RESTRICTIVE COVENANTS AND NON-COMPETE AGREEMENTS: UPDATE 2017

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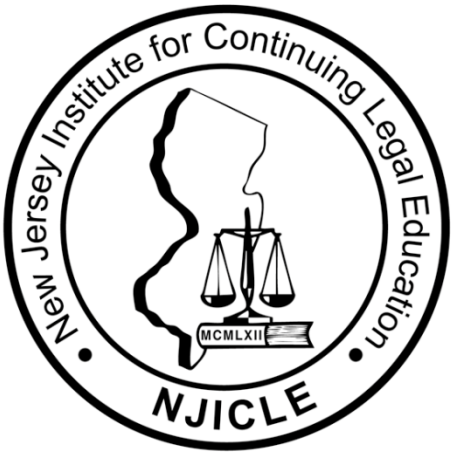

RESTRICTIVE COVENANTS AND NON-COMPETE AGREEMENTS: UPDATE 2017

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In cooperation with the New Jersey State Bar Association **Labor & Employment Law Section** and **Senior Lawyers Special Committee**

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RESTRICTIVE COVENANTS – A YEAR IN REVIEW

By: Cheyne R. Scott, Esq.

1. Chemetall US Inc. v. LaFlamme, 2016 U.S. Dist. LEXIS 29644 (D.N.J. March 8, 2016)

FACTS:

Chemetall, and Coral are manufacturers of industrial chemical products and manufacture products that target the automotive and appliance industries. LaFlamme was hired by Chemetall in May of 2010 as a Technical Sales Manager for the South Central Region. He was later promoted to Senior Technical Sales Manager, where he worked on several important national accounts and was assigned "no geographic territory" as part of his employment.

The Non-Compete Agreement

- For one year from the date of termination he would not directly or indirectly work with any company that competes with Chemetall within any territory to which he was assigned during the two years prior to termination.
- Restricted from soliciting or accepting business from or selling competitive products to Chemetall customers or prospective customers.
- Restricted from disclosing names of customers to others or request that customers withdraw their business with Chemetall.
- "Customers" were defined as any person or entity which has purchased any Chemetall product within the two years prior to the termination of employment.
- "Prospective Customers" were defined as any customer who was identified or contacted by the employee or any other representative of Chemetall within two years prior to employee's termination of employment.

Defendant's Resignation and Alleged Breach

LaFlamme resigned January of 2016 and began working with Coral two weeks later. Upon receipt of LaFlamme's letter of resignation, Chemetall restricted LaFlamme's internal network access. In response, LaFlamme copied various proprietary information onto his personal USB drives.

Two weeks after starting work with Coral, LaFlamme visited a Chemetall customer at a plant using a Chemetall vendor badge.

Chemetall filed a breach of contract action in the United States District Court for the District of New Jersey and made an application for a preliminary injunction. The Court issued a TRO and set a hearing date.

HOLDING:

The Court granted Chemetall's preliminary injunction subject to some limitations.

In determining that there was a likelihood of success on the merits, the court found that Chemetall's interest to protect its customer relations, proprietary information and competitively sensitive plans and strategies was legitimate and that it had provided sufficient facts to prove that there was potential immanent harm of disclosure of confidential information. The court also found the one-year duration of the agreement to be reasonable.

However, it found that by neglecting to define the term "territory" in its agreement, Chemetall presented insufficient evidence for the court to issue an injunction restricting LaFlamme from competing based solely on an assigned "territory." Consequently, the Court found that LaFlamme could only be restricted from soliciting customers he served in the past two years, but not all customers who were served by Chemetall in an unspecified geographic area.

Although LaFlamme claimed to have had relationships with customers prior to his employment with Chemetall, the court opined that Chemetall would be able to demonstrate that it assisted in further developing any such relationship over the past five years of LaFlamme's employment. Conversely, the Court found that the agreement's restriction on soliciting prospective clients was overly broad and unenforceable.

OF NOTE: It is important that terms regarding an agreement's duration, geographic limits and scope of activities be expressly set forth in a non-compete agreement. Additionally, these terms should be considered by the employer when an employee subject to the non-compete is promoted or assumes job duties that may alter the effectiveness of the agreement. Here, by promoting the Defendant and changing his geographic "territory" from South Central Region to "no geographic territory," Chemetall greatly diminished its ability to restrict Defendant's solicitation activities.

2. Davidovich v. Israel Ice Skating Federation, 446 N.J. Super. 1257 (App. Div. 2016)

FACTS:

Andrea Davidovich, a 19-year-old skater with both U.S. and Israeli citizenship who presently lives in New Jersey, previously skated with partner Evengi Krasnopoloski representing Israel in the pairs event at the 2014 Winter Olympics in Russia. Following the Olympics, the pair split up following disputes with their trainer and Davidovich requested a release from the Israeli Ice Skating Federation ("Federation") to allow her to skate for the United States. The Federation denied her request, claiming that releasing Davidovich would lead to other skaters, in whom which the Federation had invested substantial resources, to switch affiliations to other countries. The Federation also made public statements disparaging Davidovich's skating abilities.

