RESTRICTIVE COVENANT CASE LAW
ANNUAL REVIEW
NEW JERSEY (2013)

Anthony M. Rainone, Esq.
(arainone@bracheichler.com)

101 Eisenhower Parkway
Roseland, NJ 07068
(973) 228-5700
www.bracheichler.com

Informational and Educational Publication
of the Brach Eichler LLC Employment Services Group
SUMMARY

Many areas of labor and employment law generate countless written decisions (both published and unpublished). Yet historically, restrictive covenant disputes typically do not result in many written decisions that provide solid guidance needed to be effective advocates for the client (or, in the case of jurists, that provide meaningful precedent that can be applied in a predictable manner).

With the foregoing in mind, we welcome you to the Restrictive Covenant Case Law Annual Review – New Jersey (2013) presented by the Employment Services Group at Brach Eichler LLC. We trust you will find this review to be a valuable educational and informational tool. We have presented herein a summary of all written decisions issued in 2013 involving substantive restrictive covenant issues. For each case summary, we have included the judge deciding the case (for federal cases) or the county of venue (for state cases), the procedural posture, a brief discussion of the issues and decision, and, perhaps most importantly, the industry in which the dispute arose. Restrictive covenant cases have always involved an “uber-fact sensitive” inquiry with courts ultimately trying to render a decision usually contrary to plainly worded written restrictive covenant agreements. That inquiry and ultimate decision as to the enforceability of the restrictive covenant will be impacted by the industry setting.

In 2013, the trend of a lack of restrictive covenant case decisions continued. In fact, the courts did not issue any published decisions. Of the nine unpublished written decisions, the federal courts issued six decisions to the three decisions issued by the state courts. There was no one industry that found itself subject to more challenges than others. The decisions included disputes arising in the pharmaceutical, franchise (tax services), export, analytics, financial services, manufacturing, and information technology industries.

Of course, the few decisions annually is because many of these cases resolve prior to or at a preliminary injunction hearing by negotiations between the parties. Therefore, the court usually does not enter anything but a consent order resolving the dispute. But in order to draft effective and enforceable restrictive covenants, or to be able to negotiate the best resolution of a claim, it is imperative that the company (whether the former or current employer) know the likely outcome of the dispute if the court is forced to decide the issue. As you will see from the decisions below, for the most part, these decisions are zero sum, meaning one party wins and one party loses. Knowing the case law in these fact sensitive disputes is critical, whether you are drafting these agreements or in litigation.
Interlink Group Corporation USA, Inc. v. American Trade and Financial Corporation
2013 WL 1811898 (D.N.J. Apr. 25, 2013) (Hochberg, D.J.)
(non-competition agreement between vendors)

Plaintiff sought a preliminary injunction to enforce a restrictive covenant agreement it had with defendant, and which contained non-competition, non-disclosure, and non-solicitation provisions for which plaintiff paid defendant nearly $800,000.00. The parties’ contract related to broiler hatching egg shipments from suppliers in the United States to purchasers in various countries of the former Soviet Union. Despite the fact that only months after signing the restrictive covenant defendant’s counsel wrote to plaintiff stating that the restrictive covenant was fraudulently procured and was unconscionable, unenforceable, and void ab initio, the Court denied the preliminary injunction request. The Court found that plaintiff had not offered any proof that defendant had breached or planned to breach the restrictive covenant. Instead, plaintiff was merely seeking to allay its fears and apprehensions, which the Third Circuit Court of Appeals has previously rejected as a basis to grant a preliminary injunction.

Jackson Hewitt, Inc. v. Dupree-Roberts
(restrictive covenant in franchise context)

Franchisor-plaintiff commence suit against franchisee-defendant for breach of post-termination non-competition provision in the franchise agreement by operating a tax practice out of the same location in which defendant had operated the franchise. The matter arose in the income tax preparation industry. After defendant defaulted by failing to appear and defend the matter, the District Court granted plaintiff’s request for money damages and a permanent injunction for the term of the post-termination restrictive covenant.

