New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM
An ALM Publication
VOLUME 251—NO. 60
MONDAY, MARCH 31, 2014

EMPLOYEES IN THE WORKPLACE

Expert Analysis

New York's Post-Employment Restrictions Limit Mobility

By
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Silicon Alley—the hub of New York City's burgeoning high technology industry—has begun to boom. According to a recent report commissioned by former Mayor Michael Bloomberg, New York's tech and information sector employed 262,000 workers in 2013 and paid out wages totaling more than $30 billion.[1] That reflects an increase between 2007 and 2012 in the amount of wages in the sector of $5.8 billion, according to the Bureau of Labor Statistics Research. All told, this industry is the city's second largest contributor to private wages—trailing behind only the financial services industry. After years of growth following the burst of the dotcom bubble in 2001, Silicon Alley has come into its own, and now stands alongside Massachusetts' Route 128, North Carolina's Research Triangle, and California's Silicon Valley.

As a result of that growth spurt, and since the economic crisis of 2008, tech has become New York's second largest job sector behind financial services. However, the city's tech industry, now is its second phase of success and expansion, is once again at risk of losing its momentum and lagging behind other states because New York law allows employers to routinely impose onerous post-employment restrictive covenants[2] on the activities of their employees.

A growing body of economic and legal research is coming to a consensus that widespread use of post-employment restrictive covenants has unintended consequences, the most important of which is the hampering of economic growth through the stifling of employee mobility and technological development at a regional level. Employers generally assume that restrictive covenants are necessary to protect their business interests, but given this growing body of research, business leaders must ask themselves a difficult question: Are restrictive covenants bad for business?

If our intellectual property laws already protect what is truly proprietary and we have both criminal and civil laws against misappropriation of trade secrets, do we need to contract with employees or in most cases unwillingly impose through one-sided agreements restraints on employees that serve to prevent the free flow of information, know-how, and employee mobility? Rather, numerous studies have shown that Increased employee mobility will encourage spillovers creating new patents, spinoffs, new businesses, and an infusion of venture dollars that could give New York's tech community the competitive edge it needs to continue growing robustly throughout the 21st century.

Effects on Business

The business community generally assumes that post-employment restrictions are necessary to promote employer investment in training, development and research. However, this assumption has been challenged by leading economists and legal academics since 1994,[3] and most recently by Professors On Amir and Orly Lobel. In their Stanford Technology Law Review article "Driving Performance: A Growth Theory of Noncompete Law"[4] they examine the effects of noncompetes upon macro-level employee mobility over time and discuss how post-employment restrictions can affect motivational levels and behavior of talent. Ron Gilson, a professor of law and business at Stanford, first raised these issues when he hypothesized that Silicon Valley outgrew Route 128 because of the differential enforcement of noncompetes.

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While Massachusetts had an edge over Silicon Valley in its tech industry early on, in its second phase of development, California's non-enforcement of noncompetes encouraged the creation of spinoffs in Silicon Valley and Route 128's talent moved west.[5] Other studies have also linked relative enforcement of restrictive covenants to levels of venture capital funding and applications,[6] showing both patterns of increased investment in states that do not enforce post-employment restrictions and the increased number of patents and growth of entrepreneurial and start-up activities in these regions.[7] Ultimately Amir and Lobel conclude that regions which employ weaker controls over human capital—and hence over employee mobility—have more dynamic growth in patents, entrepreneurship and market growth.[8]

Other scholarly articles on this subject challenge both the principles of freedom to contract and freedom of competition by examining the inconsistent and unpredictable case law that has arisen among different states that enforce post-employment restrictive covenants. For instance, jurisdictions vary widely in the consideration required for an enforceable noncompete or other restrictive covenant. Recently the Appellate Court of Illinois held in *Fifield v. Premier Dealer Services*, that a nonsolicit or noncompete is only enforceable against an employee if the employee continues working for the employer for at least two years after signing the covenant. 993 N.E.2d 938 (Ill. App. 2013) appeal denied, 996 N.E.2d 12 (Ill. 2013).

Other states, like New York and Colorado, consider continued employment of an at-will employee for any length of time after signing to be adequate consideration. See *Lucht's Concrete Pumping v. Horner*, 255 P.3d 1058 (Colo. 2011); *Zellner v. Stephen D. Conrad, M.D., P.C.*, 589 N.Y.S.2d 903 (2d Dept. 1992). Still other states require consideration independent of continued employment alone. See *Midwest Sports Marketing v. Hillerich & Bradsby of Canada*, 552 N.W.2d 254 (Minn. Ct. App. 1996); *Insulation Corp. of Am. v. Brobston*, 667 A.2d 729 (Pa. Super. 1995).

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Such variances call into question whether such agreements ever actually represent any meeting of the mind, making it easy to understand the litigation that flows from efforts to enforce such agreements.[9] Rutgers law school professor Alan Hyde makes the point that since employers and employees are free to contract for compensation and benefits, why can't they contract for post-termination restrictions without any court-imposed standard of reasonableness?[10] Reasonableness, as described below, of course, being the standard that New York courts apply when considering whether such restrictions are enforceable.

