivalent when noncompete agreements diminish competition by intimidating potential competitors, by slowing down the dissemination of ideas and methods, and by inhibiting an efficient channelling of labor to maximize productivity. See Blake, supra note 1, at 627. If restrictive covenants interfere with the efficient allocation of society's labor resources, the employee's interest will not adequately reflect society's interests. The law currently acknowledges that a divergence between private and social costs might occur if the restraint were used to monopolize business within a community. Id. at 687. This is the original Restatement formulation. Restatement of Contracts § 515(c) (1932); cf. Restatement (Second) of Contracts § 188(1)(b), (2)(b) & comment c (1981)
decisions of individual units will not necessarily maximize social welfare. Furthermore, even a perfectly competitive market may be subject to external diseconomies. When diseconomies are present, private costs do not fully reflect social costs. Thus, since the labor market is not perfectly competitive, and, even if it were, might be subject to externalities, it is unrealistic to assume that the assessment of private interests under noncompete agreements adequately maximizes the public interest.

Finally, courts may be reluctant to apply antitrust law to noncompete agreements because they view freedom of contract as fundamental. In their analysis of restrictive covenants, courts often refer to the competing principles of "freedom of contract" and "freedom of trade." Freedom of contract re-

(see Sullivan, supra note 1, at 643.)

85. A perfectly competitive producer will employ a variable input (labor) until each additional unit adds the same amount to total cost and revenue, that is, employing the input at a price equal to the value of the marginal product. The imperfectly competitive producer employs the resource at a price less than the value of its marginal product and does not use as much of the resource as is socially desirable. See C. Ferguson & J. Gould, supra note 49, at 435.

86. When the actions of one economic decisionmaking unit create good or bad effects upon other units, economists say external "economies" or "diseconomies," respectively, are involved. Since economic decisionmakers only take into account the benefits and costs they see, private and social costs will diverge. For example, the individual employee may not perceive the benefits of future improved labor market competition because they do not accrue directly enough; therefore the employee may not be willing to "pay" for that social benefit by refusing to sign a noncompete agreement and incurring the private cost of a lost employment opportunity. When externalities occur, even perfect competition will not fully maximize social welfare, and action must be taken to expand situations where external economies occur (to take full advantage of social benefits being inadequately considered by individuals) or to contract situations where diseconomies occur (to cut social costs inadequately considered by private decisionmakers). P. Samuelson, supra note 37, at 451-52. For examples of externalities presented in varying legal contexts see R. Posner, supra note 65, at 34-35, 140 (discussing property rights and a divergence between private and social costs); Posner, The Right of Privacy, 12 Ga. L. Rev. 393, 398 (1978) (discussing privacy rights and the social costs of disclosure). See also C. Ferguson & J. Gould, supra note 49, at 497-500.

87. See S. LeVit, G. Mangum & R. Marshall, supra note 57, at 131-34.

88. The court in Deuerling v. City Baking Co., 155 Md. 280, 141 A. 542 (1928), explained the tension well: 

Opposed to the unlimited application of this principle of freedom of trade is the equally well recognized principle of freedom of contract,
quires that individual employers and employees be free to strike their own bargains without judicial interference. Freedom of trade requires that the law limit the employee's ability to contract away the freedom to practice a trade or to work. Enforcing a noncompete agreement necessarily upholds freedom of contract, while it demotes freedom of trade.

Although courts acknowledge both concepts, in practice the doctrine of freedom of contract clearly prevails. The explanation may lie in a judicial understanding of freedom of trade as an archaic concept. The dominance of freedom of contract,

which in its essence is also natural and inherent in the individual. . . .

And here, again, the public has a real and vital interest, because if, recognizing the right to contract, one who does contract can, without loss or penalty, disregard his obligation, there would be [chaos].


89. For example, in many instances courts merely assess the legitimacy of the employer interest to be protected without even reaching the hardship to the employee. See note 33 supra and accompanying text. The implication is that as long as the contract is freely drawn for "legitimate" purposes, its impact on freedom of trade is irrelevant.

