

BETWEEN RIGHTS AND CONTRACT:  
ARBITRATION AGREEMENTS AND NON-COMPETE COVENANTS  
AS A HYBRID FORM OF EMPLOYMENT LAW

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*The employment relationship is governed largely by contract, but with a heavy overlay of “rights”: minimum terms and individual rights that are established by external law and are typically nonwaivable. But some terms of employment are governed neither by ordinary contract nor by ordinary rights, nor even by ordinary waivable rights. Both of the two most controversial contractual instruments in employment law today—non-compete covenants and mandatory arbitration agreements—take the form of written contracts; both waive important employee rights (the right to compete postemployment, the right to litigate future claims); and both are subject to substantive criteria of validity that are set by external law. Both bodies of law may be usefully described as recognizing “conditionally waivable” rights.*

*This Article aims first to show structural parallels between non-compete covenants and mandatory arbitration agreements that place them at a distinct intermediate point along the spectrum between nonwaivable rights and ordinary contract. Second, it seeks to uncover a common logic underlying the law’s choice of this particular hybrid of rights and contract. The linchpin of that common logic lies in the threat that an unregulated waiver of one right (the right to compete or to litigate future claims) poses to adjacent employee rights that the law deems nonwaivable. Third, this Article deploys that underlying logic to offer a critical assessment of the law governing non-competes and arbitration agreements. Finally, this Article tentatively explores the broader potential usefulness of conditional waivability as a way of regulating some terms of employment. The intriguing potential of conditional waivability lies in its injection of some of the virtues of contract—especially flexibility and variability in the face of widely divergent and changing circumstances—into the pursuit of public goals and the realization of rights in the workplace.*

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INTRODUCTION .....	380
I. SITUATING CONDITIONALLY WAIVABLE RIGHTS BETWEEN RIGHTS AND CONTRACT .....	383
A. <i>Rights Versus Contract</i> .....	383
B. <i>A Primer on Non-Compete and Arbitration Agreements</i> .....	391
C. <i>Parallel Problems Arising out of Conditional Waivability</i> .....	400
II. THE LOGIC OF CONDITIONALLY WAIVABLE RIGHTS .....	406
A. <i>Why Not Contract?</i> .....	407
B. <i>Why Not Mandatory Employee Rights?</i> .....	414
III. EVALUATING THE LAW OF NON-COMPETE COVENANTS AND MANDATORY ARBITRATION AGREEMENTS.....	420
A. <i>Assessing the Law of Non-Compete Agreements</i> .....	421
B. <i>Assessing the Law of Mandatory Arbitration</i> .....	426
C. <i>A Closing Word on Conditional Waivability</i> .....	438
IV. EXTENDING THE DOMAIN OF CONDITIONALLY WAIVABLE RIGHTS: PRELIMINARY THOUGHTS .....	439
CONCLUSION.....	444

#### INTRODUCTION

Employment law straddles the divide between public law and private law. That position reflects the dual nature of the employment relationship. On the one hand, that relationship is fundamentally contractual; it originates in an individual's agreement to work for an employer, and most of its terms—wage rates, benefits, hours of work, job duties, job security, and terminability—are set by the explicit or implicit agreement of the parties. Yet the employment relationship is also constrained by employee rights and entitlements that are established by external law, that reflect public values and interests, and that typically cannot be varied or waived by contract. For example, employees cannot agree to work for less than the minimum wage or under conditions that violate safety standards, nor can they agree to accept racial discrimination. (I will refer to all such entitlements here as “rights.”) Much of employment law consists of the competing paradigms of rights and contract.<sup>1</sup>

Yet two of the most controversial and litigated instruments in contemporary employment law do not quite fit either the contract para-

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<sup>1</sup> I do not claim that employment law is unique in its interlacing of rights and contract. Landlord-tenant law, for example, has followed much the same historical trajectory over the past two centuries as has employment law: from status to contract to, in many jurisdictions, a heavy overlay of rights on the contract.

digm or the rights paradigm. Both mandatory arbitration agreements and non-compete covenants take the form of contracts—specifically, contracts that waive important employee rights; yet those contracts are not valid unless they meet specific substantive legal criteria drawn from external law.<sup>2</sup> Mandatory arbitration agreements, which waive the right to litigate future legal claims in a judicial forum in favor of arbitration (and which I will hereafter call simply “arbitration agreements”<sup>3</sup>), are subject to conditions that aim to ensure the adequacy and fairness of the arbitral regime to which they commit the employee. For example, an agreement may be invalid if it requires employee plaintiffs to pay an excessive fee for the arbitrator’s services, or if the process it prescribes is skewed toward the employer. Non-compete covenants, which constrain the right to practice one’s occupation in competition with the employer after employment has ceased, are scrutinized for the legitimacy of the employer interests that they protect and the reasonableness of the restraints they place on postemployment competition. An agreement may be invalid, for example, if it lasts too long or reaches too far geographically, or if the employer cannot show that the agreement is needed to protect trade secrets or the like.

Beyond the fact that both agreements are increasingly common, frequently litigated, and controversial among employment lawyers and legal scholars, they may initially appear to have little in common. And, to be sure, the law of arbitration agreements and the law of non-compete covenants address very different normative and policy con-

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<sup>2</sup> In a recent paper, Katherine Stone draws a different parallel between these two kinds of agreements: both impose obligations on employees that outlast the underlying employment contract, which is usually terminable at will. See Katherine V.W. Stone, *Revisiting the At-Will Employment Doctrine: Imposed Terms, Implied Terms, and the Normative World of the Workplace* 1-3 (UCLA School of Law, Public Law & Legal Theory Research Paper No. 06-38, 2006) available at <http://ssrn.com/abstract=931666>. Stone argues that the presence of terms that live beyond the life of the contract render it something other than an at-will contract, and thus raise the possibility that courts could imply other terms—terms such as fairness and good faith—that also live beyond the life of the agreement. On the other hand, the hybrid status quo might simply attest to employers’ ability to secure express contract terms that they prefer, including both terminability at will and some post-termination constraints on employees, and to the resulting difficulty of protecting employee entitlements through implied terms, default rules, or waivable rights that can be reversed by express contract. See *infra* text accompanying notes 24-27. As far as I know, Stone and I are the first legal scholars to focus on parallels between non-compete covenants and mandatory arbitration agreements.

<sup>3</sup> Not to be confused with uncontroversially valid agreements to arbitrate existing disputes.

cerns. But these two kinds of agreements, and the bodies of law that govern them, turn out to share some interesting structural features. The two bodies of law exemplify an important intermediate or hybrid form of employment regulation, one that I will call “conditionally waivable rights.”<sup>4</sup> In the case of both arbitration agreements and non-compete covenants, I will argue that conditional waivability provides a framework for protecting nonwaivable employee rights that lie immediately adjacent to the rights that can be waived, and that are at risk in these agreements, while giving the parties flexibility to achieve legitimate, mutually beneficial ends.

It is another question how well current law carries out that objective. That question, in turn, is complicated by the fact that both the law of non-compete covenants and the law of mandatory arbitration agreements come in stricter and more lenient versions. I find in both cases that the stricter versions of the law do a better job of protecting what needs protecting and accommodating what can be accommodated. In both cases, the law could be improved by a more systematic understanding of what is at stake, and how the solution of conditional waivability can and should work. In this Article, I seek to advance that end.

I begin in Part I by showing that non-compete covenants and mandatory arbitration agreements have more in common than meets the eye. The two bodies of law that govern them occupy a distinct intermediate point along the spectrum that runs from nonwaivable employee rights to ordinary contract. This distinctive hybrid of rights and contract gives rise to some characteristic problems and intriguing parallels between the two bodies of law. I proceed in Part II to investigate the logic of conditional waivability: why might the law in both areas have settled on conditional waivability as opposed to either ordinary contract or nonwaivability? I dig beneath the doctrine to identify parallel constellations of rights and interests, legitimate and illegitimate, that are at stake in the law of arbitration and non-compete agreements, and that might make sense of the law’s choice of condi-

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<sup>4</sup> Cass Sunstein identifies and briefly explores this same intermediate space: employee rights that are subject to what he calls “constrained waiver.” Cass R. Sunstein, *Human Behavior and the Law of Work*, 87 VA. L. REV. 205, 243-45 (2001). There is no substantial difference between his category and mine, though my term tends to direct attention to the particular conditions the law sets for waiver. Moreover, Sunstein does not identify either arbitration agreements or non-compete agreements as examples of “constrained waivers,” and thus perhaps underestimates the extent to which existing law populates this particular intermediate category.

tional waivability. In Part III, I deploy this analysis to cast a critical light upon existing law in both areas: given what is at stake in both arbitration and non-compete agreements, how well does the law do at setting and enforcing appropriate conditions for waiver? Finally, in Part IV, I venture some preliminary thoughts about the broader use of conditionally waivable rights within employment law.

Conditional waivability holds out the promise of introducing some of the virtues of contract—especially flexibility and variability in the face of widely divergent and changing circumstances—into the pursuit of public goals and the realization of rights in the workplace. It allows employees and employers to bargain within publicly constrained channels toward publicly sanctioned ends in light of particular circumstances and preferences. As the law of arbitration agreements and non-competes makes clear, conditional waivability is no panacea; indeed, it may have a built-in tendency to generate complexity, indeterminacy, and, as a result, litigation. Still, for some employment-related entitlements, this hybrid form of regulation might be a sensible way out of the familiar face-off between employment mandates and market ordering. As such, it might also point the way to real innovations in employment law and in workplace governance.

#### I. SITUATING CONDITIONALLY WAIVABLE RIGHTS BETWEEN RIGHTS AND CONTRACT

Two of the hottest topics in employment law—both as subjects of academic inquiry and as areas of practice—are mandatory arbitration agreements and covenants not to compete. These two seemingly unrelated bodies of law have more in common than has been previously recognized. Both straddle the basic divide between contract and employee rights, for they take the form of contract yet are subject to distinctive legal constraints that protect employee rights. These two kinds of agreements and the law that governs them represent a distinctive hybrid of rights and contract that I call “conditionally waivable rights,” and which seems to underlie some parallel doctrinal problems in the two areas.

##### A. *Rights Versus Contract*

The poles of the spectrum are familiar: on one end, the contractual paradigm of the employment relationship, and on the other, the domain of employee rights. Contract is the default mode of regulat-

ing employment relationships: unless the law has taken some issue off the bargaining table, it is governed by the agreement of the parties. The terms of the employment contract may be express, whether written or oral, or they may be implied. They may be explicitly bargained for between the parties or not. The contract may be terminable at will or not. None of these variations negates the fundamentally contractual nature of the employment relationship.

To be sure, as one commentator has observed, “the law of employment contracts is highly idiosyncratic.”<sup>5</sup> The law of the employment contract has come under pressure in part because of the perceived disparity in bargaining power between employers and employees.<sup>6</sup> Most employment contracts arise between individuals who are more or less dependent on a single job and comparatively large organizations that are repeat players with diversified investments in the labor market.<sup>7</sup> Most contract terms are offered by employers on a take-it-or-leave-it basis, and are set under the shadow of employment at will—the employer’s presumptive power to fire employees for any reason at all, including refusal to accept the employer’s proffered or modified terms of employment.<sup>8</sup> Skepticism about the bargaining

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<sup>5</sup> Rachel Arnow-Richman, *The Role of Contract in the Modern Employment Relationship*, 10 TEX. WESLEYAN L. REV. 1, 4 (2003). For example, “[c]ourts frequently find binding obligations in cases where contract formalities are absent, while avoiding enforcement of signed documents carrying all of the trappings of enforceable instruments.” *Id.*

<sup>6</sup> That perception, a *bête-noir* of many economics-oriented scholars, *see infra* note 18, is enshrined in the preamble to the National Labor Relations Act: “The inequality of bargaining power between employees who do not possess full freedom of association or actual liberty of contract, and employers who are organized in the corporate or other forms of ownership association substantially burdens and affects the flow of commerce . . . .” 29 U.S.C. § 151 (2000). Of course, saying it does not make it so, even when the speaker is Congress. But, at a minimum, it does help to explain existing law, much of which I take here as given.

<sup>7</sup> Or, in Samuel Issacharoff’s more colorful metaphor, “the hiring stage is most like a first date between a polygamist and a monogamist.” Samuel Issacharoff, *Contracting for Employment: The Limited Return of the Common Law*, 74 TEX. L. REV. 1783, 1795 (1996).

<sup>8</sup> The default presumption of employment at will has proven tenacious. Until the 1960s, the at-will presumption was fortified by requirements of “additional consideration” and “mutuality of obligation” that made it peculiarly hard to dislodge by contrary agreement. *See, e.g.*, *Pitcher v. United Oil & Gas Syndicate, Inc.*, 139 So. 760, 761 (La. 1932) (holding that an employment contract that is to continue for as long as the employer is in business lacks “mutuality”); *Savage v. Spur Distrib. Co.*, 228 S.W.2d 122, 124 (Tenn. Ct. App. 1949) (finding employment at will, and noting that “unless both parties are bound neither is bound”). Those fortifications have largely crumbled, and agreements for job security are now generally enforceable. On the other hand, the law has largely accommodated employers’ desire to retain employment at will by giving effect to “disclaimers” that have become standard features of employee handbooks.

power of employees has contributed to courts' willingness to intervene in the employment contract to redress abuses that offend public policy—for example, a discharge for refusing to violate the law or for exercising an employment-related right (e.g., filing a workers' compensation claim).<sup>9</sup> Still, most terms of the employment relationship are governed not by external law or public policy but by the express or implied agreement of the parties.

Of course, underlying the freedom of contract, in employment as elsewhere, is the law establishing the baseline entitlements of the parties.<sup>10</sup> Employers, for their part, own whatever they own under the governing law of property—typically the workplace itself and the tools and other physical means of production, as well as their trade secrets and other intellectual property. Employees own themselves and the skills, talents, experience, and most of the knowledge that contribute to their productivity.<sup>11</sup> The allocation of entitlements to the information that resides in employees' heads has grown in importance as information has become a larger factor of production and a component of commercial value.<sup>12</sup> Distinguishing between employers' intellectual property, especially their trade secrets, and the general skills and knowledge that belong to employees themselves as an aspect of self-ownership is a tricky but necessary exercise—and one to which we will

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*See, e.g.,* *Guz v. Bechtel Nat'l, Inc.*, 8 P.3d 1089, 1103-04 (Cal. 2000) (holding that a handbook's disclaimer of term employment, while not dispositive, is evidence that the contract did not limit termination rights); *Anderson v. Douglas & Lomason Co.*, 540 N.W.2d 277, 280 (Iowa 1995) (holding that a disclaimer in an employee handbook prevented the enumerated progressive discipline policies from constituting a contract).

<sup>9</sup> These are examples of "rights" being superimposed on or carved out of the employment contract; more on that development shortly.

<sup>10</sup> To underscore that "the law cannot 'do nothing,'" but rather must set the initial entitlements of contracting parties, Sunstein characterizes those entitlements that are left to contract as "waivable employers' rights." Sunstein, *supra* note 4, at 208-09. For present purposes I endorse the insight but not the terminology. It seems jarring to characterize a nonmandatory employee benefit—say, paid vacation time—as the waiver of an employer's right (namely, not to give paid vacations).

<sup>11</sup> The indispensability of self-ownership to freedom of contract was recognized by both Adam Smith and John Locke. The question of whether self-ownership was *sufficient* for genuine freedom of contract has generated controversy throughout the history of the American republic. For illuminating treatments of this history, see AMY DRU STANLEY, *FROM BONDAGE TO CONTRACT: WAGE LABOR, MARRIAGE, AND THE MARKET IN THE AGE OF SLAVE EMANCIPATION* 9-10 (1998); William E. Forbath, *The Ambiguities of Free Labor: Labor and Law in the Gilded Age*, 1985 WIS. L. REV. 767, 776-78.

<sup>12</sup> On the varieties of human capital and their legal treatment, see Paul H. Rubin & Peter Shedd, *Human Capital and Covenants Not To Compete*, 10 J. LEGAL STUD. 93, 95-100 (1981).

return in connection with non-compete covenants—because it establishes the baseline against which contracting takes place. Most basically, however, employees’ self-ownership means that they are free to accept or decline employment if it is offered, or to quit employment after it has begun. Since the inviolability of self-ownership was finally established in the United States in the mid-nineteenth century with the abolition of slavery and the adoption of the Thirteenth Amendment, it is axiomatic that one cannot sell oneself, even voluntarily, into servitude. The individual’s self-ownership, and the right to quit employment, are inalienable.<sup>13</sup>

So the legal foundation of the employment relationship is the law of property (including the inalienable right of self-ownership) and of contract. Yet, as compared to many other contractual relationships, the employment relationship is highly regulated. Beyond the basic entitlement of self-ownership and certain rights of privacy and bodily integrity that partake of that entitlement, a many-layered edifice of rights and minimum standards, grounded in federal and state constitutions, statutes, and common law doctrines, sets bounds on the freedom of contract in employment. In addition, employees have rights against discrimination (based on, for example, race, sex, age, pregnancy, and disability),<sup>14</sup> and rights to engage in certain activities free from employer reprisals (for example, supporting a union, complaining of discrimination, or in some cases revealing harmful and illegal conduct or refusing to violate the law). Employees also enjoy the protection of laws that establish minimum terms and conditions of employment, such as wages and hours, occupational health and safety, and family leave.

I denominate here as “rights” all employee entitlements, including self-ownership, that arise from external law independent of the

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<sup>13</sup> With this caveat: employees who agree to a fixed (and reasonably short) term of employment, and who quit early, may be liable for damages and may be enjoined from working for another employer, though not from quitting. The unavailability of specific performance to enforce a “personal services” contract is well established, but not without its critics. See Christopher T. Wonnell, *The Contractual Disempowerment of Employees*, 46 STAN. L. REV. 87, 90-93 (1993) (arguing that the unavailability of specific performance denies employees valuable bargaining leverage). The precise contours of the “right to quit” remain a bit hazy, and are a fit subject for further investigation.

<sup>14</sup> For an overview of the antiretaliation and antidiscrimination branches of wrongful discharge law, see Cynthia L. Estlund, *Wrongful Discharge Protections in an At-Will World*, 74 TEX. L. REV. 1655, 1669-86 (1996). Of course, many of these doctrines operate not only as constraints on discharge, but also as constraints on the employer’s treatment of the employee during the employment relationship.



agreement between the parties, and that are legally protected against invasion by the employer. As I will discuss shortly, most of these employee rights not only arise from outside the contract, but are also nonwaivable, and thus are shielded from the give-and-take of contract. The employment relationship has long been highly contested social terrain, and the public historically has staked claims to a sizable share of that terrain. The vast and varied domain of employee rights has made the employment relationship as much a creature of public law as of private law.

Much employment law scholarship concerns the wisdom of expanding or contracting the bite that rights take out of freedom of contract. Law-and-economics scholars in particular, while not uniformly opposing employee rights, have succeeded in putting some recurring questions on the table: Why not leave it to the parties to bargain over these matters? Will not those bargains better reflect the actual preferences of the parties? And will it do employees any good to impose mandates, given employers' inexorable freedom to employ or not to employ and, within wide bounds, to set wages?<sup>15</sup> These debates have been played out extensively, even exhaustively, in connection with the venerable employment-at-will presumption and the relegation of job security to the realm of contract.

While commentators continue to debate whether it makes sense to establish fixed entitlements for employees within essentially voluntary contractual relationships, American lawmakers have done so repeatedly, especially over the last half century. Proponents of employee rights, existing and proposed, sound recurring themes: Some harken to fundamental commitments to public morality and requisites of personhood in a liberal democratic society (for example, rights of self-ownership and bodily integrity, freedom of association, and freedom from discrimination).<sup>16</sup> Some accept the basic contractual paradigm but contend for exceptions based on third-party effects or other bargaining impediments.<sup>17</sup> Others emphasize—to the consternation

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<sup>15</sup> Illustrative analyses include RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 358-59 (4th ed. 1998); Richard A. Epstein, *In Defense of the Contract at Will*, 51 U. CHI. L. REV. 947, 982 (1984); Mayer G. Freed & Daniel D. Polsby, *Just Cause for Termination Rules and Economic Efficiency*, 38 EMORY L.J. 1097, 1131-37 (1989).

