

Protective Covenant Considerations in the COVID-19 Era

The Bottom Line

- In the current economic environment, courts may be less willing to enforce broad protective covenants that restrict former employees from accepting new job opportunities.
- Now is the time for employers to take a hard look at their protective covenants and make sure that they are only as broad as necessary to protect the company's legitimate business interests.
- Employers should consider offering employees terminated without cause benefits the employee would not otherwise be entitled to in exchange for the employee's agreement to adhere to reasonable restrictions.

The growing unemployment rate caused by the COVID-19 pandemic may impact companies' ability to enforce post-termination covenants designed to protect them from unfair competition by departing employees. Narrowly-tailored protective covenants are vital tools in guarding a company's proprietary information and hard-won client relationships, among other legitimate business concerns.

With new employment opportunities at a premium, what should businesses expect from courts considering applications to enforce contracts that restrict a former employee's ability to accept a position with a competitor?

Interim Relief: The Initial Remedy in Protecting the Company

Protective covenants can include prohibitions on certain conduct for a period of time post-termination, including:

- Non-competition clauses barring former employees from working for businesses that compete with their former employer;
- Client non-solicitation and non-servicing clauses prohibiting former employees from targeting and/or working with certain clients;
- Non-raiding provisions that prevent poaching former coworkers; and
- Confidentiality clauses that prohibit the use or disclosure of company information other than for company purposes.

Consider a common scenario: upon learning that a former employee is violating a protective covenant, the company files a lawsuit and immediately seeks an injunction to safeguard its rights. A court may grant a preliminary injunction if the company can establish certain required factors, which usually include:

1. The company's likelihood of succeeding on the merits of its claims;
2. Imminent, irreparable harm that the company would incur without the injunction;

3. The balance of equitable considerations tips in the company's favor; and
4. The injunction is in the public interest.

In a protective covenant dispute, a company's likelihood of success often turns on whether the court deems the relevant covenants enforceable. Approaches to protective covenants vary between jurisdictions, but most states take a cautious approach in deciding whether to enforce them.

In New York, post-employment restraints will be enforced only where they:

1. Are no greater than what is required for the protection of the former employer's legitimate business interests;
2. Do not impose undue hardship on the employee; and
3. Are not injurious to the public.

The Pandemic: Changing the Playing Field?

Judges often take a practical view of the circumstances surrounding a case and, when considering potential "hardship on the employee", consider the effect of an injunction on the employee's ability to earn a living. Courts are particularly reluctant to enforce protective covenants where an employee has been terminated without cause, unless the former employer compensates the employee during the restricted period.

In New York, while the state's highest court has not categorically ruled that employers cannot enforce protective covenants after terminating an employee without cause, several federal district judges have construed New York law in this manner. A growing number of states have passed laws preventing or circumscribing enforcement of non-competition restrictions against employees terminated without cause.

Courts in many jurisdictions are empowered to revise or "blue pencil" overbroad protective covenants and then enforce the narrowed covenant. Yet, judges may refuse to do so where they find the employer has overreached and attempted to impose unreasonable covenants on employees.

With the historic spike in layoffs due to the COVID-19 crisis, courts may be more reluctant to enforce protective covenants that might have been considered reasonable restrictions mere months ago. While relatively few cases seeking preliminary injunctive relief have been filed since states began ordering offices to close and workers to stay at home, a few judges have already shown some reluctance to grant full or even partial injunctive relief to former employers. This is so even in circumstances in which the employee appeared to have taken and used confidential information and succeeded in convincing clients to follow them elsewhere.

Maximizing the Company's Chances for Success

How can a company best protect its legitimate interests through protective covenants in the current economic environment? Every company should be considering the following steps:

Narrow the Protective Covenant

Reexamine protective covenants to make sure they are no broader than necessary. Companies should narrow non-competition clauses to truly competitive conduct, reasonably limit their duration and geographic scope and consider compensating employees during the restricted period. Likewise, companies should limit non-solicitation clauses to solicitation of competitive work from customers with which the departed employee had a relationship while at the company.

Consider Severance for Terminated Employees

Employers should consider agreeing to pay severance to employees who are terminated without cause — severance that the company was not otherwise obligated to pay — as consideration for adhering to protective covenants.

Blue-Pencil Covenants in Separation Agreements

Employers may want to consider proactively “blue-penciling” their existing covenants in separation agreements to limit the covenants to those necessary to protect the company’s business interests. Companies could waive a non-competition requirement as further consideration for the employee’s promise to adhere to non-solicitation obligations. Such consideration also provides a potential substitute for severance for companies that do not have the economic resources to provide severance to departing employees.

Compliance is Key

Companies need to be sure that they are complying with the terms of the employment agreements that contain the protective covenants. Departing employees often argue the company’s own breach as grounds for disregarding protective covenants. In today’s economy, this argument may resonate more strongly with courts.

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