Insight

IN-DEPTH DISCUSSION

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NY Attorney General Schneiderman Declares "War" on Non-Compete Agreements That He Perceives as Overbroad

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In an initiative that is virtually without precedent in New York, in the past two months (June 15, June 22 and August 4) Attorney General Schneiderman announced agreements with three separate companies in three different industries under which they each agreed to stop utilizing non-compete agreements that applied to a broad range of their employees.

We are unaware of such action by any previous New York A.G. outside of that office's traditional challenging of allegedly unlawful combinations of companies to attempt to monopolize a given industry or similar situation representing a violation of federal or state anti-trust laws. Although the use of non-compete agreements by employers can, in limited circumstances, implicate federal and state anti-trust laws, that was not behind this recent initiative.

Rather, the New York A.G.'s initiative stems from a basic philosophy arguably consistent with New York law on non-compete agreements: In order to be enforceable, such agreements must be supported by a "legitimate business purpose," generally limited to situations where the agreement is needed to protect an employer's trade secrets or its good will — or where an individual has "uniquely special skills," in the words of A.G. Schneiderman.

Absent such special circumstances, non-compete agreements are frowned upon by New York courts, particularly when the economic environment makes finding a new job difficult. From this perspective, the A.G.'s position that "rank and file" employees – particularly low-wage/ minimum wage earners – should not be subject to restrictions on going to work for a competitor after termination seems logical. The sub-titles of the three press releases clearly reveal the Attorney General's philosophy on such agreements:

"Workers Should Be Able to Change Jobs Without Fear of Being Sued" (June 15 Press Release); "Low-wage Workers Should Not be locked into Jobs By Unlawful Non-Compete Agreements" (June 22 Press Release); and "Agreement Follows Complaint From A Former Non-Managerial Employee Who was Unable To Accept A Better Job Because of Onerous Requirement" (August 4 Press Release).

A.G. Schneiderman's philosophy is also consistent with a March 2016 report published by the U.S. Treasury Department on the subject, as well as that of a May 2016 report published by the White House – both of which are referenced in the Attorney General's press releases. These reports concluded that the indiscriminate use of unjustified non-compete agreements can cause various harms to workers, business and/or the economy.

The Three Announced Settlements

In the most recent case – involving a national medical information services company – the A.G. made particular note of the fact that the company's non-compete agreements prohibited all employees from working for competitors after leaving the company, ***regardless of whether they had access to trade secrets.*** The A.G. stressed that nearly all of the company's New York employees were non-senior level, "rank-and-file employees." Under the agreement with the A.G.'s Office, the company will no longer require New York employees– other than "top executives such as directors and officers" – to sign non-compete agreements that restrict employment opportunities after they stop working for the company. The company also agreed to notify all current employees and all former employees who left within the last nine months (the restricted period under the non-competes) that the non-compete agreement was no longer in effect. Significantly, unlike the other two cases taken on by the A.G., this case stemmed from a complaint filed by a former employee of the company after her prospective new employer retracted its offer when it discovered that the employee was covered by a non-compete agreement. Under the A.G.'s agreement with the company, the company also agreed to release the individual who had complained, from her non-compete.

The first of the two June cases involved a major national legal news website, which had been using non-compete agreements that were mandatory for the vast majority of employees. According to the A.G., the agreements primarily covered editorial employees such as editors, reporters and researchers and even included "entry-level 'News Assistants' working their first jobs in journalism." Under the non-compete agreements, a departing employee was prohibited from working for "any media outlet that provides legal news" for one year after their departure from the company. Under the agreement with the A.G., the company will no longer require its editorial employees to sign non-compete agreements "except for a small number of top executives." The company also agreed to notify all current employees and all former employees who left within the prior year (the length of the restricted period) that the non-compete was no longer in effect.

The second of the two June cases involved a gourmet sandwich franchisor that included sample non-compete agreements in hiring packets it sent to its franchisees. Under its agreement with the A.G., the franchisor agreed to stop including the sample non-compete agreements in its hiring packets sent to franchisees, and also agreed to inform the franchisees "that the Attorney General has concluded the non-compete agreements are unlawful and should be voided." In addition, according to the A.G., franchisees that had been using the non-compete agreements agreed to void past agreements and discontinue their usage. The Attorney General found that the non-compete agreements were intended for use with "restaurant workers" (described by the A.G. as "sandwich makers") and "delivery drivers," who were prohibited, for a period of two years after leaving a job with a franchisee, from working at any establishment within two miles of a franchisee's location that made more than 10% of its revenues from sandwiches.

Significantly, the New York A.G. is not alone in taking action against employers who require their employees to enter into non-compete agreements. Just 14 days before the New York A.G. announced his settlement with the gourmet sandwich franchisor discussed above, the Illinois A.G., Lisa Madigan, filed a lawsuit against the same franchisor in Illinois state court based on a novel theory under the Illinois Consumer Fraud and Deceptive Practices Act (which prohibits "[u]nfair methods of competition and unfair or deceptive acts or practices. . .") In that lawsuit, the Illinois A.G. contends that the franchisor's use of its allegedly "unreasonable and unenforceable" non-competition agreements constituted a "restraint of trade" which is alleged to cause the individual employees bound by the non-compete agreements to suffer by the direct impact on them of "decreased . . .mobility," and to cause Illinois businesses to suffer by the resulting limitation on the pool of available workers.

Takeaways

New York employers – and employers generally – should draw several practical lessons from these recent actions of New York Attorney General Schneiderman and Illinois Attorney General Lisa Madigan.

First, employers should not indiscriminately require all employees to sign non-compete agreements regardless of whether or not they have access to an employer's trade secrets, deal with customers in a way that gives them access to the employer's customer "good will," or possess uniquely special skills. Rather, employers should limit the application of non-compete agreements to certain sales, managerial, executive-level or other similar employees who have access to the employers' trade secrets and/or customer good will, or who possess uniquely special skills and abilities. Employers should understand, though, that the bar is exceedingly high to satisfy the "uniquely special" standard.

Second, the more indiscriminate an employer is with regard to which of its employees are required to sign non-compete agreements: a) the more likely it will be that a court will give more scrutiny to even the employer's non-compete agreements that cover employees as to whom the employer has a legitimate business interest that supports enforcement, and b) the more likely it is that such employers may well find themselves a target of the New York Attorney General.

Third, even as to those individuals who may legitimately be required to sign a non-compete agreement, such agreements should be narrowly drawn, with reasonable limitations as to the length of the restricted period and the geographic scope of such agreements.

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