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ECONOMY

Noncompete Pacts, Under Siege, Find Haven in Idaho

By CONOR DOUGHERTY JULY 14, 2017

BOISE, Idaho — Idaho achieved a notable distinction last year: It became one of the hardest places in America for someone to quit a job for a better one.

The state did this by making it easier for companies to enforce noncompete agreements, which prevent employees from leaving their company for a competitor.

While its economy is known for agriculture — potatoes are among the state's biggest exports — Idaho has a long history as a technology hub. And the new law landed in the middle of the tech world, causing a clash between hungry start-ups looking to poach employees and more established companies that want to lock their people in place.

"We're trying to build the tech ecosystem in Boise," said George Mulhern, chief executive of Cradlepoint, a company here that makes routers and other networking equipment. "And anything that would make somebody not want to move here or start a company here is going to slow down our progress."

Alex LaBeau, president of the Idaho Association of Commerce and Industry, a trade group that represents many of the state's biggest employers, countered: "This is about companies protecting their assets in a competitive marketplace."

Versions of this clash have played out nationwide, as state lawmakers consider whether to make it easier or harder for companies to block workers from jumping to competitors. Both sides in the debate, which bridges party lines, say they are trying to create an environment in which local businesses can thrive.

For the most part, states have been moving toward making it easier for people to switch teams, but Idaho went the other direction with legislation that was friendlier to employers. The resulting law was particularly strict because it put the onus on employees to prove that they would not harm their former employers by taking the new jobs.

Proponents note that the statute applies only to "key employees" who tend to have more responsibility and better pay. But employment lawyers say Idaho companies tie down all levels of workers, not just top executives, with tough employment contracts. And indeed, the new law has roots in a yearslong fight waged by a woman who never finished high school but built a career selling tech-training services, only to be sued when she left for a better-paying job.

The most extreme end of the spectrum is California, which prohibits noncompete agreements entirely. Economists say this was a crucial factor behind Silicon Valley's rise, because it made it easier for people to start and staff new businesses. But as states like Utah and Massachusetts have tried to move closer to this approach, legislators have run into mature companies trying to hold onto their best employees.

When Mike Schultz, a Republican state representative in Utah, introduced an ultimately successful bill last year to make such agreements harder to enforce, incumbent businesses were his biggest opponents. "But then you had the new entrepreneurs, and most of those guys were in favor of doing away with noncompetes," he said. "Those are the guys out there growing and trying to hire people."

A recent survey showed that one in five American workers is bound by a noncompete clause. They cover workers up and down the economic spectrum, from executives to hairdressers. Despite their widespread use, these agreements often catch departing workers off guard because they are rarely highlighted during interviews and are usually tucked inside employment contracts that are full of impenetrable legalese few people can understand.

The growth of restrictive employment contracts dovetails with a broad pattern in the labor market: People don't quit their jobs as much as they used to. The share of workers changing jobs has been on a long-run decrease since 2000, according to research by the economists Steven J. Davis at the University of Chicago's Booth School of Business and John Haltiwanger at the University of Maryland.

One explanation offered by economists is that a bloat of regulations has made it harder for employees to change careers or move across state lines. The barriers include employment contracts and occupational licensing laws that cover a third of the work force and require people to spend months or years training to do even basic service jobs.

The impact has fallen disproportionately on start-ups and high-growth companies, which tend to be against strict employment agreements because they are primarily concerned with growth.

"The noncompete is a two-edged sword," said Matthew Marx, a professor at Boston University's Questrom School of Business. "Although it enables companies to retain their employees, it makes it harder for them to recruit workers with relevant experience."

It also ends up hurting wages, because most people get raises when they switch jobs. This goes far beyond defectors to the economy more broadly, and Idaho's tech scene shows why.

An Answer to Poaching

Boise is one of America's most remote metropolitan areas. Despite its Rocky Mountain setting, or perhaps because of it, the city and surrounding suburbs grew to prominence and affluence thanks to homegrown businesses like the semiconductor giant Micron Technology, a former start-up itself, as well as the J. R. Simplot Company and the Albertsons grocery chain.

Over the past several decades, these companies got so big that the city gained a reputation as a hub for Fortune 500 headquarters. Today, however, a new group of entrepreneurs is building on Idaho's tradition of homespun growth.

Matt Rissell is one of them. Mr. Rissell is a founder and the chief executive of TSheets, which makes time-management software. Mr. Rissell started his entrepreneurial career as the owner of three Cartridge World stores. It was a tough, low-margin business and he was losing a lot of money from employees who fudged their time sheets for extra hours.

