

## Restricting the use of non-compete clauses in employment contracts

<b>Lead department</b>	Department for Business, Energy and Industrial Strategy
<b>Summary of proposal</b>	A three-month statutory limit on the duration of 'non-compete clauses' restricting individuals' ability to compete against their former employer.
<b>Submission type</b>	Impact assessment (IA) – 27 October 2022
<b>Legislation type</b>	Primary legislation
<b>Implementation date</b>	2023
<b>Policy stage</b>	Final
<b>RPC reference</b>	RPC-BEIS-5241(1)
<b>Opinion type</b>	Formal
<b>Date of issue</b>	24 November 2022

### RPC opinion

<b>Rating<sup>1</sup></b>	<b>RPC opinion</b>
<b>Fit for purpose</b>	The IA provides a sufficient assessment of direct impacts on business, including small businesses. The IA is strong on gathering evidence and data, commissioning three surveys, and provides a balanced discussion of this evidence.

### Business impact target assessment

	<b>Department assessment</b>	<b>RPC validated</b>
<b>Classification</b>	Qualifying regulatory provision	Non-qualifying regulatory provision ( <i>de minimis</i> )
<b>Equivalent annual net direct cost to business (EANDCB)</b>	£1.5 million	<i>De minimis</i>
<b>Business impact target (BIT) score</b>	Not provided	N/A
<b>Business net present value</b>	-£12.7 million	
<b>Overall net present value</b>	-£12.7 million	

<sup>1</sup> The RPC opinion rating is based only on the robustness of the EANDCB and quality of the SaMBA, as set out in the [Better Regulation Framework](#). RPC ratings are fit for purpose or not fit for purpose.

## RPC summary

Category	Quality <sup>2</sup>	RPC comments
EANDCB	<b>Green</b>	The EANDCB is informed by survey evidence and appears to be a proportionate assessment of the direct impact on business. The IA could be improved by further discussion of other possible transition costs and ongoing impacts on business.
Small and micro business assessment (SaMBA)	<b>Green</b>	For a <i>de minimis</i> measure, the Department has helpfully included a SaMBA voluntarily. This usefully discusses disproportionality and exemption.
Rationale and options	<b>Satisfactory</b>	The IA outlines market failure and equity rationales for intervention and draws on BEIS-commissioned surveys of employers and employees for evidence of a problem. The IA provides a balanced summary of this mixed evidence. The IA could provide a clearer narrative for the rationale for intervention. The IA assesses three regulatory options and summarises the non-legislative options considered.
Cost-benefit analysis	<b>Satisfactory</b>	The IA is strong on evidence and data, including commissioning three surveys. The IA would benefit from further discussion around non-monetised impacts and risks.
Wider impacts	<b>Satisfactory</b>	The IA includes a useful discussion of indirect impacts and includes a competition impacts assessment. The IA would benefit from drawing together references to innovation impacts, considering potential impacts on employee training and discussing impacts on enforcement on the public sector.
Monitoring and evaluation plan	<b>Good</b>	The IA usefully outlines the questions that would be addressed, data sources that would be used and the research methodologies that would be applied to monitor and evaluate the policy.

<sup>2</sup> RPC quality ratings are used to indicate the quality and robustness of the evidence used to support different analytical areas. Definitions of the RPC quality ratings can be seen [here](#).

## Summary of proposal

Non-compete clauses restrict an individual's ability to compete against their former employer for a fixed period of time when they are no longer in their employ. It is estimated that non-compete clauses are used by around 300,000 to 530,000 businesses and cover around 5 million employees, with a typical clause duration of around six months. The Government consider that these clauses can have an adverse impact on the workers affected, as their future employment mobility is restricted, and on the wider economy due to the impacts on competition and innovation.

The IA considers the following options (in addition to the do-nothing option):

- Option 1: complete ban of non-compete clauses.
- Option 2: requirement for employers to pay the worker compensation (at 60, 80 or 100 per cent of the worker's average pay) for the duration of the non-compete clause.
- Option 3: a three-month statutory limit on the duration of non-compete clauses.