<sup>16</sup> On the importance of expanding legal protections for employees, see Clyde W. Summers, *Individual Protection Against Unjust Dismissal: Time for a Statute*, 62 VA. L. REV. 481 (1976).

<sup>17</sup> See, e.g., Stewart J. Schwab, *Wrongful Discharge Law and the Search for Third-Party Effects*, 74 TEX. L. REV. 1943, 1943 (1996) (arguing that many "public policy" cases can be understood as avoiding negative public externalities). For discussions of the ineffi-

of law-and-economics scholars—longstanding and pervasive doubts about employees' ability to bargain for themselves in support of higher minimum standards and more, and broader, employee rights.<sup>18</sup>

The choice between rights and contract is thus basic and hotly contested. But it is not a simple binary choice. Some employee rights are waivable (though most are not).<sup>19</sup> For example, a public employee may waive part of her First Amendment right to speak on matters of public concern by agreeing to keep certain matters confidential or by taking a job that entails speaking for the agency that employs her.<sup>20</sup> An employee may waive privacy rights by agreeing to searches that would otherwise violate those rights; she may do so at the time of the search or ahead of time by accepting an employer policy of conducting searches.<sup>21</sup> Either way, this is an instance of rights giving way

ciencies caused by racial discrimination, see John J. Donahue III, *Advocacy Versus Analysis in Assessing Employment Discrimination Law*, 44 STAN. L. REV. 1583, 1609-10 (1992) (reviewing RICHARD A. EPSTEIN, FORBIDDEN GROUNDS: THE CASE AGAINST EMPLOYMENT DISCRIMINATION LAWS (1992)); David A. Strauss, *The Law and Economics of Racial Discrimination in Employment: The Case for Numerical Standards*, 79 GEO. L.J. 1619, 1624-31 (1991); J. Hoult Verkerke, *Free to Search*, 105 HARV. L. REV. 2080, 2082 (1992) (reviewing EPSTEIN, FORBIDDEN GROUNDS, *supra*).

<sup>18</sup> Law-and-economics scholars have repeatedly criticized the "unequal bargaining power" claim and argued for greater deference to contracts. See, e.g., Stewart J. Schwab, *The Law and Economics Approach to Workplace Regulation*, in GOVERNMENT REGULATION OF THE EMPLOYMENT RELATIONSHIP 91, 111-13 (Bruce E. Kaufman ed., 1997); Michael L. Wachter & Randall D. Wright, *The Economics of Internal Labor Markets*, 29 INDUS. REL. 240, 260 (1990). For a thoughtful defense of the "unequal bargaining power" thesis, see Michael H. Gottesman, *Wither Goest Labor Law: Law and Economics in the Workplace*, 100 YALE L.J. 2767, 2787 (1991) (reviewing PAUL C. WEILER, GOVERNING THE WORKPLACE: THE FUTURE OF LABOR AND EMPLOYMENT LAW (1990)).

<sup>19</sup> That is, most employee rights—such as the right to be paid a minimum wage or to be free from discrimination—cannot be waived ex ante. See, e.g., *Barrentine v. Arkansas-Best Freight Sys., Inc.*, 450 U.S. 728, 739-40 (1981) (recognizing that the Fair Labor Standards Act's protections against substandard wages and oppressive conditions "cannot be abridged by contract or otherwise waived"); *Alexander v. Gardner-Denver Co.*, 415 U.S. 36, 51 (1974) ("[T]here can be no prospective waiver of an employee's rights under Title VII."). Of course, *claims* over the past violation of rights can be waived or settled.

<sup>20</sup> See *Snepp v. United States*, 444 U.S. 507, 510 (1980) (per curiam) (upholding an agreement requiring a former CIA agent to submit book material concerning the CIA for prepublication review). Apart from particular instances of public employees waiving speech rights, the Supreme Court's most cogent explanation of the constrained free speech rights of a public employee as against her government employer rests essentially on a notion of waiver—of accepting certain speech restrictions as a condition of employment. See *Waters v. Churchill*, 511 U.S. 661, 674-75 (1994).

<sup>21</sup> See, e.g., *Jennings v. Minco Tech. Labs, Inc.*, 765 S.W.2d 497, 498 (Tex. App. 1989) (upholding an employer's random drug-testing program).

to contract or consent.<sup>22</sup> Making employee rights waivable converts them into bargaining chips that, at least in principle, allow employees to make mutually beneficial bargains with their employers.<sup>23</sup>

There are other shades of gray at the contractual end of the spectrum. Even for those matters that are left entirely to contract, the law might set a default rule that embodies some notion of employees' presumptive entitlements, placing the burden on the employer to contract expressly for more favorable terms.<sup>24</sup> The issue is most vividly posed in the context of employment at will, where some scholars have argued for switching the default to something like just cause, partly in recognition of employees' beliefs about their entitlement to job security and about what is fair and lawful.<sup>25</sup> This might be seen as an effort to embed a weak employee right or entitlement into the employment contract.

Indeed, there is not much difference between an employee-friendly default rule and a waivable employee right: both allocate an entitlement to the employee absent an express understanding to the

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<sup>22</sup> And either way, there is a question whether "consent" is meaningful where it is a condition of continued employment and is given under threat of termination. For an argument that it is not, see Eileen Silverstein, *From Statute to Contract: The Law of the Employment Relationship Reconsidered*, 18 HOFSTRA LAB. & EMP. L.J. 479, 511-25 (2001). For an explanation of the issues posed by "consent" in many privacy disputes, see Pauline T. Kim, *Privacy Rights, Public Policy, and the Employment Relationship*, 57 OHIO ST. L.J. 671, 717-20 (1996). These issues arise as well in many cases of arbitration agreements and non-compete covenants, as discussed *infra* Parts III.A-B.

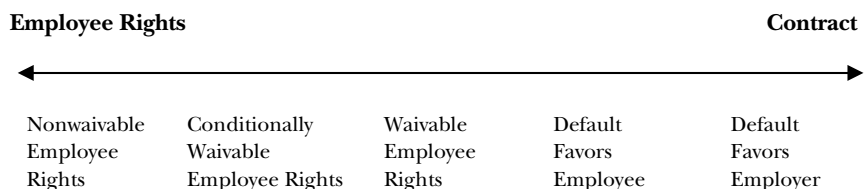
<sup>23</sup> That is the linchpin of Professor Sunstein's argument for converting many employee rights that are currently nonwaivable into waivable rights. Sunstein, *supra* note 4, at 207. He recognizes that waivable employee rights—or default rules, as they would then be—may have to be made "sticky" lest they fetch too low a price, and that the law might constrain the waiver of rights with either procedural or substantive constraints. *Id.* at 271-72.

<sup>24</sup> A "majority default" seeks to mimic the expected results of actual bargaining and thus to minimize transaction costs. Allocative efficiency can sometimes be promoted by a "penalty default" or an "information-forcing default" that operates against the party in the best position to initiate informed bargaining. Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 95-100 (1989). But a nonmajority default rule might instead reflect social norms about the better rule. *Id.* at 95.

<sup>25</sup> See Issacharoff, *supra* note 7, at 1791-97; Cass R. Sunstein, *Switching the Default Rule*, 77 N.Y.U. L. REV. 106, 119-23 (2002). Indeed, in one sense that is what the law has done: by dismantling many formalistic hurdles to showing a binding promise of job security, and by recognizing some oral and implied promises of job security, the law in many jurisdictions induces employers to act as though the default rule were "for cause" discharge, and to assert the power to terminate employees at will through express disclaimers. See Cynthia L. Estlund, *How Wrong Are Employees About Their Rights, And Why Does It Matter?*, 77 N.Y.U. L. REV. 6, 7-8 (2002).

contrary. We tend to use the language of waiver and of rights when public law has claimed a stake in the terms of the parties’ relationship, and does not relegate those terms to the ordinary rules of contract interpretation. Public law can thus make rights more or less waivable; the law might, for example, entrench an employee right by requiring that a waiver be “knowing and voluntary.” But those who are skeptical of employees’ ability to protect their interests through contract find little comfort for employees—other than a modest gain in transparency—in rights that can be waived and default rules that fill contractual gaps, for employers often have little difficulty exacting waivers and filling gaps when it behooves them to do so.<sup>26</sup> Still, the existence of waivable rights and penalty default rules makes the choice between a rights approach and a contract approach look less like a binary one and more like a spectrum of possibilities.<sup>27</sup>

Yet there remains some underexplored territory along that spectrum between contract and rights. Both arbitration agreements and non-compete covenants take the form of contracts—contracts that waive employee rights. Mandatory arbitration agreements waive the employee’s right to litigate future legal claims in court. Non-compete covenants waive part of the employee’s right to compete with the employer after employment has ceased. But these are not ordinary contracts, and the employee rights at stake are not ordinary rights—they are neither nonwaivable, like most employee rights, nor waivable in the ordinary sense. They are conditionally waivable rights.



<sup>26</sup> Catherine L. Fisk, *Reflections on the New Psychological Contract and the Ownership of Human Capital*, 34 CONN. L. REV. 765, 768-71 (2002).

<sup>27</sup> Another configuration of contract and regulation is exemplified by the law of pensions. Employers generally have no obligation to offer pension (or health) benefits at all; employees thus have no right to a pension except as a matter of contract. But if employers do agree to provide pensions, the pension plans are highly regulated, mainly by the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. §§ 1001-1461 (2000). Pension plans thus combine elements of contract and of regulation, but in a way that is distinct from the hybrid of conditionally waivable rights. ERISA cannot be understood as a set of legal conditions on waiver, as there are no underlying rights being waived.

### B. *A Primer on Non-Compete and Arbitration Agreements*

Both non-compete covenants and arbitration agreements waive employee rights established by external law. Both must be express and written.<sup>28</sup> That alone sets them apart from most terms of the employment relationship, which, like ordinary contractual terms, can be established by oral or implied agreement. Moreover, it is not enough that the employee knowingly and voluntarily enter into these agreements; to be valid, they must meet substantive criteria drawn from external law. That is what places them in the hybrid category of “conditional waivability.” A brief introduction to the law of mandatory arbitration agreements and of non-compete covenants will elaborate the point and help set the stage for the rest of my argument.

*Non-Compete Covenants:* By entering into a non-compete covenant, an employee agrees, usually early in the employment, not to enter into certain forms of competition with the employer for some period of time after employment has ceased. States vary in their treatment of non-compete agreements, though all recognize that, as contracts in restraint of competition, they are subject to limitations in the interest of the public and the restricted individual.<sup>29</sup> Covenants that restrain former employees from competing are subject to an extra measure of scrutiny (as compared to non-compete covenants in connection with the sale of a business, for example) in light of the employee’s disadvantageous bargaining position at the time of contracting and hardship at the time of enforcement.<sup>30</sup> In the more colorful words of a

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<sup>28</sup> A few states recognize oral non-compete agreements; the large majority do not. A few states also recognize a form of implied non-compete agreement by way of the doctrine of “inevitable disclosure” of trade secrets in very unusual circumstances. *See infra* text accompanying notes 38-40. Commentators have been highly skeptical of these implied non-compete agreements. *See, e.g.,* Rachel S. Arnow-Richman, *Bargaining for Loyalty in the Information Age: A Reconsideration of the Role of Substantive Fairness in Enforcing Employee Noncompetes*, 80 OR. L. REV. 1163, 1170 (2001).

<sup>29</sup> These contracts run afoul of the well-established public policy against contracts in restraint of trade, *see* RESTATEMENT (SECOND) OF CONTRACTS § 186(1) (1981), but they fall into a safe harbor for “reasonable” restraints on competition that are “ancillary to an otherwise valid transaction or relationship.” *Id.* § 188.

<sup>30</sup> *See id.* § 188 cmt. g (“Postemployment restraints are scrutinized with particular care because they are often the product of unequal bargaining power and because the employee is likely to give scant attention to the hardship he may later suffer through loss of his livelihood.”). The *Restatement* also suggests that the employer’s interest in

turn-of-the-century Georgia court, such covenants “tend to injure the parties making them; diminish their means of procuring livelihoods and a competency for their families; tempt improvident persons . . . and expose them to imposition and oppression.”<sup>31</sup>

Some observers assume that it is chiefly high-level executives who are asked to sign covenants not to compete; that assumption is bound to color one’s view of the need for legal oversight of these agreements. But as firms’ profits have come increasingly to depend on information that is carried around in the heads of employees, non-compete covenants have filtered down to lower-level employees with relatively little sophistication, bargaining power, or economic wherewithal.<sup>32</sup> At the same time, employees are increasingly unlikely to enjoy any explicit or even implicit promise of job security, or to spend their career within a single firm.<sup>33</sup> The growth of the information-based economy has converged with increasing job mobility to generate an upsurge in covenants not to compete, as well as in scholarly attention to those covenants.<sup>34</sup>

California stands at the most restrictive end of the spectrum. By statute, “every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent

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restraining competition from former employees is “less clear” and often more difficult to separate from “normal skills of the trade” than in the case of the purchasers of a business. *Id.* § 188 cmt. b. An early (pre-*Restatement*) study of non-compete covenants found that postemployment restraints were almost never enforced, while restraints in connection with sale of a business were regularly enforced. Herman Oliphant, *A Return to Stare Decisis*, 14 A.B.A. J. 71, 159 (1928), cited in Brian Leiter, *Rethinking Legal Realism: Toward a Naturalized Jurisprudence*, 76 TEX. L. REV. 267, 281-82 (1997).

<sup>31</sup> *Rakestraw v. Lanier*, 30 S.E. 735, 738 (Ga. 1898).

<sup>32</sup> For evidence of employers’ increasing use of non-compete covenants, see KATHERINE V.W. STONE, FROM WIDGETS TO DIGITS: EMPLOYMENT REGULATION FOR THE CHANGING WORKPLACE 128 n.3 (2004). I recently heard of two law students who were required to sign non-compete agreements in pre-law-school jobs (not as high-level executives!). They did so either reluctantly or with little thought because they wanted the jobs, and then later felt compelled to reject attractive job opportunities that they feared might violate the terms of the non-compete agreement.

<sup>33</sup> See *id.* at 93.

<sup>34</sup> Recent scholarly treatments include ALAN HYDE, WORKING IN SILICON VALLEY: ECONOMIC AND LEGAL ANALYSIS OF A HIGH-VELOCITY LABOR MARKET 33 (2003); STONE, *supra* note 32, at 127-56; Arnow-Richman, *supra* note 28; Catherine L. Fisk, *Working Knowledge: Trade Secrets, Restrictive Covenants in Employment, and the Rise of Corporate Intellectual Property, 1800–1920*, 52 HASTINGS L.J. 441 (2001); Ronald J. Gilson, *The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete*, 74 N.Y.U. L. REV. 575, 602-09 (1999); Gillian Lester, *Restrictive Covenants, Employee Training, and the Limits of Transaction-Cost Analysis*, 76 IND. L.J. 49, 59-71 (2001).

void.”<sup>35</sup> While the California courts have recognized in principle an exception for covenants that are necessary to protect trade secrets, they seem never to have actually met such a covenant.<sup>36</sup>

Other states are more tolerant of these covenants, though none treat them like ordinary contracts.<sup>37</sup> A non-compete covenant may meet all the usual requirements of a contract and yet be invalid if it places excessive constraints on postemployment competition. The *Restatement* provides that the covenant is void as an unreasonable restraint of trade if “the restraint is greater than is needed to protect the promisee’s legitimate interest,” or if “the promisee’s need is outweighed by the hardship to the promisor and the likely injury to the public.”<sup>38</sup> So in order to enforce a covenant, even one to which the employee knowingly and voluntarily agreed, the employer must show (1) that it has a legitimate protectible interest at stake; (2) that the particular restrictions are closely tailored to the protection of those legitimate interests; and (3) that the restrictions are not too burdensome to the public or the employee.

The protection of trade secrets is the quintessential legitimate employer interest, but most jurisdictions recognize other employer interests, such as long-term customer relationships and goodwill, that would give a former employee an “unfair advantage” in competition and thus can support a non-compete covenant. A simple desire to avoid competition from the former employee or to retain the employee’s services, however rational, is not a legitimate or protectible

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<sup>35</sup> CAL. BUS. & PROF. CODE § 16600 (West 1997). Nearly as restrictive are the laws of Colorado, *see* COLO. REV. STAT. § 8-2-113 (1986) (voiding covenants not to compete save four exceptions), and North Dakota, *see* N.D. CENT. CODE § 9-08-06 (2006) (limiting the use of covenants not to compete to the sale of goodwill or partnership interests).

<sup>36</sup> *See* Gilson, *supra* note 34, at 607-08.

<sup>37</sup> Some judges advocate a more ordinary contractual treatment of these covenants. *See, e.g.,* *Outsource Int’l, Inc. v. Barton*, 192 F.3d 662, 669–72 (7th Cir. 1999) (Posner, J., dissenting) (recommending a more deferential posture toward non-compete covenants as a matter of policy, though opining that existing Illinois law did not support enforcement of the covenant at issue); *Robert’s Hair Designers, Inc. v. Pearson*, 780 N.E.2d 858, 869 (Ind. Ct. App. 2002) (enforcing a non-compete covenant in view of “[a] very strong presumption of enforceability of contracts that represent the freely bargained agreement of the parties” (quoting *Eck & Assocs., Inc. v. Alusuisse Flexible Packaging, Inc.*, 700 N.E.2d 1163, 1167 (Ind. Ct. App. 1998))).

<sup>38</sup> RESTATEMENT (SECOND) OF CONTRACTS § 188(1)(a)-(b) (1981). Georgia law provides a typical statutory formulation: such a covenant is valid if it is “reasonable, founded on valuable consideration, reasonably necessary to protect the [employer’s] interest . . . and . . . does not unduly prejudice the interest of the public.” *Riddle v. Geo-Hydro Engineers, Inc.*, 561 S.E.2d 456, 458 (Ga. Ct. App. 2002).

interest.<sup>39</sup> Nor is the value of experience or specialized training afforded to the employee; that enhancement of the employee's general skills is deemed to belong to the employee as an inalienable aspect of self-ownership.<sup>40</sup>

Even if the employer can make the threshold showing of a protectible interest, the agreed-upon restraints on postemployment competition must be reasonable—that is, no broader than necessary in duration, in geographic reach, and in the activities covered to protect the employer's legitimate interest.<sup>41</sup> So, for example, if the employer's legitimate interest is in the protection of long-term relationships with orthodontic patients, the restraint on competition may not reach beyond the geographic limits of the employer's patient base; it may not last longer than necessary for the employer to introduce patients to a replacement orthodontist (no more than several months if that is the normal interval between orthodontic visits); and it must be limited to orthodonty and may not extend to general dentistry.<sup>42</sup> It matters not if the employee had agreed to longer or broader limits on postemployment competition; those limits will be struck (or perhaps revised) if they are longer or broader than necessary.

Finally, even agreements that are necessary to protect the employer's legitimate interests may be void if they impose too great a hardship on the public (for example, by promoting a monopoly or interfering with confidential patient and client relationships)<sup>43</sup> or on the promisor/employee.<sup>44</sup> In particular, "the harm caused to the employee may be excessive if the restraint inhibits his personal freedom by preventing him from earning his livelihood if he quits."<sup>45</sup>

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<sup>39</sup> RESTATEMENT (SECOND) OF CONTRACTS § 188 cmt. b (1981); *see also* *Hasty v. Rent-A-Driver, Inc.*, 671 S.W.2d 471, 473 (Tenn. 1984) (noting that an employer must show "special facts present over and above ordinary competition" that would otherwise give the former employee "an unfair advantage").

<sup>40</sup> Harlan M. Blake, *Employee Agreements Not To Compete*, 73 HARV. L. REV. 625, 652 (1960).

<sup>41</sup> RESTATEMENT (SECOND) OF CONTRACTS § 188 cmt. d.

<sup>42</sup> *Karpinski v. Ingrasci*, 268 N.E.2d 751, 755-56 (N.Y. 1971).

<sup>43</sup> RESTATEMENT (SECOND) OF CONTRACTS § 188 cmt. c. The rules of professional responsibility for attorneys generally prohibit the imposition of non-compete agreements. *See* MODEL RULES OF PROF'L CONDUCT R. 5.6 (1983).

