Simpson Thacher

Memorandum

New York State to Ban Non-Compete Agreements

June 20, 2023

On June 20, 2023, the New York State Assembly passed a sweeping non-compete reform bill that would prohibit almost all new employee non-compete agreements (A01278), effectively embracing the non-compete ban proposed earlier this year by the U.S. Federal Trade Commission.[1] The New York State Senate has already approved a version of the same bill (S3100A), and Governor Hochul is expected to sign it into law. The bill is being sent to the Governor while the Legislature is out of session, so the Governor has 30 days from receipt to sign it. This law takes effect on the 30th day after the Governor signs it, and it is not retroactive.

If signed by the Governor, New York will join California as the largest and most commercially critical states to effectively prohibit non-competes, although New York's law would only apply to non-compete agreements entered into or modified on or after the date the law becomes effective.[2] Unlike California's ban, the New York law contains no exception for sellers of a business[3] or partners leaving a partnership. Further, there generally is no employer option to provide for compensation or other consideration in exchange for non-compete protections (as other states, such as Massachusetts, have permitted).

***Prohibition on Non-Competes*.** Once enacted, the bill would amend the New York Labor Law by adding a new Section 191-d to:

- prohibit employers, corporations, partnerships, limited liability companies, and any other entities, from "seeking, demanding, or accepting" a non-compete agreement from any "covered individual"; and
- make void any provision in a contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind.

[1] *See* *FTC Issues Proposed Rule Barring Non-Compete Clauses With Workers, Spurring Questions About Agency's Rulemaking Authority*. In other recent federal developments, on May 30, 2023 the National Labor Relation Board's General Counsel published an advisory memorandum stating her view that most non-compete agreements violate federal law by chilling non-supervisory employees' rights to engage in protective collective action. *See* *NLRB General Counsel Issues Memo on Non-competes Violating the National Labor Relations Act*.

[2] The bill explicitly provides that the law "shall be applicable to contracts entered into or modified on or after [the] effective date." However, a separate provision states 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." We believe this latter provision (which tracks California's statute banning non-competes) should not be read to override the former to create a retroactive effect, but the conflicting language could create uncertainty. During the New York State Assembly vote, the bill's sponsor said that existing common law principles would apply to existing contracts.

[3] The FTC's proposed non-compete ban also includes an exception for "substantial owners" who sell a business. "Substantial owner" is defined as an owner, member, or partner holding at least a 25% ownership interest in a business entity.

The bill defines "non-compete agreement" as 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***.

A "covered individual" is a person 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." It is not clear from the drafting, but this definition appears to be designed to exclude from coverage true independent contractors (economic dependency being an element of employee status under the Fair Labor Standards Act and often state wage and hour laws). However, courts in New York have traditionally been hesitant to enforce non-competition restrictions with respect to independent contractors. The definition may be broad enough to potentially include partners in a partnership (as long as such partners are providing services to the partnership) notwithstanding that *bona fide* partners are not employees.

Exceptions. The bill contains explicit exceptions for certain types of other obligations, including:

- fixed term contracts;[4]
- non-disclosure agreements; and
- client non-solicitation agreements with respect to clients that the covered individual learned about during employment (the bill is silent about employee non-solicitation agreements).

Private Right of Action. The bill creates a private right of action for covered individuals to sue for violations of Section 191-d within two years following the later of: (1) when the prohibited non-compete agreement was signed; (2) when the covered individual learns of the prohibited non-compete agreement; (3) when the employment or contractual relationship is terminated; or (4) when the employer takes any step to enforce the non-compete agreement. The bill authorizes courts to award various types of damages, including lost compensation, other provable damages, and attorneys' fees and costs. In addition, the bill provides for mandatory liquidated damages of up to $10,000. This private right of action likely will result in employers being very conservative in their interpretation of some of the areas left unclear under the bill.

Open Questions. There are many unanswered questions in the bill that may be left to the courts (or to resolution by the Governor and the Legislature through subsequent legislation), including:

- whether the bill would apply to provisions which do not preclude future competitive activity entirely but would economically incentivize compliance, such as severance installments that cease if the employee accepts employment with a competitor (or forfeiture of outstanding equity awards);

[4] The bill does not include a definition of "fixed term," but this typically refers to a contract under which the employer promises to employ the individual for a specific period of time, without a provision permitting either party to terminate the agreement prior to the end of the term. This type of arrangement is in contrast to at-will employment which permits either party to terminate the relationship at any time (either with, or without, severance rights). Under a fixed term contract, employers effectively get the benefit of non-compete protection by maintaining the employment relationship for the duration of the term.

- whether courts will hold existing grandfathered non-compete agreements to a higher standard of scrutiny in light of this legislated change in public policy;
- whether the bill would restrict or limit garden leave periods; and
- whether changing the terms of pre-negotiated severance in connection with a separation (or even narrowing an existing lawful non-compete in that scenario) would result in loss of grandfathered status.

For further information regarding this memorandum, please contact one of the following authors:

NEW YORK CITY

Andrew Blau
+1-212-455-2380
andrew.blau@stblaw.com

Caitlin A. Lucey
+1-212-455-2775
caitlin.lucey@stblaw.com

Brian D. Robbins
+1-212-455-3090
brobbins@stblaw.com

Daniel J. Venditti
+1-212-455-7387
daniel.venditti@stblaw.com

Gregory T. Grogan
+1-212-455-2477
ggrogan@stblaw.com

Jeannine McSweeney
+1-212-455-3349
jeannine.mcsweeney@stblaw.com

David E. Rubinsky
+1-212-455-2493
drubinsky@stblaw.com

Jamin R. Koslowe
+1-212-455-3514
jkoslowe@stblaw.com

Laurence M. Moss
+1-212-455-2280
larry.moss@stblaw.com

Andrew M. Kofsky
+1-212-455-7437
andrew.kofsky@stblaw.com

PALO ALTO

Tristan Brown
+1-650-251-5140
tbrown@stblaw.com