The court noted that covenants not to compete in New Jersey ancillary to the sale of a business are given wider latitude than in the employer/employee context. But the court also acknowledged that New Jersey courts have not decided whether a franchise non-competition agreement is closer to an employer/employee covenant or those that are ancillary to the sale of a business. Although the court noted Jiffy Lube Int’l, Inc. v. Weiss Bros., Inc., 834 F. Supp. 683 (D.N.J. 1993), which evaluated a franchise non-compete covenant under the more lenient standard applied to the sale of a business, in this case, it held that even under the stricter employer/employee standard, the non-compete at issue was enforceable. It protected the legitimate interest the franchisor had in its customers, the defendant had signed an agreement acknowledging that she had skills that would allow her to derive income from other work, and the restriction was limited to five zip
codes, plus a ten mile radius and two years. Finally, the large amount of tax preparation
services available also meant that the public interest would not be harmed by enforcing
the restriction.

Interestingly, although nearly two years had passed at the time the court entered its
order granting a permanent injunction, the court’s injunction ordered the non-competition
period to run for two years from the date of the injunction.

_Mu Sigma, Inc. v. Affine, Inc._
2013 WL 3772724 (D.N.J. Jul. 27, 2013) (Wolfson, D.J.)
(theft of confidential information)

The former employer sued several former employees’ new entities that they
founded. The dispute involved the analytics consulting industry (i.e., consultants who
assist and advise companies that implement data-driven decision making systems). The
employees were individually dismissed from the suit based upon the lack of personal
jurisdiction so all that remained were the claims against the new entities these former
employees founded and which entities allegedly illegally acquired and continued to use
plaintiff’s proprietary information. The decision on a motion to dismiss addressed the
misappropriation claims against the new entities.

All of the individual former employees (no longer parties to the lawsuit) had
signed restrictive covenant agreements that included a non-disclosure provision relating
to proprietary information, customer lists, sales reports, and confidential agreements.
The allegation against the new entities was that the former employees used the
unlawfully taken information to benefit the new entities and, therefore, that the new
entities maliciously and willfully conspired with the individuals to misappropriate
plaintiff’s confidential information, employees, and clients. The theft of the information,
however, occurred months before the formation of the two entities that were defendants
to the lawsuit. The court dismissed all thirteen counts and provides a thorough discussion
of the law surrounding each of the thirteen counts, which are typically asserted in cases
involving theft of confidential information.

_Kinesis Group, LLC v. Troy_
(non-competition agreement)

Plaintiff-former employer sued former employee and her new employer for claims
arising out of a non-competition agreement. The sole claim against the new employer
was for conspiracy to breach the former employee’s employment agreement. The new
employer moved to dismiss the single conspiracy claim against it.
The District Court granted the motion to dismiss. The former employee had signed a two year post employment non-compete. The companies were both marketing consultants in the pharmaceutical industry, and the former employer alleged it lost business from Bristol-Myers Squibb as a result of the conspiracy, which company was the primary focus of the former employee’s marketing activities when employed with plaintiff. The former employee’s new employer was awarded the business by Bristol-Myers Squibb. The only allegation was that the new employer worked with the former employee to give a presentation, which was insufficient to state a common law conspiracy claim. There was no allegation that the “working together” was intended to injure the former employer, which was fatal to the claim on the motion to dismiss.

*Newport Capital Group, LLC v. Loehwing*
2013 WL 1314737 (D.N.J. Mar. 28, 2013) (Cooper, D.J.)
(non-solicitation agreement with respect to current, prospective and former clients)

The former employer-plaintiff sued a former employee and his new employer. Both the former employer-plaintiff and new employer-defendant are competitors in the financial services industry (both offering fee based consulting services to companies that offer retirement plans to employees) and the former employee-defendant is a financial advisor. Plaintiff sought money damages for the former employee’s breach of the two year non-solicitation provision relating to plaintiff’s current and prospective clients. The decision at summary judgment addressed the non-solicitation with respect to current, prospective, and former clients.