90. English law is similar in its failure to treat the public interest. In Nordenfelt v. The Maxim Nordenfelt Guns & Ammunition Co., [1894] A.C. 535, the court dropped the prevailing and confusing distinction between general restraints, which were always unenforceable as against public policy, and partial restraints which were enforceable. See Blake, supra note 1, at 630, 642. Instead, the court held that restraints might be justified, though generally against public policy, if they were reasonable in light of the parties' interests and the public's interests. The reference to the public interest could be interpreted as judicial reluctance to move too far, too quickly from the older absolute bar to certain restraints. In Attorney Gen. of Commonwealth of Austl. v. Adelaide S.S. Co., [1913] A.C. 781, 795 (AustL), the Judicial Committee of the Privy Council observed that they were "not aware of any case in which a restraint though reasonable in the interests of the parties has been held unenforceable because it involved some injury to the public." Kores Mfg. Co. v. Kolok Mfg. Co., [1958] 2 All E.R. 65, presented the English courts with an interesting opportunity to infuse the public interest requirement with some substance, but they declined to do so. See id. at 75.

The best explanation of the role of the public interest component is found in Lord Diplock's decision in A. Schroeder Music Publishing Co. v. Macaulay, [1974] 3 All E.R. 616. In that case, Lord Diplock thought it

[s]alutory to acknowledge that in refusing to enforce [the contract], the public policy which the court is implementing is not some 19th century economic theory about the benefit to the general public of freedom of trade, but the protection of those whose bargaining power is weak against being forced by those whose bargaining power is stronger to enter into bargains that are unconscionable. . . . If one looks at . . . what they did, one finds that they struck down a bargain if they thought it was unconscionable as between the parties to it, and upheld it if they thought that it was not.

Id. at 623. Thus, in England the courts recognize no public interest in freedom
however, means that the adverse impact of noncompete agreements on employee and public interests continues to elude judicial scrutiny. The courts' reluctance to actually balance freedom of trade against freedom of contract is, however, misplaced; the pull between these competing principles is precisely the tension that the antitrust "rule of reason" was designed to resolve. The rule of reason balances the restraint's beneficial effect against its adverse impact on competition. Under this standard, a restraint is neither automatically void nor automatically enforceable; neither freedom of contract nor freedom of trade is an absolute principle. Courts could apply the rule of reason to noncompete agreements by balancing the employer interests protected and the right of the parties to freely bargain against the potential harm to the employee and to the public arising from enforcement of the covenant. Instead of assuming that freedom of contract is preeminent, courts could infuse the principle of freedom of trade with some substance; the rule of reason would balance and accommodate both of these societal interests.

IV. FOCUSING ANTITRUST ANALYSIS ON THE LABOR MARKET

A. LABOR MARKET ANALYSIS

The most severe anticompetitive impact of noncompete agreements occurs in the labor market, rather than the product market. Although the agreements affect the product market, to labor or in competitive labor markets, but merely the interest in fairness. The test of fairness is whether the restraint is reasonable as between the parties. Arguably, these conclusions are sensible in England where there is no strong antitrust policy. See Restrictive Trade Practices Act of 1956, 4 & 5 Eliz. 2, ch. 68. In the presence of such a policy, as in the United States, the neglect of the public interest makes less sense.


The optimum balance between freedom of contract and freedom of trade present in the antitrust rule of reason is similar to the three part common law test of the reasonableness of noncompete agreements. The current reluctance of courts to weigh fully freedom of trade demonstrates judicial practice, common to courts employing the three part test, of inadequately considering the public interest in employment restraints. See notes 16-22 supra and accompanying text.

See note 50 supra and accompanying text.
that effect is attenuated. Given the number of factors influencing a firm's sales and its rivals' sales, it is unlikely that any employee could prove that elimination of one individual's labor services affected the product market. Consequently, the courts that have applied a product market antitrust analysis to noncompete agreements have upheld these agreements.\textsuperscript{94}

The impact of noncompete agreements on the labor market, however, is far more significant, since they restrain the employees' labor and not the employers' products. The restrictive covenant directly reduces the labor supply, and impairs the market's ability to reach equilibrium, thus incurring disadvantages of a noncompetitive market that the antitrust laws were designed to prevent.\textsuperscript{95} Moreover, labor market analysis is not a novel approach for courts or economists. Courts have already used it in their antitrust analysis of restraints in professional sports and of no-switching agreements,\textsuperscript{96} and economists have

