

The Business Of Protecting Customer Relationships

Law360, New York (January 25, 2012, 1:50 PM ET) -- Over a dozen years after the New York Court of Appeals specifically recognized, in *BDO Seidman v. Hirshberg*, 93 N.Y.2d 382, 690 N.Y.S.2d 854 (1999), that an employer may have a legitimate and protectable business interest in preventing former employees from exploiting or appropriating the relationships and goodwill of its customers which had been created and maintained at the employer's expense, some New York courts still appear to be reluctant to uphold contractual provisions in employment agreements that are designed simply to protect customer goodwill.

Two recent examples highlight this continuing reluctance to enforce such provisions.

In a decision issued earlier this year by the Civil Court of the City of New York, *Eyes of the World Inc. v. Boci*, slip op., Index No. 46549/09 (Civ. Ct. N.Y. County Aug. 19, 2011), the court refused to enforce a one-year post-employment nonsolicitation-of-customers provision against an individual defendant who had worked for three years performing hair removal services at the plaintiff employer's business locations.

That provision merely required the individual to refrain from providing services to any client of plaintiff to whom defendant provided services within the last 12 months of her employment. There were 86 such clients. Thus, in a city of thousands, perhaps even millions of potential customers for hair removal services, a provision prohibiting solicitation of 86 individual clients was not enforced.

Similarly, in *In The Game Fitness Corp. v. Monzillo*, No. 33167/09 (Sup. Ct. Suffolk County Jan. 26, 2010), the court denied a fitness company's application for injunctive relief against a former employee personal trainer who had agreed not to solicit *In The Game's* personal training clients for one year after termination of his employment. In that case, the number of clients at issue — approximately 10 — was even smaller.

In neither *Eyes of the World* nor *In The Game* did the respective courts apparently consider the holding of the Court of Appeals in *BDO Seidman* that the employer's protection of customer relationships that the employee acquired in the course of employment may indeed be a legitimate interest, protectable by a restrictive covenant.

Instead, those decisions were based upon the pre-*BDO Seidman* formulation of legitimate business interests, which were limited to (1) protection from misappropriation of the employer's trade secrets or confidential client lists and (2) protection from competition by a former employee whose services are unique and extraordinary.

The *Eyes of the World* and *In The Game* courts both relied upon an older Appellate Division case, *Investor Access Corp. v. Doremus & Co. Inc.*, 186 A.D.2d 401, 588 N.Y.S.2d 842 (1st Dep't 1992), in reaching their decisions.

The foregoing raises the question: is the protection by an employer of its customer relationships that the employee acquired during employment still recognized as a legitimate business interest? The answer is yes, protection of customer relationships is still recognized as a legitimate business interest, but the various rationales advanced in support of such a "customer relationship interest" have sown confusion and inconsistency in its application, as discussed below.

Development of The Law Concerning Restrictive Covenants in New York

In considering whether to enforce noncompetition and/or nonsolicitation agreements, New York courts have recognized that "an employer is entitled to protection from unfair or illegal conduct that causes economic injury." *Maltby v. Harlow Meyer Savage Inc.*, 166 Misc.2d 481, 485, 633 N.Y.S.2d 926, 929 (Sup. Ct. N.Y. Co. 1995) ("Indeed, the modern trend in the case law seems to be in favor of according such covenants full effect when they are not unduly burdensome."), *aff'd*, 223 A.D.2d 516, 637 N.Y.S.2d 110 (1st Dep't 1996).

Nevertheless, for reasons of promoting free competition, New York courts have always started from a position of reluctance to enforce restrictive covenants contained in employment agreements due to public policy considerations which militate against sanctioning the loss of a person's livelihood. *Purchasing Associates Inc. v. Weitz*, 13 N.Y.2d 267, 271, 246 N.Y.S.2d 600 (1963).

Under New York law, therefore, a restrictive covenant contained in an otherwise valid employment agreement only will be found reasonable and enforceable if it "(1) 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." *BDO Seidman v. Hirshberg*, 93 N.Y.2d 382, 388-89, 690 N.Y.S.2d 854 (1999).

In *Reed, Roberts Associates Inc. v. Strauman*, 40 N.Y.2d 303, 309, 386 N.Y.S.2d 677 (1976), the Court of Appeals set forth a narrow two-part test (hereinafter, the Reed standard) for determining whether a restrictive covenant serves the employer's legitimate interests, noting that restrictive covenants will be enforced (1) "to the extent necessary to prevent the disclosure or use of trade secrets or confidential information," or (2) "where an employee's services are unique or extraordinary."

The Reed standard was applied in *Investor Access Corp.*, where the defendant executive had signed an employment agreement restricting him from soliciting or servicing any current or former client of his former employer for 12 months after his termination.

