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Courts Put Down Their **Blue Pencils**

Recent trends affect drafting of restrictive covenants.

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Several recent decisions have underscored that New York courts continue to disfavor post-employment restrictive covenants. In recent months, both state and federal courts in New York have refused even to partially enforce restrictive covenants that they found to be unreasonable in scope.

Additionally, the Southern District of New York recently held that if an employee has not signed an enforceable restrictive covenant, it will take extraordinary circumstances for a former employer to stop the employee from working for a competitor, even if the employee had access to the former employer's trade secrets and his new position is similar to his prior post.

The courts in *Brown & Brown v. Johnson*[1] and *Veramark Technologies v. Bouk*[2] refused to judicially narrow or "blue-pencil" overbroad post-employment restrictions to make them enforceable. Rather, the courts held that employers should know the requirements for an enforceable restrictive covenant and prepare their agreements accordingly. At the same time, the Southern District, in *Janus Et Cie v. Kahnke,*[3] emphasized that without an enforceable restrictive covenant agreement, it will be extremely difficult for employers to restrict an employee's post-employment activities even if the employer believes there is a high risk that the employee will inevitably use the employer's confidential information in his or her new job.

The N.Y. Court of Appeals picked up the blue pencil in *BDO Seidman*. For many employers, their most important assets include their employees, their proprietary information and their client relationships. All of these assets may be jeopardized when an employee resigns or is terminated. As a result, employers often seek to protect these business interests by entering into agreements with their employees that restrict the employees' ability to perform certain activities after their employment terminates. These "restrictive covenants" vary from prohibitions on working for a competitor, to prohibitions on soliciting and/or hiring the employer's employees and prohibitions on soliciting and/or servicing the employer's clients.

In 1999, in the seminal case of *BDO Seidman v. Hirshberg*,[4] the New York State Court of Appeals held that a post-employment restriction is reasonable "only 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."[5] The court in *BDO Seidman* further held that a restriction prohibiting post-employment solicitation of clients is unreasonable, and therefore unenforceable, where it purports to restrict an employee from soliciting *any* of the employer's clients. The court held that client-based restrictions must distinguish between those clients with which the employee developed a relationship due to his or her employment (an employer rightfully could restrict post-employment solicitation of such clients), as opposed to clients with which the employee had a pre-existing relationship or never acquired such a relationship (restrictions with respect to those clients would be unenforceable). In *BDO Seidman* and many subsequent cases, however, the courts blue-penciled restrictions that did not make this required distinction and then enforced the judicially-narrowed restrictions.

The practice of "blue-penciling" occurs when courts strike or revise the part of a restrictive covenant that is unenforceable and then enforce what remains. Historically, New York courts regularly provided employers with this backstop even when a restrictive covenant was unreasonably overbroad so that employers still obtained some benefit from the original bargain, even if that original bargain did not comply with established parameters of reasonableness. But recent decisions suggest a trend in which courts are becoming increasingly unwilling to blue-pencil overly broad restrictive covenants and instead strike them completely.

Fifteen years after *BDO Seidman*, courts seem less willing to blue-pencil overbroad restrictions. This trend against blue-penciling was evident in the Appellate Division, Fourth Department's decision in *Brown & Brown v. Johnson*, issued in February 2014. In that case, Johnson had been hired by plaintiffs, insurance intermediaries, to provide actuarial analysis. On her first day of work, Johnson signed an employment agreement containing a non-solicitation provision. This covenant restricted Johnson from soliciting, either directly or indirectly, "any insurance or bond business of any kind or character from any person, firm, corporation, or other entity that is a customer or account of the New York offices of the Company" for two years following termination. Despite the ruling in *BDO Seidman* seven years earlier, the restriction did not delineate between clients with which Johnson acquired relationships during her employment and those with which she did not. Accordingly, when Brown & Brown attempted to enforce the restriction after Johnson's employment terminated, the Fourth Department held that the restriction was overbroad and unenforceable.

Brown & Brown urged the court to blue-pencil the restriction and enforce a judicially-narrowed provision, but the court refused. The court, citing *BDO Seidman*, held that courts should only partially enforce otherwise overbroad restrictions where "the employer demonstrates an absence of overreaching, coercive use of bargaining power, or other anti-competitive misconduct, but has in good faith sought to protect a legitimate business interest, consistent with reasonable standards of fair dealing." In other words, the Fourth Department held that courts should not blindly blue-pencil overbroad restrictive covenants, but instead analyze whether the original, overboard restriction was agreed to between the parties in good faith. The court noted that Brown & Brown had not presented the restrictive covenant agreement to Johnson until her first day of work, after she had already resigned from her prior job.

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Additionally, the court emphasized that Brown & Brown had provided the agreement to Johnson many years after *BDO Seidman*, and, therefore, found that Brown & Brown should have known the requirements for enforceable non-solicitation restrictions. Accordingly, the court held that the circumstances did not warrant the blue-penciling of the restrictive covenants.

The Fourth Department further held that even if the agreement states that, if a court found the restrictions overbroad, "the parties agree that such court shall be authorized to modify such covenants so as to render … [them] valid and enforceable to the maximum extent possible" did not *require* the court to engage in any such modification. Instead, the court held that allowing for partial enforcement of covenants employers should know are overbroad would allow employers to "use their superior bargaining position to impose unreasonable anti-competitive restrictions, uninhibited by the risk that a court will void the entire agreement." The court was unwilling to permit employers to impose the deterrent effect of an overbroad covenant without the risk of losing its ability to enforce the covenant altogether if the employee challenged it.

