

*Before the*

**FEDERAL TRADE COMMISSION**

In the Matter of Non-Compete Clause Rulemaking

Matter No. P201200

**Comments of Engine Advocacy**

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# Executive Summary

## *Startups Drive American Innovation.*

### **Today's stars were yesterday's startups.**

- Apple, Microsoft, Google, Amazon, Meta, Tesla, Netflix, Uber, Airbnb, and other innovative giants were once conventional startups—small, scrappy, and backed by funding that believed in founders, a pitch deck, and a dream.
- Of companies founded after 1968 and went public after 1978, venture-backed startup companies account for 92% of R&D spending and 93% of patent value. And these stats underestimate the impact of startups—the vast majority of startups will never receive venture capital, and some startups never seek VC funding in the first place.
- The top 6 companies on Forbes' 2022 list of the World's Most Innovative Companies are US companies that were once conventional startups.

## *Noncompetes Saddle America's Startup Ecosystem with Unnecessary Legal Complexity.*

### **Non-competes are governed by a patchwork of uncertain state law.**

- Only three states categorically ban non-competes, while the remaining 47 use complex “reasonableness” tests that vary from state-to-state, time-to-time, and industry-to-industry.

### **Navigating the patchwork of state law has costs: money, time, and opportunity—three things startups cannot afford to lose.**

- If the startup wants to do the legal analysis, it will spend *money* on counsel fees.
- Whether the startup pays for the legal analysis or moves on to the next applicant, it will spend more *time* making the hire.
- And where the startup passes over an applicant subject to an unenforceable non-compete (whether due to incorrect legal advice or a strategy of absolute avoidance), it loses an *opportunity*.

## *Banning Non-Competes Will Create a Freer Market for Startups to Thrive.*

### **More founders from more backgrounds will start new, promising companies.**

- Banning non-competes will free top talent at established companies to become founders—within-industry founders are best positioned to increase competition and drive innovation.
- Non-competes disproportionately harm women, limiting women from becoming founders.

### **Startups will have a freer talent pool to draw and learn from, leading to better teams and greater success.**

- Non-competes restrain founders from recruiting talented employees that currently work in related fields—the exact employees with expertise that startups need.
- Mentorship is critical to startup success, and non-competes can restrain seasoned founders from counseling, advising, and investing in new founders.

# Introduction

Engine is a non-profit technology policy, research, and advocacy organization that bridges the gap between policymakers and startups. Engine works with government and a community of thousands of high-technology, growth-oriented startups across the nation to support the development of technology entrepreneurship through economic research, policy analysis, and advocacy on local and national issues. Engine appreciates the opportunity to submit this response to the Federal Trade Commission's request for comment on the Commission's notice of proposed rulemaking banning most non-compete clauses in employment contracts.

The Commission's Proposed action on non-competes is an opportunity to make our markets more competitive and our workforce more dynamic. It is also an opportunity to bring clarity and freedom to American startups and entrepreneurs to maximize innovation.

First, as a legal instrument governed by a patchwork of state laws, non-competes create geographic distortions in an increasingly national startup ecosystem. Talent is everywhere, and the advent of practices like remote work should create an era of unprecedented talent mobility. And yet, non-competes distort the playing field by creating "unfavorable" geographic regions. What's more, navigating the legal uncertainty created by the patchwork of state law especially harms resource-strapped firms like startups.

Second, non-competes interfere with two critical stages in a startup's lifecycle: formation and team assembly. Any time that a would-be founder is kept from starting a potential competitor is time wasted. Competition and innovation are sacrificed at the altar of protectionism. And, in some cases, competition and innovation are estopped altogether when would-be founders never return to the fold after being sidelined by a non-compete. Even once a startup has overcome the barrier of formation, non-competes still meddle by impeding—or altogether preventing—the founder from assembling the right team. And without the right team, a startup is destined for failure.

Finally, non-competes insulate today's winners from competition, denying startups the meritocratic marketplaces in which they can compete with bigger players. However, a ban on non-competes will free up more than just our competition markets: It will free groups of underrepresented would-be founders—particularly women—from the restrictive impacts of non-competes that they disproportionately bear. More diversity means more and better innovation, but non-competes only get in the way.

Although startups would benefit most from Congressional legislation, the FTC's proposed ban is a good first step in creating a freer and more diverse startup ecosystem to do what it does best: drive American innovation.

# The FTC Should Ban Non-Competes with Extremely Limited Exceptions

## I. A National, Categorical Ban Will Create the Clarity that Startups Need to Succeed.

Navigating the current law of non-competes challenges startups in two major ways. First, non-competes are governed by a patchwork of state laws despite startup operations, employees, and contractors increasingly being spread throughout the country. Second, in the vast majority of states, the non-compete law is built on a “reasonableness” standard—resource-strapped startups do not have the time or resources to get counseled on what this means for hiring their next engineer. Federal policymakers should establish a clear rule across the country.

### *A. A National Ban Will Create Geographic Uniformity and Level the Playing Field Across the Startup Ecosystem.*

Startups are everywhere because talent and ideas are everywhere.<sup>1</sup> But non-competes keep that talent from being *accessible* everywhere. Startup success must reflect the merits of ideas and not the zip codes of operations and talent.

Despite startups and talent being spread across the country, non-compete enforceability is a patchwork of state law. The Commission has compiled an extensive survey of the state statutory and common law governing non-compete enforceability and highlighted the many differences between them.<sup>2</sup> These differences distort the starting line in a competitive race to bring innovation to market.

Startups constantly operate at the intersection between breakthrough and failure, often battling competitors on their merits to establish the best product or service. In an ecosystem built on the slimmest of margins, any daylight between one startup and the next can be the difference between success and failure. In truly healthy and competitive national markets, differences in outcomes should result from differences in the fundamental quality of firms—not exogenous legal factors. The disparate enforceability of non-competes coupled with existing regional biases unnecessarily renders the steep climb of some startups even steeper.

Consider the Washington, D.C. metro area. D.C. is a rapidly growing and Top 10 startup ecosystem by deal count and deal value.<sup>3</sup> D.C., Virginia, and Maryland, however, use different methods to determine the enforceability of non-competes, and the disparity has consequences for startups: a starting software engineer making \$125K in salary could be subject to an enforceable non-compete

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<sup>1</sup> Engine currently serves startups in all 50 states.

