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PUBLIC INTEREST COMMENT

FEDERAL TRADE COMMISSION'S PROPOSED NONCOMPETE CLAUSE RULE REQUIRES RETHINKING, AS A MATTER OF LAW AND POLICY

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Request for Comments on Noncompete Rule
Agencies: Federal Trade Commission and US Department of Justice
Comment Period Opens: January 19, 2023
Comment Period Closes: March 20, 2023
Comment Submitted: April 19, 2023
Noncompete Clause Rulemaking, Matter No. P201200

INTRODUCTION

We are pleased to respond to the request for comments to help inform the Federal Trade Commission (FTC), as it considers whether to issue a final rule (pursuant to section 6(g) of the FTC Act) aimed at prohibiting the use of noncompete clauses (NCCR).[1] We trust that the views we express may prove helpful to the FTC.

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1. We do not address the substantial legal literature suggesting that the FTC lacks the authority to promulgate substantive competition rules, pursuant to section 6(g) of the FTC Act. We do, however, incorporate by reference several commentaries by one of the authors that briefly describe the serious legal risks, which may counsel against promulgation of a section 6(g) rule on noncompetes. See Alden F. Abbott, "FTC Competition Regulation: A Cost-Benefit Appraisal" (Mercatus Policy Brief, Mercatus Center at George Mason University, Arlington, VA, June 2021); "FTC Competition Rulemaking Flunks a Cost-Benefit Test," *Truth on the Market*, June 29, 2021; "Legal Restraints on FTC Competition Rulemaking," in *Rulemaking Authority of the US Federal Trade Commission*, ed. Daniel A. Crane (New York: Concurrences, 2022), 129–55; "FTC UMC Rulemakings Would Prove Legal Failures," *Truth on the Market*, April 5, 2022; "Why FTC Competition Rulemaking Likely Will Fail," *Truth on the Market*, July 5, 2022; and "The FTC's NPRM on Noncompete Clauses: Flirting with Institutional Crisis," *Truth on the Market*, January 10, 2023.

understanding of the institutions that affect the freedom to prosper and to find sustainable solutions that overcome the barriers preventing individuals from living free, prosperous, and peaceful lives. This comment, therefore, does not represent the views of any particular affected party or special interest group; it is intended to assist the Commission in its decision-making.

We raise four key points for the Commission's consideration:

1. A federal noncompete rule would undermine federalism, preempting beneficial state policy experimentation regarding noncompetes.
2. Limitations of existing research preclude the FTC from adequately addressing the potential costs and benefits of noncompete agreements for high-skilled workers.
3. The FTC should consider research regarding the potential innovation benefits of certain noncompete agreements for high-skilled workers prior to promulgating a Notice of Proposed Rule Making. A ban on noncompete agreements could reduce innovation through (1) fewer investments in human capital, (2) a reduction in riskier R&D investments that are necessary for breakthrough innovations, and (3) a decrease in the quantity of new innovations.
4. The FTC's "unfair acts or practices" rule, which requires ex ante pre-employment notification of noncompetes to workers, merits consideration as an alternative, superior policy to an NCCR. Unlike a ban on noncompete agreements, a rule requiring ex ante pre-employment notification is grounded in empirical research.

THE FTC SHOULD CAREFULLY WEIGH FEDERALISM CONCERNS BEFORE ADOPTING AN NCCR

In the United States, noncompete agreements (decided between employers and employees) historically have been the province of state, not federal, law. In common law,[2] noncompetes generally were subject to a sort of "reasonableness" standard, which meant that a noncompete would only be upheld if it were "reasonable" in terms of duration and scope. In recent decades, the states have been very active in considering a variety of statutory restrictions on noncompetes, with a few jurisdictions prohibiting them outright—California and Washington, DC,[3] for example—and other states imposing a variety of different constraints. In short, state laws on noncompetes differ substantially and notions of "reasonableness" are still important in many jurisdictions.[4]

The fact that states are actively adopting and weighing alternative approaches to dealing with noncompetes should give the FTC pause. As a general matter, in areas of private law, federalism yields more effective and efficient policies than a centralized directive imposed by the national government.[5] The differences between state jurisprudences foster "natural experimentation," whereby the changes made between varying jurisdictions facilitate comparisons of the effects of the different approaches to noncompetes. Furthermore, having each state create its

2. See Mitchel v. Reynolds, 24 Eng. Rep. 347 (Court of King's Bench 1711).

3. See James D. Handley, "Noncompete News Alert: Update to Washington, D.C. Ban on Noncompete Agreements," FordHarrison, November 29, 2022.

