Employer Update

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Choice-of-Law Provisions in Restrictive Covenant Agreements

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Over the past several years, a number of states have adopted legislation limiting an employer's ability to enforce restrictive covenants against former employees. While some states, like California, have had longstanding prohibitions on enforcing non-competes against employees within the state, other states have enacted more limited legislation restricting the use of restrictive covenants without prohibiting their use entirely. During the past 20 months, Maine, New Hampshire, Maryland, Oregon, Washington, and Rhode Island each enacted laws restricting an employer's ability to enforce non-compete agreements. Congress and federal agencies also have considered adopting new restrictions on the use of non-competes. *See* Freedom to Compete Act, S. 124, 116th Cong. (2019-2020); *Non-Competes in the Workplace: Examining Antitrust and Consumer Protection Issues*, Federal Trade Commission, Jan. 9, 2020.

Despite renewed questioning by these governmental entities as to the legitimacy of restrictive covenants, many employers continue to rely on such agreements to protect their customer information, goodwill, trade secrets, and confidential information. Mindful of certain states' laws which limit the enforceability of restrictive covenants, as well as the existence of a multi-state workforce, employers sometimes include choice-of-law provisions in their agreements with employees that choose the law of states outside the territory where the employee works. For employers located in states that are more hostile to enforcement of restrictive covenants, these provisions may allow the parties to choose the laws of a state that would be more likely to enforce the restrictive covenants.

However, this approach presents risks, as courts in certain jurisdictions may refuse to enforce choice-of-law provisions in litigation. At least one state has gone even further and prohibits such choice-of-law provisions, except in very narrow circumstances. *See* Cal. Lab. Code §925 (prohibiting the use of contract provisions that apply another state's law as a condition of the employment of an individual who primarily resides and works in California, unless the employee is represented by legal counsel in negotiating a choice-of-law clause).

Two recent circuit court decisions highlight the difficulties employers have when seeking to enforce restrictive covenants based on the parties' contractually chosen law. In *NuVasive v. Day*, 954 F.3d 439 (1st Cir. 2020), and *Cabela's v. Highby*, 801 Fed.Appx. 48 (3rd Cir. 2020), the First and Third

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Circuits, respectively, assessed the enforceability of a choice-of-law provision selecting Delaware law to govern a restrictive covenant but arriving at divergent conclusions. In this month's column, we discuss the analysis of choice-of-law provisions in *NuVasive* and *Cabela's*, and consider the lessons these cases hold for employers seeking to craft enforceable restrictive covenants in light of these decisions.

NuVasive and *Cabela's*

In *NuVasive*, the defendant, Timothy Day, a Massachusetts resident, challenged a preliminary injunction issued by the U.S. District Court for the District of Massachusetts that prevented Day from working for a competitor of his former employer, NuVasive, a company incorporated in Delaware with its headquarters in California that designed and manufactured products for the treatment of spine diseases. During his employment as a sales representative with NuVasive, Day had signed an agreement that included one-year non-solicitation and non-competition clauses and a choice-of-law provision specifying that Delaware law governed the agreement.

After Day left his position to work at a competitor medical supplies company, NuVasive sought a preliminary injunction enforcing Day's restrictive covenants. The court granted NuVasive's request to enforce the non-solicitation provision, reasoning that the choice-of-law provision was enforceable, that Delaware law would permit enforcing the restrictive covenants, and that there was a "reasonable likelihood of success" on NuVasive's claim that Day breached the non-solicitation provision. Day appealed and challenged the court's decision to enforce the Delaware choice-of-law provision, arguing instead that Massachusetts law should apply. Alleging that the Massachusetts Noncompetition Agreement Act ("MNCA") represented a fundamental Massachusetts public policy against the enforcement of restrictive covenants, Day argued that an application of Massachusetts law would render his restrictive covenants unenforceable.

Affirming the district court's ruling issuing the preliminary injunction, the First Circuit first looked to Massachusetts' choice-of-law rules to determine whether the court could lawfully apply the choice-of-law provision in Day's agreement. Massachusetts, the court noted, enforces choice-of-law provisions in employment contracts unless one of two exceptions applies: 1) the parties have no substantial relationship with the chosen state, or 2) the application of the law of the chosen state would be contrary to a fundamental policy of a state that has a materially greater interest in enforcing its law. NuVasive was incorporated in Delaware, a connection the court deemed sufficient to establish a relationship to the state, making the first exception inapplicable. In assessing whether the second exception applied, the court first looked to the MNCA to see whether enforcing the non-solicitation agreement would violate Massachusetts public policy.

The language of the statute provides that the MNCA applied only to "noncompetition agreements entered into on or after Oct. 1, 2018." *See* St. 2018 Mass., ch. 228, §71. Because the restrictive covenant in question was a non-solicitation agreement, and because Day had signed the agreement in January 2018, the court found that the MNCA was inapplicable in this context. Because the MNCA did not govern the agreement, and Day identified no other fundamental public policy that would be violated by enforcing the restrictive covenants, the court affirmed the lower court's decision to apply the Delaware choice-of-law provision, upholding the non-solicitation covenant.

