

New Jersey Bill Seeks to Significantly Restrict the Use and Enforceability of Non-Compete Agreements

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On November 9, 2017, the New Jersey Senate introduced Senate Bill 3518, which would drastically limit an employer's ability to enter into, and subsequently enforce, restrictive covenants (or "non-compete" agreements) with employees. The bill would also impose certain notice and monetary obligations on employers that seek to enforce restrictive covenants against their former employees.

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10-Factor Test for Determining Enforceability

By way of background, a restrictive covenant is a common agreement between an employer and employee under which the employee agrees not to engage in certain specified activities competitive with the employer after the employment relationship has ended. Employees are often required to enter into these agreements as a condition of employment or as a condition of receiving severance pay. Under current law, a restrictive covenant is generally enforceable in New Jersey so long as it is reasonable in scope (in terms of competitive activities restricted and temporal and geographic limitations), protects the legitimate business interests of the employer, does not impose an undue hardship on the employee, and is not injurious to the public.

Bill 3518 would significantly limit the enforceability of restrictive covenants. First, restrictive covenants would not be enforceable *at all* against:

1. those classified as nonexempt under the Fair Labor Standards Act;
2. seasonal or temporary employees;
3. employees that have been discharged without cause or laid off by the employer;
4. employees whose period of service to the employer is less than one year;
5. “low-wage” employees (defined as those employees who make less than approximately \$62,000 annually); or
6. independent contractors.

Restrictive covenants that survive the above restrictions would *only* be enforceable if they meet each of the following 10 requirements:

1. If the agreement were entered into “in connection with the commencement of employment,” the employer would be required to “disclose the terms of 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 the employee’s employment.” Alternatively, if the agreement were entered into after commencement of employment, the employer would be required to provide the agreement to the employee at least 30 business days before the agreement would become effective. In both cases, the agreement would have to be signed by both parties and “expressly state that the employee has the right to consult with counsel prior to signing.”
2. The agreement could be no broader than necessary “to protect the legitimate business interests of the employer, including the employer’s trade secrets or other confidential information.”
3. The employer’s ability to restrict the employee from engaging in activities competitive with the employer would be limited to a period not to exceed 12 months following the date of termination of employment.
4. The prohibited activity would have to be 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,” and the restrictive covenant could not prohibit an employee from seeking employment in other states.

5. The agreement would have to 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 [his or her] employment.”
6. The agreement could not penalize an employee for defending against or challenging the validity or enforceability of the restrictive covenant.
7. The agreement could not contain a choice of law provision that would have the effect of avoiding the requirements of the bill. This requirement would apply only if the employee were a resident of or employed in the state of New Jersey at the time of the termination of his or her employment and for at least 30 days immediately preceding the termination of his or her employment.
8. The agreement could not waive an employee’s substantive, procedural and remedial rights provided under the bill, any other law or administrative regulation, or under the common law.
9. The agreement could not restrict an employee from “providing a service to a customer or client of the employer, if the employee [did] not initiate or solicit the customer or client.”
10. The agreement could not be “unduly burdensome on the employee, injurious to the public, or inconsistent with public policy.”

Notably, the bill includes a “grandfather clause,” which permits any agreements that were in effect on or before the date of enactment to remain valid.

Compensation and Benefits Continuation Requirements

The bill would also place significant monetary obligations on an employer that seeks to enforce a restrictive covenant against a former employee. If a restrictive covenant were deemed enforceable, the bill would first require an employer, during any period after the employment relationship ended and the covenant was still effective, to pay the employee an amount equal to 100 percent of the pay to which the employee would have been entitled had he or she been employed during the period for which the non-compete was in effect.

Second, the bill would also require an employer to maintain the employee’s fringe benefits for any period of time that the employee is restricted from competing with his or her former employer. “Fringe benefits” are defined under the bill as “any vacation leave, sick leave, medical insurance plan, disability insurance plan, life insurance plan, pension benefit plan, or any other benefit of economic value, to the extent that the leave, plan, or benefit is paid for in whole or in part by the employer.”

Finally, the bill would prevent employers from contracting with the employee to avoid these compensation and benefits continuation obligations.

Notice Requirements

The bill would also place an affirmative duty on the employer to notify, in writing and not later than 10 days after the termination of the employment relationship, the employee of the employer's intent to enforce the agreement. If such notice were not timely provided, the agreement would be void. However, this requirement would not apply if the employee had been terminated for "good cause," which is defined under the bill as a "reasonable basis related to an individual employee for termination of the employee's employment" based on a number of factors set forth in the bill.

Additionally, the bill would require employers to post a copy of the bill (or a summary approved by the New Jersey Department of Labor and Workforce Development) in a prominent place in the employer's worksite. Employers that failed to do so would be subject to a written warning for a first violation, \$250 for a second violation, and up to \$1,000 for the third and each subsequent violation.

Private Right of Action and Damages

Finally, the bill would allow an employee subject to a restrictive covenant to file a lawsuit against his or her employer for violations of the bill within two years of the later of:

- (1) when the prohibited agreement was signed;
- (2) when the employee learned of the prohibited agreement;
- (3) when the employment relationship was terminated; or
- (4) when the employer took any step to enforce the agreement.

If the employee were successful in such action, the bill would also allow a court to "void any agreement and to order all appropriate relief," including the payment of liquidated damages, which the bill limits to no more than \$10,000.

Key Takeaways

Many employers use restrictive covenants in an effort to protect their legitimate business interests, including their confidential and trade secret information and their client bases, and prevent unfair competition. While Senate Bill 3518 does provide some useful guidance to employers in terms of establishing some bright-line factors for determining the enforceability of a non-compete (for example, the 10-day notice provision), many of the requirements in the bill would significantly decrease an employer's ability to proactively protect its competitively-sensitive information and business interests (though the bill does not prohibit confidentiality or trade secret agreements, which employers could still use to protect their trade secret information).

For example, the bill would declare unenforceable restrictive covenants that prohibit an employee from seeking employment in another state. Theoretically, then, an employee who previously worked in Hoboken, New Jersey, could simply travel across the Hudson River and immediately begin competing unfairly with his or her former employer from New York City.

Additionally, and notwithstanding the existence of an otherwise enforceable nonsolicitation provision, the bill would permit an employee to service his or her former employer's customers so long as the employee himself or herself did not initiate or solicit the customer or client. The bill, however, does not define what constitutes "solicitation," nor does it identify what type of contact between the employee and the customer would be otherwise permissible.

The bill has been referred to the New Jersey Senate Labor Committee for consideration. It would still have to pass the full New Jersey Legislature before the governor could receive it for his consideration.

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