Noncompete Agreements Under the Microscope: A Survey of Recent Trends

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Introduction

2020 is shaping up to be a year of substantial change in the world of noncompete agreements. Until fairly recently, noncompete agreements—which restrict the ability of an employee to compete with a former employer for a period of time in a certain geographic location—were largely ignored by most lawmakers in the United States. As a result, with few exceptions, employers in most states were free to impose post-employment restrictions on their employees, confident that many employees would elect not to fight about them and that courts would likely uphold reasonable restrictions if they were challenged. That is no longer the case.

Many state legislatures have passed or are considering ambitious bills to limit noncompetes. State regulators are flexing their enforcement authority and employers such as WeWork, Law360, Jimmy Johns and others have all been forced to abandon or modify noncompete agreements in recent highly-publicized settlement agreements.[1] Meanwhile, there are increasing calls for federal action, including a petition pending before the Federal Trade Commission ("FTC") to ban noncompetes nationwide that has attracted widespread support.[2] In addition, the "Workforce Mobility Act," versions of which have been introduced in the House and Senate, would not only limit the enforceability of noncompetes but also provide employees with a private right of action.[3] Some courts, too, are becoming more hesitant to enforce noncompete restrictions that may have passed muster in the past.

This new-found scrutiny affects all employers that use noncompetes, and all employees subject to them, and given the ubiquity of these agreements, the impact will be enormous. According to a study released in December 2019, between 36 million and 60 million private sector employees in the United States are subject to non-compete agreements and nearly 50% of employers use noncompete agreements for at least some of their employees.[4]

We are still a long way from the early 1400s, when an English judge raised the possibility of jailing an employer who had imposed a six-month noncompete on an apprentice,[5] but the legal landscape for noncompete agreements has changed and is continuing to evolve.

Survey of Recent Trends

We undertook a survey of developments in six key states where many of our clients are located or do business: California, Connecticut, Delaware, Massachusetts, New Jersey, and New York. Tables summarizing existing and proposed legislation in those states are included in the Appendix. The discussion below covers trends in three areas of significant concern to employers in the financial services industry and beyond: legislative trends in the six identified states, calls for federal oversight, and increased judicial scrutiny.

A. Legislative Trends

States with Noncompete Laws

Of the states surveyed, only California and Massachusetts currently have noncompete legislation. California has long outlawed most restrictive covenants.[6] The Massachusetts legislation, while more recent, has become a model for other states.

The Massachusetts Noncompetition Agreement Act forbids noncompete agreements with:

- Employees classified as non-exempt under the Fair Labor Standards Act;[7]
- Student interns; and
- Those under the age of 18.

Further, noncompete agreements must:

- Be in writing, signed by both parties and state that the employee had the right to consult with counsel;
- Provide new and existing employees at least ten (10) days advance notice of the noncompete;
- Provide "fair and reasonable consideration" separate and apart from continuing employment;
- Entitle the employee to "garden leave" compensation or "other mutually-agreed upon consideration" during the noncompete period;
- Not exceed twelve (12) months in duration;
- Not apply to employees terminated without cause; and
- Not attempt to sidestep the application of Massachusetts law through a choice of law provision.[8]

States That Have Proposed Noncompete Legislation

New York and New Jersey have been considering bills that include many of the features in the Massachusetts Act.[9] Both states would go further and give employees the right to seek liquidated damages, lost compensation and attorney's fees in a lawsuit against employers who violate the law. If adopted, the New York and New Jersey bills would dramatically change the rules for employers and create the risk of financial sanctions for non-compliance. Connecticut considered a similar bill inspired by the Massachusetts legislation, which failed to pass in 2019.[10] Massachusetts considered a bill that would go far beyond existing law and ban virtually all noncompete agreements, which also did not pass in 2019.[11] Employers in these states should stay tuned for further legislative developments.

