REPORT BY THE TRADE SECRETS COMMITTEE

LEGISLATING FAIRNESS: REGULATING THE USE OF NONCOMPETES FOR LOWER-SALARY EMPLOYEES

Recommending New York Adopt Statutory Guidelines Governing the Use of Noncompete Agreements for Lower-Salary Employees

I. INTRODUCTION

New York now stands alone as an outlier in trade secrets law. Federal law under the Defend Trade Secrets Act ("DTSA") and the laws of 49 states under their versions of the Uniform Trade Secrets Act ("UTSA") impose statutory requirements and restrictions on trade secrets issues—except in New York, the lone remaining common law jurisdiction in the country. New York has no statutory law generally concerning trade secrets or noncompete agreements. This report advocates a limited—but important—change to New York's unique status as a common law jurisdiction—namely, enactment of a statute to regulate the use of noncompete agreements as applied to lower-salary employees in order to ensure equity and fairness in employment markets while preserving New York's traditional role as the nation's commercial leader. While practitioners often joke that if you want to enforce a noncompete you should sue a defendant who makes more than the judge, the Committee has concluded that more formal guidelines and standards are necessary to ensure fairness in the application of noncompete agreements that can have profound consequences for employees and for regulation of the employment market.

Along with enactment of federal statutory law governing trade secrets, the economic impact of noncompete agreements—traditionally the primary means by which employers seek to protect their trade secrets—has come under increasing scrutiny by governments and advocates. Since enactment of the DTSA, nine states have enacted statutes regulating the use of noncompetes for lower-salary employees in the past four years alone. With increased scrutiny toward issues of economic inequality and how it is exacerbated by legal regimes, the impact of noncompetes on lower-salary employees has become a matter of national attention and concern—and this concern only becomes more acute amidst the inequities and hardships imposed by the Coronavirus crisis.

In its first year of activities (2019-2020), the Trade Secrets Committee of the New York City Bar Association undertook a systematic review of the consequences of New York remaining the sole state without statutory law governing trade secrets, including the absence of any statutory guidelines governing the uses of noncompete agreements. As an initial result of that review, the

Committee is now issuing this report recommending the adoption in New York of statutory guidelines governing the use of noncompete agreements for lower-salary employees.

The Committee is recommending adoption of a New York State statute imposing a presumptive prohibition on noncompete agreements for employees whose salaries fall below a statutorily-defined limit as lower-salary employees. Under the proposed statutory regime, the presumption of illegality would be rebuttable only on the condition that (1) the employer agrees to pay the affected employee's full pro-rated compensation for the entire duration of any noncompetition period, (2) the agreement is found to be enforceable under any of the existing New York common law bases for enforcing a noncompete agreement and (3) the employee has full notice of both the noncompete covenant and the employer's intention to enforce it before entering into the employment relationship.

In this manner, the proposed statute would permit the continued use of noncompetes for statutorily-protected lower-salary employees, but only when they are reasonably limited to the protectable interests recognized under decades of New York common law, when the employer is willing to compensate the employee for the benefit of the noncompetition protection at issue and when the employee has full notice of the noncompete and the employer's intention to enforce it with regard to the particular position prior to entering into an employment relationship.

The Committee has arrived at this recommendation based on an extensive review of New York common law, statutory developments in other jurisdictions, and an effort to identify and assess the impact of noncompete agreements on lower-wage employees and the companies that employ them. As a result of this review, the Committee reached a consensus that continuing to leave enforcement of noncompetes against lower-salary workers to the courts alone under a common law regime can result in unfair and inequitable enforcement against employees whose earnings simply do not support a period of non-employment mandated by a noncompete and affords too much leverage to employers due to the *in terrorem* impact of actual or threatened noncompete enforcement against employees who simply are not in a position to absorb the economic cost of litigating for their employment futures. At the same time, the Committee's review of New York's common law regime has identified strengths of New York's well-developed decisional law in the area of trade secrets and noncompetes that serve New York's enterprise economy well by allowing flexibility in the law to enforce noncompetes where reasonable and necessary to protect true and valuable trade secrets, unique company-initiated and company-based customer relationships and, perhaps in certain rare situations, unique employees.

This report sets forth below the national legal and economic context in which the issue of noncompetes for lower-salary employees arises, surveys the statutory responses enacted in other states in recent years, and analyzes the pros, cons and consequences of a statutory approach in New York in light of New York's exclusively common law regime governing trade secrets. On this basis, the Committee recommends adoption of the proposed statute and looks forward to working with the trade secrets and noncompete bar more generally, the New York State Legislature and other interested stakeholders in taking this first step in developing and updating New York law on trade secrets to reflect the new statutory realities in this area of the law and the economic developments and relationships which the law seeks to regulate.

II. THE NATIONAL DEBATE ABOUT NONCOMPETES

A. Federal Action

In 2016, the DTSA was enacted with near consensus bi-partisan support in an ordinarily divided Congress and with the active support of the Obama Administration. The DTSA added trade secrets to the panoply of federally-protected intellectual property rights and provided for the first time a federal civil remedy for trade secret misappropriation. Concurrently with adoption of the DTSA in May 2016, the Obama Administration took several steps aimed at addressing concerns raised during the legislative process leading to the DTSA that are not the province of federal law, especially given a provision of the DTSA providing that it does not pre-empt state employment law. First, the Administration launched an initiative calling on departments and agencies of the federal government to stoke competition in the United States economy by taking actions to empower and inform consumers, workers and entrepreneurs.[1] Next, the U.S. Treasury and then the White House issued reports concerning what President Obama termed "one institutional factor" that has the potential to suppress wages and entrepreneurship: namely, noncompete agreements that prohibit workers from starting their own enterprises or going to work for a competitor of their current employer for a certain period after leaving their jobs.[2] These publications consistently highlighted how noncompetes impacted approximately 30 million individuals—nearly one in five U.S. workers—at the time of the reports' issuance, including approximately one in six workers without a college degree.[3]

