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Restrictive Covenants: A Means of Protecting Your Company's Business Interests

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The successful operation of nearly every business requires the contributions of certain key employees. In the course of their employment, these employees inevitably learn confidential and proprietary information that is vital to their employer's interests. Businesses invest a substantial amount of time and resources developing such information, and accordingly, seek to protect this information and their investments therein. One means of protecting such information is through the inclusion of certain covenants (commonly known as restrictive covenants) in agreements with employees.

Restrictive covenants are an effective and inexpensive tool, which, when reasonably drafted, are routinely enforced by New Jersey courts, and which enable employers to protect their business interests. Generally, these covenants take the forms of: (i) covenants to protect and not disclose confidential information; (ii) covenants not to compete; and (iii) covenants not to solicit or entice clients, customers, employees and critical vendors. These covenants may be used individually or in combination to protect an employer's interests.

While restrictive covenants serve as a highly effective mechanism for an employer to safeguard its business interests, employers should carefully choose only those covenants that are necessary and appropriate for their specific needs. Further, these covenants must be drafted with an eye toward enforceability. Under New Jersey law, restrictive covenants are valid and enforceable only if they are "reasonable."

In considering the enforceability of a restrictive covenant, New Jersey courts apply the *Solari/Whitmyer* test, a three-prong test incorporating the decisions reached in two influential New Jersey Supreme Court cases regarding restrictive covenants. Under that test, a covenant is reasonable in scope if it (1) serves to protect the legitimate business interests of the employer; (2) imposes no undue hardship on the employee; and (3) is not injurious to the public. *Ingersoll-Rand Co. v. Ciavatta*, 110 N.J. 609 (1988); (quoting *Whitmyer Bros. Inc. v. Doyle*, 58 N.J. 25, 32-33 (1971), *see also Solari Indus Inc. v. Malady*, 55 N.J. 571 (1970)). The first two prongs of the *Solari/Whitmyer* test of reasonableness dictate that restrictive covenants must be balanced so as to protect the company's interests while not being overly broad so as to unduly burden the employee. *Ingersoll-Rand, supra*, 110 N.J. at 634-635.

For a covenant to be found enforceable under the *Solari/Whitmyer* test, each restrictive covenant must be narrowly tailored to the rational protection of an employer's particular interests. More specifically, restrictive covenants must be clearly and reasonably limited in geographical scope, duration and activities from which the employee is precluded. For example, it would be very difficult for a regional business to justify restricting a terminated employee from competing against it anywhere in the United States. However, due to the globalization of commerce and the unification of world markets, worldwide competition does exist in certain industries. Accordingly, it may not be unreasonable to restrict an employee in certain industries from competing anywhere in the United States or the world, as such a restriction may, in fact, constitute the most narrowly-tailored means of protecting a company's legitimate business interests. Temporal restrictions must be drafted to balance the employee's ability to find future employment and the company's need to protect its proprietary information and business interests.

To avoid ambiguity, the terms of restrictive covenants should be clear and specific. *Whitmyer, supra*, 58 N.J. at

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33. By way of example, a confidentiality agreement should provide a clear definition of what constitutes "proprietary" or "confidential" information. This definition must not be overly broad or overreaching and should exclude information that can be demonstrated to have been in the public domain prior to the employee's employment start date or that which becomes part of the public domain independent of any unauthorized acts of the employee. Further, it is recommended and good business practice to include a provision in all confidentiality agreements that the employee should return or destroy (at the company's election) all company books, records or other proprietary information in his or her possession upon termination of employment.

The scope of restrictive covenants must also be tailored to the specific circumstances and facts relating to each employee. Employees must be given the opportunity to utilize their skill, experience, and expertise in the business of their choosing, and courts will not enforce covenants intended to unjustifiably stifle competition. *Ingersoll-Rand, supra,* 110 N.J. at 635. To avoid, or at a minimum, reduce challenges to the enforceability of a restrictive covenant, it is recommended that employers draft restrictive covenants to reflect the relative position of each employee or class of employees within a company. Only those employees with access to proprietary information, thereby posing an increased risk of exposure to a company upon termination, should be asked to sign restrictive covenants. *See Maw v. Advanced Clinical Communications*, 179 N.J. 439 (2004).

Once a court determines through fact-based inquiry that there is a proper balancing of the reasonable and legitimate interests of the employer and employee, the third prong of the *Solari/Whitmyer* test requires the court to "analyze the public's broad concern in fostering competition, creativity, and ingenuity." *Ingersoll-Rand, supra,* 110 N.J. at 639. Historically, New Jersey courts have espoused the view that the public has an interest in protecting employers from theft of proprietary secrets, ensuring fair trade practices, and promoting invention and advancement of technology. Thus, restrictive covenants, a common practice in commercial employment, do not pose a risk to the public. *See Dzwonar v. McDevitt,* 177 N.J. 451, 461, 828 A.2d 893, 900 (2003)**.** To this end, as recently as four years ago, in *Maw*, the New Jersey Supreme Court held that an employee may be terminated for refusing to sign a non-compete agreement. *See Maw, supra,* 179 N.J. at 448.

In so ruling, the court stated that an employee's challenge of a noncompete agreement was private in nature and, thus, the application of the *Solari/Whitmyer* test did not constitute a violation of "a clear mandate of public policy concerning public health, safety or welfare" as contemplated by the New Jersey Conscientious Employee Protection Act. N.J.S.A. 34:19-3(c) (3). The court's decision in *Maw* ensures that employers may properly protect themselves from unfair competition of terminated employees by conditioning an employee's continued employment upon execution of reasonable non-compete agreements.

So what happens if a court determines that the provisions of a restrictive covenant are unreasonable? Under New Jersey law, the court may modify or "blue pencil" the covenant by reducing the restrictions therein so as to make the covenant reasonable. New Jersey law is representative of the majority of states that have adopted some form of the blue pencil or reasonable modification doctrine, protecting employers and enabling fair trade and commerce. While a number of jurisdictions prohibit restrictive covenants or summarily dismiss unreasonable restrictive covenants as void and unenforceable, jurisdictions (such as New Jersey) that uphold the blue pencil doctrine give their courts the opportunity to strike only those clauses that are unreasonable, leaving the remainder of the covenant intact, and the ability to modify the covenant to reflect terms that best fit the circumstances and interests of the parties.

Nonetheless, although they have the authority to amend the terms of restrictive covenants, New Jersey courts generally do not add an entirely new term to an agreement. It is, therefore, in the best interest of the employer to draft comprehensive restrictive covenants taking into account each employee's specific circumstances. Moreover, it must be noted that the blue pencil doctrine is not an invitation to draft unreasonable noncompete agreements, as courts generally disfavor attempts to unfairly take advantage of superior bargaining power.

As is the case with many legal documents, an employer should inform each employee that he or she should seek legal advice prior to signing any restrictive covenant. It is best practice that the employment agreement explicitly states that the employee has had the opportunity to do so. These precautions help safeguard an employer against an employee's claim that he/she entered into an agreement under duress, having been intimidated by the superior bargaining power of the employer and not having had ample opportunity to understand the terms to which they were agreeing.

With appropriate restrictive covenants in place, an employer can focus on fostering the growth and development of its business, confident in the knowledge that its business interests are well protected. ■