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Enforceability of Non-Compete Provisions During COVID-19 Pandemic

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In the financial industry, as in others, employees often enter into employment agreements that require them to give early notice of their intent to terminate their employment (often three to six months prior to leaving the job), followed by an agreement to comply with a covenant not to compete against their former employer for a period of time following termination of their employment. These covenants against competition generally are disfavored under common law and have been upheld by courts only where the employer could demonstrate that they were carefully drafted to address legitimate employer interests. The COVID-19 pandemic and resulting economic instability may give rise to new employee defenses against the enforcement of non-compete clauses.

Covenants Against Competition

The law on covenants against competition varies from state to state. Such covenants are an exception to the typical rule against enforcing contracts that act as restraints of trade and are enforced only if they reasonably balance the interests of the employer, the employee, and the public. Narrowly tailored non-compete clauses are justified to the extent that they prevent an employee from *unfairly* competing against his or her former employer by using confidential trade information learned, or customer relationships developed, as a result of the employment relationship. An employee is thus prohibited from turning his or her use of the employer's resources against the employer.

But in each state, the scope of the restriction is a significant determinant of whether a court will enforce the restriction. In New York, for example, a non-compete

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clause (1) must be no greater than is required for the protection of the legitimate interest of the employer (i.e., it must be narrowly tailored); (2) must not impose undue hardship on the employee; and (3) must not be injurious to the public. *BDO Seidman v. Hirshberg*, 93 N.Y.2d 382, 388 (1999). To enforce a non-compete clause, the employer must satisfy each prong of the test.

The reasonableness of a non-compete clause is a highly fact-specific inquiry. Ordinarily, the broader the scope of a non-compete clause, the more likely it is that a former employee will succeed in a challenge to its enforcement. Non-compete clauses that are geographically limited to a region, city, or neighborhood are more likely to be enforced. *Poller v. BioScrip*, 974 F. Supp. 2d 204, 222 (S.D.N.Y. 2013). So are clauses that are temporally limited (in the financial industry, generally—but now always—to six months or less). *EarthWeb v. Schlack*, 71 F. Supp. 2d 299, 313 (S.D.N.Y. 1999). In addition, a narrowly drafted non-compete clause will usually be limited to a specifically defined industry or role within that industry—for example, trading in a particular sector of the securities market. *Integra Optics v. Messina*, 52 Misc.3d 1210(A), 2016 WL 3917764, at *3 (N.Y. Sup. Ct. Albany Cty. 2016).

Undue Hardship And Injury to the Public

The COVID-19 pandemic has changed economic circumstances in such a substantial way that it may provide the basis for a successful challenge even to narrowly tailored, short-duration non-compete clauses.

Former employees seeking to avoid enforcement of such clauses might argue that any period of forced unemployment would constitute undue hardship. The New York Court of Appeals has recognized that public policy militates against sanctioning the loss of a person's livelihood. *Am. Broadcast Cos. v. Wolf*, 52 N.Y.2d 394, 404 (1981). The wholesale collapse of many sectors (including those with lower barriers to entry, like retail and hospitality) makes it more likely that a bar from one's chosen field is effectively a complete employment bar. Employers who are concerned about the misappropriation of trade secrets can neutralize this potential defense by agreeing to continue paying salary during the non-compete period (commonly known as garden leave). *Estee Lauder Cos. v. Batra*, 430 F. Supp. 2d 158, 180-81 (S.D.N.Y. 2006).

Employees might also press the novel argument, suggested by the Restatement, that covenants against competition should be especially disfavored during a period of profound economic dislocation as contrary to public policy because they discourage

hiring and increase inefficiencies. Restatement (Second) of Contracts, §188 cmt. c (1981). Here, the employee's interest in earning a livelihood aligns with the public's interest in promoting economic mobility—restraints that artificially limit employers' ability to fill openings with appropriately skilled candidates will create unnecessary drag on economic recovery.

Impossibility

In asserting an undue hardship defense to the enforcement of a covenant against competition, a former employee might also look to the related contract doctrine of impossibility. Under this doctrine, non-performance of an otherwise valid contractual promise will be excused when an unanticipated event that could not have been guarded against at the time of contracting renders performance so difficult as to be essentially impossible. *Kel Kim v. Central Markets*, 70 N.Y. 2d 900, 902 (1987). Present economic circumstances may have the unintended effect of turning a narrow months-long non-compete covenant into a complete, indefinite bar on working in one's chosen field—a prohibition to which the employee would not reasonably have agreed. We expect that the impossibility doctrine and other contract defenses will be heavily litigated in the months to come.

Conclusion

Enforcement of non-compete provisions in employment agreements has always required careful consideration of whether the restriction in the covenant has been drafted narrowly enough to support enforcement. This includes consideration of whether (1) the limitation on new employers that may be considered competitors reasonably contemplates the geographic breadth of the former employer's business; (2) the period of non-competition is reasonable based on the nature of the former employee's position and potential harm to the former employer's legitimate business interests; and (3) the definition of which businesses reasonably may be deemed in competition with the former employer competitor has been narrowly drawn.

With the onset of the COVID-19 pandemic, non-compete provisions are more susceptible to challenge.

With the onset of the COVID-19 pandemic, non-compete provisions are more susceptible to challenge. If a former employee objects to the enforcement of a non-compete provision in his or her original employment contract, employers should consider whether it may be in their interest to negotiate a compromise (for instance, as to scope or duration), rather than to take on the expense and uncertainty of litigation to enforce the original non-compete provision. Moreover, under the "employee choice" doctrine, a post-employment agreement that conditions the availability of a post-employment benefit (like health insurance or severance pay) on compliance with a non-compete covenant is presumptively reasonable. *Morris v. Schroder Capital Mgmt. Int'l*, 7 N.Y.3d 616, 620-21 (2006). Accordingly, offering some additional benefit in exchange for a newly negotiated non-compete agreement could provide additional protection for a company seeking to safeguard its trade secrets and competitive information.