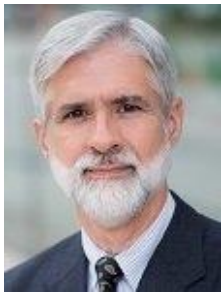
Enforcing Restrictive Covenants In The COVID-19 Era

By **Anthony Kraus** (May 4, 2020)



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As the COVID-19 pandemic increasingly impacts employers' ability to do business, their primary worries have become managing furloughs, reductions of hours and pay, layoffs and unemployment, and leave-related benefits. Hiring and its competitive impact seem like distant concerns.

A favored few, however, still need to take on new employees; and most businesses cutting personnel can still envision a day when they and their competitors will be hiring. What then will be the impact of restrictive covenants?

If laid-off employees are not rehired by their former employers, but are offered work by competitors either during, or in the wake of the pandemic, will such covenants be enforceable to prevent it or support a claim for damages for any provable related losses?

A minority of employers have effectively answered the question in the text of their covenants, although somewhat inadvertently. Their agreements expressly exclude layoffs, or other involuntary terminations not for cause, as a triggering event for post-termination restrictions.

They have adopted such limitations in realistic recognition that restraints can be difficult to enforce against employees let go through no fault on their part. By embracing such an exclusion, their restraints are enhanced by seeming less oppressive and being less susceptible to accusations of overreaching; and the companies can still at least partially manage competitive threats by judiciously choosing whom to let go and whom to retain.

Unfortunately for such employers, they are not likely to have foreseen the necessity for mass layoffs from an unexpected world health crisis or to have appreciated the threat they may face from former employees competing against them as the businesses attempt to rebound.

At least one state — Massachusetts — commands the same result by statute, precluding enforcement of noncompetition agreements against employees laid off or terminated without cause.[1] For most other employers elsewhere requiring covenants, however, their restraints purport to be triggered by any separation of employment; and no statute overrides such breadth.

By their terms, such covenants will consequently apply to any employees laid off during or as the result of the current emergency. Their enforceability will be determined by the usual tests.

Courts in most states assess covenants for the reasonableness of their restrictions in length of operation, geographic scope and activities constrained.[2] Assuming that the covenants pass the test of reasonableness, courts also rely on a multi-factored balancing of interests, including the hardship on the employee and the impact on the public interest, to determine enforceability.[3]

Impact of No-Fault Termination on Enforceability

The balancing of interests will be the most critical aspect of restrictive covenant disputes arising from pandemic-based layoffs. As already noted, many courts have expressed general reluctance to enforce covenants in situations where employees have been let go by their employer through no fault of their own.

Some decisions conclude that because layoffs serve the unilateral business interest of the employer, destroying the mutually beneficial employment relationship between the parties, the employee's unilateral interest in finding new work, even if for a competitor, should reciprocally be given controlling weight after the layoff.[4] Other cases stress that because the employer has cast the employee aside, it should be deemed in fairness to have forfeited any right to limit the employee's ability to find other available work, including in competitive positions.[5]

Augmenting such concerns is the maxim that restrictive covenants generally conflict with the public policy of promoting competition and are disfavored. Such precedents might therefore seem, at least superficially, to portend a mass liberation from post-termination restraints for employees terminated in COVID-19-related layoffs and who, for various possible reasons, do not return to their old jobs.

There are a number of other factors, however, that conceivably might mitigate against any such automatic limitation on enforcement. Layoffs caused by COVID-19-related closures or restrictions on operations cannot be so easily characterized as initiated simply for the business convenience of the employer.

Nor do they rest upon any ordinary business judgment that the employees are expendable, which typically can undercut an employer's right to, or perceived need for, competitive restraints upon them. Instead, such layoffs in many instances are legally compelled because the employers are nonessential businesses, or are economically necessitated because of a temporary dip in demand.

Such layoffs are sudden and contrary to the employer's wishes or expectation, and can be required to enforce the public interest in social distancing, or compelled as a temporary necessity to keep businesses solvent for the short term, so that they are able to rehire employees after the emergency abates. Accordingly, the normal judicial inclination to decide in favor of employees discharged without fault may be offset by legitimate concerns about fault-free employers, who are not acting exclusively from self-interest, but in part for the interests of others.

Other factors that also might make a difference are whether the employer initially made efforts to manage around layoffs and keep workers partially employed; or represented to employees the intent to rehire as soon as conditions allowed; or is able to show a likelihood of offering to rehire in the near future. Similarly, if the employee has qualified for unemployment or other relief during the layoff, it also could be a factor militating against any instant emancipation from restrictive covenants, much as, for example, extending salary through garden leave helps mitigate the perceived hardship of restrictions.

Impact of Suspended Operations as Competitor

Another common setting in which employees have been able to evade their restrictive covenants is when their former employer is no longer competing in the restricted market.[6] These situations typically involve employers who have changed product or service offerings

or are in economic distress or bankruptcy and unable, at least temporarily, to operate.

