

Subjective Beliefs about Contract Enforceability

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Abstract

This paper assesses the content, role, and adaptability of subjective beliefs about contract enforceability in the context of postemployment covenants not to compete (“noncompetes”). We show that employees of all stripes tend to believe that their noncompetes are enforceable, even when they are not. We provide evidence in support of both supply- and demand-side stories that explain employees’ persistently inaccurate beliefs. Moreover, we show that mistaken beliefs are not innocuous. Rather, believing that unenforceable noncompetes are enforceable causes employees to forgo better job options and to perceive that their employer is more likely to take legal action against them if they choose to compete. However, despite mobility-reducing effects *ex post*, we find no evidence that mistakenly believing that a non-compete is enforceable causes employees to be more likely to negotiate over such provisions *ex ante*. Finally, we use an information experiment to simulate an educational campaign that informs employees about the enforceability (or lack thereof) of their non-compete. We find that this information matters a good deal to employee beliefs and prospective behavior; however, information alone does not appear to entirely eliminate an unenforceable non-compete as a factor in the decision whether to take a new job. We discuss the implications of our experimental results for policy debate regarding the enforceability of noncompetes.

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