NEW JERSEY CIVIL JUSTICE INSTITUTE

MEMORANDUM

TO: Assembly Labor Committee
FROM: Anthony M. Anastasio, President
SUBJECT: A1650
DATE: February 24, 2021

The New Jersey Civil Justice Institute is a statewide, nonpartisan coalition of the state's largest employers, small businesses, and leading trade associations. NJCJI's mission is to promote a fair and predictable civil justice system in New Jersey, which is essential for the State's economic health. This correspondence serves to identify NJCJI's concerns regarding A1650, which seeks to limit the use of restrictive covenants in the employment context.

NJCJI fully appreciates the sponsors' concerns about oppressive imposition of such agreements on low-wage workers. However, in its current form, A1650 casts a net so wide that it would all but eliminate the use of restrictive covenants from a practical perspective. This will generate legal uncertainty and unintended consequences. For the reasons set forth below, NJCJI respectfully requests that the Assembly Labor Committee not release this sweeping bill in its current form.

Background

For well over a century, our courts have validated reasonable agreements that restrain employees' post-employment activities. *See Mandeville v. Harman*, 42 N.J. Eq., 185, 189-90, 7 A. 37 (Ch. 1886). New Jersey courts uphold these restrictive covenants if they protect a legitimate interest of the employer, do not impose an undue hardship on the employee, and do not otherwise harm the public interest. *See Solari Indus., Inc. v. Malady*, 55 N.J. 571, 583, 264 A.2d 53 (1970). In making this determination, courts consider whether a protectable interest exists or whether the restrictive covenant merely exists to prevent lawful competition. *Id.* Courts typically consider protectable interests to be things such as trade secrets, other confidential information, or preservation of customer relationships. *See Whitmyer Bros., Inc. v. Doyle*, 58 N.J. 25, 33, 274 A.2d 577 (1971). If no protectable interest is found, then the restrictive covenant is invalid. *Id.* However, if a protectable interest exists, then courts will balance it against any hardship on the employee. *See Ingersoll-Rand Co. v. Ciavatta*, 110 N.J. 609, 635, 542 A.2d 879 (N.J. 1988). Restrictive covenants that are overbroad in duration and/or geographic scope create an undue hardship for employees and are therefore invalid. *Id.*

But that is not the end of the court's function in such disputes. Our courts may then reform or "blue pencil" unreasonable restrictive covenants so they remain enforceable in a revised form. *Solari*, *supra*, 55 N.J. at 585, 264 A.2d 53; *see also ADP, LLC v. Kusins*, 460 N.J. Super. 368, 402, 215 A.3d 924 (App. Div. 2019). That is, courts can revise an agreement's geographic reach, time limitations and/or the nature of restricted activity so it protects both the employer's legitimate interests and the employee's continued livelihood. *Id.* In doing so, our courts fulfill their essential equitable role by ensuring parties to such agreements are not completely stripped of the benefit of their bargain.

In its current form, A1650's requirements would drastically limit our courts' flexibility in reforming invalid restrictive covenants. Indeed, it is unclear whether this equitable function would still be possible given the legislative findings and detailed prescription for the content of restrictive covenants set forth in Sections 1 and 3. Again, equitable relief ensures that parties to such agreements maintain some semblance of the bargain underlying formation of the employee-employer relationship. Accordingly, to prevent widespread legal uncertainty, NJCJI respectfully submits that the bill should be revised to expressly state that lawful provisions in restrictive covenants remain severable (either through prior agreement or judicial action), and that blue penciling is still a permissible judicial function to conform invalid agreements with the requirements of the law.

Garden Leave Entitlement

"Garden leave" is an arrangement through which an employer compensates an employee and maintains the same level of benefit contributions after an employee has resigned or is effectively terminated. Garden leave is typically provided when an employer wants to ensure that certain employees, who possess valuable proprietary information or deep institutional knowledge, honor their post-employment obligations, such as those established by restrictive covenants. Regardless of whether such arrangements are pre-agreed or developed on an *ad hoc* basis at the time of separation, they are still implicitly considered during negotiation of an employee's annual compensation, bonuses, and fringe benefits.

Section 3(d) of A1650 *requires* garden leave for *all* employees who are subject to restrictive covenants. Garden leave is apparently required by the bill even if an employee resigns and/or obtains new employment. By imposing this requirement across the board, the bill will have the unintended consequence of depressing wages for New Jersey employees. That is, employers must require restrictive covenants for certain employees to protect legitimate proprietary interests that are essential to viable competition in the marketplace. These employees are often highly skilled and talented, and therefore, well compensated. Section 3(d) will force employers to reduce compensation and benefits for such employees to ensure sufficient funds are available for garden leave. Employers who cannot afford to pay competitive compensation *and* effectively budget for garden leave may seek alternative jurisdictions for highly skilled positions to remain competitive in the labor market. Alternatively, such employers may reduce compensation for lower-level employees to fund required garden leave for higher-level employees subject to restrictive covenants. Either way, *this hurts New Jersey.*

Finally, the garden leave requirement applies even if an employee secures new employment. This effectively penalizes businesses for reasonable restrictive covenants that have not impacted an employee's pursuit of other employment opportunities. For instance, some employees may quickly secure new positions outside the geographic scope of a valid restrictive covenant, earning higher compensation than before. A1650 would provide those employees with a windfall with no cognizable benefit to the public at large. On the other hand, Section 3(d) could also disincentivize some employees from pursuing new employment at all while receiving full pay, which is drag on overall productivity in New Jersey.