Davidovich filed a complaint in September 2014 seeking a formal release from the Federation. One year later, the Law Division ruled in her favor, ordering the Federation to release her to skate for the United States. The Federation appealed and the Appellate Division initially asked Davidovich to seek other remedies to break free under the rules of the Switzerland-based International Skating Union (the "Union"). The case was remanded to the Law Division.

In April of 2015, the Law Division again ruled in Davidovich's favor, granting her declaratory judgment against the Federation stating that the lawsuit had harmed her ability to find a partner and could lead to "a deprivation of any genuine prospect that she may skate in the future."

Again, the Federation appealed. During the pendency of the appeal, the Union revised its eligibility rules for skaters to allow a 12-month waiting period before any skater could be released to skate for whichever country he or she wished. The United States filed a formal request with the Federation seeking Davidovich's release in time to meet the July 1 deadline for the 2016-2017 skating season. This request was again denied.

HOLDING:

The Appellate Division reversed the Law Division's grant for declaratory judgment, stating that courts should stay out of sporting disputes until all internal procedures have been exhausted.

OF NOTE:

Under normal circumstances, the restrictions placed on plaintiff could arguably be found to be unreasonable and unenforceable. However, this case demonstrates the deference given to sporting organizations to resolve disputes internally and administratively.

3. APR, LLC v. Lomans, 216 N.J. Super. Unpub LEXIS 162 (Law Div. January 27, 2016)

FACTS:

APR, Lomans and Dr. Reddy's Laboratories ("Dr. Reddy's") worked together under a Joint Development Agreement to develop a pharmaceutical product. In 2011, Dr. Reddy's acquired all physical assets, intellectual property and trade secrets of APR and the parties terminated their Joint Development Agreement. As part of this process, the parties executed the following:

- An Asset Purchase Agreement ("Purchase Agreement"), under which Dr. Reddy's acquired all of APR's assets, liabilities and assumptions of APR's Lease with Lomans;

- A Development Intellectual Property Transfer and Royalty Agreement ("Royalty Agreement"), under which Dr. Reddy acquired all intellectual property of APR in exchange for $2.5 million dollars and agreed to pay APR royalties for 21 years at a percentage of net profits;

- A Consulting and Transitional Services Agreement ("Consulting Agreement"), pursuant to which Lomans and Dr. Reddy's agreed to provide transition and consulting services for three years. Contained in the Consulting Agreement, was a restrictive covenant preventing Lomans from competing against the product during the term of the Royalty Agreement.

Litigation ensued when it was discovered that Lomans was independently developing a competing pharmaceutical product. Lomans argued that Dr. Reddy's breached the agreement when it filed misrepresented data with the U.S. Food and Drug Administration and blocked him from key meetings and discussions. This breach, according to Lomans, terminated the restrictive covenant. Dr. Reddy's argued that explicit language in the contract clearly established that the restrictive covenants survive any termination of the agreement.

HOLDING:

The Appellate Division granted Dr. Reddy's Motion for Summary Judgment. The Court found that independent covenants are enforceable against a non-breaching party even if the other party may have breached its obligations under the same contract. Therefore, any purported breach by Dr. Reddy's did not relieve Lomans of his contractual obligations under the restrictive covenants.

Lomans argued that the restrictive covenants were invalid for lack of separate, independent consideration. The Court rejected this argument finding that a plain reading

of the contractual agreements lead to the conclusion that the restrictive covenants were supported by separate consideration. The court concluded that the payments made under the Purchase Agreement and Royalty Agreement were made in exchange for compliance with the restrictive covenants.

OF NOTE:

Courts will not terminate a restrictive covenant even if the party seeking to enforce the covenant has breached the contract.

4. AIT Global, Inc. v. Yadav, 445 N.J. Super. 513 (App. Div. 2016)

FACTS:

AIT Global is a temporary help service firm ("THSF") that provided short-term information technology consultants for plaintiff's customers. A THSF is required to be licensed as an employment agency pursuant to the Private Employment Agency Act (the "Act"), N.J.S.A. 34:8-48 et seq., in order to enforce an employment agreement.

Under the Act, an employment agency is defined as a person who, in exchange for a fee or commission, provides employees to employers seeking workers on a part-time or temporary basis. Employment agencies must be licensed in order to file a lawsuit seeking to collect a fee from an employee. Conversely, a THSF is defined as someone who runs a business that assigns people to help its customers with temporary, extra or special workloads

Defendant was an IT consultant who executed an employment agreement that contained an early termination provision obligating the employee to pay liquidated damages for every month remaining in the 12-month term and a restrictive covenant agreement restricting Defendant from being employed by any competitor for one year following termination of employment. Defendant resigned after five months of employment and AIT filed suit to enforce its early termination provision.

Defendant argued that the THSF violated the Consumer Fraud Act by failing to obtain a license as an employment agency under the Act. The Law Division agreed, granting Defendant's motion for summary judgment.

HOLDING:

The Appellate Division reversed the trial court order granting summary judgment and found for Plaintiff employer. Reviewing the Act and acknowledging that this was an issue of first impression before it, the court concluded that the Act requires employment agencies to be *licensed* and THSFs to be *registered* in order to bring actions to enforce

contracts made by their employees. Accordingly, THSF had complied with the provisions of the Act by registering and its employment contract was enforceable.