<sup>2</sup> Non-Compete Clause Rule, 88 Fed. Reg. 3482, 3493, 3496 (Jan. 19, 2023) (to be codified at 16 C.F.R. pt. 910) [hereinafter NPRM].

<sup>3</sup> See PITCHBOOK, VENTURE MONITOR: Q4 2022, at 19.

in Maryland and Virginia, but not in D.C.<sup>4</sup> A young engineer should not have her career mobility restricted only because she took her first job across the Potomac. What’s more, the disparate treatment unnecessarily undermines remote worker mobility and tees up complex choice-of-law issues (discussed in greater detail below).

By taking federal action, the Commission’s proposed ban would help to level one critical aspect of the competition playing field: access to talent. With remote work and investment attention increasingly directed to new and diverse startup ecosystems, we should be entering into a golden era of startup growth and talent mobility across the country. Startups everywhere should be able to rely on a clear playbook for talent acquisition.

*B. A Categorical Ban Minimizes Uncertainty for Resource-Strapped Startups.*

A Texas startup wants to hire a remote engineer in Washington state, who is subject to a non-compete clause with a former employer that claims to be governed by the law of Delaware. Which law applies? What is the result under that state’s law? And does it matter whether the engineer is hired as an employee or a contractor? That the engineer was highly compensated at their previous employer? That the previous employer is a Delaware corporation and has a small, satellite office in Austin?

This is a real-world issue faced daily by countless startups across the country—and the possible permutations of the issue are endlessly complex and fact-intensive. So not only is national direction necessary, but that direction must also be clear and categorical to the greatest extent possible. The FTC correctly embraces a categorical ban on non-competes that greatly reduces legal uncertainty across three dimensions: (1) which *law* applies, (2) is the non-compete *enforceable* under that law, and (3) what is the *remedy* if the non-compete is unenforceable?

Three states have used statutes to make non-competes mostly unenforceable and to resolve choice-of-law conflicts. Everywhere else, it remains a headache. Out of the 47 states that have not statutorily banned non-competes, most employ a reasonableness inquiry in determining enforceability. As a fact-intensive standard, there is no clear rule in how the law will be applied case by case. Over time, what is “reasonable” has differed from state to state and from industry to industry.<sup>5</sup>

But the patchwork issue runs even deeper than mere enforceability standards: Legal analysis may also face a complex choice-of-law question. The Commission, too, has examined this issue in great detail and has explained that the choice-of-law question can be outcome determinative, can place a greater burden on the less sophisticated employee, and can even create a race to the courthouse.<sup>6</sup>

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<sup>4</sup> Compare District of Columbia, D.C. Code sec. 32-581.02(a)(1) (effective Oct. 1, 2022) (non-competes are unenforceable for employees whose compensation is less than \$150,000, or less than \$250,000 if the employee is a medical specialist), with Maryland, Md. Code Ann., Lab. & Empl. sec. 3-716(a)(1)(i) (effective Oct. 1, 2019) (non-competes are unenforceable for employees who earn equal to or less than \$15 per hour or \$31,200 per year), and Virginia, Va. Code Ann. sec. 40.1-28.7:8(B) (effective July 1, 2020) (non-competes are unenforceable for employees whose average weekly earnings are less than the Commonwealth’s average weekly wage).

<sup>5</sup> See generally ORLY LOBEL, TALENT WANTS TO BE FREE 53-57 (Yale Univ. Press 2013).

<sup>6</sup> See NPRM, *supra* note 2, at 3495-96; Application Group, Inc. v. Hunter Group, Inc., 61 Cal. App. 4th 881 (1998).

Forum-selection and mandatory arbitration clauses create even more uncertainty, which the Commission has also noted.<sup>7</sup>

And even if the *enforceability* of a non-compete is relatively predictable, courts may inject fresh uncertainty in creating the remedy. Again, the Commission has noted the differences between the “equitable reform,” “blue pencil,” and “red pencil” methods for reforming an unenforceable non-compete,<sup>8</sup> but none offer sufficient clarity.

This is a complicated legal landscape. **Navigating each stage in this uncertain patchwork has costs: money, time, and opportunity—three things startups cannot afford to lose.**

**Founder Testimony:** “We made an executive hire who was covered by a noncompete from a larger company. We had to think very hard about whether, as a startup, we could afford to take on the risk. Ultimately we relied on goodwill, but the uncertainty the noncompete created was in no one's best interest.”

Matthew Caywood, Actionfigure. Washington, DC

Startups operate with finite resources, slated to last a short period of time. Time is money, and that money is almost always coming from the founders’ own pockets, investors, or alternative forms of financing. It is in tight supply—for many underrepresented founders, it is even tighter<sup>9</sup>—and unless the business shows continual progress, it will dry up.

No startup enjoys paying fees for legal counsel. Few startups even have the luxury. Money spent on counsel can be necessary and worthwhile, but it always represents an opportunity cost—products and services need to be developed and brought to market, and time and money unnecessarily spent on anything else impedes progress.

The average seed stage startup, for example, only has \$55,000 a month in resources.<sup>10</sup> After payroll and expenses, startups have extremely little wiggle room to cover additional costs like hourly fees from legal counsel.

For these reasons, many startups (outside of states with statutory bans, like California) will see that a prospective hire has a non-compete and end recruitment right there. The startup does not have the time or the money to figure out whether the non-compete is enforceable. In many cases, it likely isn't, so the startup has lost the opportunity to hire talent.

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<sup>7</sup> NPRM, *supra* note 2, at 3495-96.

<sup>8</sup> *Id.* at 3495.

<sup>9</sup> *See, e.g.*, PITCHBOOK, ALL IN: FEMALE FOUNDERS IN THE US VC ECOSYSTEM 4-5 (2022) (showing lower pre-money valuations for female-founded startups as compared to male-founded startups at similar points in their lifecycle).

<sup>10</sup> ENGINE, STARTUP POLICY AGENDA: HOW POLICYMAKERS CAN BE STARTUP CHAMPIONS 4 (2023), <https://perma.cc/S2H8-WLFY>.

