New Jersey Law Journal

VOL. CXCIX - NO.6 - INDEX 382 FUBRUARY 8, 2010 ESTABLISHED 1878

IN PRACTICE

EMPLOYMENT ALW

Does an Employer Own Customer Relationships Or Just Rent Them?

Restrictive covenants must be made clear

BY RICHARD G. ROSENBLATT

During the current economic downturn, employers have been aggressive in enforcing noncompetition and nonsolicitation employment covenants, seeking to protect both their confidences and goodwill. While the Internet is full of bloggers fueling the common misperception that departing employees can "beat a noncompete," the simple fact is that most jurisdictions — including New Jersey — generally enforce such covenants if reasonable and directed at protecting legitimate business interests.

In New Jersey, most noncompete litigation centers on factual disputes as many, if not most, legal questions are fairly well settled. One issue, however, that remains the subject of debate is the meaning of *Coskey's Television & Radio Sales and Service, Inc. v. Foti,* 253 N.J. Super. 626 (App. Div. 1992). Many departing employees and their new employers (hereinafter, "the defendants") invoke *Coskey's* to justify violating the express terms of a restrictive covenant insofar as they seek permission to solicit customers with whom the departed employee may have had a relationship prior to his working for the suing employer ("the plaintiff"). The defendants often cite *Coskey's* to argue that the plaintiff only "rented" customer relationships the defendant employee had brought to the plaintiff employer and, therefore, the departing employee is free to take those relationships even in the face of a reasonable restrictive covenant. In fact, a number of secondary resources seem to accept that proposition blindly. This article questions that proposition.

At issue in *Coskey's* was Ronald Foti, who had sold communications systems and services for Coskey's. Coskey's often generated business "through contacts with architects, engineers, and other professionals who specif[ied] Coskey's products in proposed projects." Coskey's employees worked closely with these key relationships. Notably, these relationships were not customers, but instead were a conduit to potential customers. Prior to joining Coskey's, Foti had more than 25 years of industry experience and an extensive network of vendor contacts.

After three years working for Coskey's, Foti accepted employment with a competitor. Coskey's sought an injunction to enforce Foti's employment contract, which provided broadly that Foti would not "directly or indirectly, either as an employer, employee, consultant, agent, principal, partner, stockholder, corporate officer, director, or in any other individual or representative capacity, engage or participate in any business that is in competition in any manner whatsoever with the business of [Coskey's]." According to its terms, this restriction would extend "within the existing marketing area of [Coskey's], or any future marketing area of [Coskey's] begun during the employment" and would continue for three years. The trial court enforced the covenant, enjoining Foti from "directly or indirectly either on his own behalf or on behalf of any other person or firm contacting for business purposes any of the architects, engineers, contractors, or customers with whom he dealt" on behalf of Coskey's. The injunction further barred Foti from communicating with "all or any architects, engineers, designers, contractors, subcontractors, customers, clients, or other business persons or companies with whom Foti

Rosenblatt is a partner in the labor and employment practice group at Morgan, Lewis & Bockius in Princeton.

had 'meaningful contact' during" his employment at Coskey's.

Given the sweeping breadth of the non-compete and the injunction, it should come as no surprise that the Appellate Division vacated the preliminary injunction in part, holding that the injunction was overbroad and would result in an extreme hardship to Foti. With respect to the vendor relationships that Foti had developed during his many years in the business, the court used expansive language, stating: "What Foti brought to his employer, he should be able to take away. . . . Foti's relationships within the industry were not bought and paid for; they were merely rented during the period of employment." Defendants frequently invoke this holding to justify a departing employee continuing to sell to customers with whom he did business prior to joining the plaintiff employer. Whether *Coskey's* justifies such an argument remains subject to debate.

Initially, the Appellate Division observed that it based its decision to partially vacate the preliminary injunction entered in *Coskey's* upon the unique facts and circumstances presented. The court noted that the relationships at issue were "eminently distinguishable" from those in other non-compete matters because "the business . . . involves discrete projects, with many bids and proposals being developed which the parties realize may never result in a contract, and where the customers are a finite group dealt with by all competitors in the field."

Further, the court expressed concern that the consideration given for the covenant was insufficient to justify the extraordinarily broad restrictions imposed by the trial court. The court noted that Foti had been paid $11,250 to sign the employment agreement containing the restrictive covenant and stated "it would be unreasonable for us to say that the parties intended that an $11,250 payment was to compensate Foti for the potential three-year loss of a $53,000 per year salary, plus commissions and benefits."

Finally, and most importantly, the Appellate Division — despite the ambiguity of its language — held that Coskey's had a right to safeguard its customer relationships and, therefore, affirmed the injunction insofar as it prohibited Foti from interfering with Coskey's contracts. The court recognized that "if Foti successfully negotiated a contract for a particular engineer whose proposals were accepted in a public works or private industrial project, and if there was to be a subsequent modification of that project, Foti's employer [Coskey's] would have a right to protect its contractual relationship." The court further stated that "we have indicated that we would sustain so much of the [preliminary injunction] that restrains Foti from interfering with any ongoing contract, including any modifications thereof, in which he had participated on behalf of Coskey's during his employment." Practically, this means that to the extent that the plaintiff former employer has a contract with a customer — whether the customer previously had done business with the defendant employee or not — *Coskey's* can be read to protect that contractual relationship from interference by a departing employee.

In the years since the *Coskey's* decision, and despite its frequent invocation by defendants to justify a breach of a noncompete, the courts have commented on the case remarkably infrequently. However, it is notable that a number of decisions that do cite to *Coskey's* reference it only for the settled proposition that "matters of general knowledge within an industry, the skills or experience an employee learned or developed during an employee's tenure with the employer, or the knowledge, skills, or abilities an employee brought with him to the employer are not worthy of protection through a non-compete agreement."

A plaintiff employer seeking to prohibit a former employee from soliciting customers with whom the former employee had a business relationship prior to joining the plaintiff employer should marshal evidence demonstrating the plaintiff employer's investment of resources and money into preserving and growing those transferred customer relationships. For example, if the plaintiff employer had paid substantial consideration for the restrictive covenant, there may be a strong argument that, in fact, the employer did buy the relationships. Similarly, if the plaintiff employer has evidence that it paid for entertainment of the customers and other expenditures intended to promote goodwill with those relationships, that too may help defeat a *Coskey's* argument. Likewise, if the plaintiff employer can demonstrate that the departing employee had joined it because his customers were dissatisfied with a prior employer's products or services, the plaintiff employer should have a solid argument that its investment in materials and service was instrumental to the retention and maintenance of the customer relationship. In addition, if the plaintiff employer had provided integral technical service that too can establish the type of investment to which the plaintiff employer can cite to protect those customer relationships. Finally, and perhaps the safest way to avoid a *Coskey's* argument is to draft a restrictive covenant to make it clear that the restrictions apply to relationships that both pre- and post-date the commencement of employment.

In summary, the true significance of the *Coskey's* decision remains subject to debate. It is by no means settled that a departing employee subject to a restrictive covenant is free to solicit customers brought with him to the plaintiff employer. Whether or not a court will enjoin such conduct may depend upon the facts and circumstances presented. An employer seeking to obtain injunctive relief should present whatever evidence available that demonstrates it has made an investment in preserving and growing those relationships that might justify an injunction.■