\textsuperscript{94} Several cases illustrate the problem. In Newburger, Loeb & Co. v. Gross, 563 F.2d 1057, 1061 (2d Cir. 1977), cert. denied, 434 U.S. 1035 (1978), the court dismissed an employee's antitrust counterclaim against his former employer for destruction of an employment opportunity with another company. The court concluded that the employee failed to show sufficient "anticompetitive impact, industry practice, etc." to document his assertion that the restraint was unreasonable. \textit{Id.} at 1083. While the court did not specify the particular market in which anticompetitive impact should have been shown, it appears from this language that the court focused on the securities market, that is, the product market. The court emphasized the interest of the employer (a brokerage firm) in preventing former employees from taking customer accounts to competing firms. \textit{Id.} at 1082-83. In Lektro-Vend Corp. v. Vendo Co., 500 F. Supp. 332 (N.D. Ill. 1975), an employee who sought to enjoin recovery of a judgment against him for violation of an anticompetition agreement on grounds that the covenant violated the antitrust laws failed to establish that the restrictive covenant adversely affected the market or competition. \textit{Id.} at 355. The court clearly was looking for product market impact. \textit{Id.} at 350.

Emphasis on the product market was explicit in United States v. Empire Gas Corp., 537 F.2d 296, 307-08 (8th Cir. 1976), cert. denied, 429 U.S. 1122 (1977). The government contended that Empire had violated § 1 of the Sherman Act by obtaining numerous covenants not to compete from employees (over 3,000 employee covenants in 8 years). The government argued that many of the employees did not have customer contact or access to confidential information warranting protection, that the covenants were unnecessarily restrictive in area and time, and that the practice of obtaining agreements from such a large number of potential competitors in itself restrained trade regardless of the validity of individual contracts. The court held for defendant Empire because the government failed to meet its burden of showing that any of the 3,000 contracts was unreasonable. The court specifically required a showing of impact on competition in the product market, noting that "the record is barren as to the actual effect of these covenants on competition in the LP retail market." \textit{Id.} at 308.

\textsuperscript{95} \textit{See} notes 48-63 \textit{supra} and accompanying text.

long scrutinized the labor market.

The professional sports cases seem to provide an apt comparison to noncompete agreement cases. The courts, due to the labor intensive nature of the profession, have been unable to avoid an indirect analysis of the labor market effects of employment restraints challenged under the antitrust laws. Since the product market in those cases (the game) is highly dependent on the labor market (the players), causing any post employment restraint on the players to directly affect the quality of the product, the cases do not necessarily imply that courts will currently use a labor market analysis in different circumstances. With such a clear nexus between the product and labor market, however, courts in the professional sports cases have not hesitated to find antitrust violations. 97

Courts have experienced more difficulty finding antitrust violations in the use of no-switching agreements, in which employers agree not to hire one another's employees. In these cases, the connection between product and labor markets is more fragile, depending upon the particular industry, and courts have differed in the degree to which they are willing to focus directly on labor market effects. One court focused on the encyclopedia product market and invalidated the no-switching agreement, reasoning that the agreement might impair competition in the supply of a service or commodity to the public. 98 Another court acknowledged both labor market and product market effects of no-switching agreements between magazine subscription solicitation agencies, but failed to explain whether the labor market effects were an independent ground for the holding, or merely relevant to the reasonableness of the no-switching agreements. 99 The court considered the actual and potential impact of such agreements on the in-

97. See cases in note 96 supra.
98. Nichols v. Spencer Int'l Press, Inc., 371 F.2d 332, 335-37 (7th Cir. 1967). Acknowledging that the antitrust laws were not enacted to preserve freedom in the labor market or to regulate employment practices as such, the court nevertheless concluded that no-switching agreements restricted freedom to enter into employment relationships and thus impaired competition in the supply of a service. Id. at 335-36.

In Quinonez v. National Ass'n of Sec. Dealers, Inc., 540 F.2d 824 (5th Cir. 1976), the court held that agreements among security brokerage firms to deny employment to sales persons who were discharged by another firm, which allegedly impaired competition among the defendants, were sufficient as a matter of law to state a claim under the Sherman Act, but did not explain whether the labor market effect was independently significant. Id. at 829.

industry's competitive structure, finding that labor market effects were crucial to an accurate evaluation of the industry's structure.\textsuperscript{100} Finally, one court looked directly at the labor market impact of no-switching agreements among brokerage firms that also provided for fixed sales commissions, and found those effects within the ambit of antitrust prohibition.\textsuperscript{101} Despite their diversity in approach, the cases are important because they considered in an antitrust context the labor market effects of agreements regarding post employment restraints.

