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FIRM MEMORANDUM

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New Bill Poses Major Overhaul of New York Law on Noncompete Agreements

On June 7, 2023, New York's Senate passed a bill (S3100A) that effectively bans non-compete agreements. So too did the New York State Assembly (A1278B) on June 20, 2023. To become law, all that remains is for NY Governor Hochul to sign the legislation, and by all accounts she is poised to do so. Should the legislation become state law, it would arguably mark the most significant revamping of the legal landscape governing restrictive covenants in the employer-employee context in New York's history by stripping employers of a significant right to protect their business interests.

Critically, should the bill become law, it will not apply to non-competes that are already in place. Rather, it will apply to non-competes that are entered into as of thirty (30) days after Governor Hochul signs it. Nevertheless, all employers should review their current employment contracts, including not just non-competes, but also any confidentiality, non-disclosure and trade secret agreements in place. Should the bill become state law, some of these agreements may be able to remain effective, as written, but some may not as it is likely that all will at least be subject to scrutiny and potential challenge. Employers should also review policy statements codified in employee handbooks and employee manuals to ensure that they don't run afoul of the new legal provisions set forth in the bill. Below, we summarize several key aspects of the potential changes the new law, if passed, will impose:

All employees: The bill applies to "covered individuals", which it defines as "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." Thus, the bill applies to all employees, without regard to position, title, or compensation level.

Broadly defines and generally restricts all non-competes: The bill, with certain exceptions, voids any agreement that prohibits a "covered individual" from "engaging in a lawful profession, trade, or business of any kind." The bill prohibits any employer, partnership, company, or other entity from seeking, requiring, demanding or accepting a "non-compete agreement" from any "covered individual." The bill broadly defines "non-compete agreement" as "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."

Allows "covered individuals" to sue employers: The bill affords each "covered individual" who contends that his or her employer violated the bill's provisions the right to sue the employer to seek (a) a court order voiding any non-compete that violates the bill; (b) injunctive relief barring the employer from enforcing any such non-compete; (c) liquidated damages up to $10,000; and (d) lost compensation, damages, and reasonable attorneys' fees and costs.

Two-Year Statute of Limitations. The bill provides a two-year statute of limitations, which accrues when the *latest* of the following events occurs: (i) the non-compete is signed by the parties; (ii) the "covered individual's" discovery of the prohibited non-compete agreement; (iii) the termination of the "covered individual's" employment; or (iv) the employer takes any actions to enforce the prohibited non-compete.

Exceptions: The bill, although extremely broad in scope, contains certain limited exceptions. For instance, it expressly states that it does not prohibit employers from entering into a "fixed-term of service" agreement with any "covered individual." It also permits employers to enter into agreements to protect trade secrets, confidential and proprietary client information and prohibit solicitation of the employer's clients that the covered individual learns about during the course of employment, "provided that such agreement does not otherwise restrict competition in violation of this section."

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Potential Ripple Effects and Pitfalls

Decades ago, California famously took the lead in restricting non-competes when it passed California Business & Professions Code § 16600 ("Section 16600"). Section 16600 provides, in relevant part, "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void," and thus renders California one of the most employee-friendly states in the country. Section 16600 is not without its limits. For instance, its restrictions on noncompetes expressly apply only to *post*-employment agreements (*e.g.* severance agreements), and thus the statute permits California employers to restrict their employees from competing against them while they are employed. New York's bill contains the same temporal restrictions. Additionally, Section 16600, like New York's bill, contains an exception which permits non-competes to protect confidential information and trade secrets.

However, California's statute and New York's bill contain significant differences. For instance, California's statute expressly contains a second exception which permits noncompetition agreements entered into in connection with the sale of a business, or the dissolution of a partnership or limited liability company. New York's bill, however, is conspicuously silent on the topic, and thus leaves it to the state's courts to determine if the exception applies. Given that such a non-compete provision is a common feature of "M&A" deals, this gap in New York's bill portends ripple effects for New York's business world that cannot be overstated. Indeed, if New York's legislation is deemed to render non-competes in the context of the purchase or sale of business unenforceable, not only would the legislation overhaul the New York employment landscape, but it would potentially enact the most significant reconfiguration of the state's business law in modern history.

Moreover, it should be noted that while California law (*see* Cal. Labor Code § 925) generally bars California employers from applying the laws of another state to California employment contracts, New York's bill is silent on this topic. This leaves open the question whether New York employers who have operations or other ties to other jurisdictions with laws more friendly to non-competes will be able to select the laws of those jurisdictions in their employment contracts in lieu of New York law. Nor does New York's bill address non-solicitation covenants, forfeiture upon competition provisions (*i.e.*, contractual provisions contained in severance agreements which permit a former employee to choose between receiving certain economic benefits in return for not competing, or forfeiting some or all of those economic benefits in return for the right to compete); or "garden leave" (*i.e.*, when companies pay former employees not to work for other employers for a certain period of time). Up until now, New York courts routinely found such non-compete provisions to generally be enforceable (as long as they were reasonable in terms of scope, time period, geographical limits, etc.). However, this legal precedent is now uncertain, and assuming New York's bill is signed into law soon, the future enforceability of such non-compete provisions will likely have to be resolved by future litigation and New York State Department of Labor regulations.

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Our Takeaways

Should it be signed into law, New York's bill will reconfigure the legal landscape surrounding the enforceability of non-competes. The many conspicuous gaps in the statute pose potentially sweeping, unintended consequences not just for the state's employment landscape, but also for New York's business world, especially "M&A". Although there are still questions as to whether Governor Hochul will sign the bill, employers with significant business operations and employees in New York should consider the implications of the bill and what actions, if any, they should undertake now in anticipation of the bill's enactment. We recommend that employers imminently review their current employment contracts and policy statements with counsel to determine whether they may soon require changes to conform with the new restrictions, or if they can remain as is without modification or amendment.

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