<sup>44</sup> *See* *Valley Med. Specialists v. Farber*, 982 P.2d 1277, 1283-85 (Ariz. 1999) (holding that the employer's interest in protecting its patient base was outweighed by other factors, including the personal relationship between doctor and patient).

<sup>45</sup> RESTATEMENT (SECOND) OF CONTRACTS § 188 cmt. c.



The doctrine follows these same basic lines across the country (outside of California). Some jurisdictions (Texas, for example, at least until recently) apply the doctrine with a strong background presumption against validity—a predisposition against these restraints on freedom of labor and competition.<sup>46</sup> That translates into something akin to “strict scrutiny,” with demands for more “compelling” employer interests and a tighter fit between those interests and the covenant’s restrictions. That approach can lead, as it does in its constitutional version, to the consideration of “less restrictive alternatives,” such as nonsolicitation and nondisclosure restraints that do not tread on the employee’s ability to work. Other jurisdictions apply the same basic doctrinal limitations with less rigor and regularly enforce non-compete agreements under something like a “rule of reason.” For example, Massachusetts law, which appears to be fairly representative,<sup>47</sup> entertains a relatively broad range of legitimate employer interests—trade secrets, confidential information, and goodwill—and regularly enforces covenants as reasonably “necessary” to protect those interests.<sup>48</sup> Across the country, however, postemployment covenants not to compete are subject not merely to the ordinary requirements of contract law but to additional substantive conditions that external law imposes on these agreements in particular.<sup>49</sup>

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<sup>46</sup> The Texas courts’ traditional hostility to non-compete covenants provoked a series of legislative interventions aimed at securing the enforceability of such covenants. The courts responded with restrictive interpretations of the law that preserved their discretion to deny enforcement. For a review of the saga through 2000, see Ernest C. Garcia & Fred A. Helms, *Covenants Not To Compete and Not To Disclose*, 64 TEX. B.J. 32, 33-35 (2001). Recently the Texas Supreme Court enforced a non-compete covenant under standards that clearly make it easier to do so. Under prior law, a covenant was unenforceable if consideration took the form of unenforceable promises by the employer; under *Sheshunoff*, such a covenant becomes enforceable once the employer makes good on those promises. *Alex Sheshunoff Mgmt. Servs. v. Johnson*, No. 03-1050, 2006 WL 2997287, at \*1 (Tex. Sup. Ct. Oct. 20, 2006). The upshot, according to a Texas lawyer who represents employees, is that “Texas has gone from being employee-friendly to employer-friendly on noncompetes.” Mary Alice Robbins, *High Court Makes Noncompete Covenants Easier To Enforce*, TEX. LAW., Oct. 30, 2006, at 7, 7.

<sup>47</sup> See Gilson, *supra* note 34, at 603.

<sup>48</sup> See *id.* at 603-06.

<sup>49</sup> In the words of Professor Stone, “[c]ovenants not to compete occupy a peculiar legal ‘Never-Never Land’ between contract and tort, in which party consent and externally imposed obligation are intimately and complexly intertwined.” Katherine V.W. Stone, *Knowledge at Work: Disputes Over the Ownership of Human Capital in the Changing Workplace*, 34 CONN. L. REV. 721, 739-40 (2002).

One might object that none of this places non-compete agreements outside the domain of ordinary contract, and that the legal standards governing these agreements are merely specific elaborations of the limitations that public policy—in this case the public policy against restraints on competition—places upon contracts generally. This objection may take two forms. First, some readers may deny that the law of non-competes has much to do with the protection of employee rights, as opposed to the public interest in competition that is expressed in the general public policy against agreements in restraint of trade.<sup>50</sup> To that objection, I would point to the many cases that explain the rigorous scrutiny of postemployment non-competes in terms of the former employee's freedom to work in her trade or occupation, as well as her freedom during the employment relationship to quit.<sup>51</sup>

Another form of the objection is more conceptual: even if the limitations on non-competes do protect employee rights, they can be adequately understood without leaving the domain of contract through the lens of public policy limitations on contract. But public policy is only *part* of the domain of contract in the sense that it is a particularly familiar and well-established *constraint* on contract. To be sure, the entire domain of freedom of contract is bounded by competing principles, including the nonwaivable rights of contracting parties. The question is not whether the law's conditions on non-compete covenants are really just a reflection of public policy; it is whether it is illuminating to think of them as conditions on the waiver of employee rights. When the public policy constraints on a particular type of contract crystallize into discrete substantive criteria for validity, then the form itself raises distinct issues (as we shall see shortly) and is worth examining, as I aim to do here.

In my view, treating the legal constraints on non-competes as ordinary public policy constraints on contract obscures more than it illuminates, for it is equally possible to crowd the entire edifice of employee rights under the rubric of public policy constraints on contract. If we can agree that there is a basic difference in the employment rela-

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<sup>50</sup> The *Restatement* does treat the law on ancillary restraints on competition, including postemployment restraints, within the chapter on unenforceability on grounds of public policy. RESTATEMENT (SECOND) OF CONTRACTS §§ 187–188 (1981).

<sup>51</sup> See, e.g., *C.G. Caster Co. v. Regan*, 357 N.E.2d 162, 165 (Ill. App. Ct. 1976); *Solari Indus., Inc. v. Malady*, 264 A.2d 53, 56–57 (N.J. 1970); *Reed, Roberts Assocs., Inc. v. Strauman*, 353 N.E.2d 590, 593 (N.Y. 1976); *Hopper v. All Pet Animal Clinic, Inc.*, 861 P.2d 531, 539 (Wyo. 1993).

tionship between terms that are left to contract and those that are established by external law in the form of legal rights, then we can also agree that the terms that are covered by non-compete covenants partake of both. Whether those terms are well described by the term “conditional waivability,” as opposed to, for example, “partial waivability,” is a question to which I will return below.

*Arbitration Agreements:* Mandatory arbitration agreements also represent the hybrid form of “conditional waiver.” These agreements waive the right to litigate employment claims in court, including claims under state and federal statutes. The terms of that waiver are subject to scrutiny under substantive criteria drawn from external law. The external law in this case stems from a variety of sources.

The Supreme Court held in *Gilmer v. Interstate/Johnson Lane Corp.*<sup>52</sup> and *Circuit City Stores, Inc. v. Adams*<sup>53</sup> that the Federal Arbitration Act of 1923 (FAA) makes enforceable agreements to arbitrate rather than to litigate employment claims, including state and federal statutory discrimination claims. The FAA provides that agreements to substitute arbitration for litigation “shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.”<sup>54</sup> It thus preempts state laws and doctrines that single out arbitration agreements for disfavored treatment, while preserving general constraints on contract (the unconscionability doctrine or the need for consideration, for example). But the FAA itself imposes some requirements of a fair arbitral process and award.<sup>55</sup> The Supreme Court has also held that an agreement to arbitrate statutory claims, to be valid, must enable plaintiffs “effectively [to] vindicate” their substantive statutory rights.<sup>56</sup> In particular, it must preserve all rights and remedies to which substantive law entitles the plaintiff (e.g., attorneys fees under Title VII); only the judicial forum, not the underlying claim, is waivable.<sup>57</sup>

The Supreme Court added the “effectively vindicate” standard to the mix, not coincidentally, when the FAA and the enforceability of mandatory arbitration agreements were first clearly extended to statu-

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<sup>52</sup> 500 U.S. 20, 26 (1991).

<sup>53</sup> 532 U.S. 105, 123 (2001).

<sup>54</sup> 9 U.S.C. § 2 (2000).

<sup>55</sup> See 9 U.S.C. § 10(a) (2000) (setting out grounds for vacation of arbitral awards).

<sup>56</sup> *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 28 (1991) (citing *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 (1985)).

<sup>57</sup> *Id.* at 26 (citing *Mitsubishi*, 473 U.S. at 628).

tory claims.<sup>58</sup> When an arbitration agreement covers only contractual claims—and that was the main domain of arbitration when the FAA was enacted—it raises no special concerns to allow the parties to contract for highly abbreviated dispute resolution procedures as part of the overall transaction; the rudimentary standards of the FAA may be sufficient. But when arbitration agreements encompass statutory rights, the freedom to contract over dispute resolution procedures must be constrained to ensure that the public interest and the statutory rights are protected. When the rights at issue are themselves nonwaivable, such constraints are necessary to ensure that those rights are not effectively waived by the imposition of an unfair or inadequate forum for their adjudication.<sup>59</sup>

So arbitration agreements are subject to challenge under three different bodies of law: the FAA itself, generally applicable state law governing contracts, and the law governing the employee's underlying substantive claim. Under one or another of these (sometimes unspecified) bodies of law, courts have struck down provisions that impose too great a cost on employees in the form of excessive arbitrator fees;<sup>60</sup> that limit a prevailing plaintiff's ability to recover attorneys' fees or punitive damages where the substantive law allows such recovery;<sup>61</sup> that put unreasonable time limits on the filing of claims;<sup>62</sup> that do not allow reasonable discovery;<sup>63</sup> that give the employer greater power over the selection of arbitrator;<sup>64</sup> that are "one-sided" in covering employee but not employer claims;<sup>65</sup> or that are "illusory" in that the em-

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<sup>58</sup> This phrase first appeared in *Mitsubishi*, 473 U.S. at 637, which decisively rejected the argument that statutory claims, including federal statutory claims, were categorically unsuitable or less suitable for arbitration.

<sup>59</sup> The argument here is infused with due process concerns, which are discussed below. See *infra* text accompanying notes 89-95.

<sup>60</sup> See *Alexander v. Anthony Int'l, L.P.*, 341 F.3d 256, 270 (3d Cir. 2003); *Ferguson v. Countrywide Credit Indus., Inc.*, 298 F.3d 778, 785-86 (9th Cir. 2002); *Shankle v. B-G Maint. Mgmt. of Colo., Inc.*, 163 F.3d 1230, 1235 (10th Cir. 1999); *Cole v. Burns Int'l Sec. Servs.*, 105 F.3d 1465, 1485 (D.C. Cir. 1997).

<sup>61</sup> See *Morrison v. Circuit City Stores, Inc.*, 317 F.3d 646, 673 n.15 (6th Cir. 2003) (en banc); *Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165, 1177-78 (9th Cir. 2003); *Alexander*, 341 F.3d at 267; *McCaskill v. SCI Mgmt. Corp.*, 298 F.3d 677, 680 (7th Cir. 2002).

<sup>62</sup> See *Ingle*, 328 F.3d at 1175; *Alexander*, 341 F.3d at 266; *Plaskett v. Bechtel Int'l, Inc.*, 243 F. Supp. 2d 334, 341-42 (D.V.I. 2003).

<sup>63</sup> See *Ferguson*, 298 F.3d at 786-87.

<sup>64</sup> See *Murray v. United Food & Commercial Workers Int'l Union, Local 400*, 289 F.3d 297, 303 (4th Cir. 2002).

<sup>65</sup> See *Ingle*, 328 F.3d at 1173; *Ferguson*, 298 F.3d at 785; *Gibson v. Neighborhood Health Clinics, Inc.*, 121 F.3d 1126, 1131-32 (7th Cir. 1997).

ployer reserves the right to change any feature of the agreement at any time.<sup>66</sup>

Much of the judicial scrutiny of arbitration agreements is carried out under the formal umbrella of unconscionability doctrine, a component of ordinary state contract law. Of course, all contracts are subject to unconscionability constraints; one might argue that the courts are up to nothing new in holding mandatory arbitration agreements up to scrutiny under this doctrine—or that, if they are up to something new in these cases, they are violating the strictures of the FAA, which preempts state doctrines that single out arbitration agreements for hostile treatment.<sup>67</sup> It appears, however, that unconscionability often serves as a doctrinal vehicle—a flawed vehicle, as I will later show—for protecting the employee's underlying substantive rights and remedies. An agreement that is skewed in the employer's favor, or that sets up unreasonable hurdles to adjudication, threatens the vindication of the employee's substantive rights every bit as much as an agreement that expressly bars a legally authorized remedy. In other words, such an agreement operates to waive substantive rights of employees that the law deems nonwaivable.

One might still parse this constellation of constraints on arbitration agreements into its separate parts and contend that nothing interestingly hybrid is really happening. Under the FAA, state contract law can condition the enforceability of these agreements only to the same extent that it conditions the enforceability of contracts generally; the constraints that substantive employment law places on these agreements merely enforce the nonwaivability of the underlying employee rights. On that understanding, arbitration agreements amount to nothing more than the ordinary contractual waiver of the right to litigate nonwaivable rights—not a hybrid form but merely a specific application of the law of contract where it intersects with the domain of rights.

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<sup>66</sup> See *Hooters of Am., Inc. v. Phillips*, 173 F.3d 933, 939-40 (4th Cir. 1999); *Perez v. Hospitality Ventures-Denver LLC*, 245 F. Supp. 2d 1172, 1174-75 (D. Colo. 2003).

<sup>67</sup> Judge Easterbrook, in *Obliv, Inc. v. Winiecki*, thus noted that applying a heightened standard of unconscionability to arbitration agreements would be preempted by the FAA. 374 F.3d 488, 492 (7th Cir. 2004). For an argument that California's unconscionability analysis of arbitration agreements is preempted, see Michael G. McGuinness & Adam J. Karr, *California's "Unique" Approach to Arbitration: Why This Road Less Traveled Will Make All the Difference on the Issue of Preemption Under the Federal Arbitration Act*, 2005 J. DISP. RESOL. 61, 62.

The sheer volume of doctrine arising out of these agreements suggests, however, that more is going on here than the application of ordinary contract law to agreements that affect ordinary rights. First, the law does not permit the wholesale waiver, however “voluntary,” of the right to litigate nonwaivable employment claims; it permits only the substitution of a fair alternate forum—arbitration that deserves the name, with impartial decision makers and at least minimally fair and adequate procedures.<sup>68</sup> The FAA’s requirements alone thus make the law of arbitration agreements an example of “conditional waivability.” The two other relevant bodies of law—the law governing contracts generally, and the law governing the underlying claim—work in tandem to place additional conditions on the validity of arbitration agreements. In particular, they guard against agreements that skew the process in the employer’s favor, or that otherwise impede the employee’s ability to invoke the arbitral forum or to effectively vindicate substantive rights. That this scrutiny often takes place under the rubric of unconscionability should not obscure the fact that something different is at work than ordinary contract law, nor should it condemn that extra scrutiny to FAA preemption. We will return to this point in Part III below.

One familiar with these cases cannot fail to recognize an emerging body of law that is specific to mandatory arbitration agreements, and that is evolving toward settled standards of fairness—adequate or otherwise—that condition the enforceability of these agreements. The law of mandatory arbitration agreements, like the law of non-compete covenants, straddles the divide between rights and contract by imposing substantive conditions on contracts that waive certain rights.

### C. *Parallel Problems Arising out of Conditional Waivability*

A skeptical reader may still object to the parallel drawn here between these two disparate bodies of law, and to the very concept of

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<sup>68</sup> For example, in *Hooters of America, Inc.*, the Fourth Circuit struck down an “arbitration agreement” that, in the court’s view, did not deserve to be called arbitration at all: “Hooters materially breached the arbitration agreement by promulgating rules so egregiously unfair as to constitute a complete default of its contractual obligation to draft arbitration rules and to do so in good faith.” 173 F.3d at 938. Interestingly, as the foregoing passage indicates, the *Hooters* court invoked another doctrine that is part of the general law of contract: the implied covenant of good faith and fair dealing. The agreement at issue was “so egregiously unfair,” however, that its invalidity was overdetermined; the same result could have been reached under unconscionability analysis, the “effectively vindicate” standard, or the FAA itself.

conditional waivability that is said to unite them. In both cases, the doctrine that I describe here as establishing conditions on the waiver of rights could be described differently. The right to compete could be viewed not as a conditionally waivable right but as a partially waivable right, or as a bundle of rights, some of which can be given up and some of which cannot. The determination of which is which may be fact specific and complex, but it may not require the invention of a new category such as I have proffered. Similarly, the right to litigate future rights claims might be described as an ordinary waivable right, behind which lies a nonwaivable right to a fair and impartial adjudicatory process. Perhaps the term “conditional waivability” conflates what are really two unusual but different juxtapositions of waivable and nonwaivable rights.

As a conceptual matter, I will provisionally concede that the law that I describe as setting conditions on waiver could also be described as drawing a line between the waivable and the nonwaivable components of the right to compete, or as delineating the contours of the nonwaivable right to a fair hearing that lies behind the waivable right to litigate. But I want to postpone discussion of whether anything is gained or lost by those alternative characterizations and whether they render illusory the concept of conditional waivability. For if the claim is that these two bodies of law have rather little in common after all, then it may be useful first to delve a bit deeper into what they do have in common.

The first thing that mandatory arbitration agreements and non-compete agreements have in common is rather discouraging: they generate an unusual number of disputes about their validity.<sup>69</sup> That may be a reason for caution down the line when we consider whether to make broader use of conditional waivability. For it may be precisely the intersection of rights and contract that makes these agreements such prolific sources of litigation. The contractual platform enables parties—read “employers”—wide discretion in drafting agreements, and generates almost endless variety in the kinds of provisions that might be included. Those provisions are potentially reviewable in court under multifaceted (and, in the case of arbitration agreements, still-evolving) legal standards that govern validity. Conditionally waiv-

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<sup>69</sup> Professor Stone maintains that “disputes over ownership of human capital”—mostly involving postemployment restraints on competition—“are becoming one of the most frequently litigated issues in the employment law field.” STONE, *supra* note 32, at 128.

able rights have neither the uniformity of ordinary rights nor the presumptive validity of ordinary contracts.

In each case there is much controversy over whether these agreements are subject to too little or too much judicial oversight. That debate has a great deal to do with the basic tension between a rights approach and a contract approach to regulating employment. Those who put much faith in the fairness and efficiency of contract call for more contractual freedom and less judicial oversight of both non-compete and arbitration agreements.<sup>70</sup> Those who weigh the underlying rights at stake most heavily, or who are most skeptical of employees' ability to bargain effectively for themselves, advocate for more rigorous scrutiny and higher standards for the validity of these agreements.<sup>71</sup>

Indeed, in each case there are those who contend that these contracts should never, or almost never, be valid—that the rights that employees thereby give up ought not to be up for grabs by employers on what is almost inevitably an uneven bargaining table.<sup>72</sup> They con-

<sup>70</sup> See, e.g., *Oblivion*, 374 F.3d at 491 (“It is hard to see how the arbitration clause is any more suspect, or any less enforceable, than the others—or, for that matter, than her salary.”); *Outsource Int'l, Inc. v. Barton*, 192 F.3d 662, 670 (7th Cir. 1999) (“I can see no reason in today’s America for judicial hostility to covenants not to compete.”); cf. *Arnow-Richman*, *supra* note 28, at 1168 (proposing a shift in scrutiny away from the consequences of non-competes and toward the fairness of the agreement at the time of formation, with an eye toward “normaliz[ing] . . . these agreements from the perspective of contract law”). In the case of arbitration, the dispute also reflects a division of opinion over the fairness and adequacy of arbitration itself. Those who come to employment arbitration out of an arbitration background are generally more sanguine about it than those who come to employment arbitration from the perspective of employment law and employee rights.

<sup>71</sup> See, e.g., *STONE*, *supra* note 32, at 156 (advocating stricter scrutiny of non-compete covenants in light of changing expectations about the employment contract); *id.* at 191 (advocating judicially imposed standards of due process on arbitration proceedings).

<sup>72</sup> For arguments against the enforceability of mandatory arbitration agreements, see David S. Schwartz, *Enforcing Small Print To Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled Arbitration*, 1997 WIS. L. REV. 33, 36 (“[W]here waiver of so important a right as access to the courts is imposed through a contractual form infamous for the absence of real consent, courts should draw a protective line by holding the form term at least presumptively unenforceable.”); Katherine Van Wezel Stone, *Mandatory Arbitration of Individual Employment Rights: The Yellow Dog Contract of the 1990s*, 73 DENV. U. L. REV. 1017, 1019 (1996) (arguing that these agreements “threaten[] to turn back the clock on workers’ rights”). For arguments against the enforceability of (nearly all) covenants not to compete, see Eileen Silverstein, *Bringing Forth a New World from the Ashes of the Old*, 34 CONN. L. REV. 803, 815 (2002) (suggesting “that employees own their human capital and that the claim to knowledge acquired on



tend, in short, for placing the underlying entitlements into the more familiar and conventional category of “rights.” But the law in each case has opted instead for this hybrid form of regulation.

