Suddenly noncompetes and trade secrets are public policy issues. Congress is moving ahead with the first federal trade secrets statute—the Defend Trade Secrets Act. Its interplay with state laws governing employment agreements will be a hot topic. Several states have adopted new noncompete statutes. Worried its tech industry is falling behind Silicon Valley, Massachusetts nearly adopted California's prohibition on noncompetes before conceding to opposition from more traditional corporate employers. Economists and law professors are engaged in a rich theoretical and empirical exploration of the impact of noncompetes on economic growth and innovation. And New York Attorney General Eric Schneiderman is reportedly investigating employers' use of noncompetes for junior employees in the media and food services industries.¹

New York's policy on employee mobility is set through thousands of commercial disputes involving noncompetes, trade secrets, and fiduciary duties decided on a case-by-case basis. So, how is New York's judge-made common law of employee mobility evolving in light of the economic policy questions raised in the broader debate?

Noncompetes are pervasive

Let's start with the data. Eighty percent of public company CEOs have noncompetes; 76 percent of CEOs have nonsolicitation of employee covenants; 51 percent have customer nonsolicit clauses; and 87 percent have nondisclosure agreements. Half of all technical professionals—patent holders and engineers—have noncompetes. Reported decisions in noncompete and trade secret cases have tripled over the past 15 years, exceeding 3,000 decisions nationally in 2014. Unreported preliminary motions, settlements and arbitrations drive that number higher many times over.²

The prevalence of noncompetes in lower-level "rank and file" positions is harder to gauge. But noncompetes in certain job categories—such as sandwich-workers at a chain restaurant—have gotten the attention of government officials, including Schneiderman. New York law is supposed to protect only trade secrets, customer goodwill in certain situations, or "unique" employees. It has become cost-prohibitive for many companies to enforce "rank and file" noncompetes before skeptical judges. Yet the in terrorem non-litigated impact they may have in the work force is certainly a legitimate policy concern.

Economic impacts

What is the economic impact of all these restrictive covenants and enforcement litigations? Are they protecting corporate intellectual property and human resources investments to enhance growth? Or, are they an impediment to entrepreneurial mobility and the spillover innovation that fosters breakthrough growth in the emerging economy?

The debate crystallized around comparisons of the rates of growth of California's Silicon Valley versus Massachusetts's Route 128 tech corridor. Silicon Valley's high-velocity employment market in which knowledge spillover fuels inventions and second-stage spin-offs has become the stuff of legend. Diasporas from Fairchild Semiconductor, Google and other breakthrough companies have generated successive generations of creative growth and wealth. One theory is that California's statutory ban on noncompete agreements has fostered an entrepreneurial culture of spin-offs, start-ups and innovation.

In Massachusetts, by contrast goes the theory, where noncompetes are enforceable, they have become a barrier to entry for second-stage entrepreneurs and technology career paths have instead resembled more traditional, industrial patterns...
emphasizing internal vertical mobility and career loyalty within firms.³

This "California effect" theory buttressed by studies attempting to empirically document it were used by the venture capital industry, with the support of former Governor Deval Patrick, in coming close to passing legislation prohibiting noncompetes in Massachusetts in 2014.

Everything has consequences, of course, including California's statutory ban on using employment contracts to regulate employee mobility. The U.S. Department of Justice prosecuted numerous California companies for antitrust violations arising from agreements among employers not to hire from competitors, with class-action settlements following on in the nine-figure range.⁴

Federal Trade Secrets Act

California's policy on employee mobility is an outlier among the large business center states. At the same time as some advocates and industries seek to replicate California, there is also strong movement in the opposite direction. Corporate concerns over trade secrets theft and economic espionage are driving legislation that would, for the first time, create federal protections—and private rights of action—against trade secret misappropriation. The Defend Trade Secrets Act, with significant sponsorship in both houses of Congress, has been approved by the Senate Judiciary Committee.⁵ The bill creates expedited procedures for seizures to protect trade secrets from misappropriation, akin to ex parte seizure provisions in the Trademark Act. Yet most litigated trade secret matters arise from the employment context. The interplay of this federal legislation with existing state laws regarding noncompetes, will be a substantial issue during the legislative process and the interpretive litigation that will inevitably follow.

The Senate Judiciary Committee has amended the bill in an attempt to accommodate California's statutory prohibition against noncompetes. The version of the legislation approved in the committee permits for trade secrets injunctions in proceedings to be brought under the legislation so long as such injunctions do not:

(I) prevent a person from entering into an employment relationship, and that conditions placed on such employment shall be based on evidence of threatened misappropriation and not merely on the information the person knows; or

(II) otherwise conflict with an applicable state law prohibiting restraints on the practice of a lawful profession, trade, or business.

The House Judiciary Committee has yet to act on the issue.⁶

No doubt every litigator and jurist reading the Senate amendment can foresee the wealth of litigation this language will spawn. Parsing when a federal claim for a trade secrets injunction conflicts with a state's restrictive covenants law, and what injunction measures will be so restrictive as to effectively prevent a person from entering into an employment relationship, will require courts to be much more attuned to distinctions between the trade secrets that will now be subject to federal statute and the range of categories of confidential information often protected by noncompetes and other restrictive covenants. As the U.S. Court of Appeals for the Sixth Circuit noted in November, "a nondisclosure agreement prohibiting the use and disclosure of particular information can clarify and extend the scope of an employer's rights' beyond the protections afforded by trade secret statutes."⁷

Common Law and Change

New York's common law is more than keeping up with changing economic times and work force development. New York's courts have gone a substantial way toward mitigating the negative economic policy consequences that noncompetes arguably can cause. The appellate courts have afforded the Commercial Division justices who live and breathe these cases with more refined and flexible tools to decide disputes in keeping with the equities and economic realities.