OF NOTE:

Although the restrictive covenant itself was not directly at issue in this matter, it is important to be aware that a THSF only needs to be registered, not licensed, in order to enforce a restrictive covenant.

Crafting Restrictive Covenants in New Jersey

By Steven M. Berlin

Types of Restrictive Covenants

- Non-Competition
  - Restricts employment (or ownership) with competing entity.
- Non-Solicitation
  - Restricts soliciting current/ former customers.
  - Restricts hiring away employees to join a new entity
- Non-Disclosure
  - Restricts utilizing/disclosing employer's trade secrets and confidential information.

Restrictive Covenants are

- Enforceable to the extent
  - reasonable under all the circumstances of the case. See, Karlin v. Weinberg, 77 N.J. 408, 417 (1978)
  - reasonable in scope and duration. See, Community Hosp. Group, Inc. v. More, 183 N.J. 36, 57 (2005).
- Reasonable if:
  - protect a **legitimate interest** of the employer;
  - impose no **undue hardship** upon the employee; and
  - **not injurious to the public** interest.
- Subject to enforcement--**in whole or in part**--to the extent reasonable.
  - Blue Pencil Doctrine—court may modify
  - Unreasonable provisions will not be enforced
  - Deliberately oppressive agreements may be invalidated it in its entirety.

See, Solari Industries Inc. v. Malady, 55 N.J. 571, 585 (1970).

  - Avoid overbroad, one-size fits all
  - Non-solicit or non-disclosure when non-compete not necessary
  - Balance legitimate interests with fairness to employee

Legitimate Interest of the Employer

The specific business interests the company seeks to protect. Can include:

- Customer relationships. See, Whitmyer Bros., Inc. v. Doyle, 58 N.J. 25, 33 (1971); Mailman, Ross, Toyes, & Shapiro v. Edleson, 185 N.J. Super. 434 (Ch. Div. 1982).,
  - patient referral
  - Not continuing relationships with pre-employment customers. See, Coskey's T.V. & Radio Sales v. Foti, 253 N.J. Super. 626 (App. Div. 1992),

- Trade secrets and confidential business information. See, Ingersoll-Rand Co. v. Ciavatta, 110 N.J. 609 (1988), See, Raven v. A. Klein & Co., 195 N.J. Super. 209 (App. Div. 1984).
- Return on investment in training, Community Hosp., 183 N.J at 57
- Unique methods, procedure, techniques, Raven v. A. Klein & Co., 195 N.J. Super. 209 (App. Div. 1984)
- Describing helps establish legitimate business interest
    - Nature of business or industry
    - Nature of product or service

Undue Hardship of Employee

- Restriction on employee's ability to find work in employee's field
    - Generally not personal inconvenience or financial hardship. See, Karlin v. Weinberg, 77 N.J. 408 (1978).
- More narrowly drafted restriction is, undue hardship less likely
    - i.e. restrict employee from all selling any type of software or any job related to sales support software or just restrict employee for selling sales support software in a specific geographic location
    - i.e., limit non-solicit to sales of existing customers as opposed to existing and potential

Public Interest

- Most common situation is healthcare
    - Balance public's right to professional advice with employer's patient or client relationship

Geographic Restraints (or None)

- Goes to issue of reasonableness-areas where the employee worked, not the entire territory of employer's business
    - Depends on facts and circumstances, Karlin, 77 N.J. at 422.
    - i.e., Where does employer do business, where did employee work for employer, where does employer plan to do business
- More the restricted geographic area relates to where employer regularly conducts its business, greater likelihood of enforceability.
    - A few miles, or an entire town, county or state, region or whole country
- More frequently no geographic area is appropriate and **focus on information need to protect**
    - i.e. purpose is preserve business relationships, client lists, Solari, 55 N.J. at 585
        - customers employee contacted
        - not customers/clients employee had pre-employment relationship with
    - reflect nature of business, product or service
    - protect information that gives employer competitive advantage, could harm employer if disclosed. makes employer unique

Temporal Restraints

- Time periods restricting how long former employee must refrain from

    - Engaging in a competitive business
    - Soliciting former customers/clients/employees
    - Using business confidential information
- Reasonableness
    - Depends on facts and circumstances
    - How much time needed to protect legitimate business interest from unfair competition?
    - Nature of relationship between customer/client and employee
    - Nature of information sought to be protected, is it in public domain?
- Restrictive covenants with durations of two years have historically been upheld. See Schuhalter v. Salerno, 279 N.J. Super. 504 (App. Div.), certif. denied, 142 N.J. 454 (1995); A.T. Hudson v. Donovan, 216 N.J. Super. 426 (App. Div. 1985).
- Longer time periods upheld under appropriate circumstances
    - Court enforced a dermatologist's five-year, ten-mile restriction because there was no evidence that it was unreasonable (Karlin, 77 N.J. at 422).
- But time periods also evaluated against rapidly changing business environment. See Earth Web Inc. v. Schlack, 71 F.Supp.2d 299 (S.D.N.Y. 1999), remanded, 205 F.3d 1322 (2d Cir.), aff'd, 2000 USApp LEXUS 11446 (2d Cir. N.Y. May 18, 2000)(holding one year covenant in internet company officer's employment to be "too long given the dynamic nature of the [information technology] industry

