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Professional Perspective

Non-Competes in the Economic Wake of Covid-19

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Contributed by Kristopher Hill, Bell Nunnally & Martin

A reeling economy, uncertain revenue streams, and mandated shutdowns caused by the Covid-19 pandemic forced businesses to adjust and adapt on the fly. Perhaps some of the hardest decisions come when an employer must decide when and how to let employees go. A key factor in these decisions is often the existence of non-compete agreements. In the economic wake of the pandemic, employers and employees alike face critical decisions concerning the use, application, and enforceability of non-competes.

Unemployment and Non-Competes

Since President Donald Trump's declaration of a national emergency on March 13, 2020, over 40 million people applied for unemployment benefits, as of the time of publication of this article. Unfortunately, this staggering number does not fully account for the toll that the outbreak of Covid-19 has taken on the American workforce, nor does it account for what is to come as businesses across the country remain shuttered or restricted by government mandates.

Meanwhile, non-competes are firmly entrenched in the business landscape. In 2015 and 2016, the U.S. Treasury Department and White House, respectively, estimated that close to 20% of the country's workforce was under a non-compete. Today, the percentage is likely even higher in light of many factors, including:

- Non-Competes, in varying forms, are expressly permitted by every state except California, North Dakota, and Oklahoma.
- The all-too-common scenario of employees who unsuspectedly sign non-competes as part of voluminous packages of new-hire documents without complete knowledge of what they actually signed.
- Inherent limitations in accessing and researching private-sector data.

Recent employment practices of two corporate giants—Jimmy John's and Amazon—indicate that non-competes remain on the rise. The same practices also reveal that non-competes have expanded beyond the typical realm of highly paid white-collar employees and have infiltrated the employment contracts of the rank-and-file. Specifically, Jimmy John's and Amazon were spurred to curtail their use of non-competes after receiving national media attention and governmental scrutiny over their respective employment policies that required low-wage sandwich makers and temporary warehouse workers to be bound by non-competes.

In light of the prevalence of non-competes and high-profile examples of overreach, several states enacted laws to rein in non-competes. To name a few:

- Nevada prohibits non-competes that impose undue hardship on the employee.
- Illinois, Maine, Maryland, New Hampshire, Washington, and Rhode Island do not allow Non-Competes with low-wage employees.
- Massachusetts has banned non-competes with workers classified as nonexempt under the Fair Labor Standards Act and mandates garden-leave compensation of at least 50% of an employee's salary during the non-compete period.
- Hawaii does not permit non-competes with an employee of a "technology business."
- Attorneys General in California, Illinois, Maryland, Massachusetts, Minnesota, New York, Oregon, Pennsylvania, Rhode Island, and Washington, among other states, launched investigations of employers that broadly use non-competes.

Before Covid-19, employers trended towards an increased use of non-competes at all levels. In response, many states and the federal governments have trended towards increased scrutiny of the use of non-competes, especially among the rank-in-file. What impact will Covid-19 have on these trends and the enforceability of non-competes? For example, will employees who are laid off as a result of Covid-19 be bound by non-competes they signed years ago? Will courts enforce non-competes with injunctions at the same level as before? How will companies that decline to enforce their non-competes

in light of current economic factors be affected? And will the combination of widespread unemployment and non-competes (many of which are unenforceable as drafted) have a chilling effect on lawful competition and employee mobility?

The Basics of Non-Competes

Non-competes are contracts that restrict employees from joining or starting a business in competition with their former employer or soliciting their former employer's employees or customers for a certain period of time after leaving a job. Non-competes inherently restrain trade and competition. Yet they have long been an integral part of American commerce because—when valid and reasonably restricted—they promote efficiency by encouraging employers to entrust confidential information, trade secrets, and important client relationships to key employees and incentivize employers to develop goodwill by reducing the risk of valued employees turning around and using an employer's goodwill against it in a competing business. See *Marsh USA Inc. v. Cook*, 354 S.W.3d 764, 769 (Tex. 2011).

States that permit non-competes generally require some combination of the following factors to form an enforceable non-compete:

- Sufficient consideration, such as confidential information, trade secrets, goodwill, or specialized training
- Reasonable restrictions as to time, geography, and scope that do not impose a greater restraint than is necessary to protect a legitimate business interest of the employer.

Perhaps the most pressing non-compete question facing employers and employees in the age of Covid-19 is whether a non-compete is enforceable when an employee is let go as a result of the downturn in the economy. A common misconception is the notion that an employee who is fired—as opposed to one who voluntarily quits a job—is immune from post-employment restrictions they agreed to in a non-compete. Absent an agreement to the contrary between the employer and employee, this is not the law in most jurisdictions where non-competes are permitted. Stated differently, the majority of states that permit non-competes allow them to be enforced regardless of whether an employee's termination is voluntary or involuntary.

