

Proposed New Jersey Legislation Would Significantly Impact Restrictive Covenants

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In an environment where New Jersey's employment law landscape has been increasingly less hospitable to employers, another employee-friendly piece of proposed legislation – this time targeting restrictive covenants – is now on the horizon.

On May 10, 2018, the New Jersey Assembly Labor Committee pushed forward Assembly Bill No. 1769, introduced by Assemblywoman Annette Quijano (D-Union). If passed into law, the bill would significantly limit the ability of employers to impose and enforce restrictive covenants.

A restrictive covenant (often referred to as a non-compete agreement) is a contract under which an employee is prohibited from engaging in certain activities within a specific geographic location, and for a designated time period, that would compete with the employer after the employment relationship has ended. Restrictive covenants can serve to protect an employer's legitimate business interests, including trade secrets, confidential information, and customer/client goodwill. When too expansive, however, restrictive covenants may impose an unreasonable restraint on trade and prevent an individual from earning a living by limiting career options. The balancing of these interests has historically been handled by the courts. The proposed legislation, while codifying certain case law precedent, swings the pendulum far into the favor of employees.

Overview of Proposed Legislation

As currently written, the legislation provides that “[a]n employer may require or request that an employee enter into a restrictive covenant as a condition of employment or with respect to severance pay as provided in this act.” However, the restrictive covenant would only be valid if the following requirements were satisfied:

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- If the employer seeks to impose the restrictive covenant at the start of employment, the employer must disclose its terms, in writing, to the employee either when a formal offer is made, or 30 business days before the employee starts working, whichever comes first. If the worker is a current employee, the employer must provide the agreement 30 business days before its effective date.
- The agreement must expressly state that the employee “has the right to consult with counsel prior to signing.”
- The restrictive covenant must be tailored to protect only the legitimate business interests of the employer, including the protection of trade secrets or other confidential information.
- The duration of the restrictive covenant may not exceed 12 months following the date of termination of employment.
- The geographical reach of the restrictive covenant must be “reasonable” and “limited to the geographic areas in which the employee provided services or had a material presence or influence during the two years preceding the date of termination of employment.” It cannot prevent an employee from working outside of New Jersey.
- The restrictive covenant must be “reasonable in the scope of proscribed activities in relation to the interests protected and limited to only the specific types of services provided by the employee at any time during the last two years of employment.”

In addition to defining the scope of restrictive covenants, perhaps the most far-reaching provisions of the legislation would render restrictive covenants unenforceable against broad categories of employees, as follows:

- Employees classified as nonexempt under the FLSA
- Undergraduate or graduate students working as interns or engaged in other short term employment while enrolled full or part-time at an educational institution
- Apprentices
- Seasonal or temporary employees
- Employees not terminated as a result of “misconduct” or laid off by the employer
- Independent contractors
- Employees under the age of 18
- Low-wage employees
- Employees whose period of service to an employer is less than one year

The legislation would further prohibit an employer from:

- Penalizing an employee for challenging the restrictive covenant

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- Including a choice of law provision that would avoid the applicability of the legislation (if the employee is a resident of or employed in New Jersey)
- Having an employee contractually waive the rights under the legislation
- Stopping an ex-employee from providing services to customers/clients of the employer if contact is initiated by the customer/client
- Otherwise unduly burdening the employee to the extent it violates public policy

The legislation provides for a time-limit on an employer's ability to enforce the restrictive covenant. If the employer fails to notify the employee of its intent to enforce the restrictive covenant in writing within 10 days of the termination of his/her employment, the restrictive covenant would be deemed void. This provision, however, would not apply if the employee was terminated as a result of "misconduct."

Moreover, the legislation provides that if all of the above requirements are satisfied, the employer would still be obligated to "pay the employee an amount equal to 100 percent of the pay to which the employee would have been entitled for work that would have been performed during the period" of the restrictive covenant. Further, the employer would need to continue "to make whatever benefit contributions would be required in order to maintain the fringe benefits to which the employee would have been entitled for work that would have been performed during the period" of the restrictive covenant.

Finally, the legislation expressly creates a cause of action for an employee who desires to challenge the validity of the restrictive covenant. An employee will have to file suit within two years of the later of when: the agreement was signed; when the employee learns of the prohibited agreement; when the employment relationship is terminated, or; when the employer seeks to enforce the agreement. In addition to having the restrictive covenant voided, an employee would be able to seek an order from the court enjoining the conduct of the employer, ordering the payment of liquidated damages, and "awarding lost compensation, damages, reasonable attorneys' fees and costs."

Next Steps for Employers

Although enactment of the proposed legislation remains to be seen, in keeping with the passage of other pro-employee legislation in recent months, the bill may well become law. Consequently, employers should evaluate, at least for all non-exempt employees, which employees have significant customer contacts and access to trade secrets. It may be prudent to consider ways to elevate those employees to exempt status, or to address proactively with the attrition rates and turnover among those employees.

While the legislation is still pending, employers should be mindful of any restrictive covenants that may be viewed as overreaching because of their geographic reach, length or the fact that they primarily restrict competition rather than protecting the legitimate business interests of the employer. It should also be noted that this pending legislation aside, New Jersey courts have shown an increased willingness to scale down overly-broad restrictive covenants through blue penciling, and have more recently and with greater frequency invalidated entire restrictive covenants that they viewed as overreaching.

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If you have questions regarding the issues addressed in this Alert, please contact the authors, **Maja M. Obradovic** and **Charles J. Vaccaro**.