Discussion of:

“Non-compete agreements and the market for corporate control”

by Golubov and Zhong

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Introduction, 1

- This paper demonstrates that non-compete agreements (NCAs) appear to impact the takeover market
    - A non-compete agreement (NCA) is a part of an executive's employment contract that *restricts the employment opportunities of a firm's executives when they leave the employment of the firm*
        - These restrictions can take various forms, and are subject to negotiation between the firm and the executive, but typically restrict executives from working for the firm's industry- or geographic-competitors for a period of time after their separation from the firm
        - Designed to protect the firm's intellectual property and intangible capital (trade secrets, customer relationships, etc…)
    - Enforceability has changed over the years
        - Employment contracts (including NCAs) are *generally enforced at the state level* (and not the US-national level), which makes state-level changes in the enforcement regime critical (and is the focus of the authors in this paper)
    - Recent debates *at the US-national level* (Federal Trade Commission) appear to have made NCAs currently *unenforceable* anywhere in the US, although to my knowledge those rules have not yet survived a legal challenge

Introduction, 2

- The central hypothesis revolves around the notion that target-firm executives' employment is more likely than not to end following a takeover by a competitor in the same industry (i.e., after *horizontal takeovers*)
    - Therefore, those CEOs (who have *a lot of power in the takeover process*) are unlikely to be excited about a horizontal M&A deal *ex ante*, especially when a NCA limits their *ex-post* employment opportunities!
    - Roughly half of target CEOs lose their job following acquisitions of their firm
        - In other words, their services are *not* retained by the merged firm
        - You could tell a number of stories consistent with this fact, probably the easiest way to conceptualize it is to think about takeovers as a disciplinary measure
            - Although that conflicts with the dearth of *hostile* takeovers in the modern US economy
            - Also is very different from the popular notion of *acqui-hires*
    - The results in this paper, therefore, make intuitive sense to me and I believe the story
        - I also really like the *identification strategy centered on changes in enforcement*
    - While I will quibble with a few things that the authors do, for the most part I think they present sensible results from careful (and well thought-out) empirical tests
        - Most of my discussion is not going focus on what the authors do, but rather on *what they don't do*
        - I hope to give the authors some things to think about as they revise the paper

Garden(ing) leave?

- How is an NCA different from "gardening leave"?
  - A quintessentially British term
  - The key difference is that with "gardening leave" the executive *remains on the firm's payroll even though they are not allowed to "work" for the firm*

> The essential difference between a garden leave provision and a traditional non-compete agreement is that the employee who is subject to a garden leave remains on the company's payroll and is considered an employee of the company during the garden leave period when he or she may not compete with the employer. In contrast, with a traditional non-compete agreement, the non-compete period typically begins on the date that the company has terminated the employee's employment.

Empirical tests and results

- The authors of this paper use *panel data* in their main tests
  - Cannot observe deals that were *not done* because a firm's CEO was concerned about their labor market outcome
    - Therefore, a sample of deals *that were proposed or completed* is not going to tell you much about the effect of NCA enforceability
  - But in panel data you can observe how the probability of observing a horizontal takeover offer relates to firm-, industry-, and state-level characteristics
    - Including *state-level changes in the enforceability of NCAs*
  - Using panel data, the authors report that when NCA are *more* enforceable, firms in the state are *less likely to receive (or accept?) horizontal takeover offers*
  - Using deal-specific data, the authors report that when NCA are *more* enforceable:
    - Received takeover offers are involve *higher premiums* paid to target shareholders
      - An accident driven by the desire to drive the potential acquirer away?
      - Offsetting their personal employment losses from the takeover with gains on their share ownership?
    - Received takeover offers are more likely to be *initially greeted by hostility* on the part of target executives (or the board)
    - Received (announced) takeover offers are *less likely to be consummated*

Quibbles with what the authors do…

- Deal post-announcement terminations / withdrawals?
    - Table 9
    - Do the executives wake up one morning (after deal announcement but before completion) and *suddenly realize that they are subject to a NCA* and need to cancel the deal they just carefully negotiated?
    - Or is the story something to do with an *increase in the **enforceability*** of NCAs in the roughly *9- to 12-month period during which a given deal has been announced but not consummated?*
    - I find the "change in enforceability" story somewhat hard to believe
        - But it is testable!
    - I also find the "waking up with ex-post regret" story hard to believe, but I struggle to rationalize the results any other way
- Why limit the investigation to *horizontal takeovers?*

