Employers Will Soon Face Increased Scrutiny Of Restrictive Covenants With Employees

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With every new administration comes a new choreography to which an employer's policies and practices must adapt. The key to managing a productive workforce without missteps is to stay informed about the changes on the horizon, review and rework existing workplace policies to ensure they will pass any new regulatory scrutiny. This article discusses reasonably anticipated changes in the employment context that will have a significant impact on many employers in the Garden State. Employers that rely on non-compete agreements to protect their business interests should closely watch these developments and prepare for necessary adjustments to their employment practices.

Restrictive Covenants/Non-competes

On July 9, 2021, President Biden issued an Executive Order that seeks to advance aggressive legislative reforms to curtail employers from widespread use of restrictive covenants, i.e., non-compete clauses and other agreements that limit employees' ability to change jobs, including their ability to accept work with the employer's direct competitors. Although recent reporting speculates on the potential impact on the enforceability of non-compete agreements, the actual text of the Executive Order reaches further as it applies to non-compete provisions “and other clauses or agreements that may unfairly limit worker mobility.” This language arguably may preclude other restrictive covenants that currently are permissible in most states, such as customer non-solicitation provisions, employee non-poaching clauses, no-hire agreements with competitors, and non-servicing provisions. All such agreements that restrict workforce mobility may be subject to scrutiny if the employer is unable to articulate a legitimate protected business interest that the agreement purports to preserve -- other than a mere competitive advantage.

The Order established a White House Competition Council within the Executive Office of the President which consists of the heads of most of the major federal agencies, including the Secretary of Labor, which tasks the agencies to work with the Federal Trade Commission in promulgating regulations consistent with the Executive Order and to investigate, curtail and penalize such proscribed agreements.

Employers who routinely require all employees to sign restrictive covenants as a condition of employment need to rethink the purpose of this practice. If the primary goal is to stifle competition, the agreement itself would not likely be enforceable and may subject the employer to investigations and/or penalties in the coming months. This is particularly true where most of the workforce subject to a restrictive covenant are entry- or low-level employees with little access to trade secret-level information, which effectively undermines the employer's justification that the agreements are effective in preventing the disclosure of trade secrets or proprietary information.

Legislative disfavor of non-compete agreements has been increasing in recent years in a number of jurisdictions. Several states, currently California, North Dakota, Montana, and Oklahoma, have enacted outright prohibitions on employee non-compete agreements in all or nearly all circumstances. Early in 2021, Washington, D.C. enacted its own ban on non-competes. Other jurisdictions prohibit or limit enforcement for certain types of employees, such as low-wage or entry-level workers, while others, such as Massachusetts, require payment to the employee during the restricted period. Where employers present existing employees with non-compete agreements, quite a few state courts have found that mere continued employment was not sufficient consideration to enforce a non-compete agreement after employment already has started.

Employers are not without protections from employees' disclosure of legitimate proprietary information. Many states have laws prohibiting trade secret misappropriation and disclosure and provide effective legal redress for such disclosures. For example, the New Jersey Trade Secrets Act provides comprehensive protections and remedies available to employers seeking to protect their business interests. The Act not only prohibits actual misappropriation of an employer's trade secrets, but also permits an aggrieved employer to seek court redress with the misappropriation that is being threatened. The damages and equitable relief available to employers under the Act is very broad, including injunctive relief for a necessary period of time in order to eliminate any economic advantage caused by the misappropriation; actual damages caused by the unlawful misappropriation; and an award of reasonable attorneys' fees and punitive damages in an amount not to exceed twice of the total award for actual damages, including unjust enrichment if the court finds the liable party to have "acted willfully and maliciously."

Further, under New Jersey's statute, "trade secret" is broadly defined as "information . . . without regard to form, including a formula, pattern, business data compilation, program, device, method, technique, design, diagram, drawing, invention, plan, procedure, prototype or process," that has economic value, "actual or potential," that is not known to others, and who might derive economic value from its use, and that is subject to an employer's reasonable efforts to maintain its secrecy. *N.J.S.A.* 56:15-2.

Employer Actions:

No longer will one-size-fit-all in restrictive covenant agreements with employees. Employers should be informed about, and prepared to quickly act upon, the statutory protections available to them instead of relying solely on private agreements to protect legitimate business interests. Restrictive covenant agreements should be used sparingly and only for high-level employees that pose an actual threat of misappropriation of the employer's trade secrets and proprietary information. The agreements should be tailored narrowly to the specific employee and delineate the employee's job title, duties, specify the confidential or proprietary information to which they have access, and the nature and extent of that access, to establish irrefutably the level of risk for his or her potential misappropriation. Agreements that contain any provision not clearly applicable to the employee in question will face higher scrutiny and likely be found to be unenforceable by a court of law.

The Porzio employment team routinely advises employers on the appropriate use of restrictive covenants, drafts narrowly tailored agreements for specific key employees of the business and prosecutes cases on behalf of employers who are imminently threatened with misappropriation or disclosure of trade secrets and other proprietary information.