States with No Proposed Laws

Not surprisingly, Delaware, known as a pro-management state, does not currently have any noncompete legislation or pending legislation. Note, however, that Delaware courts are unlikely to validate agreements that choose Delaware law to avoid the strictures of the state in which the employer is physically located where the other state – California, for example – has a strong policy against such restrictions.[12]

B. Calls for Federal Oversight

Attorneys General from 18 states and the District of Columbia have thrown their support behind a petition urging the FTC to "prohibit employers from presenting non-compete clauses as a condition of employment."[13] That petition was originally filed by the AFL-CIO and more than 60 stakeholders, which joined together in arguing that "[e]mployers have deprived tens of millions of workers of their freedom to leave their current job" through noncompete agreements.[14] The state officials, including the Attorneys General of California and Massachusetts, said that while they support legislative reforms, "we believe an FTC rule offers the quickest, most comprehensive

regulatory path to protecting all workers from these exploitative contracts."[15] A number of Democratic Senators, including two Presidential candidates, voiced support for the petition.[16] The FTC held a workshop in January 2020 to consider the issues raised in the petition and subsequently invited public comment on the issue of whether state law is sufficient to address harms related to noncompete agreements.[17]

C. Increased Judicial Scrutiny

Under existing law, courts in New York, New Jersey, Connecticut and Delaware generally weigh a number of factors in determining whether a noncompete restriction is enforceable. The tests vary slightly from state to state but the common touchstone is reasonableness.[18]

Absent legislation or regulation, it is unlikely that the Courts in these states will refuse to enforce noncompete agreements that do not provide all the protections afforded to employees under the Massachusetts Act or the proposed bills, but there are indications in recent New York cases at least that some courts are applying heightened scrutiny under certain circumstances. For example, in a significant decision, the highly-respected Appellate Division, First Department refused to enforce a noncompete provision where the employee was terminated without cause.[19] Other New York courts have refused to rewrite, or "blue pencil", extremely onerous restrictions and instead have stricken the provisions entirely, thus creating risk for employers who draft overly burdensome provisions.[20] And in a recent decision, a federal judge noted the fact that the restrictions involved at will employees in refusing to enforce noncompete and non-solicitation provisions that had been agreed to by high-level sales personnel who resigned en masse to join another employer.[21] The Court observed that the employer "cannot use restrictive covenants to supply itself of all the benefits of term agreements while simultaneously retaining the right to lay off its personnel whenever it so desires."[22] It will be interesting to see how other Courts, including the New York Court of Appeals, deal with these and other issues that are being considered by legislators in evaluating the reasonableness of noncompete agreements.

Conclusion

Going forward, noncompete agreements will likely continue to be subject to heightened scrutiny and further developments at the state and federal level. This portends significant changes – and potential risk – for employers who do not provide advance notice to employees about noncompetes, advise them to consult with counsel, or undertake to pay former employees during the noncompete period, as they would be required to do under some of the proposed laws. Employers who seek the protection of noncompete agreements are advised to carefully consider the interests that may legitimately be protected in the jurisdictions where they do business and draft post-employment restrictions narrowly, monitor developments in this area and consider including some of the protections being debated by lawmakers to increase the likelihood that their agreements will, in fact, be enforceable.

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Current Legislation

State	Current Legislation	Notice/Consideration Required	Duration/Geographic Limitation	Compensation During Non-Compete Period Required	Enforced in Without Cause Termination	Blue Pencil	Choice of Law Restrictions	Civil Cause of Action for Violation
California	Covenants not to compete are void under California Business & Professional Code §16600, with limited exceptions, which include (1) in connection with the sale of a business, § 16601, and (2) agreements by partners or LLC members in anticipation of dissolution or dissociation from the partnership or the LLC, §§ 16602, 16602.5.	– –	– –	– –	– –	– –	Yes. California Labor Code § 925 requires all employment agreements with employees working in California to be governed by California law. However, this restriction does not apply where the employee is represented by counsel in negotiating the governing law and venue terms of the agreement, § 925(e). See, e.g., Nuvasive, Inc. v. Miles, C.A. No. 2017-0720-SG, 2018 Del. Ch. LEXIS 329, at *3 (Sept. 28, 2018).	No; however, employees may file a lawsuit under California's Private Attorneys General Act for a violation of Cal. Lab. Code § 432.5.
Massachusetts	Massachusetts Non-Competition Agreement Act, Mass. Gen. Laws ch. 149, § 24L, effective October 1, 2018.	Must provide the noncompete for new hires at the earlier of (1) at or before the time of the offer and (2) 10 business days before the employee's start date. For current employees, must provide at least 10 business days' notice of the noncompete before the agreement is to be effective. Fair and independent consideration required (either "garden leave" consideration or "other mutually-agreed upon consideration"), aside from continuation of employment.	Cannot exceed 12 months, unless employee has breached fiduciary duty to employer or unlawfully taken property. In no event may it exceed 2 years. Geographic restrictions must be reasonable.	Payment of 50% of employee's highest annualized base salary in last two years of employment or other mutually-agreed upon consideration.	No	– –	Yes. Employer cannot choose law of another state to avoid Massachuetts noncompete restrictions provided employee has been employed in or resident of Massachusetts at time of termination.	Yes