This particular hybrid of external public law and private contract gives rise to some characteristic problems that arise in strikingly parallel form under both non-compete and arbitration agreements. One question is whether such agreements can be made a condition of employment. Employees who are—as most are—terminable at will, can presumptively be terminated for refusing to agree to any terms or to sign any agreement sought by the employer. But because these agreements waive important rights, it has been argued that they must be voluntary, and that an agreement imposed under threat of discharge is not voluntary. Employees have mostly lost those arguments in both cases.<sup>73</sup>

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the job as the ‘property’ of employers is historically wrong and morally offensive”) (footnotes omitted).

<sup>73</sup> In the case of arbitration: contrary to early rulings that consent to arbitration must be knowing and voluntary, *see, e.g.*, *Prudential Ins. Co. of Am. v. Lai*, 42 F.3d 1299, 1304 (9th Cir. 1994), and not a condition of employment, *see, e.g.*, *Penn v. Ryan’s Family Steakhouses, Inc.*, 95 F. Supp. 2d 940, 941, 943 (W.D. Ind. 2000), *aff’d*, 269 F.3d 753 (7th Cir. 2001), most courts have concluded that nothing more than ordinary contractual consent is required (or can be required, consistent with the FAA). *See Caley v. Gulfstream Aerospace Corp.*, 428 F.3d 1359, 1371 (11th Cir. 2005), *cert. denied*, 126 S. Ct. 2020 (2006); *Am. Heritage Life Ins. Co. v. Orr*, 294 F.3d 702, 711 (5th Cir. 2002), *cert. denied*, 123 S. Ct. 871 (2006); *Cole v. Burns Int’l Sec. Servs.*, 105 F.3d 1465, 1482 (D.C. Cir. 1997); *Patterson v. Tenet Healthcare, Inc.*, 113 F.3d 832, 837-38 (8th Cir. 1997); *Melena v. Anheuser-Busch, Inc.*, 847 N.E.2d 99, 103 (Ill. 2006). There is a separate question under the unconscionability doctrine whether arbitration agreements that are imposed as a condition of employment are deemed “procedurally unconscionable” contracts of adhesion, and thus subject to scrutiny for potential “substantive unconscionability” in their terms. *See infra* note 132 and accompanying text.

In the non-compete context, the argument that a non-compete agreement is unenforceable if imposed as a condition of employment has had mixed success. A number of courts have held that an initial promise of new employment, or possibly a promotion to new job responsibilities, will support an otherwise valid covenant not to compete. *See, e.g.*, *Milner Airco, Inc. v. Morris*, 433 S.E.2d 811, 813 (N.C. Ct. App. 1993); *Wilmar, Inc. v. Corsillo*, 210 S.E.2d 427, 429 (N.C. Ct. App. 1974). For a non-compete promise executed during the employment, some courts have held that continued at-will employment is insufficient consideration. *See, e.g.*, *IKON Office Solutions, Inc. v. Belanger*, 59 F. Supp. 2d 125, 131 (D. Mass. 1999); *James C. Greene Co. v. Kelley*, 134 S.E.2d 166, 168 (N.C. 1964); *Maint. Specialties, Inc. v. Gottus*, 314 A.2d 279, 281 (Pa. 1974); *Martin v. Credit Prot. Ass’n*, 793 S.W.2d 667, 669-70 (Tex. 1990). Other courts have held the opposite, enforcing agreements that were imposed as a condition of continued employment. *See, e.g.*, *Mattison v. Johnston*, 730 P.2d 286, 288 (Ariz. Ct. App. 1986); *Abel v. Fox*, 654 N.E.2d 591, 593 (Ill. App. Ct. 1995); *Canter v. Tucker*, 674 N.E.2d 727, 730 (Ohio Ct. App. 1996); *Copeco, Inc. v. Caley*, 632 N.E.2d 1299, 1301 (Ohio Ct. App. 1992).

However, the problem is posed in a more acute form—and in a form that is characteristic of conditionally waivable rights—when the agreement that is presented as a condition of employment is invalid because it violates one or more of the law’s constraints. If the employer were to seek eventually to enforce the agreement, it would be found partially or entirely void regardless of the circumstances in which the employee agreed to it. But if an at-will employee refuses to sign an overbroad non-compete agreement or an unfair arbitration agreement, can the employer fire her? Or is such a discharge contrary to public policy and actionable as an exception to employment at will? The same question arises with both non-compete covenants and arbitration agreements.<sup>74</sup> The right answer turns on an understanding of what rights and interests are at stake and how conditional waivability needs to work to protect those rights and interests, questions to which we will turn shortly.

Another problem that is common to these agreements, and that arises out of the peculiar feature of conditional waivability, is the issue of severability.<sup>75</sup> If one or more provisions of the contract is invalid under external law, does this invalidate the agreement as a whole—leaving the employee free to litigate or to compete with the former employer—or should the court sever invalid clauses, and either strike or reform them, while upholding the remainder of the agreement?<sup>76</sup> In both cases, most courts lean toward severance and toward enforcing the reformed agreement, unless the agreement is egregiously unfair or overbroad. Courts thus tend to reform or strike overbroad provisions of non-competes, but otherwise enforce them, absent evi-

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<sup>74</sup> In the context of non-competes, compare *D’sa v. Playhut, Inc.*, 102 Cal. Rptr. 2d 495, 497 (Cal. Ct. App. 2000) (holding that discharge for refusal to sign an invalid non-compete was wrongful discharge in violation of public policy), with *Maw v. Advanced Clinical Commc’ns, Inc.*, 846 A.2d 604, 608 (N.J. 2004) (finding no public policy implicated by discharge for refusal to sign non-compete covenant), and *Tatge v. Chambers & Owen, Inc.*, 579 N.W.2d 217, 223 (Wis. 1998) (same).

In the context of arbitration agreements, the court in *Lagatree v. Luce, Forward, Hamilton & Scripps LLP* held that no public policy was offended by the discharge of an employee for refusing to sign an arbitration agreement that itself violated no clear public policy, but it left open the possibility that such a discharge would be actionable if the underlying arbitration agreement were clearly invalid. 88 Cal. Rptr. 2d 664, 672 (Cal. Ct. App. 1999).

<sup>75</sup> In principle the issue can arise with any contract, some term of which is, for example, contrary to public policy. The issue arises much more often in the case of these two agreements because there are many more constraints on their terms.

<sup>76</sup> In both cases, the answer may depend to some degree on whether the agreement contains a severability clause. But even if it does, a court may refuse to sever in the case of pervasively unfair or overbroad agreements. See *infra* notes 77-78.

dence of bad faith on the part of the drafter.<sup>77</sup> Similarly, most courts will strike or edit invalid provisions of an arbitration agreement and then compel arbitration, unless the agreement is pervasively unfair.<sup>78</sup>

More striking than the parallel resolutions of this issue, however, are the parallel concerns animating the debate. In both cases, the argument against severance, and for invalidating the whole agreement at a relatively low trigger point, is that this approach raises the cost of contravening legal standards and induces the employer to stay within the law in drafting the agreement (as they are understood to do more or less unilaterally). Judicial willingness to edit or reform agreements, by contrast, may invite employers to overreach. In the non-compete context, for example,

[t]oo great a readiness on the part of courts to preserve the valid portions of overbroad restrictions would induce employers to draft such restrictions overbroadly, intimidating [employees] by the ostensible terms of the written contract and relying on courts to enforce the valid portion against an employee who is not intimidated.<sup>79</sup>

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<sup>77</sup> See MARK A. ROTHSTEIN ET AL., *EMPLOYMENT LAW* 725-26 (3d ed. 2005). While the “modern trend” is thus to reform overbroad covenants unless they are “deliberately unreasonable,” *id.* at 726, some courts take one of two stricter views: some hold that overbroad covenants cannot be enforced at all. *Id.* at 725; *see, e.g.*, *Rector-Phillips-Morse, Inc. v. Vroman*, 489 S.W.2d 1, 3 (Ark. 1973) (refusing to enforce for any period of time an agreement that called for a three-year ban on competition). A smaller number of courts follow the “blue pencil” rule, under which they may delete offending provisions (but not rewrite them) and enforce the remainder of the agreement if it is then reasonable. ROTHSTEIN, *supra*, at 726; *e.g.*, *Licocci v. Cardinal Assocs., Inc.*, 432 N.E.2d 446, 453 (Ind. App. 1982), *vacated*, 445 N.E.2d 556 (Ind. 1983).

<sup>78</sup> That is, unless the court concludes that the employer acted in “bad faith or in an attempt to contravene public policy,” or “numerous invalid or biased provisions in an agreement combine to undermine the validity of an agreement.” *Booker v. Robert Half Int’l, Inc.*, 315 F. Supp. 2d 94, 108-09 (D.D.C. 2004) (citing *Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165 (9th Cir. 2003); *Hooters of Am. v. Phillips*, 173 F.3d 933, 940 (4th Cir. 1999); *Graham Oil Co. v. ARCO Products Co.*, 43 F.3d 1244, 1248 (9th Cir. 1994)).

<sup>79</sup> *Webcraft Techs., Inc. v. McCaw*, 674 F. Supp. 1039, 1047 (S.D.N.Y. 1987). Similarly, a Georgia court, in rejecting the blue pencil rule, noted:

Employers covenant for more than is necessary, hope their employees will thereby be deterred from competing, and rely on the courts to rewrite the agreements so as to make them enforceable if their employees do compete. When courts adopt severability of covenants not to compete, employee competition will be deterred even more than it is at present by these overly broad covenants against competition.

*Howard Schultz & Assocs., Inc. v. Broniec*, 236 S.E.2d 265, 269 (Ga. 1977); *see also* Philip J. Closius & Henry M. Schaffer, *Involuntary Nonservitude: The Current Judicial Enforcement of Employee Covenants Not To Compete—A Proposal for Reform*, 57 S. CAL. L. REV. 531, 547 (1984) (arguing that judicial reform of overbroad covenants “encourage[s]

If the worst that can happen is that the offending clauses will be struck in the event of judicial review, why not take the chance? There may be no judicial review at all. In the meantime, an unlawfully broad or skewed agreement may accomplish the employer's illegitimate purpose. An overbroad non-compete—one that lasts too long or that covers activities that do not threaten the employer's legitimate interests—may deter the employee from quitting and competing even when she has a right to do so, or it may deter a competitor from hiring the employee.<sup>80</sup> A skewed arbitration agreement—one that gives the employer its pick of arbitrators or denies attorneys' fees to prevailing plaintiffs—may deter the employee from litigating her claim or deter an attorney from taking the case.<sup>81</sup>

Even in this comparatively minor lacuna of the law, the parallels between the two legal doctrines, and between the concerns that animate competing views, suggest again that these two areas of employment law have more in common than first meets the eye. Enough unites them at a structural level to warrant digging one level deeper in search of some common explanation for the choice of this hybrid form of regulation, instead of either an ordinary contract or an ordinary rights-like approach.

## II. THE LOGIC OF CONDITIONALLY WAIVABLE RIGHTS

What explains the choice of conditional waivability as opposed to the more familiar poles of the rights-contract spectrum? I am not looking for a causal or historical explanation, but for more of a justification: why should the rights at stake in arbitration and non-compete agreements be waivable at all? And if they are to be waivable, why only under substantive conditions specified by external law? If the reasons for "conditional waivability" in the two cases were unrelated and grounded entirely in the substantive policies at stake, then there

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employers to be 'unreasonable' in drafting covenants"); *accord* Arnow-Richman, *supra* note 5, at 167.

<sup>80</sup> See ROTHSTEIN, *supra* note 77, at 725-26.

<sup>81</sup> See, e.g., *Perez v. Globe Airport Sec. Servs.*, 253 F.3d 1280, 1286-87 (11th Cir. 2001), *vacated by* 294 F.3d 1275 (11th Cir. 2002) (refusing to sever an invalid provision limiting employee remedies, and declining to compel arbitration, because this "would reward the employer for its actions and fail to deter similar conduct by others"). *But see* *Gannon v. Circuit City Stores, Inc.*, 262 F.3d 677, 682 n.7 (8th Cir. 2001) (rejecting the "no-severance rule" because the incentive that severance may give employers to include invalid terms is offset by the disincentive produced by the cost of litigating over those provisions).

would not be much to say about them that has not already been said in the voluminous commentary on each of these two types of agreements. But I believe that non-compete covenants and arbitration agreements reach parallel solutions to parallel problems. Beneath their widely divergent policy preoccupations, they share a deeper logic that points toward the middle ground of conditional waivability.

#### A. *Why Not Contract?*

Let us begin with some reasons for rejecting the default solution of ordinary contract or its close cousin, ordinary waivability. The first and most important point to notice is that both agreements steer very close to, and risk treading upon, employee rights that are themselves nonwaivable or inalienable. Indeed, in each case those endangered rights not only are nonwaivable but also reflect constitutional concerns.

Non-compete covenants do not merely restrain competition; they also relinquish aspects of the employee's right to dispose of her labor and to work in her chosen occupation after employment has ceased. The freedom of labor has a fascinating legal history, one that has been intertwined at times with the abolitionist movement and at other times with the *Lochner* era's "liberty of contract."<sup>82</sup> Sometimes the freedom of labor has been depicted as a means to competitive labor markets, but it has also been understood as basic to the individual's economic liberty and welfare.<sup>83</sup> Broad postemployment restrictions on an individual's freedom to work in her occupation are obviously in tension with both dimensions of the freedom of labor.

But perhaps the most troubling effect of non-compete covenants is that, by limiting what the employee can do after leaving the job, they also burden the ability to quit, and with it the ability to demand better wages and working conditions and to resist oppressive conditions in the current job. The Supreme Court has described the right to quit, guaranteed by the Thirteenth Amendment, as a critical "de-

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<sup>82</sup> For a brilliant elucidation of these themes, see Forbath, *supra* note 11.

<sup>83</sup> See cases cited *supra* note 51. For other cases emphasizing the individual freedom to work as a reason for policing postemployment non-compete covenants, see *Woolley's Laundry, Inc. v. Silva*, 23 N.E.2d 899, 901 (Mass. 1939); *Bennett v. Storz Broad. Co.*, 134 N.W.2d 892, 898 (Minn. 1965); *Healthcare Servs. of the Ozarks, Inc. v. Copeland*, No. SC 87083, 2006 WL 2257015, at \*3 (Mo. Aug. 8, 2006); *Grebing v. First Nat'l Bank of Cape Girardeau*, 613 S.W.2d 872, 874 (Mo. Ct. App. 1981); *Arthur Murray Dance Studios of Cleveland, Inc. v. Witter*, 105 N.E.2d 685, 704 (Ohio Ct. Com. Pl. 1952); *Summits 7, Inc. v. Kelly*, 886 A.2d 365, 369-70 (Vt. 2005).

fense against oppressive hours, pay, working conditions, or treatment . . . . When the master can compel and the laborer cannot escape the obligation to go on, there is no power below to redress and no incentive above to relieve a harsh overlordship or unwholesome conditions of work.”<sup>84</sup> The right to quit is thus inalienable.<sup>85</sup>

Of course, a contractual restraint on postemployment activities is not the same as a waiver of the right to quit; however, such a restraint clearly impairs the practical *ability* to quit, and with it the ability to resist oppression.<sup>86</sup> Given the contractual nature of the employment relationship, most of what matters to employees depends on their bargaining power, and their bargaining power depends at least as much on their ability to quit and work elsewhere as on their vulnerability to discharge.<sup>87</sup> There is no doubt that a broad postemployment restraint impairs both the ability to quit and the bargaining power that it entails. A carpenter who gives up the right to practice carpentry within 500 miles of the employer for 10 years after termination of employment may find that quitting is nearly unthinkable, for it would reduce the employee to low-paying unskilled work; if quitting is unthinkable, then a threat to quit over unsatisfactory wages or working conditions lacks credibility. An extremely broad waiver of the right to work elsewhere after quitting, such as would be permitted under an ordinary contractual treatment of these agreements, comes very close in effect to contracting away one’s inalienable right to quit. So the pall of the Thirteenth Amendment and its ban on involuntary servitude hangs over these agreements.<sup>88</sup>

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<sup>84</sup> Pollock v. Williams, 322 U.S. 4, 18 (1944).

<sup>85</sup> See Randy E. Barnett, *Contract Remedies and Inalienable Rights*, 4 SOC. PHIL. & POL’Y 179, 195 (1986); Lea S. VenderVelde, *The Labor Vision of the Thirteenth Amendment*, 138 U. PA. L. REV. 437, 438 (1989). For a critical take on the inalienability of the right to quit, see Wonnell, *supra* note 13, at 89 (positing that an inalienable right to leave employment harms employees).

<sup>86</sup> To be sure, the practical ability to quit may be compromised by any number of economic practicalities, such as seniority rights or health and pension benefits that may not be replaceable on the external job market. But those are benefits that the law does not require the employer to offer at all; they may be seen as “carrots” that induce employees to stay. By contrast, inducing employees to stay by restricting their presumptive right to work elsewhere after quitting looks more like the use of a “stick,” and should arouse much greater legal suspicion.

<sup>87</sup> Employees with job security—a right not to be fired without cause—can more freely protest or reject disagreeable demands or conditions of employment than one employed at will. But at-will employees still have leverage if they are free to quit and the employer wants them to stay.

<sup>88</sup> See Hendrik Hartog, *Stone’s Transitions*, 34 CONN. L. REV. 821, 823 (2002) (equating non-competition agreements with “debt peonage” and “slavery by con-

For their part, arbitration agreements waive the right to litigate over rights that are themselves nonwaivable—for example, the right not to be subject to race discrimination. A waiver of the right to litigate future discrimination claims, if not coupled with an adequate substitute mode of adjudication, effectively waives the underlying right itself. There is no doubt, of course, that a discrimination *claim* may be waived or settled after it has arisen; accordingly, agreements to arbitrate *existing* disputes are uncontroversial. But employees cannot waive *ex ante* the right to be free from discrimination, and that is what they would do, in effect, by agreeing to a highly skewed or prohibitively expensive arbitration process as the exclusive avenue for vindicating future discrimination claims. Such an agreement would insulate the employer from liability for future misconduct and function like a waiver of antidiscrimination rights themselves. This is the primary reason why a waiver of the right to litigate future discrimination claims in favor of arbitration warrants close scrutiny.

Of course, the range of nonwaivable substantive employee rights that are at stake in arbitration agreements runs a wide gamut from very basic civil rights under Title VII, to the right to time-and-a-half pay for overtime, to some genuinely picayune “rights.” What, one might ask, holds these substantive rights together or qualifies them as fundamental, much less constitutional? What holds them together is not their substance but the system of rights enforcement itself. For behind the scenes, but rarely on stage, in discussions of arbitration is the constitutional right to due process of law.<sup>89</sup>

Whether or not it is true that for every legal right there must be a remedy,<sup>90</sup> it must be true that where the law grants both a right and a

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tract”); VanderVelde, *supra* note 85, at 495 (“By abolishing slavery and involuntary servitude, the framers of the thirteenth amendment sought to advance both a floor of minimum rights for all working men and an unobstructed sky of opportunities for their advancement.”); *cf.* Stewart E. Sterk, *Restraints on Alienation of Human Capital*, 79 VA. L. REV. 383, 410-12 (1993) (recognizing, but criticizing, the restrictions on non-compete covenants and their roots in Thirteenth Amendment considerations).

<sup>89</sup> Here I argue only that due process concerns lie behind the law governing mandatory arbitration. A full-blown argument that mandatory arbitration (or a particular mandatory arbitration agreement) is a denial of due process of law would require more detailed consideration of (1) what process is due in connection with the adjudication of nonwaivable employment claims; (2) what would count as a valid waiver of due process rights; and (3) whether the judicial enforcement of an arbitration agreement that does not meet due process standards is state action for purposes of establishing a due process violation. On the last point, see *infra* note 95.