As New York's economy has become increasingly oriented to the FIRE industries (Finance, Insurance, Real Estate), and the high-end providers of professional services who increasingly characterize that sector become more mobile, our courts are emphasizing and protecting the efforts and relationships that originate a customer relationship. This permits entrepreneurs to port their own books of business while companies can protect their institutional clientele from departing employees.

All told, noncompetes remain enforceable in New York, but only when unique or extraordinary company investments and customer relationships or trade secrets are at stake. Absent those legitimate interests, New York law tends to favor entrepreneurial competition.
The appellate case law over the past two decades shows a clear evolution toward an entrepreneurial model of employee mobility law that balances trends in the work force with appropriate protections for the investments of New York's corporate community.

**Protecting Entrepreneurial and Institutional Customer Relationships.** New York law has not traditionally recognized the protection of customer relationships alone, without more, as a legitimate interest for enforcing noncompetes. In a pair of concurrent but unrelated decisions in the spring of 1999, the U.S. Court of Appeals for the Second Circuit and the state Court of Appeals created a set of rules that protect customer relationships and the goodwill derived from meaningful business development efforts.

In *Ticor Title Ins. v. Cohen*, the Second Circuit enforced a short, post-employment noncompete to protect an employer's legitimate interest in long-standing, deeply rooted company customer relationships against solicitation by a former employee. The Second Circuit applied New York's long-standing "unique employee" doctrine supporting enforcement of noncompetes against employees with unique skills or market status. The court noted that the employee "enjoyed exclusive responsibility for key [company] accounts throughout the entire term of his employment, and no other [company] sales representative was permitted to service them during the term of the Employment Contract."8

Six weeks later, the New York Court of Appeals distinguished institutional customer relationships, of the sort the Ticor court had protected, from entrepreneurial relationships—namely, the book of business of accounting customers that the defendant accountant had brought with him to the plaintiff firm. The court held that those relationships belonged, in essence, to the former employee and not the employer firm. In *BDO Seidman v. Hirshberg*, the state high court held that an accounting firm's clause requiring an ex-employee to share fees from former clients should be determined by considering the enforceable "goodwill of a client or customer, which had been created and maintained at the employer's expense" and the unenforceable "personal clients of defendant who came to the firm solely to avail themselves of his services and only as a result of his own independent recruitment efforts."9

**Partial Enforcement to Protect Only Legitimate Interests.** The Court of Appeals instructed New York courts in *BDO Seidman* to sever unenforceable provisions and to enforce other valid provisions when an employer "has in good faith sought to protect a legitimate business interest, consistent with reasonable standards of fair dealing."10 This affords judges discretion and flexibility to strike an equitable balance by rejecting employer overreach while still enforcing against employee unfair competition.

**Employee Choice Doctrine.** The Second Circuit again emphasized fairness in employee mobility law in *Morris v. Schroder Capital* by holding that when employees decide between receiving post-employment benefits—i.e., deferred compensation—or forfeiting the benefit and competing, a post-employment restrictive covenant is not an "unreasonable restraint upon an employee's liberty to earn a living." But, when an employer terminates an employee without cause, there is no mutuality of obligation and a restrictive covenant may not be enforced.11

**Public Policy Limits on Enforcement.** Most recently, the Court of Appeals struck a noncompete governed by a Florida choice of law provision because of that state's "nearly-exclusive focus on the employer's interest…and refusal to consider the harm to the employee."12 Here, too, New York law requires balance between employer and employee interests—and New York courts cannot vary from that requirement even to apply a contractual foreign choice of law clause.

**Rank and File Employees.** The issue of overreach in enforcing noncompetes against junior or lesser-skilled employees would not seem to be much of a problem under New York law. There is a wealth of precedent, including two Court of Appeals decisions, holding that absent trade secrets, noncompetes cannot be enforced against employees who do not provide unique or extraordinary services. These employees, however, can least afford to litigate and for the companies hiring them, challenging noncompetes may not be worth it.13

By one business school professor's careful reckoning, New York was the 35th ranking state in terms of strength of enforcement in 1991. Following the developments outlined above, New York dropped to 42nd place.14 However assessed, New York's law of employee mobility may not be simple or certain, but it is thoughtful, flexible and market-oriented.

So, while other states, Congress and commentators debate wholesale, bright-line statutory rules derived from economic theory, New York's market-oriented, common law of employee mobility is actually out front on these issues, striking a careful and appropriate balance that permits the commercial court judges who decide most of these cases the discretion and flexibility to strike an appropriate balance. The subtlety and case specific applications of the common law are proving to be more adaptable and equitable than statutory bright-lines for the law and policy of employee mobility in a changing work force.
Endnotes:


8. 173 F.3d 63, 67 (2d Cir. 1999) (emphases added). The author was the second chair attorney representing the plaintiffs in the case.


10. Id. at 394.


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John Siegal is a partner at BakerHostetler. Anat Maytal, an associate at the firm, assisted with research for this article.