Ambiguities In NY's Broad Prospective Noncompete Ban

By **Gail Weinstein, Peter Simmons and Jeffrey Ross** (June 27, 2023, 5:52 PM EDT)



Gail Weinstein



Peter Simmons



Jeffrey Ross

The New York State Legislature recently passed a sweeping bill that, if enacted as drafted, would broadly prohibit most noncompetes.

The law apparently would not have retroactive effect, but would prohibit any noncompete arrangement entered into or modified on or after the date that the law becomes effective. The bill has been sent to New York Gov. Kathy Hochul to be signed into law.

The bill's provisions are summarized below.

Key Points

Breadth and Uncertainties

The bill is drafted very broadly and includes numerous ambiguities that lead to considerable uncertainty as to how it will be interpreted and applied.

No Exceptions for Noncompetes Under Certain Common Circumstances

Unlike other recently enacted or proposed state laws and proposed federal rules restricting noncompetes, the bill provides no exceptions permitting noncompetes under common circumstances such as when entered into with employees having high-level salaries or job functions or in connection with a negotiated separation package.

Also, there is no express exception for noncompetes entered into in connection with the sale of a business — although it appears that the bill is not intended to prohibit such noncompetes except to the extent the buyer enters into an employment arrangement with a seller.

Uncertainty as to Enactment

It is not clear whether the governor will sign the bill into law, veto the bill, or work with the Legislature to modify the bill.

The business community, which has not previously been focused on the bill, may now mobilize to advocate against its enactment or for modifications.

Background

On June 20, the New York State Assembly passed Assembly Bill A.1278-B, which would amend the New York Labor Law by adding a new Section 191-d, covering noncompete agreements.

The New York State Senate had passed Senate Bill S. 3100-A, which was a version of the

same bill, on June 7. The bill will become law if signed by New York Gov. Kathy Hochul.

The legislation reflects recent attention to the impact of noncompete agreements on employees — in particular, the potentially harsh effect of noncompetes that have sometimes been imposed as a condition of obtaining low-wage jobs and/or certain nonexecutive positions.

The Federal Trade Commission has proposed a ban on noncompetes in most employment agreements, with the proposed rule to be voted on in April 2024.

Many states have been considering the adoption of laws restricting noncompetes, although, to date, only five — California, Massachusetts, Oklahoma, North Dakota and Minnesota — have enacted such laws.

The proposed FTC rule and the state laws — unlike the New York bill — all provide significant exceptions to their bans on noncompetes.

While the New York Legislature has stated that it seeks to adopt the bill to align New York law with California's long-standing law prohibiting noncompetes, the New York bill is far broader than California's.

Summary of the New York Bill

Noncompete Ban

The bill provides that it would prohibit employers, corporations, partnerships, limited liability companies and any other entities from seeking, demanding or accepting a noncompete agreement from the people it calls covered individuals — essentially, employees working in New York.

The bill also contains more general language stating that any prohibition in a contract by which anyone is restrained from engaging in a lawful profession, trade or business of any kind is void.

It is unclear how expansively the Legislature intends this latter clause to be read given the more specific language of the bill relating to employment-based noncompetes.

Effective Date

The New York governor has 30 days from receipt of the bill to sign it into law. The law would be effective starting the 30th day after the governor signs it.

The bill states that the law would apply only to noncompete agreements "entered into or modified" on or after the date the law becomes effective. Accordingly, noncompetes that exist before the effective date should remain in effect and not be prohibited or rendered void.

We note the potential, however, given the dramatic change in New York's public policy that the bill represents, that it could, if enacted, affect how New York courts view and interpret restrictive covenants entered into previously.

Permissible Restrictive Covenants

The bill specifies that nondisclosure agreements to protect trade secrets and confidential information, and nonsolicitation agreements that prohibit solicitation of clients of the employer that the covered individual learned about during the employment, would still be permissible.

The bill also specifies that "fixed term contracts" — that is, employment contracts that cannot be terminated by either party prior to expiration of the contract — would be permissible.

Notably, fixed term contracts are rarely seen in the market presently. As the bill does not define or otherwise address such contracts, it is uncertain to what extent the bill may prompt a change in market practice such that these types of contracts would become more common and could be used to impose noncompete obligations.