During a period of pandemic-based closure, or of limited operation involving curtailed lines of business, a former employee might therefore also be able to argue that if the employer is not operating competitively, it has no protectable interest that can justify restraining a former employee. The argument will be stronger if the former employer remains closed for a significant period after emergency restrictions are lifted, as many smaller or marginally sustainable businesses are anticipated to do.

In such cases, however, there is the counterargument that a period of economic distress is exactly when an employer especially needs protection of restrictive covenants in order to have a chance at recovery. During a period of pandemic-based closure, that rejoinder is even stronger due to the accidental nature of the disruption, the public purposes which can prompt closure, and the general interest in promoting businesses' efforts to restart. The competing equities in such can be complicated.

Impact of Pandemic-Related Contract Changes

Apart from the effect of no-fault employee terminations and former employers' suspended status as competitors, there are other more specific pandemic-related issues that are likely to arise concerning enforceability of employee restrictive convents, including even for non-laid-off employees. One likely example will involve employers' efforts to revise the terms of employment for some or all personnel, to reduce costs during the pandemic's economic downturn.

Such changes can arguably violate the terms of express or implied employment contracts, although in many jurisdictions the employment-at-will doctrine precludes such changes from being considered breaches. If the employer arguably does breach a contractual right, and it is significant enough to be material, the affected employee may be able to claim the employer was first to breach their contract, thus discharging the employee from the obligation to counterperform by obeying restrictive covenants.[7]

There are likely to be significant disputes over whether employer breaches exist, whether the unique circumstances can in any way excuse such breaches, and whether common covenant language purporting to make covenants enforceable despite employer breaches is enforceable in such cases.

Impact on Employee Solicitation and Recruitment

Another likely hot spot may arise in connection with covenants that seek to prohibit employees' post-termination efforts to recruit co-workers for other employers. Employees who have been laid off by or have left an employer as a result of the pandemic's impact will often want to watch out for the interests of laid-off former co-workers and to direct them to other employment opportunities they learn about.

Such conduct may violate the terms of their nonsolicitation and nonrecruitment covenants, which not only prohibit recruitment of currently retained employees, but often try to encompass departed personnel who worked for the employer anytime during a look-back period, often a year in duration. One likely issue will be whether prohibiting recruitment of laid-off former personnel, who will only fall within the prohibition by virtue of such lookback periods, furthers a valid protectable interest and is enforceable.

That lurking issue has not attracted much attention historically but is likely to now. Former employers will contend that efforts to recruit such employees deprive them of a pool of trained personnel for rehiring, and will hamper their economic recovery.

Employees will contend that they are entitled to keep all avenues of reemployment for themselves and others open, and cannot be impeded in helping former co-workers earn a livelihood. Once an employee is out the door, they will contend, the former employer should have no right in any way to affect their prospects.

Impact of Predatory Intent

The situations discussed above do not involve any predatory or other improper intent by the parties, but rather simply unforeseen changes in circumstances and the need for the employer to take action and for employees to earn a livelihood from available sources. Obviously, if there is evidence of an effort to exploit the crisis for unfair competitive advantage, it is easy to imagine that also being an important consideration in this context.

If a large out-of-state competitor, for example, was subject to less legal or economic constraint during the crisis than hard-pressed local firms in a heavily affected area, and sought to pirate the temporarily laid-off employees of local firms in the same business, the former employer's interest against such calculated predation might influence a court against permitting disregard of restrictive covenants.

Existing Case Law and Possible Legislative Intervention

The existing case law appears not to contain much direct guidance involving the enforceability of restrictive covenants in the wake of business closures and temporary layoffs from disasters, such as hurricanes, terrorist attacks or similar catastrophes. Such events are usually local in impact and do not prompt widespread or readily discoverable legal precedents. While there were a handful of cases addressing covenant enforcement in the wake of the 2008 economic downtown, their resolution did not involve distinctive considerations related to that crisis; and many industries were not greatly affected by it.

In contrast, because the current crisis is likely to have a much more pervasive impact, we can expect in coming months to see pandemic-based concerns playing a significant role in covenant enforcement litigation. It is also likely that legislators who have been advocating for cutbacks in restrictive covenants will see the pandemic as an opportunity to try to place further constraints on them, which can be promoted as a form of relief for widespread unemployment caused by the emergency. Courts and legislatures confronted with such issues will face difficult choices, with complicated balances of interests to weigh.

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[1] M.G.L c. 149, § 24L(c).

[2] See, e.g., Deutsche Post v. Conrad, 292 F. Supp. 2d 748, 754-756 (D. Md. 2003); aff'd,

116 Fed. Appx. 435 (4th Cir. 2004).

[3] Id.

[4] See, e.g., Post v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 48 N.Y.2d 84, 89 (1979).

[5] Insulation Corp. of Am. v. Brobston, 667 A.2d 729, 735 (Pa. Super. Ct. 1995).

[6] See, e.g., PlanGraphics, Inc. v. Hall, 2006 WL 8446168 at *1 (E. D. Ky., Feb. 17, 2006).

[7] See, e.g., Jorgensen v. United Communications Group Ltd. Partnership, 2011 WL 3821533 at *10 (D. Md., Aug. 25, 2011).