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New York Inches Closer to Banning Non-Compete Agreements

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The New York State Legislature passed a bill on June 20, 2023, that seeks to prohibit employers from entering into non-compete agreements with their employees (the "Bill"). If signed by Governor Hochul, the Bill will be a sea change for New York employers who have historically been able to enter into non-compete agreements with their employees so long as they are reasonable. The Bill mirrors the recent FTC proposed rule banning non-compete agreements nationwide and follows the trend of other state's codifying such bans in state law including, most recently, Minnesota. If signed into law, it will prohibit any non-compete agreement entered or modified 30 days after signed by the Governor. While this Bill applies prospectively only, there is also proposed legislation that, if enacted, would require employers to rescind existing non-compete agreements.

1. The Bill Applies Broadly to All Employees

The Bill prohibits any employer from seeking, requiring, demanding, or accepting a "Non-Compete Agreement" from any "Covered Individual." Non-Compete Agreement is defined as any agreement between an employer and a Covered Individual that prohibits or restricts the Covered Individual from obtaining employment after the conclusion of employment with the employer. Covered Individual is defined broadly to include all employees and potentially certain independent contractors as well. According to the Legislature, non-compete agreements have a negative effect on the labor market and New York economy because they restrict employee mobility and decrease employee benefits and wages. The Legislature specifically notes the impact on consumers in the medical industry, because non-compete can disrupt continuity of care.

2. The Bill Provides a Private Right of Action for Employees

The Bill provides a private right of action for employees to sue their employer to void the non-compete and to seek monetary relief, including liquidated damages up to $10,000, lost compensation, damages, and reasonable attorneys' fees. An action may be brought within two years of the later of (i) when the prohibited noncompete is signed; (ii) when the Covered Individual learns of the noncompete; (iii) when the employment or contractual relationship is terminated; or (iv) when the employer takes steps to enforce the noncompete.

3. The Bill Does Not Apply to Client Non-Solicitation, Confidentiality, and Non-Disclosure Agreements

The Bill expressly does not affect an employer's ability to enter an agreement that "establishes a fixed term of service or prohibits disclosure of trade secrets, disclosure of confidential and proprietary client information, or solicitation of clients of the employer that the covered individual learned about during employment, provided that such agreement does not otherwise restrict competition." The Bill also states that it does not affect "any other provision of federal, state, or local law, rule, or regulation." Therefore, it appears confidentiality agreements and client non-solicitation agreements will still be enforceable if they satisfy New York's reasonableness test. Under New York law, these restrictive covenants are enforceable if they are no broader than is required to protect a legitimate interest of the employer, does not impose undue hardship on the employee, and is not harmful to the public.

4. The Bill Is Silent On Employee Non-Solicitation, Sale-Of-Business, and Forfeiture Provisions

Notably, the Bill does not include an exception for non-competes entered in connection with a sale of a business. Courts typically favor enforcement of such non-compete agreements to protect buyers and the goodwill of the

business they have purchased. Even in jurisdictions such as California, which has long barred post-employment non-compete agreements, make an exception for non-compete agreements in the context of a sale of business.

The Bill is also silent on whether it applies to employee non-solicitation agreements or forfeiture provisions. Under New York's employee choice doctrine, forfeiture provisions have long been enforced where employees leave their employer voluntarily or are terminated for cause without regard to the reasonableness of the provision. "The doctrine rests on the premise that if the employee is given the choice of preserving his rights under his contract by refraining from competition or risking forfeiture of such rights by exercising his right to compete, there is no unreasonable restraint upon an employee's liberty to earn a living."[1] While "Non-Compete Agreement" is defined broadly in the Bill, it does not appear on its face to affect forfeiture provisions. Notably, unlike the proposed FTX rule, the Bill does not address "de facto" non-compete clauses – provisions that effectively preclude employees from competing.

5. Takeaways for New York Employers

New York employers should review their current agreements with their employees to determine if the Bill will impact future agreements and consider revising template agreements with counsel. Employers should monitor this development closely and be prepared to immediately cease the use of non-compete provisions in their employment contracts if the Bill is signed into law as expected. Finally, employers that have historically relied on non-compete agreements may want to consider less onerous options to protect its interests, including customer non-solicitation, confidentiality, and non-disclosure agreements.

ENDNOTES

[1] *Morris v. Schroder Cap. Mgmt. Int'l*, 859 N.E.2d 503, 506 (N.Y. 2006).

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