Non-Compete Agreements and Changes in New Jersey's Business Climate

February 27, 2023

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Employment Law Monthly

Savvy employers see the changing macro and micro-economic trends and are considering how those trends will alter the business environment. Changes in law and public policy, particularly the expansion of employee rights in some key areas, look to be significant factors in the near future. In addition, there currently are State and Federal proposals that, if implemented, will significantly impact how businesses use one of their most important tools: the covenant not to compete. This change is the proverbial "canary in the coal mine" for how things were done and is a signal to adopt new and forward-thinking policies and practices.

At the state level, the New Jersey legislature has moved to restrict employer use of non-compete agreements. Currently pending, Assembly Bill A3715 would restrict the use of non-compete agreements to certain types of employees. Under the proposal, nine categories of workers would be excluded from non-compete agreements. Those categories are:

1. an employee who is classified as nonexempt under the federal Fair Labor Standards Act of 1938 (29 U.S.C. § 201 et sec.),
2. undergraduate or graduate student interns, whether paid or unpaid,
3. an apprentice participating in an apprenticeship program registered by the Office of Apprenticeship,
4. a seasonal or temporary employee,
5. an employee who has been terminated without a determination of misconduct or laid off by the action of the employer,
6. an independent contractor,
7. an employee under 18,
8. a low-wage employee, and
9. an employee whose period of service is less than one year.

The above categories cover so many types of workers across so many industries that employers may have difficulty tracking if a non-compete is permissible or not.

In addition to the above restrictions on the application of non-competes, employers will be required to notify an employee no later than 10 days after termination of the employment relationship of the intent to enforce the non-compete agreement. Failure to properly notify would invalidate the agreement.

For those employees who still would be subject to non-compete agreements, this proposed law substantially limits the breadth and length of a possible non-compete agreement. Employers may find themselves particularly vulnerable to job-hopping employees, leaving before their one-year anniversary and invalidating an otherwise valid non-compete agreement. Even when employers can enforce agreements, it will only be for up to one year after the employee's termination, only within the specific geographic areas of the employee's work, and only within the State of New Jersey. Employers should review their non-compete agreements and, if necessary, begin discussing other tools to protect their business interests.

Irrespective of potential state action limiting the use of non-compete agreements, the Federal Trade Commission also has taken steps to ban the use of non-compete agreements nationwide. The proposed rule, put forward last month, would define non-compete agreements as an unfair method of competition. This action would not only ban non-competes moving forward but likely would require any agreement in effect to be rescinded. Currently, by the FTC's own estimates, 1 in 5 workers is covered by a non-compete. This has the potential to invalidate close to 30 million non-compete agreements. Congressional leaders have requested additional information about the FTC's ability to make such a broad rule, likening this proposal to a “power grab.” In other words, there is concern over whether the FTC has the authority to impose such a nationwide ban on non-compete agreements.

While neither the New Jersey bill nor the FTC rule change has become law, it is clear that the pendulum appears to be swinging away from employers. To date, ten states have passed some restriction on the use of non-compete agreements, mostly focused on low-wage workers. Whether non-competes are permitted and which employees they apply to varies depending on the jurisdiction. Some jurisdictions rely on wage levels to determine if a non-compete is appropriate. For example, in Maryland, an employee can earn $31,200.00 per year and still be subject to a non-compete agreement, while in Oregon, the bar is set at $100,533.00. Other recent non-compete laws, like the 2018 revision to the non-compete law in Massachusetts, include tools to make non-competes more expensive for the employer in addition to restricting non-competes to fewer types of workers. Non-compete agreements in Massachusetts are required to have either a “garden-leave” clause, or some other mutually-agreed upon provision which benefits the employee. A “garden-leave” clause requires the employer to pay the employee at least 50% of their salary during the restricted period, thus leaving the employee time for their hobbies, like gardening. Employees who breach a fiduciary duty or otherwise breach the non-compete, forgo their garden-leave payment.

While garden-leave is not included in the New Jersey law, New Jersey employers should review their non-compete agreements. This includes not just a review of the specific language in your non-compete agreement but which types of employees you plan to require to sign non-compete agreements. Employers will find it beneficial to review their existing agreements for problematic language and to draft new non-compete agreements that are likely to be enforceable within the confines of the proposed law. Moving full-speed ahead with contracts that may not be enforceable likely will lead to more litigation and expense in the future. Looking even further ahead, employers will want to assess the value of a non-compete carefully on each type of worker and whether other tools will be better able to protect the business interests without the additional exposure brought on by these new regulations.