4. See Russell Beck, "Employee Noncompetes: A State-by-State Survey," July 21, 2022, https://beckreedriden.com/wp-content/uploads/2022/07/Noncompetes-50-State-Survey-Chart-20220721.pdf.

5. See, generally, Akhil Reed Amar, "Five Views of Federalism: 'Converse-1983' in Context," *Vanderbilt Law Review* 45, no. 5 (October 1992): 1233–36.

own regulations on noncompete laws will allow for the "best practices" to emerge and thereby drive welfare-enhancing reforms across multiple jurisdictions.[6] Commission promulgation of a final NCCR that effectively preempt this state policy experimentation would freeze into place a one-size-fits-all approach that could harm economic welfare.[7]

THE FTC SHOULD ADHERE TO CURRENT ACADEMIC RESEARCH AND ACKNOWLEDGE THAT THERE ARE SIGNIFICANT DATA AND RESEARCH GAPS THAT PREVENT REGULATORS FROM PROPERLY ADDRESSING THE COSTS AND BENEFITS OF NONCOMPETE RULES

The FTC is operating from a framework that there is a research consensus (or near-consensus) regarding the adverse consequences of noncompete agreements. But two of the most prominent noncompete scholars Norman Bishara and Evan Starr, both of whom are cited extensively by the FTC, caution policymakers and regulators against such a mindset. In particular, they state, "we are concerned that such policy changes [bans on noncompetes] are being made without the proper empirical foundation."[8] They explain that the recent focus on noncompete agreements has pressured government actors into "making hasty reforms, thus risking poor public policy decisions"[9] when there are missing gaps in the research.

Bishara and Starr conclude that, while it is unfeasible to have all the facts, the current research methods and data are completely inadequate for making policy decisions and reforms on banning noncompetes:

> While it is impossible to have complete information about how noncompetes are used, the data we have currently is woefully inadequate and more research is needed to reach meaningful conclusions about reforms. Unless we have a fuller picture of the impact of firms' use of noncompetes—as well as the impact of new policy solutions such as notice periods, professional carveouts, or wage thresholds—there remains a risk that policy proscriptions may have unintended negative consequences or be aimed at problems that are not significant enough to garner actual policy solution.[10]

Additionally, Bishara and Starr argue that many of the current academic methods and research papers have significant limitations and do not signify causal claims—including much of the research that is currently cited by the FTC in its rule. There is concern that the FTC excluded discussion of the limitations and criticisms that have cast doubt on the validity of those studies making the claims. In particular, the FTC cites heavily the studies using the Michigan noncompete

6. Federalist systems are better able to limit the harms caused by policy experiments. See Jenna Bednar, *The Robust Federation: Principles of Design* (Cambridge, UK: Cambridge Unversity Press, 2008), 31. A suboptimal policy adopted by one state can be studied and rejected by other states, facilitating convergence toward a superior policy over time.

7. See Brian Albrecht, "Knowledge, Decisions, and Noncompetes," *Truth on the Market*, January 6, 2023.

8. Norman Bishara and Evan Starr, "The Incomplete Noncompete Picture," *Lewis & Clark Law Review* 20, no. 2 (2016): 497–547.

9. Bishara and Starr, "Incomplete Noncompete Picture," 546.

10. Bishara and Starr, "Incomplete Noncompete Picture," 546.

reversal[11] as a natural experiment, when in fact there is existing research that casts doubt on the validity of this method. As explained by Bishara and Starr:

> Given the extensive work that now relies on the Michigan noncompete experiment, it is important to note that recent work by Barnett and Sichelman calls into question the validity of the initial work studying the effect of this change in Michigan law. Among other issues, such as the validity of the comparison group developed in Stuart and Sorenson, Barnett and Sichelman report that the Michigan noncompete reversal was not applied retroactively, such that only new noncompetes signed after the change in the law were enforceable.[12]

If the Michigan noncompete reversal was applied retroactively and the true regime change "took considerable time," then a sizeable portion of the of the results drawn from these Michigan studies are unlikely to be causally linked to changes in Michigan's noncompete laws.[13] By not including the recent studies on the limitations of interpreting and using the Michigan experiment, the FTC comes off as cherry-picking research studies that conform to its existing narrative. It is thus prone to exactly the criticism made by Bishara and Starr that regulators are introducing rules without addressing the empirical evidence properly.