Option 3 is the preferred option.

## EANDCB

The IA estimates an EANDCB of £1.5 million, consisting of one-off familiarisation costs of £14.9 million. This estimate is based upon survey evidence of the number of businesses that use non-compete clauses and responses by business on the time taken to familiarise with statutory flexible working policies. The assumed one-hour per manager/HR officer familiarisation time is broadly consistent with that used in other recent IAs on labour market measures. The estimate therefore appears to be reasonably supported by evidence and proportionate. Although the estimate varies by business size, with more employees needing to familiarise in medium to large businesses, the IA could discuss further any costs associated with disseminating information throughout the business, as appropriate.

The IA does not quantify any ongoing impacts on business of the proposed three-month limit. In EANDCB terms, this appears to be reasonable as the impacts appear to be indirect, particularly those that result from competition or innovation impacts (facilitated by the information an ex-employee brings to a new firm). However, the IA would benefit significantly from discussing further the area of ongoing impacts on business.

## SaMBA

As a *de minimis* measure, there is no better regulation framework requirement for a SaMBA. However, the IA usefully includes one (page 42). The IA discusses disproportionality of impact, indicating that small businesses are less likely to use non-compete clauses but, where they do, they might be slightly longer in duration. The IA notes that the proposal is expected to increase the number of start-up

businesses. The decision not to exempt SMBs appears to be based upon a reasonable level of evidence and analysis, although the argument that exemption would be an impediment to business growth is a generic one and of limited value in the assessment. The IA notes that new entrants, who would benefit from having easier access to skilled/experienced employees, are more likely to be small or medium-sized entities. The IA would benefit from some discussion of mitigation, for example whether guidance or information campaigns would assist small businesses' familiarisation.

### *Medium-sized business considerations*

As a *de minimis* measure, there is no requirement for the IA to take account of the Government's recent announcement of plans to widen presumed exemptions on regulation of businesses with fewer than 500 employees.<sup>3</sup> However, the IA would benefit from addressing, proportionately, the impact of exemption of businesses with fewer than 500 employees on achievement of the policy objectives. The IA could also adjust its tables of businesses affected by number of employees to reflect this new requirement (for example by differentiating between medium-sized and large businesses, where possible).

## **Rationale and options**

The IA refers to market failure and equity considerations to restrict the use of non-compete clauses (page 10). The assessment draws on a literature review and BEIS-commissioned surveys of employers and employees to examine the scale of the extent and impact of these failures. The IA concludes fairly that this evidence does not provide clear-cut conclusions. For example, the survey evidence does not appear to provide strong support for the existence of asymmetric information, with 72 per cent of employees being aware of the clause prior to signing their contract (although this does not necessarily mean they were fully aware of its implications). However, the survey evidence does appear to provide some support for imbalance of power (a significant proportion of employees felt they were not in a position to negotiate over the clause).

Overall, the proposal appears to be aimed at a variety of policy objectives and the IA would benefit from a clearer narrative of the rationale for intervention. The IA could be improved by a clearer comparison of the costs, risks and benefits and explanation for the expected overall net benefits.

The IA indicates that non-compete clauses reduce skilled labour availability to new entrants and could, therefore, have the effect of creating entry barriers and protecting incumbents with market power. To pursue this satisfactorily, the IA would need to provide systematic analysis of industries where true market power is a problem that would be addressed by the proposal. The assessment would also need to take account of market power - the ability to sustain prices significantly above

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<sup>3</sup> <https://www.gov.uk/government/news/red-tape-cut-for-thousands-of-growing-businesses>. Associated Better Regulation Executive guidance: <https://www.gov.uk/government/publications/better-regulation-framework/medium-sized-business-regulatory-exemption-assessment-supplementary-guidance>

competitive levels – being normally associated with high levels of market concentration and entry barriers typically including many factors other than labour/skill shortages.

