A Heads-Up on Employment Issues Confronting the Hedge Fund and Private Equity Industries

Akin Gump
STRAUSS HAUER & FELD LLP

The New York Attorney General's Crackdown on Non-Compete Agreements: What It Means for Investment Managers

July 29, 2016

Contact

Richard J. Rabin
Partner
rrabin@akingump.com
New York
+1 212.872.1086

Lauren Helen Leyden
Partner
lleyden@akingump.com
New York
+1 212.872.8172

R.D. Kohut
Senior Counsel
rkohut@akingump.com
New York
+1 212.872.7488

Anastasia Marie Kerdock
Counsel
akerdock@akingump.com
New York
+1 212.872.7432

Desiree E. Busching
Counsel
dbusching@akingump.com
New York
+1 212.872.1061

Key Points

- To the surprise of many, the New York Attorney General (NYAG) has become active in challenging non-compete agreements entered into between companies and their employees.
- The NYAG's initiative further complicates companies' efforts to enforce restrictive covenants.
- Firms should review their use of non-compete clauses and assess whether changes are advisable in light of these developments.

Background

Last month, the NYAG turned quite a few heads by entering into a new legal arena: challenging non-compete agreements between companies and their employees. The NYAG settled two investigations brought pursuant to Section 63(12) of the New York Executive Law, which authorizes the NYAG to investigate and redress "unconscionable contractual provisions."

First, on June 15, 2016, the NYAG announced a settlement with Law360, a prominent legal news outlet, restricting Law360's use of non-compete agreements with members of its editorial staff. Before the settlement, Law360 required all of its editorial employees to sign agreements preventing them from working for a "direct competitor" for one year after leaving the company. Under the settlement agreement, Law360 will no longer include non-compete provisions in its agreements with most editorial staff members, and it will alert former employees who left the publisher in the past year that their non-compete provisions will not be enforced.

Second, on June 22, 2016, the NYAG announced a settlement with Jimmy John's Gourmet Sandwiches ("Jimmy John's"). Under the settlement, Jimmy John's franchisees based in New York will cease requiring Jimmy John's sandwich makers to sign non-compete provisions in connection with their employment and will void all such

agreements currently in effect. Jimmy John's also will cease including sample non-compete agreements in the hiring packets that it sends to franchisees, and it will alert franchisees that the NYAG believes that such clauses are unlawful.

The NYAG's announcements come at a time when non-compete arrangements are under increasing scrutiny nationwide, following reports by both the U.S. Treasury Department and the White House regarding the purported anticompetitive nature of such provisions and the degree to which they "hurt worker welfare, job mobility, business dynamics, and economic growth more generally." Several states have introduced legislation to prohibit non-compete arrangements, and at least one other state attorney general has initiated litigation challenging the use of such provisions.

Takeaway

The NYAG's newfound interest in non-compete provisions is a significant development. Many investment managers require employees to assent to non-compete provisions as a condition of employment, and the prospect of a NYAG investigation into such practices—or, worse, litigation with the NYAG over such provisions—is disconcerting at best. While the enforceability of restrictive covenants always has been subject to legal challenge, litigating against a former employee is an entirely different proposition than litigating against the State of New York. Investment managers should monitor the NYAG's actions in this area and take added care in drafting, negotiating and enforcing non-compete provisions.

At the same time, there are several reasons to doubt that the NYAG's initiative will significantly impact the hedge fund or private equity industries:

First, the NYAG's efforts to date have focused on non-compete agreements with lower-level employees, whom the NYAG claimed had "little to no knowledge of any trade secrets or confidential information." The investigations of Law360 and Jimmy John's were led by the NYAG's Labor Bureau, whose principal focus is the enforcement of laws protecting low-wage workers. In each case, the NYAG abstained from challenging the use of non-compete provisions in contracts with certain senior personnel who were more likely to have access to confidential information and trade secrets.

At many hedge funds and private equity firms, the use of non-compete provisions is limited to more senior personnel who **do** have access to confidential information. These provisions typically apply to members of an investment manager's investment team—such as its portfolio manager(s), analysts, traders and investor relations personnel—and/or to senior members of the investment manager's back-office team.

Second, the high burden of proof applicable to actions under the Executive Law hopefully will deter overreaching by the NYAG's office. To prevail in such an action, the NYAG has to prove not only that a particular non-compete provision is unenforceable as a matter of law, but that it is so far out of bounds as to be "unconscionable." So long as an investment manager is reasonable, and has a good-faith basis for the inclusion of a non-compete provision, the NYAG should have a difficult time establishing a viable claim.

© 2018 Akin Gump Strauss Hauer & Feld LLP

Last, it bears noting that, at least to date, the NYAG has challenged only non-compete provisions and has not sought to challenge other restrictive covenants, such as provisions prohibiting the solicitation of a company's employees or investors. Many investment managers rely largely on such non-solicitation provisions to protect their interests. Absent an expansion of the NYAG's current initiative, the use of such non-solicitation provisions will remain outside of the NYAG's focus.

We are available to further discuss these matters, and the potential impact on your firm, at your convenience.

© 2018 Akin Gump Strauss Hauer & Feld LLP