Other Drafting Considerations

- Define employer-Who is protected?
    - One entity
    - Affiliates, subsidiaries, or parents
    - Limit to a division or unit

- Consideration—restrictive covenants are contracts
    - Employment offer or continued employment. See A.T. Hudson, 216 N.J. Super. at 431.
    - Continued employment. See Hogan v. Bergen Brunswig Corp., 153 N.J. Super. 37, 41 (App. Div. 1977).
        - Not continued employment in all states, i.e. PA.
    - Stock options, bonus etc.
    - Change in employment terms and conditions
- Choice of Law
- Attorney's fees and costs
- Enforcement—right to seek injunction and other relief; breach is irreparable injury

ARE RESTRICTIVE COVENANTS ENFORCEABLE?

LOOK BEYOND THE BOX

By

John H. Schmidt, Jr., Esq.

Were The Restrictive Covenants Agreed To and Accepted By the Employee?

Electronic Acceptance:

- The principal of law overriding all electronic agreements is that there must be "mutual manifestation of assent, whether by written or spoken word or by conduct." *Fteja v. Facebook, Inc.*, 841 F. Supp. 2d. 829 (S.D.N.Y. 2012).
- "[A] user must click on an icon that *affirmatively demonstrates assent to be bound by the terms and conditions*." *Holdbrook Pediatric Dental, LLC v. Pro Computer Service, LLC,* 2015 U.S. Dist. Lexis 94556 (D.N.J. 2015);, *Liberty Syndicates at Lloyd's v. Walnut Advisory Corp.*, 2011 U.S.Dist. LEXIS 132172, at *4 n.5 (D.N.J. November 16, 2011)
- When the contractual provision sought to be enforced is *not* embodied in a document signed by the parties, the Court must determine whether there was mutual assent to include the additional term(s) contained in the separate document. *Holdbrook, supra*.
- "In order for there to be a proper and enforceable incorporation by reference of a separate document… the party to be bound by the terms must have had knowledge of and assented to the incorporated terms." *Alpert, Goldberg, Butler, Norton & Weiss, P.C. v. Quinn,* 410 N.J. Super 510, (App.Div. 2009), certif. den. 203 N.J. 93 (2010); *Holdbrook, supra*.
- "[I]n the internet era, when agreements are often maintained, delivered and signed in electronic form, a separate document may be incorporated through a hyperlink [or.*pdf*] but the traditional standard nonetheless applies: the party to be bound must have had reasonable notice of and manifested assent to the additional terms." *Holdbrook, supra*. "If the terms are not 'reasonably conspicuous,' such that a reasonably prudent offeree would notice them, a party will not be bound by those terms despite clicking on a 'Yes I agree' icon." *Guadagno v. E*Trade Bank*, 592 F.Supp.2d 1263 (C.D. Cal. 2008). "[A]n offeree, regardless of apparent manifestation of his consent, is not bound by inconspicuous contractual provisions of which he is unaware, contained in a document whose contractual nature is not obvious." *Schnabel v. Trilegiant Corp.*, 697 F.3d 110 (2d Cir. 2012).

- Clickwrap agreements were enforced when the website was designed so the user was required to access the document sought to be enforced by hyperlink (or otherwise presented with its terms) *and* also had to affirmatively check a box that clearly stated the user was consenting to the terms of that agreement. *Mohamed v. Uber Techs, Inc.,* 109 F.Supp.3d 1185 (N.D. Cal. 2015); *Fteja v. Facebook, supra,* 841 F.Supp.2d 829; *Swift v. Zynga Game Network, Inc.*, 805 F.Supp.2d 904 (N.D.Cal. 2011); *Moore v. Microsoft Corp.*, 741 N.Y.S.2d 91 (App. Div. 2002); *Forrest v. Verizon Comm., Inc.,* 805 A.2d 1007, 1010-11 (D.C. Cir. 2002); *Lan Systems, Inc. v. Netscount Serv. Level Corp.*, 183 F. Supp.2d 328, 338-39 (D. Mass. 2002).
- Courts have held that the agreement sought to be enforced, "cannot be proffered unfairly, or with a design to conceal or de-emphasize its provisions." *Hoffman v. Supplements Togo Management, LLC*, 419 N.J. Super. 596 (App. Div. 2011), *cert. granted*, 209 N.J. 231 (2012); *see also, Jerez v. J.D. Closeouts*, LLC, 943 N.Y.S.2d 398 (Nassau Cty. 2012); *Noble v. Samsung Electronics of America, Inc*., 2016 U.S. Dist. LEXIS 33406 at *10-11 (D.N.J. March 15, 2016)
- [T]he onus must be on website owners to put users on notice of the terms to which they wish to bind consumers. Given the breadth of the range of technological savvy of online purchasers, consumers cannot be expected to ferret out hyperlinks to terms and conditions to which they have no reason to suspect they will be bound. *Nguyen v. Barnes & Noble, Inc.*, 763 F.3d 1171 (9th Cir. 2014)

