

# Science Policy Research Report: Employee Non-compete Agreements

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# Recent non-compete reforms

State	Date	Details
Illinois	August 19, 2016	The Illinois “Freedom to Work Act” bans the use of non-competes for workers earning less than the \$13.50 minimum wage and states that any such term in an employment agreement is void.
Idaho	March 30, 2016	House Bill 487 stipulates that “key <b>employees</b> ” (among the 5% most highly paid) “ <b>must show</b> that [they have] <b>no ability to adversely affect the employer's</b> legitimate business interests” <b>or else a non-compete</b> of up to 18 months in duration is <b>presumptively enforceable</b> .
Utah	March 22, 2016	The Utah Post-Employment Restrictions Act restricts non-competes to one year and requires an ex-employer whose non-compete suit is not upheld to pay its ex-employee’s legal expenses.
Hawaii	June 26, 2015	Hawaii Act 158 voids any “non-compete clause or a non-solicit clause in any employment contract relating to an employee of a technology business.”

		<i>Direct evidence</i>	<i>Cross- sectional policy comparison</i>	<i>Policy shocks</i>	<i>Instrumental variable</i>	<i>Laboratory experiment</i>	Total
Individual	Prevalence of contracts	4(1)					5(1)
	Process of obtaining signatures	1(1)					1(1)
	Mobility between firms and industries	1	1	2(5)			4(5)
	Compensation	(3)		1			1(3)
	Motivation/productivity	(1)				1(1)	1(2)
Firm	Performance			2			2
	Investment	(1)		1(1)			1(2)
	Innovation			1			1
	M&A			1			1
Region	Flow of talent		(1)	1			1(1)
	Flow of knowledge			1			1
	Entrepreneurship		2	1(4)	1		3(4)

Level of Analysis	Findings
<p><b>Individual</b></p>	<p>Workers subject to non-competes are 8-47% less likely to change jobs, depending on their role.</p> <p>Executives subject to non-competes enjoy 8.2% less growth in compensation.</p>
<p><b>Firm</b></p>	<p>Public companies enjoy a short-term boost of 10% in Tobin’s q from being able to enforce non-competes.</p> <p>Firms are 7-15% more likely to pursue riskier R&amp;D projects when they are able to enforce non-competes.</p> <p>Non-competes promote a somewhat more robust market for acquisitions, approximately 3% more acquisitions following Michigan’s abandonment of a non-compete ban.</p> <p>Venture-backed startups are less likely to achieve attractive liquidity events when subject to non-competes because it is more difficult to bring in experienced executives to replace the founders.</p>
<p><b>Region</b></p>	<p>Non-competes create a “brain drain” as top talent leaves states that allow non-compete enforcement. Inventors overall are twice as likely to leave the state, and highly prolific inventors are three times as likely to leave.</p> <p>Non-competes mute the flow of knowledge.</p> <p>Non-competes discourage would-be entrepreneurs from starting new companies in their industry.</p> <p>Venture capital is less effective in creating companies, jobs, and innovation where non-competes can be enforced.</p>

# Research directions

- Most papers EITHER
  - Collect single-point-in-time data on usage
    - Informative regarding process, but difficult to make causal claims
  - Assess impact of policy shocks w/o data on usage
    - More useful for causality, but what is being measured?
    - Contracts can have an impact independent of policy
- Gap: *large-scale, longitudinal data on usage*
  - Executive contracts for public companies (one working paper)
  - NLSY (but small-scale, need concurrent policy changes)
- More generally, firms & regions need attention
  - Zero work on gender effects (risk aversion), wealth, minorities



# Policy recommendations

- Notice
- Up-or-down validity / end “reformation”
- Address the “chilling effect”

Policy recommendation: notice

- *“the non-compete issue is really about choice for both individuals and employers, who should be free to negotiate contracts of mutual benefit.”*

Brad MacDougall

Vice President of Government Affairs  
Associated Industries of Massachusetts

# A “negotiation” or an ambush?

with job offer	After offer, but before started	on first day of work	after started working
30.5%	22.2%	24.5%	22.9%

- Nearly half told on or after first day  
*“I never received any information ahead of time before showing up to my first day: health insurance, 401(k), and non-compete. It was either sign it and work here or don't sign it and don't work here.”*
- Especially true for younger workers

# Policy recommendation: notice

- Workers must be told *in the offer letter* that they will be asked to sign
- Copy of the agreement must be furnished upon request
- Post-hire “afterthought” non-competes
  - Must be accompanied by material consideration (not just keeping your job)
  - Worker must have time to review w/legal counsel
  - Worker must be allowed to decline and keep job

Policy recommendation: end so-called “judicial reformation”

# Ballot Summary of Proposed 2010 Amendment to Georgia Constitution

*Shall the Constitution of Georgia be amended so as to make Georgia more economically competitive by authorizing legislation to uphold reasonable competitive agreements?*

Mr. Marx agrees not to work for any company in the speech recognition industry, anywhere in the world, for a period of three years after leaving SpeechWorks International.



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# Policy recommendation: end “reformation”

- Judges should make up-or-down decisions regarding validity
- So-called “reformation” enables firms to be
  - Sloppy
  - Strategic
- when drafting non-competes because the judge can always “fix” overbroad agreements
- Meanwhile, worker may *think* broader contract is valid

Policy recommendation: the  
“chilling effect”

# # published non-compete decisions



court  
cases →

**Unlitigated  
threats →**

**Voluntary  
compliance →**



# Policy recommendation: the “chilling effect”

- Most reforms focus on whether non-compete can be enforced in a court of law (duration, breadth, etc.)
- Reforms re: notice and reformation begin to address chilling effect
- Still, little incentive for firms not to act badly
- Illinois reform: *No employer **shall enter into** a covenant not to compete with any low-wage employee of the employer.*
  - Empowered AG Lisa Madigan to sue Check Into Cash LLC for violation
  - Anonymous reports from employees → high-profile actions → civil penalties

# Summary of policy recommendations

1. notice & consideration for employees asked to sign
2. Abolishing so-called judicial “reformation” → up/down rulings
3. Adopt Illinois-style *usage* bans & empower state AGs to sanction bad actors