The FTC also relies heavily on the academic literature that uses the Stuart and Sorenson index but ignores the recent criticisms that cast doubt on its validity, as detailed by Bishara and Starr (2016). For example, Barnett and Sichelman argue that at most two states are non-enforcing, while all others enforce to some extent. They explain, "we find that during the relevant time periods, other than California and North Dakota, none of the purported 'non-enforcing' states in Stuart and Sorenson (2003)—namely, Alaska, Connecticut, Michigan, Minnesota, Montana, Nevada, Oklahoma, Washington, and West Virginia—can plausibly be classified in this manner."[14] Several of the research papers cited in the FTC rule use the Stuart and Sorenson index, and yet the FTC has not acknowledged any of its limitations.

In their conclusion, Bishara and Starr reiterate again that recent work "casts *significant doubt* on the validity of the studies using the Michigan noncompete reversal and studies that use the Stuart and Sorenson index."[15] In a 216-page proposed rule, the FTC does not provide a single reference or explanation to the recent work by Barnett and Sichelman or other scholars that casts doubt on these research methods and how to interpret the results.

While new research has surfaced since Bishara and Starr cautioned policymakers, there is still insufficient empirical data on the missing questions raised by the scholars. For example, Starr, Prescott, and Bishara's survey, cited heavily by the FTC in this rule, is a new research that fills one

11. The Michigan Antitrust Reform Act (MARA) of 1985 removed a prohibition on noncompetes, leading Michigan to enforce noncompetes starting in 1987.

12. Bishara and Starr, "Incomplete Noncompete Picture," 528.

13. Jonathan M. Barnett and Ted Sichelman, "The Case for Noncompetes," *The University of Chicago Law Review* 87, no. 4 (2020): 953–1049.

14. Barnett and Sichelman, "The Case for Noncompetes."

15. Bishara and Starr, "Incomplete Noncompete Picture," 544 (emphasis added).

of the gaps identified by Bishara and Starr.[16] However, the remaining significant research methods and data gaps identified have yet to be addressed. For example, there is still no real knowledge about how, why, and to what extent firms use noncompetes, so many of the foundational issues remain unanswered. Unpacking the firm-level research is vital to understanding "the business value of noncompetes to firms and to potentially [rebalancing] the public debate from one of fairness to one viewing the overall mix of costs and benefits involved."[17]

Finally, the FTC's rule excludes reference to a literature review study by an FTC economist John McAdams, whose paper was discussed at an FTC's noncompete agreements workshop in 2020.[18] McAdams's conclusion is similar to the conclusion made by Bishara and Starr, which is that there is no research consensus on whether noncompetes positively or adversely impact training, wages, information sharing, firm entry, and innovation.[19] The only tentative research consensus findings are that noncompetes are associated with longer work tenure and less mobility; all other outcomes are "mixed."[20] This again seems to indicate that the FTC is cherry-picking examples of studies to create a perception that there is a research consensus to support the rule it wants, rather than engaging in rulemaking based on empirical evidence.

In its notice, the FTC claims that "in this rulemaking, the Commission seeks to ensure competition policy is aligned with the current economic evidence about the consequences of non-compete clause."[21] It is imperative that the FTC actually adheres to this principle. Doing so would mean that the FTC would acknowledge it is largely unaware of the impact of noncompetes. As stated by Bishara and Starr, "without the full picture of noncompete use within and across firms, better measures of enforceability, worker perceptions, and employer motivations, policymakers are still largely in the dark about what reforms, if any, are needed."[22]

THE FTC SHOULD CONSIDER RESEARCH REGARDING THE INNOVATION-RELATED BENEFITS OF CERTAIN NONCOMPETE CLAUSES PRIOR TO ADOPTING AN NCCR

The FTC claims "the weight of the evidence indicates non-compete clauses decrease innovation."[23] However, based on the FTC's own rulemaking notice and the literature cited, the weight of the evidence does not indicate this claim. The FTC uses one unpublished working paper, which finds that noncompetes cause a decrease in the value of patents,[24] to conclude that noncompete clauses

16. Evan P. Starr, James J. Prescott, and Norman D. Bishara, "Noncompete Agreements in the U.S. Labor Force," *Journal of the Law and Economics* 64, no. 1 (2021).