Although the Third Circuit was also reviewing a restrictive covenant with a Delaware choice-of-law provision in *Cabela's*, the court found the choice-of-law provision unenforceable. The plaintiff, Cabela's, a nationwide retailer specializing in hunting, fishing and other outdoor products, appealed the U.S. District Court for the District of Delaware's decision denying its motion for a preliminary injunction enforcing non-competition, non-solicitation, and confidentiality provisions against two former senior managers. Incorporated in Delaware with its headquarters in Nebraska, Cabela's filed suit after the defendants left to establish their own outdoor retail company, Highby Outdoors, allegedly in violation of their restrictive covenants. In its appeal, Cabela's argued that the

district court erred in finding that Nebraska law applied, rather than Delaware law as contained in the contract's choice-of-law provision. The defendants alleged that, because of Nebraska's opposition to enforcing restraints on trade, an application of Nebraska law would have rendered the covenants unenforceable. Alternatively, given Delaware's emphasis on a party's freedom to contract, application of Delaware law would permit their enforcement.

The court first noted that, under Delaware law, courts must look to which state involved in the action had a "materially greater interest" in applying its law to the interpretation of the restrictive covenants before determining the enforceability of the choice-of-law provision. The court reasoned that the case represented a conflict between Delaware's fundamental public policy in upholding freedom to contract and Nebraska's fundamental public policy of not enforcing covenants that prohibit competition. Ultimately, the court found that because the agreements had been negotiated in Nebraska between Nebraska citizens and the alleged breaches occurred there, Nebraska had the "materially greater interest" in the litigation, justifying the application of Nebraska law. The court reached this ruling despite the fact that Cabela's, like NuVasive, was incorporated in Delaware. Under those circumstances, application of Delaware law would be contrary to Nebraska's fundamental public policy against enforcing restraints of trade, so the Delaware choice-of-law provision was unenforceable, even though Nebraska has no statutory prohibition against enforcing choice-of-law provisions in restricting covenants. *See* Jeffrey S. Klein and Nicholas J. Pappas, *Can Employers Enforce Non-Competes Against California Employees?* (Feb. 05, 2019). Because the restrictive covenants were unenforceable under Nebraska law, the court affirmed the district court's ruling refusing to issue a preliminary injunction enjoining the defendants from violating the restrictive covenants.

Strategies for Employers

As illustrated in *NuVasive* and *Cabela's*, enforcement of a choice-of-law provision found in a restrictive covenant agreement frequently depends not only on the unique circumstances of each case, but on the public policies of the states involved. In *Cabela's*, the court found that the parties' ties to Nebraska, showing the state had a "materially greater interest" in the litigation than Delaware, merited looking to Nebraska public policy in determining whether to enforce the choice-of-law provision. The *NuVasive* court found that NuVasive's Delaware incorporation was sufficient to show Delaware had a material interest in the litigation. Because it determined that the MCNA was inapplicable to that agreement in question, the court declined to inquire whether the MCNA represented a Massachusetts fundamental public policy, and enforced the Delaware choice-of-law provision.

Accordingly, employers should carefully assess each restrictive covenant they enter into, and determine whether the facts underlying the agreement demonstrate a sufficient nexus with the state chosen for the choice-of-law provision. *See* Restatement (Second) of Conflict of Laws §187 (prohibiting the enforcement of a choice-of-law provision if "the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice"). For example, employers drafting restrictive covenants with choice-of-law provisions should consider where the employer is incorporated, where it has its headquarters and principal place of business, where the employee will be performing services for the company, and where the parties negotiated and executed the agreement. Although not addressed by the courts in *NuVasive* or *Cabela's*, multi-state employers also may consider additional interests supporting their choice of the law of a single state to govern their agreements with employees, inasmuch as having a single state's law apply across the workforce serves the employer's interests of administrative convenience, uniformity and ultimately fairness to workers in managing the workplace. Certainly, these interests would appear to address the Restatement's requirement of a "reasonable basis for the parties' choice." Despite the strength of such arguments, employers should be mindful that, even if the employer can point to a sufficient relationship with

the chosen state to warrant enforcing the choice-of-law provision and other reasonable interests, courts may decide that public policy considerations justify disregarding such provisions.

An employer's decision with respect to choice-of-law provisions for an employee's restrictive covenant may become more relevant in light of the ongoing COVID-19 pandemic. Although few courts have addressed the pandemic's impact on the enforceability of restrictive covenants, at least one court has considered the pandemic's economic impacts when weighing the potential harm arising out of enforcing a non-competition agreement. *See Schuylkill Valley Sports v. Corp. Images Co.*, No. 5:20-CV-02332, 2020 WL 3167636, at *17 (E.D. Pa. June 15, 2020) (noting that "[i]n light of the coronavirus pandemic and closing of non-essential businesses" and the limited economic opportunities, the harm from granting an injunction enforcing a non-compete agreement against an employee would be much greater than the harm felt by the former employer). These public policy considerations may provide employees an additional ground to challenge a choice-of-law provision, as courts may be more reluctant to enforce choice-of-law provisions during the current economic climate.

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