New York State Bar Association

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Memorandum in Opposition

Business Law Section

_____, 2023

S. 3100 Sponsor: Senator Ryan
A. 1278 Sponsor: M. of A. Joyner
Senate committee: Labor
Assembly Committee: Labor
Effective Date: 30 days after enactment

AN ACT to amend the labor law, in relation to prohibiting non-compete agreements and certain restrictive covenants and authorize covered individuals to bring a civil action in a court of competent jurisdiction against any employer or persons alleged to have violated such prohibition.

LAW & SECTION REFERRED TO: Section 191 of the Labor Law.

THE NEW YORK STATE BUSINESS LAW SECTION OPPOSES THIS LEGISLATION IN ITS CURRENT FORM

Introduction

Labor Law Section 191 does not currently prohibit non-compete agreements.

This bill would prohibit non-compete agreements and certain restrictive covenants and would authorize covered individuals to bring a civil action against an employer or persons alleged to have violated such prohibition.

The Business Law Section of the New York State Bar Association ("BLS") does not object as a general matter to the purported objective of the bill to protect an individual's ability to earn a living. However, the BLS strongly opposes this bill in its current form because the legislation does not contain an exception for non-compete clauses in connection with the sale of a business.[1]

[1] The Business Law Section also has other concerns with the legislation, including the absence of exceptions for non-compete covenants in franchise agreements (as between franchisee and franchisor, not as to franchisee employees) and for highly compensated employees. These subjects are often addressed in other statutes, regulations, and common law relating to non-compete agreements.

While the bill appears to be intended to prohibit non-compete agreements between employers and their employees, Section 3 of the bill is far broader than that, declaring that "[e]very contract by which ***anyone*** is restrained from engaging in a lawful profession, trade, or ***business of any kind*** is to that extent void." (Emphasis added.) This language would void any agreement by which the seller of a business is prohibited from engaging in the very business he or she has just sold for a substantial payment.

Rationale for and Importance of Non-competes in Business Sales

Non-compete clauses offer critical legal protections in connection with the sale of a business and help to assure the buyer that it will get the benefit of its bargain. It thus is commonplace for business sales to include non-compete clauses. In fact, in a Federal Trade Commission ("FTC") inquiry into past acquisitions by the largest technology platforms, it was found that "*more than 75 percent of transactions* included non-compete clauses." (Emphasis added).[2]

Non-compete clauses entered into in connection with the sale of a business provide assurances to buyers that sellers will not compromise the goodwill of the business by joining or opening a new competing business that will capitalize on sellers' unique understanding of the operations of the business, its customers, its products or services, and other business details, including years and sometimes decades of familiarity with the trade secrets and other confidential business information of the business for which it will have been paid by the buyer As observed by the Court of Appeals, "[t]his rule is grounded, most reasonably, on the premise that a buyer of a business should be permitted to restrict his seller's freedom of trade so as to prevent the latter from recapturing and utilizing, by his competition, the good will of the very business which he transferred for value." *Purchasing Assocs., Inc. v. Weitz*, 13 N.Y.2d 267, 271 (1963); *see also Intertek Testing Servs., N.A., Inc. v. Pennisi*, 443 F. Supp. 3d 303, 330 (E.D.N.Y. 2020).

The assurances given by non-compete agreements thus protect buyers' right to the full value of the business for which it is paying the seller. Without them, the value of the business to the buyer is far less, and the seller – whom the bill is ostensibly intended to protect – will realize far less for the business he or she has built, as a buyer will anticipate the risk of such competition, and the dissipation of its newly acquired asset, and so be likely to pay far less for the business.

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[2] FTC, *FTC Staff Presents Report on Nearly a Decade of Unreported Acquisitions by the Biggest Technology Companies*, FTC.GOV (Sept. 15, 2021), https://www.ftc.gov/news-events/news/press-releases/2021/09/ftc-staff-presents-report-nearly-decade-unreported-acquisitions-biggest-technology-companies.