17. Bishara and Starr, "Incomplete Noncompete Picture," 545.

18. John McAdams, "Non-Competes in the Workplace: Examining Antitrust and Consumer Protection Issues" (FTC Workshop, Washington, DC, January 9, 2020).

19. John McAdams, "Non-Compete Agreements: A Review of the Literature," SSRN, January 27, 2020.

20. McAdams, "Non-Compete Agreements."

21. Federal Trade Commission, Non-Compete Clause Rule, 16 C.F.R. Part 910 (2023), https://www.regulations.gov/document/FTC-2023-0007-3959.

22. Bishara and an Starr, "Incomplete Noncompete Picture," 541.

23. Federal Trade Commission, Non-Compete Clause Rule, 16 C.F.R. Part 910.

24. Zhaozhao He, "Motivating Inventors: Non-Competes' Competes, Innovation Value and Efficiency," SSRN, May 15, 2021.

decrease innovation: "The Commission therefore places greatest weight on the study by He, which suggests innovation is largely harmed by noncompete clause enforceability."[25]

The FTC faces four significant challenges to this claim, the most important of which is that the FTC misunderstands innovation and assumes that patents (and economic value of the patent filed) is the only way to measure innovation. The innovation economics research indicates that the value of patents is just *one* indicator of innovation and that broad conclusions cannot be drawn about the overall innovation landscape from just patents. Below is a comprehensive review of the innovation literature for the FTC to help rectify its claims regarding the relationship between noncompete agreements and innovation.

Challenge 1: It is inappropriate for the FTC to rely on one working paper to make the claim that noncompete enforceability leads to a decrease in innovation.

The FTC first discusses three main studies on innovation. Two of those studies—Samila and Sorenson (2011) and Carlino (2021)—use the number of patents as a measure of innovation. Samila and Sorenson finds that when noncompete clauses are enforceable, there is a decrease in venture capital induced patenting.[26] Carlino finds that greater noncompete enforceability led to greater mechanical patenting.[27] The FTC then excludes these two studies in its analysis, because it states: "patenting may or may not reflect the true level of innovation, as firms may use patenting as a substitute for non-compete clauses where they seek to protect sensitive information."[28]

Therefore, the FTC places its weight on one working paper, which uses the value of patenting rather than the number of patents as a measure of innovation. This working paper by He was released on SSRN in 2021, has not yet gone through the peer-review process, and remains unpublished.[29] We do not dispute the methods or findings of He's study. We are merely concerned that other scholars have not had an opportunity to engage with this research. In other words, the FTC is not giving the scientific process to unfold and test whether the results are indeed true and replicable.

Challenge 2: The FTC assumes that innovation is derived only from an increase in the value of patents, which is incorrect.

By relying on one working paper that measures one aspect of innovation, the FTC assumes that innovation comes from one ingredient: the value of patenting. Inventors and the valuable patents that they create are indeed a key indicator of innovation, but innovation comes from many different and interlinked ingredients. The study by He measures only one of those ingredients, and it does not tell us anything about the full innovation picture. Therefore, it is incorrect to conclude from this

25. Federal Trade Commission, Non-Compete Clause Rule, 16 C.F.R. Part 910.

26. Sampsa Samila and Olav Sorenson, "Noncompete Covenants: Incentives to Innovate or Impediments to Growth," *Management Science* 57, no. 3 (March 2011): 425–38.

27. Gerald A. Carlino, "Do Non-Compete Covenants Influence State Startup Activity? Evidence from the Michigan Experiment at 16" (Working Paper No. 21-26, Federal Reserve Bank of Philadelphia, 2021).