This means that the patchwork of state law and enforceability poses a triple threat to resource-strapped firms like startups:

- If the startup wants to do the legal analysis, it will spend *money* on counsel fees.
- Whether the startup pays for the legal analysis or moves on to the next applicant, it will spend more *time* making the hire.
- And where the startup passes over an applicant subject to an unenforceable non-compete (whether due to incorrect legal advice or a strategy of absolute avoidance), it loses an *opportunity*.

By adopting a rule with a categorical ban as its cornerstone, the FTC is building a foundation of certainty on which startups and other resource-limited firms can rely on in their uphill fight to secure top talent.

## II. A Categorical Ban Will Free Startups to Maximize Innovation.

It's no secret that America's startups of yesterday are to thank for many of the world's innovations of today: the smartphone, the electric car, cloud computing, the reusable rocket, and more. If innovation is a race, startups are behind the wheel. But non-competes are a redundant roadblock: they hinder both the formation and talent recruitment of startups, just as other sufficient legal mechanisms stand ready to protect innovation and investment.

### *A. Startups Drive American Innovation.*

Apple. Microsoft. Google. Amazon. Meta. Tesla. Netflix. Uber. Airbnb. These American companies represent a rich history of innovating across devices, computing, virtual reality, electric vehicles, entertainment, travel, and more. But these companies also were, at one point in time, conventional startups—small, scrappy, and backed by funding that believed in founders, a pitch deck, and a dream. **Today's stars were yesterday's startups.**

In 2015, companies that were once venture-backed startups accounted for 41% of total US market capitalization and 63% of R&D spending by US public companies.<sup>11</sup> If the universe of companies is confined to the modern era of startups and venture capital (i.e., companies that were founded after 1968 and went public after 1978) the impact is staggering: “VC-backed companies account for half of these recent companies by number and three quarters by value, as well as, remarkably, generating 92% of R&D spending and 93% of patent value.”<sup>12</sup> Given the onward march of technology and high-growth companies since then, the economic impact is likely even greater today. And these stats underestimate the impact—the vast majority of startups will never receive venture capital (and even most of those that do will fail), and some startups never seek VC funding in the first place. And yet, their positive impacts across American innovation, labor markets, and entrepreneurship are immense. It takes startups of all stripes to fill the many diverse niches of a vibrant ecosystem.

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<sup>11</sup> Will Gornall & Ilya A. Strebulaev, *The Economic Impact of Venture Capital: Evidence from Public Companies* 3 (June 2021) (unpublished manuscript), <https://perma.cc/M4QD-BPES>.

<sup>12</sup> Gornall & Strebulaev, *supra* note 111111, at 3, 17.



Economic impact is often a proxy for innovative impact, but the case is even clearer for startups and venture-backed companies: **The top 6 companies on Forbes’ list of the World’s Most Innovative Companies are US companies that were once startups receiving extensive venture backing during their early stages.**<sup>13</sup>

There is no shortage of literature hypothesizing *why* startups have such an outsized impact on American innovation.<sup>14</sup> And while the reasons for the innovativeness of a particular startup can only be guessed at, the outsized impact of a healthy startup ecosystem on nationwide innovation requires no guesswork.

*B. By Hindering Startup Formation and Success, Non-Competes Hinder National Innovation.*

**Worker mobility is a critical feature of a vibrant startup ecosystem.** The story of success of the American startup ecosystem is a story of unfettered worker mobility—when nothing can come between the right idea attracting the right talent, innovation takes place on a staggering scale.

When worker mobility is constrained, fewer startups are formed, and those that are formed struggle to secure talent. When startups suffer, innovation suffers. As perhaps the single most restrictive legal device on worker mobility, non-compete agreements hinder national innovation by hindering startup formation and success.

1. Company Formation

Worker mobility is key at every stage of a startup’s lifecycle. Workers unable to leave their current employers—including by way of a non-compete—cannot start their own competitor companies. Recent research from the Economic Innovation Group (EIG) shows that a ban on non-compete agreements can positively impact business formation in the technology industry.<sup>15</sup>

In 2015, Hawaii banned non-competes for “any employment contract relating to an employee of a technology business.”<sup>16</sup> The reform also included a ban on co-worker non-solicitation covenants. EIG’s study found that Hawaii’s ban on non-competes for tech workers resulted in a 10.2 percent increase in the number of “technology establishments” and seeded skilled technology workers across the labor market.<sup>17</sup> To no one’s surprise, more mobile tech workers led to more tech startups.

While it is too early to gauge the positive innovation and economic impacts that will come out of Hawaii’s revitalized startup scene, it is likely to ripple across the technology industry. Due to the specialized skills and know-how that employees develop within their industry, the most successful

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<sup>13</sup> *The World’s Most Innovative Companies*, FORBES, <https://perma.cc/L9L3-AVW2> (last updated May 12, 2022).

<sup>14</sup> See, e.g., Jeremy Jurgens, *How Startups Drive Economic Recovery While Growing Responsibly*, World Econ. Forum (May 12, 2022), <https://perma.cc/GE58-KMAM> (“Technology startups are more than catalysts for growth. They are the engine of growth itself. They solve problems no other sector is addressing with innovative thinking, thus pushing society forward - all while creating jobs, stimulating the economy, and attracting foreign investment.”); KPMG, *WHY ARE BIG BUSINESSES LOOKING TO START-UPS FOR INNOVATION?* 12 (2015), <https://perma.cc/3Z35-3R61> (“Start-ups are at the forefront of innovation. They disrupt the market and represent everything big business isn’t.”).

<sup>15</sup> See BENJAMIN GLASNER, *THE EFFECTS OF NONCOMPETE AGREEMENT REFORMS ON BUSINESS FORMATION: A COMPARISON OF HAWAII AND OREGON* (2023).

<sup>16</sup> *Id.* at 4.