Examples:

- In *James v. Global Tel*Link Corp.,* 2016 U.S. Dist. LEXIS 17099 (D.N.J. 2016), the court found an enforceable arbitration agreement where users were shown an *actual copy* of the agreement within their browser, and were required to click a button labeled "Accept" on that same screen before completing the account creation process.
- In *Caspi v. Microsoft Network, LLC,* 323. 118 (App. Div. 1999), *cert. denied,* 162 N.J. 199 (1999), prospective subscribers were required to view multiple computer screens of information, including a membership agreement containing a forum selection clause appearing next to blocks providing the choices "I Agree" and "I Don't Agree" before becoming an MSN member. *Id.* at 121.
- in *Mohamed, supra,* Uber drivers were presented with a screen shot when they attempted to log-on to the Uber application that stated "TO GO ONLINE, YOU MUST AGREE TO ALL THE CONTRACTS BELOW" which was immediately followed by three hyperlinks to three agreements. Directly below appeared the following language: "By clicking below, you acknowledge that you agree to *all* the contracts above." This was immediately followed by a large box labeled "Yes. I agree." *Id.* at 1190 (emphasis added). In addition, if the Uber drivers clicked "Yes, I Agree," they then saw a screen stating "PLEASE CONFIRM THAT YOU HAVE

REVIEWED *ALL* THE DOCUMENTS AND AGREE TO *ALL* THE NEW CONTRACTS." *Id.* at 1191 (italics added). The court concluded that Uber submitted sufficient evidence of assent. *Id.* at 1197.

- In *Guadagno v. E*Trade Bank*, 592 F. Supp. 2d 1263 (C.D. Cal. 2008), the Court held that while a party may be bound by a "clickwrap" agreement regardless of whether he or she actually reads it, this is only true if the terms are clear and acceptance of the agreement is unambiguous. There, a highlighted, underlined link to the Agreement was directly above the acknowledgment box, along with notice that "The following contain important information about your account(s)." In addition, it also stated by "requesting an account, or maintaining an account, you acknowledge that you have reviewed, understand and agree to these terms," and "YOUR ATTENTION IS DRAWN TO THE ARBITRATION PROVISION OF THIS AGREEMENT." Moreover, the Arbitration clause itself stated: "IT IS IMPORTANT THAT YOU READ THIS ARBITRATION CLAUSE." *Id*. at 1271.
- *Noble v. Samsung Electronics of America, Inc*., supra, the Court rejected Samsung's effort to bind its consumers to an arbitration agreement hidden deep within the Guide booklet that accompanied the purchase of a smartwatch.

Knowledge And Candor In Presentation To Employee

- Restrictive covenants are disfavored as restraints of trade and should be narrowly construed by the courts. *J.H. Renarde, Inc. v. Sims,* 312 N.J. Super. 195, 205 (Ch. Div. 1998). Whereas restrictive covenants are disfavored, the law should also impose an affirmative obligation upon an employer to (i) conducted itself in a fair, upfront and reasonable manner in its dealings with its employees; (ii) be open and notorious and provide notice to its employees that it will impose restrictive covenants and/or new restrictive covenants upon them as a condition of employment or receipt of a new employment benefits; and (iii) not use economic leverage (e.g., offering incentive stock awards) over "unsuspecting" employees to surreptitiously impose restrictive covenant obligations upon its employees. In short, the well-recognized contractual doctrine of "good faith and fair dealing" implicit in every contract should be imposed upon employers attempting to enforce restrictive covenants. As summarized by Justice Wallace in *Wade v Kessler Institute for Rehabilitation*, 343 N.J. 338, 345 (2001):

> Our Supreme Court has stated that "[i]n every contract there is an implied covenant that 'neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract; in other words, in every contract there exists an implied covenant of good faith and fair dealing.'" *Palisades Properties Inc. v. Brunetti*, 44 N.J. 117, 130, 207 A.2d 522 (1965) quoting 5 Williston on

Contracts, § 670, pp. 159-60 (3d ed.1961). *See also Wilson v. Amerada Hess Corporation*, 168 N.J. 236, 773 A.2d 1121 (2001).

If restrictive covenants are presented to employees electronically, investigate to determine if the websites were designed in such a way to ensure that existence of a restrictive covenant, let alone its actual terms, were disclosed to the user. In *Genovese Drug Stores, Inc. v. Conn. Packing Co.*, 732 F.2d 286, 290 (2d Cir. 1984) the Second Circuit vacated a preliminary injunction seeking enforce the terms a restrictive covenant contained in a lease agreement. Is so doing, the court recognized that "[a]s the beneficiary of a restrictive covenant, Genovese has the obligation to give its potential competitors constructive notice of the restriction it had obtained on the ability to compete . . ." (emphasis added) The same rationale should be applicable in the employment case also. Employers should be obligated to do far more to ensure that its employees were on notice of the post-employment restrictions they were being asked to accept.

