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Non-Compete Clauses: Uses and Enforceability

In a global climate where it is common for people to hold a multitude of different occupations and work in different locations throughout a lifetime, corporations continue to make efforts to protect business interests even after an employee leaves their company. Importantly, despite even the best employee leaving on good terms, a former employee could potentially become a direct competitor, solicit clients, and use a company's trade secrets. Protecting the corporate interest can depend on the ability to enforce a non-competition clause.

A non-competition clause, or non-compete clause, is a restrictive covenant that endeavors to prevent the employee from becoming a direct competitor of the employer upon departure from a company. Certain restrictive covenants specifically bind the employee by limiting employee's ability to work in a certain geographic location, or for a specified amount of time, or within a certain field and with certain clients.

Not all non-compete clauses are enforceable. In fact, non-compete clauses are generally unpopular and are met with reluctance in the court system.¹ A non-compete clause has the negative effect of limiting a person's ability to work, thus it is scrutinized carefully. Corporations must carefully consider the parameters of the non-compete clause as too many limitations on the former employee may prove ineffective.

To find a non-compete clause valid and therefore enforceable, New York courts apply a three-part reasonableness test. The general rule to determine if an employee's non-competition clause is enforceable is if, "(1) it is no greater than is required for the protection of the legitimate interest of the employer, (2) does not impose undue hardship on the employee, and (3) is not injurious to the public."² Therefore, reasonableness varies and the court will look at all the case specifics before making a determination of law. To be effective, the non-compete agreement should mirror this reasonableness standard.

First, the non-compete agreement should outline the corporation's legitimate business interest. The United States District Court for the Southern District of New York has considered that an employer's legitimate interest is 1) to prevent disclosure of trade secrets or employee/client solicitation, 2) to prevent disclosure of private client information, or 3) where employee's skill and service is considered "special or unique."³ Sometimes, New York courts determine that the restrictive covenant is unnecessary and therefore the non-compete clause is ineffective. For example, in *Last v. New York Institute of Technology*, a doctor signed an anti-competition clause stating he would not work within 10 miles of the clinic where he was assigned to work.⁴ The doctor was fired after refusing to relocate elsewhere with the clinic, and he remained in the area seeing patients. Despite signing an anti-competition clause and still practicing in the same area, the Second Judicial Department determined that



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since that employer relocated it was not in the employer's "legitimate interest" to prevent clients in the local area from receiving treatment from the doctor.

In other cases, however, New York courts have found a significant and legitimate employer interest that warrants upholding the non-compete clause. According to the Restatement Third of Employment Law § 8.07, restrictive covenants may be valid in order to protect employer's interests such as trade secrets or the misappropriation of client information.⁵ For example in *Ticor Title Ins. Co. v. Cohen*, the Second Circuit Court of Appeals determined that a title insurance salesman's job was considered "unique" because he worked for the company throughout most of his career, was one of its highest paid employees, and most importantly, the pool of potential clients was very limited.⁶ Given that there were limited potential clients, the court appreciated the importance of client and employee relationships in this business and considered this job as special and extraordinary. As a result of the uniqueness of the employee's services, the restrictive covenant was enforceable.

Notably, however, in instances where a personal client relationship is a result of the employee's skill, reputation and previous relationship, as opposed to the direct performance of working for the employer, a non-compete clause is not likely to be broadly applied to all of employee's client relationships.⁷ According to the New York Court of Appeals in *BDO Seidman v. Hirshberg*, only if a client relationship occurred as a result of working for the employer can the employer have a legitimate interest in preventing the employee's "competitive use of a client relationship." Therefore, attempting to restrict a pre-existing employee/client relationship is not likely to be enforced by a restrictive covenant. Non-compete agreements are more likely considered reasonable and enforceable in preventing employee solicitation where the employee sold their customer accounts or business to the employer.⁸

