Non-Compete Enforcement Considerations in the Context of a Reduction-in-Force

Insights
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The COVID-19 pandemic has led to an unprecedented economic disruption, forcing many employers to reduce their workforce. In the face of state and local shutdown orders and a sudden drop in business, many employers moved quickly to shut down or curtail operations – leading to the termination of millions of employees, many of whom are subject to noncompete agreements. Now that most cities and states have begun to reopen their economies, there has been a resurgence of business activity and a commensurate increase in hiring. The question now is what to do when a furloughed or laid-off employee find a job with a competitor.

Noncompete Enforcement Post RIF

While unfair competition concerns were not front and center for most employers during the tumultuous months of March and April, an improving economy means former employees are seeking out and finding new employment, some with competing businesses. Can you enforce the noncompete agreement of an employee terminated during a reduction-in-force when that employee accepts a position with a "competitor?" The answer is "it depends," since noncompete enforcement is dependent on state law and the facts and circumstances surrounding the former employment relationship. Many states have enacted statutes which prohibit noncompete agreements for workers earning below a certain threshold amount and place other restrictions on their enforcement. While there are numerous factors to consider, a critical threshold inquiry is whether there was sufficient legal consideration for the noncompete agreement.

There are also some states that limit the enforceability of post-employment non-compete and customer non-solicitation covenants if the employee the company seeks to enforce the agreement against lost their job as the result of a layoff, reduction-in-force, or elimination of position having nothing to do with their performance or conduct. These jurisdictions are: Arkansas, District of Columbia, Iowa, Kentucky, Maine, Mississippi, New York, Pennsylvania, South Dakota, and Tennessee. In these jurisdictions, even if the non-compete or non-solicit is unenforceable, the company can still require the return of its confidential information and trade secrets and can still prevent the departing employee's use or disclosure of such information.

Two Scenarios

Two scenarios illustrate potential noncompete enforcement problems in a reduction-in-force environment. The first involves recently hired at-will employees who signed a noncompete agreement at the outset of employment or during employment supported only by the consideration

agreement at the outset of employment or during employment supported only by the consideration of continuing employment who are terminated during a reduction-in-force. Even in states that readily enforce noncompete agreements like Tennessee, the termination of an at-will employee a short time after execution of the agreement may render the agreement unenforceable. *Central Adjustment Bureau v. Ingram*, 678 S.W.2d 28, 35 (Tenn. 1984). The second involves employees subject to a noncompete agreement who are terminated without severance pay or continued compensation or benefits. Some states, like Nevada, Oregon, Washington, and Massachusetts (so-called "garden leave" states), condition the enforcement of noncompete agreements on the former employee receiving compensation during the period of the restriction under certain circumstances.

Addressing Consideration Issues

What can employers do to address enforceability concerns in these situations? For employees covered in the first scenario, you should consider offering severance pay as part of a separation agreement at least to those employees who could "harm" your business if they went to work for a competitor. The separation agreement can condition the payment of severance on the employee releasing all claims against your business and agreeing to noncompetition provisions which may be the same as in the original noncompete agreement. The severance amount (consideration) should also be separately allocated to the release of claims and the noncompetition provisions. This provides a safeguard to possible enforcement issues with the original agreement by providing a backstop agreement supported by new consideration.

With respect to the second scenario, in the event the noncompete agreement has a choice of law provision which stipulates that a state law requiring "garden leave" applies (or if the employee worked in one of those states), you must provide the former employee with whatever compensation is required under state law for the period of the noncompete restriction. For example, under Nevada law, when the termination of employment is the result of a reduction-in-force, the noncompete agreement "is only enforceable during the period in which the employer is paying the employee' s salary, benefits or equivalent compensation, including, without limitation, severance pay." NV St 613.195(4).

Given the rapid evolution in state noncompete law, you should always seek advice from an experienced labor and employment attorney to create enforceable noncompete agreements and ensure their validity during times of workplace restructuring.

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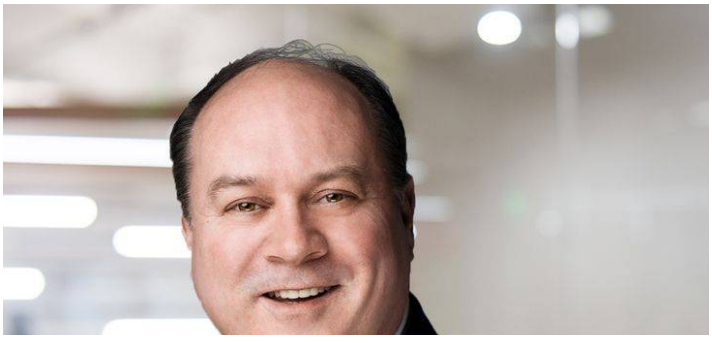

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Employee Defection and Trade Secrets

Reductions in Force (RIFs)