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Commercial division update: Limitations on restrictive covenant enforceability

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Restrictive covenants in the context of modern employment provide for various employer protections; most frequently, protection against noncompetition with the former employer's business, nonsolicitation of its clients or employees and use of the former employer's proprietary information. Employers rely on these provisions not only to protect trade secrets and client relationships, but to protect the return on their substantial investments in employee training. At the same time, restrictive covenants may constrain the individual's future employment options, and can be seen as inconsistent with the public interest in free competition. These concerns lead New York courts to view these covenants with suspicion, enforcing only those restraints that are carefully calibrated to legitimate business needs.

In the absence of a comprehensive statutory regime governing employment-related restrictive covenants, New York courts have fashioned a balancing test grounded in the Court of Appeals' landmark decision in *BDO Seidman v. Hirshberg*, 93 N.Y.2d 382 (1999). The *BDO* court fashioned a three-part inquiry, under which a post-employment restriction will survive only if the employer can demonstrate that the restraint is no greater than necessary to protect its legitimate interest. The employer must also show the covenant does not impose an undue hardship on the employee. Finally, the employer must show the covenant is not injurious to the public, such that the covenant's geographic reach, duration and prohibited activities are sufficiently narrow so as not to unduly restrict the former employee or injure the public interest.

This column examines the recent application of these criteria by New York's Commercial Division courts.

Legitimate employer interest

To establish the enforceability of a restrictive covenant, New York law first requires an employer to identify a protectable interest. Such interests include protection of the employer's trade secrets, confidential information, customer relationships and the fruits of specialized employee training. Blanket assertions of "goodwill" or "confidentiality" will not suffice.

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In *Gujral v. Anesthesia Group of Albany*, 2023 N.Y. Slip Op. 51452 (U) (Albany Co. 2023), Justice Richard Platkin of the Albany County Commercial Division denied a motion for a preliminary injunction by which the plaintiff employee sought to prevent his former employer, an anesthesiology medical practice, from enforcing a restrictive covenant against him. The plaintiff had been employed by defendant as an anesthesiologist and was a shareholder thereof. While the court found the two-year duration and geographic scope of the covenant limited to facilities where plaintiff had practiced to be reasonable, it determined that the employer failed to demonstrate a legitimate business interest in enforcing the covenant with respect to its clients. The court noted that the services at issue were not unique, and that the employer did not show that enforcement was necessary to protect trade secrets, confidential information or goodwill. Nevertheless, although the court concluded that the employee had demonstrated a likelihood of success that the covenant was unenforceable, the court denied the request for preliminary injunction due to failure to establish irreparable harm.

In *Davis v. Marshall & Sterling*, 217 A.D.3d 1073 (3d Dep't 2023), a non-Commercial Division case, the Third Department upheld restrictive covenants in employment agreements between an insurance company and its account executives, finding them necessary to protect the employer's goodwill and client relationships. The plaintiffs challenged the enforceability of nonsolicitation and post termination commission-sharing provisions in their employment agreements. The court found that the defendant had a legitimate interest in protecting its goodwill and client relationships, as the plaintiffs had no prior experience in the insurance field and no clients of their own, and the accounts in question had been developed and historically serviced by the company.

Reasonable scope

Even where a legitimate interest is found to exist, a restrictive covenant must be narrowly tailored in terms of duration, geographic reach and the scope of prohibited activities.

In *Power-Flo Technologies v. Crisp*, No. 610365-2022 (Nassau Co. Dec. 13, 2022), *aff'd*, 231 A.D.3d 1070 (2d Dep't 2024), the plaintiff owned and operated electric motor repair shops in four locations in upstate New York, and the defendant, its former employee, served as its Senior Manager in two of those shops. The plaintiff alleged that, while employed by plaintiff, defendant formed a competing company and, following his termination for cause, violated his nonsolicitation agreement by soliciting plaintiff's customers, employees and vendors. Justice Jerome Murphy of the Nassau County Commercial Division denied the company's motion for a preliminary injunction, finding that the non-solicitation agreement at issue, as well as the relief sought by the motion, was not reasonably limited to geographic areas in which plaintiff did business. The court was struck by the fact that the agreement, if enforced, would have prevented the defendant from working in this industry as far away as Canada and Pennsylvania. In affirming, the Second Department went further, finding that the company had failed to establish that the restrictive covenant was necessary to protect its legitimate interests and failed to show that the former employee misappropriated trade secrets or confidential customer lists or that his services were unique or extraordinary.