<sup>17</sup> *Id.* at 2, 6.

and innovative startups tend to have within-industry alumni as their founders. The numbers speak volumes:

<b>Company Alumni</b>	<b>Number of Startups Founded</b>	<b>Unicorns</b>	<b>Investment Raised</b>
Google <sup>18</sup>	2,801	65	\$108.09B
Microsoft <sup>19</sup>	3,579	47	\$67.66B
Meta <sup>20</sup>	812	24	\$38.13B
Amazon <sup>21</sup>	1,405	18	\$24.23B
Apple <sup>22</sup>	984	6	\$16.89B

The Commission, too, has collected literature on this phenomenon, including the connection between VC investment and new business formation,<sup>23</sup> as well as the success of within-industry spinouts (WSOs).<sup>24</sup> Yet despite the staggering impact, there is reason to think it could have been greater—leaders in Boston’s startup scene, for example, have seen Massachusetts’s prior history of strictly enforcing non-competes delay new entity formation, thus explaining “why Boston didn’t become the next Silicon Valley.”<sup>25</sup> And despite the success, establishing within-industry competitors is exactly the type of entrepreneurship that highly enforceable non-competes quashes.

Consider aerospace, one of the most cutting-edge, innovative industries. Modern-day aerospace companies are building 3D printed rockets, hypersonic passenger aircraft, carbon-fiber rockets, and more. An observer would be hard-pressed to find an innovative startup that was not founded by a senior employee at a larger within-industry competitor.

<sup>18</sup> *Startups by Google Alumni*, TRACXN, <https://perma.cc/M5K7-ZB3C>, (last updated Jan. 11, 2023).

<sup>19</sup> *Startups by Microsoft Alumni*, TRACXN, <https://perma.cc/KP4A-ZPFR>, (last updated Jan. 11, 2023).

<sup>20</sup> *Startups by Facebook Alumni*, TRACXN, <https://perma.cc/LP4N-LN9P>, (last updated Jan. 11, 2023).

<sup>21</sup> *Startups by Amazon Alumni*, TRACXN, <https://perma.cc/7C9H-2JY5>, (last updated Jan. 11, 2023).

<sup>22</sup> *Startups by Apple Alumni*, TRACXN, <https://perma.cc/A36W-BRCT>, (last updated Jan. 11, 2023).

<sup>23</sup> See NPRM, *supra* note 2, at 3491-92.

<sup>24</sup> *Id.*

<sup>25</sup> Imani Webb, #StartupsEverywhere: Boston, Mass., ENGINE (July 7, 2022), <https://perma.cc/CF88-BASC>.

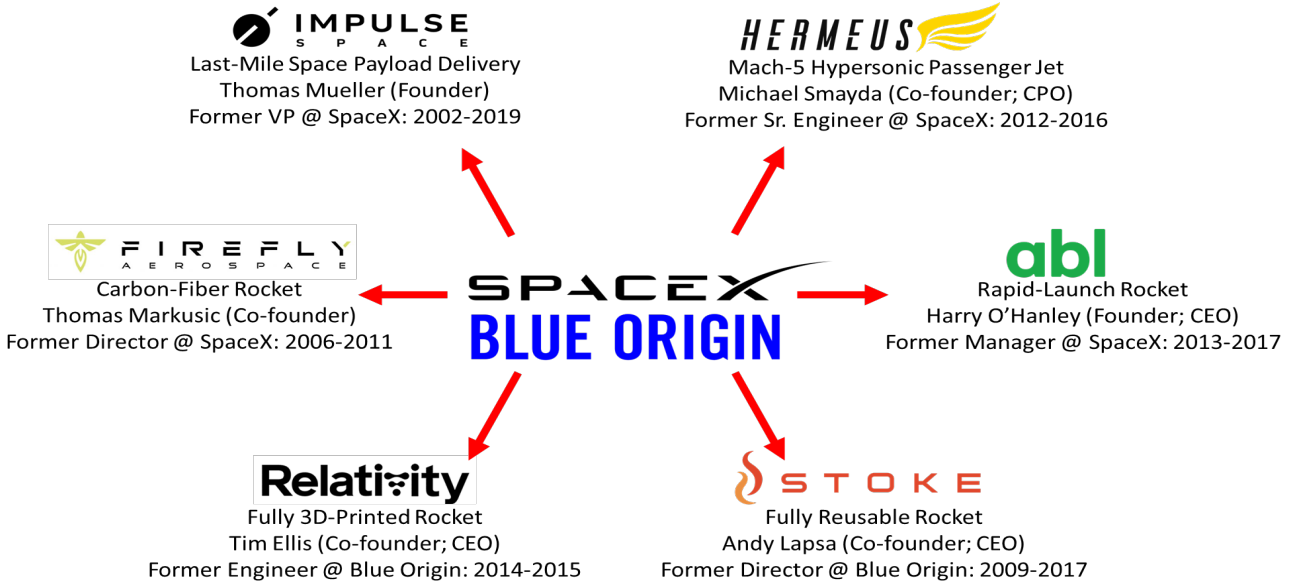


Figure 1: Sample of aerospace startups founded by senior alumni of SpaceX and Blue Origin

While we have no way of knowing whether these founders were theoretically restrained by a non-compete, their self-reported employment history<sup>26</sup> suggests that they moved between companies as if they had little to no constraints. The transitions also speak to another truth: Often, even a “short” non-compete (say, six months) would result in irreparable loss for entrepreneurs in industries that rapidly evolve day-to-day, let alone from winter to summer.

Even if these founders were subject to non-competes that simply weren’t enforced against them, what role does the non-compete even serve? If reputational or other factors would keep an employer from enforcing the non-competes of its former employees, then those non-competes only

<sup>26</sup> Tim Ellis, LINKEDIN, <https://www.linkedin.com/in/tim-ellis-11167172> (last visited Mar. 14, 2023).

- Relativity Space (Co-founder/CEO): Jan 2016 – Present
- Blue Origin (Engineer): Jan 2015 – Dec 2015

Andy Lapsa, LINKEDIN, <https://www.linkedin.com/in/andylapsa> (last visited Mar. 14, 2023).

- Stoke Space (Co-founder/CEO): Oct 2019 – Present
- Blue Origin (Director): Apr 2009 – Sep 2019

Thomas Mueller, LINKEDIN, <https://www.linkedin.com/in/thomas-mueller-2094513b> (last visited Mar. 14, 2023).

- Impulse Space (Founder/CEO): June 2021 – Present
- SpaceX (VP): May 2002 – Jan 2019

Harry O’Hanley, LINKEDIN, <https://www.linkedin.com/in/harry-o-hanley-27087382> (last visited Mar. 14, 2023).

