WINSTON & STRAWN LLP

CLIENT ALERT

Navigating A Potential Ban on Non-Competition Agreements in New York

JULY 6, 2023

Following recent legislation, New York employers may soon be unable to enter into non-competition agreements with most workers. On June 20, 2023, the New York State Legislature passed a bill that would broadly ban employers from entering into non-competition agreements. If signed into law by Governor Hochul, the ban would apply to any "covered worker" who "performs work or services for another person on such terms and conditions that they are, in relation to that other person, in a position of economic dependence on, and under an obligation to perform duties for, that other person." The bill further would invalidate any agreement restraining "anyone" from "engaging in a lawful profession, trade, or business of any kind." By its terms, the ban would apply only to agreements entered into or modified on or after the bill's effective date, which would be thirty days after Governor Hochul signs the bill into law.

ENFORCEMENT PROVISIONS

The bill includes private-enforcement provisions that are particularly advantageous to covered workers. In particular, the bill provides for a civil action in court that may be brought within two years of the latest of "(i) when the prohibited non-compete agreement was signed; (ii) when the covered individual learns of the prohibited non-compete agreement; (iii) when the employment or contractual relationship is terminated; or (iv) when the employer takes any step to enforce the non-compete agreement." The bill also includes expansive remedies and damages provisions, including invalidation of any prohibited non-competition agreement, recovery of lost compensation, attorneys' fees and costs, and mandatory liquidated damages of up to $10,000 in addition to any other recoverable damages. These provisions would likely be a strong deterrent against employers entering into prohibited agreements because a worker could bring an action to invalidate a non-competition agreement even before an employer has sought to enforce the agreement and seek liquidated damages along with fees and costs.

ALTERNATIVE TO NON-COMPETITION CLAUSES

Some post-employment restrictive covenants would likely remain available to employers even if the bill were signed into law. The bill would explicitly not apply to contracts prohibiting the disclosures of trade secrets, confidential and proprietary information of clients, and solicitation of clients of an employer that the worker "learned about during employment." Further, New York courts have historically viewed forfeiture-for-competition provisions as routine contracts not subject to the reasonableness review applicable to non-competition agreements. How that line of

case law will fare under this statutory non-competition ban will have to be decided through inevitable court challenges. Likewise, agreements with business owners, such as partners, and agreements in the course of the sale of a business may be beyond the scope of the legislation.

OTHER JURISDICTIONS

The New York legislation follows similar actions by several states and the federal government. While California and Oklahoma have long refused to enforce non-competition agreements, Minnesota and North Dakota have recently adopted similar laws. Minnesota's new non-competition statute goes further than the other states' bans, protecting both employees and independent contractors. In addition, courts in these four states have barred out-of-state employers from relying on forum-selection or choice-of-law provisions to enforce non-competition agreements that are valid under other states' laws.

These states recognize narrow exceptions to their broad bans on non-competition agreements. Courts in these jurisdictions uphold non-competition agreements entered into in conjunction with the sale of a business or in anticipation of the dissolution of a business. In addition, Minnesota's and Oklahoma's statutes carve out agreements that prevent an employee from soliciting an employer's clients or recruiting the employer's workers to work for another employer. On the other hand, North Dakota enforces employee non-solicitation agreements but bars client non-solicitation agreements, and California courts generally void both employee and client non-solicitation agreements. Other jurisdictions have adopted more limited restrictions on the use of non-competition agreements. Washington, D.C., for example, has banned non-competition agreements for most employees who earn less than $150,000 annually.

WHITE HOUSE AND FEDERAL AGENCY ACTIONS

At the federal level, President Biden issued Executive Order (EO) 14036, "Promoting Competition in the American Economy," on January 9, 2021, which called on certain federal agencies to ban or limit non-competition agreements and certain "unnecessary" occupational licensing requirements. The EO also directed the agencies to take steps to prevent employers from colluding to suppress wages or reduce employee benefits. Following the EO, the Federal Trade Commission (FTC) proposed a new rule on January 5, 2023, that would prohibit employers from imposing most non-competition agreements on workers. The proposal classifies non-competition agreements as an unfair method of competition prohibited by Section 5 of the FTC Act. The proposed ban applies broadly to cover non-competition agreements that restrain either employees or "workers," a group that includes independent contractors, interns, and volunteers. The proposed ban would generally not reach other forms of restrictive covenant agreements, such as non-disclosure agreements and client non-solicitation agreements, unless such agreements are "de facto" non-competition agreements that would prevent workers from obtaining new employment. For example, the ban prohibits non-disclosure agreements that bar workers from working in the same field and provisions that require workers to repay training costs. The FTC is currently reviewing voluminous comments that were submitted regarding the proposed rule. The proposed rule will not be effective until the FTC votes on a final rule, which is anticipated to be in 2024. See Winston's Competition Corner Blog for more detail on the FTC's proposed rule and practical advice to prepare for its implementation

The General Counsel of the National Labor Relations Board (NLRB) issued a memorandum on May 30, 2023, stating that most non-competition agreements between employers and employees violate Section 7 of the National Labor Relations Act (NLRA), which protects certain employees' right to unionize or engage in other activities for their mutual aid and protection. Specifically, the memorandum asserts that non-competition agreements violate Section 7 because they discourage employees from unionizing by limiting their employment opportunities. The memo explains that employees subject to non-competition agreements understand they will have limited employment opportunities should they be fired for unionizing. The memorandum suggests that non-competition agreements that are "narrowly tailored to special circumstances" may still be lawful. Although the memorandum does not clarify what situations qualify as "special circumstances," it specifies that an employer's desire to avoid competition, retain employees, or protect investments in employee training do not qualify. Notably, the protections under the NLRA do not apply to supervisors, placing non-competition agreements with supervisors beyond the scope of the General Counsel's memorandum. The General Counsel's memorandum is a statement of General Counsel's opinion, not

binding authority under the NLRA. The NLRB will need to adopt the General Counsel's opinion in an individual case, which will then likely be challenged through judicial review.

CONCLUSION

Although it remains to be seen whether Governor Hochul will sign the non-competition ban into law, she has voiced support for limiting the use of non-competition agreements with employees. Employers should begin assessing their current use of non-competition agreements and evaluating less restrictive alternatives that may continue to be available following the potential non-competition ban, including client non-solicitation agreements, confidentiality agreements, forfeiture-for-competition provisions, and clawbacks of equity grants. Employers should also evaluate whether amending their choice-of-law provisions could be advantageous.

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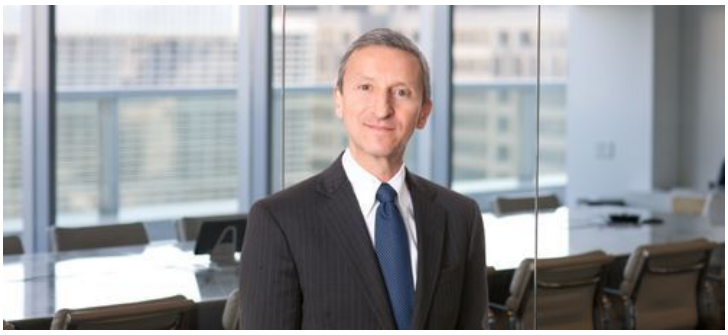

Stephen Sheinfeld