The similar effects of noncompetition and no-switching agreements on the market further strengthen the analogy between the two covenants.\textsuperscript{102} Both agreements hamper employee mobility and have a potential anticompetitive effect on the industry. In fact, a noncompete agreement can have an even greater deleterious effect on competition than a no-switching agreement, since a no-switching agreement restricts employee mobility only within the group of employers party to the agreement, while a noncompete agreement may effectively prevent an employee from working for any competitor in the same industry. If no-switching agreements violate the antitrust laws, noncompetition agreements that adversely affect competition are, a fortiori, illegal.\textsuperscript{103}

B. OVERCOMING RESISTANCE TO THE LABOR MARKET APPROACH

Despite the significant anticompetitive impact of noncompete agreements on the labor market, courts have been reluctant to analyze that market because they fear the approach does not satisfy the Sherman Act's interstate commerce re-

\textsuperscript{100} Id. The court found that no-switching agreements would diminish competition between existing agencies and would prevent potential competitors from entering the business by freezing the labor supply. Id. Since the industry's composition might become static to the advantage of the large, well-established agencies and to the disadvantage of infant organizations, the court concluded that the agreements impaired competition and violated section 1 of the Sherman Act, 15 U.S.C. § 1 (1976), and section 5(a) of the Federal Trade Commission Act, 15 U.S.C. § 45(a) (1976). The court did not examine impact on magazine sales, as a product market approach would dictate.

\textsuperscript{101} Cordova v. Bache & Co., 321 F. Supp. 600, 608 (S.D.N.Y. 1970). Although the court found that the agreement to reduce brokerage commissions was analogous to illegal price-fixing, it further observed that the agreement could restrain mobility on the part of the employees who would otherwise have the opportunity, in a competitive market for services, to move to higher paid positions. Id. at 606.

\textsuperscript{102} See Note, Antitrust Implications Arising From the Use of Overly Broad Restrictive Covenants for the Protection of Trade Secrets, supra note 14, at 316.

\textsuperscript{103} Id.
quirement, or is rendered useless by the Clayton Act's labor exemption. The commerce clause and the labor exemption, however, present no barriers to a labor market antitrust analysis of noncompete agreements.

Courts may feel compelled to focus on the product market because the jurisdictional reach of the Sherman Act requires that the restraint affect interstate markets and the interstate flow of goods. The statute specifically prohibits "every contract, combination . . . or conspiracy, in restraint of trade or commerce among the several States." Courts have not often thought in terms of an interstate commerce in labor; therefore, they continue to perceive the interstate market in terms of goods and services. Since 1937, however, courts have construed the commerce clause to give Congress broad power over both interstate and intrastate activities, including labor-management relations. The Supreme Court has construed the Sherman Act to reach local activities that "substantially and adversely affect" commerce. Therefore, an anticompetitive impact, either in an interstate product market or in an intrastate market that "affected" interstate trade in that product, would clearly bring a noncompetition agreement within the reach of the interstate commerce requirement. Labor market impacts "affect" interstate commerce in the same manner as product market impacts. A noncompetition agreement that restricted employment in more than one state would clearly involve interstate commerce for labor. Similarly, a more limited local covenant might "affect" interstate trade in labor by, for example, decreasing supply in that locality, thus impairing supply in a several-state area.

The interstate commerce provision has not forestalled antitrust analysis of analogous no-switching agreements that obviously impede labor mobility. The Supreme Court has acknowledged the federal antitrust jurisdiction of postemploy-

106. The plaintiff in Frackowiak v. Farmers Ins. Co., 411 F. Supp. 1309, 1314 (D. Kan. 1976), mistakenly couched his argument in terms of the product market, alleging that the noncompete clause prevented the free flow of insurance coverage. Since the plaintiff did not sell insurance, but only trained agents, the court found that his elimination from the employment market did not have "any effect whatsoever upon the quantity, quality, price, or 'free flow' of insurance policies available . . . in the interstate market." Id. at 1314.
ment restraints in its holding that "ships and those who operate them are instrumentalities of commerce and within the commerce clause no less than cargoes."\textsuperscript{109} Nor has the interstate commerce requirement immunized professional sports from the antitrust laws.\textsuperscript{110} A team blacklisting agreement, for example, could impair the quality of service provided, a product market effect, as well as impair freedom of employment, a labor market effect. The Supreme Court has held that a player who claimed he was denied employment opportunities because of an alleged blacklisting agreement did state a cause of action under section 4 of the Clayton Act.\textsuperscript{111}