For these reasons, NJCJI respectfully submits that A1650 should be amended to remove the garden leave requirement set forth in Section 3(d). In the alternative, NJCJI respectfully submits that Section 3(d) should be modified so that it only applies to low-wage employees. Any such modification should also carve out employees who voluntarily resign. Finally, the modification should ensure that employees receiving garden leave must actively seek new employment during leave and that pay will be terminated after new employment is secured.

Ability to Service Customers Who Solicit or First Initiate Contact with a Former Employee

Read together, Section 3(a)(9) and 3(e) of A1650 invalidate restrictive covenants that prohibit former employees from engaging customers of their former employer when such customers solicit the former employee or otherwise first initial contact. By affording statutory protection to engagement with former customers in this manner, the bill effectively insulates former employees from liability for unlawful competition in all future engagements with those customers, regardless of who initiates subsequent contact. It will also generate significant litigation over backdoor solicitations by former employees who disingenuously seek protection under Section 3(a)(9). (Make no mistake: Such solicitations *will* occur). Backdoor solicitations cause immediate, irreversible damage to an employer's customer relationships. For these reasons, NJCJI respectfully submits that Section 3(a)(9) undermines the entire purpose of restrictive covenants and should therefore be removed from the bill.

Prohibition of Enforcement of Restrictive Covenants against Independent Contractors

Section 3(b)(6) bans enforcement of restrictive covenants against independent contractors. Independent contractors are regularly used by businesses that partner with other businesses to complete unique tasks like specialty product design or manufacturing, marketing, or provision of specialty services. Restrictive covenants are commonplace in such arrangements to protect the legitimate business interests discussed above.

As written, Section 3(b)(6) casts doubt on the enforceability of such agreements where business #1 agrees to a restrictive covenant for the benefit of business #2 that also binds business #1's employees and lawfully engaged independent contractors. This practice is commonplace in modern business arrangements that often span multiple continents. Section 3(b)(6)'s apparent total ban on restrictive covenants in this context would hurt businesses that do not perform all tasks in-house or utilize independent contractors employed outside of the State New Jersey. That is, such businesses would be deprived of any ability to protect their proprietary information from

misappropriation by contractors. There is no cognizable policy rationale that justifies this outcome. Accordingly, NJCJI respectfully submits that Section 3(b)(6) be deleted from A1650.

Restriction of the Duration of All Restrictive Covenants

Section 3(a)(3) of A1650 limits the duration of restrictive covenants to twelve (12) months following the date of termination of employment. This limitation completely disregards the unique realities of employment in different industries. For instance, highly skilled employees may make significant contributions to the development of important products, such as pharmaceutical drugs, that take well over a year to bring to market. Employers may have legitimate interests in protecting proprietary information used in the development of such products for longer than 12 months after an employee moves on to other employment.

Given the myriad factual scenarios that determine the relative reasonableness of the duration of a restrictive covenant, the timeframe set forth in Section 3(a)(2) should be deleted. Notably, New Jersey courts have upheld durations well over 12 months in many cases. As mentioned above, courts should retain their ability to blue pencil unreasonable agreements as a matter of equity. In the alternative, this 12-month timeframe should be limited to low-wage employees.

Creation of a Cause of Action and Statutory Remedies

Section 4 of the bill creates a new cause of action for employer violations of A1650, which includes a liquidated damages provision and entitlement to reasonable attorneys' fees and costs. The liquidated damages provision is particularly troubling. Since Section 3 the bill sets forth a detailed prescription for the content of all restrictive covenants and related employer conduct, any technical violation of those requirements could theoretically sustain a cause of action for liquidated damages. That is, such damages are typically recoverable regardless of actual or particularized harm. Accordingly, in its current form, this new cause of action could result in a torrent of class action litigation based on alleged technical violations of A1650 in an employer's standard restrictive covenant provided to its employees. Of course, this dynamic will completely gut any deterrent effect of restrictive covenants.

Currently, New Jersey courts can enter declaratory judgments and provide equitable relief in disputes involving restrictive covenants. Courts have the flexibility to do justice and ensure neither the employer nor the employee is capable of walking away with more than they bargained for. The cause of action set forth in Section 4 upends that balance and will allow aggressive plaintiffs' attorneys to push the employee's side of the scale to all the way to the ground. This does not promote a fair and predictable justice system in New Jersey.

Conclusion

New Jersey courts currently apply robust standards to restrictive covenants in the employment context, readily invalidating and rewriting unreasonable agreements. To the extent that low-wage workers lack resources to litigate such disputes, a ban on inherently oppressive restrictive covenants for such workers may be sound public policy. But A1650 goes much further than just

addressing that issue, effectively throwing out the baby with the bathwater. As set forth above, the unintended consequences and legal uncertainty caused by the bill will be extremely disruptive and erode New Jersey's competitiveness in the global marketplace.

For these reasons, NJCJI respectfully requests that the Assembly Labor Committee vote **NO** on the bill in its current form. We appreciate the Committee's time in reviewing this submission.