Citing numerous studies in this area, Hyde also states that information in the public domain is best disseminated by mobile employees and that restrictions upon employee mobility between competitors stop the free flow of information.[11] Such restrictions also stymie collaboration across companies and therefore stifle flexibility and growth, particularly in the technology industry, where new information leads to patents, start-ups and spillovers.[12]

Additionally, other states have successfully adopted approaches that sensibly balance the protection of employer interests against the growing need for employee mobility without restrictive covenants. For example, California and Colorado consider almost all noncompetes void as a matter of public policy,[13] and other states have begun to introduce legislation to restrict noncompetes with the explicit goal of creating a business environment that fosters information-sharing and innovation.[14] In September 2013 the governor of Massachusetts voiced his support for legislation that would outright eliminate noncompetes in the state, voicing concerns that they continue to stifle the growth of innovative businesses.[15]

New York

On the opposite spectrum, New York employers currently have a variety of legal tools to easily restrict employee movement, including the doctrine of inevitable disclosure and a legal regime that routinely enforces restrictive covenants against employees. While restrictions on trade were generally unenforceable at common law, New York courts have gradually created an expanse of exceptions with the goal of protecting employer interests.

Courts generally will enforce a noncompete if it (1) is reasonable in time, duration, and geographic scope, (2) is no greater than required to protect a legitimate business interest of the employer, (3) does not impose undue hardship on the employee, and (4) does not injure the public at large.[16] This inquiry is heavily fact-intensive, so courts necessarily review the reasonableness of each noncompete on a case-by-case basis. Additionally, under the doctrine of inevitable disclosure, a court may enjoin an employee who is not subject to a noncompete but where the court finds that the employee will inevitably disclose trade secrets to a new employer because of the nature of the employee's position.[17]

Cases in the past 15 years have seen a meteoric rise in the prevalence of overbroad restrictive covenants, over inclusive confidentiality provi-

sions and absurdly long durations of time for soliciting employees or clients—virtually turning them into noncompetes. See *Jay's Custom Stringing, Inc. v. Yu*, 01 Civ..1690, 2001 WL 761067, at *3 (S.D.N.Y. July 6, 2001) (employee's broad confidentiality covenant "effectively barred him from working as a tennis racket technician anywhere in the world for a period of two years"); *EarthWeb v. Schlack*, 71 F.Supp.2d 299, 307-11 (S.D.N.Y 1999) (broad reading of confidentiality provision would effectively expand scope of noncompete and "indenture" employee to employer).

The majority of written employment agreements in New York now contain such provisions and not surprising, in recent years the amount of nationwide litigation related to noncompetes has nearly doubled, as companies and employees struggle over enforcement.[18] Even many employees who otherwise do not have written employment agreements or any protections against arbitrary termination without cause are bound to restrictions; having signed them the first day of employment—or risk not starting at the job—usually with no time to review or seek legal advice.

The Internet further complicates enforcement of restrictive covenants during or post employment, particularly restrictions on shared information after the advent of social media and the proliferation of tweeting, blogging and other shared sites. The concept of secrecy has been redefined in the workplace, and in many respects so has the scope of what information counts as proprietary.[19] Changes in the way business information is created, stored, used and shared have made confidentiality an increasingly difficult obligation to enforce. Sadly, this has not stopped companies from continuing to try to punish employees who disobey the rules.[20]

The ultimate goal of a restrictive covenant is to restrict an employee's post-employment ability to work for a competitor, solicit the employer's clients and employees, or start a competing business. The question is: to what end? In states where post-employment restrictions are not enforced, and in many European countries for example, employers are forced to assess their vulnerability and contract against the risk of losing talent and information. That may mean offering the employee more money to stay or paying the employee not to compete, but those are contractual and economic issues businesses often face when times are good–when business is booming and competition is healthy. The employer still has the deep pocket advantage as well as a relationship with the employee, which again speaks to the value of human capital retention. On the other hand, even if the law does not enforce against the ability to leave the job and go across the street to a competitor, trade secret laws, copyright protection and federal antitrust laws have been promulgated to prevent "unfair competition,"[21] not to stifle growth and development in a region.

Conclusion

While Silicon Alley has experienced strong growth these last few years, it risks becoming like Route 128 if New York continues to follow Massachusetts' example. However, if New York adopts California's zero tolerance approach to noncompetes, New York may see a significant upsurge in the amount of venture capital investment and industry growth in Silicon Alley. In addition, litigation would decrease and employees could spend more productive time creating and inventing—as opposed to defending themselves in injunctions. It is difficult to overstate the potential economic benefits of such a move—an outright ban on noncompetes in New York could, as it has in California, result in more patenting, more start-ups, and more high-income jobs.