Aqualife v. Leibzon, 2016 N.Y. Slip Op. 50002 (U) (Kings Co. 2016), involved a restrictive covenant between a corporation engaged in the sale, installation and maintenance of reverse osmosis water purification and filtration systems and several of its former salespersons, who allegedly formed a competing business and solicited their former employer's customers. Justice Carolyn Demarest of the Kings County Commercial Division found the restrictive covenant to be unenforceable, including because of its worldwide scope. In response to the company's argument that, even if overbroad, the covenant should be partially enforced as to a smaller geographic area, the court characterized the standard for partial enforcement as follows:

> "'Factors weighing against partial enforcement are the imposition of the covenant in connection with hiring or continued employment -- as opposed to, for example, imposition in connection with a promotion to a position of responsibility and trust -- the existence of coercion or a general plan of the employer to forestall competition and the employer's knowledge that the covenant was overly broad.'"

(Quoting *Scott, Stackrow & Co. v. Skavina*, 9 A.D.3d 805, 807 (3d Dep't 2004), *lv. denied*, 2 N.Y.3d 612 (2004)).

Applying these factors, the court found partial enforcement not justified under the facts of the case.

Further illustrating a distinct separation between enforceability and reasonableness is *Perella Weinberg Partners v. Kramer*, 188 N.Y.S.3d 915 (N.Y. Co. 2023), *aff'd*, 230 A.D.3d 451 (1st Dep't 2024). There, the defendants, former employees in plaintiff's restructuring group, disputed the enforceability of their non-solicitation agreements with the plaintiff financial firm. In granting the company's motion for summary judgment declaring that covenant enforceable, Justice Robert Reed of the New York County Commercial Division found it necessary to protect plaintiff's legitimate interests. The company submitted evidence that it spent substantial resources enabling defendants to develop close relationships with its clients, and that it paid defendants substantial compensation to do so. While the defendants argued that the restriction was too broad to be enforced, the court noted that, unlike the outcome in the *Aqualife* case, overbroad covenants could be severed and partially enforced to align with reasonable standards of fair dealing, an issue left for further proceeding in that case.

In a case with a unique twist, *R & G Brenner Income Tax Consultants v. Gilmartin*, No. 16901/11 (Nassau Co. Dec. 8, 2020), *rev'd in part*, 233 A.D.3d 819 (3d Dep't 2024), Justice Stephen Bucaria of the Nassau County Commercial Division found enforceable a restrictive covenant between the plaintiff accounting firm and its former accountant employee who had prepared tax returns for the firm's clients and allegedly solicited them post-employment. In granting the former employer summary judgment on its breach claim, the court found the evidence "overwhelming" that, prior to his resignation and thereafter, the defendant established his own competing business, solicited and diverted plaintiffs' clients and removed plaintiff's proprietary property. On appeal, the Second Department took no issue with the lower court's finding that the restrictive covenant was prima facie enforceable. However, the court found the trial court did not give adequate consideration to the former employee's defense that the plaintiff had materially breached the parties' agreement containing the restrictive covenant by failing to pay the defendant commissions he allegedly earned. The appellate court held that restrictive covenants are unenforceable if the party benefiting from the covenant materially breaches the contract containing it. The court thus reversed the summary judgment finding in plaintiff's favor, finding the existence of triable issues of fact regarding whether the company had materially breached the agreement.

Conclusion

Recent Commercial Division decisions reflect a sophisticated and fact-intensive approach to restrictive covenants. Employers must do more than invoke generic interests; they must demonstrate a concrete need for protection, tailored to the employee's role and the nature of the business. Covenants must be narrowly drawn, and employers must ensure their own compliance with contractual obligations before seeking enforcement. Employers should avoid overbroad language and instead focus on narrowly tailored provisions that reflect the specific risks posed by departing employees.

As the Commercial Division continues to refine its analysis, restrictive covenants are likely only enforceable only when they are fair, necessary and consistent with public policy. The evolving jurisprudence demands that employers and their counsel engage in thoughtful drafting and proactive compliance, lest they find their covenants unenforceable in the face of judicial scrutiny.

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