1) *U.S. Treasury Report*

In March 2016, the Office of Economic Policy, U.S. Department of the Treasury, released a report, "Non-compete Contracts: Economic Effects and Policy Implications" ("Treasury Report"), which provides an overview of research—spurred by the development of more comprehensive data—into the prevalence of noncompete agreements in the economy, their effects, and their enforcement. The Treasury Report defines noncompete agreements as "agreements between workers and firms that restrict workers' ability to take new employment."[4] The report also notes how the details of these agreements vary widely across firms and states, but share a common purpose: "restricting the ability of a worker to compete with his or her current employer for some specified period of time, often in a specified geographic area."[5]

According to the report, employers justify these agreements on a variety of bases, some invoking social benefits: to protect trade secrets (the principal social benefit cited), reduce labor turnover costs, encourage more employer investment in employee training (another often cited benefit), and improve employer bargaining power in future negotiations with workers.[6] The report,

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[1] *State Call to Action on Non-Compete Agreements,* The White House, at 1 (2016).

[2] *Id.*

[3] *Id.*

[4] *Non-Compete Contracts: Economic Effects and Policy Implications*, U.S. Dep't. of the Treasury, at 6 (2016).

[5] *Id.*

[6] *Id.* at 6, 8-9, 26.

however, also highlights how these benefits come with costs to workers and the broader economy, and the prevalence of such agreements (which affect as many as 30 million people, or 18 percent of all workers, at the time of the study) merits examination of their effects on worker welfare and job mobility, as well as their effects on the broader economy.[7]

Relying on economic theory and empirical evidence regarding the economic effects of noncompete agreements, the Treasury Report sought to help clarify public discourse regarding noncompetes as well as noncompete reform. The report notes that:

> Constructing ideal policy for non-competes requires determining which explanation [for the non-compete] is most relevant for a particular type of worker (i.e., for low-skill service workers vs. high-skill IT workers), and balancing the trade-offs between non-competes' benefits and their undesirable consequences. *For instance, low-wage workers may be particularly poorly served by non-competes due to the lower likelihood that trade secrets are relevant.*[8]

The research cited in the Treasury Report seems to bear out this highlighted hypothesis. The evidence indicated noncompetes are commonly used in situations where the social benefit is likely to be low (e.g., where workers do not have trade secrets) but the cost to the worker is high. For example, noncompetes are common among workers who report lower rates of possession of trade secrets. The Treasury study found that 15 percent of workers without a four-year college degree and 14 percent of workers earning less than $40,000 per year are subject to noncompete agreements; numbers that, as of the time of the study, were only slightly lower than the percentage of "all workers" with noncompetes.[9] Yet, according to the Treasury Report, "workers without four-year degrees are half as likely to possess trade secrets as those with four-year degrees, and workers earning less than $40,000 possess trade secrets at less than half the rate of their higher earning counterparts."[10] Indeed, fewer than half of all workers with noncompetes reported possessing trade secrets.[11]

The Treasury Report also emphasized evidence that noncompete enforcement diminishes worker mobility and wage growth, as well as workers' leverage in wage negotiations.[12] Much of this comes from what the report calls "lack of salience": the fact that many workers do not pay attention to or are not knowledgeable about what they give up in noncompete agreements (or even know whether they are subject them), and some are not presented with them until they have accepted a position or after they have started working, and not at the time the job offer was

[7] *Id.* at 11.

[8] *Id.* at 10 (emphasis added).

[9] *Id.* at 4.

[10] *Id.*

[11] *Id.* at 12.

[12] *Id.* at 10, 18-19.

originally extended.[13] Evidence showed that some employers "exploit[] this lack of understanding in ways that harm workers without producing corresponding benefits to society."[14]

The Treasury Report found stricter noncompete enforcement to be associated with both lower initial wages and lower-wage growth, evidence that also suggests that lack of salience may be the dominant policy explanation for noncompete agreements.[15] The evidence in support undermines the rationale that noncompete agreements incentivize employers to provide training to employees, suggests that states with higher levels of noncompete enforcement see lower wages in general, and shows that wage disparities between high and low enforcement states actually increase as workers age.[16] The study on which the Treasury relied also found a lack of relationship between expected job tenure and likelihood of having signed a noncompete, further undermining another common justification for noncompetes: reduction in labor turnover.[17]

This evidence suggests that the benefits of noncompetes for lower-earning workers are outweighed by their negative effects, particularly where noncompetes are not the only tool at an employer's disposal—all states and federal statutory law prohibit the theft or disclosure of trade secrets.[18] In addition, employers may provide additional compensation to workers in possession of trade secrets contingent on the worker remaining at the firm.[19] As such, in addressing reform, the Report proposes that, "[e]nhancing the transparency of non-competes, better aligning them with legitimate social purposes like protection of trade secrets, and instituting minimal worker protections can all help to ensure that non-compete contracts contribute to economic growth without unduly burdening workers."[20]

2) *White House Report And Call To Action*

A few months later, in May 2016, the White House issued a report entitled "Non-Compete Agreements: Analysis of the Usage, Potential Issues, and State Responses" ("White House Report"). The White House Report begins by explaining how noncompete agreements impact nearly 20 percent of U.S. workers, including a large number of low-wage workers, and that "[r]ecent media coverage has raised awareness of the usage and enforcement of non-competes among low-wage occupations, including fast-food employees, warehouse workers, and camp counselors."[21] As such, according to the report, federal legislation was proposed "to limit the use

[13] *Id.* at 9.

[14] *Id.* at 24.

[15] *Id.* at 19 and n.32.

[16] *Id.* at 20-21.

[17] *Id.* at 12.

[18] *Id.* at 8.

[19] *Id.*

[20] *Id.* at 26.