- ABL Space Systems (Founder/CEO): Aug 2017 – Present
- SpaceX (Manager): Mar 2013 – May 2017

Thomas Markusic, LINKEDIN, <https://www.linkedin.com/in/thomas-markusic-81a5889> (last visited Mar. 14, 2023).

- Firefly (Co-founder): Jan 2014 – Present
- Virgin Galactic (VP): Dec 2013 – Present
- Blue Origin (Sr. Engineer): Apr 2011 – May 2011
- SpaceX (Director): Jun 2006 – Apr 2011

Michael Smayda, LINKEDIN, <https://www.linkedin.com/in/michaelsmayda> (last visited Mar. 14, 2023).

- Hermeus (Co-founder; CPO): Nov 2018 – Present
- SpaceX (Sr. Engineer): June 2012 – Apr 2017

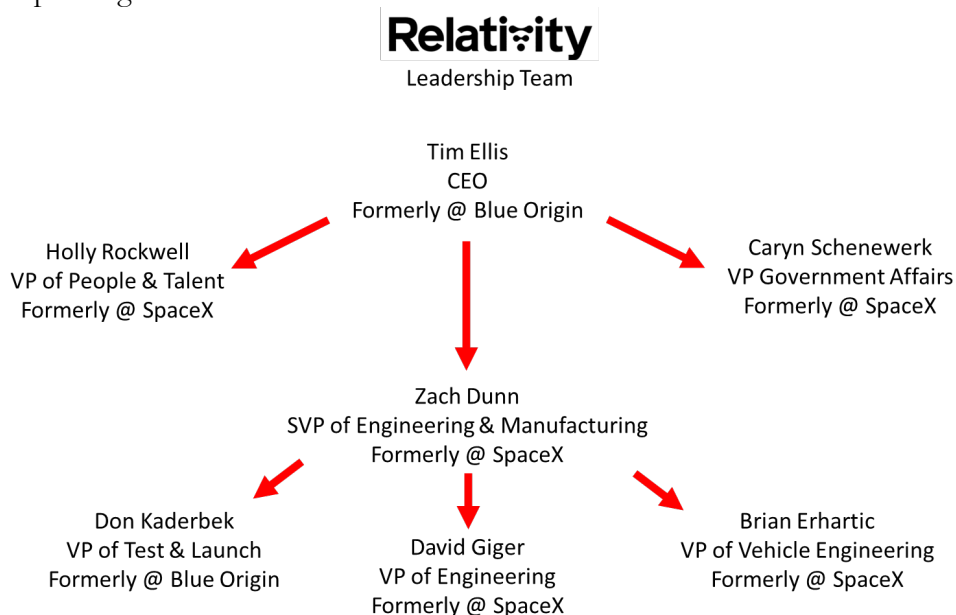
serve to chill the mobility of employees who *think* they might be enforced—and studies have shown this disproportionately harms women.<sup>27</sup>

Put simply, non-competes delay and prevent would-be founders from ever pursuing their vision, whether that be developing a new idea or improving an existing product. Delays keep star talent on the bench for longer than necessary and slow the innovation race. But for those entrepreneurs for whom a non-compete tips the scale from ever taking up the founder’s mantle, the harm to the startup ecosystem is irreparable.

## 2. Team Assembly, Development, and Success

Forming a startup is only the beginning. Founders are then tasked with assembling talented employees to turn their innovative visions into reality. Non-compete agreements, however, impede team formation by restraining talent from finding its way to where it will have the greatest impact—to where it is needed *now*. Again, even enforceable yet short duration non-competes cause major problems—6 months is an eternity in today’s startup ecosystem. The stakes of being restrained from assembling the best, talented team could not be clearer: The Commission will be hard-pressed to find a write-up on “Why Startups Fail” that does not list some variation of “Failure to Assemble the Right Team” as a principal reason.<sup>28</sup>

Relativity Space, an aerospace company preparing to launch the first ever 3D-printed rocket, has assembled an internal team of SpaceX veterans. These “ex-SpaceXers” already learned to build production-grade rockets while at SpaceX. That experience has proven invaluable as these same employees prepare to push the envelope further at Relativity Space: to do what they already did, but now, with 3D printing.



<sup>27</sup> See *infra* Part III.B.

<sup>28</sup> See, e.g., TOM EISENMANN, WHY STARTUPS FAIL (2021) (“Good Idea, Bad Bedfellows”); *The Top 12 Reasons Startups Fail*, CBInsights (Aug. 3, 2021), <https://perma.cc/CHS3-F8TX> (“Not the right team”); Ranjay Gulati & Vasundhara Sawhney, *Why Your Startup Won’t Last*, Harv. Bus. Rev. (Dec. 16, 2019), <https://perma.cc/3DMA-C9LG> (“Spotting the Right Talent”); *Why Do Startups Fail?*, BBVA (June 25, 2018), <https://perma.cc/P5RG-TURL> (“Team failure”).

Figure 2: Relativity Space Leadership Team<sup>29</sup>

If non-competes were strictly enforced, startups like Relativity Space would have needed to spend more time, money, and energy to assemble their teams of experienced employees.

Related to the issue of team assembly is the issue of mentorship. Approximately 70% of small business founders who receive mentoring survive for at least five years—twice the survival rate of those without mentorship.<sup>30</sup> Mentoring startups has even been called “the ‘secret sauce’ of corporate innovation,”<sup>31</sup> and who better to mentor a new founder than a founder who has been there before? And yet, when broadly applied, non-competes can even keep exited founders from counseling, advising, or investing in other startups. This slows both knowledge sharing and the development of collaboration networks, both of which are critical to idea generation, innovation, and ecosystem development.<sup>32</sup>

### *C. Non-Competes Are Unnecessary to Safeguard Innovation.*

Trade secret law and NDAs render non-competes unnecessary. Advocates for non-competes argue that a ban could somehow hinder innovation.<sup>33</sup> They worry that a ban would deter employers from investing in employee-development and R&D, fearing that those employees will soon go somewhere else, taking the training and knowledge with them. And without investment in human capital and R&D, innovation will suffer. But the exact opposite might be true—employers might invest more in human capital in order to increase employee satisfaction and retain talent. Furthermore, trade secret protections and NDAs are existing legal tools specifically designed to address investment, R&D and innovation concerns.

