Employers Beware: Non-Compete Agreements May Soon Be Banned in New York State

By Kevin J. Mulvehill and Nicholas P. Fedorka

Phillips Lytle LLP

A company's employees can be its greatest assets. However, employees are often also the greatest threat to a company's business, confidential information, trade secrets and reputation.

Unfortunately, it is not uncommon for a disloyal employee or a group of disloyal employees to take what an employer has built, including the employer's trade secrets or confidential information, and attempt to use it, directly or indirectly, for their own benefit and/or in order to unfairly compete against their former employer.

Facing this reality, many employers appropriately take precautionary measures to attempt to protect themselves from disloyal employees. This can include utilizing appropriate restrictive covenants, limiting employee access to sensitive information, implementing security measures, and updating employment policies regarding confidentiality, online conduct, digital devices and more.

One such precautionary measure—non-compete agreements—is currently under attack and at the forefront of a national discussion. By way of background, non-compete agreements are intended to limit certain competitive activities of an employee during his or her employment and after their employment relationship ends.

Proponents of a ban on non-compete agreements argue, among other things, that non-competes are exploitative and suppress wages, hamper innovation and block entrepreneurs from starting new businesses.

In contrast, their opponents contend that non-competes are necessary to protect a company's investments and trade secrets and prevent employees from utilizing confidential information learned during the employee's employment to unfairly compete against their former employers.

As part of this national discourse, here in New York, the Assembly recently passed A1278B, which attempts to prohibit non-compete agreements and certain other restrictive covenants in New York State. This followed the New York Senate's passage of A1278B's sister bill, S3100A (the "Bill"). If signed into law, the Bill would enact one of the most expansive bans on non-compete agreements in the United States. The Bill would ban "non-compete agreements" between an employer and a "covered individual." The Bill would also provide individuals a private right of action to sue against any employer or individual violating the rule.

The Bill's definitions of what constitutes a "non-compete agreement" and a "covered individual" are broad and confusing.

If the Bill becomes law, courts will have the power to void any prohibited non-compete and the power to award "all appropriate relief," including enjoining the conduct of the former employer, ordering payment of liquidated damages, and awarding lost compensation, damages, and reasonable attorneys' fees and costs.

Fortunately, the expansive Bill does not prohibit agreements that: (1) establish a fixed term of service; (2) prohibit disclosure of trade secrets; (3) prohibit disclosure of confidential and proprietary information; or (4) prohibit solicitation of clients of the employer that the covered individual learned of during the employment, assuming that such agreements do not "otherwise restrict competition in violation of this section."

However, astonishingly, the Bill fails to include an exception relating to the sale of a business. On this point, non-competes are commonly a necessary part of such transactions. These non-competes typically prohibit the seller from working in, or being otherwise associated with, businesses in the same or similar industries as the business being sold. In the absence of such covenants being permissible, the value of the business being sold to a buyer may be reduced substantially, as the buyer would have less protection against future competition from the seller.

Kevin J. Mulvehill
Partner

Nicholas P. Fedorka
Attorney

Further, the Bill, as drafted, leaves a number of questions unanswered. For example:

- Why wasn't a sale of business exception included?
- Does the Bill void entire employment agreements or simply the non-compete provision(s) contained therein?
- Can employers still utilize garden leave to restrict competition during periods that former employees continue to receive compensation from the employer?
- What will the Bill's effect be on New York businesses and the State's economy?
- Why aren't existing restrictions and limitations on non-compete agreements sufficient?

It will take time for the government, the courts and the marketplace to answer these questions. Indeed, as of July 20, 2023, the Bill has still not been delivered to the governor.

That said, major changes to the law surrounding non-competes appear to be on the horizon in New York. In order to mitigate risk, employers are well advised to consult with their employment attorneys before drafting, modifying or attempting to enforce any non-compete agreement. Phillips Lytle's attorneys would be grateful for the opportunity to assist your company.

Kevin J. Mulvehill is a partner and the Rochester office leader at Phillips Lytle LLP. He serves as head of the firm's Labor and Employment Law Practice Team and can be reached at (585) 238-2095 or kmulvehill@phillipslytle.com

Nicholas P. Fedorka is an attorney at Phillips Lytle LLP and a member of the firm's Labor and Employment Law Practice Team. He can be reached at (585) 238-2046 or nfedorka@phillipslytle.com