New Jersey Restrictive Covenant Bill Aims to Change the Landscape

By Clifford R. Atlas

December 6, 2017

Providing a private right of action and barring judicial modification are just two features of a bill that aims to severely limit the use of non-compete agreements in New Jersey.

Over the past few years, academic and media reports have claimed that employers are abusing the use of restrictive covenant agreements to the detriment of employees and economic innovation. The reports suggest that employers are increasingly imposing such agreements on employees who pose no risk to their legitimate business interests. They also suggest that employers are insisting on excessive restraints that suppress far more than simply unfair competition.

While the findings and conclusions of these reports invite considerable skepticism, their impact on legislative initiatives, at both the federal and state level, is clear. Proposals to limit the use of non-compete agreements have been introduced in the Massachusetts Legislature and the New York City Council. The latest effort to curb the use of non-compete agreements is in New Jersey. State Senator Robert Gordon introduced Senate Bill 3518 (SB 3518) on November 9, 2017, and Assemblywoman Annette Quijano introduced an identical bill, Assembly Bill 5261, in the New Jersey General Assembly on December 4, 2017.

If enacted, SB 3518 would impose significant restrictions and limitations on an employer's ability to control the competitive activities of former employees who may be walking away with valuable business information.

Definition of "Restrictive Covenant"

The stated purpose of SB 3518 is to "limit[] certain provisions in restrictive covenants[.]" "Restrictive covenant" is defined as "an agreement between an employer and an employee arising out of an existing or anticipated employment relationship, or an agreement between an employer and an employee with respect to severance pay, under which the employee or expected employee agrees not to engage in *certain specified activities competitive with the employee's employer after the employment relationship has ended."* (Emphasis added.)

This definition fails to answer clearly whether SB 3518 extends beyond non-compete covenants to cover:

- Customer and/or employee non-solicitation provisions, or
- Agreements regarding confidential information and/or trade secrets.

While the solicitation of a company's customers, solicitation of a company's employees, or the use of a company's proprietary information on behalf of a competitor arguably might qualify as being "competitive with the employee's [former] employer[,]" other provisions in SB 3518 suggest that *traditional* non-competition covenants are the only "restrictive covenants" at issue. For instance, SB 3518 distinguishes between "restrictive covenants" and non-solicitation covenants. It states that a "restrictive covenant ... may be presumed necessary where [the employer cannot adequately protect its] legitimate business interest ... through *an alternative agreement,* including ... an agreement not to solicit or hire employees of the employer; [or] an agreement not to solicit or transact business with customers, clients, referral sources, or vendors of the employer[.]" (Emphasis added.) It also generally requires employers to provide post-employment compensation, or "garden pay," as a condition for enforcing any "restrictive covenant." Continuing compensation, however, would make little sense where a former employee is free to work for a competitor. Upcoming legislative proceedings may clarify this point.

Legitimate Business Interests

SB 3518 permits employers to request or require a prospective or existing employee to agree to a restrictive covenant, provided it is narrowly tailored to serve one or more legitimate business interests.

Meet the Author

Clifford R. Atlas

Principal
New York Metro
New York City 212-545-4017
Email

Practices

Restrictive Covenants, Trade Secrets and Unfair Competition

Industries

Chemicals
Construction
Energy and Utilities
Financial Services
Government Contractors
Healthcare
Higher Education
Hospitality
Insurance
Life Sciences
Manufacturing
Media
Professional Services
Real Estate
Retail
Technology
Transportation

The bill states, "[t]he agreement shall not be broader than necessary to protect the legitimate business interests of the employer, including the employer's trade secrets or other confidential information that would not otherwise qualify as a trade secret, including sales information, business strategies and plans, customer information, and price information."

SB 3518 does not state that these categories of "legitimate business interests" is non-inclusive. It appears to ignore other business interests that have been recognized routinely as the basis for restrictive covenant agreements. These include customer relationships and good will. Upcoming legislative proceedings may clarify this point.

The Reasonableness Requirement

SB 3518 also requires the restrictive covenant to be reasonably tailored to protect the "legitimate business interest." This standard would apply to the types of activities restricted, the duration of the restrictions, and the geographic scope of the restrictions.

With respect to duration, SB 3518 expressly prohibits any restrictive covenants lasting more than one year. With respect to geographic scope, restrictive covenants generally must not restrict competition outside the areas "in which the employee provided services or had a material presence or influence during the two years preceding" separation of employment. That general guideline is qualified by the admonition that a restrictive covenant "shall not prohibit an employee from seeking employment in other states." Does this mean an employee may seek out-of-state employment in any location he or she chooses, even if it is within the boundaries of his or her former territory? While "seeking employment in" a particular location is not necessarily equivalent to engaging in "competition" there, it is unclear whether SB 3518 aims to bar completely an employer's ability to restrict out-of-state activities.

No "Blue-Penciling"

Importantly, SB 3518 *does not permit* judicial modification of restrictive covenants that are found to be overly restrictive or otherwise in violation of the law. Rather, such covenants "shall be … void and unenforceable." This is a stark departure from established New Jersey law.

The Garden Pay Requirement

Garden pay is a requirement under SB 3518. If an employer requires a former employee to comply with his or her restrictive covenants, it must continue paying or providing 100 percent of the wages and fringe benefits that the employee would have been entitled to receive had the separation of employment not occurred. SB 3518 prohibits employers from contractually limiting this obligation. It also prohibits employers from prematurely discontinuing garden pay, except where the former employee breaches the restrictive covenant agreement.

