

Noncompete Considerations for Employers Implementing COVID-19 Cost-Cutting Measures and Operational Changes

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As COVID-19 continues to spread and economic uncertainty persists, many employers are implementing layoffs, pay cuts, furloughs and other operational changes that could cause them to lose the ability to enforce their noncompete agreements. Accordingly, before implementing these cost-cutting measures, it is critical for employers to evaluate how such measures could affect the enforceability of their noncompete agreements. To assist with this analysis, we have outlined below the various issues employers faced with these circumstances should consider.¹

Layoffs

Before implementing layoffs, employers should determine whether relevant state law would preclude the enforcement of the noncompete agreements applicable to the laid off employees, as this may influence which employees are included in the reduction-in-force.² Although many states permit the enforcement of noncompete agreements against laid off employees, some states prohibit enforcement against employees who are terminated through no fault of their own. For example, under the new Massachusetts statute, noncompete agreements are not enforceable against “employees that have been terminated without cause or laid off.”³ Similarly, under the common law, courts in some states such as New York and Illinois generally will not enforce noncompete agreements against employees who were terminated without cause.⁴ In other states, including Nevada and Washington, courts will only enforce a noncompete agreement against a laid off employee if the employer compensates the employee during the restricted period.⁵

Employers implementing layoffs should also be mindful that courts may be reluctant to enforce restrictive covenants in the current economy. Specifically, courts may deny an employer’s request for injunctive relief if they find that under the current economic climate (1) the threatened harm to the employee outweighs the threatened injury to the employer or (2) enforcement of the noncompete covenant will disserve the public interest.⁶

Given that many companies are not currently hiring and the United States has been facing its highest unemployment rate since the Great Depression, it will be more

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difficult for laid off employees to find replacement jobs. As such, employees who were terminated through no fault their own will have strong arguments that the enforcement of noncompete agreements would cause them significant harm and disserve the public's interest in improving the economy. The Eastern District of Pennsylvania recently gave credence to this argument, denying an employer's request for injunctive relief and stating: "[I]n light of SV Sports' decision to lay-off Snyder and the former Sales Team members and of the fact they would be forced out of work when the country is facing the highest unemployment rates in more than seven decades, the public interest does not favor granting an injunction that would prevent these individuals from working for CI."⁷ During this pandemic, employers should expect courts to apply a similar rationale when asked to enforce restrictive covenants against employees who work in essential industries, such as health care.

Additionally, employers implementing layoffs should be cognizant of any post-termination notice requirements. For instance, Oregon's new noncompete statute requires employers to provide employees a signed, written copy of the noncompete agreement within 30 days after the date of termination.⁸

Pay Cuts

When evaluating pay cuts, employers should be mindful of new state statutes that prohibit noncompete agreements against employees who earn salaries or wages below a certain threshold. For example, under Washington's new noncompete statute, a noncompete covenant is void and unenforceable against employees earning less than \$100,000 per year.⁹ Maryland's new statute prohibits noncompete covenants against employees earning equal to or less than \$15 per hour or \$31,200 annually.¹⁰ Other states, including Illinois, Maine, Massachusetts, New Hampshire, Oregon and Rhode Island, also prohibit noncompete agreements against certain low-wage employees.¹¹ As such, employers intending to enforce their noncompete agreements should make sure the affected employees' reduced salaries or wages exceed the minimum thresholds, where applicable.

Furloughs

Existing case law is largely undeveloped with respect to how a furlough affects the duration of a noncompete agreement. If a furlough transforms into a layoff or even a voluntary resignation, employers should expect employees to argue that the duration of the noncompete covenant began to run from the time the employee was furloughed, not the time of the permanent separation.

If a furloughed employee returns to work, the employee should reaffirm his or her prior restrictive covenants so there is no confusion as to whether the covenants still apply.¹²

Evolution of Employer's Business and Changes to an Employee's Role

When employers adapt their business and restructure their workforces as a result of the pandemic, they should consider the impact these changes could have on the enforceability of their noncompete agreements. For example, many employers have begun offering new products and services, have expanded the geographic footprint of their business or customer base, or have shifted to digital commerce. Similarly, many employers have significantly restructured their workforces, requiring employees to take on expanded duties, new sales territories or new positions altogether. Because the scope of existing noncompete agreements may not adequately capture these

changes, employers should review them and determine whether amendments to the type of activity restrained, definition of competitors or geographic territory are necessary to make the covenants more effective.¹³

Conversely, as a result of the pandemic, some employers may discontinue key lines of business or permanently shut down operations in certain geographic areas. In these situations, employers operating in states that do not reform overly broad covenants (i.e., “red pencil” states, such as Nebraska and Virginia) or in states that limit the employer’s remedies if the noncompete covenant is reformed, such as Texas,¹⁴ should consider narrowing their noncompete agreements so that the covenants remain reasonable in scope of activity restrained and geographic scope and are more likely to be enforceable as drafted.