When the executive began working for a competitor and a major account followed him, the court refused to grant specific enforcement of the restrictive covenant because it did not protect a legitimate interest of the employer, i.e., the executive did not provide "unique or extraordinary" services, and had not misappropriated any trade secrets or confidential information.

Further, the court held that the executive's recollection of information pertaining to particular clients is not confidential, and the client's decision to follow the defendant was based on the defendant's familiarity with the client's needs and his ability in the field. *Investor Access Corp.*, 186 A.D.2d at 404; 588 N.Y.S.2d 842.

These were the bases on which the plaintiffs' attempts to enforce the restrictive covenants in *Eyes of the World* and *In the Game* were denied.

Seven years after *Investor Access Corp.*, however, the Court of Appeals modified the Reed standard in *BDO Seidman v. Hirshberg*, 93 N.Y.2d 382, 690 N.Y.S.2d 854 (1999), where it noted that an employer may legitimately seek to protect, in certain circumstances, the “good will” which an employee develops with the employer’s client in the course of employment.

In applying the Reed standard, the Court of Appeals determined that the employee in that case did not gain a competitive advantage by using confidential information. *Id.* at 391.

The court nevertheless recognized a “legitimate interest” held by the employer in seeking to protect its client relationships and goodwill. *Id.* at 391. See also *Scott, Stackrow & Co., C.P.A.’s PC v. Skavina*, 9 A.D.3d 805, 806, 780 N.Y.S.2d 675, 677 (3d Dep’t 2004) (“an anticompetitive covenant may prevent the competitive use of client relationships that the employer assisted the employee in developing through the employee’s performance of services in the course of employment.”)[1]

Perhaps because the Court of Appeals in *BDO Seidman*, while recognizing the customer relationship interest as an additional legitimate business interest that can support the enforcement of restrictive covenants, did not specifically modify the narrower Reed analysis, subsequent court decisions have applied the customer relationship interest in various ways, including by trying to shoehorn that interest into the Reed analysis.

This situation was recognized in a 2004 federal court decision: “whether viewed conceptually as a type of special service, an offshoot from an employer’s interest in safeguarding customer information or as a distinct cognizable interest, it is now clear that under New York law an employer also has a legitimate interest in protecting client relationships developed by an employee at the employer’s expense.” *Johnson Controls, Inc. v. A.P.T. Critical Systems, Inc.*, 323 F. Supp. 2d 525, 534 (S.D.N.Y. 2004).

Customer Relationships As Unique Services To The Employer

A number of courts, in attempting to fit within the Reed analysis, have ruled that an employee who has special relationships with the employer’s clients has provided “unique services,” and therefore those relationships are protectable. See *Natsource LLC v. Paribello*, 151 F. Supp. 2d 465, 472–74 (S.D.N.Y. 2001) (recognizing that special relationships with clients were “unique services” necessary to enforce a restrictive covenant); *Crown It Services Inc. v. Koval-Olsen*, 11 A.D.3d 263, 264-65, 782 N.Y.S.2d 708 (1st Dep’t 2004) (enforcing noncompete clause limited to former clients of the plaintiff to which former contractor had been introduced directly or indirectly through plaintiff); *Willis of New York Inc. v. DeFelice*, 299 A.D.2d 240, 241, 750 N.Y.S.2d 39 (1st Dep’t 2002) (enforcing restrictive covenant against insurance broker who provided “unique” services).

See also *Ticor Title Ins. Co. v. Cohen*, 173 F.3d 63, 70-72 (2d Cir. 1999) (upholding trial court’s finding that defendant’s relationship with clients were “special” and qualified as “unique services”); *Maltby v. Harlow Meyer Savage Inc.*, 166 Misc.2d 481, 486, 633 N.Y.S.2d 926 (Sup. Ct. N.Y. Co. 1995) (holding that traders had “unique relationships with the customers with whom they have been dealing”), *aff’d*, 223 A.D.2d 516, 637 N.Y.S.2d 110 (1st Dep’t 1996).

It is questionable, however, whether the fact that an individual defendant enjoys good relationships with the customers of the employer really makes that individual’s services unique or extraordinary in the way that the terms were traditionally employed in case law, such as with respect to specially talented employees like musicians, professional athletes, actors and writers. See *American Broadcasting Cos. Inc. v. Wolf*, 52 N.Y.2d 394, 403 n.6, 438 N.Y.S.2d 482, 486 n.6 (1985) (noting that few reported cases had been decided based only on the uniqueness of an employee’s services).

Eyes of the World and *In the Game* take the literal and traditional use of those terms to deny relief rather than the broader interpretation mandated by the Court of Appeals in *BDO Seidman*.