The Restrictive Covenants Must Protect Legitimate Business Interests of the Employer

- New Jersey disfavors restraints on trade; restrictive covenants are therefore to be narrowly construed by the courts. *J.H. Renarde, Inc. v. Sims,* 312. 195, 205 (Ch. Div. 1998). The New Jersey Supreme Court emphasized that "an employee's covenant not to compete after the termination of his employment is not as freely enforceable [as other types of restrictive covenants] because of well recognized countervailing policy considerations". *Whitmyer Bros., Inc. v. Doyle*, 58 N.J. 25, 33 (1971) (citing *Solari Industries, Inc. v. Malady*, 55 N.J. 571, 576 (1970). Thus,
- An employer seeking to enforce a non-competition agreement bears the burden of proving the agreement's enforceability. See *Ingersoll-Rand Co. v. Ciavatta*, 110 N.J. 609, 640 (1988). a restrictive covenant will be deemed reasonable and enforceable if i) it simply protects the legitimate interests of the employer; ii) imposes no undue hardship upon the employee; and iii) is not injurious to the public interest. *Ingersall-Rand* at 576. Conversely, a covenant will be deemed unreasonable if it i) extends beyond any apparent protection that the employer reasonably requires; ii) prevents the employee from seeking other employment; or iii) adversely impacts the public. Id. at 627.
- Whether a restrictive covenant is enforceable is a question of law to be decided by the court. *Kieffer v. Best Buy*, 205 N.J. 213, 222-23 (2011).
- The courts recognize that an employee's knowledge, skill, expertise and other information acquired during the course of his employment "belong to him as an individual for the transaction of any business in which he may engage . . . including a competitive business with his former employer." *Id.* The line

between these competing interests may be difficult to draw, and the employer bears the burden on this issue. *Ingersall-Rand* . at 638.

- In *Laidlaw, Inc. v. Student Transportation of America*, 20 F.Supp.2d 727, 757 (D.N.2J. 1998), the court considered the enforceability of a restrictive covenant that was *not* signed contemporaneously with the start of the employment, but rather, was presented to select employees together with stock options long after the employees commenced employment. The court began its inquiry by noting that normally, businesses seeking to protect confidential information or customer relationships require employees to sign non-competes in exchange for the receipt of confidential information and the development of customer relationships. *Id.* at 763. However, the court noted that Laidlaw did not require the stock-option non-competes in exchange for the foregoing, because the employees had already received confidential information and developed customer relationships without executing the non-competes. In addition, Laidlaw acknowledged that it took no action against employees who did not sign the non-competes, and that key employees who were also privy to the confidential information were not bound to any restrictions. *Id.* Whereas Laidlaw's restrictive covenants were clearly not in exchange for the receipt of confidential information and the opportunity to develop Laidlaw's client relationships, the court concluded that the principle thrust of the covenants was not protecting Laidlaw's legitimate interests; it was to buy out competition and was therefore an unenforceable restraint of trade.

<u>The Covenants Should Not Be Overbroad</u>

- Although it is accepted that an employer has a legitimate interest in protecting its client relationships, "employers should not be permitted to include the broadest possible restrictions in an employment contract, thus achieving the greatest possible amount of protection for themselves, to the unreasonable restriction of an employee's right to use his skills to the best advantage, and then be enabled to enforce so much and so many of the restrictions as can be found by a court to be reasonable under the circumstances. If such were the rule, it would afford employers an unconscionable advantage over their employees." *Hudson Foam Latex Products, Inc. v Aiken*, 82 N.J. Super. 508, 516-517 (App. Div. 1964)"The balance is struck thusly: if the contractual prohibition is reasonably necessary for the protection of the employer's business and at the same time is neither *unreasonably restrictive of the rights of the employee with regard to time period or territory*, nor prejudicial to the public interest, it will be enforced." *Id.* at 513. Conversely, "[w]hen an employer, through superior bargaining power, extracts a deliberately unreasonable and oppressive noncompetitive covenant he is in no just position to seek, and should not receive [ ] relief from the courts." *A.T. Hudson & Co. v. Donovan*, 216 N.J. Super 426, 576 (App. Div. 1987); *Solari Industries, Inc. v Malady*, 55 N.J. 571, 576 (1970); *Laidlaw, supra* at 765.
- The Courts should not enforce covenants that prevent an employee from soliciting "all clients" of the employer. Although New Jersey state courts have not squarely ruled on a restrictive covenant preventing an employee from soliciting all clients of the former employer, they have clearly indicated that they would limit the

restriction to those clients with whom the employee had substantial dealing on behalf of the employer. In *Solari, supra*, the New Jersey Supreme Court was called upon to consider the enforceability of a restrictive covenant. The trial court had determined that the restrictive covenant at issue was overbroad and unenforceable, as it barred the former employee from soliciting the business of any of Solari's customers or engaging in a competing business. The *Solari* Court determined that New Jersey should adopt the "blue-penciling" doctrine permitting courts to limit the provisions of overbroad restrictive covenants. In remanding the case to the trial court to apply the "blue-pencil" doctrine, the Court observed:

