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Wide-Ranging New York Noncompete Law Awaits Governor's Signature

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Summary

On June 20, the New York State Legislature passed a bill prohibiting noncompetes. The bill currently awaits Governor Hochul's signature. If signed into law, it will take effect just 30 days later, but will only be applicable to contracts entered into or modified on or after the effective date — it will not have retroactive effect.

The proposed law would prohibit employers from entering into noncompete agreements with "covered individuals," which, as explained in more detail below, clearly includes employees and may also include independent contractors. Noncompete agreements are defined as any agreement that prohibits or restricts a covered individual from obtaining employment after the individual concludes employment with the employer who is party to the noncompete.

The proposed law does not impact client nonsolicitation provisions, so long as they are limited to clients that an employee learned about during employment, and do not otherwise restrict competition in violation of the law. In addition, the proposed law does not prohibit provisions protecting an employer's confidential and proprietary information or trade secrets.

The proposed law is silent on employee nonsolicitation provisions, and the prohibition in the proposed law relates to "obtaining employment," not conduct during subsequent employment.

The proposed law does not contain an explicit exception for sale of business restrictive covenants. As explained in more detail below, based on the current language of the law, whether a sale of business restrictive covenant is prohibited likely depends on whether the restriction impacts a seller's future employment opportunities, as compared to ownership or investment opportunities.

Multiple aspects of New York's proposed law are distinctly more unfriendly to employers than other state noncompete laws. First, unlike other states, including Colorado and Washington, there is no exception for employees who make more than a certain compensation threshold. Similarly, unlike states like Georgia, there is no exception for employees who customarily and regularly solicit customers for the employer or have other duties of a "key employee." Second, unlike states such as Massachusetts, New York's proposed law does not provide employers the option to pay for a noncompete period through a garden leave concept. Finally, unlike many other state laws (including California, which is notoriously anti-noncompete), as noted above, New York's version does not explicitly include a sale of business exception.

Key Details and Considerations

Applicability to Independent Contractors

The proposed law applies to any "covered individual." Covered individuals are defined to clearly include employees and any other person who "performs work or services for another person" on such terms and conditions that they are "in a position of economic dependence on, and under an obligation to perform duties for" that person. Under this definition, arguably any person who provides any services for compensation, whether as an employee or independent contractor, would be covered by the law. However, the definition of noncompete explicitly references obtaining employment "after the conclusion of employment" with the employer who is party to the noncompete. This could be read to mean the prohibition only applies to independent contractors to the extent that a noncompete impacts their ability to find future employment (as opposed to additional contracting opportunities). However, this interpretation is just that — an interpretation — and as currently written, it is unclear whether the prohibitions extend to nonemployees.

Impact on Sale of Business Noncompetes

The proposed law does not explicitly address sale of business noncompetes. However, the definition of "covered individuals" protects those individuals who perform work or services, and the definition of "noncompete" is linked to employment. Thus, a sale of business covenant linked to employment (for example, a noncompete that prohibits the sellers of a business from becoming employees of a competing business) could fall within the proposed law's prohibitions. On the other hand, a sale of business covenant not linked to employment (for example, a noncompete that prohibits the sellers of a business from owning a competing business) arguably falls outside the proposed law's prohibitions. Because the lack of an explicit exception creates uncertainty, until and unless the law is amended or official guidance is released that makes New York's position clear, companies may want to consider using non-New York law for purchase agreements. This uncertainty also highlights the importance of making the contexts for restrictive covenants (employment vs. sale of business) extremely clear in the relevant documentation and taking care not to muddy the waters between the two.

Client Nonsolicits

If the proposed law is passed, employers should take care to ensure that future client nonsolicitation provisions are crafted to clearly fall within the law's ambit — *i.e.,* are limited to clients that an employee learned about during employment, rather than all clients. The proposed law leaves ambiguity as to what "learned about during employment means" — is it only clients with whom the employee worked, or does it also include clients about whom the employee had access to confidential information? Given the ambiguity in the language, until there is further guidance, employers may wish to track the statutory language precisely in their agreements.

Employers also should note that client nonsolicitation provisions cannot "otherwise restrict competition." For example, a provision that prohibits an employee from working for a client for a period post-employment would violate New York's proposed law.

Employee Nonsolicits

The proposed law does not address the permissibility of employee nonsolicitation provisions. Though it is not absolutely clear that such provisions would remain enforceable under New York law, given that employee nonsolicitation provisions typically are the least scrutinized of restrictive covenants, we anticipate their enforceability would be unaffected.

Remedies

The proposed law provides that a covered individual may bring a civil action against employers/persons for violations. The law prohibits employers from seeking, requiring, demanding, or accepting a noncompete from any covered individual — thus, having an employee enter into a prohibited noncompete, even if the employer does not enforce it, could be considered a violation and give rise to a private right of action. A court has jurisdiction to void any prohibited agreement and can award liquidated damages (not to exceed $10,000 per covered individual), lost compensation, damages, and reasonable attorneys' fees and costs. The law's inclusion of liquidated damages "per covered individual" raises the question of whether such actions could be brought on a classwide or representativewide basis and seems to leave the door open to such a possibility.

The proposed law also provides for a lengthy statute of limitations — a covered individual has two years to bring an action, which runs from the later of: (1) the signing of the noncompete; (2) when the covered individual learns of the prohibited noncompete (presumably under the theory that the individual was not aware of the noncompete when they signed it); (3) when the employment or contractual relationship is terminated; or (4) when the employer takes steps to enforce the noncompete.

Conclusion

Given the uncertainty about the proposed law's prohibitions and its potential wide-ranging impact, clients should start considering what revisions should be made to their New York restrictive covenant agreements if the law is enacted. Please consult with a Troutman Pepper attorney for assistance with such revisions, as well as to keep abreast of future developments.

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