1. Conference Report, Michael Mandel, Bloomberg Technology Summit, Building a Digital City: The Growth and Impact of New York City's Tech/Information Sector (Sept. 30, 2013), http://www.mikebloomberg.com/files/buildingadigitalcity.pdf.

2. For the sake of simplicity, this article uses "restrictive covenant" as an umbrella term that encapsulates a variety of post-employment covenants whose primary effect are to impose post-employment obligations on an employee. Such covenants include, for example, covenants not to compete, covenants that forbid solicitation of other employees, and no-hire agreements.

3. See ANNALEE SANEXIAN, REGIONAL ADVANTAGE: CULTURE AND COMPETITION IN SILICON VALLEY AND ROUTE 128 (1994) (discussing how varying business-cultural and organizational approaches led to developmental differences between the two areas).

4. On Amir and Orly Lobel, "Driving Performance: A Growth Theory of Noncompete Law," 16 STAN. TECH. L. REV. 833 (2013).

5. Ronald J. Gilson, "The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete," 74 N.Y.U. L. REV. 575, 629 (1999).

6. Samila Sampsa and Olav Sorenson, Non-compete Covenants: Incentives to Innovate or Impediments to Growth (October 5, 2010), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1411172.

7. On Amir and Orly Lobel, "Driving Performance: A Growth Theory of Noncompete Law," 16 STAN. TECH. L. REV. 833, 859-61 (2013).

8. See id. at 857-61.

9. See generally Alan Hyde, "Should Noncompetes Be Enforced?" REGULATION, Winter 2010-2011, 6.

10. See id. at 7.

11. See id. at 9.

12. See id.; see also Paul Almeida and Bruce Kogut, "Localization of Knowledge and the Mobility of Engineers in Regional Networks," 45 MGMT. SCI. 905, 907-08, 916 (1999).

13. See *Edwards v. Arthur Andersen LLP*, 189 P.3d 285, 288-89 (Cal. 2008) (citing CAL. BUS. & PROF. CODE §16600 (West 2008)) (California); Colo. Rev. Stat. Ann. §8-2-113 (West) (Colorado).

14. Hearing Before the Massachusetts Joint Committee on Labor and Workforce Development (Sept. 10, 2013) (Statement of Gregory Bialecki, Secretary of Housing and Economic Development, Commonwealth of Massachusetts), available at http://www.boston.com/business/technology/innoeco/9-10-2103Testimony.pdf.

15. Id.

16. See *Reed, Roberts Assocs. v. Strauman*, 40 N. Y. 2d 303, 307 (1976); *BDO Seidman v. Hirshberg*, 93 N.Y.2d 382, 389 (1999).

17. See, e.g., *Doubleclick v. Henderson*, No. 116914/97, 1997 WL 731413, at *4-*6 (Sup. Ct. N.Y. County Nov. 7, 1997); *Wenner Media v. N. & Shell N. Am.*, No. 05 Civ. 1286, 2005 WL 323727, at *4 (S.D.N.Y. Feb. 8, 2005); *Global Telesystems v. KPNQwest*, 151 F.Supp.2d 478, 482 (S.D.N.Y. 2001); *Lumex v. Highsmith*, 919 F.Supp. 624, 631 (E.D.N.Y. 1996); *IBM Corp. v. Papermaster*, No. 08 Civ. 9078, 2008 WL 4974508, at *7-*10 (S.D.N.Y. Nov. 21, 2008); *Am. Airlines v. Imhof*, 620 F.Supp.2d 574, 581–83 (S.D.N.Y. 2009).); *Janus et Cie v. Kahnke*, No. 12 Civ. 7201, 2013 WL 5405543, at *2-*4 (S.D.N.Y. Aug. 29, 2013).

18. Russell Beck, "Trade Secret and Noncompete Survey—National Case Graph" 2013, FAIR COMPETITION LAW, (Jan. 6, 2013), available at http://www.faircompetitionlaw.com/2013/01/06/trade-secret-and-noncompete-survey-national-case-graph-2013-preliminary-data.

19. See *Sasqua Grp. v. Courtney*, No. 10 Civ. 528, 2010 WL 3613855, at *22 (E.D.N.Y. Aug. 2, 2010), report and recommendation adopted, No. 10 Civ. 528, 2010 WL 3702468 (E.D.N.Y. Sept. 7, 2010) (held employer's client database contained readily ascertainable information not protectable as a trade secret due to "the exponential proliferation of information made available through full-blown use of the Internet").

20. See, e.g. *EarthWeb*, 71 F.Supp.2d 299; *Sasqua Grp*, 2010 WL 3613855; *Doubleclick*, 1997 WL 731413..

21. The concept of "unfair competition" is difficult to define. For example, New York insurance laws define the term as, in addition to a number of enumerated acts, "any unfair method of competition or any unfair or deceptive act or practice." N.Y. INS. LAW §2402 (McKinney 2014).