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Civil LITIGATION

# Common law duty of non-solicitation of customers for sellers of businesses

For good reason, given the volume of litigation generated by them, restrictive covenants in employment agreements attempting to limit or prevent solicitation of customers have received extensive coverage in employment law articles and blogs. Regardless of what an employment agreement might provide, and even in situations where there is no employment agreement, New York case law (common law) provides that those who sell a business, including that business' goodwill/customer relationships, may not thereafter solicit those same customers for his or her new business. New York courts have noted that this implied covenant is permanent, does not change over time, and exists independently of any contractual duty not to compete and/or solicit.

The current leading case in New York regarding the common law duty of non-solicitation for business sellers is the New York Court of Appeals' (New York's highest court) 1991 decision in *Bessemer Trust Co. v. Branin. The Bessemer Trust* court discussed the long-standing rule and noted that the simplest violation of it occurs where the business seller initiates contact with the former customer on behalf of his/her new business, particularly where the business seller is in competition in the same industry he/ she was in before.

Improper direct solicitations include phone calls, emails, social media and text messages etc., but also include direct, targeted mailings to former customers. Absent an improper solicitation or a separate non-compete agreement, though, the business seller is free to compete in the same industry post-sale. Certainly, though, as the *Bessemer Trust* court noted, where the seller agrees to an express non-solicitation covenant in a sale contract or post-sale employment agreement, that promise will be given equal or greater weight than where the common law non-solicitation duty is not present.

**BY PAUL F. KENEALLY**
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Indeed, the local Fourth Department of the New York State Appellate Division, in *Genesee Valley Trust Co. v. Waterford Group, LLC* recently held in 2015 that such non-solicitation written agreements are enforced if reasonably necessary to enforce the buyer's interest in the purchased asset, without resort to the stricter standard of reasonableness applicable to employment agreements where no sale has occurred.

## 'Touting' a business

The *Bessemer Trust* court also discussed that the non-solicitation rule further bars the business seller from "touting" his or her new business, or disparaging the buyer, even where the former customer makes the initial post-sale contact.

Finding and offering evidence of improper touting is a much more subtle and difficult task in litigation, but can make a crucial difference. *In Honeywell Int'l Inc. v. Stacey*, a federal court in Minnesota considered this aspect of the *Bessemer Trust* decision in noting that solicitation is broader than merely who makes the first contact. The *Honeywell* court determined that the issue of whether touting has occurred must be on a case-by-case basis, and in that particular case the defendant had not yet done any soliciting. The *Honeywell* court also recognized the flip side of that issue: In the absence of solicitation (or a separate non-compete promise), the business seller is permitted to accept business from a former customer.

In a case decided soon after the *Bessemer Trust* decision was issued in 2011, the Southern District of New York federal court in *USI Ins. Servs. LLC v. Miner* found in favor of the plaintiff based on the defendant's email to everybody in his contact list, including former customers, after he sold his business and goodwill to the plaintiff. The court noted that the defendant was in the exact same industry as pre-sale and that the email at issue contained direct, active solicitation by claiming his new company was superior to the plaintiff. Adding to the defendant's problems in the case was the fact that some of the recipients of the solicitation email were from a list the defendant had taken from the plaintiff while employed and emailed to himself (this conduct also constituted an independent claim for breach of fiduciary duty). The USI court acknowledged that, while the clients were free to approach the defendant with questions about the plaintiff's new business, it did not change the defendant's liability for the solicitations.

Another court that recently considered the common law prohibition on a seller of a business from soliciting his or her former customers under *Bessemer Trust, Mar-Cone Appliance Parts Co. v. Mangan*, noted that

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the implied non-solicitation covenant prevents the seller from committing a fraud on the sale contract by diverting the very customers just sold. In the *Mar-Cone* case, the defendant also had an employment agreement non-solicitation promise, and it was important to the ancillary issue of contribution under New York tort law that the court find the plaintiff could proceed under the agreement or under the common law rule and it specifically did so.

Earlier this year, a New York state court in Ulster County in a case titled *Trimm v. Freese*, relied on the *Bessemer Trust* case (and its predecessor, *Mohawk Maintenance Co. v. Kessler* from which the rule is sometimes called the Mohawk Doctrine) to uphold a Temporary Restraining Order prohibiting the defendant from contacting his former customers after a business sale.

The court actually allowed the TRO to go beyond the *Bessemer Trust* holding and prohibit the defendant from even answering former customer questions based on the evidence that the defendant had already lied to some former customers that the sale had not worked out. The Trimm court declined to prohibit the defendant from operating a competing business altogether, however, or from general public advertising of the new business on Angie's List.

As should be clear from the above, issues regarding duties following the sale of a business, and restrictive covenants in agreements, present tricky, subtle, fact-intensive distinctions that should be discussed with employment law counsel as early as possible.

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