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Preserving Noncompete Enforcement Rights Amid COVID-19

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Many employers have reduced the size of their workforce as a result of shelter-in-place and business-closure orders that have been issued around the country. With a double-digit unemployment rate, laid-off workers are seeking new employment wherever they can find it, which often means in the same industry where they last worked.

Assuming they find new employment with a competitor, employers are tasked with the unenviable question of whether, at this unprecedented time, to seek enforcement of restrictive covenants like noncompetition and customer nonsolicitation provisions to effectively put their former employees back out of a job.

Relaxing enforcement of restrictive covenants is understandable and appropriate in this current environment. But in doing so, employers must keep in mind that their current behavior could be used against them when they try to enforce similar agreements against other employees in the future when COVID-19 is no longer an issue.

In particular, there is a risk that former employees who breach their restrictive covenant agreements may assert a waiver argument — namely, that the employer's prior forbearance evidences its lack of a legitimate interest that would support enforcement of the noncompete or nonsolicit provision.

Employers that choose not to seek to enforce restrictive covenants at this time should thus take steps to minimize the risk that their well- intentioned inaction now may preclude later enforcement.

What are the requirements for enforcing a restrictive covenant via injunctive relief?

Restrictive covenants are not self-executing. Thus, even though an agreement may specify that an employer is entitled to an injunction if an employee breaches a noncompete or customer nonsolicit clause, the employer has a burden to do far more when it seeks an injunction in court.

To obtain a preliminary injunction enforcing a noncompetition agreement against an employee, an employer must generally establish that: (1) it has a likelihood of succeeding on the merits; (2) it has an inadequate remedy at law, and will suffer irreparable harm if the agreement is not enforced; (3) the balance of equities between the parties weighs in favor of enforcing the noncompetition agreement; and (4) enforcement of the agreement is in the public interest.[1]

As discussed below, an employer's selective enforcement of a noncompetition agreement could implicate a number of these factors. In particular, such inaction may be used in future litigation involving other employees to suggest that the alleged legitimate interest at issue is actually not in need of protection.

Inconsistent enforcement can call into question whether an employer has a legitimate interest to protect via an injunction.

Noncompetition agreements must serve to protect an employer's legitimate business interests.[2] The following are typically considered legitimate business interests: (1) protection of trade secrets and confidential information; (2) protection of customer relationships; and (3) protection of employees with special or unique skills.[3] The employer bears the burden of demonstrating that the restrictive covenant reasonably protects one of these legitimate interests.[4]

However, it should be noted that many trial courts in various states are hesitant to or will not enforce noncompetition agreements against employees who are involuntarily terminated from their jobs.[5] Other courts suggest that a noncompetition agreement is not precluded against involuntarily terminated employees following a determination of the reasonableness of the restriction.[6]

There are several notable decisions regarding whether selective enforcement results in a waiver.

As noted, in cases in the future where a company seeks to enforce a noncompetition agreement against a former employee, the employee may argue that the employer has waived its ability to enforce the agreement by choosing not to enforce the agreement in the past vis-a-vis other former employees.

Waiver is the voluntary and intentional relinquishment of a known right, and the burden to prove waiver is upon the party claiming it.[7] If a waiver is implied by a party's conduct, there must be a clear, unequivocal and decisive act of the waiving party showing such purpose, and that act must be so consistent with an intention to waive that no other reasonable explanation is possible.[8]

The good news is that, contrary to many urban legends that come up all the time during oral arguments in court, waiver is the exception and not the rule. While some cases provide that an employee has a high burden to demonstrate that the employer waived the noncompete clause[9] as a matter of equity, trial courts consider the circumstance that was created by the employer to put the employee out of a job and determine whether it would be fair to also prevent the employee from taking on another job.

For example, if an employer discharged an employee for poor performance, a court driven by equitable considerations might evaluate whether the poor performer could compromise the former employer by working at a new employer. Similarly, if an employee is discharged because a particular business function or division is slow or has become obsolete, a court might find it inequitable to preclude an employee from doing similar work at another company.

A few cases where courts have found that lax enforcement of restrictive covenants result in a waiver are instructive. For example, in *Estee Lauder Cos. Inc. v. Batra*, the company sought to enforce noncompetition and nondisclosure agreements against Shashi Batra, a high-level executive who had resigned for a job with a competitor.[10]

Batra's restrictive covenant, which was the covenant that the company required of all new executives, prohibited Batra for one year from the date of his termination, regardless of reason, from, among other things, working for any business on behalf of any competitor where he could benefit the competitor or harm the company by using or disclosing confidential information.

