

Enhancing Enforceability of Restrictive Covenants Against Terminated Employees

The Bottom Line

- *Employers seeking to enforce post-employment restrictions against terminated employees will face an uphill battle if they are unable to demonstrate that the employee was terminated with cause.*
- *There are two ways for employers to mitigate this situation.*
 - *First, they should maintain employee performance management systems and contemporaneously document performance issues.*
 - *Second, they should ensure that separation agreements with terminated employees provide sufficient severance to the employee, with the employee re-affirming in the severance agreement the binding nature of the restrictive covenant.*

Employers must be aware that restrictive covenants may not be enforceable against employees—even employees whose employment is at will—if and when an at will employee is terminated without cause. Employers who effect terminations due to a downturn in business, reduction in force, loss of a major client, closure of an office or simply a desire to maintain strong profitability may be surprised to learn that enforcing non-compete agreements against those terminated employees presents significant challenges.

Courts increasingly regard enforcement of restrictive covenants against an employee who is discharged by no fault of their own as unfair and beyond the legitimate business needs of the prior employer. This is based on the reasoning that it would be disingenuous for the employer to consider the employee unnecessary to its own business, but simultaneously limit the employee's unfettered ability to service a former client or hire a former co-worker.

In fact, a growing body of statutes and case law requires employers seeking to enforce restrictive covenants against terminated employees to demonstrate cause for the termination. For example, the recently enacted Massachusetts Noncompetition Agreement Act prohibits enforcement of non-compete agreements entered into on or after October 1, 2018 against employees who have been terminated without cause (please see a recent Davis & Gilbert alert titled, "[New Massachusetts Law Specifies Requirements for Noncompetition Agreements](#)"). Many courts, including in the District of Columbia, Illinois, Maryland, and Pennsylvania, consider the reasons of an employee's discharge when assessing of the enforceability a restrictive covenant. These states may also view restrictive covenants with heightened disfavor where an employer ends the relationship, and refuses to enforce such agreements where an employee was terminated without cause.

New York is among those states that regularly refuse to enforce restrictive covenants against employees terminated without cause (please see an April 2017 Davis & Gilbert alert titled, "[Enforcing Restrictive Covenants Against Employees Discharged Without Cause](#)"). In December, a New York court in *Davis v. Zeh* refused to enforce a contractual provision prohibiting a terminated employee from working within 40

miles of the employer's clinic for a one-year period following the termination. The employer's only evidence to support the reason for the employee's termination was a speculative allegation, not based on the employer's personal knowledge, that the employee violated the company's employment handbook. The employer's proffered reason for termination—if true—may have demonstrated sufficient cause. However, the court refused to enforce the restriction in part due to the dubious, unsubstantiated nature of the employer's allegations.

Recommendations

It is good HR practice to maintain a robust performance management program that includes documentation of performance issues, as well as sharing feedback in periodic reviews and immediately after performance issues arise. These HR best practices will serve employers who seek to enforce restrictive covenants against departing at will employees. Documentation of performance issues will help demonstrate that termination was for legitimate performance reasons and not arbitrary.

Another way for employers to maximize the enforceability of their restrictive covenants for all departing employees—including for those employees who are terminated without cause—is to utilize carefully-drawn separation agreements to provide severance benefits to departing employees. The separation agreement should have the employee reaffirm the terms of the restrictive covenant and that the employee agrees to be bound by the restrictive covenant in consideration for receiving the severance benefit.

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