Private Right of Action

The bill creates a private right of action for covered individuals to bring suit in connection with violations of the law. The bill provides that a court can order equitable and damages remedies, including attorneys' fees and costs, and is required to order payment of liquidated damages up to $10,000 in addition to any other remedies.

The bill provides that a covered individual can sue within two years of the latest to occur of: (1) the prohibited noncompete agreement being signed; (2) the covered individual learning of the prohibited noncompete agreement; (3) the termination of the employment or contractual relationship; or (4) the employer taking any step to enforce the noncompete agreement.

The court is specifically authorized to order any appropriate relief, including injunctions and damages — including attorney's fees and costs — and is required to order payment of liquidated damages up to a maximum of $10,000 in addition to any other remedies.

Open Issues

As noted, there are significant uncertainties due to lack of clarity throughout the drafting of the bill. Significant open issues include the following.

Application of the Law to Noncompetes in Connection With the Sale of a Business

As noted above, there is broad language suggesting that the law may prohibit all noncompetes, even in a context such as a sale of a business where the buyer will not be retaining a seller, founder or key employee post-closing but would want to protect against such person being able to become employed by a competitor or to rebuild the business sold immediately post-closing.

While clarification of the broad language would be helpful, the general tenor of the bill appears to indicate that the intention is not to prohibit noncompetes outside the employment context.

We note that this framework would potentially produce a perverse result. A buyer would obtain greater protection for the goodwill of the business acquired by not hiring the founder or key executives but protecting the business with a noncompete —
whereas retaining the personnel, which may be more valuable to the business in the near-term, would require forgoing that protection and risking founder or key executive

departures at any time to become employed by a competitor or to rebuild the business sold.

Application of the Law to Other Restrictive Covenants

The bill does not specifically address whether post-employment agreements not to solicit or hire the employer's employees are excepted from the prohibition on noncompetes.

However, these nonsolicitation agreements would appear not to come within the bill's definition of noncompete agreements — as they do not prevent an employee from working for a competitor.

Forfeiture-for-Competition Clauses and "Garden Leave" Arrangements

The bill does not specifically address whether arrangements that incentivize noncompetition but do not require it — such as forfeiture of equity awards — would be prohibited under the law.

It also leaves open the question of whether so-called garden-leave arrangements — during which the employee remains on payroll, and presumably still owes duties of loyalty to the employer — could be a mechanism to obtain at least a short-term restriction on the employee's ability to compete.

Identifying Covered Individuals

The definition of "covered individuals" — for whom noncompetes clearly are prohibited in the employment context, and who have a right of private action with respect to violations of the law — is not clear.

It appears to cover employees who work in New York. It is unclear whether it also covers independent contractors, or partners who service a partnership.

Modifications to Existing Noncompetes

The bill does not address what types of "modification" to an existing noncompete agreement would trigger application of the new law — rendering the agreement void.

We presume that such a minor and nonsubstantive modification as, say, a change to the notices provision to update the addresses to which notice should be sent would not be a modification that would trigger application of the new law to the agreement.

Practice Points

Companies with New York employees should do the following.

Review employee arrangements.

Companies should conduct reviews to determine what noncompete agreements currently exist, and whether such agreements should be amended or new noncompetes should be entered into before the bill is signed into law and becomes effective.

Noncompete agreements currently existing, or to be entered into in the near term, should be reviewed to determine whether New York law applies — and, whether it is possible and desirable to provide for a different choice of law — we note that recent Delaware decisions

also cast doubt on the desirability of Delaware as the governing law for noncompetes.

Be prepared for suits by New York employees who are subject to noncompete agreements.

While class actions also may be filed by the plaintiffs bar on behalf of such employees, we expect that they would not likely be successful.

Consider engaging with the ovgernor and the Legislature to advocate for nonenactment of or modifications to the bill.

Most critically, advocacy is needed to add express exceptions, such as for noncompetes entered into in connection with the sale of a business; entered into with high-income or sophisticated individuals; or for which reasonable compensation was paid to the employee.

Final Thoughts

We note that, if the bill becomes law in its current form, in situations where a business is particularly dependent on key employees, the company may consider moving such employees outside New York so that the prohibition on noncompetes would not be applicable to them.

Gail Weinstein is senior counsel, and Peter L. Simmons and Jeffrey Ross are partners, at Fried Frank Harris Shriver & Jacobson LLP.

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