> Similarly in *A.T. Hudson, supra,* 216 N.J. Super, at 428, the Court considered a restrictive covenant prohibiting solicitation of any business that had been a client of the former employer "at any time or from time to time during the two (2) year period prior to the date of termination of your employment with the Company." The trial court determined that the restrictive covenant was unenforceable because it impaired public interest. On appeal, the Appellate Division reversed and remanded. In so doing, it cited with approval *Solari's* limiting principle that "the appropriate remedy might be a limited restraint against [the employee's] dealing with any of [the employer's] actual customers or prospective customers in the United States with whom he had substantial dealings" on the employer's behalf while in its employ. *Id.*
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> In *Laidlaw, supra* at 764, the New Jersey District Court struck down a restrictive covenant covering the United States as an unreasonable restraint of trade. As the *Solari* Court suggested, the *Laidlaw* Court determined that "[a]t most, Laidlaw would have been entitled to a one-year non-competition agreement that prevents [the employee] from having any dealings with or working on any bids involving any of Laidlaw's actual or prospective customers with whom Pearson had substantial dealings on Laidlaw's behalf while in Laidlaw's employ." *Id.* (emphasis added).
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> The principle of limiting client non-solicitation restrictions to those that the employee had dealings with has been applied by nearly all of the other jurisdictions that have addressed the issue. In *BDO Seidman v Hirschberg,* 93 N.Y.2d 382 (1999), New York's highest court refused to enforce a restrictive covenant barring the solicitation of all clients of the employer's Buffalo office, regardless of whether the employee had contact with the client while working for the employer, stating:
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> > Legal scholars and courts have more circumspectly identified the employer's legitimate interest in employee anti-competitive agreements than that of preservation of the employer's entire client base where, as here, there is no evidence that the employee obtained a competitive advantage by using confidential information… [T]he legitimate purpose of an employer in connection with employee restraints is "to prevent competitive use, for a time, of *information* or *relationships* which pertain

> peculiarly to the employer and which the *employee acquired* in the course of the employment."
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Other states' courts have reached similar conclusions. *See, e.g., Mertz v. Pharmacists' Mut. Ins. Co.*, 261 Neb. 704 (S.Ct. Neb. 2001) ("a covenant not to compete in an employment contract may be valid only if it restricts the former employee from soliciting the former employer's clients or accounts with whom the employee actually did business and had personal contact"); *W.R. Grace & Co., v. Mouyal,* 262 GA. 464 (S. Ct. GA. 1992) (prohibition against the solicitation of any customer located in a specific geographic area is "an unreasonable and overbroad attempt to protect the employer's interest in preventing the employee from exploiting the personal relationship the employee has enjoyed with the employer's customers"); *Intermountain Eye & Laser Ctrs. v. Miller*, 142 Idaho 218 (S. Ct. Id, 2005) (an employer has a "protectable interest in the customer relationships of its former employee established and/or nurtured while employed by the employer and is entitled to protect itself from the risk that a former employee might appropriate customers by taking unfair advantage of the contacts developed while working for the employer"); *Merrymack Valley Wood Prods. v. Near*, 152 N.H. 192 (S.Ct. NH 2005) (striking down the customer non-solicitation clauses that prohibited defendants from soliciting the employer's existing or prospective customers with whom they had no dealings, and enforcing it to the extent it prohibited defendants from soliciting those customers with whom they had developed relationship); *Concord Orth. Prof"l Ass'n v. Forbes,* 142 N.H. 440 (1997)(under New Hampshire law, the legitimate interests of the employer only extend to those areas in which the employee had actual client contact); *Gleeson v. Preferred Sourcing, LLC,* 883 N.E. 2d 164 (Ct. App. Ind. 2008) (noting that Indiana courts recognize that a sales person may be restrained from contacting former customers within a previous sales area because there is a personal nature to the relationship between a salesperson and customers); *Environmental Serv. v. Carter,* 9 So.3d 1258 (Ct. App. FL, 2009) (Florida courts will uphold non-compete clauses without geographic limitations so long as the non-solicitation clause prohibits the employee from soliciting previous customers with whom the employee had business contact.); *Knight v. McDaniel*, 37 W. App. 366 (Ct. App. WA, 1984) (covenant reasonable where it only precluded defendants from serving those clients that they came into contact with as a direct result of their employment); *Lawrence and Allen v. Cambridge Human Resources Group,* 292 Ill. App. 3d 131 (App. Ct. Ill., 1997) (declining to enforce overbroad covenant prohibiting employee from soliciting "any client" of employer regardless of whether employee developed a relationship with that client during his employment); *Evo Corp. v. Poling,* 2015 N.C. 80 (N.C. Sup. Ct. 2015) (refusing to enforce restrictive covenant that precluded solicitation of all employer's customers including those with which defendant had no direct dealings); *Laser Ship Ink v. Watson,* 79 VA. Cir. 205 (Cir. Ct. VA, 2009) (provision preventing employee from contacting any customer that was invoiced by the company in the year prior to employee's departure was an unreasonable burden on the employee to know all customers and was overbroad and