28. Federal Trade Commission, Non-Compete Clause Rule, 16 C.F.R. Part 910.

29. He, "Motivating Inventors."

one study that noncompete clauses decrease overall innovation. The other ingredients of the innovation puzzle come from investments in human talent and capital, R&D investments, advancements in processes (the majority of which come from large firms), innovative clusters and environments, technological spillovers, and other environmental and institutional features that encourage discovery of knowledge, experimentation (which includes risk and failure), and entrepreneurship.[30]

Challenge 3: The FTC assumes that risk, failure, experimentation, and breakthrough innovations are not indicative of innovation, which is the opposite of the empirical evidence.

The FTC briefly acknowledges two studies related to innovation—Conti (2014) and Xiao (2022)—but quickly dismisses them due to an incomplete understanding of innovation.

The first study by Conti finds that noncompete agreements encourage firms to make investments in riskier R&D projects.[31] The FTC dismisses this study, stating that "riskier research and development strategies lead to more breakthrough innovations, but also lead to more failures, leaving the net impact unclear."[32] The FTC therefore overlooks several dozens of academic studies showing how the combination of risky investments *and* many failures is precisely what leads to innovation.[33] The net impact is not "unclear"; failure is a key part of innovation because innovation is not an end goal but a process that involves experimentation with new ideas, which means there will be many failures along the way. This is why the innovation economics literature is ripe with how failures are a key ingredient for innovation.[34]

Indeed, several studies find that the decline in breakthrough therapeutics and innovative drugs has been attributed to a *lack* of risk-taking by pharmaceutical and biotech tech companies, despite increase in R&D spending.[35] For example, Munos and Chin directly state that there will be more breakthrough therapeutics only if the industry ceases to pursue safe incremental innovation

30. For overview of literature on innovation, see Browyn Hall and Nathan Rosenberg, eds., *The Handbook of the Economics of Innovation*, 2 vols. (Amsterdam, Netherlands: Elsevier, 2019); Robert Dewar and Jane Dutton, "The Adoption of Radical and Incremental Innovations: An Empirical Analysis," *Management Science* 32, no. 11 (1986): 1422–33; Zvi Girliches, *R&D and Productivity: The Econometric Evidence* (Chicago: University of Chicago Press, 1998); Kevin J. Boudreau et al., "Looking Across and Looking Beyond the Knowledge Frontier: Intellectual Distance, Novelty, and Resource Allocation in Science," *Management Science* 62, no. 10 (2016): 2765–83; Gustavo Manso, "Motivating Innovation," *Journal of Finance* 66, no. 5 (2011): 1823–60; and Bernard H. Munos and William W. Chin, "How to Revive Breakthrough Innovation in the Pharmaceutical Industry," *Science Translational Medicine* 3, no. 89 (2011).

31. Raffaele Conti, "Do Non-Competition Agreements Lead Firms to Pursue Riskier R&D Strategies?," *Strategic Management* 35, no. 8 (2014): 1230–48.

32. Federal Trade Commission, Non-Compete Clause Rule, 16 C.F.R. Part 910.

33. Gustavo Manso, "Motivating Innovation," *Journal of Finance* 66, no. 5 (2011): 1823–60; Pierre Azoulay, Joshua S. Graff Zivin, and Gustavo Manso, "Incentives and Creativity: Evidence from the Academic Life Sciences," *The RAND Journal of Economics* 42, no. 3 (2011): 527–54; James G. March, "Exploration and Exploitation in Organizational Learning," *Organization Science* 2, no. 1 (1991): 71–87; and Richard Carson et al., "The Risk of Caution: Evidence from an R&D Experiment" (NBER Working Paper No. 26847, National Bureau of Economic Research, Cambridge, MA, March 2020).

34. Manso, "Motivating Innovation"; Azoulay, Zivin, and Manso, "Incentives and Creativity"; and March, "Exploration and Exploitation in Organizational Learning."