Pending/Proposed Legislation

State	Pending/Proposed Legislation	Notice/Consideration Required	Duration/Geographic Limitation	Compensation During Non-Compete Period Required	Enforced in Without Cause Termination	Blue Pencil	Choice of Law Restrictions	Civil Cause of Action for Violation
New Jersey	Proposed bill (A1769/S2872 - stalled in the 2018-2019 session but expected to be reintroduced in the 2020-2021 session) would permit noncompete agreements under certain limited circumstances.	For new employees, employer must disclose by earlier of formal offer or 30 days before employment commences. For existing employees, 30 business days notice required. Employees must be advised to consult with counsel, and post-employment notice of intent to enforce a noncompete also required within 10 days of termination.	12 months maximum. Does not apply to employment in other states.	Termination without good cause requires employer to pay 100% of the pay employee would have been entitled to for work performed plus fringe benefits	Yes	– –	Bans choice of law provision that would avoid this legislation if employee is a resident or employed in the state at time of termination	Gives employees a civil cause of action for violations and permits award of up to $10,000 in liquidated damages, lost compensation, reasonable attorneys fees and costs.
New York	Pending bill (A7193/S5790) prohibits noncompete agreements for workers earning less than $75,000/year. For all other employees, the proposed bill requires a noncompete agreement to be in writing signed by the employer and employee and comply with notice requirements.	Yes. For new employees, earlier of formal offer of employment or 30 days before noncompete goes into effect. For existing employees, 30 days before the agreement goes into effect.	– –	– –	No	– –	– –	Gives employees a civil cause of action for violations and permits award of up to $10,000 in liquidated damages in addition to lost compensation, reasonable attorneys fees and costs, and a consideration payment if the employer failed to provide one when due.
Connecticut	Proposed bill (HB 6913 - failed to pass in 2019) set forth notice provisions, required any agreement with a noncompete to be in writing, expressly stated the employee has the right to consult counsel and placed limits on the terms of the non-compete as noted herein.	Yes, not less than 10 days prior to the date of signing the agreement containing the restriction.	12 months maximum. May be extended to a maximum of 24 months total if employer provides employee with base salary and fringe benefits for at least 12 months.	Only if the noncompete is longer than 12 months.	No. Also not enforced if the employee terminates the employment relationship for good cause.	– –	– –	– –

[1] See N.Y. State Att'y Gen., *Non-Compete Agreements In New York State Frequently Asked Questions, https://ag.ny.gov/sites/default/files/non-competes.pdf* (last visited Nov. 16, 2019); Robert Channick, *Low-wage workers free to quit Chicago-area payday lender for new jobs after state ends 'unfair' noncompete agreements*, CHI. TRIB. (Jan. 7, 2019, 6:20 PM), https://www.chicagotribune.com/business/ct-biz-illinois-payday-lender-noncompete-20190107-story.html; Glenn Fleishman, *WeWork Settles With New York, Drops Broad Employee Non-Compete Clauses*, FORTUNE (Sept. 18, 2018), https://fortune.com/2018/09/18/WeWork-Drops-Noncompete-Settlement; Melissa Daniels, *Jimmy John's Settles Illinois Noncompete Suit*, LAW360 (Dec. 7, 2016, 8:48 PM), https://www.law360. com/articles/870376/jimmy-john-s-settles-illinois-noncompete-suit.