Customer Relationships As Protectable In Order To Safeguard Confidential Information

Other decisions have focused on whether the former employee's solicitation of a customer implicates confidential information and will enforce a restrictive covenant only if such information requires protection.

See *Concord Limousine Inc. v. Orezzaoli*, 7 Misc. 3d 1026(A), 801 N.Y.S.2d 232 (Sup. Ct. Kings County May 20, 2005) ("the enforcement of such covenants on the basis of a close business relationship between the employee and the employer's customers is generally limited to instances where the defendant rendered specific substantive services of a confidential nature to the employer's customers"); *Chernoff Diamond & Co. v. Fitzmaurice Inc.*, 234 A.D.2d 200, 202-03, 651 N.Y.S.2d 504 (1st Dep't 1996) (enforcing provision prohibiting soliciting or servicing clients where former employee "obtained, while in plaintiff's employ, invaluable and unobtainable information concerning the business practices and resulting insurance needs of those clients due to his position as their trusted professional advisor").

There does not appear to be good reason, however, to so limit application of the customer relationship interest only to situations where confidential information is at risk.

If they choose, an employer and an employee engaged in a business, such as providing hair removal services or providing personal training, which does not entail the use of confidential information, should be able to enter into an agreement prohibiting the employee during some reasonable period of time post-employment from soliciting or servicing the employer's customers who the employee first got to know during that employment.

Protection of Customer Relationships As A Distinct Cognizable Interest

Rather than trying to fit the customer relationship interest into the Reed analysis by noting the uniqueness of the former employee's relationship with certain customers, or by enforcing restrictive covenants only when confidential information is threatened, it is preferable for courts to specifically recognize an employer's legitimate business interest in protecting its goodwill with customers as a basis for enforcing restrictive covenants.

See *Kelly v. Evolution Markets Inc.*, 626 F. Supp. 2d 364, 372 (S.D.N.Y. 2009) ("EvoMarkets' desire to protect its goodwill that it fostered with customers constitutes a legitimate business interest"); *DS Courier Services Inc. v. Seebarran*, 40 A.D.3d 271, 272, 834 N.Y.S.2d 191, 192 (1st Dep't 2007) ("the covenant legitimately protects the goodwill that plaintiff had developed with certain of its customers"); *Portware LLC v. Barot*, 11 Misc. 3d 1059(A), 815 N.Y.S.2d 495 (Sup. Ct. N.Y. County Mar. 2, 2006) (enforcing 12 month nonsolicitation and nonservice covenant against former account manager with respect to customer or potential customers with whom he first developed a relationship during his employment).

BDO Seidman is clear that an employer has a legitimate interest in the protection of client relationships acquired during the course of employment in which the employer has invested its resources — through the employees — to cultivate. *BDO Seidman*, 93 N.Y.2d at 391-92; see *Marsh USA Inc. v. Karasaki*, No. 08 Civ. 4195 (JGK) (S.D.N.Y. Oct. 31, 2008) (granting injunction enforcing nonsolicitation and nonservice provisions of employment agreement).

BDO Seidman also makes clear that protection of those relationships does not depend on the uniqueness of the employee or on protection of confidential information. BDO Seidman, 93 N.Y.2d at 390 (“his status in the firm was not based upon the uniqueness or extraordinary nature of the accounting services he generally performed”) and 391 (“there is no evidence that the employee obtained a competitive advantage by using confidential information”).

Upon departure, the employer should have a period of time to put another employee in place to establish a relationship and to level the playing field in competing for the customer’s future patronage.

Accordingly, there is ample precedent for New York courts to treat the customer relationship interest as a stand-alone legitimate business interest sufficient to support enforcement of an otherwise reasonable noncompetition or nonsolicitation covenant in an employment agreement.

--By Peter L. Altieri and David J. Clark, Epstein Becker Green PC

Peter Altieri is a member of the litigation and labor and employment practices in Epstein Becker Green's New York office, where he serves as the managing shareholder. David Clark is a senior counsel in the litigation practice in the firm's New York office.

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[1] New York courts are clear that an employer has no legitimate business interest in preventing a former employee from competing for the patronage of customers with whom the employee: (a) never developed a relationship while employed, (b) had an established relationship prior to the employment, and (c) began a relationship after termination of the employment. See *Portware, LLC v. Barot*, 11 Misc. 3d 1059(A), 815 N.Y.S.2d 495, 2006 WL 516816, at *5 (Sup. Ct. N.Y. County Mar. 2, 2006); *Riedman Corp. v. Gallagher*, 48 A.D.3d 1188, 1190, 852 N.Y.S.2d 510 (4th Dep’t 2008).

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