Proskauer

Implications of and Open Questions Regarding the N.Y. State Legislature's Passage of Bill Banning Non-Competes

Law and the Workplace on **June 23, 2023**

On June 21, 2023, the New York State Assembly passed a sweeping bill (Bill No. S03100/A1278B — An Act to Amend the Labor Law, in Relation to Prohibiting Non-Compete Agreements and Certain Restrictive Covenants) that, if it becomes law, would impose a near-total ban on new non-compete agreements within the state or otherwise governed by New York law. The legislation aligns with a broader national trend towards limiting non-compete agreements. Yet, it stands out due to its stringency, offering virtually no exceptions, unlike similar restrictions in California, Minnesota, North Dakota and Oklahoma, or even the Federal Trade Commission's proposed Rule.

Current Status of Bill

The bill has passed both houses of the New York State Legislature. Now it awaits Governor Hochul's review once the Legislature sends it to the Governor's office, which, as of June 23rd, has not happened. It is not yet clear what the Governor's intentions are with respect to the bill in its current form.

The bill's passage at the end of the legislative session gives the Governor 30 days after transmittal to act. The Governor can sign or veto the bill or do nothing. Failure to act would result in a pocket veto subject to legislative override. The Governor also has the option of signing the bill with "chapter amendments" (a deal with the sponsor/s that an amending bill will be passed in the next legislative session to fix minor or technical problems). The next legislative session does not begin until January 2024. Thus, if the bill is not signed in its current form by the Governor or is vetoed, pocket vetoed, or signed with chapter amendments, further action on the bill will not occur until next year unless the legislature agrees to convene a special session, which is unlikely.

Non-Compete Ban

The bill bans non-compete agreements "between an employer and a covered individual that prohibit[] or restrict[] such covered individual from obtaining employment, after the conclusion of employment." The use of the undefined but vague word "restricts" leaves the possibility that courts could determine that agreements other than traditional non-competes are covered.

A "covered individual" is defined 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.

The law does not define what is meant by "in a position of economic dependence." "Economic dependence" is a factor typically used in the context of an economic re.alities test established through a series of court cases, including the U.S. Supreme Court, and adopted by the U.S. Department of Labor for evaluating whether an independent contractor relationship exists. [1] Therefore the "economic dependence" language may ultimately be interpreted as a carve-out for *bona fide* independent contractor relationships. It is also possible that the law could be interpreted to exclude employees who are not deemed economically dependent on their employers for other reasons. The law does not explicitly reference partnerships, so it is unclear whether the definition of "covered individual" would apply to *bona fide* partners in a partnership, or members in a limited liability company.

Impact on Existing Agreements

While there is some apparent conflict in the bill's provisions as to how they might apply to existing non-compete agreements, if the bill does become law the plain language of §3 states that the law will apply only to "contracts entered into or modified on or after" the effective date. [2] The word "modified" is not defined, and it is unclear what would constitute a modification of an existing agreement sufficient to implicate the law. For example, would an amendment to a provision in an existing agreement (e.g., a change in the compensation stated in the agreement) wholly unrelated to a non-compete clause amount to a modification that could render the non-compete clause void?

Exceptions

Notably, the bill explicitly states that it *does not* impact law applicable to agreements that: (i) establish a fixed term of service, (ii) protect trade secrets and confidential information, or (iii) prohibit the solicitation of clients that the employee learned about during employment. The bill makes no reference to agreements which restrict the post-employment solicitation of employees, suggesting that the bill is also not intended to restrict such agreements.

Unlike non-compete restrictions in other jurisdictions, and in the FTC's proposed rule, the bill does not contain any explicit exception that would apply to non-competes entered into in the context of the sale of a business. The bill provides, however, what might be interpreted as a ban that extends beyond the employer-employee relationship: "[e]very contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void." It is, therefore, unclear whether, in the context of a sale of business transaction, the parties could negotiate language that avoids implicating the law.

The bill does not address whether garden leave and forfeiture-for-competition provisions (which typically call for an employee's forfeiture of payments, deferred compensation, equity, and other interests in the event of competition with the employer) will be deemed unenforceable under the law for covered individuals. [3]

Private Right of Action

The bill provides a private right of action against an employer that "seek[s], require[s], demand[s], or accept[s] a non-compete from any covered individual," and courts can order injunctive relief, liquidated damages up to $10,000 per violation, and compensatory damages, including lost compensation and attorneys' fees and costs.

Open Issues

As noted above, there remains some lack of clarity on how the bill will be interpreted if it becomes law. Key issues that may need to be clarified include:

- How broadly will courts interpret the term "restricts" used in the definition of "non-compete agreement"?
- Does the reference "[e]very contract by which anyone" extend the ban beyond agreements between employers and "covered individuals."

- Whether the law applies to *bona fide* independent contractors, partners, and other non-employees.
- Whether and the extent to which the law would apply to agreements already in existence when the law comes into effect.
- What is a "modification" to a contract that could trigger the application of the law?
- Whether the law will be interpreted to restrict garden leave and/or forfeiture for competition provisions.

We will continue to monitor the status of the bill and will provide updates on further developments.

[1] *See, e.g.*, Proposed Rule – Employee or Independent Contractor Classification under the Fair Labor Standards Act.

[2] §3 of the Bill states that it "shall be applicable to contracts entered into or modified on or after" the "effective date." There is some ambiguity in the language of the Bill, however, with respect to its impact on existing agreements because the Bill also states: "[e]very contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void." Further, the "Justification" section of the "Memorandum in Support of Legislation" states: "The bill **would void current non-compete agreements** and prohibit employers from seeking such agreements. Similarly the Senate "Sponsor Memo" "Summary of Specific Provisions" states: "Subsection 3: **Voids current non-compete agreements** and prohibits employers from seeking such agreement." However, when interpreting statutes, New York Courts look first to the "plain text" of a statute in order to interpret its meaning and interpret that language in "a sensible and practical over-all construction, which … harmonizes all its interlocking provisions." *See Bank of America v. Kessler, 206 N.E.3d 1228, 186 N.Y.S.3d 85 (2023).* The most sensible way to interpret the "void" provision in concert with the "effective date" provision is that the void provision operates only on agreements "entered into or modified" after the law becomes effective.

[3] A second bill that would ban non-competes also passed the state Senate on June 7th and is still pending Assembly consideration, which likely will not occur until 2024. That bill contains language not present in the Bill passed on June 21 that includes a specific ban of *de facto* non-competition provisions, such as a non-disclosure provision "written so broadly that it effectively precludes the worker from working in the same field after the conclusion of the worker's employment with the employer," or terms that penalize departing employees by requiring them to pay back "training" fees, when the fees are not reasonably related to the actual cost of the training. S6748 at § 8(1).

View original.

Related Professionals

- **Steven J. Pearlman**
  Partner