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Too Unique to Compete?

Douglas J. Good

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He's back. After a five-year absence, banking wizard John Kanas has returned to the New York banking scene. Kanas is best known for the meteoric rise of Long Island's North Fork Bank—from four branches and $20 million in assets, to over 350 branches and $60 billion in assets. As president, CEO and chairman for nearly 30 years, he also spearheaded North Fork's 2006 sale to Capital One Financial for $13.2 billion.

In mid-2011, Kanas and his business partner John Bohlsen, another former North Fork executive, took steps to grow their Florida-based bank, BankUnited, in New York. Aug. 7, 2012 would have been the end of their five-year non-competes with Capital One. But, as part of the settlement of a lawsuit charging violations of those non-competes, BankUnited was barred from opening branches in New York's tri-state region through Jan. 31, 2013. The settlement—including a reported $20 million payment to Capital One—followed a ruling by a Virginia federal court holding the non-compete to be enforceable.

Non-Compete Agreement

When Capital One acquired North Fork, Kanas and Bohlsen agreed to stay on for three years, and not to compete with Capital One—essentially nationwide—for five years after they left. In exchange, Kanas and Bohlsen received $24 million and $18 million respectively in restricted shares of Capital One stock. (The $42 million of restricted stock was in addition to the $150 million they received for sale of their North Fork stock to Capital One.)

Yet a mere seven months after the sale, Kanas and Bohlsen left Capital One, signing separation agreements that superseded their original employment contracts. Under those new agreements their restricted shares vested almost immediately. New, narrower, non-competes were included, applicable only in the tri-state area rather than nationwide.[1]

For two years, Kanas and Bohlsen quietly obeyed the covenant. Then in 2009, Kanas and Bohlsen, along with other investors, formed BankUnited. Because BankUnited's branches were all in Florida, the new enterprise was permissible under the (revised) non-competes.

However, their next steps apparently crossed the line: BankUnited acquired mortgage portfolios partially secured by property in the tri-state area. Then, BankUnited formed a subsidiary that made loans secured by assets in the tri-state

area. Finally, in June 2011, BankUnited agreed to acquire Herald National Bank. Herald National had but two branches, but both were located in New York. Capital One brought suit in the federal district court in Virginia, alleging that Kanas and Bohlsen violated their non-competes.

Virginia Court's Ruling

Kanas and Bohlsen asked the court to reject the non-compete as overbroad. They argued that because they had no decision-making authority and Herald National remained a separate entity, they did not violate their non-competes. The district court, applying Virginia law, saw it differently and ruled the non-competes were reasonable and enforceable.

Virginia courts, as New York's, generally disfavor non-compete covenants because of the restraints they place on individuals and on competition. A Virginia court will not enforce a non-compete covenant unless it is "reasonable." Virginia courts use two separate frameworks to analyze reasonableness: a non-compete covenant in the context of an employer-employee relationship is less likely to be enforced; but "greater latitude is allowed in determining the reasonableness of a restrictive covenant when the covenant relates to the sale of a business."[2]

The court applied the employer-employee test for enforceability, reasoning that the superseding separation agreement was premised more upon the employer-employee relationship than on the sale of North Fork, seven months earlier. Under the employer-employee framework, a non-compete is reasonable only if: 1) It is narrowly drawn to protect the employer's legitimate business interest; 2) it does not unduly burden the employee's ability to earn a livelihood; and 3) it does not offend public policy. Virginia courts consider the covenant in terms of function, geographic scope and duration. Because non-compete covenants are disfavored, an employer bears the burden of proof on reasonableness.

The court determined that enforcement of the covenant would not affect Kanas' and Bohlsen's ability to earn a living or offend public policy, noting that the consideration they received for their covenant not to compete—collectively the vesting of $42 million in restricted stock they otherwise would have forfeited—dwarfed what was found sufficient in previous cases. Too, the non-compete was limited, permitting Kanas and Bohlsen to be employed in the banking industry; indeed, they conceded that the covenant would not impact their ability to earn a living.

The court emphasized that the employees here possessed unprecedented bargaining power and business sophistication: Kanas and Bohlsen knew exactly what they were doing and "stood on equal footing at the bargaining table."[3] The court also commented on the great skill of their counsel. Thus, enforcement of the covenant did not offend public policy.

Next, the court found that the covenant was narrowly tailored to protect Capital One's legitimate business interests and was reasonable in terms of duration, geography, and function. Again, the court emphasized Kanas' exceptional business savvy. Kanas went from being a school teacher to a North Fork president in six years. By the time Capital One purchased North Fork, the goodwill Kanas and Bohlsen had built was valued at $9.7 billion. "Capital One feared the Defendants' ability to swiftly grow a bank into a formidable competitor. After all, they had done it before. This time, however, they would not start from scratch, but with thirty years of experience, which afforded the Defendants' a stellar reputation and longstanding personal relationships with numerous customers."[4]

Additionally, the court found that Kanas and Bohlsen had obtained confidential information about Capital One's consumer and commercial banking business. Access to that information, together with their proven ability and considerable goodwill, provided overwhelming support to Capital One's contention that the covenant protected a legitimate business interest. The court found the covenant, with a circumscribed geographic area and a duration of five years, enforceable.

New York Perspective

Kanas' strong ties to New York prompt the question: Would he have fared any better under New York law? The answer, it seems, is no. In fact, a New York court may have an additional basis for enforcing the covenant: Kanas' "unique or extraordinary" skills.