Employer’s Material Breach

An employer may lose its right to enforce a noncompete covenant if the employer is the first party to materially breach the contract housing the covenant. Therefore, before implementing pay cuts or other austerity measures, employers should evaluate whether the proposed action would constitute a prior material breach of the contract, rendering the covenant unenforceable. Determining whether an employer’s breach is material will depend on the applicable state law and the specific circumstances and contract at issue, but employers should review existing agreements and take note of any fixed term requirements, compensation and benefits requirements, duties provisions, and termination provisions, such as advance notice and severance. For example, a furloughed employee could argue that the furlough violates the term and/or compensation provisions of the contract. Likewise, an employee whose contractual salary or benefits are cut (e.g., guaranteed bonus, 401(k) matching) could claim that the reduction rendered the noncompete covenant unenforceable. Similarly, an employee who is transferred to a new position or a high-level manager who has a division removed from his or her responsibilities could argue that the noncompete is unenforceable due to a material diminution in duties. Accordingly, employers should consider obtaining an employee’s written consent to the proposed action and/or reaffirmation of his or her noncompete obligations when implementing measures that could otherwise constitute a material breach of a contractual term.

Practical Considerations

Employers implementing layoffs should determine if they intend to enforce restrictive covenants applicable to laid off employees. If so, their severance agreements should acknowledge and reaffirm the restrictive covenants to eliminate an argument that the severance agreement superseded them. If an employer does not intend to enforce restrictive covenants applicable to laid off employees, it should consider incorporating a release of the covenants in its severance agreements to avoid a future argument of selective enforcement. The release should include the employer’s rationale for the decision and a statement that the release should not be interpreted as a waiver of any future right to enforce restrictive covenants against other former employees.

Lastly, during the pandemic, employers should keep in mind that they may face procedural obstacles if they elect to seek enforcement of a noncompete agreement due to limited access to the court systems. Although courts are adapting to virtual hearings, some courts are still operating in limited capacity, which could make it

difficult or even impossible for an employer to quickly obtain injunctive relief when enforcing a noncompete agreement.

¹ The law on noncompete agreements varies from state to state and is governed by the common law, statutes or a combination of both. The statutes discussed herein took effect in recent years, and not all apply retroactively. Employers should review the effective dates of their noncompete agreements and the statutes, as well as any retroactivity provisions, to determine whether the statutes are applicable.

² Employers should also confirm whether an employee's noncompete agreement contains an express carve-out under which the covenant will not apply if the employee is terminated without cause.

³ Mass. Gen. Laws ch. 149, § 24L(c) (2018) (applicable to noncompete agreements entered into on or after October 1, 2018).

⁴ See, e.g., *Arakelian v. Omnicare, Inc.*, 735 F. Supp. 2d 22, 41-42 (S.D.N.Y. 2010) ("New York courts 'will not enforce a non-competition provision in an employment agreement where the former employee was involuntarily terminated.'" (citation omitted)); *Bishop v. Lakeland Animal Hosp., P.C.*, 644 N.E.2d 33, 36-37 (Ill. App. Ct. 1994) ("We . . . find that the implied promise of good faith inherent in every contract precludes the enforcement of a noncompetition clause when the employee is dismissed without cause.").

⁵ Nev. Rev. Stat. § 613.195(4) (2017) ("If the termination of the employment of an employee is the result of a reduction of force, reorganization or similar restructuring of the employer, a noncompetition covenant is only enforceable during the period in which the employer is paying the employee's salary, benefits or equivalent compensation, including, without limitation, severance pay."); Wash. Rev. Code § 49.62.020(1)(c) (2020) (providing that a noncompetition covenant is unenforceable against an employee who is laid off "unless enforcement of the noncompetition covenant includes compensation equivalent to the employee's base salary at the time of termination for the period of enforcement minus compensation earned through subsequent employment during the period of enforcement").

⁶ See, e.g., *Bluefield Water Ass'n, Inc. v. City of Starkville, Miss.*, 577 F.3d 250, 252-53 (5th Cir. 2009) (listing requirements to obtain a preliminary injunction).

⁷ *Schuykill Valley Sports, Inc. v. Corp. Images Co.*, No. 5:20-CV-02332, 2020 WL 3167636, at *19 (E.D. Pa. June 15, 2020).

⁸ Or. Rev. Stat. § 653.295(1)(e) (2020).

⁹ Wash. Rev. Code § 49.62.020(1)(b) (2020). This dollar amount must be adjusted annually in accordance with Washington Revised Code section 49.62.040. *Id.*

¹⁰ Md. Code Ann., Lab. & Empl. § 3-716 (2019).

¹¹ Some of these statutes prohibit employers from "entering" into noncompete agreements with employees below the minimum earnings threshold. For example, Maine's statute states that "an employer may not require or permit an employee earning wages at or below 400% of the federal poverty level *to enter* into a noncompete agreement with the employer." Me. Stat. tit. 26, § 599-A(3) (2019) (emphasis added). In these states, employers should expect litigation regarding whether the covenant is enforceable if the employee's compensation exceeded the earnings threshold at the time of execution but not at the time of termination.

¹² In contrast, if there was a break in the employment relationship (i.e., temporary layoff), then a new restrictive covenants agreement—updated to account for any recent changes in applicable state law—should be signed as a condition of re-hire.

¹³ In some states, continued employment cannot serve as consideration for an at-will employee's agreement to a restrictive covenant. In accordance with applicable state law, employers may need to provide other consideration, such as continued access to confidential information or a monetary incentive, for the amended noncompete agreement to be enforceable.

¹⁴ See Tex. Bus. & Com. Code § 15.51(c) ("[T]he court shall reform the covenant to the extent necessary to cause the limitations contained in the covenant as to time, geographical area, and scope of activity to be restrained to be reasonable . . . and enforce the covenant as reformed, except that the court may not award the promisee damages for a breach of the covenant before its reformation and the relief granted to the promisee shall be limited to injunctive relief.").

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