#### 1. Trade Secret Law

Both federal and state law protect trade secrets from misappropriation. Federal law not only provides a civil cause of action for trade secret misappropriation, but it also provides for criminal liability in specific circumstances.<sup>34</sup> Additionally, every state protects trade secrets under state law, whether through adoption of the Uniform Trade Secrets Act (UTSA), common law, or statute.<sup>35</sup> Employers can rely on this double-layered safety net to ensure company secrets do not leave, but

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<sup>29</sup> This leadership team chart is inferred from public information on the Relativity Space website. See *Expanding the Possibilities for Human Experience*, RELATIVITY, <https://web.archive.org/web/20230120162826/https://www.relativityspace.com/mission>.

<sup>30</sup> Abdo Riani, *Why Mentors Are Vital for New Startup Founders*, FORBES (Aug. 29, 2022, 4:59 PM), <https://perma.cc/PDM6-VN4N>.

<sup>31</sup> Illai Gescheit, *Why Mentoring Startups Is the ‘Secret Sauce’ of Corporate Innovation*, SIFTED (Feb. 15, 2022), <https://perma.cc/H8MF-QZZ5>.

<sup>32</sup> See Sharon Belenzon & Mark Schankerman, *Spreading the Word: Geography, Policy, and Knowledge Spillovers*, 95 REV. ECON. & STAT. 884, 886 (2013) (“showing that noncompete statutes [negatively] affect not only labor mobility directly, but also the knowledge diffusion that labor mobility generates.”); Orly Lobel, *Noncompetes, Human Capital Policy & Regional Competition*, 45 J. OF CORP. L. 931 (2020).

<sup>33</sup> NPRM, *supra* note 2, at 3505 (explaining that “the most commonly cited justifications for non-compete clauses are that they increase an employer’s incentive to make productive investments—such as investing in trade secrets or other confidential information, sharing this information with its workers, or training its workers—because employers may be more likely to make such investments if they know workers are not going to depart for or establish a competing firm.”).

<sup>34</sup> See *id.* at 3506.

<sup>35</sup> *Id.*

that a worker’s skills and general knowledge can. Trade secret law directly protects the former without impeding the latter.

Proponents for non-competes raise two main concerns for relying on trade secret law: (1) the law only operates once the secret has been leaked, and (2) the law only operates if an employer proves that a trade secret exists in the first place, a potentially difficult feat. Neither of those concerns carries weight.

First, several states allow employers to invoke the “inevitable disclosure” doctrine under their state law. In such states, a preliminary injunction can prevent a worker from taking up a new job if their previous employer can show that the employee will “inevitably disclose” trade secrets to the new employer.<sup>36</sup> This creates a *preventative* tool for employers to preserve their secrets by invoking trade secret law *before the secret gets leaked*. However, some states—including California—do not adopt this doctrine.<sup>37</sup> But the success of California-based technology companies proves that neither enforceable non-competes nor an “inevitable disclosure” doctrine is necessary to spur innovation.

Second, the burden of proving the existence of a trade secret does not render trade secret protections unattainable—even for startups—nor does it require significant costs. Startups already rely on trade secrets for protection,<sup>38</sup> often for their simplicity and the breadth of subject areas that they can reach: everything from algorithms to recipes.<sup>39</sup> All companies—from multi-national behemoths to scrappy startups—can rely on robust and accessible trade secret law protections for their valuable know-how that does not already fall under other IP protections.

## 2. Non-Disclosure Agreements

Employers can also rely on non-disclosure agreements (NDAs) to protect their ideas. These agreements prevent the employee from disclosing any information the contract designates as confidential, which will almost always include trade secrets and know-how not broadly shared in the industry.<sup>40</sup> Like a non-compete, an NDA prevents an employee from sharing certain information with other employers or competitors. Unlike a non-compete, NDAs do not restrain the geographic mobility of the worker. NDAs rightfully restrain *what* the employee says, not *where* the employee goes. And while no “inevitable disclosure” doctrine exists for NDAs, NDAs can provide for liquidated damages like any other contract, creating some additional shield disincentivizing disclosure in the first instance.

All major companies, including startups, are accustomed to relying on the ease of NDAs for protecting sensitive information. A variety of accessible NDA templates exist online for those small

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<sup>36</sup> See e.g., *PepsiCo, Inc. v. Redmond*, 54 F.3d 1262, 1272 (7th Cir. 1995) (affirming an injunction barring an employee from working for a competitor for six months because it was inevitable that he would rely on PepsiCo’s information).

<sup>37</sup> California courts, for example, refuse to apply the inevitable disclosure doctrine because of its restrictive effect on worker mobility. See *Whyte v. Schlage Lock Company*, 101 Cal.App.4th 1443 (2002) (holding that California rejects the inevitable disclosure doctrine).

<sup>38</sup> David S. Levine & Ted Sichelman, *Why Do Startups Use Trade Secrets?*, 94 NOTRE DAME L. REV. 751, 754 n.6 (2019).

<sup>39</sup> *Id.* at 756-57.

<sup>40</sup> NPRM, *supra* note 2, at 3506-07.

businesses and startups looking to craft an NDA.<sup>41</sup> And while NDAs are a reliable and cheap form of protection, the FTC’s “functional test” will appropriately constrain the weaponization of overly broad NDAs as de facto non-competes.<sup>42</sup>

With legal tools like trade secrets and NDAs already available to protect the sensitive ideas that lead to innovation, non-competes’ only purpose is to restrain worker mobility and competition, making our markets less free.

### III. A Categorical Ban Will Grow and Diversify the Startup Ecosystem.

#### *A. Non-Competes Pose an Additional Barrier to Diversifying the Startup Ecosystem.*

A federal ban on non-competes will help diversify the startup ecosystem, and an inclusive economy spurs greater innovation.

Mobility is always good for the marketplace.<sup>43</sup> A freer labor market not only helps startups thrive, but also fosters dynamism that leads to economic prosperity for the whole country. When non-competes hinder mobility, they also adversely restrict the free flow of diverse talent. Data show, for example, that non-competes disproportionately harm women.<sup>44</sup> A ban on non-competes will remove one more of the many barriers historically underrepresented founders face, helping the startup ecosystem reach its full potential.