[21] *Non-Compete Agreements: Analysis of the Usage, Potential Issues, and State Responses*, The White House, at 3 (May 2016).

of non-compete agreements below a certain income threshold where they are less likely to have valid uses."[22]

The White House Report recognizes that, based on the impacts of unnecessary noncompetes on workers, consumers and the broader economy—including lower wages, reduced employee mobility and bargaining power, negative impacts on the labor pool and entrepreneurship, stifling innovation, and restricting consumer choice—several states had passed or were weighing reforms to the ways noncompete agreements are used and regulated.[23]

Citing the Treasury Report, the White House Report notes that "fewer than half of workers who have non-competes report possessing trade secrets, suggesting that trade secrets do not explain the majority of non-compete activity."[24] The White House Report further states, "If protection of trade secrets were the main explanation for non-compete agreements, then one would expect such agreements to be highly concentrated among workers with advanced education and occupations entrusted with trade secrets."[25] Yet, as the U.S. Treasury Report previously found, statistics reflect that a significant presence of noncompete agreements govern lower wage, less educated workers who did not report possessing trade secrets of their employers and, as the White House Report adds, "[n]on-competes can also become overly burdensome when they apply too broadly in terms of geography or time," sometimes forcing job seekers to leave their industries in order to make a living that does not put them in conflict with their noncompete agreements.[26]

The White House Report acknowledged that, "[w]hile we are still learning more about non-competes and their impact, the available evidence suggests that they can be used or enforced in ways that favor the interests of the firm over the workers."[27] The White House Report lists seven areas (many of which are also discussed in the Treasury Report) that "highlight how workers may

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[22] *Id.* Past congressional efforts at noncompete legislation include the following: In June 2015, U.S. Senators Chris Murphy (D-Conn.) and Al Franken (D-Minn.) introduced the Mobility and Opportunity for Vulnerable Employees (MOVE) Act (S. 1504), co-sponsored by U.S. Senator Elizabeth Warren (D-Mass), which would prohibit noncompetes for workers making less than $15 per hour, $31,200 per year or the minimum wage in the employee's municipality and would require employers to notify prospective employees that they may be asked to sign a non-compete. Also in June 2015, Representative Joseph Crowley (D-NY) introduced the LADDER Act (H.R. 2873), which would prohibit employers from requiring low-wage employees (defined as those individuals who make less than $15 per hour or the hourly rate equal to the minimum wage required by state/local law, or who are classified as non-exempt under the Fair Labor Standards Act) to sign non-compete agreements. In 2018, Warren, Murphy, and Senator Ron Wyden (D-Ore.) introduced the Workforce Mobility Act (WMA) (S. 2782), which would impose a total ban on all noncompete agreements except in limited situations involving the sale of a business or dissolution of a partnership; a companion bill was also introduced in the House (H.R. 5631). The WMA was reintroduced in October 2019 by Murphy and Senator Todd Young (R-Ind.) (S. 2614). At the date of this writing, none of the aforementioned efforts has become law.

[23] *Id.* at 2-3.

[24] *Id.* at 4.

[25] *Id.*

[26] *Id.* at 5.

[27] *Id.* at 7.

be disadvantaged by non-competes."[28] For each of these, the White House Report also includes state-specific examples of action taken to address the issue.[29]

As the White House Report concludes, "[u]ltimately, most of the power is in the hands of State legislators and policymakers in their ability to adopt institutional reforms that promote the use and enforcement of non-competes in instances that appropriately weigh their costs and benefits and in ways that provide workers appropriate levels of transparency about their rights."[30]

After issuing the White House Report, the White House issued a "State Call to Action on Non-Compete Agreements" ("Call to Action") which bluntly states, "Most workers should not be covered by a non-compete agreement."[31] As the White House further states, "we believe that employers have more targeted means to protect their interests, that non-compete agreements should be the exception rather than the rule, and that there is gross overuse of non-compete clauses today."[32] The Call to Action also explains that, "we have heard from experts that only in rare cases is a non-compete the best option for an employer to use," citing other legal frameworks such as trade secret protections, non-solicitation agreements and non-disclosure agreements.[33] While acknowledging certain states had drafted or were drafting legislation to help curtail abusive and unfair noncompete agreements, the White House also called on state policymakers in those states that enforce such agreements to pursue "best practice policy objectives," including the following:[34]

1. Ban noncompetes for certain categories of workers, including workers under a certain wage threshold and workers who are unlikely to possess trade secrets.

2. Improve transparency and fairness of noncompete agreements by, for example, "disallowing non-competes unless they are proposed before a job offer or significant promotion has been accepted…; providing consideration over and above continued employment for workers who sign non-compete agreement; or encouraging employers to better inform workers about the law in their state and the existence of non-competes in contracts and how they work."

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[28] The White House Report titles the seven areas as follows: (1) Workers Who Are Unlikely To Possess Trade Secrets (In Particular, Low Wage Workers) Are Nonetheless Compelled To Sign Non-Competes; (2) Workers Are Asked To Sign A Non-Compete Only After Accepting A Job Offer, When They Have Already Declined Other Offers And Thus Have Less Leverage To Bargain; (3) Non-Competes, Their Implications, And Their Enforceability Are Often Unclear To Workers; (4) Employers Often Write Non-Compete Agreements That Are Overly Broad Or Unenforceable; (5) Employers Requiring Non-Competes Often Do Not Provide 'Consideration' That Is Above And Beyond Continued Employment; (6) In Some Cases, Non-Competes Can Prevent Workers From Finding New Employment Even After Being Fired Without Cause; and (7) In Some Sectors, Non-Competes Can Have A Detrimental Effect On Health And Well-Being By Restricting Consumer Choice. *Id.* at 8-14.

[29] *Id.*

[30] *Id.* at 16.