The IA could explore further the reasons for the different responses between the 2016 call for evidence and the 2020-21 consultation, discussing further the possible impact of the Covid-19 pandemic, including a greater level of home working. This could include whether this might have an impact on the noted long-term decline in employee mobility (paragraph 19, page 7).

The IA considers three regulatory options and provides cost estimates for each. The IA could be improved by including the non-preferred options 1 and 2 in the summary sheets. The IA helpfully summarises non-legislative options considered, such as provision of guidance and communications campaigns.

## Cost-benefit analysis

### Evidence and data

The IA is strong on evidence and data, drawing upon international evidence, a literature review and, most importantly, commissioning three surveys (two of employers; one of employees). The IA provides a balanced conclusion from this evidence. The IA would benefit from explaining further the differences in the results of the two employer surveys, from *IFF* and *YouGov*. The IA's estimate of the proportion of businesses using non-compete clauses is based on results from two surveys and the IA would benefit from discussing the robustness of this evidence.

### Methodology

The methodology for the assessment of the impact of the preferred option is relatively straightforward but the IA helpfully sets out in some detail (pages 31-38 and Annex A) the more complex approach to assess the transfer of pay from the employer to the worker under option 2.

The IA quantifies only the direct impacts on business. The Department is unable to monetise the ongoing impacts of the proposal. However, the IA would benefit from further discussion of these impacts, both on business and wider society. For example, while to some extent the ongoing impacts on business will net off (one firm's gain is another firm's loss), there could be net effects, particularly if existing non-compete clauses protect genuine market power. In this situation, the incumbent business could have 'more to lose' (monopoly profit) than a new entrant (normal profit in a newly-competitive market), but with consumers gaining through lower prices. There might also be longer-term gains from any increased competition or innovation. The IA could usefully discuss such impacts.

### Non-monetised impacts

The IA explains that businesses would not be required to amend existing employment contracts to reflect a three-month limit and does not, therefore, include an estimate of the administrative cost of this in the preferred option. This is calculated for the non-preferred option 2, where amendment of contracts would be

required. The IA would benefit from discussing further whether businesses are likely to incur this cost under the preferred option as 'best practice'. This could include consideration of whether such amendment of contracts could present an opportunity for employees to seek to negotiate more generally over the contract, particularly with inflation being high.

### Assumptions and risks

The IA notes that a consultation stage IA was not published (paragraph 10, page 5) because of a limited evidence base. The RPC notes that even an indicative assessment may have been useful to provide further assurance on some of the assumptions, for example on familiarisation time.

The IA includes a useful section on risks. This could be strengthened by addressing the concerns expressed during consultation that exceptional cases may require a longer period and that employers might respond by increasing the length of non-compete clause up to the statutory maximum.

## **Wider impacts**

The IA includes a useful discussion of indirect impacts on businesses, workers and the wider economy (pages 26 and 38-39). There is a competition impacts assessment (page 41) and a discussion of risks (pages 40-41). The IA refers to innovation impacts throughout (in particular at page 12) but would benefit from summarising these impacts in an expanded specific section. The IA could also be strengthened by discussing public sector impacts in terms of enforcement of a three-month limit.

The IA would benefit from discussing potential disincentives for employers to invest in training employees and consequential effects on human capital.

## **Monitoring and evaluation plan**

The IA provides a good monitoring and evaluation plan for an IA for primary legislation. The plan outlines the questions that would be addressed, data sources that would be used and the research methodologies that would be applied, including potentially commission a survey.

### **Regulatory Policy Committee**

For further information, please contact [regulatoryenquiries@rpc.gov.uk](mailto:regulatoryenquiries@rpc.gov.uk). Follow us on Twitter [@RPC\\_Gov\\_UK](https://twitter.com/RPC_Gov_UK), [LinkedIn](#) or consult our website [www.gov.uk/rpc](http://www.gov.uk/rpc). To keep informed and hear our views on live regulatory issues, subscribe to our [blog](#).