As it stands, the startup ecosystem is not diverse enough to operate at its full potential. Women and racial minorities are woefully underrepresented on founding teams. In 2019, Diversity VC reported that 82% of founding teams were all-male and 60.4% of founding teams were all-white, whereas only 1.3% of founders were LatinX and only 1.7% were Black.<sup>45</sup> And funding disparities exacerbate founder disparities. Female founders are funded less often than men, and when they do receive funding, their companies are valued half as highly as those of men (as of 2022, female-founded companies only represented 25.5% of total VC deal count in the US; median late-stage VC pre-money valuation of all-female-founded startups was \$49 million compared to \$95 million for all startups).<sup>46</sup> Non-competes only create an additional barrier.

A ban on non-competes brings us one step closer to diversifying the startup ecosystem to be more representative of the country as a whole and lead to significant economic growth.

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<sup>41</sup> See e.g., *Non-Disclosure Agreements for Startups*, THOMPSON HINE (Sept. 21, 2021), <https://perma.cc/955U-WXHW>; Nick Frost, *The Startup Guide to NDAs*, DOCSEND (Sept. 17, 2021), <https://perma.cc/2TXS-UJPI>; Kirsty MacSween, *What’s an NDA and When Does Your Startup Need One?*, SEEDLEGALS (Sept. 15, 2022), <https://perma.cc/R3LT-KDJ3>; *NDA (Non-Disclosure Agreement) Template for Startups*, LEGAL NODES (June 30, 2022), <https://perma.cc/N7Q5-P9X9>.

<sup>42</sup> See NPRM, *supra* note 2, at 3507.

<sup>43</sup> See *supra* Part II.B.

<sup>44</sup> Matthew S. Johnson et. al., *The Labor Market Effects of Legal Restrictions on Worker Mobility* 10-11 (Oct. 13, 2021) (unpublished manuscript), <https://perma.cc/E3J4-4W6C> (summarizing research finding that non-competes “may have a stronger deterrent or ‘chilling’ effect for women than for men.”).

<sup>45</sup> DIVERSITY VC, *DIVERSITY IN U.S. STARTUPS* 8, 14-16 (2020), <https://perma.cc/EEC4-FG4Y>.

<sup>46</sup> PITCHBOOK, *supra* note 9, at 4-5.

## B. *Non-Competes Disproportionately Harm Women Entrepreneurs.*

Non-competes create two main risks for founders: (1) the risk of violating one’s own non-compete agreement; and, (2) the risk of hiring other talent with relevant experience who are subject to a non-compete.<sup>47</sup> These risks have costs, and the costs of violating a non-compete are often greater for women than men.

Non-competes often prevent women from becoming founders in the first place. Female founders are disproportionately impacted by non-competes compared to their male counterparts: non-competes have a greater deterrent or “chilling effect” for women than men.<sup>48</sup> For example, empirical data show that “women in states with stricter non-compete enforceability are less likely than men to leave their jobs and start rival ventures.”<sup>49</sup> This is in part because women are subject to stricter terms in their contracts than men are,<sup>50</sup> and men are more willing (and able) to violate their non-compete agreements.<sup>51</sup> Non-competes therefore hinder our startup ecosystem from reaching its full potential because they lock up reservoirs of diverse talent, preventing them from ever becoming founders.

Even when women surmount the many hurdles to becoming founders, non-competes still pose challenges for them. Non-competes disproportionately impose legal costs and burdens on women founders, during both formation and talent assembly. As previously mentioned, women-founded companies are valued relatively less than those of their male counterparts and such female founders likely began with fewer resources given the pervasive gender wage gap.<sup>52</sup> When founders are resource-strapped, they have few resources to dedicate to investigating a non-compete—after payroll and expenses, startups have little left to dedicate to legal fees.<sup>53</sup> Thus, women have relatively fewer resources to defend themselves against lawsuits from their previous employer if their non-compete is challenged.

And the challenges don’t end after formation. Women founders have fewer resources to hire legal counsel if they would like to investigate the non-compete of potential hires. And for women who shirk their non-competes and start their own business anyway, they are less likely to draw on their prior professional networks to hire employees with relevant experience in order to keep a low profile, because their own non-competes are often stricter than those of men: “Women subject to stricter non-competes are particularly unlikely to hire workers with industry experience from their

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<sup>47</sup> Tom Fleischman, *Women Indirectly Hurt More by Noncompete Pacts*, CORNELL CHRON. (Oct. 5, 2021), <https://perma.cc/X2Y2-YY99> (explaining that Marx’s research found that “[s]ame-industry startups founded under stricter noncompete enforcement penalized potentially strong women-owned businesses. That’s likely due to the fact that hiring workers with relevant experience – with the threat of legal action due to noncompetes – has a chilling effect on startup growth and sustainability.”).

<sup>48</sup> Johnson, *supra* note 44, at 10-11.

<sup>49</sup> Matt Marx, *Employee Non-compete Agreements, Gender, and Entrepreneurship*, 33 ORG. SCI. 1756, 1756-57 (2022) (finding in a study of workers employed exclusively within 25 states and the District of Columbia from 1990 to 2014 that “women subject to tighter non-compete policies were less likely to leave their employers and start rival businesses . . . [and] that women in states with stricter non-compete enforceability are less likely than men to leave their jobs and start rival ventures.”).

<sup>50</sup> *Id.* at 1768 (finding that women are subject to more stringent non-compete terms regarding duration or the field of service and that such stricter terms may lead ex-employers to believe that they will prevail in court).

<sup>51</sup> Johnson, *supra* note 44.

<sup>52</sup> PITCHBOOK, *supra* note 9, at 4-5.

<sup>53</sup> See ENGINE, *supra* note 10.



own networks, increasing the chances of failure and discouraging them from founding in the first place.”<sup>54</sup> If you can’t hire great talent, which often comes from the same industry as your former employer, it is hard to succeed. As a result, great women-led startups are more susceptible to failure. This doesn’t have to happen.