Batra successfully challenged the company's attempt to completely enforce its agreement because he demonstrated that the company rarely sought a restraint for the entire one -year duration of its own agreement. On the contrary, the restrictive covenants of other former company executives, who were at the same level as Batra and possessed the same confidential company information, included much shorter post-separation restraints.

Based upon the company's past practice of reducing its own restrictive covenants with other departing executives, the U.S. District Court for the Southern District of New York ruled that the company's "general behavior surrounding the enforcement of restrictive covenants" suggests that a one-year restraint "is generally unnecessary."[11] Though most of the restrictive covenant was left intact, it was shortened to five months, as that was the amount of time deemed necessary to protect the company's interests.

The U.S. District Court for the District of Minnesota's finding of a waiver that would preclude enforcement of a noncompetition agreement in *Surgidev Corp. v. Eye Technology Inc.*, is also instructive.[12] There, a company attempted to enforce noncompetition agreements against four officers.

The court rejected the company's attempt to enjoin the former employees because it had failed to attempt to enforce the restrictive covenants of 28 other former employees, including high-ranking executives, who had left the company over the years for positions with competitors. The court concluded that "[u]nder the circumstances, it would be inequitable to permit plaintiff to now rely on a non-compete agreement which it has so blithely ignored in the past."[13]

On the other hand, a number of courts have been reluctant to find that an employer waived its right to enforce a noncompetition agreement where it did not seek to enforce it in the past.

For example, in *HR Staffing Consultants LLC v. Butts*, a health care staffing company moved for a preliminary injunction to enforce a noncompetition agreement against its employee, Richard Butts, in order to prevent him from working at a company to which he was assigned as a high-level executive.[14]

Butts had argued that the company waived its ability to enforce the noncompetition agreement because it had permitted others to work at the company where Butts sought to work. However, the U.S. District Court for the District of New Jersey found it was reasonable for the former employer to exercise some selectivity when incurring the trouble and expense of enforcing noncompetition agreements.

And the court emphasized that Butts was a high-level and valuable employee. The court concluded that it makes sense that the plaintiffs would focus their prevention efforts on Butts in particular.[15] The court further determined that the company did not waive Butts' noncompetition agreement, noting that the agreement states that it may be modified only by a written instrument signed by both parties, and Butts never received a written waiver of the agreement.[16]

Another noteworthy case where a court refused to f ind a waiver is *Custom Hardware Engineering & Consulting Inc. v. Dowell*.[17] There, the defendants formed and operated a competing company, of which the plaintiff (their employer) did not approve, as required bytheir employment agreements.

The defendants argued that the employer waived its right to enforce the noncompetition provisions in their employment agreements by failing to prevent other employees from engaging in side jobs. The U.S. District Court for the Eastern District of Missouri disagreed, noting that Missouri limits the application of waiver by virtue of long continued course of conduct strictly to conduct between the parties themselves.[18] Likewise, the court found that there was no intentional or implied waiver.[19]

There are several ways to minimize the risks.

Employers should take steps to minimize the risk that a decision at this time not to enforce a restrictive covenant will preclude them from effectively arguing that their legitimate interests are not worthy of protection in the future or that they otherwise have waived their right to enforce the covenant.

To that end, employers should ideally memorialize their rationale for not seeking to enforce the restrictive covenant at this time. The rationale can be included in a settlement agreement or in other contemporaneous documentation that can be kept in house and need not be shared with the workforce.

But it could be produced in the event a waiver argument is advanced in the future — the contemporaneous preparation of the document as opposed to an effort to reassemble the rationale in the future will be far more effective and persuasive.

Here are some reasons that serve to differentiate the decision not to enforce the noncompetition covenant:

- The employee is not perceived as a threat to the company's trade In this regard, a company could reference, among other things, an employee's: long history or tenure as a model employee; return of all confidential information in his/her possession at the time of termination; assistance with transitioning ongoing business; having never engaged in nefarious behavior; and/or representation of compliance with ongoing confidentiality obligations.
- The employee is not perceived as posing a threat to client For example, clients may not be operating during the pandemic, may have gone out of business or reduced business as a result of the pandemic, or the client relationships have been appropriately transitioned such that there is no substantial risk that the business would be lost due to solicitations. The former employee may also agree not to solicit the customers he or she serviced in the final months of employment.
- As a practical matter, the employer lacks the resources necessary to enforce the restrictive covenant due to the impact the pandemic has had on the employer's business.

