The Changing Landscape of Non-Competes and Restrictive Covenants

September 5, 2023

Source: New Jersey CPA Magazine

A common example of a non-compete restriction is a new CPA who signs such an agreement as part of his or her onboarding paperwork. Years later, the CPA considers moving to another firm, or opening their own firm, but that non-compete still exists, with everyone unsure of what it means. Will the employee comply with it? Will the employer seek to enforce it? If a lawsuit is filed, will a court enforce it? In New Jersey, the general rule is that it depends.

Restrictive covenants are agreements — such as non-competes, non-solicitation agreements and non-disclosure agreements — that govern an employee's rights and obligations after he or she separates from an employer. Under current New Jersey law, these agreements are generally enforceable and must be considered on a case-by-case basis.

A non-compete is enforceable as long as it is reasonable in duration, territory and scope. The court will weigh an employer's legitimate business interests against the hardship imposed on the employee. If a court determines that a non-compete is overly broad, it can "blue pencil" the agreement to narrow it in a way that would be reasonable and enforceable. This remains the current law in New Jersey. However, over the past few years, there have been several proposals that would upend years of state jurisprudence by curtailing, or completely eliminating, non-competes.

PROPOSED NEW JERSEY LEGISLATION

There is legislation pending in the New Jersey Legislature (A3715) that would significantly limit the enforceability of non-competes. Among other things, the proposed legislation would statutorily limit non-competes to one year and would limit the scope of a non-compete to the borders of New Jersey. An employee working in New Jersey could not be precluded from working in New York, for example.

In addition, under the proposed legislation, an employer would be required to pay an employee "garden leave" for the entire duration of the non-compete. This means that the employer would have to pay 100% of the employee's pay and benefits for the entire time that the employee is precluded from working for a competitor. Under the proposed legislation, overly broad non-competes would be null and void and the court would no longer have the ability to blue pencil a non-compete to make it reasonable. The pending legislation would not apply retroactively to existing agreements.

This legislation has been pending in the Legislature for over a year, and it remains unclear whether it will gain the momentum necessary to be passed into law. But the theme of limiting the

enforceability of non-competes is consistent with nationwide trends, including those occurring at the federal level. It should be noted that the New York legislature recently passed a bill banning non-competes between employers and employees. The legislation will not apply to agreements entered into in New Jersey but could influence the New Jersey Legislature with regard to its pending legislation.

THE PROPOSED FTC RULE

In January 2023, the Federal Trade Commission (FTC) proposed a rule condemning non-competes as a violation of anti-trust law and prohibiting noncompetes nationwide, with a few very limited exceptions. The proposed FTC rule would apply retroactively to existing agreements and would apply to "de facto non-competes," including overly broad nonsolicitation agreements and non-disclosure agreements. If implemented, the proposed FTC rule would be a sweeping change that would invalidate an immeasurable number of currently valid non-compete agreements.

While the proposed FTC rule appears to have bipartisan and media support, there is a question as to whether the FTC has the constitutional authority to pass such a rule. If implemented, the proposed rule will likely be challenged on several theories, including the argument that the FTC's rule-making authority is limited and does not include the authority to upend established state contract law.

THE NLRB GENERAL COUNSEL OPINION

Similarly, in May 2023, the National Labor Relations Board (NLRB) General Counsel issued a memorandum opining that non-competes, as a general proposition, violate the National Labor Relations Act because they "reasonably tend to chill employees" or stop them entirely from exercising their rights to organize for the purpose of collective bargaining. While the memorandum makes no change to the law, it is significant because it shows that the NLRB has its sights set on non-competes for NLRB litigation.

THE WORKFORCE MOBILITY ACT

The Workforce Mobility Act (WMA) is bipartisan federal legislation pending in Congress. If passed, it would prohibit noncompetes nationwide, with a few minimal exceptions. The WMA would specifically charge the FTC with the authority to enforce the ban and would provide a right of action in federal court against employers that impose non-competes on their employees. Unlike the proposed FTC rule, the WMA would not apply retroactively to existing agreements.

WHAT DOES THIS ALL MEAN?

In New Jersey, restrictive covenants, including non-competes, remain enforceable. However, consistent with the national trend, New Jersey courts are becoming less inclined to enforce non-competes without a very compelling and legitimate business interest that can only be protected through a non-compete. If there is an option that would impose less of a hardship on the employee, the court is likely to prefer that option.

The critical question that should be considered when entering into a noncompete is: what legitimate business interest are we looking to protect? For many CPA firms, that interest might be customer relationships or details of how the firm prices its services. If the goal is to create an agreement that will be enforceable after an employee separates from the firm, the employer should endeavor to narrowly tailor the restrictive covenant to address the specific protectable interest. In some situations, a non-solicitation agreement, or a non-disclosure agreement, may be sufficient, may provide more protection than a non-compete and may remain enforceable even if some of the aforementioned proposals become law.

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John M. Losinger, J.D., is a member at Saiber LLC, where he advocates on behalf of businesses and individuals in connection with commercial disputes. He can be reached at jlosinger@saiber.com.