35. Munos and Chin, "How to Revive Breakthrough Innovation"; and Joshua Krieger, Danielle Li, and Dimitris Papanikolaou, "Missing Novelty in Drug Development," *The Review of Financial Studies* 35, no. 2 (2019).

and "reengages in high-risk discovery research."[36] Such studies' findings also indicate that innovative ideas do not merely emerge from greater R&D spending, but that these investments must be high-risk. The biggest challenge in biomedical innovation is that it is "extremely difficult to obtain funding for groundbreaking, high-risk research."[37] A similar challenge exists in semiconductor manufacturing, which also requires more risk-taking to realize discovery and innovation.[38]

The reason that failure is key to the process of innovation is because true and genuine innovation consists in the discovery of what is not yet known—that is, failed experiments indicate which methods are and are not working. As discussed by Manso, innovation activities require investing many resources and facing a high risk of failure. This is a necessary process for genuine discovery.[39]

The FTC is therefore incorrect in making an assumption that failures mean less innovation, when in fact failures are a key aspect of innovation. Without failures, there cannot be genuine discovery and innovation. The FTC also does not acknowledge the innovation economics research, which shows that risky R&D investments are indeed a crucial and necessary ingredient for breakthrough technologies, and that breakthrough technologies are at the heart of innovation and progress.

The second study that the FTC dismisses is by Xiao, which finds that noncompete enforceability leads to an increase in exploitative innovation (innovation which stays within the bounds of the innovating firm's existing competences) and a decrease in exploratory innovation (innovation which moves outside of those bounds) in medical devices. The FTC provides the following commentary on this study:

> Overall this leads to an increase in the quantity of innovation as measured by the introduction of new medical devices. This increase in quantity, however, is the net result of an increase in exploitative innovation and a decrease in explorative innovation, where the latter is the mode of innovation which the empirical literature has found to be associated with high growth firms.[40]

The FTC does not provide any further commentary on this paper. It therefore dismisses without justification Xiao's finding that greater enforceability led to an increase in the introduction of new medical devices. For the purposes of innovation, it does not matter whether explorative innovation is associated with high growth firms; what matters is that greater enforceability led to an increase in the quantity of innovation as measured by the introduction of new medical devices.

We are concerned that the FTC has misinterpreted the relevance of Conti and Xiao when it concludes:

36. Munos and Chin, "How to Revive Breakthrough Innovation."

36. Andrew Marks, "Repaving the Road to Biomedical Innovation Through Academia," *Science Translational Medicine* 3, no. 89 (2011).

37. Nicholas Bloom, Charles I. Jones, John Van Reenen, and Michael Webb, "Are Ideas Getting Harder to Find?" (NBER Working Paper No. 23782, National Bureau of Economic Research, Cambridge, MA, September 2017), 53.

38. Manso, "Motivating innovation."

39. Federal Trade Commission, Non-Compete Clause Rule, 16 C.F.R. Part 910.

> While these two additional studies bring nuance to the changes in the types of innovation pursued by firms when non-compete clause enforceability changes, neither undermines the weight of the evidence described above: that increased non-compete clause enforceability broadly diminishes the rate of innovation.[41]

The economics of innovation literature indicates that these are not "nuanced" changes but that riskier R&D investments and exploitative innovations are, in fact, vital aspects of innovation and progress. We would like to explicitly point out again that when the FTC states "neither undermines the weight of the evidence," what they mean is that neither undermines *one* unpublished paper. We trust the FTC will revisit this claim on innovation, especially given that it is required by Executive Order No. 13563 to provide a reasoned determination of *all* the costs and benefits.[42]

Challenge 4: The FTC should acknowledge that noncompete agreements lead to greater investments in human talent, risky R&D investments, and breakthrough innovations—which are all linked to greater innovation.

There are several empirical studies that have been dedicated to unpacking how noncompetes may impact the various ingredients or parts of innovation. Conti, Xiao, and He are some of those empirical studies that were referenced by the FTC.

However, one important ingredient for innovation that the FTC did not discuss is human capital investments. The FTC fails to acknowledge any of the empirical literature showing that investments in human capital are vital for innovation.[43] In one of the studies focusing on process innovation, the researchers explicitly find that larger firms are likely to have more technical specialists and adopt radical innovation, and furthermore that "investments in human capital in the form of technical specialists appear to be a major facilitator of technical process innovation adoption."[44]

The relationship between investments in human capital and innovation is a key component of the noncompete debate, because noncompete agreements have been found to increase training for high-skilled workers. For example, a recent study by Evan Starr finds that greater noncompete enforcement is associated with a 14 percent increase in training, which tends to be firm-sponsored

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40. Federal Trade Commission, Non-Compete Clause Rule, 16 C.F.R. Part 910.