The Court held that as to plaintiff’s current clients, New Jersey law clearly supported enforcement of the non-solicitation provision. As to prospective clients, however, the Court ruled that the non-solicitation provision was not enforceable. First, the fact that plaintiff marketed to, met with and answered questions of a prospect did not render that prospect a client. Then, citing *Platinum Management v. Dahms*, 285 N.J. Super. 274 (Law Div. 1985), the Court held that on the facts presented, the two year non-solicitation of prospective customers was unenforceable finding that there is no legitimate business interest in protecting relations with prospective clients. The Court based its decision on the fact that the prospective client list, although a combination of publicly available information and a list that was purchased by the plaintiff for several thousand dollars, would have barred the former employee from contacting virtually any groups or individuals within New Jersey and surrounding states and even prospects for which there was no proof that the former employee had any awareness of the person or entity’s status as a prospect.

The Court, however, wrote that the result may have been different had the non-solicitation agreement differentiated between prospective clients with whom the former
employee had substantial contact and those with whom he had little or no contact. Finally, because the non-solicitation provision was silent as to former clients, the Court denied relief requested by plaintiff that would have barred the former employee’s contact with plaintiff’s former clients.

2013 WL 103392 (D.N.J. Jan. 7, 2013) (McNulty, D.J.)
(confirmaton of arbitration award against former executive for breaching duty of loyalty)

Plaintiff was a former executive (president and COO) of defendant, which manufacturers fire retardants. Plaintiff filed a demand for arbitration seeking payment of bonuses for a three year period and for unpaid salary. In response, defendant filed a counterclaim alleging the former executive breached his employment agreement and restrictive covenant, and breached his duty of loyalty, all arising out of contacts the executive had with a competitor of defendant. The arbitrator ruled in favor of the former employer and held the former executive liable for nearly $800,000.00 in damages based upon the breach of the duty of loyalty (in addition to finding he had a fiduciary duty because of his high level position) and violation of the restrictive covenant provisions relating to non-competition/non-solicitation.

The executive breached his duties and contract by repeatedly meeting with a competitor while out on administrative leave and failing to notify the employer of the meetings. The damages award consisted of recoupment of the executive’s wages, benefits, and bonuses for a two year period in addition to attorneys’ fees and costs for incurred by the company in the arbitration. The Court confirmed the award in its entirety.
NEW JERSEY STATE COURTS

Miles Technology, Inc. v. Apex I.T. Group, LLC
(non-competition agreement)

The former employer-plaintiff sued two former employees and their new employer all arising out of the two former employees’ restrictive covenant agreements. The employees and the companies all work in the information technology industry. Judgment was entered against Defendants at trial and the Appellate Division affirmed.

The two former employees had executed restrictive covenant agreements with a two year post employment non-competition provision, which prohibited both employees (who were customer service representatives and had exclusive client contact for two customers) from performing any service for any existing or prospective clients of their former employer. Upon separation of employment, one employee signed an exit affidavit acknowledging his two year post employment restriction but started working for the competitor one month later.

The employee who signed the exit affidavit went to work for a competitor one month after the exit interview and rendered services to a client to which the employee was the exclusive customer service representative. One month after that, the former employer filed a lawsuit, which resulted in a consent order directing the employee to cease performing services for any of his former employers customers. Several months later, the former employer dismissed the balance of the lawsuit without prejudice based upon a representation from the new employer’s attorney in writing that the new employer had terminated the employee rendering the lawsuit moot. A few months later, however, the employee was rehired and the new employer obtained the customer at issue as its client, never to return to the former employer.

A few months later, the second employee began working for the competitor with his former colleague and the former employer learned of this fact about one year later, which prompted the new lawsuit for violation of the non-competition clauses and against the new employer for fraud. The new employer, however, filed counterclaims for tortious interference with contract/economic advantage, unfair competition, and conversion. The jury found the employees breached their employment agreements but did not cause any damages. The new employer, however, was $70,000 against the new employer on the fraud claim and punitive damages of $30,000, which after interest, resulted in a judgment of over $110,000 against the new employer. The former employer supported its damages claim with only the testimony of the owner of the company, who set forth the revenue generated from the clients at issue and established the revenues on a daily basis from each client.
Truong, LLC v. Tran
(non-competition agreement)

Motion for leave to appeal granted to review the grant of a preliminary injunction enforcing a restrictive covenant that barred two former employees from competing with their former employer in the nail salon business. The injunction was stayed pending appeal and the Appellate Division reversed the grant of a preliminary injunction as to one of the former employees.