[31] *State Call to Action on Non-Compete Agreements*, The White House, at 1 (2016).

[32] *Id.*

[33] *Id.* at 2.

[34] *Id.* at 1-2.

3. Incentivize employers to write enforceable contracts, and encourage the elimination of unenforceable provisions, by for example, promoting the use of the "red pencil doctrine," which allows courts to render noncompete agreements containing unenforceable provisions void in their entirety.

B. State Legislation Limiting Noncompete Agreements For Low-Wage Workers

As foreshadowed by the Obama Administration publications, in the four years following the passing of the DTSA, nine states have enacted legislation specifically limiting noncompete agreements for low-wage workers. Illinois was the first state to protect this class of employees, enacting its legislation in August 2016.[35] After three years, eight other states (Maine, Maryland, Massachusetts, New Hampshire, Oregon, Rhode Island, Virginia, and Washington) followed suit in late 2018 and 2019 after a spate of editorials in the *New York Times* that proclaimed noncompete clauses "lock up workers."[36] Virginia was the most recent state to enact legislation, with Governor Ralph Northam quietly signing the bill in the midst of the COVID-19 pandemic in April 2020.[37] The devastating effects of the COVID-19 pandemic on lower-income members of the American economy will likely further fuel the debate on the harmful effects of noncompete clauses on low-wage workers.[38]

1) *Defining A "Low-Wage Worker"*

The nine states that have enacted legislation regarding lower-wage noncompetes have varied in their statutory definitions of "low-wage workers" or "employees" under the scope of their states' legislation. Five states refer to federal standards to do so, either following the guidelines under the Fair Labor Standards Act ("FLSA"), the federal income thresholds, or a combination of both. For example, Massachusetts and Rhode Island prohibit noncompete agreements between employers and non-exempt employees under the FLSA.[39] Rhode Island also classifies a low-wage employee as one whose average annual earnings are up to 250 percent of the federal poverty

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[35] 820 Ill. Comp. Stat. 90/5 (2016).

[36] *Agreements That Lock Up Workers, Legally*, New York Times (May 16, 2017), https://www.nytimes.com/2017/05/16/opinion/noncompete-agreements-workers.html. (All websites last visited Feb. 4, 2021).

[37] Henry Morris, Jr. and Michael L. Stevens, *Virginia Governor Ralph Northam Signs Spate of Pro-worker Statutes*, Arent Fox (Apr. 16, 2020), https://www.arentfox.com/perspectives/alerts/virginia-governor-ralph-northam-signs-spate-pro-worker-statutes.

[38] John Marsh, *Back to the Future: Do Restrictive Covenant Cases from the 2008 Recession Offer Clues to How Courts Will Rule in the Aftermath of COVID 19?*, Bailey Cavalieri (May 22, 2020), https://www.tradesecretlitigator.com/2020/05/back-to-the-future-do-restrictive-covenant-cases-from-the-2008-recession-offer-clues-to-how-courts-will-rule-in-the-aftermath-of-covid-19/.

[39] Mass. Gen. Laws ch. 149 § 24L(c) (2018); R.I. Gen. Laws § 28-59-3(a). Notably, in addition to rendering noncompetes for lower-wage workers unenforceable, Massachusetts is the only state that requires an employer to offer an employee paid garden leave or mutually agreed upon consideration specified in the noncompete agreement. Mass. Gen. Laws ch. 149 § 24L(b)(vii).

level.[40] Maine employs a similar definition to Rhode Island, designating a low-wage worker as an individual earning wages at or below 400 percent of the federal poverty level.[41] New Hampshire uses an hourly rate less than or equal to 200 percent of the federal minimum wage,[42] while Oregon uses median family income for a four-person family as the threshold of what comprises a low-wage employee.[43]

Virginia, using a similar methodology, instead employs state instead of federal thresholds. In doing so, Virginia considers instead whether an individual's average weekly earnings during the prior 52 weeks are less than the Commonwealth's average weekly wage for the previous year as reported by the Virginia Employment commission.[44]

Other states expressly set fixed thresholds within the language of the legislation itself. Washington considers a low-wage employee one who earns $100,000 per year or less.[45] Maryland requires that a qualifying employee earn less than $15 per hour, or $31,200 annually.[46] Illinois is the only state to employ a hybrid of all methods, designating a low-wage employee as one whose earnings "do not exceed the greater of (1) the hourly rate equal to the minimum wage required by applicable federal, state, or local minimum wage law or (2) $13 per hour."[47]

2) *Methods Of Restricting Noncompetes For Low-Wage Workers*

Though states that regulate noncompetes for low-wage workers vary in how they define a low-wage worker, the method of restriction among states that do regulate low-wage workers is uniform. All nine states consider a noncompete entered into with a low-wage worker, as defined under their state statute, to be considered void and unenforceable. Two states, Virginia[48] and Maine,[49] explicitly forbid an employer from entering into or attempting to enforce, a noncompete with any low-wage employee. Virginia provides that employers face civil penalties of up to $10,000 for every violation of the law.[50] Maine's statute provides for the Maine Department of

[40] R.I. Gen. Laws § 28-59-2(7) (2019).

[41] Me. Rev. Stat. Ann. tit. 26 § 599-A(3) (2019).

[42] N.H. Rev. Stat. Ann. § 275:70-a (2019).

[43] Or. Rev. Stat. § 653.295(1)(c)(C)(ii) (2019).

[44] Va. Code Ann. § 40.1-28.7:7 (2020).

[45] Wash Rev. Code § 49.62.020 (2020).

[46] Md. Code Ann. § 3-716(a) (2019).

[47] 820 Ill. Comp. Stat. 90/1–10 (2016).

[48] Va. Code Ann. § 40.1-28.7:7 (2020).

[49] Me. Rev. Stat. Ann. tit. 26 § 599-A(3) (2019).

