COVID-19 Fallout: Enforceability of Restrictive Covenants Against Furloughed and Laid Off Employees

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The COVID-19 pandemic has forced many employers to make the difficult decision to institute mandatory furloughs and lay off valued employees. Invariably, some of the employees who stand to be affected by these decisions are subject to restrictive covenants (e.g., non-compete and/or non-solicit clauses) that purport to limit the employee's lawful ability to work in his/her chosen profession for a competitor. Does an employer's decision to furlough or lay off employees during the ongoing pandemic impair its ability to enforce its restrictive covenants against those employees? The answer is: maybe.

Restrictive covenants are generally enforceable if they are: (1) supported by adequate consideration; (2) reasonably necessary to protect the legitimate business interests of the employer; and (3) reasonably limited in temporal and geographic scope. The challenges posed by the COVID-19 pandemic give rise to circumstances that primarily will bear on the second of these inquiries. In its most basic sense, this element charges the court with balancing the employer's interest in protecting a legitimate business interest against an employee's interest in earning a living.

In Pennsylvania, for example, it is settled law that the reason(s) behind an employee's termination must be considered among many factors when determining whether a restrictive covenant is reasonably necessary to protect a legitimate business interest.[1] This is to say, an employer does not automatically forfeit its ability to enforce its restrictive covenants by terminating or furloughing an employee due to the COVID-19 pandemic. Similarly, employees are not automatically absolved of their obligations to their former employer if they are furloughed or laid off.

How will COVID-19 furlough or layoff decisions color a court's analysis of the reasonableness of enforcement? Since the goal of the court is to determine reasonableness, there are multiple factors directly related to the pandemic that courts are likely to consider (in addition to others irrespective of today's extraordinary circumstances). Importantly, because each employment relationship is unique, the court's decision requires a highly fact-intensive inquiry and must be decided on a case-by-case basis.

Predicting Harm to the Employer in the Absence of Enforcement

As noted above, courts will consider the reason behind the adverse employment decision itself as part of the analysis. The primary focus in examining the reasons behind a termination decision is to help the court determine whether enforcement of a restrictive covenant is truly necessary to protect the employer's business interests . . . or simply to prevent lawful competition. While the current times are unprecedented, some guidance can be gleaned from prior decisions in which the reasons behind a termination decision played a significant role in the outcome.

In *Insulation Corporation of America. v. Brobson,[2]* the court concluded that termination for poor performance implicitly spoke to the employer's assessment of the terminated employee's worth to its business interests, and thus weighed against enforcement of a restrictive covenant. The court explained, "[w]here an employee is terminated by his employer on grounds that he has failed to promote the employer's legitimate business interest, it clearly suggests an implicit decision on the part of the employer that its business interests are best promoted without the employee in its service . . . . Once such a determination is made by the employer, the need to protect itself from the former employee is diminished by the fact that the employee's worth to the corporation is presumably

insignificant." *Id.* In simple terms, the *Brobson* court suggested that termination for poor performance cannot be squared with an argument that an employer's business will be harmed if the poorly-performing employee is allowed to compete with it.

To be sure, COVID-19 furloughs or layoffs cannot fairly be equated to termination for poor performance. However, an employer should be mindful of this line of reasoning if it is contemplating less than a complete furlough or layoff of its workforce. *Brobson* suggests that consideration of employees' historical job performance when determining who to lay off or furlough (i.e. high-performing employees are spared) may weigh against enforceability.

The *Brobson* court also suggested (in dicta) that termination for economic reasons likewise may subject a restrictive covenant to greater scrutiny by the court in the context of a reasonableness analysis. Specifically, the court opined that its decision "would remain the same" even if the employee was terminated "for economic reasons" and to protect the employer's "bottom line." *Id.* at 735, n. 6. Although at least one subsequent decision by the same court sought to loosen that seemingly rigid guidance, by emphasizing that termination for economic reasons is not alone determinative of enforceability, it remains a viable consideration. COVID-19 furloughs or layoffs technically constitute decisions designed to protect the employer's economic position.

Under present circumstances, however, characterizing a pandemic-related furlough or layoff decision so generally does not fairly tell the whole story. Many employers were forced to entirely shutter their business operations due to government-mandated closure orders. Still others face unprecedented business losses entirely beyond their control due to the impact of closure orders on the business of their customers. Furlough and layoff decisions made under those circumstances convey a different message than instances where the termination was driven exclusively by the employer's decision that monetary savings were more important than the employee's continued service to the company.[3]

On the other hand, whether the employer had other reasonable alternatives to furloughs or layoffs, such as allowing employees to work remotely from home, may move the needle against enforcement. For that matter, whether the employee was furloughed versus laid off presents another material consideration for the court. While in both instances the employee is unpaid, a furlough with the intent to re-hire arguably demonstrates recognition of the employee's value to the employer's business interests and, accordingly, may counsel in favor of enforcement of restrictive covenant obligations to protect them.

Evaluating Hardships Caused by Enforcement of Restrictive Covenants

Of course, while courts will consider the reasons behind a furlough or layoff decision in their reasonableness analysis, another critical factor is the impact of the decision on the affected employee. In the context of weighing the harm to an employee through enforcement, the scope and type of restrictive covenant at issue is material. Its terms will help the court decide whether enforcement, to the full extent of the covenant or some lesser extent, is necessary to protect the employer's business interests and also whether enforcement will impose an undue hardship on the employee. Predictably, therefore, the specific circumstances of the employer and employee are of paramount importance. For instance, a one-year non-competition clause that prohibits an employee from working for a competitor within a 30 mile radius of his former office may be more restrictive than a non-solicitation clause that allows the employee to work for any competitor, but prohibits him or her from soliciting former clients for two years. The same non-solicitation clause may be more restrictive than the aforementioned non-competition clause in a scenario where the universe of clients is very small.

These types of considerations are not new or unique to employment relationships impacted by COVID-19. However, overarching each is the current unprecedented compression of the job market in which an employee's ability to obtain another job in his chosen line of work is likely limited. The relative difficulty of securing a new job during these challenging economic times will undoubtedly be carefully considered by courts. As a result, employers can expect to face a heavy burden when advocating for enforcement of a covenant that would preclude a former employee from accepting a scarce job opportunity.

Conclusion

Employers should be mindful of these and related considerations when deciding how to approach furlough or layoff decisions, and whether to take legal action to enforce a former employee's restrictive covenants.[4] Because the applicable tests to determine the enforceability of restrictive covenants vary from state to state, employers and employees should consult with experienced counsel practicing in their state about the specific laws that apply. As is true for so many things during this time, a thoughtful and measured approach to either decision is the best practice.

If you have questions, please contact Vince Barbera (barberav@whiteandwilliams.com; 215.864.7137), George Morrison (morrisong@whiteandwilliams.com; 610.782.4911) or another member of our Commercial Litigation or Labor and Employment Groups.

As we continue to monitor the novel coronavirus (COVID-19), White and Williams lawyers are working collaboratively to stay current on developments and counsel clients through the various legal and business issues that may arise across a variety of sectors. Read all of the updates here.

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[1] *See Missett v. HUB Int'l Pa., LLC*, 6 A.3d 530, 539 (Pa. Super. Ct. 2010).

[2] *Insulation Corporation of America. v. Brobson*, 667 A.2d 729, 735 (Pa. Super. Ct. 1995)

[3] *See, e.g., Missett*, 6 A.3d at 533 (employee terminated because company no longer wanted to pay his high commission schedule).