42. Exec. Order No. 13563, 76 Fed. Reg. 3821 (January 21, 2011).

43. Gene M. Grossman and Elhanan Helpman, "Endogenous Innovation in the Theory of Growth," *Journal of Economic Perspectives* 8, no. 1 (1994): 23–44; Mourad Dakhli and Dirk De Clercq, "Human Capital, Social Capital, and Innovation: A Multi-country Study," *Entrepreneurship & Regional Development* 16, no. 2 (2004): 107–28; Elena Pelinescu, "The Impact of Human Capital on Economic Growth," *Procedia Economics and Finance* 22 (2015):184–90; Robert Dewar and Jane Dutton, "The Adoption of Radical and Incremental Innovations: An Empirical Analysis," *Management Science* 32, no. 11 (1986): 1422–33; and Mohammad Alawamleh, Loiy Bani Ismail, Diana Aqeel, and Kamal Jamal Alawamleh, "The Bilateral Relationship Between Human Capital Investment and Innovation in Jordan," *Journal of Innovation and Entrepreneurship* 8, no. 1 (2019): 1–17.

44. Robert Dewar and Jane Dutton, "Adoption of Radical and Incremental Innovations."

and designed to upgrade or teach new skills.[45] At the same time, he finds that there is no evidence of a negative relationship between noncompete enforceability and self-sponsored training. This latter point is important because, while noncompetes increase the incentives of firms to invest in human capital, there is a question of whether that means workers are less likely to invest in themselves. This is the implicit story in Mark Garmaise's findings that executives earn less in higher enforceability states.[46] However, Starr shows that negative wage estimates are driven not by noncompete enforceability but by state policies that do not require any additional considerations with noncompete agreements. For example, these "consideration policies" in some states may require that noncompete agreements be tied to greater pay increases or that firms must make it clear in their offer letters if employees will be expected to sign a noncompete agreement.

Therefore, outright ban on noncompete agreements could discourage investments in human capital, thereby reducing one ingredient of innovation. This connection between noncompetes and firms being more likely to provide specialized training for high-skilled workers or workers with trade secrets is vital for understanding the potential consequences of banning noncompete agreements. We reiterate the arguments made by Bishara and Starr that more research is required before the FTC blindly bans noncompete agreements (for high-skilled workers in particular) that could have a negative impact on human capital investments and innovation.

To summarize, a ban on noncompete agreements could reduce innovation in the following ways:

1. Reductions in human capital investments (Starr 2019)
2. Reductions in risky R&D investments and fewer breakthrough innovations (Conti 2014)
3. Reductions in the quantity of new innovations (Xiao 2022)

The FTC should therefore consider the research, such as those provided here, regarding the innovation-related benefits of certain noncompete clauses for high-skilled workers.

THE FTC MAY WISH TO CONSIDER PROMULGATING AN "UNFAIR ACTS OR PRACTICES" RULE REQUIRING EX ANTE PRE-EMPLOYMENT NOTIFICATION OF NONCOMPETES TO WORKERS AS AN ALTERNATIVE TO AN NCCR

While there is no research consensus to support the idea of absolute bans on noncompetes, there are two areas that have research support:

1. Noncompete agreements should be confined to occupations and industries that require specialized training or access to valuable information. Almost all research studies point to negative consequences of noncompetes for low-skilled workers without any additional benefits.
2. The majority of the negative outcomes stemming from noncompete agreements occur when there have been late-notice noncompetes.

45. Evan Starr, "Consider This: Training, Wages, and the Enforceability of Covenants Not to Compete," *ILR Review* 72, no. 4 (2019): 783–817.

46. Mark J. Garmaise, "Ties that Truly Bind: Noncompetition Agreements, Executive Compensation, and Firm Investment," *Journal of Law, Economic, and Organization* 27, no. 2 (2011): 376–425.

