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Potential Hostile Territory in Shifting Non-Compete Landscape

By Christopher Pardo and Elizabeth Sherwood
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Over the opening months of 2023, several significant governmental actions intended to chill the use of non-competes have taken place, including (i) the FTC's notice of its intention to propose a ban on non-competes, (ii) the NLRB's General Counsel opining that certain non-competes violate the National Labor Relations Act, and (iii) Minnesota's banning of non-competes. Most recently, New York's Legislature has taken action to curtail usage of the controversial restrictive covenants.

On June 7, the New York Senate passed Senate bill S3100A ("the bill"). Shortly thereafter, on June 20, 2023, the New York State Assembly passed the bill by a 95-to-49 vote at a special assembly session. The fate of the bill will next be decided at Governor Kathy Hochul's desk, where she may sign, veto, revise, or fail to act upon it.

Should Hochul decide to sign the bill in its current form, it will amend the New York Labor Law by adding a new section, Section 191-d, to go into effect 30 days after her signature. As presently drafted, it will not apply retroactively to previously executed non-compete agreements. Nonetheless, the bill seems likely to precipitate litigation regarding its breadth and impact.

The following broad definitions apply to the bill's various prohibitions:

• Non-compete agreements are defined as "any agreement, or clause…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…," except that contracts for a fixed term of service, confidentiality agreements, and customer non-solicitation agreements are arguably excluded, as discussed further below.

• Covered individuals are defined as any "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."

Given those definitions, several concerning aspects of the bill are briefly addressed below:

• Prospective Effect: The bill appears to apply only prospectively, not retroactively.

• Non-Solicitation: The bill carves out non-solicitation provisions, saying that they are not affirmatively prohibited provided that the excluded customers are those that the covered individual "learned about

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during employment. ”However, the bill also goes on to state that any such non-solicitation agreement would be void if it “otherwise restrict[s]competition in violation of this section.” This language may become a flashpoint for litigation if signed into law, particularly surrounding the meaning of “learned about” and the significance of the clause “does not otherwise restrict competition.”

• Non-Disclosure: Non-disclosure agreements are permissible to prevent the disclosure of trade secrets and confidential or proprietary information, but, like customer non-solicitation clauses under the bill, they cannot “otherwise restrict competition.” Extending these protections into an argument prohibiting employment on the basis of inevitable disclosure, however, may not be viable.

• Sale of a Business: The bill does not explicitly contain any carve-outs for the sale of a business. The validity of such covenants may turn on whether the seller meets the definition of “covered individual,” but the law is unclear as written. Of course, the sale of a business is widely accepted as one of the moments where non-competition, non-solicitation, and other restrictive covenants are most commonly and broadly enforceable, so the failure to address this concern further underscores the lack of practicality in the drafting of the current version of the law.

• Private Right of Action and Timing of Suit: Covered individuals have a private right of action to bring civil enforcement actions against any employer who requests their signature upon a non-compete agreement within two years of: (i) the date the non-compete agreement was signed; (ii) the employee’s discovery of the non-compete; (iii) the employment relationship ends; or (iv) an employer takes any step toward enforcement of the non-compete against the employee.

• Remedies: Remedies include liquidated damages (up to $10,000) per covered individual, as well as voiding the non-compete agreement(s), enjoining attempted enforcement action, and awarding lost compensation, damages, and attorneys’ fees and costs.

• Class Action Risk: The bill does not specifically address whether class actions under the proposed law may be viable. But, because the bill appears to provide for a private right of action, attorneys’ fees, and liquidated damages “to every covered individual affected” without a correspondingly obvious requirement to show individualized harm beyond the existence of a non-compete agreement, it is unclear whether the current form of this legislation could become an attractive target for class action plaintiffs’ attorneys.

• Garden Leave: The bill only prohibits post-termination non-competes, raising the possibility that well-drafted garden leave and/or notice provisions which would be deemed to extend an employee’s status as employed may be exempt from the reach of the bill. Employers should carefully consider this option for key personnel should the bill be signed into law.

• Independent Contractors: Though other considerations may also weigh against providing independent contractors with a non-compete, the language contained in the bill indicates that independent contractors would be included in the non-compete ban, raising concern relative to non-solicitation provisions that are commonly used when engaging contractors. However, nothing in the law expressly prohibits establishing a “fixed term of service,” such as those sometimes seen in independent contractor agreements.

• Governing Law: As written, the bill does not currently appear to prevent employers from taking action to attempt to avoid the application of New York law, as states such as California and Massachusetts have taken affirmative steps to prohibit, even where there is a meaningful connection in the employee-employer relationship to another jurisdiction.

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If Governor Hochul recommends changes to the law to avoid any of the implications of the above, instead of outright rejecting or accepting the bill, it is likely that the new version would not take effect before 2024.

Christopher Pardo *is a partner in the firm's Labor and Employment group in the firm's Boston office. A highly regarded problem-solver, Chris represents businesses and their executives across a broad spectrum of industries, focusing his practice on the defense of complex employment litigation, high-stakes commercial lawsuits and providing timely and thoughtful advice to his clients. He can be reached at +1 (617) 648-2759 or cpardo@HuntonAK.com.*

Elizabeth Sherwood *is an associate in the firm's Labor and Employment group in the firm's Boston office. An experienced litigator and problem-solver, Beth's practice encompasses all aspects of labor and employment litigation, advice and counseling. She can be reached at +1 (617) 648-2753 or esherwood@HuntonAK.com.*

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