Science Policy Research Report: Employee Non-compete Agreements

Matt Marx



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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 employees " (among the 5% most highly paid) " must show that [they have] no ability to adversely affect the employer 's legitimate business interests" or else a non-compete of up to 18 months in duration is presumptively enforceable .
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."

		Direct evidence	Cross- sectional policy comparison	Policy shocks	Instrumental variable	Laboratory experiment	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)
Region Firm	Performance			2			2
	Investment	(1)		1(1)			1(2)
	Innovation			1			1
	M&A			1			1
	Flow of talent		(1)	1			1(1)
	Flow of knowledge			1			1
	Entrepreneurship		2	1(4)	1		3(4)

Level of Analysis	Findings			
Individual	Workers subject to non-competes are 8-47% less likely to change jobs, depending on their role.			
	Executives subject to non-competes enjoy 8.2% less growth in compensation.			
Firm	Public companies enjoy a short-term boost of 10% in Tobin's q from being able to enforce non-competes.			
	Firms are 7-15% more likely to pursue riskier R&D projects when they are able to enforce non-competes.			
	Non-competes promote a somewhat more robust market for acquisitions, approximately 3% more acquisitions following Michigan's abandonment of a non-compete ban.			
	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.			
Region	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.			
	Non-competes mute the flow of knowledge.			
	Non-competes discourage would-be entrepreneurs from starting new companies in their industry.			
	Venture capital is less effective in creating companies, jobs, and innovation where non-competes can be enforced.			

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 recommenations

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 socalled "judicial reformation"

Ballot Summary of Proposed 2010 Amendment to Georgia Constitution

Shall the Constitution of Georgia be amended so as to <u>make Georgia more</u> 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"

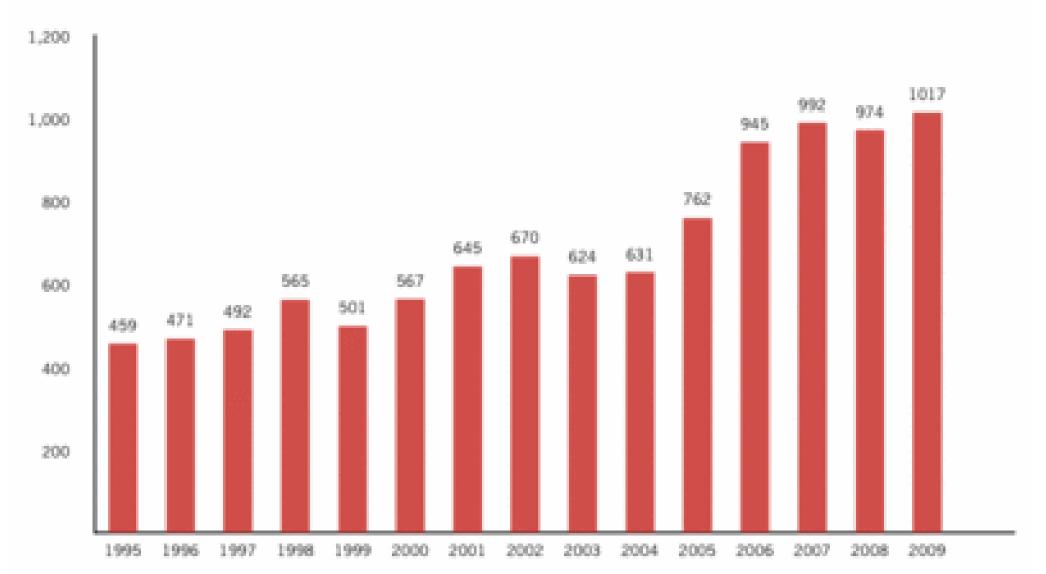
Judges should make up-or-down decisions regarding validity

- 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"

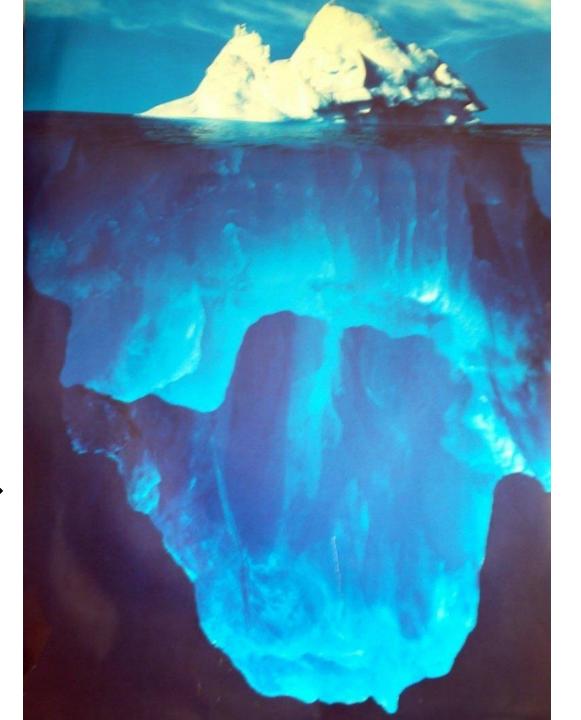
published non-compete decisions



court →

Unlitigated threats →

Voluntary compliance →



Policy recommendation: the "chilling effect"

- Most reforms focus on whether non-compete can be <u>enforced</u> 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 \rightarrow high-profile actions \rightarrow civil penalties

Summary of policy recommendations

1. notice & consideration for employees asked to sign

2. Abolishing so-called judicial "reformation" \rightarrow up/down rulings

3. Adopt Illinois-style *usage* bans & empower state AGs to sanction bad actors