[50] Va. Code Ann. § 40.1-28.7:7 (2020).

Labor to impose monetary civil fines of "not less than $5,000" on an employer who enters into noncompete agreements with a low-wage employee.[51]

3) *Policy Considerations In State Policy-Making*

States enacting legislative prohibitions on noncompetes for lower-wage employees have all adopted policy rationales focused on the needs of their employee citizens. For example, when signing Virginia's legislation into law, Governor Northam stated that "every Virginian deserves access to a safe and well-paying job."[52] Maine enacted its legislation as a method to keep workers located in Maine. Representative John Schneck of Maine, the legislation's sponsor, cited noncompetes as a method that "makes it harder for workers to find new jobs and stay employed in Maine. These agreements stifle fair competition and harm workers. We should be finding ways to help working people stay in Maine, not forcing them to move."[53] Similarly, Rhode Island's Senate Majority Whip Maryellen Goodwin cited the need for "[h]ourly workers, low-wage employees and people who are just starting out" to "keep working."[54] Senator Goodwin went on to state that "non-compete agreements are one more roadblock that can contribute to keeping poor people poor, and they should not be allowed to be used in that way."[55] Echoing these considerations, the Washington state legislature found that restrictions on low-wage workers' noncompete agreements are vital because "workforce mobility is important to economic growth and development."[56]

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[51] Me. Rev. Stat. Ann. tit. 26 § 599-A(3) (2019).

[52] *Governor Northam Signs New Law to Support Virginia Workers*, A Commonwealth of Va. Website (Apr. 12, 2020), https://www.governor.virginia.gov/newsroom/all-releases/2020/april/headline-856057-en.html.

[53] *Bill Introduced to Protect Maine Workers*, MAINE HOUSE DEMOCRATS (Feb. 27, 2019), https://www.maine.gov/tools/whatsnew/index.php?topic=HouseDems+News&id=1124239&v=Article.

[54] *Bill Limiting Noncompetition Agreements Becomes Law*, State of R.I. Gen. Assemb. (July 25, 2019), http://www.rilegislature.gov/pressrelease/_layouts/RIL.PressRelease.ListStructure/Forms/DisplayForm.aspx?List=c8baae31%2D3c10%2D431c%2D8dcd%2D9dbbe21ce3e9&ID=370542&Web=2bab1515%2D0dcc%2D4176%2Da2f8%2D8d4beebdf488.

[55] *Id.*

[56] Wash Rev. Code § 49.62.005 (2019).

C. Other States' Attempts At Regulating Noncompete Agreements For Lower-Wage Employees

Three state legislatures, Connecticut,[57] Hawaii,[58] and Missouri,[59] made substantial progress in considering legislation to limit noncompete agreements for lower-wage employees, but did not succeed in passing legislation. Similar to the nine states that have enacted laws protecting low-wage workers from noncompetes, Connecticut, Hawaii, and Missouri proposed banning noncompete agreements for lower-wage employees entirely. Regarding who would qualify as a low-wage worker under the proposed legislation, Connecticut proposed banning noncompete agreements for employees whose base pay and benefits totaled less than twice the state minimum wage.[60] Hawaii's proposal prohibited noncompete agreements for low-wage workers whose earnings do not exceed the greater of the hourly rate equal to the minimum wage required by applicable federal or state law or $15 per hour.[61] Missouri proposed to ban noncompete agreements for all hourly workers.[62] The proposed legislation for these three states ultimately fell off the calendar after sitting in Committee.

III. CONSIDERATION AND COMPENSATION: ISSUES ARISING FROM NONCOMPETES AND OTHER EMPLOYMENT-BASED RESTRICTIVE COVENANTS FOR LOWER-WAGE EMPLOYEES

In New York, unlike many other states, the validity and enforceability of noncompetes is purely a matter of common law, with minimal statutory or regulatory restrictions, and New York, as distinct from every other state, has no statutory trade secrets law. Under New York law, courts evaluate noncompetes on fact-specific bases, and a noncompete will be enforced only if it is no greater than required to protect an employer's legitimate protectable interest, does not impose undue hardship on the employee, does not cause injury to the public, and is reasonable in duration and geographic scope.[63] New York courts have recognized protectable interests that may be sufficient to support a reasonable noncompete to include an employer's trade secrets or confidential information, the employer's goodwill, and the employer's interest in preventing loss

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[57] *New Trade Secret and Noncompete Legislation: What's Already Happened and What You Can Expect for the Rest of the Year in Every State*, Fair Competition Law, (Apr. 22, 2019), https://www.faircompetitionlaw.com/2019/04/22/new-trade-secret-and-noncompete-legislation-whats-already-happened-and-what-you-can-expect-for-the-rest-of-the-year-in-every-state/#:~:text=Connecticut%20%5BNoncompetes%5D,noncompetes%20in%20physician%20employment%20contracts.

[58] *Hawaii Senate Bill 328*, Legiscan, https://legiscan.com/HI/bill/SB328/2019; *Hawaii House Bill 1059*, Legiscan, https://legiscan.com/HI/bill/HB1059/2019.

[59] *New Trade Secret and Noncompete Legislation: What's Already Happened and What you can Expect for the Rest of the Year in Every State*, *supra* note 57.

[60] *Id.*

[61] *Id.*

[62] *Id.*

[63] *BDO Seidman v. Hirshberg*, 690 N.Y.S.2d 854, 856-57 (1999).

to a competitor of an employee whose services are special, unique, or extraordinary.[64] While the Committee believes there are advantages to New York's common law regime in terms of fact-specific and rule of reason application of the law, as described next, the Committee also has concluded that regulation of the use of noncompetes and similar restrictive covenants as applied to lower-wage workers would be a positive and required step.