<sup>90</sup> So held the first Justice Marshall, on the authority of no less than Blackstone. *See* *Marbury v. Madison*, 5 U.S. (1 Cranch) 137, 163 (1803) (“[I]t is a general and in-

remedy—that is, a claim for legal redress—that carries with it the right to a fair process for adjudicating the claim.<sup>91</sup> In other words, a substantive legal right and claim for relief is a property interest of which one may not be deprived without due process of law.<sup>92</sup> Due process does not necessarily mean judicial process. Arbitration can supply the essentials of due process: an opportunity to discover relevant facts and present evidence and arguments at an adversarial hearing before an impartial decision maker.<sup>93</sup> However, those essentials can no more be waived than can the underlying rights or remedies. That is, if the underlying substantive legal right is itself nonwaivable *ex ante*, then so must be the right to a fair adjudication of a future claim that the right has been violated, for a predispute waiver of a fair process for adjudicating future rights claims operates as a waiver of the underlying rights themselves.<sup>94</sup> Relegating an individual to an unfair arbitration process for a viable substantive legal claim arguably deprives her of property without due process of law.

The due process issue is complicated by the private nature of the waiver or arbitration agreement that is being enforced. As a matter of positive law, it is unclear whether judicial enforcement of such a waiver—that is, of a predispute arbitration agreement whose procedures do not meet constitutional due process standards—counts as

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disputable rule, that where there is a legal right, there is also a legal remedy by suit or action at law, whenever that right is invaded . . . . [I]t is a settled and invariable principle in the laws of England, that every right, when withheld, must have a remedy, and every injury its proper redress.” (citing WILLIAM BLACKSTONE, 3 COMMENTARIES \*23, \*109) (quotation marks omitted)).

<sup>91</sup> Judge Harry Edwards recognized this principle and its implications for arbitration. See *Cole v. Burns Int’l Sec. Servs.*, 105 F.3d 1465, 1482 (D.C. Cir. 1997) (“[S]tatutory rights include both a substantive protection *and* access to a neutral forum in which to enforce those protections.”).

<sup>92</sup> *Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 428 (1982) (citing *Mullane v. Cent. Hanover Bank & Trust Co.*, 339 U.S. 306 (1950)).

<sup>93</sup> In determining what process is due, due process jurisprudence is sensitive to context and often tolerant of a degree of informality and expedition. But it does demand at least “some form of hearing” before an impartial decision maker. See *Marshall v. Jerrico, Inc.*, 446 U.S. 238, 242 (1980); *Mathews v. Eldridge*, 424 U.S. 319, 333 (1976).

<sup>94</sup> For elaboration of this argument, see *Cole*, 105 F.3d at 1482; Richard A. Bales, *A Normative Consideration of Employment Arbitration at Gilmer’s Quinceañera*, 81 TUL. L. REV. (forthcoming 2006) (manuscript at 37, on file with author). Once a legal claim has accrued, of course, one can waive or settle it, and with it the right to a hearing. There is, again, a basic distinction between giving up one’s legal rights *ex ante*—before any claim has accrued—and *ex post*, when the nature of the claim is at least knowable.



state action.<sup>95</sup> But it certainly raises due process concerns analogous to the Thirteenth Amendment concerns that attend the enforcement of a broad non-compete covenant. In the end, the invocation of constitutional due process concerns does not so much add to as it fortifies the Supreme Court's instruction in *Gilmer* that arbitration agreements must allow plaintiffs to effectively vindicate their statutory claims in the arbitral forum. One can waive the right to *litigate* future claims in court in favor of arbitration, but one cannot waive the right to a fair adjudication of one's future claims.

It is striking that both non-compete agreements and arbitration agreements pose a potential threat to adjacent employee rights that are nonwaivable and constitutionally grounded. This one common feature will take us a good distance toward explaining why these particular agreements are subject to unusually close supervision. It will also provide a platform from which to assess existing law in Part III. But that is not the only common feature of these agreements that militates against ordinary contractual treatment.

Both agreements also have recognized *public* externalities; that is, the public has some stake beyond that of the individual parties in the vitality of the rights being waived. Non-compete agreements obviously

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<sup>95</sup> For arguments that state action may exist in such circumstances, see Richard C. Reuben, *Public Justice: Toward a State Action Theory of Alternative Dispute Resolution*, 85 CAL. L. REV. 577, 615-19 (1997) (suggesting that judicial enforcement of arbitration agreements inherently makes them the product of state action); Jean R. Sternlight, *Rethinking the Constitutionality of the Supreme Court's Preference for Binding Arbitration: A Fresh Assessment of Jury Trial, Separation of Powers, and Due Process Concerns*, 72 TUL. L. REV. 1, 44 (1997) (arguing that state action may be found in judicial interpretation of the FAA to require arbitration under ambiguous agreements to arbitrate). The state action argument rests not only on the notoriously narrow authority of *Shelley v. Kraemer*, 334 U.S. 1, 23 (1948) (finding state action in judicial enforcement of racially discriminatory private covenants restricting the alienability of residential property), but also on the courts' invocation of the FAA and the federal policy favoring arbitration to compel the enforcement of arbitration agreements. Still, the state action question is complicated by the waiver issue. Some courts that have confronted the question have found no state action in the enforcement of private arbitration agreements. See *Desiderio v. Nat'l Ass'n of Sec. Dealers*, 191 F.3d 198, 207 (2d Cir. 1999) (citing *Blum v. Yaretsky*, 457 U.S. 991, 1004 (1982)); *Duffield v. Robertson Stephens & Co.*, 144 F.3d 1182, 1200-02 (9th Cir. 1998), *overruled on other grounds by EEOC v. Luce, Forward, Hamilton & Scripps*, 345 F.3d 742 (9th Cir. 2003); *Davis v. Prudential Sec., Inc.*, 59 F.3d 1186, 1192 (11th Cir. 1995); *Cremin v. Merrill Lynch Pierce Fenner & Smith, Inc.*, 957 F. Supp. 1460, 1468 (N.D. Ill. 1997); see also Carole J. Buckner, *Due Process in Class Arbitration*, 58 FLA. L. REV. 185, 205-06 (2006) (supporting the finding of no state action in the enforcement of arbitration agreements). For present purposes it is enough to identify the due process concerns that lie behind the law governing arbitration. But the state action question would require closer attention in a thorough due process analysis of mandatory arbitration agreements.

stifle competition; they run into the venerable public policy against contracts in restraint of trade. Mandatory arbitration not only risks compromising the public interest in enforcing the substantive employee rights at issue. Even when it preserves those rights and remedies, it may detract from the public character of the enforcement of public law rights in the workplace setting—the elucidation of precedent and public norms, for example—by relegating the dispute to a private forum and private actors whose decisions may not be publicized.

These two considerations together—the proximity of inalienable employee rights and the negative public spillover from these agreements—point to a third common feature: in each case the law denominates certain rational employer aims as *illegitimate*. In the case of non-competes, the law is quite explicit: while it is legitimate for employers to seek to protect certain limited interests, such as trade secrets, it is illegitimate to seek to quash competition as such from the former employee or bind the employee to the job by proscribing alternative employment. In the case of arbitration agreements, while it is legitimate for employers to seek to reduce the overall cost of adjudicating employment disputes by substituting a more streamlined and informal arbitral forum, it is illegitimate to seek insulation from liability itself—for example, by skewing the selection of decision makers or limiting legally prescribed remedies.

In both cases, employers have an incentive to overreach—to use these agreements to impair employees' inalienable rights, injure the public interest, or both. The loss of a valued employee, especially to a competitor, is undesirable; the employer may be tempted to secure as much insulation from that loss, and from that future competition, as its market power will permit. Similarly, liability for employment claims is anathema to employers, who may be tempted to use arbitration agreements not merely to substitute one neutral forum for another, but also to curtail liability by stacking the deck in the employer's favor. So both types of agreements can be used, and employers will be tempted to use them, to advance illegitimate employer aims. Those illegitimate aims are simply the flipside of the nonwaivable employee rights and public interests that these agreements risk impairing. Still, recognizing the employer's temptation to overreach, and to impair nonwaivable rights or public interests, underscores the need for public oversight of these agreements.

In both cases, employers are at least theoretically constrained from overreaching by market forces: some employees may recognize

these costs, balk at an unfair agreement, or choose a more fair-minded employer. But many employees will not. Indeed, many will not in part because of another striking similarity between these agreements: both waive rights that will become operative only upon the occurrence of a future event that is remote, uncertain, and often undesirable (the right to work for a competitor after the current job ends, and the right to litigate a future dispute with the employer, usually in connection with discharge). That is unlike most contractual terms of the employment relationship—such as wages, hours, job duties, or working conditions—which take effect more or less immediately.<sup>96</sup> Arbitration and non-compete agreements constrain employees only in a fairly remote and uncertain future event; and we may expect employees to overdiscount the likelihood of these events or the importance of the rights at stake. Cognitive biases or informational asymmetries might thus aggravate concerns about the fairness of bargains struck at an earlier point, especially at the outset of employment, when questions about the forum in which one might later sue the employer, or about one's ability to compete with the employer after termination, are likely to tarnish the appeal of an applicant or new employee. All of this might make it easier for employers to overreach and invade employee rights.

These are, of course, among the recurring objections to relying on the market and on contract in the employment context. In particular, they feature prominently among critiques of the presumption that employment is terminable at will.<sup>97</sup> But even if these bargaining im-

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<sup>96</sup> Other terms of employment, such as pensions, take effect in the remote future (though the accumulation of assets in defined contribution plans may help to concretize the benefits). But again, there is a legally significant difference between terms that confer optional benefits (which employees may be inclined to undervalue because of their deferred nature) and terms that waive important employee rights under public law. The former may be an occasion for useful legal intervention, *see, e.g.*, Colin Camerer et al., *Regulation for Conservatives: Behavioral Economics and the Case for "Asymmetric Paternalism"*, 151 U. PA. L. REV. 1211, 1227-30 (2003) (describing methods of encouraging retirement saving by changing default rules), but the latter may demand it.

<sup>97</sup> *See, e.g.*, Issacharoff, *supra* note 7, at 1792-93 (arguing on these grounds for penalty default rules that are less favorable to employers than the at-will doctrine); Walter Kamiat, *Labor and Lemons: Efficient Norms in the Internal Labor Market and the Possible Failures of Individual Contracting*, 144 U. PA. L. REV. 1953, 1955-56 (1996) (arguing that bargaining impediments discourage employees from contracting for job security); Pauline T. Kim, *Bargaining with Imperfect Information: A Study of Worker Perceptions of Legal Protection in an At-Will World*, 83 CORNELL L. REV. 105, 106 (1997) (adducing empirical evidence that employees overestimate their legal rights when contracting for employment); Sunstein, *supra* note 25, at 108 (marshalling several arguments for creating employee-friendly default rules).

pediments fall short as a justification for mandating job security or other benefits, in some contexts they may converge with concerns about externalities and the erosion of inalienable employee rights to justify stacking the deck in favor of the employee's entitlement and against its contractual waiver.

### B. *Why Not Mandatory Employee Rights?*

So far, all of the common features of arbitration agreements and non-compete covenants that we have identified—the proximity of inalienable employee rights, the problem of public externalities, the employer's incentive to overreach and to pursue illegitimate objectives, and the bargaining impediments posed by the remote and uncertain nature of the constraint—point in the same direction: against the market mechanism of contract. The question remains: why the middle ground of conditional waivability as opposed to the more conventional solution of nonwaivable rights? Are there affirmative reasons for allowing these contracts at all—that is, for allowing even the regulated waiver of the rights to litigate future legal claims in court and to compete with the employer after termination of employment?

In neither case is this an idle question, for serious observers have contended for the categorical invalidity of mandatory arbitration agreements and the nearly categorical prohibition of non-competes.<sup>98</sup> Some of their arguments are specific to the policies or rights at stake in each type of agreement. Others echo themes that recur in every effort to take some term or condition of employment off the bargaining table: the employee rights at stake are too important to be subjected to the vagaries of bargaining, given the leverage that employers bring to the table.

By and large, those arguments have not carried the day.<sup>99</sup> In the case of arbitration agreements, the Supreme Court has held that employees may waive the right to litigate state and federal employment claims, including discrimination claims, subject to standards of fair arbitration that are drawn from the FAA, the substantive law governing the underlying claim, and the state law of contracts. Mandatory arbitration agreements remain controversial. But for now the right to litigate future employment claims has been declared conditionally waivable.

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<sup>98</sup> See *supra* note 72 and accompanying text.

<sup>99</sup> See *supra* notes 52-53 and accompanying text.

In the case of non-compete covenants, California comes close to rejecting them categorically.<sup>100</sup> In effect, the right to compete with one's former employer is nonwaivable in California. Most states, however, admit a wider range of legitimate employer interests and allow "reasonable" non-compete provisions—those that are narrowly tailored to protect legitimate interests. The validity and scope of non-compete covenants is becoming more controversial as employees become more mobile and more dependent on their access to external job markets, and as employers become less inclined to offer long-term employment and more aggressive in their use of these agreements to capture what even lower-level employees know about their products, services, markets, and customers.<sup>101</sup> Still, the right to engage in postemployment competition with one's employer has long been, and is likely to remain, partially and conditionally waivable in most jurisdictions.

So what justifies permitting these agreements at all, given the array of reasons for constraining them? Of course any persuasive justification would have to be grounded in the particular interests and policies at stake in each case. But I mean to ask the question at a level of generality that permits comparison of the two cases. At the most general level, there might be employer interests or rights, employee interests or rights, or public interests that weigh in favor of the enforceability of arbitration and non-compete agreements. Let us examine each briefly.

*Employer Interests or Rights:* It is tempting to say that the claim that these agreements serve the interests of *employers* should not count as a justification for permitting them. After all, agreements to accept subminimum wages or discriminatory treatment may serve employers' interests, but we do not allow those agreements at all. But we should distinguish between employers' illegitimate interests and their legitimate interests. Employer interests that are intrinsically at odds with the employee rights or public interests at stake, such as an interest in restraining competition from former employees or in barring employees' legal claims, obviously cannot count as reasons for allowing these agreements. But the law generally counts as legitimate an employer's interest in protecting long-term client relationships against the employee's competition, or in lowering the cost of the dispute resolution process. Those employer interests presumably do count in favor of

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<sup>100</sup> See *supra* notes 35-36 and accompanying text.

<sup>101</sup> See *supra* note 34 and accompanying text.

allowing these agreements. But it is not clear that they can count for much. Given that these agreements risk impairing both inalienable employee rights and public interests, employer interest alone seems to fall short as a justification for allowing them.

On the other hand, some legitimate employer interests fall into a weightier subcategory of employer *rights*—that is, entitlements that external law recognizes and protects independent of the terms of the employment contract.<sup>102</sup> In the case of arbitration agreements, the potential for conflicting rights is entirely theoretical, for there is nothing one could call an employer right at stake in those agreements. There is a potential for conflicting rights, however, in the case of non-compete agreements that protect trade secrets. Trade secrets are directly protected against misappropriation by former employees and others, even in the absence of a covenant not to compete.<sup>103</sup> But non-compete covenants are said to provide an extra layer of protection that is sometimes necessary in light of the difficulties of detecting misappropriation. Some non-competes—those that protect employers' trade secrets—may thus be justified as necessary to protect independently recognized employer rights.

Note that even these employer rights are not on par with the inalienable employee rights at stake in these agreements. Trade secrets are ordinary property rights and are fully alienable. So, where non-compete covenants are necessary to protect trade secrets, that would surely count as a reason to allow them, but those employer rights are still trumped by inalienable employee rights where those are infringed. An agreement that is necessary to protect (alienable) employer rights is still not justified if it will necessarily infringe upon inalienable employee rights.<sup>104</sup>

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<sup>102</sup> As in the case of employee rights, I take existing external law on this score as a given.

<sup>103</sup> To be sure, the definition of “trade secrets” is malleable and expanding. Under the Uniform Trade Secrets Act, followed in most states, it has come to include virtually any information that is both commercially valuable and kept reasonably secret. UNIF. TRADE SECRETS ACT § 1(4), 14 U.L.A. 538 (2005) (amended 1985). That goes beyond the traditional compass of trade secrets and effectively allows employers to make any potentially valuable information into a trade secret if it is capable of being closely held, by requiring employees to sign broad “confidentiality agreements.” But I take the current definition of trade secrets as given here.

<sup>104</sup> If the non-compete barred only employment that would *inevitably* result in disclosure of trade secrets, then it might seem that no employee right would be at issue. Indeed, where disclosure is inevitable given the nature of the new job, some courts would enjoin the former employee even absent a non-compete covenant. *See Pepsico, Inc. v. Redmond*, 54 F.3d 1262, 1271 (7th Cir. 1995) (upholding an injunction against

So the affirmative case for allowing arbitration agreements and most non-competes (other than those that are necessary to protect trade secrets) rests thus far on the rather shaky ground of employer interest. It remains to ask whether these agreements—either arbitration agreements or non-competes—can be justified on the basis of employee or public interests.

*Employee Interests:* At this point, contract enthusiasts may simply harken back to the general brief for freedom of contract and market ordering. Contract is said to be an efficient mechanism for allocating entitlements in accordance with the parties' preferences. Even contractual provisions that appear burdensome to employees may be *presumed* mutually beneficial where freely bargained, if only by virtue of what the apparently burdened party *presumably* received in exchange. Of course, in the employment setting these presumptions seem heroic at best to many observers. That is especially true here, given the presence of public interests and the proximity of nonwaivable employee rights.

But we might put a little substantive meat on those formalistic bones by pointing out that both arbitration and non-compete agreements are said to have built-in benefits for employees as well as employers—not only some presumed trade-off elsewhere in the employment contract, but particular benefits that flow from the agreements themselves. They are touted as “win-win” propositions. Non-compete covenants are said to benefit employees by freeing employers to share valuable information, making employees more productive and earning them a higher wage during employment. Arbitration is said to be faster, cheaper, and more accessible than litigation; employees may find it easier to get a hearing and even some relief.<sup>105</sup> This quid pro

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employment with a competitor on these grounds). The “inevitable disclosure” doctrine effectively implies a non-compete covenant in rare cases, and is highly controversial. Whatever its merits, it cannot rest on the proposition that no employee right is at stake, for the employee is losing not just the non-right to appropriate trade secrets, but the larger right to engage in one's occupation, including in competition with the employer.

<sup>105</sup> A party agreeing to submit claims to arbitration gives up no substantive rights or remedies; she simply “trades the procedures and opportunity for review of the courtroom for the simplicity, informality, and expedition of arbitration.” *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985). The quid pro quo of arbitration distinguishes predispute arbitration agreements from predispute agreements to waive the right to a jury trial or to participate in aggregate or class actions (that, plus the utter lack of statutory authority for the latter). A jury trial waiver or class action waiver for future disputes simply takes away part of the employee's private enforcement arsenal, and reduces the law's deterrent impact, without giving any-

quo was central to the Court's explanation of why it was acceptable to subject statutory claims to mandatory arbitration.<sup>106</sup> Of course, that would only explain why employees might voluntarily agree to arbitrate an existing dispute. To demonstrate that employees benefit from *mandatory* arbitration agreements requires a further showing that employee access to arbitration depends on its being mandatory; that is, that employers will only agree to arbitrate the cases that employees want to arbitrate (for example, lower-value claims) if they can also bind employees to arbitrate the cases that employees would prefer to litigate (for example, cases with potentially large noneconomic damages).<sup>107</sup> In other words, the claim must be that these agreements—and this is true of both arbitration agreements and non-competes—benefit employees as well as employers *ex ante*. At the time of en-

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thing in return. It poses some of the same risks to employees' inalienable rights that arbitration agreements pose, but promises no countervailing benefits to employees. Arbitration agreements, of course, necessarily entail waiving a jury trial; the question of whether they may contain a class action waiver is taken up below. *See infra* text accompanying note 122. But arbitration agreements are also supposed to deliver benefits to employees.

