



10 Takeaways as New Jersey Set to Drastically Limit Non-Competes and Other Restrictive Covenants

Insights

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The New Jersey legislature is currently considering legislation that would add the state to the growing list of jurisdictions that have significantly limited the scope and enforceability of non-competition agreements and other restrictive covenants. Among other things, the recently introduced Assembly Bill 3715 (AB 3715) – which was just reported favorably by a committee of state lawmakers on May 19 – would add a number of roadblocks that would limit the ability of employers to engage in common business practices and require additional procedural steps for businesses. What are the 10 biggest takeaways you need to know about this pending legislation?

Recapping the Current Landscape of Restrictive Covenants in NJ

Longstanding in New Jersey is the fact that courts generally find that restrictive covenants are enforceable, provided they are reasonable. A restrictive covenant is considered reasonable if it:

- protects legitimate interests of the party seeking to enforce the covenant;
- does not impose an undue hardship on the party to be restricted; and
- is not injurious to the public.

As to the “undue hardship” inquiry, the scope of the restrictive covenant must be limited as to both the duration of its restriction and the geographic area it covers.

There have been past efforts made by the New Jersey legislature to codify these concepts, or narrow them further, including as recently as the 2020-2021 Session. However, AB 3715 seems to have momentum and appears likely to be passed and signed into law.

New Jersey’s increased scrutiny of restrictive covenants is consistent with efforts taken by legislatures across the United States to narrow the scope and limit the enforceability of post-employment restrictive covenants. Between 2019 and 2020, states such as Maine, Maryland, New Hampshire, Rhode Island, Virginia, and Washington passed or modified legislation that restricts an employer’s ability to enforce restrictive covenant agreements.

In 2021, the national trend continued with Washington D.C., Oregon, and Illinois all passing legislation that tightened the restrictions on the enforceability of restrictive covenants. 2022 has

already seen Colorado pass one of the nation's strictest restrictions, and now New Jersey seems poised to join these ranks.

Top 10 Takeaways

How will AB 3715, if passed as law, change the current landscape of an employer's use of restrictive covenants in New Jersey? Here's what you need to know.

1. Codifies Factors Typically Evaluated by Courts but Sets Forth New Limitations

First and foremost, AB 3715 would codify existing common law regarding restrictive covenants, including that the restriction must be reasonable in geographic scope and no broader than necessary to protect the legitimate business interests of the employer, which may include the employer's trade secrets and other confidential information.

However, New Jersey case law currently provides that, depending on the circumstances, a restrictive covenant of up to two years may be reasonable. The legislation would change this by restricting the temporal scope to just 12 months following the termination of employment. Moreover, restrictive covenants would be limited to the geographic areas in which the employee provided services or had a material presence or influence during the two years prior to the termination of employment. Importantly, the bill would not allow covenants to restrict an employee from seeking employment in other states.

2. Requires Minimum 30-Day Notice to Employees

Prospective or new employees would be required to receive the restrictive covenant terms in writing either when a formal offer of employment is made or 30 business days prior to commencement of employment – whichever is earlier. Existing employees would be required to receive 30 business days' notice of the restriction before it became effective.

3. Limits Restrictions on Preventing Employee from Working with Customers or Clients

Employers typically seek to limit a separating employee's ability to do business with their customers or clients at their new place of employment for fear of losing that business. The bill would not allow an employee to be restricted from providing a service to a customer or client of the employer, as long as the employee did not initiate or solicit that customer or client.

4. Limits Choice of Law

The restrictive covenant agreement may not include a choice of law provision that would allow an employer to avoid applying New Jersey laws, if the employee is a resident of or employed in New Jersey at the time of their termination and has been for at least 30 days immediately preceding their termination.

5. Excludes Broad Category of Individuals

Perhaps relief to many employers, restrictive covenants would not be enforceable against certain categories of workers, including:

- Employees who are non-exempt under the Fair Labor Standards Act;
- Student interns;
- Seasonal or temporary employees;
- Employees terminated without a determination of misconduct;
- Independent contractors;
- Individuals under the age of 18;
- Low-wage employees (defined as those whose average weekly earnings are less than the statewide average weekly remuneration); and
- Employees whose period of service to an employer is less than one year.