The Fourth Department is not alone in refusing to blue-pencil otherwise unenforceable restrictive covenants. On April 2, 2014, the U.S. District Court for the Western District of New York, in *Veramark Technologies v. Bouk*, refused to blue-pencil a non-compete provision. The restriction at issue prohibited a former employee from "directly or indirectly performing services for any enterprise that engages in competition with the business conducted by Veramark or its affiliates." Veramark argued that it needed this worldwide non-compete to protect "customer goodwill." The court found that this restriction was not targeted to protecting customer goodwill, and held that "[o]n its face, the non-compete is overreaching and coercive, and partial enforcement would not be appropriate."

As the court in *Brown & Brown* had done, the court in *Veramark* emphasized that the employer had presented the employee with the agreement at issue many years after *BDO Seidman* and, therefore, found that the employer should have known the standard for a reasonable restrictive covenant. Quoting *Brown & Brown*, the court in *Veramark* held that blue-penciling under these circumstances would permit employers to "use their superior bargaining position to impose unreasonable anti-competitive restrictions, uninhibited by the risk that a court will void the entire agreement."

The court in *Veramark* further found that the employer did not need to enforce the non-compete provision because the non-solicitation provisions in the agreement sufficiently protected the employer's proffered legitimate interest of protecting customer goodwill. This aspect of the decision is significant: While the court would not blue-pencil the unreasonable non-compete restriction, it severed that provision and enforced the remaining restrictive covenants. This suggests that employers should draft restrictive covenant agreements so that each restriction (non-competition; employee non-solicitation; client non-solicitation; etc.) is contained in a stand-alone provision. If a court finds that one of those restrictions is unreasonable, then, even without blue-penciling the unenforceable provision, it may enforce the separate restrictions.

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The risk of "Inevitable Disclosure" alone will not support enjoining an employee from competing. If an employee has not signed an enforceable restrictive covenant, it will be difficult to restrict that employee from working for a competitor in a similar job, even if that competitive position raises the concern that the employee might use the former employer's confidential information. Many employers have tried to stop certain former employees who had not signed any restrictive covenant agreements from accepting similar posts with a competitor on the theory that they will "inevitably" use or disclose the former employer's confidential information. The recent decision by Judge William H. Pauley III of the Southern District of New York, in *Janus Et Cie v. Kahnke* held that, under New York law, there is no stand-alone claim of inevitable disclosure to support enjoining a former employee from competing.

In February 2008, Janus et Cie had hired Andrew Kahnke as a sales associate. At the time of his hire, Kahnke signed a non-disclosure agreement, but did not enter into any non-compete or other post-employment covenants. Three years later, in March 2011, Kahnke was promoted to the position of sales manager, and his responsibilities included the development and customization of Janus' account management system and other documents containing critical customer and competitor information. This information included financial, marketing and new production information, selling reports, order processing, product flow, inventory management, historical customer information and customized management systems. He did not enter into any new agreements at the time of his promotion or thereafter. In August 2012, Kahnke notified Janus that he had accepted a "very similar position" with Dedon, Inc., a direct competitor of Janus.

In response to Kahnke's resignation, Janus sued to enjoin Kahnke from disclosing any of Janus' trade secrets or confidential information and from working for Dedon in any area where Janus and Dedon are direct competitors. But Janus had no evidence that Kahnke had violated his non-disclosure agreement, misappropriated any trade secrets, or disclosed any trade secrets to Dedon or any other third party. Instead, Janus alleged that "Kahnke's position with Dedon is so similar … that he cannot possibly perform the functions of his position … without using and/or disclosing confidential information and trade secrets belonging to Janus."

The court granted Kahnke's motion to dismiss Janus' action, holding that inevitable disclosure of trade secrets is not a recognized cause of action in New York. Pauley explained that the concept of inevitable disclosure may be relevant for purposes of evaluating whether to enforce an existing restrictive covenant agreement or whether to enjoin a former employee from competing when there is evidence that he or she actually stole the former employer's trade secrets. Absent an otherwise enforceable restrictive covenant agreement or evidence of the former employee's misappropriation of confidential information, however, the risk of inevitable disclosure is an insufficient basis to enjoin a former employee from working for a competitor in a position that is similar to the one he or she held while working for the former employer.

Given the decision in *Janus et Cie*, it remains critical that employers protect their trade secrets (and other legitimate business interests) through the use of restrictive covenant agreements. But the decisions in *Brown & Brown* and *Veramark* should remind employers that, to be enforceable, these agreements must be narrowly drawn so that, consistent with the standard set forth in *BDO Seidman*, they are no broader than necessary to protect the employer's legitimate interests.

1. *Brown & Brown v. Johnson*, 115 A.D.3d 162 (4th Dep't. 2014).
2. *Veramark Technologies v. Bouk*, 2014 U.S. Dist. LEXIS 46198 (W.D.N.Y. April 2, 2014).
3. *Janus Et Cie v. Kahnke*, 2013 U.S. Dist. LEXIS 139686 (S.D.N.Y. Aug. 29, 2013).
4. *BDO Seidman v. Hirshberg*, 93 N.Y.2d 382, 389 (1999).
5. This article focuses on restrictive covenants under New York law. Other jurisdictions may have drastically different requirements and engage in very different analyses.