Moreover, it is possible for a court to grant a partial enforcement of a non-

compete clause or to uphold one part of a non-compete clause and not another. This can occur in cases where the employer has a legitimate, protectable business interest but the non-compete clause is too broad. In these cases, the court looks to details about the employer's conduct to see if the employer acted in good faith or if the employer tried to overreach or manipulate the employee using unequal bargaining power.⁹

Second, if the court determined that the non-compete clause is required to protect the legitimate interest of the employer, then the court proceeds to the second factor to analyze whether enforcing the non-compete clause is not overly burdensome for the employee. Although non-compete clauses must be reasonable in time and geographic scope, this does not require a specific, limited duration. The First Department in *Ashland Management Inc. v. Altair Investments NA, LLC*, upheld a non-compete agreement because it would not prevent the employees from enjoying a successful future business just because there was no end time specified on their confidentiality agreements. As long as the employee is not caused undue hardship, as was the case, the non-compete agreement still can be enforceable.

Similarly, restricting a former employee's competition inside the geographic region that includes the corporate business is likely to be found reasonable and not overly burdensome for the employee. For example, in *Innovative Networks, Inc. v. Satellite Airlines Ticketing Centers, Inc.*, the Southern District of New York determined that limiting the employee from specifically competing or misappropriating information within the whole of the continental United States, although sizeable, was reasonable given that Innovative Network Inc. monitored airline business centers throughout the country and the restriction was only to last for 12 months.¹⁰ However, in *Ivy Mar Co., Inc. v. C.R. Seasons Ltd.*, the Eastern District of New York held that the employer's non-compete clause was unenforceable because it was unreasonable in geographic scope when the agreement

restricted the employee company for six years from engaging in business anywhere on earth where the employer did business, marketed their products, or even planned to market their products.¹¹

Third, the court weighs whether enforcing the non-compete clause will cause injury to the public at large. Not all restrictive covenants will be injurious to the public. Corporate restrictive covenants should not promote general anti-competition, as this is considered harmful for economic growth. For example, a non-compete agreement that is signed during the sale of a business and containing a severely restrictive burden placed on the seller, could result in the seller withdrawing from this type of business altogether. This withdrawal can be damaging to the public if the result is removing competitors, reducing a skill set in the marketplace, and minimizing competition.¹²

With the increased likelihood of worker mobility, it is crucial for counsel to construct the non-compete agreement in consideration of the three-part reasonableness standard. At the very least, the court will always look at the specifics of the non-compete clause and determine reasonableness and good will on behalf of the employer, and the resulting burden on the employee and general public. **P**

1 Last v. New York Institute of Technology, 219 A.D.2d 620 (2d Dep't 1995).

2 BDO Seidman v. Hirshberg, 93 N.Y.2d 382, 388-389 (1999).

3 Johnson Controls, Inc. v. A.P.T. Critical Systems, Inc., 323 F.Supp.2d 525 (S.D.N.Y. 2004).

4 Last at 219 A.D.2d 620.

5 Restatement Third of Employment § 8.07 (2010): Protectable Interests for Restrictive Covenants; See also: Restatement Second of Contracts § 188, (1981): Ancillary Restraints on Competition. See also Ashland Management Inc. v. Altair Investments NA, LLC, 59 A.D.3d 97, 103 (1st Dep't 2008) where non-compete agreements can strictly prohibit the use of any company trade secrets that are explicitly or implicitly known.

6 Ticor Title Insurance Co. v. Cohen, 173 F.3d 63 (2d Cir. 1999)

7 BDO Seidman v. Hirshberg, 93 N.Y.2d 382 (N.Y. 1999).

8 Ecolab Inc. v. Paolo, 753 F.Supp. 1100 (E.D.N.Y. 1991).

9 BDO at 394-395.

10 Innovative Networks, Inc. v. Satellite Airlines Ticketing Centers, Inc., 871 F.Supp. 709 (S.D.N.Y. 1995).

11 Ivy Mar Co., Inc. v. C.R. Seasons Ltd., 907 F.Supp 547 (E.D.N.Y. 1995).

12 Restatement Second of Contracts § 188c, (1981) Ancillary Restraints on Competition