A key exception to the garden pay requirement exists where the employer terminates the employee for "good cause." SB 3518 defines "good cause" as "a reasonable basis related to an individual employee for termination of the employee's employment in view of relevant factors and circumstances[.]" SB 3518 provides a *non-inclusive list* of potentially "relevant factors and circumstances." These range from poor job performance to "serious misconduct."

Under SB 3518, restrictive covenants are entirely unenforceable against any employees who have been terminated without "good cause" (discussed further below). In other words, an employer's compliance with the garden pay requirement will not save a restrictive covenant where the employee subject to the covenant is terminated without "good cause." As garden pay would be ineffective where termination is without "good cause," and unnecessary where termination is *with* "good cause," SB 3518 essentially requires garden pay only in a voluntary resignation.

Procedural Obligations

SB 3518 would impose new procedural obligations on employers, first, when seeking to enter into a restrictive covenant agreement, and second, when the employment relationship terminates.

Entry into a Restrictive Covenant

In the case of a prospective employee, SB 3518 requires the employer to disclose the agreement in writing to the prospective employee "by the earlier of a formal offer of employment, or 30 business days before the commencement of … employment." If the requirement or request is made to an existing employee, the employer must provide the agreement to the employee at least 30 days before its effective date. Further, the employer must "expressly state that the employee has the right to consult with counsel prior to signing."

Separation from Employment

Upon separation from employment of an employee who is subject to a restrictive covenant, SB 3518 requires the employer to inform the employee if it intends to require compliance with the post-employment restrictions. Such notice must be given "[n]ot later than [10] days after the termination of

an employment relationship."

As with garden pay, the notice requirement is inapplicable where an employee has been terminated for "good cause." Consequently, the notice requirement also appears to apply only to employees who have voluntarily resigned their employment.

Prohibition of Restrictive Covenants for Certain Types of Employees

In its introduction, SB 3518 expresses concern that restrictive covenant agreements are imposed on lower-level employees who pose no threat to an employer's legitimate business interests. To combat that scenario, it prohibits imposing restrictive covenants on the following categories of employees:

- Employees classified as nonexempt under the Fair Labor Standards Act;
- Undergraduate or graduate students who intern or engage in short-term employment while they remain enrolled in school;
- Apprentices who meet the applicable federal or state apprenticeship qualifications;
- Seasonal or temporary employees;
- Employees who have been terminated without good cause or been laid off;
- Independent contractors;
- Employees under the age of 18;
- "Low-wage" employees, defined as employees whose weekly wage is less than the state-wide average, as determined by the New Jersey Department of Labor and Workforce Innovation (currently, $1,203.43 per week, equivalent to $62,578.36 per year); and
- Employees whose period of service with the employer is less than one year. SB 3518 makes no distinction based on the reason for the separation or whether it was voluntary or involuntary.

This provision bans non-competition restrictions for broad swaths of workers *even if* they have knowledge of or access to trade secrets, and even if the scope of the restrictions narrowly meets the duties of the particular employee.

Private Right of Action

Uniquely, SB 3518 confers a private right of action to employees and former employees who allege they are subject to a restrictive covenant that violates the law.

Significantly, SB 3518 affords a two-year statute of limitations for an employee to file suit, and provides that the two-year period will be triggered by "the later of: (1) when a prohibited agreement is signed; (2) when the employee learns of the prohibited agreement; (3) when the employment relationship is terminated; or (4) when the employer takes any steps to enforce the agreement."

This suggests that an employee may file suit before he or she intends to engage in conduct contrary to the applicable restrictive covenant, and before the employer has indicated an intent to enforce the covenant. Further, relief available under SB 3518 include voiding the restrictive covenant or "enjoining the conduct of any person or employer," as well as monetary damages, including "liquidated damages; … lost compensation, damages, reasonable attorneys' fees and costs." It does not provide any standard for determining liquidated damages, other than that the amount of such damages will not exceed $10,000.

Posting Requirement

SB 3518 additionally requires that employers post a copy of the bill "in a prominent place in the work area." Violations of this requirement are subject to a written warning for the first violation, a fine of up to $250 for the second violation, and fines of up to $1,000 for every subsequent violation. The New Jersey Department of Labor and Workforce Development will enforce this requirement.

Grandfather Clause

SB 3518 would take effect immediately upon signing by the governor. However, it would "not apply to any agreement in effect on or before the date of enactment." Existing restrictive covenants would continue to be evaluated under prior court precedent.

***

"The law turns gray into black and white, and lawyers turn black and white into gray."

SB 3518 appears to disregard decades of well-established case law providing simple guideposts for employers and the courts. Courts are well-equipped to apply these guideposts to the facts and circumstances of the individual case, which vary from situation to situation.

Indeed, the bill seeks to limit broadly the use of restrictive covenant agreements in many ways. This includes reducing the categories of employees who can be subjected to restrictive covenants, limiting the permissible scope of restrictive covenants, and imposing procedural and monetary obligations on employers.

It is too early to predict the bill's chances of passage. We will continue to follow developments and provide updates. Employers who may be affected by new legislation on restrictive covenant agreements are encouraged to contact Jackson Lewis for assistance.