A. Arguments In Favor Of Noncompetes For Lower-Wage Employees

While the traditional reasons why a company would insist on noncompete agreements—training, protection of confidential information and unique skills of the covered employee—also apply to many lower-wage employees, the New York labor market provides several unique considerations supporting the use of such agreements. We briefly summarize these considerations below.

1) *Preservation Of Entry-Level Jobs And Training*

Given New York City's status as a top-tier global business center, New York has always been a destination for entry-level employees in several highly competitive industries, including but not limited to finance, technology, real estate, media, publishing, entertainment and fashion. Employers in New York have provided valuable training to these entry-level employees as a form of added benefit, given that their entry-level salaries are significantly lower than their senior colleagues. In most cases, however, employers are only willing to make this investment with the security of knowing that their newly-trained employees will remain in their employ, and without the risk of these employees moving to competitors upon the completion of their valuable (and expensive) training. For employees, the restrictions imposed by a noncompete are offset by the benefits of their on-the-job training, including increased mobility within the company, and increased earning potential overall. Not having the protection of noncompete agreements may incentivize these employers to cluster entry-level employees in states immediately outside of New York.

2) *Low-Wage Employees Can Have Exposure To Trade Secrets And Possess Unique Skills*

While the common perception and the conclusion of the federal government reports summarized above may be that lower-wage employees do not serve an integral role at companies, in many highly competitive businesses, entry-level employees and other lower-wage employees are regularly exposed to trade secrets and confidential information, and often to vital customer or client relationships. Requiring an employer to regulate how information is shared based on salary-level alone would not only be difficult to enforce, but could lead to claims of discriminatory treatment, and significantly impact employee morale and opportunities. In addition, in certain industries prominent in New York, such as technology, fashion and entertainment, lower-wage employees often possess unique skills that cannot be easily replaced by their employers. In these cases, requiring an employer to pay above market salaries just to enforce a noncompete could have a disproportionately negative impact on the business.

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[64] *Ticor Title Ins. Co. v. Cohen*, 173 F.3d 63, 70 (2d. Cir. 1999).

3) *Emergence Of The Startup Economy*

New York City, through its "Silicon Alley" entrepreneurial economy and with the recent expansion of Manhattan offices by several global technology behemoths, has become the center of the East Coast technology scene, but lacks the extensive talent pool present in Silicon Valley. As is widely known, many startups commonly pay key employees lower salaries in exchange for equity in the company. Further, many startups are proud of their open culture and discourse, where strategic and confidential information is freely exchanged. Noncompetes are essential to these startups given the limited talent pool for technology companies in New York. The imposition of noncompete restrictions based on salary, without any regard or carve-out for equity, could be a major disincentive to technology companies who are considering headquarters in New York.

B. Arguments Against Noncompetes For Low-Wage Workers

Employers' use of noncompetes extend beyond traditional justifications for noncompetes, such as protection of trade secrets, encouragement of employer-sponsored training, or protection of an employee's unique or extraordinary services. Noncompetes have been applied to occupations that typically qualify as lower-wage such as camp counselors, event planners, yoga instructors,[65] home health aides, janitors, landscapers—and, notably, sandwich makers.[66] For reasons of equity and fairness, however, the Office of the New York State Attorney General has sought to prevent the use of such noncompetes. Two examples are described below.

In June 2016, Jimmy John's Gourmet Sandwiches agreed to stop using form noncompete agreements in the hiring packets it sends to its franchisees as part of a settlement with the New York Attorney General's Office.[67] The noncompete agreements prohibited sandwich makers for a period of two years after leaving a job with Jimmy John's from working at any establishment within a two-mile radius of a Jimmy John's location that made more than 10 percent of its revenue from sandwiches. While not all franchisees in New York utilized the noncompete agreement, the franchisees that did use the agreements agreed to void past agreements and discontinue their usage.

Similarly, in September 2018, WeWork Companies, Inc. agreed to release 800 employees in New York from noncompete agreements pursuant to a settlement agreement with the New York Attorney General's Office.[68] In addition, as part of the same settlement, the noncompetes

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[65] Steven Greenhouse, *Noncompete Clauses Increasingly Pop Up in Array of Jobs*, N.Y. Times (June 8, 2014), https://www.nytimes.com/2014/06/09/business/noncompete-clauses-increasingly-pop-up-in-array-of-jobs.html.

[66] Sophie Quinton, *Why Janitors Get Noncompete Agreements, Too*, Pew Trusts: Stateline (May 17, 2017), https://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2017/05/17/why-janitors-get-noncompete-agreements-too.

[67] Press Release, *A.G. Schneiderman Announces Settlement With Jimmy John's To Stop Including Non-Compete Agreements In Hiring Packets*, Office of the New York Attorney General (June 22, 2016), https://ag.ny.gov/press-release/2016/ag-schneiderman-announces-settlement-jimmy-johns-stop-including-non-compete.

[68] Press Release, *A.G. Underwood Announces Settlement with WeWork to End Use of Overly Broad Non-Competes That Restricted Workers' Ability To Take New Jobs*, Office of the New York Attorney General (Sept. 18, 2018), https://ag.ny.gov/press-release/2018/ag-underwood-announces-settlement-wework-end-use-overly-broad-non-competes.

applicable to roughly 1,400 New York employees were made less restrictive, with noncompete periods dropping from one year to six months and the applicable geographic restriction dropping from anywhere WeWork operated to a 15-mile radius of WeWork branches that practice the type of work that the employee did. The company had required almost all of its employees to sign noncompetes, including cleaners, mail associates, executive assistants, baristas, and employees paid as little as $15 per hour.