Courts may also be reluctant to use the labor market analysis because they believe the Clayton Act\textsuperscript{112} exempts labor from antitrust examination. Section 6 states that "the labor of a human being is not a commodity or article of commerce."\textsuperscript{113} Defendants in a number of cases involving labor market restraints have argued that a noncompete agreement could not, under section 6, violate the antitrust laws as a matter of law.\textsuperscript{114} If labor is not an article of commerce, they argue, contracts, combinations, or conspiracies that restrain labor do not restrain interstate commerce, and thus do not violate section 1 of the Sherman Act.

The statutory labor exemption, however, should not prevent the application of antitrust law to noncompete agreements.\textsuperscript{115} Although the literal language of section 6 appears to

\textsuperscript{109} Anderson v. Shipowners Ass'n of the Pacific Coast, 272 U.S. 359, 363 (1926) (emphasis added).

\textsuperscript{110} See Mackey v. National Football League, 543 F.2d 606, 616 (8th Cir. 1976), cert. dismissed, 434 U.S. 801 (1977). The court noted the Sherman Act's interstate commerce requirement, observing that the NFL "operates in interstate commerce." \textit{Id.} at 616 n.19. The court found important labor market effects of the challenged Rozelle rule, which gave the commissioner the freedom, whenever a player became a free agent and signed a contract with a new club, to award players of the acquiring club to the former club as compensation. The court found that the rule deterred clubs from negotiating with and signing free agents, and thus deterred players from becoming free agents, decreased players' bargaining power in contract negotiations, and denied players the right to sell their services in a free and open market. \textit{Id.} at 620.


\textsuperscript{112} Ch. 323, 38 Stat. 731 (1914) (current version at 15 U.S.C. § 17 (1976)).

\textsuperscript{113} \textit{Id.} § 6 (current version at 15 U.S.C. § 17 (1976)).


\textsuperscript{115} In addition to a statutory labor exemption, courts have created a non-statutory exemption that protects some collective bargaining agreements that
exempt labor restraints from antitrust scrutiny, the language must be read in context. Courts have held that the sole purpose of the exemption was to permit the existence of labor unions, agricultural associations, and other organizations that would otherwise violate the antitrust laws by engaging in a collective activity such as a strike. The language immediately following the exemption explains its purpose: "Nothing contained in the antitrust law shall be construed to forbid... labor... organizations... nor shall such organizations, or the members thereof, be held... to be illegal combinations or conspiracies in restraint of trade... ." In both the no-switching and professional sports cases, courts have specifically rejected defendants' arguments that section 6 precludes antitrust analysis of the agreement at issue. The court in Cesnik v. Chrysler Corp., observing that the Supreme Court interprets section 6 as providing labor

have anticompetitive effects. See Note, Establishing an Objective Intent Standard for the Labor Antitrust Exemption: Consolidated Express, Inc. v. New York Shipping Association, 64 MINN. L. REV. 1275, 1284-85 (1980). The policy supporting exemption seeks "to balance the concern of antitrust law—the preservation of a competitive economy—with that of labor law—the regulation of the struggle for power between unions and employers in which unions seek to achieve a monopoly over the labor supply." Id. at 1292. Traditional interpretations of the exemption protect an agreement from antitrust scrutiny if it is not a business conspiracy, and if it is intimately related to a legitimate union goal. Id. at 1282. As long as a collectively bargained restrictive covenant met these criteria, it would be exempt. Under more recent tests that place greater emphasis on the actual and potential anticompetitive effects of the bargaining agreement, the noncompete agreement might not qualify for exemption. The answer depends on the resolution of this labor law dispute. For the purposes of this Note it is sufficient to observe that the non-statutory exemption, like the statutory labor exemption, presents no barriers to the antitrust scrutiny of non-collectively bargained restrictive covenants.