Quibbles with what the authors do…

- Hostility?
    - Table 6: one of the key results in the paper is that deals which are consummated are more likely to be hostile deals
        - Because the employment-mobility constrained CEO is less likely to consent to a takeover that will likely result in the loss of their job
    - Deal attitude is (mostly) defined using the *initial* attitude of the target board's reaction to the offer
        - But shouldn't the *final* attitude be the one that matters?
        - If the target's executives are *"bought off"* in some fashion to overcome their job market concerns, then the final attitude will be friendly even if the initial reception is hostile
        - Also, as a practical matter, in my experience there just are not many deals that are completed in the US where the initial *and* final attitude of the target is hostile…
    - It is also worth thinking about the difference between the target *board's* attitude versus the *executive's* attitude
        - I do not think it is common to NCA a board member
        - If "attitude" is measured at the *board* level (as I think it is), should / could / would the *board* care about the *executive's* NCAs?

*Quibbles with what the authors **do not do**…*

- Industry specialists vs. functional specialists?
    - CEOs that are *industry specialists* are more likely to care about NCAs than *functional specialists*
- Retirement age
    - CEOs that are *closer to retirement age* are less likely to care about NCAs
    - Jenter and Lewellen (2015, JF)
        - This paper is cited here, but the authors *do not* do anything empirically with the implications
- Interactions?

*Quibbles with what the authors **do not do**…*

- What about the effect of *golden parachutes?*
    - "Golden parachutes" are contractual clauses in an executive's employment contract that *pay them a lump sum (often many millions of dollars)* if they lose their job with the firm *soon after a "change in control"* at that firm
        - Most are *double trigger*
            - NCAs *do not* (generally) require the takeover trigger
        - Golden parachutes are widely disparaged in the popular press, but the economic motivation for these clauses is clear (and sensible):
            - Provide an executive at the target firm with compensation for losing their job in a takeover…
            - … So that they *do not impede* a deal which is likely *very good for target shareholders*
        - It feels to me that the existence of a golden parachute would *reduce the concern* that an executive faces about their post-acquisition employment mobility!
    - Offenberg and Officer (2014, JCF)
        - Golden parachutes are extremely common and often involve large sums of money!
        - Which is *mostly "new" compensation* and *not* simply the acceleration of *"old" (i.e., unvested) compensation*

*Quibbles with what the authors **do not do**…*

- Recent changes in the enforceability of NCAs in the US
    - Effective very soon, the final rule has already been published
    - *Current* NCAs with senior executives (>$151,164 in annual salary) are grandfathered
    - But prohibit *new* NCAs (with executives at any salary level)

> **SUMMARY:**
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> Pursuant to Sections 5 and 6(g) of the Federal Trade Commission Act, the Federal Trade Commission ("Commission") is proposing the Non-Compete Clause Rule. The proposed rule would, among other things, provide that it is an unfair method of competition for an employer to enter into or attempt to enter into a non-compete clause with a worker; to maintain with a worker a non-compete clause; or, under certain circumstances, to represent to a worker that the worker is subject to a non-compete clause.

- Can we think of (NCAs + severance) as *observationally equivalent* to "gardening leave"?
    - Might that contractual form replace NCAs in the US?
    - Again, *legal challenges have already been filed*

Conclusions

- Overall, a great paper that is well worth reading!
    - I am *more wary of what the authors do not do* than I am of what they actually do
    - If I were an author of this paper, I would be most concerned about the reaction from a referee / editor that the paper is no longer relevant because, as of 2024, *NCAs are banned in the US*
        - The authors acknowledge this potential weakness in the paper, but in my opinion they need to be *more forceful* about making the case that this exercise is still relevant
        - Especially because the *"final"* rule is now part of administrative law in the US and the *public comment period is over*
        - There are *legal challenges* to this federal rule, and the authors may be able to use that *uncertainty about the constitutionality of the rule* to make the case that their paper has relevancy
        - Or that NCAs were formerly so common that it is likely that a different (more business friendly?) administration in Washington will *change the rule to allow future NCAs*
    - I hope to have given the authors some things to think about as they revise the paper!