Outside Counsel

Decisions Spur Confusion as to Non-Competes

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For several decades, New York's courts have read the seminal state Court of Appeals decision in *Post v. Merrill Lynch, Pierce, Fenner & Smith*, 48 N.Y.2d 84, 421 N.Y.S.2d 847, 397 N.E.2d 358 (1979) to mean that once an employee is terminated without cause from her job, her non-compete is rendered unenforceable as a matter of law.[1] The rationale behind this reading of *Post* was twofold.

First and foremost, it was grounded in the New York judiciary's long-standing "disfavor" for non-compete agreements,[2] which "was provoked by powerful considerations of public policy which militate against sanctioning the loss of a man's livelihood."[3] Second, and less obvious, was the straightforward application of elemental contract law: "[E]nforcing a noncompetition provision when the employee has been discharged without cause would be 'unconscionable' because it would destroy the mutuality of obligation on which a covenant not to compete is based."[4] In other words, the (now former) employee cannot be held to an agreement without consideration.

'Hyde' and the Recent Trend

In the last two years, however, a trend has emerged where some courts in New York have pointedly declined to read *Post* in this fashion.

In the 2012 case of *Hyde v. KLS Professional Advisors Group*,[5] the plaintiff, a senior-level employee who was previously responsible for managing assets of the defendant's clients, sought an order declaring unenforceable KLS's non-compete agreement barring him from contacting any of the firm's past, present, or potential clients for three years following his termination, regardless of the reason for his departure from the firm. In addition, Hyde sought an order enjoining KLS from enforcing the agreement.

In vacating the trial court's order that had granted the plaintiff's request for an injunction, the U.S. Court of Appeals for the Second Circuit held that plaintiff had failed to demonstrate that absent the injunctive relief, he would suffer irreparable harm. Logically, that is where the court's inquiry should have ended.

Nevertheless, the Second Circuit went out of its way to opine that an employee who was terminated without cause may remain bound to his non-compete clause, and pointedly disagreed with the trial court's reading of New York's law on this issue, stating as follows:

Having concluded that [plaintiff] failed to establish irreparable injury, we need go no further. In the interest of judicial economy, however, we note our reservation about the district court's preliminary interpretation of New York law. Relying on *Post v. Merrill Lynch, Pierce, Fenner & Smith*, 48 N.Y.2d 84, 421 N.Y.S.2d 847, 397 N.E.2d 358 (1979), the district court concluded that restrictive covenants are per se unenforceable in New York against an employee who has been terminated without cause. But in *Post*, the New York Court of Appeals held only that when an employee was terminated without cause, the employer could not condition the employee's receipt of previously earned pension funds on compliance with a restrictive covenant. Id. at 89, 421 N.Y.S.2d at 849, 397 N.E.2d 358. We caution the district court against extending *Post* beyond its holding, when a traditional overbreadth analysis might be more appropriate. See *BDO Seidman v. Hirshberg*, 93 N.Y.2d 382, 392–93, 690 N.Y.S.2d 854, 858–59, 712 N.E.2d 1220 (1999).

In other words, the Second Circuit said that it does not believe the trial court's reading of *Post* as inherently invalidating non-competes for employees that were fired without cause was correct.

Confusion Wrought by 'Hyde'

Other courts, such as the Appellate Division, Fourth Department, in *Brown & Brown v. Johnson*, 115 A.D.3d 162, 980 N.Y.S.2d 631 (4th Dept. 2014) have now followed the Second Circuit's dicta in *Hyde*, leaving practitioners confused as to the proper reading and application of *Post* with respect to the enforceability of non-compete agreements of employees who are terminated without cause.

In *Brown*, plaintiff and its parent corporation hired the defendant to perform actuarial work. As part of their employment agreement, the defendant agreed to be bound by restrictive covenants barring her from inducing plaintiff's clients or employees to leave, and from disclosing Brown's confidential information for two years post-employment. After being fired by Brown, Johnson went to work for a competitor. Brown then sued Johnson for breach of the restrictive covenants.

Ultimately, the Brown court held the non-compete provisions unenforceable, but specifically noted that those provisions were not automatically invalidated by virtue of the defendant's involuntary termination, stating:

Contrary to defendants' contention, this Court's decision in *Eastman Kodak Co. v. Carmosino*, 77 A.D.3d 1434, 909 N.Y.S.2d 247 did not extend the *Post* holding to establish a per se rule that involuntary termination without cause renders all restrictive covenants unenforceable.[6]

Unfortunately, both the Hyde court, as well as the Brown court, stopped abruptly after opining that the trial courts read the Post opinion too broadly; neither court articulated any policy reasoning as to why a former employee who is fired without cause should remain bound to a non- compete.

Concluslon

Assuming the Hyde court was correct, and *Post* does not inherently invalidate the non-compete agreement of an employee who was terminated involuntarily and without cause, the lack of any

underlying rationale supporting this proposition remains troubling, particularly given that the contrary reading traditionally followed by other New York courts seems well-grounded in established public policy. Indeed, it appears that even if the older reading of *Post* is not the law in New York, it should be. With the proliferation of lawsuits surrounding non-compete agreements, let us hope that New York's courts clarify this issue in the near future.

Endnotes:

1. See, e.g., *SIFCO Indus. v. Advanced Plating Techs.*, 867 F.Supp. 155, 158 (S.D.N.Y. 1994); *Arakelian v. Omnicare*, 735 F.Supp.2d 22 (S.D.N.Y. 2010).

2. See, e.g., *Ginett v. Computer Task Group*, 962 F.2d 1085, 1099 (2d Cir. 1992).

3. *Reed, Roberts Assocs. v. Strauman*, 40 N.Y.2d 303, 386 N.Y.S.2d 677, 353 N.E.2d 590, 593 (1976); see also *McKay v. Communispond*, 581 F.Supp. 801, 806 (S.D.N.Y. 1983).

4. *Morris v. Schroder Capital Mgmt. Int'l*, 445 F.3d 525, 529–30 (2d Cir. 2006) (quoting *Lucente v. IBM Corp.*, 310 F.3d 243, 254–55 (2d Cir. 2002)).

5. *Hyde v. KLS Professional Advisors Group*, 500 Fed.Appx. 24, 2012 WL 4840714 (2d Cir. 2012).

6. In *Eastman Kodak*, the plaintiff sought to enjoin its former employee from working for a competitor. In affirming the trial court's denial of Eastman Kodak's application for injunctive relief, the Appellate Division, Fourth Department, noted that the defendant was terminated without cause and, even after he was notified of his involuntary termination, he tried to remain an employee of plaintiff by applying for one of the new positions created in the reorganization.

Significantly, the Kodak court further noted its belief that the Court of Appeals' holding in *Post* was limited to cases involving an employee's forfeiture of previously earned pension benefits, stating:

As the Court of Appeals reasoned in *Post v. Merrill Lynch, Pierce, Fenner & Smith*, 48 N.Y.2d 84, 421 N.Y.S.2d 847, 397 N.E.2d 358, rearg. denied 48 N.Y.2d 975, 425 N.Y.S.2d 1029, 401 N.E.2d 433, a case involving a forfeiture-for-competition clause in a private pension plan, "[a]n employer should not be permitted to use offensively [a noncompetition] clause…to economically cripple a former employee and simultaneously deny other potential employers his [or her] services" (id. at 89, 421 N.Y.S.2d 847, 397 N.E.2d 358).