<sup>106</sup> It is therefore crucial to know more than we do about how many employment cases are actually arbitrated. Arnold Zack, a prominent labor arbitrator and expert on arbitration, has gathered some data on this question. He initially suspected that, with eight to twelve million employees covered by such systems, there would be tens or hundreds of thousands of arbitration cases, as well as a large "gray market" of employer-dominated arbitration providers. However, his extensive informal inquiries (among designating agencies and attorneys who advise employers on developing arbitration systems) suggested that, while there is not much of a "gray market," fewer than four thousand employment disputes per year are actually arbitrated. E-mail from Arthur Zack to author (Oct. 21, 2006) (on file with author). Zack found that most employer systems do appear to use established, reputable agencies that adhere to the Due Process Protocol to increase the legitimacy and acceptability of arbitration. As for actual arbitrations, he concluded that most were conducted under the auspices of the American Arbitration Association; other designating agencies each do no more than a few hundred cases per year. If these preliminary findings are borne out by more systematic research, they would contradict some of the harshest critiques of employment arbitration, which question the impartiality of this employer-driven system; however, they would also deal a serious blow to the standard case for arbitration, which rests in part on the claim that arbitration affords employees greater access to an impartial hearing. The very small number of arbitrations suggests that employees are not enjoying readier access to a fair hearing pursuant to arbitration agreements, but are simply settling or giving up their claims under the shadow of arbitration rather than under the heavier shadow of litigation.

<sup>107</sup> For arguments and some evidence to that effect, see Lewis L. Maltby, *Out of the Frying Pan, into the Fire: The Feasibility of Post-Dispute Employment Arbitration Agreements*, 30 WM. MITCHELL L. REV. 313 (2003); David Sherwyn, *Because It Takes Two: Why Post-Dispute Voluntary Arbitration Programs Will Fail To Fix the Problems Associated with Employment Discrimination Law Adjudication*, 24 BERKELEY J. EMP. & LAB. L. 1 (2003).



forcement, the advantage presumably runs to the party seeking enforcement, almost invariably the employer, and against the party seeking to litigate (or compete).

The supposed “win-win” potential of these agreements is an important part of the case for allowing them in spite of the threat to employee rights and public interests. If mandatory arbitration agreements and non-compete covenants can benefit employees as well as employers, that would weigh in favor of allowing them, subject to conditions that protect nonwaivable employee rights and public interests, instead of banning them altogether. It remains to consider whether some public interest might weigh *in favor* of allowing these agreements (thus offsetting or outweighing the public interest on the other side).

*Public interests:* The only societal benefits that would add to the case in favor of non-competes or arbitration agreements would be those that are external to the parties, for the legitimate benefits to employers and employees are already being counted. In the case of non-competes, it is possible that employers’ greater willingness to expose employees to valuable information yields external benefits beyond the economic benefits to employees and employers. But those benefits are not likely to be large or to outweigh the recognized public interest in competition that weighs against these agreements.

In the case of arbitration, the FAA has been held to embody a “liberal federal policy favoring arbitration agreements.”<sup>108</sup> To the extent that policy is based on the perceived *ex ante* benefits to the parties alone, it adds nothing to our ledger of costs and benefits. Still, arbitration presumably does reduce the burden on courts and on judges’ time, the costs of which are borne by the public. It is unclear how much weight we can assign to the public cost of adjudicating rights under public law; that is what courts and judges are there for, after all. And that is the price we pay for the public benefits of judicial resolution—published decisions, precedent, and reinforcement of public norms. The contest between the public benefits and the public costs of arbitral resolution might seem to be at best a toss-up, but it has been officially decided in favor of arbitration (where the parties have “agreed” to it). Even so, it seems that we will not miss much if we ignore any external public benefits from these agreements and limit ourselves to the claimed benefits to employees and employers.

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<sup>108</sup> *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 35 (1991) (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 625 (1985)).

So the single weighty justification for allowing these agreements is that they can serve the legitimate interests of both employees and employers. But for the reasons reviewed above, employers will be tempted to overreach in both cases, and to overreach in ways that imperil inalienable employee rights, important public interests, or both. Without fairly strict legal regulation of these agreements, employees will not get the benefits that justify allowing these agreements, and they will risk losing rights that are supposed to be insulated from contractual waiver. At least in principle, the hybrid solution of conditionally waivable rights provides a vehicle for realizing the mutual benefits of these agreements while guarding against their dangers.

### III. EVALUATING THE LAW OF NON-COMPETE COVENANTS AND MANDATORY ARBITRATION AGREEMENTS

So conditionally waivable rights might provide a better resolution than either ordinary contract or mandatory rights to certain problems within the employment relationship. That does not mean, of course, that the law as it stands achieves this happy result. But it does tell us something about what the conditions for waiver ought to be, and ultimately about when employee rights ought to be conditionally waivable. The foregoing discussion suggests four criteria by which we can evaluate the law governing arbitration and non-compete agreements.

*First*, the law—that is, the conditions that the law places on validity—must protect the nonwaivable employee rights that are at stake in these agreements. If the law cannot reliably protect those inalienable employee rights, then the case for allowing these agreements collapses. Unfortunately, it may often be hard to judge whether employee rights are secure or not. At what point does a set of limitations on what the employee can do after termination significantly burden the right to quit? At what point do limitations on discovery in arbitration impinge on the vindication of the underlying substantive rights? Yet however difficult it may be to apply this principle, it must be paramount.

*Second*, the law must protect the public interest at stake in these agreements where that interest goes beyond the protection of inalienable employee rights. Distinctly public interests that are external to the parties may call for additional conditions that are not necessary for the protection of employee rights alone.

*Third*, the law should ensure that agreements advance only the legitimate and not the illegitimate aims of employers. To some degree

this replicates the goals of protecting employees' nonwaivable rights and the public interest. But scrutiny of employer aims may reinforce that protection, for some provisions may betray an illegitimate motive more clearly than they threaten an impermissible result.

*Fourth*, and finally, the law should operate so as to foster self-policing by employers in drafting these agreements. It should give clear guidance about what is and is not permissible, and it should deter employers from overreaching, not only in the agreements that come before courts but in the many more agreements that do not. Employers must be discouraged from taking a gamble that they will stay below the judicial radar, for agreements that are onerous to employees may (and may be intended to) deter employees from doing what they are entitled to do—quitting and competing, or litigating—and from thus testing the agreement's validity.

An additional objective might be to ensure that these agreements do indeed secure benefits to employees as well as to employers *ex ante*. But that objective might be best pursued indirectly, by ensuring that agreements do not impair employees' inalienable rights or the public interest and betray no illegitimate employer objective. In other words, once the parties are confined to agreements that meet the first three criteria, we might be entitled to indulge the presumption that freedom of contract will produce mutual gains.

#### A. *Assessing the Law of Non-Compete Agreements*

The conditions to which non-compete covenants are subject vary from state to state, as noted above, and can be roughly arrayed along a spectrum from California, which prohibits nearly all postemployment restraints on competition, to the "strict scrutiny" states, to the more deferential "rule of reason" states. The foregoing dissection of the underpinnings of conditionally waivable rights militates against the last and most lax approach. These agreements are not ordinary contracts because they risk impairing fundamental nonwaivable employee rights (as well as public interests). Most importantly, they risk impairing the employee's inalienable right to quit her current employment. "Strict scrutiny" does a better job of protecting the inalienable right to quit, which is potentially imperiled by a non-compete agreement.

Strict scrutiny need not be fatal in fact, but sometimes it should be. In particular, any agreement that so restricts the employee's future employment options as to effectively bond the employee to the current employer should be invalid. That should be true even if the

agreement is *necessary* to protect employer *rights*, such as trade secrets. Fortunately, it will be rare to encounter an agreement that is both so onerous to the employee and yet necessary to the employer (especially given the availability of less restrictive means of protecting trade secrets). But the point is worth underscoring: employer trade secrets are not inalienable. They do not go to the core of personhood and self-ownership as does the freedom to quit one's job, and they might have to give way in the rare case of an unavoidable conflict.

The strict scrutiny approach responds to at least the first three criteria set out above: it protects inalienable employee rights against indirect waiver, it protects the public interest in competition, and it guards against employers' sub rosa pursuit of illegitimate ends. In other words, it does in the arena of non-competes what its constitutional counterpart is meant to do in protecting fundamental rights and suspect classes. Moreover, the non-competes that pass muster under strict scrutiny are likely to be those that benefit employees as well as employers *ex ante*: if a non-compete is genuinely necessary to protect an employer's trade secrets (and does not unduly burden the employee's freedom to quit and work elsewhere), then it presumably frees the employer to share valuable secrets with the employee that it would not otherwise agree to share (or for which it would otherwise exact a high price from the employee to do so).

The last condition—establishing clear guidance and deterring employers from overreaching—requires more attention. Clear guidance has been notoriously lacking in the law of non-compete covenants. That is largely because the existence of a legitimate interest and the necessity of the restraints imposed by a non-compete are unavoidably peculiar to the particular employer, employee, and job at issue. So the law consists of standards that are relatively easy to formulate, but difficult to apply predictably in particular cases.<sup>109</sup> That has made the law of non-competes a source of rampant discontent. Tightening up the standards, as recommended here, might seem to do little to promote predictability; however, raising the bar for validity would reduce the number of arguably valid covenants and potentially the number of disputes. At the extreme, California employers face little uncertainty about the validity of non-compete covenants.

Still, whatever standard would be applied in court, some overbroad agreements may escape scrutiny by discouraging employees

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<sup>109</sup> For elucidation of this point, see Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 562-63 (1992).

from quitting and testing their validity. As suggested above, the problem of “overreaching under the radar” is exacerbated by courts’ increasing willingness to sever or edit offending provisions rather than voiding the whole agreement: for the employer who seeks to impose the widest restrictions possible, why not take a chance and overstep the bounds of the law? If courts instead set a relatively low threshold for voiding the agreement—say, an agreement that is substantially overbroad under existing law—then employers and their counsel will have to play it safe and forego provisions that might be viewed as too onerous by a court. Under this regime, some employees who could be subject to a valid non-compete will escape postemployment restraints altogether; their freedom to compete is the penalty that deters employers from imposing overbroad non-competes that purport to prohibit employees from competing in ways they are entitled to do.

A different sort of penalty would be required to deter the employer that has no legitimate interest at stake, and is thus not entitled to a non-compete covenant at all, from imposing one anyway in hopes of evading scrutiny. Even a manifestly invalid non-compete may have *in terrorem* value against an employee without counsel. Some employers insert non-compete covenants as near-boilerplate in employment agreements for a wide variety of positions, with little regard to the particulars of the position or to whether employees are privy to protectible information. As far as the law is concerned, employers risk nothing with that sort of overreaching (though the market might sometimes exact a price), and they might succeed in keeping employees from leaving and moving to competitors when they are entitled to do so.<sup>110</sup> The problem of “overreaching under the radar” is common to non-competes and arbitration agreements. A solution proposed in the arbitration setting may make sense here as well: award attorneys’ fees against employers whose agreements are thrown out as invalid (either on the employer’s motion to enforce or the employee’s motion to declare it invalid).<sup>111</sup>

Another indirect check on employer overreaching may be found in the law of wrongful discharge, at least for the few employees who recognize an overbroad covenant up front: the law should protect an employee who is fired for refusing to sign an overbroad non-

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<sup>110</sup> See *supra* note 32 and accompanying text.

<sup>111</sup> Professor Bales argues that awarding attorneys’ fees to employees who challenge invalid agreements would “help compensate employees for the costs of litigating enforceability, and would modestly discourage employers from imposing lopsided agreements.” Bales, *supra* note 94, at 47.

compete.<sup>112</sup> It is hard to fathom why the law would allow the employer to fire (or threaten to fire) an employee for refusing to sign an illegally overbroad non-compete agreement. This use of employment at will offends public policy much like the discharge of an employee for refusing to violate the law or for filing a workers' compensation claim. Those classic and widely accepted public policy exceptions to employment at will have cleared a path for enforcing the legal conditions on waiver of the right to compete in the rare case of the employee who demurs.

The recommended "strict scrutiny" approach to non-compete agreements takes away from employers some contractual tools for protecting legitimate interests that do not rise to the level of property rights. For those who worry that the economy will suffer if employers cannot reliably protect their interest in the valuable knowledge that their employees accumulate, it is worth pointing out that Texas and California—at least until recently two of the strictest jurisdictions with regard to non-competes<sup>113</sup>—are also home to the two most vibrant concentrations of high-tech industry, in which the knowledge inside employees' heads accounts for a very large share of firm value. Some scholars have argued that the very weakness of employers' property and contract rights—limited protection of trade secrets and restrictions on non-compete covenants—contributed to those regional success stories, in part by fostering employee mobility.<sup>114</sup> Indeed, those accounts suggest that non-compete covenants not only threaten the general public interest in competition but generate a collective action problem among firms, at least in some industries and regions. In Ronald Gilson's words, "[w]hile it would be in the interest of [a] region's firms collectively to facilitate employee mobility even at the expense of diluting the intellectual property of individual firms, it will be in the interest of any individual firm to impede the mobility of its own employees."<sup>115</sup> A very restrictive legal approach to non-compete covenants, as exists in California, may solve that collective action prob-

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<sup>112</sup> California law does so; other courts have refused to do so. *See supra* note 74 and accompanying text.

<sup>113</sup> *See supra* note 46.

<sup>114</sup> *See Gilson, supra* note 34, at 578-79 (contending that California's prohibition on non-compete agreements helps promote growth in Silicon Valley by fostering the transfer of knowledge among its technology firms); *see also HYDE, supra* note 34, at 31-32 (arguing that Silicon Valley's growth stems partly from a "culture of employee mobility" and the related weakness of protection of trade secrets and non-competes).

<sup>115</sup> Gilson, *supra* note 34, at 596.

lem and help facilitate the spillover of employee knowledge and the vibrancy of the local economy through mobility.

Employers faced with tight restrictions on non-competes may seek other means of protecting valuable information and relationships. Some of those, such as no-solicitation agreements, impose lower costs on the employee and the public and run into a less hostile reception in the courts. Employers looking beyond those devices may consider borrowing from the British tradition of “garden leave” agreements.<sup>116</sup> In a garden leave agreement, the employee agrees to give notice some months prior to departure—say, six months—during which period the employer must pay the employee’s salary but may choose not to assign any duties, and in any event may prevent the employee from working elsewhere. The employer gets the same protection as a similar period of “non-competition,” but must bear the primary economic burden itself rather than casting it on the employee. Employees’ postemployment activities are still restricted; some opportunities may dry up and some employee knowledge may grow stale during the period of enforced idleness. But the garden leave device has the virtue of forcing employers to internalize the primary cost of restrictions on employees’ postemployment activities, and thus to think twice about whether and how long they are willing to do so.

That virtue suggests another way to promote self-policing by employers: perhaps an additional condition for the enforcement of a non-compete should be the employer’s willingness to continue the employee’s salary for the period of enforced idleness—a kind of mandatory garden leave provision. Proponents of non-competes may be willing to presume that the employee has already earned a premium to compensate for the non-compete restrictions; if that is true, that premium would presumably be reduced in light of the possible future garden leave obligation. But a garden leave provision would induce the employer to reassess the value of the non-compete at the point at which it became operative and to bear the primary cost that enforcement imposes on the employee.<sup>117</sup>

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<sup>116</sup> For an analysis of “garden leave” provisions and their viability in the United States, see Greg T. Lembrich, Note, *Garden Leave: A Possible Solution to the Uncertain Enforceability of Restrictive Employment Covenants*, 102 COLUM. L. REV. 2291, 2292 (2002).

<sup>117</sup> See Silverstein, *supra* note 72 at 817 (“I suspect that if employers were required, as a condition of enforcing non-compete and non-disclosure agreements, to subsidize employees during their non-working time the allure of such covenants, for all but the most highly prized employees, would diminish rapidly.”).

B. *Assessing the Law of Mandatory Arbitration*

In non-compete covenants, only a few variables are usually in play: mainly the nature of the employer's interest in noncompetition, and the scope—temporal, geographic, and occupational—of the ban on competition. Many more variables are in play in mandatory arbitration agreements, which effectively set out, in more or less detail, an alternate forum, decision maker, and set of rules to replace the default system of courts, judges, and rules of civil procedure. So it is impossible to devise a formula, akin to the “strict scrutiny” standard suggested above, to resolve disputes over the validity of these agreements.

On the other hand, the law of arbitration may lend itself to greater determinacy down the line, for the conditions on enforcement of arbitration agreements need not be tailored to particular circumstances on a case-by-case basis, as the conditions on enforcement of non-competes must be. All employers are entitled to seek arbitration of future employment disputes; no threshold showing of special need is required. Moreover, the conditions on enforceability are largely drawn from fixed features of external law and from principles of fair adjudication that are independent of the particular parties or dispute. So it should be possible to devise a set of rules that makes the enforceability of a particular agreement quite predictable *ex ante*.<sup>118</sup> In the relatively short period since *Gilmer*, the law has not yet generated those settled rules. But there is more reason to hope that this will happen in the case of arbitration agreements than in the case of non-compete covenants.

Given the range of potential controversies, my aim here will be to show how the four criteria identified above might help to resolve some major issues and perhaps generate some rules along the way. While leaving untouched many controversies in the modern law of employment arbitration, I hope to show how the foregoing analysis, and the underlying analogy to non-compete covenants, might guide their resolution.

The first and most important criterion is that these agreements preserve the nonwaivable employee rights that are at stake—in this case the employees' underlying substantive legal rights. The Supreme Court has said that arbitration agreements are valid (as to statutory claims) only “so long as the prospective litigant effectively may vindi-

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<sup>118</sup> The rules would not resolve all controversies; the broader principles from which they were derived would continue to govern novel arbitration provisions.



cate [her] statutory cause of action in the arbitral forum.”<sup>119</sup> That condition is most obviously violated by provisions that explicitly bar rights or remedies that external law allows. And indeed, courts have invalidated provisions barring punitive damages where they would be available in court, requiring each party to bear its own attorneys’ fees where the statute awards attorneys’ fees to prevailing plaintiffs, and capping damages below the level provided by the relevant statute.<sup>120</sup> This can fairly be called a rule: arbitration agreements may waive or take away not substantive rights and remedies but only access to the judicial forum (and some of the procedural perquisites of that forum).

But the last parenthetical concession exposes the soft underbelly of this simple command: when do procedural provisions—for example, limited discovery, time limits, a ban on aggregation of claims—amount to an impermissible denial or waiver of the substantive rights at stake? And when are they part of the permissible trade-off that arbitration entails and that the Supreme Court has blessed?

Some procedural provisions may operate to block adjudication. Consider, for example, the increasingly prevalent provisions barring aggregate claims or class actions either within arbitration or outside of it by signatory employees. For many employers, the perceived ability to foreclose class actions is the single greatest advantage to mandatory arbitration.<sup>121</sup> To be sure, a class action waiver will have little impact on many employment claims, especially those based on discharge, either because the claims are not suitable for aggregate treatment or because they are in any event viable as individual claims.<sup>122</sup> But a ban

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<sup>119</sup> *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 28 (1991) (quoting *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637 (1985) (quotation marks omitted)).

<sup>120</sup> *See supra* note 61.

<sup>121</sup> *See Hans Smit, Class Actions in Arbitration*, 14 AM. REV. INT’L ARB. 175, 176 (2003) (“[T]he preference for arbitration may be inspired in part by the perceived lack of class actions in arbitration . . . .”); Michael R. Triplett, *Class Action Bans in Arbitration Pacts Could Create Limits on Substantive Rights*, Daily Lab. Rep. (BNA) No. 220, at A-6, A-7 (Nov. 14, 2003) (quoting a management-side attorney as saying that “the primary question asked by companies considering arbitration is: ‘Can we cut off class and collective actions by requiring arbitration?’”); Peter J. Kreher & Pat D. Robertson III, Comment, *Substance, Process, and the Future of Class Arbitration*, 9 HARV. NEGOT. L. REV. 409, 423 (2004) (“Defendants use arbitration agreements, at least in part, to prevent class proceedings.”).

<sup>122</sup> “Class action waiver” provisions are thus much more threatening in the consumer context, where individual claims are often very small but very numerous, than in the employment context, where enough is often at stake to warrant individual litiga-

on aggregate actions may doom some otherwise viable claims; that is especially likely with claims under the wage and hour laws.