Mr. Rissell enlisted an engineer friend to help him fix the problem with software. When his stores saved $2,400 the first month, Mr. Rissell realized he had found a much better business than selling printer cartridges.

Today, TSheets is the darling of Idaho's start-up scene. The company was founded in 2006, but two years ago took on its first $15 million in venture capital. Since then the company has grown to 200 people from 60, and is on pace to add 100 more by the end of the year.

TSheets is tiny compared with companies like Micron, which has about 30,000 employees around the world. But according to Mr. Haltiwanger's research, a relative handful of high-growth companies — most of them youngish companies like TSheets — account for about half of new jobs created. They also play an outsize role in raising wages, because people quit their jobs to join them.

During a recent interview in his office, Mr. Rissell said that one of his main challenges was simply finding enough people. TSheets has about 70 employees on its engineering and product team, and almost all moved there from jobs at local companies.

"The ability to recruit from the local area has been extraordinary for us," he said.

Two years ago, TSheets hired a pair of engineers from a smaller software company called Zenware. Jody Sedrick, Zenware's chief executive, was hurt and disappointed. He contacted a lawyer to see if it was possible to prevent his employees from leaving for a rival, but instead of spending money on legal costs, he decided to try something else: He gave each of his remaining employees a raise.

"I said, 'You know what, we're going to double down internally,'" he said in a recent interview.

The result for the Idaho economy was that TSheets hired two people — but in doing so got 12 other people a raise. Had Mr. Sedrick decided to sue his two departing employees, something Idaho's new law made easier, those raises might never have happened.

'Trust No One'

For a law that would end up riling tech companies, Idaho's statute began with an unlikely character: Debbie Nolan, a 51-year-old saleswoman who never went to high school.

Ms. Nolan is from the New York City borough of Queens. She left school at 13 but through decades of work experience managed to carve out a middle-class career selling technology-training classes for office workers. She moved from New York to California to Nevada and finally to Idaho, where she worked at a company called LeapFox Learning. Ms. Nolan made $48,000 a year there, based on her extensive work history and little else.

"I don't think I could get a job at Walmart without a high school diploma," she said in an interview.

Three years ago Ms. Nolan quit and started working at ExecuTrain — LeapFox's main competitor — where she negotiated a $65,000 salary. LeapFox sued her for violating her exit agreement, setting off a three-year legal battle that was settled out of court but inspired Ms. Nolan to get a tattoo that sits just under her collarbone and reads: "Trust No One."

After Ms. Nolan's defection, Codi Galloway, who owns LeapFox with her husband, Scott, became an outspoken advocate for amending state law to make it less expensive for businesses to block an employee from going to work for a rival. The result was a bill that shifted the burden from companies to employees, who must now prove they have "no ability to adversely affect the employer's legitimate business interests."

The bar for that is so high that Brian Kane, an assistant chief deputy in the Idaho attorney general's office, wrote that this would be "difficult if not impossible" for an employee to do.

Ilana Rubel, one of the few Democrats in Idaho's House of Representatives, became the bill's fiercest critic. Ms. Rubel, a Harvard-trained lawyer who does intellectual property litigation for the Silicon Valley-based law firm Fenwick & West, described the proposal as "toxic to a good business ecosystem."

"This bill was a giant thumb on the scale in favor of old established business at the expense of start-ups," Ms. Rubel said.

Despite the bill's passage, Ms. Rubel is undeterred. She has drafted legislation to repeal the law and is enlisting tech executives to help.

As Jeff Reynolds, a local entrepreneur who advises young companies at a co-working space called Trailhead, noted: "If you're in Boise, Idaho, and you're trying to build a start-up culture, it's not like we have a head start in doing that. We shouldn't try to put new impediments in our way."

At a hearing last year to debate the proposed law, one of those who showed up was Mr. Sedrick, the Zenware chief executive who lost two engineers to TSheets. He didn't mention his competitor by name, but complained about a local software company "hand-poaching" engineers.

Today, Mr. Sedrick tells a different story. In a recent interview, he said his feelings on noncompete agreements had mellowed.

"I want to create a good marketplace as a whole, and in reality there is enough room for all of us," he said.

In addition, he said, the defections taught him how to be a better leader and more efficient boss. His employees are happier and better paid.

"Rather than going on the defensive, because that's what a noncompete is, just go on the offensive and create a great environment so that people want to stay with you," he said. "That makes you a better company in the end."

Doris Burke contributed research.

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