Undeterred and often unwarranted use of noncompetes with lower-wage employees underscores the need for regulation. While precise data concerning what proportion of workers have noncompetes is not available, a recent study by the Economic Policy Institute found that in a random employer sample (634 employees with 50 or more employees), nearly half required noncompete agreements for at least some employees, and nearly one-third required all employees to sign noncompetes.[69] A 2014 online survey of over 11,000 people that was recently analyzed by researchers Evan Starr of the University of Maryland and J.J. Prescott and Norman Bishara of the University of Michigan concluded that of those earning less than $40,000 per year, 13.3 percent were currently subject to a noncompete and 33 percent reported that they had been subject to one at some point in their careers.[70] In discussions with the City Bar's Trade Secrets Committee, leaders of the Legal Aid Society's employment law group reported that even Legal Aid has clients who are subject to noncompetes and require representation in court proceedings in which employers seek to enforce noncompetes against Legal Aid clients.

In general, although there are exceptions as noted, the traditional justifications for noncompetes—protection of trade secrets, encouragement of employer-sponsored training, or protection of an employee's unique or extraordinary services—are much less likely to apply in the context of lower-wage employees.[71] Noncompetes for lower-wage employees can also be unfair from a process standpoint due to the unequal bargaining power between employer and employee. Few workers in general—even outside of the lower-wage context—report bargaining over their noncompete agreements.[72] Again, this dynamic is likely to be even more pronounced with respect to lower-wage employees. In addition, the unequal bargaining power between employer and employee may be exacerbated because noncompetes may be presented as a condition of

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[69] Alexander J.S. Colvin and 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 Institute (December 2019), https://www.epi.org/publication/noncompete-agreements/.

[70] Evan Starr, J.J. Prescott, and Noman Bishara, *Noncompetes in the U.S. Labor Force*, University of Michigan Law & Econ, Research Paper No. 18-013 (Posted July 3, 2015; Written May 7, 2020; Last Revised May 18, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2625714.

[71] The Committee acknowledges that there will be situations in which some employers have legitimate concerns that still may not rise to the level of protectable interests that New York courts will recognize as a basis for enforcing a noncompete, for example, where an employer pays for specific training or license applications required for a lower-salaried employee to begin work. Noncompetes are a fairly blunt tool to protect the employer in such situations, however, and the proposed legislation may lead employers in such situations to utilize less far-reaching measures to protect their investments in training by, for example, contractually requiring pay-back or claw-back of license application fees or training costs when an employee leaves shortly after receiving the benefit of the employer's training investment.

[72] *Id.*

employment after employment has already begun, as New York courts have held that continuation of at-will employment is sufficient consideration to support a noncompete.[73]

Finally, while not specific to the lower-wage employee context, numerous studies continue to show that noncompetes adversely affect wages and job mobility.[74]

C. Impact Of COVID-19

The economic consequences of the COVID-19 pandemic may be creating additional hurdles for lower-wage employees with noncompete agreements. Unfortunately, while many companies have been forced to lay off or furlough employees due to the economic downturn, noncompete agreements may still be in place for such displaced workers. This would be damaging to the State's economy, creating additional hardship for low-wage workers, for several reasons. Refusal to waive noncompetes for employees who have been laid off as a result of COVID-19 would impede these employees' ability to obtain new employment and thus slow down any potential economic recovery. This would be particularly problematic for lower-wage employees who may not be able to afford to pay for legal representation to negotiate the reduction or elimination of such restrictions. Further, this inability to seek other employment would put increased strain on New York's unemployment insurance system, as employees believe they are not able to seek other employment.

IV. THE CURRENT STATUS OF NONCOMPETES AND OTHER EMPLOYMENT-BASED RESTRICTIVE COVENANTS FOR LOWER-WAGE WORKERS IN NEW YORK

Since 2017, the New York State Legislature has reviewed at least three bills relating to agreements that impose limits on employees' ability to seek future employment. These bills seek to provide protections to employees as they relate to employment agreements: namely, requiring employers to disclose that they are imposing such an agreement on an employee, and exempting certain employees from noncompete agreements or restrictive covenants. Currently in New York, noncompete agreements are prohibited by statute only in the broadcast industry.[75]

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[73] *See, e.g.*, *Gazzola-Kraenzlin v. Westchester Med. Grp., P.C.*, 10 A.D.3d 700, 702, 782 N.Y.S.2d 115, 117 (2d Dep't 2004), (continued employment of an at-will employee was adequate consideration such that noncompete was enforceable); *Fullman v. R & G Brenner Income Tax Consultants*, No. 106634/07, 24 Misc. 3d 1214(A), 897 N.Y.S.2d 669 (Sup. Ct. N.Y. County June 23, 2009) (restrictive covenants that needed to be signed as a condition of initial employment did not appear to be the product of an agreed exchange but rather of the former employer's superior bargaining power).

[74] *See* Matthew S. Johnson, Kurt Lavetti, and Michael Lipsitz, *The Labor Market Effects of Legal Restrictions on Worker Mobility* (June 6, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3455381; Michael Lipsitz and Evan Starr, *Low-Wage Workers and the Enforceability of Non-Compete Agreements* (Aug. 22, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3452240.

[75] *See Non-Compete Agreements in New York State: Frequently Asked Questions*, New York State Attorney General, https://ag.ny.gov/sites/default/files/non-competes.pdf.

A. State Assembly Bill A.7193 / State Senate Bill S.5790 (NYS 2019-20)

As part of an effort over recent years to address overly broad noncompetes, State Assembly Bill A.7864 (May 17, 2017) was proposed by the Office of the New York State Attorney General "to better protect workers from growing abuse of noncompetes."[76] The bill was reintroduced for the 2019-20 legislative session as A.7193/S.5790; it has not been reintroduced to date in the new session.

The proposed legislation prohibits noncompetes for workers earning below $75,000 annually. It also addresses disclosure requirements regarding noncompete agreements. A.7193/S.5790 seeks to prohibit an employer from seeking, requiring, demanding, or accepting a noncompete agreement from an employee, who is not a "covered employee," unless the noncompete agreement (i) is in writing and signed by the employer and employee; (ii) had been presented to the employee by the earlier of a formal offer of employment or thirty (30) days prior to the noncompete agreement coming into effect; or (iii) as a new noncompete agreement, is provided at least 30 days prior to such agreement coming into effect in relation to a current employee who is not subject to a noncompete agreement. If an employee subject to a noncompete agreement is discharged without cause, the noncompete agreement is no longer enforceable as to that employee.