The former employee-defendants allegedly signed a two year, twenty-five mile, post employment restrictive covenant. With respect to the first employee, the Appellate Division reversed the injunction finding that the termination of employment triggered the two year post employment restrictive covenant. Thus, the fact that the employee returned to work a few months later did not revive and restart the restrictive covenant period. In order to have revived the agreement, the parties would have had to execute an agreement so stating. The Court’s decision was also based upon the wording of the agreement thus, this issue likely could have been avoided by better drafting.

With respect to the second employee, the Court reversed the injunction because the two year restriction was too long to protect the legitimate interest the employer had in its customer list. The Court then reviewed the nature of the client relations sought to be protected (comparing longer restrictions seen in medical doctor agreements where patient-doctor visits are infrequent) and wrote that the time period that is enforceable is the time period necessary for the former employer to introduce a new employee to the client to develop and maintain the client relationship. The employee did not begin competing until eight months after he terminated his employment with plaintiff and there was no evidence offered to show why a reasonable restriction was more than eight months. Further, plaintiff did not offer any evidence of how long it would take for it to solidify current customer relationships with new salon employees. The Appellate Division assumed customers in this industry met monthly with the company thus, over eight months, plaintiff would have had eight opportunities to solidify its customer relationships. The decision to reverse the grant of the injunction was also based upon the fact that the case did not involve a “secret process” that would make it difficult to determine if a former employee is exploiting the protected information and causing a business to lose income.
Former employer commenced lawsuit alleging breach of contract, misappropriation and unfair competition against a former employee of several of plaintiff’s predecessor companies and his new employer for disclosing confidential information to the new employer. The case involved two pharmaceutical companies and the former employer alleged the confidential information was used by the new employer to develop a generic cough medicine that was the equivalent of a formerly patented product.

The Appellate Division affirmed the grant of summary judgment dismissing the claims. The lower court held that all information allegedly divulged was already in the public domain and not entitled to protection under the confidentiality agreement at issue. Further, under New York law, the confidentiality agreement was unenforceable with regard to the particular categories of information – negative know-how (i.e., knowing what does not accomplish the objective) and general experience. Ultimately, the Appellate Division affirmed the dismissal of the claims because it agreed with the lower court’s findings that the generic drug was developed and manufactured based upon publicly available information (or was susceptible to reverse engineering) and the former employee’s use of his general pharmaceutical knowledge he had obtained in the course of his education and work experience. The Appellate Division also held against the plaintiff the facts that the agreement had no limitation of time, space, or scope but, rather, was simply an exhaustive and non-exclusive list of information to be restrained from disclosure for the remainder of the former employee’s career as a pharmaceutical scientist. The fact that plaintiff had voluntarily abandoned its trade secrets claim (leaving only the breach of contract and unfair competition claim) also was a factor in the court in granting summary judgment for defendants.

One other important discussion in this decision was that the trial court erred in relying on its credibility determinations from the preliminary injunction stage at summary judgment. The Court reiterated that generally, absent consent of the parties, the judge should have applied the normal summary judgment standard. Notwithstanding, because the Appellate Division ruled as a matter of New York law the confidentiality agreement is not enforceable, the error was not sufficient to reverse the grant of summary judgment.
DISCLAIMER

As with any other educational and informational publications provided by Brach Eichler LLC, the information contained herein is not to be construed as legal advice nor
advice as to any particular case or matter. The sending or receipt of this publication is in
no way intended to and does not form or constitute an attorney-client relationship
between the firm and the author on the one hand, and the recipient and reader on the other
hand. For specific legal advice on a particular matter, you may contact the author of this
publication.