unenforceable as a matter of law); *Nat'l Engineering Serv. Corp. v. Grogan,* 2008 Mass. Super. LEXIS 15 (S. Ct. Ma, 2008) (recognizing that a former employee with close association and relationships with an employer's customers is in a position to harm the employer's good will because the close relationships with the employer's customers may cause the customers to associate the former employee, and not the employer, with the product and services delivered to the customers through the efforts of the former employee); *Cuna Mut. Life Ins. Co. v. Butler*, 2007 Conn. Super. LEXIS 1623 (S. Ct. Conn. 2007) (although the geographic area of the restriction was large, where non-solicitation was limited to those customers whom defendant dealt with while employed, the provision was not overbroad or unreasonable); *Robert Half of Pa., Inc. v. Freight*, 2000 Pa. Dist. & Cnty. Dec. LEXIS 239 (Phil. Cty, 2000) (noting that the Pennsylvania Supreme Court has repeatedly recognized the employer's right to protect through non-solicitation agreements the interest in customer good will that was acquired through the efforts of the employee subject to the restriction).

- The courts should not enforce covenants that prevent an employee from soliciting "prospective clients" of the employer. In *Platinum Management v. Dahms*, 285 N.J. Super. 274 (Law Div. 1995*)* the court reasoned that to the extent a restrictive covenant prohibited the solicitation of prospective customers it was overbroad and unenforceable. Similarly, in *Newport Capitol Group v. Loehwing*, 2013 U.S. Dist. LEXIS 44479, the New Jersey District Court characterized a prospective client non-solicitation provisions as "all-encompassing, and is bounded only by the imagination." Id. at *28. Notably, the court expressed concern that the clause prohibited the employee from soliciting individuals and entities that he was not even aware of, effectively preventing him from soliciting "*any* entity, for fear that Newport or its employees may have identified that entity as a prospective client during the term of his employment at Newport." Id. at *29. The court observed that it may have reached a different conclusion had the agreement differentiated between prospective clients with whom the employee had substantial contact and those with whom he had little or no contact. *Id.*

About the Panelists…

Steven M. Berlin is Of Counsel to Abrams, Gorelick, Friedman & Jacobson, LLP in New York City. With more than 25 years of experience representing businesses of all sizes, he defends employers and executives against a broad range of employment practices, discrimination, civil rights, and regulatory and business claims including wrongful discharge, unlawful harassment, breach of contract, whistleblower, retaliation, family leave, wage and hour, class and collective actions, the enforcement of restricted covenants, and disability and place of public accommodation claims. He also has extensive litigation experience in federal and state courts, and before administrative and arbitral tribunals including the EEOC, the Department of Labor, the NLRB and the American Arbitration Association.

Mr. Berlin is admitted to practice in New Jersey and New York, and the before the United States District Court for the District of New Jersey and the Southern and Eastern Districts of New York, and the Second and Third Circuit Courts of Appeals. He has been Programming Committee Chair of the Labor and Employment Committee of the American Bar Association's Litigation Section as well as Past President and Legislative Committee Chair of the Human Resources Management Association of Princeton. He has also served as an Editorial Board Member for the *New Jersey Labor and Employment Law Quarterly* of the New Jersey State Bar Association and on the board of directors for the IEP Foundation for Youth Services in Monmouth County.

Mr. Berlin has been a lecturer at a number of labor and employment law-related seminars, including programs for ICLE and Lorman Education Services. He is the author of articles which have appeared in the *New Jersey Labor and Employment Law Quarterly*, the *New York Law Journal* and other publications. He has written a regular column for *M.D. News* entitled "The Employment Lawyer's Prescription" and is also a contributing author to the Matthew Bender text *Employment Litigation in New Jersey*.

Mr. Berlin received his B.S. from the University of Maryland at College Park and his J.D. from Brooklyn Law School.

Honorable Robert P. Contillo, P.J.Ch. is Presiding Judge, Chancery Division, Bergen County, and sits in Hackensack, New Jersey. Appointed to the bench in 2002, he previously served in the Civil and Criminal Divisions before being assigned to the Chancery Division in 2006 and being named Presiding Judge in 2010.

Judge Contillo is a member of the Judiciary-Surrogates Liaison Committee and the Supreme Court Advisory Committee on Public Access to Court Records, and serves as Domestic Security Judge. Past Chair of the District IIA Ethics and Fee Arbitration Committees, he has also been a member of the National Conference of Probate Judges and the District of Columbia and Bergen County Bar Associations. Judge Contillo has served as a municipal court judge for Norwood and Paramus and as counsel to several local planning boards. Prior to his appointment, he was in general civil practice.

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Admitted to practice in New Jersey and before the United States District Court for the District of New Jersey and the Southern District of New York, the Third Circuit Court of Appeals and the United States Supreme Court, Mr. Schmidt is a Fellow of the College of Labor and Employment Lawyers and a founding member of the Academy of New Jersey Management Attorneys. He has also been a member of the American, New Jersey State and Union County Bar Associations, and has been involved in a number of reported decisions.

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Ms. Scott received her B.A. from Michigan State University and her J.D., *cum laude*, from Thomas M. Cooley Law School. She served as a Judicial Intern to the Honorable Patrick J. Duggan, United States District Court for the Eastern District of Michigan. She was also Law Clerk to the Honorable Sheila A. Venable, Presiding Judge, Criminal Division, Hudson County, Superior Court of New Jersey.