Effect of the Bill on Transitional Employment and Business Continuity

Moreover, even if the bill is limited to a prohibition on non-compete clauses in an employment relationship, without an exception for the sale of a business, the bill will disincentive buyers to employ seller principals post-closing. Such employment for a transitional period is common, and often critical, in business sales, as it assures a smooth transition to the new owners with minimal disruption to the business. If the price of such employment is the inability to prohibit the seller principals from competing with the business, buyers will be reluctant to provide for such transitional assistance, creating a greater risk to the continued success of the business. That creates a risk that New York employees may lose their jobs if the business is less successful or fails entirely. In addition, the resulting inability to have the seller's transitional assistance will again militate in favor of lower purchase prices for sellers, because buyers will not be willing to pay as much as they would were they to have that help, resulting in in a significant reduction in the enterprise values of New York businesses.

Likely Significant Erosion of New York Business Prospects and Values, Employment Opportunities and Tax Revenue

BLS expects that this legislation will discourage the purchase of businesses with New York operations, reduce their value, cause prospective buyers of business to look elsewhere for businesses to buy, and incentivize entrepreneurs to locate their new businesses in more favorable environments, where they can ultimately realize the full value of their efforts. *All of these consequences will be to the detriment of New York, its workers, and the tax base.*

Indeed, this legislation would make New York the only jurisdiction to enact a complete ban on non-compete agreements *without* a sale of business exemption. Indeed, California, North Dakota, Oklahoma, and Minnesota are currently the only states with complete bans on non-compete agreements.[3] In every case, each of them explicitly recognizes a sale of business exception. For example, in California:

[3] There are other states with restrictions on non-compete agreements that are less than the complete ban in the bill at issue. Many of these also have exceptions for sales of businesses. It is only in a half-dozen states that prohibit non-compete agreements only for lower-income employees (with wages below a defined threshold) that do not provide for exceptions for sales of businesses or protection of the business's goodwill. Such restrictions on lower-income employees are not likely to apply to the owners of a business being sold.

> "Any person who sells the goodwill of a business...may agree with the buyer to refrain from carrying out a similar business..." (Cal.Bus. & Prof.Code § 16600-16607).

See also 15 Okl.St.Ann. § 217-219B; Minn. S.F. No. 3035, § 181.988 (*available at* https://www.revisor.mn.gov/bills/text.php?number=SF3035&version=4&session=ls93&session_year=2023&session_number=0&format=pdf); N.D. Cent. Code § 9-08-06.

A sale of business exemption is a *sine qua non* for sound regulation of non-compete agreements. In addition to our own Court of Appeals in *Purchasing Assocs., Inc., cited above*, the California Court of Appeals has stated that:

> "[i]n the case of the sale of the goodwill of a business it is 'unfair' for the seller to engage in competition which diminishes the value of the asset he sold."

Monogram Indus., Inc. v. Sar Indus., Inc., 64 Cal. App. 3d 692, 69 (Ct. App. 1976). And even in states in which non-compete agreements are limited under case law rather than by statute, the need for such restrictions in the sale of business is recognized. For example, the 11th Circuit has held that, under Georgia law, while restrictive covenants are generally analyzed with strict scrutiny in connection with employment, restrictive covenants in connection with the sale of a business are reviewed using only a low level of scrutiny. *Mohr v. Bank of New York Mellon Corp.*, 371 Fed.Appx. 10, *5 (11th Cir. 2010) (*citing White v. Fletcher/Mayo/Assocs., Inc.*, 251 Ga. 203, 204-07, 303 S.E.2d 746, 748-50 (1983). As the *Mohr* court noted, quoting *Russell Daniel Irrigation Co. v. Coram*, 237 Ga.App. 758, 759, 516 S.E.2d 804, 805 (Ct.App. 1999):

> "The business seller is receiving substantial consideration for the business he has built up, the value of which would be significantly diminished to the buyer if he were allowed to compete in the same market."

Conclusion and Recommendation

For the foregoing reasons, the New York State Bar Association's Business Law Section **OPPOSES** the passage and enactment of this legislation in its current form, and urges Governor Hochul to **VETO** the legislation, with a request to the Legislature to include an exception for non-compete agreements in the context of the sale of a business.

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