NJ Appellate Ruling Addresses the Scope and Enforceability of Restrictive Covenant Agreements

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A recent published decision by the Superior Court of New Jersey, Appellate Division aims to provide clarity and uniformity in analyzing the enforceability of restrictive covenant agreements (RCAs) in the employment context. Employers who wish to enforce such agreements against former or departing employees should familiarize themselves with the Appellate Division's ruling in *ADP, LLC v. Kusins*, which is summarized in this Alert.

In this case, which involved six consolidated actions, ADP filed suit against six former employees for allegedly violating their respective RCAs to varying degrees after they voluntarily resigned from ADP and obtained employment with a direct competitor. ADP provides business outsourcing and software services pertaining to human resources, payroll, taxes and benefits administration to thousands of companies worldwide. In an effort to protect its "confidential business interests," ADP imposed a two-tiered system of restrictive covenants on its sales representatives.

In the first tier, when initially hired, all sales representatives were required to sign a sales representative and nondisclosure agreement containing "general non-compete and non-solicitation provisions that [were] narrowly tailored in scope and geographical region, and prevent[ed] employees from soliciting any clients the employee had contact with at ADP for twelve months after terminating their employment."

ADP offered its top-performing sales representatives the option to participate in a stock option incentive program. However, as a condition to participating in the program, the sales representatives were required to agree to and sign a second tier RCA that was more restrictive than the first tier RCA. The second tier RCA "prevented employees from soliciting any actual or prospective ADP client, regardless of the employee's geographical location or personal contact with the client, for a twelvemonth period after termination." Further, violation of the second tier RCA tolled its time limitation and permitted ADP to collect its legal costs and fees incurred in its enforcement.

At the trial court level, all six of the top-performing former employees filed motions for summary judgment in their respective cases, contending that the second tier RCAs they signed were unenforceable. Although the trial court decisions varied, each judge generally ruled in the former employee's favor and found that the second tier RCAs were either overly broad or unenforceable. ADP filed an appeal.

The Appellate Division reversed the trial court decisions, finding that the second tier RCAs were enforceable after engaging in "blue-penciling" – a term used to describe the court's modification or tailoring of a RCA. The three-judge panel first recognized the longstanding principle that "a determination of the enforceability of a restrictive covenant requires a court to balance the employer's need to protect its legitimate interests against the hardship placed on the employee by the agreement." The panel noted that "[a]n employer's legitimate interests include the protection of trade secrets or proprietary information, as well as customer relationships," but that the restrictions protecting those interests must be "reasonable in duration, area, and scope of activity," not impose an undue hardship on the employee and not be injurious to the public.

In considering ADP's two-tiered system, the Appellate Division approved of ADP's efforts to impose heightened restrictions on upper level employees under the circumstances, finding that ADP's "top-performing employees" – who received additional training, had significant client contact, and had ready access to specialized information – "have the greatest potential to damage ADP's relationship with its current and prospective clients." Nevertheless, the Appellate Division found that the second tier RCAs' non-compete and non-solicitation clauses were unreasonable as written. To make the agreement enforceable and to protect ADP's legitimate business interests, the panel scaled down the scope and breadth of the provisions to make them enforceable.

The Appellate Division found that the second tier RCA's provision that prevented an employee "from soliciting business from <u>all</u> of ADP's 620,000 existing clients, not just those the employee had substantial dealings with or acquired knowledge about while at ADP" was unreasonable, explaining "that restrictive language is untenable as an ADP employee could not possibly know all of ADP's actual clients." As a result, the panel blue-penciled the provision to "prevent an employee from having any dealings with existing ADP clients that the employee was actively involved with or whose names the employee learned during his or her employment."

Next, the Appellate Division found that the second tier RCA's provision that "prohibits a former employee from soliciting any prospective client that ADP 'reasonably expects' to provide business to within the two-year period following the employee's departure" was overly broad and created an undue hardship. The Appellate Division reasoned that "[d]ue to the breadth of ADP's worldwide reach, any company defendants approach might be a potential 'prospective' ADP client," and, thus the panel could not "envision any practical manner in which defendants could conduct business without offending this provision." As such, the panel limited the provision to only those prospective clients a former employee had gained knowledge of while at ADP and who "directly or indirectly solicits that client after leaving and working for a competitor."

Finally, the Appellate Division held that the second tier RCA's provision that "blocks a former employee from working with a competing business and selling the same services in the geographic area in which they worked while at ADP" was reasonable, finding that "the inclusion of a geographic restriction is common and a reasonable component of an RCA." The panel, however, rejected a trial court's attempt to narrow this provision by further restricting it to the former employee's market segment at ADP, as it could not "discern any rationale in the record to blue-pencil a market segment component." It should also be noted that the Appellate Division upheld the provision permitting ADP to seek its legal fees in prosecuting its claims and the equitable tolling provisions.

ADP, LLC v. Kusins is a key decision that should be reviewed by all employers who have in place and anticipate enforcing RCAs in New Jersey, as the case accurately reflects the current landscape of state law on restrictive covenants and is consistent with New Jersey courts' increased willingness to scale down overly broad restrictive covenants through blue-penciling. As such, employers should be mindful in drafting RCAs that the scope of restrictions imposed are not designed purely to restrict competition, but are narrow enough to protect their legitimate business interests and not create an undue burden.

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