Simpson Thacher

Memorandum

Federal and State Officials Increase Scrutiny of Non-Compete Agreements

July 7, 2016

New York Attorney General Eric T. Schneiderman (the "NYAG") recently announced the resolution of separate inquiries into two employers' alleged misuse of employee non-compete agreements. The NYAG's June 2016 settlements with legal publisher Law360 and sandwich chain Jimmy John's come against a backdrop of heightened scrutiny of non-compete agreements by both federal and state agencies, particularly with respect to employers' use of restrictive covenants for low level employees. Within the last several months, the Illinois Attorney General filed a lawsuit against Jimmy John's over its use of non-competes, and the U.S. Treasury Department's Office of Economic Policy and the White House each published a critical report discussing the adverse economic impact on the workforce of non-compete agreements and related issues.

The enforceability of non-compete agreements generally is governed by state law, which varies among jurisdictions. Although non-compete agreements generally are disfavored by courts, some form of non-compete is permissible in most states provided the agreement furthers a legally protectable business interest and is reasonable in scope, including any geographical and temporal restrictions. With that context, the recent enforcement actions of the NYAG and Illinois Attorney General do not represent attempts to change or expand the law governing non-competes in their respective states. Rather, these actions enforce existing legal principles against the use of agreements which those state officials believe are clearly unenforceable as a matter of law.

NYAG Settlement with Portfolio Media, Inc./Law360

On June 14, 2016, the NYAG entered into an Assurance of Discontinuance ("AOD") with Portfolio Media, Inc., the parent company of legal news publisher Law360, requiring Law360 to stop asking most of its editorial employees to enter into non-compete agreements as a condition of their employment. The NYAG investigated Law360's requirement that all "senior staff" and editorial staff sign a non-compete. The NYAG

found that Law360's non-compete agreements with lower level editorial staff were unenforceable under New York law because these employees do not have access to competitively sensitive information. The NYAG's position in this investigation was not that Law360 had violated any specific law by entering into the agreements, but that workers seeking to change jobs should not be burdened with the fear of being sued for breaching an unenforceable agreement. The AOD requires Law360 to send a notice to covered current and former employees who entered into non-competes advising them that the agreements are not enforceable, and to stop entering into such agreements with lower level editorial employees in the future. The AOD does not restrict Law360's ability to enter into non-compete agreements with various non-editorial senior staff members, and certain senior editorial employees including the Editor in Chief, Managing Editor, and Graphics Chief.

NYAG Settlement with Jimmy John's

On June 16, 2016, just two days after entering into the Law360 AOD, the NYAG entered into a letter agreement with Jimmy John's sandwich chain requiring Jimmy John's to confirm that it has stopped providing its form non-compete agreement to franchisees operating in New York State. Until late 2014, Jimmy John's provided its franchisees with sample forms of non-compete agreements, which a number of the franchisees then used with employees under the impression that Jimmy John's required them to do so. Some of these agreements prohibited workers from working for (a) any other business that makes more than ten percent of its revenue from selling sandwiches and is located within a two mile radius of a Jimmy John's Sandwich Shop nationwide, for a period of two years following the end of their employment, and (b) another Jimmy John's franchise for a period of one year following the end of their employment.

The NYAG found that Jimmy John's non-compete agreements placed an unreasonable restraint on employees who were unlikely to have access to competitively sensitive information or unique skills, and that they were not reasonably limited as to time and geographic scope. The settlement letter states that the NYAG reached separate agreements with Jimmy John's' individual franchisees to discontinue the use of those agreements, but is also requiring Jimmy John's to (i) confirm that it has discontinued offering the sample agreements, (ii) notify franchisees that the NYAG found the agreements to be unenforceable, and (iii) remove any sample non-compete agreements from its operations manual.

Illinois Attorney General Lawsuit Against Jimmy John's

On June 8, 2016, Illinois Attorney General Lisa Madigan (the "IAG") sued Jimmy John's, seeking to have Jimmy John's' non-compete agreements declared unenforceable under Illinois law and an injunction against continued or future use of the non-competes in Illinois. The IAG's lawsuit also alleges that Jimmy John's' imposition and use of broad non-competes on employees, including at-will, low wage employees such as sandwich makers and delivery drivers, violated Illinois' Consumer Fraud and Deceptive Business Practices Act. In connection with the IAG's unlawful business practices claim, the IAG is seeking restitution, disgorgement, civil penalties, and the costs of investigation and prosecution. This matter remains open.

U.S. Treasury and White House Reports on the use of Non-Competes

On March 31, 2016, the U.S. Department of the Treasury's Office of Economic Policy published a report stating that nearly one-fifth of all American workers are currently bound by a non-compete agreement. The Treasury's report acknowledges that non-compete agreements can produce important benefits, including the protection of trade secrets and incentivizing employers to provide training. But the report also concludes that non-competes are sometimes overused, are implemented in non-transparent ways, and may contain overbroad provisions. Ultimately, the Treasury offers several broad recommendations intended to "minimize the harms associated with non-compete agreements." These recommendations do not have any legally binding effect.

On May 5, 2016, the White House released its own report on non-competes, which summarizes and draws from the Treasury's report to provide "an overview of the research on the prevalence of non-competes, evidence of their effects, and examples of actions states are taking to limit the use and enforcement of unnecessary non-competes." According to the report, the White House plans to work together in the coming months with the Treasury Department and the Department of Labor to convene a working group to further study the impact of non-competes and identify key areas and make recommendations where the Administration believes state-level reform is needed.

In light of the level of attention currently being paid to employee non-competes and these recent state-level enforcement activities, employers may consider it an appropriate time to review their existing non-compete arrangements to determine whether they are truly needed, in terms of the covered population of employees (considering issues such as the employees' bargaining power, compensation, and access to trade secrets), and the reasonableness of the geographic restrictions and duration. In doing so, note that "less can be more" in terms of supporting enforceability and avoiding governmental investigations.

If you have any questions or would like additional information, please do not hesitate to contact any of the below-referenced members of our Labor and Employment Practice or Executive Compensation and Employee Benefits Practice Groups.

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