[2] *Re: Petition for Rulemaking to Prohibit Worker Non-Compete Clauses, Before the Federal Trade Commission, Washington, D.C.* 20580, OPEN MARKETS INST., at 1, 4 (Mar. 20, 2019), https://openmarketsinstitute.org/wp-content/uploads/2019/03/Petition-for-Rulemaking-to-Prohibit-Worker-Non-Compete-Clauses.pdf; *Open Markets, AFL-CIO, SEIU, and Over 60 Signatories Demand the FTC Ban Worker Non-Compete Clauses*, OPEN MARKETS INST., (Mar. 20, 2019), https://openmarketsinstitute.org/releases/open-markets-afl-cio-seiu-60-signatories-demand-ftc-ban-worker-non-compete-clauses/.

[3] Workforce Mobility Act of 2019, S. 2614, 116th Cong. (2019), https://www.congress.gov/bill/116th-congress/senate-bill/2614/text; Workforce Mobility Act of 2018, H.R. 5631, 115th Cong. (2018), https://www.congress.gov/bill/115th-congress/house-bill/5631/text?r=38.

[4] *Alexander J.S. Colvin & Heidi Shierholz, Noncompete Agreements: Ubiquitous, Harmful to Wages and to Competition, and Part of a Growing Trend of Employers Requiring Workers to Sign Away Their Rights*, ECONOMIC POLICY INST. (Dec. 10, 2019), https://www.epi.org/publication/noncompete-agreements/.

[5] *John Dyer's Case*, Y.B. 2 Hen. 5, fo. 5 (C.P. 1414).

[6] CAL. BUS. & PROF. CODE § 16600 (Deering 2019).

[7] 29 U.S.C. §§ 201–219 (2018).

[8] MASS. GEN. LAWS Ch. 149, § 24L (2019).

[9] A7193, 2019 Gen. Assemb., 2019-2020 Reg. Sess. (N.Y. 2019); A1769, 2018 Leg. 2018 Sess. (N.J. 2018). The New Jersey bill A1769 stalled in the Assembly Labor Committee in 2019; however, the office of Assemblywoman Annette Quijano, one of the bill's sponsors, confirmed the noncompete bill will be reintroduced during the 2020-2021 session.

[10] H.B. 6913, 2019 Gen. Assemb., 2019 Reg. Sess. (Conn. 2019). Connecticut does, however, regulate noncompete agreements for employees in specific industries. Such agreements are banned for broadcast employees and permitted for security guards only in limited circumstances. CONN. GEN. STAT. §§ 31-50a, 31-50b (2019). Agreements involving physicians must also be reasonable, necessary to protect a legitimate business interest, and consistent with Connecticut law and public policy. CONN. GEN. STAT. § 20-14p(b) (2019).

[11] S.B. 1083, 191st Gen. Ct. (Mass. 2019).

[12] *See Nuvasive, Inc. v. Miles*, C.A. No. 2017-0720-SG, 2019 Del. Ch. LEXIS 325, at *2 (Del. Ch. Aug. 26, 2019) (noting that while individuals in Delaware are entitled "within reason" to "contract away the right to pursue a trade or occupation, post-employment" an employer in a state with a "strong public policy" against such restrictions – in this case California – cannot evade the application of that law by incorporating a Delaware choice of law provision); *see also* CAL. LAB. CODE § 925 (2019) (prohibiting employers from requiring employees who primarily reside and work in California from agreeing to governing law and venue provisions that would apply the law of a state other than California with limited exceptions).

[13] *Petition for Rulemaking to Prohibit Worker Non-Compete Clauses, Before the Federal Trade Commission, supra* note 2, at 4; *see* Letter from Keith Ellison, Minnesota Attorney General et al. to Joseph Simons, Chairman, FEDERAL TRADE COMMISSION (Nov. 15, 2019), *available at* https://ncdoj.gov/wp-content/uploads/2019/11/11-15-19-Multistate-FTC-Non-Compete-Letter-FINAL.pdf; Kevin Stawicki, *State AGs Call On FTC To Ban 'Abusive' Noncompetes*, LAW360 (Nov. 18, 2019, 6:56 PM), https://www.law360.com/employment/articles/1220831/state-ags-call-on-ftc-to-ban-abusive-noncompetes?nl_pk=e4718f78-20de-4122- 944d.