New York courts, like Virginia's, generally will not enforce employee non-competes unless they are reasonable. New York also analyzes non-competes differently depending on whether they arise from mere employee/employer relationships or sale of business. In the employment context, a covenant must be necessary to protect the employer's legitimate interests, not harmful to the general public and not unreasonably burdensome to the employee (in time, scope and extent).[5] New York courts apply these parameters in much the same way as courts in Virginia. Thus, it is likely that a New York court applying the employer-employee framework, would have found the covenant reasonable.

But, New York courts will also enforce a non-compete agreement where an employee's services are *unique or*

extraordinary. To be "unique or extraordinary," an employee's skills must go beyond simply being of value to the employer. New York courts reason that if "unique" services of an employee are available to a competitor, the employer may suffer irreparable harm.[6] However, the "unique or extraordinary" standard is extremely difficult to meet; it is typically applied to entertainers, such as musicians, and to athletes. In those cases, injunctive relief has been available where the employee has "such ability or reputation that his or her place may not be easily filled."[7]

Although the test for uniqueness focuses more on the employee's relationship to the employer's business than on the individual persona of the employee, corporate executives are not considered to have unique or extraordinary skills except in the rarest of circumstances.[8] But, if ever there were a corporate executive who could qualify as unique, Kanas is that executive. Both his relationship to Capital One's (North Fork) business and his experience in building a bank from scratch set him apart as possessing unique or extraordinary skills; a New York court would likely enforce the non-compete covenant and grant injunctive relief on that basis.

Many of the factors cited by the Virginia court also suggest Kanas would be "unique or extraordinary" under New York law. Kanas is one of the New York region's best known bankers and businessmen. He has countless connections, networks, and support systems in the area, as well as decades of accumulated goodwill. His relationships with major players in the financial industry and his green thumb when it comes to growing banks are second to none. While it took Kanas 30 years to build North Fork bank from four branches to 350, it took just three years for Kanas to create a BankUnited with over 90 branches. If Kanas were permitted to compete directly in the New York region, Capital One would certainly suffer competitive injury. A New York court would likely have classified Kanas' skills as unique and granted Capital One injunctive relief. Ultimately, an orchestra can find another violinist, a circus can find another tumbler, and a network can find another sportscaster,[9] but there is not a man in New York who can build a bank like Kanas.

Settlement: What Price for Freedom?

The court having found the non-compete enforceable on partial summary judgment, Kanas (and Bohlsen) agreed to pay a $20 million settlement in order to gain complete freedom from the non-compete on Jan. 31, 2013. Should they have simply waited longer before moving to the New York region, or was the $20 million settlement with Capital One just the cost of doing business? Perhaps if he had waited for the non-compete agreement to expire, Kanas could have avoided the headache and expense of a lawsuit, but in the end, both parties got what they wanted.

Capital One received $20 million for allowing Kanas' inevitable competition to start one year early. For Kanas, the acquisition of Herald National was likely a deal too good to defer. Between the sale of North Fork and the vesting of restricted shares in Capital One, Kanas and Bohlsen made close to $200 million. If they have a fraction of the success with BankUnited and Herald National as they had with North Fork, that $20 million will merely be a small ante in a high stakes card game. And the extra six months competitive delay, which restricted Herald National branch openings, hiring decisions, and customer solicitations, only represents a slight hiccup in what will likely become a highly competitive and successful banking enterprise.

Douglas J. Good *is a partner and chairman emeritus of the litigation department at Ruskin Moscou Faltischek.* **Samantha Baer***, a third-year student at Brooklyn Law School, assisted in the preparation of this article.*

Endnotes:

1. The agreements defined a "Competitive Business" as: "[C]onsumer and commercial banking…including the business of acquiring and/or managing [directly or indirectly] all commercial and consumer banking products (including but not limited to, commercial and industrial loans, commercial real estate loans, middle market and small business loans…and commercial and consumer deposits), in New York, New Jersey, and Connecticut." *Capital One Financial v. Kanas*, 2012 WL 1806138 at *2 (E.D. Va. 2012).

2. Id. at *4.

3. Id at *7.

4. Id. at *9.

5. See, e.g., *BDO Seidman v. Hirschberg*, 93 N.Y.2d 382, 389-90 (1999); *Reed, Roberts Associates v. Strauman*, 40 N.Y.2d 303, 308 (1976).

6. See *Ticor Title Ins. v. Cohen*, 173 F.3d 63 at 70 (2d Cir. 1999)

7. *Ticor*, 173 F.3d at 70; see also *Shubert Theatrical v. Rath*, 271 F. 827, 829-30 (2d Cir. 1921) (acrobat who lifted a grown man with one hand, from a full length position on the floor, considered "unique"); *Associated Newspapers v. Phillips*, 294 F. 845, 850 (2d Cir. 1923) (writer of newspaper features article considered "unique"). But see *Reed, Roberts Associates*, 40 N.Y.2d at 308 (vice president of consulting company primarily responsible for devising company forms and computer system, not unique and extraordinary, and therefore not bound by non-compete).

8. See *Ticor*, 173 F.3d at 63 (non-compete covenant enforceable against former "star" title insurance salesman who had "unique" abilities relationships with clients).

9. See *American Broadcasting v. Wolf*, 52 N.Y.2d 394, n. 6 (1981) ("[N]o New York case has been found where enforcement [of a non-compete] has been granted, following termination of the employment contract, solely on the basis of uniqueness of the services").