

Client Alert

Obama Administration Wants States to Limit Enforceability of Non-Compete Agreements

October 28, 2016 – President Obama this week asked state law makers across the country to enact legislation that would significantly limit the enforceability of noncompetition agreements (commonly referred to as “non-competes” or “restrictive covenants”) for certain employees in the workplace. Both the White House and U.S. Treasury Department issued reports indicating non-compete agreements, which are intended to prohibit workers from accepting employment with a competitor for a certain period of time, have had a negative influence on wage levels and have limited entrepreneurial growth in our country. The statistics cited in these reports show that nearly 30 million U.S. workers are impacted by non-compete agreements, including a significant number of low-income workers who by the nature of their work do not pose a threat to their former employers.

Almost every state currently allows for some form of non-compete agreement, although enforceability varies from state to state depending on the employment relationship and the particular circumstances involved. The validity of these restrictive covenants is often tested through costly litigation. In determining the enforceability of non-compete agreements, most courts, including those in New York, employ a reasonableness standard. In other words, courts will uphold a non-compete that is (i) reasonable in terms of time, scope, and area, (ii) necessary to protect a legitimate interest of the employer, and (iii) is not harmful to the general public or unreasonably harmful to the employee. Unfortunately, this standard creates a lot of uncertainty in terms of predicting whether a particular non-compete agreement will be upheld.

Several states, including California, Oklahoma and North Dakota have already enacted legislation that prohibits the use of non-compete agreements with limited exceptions (e.g., situations involving the sale of a business). Covenants not to compete between employers and employees are otherwise void and unenforceable in these states. Many other states are in the process of implementing their own types of legislative reform that limits enforceability of non-compete agreements.

Here are the proposals the White House would like to see state legislatures consider:

- Ban on all non-compete agreements for (i) low wage earners; (ii) workers in industries related to public health and safety; (iii) workers who are unlikely to possess trade secrets; and (iv) workers who were terminated without cause.

- Improve transparency and fairness of non-competes by (i) requiring the covenant be negotiated prior to commencing employment or prior to receiving a significant promotion, or (ii) providing additional consideration beyond continued employment for those employees who sign non-competes during the term of their employment.
- Incentivize employers to draft enforceable agreements by eliminating the “blue-pencil” doctrine that allows a court to strike or amend unenforceable provisions in a contract without voiding the entire agreement.

New York Attorney General Eric T. Schneiderman has already indicated that he plans to propose new legislation in 2017 that would void non-compete agreements for employees who earn less than \$900 per week. He also will seek to ban non-compete agreements that are broader than necessary to protect an employer’s confidential or trade secret information.

While it remains to be seen the extent to which state legislatures will heed President Obama’s suggestions, new legislation addressing non-compete agreements does seem likely in many states and could significantly impact the use of such agreements in the future, particularly with lower level employees. As such, employers should evaluate their current restrictive covenant and/or non-compete agreements with legal counsel and consider whether modifications are necessary to better ensure that those agreements remain enforceable in the future when the likelihood for them being challenged is increased.

If you require any additional information about restrictive covenants, or any other employment-related issue, please contact:

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