[14] *Petition for Rulemaking to Prohibit Worker Non-Compete Clauses, Before the Federal Trade Commission, supra* note 2, at 1.

[15] Letter from Keith Ellison, Minnesota Attorney General et al., *supra* note 13.

[16] Letter from Sens. R. Blumenthal, B. Cardin, S. Brown, E. Warren, E. Markey, C. Van Hollen and A. Klobuchar to Mr. Joseph Simons, Chairman, Federal Trade Commission (Mar. 20, 2019), *available at* https://www.blumenthal.senate.gov/imo/media/doc/Sen%20Blumenthal%20et%20al%20re%20non%20competes_ vF.pdf.

[17] *Non-Competes in the Workplace: Examining Antitrust and Consumer Protection Issues*, FEDERAL TRADE COMMISSION (Jan. 9, 2020), https://www.ftc.gov/news-events/events-calendar/non-competes-workplace-examining-antitrust-consumer-protection-issues; *FTC Extends Deadline for Comments on Workshop Addressing Non-Compete Clauses in Employment Contracts*, FEDERAL TRADE COMMISSION (Jan. 28, 2020), https://www.ftc.gov/news-events/press-releases/2020/01/ftc-extends-deadline-comments-workshop-addressing-non-compete.

[18] *See Cmty. Hosp. Group, Inc. v. More*, 869 A.2d 884, 897 (N.J. 2005) (New Jersey courts apply a three-factor test: (1) is the restriction necessary to protect the employer's legitimate business interests; (2) does the restriction cause undue hardship on the former employee; and (3) is it contrary to the public interest); *All Pro Maids, Inc. v. Layton, C.A.*, No. 058-N, 2004 Del. Ch. LEXIS 116, at *16 (Del. Ch. Aug. 9, 2004) (Delaware courts apply a four prong test: (1) meets general contract law requirements; (2) reasonable in scope and duration; (3) advances a legitimate interest of employer; and (4) survives a balancing of the equities); *NatSource v. Paribello*, 151 F. Supp. 2d 465, 470 (S.D.N.Y. 2001) (citing *Reed, Roberts Assoc., Inc. v. Strauman*, 40 N.Y.2d 303, 307 (1976)) (New York courts assess the reasonableness of a restrictive covenant by evaluating the time, restriction, geographic scope, balance of harms, including the necessity to prevent disclosure of trade secrets or confidential information, or stop an employee with "unique" or special abilities from competing); *Weiss v. Wiederlight*, 546 A.2d 216, 219 n.2 (Conn. 1988) (Connecticut courts assess reasonableness based on five factors: (1) length of time; (2) geographical area; (3) fairness of the protection accorded employer; (4) extent of restriction on employee; and (5) extent of interference with public's interest).

[19] *Buchanan Capital Mkts., LLC v. DeLucca*, 41 N.Y.S.3d 229, 230 (1st Dept. 2016).

[20] *See, e.g., Aqualife Inc. v. Leibzon*, No. 2717/2013, 2016 N.Y. Misc. LEXIS 6, at *17-27 (N.Y. Sup. Ct. Jan. 5, 2016) (the court refused to blue pencil a noncompete where there was extremely unequal bargaining power at the creation of the provision); *Elexco Land Servs. v. Hennig*, No. 11-CV-00214(A)(M), 2011
U.S. Dist. LEXIS 156476, at *13-14 (W.D.N.Y. 2011) (courts strike noncompete agreements completely when they serve little to no legitimate interest for the employer at the expense of the employee).

[21] *In re Document Techs. Litig.*, 275 F. Supp. 3d 454, 466-67 (S.D.N.Y. 2017) (citing *Kelly v. Evolution Markets, Inc.*, 626 F. Supp. 2d 364, 374 (S.D.N.Y. 2009)).

[22] *Id.* at 467.