B. State Assembly Bill A.2192

Also referred to as the "New York State mobility and opportunity for vulnerable employees act" or the "NY MOVE Act," State Assembly Bill A.2192 also addresses excepting certain employees from noncompete restrictions and disclosure requirements for noncompete agreements. Notably, as compared to A.7193/S.5790, A.2192 advocates for a different, and lower, employee compensation threshold as it relates to employees excepted from noncompete restrictions. A.2192 seeks to amend the labor law, by adding a new article 33, to (1) prohibit employers from requiring low-wage employees to enter into covenants not to compete, and (2) require employers to notify potential employees of any requirement to enter into a covenant not to compete.

A.2192 also explicitly defines a "low-wage employee" as:

> (a) an employee who, excluding any overtime compensation required under section seven of the Fair Labor Standards Act of 1938 (29 U.S.C. 203) or under an applicable state law, receives from the applicable employer: (i) an hourly compensation that is less than the liveable hourly rate; or (ii) an annual compensation that is equal to or less than: (A) for the fiscal year of the effective date of this article, thirty-one thousand two hundred US dollars ($31,200) per year; and (B) for each succeeding fiscal year, the adjusted amount described in subdivision three of section nine hundred fifty-one of this article; and

[76] *Id.*

> (b) does not include any salaried employee who receives from the applicable employer compensation that, for two consecutive months, is greater than: (i) for the fiscal year of the effective date of this article, five thousand dollars; and (ii) for each succeeding fiscal year, the adjusted amount described in subdivision three of section nine hundred fifty-one of this article.

The proposed rule's definition of a "liveable hourly rate" is fifteen dollars per hour or an hourly rate as determined by or calculated based on state or local minimum wage laws. A.2192 remains under consideration by the New York State Legislature.

C. State Assembly Bill A.1463 / State Senate Bill S.562

Unlike the bills described above, A.1463/S.562, the "End Employer Collusion Act," does not address compensation and disclosure criteria in connection with noncompete agreements. The purpose of the bill is to prevent "no-poaching" agreements between certain employers.[77] A.1463/S.562 seeks to amend the General Obligations Law, Section 5-338 to deem, as void, agreements between employers that directly restrict the current or future employment of any employee. In particular, the bill defines a "restrictive employment agreement" as any agreement (and presumably a particular contract clause of the same effect) that: "(i) is included in a franchise agreement; and (ii) prohibits or restricts one or more franchisees from soliciting or hiring the employees or former employees of the franchisor or another franchisee." A.1463/S.562 states that no franchisor or person acting on its behalf may enter into or renew a restrictive employment agreement, enforce a restrictive employment agreement, or threaten to enforce a restrictive employment agreement and any restrictive employment agreement is void.

V. A FRAMEWORK FOR ACTION

Based on the Committee's research and analysis, the Committee is recommending a statutory approach that substantially restricts the use of noncompete agreements for lower-wage employees while preserving the flexibility of New York's common law that recognizes important commercial considerations for New York's economy. In this hybrid approach, the Committee advocates adoption of a New York State statute imposing a presumptive prohibition on noncompete agreements for employees whose salaries fall below a statutorily-defined limit as lower-wage employees. Under the proposed statutory regime, the presumption of illegality would be rebuttable only on condition that (1) the employer agrees to pay the affected worker's full pro-rated compensation for the entire duration of any noncompetition period; (2) the agreement is found to be enforceable under any of the existing New York common law bases for enforcing a noncompete agreement, e.g., trade secrets protections, protectable customer relationships, or employees possessing unique skills or expertise; and (3) the employee was provided with notice of any noncompete agreement and the employer's intention to enforce the noncompete with respect to the particular position prior to the employee's agreement to enter into the employment relationship.

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[77] *See* S.562 Sponsor Memo, https://www.nysenate.gov/legislation/bills/2021/s562.

Defining a salary threshold for purposes of this proposed statute will be a challenge for the Legislature given New York State's widely-divergent regional economies and the competitive challenges faced by different types of businesses large and small in our economy. Having reviewed the thresholds utilized by other states that have legislation restricting the use of noncompetes for lower-salaried employees and the economic considerations entailed in implementing similar legislation in New York's economy, the Committee recommends that the best practice for utilizing an existing threshold would be to adopt the exempt employee definitions contained in the Fair Labor Standards Act and the New York Minimum Wage Act that require overtime pay for work in excess of 40 hours. They exempt employees with Executive functions (subject to minimum pay thresholds), Administrative functions (again, subject to minimum pay thresholds) and Professional functions (requiring a "prolonged course" of training in a "field of science and learning" akin to the New York common law holding that noncompetes are more enforceable when applied to "learned professions."[78] The current FLSA and Minimum Wage Act thresholds reflect differences in New York's regional economies, with different rates for New York City, the Nassau, Suffolk and Westchester County suburbs and upstate and, for New York City employees, different pay thresholds for employers with 11 or more employees than for small employers with 10 employees or fewer. The current threshold for New York City employees at larger employers is $1,125 per week.

The Committee believes that this approach provides the needed balance between permitting the continued use of noncompetes for statutorily-protected lower-salary employees, *but only* under specified circumstances where the employer establishes protectable interests recognized under decades of New York common law *and* when the employer is willing to compensate the employee for the benefit of the noncompetition protection at issue and to provide procedural fairness to the employee in the adoption of the noncompete agreement.

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[78] *See Reed, Roberts Assocs. v. Strauman*, 40 N.Y.2d 303, 308 (1976).