As Professor Matt Marx of Cornell College of Business said reflecting on the findings of his hallmark study illustrating the disparate impact non-competes have on women entrepreneurs:

This is the really sad thing... You look at women who start businesses nonetheless, despite the risk. The companies that get blocked are not the companies that would have failed anyway; they’re the high-potential, high-risk companies. And that’s the real tragedy: The non-competes are actually blocking women from starting the kind of companies that we care about most, the high-growth companies, and that’s why they’re making the gender gap worse. That’s the real point of the study.<sup>55</sup>

Lastly, even after a venture fails, women are disproportionately harmed. Women are more heavily penalized for returning to the labor force following entrepreneurial failure because women who abandon startups might be less well compensated upon returning to paid employment due to the pervasive gender wage gap.<sup>56</sup>

Women already face many barriers to becoming founders and accessing the startup ecosystem—the deleterious effects of non-competes only deepen the problem. Non-competes leave significant economic gains on the table. While there are disproportionately few female founders, we have seen the potential for roaring success. For example, immigrant women founders have started some of today’s most successful unicorns: Sherry Wei from China founded Aviatrix valued at \$2 billion; and Jen Rubio from Philippines cofounded Away suitcases valued at \$1.5 billion.<sup>57</sup> And in 2022, female-founded Deel and Talkdesk became Decacorns, valued at \$12.1 billion and \$10 billion, respectively.<sup>58</sup> What’s more, some of today’s most exciting public companies were once women-founded startups: Diane Greene cofounded VMware, Anne Wojcicki and Linda Avey cofounded 23andMe, Lynn Jurich cofounded Sunrun, Katrina Lake founded Stitch Fix, Melanie Perkins founded Canva, Whitney Wolfe Herd founded Bumble—and there are many more.

Non-competes are leaving reservoirs of diverse talent untapped. “Diverse teams generate better economic results, and more—often better—innovation emerges from their unique perspectives.”<sup>59</sup>

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<sup>54</sup> Marx, *supra* note 49, at 1757, 1770.

<sup>55</sup> Fleischman, *supra* note 47.

<sup>56</sup> Marx, *supra* note 49, at 1767 (“Moreover, women may face higher relative costs upon returning to paid employment if they abandon their startup—for example, after losing or declining to contest a non-compete lawsuit. . . . If women are penalized more for failure, women who abandon startups might be less well compensated upon returning to paid employment.”) (citation omitted).

<sup>57</sup> STUART ANDERSON, IMMIGRANT ENTREPRENEURS AND U.S. BILLION-DOLLAR COMPANIES 3, 8 (Nat’l Found. for Am. Pol’y, July 2022), <https://perma.cc/ZT3K-H9XM>.

<sup>58</sup> PITCHBOOK, *supra* note 3, at 4.

<sup>59</sup> See generally ENGINE, ENGINE’S RESPONSE TO THE CALL FOR COMMENTS ON EXPANDING AMERICAN INNOVATION (2021).

Women talent and entrepreneurship have been sidelined, keeping our startup ecosystem from reaching its full potential. An inclusive economy is a strong one.

#### **IV. Any Exceptions to a Categorical Ban Must Not Frustrate Key Drivers of Innovation**

Engine is broadly in favor of a ban on non-competes. In general, the startup ecosystem is better able to promote entrepreneurship, create new businesses, and foster innovation when all talent is free in as many circumstances as possible.

However, the startup ecosystem is not a monolith. Some small, talent-strapped startups are forced to use every tool at their disposal—including non-competes—to hold their own against established companies to attract and retain talent. These startups, accustomed to operating in non-compete enforcing states, might be nervous to imagine a world without this tool. Simply put, the means realistically available to attract and secure talent are leagues different between a four-person, resource-strapped startup, a hundred-person, venture-backed startup, and Google.

Furthermore, non-competes often play a role in startup acquisitions—even in states like California.<sup>60</sup> These sale-of-business transactions are critical to the current startup ecosystem. In general, startups require an “exit” to realize the value built in developing the business and overcoming the risk of failure. The exit is what generates a return for investors and a payout for founders and equity-holding employees. Investors redeploy the returned capital into new ventures, while founders often use their payout to seed their next startup. Acquisitions are by far the most important exit path for successful startups, accounting for approximately 85% of recent successful startup exits.<sup>61</sup> It is possible that some acquisitions today—and their positive externalities for the startup ecosystem<sup>62</sup>—might not happen without the assurance of non-competes.

Still, non-competes can be a net-negative for the startup ecosystem in certain acquisitions, particularly when founders feel coerced into them by miscalculating that the deal could be threatened otherwise. Acquirers generally have other means available to protect themselves and retain talent—particularly stock consideration plus vesting—and some acquired talent only comes to realize the crippling professional restraint of agreeing to a non-compete after-the-fact.

Finally, the Commission has asked if the ban should only apply to low-wage workers.<sup>63</sup> However, new research suggests that a ban on non-competes for higher-earning knowledge workers is key to encouraging entrepreneurship and fostering economic dynamism.<sup>64</sup> Research found that “legislation limiting the enforceability of non-competes among a subset of high-wage workers with in-demand skills resulted in the formation of new businesses and increased transfer of knowledge as workers

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<sup>60</sup> Cal. Bus. & Prof. Code § 16601 explicitly allows non-competes in sale-of-business transactions.

<sup>61</sup> See ENGINE, EXITS, INVESTMENT, AND STARTUP EXPERIENCE: THE ROLE OF ACQUISITIONS IN THE STARTUPS ECOSYSTEM (2022), <https://perma.cc/5DBC-N6BJ>.

<sup>62</sup> See *id.*; John F. Coyle & Gregg D. Polsky, *Acqui-Hiring*, 63 DUKE L.J. 281, 311 (2013).

<sup>63</sup> NPRM, *supra* note 2, at 3512-13, 3516.

<sup>64</sup> See Glasner, *supra* note 16, at 2.

changed jobs.”<sup>65</sup> Any rule that exempts high-wage workers will miss an opportunity to promote entrepreneurship and support our startup ecosystem.

In short, the relationship between innovation, competition, talent mobility, and a healthy startup ecosystem is extremely complex. To the extent the FTC decides to carve out any exceptions to a broad, categorical ban on non-competes, it must choose and structure such exceptions in a way that protects the startup ecosystem and carefully considers its many nuances.

## Conclusion

Non-competes stifle startups. For too long, they have impeded startups from being formed and developing new technologies. The FTC’s proposed rule is a good first step for fostering entrepreneurship, seeding greater innovation, and boosting the startup ecosystem.

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<sup>65</sup> *Id.*