118. See Quinonez v. National Ass'n of Sec. Dealers, Inc., 540 F.2d 824, 829 (5th Cir. 1976); Nichols v. Spencer Int'l Press, Inc., 371 F.2d 332, 335 (7th Cir. 1967); Cordova v. Bache & Co., 321 F. Supp. 600, 605 (S.D.N.Y. 1970). In Quinonez, the court specifically rejected the applicability of the section 6 labor exemption, noting that the defendant brokerage firms were not labor organizations and the alleged agreements seemed "primarily designed to restrict the movement of the labor force in the industry rather than promote any legitimate labor objective." Id. at 829 n.9. See also Mackey v. National Football League, 543 F.2d 605, 617 (8th Cir. 1976), cert. dismissed, 434 U.S. 801 (1977).

union protection, 120 rejected defendant's contention that section 6 barred plaintiff's suit, and instead concluded, in light of prior cases, 121 that "the market for employee skills is a market subject to the provisions of the Sherman Act." 122 The court reasoned that alleged restraints on competition for employee services could be a form of restraint on trade under section 1 of the Sherman Act. 123 The analysis shows that the antitrust laws do not prevent courts from focusing on labor market effects of noncompete agreements.

V. A SUGGESTED APPROACH

Determining the boundaries of the relevant market is traditionally an important inquiry in antitrust cases. 124 Generally, the outer boundaries of the product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and its substitutes. 125 Within that broad market submarkets may exist, defined by industry or public recognition of the submarket, the product's peculiar characteristics or uses, unique production facilities, distinct prices, sensitivity to price changes, or specialized ven-

122. 490 F. Supp. at 864. Applying the rule of reason, the court found that plaintiff failed to demonstrate that the restraint was calculated to prejudice the public interest. Id. at 867. While the court based its decision on the lack of public injury, it also found that the restraint was reasonable under a rule of reason analysis. Id. at 868. Although the court used the more liberal "ancillary to sale of business" test of reasonableness, it would have been more appropriate to use the the more restrictive "ancillary to employment" test. See Blake, supra note 1, at 646-48. The sale of business test holds that a restraint is reasonable if it is calculated to protect the purchaser's interest in the business's goodwill, and unreasonable if its true purpose is to foster monopoly. 490 F. Supp. at 888. The court found that the purpose of the agreement was to increase the likelihood that the purchaser would enjoy the services of experienced employees (who were treated like goodwill of the business). The court found no reason to infer that the agreement fostered a monopoly on the market for employee services or any other market. Id. The use of the liberal sale of business test explains the court's failure to find either public injury or unreasonableness. The case's significance lies in its recognition of the labor market as a legitimate market for antitrust analysis.
123. Id. at 864.
124. See note 27 supra and accompanying text.
These same criteria can determine the boundaries and submarkets of the employee service or labor market. Economists have long recognized labor markets as legitimate objects of inquiry; their testimony should assist courts in defining the relevant labor market for particular agreements.

Analyzing the labor market should be no more difficult than analyzing the traditional product market. Professor Sullivan has devised seven factors in a product market context that courts can use as practical guides to assess the antitrust implications of employee noncompete agreements in the labor market. Under this approach, courts should: 1) look at the totality of the employer's restraints, not only at the particular contract in issue; 2) examine the industry-wide use of restraints to determine whether collectively they create general barriers to competition by locking in key employees; 3) assess the general state of competition in the relevant market; 4) inquire into the scope or force of the restraint; 5) consider

127. There is an exception, however, of unique production facilities, which could be reformulated as unique training facilities.
128. See notes 48-53 supra and accompanying text.
129. Sullivan, supra note 1, at 647-50. Sullivan actually developed only six factors, but since the sixth factor includes two components, this Note, for clarity, treats them as seven factors.
130. The number of contracts by one employer may, by their multitude, create a measurable effect on either the product or labor market, while one contract alone may have no empirically discernible impact. Furthermore, the focus on only one contract understates the antitrust impact of noncompete agreements because it ignores the potentially significant number of employees whose mobility is impaired because of the agreement's deterrent effects. See Sullivan, supra note 1, at 647.
131. A restraint that appears insignificant to an individual firm may have important adverse labor market effects if employed by a large number of firms in the industry. One effect may be to raise barriers to the entry of new firms, a condition that makes the long-run costs of a new entrant into a market higher than the long-run costs of the existing firms in the market. See R. Posner, supra note 65, at 227-28.
132. A reduction in competitiveness in a labor market approximating perfect competition would not violate antitrust policies as seriously as would anticompetitive practice in a less competitive market. This factor simply urges courts to consider the restraint's effect in the context of the relevant market. See Sullivan, supra note 1, at 648.
133. Courts should examine whether the employee is merely forbidden from copying the employer's list of customers and then soliciting that business for himself, or whether the employee is forbidden from working in any capacity related to his current one for any employer anywhere in the United States. Clearly a narrower restraint would have less adverse competitive impact than a broader restraint. Even a fairly narrow restraint, however, would not be justified if its avowed purpose is to protect employer interests already protected in a less restrictive manner by state unfair competition and trade secret law. A court should thus ask what interests the employer is attempting to protect,
the nature of the employee being restrained; closely examine employer motivations; and adopt the majority American rule that the proponent of a trade restraint bears the burden of proving it reasonable. In analyzing the antitrust