The Injunction

An employer's top priority in enforcing a non-compete is stopping competition in its tracks. The typical vehicle to accomplish this goal is filing a lawsuit to obtain an injunction. Upon a proper evidentiary showing, different types of injunctions to enforce non-compete are available at different phases of a lawsuit:

- Temporary restraining orders (TROs) can be issued without notice and expire after 14 days.
- Preliminary or temporary injunctions can be issued after notice and an evidentiary hearing and are effective for the duration of a lawsuit.
- Permanent injunctions can be issued as part of the judgment after trial.

Injunctions are "extraordinary remedies" rooted in principles of equity. In federal court proceedings, an employer seeking to enforce a non-compete by obtaining a preliminary injunction must prove that it is likely to succeed on the merits, likely to suffer irreparable harm in the absence of preliminary relief, the balance of equities tips in its favor, and that an injunction is in the public interest. See *Winter v. Natural Res. Def. Council*, 555 U.S. 7, 20 (2008). Typically, state-court injunction proceedings are governed by similar standards. On the other side of the coin, employees routinely rely on equitable defenses to avoid an injunction, such as waiver, estoppel, laches, and an employer's unclean hands.

Non-compete cases rise and fall at the preliminary-injunction stage. In a typical case, a judge determines whether to grant a preliminary injunction within weeks of the employer's request for the injunction. If granted, the preliminary injunction is a court order that requires the former employee to obey the terms of the non-compete until trial. As trial will not likely occur for at least 18 months to two years after the preliminary injunction is issued, the employer has practically accomplished its goal of halting competition because: the non-compete will have expired or be close to expiring according to its terms when the case gets to trial, and most employees simply cannot be sidelined from employment for that amount of time.

On the other hand, if the judge denies an employer's request for a preliminary injunction, the former employee may compete or solicit business freely for the duration of the lawsuit with minimal risk. For this reason, most non-compete cases settle after the judge decides the temporary injunction.

What Can Employers and Employees Expect?

In jurisdictions where non-competes are enforced regardless of whether employees quit their jobs or are laid off, employers and employees can expect that the effects of Covid-19 will not stop courts from continuing to enforce valid non-competes even in the context of layoffs resulting from the pandemic-related economic downturn.

It is the rare TRO or temporary-injunction hearing that ends without the judge asking if an injunction will keep the defendant-worker from working and providing for his or her family. It is reasonable to assume judges will be on high alert to the struggles in the current economic climate and require employers who seek non-compete injunctions to make strong showings that: restrictions on time, geography, and scope are reasonable, agreements do not impose a greater restraint than necessary to protect their goodwill or legitimate business interests, and competitive harm is truly irreparable. Employers seeking to enjoin workers in the context of an "essential business," as defined by a shelter-in-place order, could see increased scrutiny, especially in federal court where the balance of equities must tip in their favor and the injunction must serve the public interest.

Employers should also be wary of sitting on their hands in the wake of Covid-19—be it for altruistic motives, uncertainty, or otherwise—when their non-compete rights are violated. In legal speak, knowingly relinquishing, or delaying the enforcement of, legal rights are legal defenses referred to as waiver and laches; and either defense can bar an employer's ability to enforce a Non-Compete now or in the future. Thus, deciding not to enforce a non-compete today may limit your rights tomorrow.

Companies in highly competitive industries where employee/customer poaching is rampant, such as with mortgage originators, insurance brokers and financial-services providers, should be on guard and prepared to enforce their non-competes. Knowing resources are scarce and reluctance to litigate may be high, aggressive companies may be emboldened to pounce on the opportunity to hire valuable employees away from competitors despite the existence of valid non-competes.

Employers should be aware that non-compete laws vary across the country, and many states have taken recent action to restrict the reach of non-competes—and that was in a healthy economy. With the blow Covid-19 has dealt the economy, a whole new wave of investigations and legislations clamping down on non-competes could be on the horizon.

Perhaps the most complex question is whether the economic wake of Covid-19 will have a chilling effect on lawful competition and employee mobility. Employees who are subject to overly broad, unenforceable non-competes may be hesitant to change the status quo by taking new jobs or starting new ventures. Competitors, too, may be wary of hiring employees who are deemed a litigation risk because of a non-compete. If such a chilling effect plays out and employees and competitors are wary to challenge unreasonable, unenforceable non-competes, the resulting restraint on trade will likely stifle competition and innovation in an already struggling economy. Only time will tell.