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The Fate of Non-Competes in New York?

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On June 20, 2023, the New York State Assembly voted to approve Bill No. S.3100A/A.1278B, which, if enacted, would ban all post-employment non-compete agreements entered into between employers and employees in New York.

The bill, which also passed the New York State Senate, will next be sent to Governor Kathy Hochul. If enacted in its current form, the law would go into effect 30 days after the Governor's signature and would apply prospectively to non-competes entered into or modified on or after its effective date.

Background and Nature of the Ban

For years, New York lawmakers have publicly decried non-compete agreements, promising to eliminate them for employees in specific industries or for workers making less than a certain threshold annual income.

In the wake of the Federal Trade Commission's (FTC) proposed nationwide ban on the use of non-compete agreements, the General Counsel of the National Labor Relations Board's memorandum declaring most non-competes to be in violation of federal labor law, and other states' recently enacted measures that ban or limit the use of non-competes, the New York legislature officially joined the fray by passing its own ban on employee non-compete agreements.

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In early June, the legislature adjourned as scheduled, without taking any further action on two proposed bills that had been passed by the New York State Senate. Unexpectedly, the New York State Assembly was called back into session to take up "unfinished business" following the end of the regular legislative session. By a roll call vote of 95-52, the Assembly passed Bill No. S.3100A, which would impose a blanket ban on non-compete agreements with employees, regardless of their salary, industry or job function.

Specifically, the legislation would create a new "Section 191-d" of the New York Labor Law, prohibiting an employer from entering into a "non-compete agreement" with any "covered individual." These terms are defined as follows:

- "Covered individual" means "any other person who, *whether or not employed under a contract of employment, 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;" and

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• "Non-compete agreement" means "any agreement, or clause contained in any agreement, *between an employer and a covered individual* that *prohibits* or *restricts* such covered individual from obtaining employment, *after the conclusion of employment with the employer* included as a party to the agreement."

2023 N.Y. Senate-Assembly Bill S3100A, A1278B (emphasis added). In addition to declaring that "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void," the bill prohibits employers and other entities, their officers and agents from seeking, requiring, demanding, or accepting a non-compete agreement from any covered individual.

Enforcement

The bill grants a private right of action to covered individuals and sets a two-year statute of limitations, triggered by the later occurrence of any of the following events: (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.

An employer found to have violated these provisions shall be civilly liable for liquidated damages of up to $10,000 per violation, and may also be liable for any lost compensation, damages, and reasonable attorneys' fees and costs.

Exceptions

The exact contours of the law are still to be determined. The bill seems intended to carve out an exception for certain types of restrictive covenants, stating: "Nothing in this section shall be construed or interpreted as affecting any other provision of federal, state, or local law, rule, or regulation relating to the ability of an employer to enter into an agreement with a prospective or current covered individual" that (1) establishes a fixed term of service, (2) prohibits disclosure of trade secrets or confidential client information, or (3) prohibits solicitation of clients of the employer that the covered individual learned about during employment.

However, the exceptions are limited by the proviso: "provided that such agreement does not otherwise restrict competition in violation of this section." While "restrict competition" is not expressly defined, the bill suggests that properly tailored client non-solicitation and confidentiality/non-disclosure agreements would be permissible to the extent necessary to protect an employer's legitimate interest. The bill is also silent regarding restrictions on solicitation of employees, and as discussed below, does not expressly carve-out non-competes in the sale-of-business context.

Additionally, since the bill appears to focus on *post-employment* non-compete agreements –that "prohibit or restrict" individuals from obtaining employment "*after the conclusion of employment with the employer*"— it would appear to permit employers to continue to utilize notice periods and "garden leave" provisions, during which an employee is typically relieved of their active duties but continues to receive a salary and remains employed by the employer, subject to a common law duty of loyalty.

Given that New York law and forum is often the preferred choice for parties in commercial multi-jurisdictional transactions, the new law will undoubtedly have a significant nationwide impact.

Questions Remain

The bill leaves several important questions unanswered. As noted, it does not expressly address non-compete agreements ancillary to or arising out of the sale of a business, in which a buyer of a business routinely seeks to protect the goodwill of the business it acquires by prohibiting the seller(s) from working for, owning, or otherwise providing services to, a competing business for a certain period of time and geographic region.

As courts across the country (including New York) have long recognized, non-competes in the sale of business context are essential and necessary to protect acquired goodwill and are therefore subject to a less exacting standard than non-competes in the employer-employee context. *See, e.g., Purchasing Associates, Inc. v Weitz*, 13 NY2d 267, 271 (1963) ("buyer of a business should be permitted to restrict his seller's freedom of trade so as to prevent the latter from recapturing and utilizing, by his competition, the good will of the very business which he transferred for value").

Some of the legislative history suggests that this omission may simply be an oversight. For example, the Sponsor Memorandum justifies the bill, in part, by referring to the FTC's recently proposed ban on non-compete agreements and stating that "[t]his bill would codify such a ban in state law." *See* Assembly Mem in Support of 2023 Assembly Bill A1278B.

Unlike the proposed FTC rule, however, the bill does not include an express carveout for non-compete agreements entered into in connection with the sale of a business. Likewise, testimony from certain proponents of the bill also appears to indicate that S3100A was not intended to cover non-compete agreements in the sale of a business. *See, e.g.*, Testimony of Najah Farley, National Employment Law Project, Transcript of Senate Public Hearing, May 23, 2023 (noting that S.3100 "would stop the usage of these agreements for the majority of workers in New York State, *limiting them to the sale of a business* and other clearly defined instances").

Indeed, sale-of-business context exceptions are regularly included in even the broadest state bans on non-compete agreements, including California's Cal. Bus. & Prof. Code §§ 16600-16602, which also exempts non-competes in partnership agreements and upon dissolution or sale of a business entity.

Given the specific language in the bill referenced above that defines "covered individual" as someone "*in a position of economic dependence*," and defines a "non-compete agreement" as being "*between an employer and a covered individual*" that prohibits or restricts employment "*after the conclusion of employment with the employer*" the bill may already exclude non-competes—at least implicitly—that are ancillary to the sale of a business.

However, New York businesses would certainly benefit from clarity on this issue, as well as from confirmation on whether restrictions on employee non-solicitation, garden leave, and compensation forfeiture provisions (under the longstanding "employee choice doctrine") remain permissible in New York.

Next Steps

Once the bill is received by Governor Hochul, she will have 30 days to either sign it into law as is, propose amendments, or veto it. If enacted, the law would go into effect 30 days after it is signed and approved by the governor.

Hochul and legislative leaders may also agree on additional changes (known as "Chapter Amendments") to the bill, which could be modified before it is signed into law. Any such amendments may be deferred until the start of the new legislative session in January 2024.

Conclusion

While several states have recently enacted statutes curtailing noncompete provisions in employment contracts, only four other states—California, Minnesota, North Dakota, and Oklahoma—currently impose a blanket ban on non-compete agreements, with limited exceptions such as the sale of a business.

Given that New York law and forum is often the preferred choice for parties in commercial multi-jurisdictional transactions, the new law will undoubtedly have a significant nationwide impact.