Consider, for example, a challenge to employer policies that exact several minutes per day of work from employees “off the clock” and without pay.<sup>123</sup> Such policies may deprive hundreds or thousands of employees of a fraction of the pay to which they are entitled—perhaps \$2000 or \$3000 per worker over a few years. That is not a trivial amount for the average worker, but it is surely less than the cost of adjudication even in a lower-cost arbitral forum. Each individual thus has a “negative value claim” that is very unlikely to be brought.<sup>124</sup> But the whole class of affected employees may have a perfectly viable aggregate claim. A class action waiver provision, as applied to such claims, would amount to a waiver of the substantive claim itself.<sup>125</sup> Let us be clear on what this means: for employees who are bound by a class action waiver, an employer has a virtual free pass to engage in these illegal practices, and to skim thousands or millions of dollars off

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tion. In the consumer context, the proliferation of class action waivers threatens to vitiate many consumer protection laws. See Myriam Gilles, *Opting Out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action*, 104 MICH. L. REV. 373 (2005). For a thoughtful analysis of the substantive implications of class action waivers, see Richard A. Nagareda, *Aggregation and its Discontents: Class Settlement Pressure, Class-Wide Arbitration, and CAFA*, 107 COLUM. L. REV. (forthcoming 2007) (manuscript at 69, on file with author).

<sup>123</sup> Such policies have been challenged in lawsuits against Wal-Mart, for example. See Steven Greenhouse, *Forced To Work off the Clock, Some Fight Back*, N.Y. TIMES, Nov. 19, 2004, at A1. Similarly, it has been reported that several retailers, including Wal-Mart, have deleted time from employees’ time records, thus cutting many employees’ paychecks by small amounts. See Steven Greenhouse, *Altering of Worker Time Cards Spurs Growing Number of Suits*, N.Y. TIMES, Apr. 4, 2004, at A1. For a recent example of a successful class action in pursuit of wage claims that were small for each individual but large across the employer’s operations, see *IBP, Inc. v. Alvarez*, 126 S. Ct. 514 (2005).

<sup>124</sup> One might argue that the law’s provision of “reasonable attorneys’ fees” for prevailing plaintiffs makes these cases viable. But courts’ unwillingness to award full fees (much less an enhancement in view of the contingent nature of the fee) in such “negative value” cases makes attorneys almost uniformly unwilling to take these very low-value cases on an individual basis.

<sup>125</sup> California law appears to find a class action waiver “substantively unconscionable” as applied to such small but repetitive (consumer) claims, *Discover Bank v. Superior Court*, 113 P.3d 1100, 1108 (Cal. 2005), but not the same waiver as applied to more substantial individual (employment) claims. *Gentry v. Superior Court*, 37 Cal. Rptr. 3d 790, 794 (Cal. Ct. App. 2006). These decisions draw the right line, but by doing so within the framework of unconscionability, they effectively allow employees to waive the right to a fair and viable means of adjudicating nonwaivable claims as long as the waiver is not a contract of adhesion. See *infra* text accompanying note 130.

their employees' paychecks, with virtually no worries about liability.<sup>126</sup> Where a class action waiver or any other procedural hurdle to adjudication effectively insulates the employer from liability altogether, it simply nullifies employment protections that are enforced primarily through private rights of action.

Indeed, an arbitration agreement's ban on class or aggregate claims arguably suggests an illegitimate purpose on the employer's part. Because aggregation almost only occurs when it is a *more* cost-efficient way to process certain substantive claims—not only more efficient than individual litigation but usually more efficient than individual arbitration as well—a ban on aggregation suggests that the employer's aim is not to reduce the cost of the adjudication process but to escape some liabilities altogether. Both the effect of negating some nonwaivable employee rights and the apparent purpose of foreclosing some meritorious claims altogether condemn class action waiver clauses.

This is not the place for a review of every procedural quirk—short filing deadlines, high arbitrator fees, or such—that might operate to block employees' ability to vindicate substantive rights. But the point is to place that precise question—the impact on substantive rights—at the center of the inquiry. The trick is to figure out how to do that without resorting to case-by-case assessment of each procedural provision's impact on each particular claim. For the potential mutual gains from a more efficient and accessible arbitral forum would be quickly consumed by frequent and unpredictable resort to judicial review.

By that measure, the Supreme Court failed when it provisionally resolved the roiling controversy over allocation of arbitrator fees by requiring plaintiffs to prove that fees would be “prohibitively expensive.”<sup>127</sup> Lower courts have construed that command to require a case-by-case assessment of the fees in light of the plaintiff's ability to pay in the particular case.<sup>128</sup> That is a supremely unhelpful approach to employers, employees, and lower courts evaluating the lawfulness of any

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<sup>126</sup> “Virtually no worries,” as opposed to a complete free pass, because there is a remote possibility of public enforcement by the Department of Labor or a state agency.

<sup>127</sup> *Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79, 92 (2000). *Green Tree* involved a consumer claim, not an employment claim, but the lower courts have assumed that the same standard applies in employment cases, as in *Parilla v. IAP Worldwide Services, VI, Inc.*, 368 F.3d 269, 283-84 (3d Cir. 2004).

<sup>128</sup> See *Bradford v. Rockwell Semiconductor Sys., Inc.*, 238 F.3d 549, 557-58 (4th Cir. 2001).

particular fee scheme. By contrast, a rule that employee (or consumer) plaintiffs cannot be required to pay arbitrator fees in excess of the court fees they would have had to pay to litigate would vindicate the basic principle—no unreasonable hurdles to adjudication of non-waivable rights claims—yet be applicable in a predictable and straightforward way.

Another variation on the problem of procedures that affect substantive rights is the problem of biased decision makers—or, more to the point, procedures that permit employers to choose decision makers that favor them. Some critics have contended that employers' "repeat player" status gives them a built-in advantage with arbitrators who hope for repeat business.<sup>129</sup> Efforts to verify the repeat-player advantage empirically have been equivocal at best.<sup>130</sup> But employers' repeat-player status does induce them to invest in writing favorable agreements (to the extent the law allows them to do so). Some employers have sought to improve their odds by skewing the selection of arbitrators, either by limiting the pool of arbitrators to those likely to favor them or by tilting the selection process in their own favor. The widely noted *Hooters* case in the Fourth Circuit provides an example of such a procedure and its inauspicious judicial reception.<sup>131</sup>

Courts sometimes view the problem of biased arbitration procedures, as well as the problem of barriers to adjudication, through the lens of unconscionability. But the real problem is that binding employees to a biased arbitral forum effectively amounts to securing a waiver of nonwaivable substantive rights. (It also betrays an illegitimate purpose on the part of the employer to shield itself from liability for future conduct.) It matters a great deal whether a problem like this is analyzed through the lens of unconscionability or of "effective vindication" of substantive rights. That is because, in many states, a contract is not void unless it is both procedurally unconscionable—secured under conditions of adhesion by a party with superior bargaining power—and substantively unconscionable—unduly oppressive

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<sup>129</sup> See Clyde W. Summers, *Mandatory Arbitration: Privatizing Public Rights, Compelling the Unwilling to Arbitrate*, 6 U. PA. J. LAB. & EMP. L. 685, 690 (2004) ("To continue their acceptability, arbitrators may, consciously or subconsciously, tend to avoid a record which employers will view as unfavorable.").

<sup>130</sup> See generally Bales, *supra* note 94, at 42-43 (describing studies that have reached inconclusive results).

<sup>131</sup> *Hooters of Am., Inc. v. Phillips*, 173 F.3d 933 (4th Cir. 1999).

or unfair in its terms.<sup>132</sup> Provisions that skew the choice of arbitrators toward the employer or that create hurdles to adjudication may be substantively unconscionable, but under the two-pronged test of unconscionability the agreement could nonetheless stand. It is thus essential that courts ask independently whether the agreement contains provisions that threaten the effective vindication of the substantive rights at issue; such an agreement amounts to a waiver of nonwaivable rights and should be invalid even if the employee voluntarily agreed to it.

That is what the California Supreme Court did in its *Armendariz* decision. Recognizing that “an arbitration agreement cannot be made to serve as a vehicle for the waiver of [nonwaivable] statutory rights,”<sup>133</sup> the court set out five “minimum requirements for [a lawful] mandatory employment arbitration agreement”: (1) neutral arbitrators; (2) more than minimal discovery; (3) a written award; (4) all relief that would be available in court; and (5) no unreasonable costs or fees as a condition of access to the arbitral forum.<sup>134</sup> Only after finding that those “minimum requirements” were met did the court turn to the additional constraints that the “unconscionability” doctrine im-

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<sup>132</sup> See, e.g., JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE 138 (4th ed. 1995) (concluding that unconscionability requires both “an absence of meaningful choice” and “contract terms which are unreasonably favorable to the other party”). The now-prevalent “two-pronged” approach to unconscionability is traced to an important scholarly intervention: Arthur Allen Leff, *Unconscionability and the Code—The Emperor’s New Clause*, 115 U. PA. L. REV. 485 (1967). See George A. Nation III, *Obscene Contracts: The Doctrine of Unconscionability and Hospital Billing of the Uninsured*, 94 KY. L.J. 101, 110 (2005) (“[A]nalysis of court decisions suggests that a majority of courts generally accept Leff’s framework . . .”). But the two prongs are often described as creating a “sliding scale”:

The prevailing view is that [procedural and substantive unconscionability] must both be present in order for a court to exercise its discretion to refuse to enforce a contract or clause under the doctrine of unconscionability. But they need not be present in the same degree. Essentially a sliding scale is invoked which disregards the regularity of the procedural process of the contract formation, that creates the terms, in proportion to the greater harshness or unreasonableness of the substantive terms themselves. In other words, the more substantively oppressive the contract term, the less evidence of procedural unconscionability is required to come to the conclusion that the term is unenforceable, and vice versa.

*Armendariz v. Found. Health Psychcare Servs., Inc.*, 6 P.3d 669, 690 (Cal. 2000) (citations and quotation marks omitted); see also *Zobrist v. Verizon Wireless*, 822 N.E.2d 531, 541 (Ill. App. Ct. 2004) (endorsing the sliding scale method of weighting procedural and substantive unconscionability).

<sup>133</sup> *Armendariz*, 6 P.3d at 681.

<sup>134</sup> *Id.* at 682 (citing *Cole v. Burns Int’l Sec. Servs.*, 105 F.3d 1465, 1482 (D.C. Cir. 1997)).

poses on contracts of all kinds.<sup>135</sup> The first step is essential, given the primacy of protecting employees' substantive nonwaivable rights.

The Ninth Circuit, however, muddied the waters in a pair of decisions that purported to follow *Armendariz*. In *Circuit City Stores, Inc. v. Adams*, on remand from the Supreme Court, the court skipped the first step and proceeded straight to the question of unconscionability.<sup>136</sup> Because the agreement was presented as a condition of employment, it was procedurally unconscionable under *Armendariz*. Because it contained a number of provisions that added up to "a thumb on Circuit City's side of the scale should an employment dispute ever arise," the agreement was substantively unconscionable and invalid.<sup>137</sup> It did not matter in that case that the agreement would also have failed the minimum requirements of *Armendariz* for waiver of the right to litigate statutory claims. But in another Circuit City case a few weeks later, the other shoe dropped: an agreement with the same substantively unfair provisions was not void because it was not procedurally unconscionable. Employees had "a meaningful choice not to participate in the program;" a "genuine possibility to opt-out of the arbitration."<sup>138</sup> The court thus enforced an agreement that effectively, albeit more voluntarily, waived the right to a fair adjudication of non-waivable rights. That was a mistake.

The mistake of using unconscionability as the sole framework for judging the fairness of arbitration agreements is greatly magnified in those jurisdictions that find no procedural unconscionability in agreements imposed as a take-it-or-leave-it condition of employment.<sup>139</sup> In those jurisdictions, the unconscionability doctrine appar-

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<sup>135</sup> I put aside the question whether *Armendariz* applies the standard unconscionability doctrine or some heightened scrutiny that reflects hostility to arbitration agreements (and that would in that case be preempted by the FAA), as some have argued. See McGuinness & Karr, *supra* note 67, at 62.

<sup>136</sup> 279 F.3d 889, 893-95 (9th Cir. 2002).

<sup>137</sup> *Id.* at 892.

<sup>138</sup> *Circuit City Stores, Inc. v. Ahmed*, 283 F.3d 1198, 1199 (9th Cir. 2002); *accord* *Circuit City Stores, Inc. v. Najd*, 294 F.3d 1104, 1108 (9th Cir. 2002).

<sup>139</sup> See, e.g., *In re Halliburton Co.*, 80 S.W.3d 566, 567 (Tex. 2002) (finding no procedural unconscionability in an arbitration agreement presented as a condition of continuing employment); *Zuver v. Airtouch Commc'ns, Inc.*, 103 P.3d 753, 760-61 (Wash. 2004) (finding no procedural unconscionability). The *Halliburton* court did proceed to examine (and approve) the substantive fairness of the agreement in question under a less rigid version of unconscionability doctrine than that followed in California. See also *Carter v. Countrywide Credit Indus., Inc.*, 362 F.3d 294, 301 (5th Cir. 2004) (following *Halliburton* and upholding arbitration agreements presented as a condition of employment); cf. *Zobrist v. Verizon Wireless*, 822 N.E.2d 531, 540 (Ill. App. Ct. 2004)

ently poses no bar to employees being required as a condition of employment to waive their right to a fair adjudicatory process for future statutory claims. An agreement that impairs the effective vindication of nonwaivable statutory rights—whether by limiting remedies, unduly constraining access to the forum, or skewing the decision-making process—is invalid whether the contract is one of adhesion or one to which the employee agreed “voluntarily.” Recognizing this is the linchpin to meeting the first and most important objective set out above: protecting nonwaivable employee rights.

The second objective is protection of the public interest, specifically the public’s interest in what we may call the “publicness” of adjudication: accountability, the development of the law through precedent, and the transparency of the adjudicatory process and resulting decisions. That public interest is necessarily compromised by the shift from litigation to arbitration, and from publicly selected judges to private arbitrators. That might have been a reason for rejecting mandatory arbitration of statutory claims altogether. But the Supreme Court’s decision in *Gilmer* implies that the trade-off of publicness that is built into the choice of arbitration is contemplated by the FAA, and is permissible even in the core public law arena of antidiscrimination law.<sup>140</sup> The question remains whether the conditional waivability of the judicial forum might allow us to salvage a degree of publicness even within the regime of mandatory arbitration.<sup>141</sup>

A modicum of publicness might be preserved, for example, through the issuance and publication of written, reviewable arbitration awards and by judicial review of awards. The major arbitration organizations have taken the lead in encouraging meaningful written

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(in the consumer context, finding no procedural unconscionability in a “take-it-or-leave-it” contract).

<sup>140</sup> *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 35 (1991).

<sup>141</sup> In addition to the issue of judicial review discussed here, the public interest would have a bearing on confidentiality provisions. Consider a clause that commits the parties and the arbitrator to confidentiality about arbitration proceedings and decisions. Should employers be able to ensure in advance that whatever they do that is illegal or actionable cannot be made public in connection with an employee’s legal claim against it? Or is the employer’s interest trumped by the public’s interest in learning about allegations or findings of wrongful conduct by employers, and in the development of precedent through published opinions? This issue arises in connection with confidentiality agreements in ordinary settlements, but it is more acute in the context of a predispute agreement that imposes a vow of silence even before the claim is made.

awards and their dissemination.<sup>142</sup> However, the traditional standard for judicial review of arbitration awards has been very narrow.<sup>143</sup> There is a substantial literature debating the virtues of wider judicial review of arbitration awards.<sup>144</sup> Pushing against a broad standard of review is the fact that the cost and delay of routine pre- and post-arbitration judicial review would defeat the main advantages of arbitration to both employers and employees. Still, some modicum of publicness, and of legal integrity, must be maintained.

The third objective set out above is to ensure that arbitration agreements advance only the legitimate and not the illegitimate aims of employers. The employer's legitimate aim is to minimize the cost of resolving disputes—not the direct costs of liability, but the process costs. By most accounts, those process costs (which include lost work time, attorneys' fees and other litigation costs, and the more intangible costs of delayed resolution and internal friction) are lower in arbitration than in litigation.<sup>145</sup> Some provisions are obviously designed to reduce costs and should be struck only if they impede effective vindication of employees' substantive rights. But provisions that might handicap plaintiffs and that do not appear to reduce process costs—e.g., class action waivers—should be highly suspect, for they may betray an illegitimate motive. Such a provision should trigger close scru-

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<sup>142</sup> The American Arbitration Association has made employment arbitration awards, redacted "to ensure the confidentiality of the parties," available in a searchable online database since 1999. See Am. Arbitration Assoc., Employment Awards Database, <http://www.adr.org/AAAawards/> (last visited Dec. 2, 2006) (cataloging awards filed after January 1, 1999).

<sup>143</sup> The FAA provides for vacating an award in cases of corruption or "evident partiality," or where the arbitrator committed misconduct, exceeded its powers, or failed to make an award. 9 U.S.C. § 10(a) (2000). To these minimalist grounds for review, the Supreme Court has added, for statutory claims, review for "manifest disregard" of the law. *Wilko v. Swann*, 346 U.S. 427, 436 (1953), *rev'd on other grounds*, *Rodriguez de Quijas v. Shearson/Am. Express, Inc.*, 490 U.S. 477, 484 (1989). But that standard has generally been applied very narrowly and rarely produces a reversal. See Bales, *supra* note 94, at 44.

<sup>144</sup> A number of commentators advocate continued narrow review of credibility and other factual findings but broader review of legal conclusions. See Bales, *supra* note 94, at 45 (noting Judge Edwards's proposal to give "broad deference" to findings of fact but increased review to conclusions of law); Martin Malin, *Privatizing Justice—But by How Much? Questions Gilmer Did Not Answer*, 16 OHIO ST. J. ON DISP. RESOL. 589, 631 (2001); Dennis R. Nolan, *Employment Arbitration After Circuit City*, 41 BRANDEIS L.J. 853, 887-89 (2003); Calvin Sharpe, *Integrity Review of Statutory Arbitration Awards*, 54 HASTINGS L.J. 311, 338-42 (2003).

<sup>145</sup> See Bales, *supra* note 94, at 8-17 (reviewing the empirical literature on litigation and arbitration process costs).



tiny of the agreement's overall fairness even if it does not handicap the plaintiff in a particular case.

I have posited, finally, that the law should aim to set clear criteria of validity and should operate so as to *deter* employers from overreaching and imposing provisions that are invalid but that discourage employees from litigating and testing the agreement's validity. On the aim for clarity, I recognize that the multiple criteria set out here for the validity of arbitration agreements may exacerbate the problem; a lax standard may be easier to apply and yield more predictable outcomes. Having explained the need for these criteria, I can add little but to reiterate the aspiration to derive rules out of these standards, wherever possible, to deal with recurring issues.

On the need to deter overreaching, the problem is parallel to that with non-compete covenants: an invalid agreement can do its dirty work without ever getting before a court. In this case, an unfair arbitration agreement may deter the employee from suing (or deter attorneys from suing on her behalf) by putting the employee to a choice between arbitrating under the unfair process or challenging it in court at significantly added cost. Some of the solutions suggested for non-compete covenants work for arbitration agreements as well. First, if employers face the risk that offending provisions will lead a court to void the whole agreement rather than merely edit or sever the provisions, the employer will have to police itself and avoid overreaching, lest it lose the entire benefit that it could have secured through a valid agreement. If the court's standard response to an invalid clause is to sever or "blue pencil" it, the employer has much less incentive to police itself.<sup>146</sup> Second, as in the non-compete setting, it should be unlawful—a wrongful discharge in violation of public policy—to fire an employee for refusing to sign an *invalid* arbitration

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<sup>146</sup> There is still a potential problem of rogue agreements that plainly cannot meet the law's standards but that might still pay off by deterring litigation and skewing arbitral results without ever seeing a court. The problem is less acute here than with non-competes, in that all employers could secure valid arbitration agreements from all employees and sacrifice their ability to do so by overreaching too badly. Still, some additional penalty beyond non-enforcement may be required to deter blatant overreaching. That might come in the form of attorneys' fees or allowing an adverse inference on the merits of any litigation that is eventually brought that the invalid agreement purported to bar. See *id.*, *supra* note 94, at 47 (suggesting that courts could "permit employees to use the lopsided agreement as evidence supporting punitive damages").

agreement.<sup>147</sup> Few employees will have the knowledge and fortitude to refuse to sign such an agreement, but those who do refuse should not be faced with discharge, and those who are fired should have a remedy in tort to discourage employers from thus abusing their power under employment at will.