whether state law already protects these interests, and whether the restraint impairs the employee's mobility—and thus labor market competition—moderately or severely.

134. If the employees were sufficiently important in the industry involved, decreased competition in the labor market might adversely affect competition in the employer's product market. In a recent work on the structure of the computer industry, Professor Brock found that the area of the most substantial economies of scale is that of software. In the extreme case, software has effectively zero marginal cost because of the insignificant cost of duplicating a tape of the program. G. Brock, supra note 66, at 38. The link between a labor market restraint and impact on product market competition is admittedly attenuated, and is provable only in certain fact situations. The courts' unrealistic and rigid imposition of this factor as the only test of impact under current interpretations does not deny the factor's usefulness under a more comprehensive approach.

135. While arguably difficult problems of proof might be raised, the antitrust laws have often required examination of a defendant's motives. For example, they require that intent to monopolize be proved in a case under section 2 of the Sherman Act, or that a union prove lack of business conspiracy to qualify for the non-statutory exemption. In addition, illegitimate motives could probably be inferred from the defendant's failure to prove legitimate justifications for the restraint.

An employer who intends only to protect confidential information and customer relations with a noncompetition agreement would not be likely to consider the restraint's labor market impact. The judicial balancing process must nevertheless weigh both product and labor market impacts against the employer's justifications. Omitting labor market impact from that calculation encourages a finding of legitimate employer justification. The requirement that courts examine the labor market effects of noncompetition agreements implies that employer justifications must be stronger than they have been in the past to prevail. At the same time, recognition that noncompete agreements adversely affect the labor market illuminates a host of potentially illegitimate employer interests. For example, an employer's desire to raise entry barriers to new competition or to increase labor costs, thus decreasing the profit margins of existing rivals by restricting the availability of key employees, is an illegal objective under the Sherman Act.

136. See Sullivan, supra note 1, at 649. "[T]he burden of showing unreasonableness of a restraint of trade, except where there is a per se violation ... is on the plaintiff." United States v. Empire Gas Corp., 537 F.2d 296, 308 (8th Cir. 1976).

Currently the employee must prove that the restraint is unreasonable by showing adverse impact on competition in the product market. If the employer had the burden of proving reasonableness of the restraint, the employee challenging the restraint would present a prima facie case of unreasonableness merely by proving the agreement's existence, forcing the employer to rebut the claim of unreasonableness by coming forward with legitimate justifications for the restraint. The employee could respond with evidence attesting to the restraint's adverse competitive impact on both the labor and product markets. Since the burden of persuasion would also fall on the employer, the employee would receive the benefit of the doubt in close cases. This simple procedural shift in the burden of proof would increase the employee's chance of demonstrating that a noncompetition agreement violates the antitrust laws.
impact of noncompete agreements on the labor market, courts should give full emphasis to the labor market as an important independent area of investigation.\textsuperscript{137} The courts should avoid reliance on a product market bootstrap while continuing to define and analyze the product impact separately. The labor market definition and analysis would supplement, not replace, product market investigation.

VI. CONCLUSION

Current analysis of noncompete agreements under state contract law inadequately protects employee and public interests. The few cases that have raised the antitrust implications of such agreements have been unsuccessful largely because courts analyze the agreement's impact on the product market instead of on the labor market. The agreement's major anticompetitive effect, however, occurs in the labor market and it is that market that courts should examine. The shift in focus advocated by this Note would enable employees to defend the interests that the antitrust laws protect.