Employers also may wish to consider acknowledging that enforcement of the restrictive covenant at this time may be construed as imposing an undue hardship on the employee. In doing so, employers should emphasize the uniquely compromised state of the economy due to the pandemic to differentiate future circumstances where it seeks to enforce the restrictive covenant.

For good measure, employers should expressly include their position that the decision should not be interpreted as a waiver of any future right to enforce the restrictive covenant against other former employees.

Lastly, employers should review and, where appropriate, update their post-employment restrictive covenants to make sure they accurately reflect the needs of the business without being impermissibly overbroad.

Conclusion

Again, at a time of severe economic turbulence, employers that are strapped for cash and hopeful that their former employees land on their feet may be hesitant to enforce restrictive covenants like noncompetition and nonsolicitation agreements. Those employers also may be mindful of potential public relations risks attendant to enforcing noncompetes at this time.

But they should recognize that forbearance may invite arguments that they lack a legitimate interest supporting the agreement and/or have waived the agreement. Courts in different jurisdictions have taken varying approaches to this issue, with some countenancing such arguments and others deferring to the employer's decisions.

Thus, employers should consider creating a record explaining their rationale for not enforcing noncompetes at this time so that they can distinguish the circumstances surrounding the decision when the economy improves.

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[1] See Winter v. Nat. Res. Council, Inc., 555 U.S. 7, 20 (2008).

[2] See Brown & Brown, Inc. v. Johnson, 34 E.3d 357, 361 (N.Y. 2015); Reliable Fire Equip. Co. v. Arredondo, 2011 IL 111871, ¶ 17; Automile Holdings, LLC v. McGovern, 136 N.E.3d 1207, 1218 (Mass. 2020).

[3] See ADP, LLC Rafferty, 923 F.3d 113, 121 (3d Cir. 2019) (applying New Jersey law related to trade secrets, confidential information and customer relationships); Ticor Title Ins. Co. v. Cohen, 173 F.3d 63, 70 (2d Cir. 1999) (applying New York law regarding employees with unique skills).

[4] See, e.g., Hosp. Grp., Inc. v. More, 869 A.2d 884, 897 (N.J. 2005) (turning to the "Solari/Whitmyer test for determining whether a noncompete agreement is unreasonable and therefore unenforceable. That test requires us to determine whether (1) the restrictive covenant was necessary to protect the employer's legitimate interests in enforcement . . ."); Brown & Brown, Inc, 34 N.E.3d at 361 ("[U]nder New York's three-prong test, a restraint is reasonable only if it: (1) is no greater than is required for the protection of the legitimate interest of the employer . . . .") (emphasis in original).

[5] See, e.g., Random Ventures, Inc. v. Advanced Armament Corp., LLC, No. 12-cv-6792, 2014 WL 113745, at *52-53 (S.D.N.Y Jan. 13, 2014), aff'd as modified, 614 F. App'x 523 (2d Cir. 2015); see also Mass. Gen. Laws c. 149, § 24L(c) ("A noncompetition agreement shall not be enforceable against . . . (iii) employees that have been terminated without cause or laid off.").

[6] See Wise v. Transco, Inc., 425 Y.S.2d 434, 435-36 (N.Y. App. Div. 1980); Hyde v. KLS Prof'l Advisors Grp., LLC, 500 F. App'x 24, 26 (2d Cir. 2012) (citing BDO Seidman v. Hirshberg, 712 N.E.2d 1220, 1224-25 (N.Y. 1999)) (proposing that "a traditional overbreadth analysis might be more appropriate" in determining whether a restrictive covenant is enforceable against an employee who has been terminated without cause).

[7] See Custom Hardware Eng'g & Consulting, v. Dowell, 918 F. Supp. 2d 916, 930-31 (E.D. Mo. Jan. 23, 2013); HR Staffing Consultants, LLC v. Butts, 2015 WL 3492609, at *14 (D. N.J. June 2, 2015).

[8] Dowell, 918 F. Supp. 2d at 931; Butts, 2015 WL 3492609, at *14.

[9] See, e.g., Kempner Mobile Elecs., Inc. v. Sw. Bell Mobile Sys., 02-cv-05403, Docket No. 48 (N.D. Ill. Mar. 7, 2003).

[10] 430 F. Supp. 2d 158 (S.D.N.Y. 2006).

[11] Id. at 182.

[12] 648 F. Supp. 661 (D. Minn. 1986).

[13] Id. at 698.

[14] 2015 WL 3492609, at *14-1

[15] See at *11.

[16] See at *14.

[17] 918 F. Supp. 2d at 930-31.

[18] Id. at 930.

[19] Id. at 931.

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