BOND INFORMATION MEMO

Labor and Employment Law

February 2014

Recent Fourth Department Decision Provides Guidance on the Enforceability of Restrictive Covenants

On February 7, 2014, the Appellate Division, Fourth Department, issued a significant decision regarding restrictive covenants. In *Brown & Brown, Inc. v. Johnson*, the plaintiffs terminated the defendant-employee and then sued her for violating non-competition and non-solicitation provisions in her employment agreement, which contained a provision stating that Florida law would govern. The Fourth Department considered several issues, including: (1) whether to enforce the Florida choice-of-law provision for the restrictive covenants; (2) whether employers can enforce restrictive covenants against employees who were involuntary terminated; and (3) whether the court must partially enforce an overbroad restrictive covenant where the agreement expressly provides for such partial enforcement.

First, the Fourth Department considered the issue of whether the Florida choice-of-law provision in the agreement was enforceable. The court noted that choice-of-law provisions are generally enforceable in New York as long as the chosen law: (1) bears a reasonable relationship to the parties or the transaction; and (2) is not "obnoxious" to New York public policy. The Fourth Department concluded that while Florida law met the first prong of this test, it failed the second prong. The court explained that under New York law, restrictive covenants are enforceable if they are no greater than necessary to protect a legitimate interest of the employer, are not unduly harsh or burdensome to the employee, and do not injure or harm the public. In contrast, Florida law does not permit courts to consider the hardship to the employee in determining whether to enforce a restrictive covenant. Based on this difference, the Fourth Department ruled that the choice-of-law provision in the employment agreement was unenforceable, and proceeded to apply New York law to the dispute. Significantly, the Fourth Department's ruling did not depend on the specific facts of this case, so it is unlikely that the Fourth Department would enforce a Florida choice-of-law provision in any employer-employee restrictive covenants.

Second, the Fourth Department considered defendants' argument that plaintiffs could not enforce the restrictive covenants because they terminated the defendant-employee. Defendants relied on a Court of Appeals decision which involved an agreement that employees would forfeit their benefits under pension and profit-sharing plans if they competed with their employer after the end of their employment. The Court of Appeals held that the employer could not enforce the forfeiture-for-competition clause because the employees were involuntarily terminated without cause. In *Brown & Brown*, the Fourth Department refused to apply the Court of Appeals decision to create a per se rule that an involuntary termination without cause always renders a restrictive covenant unenforceable.

Third, the Fourth Department ruled that the non-solicitation covenant was overbroad and unenforceable because it prohibited solicitation of any clients of plaintiffs' New York offices, regardless of whether the employee developed a relationship with those clients during her employment. Plaintiffs argued that the court should partially enforce the covenant because plaintiffs only sought to prevent the defendant-employee from soliciting clients with whom she developed a relationship during her employment. The Fourth Department disagreed and explained that partial enforcement is not justified where the covenant is imposed in connection with hiring or continued enforcement or where the employer knew the covenant was overbroad. The court ruled that several factors weighed against partial enforcement in this case. Specifically, the employee received the covenant upon hire and did not receive any benefit for signing the agreement other than continued employment. In addition, the Fourth Department held that the employer was on notice that the covenant was overbroad based on existing case law. Plaintiffs argued that partial enforcement was required because the employment agreement expressly provided for partial enforcement in the event that a court found the restrictive covenant unenforceable. The Fourth Department disagreed and found that plaintiffs' position would permit employers to use their superior bargaining position to impose unreasonable restrictive covenants without any real risk that courts would deem them unenforceable in their entirety.

In light of this decision, New York employers should review any choice-of-law provisions governing their restrictive covenants. If these provisions select Florida law or any other state laws that vary substantially from New York law, they may not be enforceable in the Fourth Department or other New York courts. Employers should also review the scope of their restrictive covenants to determine whether they are overbroad under New York law. Based on the reasoning set forth in the Brown & Brown decision, New York courts may sever any overbroad restrictive covenants in their entirety from agreements, even if there is a provision for partial enforcement.

To learn more, contact Katherine S. McClung at (585) 362-4703 or kmcclung@bsk.com.