For example, Starr et al. highlights the significant differences between when a noncompete agreement is presented and its relevant outcomes:

> Those presented with a noncompete after they accept an offer (excluding those furnished with a noncompete following a promotion or a change in responsibilities) appear to receive no observable boost in wages or training, are 13.4 percentage points less likely to have had information shared with them (a 24 percent reduction), and are 8.5 percentage points less likely to be satisfied in their employment (a 12.5 percent reduction).
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> With regard to those who learn of their noncompete before they accept their job offers, our most saturated model indicates that these employees have 9.7 percent higher earnings, are 4.3 percentage points more likely to have information shared with them (a 7.8 percent increase relative to the sample average), are 5.5 percentage points more likely to have received training in the last year (an 11 percent increase), and are 4.5 percentage points more likely to be satisfied in their jobs (a 6.6 percent increase) relative to employees without a noncompete.[47]

Following these two areas of research consensus, a 2021 Mercatus Center Policy Brief by Alden Abbott and Andrew Mercado[48] explains that a trade regulation rule promulgated pursuant to section 18 of the FTC Act could prove far more promising in addressing noncompetes, on both legal and policy grounds, than a competition rule promulgated pursuant to section 6(g).

Specifically, a section 18 rule mandating that an employer grant clear and conspicuous notice to prospective employees from whom they require noncompetes would reduce asymmetric information in the market and enhance prospective employees' bargaining power vis-à-vis employers. Failure to grant such notice would be an "unfair act or practice" under the rule. Such a rule would stand on strong legal ground as a cost-beneficial initiative, issued pursuant to well-established FTC rulemaking authority, and would likely be upheld if challenged. As explained in the policy brief:

> [A] targeted rule begins to take shape: for a noncompete agreement to be fair (and, arguably, nondeceptive), the employer must proffer the noncompete agreement before or when the employment contract is signed. This formulation would combine all the beneficial aspects of noncompete agreements for employers and would have the potential to protect employees from the greatest harmful effects for two main reasons.
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> First, it would allow employers to continue to present noncompete agreements to the same employees in enforcing states and thereby preserve the benefits of noncompete agreements. Trade secrets, training expenditures, and intellectual property protections would all be maintained, just as they were in the absence of the targeted rule. Only the timing of the presentation of the noncompete agreement may change, such that the portion

46. Starr, Prescott, and Bishara, "Noncompete Agreements in the U.S. Labor Force."

47. Alden Abbott and Andrew Mercado, "FTC Rulemaking on Noncompete Agreements" (Mercatus Policy Brief, Mercatus Center at George Mason University, Arlington, VA, September 2021).

of bargaining power enjoyed by the employer owing to ex ante asymmetric information regarding the noncompete agreement would shift to the worker.

Second, employees would be able to consider the effects of noncompete clauses when deciding whether to accept an employment offer. If there is no scope for bargaining over a contract, then the proffered contract may not be signed. However, both sides have an incentive to bargain for the optimal outcome. The potential employee should be willing to take the job but may request higher compensation owing to the existence of a noncompete clause. On the other side, the employer reasonably would like to retain the employee for as little as possible but would see the increased value in the noncompete clause and would be willing to transfer some of the benefit of the noncompete clause to the employee. In this case, there would be no welfare loss because a mutually agreeable transfer of benefits would be reached at the bargaining table.

Any proposal rule set forth by the FTC could be modeled after the 2018 noncompete and trade secrets reform law passed by the Massachusetts Legislature.[49]

Adopting a rule of this sort, which is supported through empirical research, could prove to be an efficient and beneficial use of FTC resources that substantially advance the public interest.

CONCLUSION

An NCCR banning the use of noncompete agreements would have profound implications for the US economy. As FTC weighs the advisability of issuing such a rule, we respectfully request that it consider the federalism concerns the rule raises as well as the significant limitations of the existing literature on the economic effects of noncompetes. In light of those limitations, we believe that the FTC has an insufficient basis for promulgating an NCCR that would generally ban noncompetes. We also urge that, in lieu of issuing an NCCR, the FTC consider the potential benefits of promulgating an alternative rule (pursuant to section 18 of the FTC Act) that would require ex ante disclosure of noncompete agreements. We believe that such an alternative rule would be superior as a matter of law and policy to an NCCR.

48. Abbott and Mercado, "FTC Rulemaking on Noncompete Agreements."