6. Requires 100% Compensation Payment During Restricted Period

What may be most shocking to employers, if the legislation is passed in its current form, an employer would be required to pay the employee 100% of the compensation that they would have received for work that would have been performed during the restricted period. This means that New Jersey employers would be required to continue to pay an employee their full salary and benefits for up to 12 months after termination (depending on the temporal scope of the restrictive covenant).

7. Prohibits No-Poaching Agreements

The bill defines a no-poach agreement as “any agreement between employers... that restricts or hinders the ability of an employer to contract for the services of a low-wage employee.” If the legislation passes as drafted, it automatically declares no-poach agreements to be “contrary to public policy” and “void.”

8. Requires Notice of Enforcement Within 10 days of Separation

Within 10 days after termination of employment, the employer would be required to provide written notice to the employee of their intent to enforce the agreement. If timely notice is not provided, the agreement would be considered void. However, this requirement would not apply if the employee was terminated for misconduct.

9. Requires Posting

The legislation would require employers to post a copy of this law, or an approved summary by the State of New Jersey Department of Labor and Workforce Development, in a prominent place in the work area. Failure to do so could include fines following a written warning for the first violation.

10. Creates Private Right of Action with 2-Year Statute of Limitations

It would be unusual compared to other states, but the bill would permit an employee subject to a restrictive covenant or covered by a no-poach agreement to bring a civil action against an employer or person who violates this act within two years of certain triggering events. The courts would also be empowered to void any agreement (as opposed to just blue-penciling voidable clauses in an agreement) and to order all appropriate relief, including enjoining the conduct of any person or employer, ordering payment of liquidated damages (which is capped at \$10,000), and awarding lost compensation, damages, reasonable attorneys' fees and costs.

What's Next?

AB 3715 was reported favorably out of committee on May 19 only a few weeks after it was introduced, and smooth sailing is expected in front of the full legislature in the near future. A similar bill, SB 1410, was introduced in the Senate and referred to the Senate Labor Committee in February. While it is unclear how quickly the Senate will consider the bill given that similar legislation has not made much progress in the past, it is likely that some sort of restrictive covenant reform makes it to Governor Murphy's desk in the near future.

If there is any good news, it's that AB 3715 would not be retroactive, meaning it would not apply to agreements in effect on or before the date the legislation becomes law.

What Should Employers Be Doing?

Given the frequent developments in restrictive covenant legislation, employers in New Jersey – and throughout the United States – need to be proactive in order to ensure that restrictive covenants remain enforceable.

You should start reviewing your current restrictive covenant agreements and consider taking the following steps:

- Stay abreast of the developments in restrictive covenant legislation in the jurisdictions where you operate and assess the legislation's impact on your business. Consideration should be given to issues such as:
- Whether a restrictive covenant agreement can be enforced against specific employees, based on factors such as income level and occupation;
- Whether the temporal and geographic scopes in your covenants are permissible; and
- Whether you are required to take any additional steps in order to preserve the enforceability of the agreement, such as providing advance notice of the agreement to a new employee; providing the agreement to a departing employee within a specified time period following the termination of employment; or providing timely notice to the employee of your intent to enforce the agreement.

- If your restrictive covenants are now or later become unenforceable, determine whether you can have your existing employees enter into new agreements. For example, some states require employers to provide something more than continued employment in exchange for a new agreement from an existing employee, although this is generally permissible consideration in New Jersey. p
- Avoid uniform, one-size-fits all contracts and tailor your restrictive covenant agreements for the specific jurisdictions in which they are being used.

Fisher Phillips will continue to monitor events and provide updates as warranted, so make sure you are signed up to receive Insights directly to your inbox to receive the latest information. If you have any questions regarding your organization's restrictive covenant agreements, please consult your Fisher Phillips attorney, the authors of this Insight, any attorney in our New Jersey office, or any attorney in the Employee Defection and Trade Secrets practice group.

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