Another way to promote self-policing by employers would be to treat arbitration agreements that are one-sided—that cover employee claims but not employer claims, such as those based on appropriation of trade secrets or breach of non-compete covenants—as at least suspect. Call it the “good for the goose, good for the gander” principle. Some courts have characterized one-sided agreements as lacking consideration or mutuality. But the real problem is that when the employer excludes its own future claims from coverage of an agreement that it drafts unilaterally, it has too little incentive to create a fair and adequate arbitral process and may be tempted to interpose unreasonable hurdles to meaningful adjudication (e.g., very short filing deadlines or sharply curtailed discovery). Those flaws might be corrected by a reviewing court, but only if the employee challenges the agreement. By contrast, an agreement that covers employer claims contains some built-in incentive for self-policing: employers who contemplate the possibility of arbitrating their own claims against employees or ex-employees will have an incentive at least to designate a competent tribunal without unreasonable hurdles to adjudication. Of course they will in that case have a *greater* incentive to skew the decision-making process in their own favor if they can; there must be other mechanisms to reach that kind of abuse.

Agreements that pass muster under all four criteria—in particular those under which employees can effectively vindicate their substantive nonwaivable rights and which advance only the legitimate and not the illegitimate aims of the employer—should be those that secure benefits to employees as well as to employers *ex ante*. It is controversial among employee advocates to concede that any predispute arbitration agreement can secure benefits to employees. But a fair agreement that speeds the resolution of disputes at a lower cost—one that meets the first three requirements—will allow more employees to get a prompt and fair adjudication of their claims. Evidence that very

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<sup>147</sup> The public policy lies both in the underlying legal protections that are threatened by an unfair arbitration agreement and in the public policy of fair adjudication of existing rights.

few employment cases actually go to arbitration<sup>148</sup> is disturbing on this score. Indeed, evidence is mounting that, when cases do go to arbitration, arbitrators rule for employees more often than courts do (though in smaller amounts). The subset of would-be complainants whose claims are strong enough and lucrative enough to attract a lawyer and to be worth litigating will lose much of the leverage that comes from the threat of a public jury trial. That is a trade-off that plaintiffs' attorneys vigorously resist but that might better serve employees as a group.<sup>149</sup>

Indeed, as the law of arbitration has curbed some of the worst abuses, and the pool of employment arbitrators has become more educated and diverse, some observers have begun to question whether arbitration agreements actually produce net gains for employers or whether the reduced cost of each case is outweighed by the greater number of cases in which employees succeed.<sup>150</sup> That equivocation should be mildly reassuring about the fairness of the arbitration bargain. A few years ago, when arbitration agreements were sweeping the country and their adoption appeared to be a "no-brainer" for employers, it was hard to credit claims of the reciprocal advantages of arbitration for employees. Now that some employers are questioning whether they gain from mandatory arbitration, it is easier to believe that employees do gain something. It also seems less likely that arbitration will completely supplant litigation, public trials, and judicial involvement in the development of employment law.

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<sup>148</sup> See *supra* note 106.

<sup>149</sup> Or it might not. There is a plausible competing story by which employees as a group do benefit indirectly from the ability of very few employees to secure a big (jury) verdict through litigation. First, the fear of costly high-profile litigation, and potentially a jury trial, is a major impetus to internal reform by employers that benefits all employees. Think, for example, of the antiharassment and antidiscrimination policies that have transformed employment relations in recent decades. Second, the rare big verdict casts a shadow over the settlement process and may yield larger out-of-court settlements for a wide swath of plaintiffs. Third, the occasional large verdicts and the sizable settlements they induce may be crucial to the business model and the success of the plaintiffs' employment bar, which benefits employees. The leading members of the plaintiffs' employment bar largely succeed by judicious selection and vigorous prosecution of the strongest cases and the deftly deployed threat of a jury trial. The virtual elimination of juries and of very large verdicts that juries sometimes award might reduce the plaintiffs' employment bar to something much less dynamic and fearsome to employers.

<sup>150</sup> See Michael Z. Green, *Debunking the Myth of Employer Advantage from Using Mandatory Arbitration for Discrimination Claims*, 31 RUTGERS L.J. 399, 405 (2000).

The right to litigate future employment claims, like the right to compete with one's employer postemployment, is waivable largely because of the potential mutual benefits of the arbitral forum. But that right is only conditionally waivable primarily because of the importance of protecting the nonwaivable employee rights that would be at risk under the regime of ordinary contract. Once the reasons for conditional waivability are better understood, as I have sought to make them here, they give some critical purchase on the law that governs both mandatory arbitration agreements and non-compete covenants.

### C. *A Closing Word on Conditional Waivability*

Up to now I have used the concept of conditional waivability while putting to one side questions about whether the concept aptly captures the nature and structure of the law governing arbitration agreements and non-compete covenants. By and large, I leave it to the reader to judge whether the concept of conditional waivability proves useful in recognizing common problems and common solutions in the two areas. But a few more words may be in order.

It should now be clear that there are deep congruences between the two bodies of law. In both cases, waivable and nonwaivable employee entitlements are intertwined somehow, and need sorting out. It may be less clear whether "conditional waivability" is the best characterization of this intertwining of entitlements, for one might well describe the two bodies of law differently. The right to compete may be seen as a partially waivable right, and the law governing non-compete covenants may be seen as identifying the line between what is waivable and what is not. The right at stake in arbitration might be described as a waivable right to litigate future claims coupled with a nonwaivable right to a fair adjudicatory process, the contours of which are being worked out through the law of arbitration.

But the concept of conditional waivability helps to focus attention on the conditions that the law imposes on these two discrete and rather common sorts of agreements: what are the conditions of validity, where do they come from, what are they accomplishing, and what happens if they are violated? The specific answers to those questions obviously depend on the differing rights and interests at stake in the two cases. But the shared analytical framework helps to frame a set of questions common to the two cases, and encourages us to try out lessons learned in one domain to problems in the other.

#### IV. EXTENDING THE DOMAIN OF CONDITIONALLY WAIVABLE RIGHTS: PRELIMINARY THOUGHTS

Let us now switch to a wider-angle lens and ask whether conditional waivability might be of broader use within the law of employment. Of course the structure of conditional waivability could be adapted to a wide variety of entitlements. Some entitlements that are currently in the general domain of contract—entitlements that employees have only if the contract so provides, either affirmatively or by a default rule—might be shifted to the employee but made conditionally waivable. Some rights that are currently waivable might be fortified by making them conditionally waivable. Or some employee rights that are currently nonwaivable might be made waivable under appropriate conditions. The question is when it might make sense to do so.

One lesson of the foregoing exercise is that conditional waivability tends to be complex and costly to administer—not more costly than mandatory rights, perhaps, but certainly more costly than ordinary contract terms, which come with a strong presumption of validity. So whether it makes sense to move toward conditional waivability in any particular case depends partly on solving that problem: can conditions be made reasonably clear and predictable, and can the law effectively induce employers to police themselves in the formation of agreements? If not, conditional waivability may make sense only in rare circumstances in which the relevant rights and interests are aligned much as they are in the case of non-compete and arbitration agreements. If the domain of conditional waivability is defined by a convergence of all of the shared features that have been identified in those two cases, then it may be very limited. In particular, the distinctive pairing of rights observed in both cases—one right supplying essential support to an adjacent nonwaivable right—may be rare in existing law and hard to reproduce even if we relax the constraint of existing law.

On the other hand, if we can solve the problem of cost and complexity, then conditional waivability could prove to be widely useful. For the distinctive virtue of conditional waivability is that it allows for the pursuit of public values within the flexible framework of private contract. Ordinary contract law is said to afford the parties optimal freedom to pursue their own preferences and to reach efficient bargains. But in the employment context, doubts about the contractual paradigm have often won the day when it has run up against cherished public values or goals. Current law reflects a broad consensus that some rights of employees must be fortified against the give-and-

take—and especially the take—of ordinary contractual bargaining. Conditional waivability fortifies employee rights without foreclosing mutually beneficial trades. It allows the parties to bargain within publicly constrained channels toward publicly sanctioned ends in light of private and particular needs and interests.

With that kind of recommendation, the potential domain of conditionally waivable rights may appear vast indeed. That is particularly true in light of growing doubts about the ability of uniform mandates and command-and-control regulatory structures to protect employees' interests in the face of boundaryless global competition, organizational instability, rapidly changing technology, and firms' incessant demands for flexibility. For some entitlements, a mechanism that allows bargaining within publicly constrained channels under some kind of public oversight might be a way to mitigate the inflexibility of mandates without giving up on the promotion of public norms.<sup>151</sup> What follows here is merely suggestive.

Conditionally waivable rights could be created from either end of the rights-contract spectrum. Such rights might be carved out of what is now the domain of contract. One obvious possibility is job security, which employees can now secure only by some form of contract—individual or collective, express or implied, negotiated bilaterally or conferred unilaterally by official policy. That is in striking contrast to mandatory unjust dismissal protections that exist in nearly all other advanced economies. Commentators have proposed switching to a default principle of “good cause” dismissal to reflect widespread employee beliefs and bargaining impediments;<sup>152</sup> but most employers are already a step ahead, having reasserted their power to discharge at will through express disclaimer clauses. One might construct instead a legal right to job security that can be waived under specified conditions.<sup>153</sup> For example, a waiver of job security might be upheld where it came with some combination of severance pay and relocation and retraining benefits.<sup>154</sup> The idea would be to impose conditions that

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<sup>151</sup> The potential use of conditionally waivable rights as one building block of a post-command-and-control employment law is an extension of themes I have explored elsewhere and plan to develop in future work. See Cynthia Estlund, *Rebuilding the Law of the Workplace in an Era of Self-Regulation*, 105 COLUM. L. REV. 319, 333 (2005).

<sup>152</sup> See Issacharoff, *supra* note 7, at 1794; Sunstein, *supra* note 25, at 120.

<sup>153</sup> I explored this possibility briefly in another article. See Cynthia L. Estlund, *How Wrong Are Employees About Their Rights, and Why Does It Matter?*, 77 N.Y.U. L. REV. 6, 23-27 (2002).

<sup>154</sup> The standard economic argument would hold that increasing the cost of terminations, whether through mandated job security or the proposed alternative pack-

gave employees some of the economic security and employability that job security does (or did in the halcyon days of “lifetime employment”), while affording more flexibility to employers who need it and are willing to pay for it.<sup>155</sup>

Other employment benefits that are currently available only by contract might be made into conditionally waivable employee entitlements. Employees might, for example, be granted a statutory right to health benefits that is waivable under conditions that ensure that the employee has adequate alternative coverage, public or private.<sup>156</sup> A conditionally waivable employee right to health care coverage may be a distant second-best alternative to a universal health care guarantee, but it might also be a more politically viable step in that direction.

Conditional waivability could also be imposed on rights that are otherwise freely waivable (or are subject to “knowing and voluntary” but otherwise unconstrained waiver). That is essentially what Congress did to claims under the Age Discrimination in Employment Act (ADEA) in enacting the Older Workers’ Benefits Protection Act (OWBPA). A valid waiver of an existing ADEA claim must be “in exchange for consideration in addition to anything of value to which the [employee] already is entitled,” such as normal severance pay, and it must be preceded by disclosure of information about the triggering event and sufficient time to consult with an attorney.<sup>157</sup> Existing legal claims, unlike future claims, are inevitably settleable, and almost necessarily waivable. But the OWBPA seeks to ensure that employees have some idea of what they might be giving up and that they get something in exchange.<sup>158</sup> The OWBPA might serve as a useful legal

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age of protections, is unlikely to be absorbed by employers and will be paid for by workers in the form of either reduced wages or reduced employment. I offer no response here except to suggest that what we have now—employment at will coupled with numerous exceptions—is itself quite costly to administer. *See* Estlund, *supra* note 14, at 1675.

<sup>155</sup> One might achieve economically similar results by imposing mandatory good cause if it took the form of a liability right (a right to limited damages but not to reinstatement), or if it were coupled with a willingness to enforce contractual liquidated damages provisions. The advantage of a conditionally waivable right, if any, would lie in the ability to customize the conditions—for example, by the provision of employability benefits—beyond what standard remedial options permit.

<sup>156</sup> There is an analogous logic to some state “pay-or-play” laws, which require covered employers either to offer health coverage to their employees at a reasonable rate or to pay into a public fund that provides a default system of health insurance.

<sup>157</sup> 29 U.S.C. § 626(f) (1) (A)-(H) (2000).

<sup>158</sup> The unspecified requirement of additional consideration is the only substantive condition on OWBPA waivers; the other conditions are basically procedural. As

template for regulating the waiver of other existing employment claims. Indeed, in practice, the OWBPA is serving as a broader template: because ADEA claims may be included in the single broad waiver that employers often seek from employees at the time of severance, employers are well advised to, and often do, follow the relatively stringent statutory standards of the OWBPA.<sup>159</sup>

Finally, some employee rights that are currently nonwaivable might be made waivable under appropriate conditions. The key would be to identify nonwaivable rights that are not essential to personhood and citizenship in a free society, that need not be universal to vindicate the underlying public objectives, and that might be unduly rigid given the diversity of organizations and the changing conditions they face. I will not venture here to fill out these broad outlines with more than a few examples.

An example might be the right to the overtime premium (time-and-a-half) under the Fair Labor Standards Act (FLSA) for hours in excess of forty per week. Some employees—especially those with family responsibilities—might prefer compensatory time off instead. Conditional waivability might be a way of satisfying those preferences without simply dumping overtime rights into the free-for-all of the market. Waiver of the overtime premium might be conditioned, for example, on “comp time” accruing at the same time-and-a-half rate, and on some assurance of its being available to meet employee and not just employer needs.<sup>160</sup> In fact, the FLSA allows precisely this trade-off for some employees: public employers are permitted to give compensatory time off in lieu of overtime pay pursuant to an individual or collectively bargained agreement.<sup>161</sup> So while most private sector employees have a nonwaivable statutory right to overtime pay, public employees have a conditionally waivable right—a bargaining chip

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such, the OWBPA requirements only barely represent a form of conditional waivability as I have defined it.

<sup>159</sup> Jonathan D. Glater, *For Last Paycheck, More Workers Cede Their Rights To Sue*, N.Y. TIMES, Feb. 24, 2001, at A1.

<sup>160</sup> This would be an example of converting a nonwaivable right into a conditionally waivable right, but it might also be a mechanism for creating a conditionally waivable right out of what now lies in the domain of contract. Salaried professional and managerial employees who fall within the FLSA’s “white collar exemptions” currently have no right to the overtime premium. Fair Labor Standards Act, 29 U.S.C. § 213(a)(1) (2000). Allowing the conditional waiver of overtime rights in favor of “comp time” might pave the way for extending overtime rights to some groups of employees who are currently exempt.

<sup>161</sup> 29 U.S.C. § 207(o) (2000).



that they can trade for a publicly approved substitute benefit (comp time) that they may value more.

Many employee rights are nonwaivable for sound reasons; some are essential to human freedom and equal citizenship. The core of antidiscrimination law is a prime candidate for continued nonwaivability. But it is important to note that, at the margins, antidiscrimination law has begun to permit the trade-off of some elements of liability in exchange for internal avenues of relief (albeit not through the mechanism of contractual waiver, but through judicially crafted standards of liability and affirmative defenses). For example, employers can escape liability for some harassment claims if they take reasonable steps to prevent and redress harassment.<sup>162</sup> Employers can escape punitive damages under Title VII if they demonstrate “good faith efforts to comply” with the law through internal procedures.<sup>163</sup>

These developments are controversial.<sup>164</sup> But they do show that trade-offs of the sort that conditional waivability might permit are not unthinkable even within the domain of antidiscrimination law. They also suggest a particular sort of trade-off—some elements of external liability in exchange for internal rights, remedies, and procedures—that may further extend the usefulness of conditional waivability. Many of the rights that external law confers on employees deliver far less to employees than they cost employers, given the unwieldiness and burdens of regulation and litigation. It may therefore be worth thinking of some employee rights as potential leverage for the promotion of better forms of workplace governance in which employees have a real voice. It is worth thinking about, but it is not worth doing unless the conditions and the mechanism for enforcement are at least as effective in protecting public goods and employee interests, and no more costly than the existing rights-enforcement regime. If that challenge can be met, some of the myriad employee rights might be made

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<sup>162</sup> See, e.g., *Faragher v. City of Boca Raton*, 524 U.S. 775, 807-08 (1998) (recognizing an affirmative defense to harassment liability if no “tangible employment action” is taken, if the employer has exercised “reasonable care” to prevent harassment, and if the employee unreasonably failed to take advantage of the employer’s procedures).

<sup>163</sup> *Kolstad v. Am. Dental Ass’n*, 527 U.S. 526, 544 (1999).

<sup>164</sup> See Lauren B. Edelman et al., *Diversity Rhetoric and the Managerialization of Law*, 106 AM. J. SOC. 1589, 1632-34 (2001) (arguing that judicial approval of and deference to corporate antidiscrimination and diversity programs have transformed legal rights to be more congenial to managerial values); Kimberly D. Krawiec, *Cosmetic Compliance and the Failure of Negotiated Governance*, 81 WASH. U. L.Q. 487, 492 (2003) (contending that a liability regime focused on compliance with internal procedures may lead to underenforcement).

partially and conditionally waivable to the end of promoting more democratic workplace governance mechanisms that serve employees better than the rights-litigation paradigm that has loomed so large in the law of employment.

In considering the extension of conditionally waivable rights to new areas, it is worth recalling the several criteria proposed above for the valid waiver of the right to compete and the right to litigate, for those same conditions might provide useful guidance in crafting new conditionally waivable rights. Above all, the law should protect any nonwaivable employee rights that are at stake in these agreements. Having now relaxed the fixed constraint of existing law on what is nonwaivable, I have introduced both more flexibility and greater risk into the equation. Before making any nonwaivable rights conditionally waivable, or even partially so, we should consider carefully whether some core of the right should remain nonwaivable and shielded from effective waiver. I do not claim to have set out the normative criteria that should guide this inquiry; I have only shown why the inquiry is a crucial one.<sup>165</sup>

A major challenge in crafting any new conditionally waivable rights will be making them reasonably administrable. We have seen that the structure of conditional waivability may tend to promote complexity and indeterminacy: the contractual form affords flexibility and invites both experimentation and opportunism; the legal conditions on validity allow for the promotion of public norms, but also require effective oversight. Greater awareness of these built-in difficulties, to which I hope to have contributed here, may allow policy- and lawmakers to craft conditionally waivable rights that avoid those difficulties and that secure benefits to employees as well as to employers.

#### CONCLUSION

Conditionally waivable rights in the employment setting present some characteristic challenges and puzzles, but also some distinctive virtues. A better understanding of this hybrid form provides a useful critical vantage point from which to assess the two primary examples

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<sup>165</sup> In addition, the substance and the form of conditional waivability should protect whatever public interest is at stake in these agreements beyond the enforcement of employee rights; it should aim to ensure that the agreements advance only the legitimate and not the illegitimate aims of employers—"illegitimacy" being defined by reference to whatever inalienable employee rights or public interests are at risk.

of conditionally waivable rights in existing employment law, and may point toward improvements in the law governing both non-compete covenants and mandatory arbitration agreements. A better understanding of conditional waivability may also point to a middle path between the more familiar forms of employment law, bringing flexibility to the realization of employee rights and public values to the employment contract.

On the other hand, conditionally waivable rights are at best only a small part of the solution to the simmering crisis of labor and employment law in an increasingly globalized economic environment. The crisis lies in the enfeeblement of familiar tools for the social control of labor market dynamics and outcomes. The domain of collective bargaining has shrunk to well under one-tenth of the private sector workforce. Command-and-control regulatory schemes have come under attack from all sides, both for their rigidity and for their lax enforcement and their loose grip on footloose firms. The vindication of rights through litigation has proven both ineffectual for many employees and burdensome to employers, and is being transformed and potentially weakened by the move toward arbitration. New tools are required to meet the needs of an increasingly diverse and mobile workforce in an increasingly global, competitive, and fast-changing market for goods and services, and in the increasingly volatile organizations that compete in that market. The intriguing promise of conditional waivability lies in its potential for enabling social control and promoting public norms while reckoning with organizations' need for flexibility.