Employer Update

Weil

February 2019

Can Employers Enforce Non-Competes Against California Employees?

*By Jeffrey S. Klein and Nicholas J. Pappas**

In This Issue

1 Can Employers Enforce Non-Competes Against California Employees?

The State of California has long prohibited employers from enforcing non-compete agreements within the boundaries of that state. This prohibition has posed a significant challenge to employers with operations in California who seek to protect their goodwill and confidential information. Without the benefit of enforceable non-compete agreements, employers have been exposed to the risk of flight of their key talent. Employers have sought to protect themselves by using confidentiality agreements, customer non-solicitation agreements or other common law protections. However, these efforts often prove to be inadequate.

One strategy employers have tried to avoid the negative effects of California law is to enter into agreements with employees providing that California law will not apply, and that disputes will be decided in jurisdictions outside of California. However, many California employees who wish to work for competitors responded to choice of law and forum selection clauses by engaging in a "race to the courthouse" seeking to nullify their non-compete agreements under California law before employers headquartered or incorporated outside of the state are able to enforce the agreement in a non-California court. In many such cases, California courts have held that choice of law and forum selection clauses are not enforceable, because they are contrary to California public policy. *See*, *e.g.*, *Davis v. Advanced Care Techs., Inc.*, 2007 WL 2288298, at *7 (E.D. Cal. Aug. 8, 2007) (refusing to enforce a Connecticut choice of law provision in a non-competition agreement because doing so would violate California's public policy); *Doe 1 v. AOL LLC*, 552 F.3d 1077, 1084 (9th Cir. 2009) (refusing to enforce a Virginia forum selection clause because Virginia state courts did not allow consumer class actions).

The decisions in this area are by no means uniform, as courts have ruled to the contrary and have enforced forum selection clauses requiring litigation outside of the state of California. *See*, *e.g.*, *Marth v. Innomark Commc'ns LLC*, 2017 WL 3081684, at *3-4 (C.D. Cal. Apr. 19, 2017) (finding the forum selection clause in a non-competition agreement valid noting that the Ohio court could apply California law); *Olinick v. BMG Entm't*, 138 Cal. App. 4th 1286 (Cal. Ct. App. 2006) (requiring California employee to litigate discrimination claims in New York); *Sarmiento v. BMG Entm't*, 326 F. Supp. 2d 1108 (C.D. Cal. 2003) (requiring California employee to litigate breach of contract and wage claims in New York).

**Associate Chris Dyess assisted with the drafting of this article.*

In 2016, the California legislature enacted Labor Code § 925 (Section 925) in response to the phenomenon of employers including choice of law and forum selection clauses favoring non-California courts and law. Section 925 provides that an employer cannot require, as a condition of employment, that an employee who primarily resides and works in California agree to a provision requiring the employee to either adjudicate a California-based claim in another state or deprive the employee of the substantive protection of California law. Any contract that violates Section 925 is voidable by the employee. However, Section 925 contains an exception which has recently become the subject of litigation. Section 925 provides that it "shall not apply to a contract with an employee who is in fact individually represented by legal counsel in negotiating the terms of an agreement" with respect to choice of law or forum selection clauses (Represented Employee Exception).

While Section 925 does not directly address California's fundamental public policy prohibiting non-competes, a recent decision by the Delaware Chancery Court focused on how the Represented Employee Exception may have changed California's fundamental public policy. As discussed below, in *NuVasive, Inc. v. Miles*, 2018 WL 4677607, at *1 (Del. Ch. Sept. 28, 2018) the court found that the Represented Employee Exception was an exception to California's strong public policy against non-competition agreements providing that an employee who was individually represented by counsel would be bound to the choice of law and/or forum selection clauses.

In this month's *Employer Update*, we analyze *NuVasive,* and consider the extent to which Section 925 may provide employers with operations in California an opportunity to use the Represented Employee Exception to enforce non-competition agreements against California employees.

Background

Section 16600 states that "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void." Cal. Bus. & Prof. Code § 16600.

California courts have invoked Section 16600 to void non-competition agreements. Further, at least one California court has ruled that an employer who violates Section 16600 by entering into a non-compete agreement with a California employee also violates California's unfair trade practices law, California Business and Professional Code Section 17200 (Section 17200). *See Application Grp., Inc. v. Hunter Grp., Inc.*, 61 Cal. App. 4th 881 (1998). Moreover, California's Private Attorneys General Act (PAGA) allows private citizens to file lawsuits to recover civil penalties on behalf of themselves and others for violations of the labor code. Labor Code Section 432.5 (Section 432.5) states that it is illegal for an employer to require an employee to agree in writing to any term that the employer knows is illegal. Cal. Lab. Code § 2698, et seq.

In 2002, in *Advanced Bionics Corp. v. Medtronic, Inc.*, 29 Cal.4th 697 (2002) the California Supreme Court opened the door to the enforcement of non-compete agreements in California by non-California courts in certain circumstances. In *Medtronic*, plaintiff Mark Stultz was employed by Medtronic in Minnesota and voluntarily signed an employment contract that included a non-competition clause with a Minnesota choice of law provision. Stultz was subsequently recruited and hired by Advanced Bionics, a California company which competed with Medtronic. Advanced Bionics and Stulz sought a declaratory judgment in California state court that the non-competition agreement was void under California law and filed for a temporary restraining order, *ex parte*, in a different California state court to prevent Medtronic from seeking to enforce the agreement in Minnesota. Medtronic filed suit in Minnesota seeking a temporary restraining order enjoining Stultz from working on certain products with Advanced Bionics and preventing Stultz and Advanced Bionics from seeking an order in California that would interfere with the Minnesota court's jurisdiction. Both the Minnesota and California courts granted the parties' requests for a temporary restraining order.

On appeal, the California Supreme Court reversed the ruling of the lower California court holding that while California did have a strong public policy against

enforcing non-competition agreements, it was not so strong as to warrant enjoining an employer from seeking relief in another forum. The California cases following *Medtronic* largely affirmed that California courts were unwilling to issue an injunction preventing an employer from seeking enforcement of a non-competition agreement in another jurisdiction. *See*, *e.g.*, *Biosense Webster, Inc. v. Superior Court*, 135 Cal. App. 4th 827 (2006).

Labor Code Section 925

Section 925's prohibition of choice of law and forum selection clauses in California employment contracts comes with a big caveat for employees who are individually represented by counsel in negotiating these agreements. Indeed, the Delaware Court of Chancery invoked Section 925 in *NuVasive, Inc. v. Miles*, 2018 WL 4677607, at *1 (Del. Ch. Sept. 28, 2018) to conclude that even after considering California's strong public policy against non-competition agreements a Delaware choice of law and forum selection clause was valid. In *NuVasive*, the employee worked for NuVasive, Inc. (NuVasive), a Delaware corporation, in California where he also resided. His employment agreement with NuVasive included a non-competition clause as well as Delaware choice-of-law and forum selection clauses. During his negotiation of the employment agreement, the employee was represented by counsel. The issue before the court was whether the Delaware choice-of-law provision should be recognized, or if the court should find that California law would apply given the state's strong public policy against non-competition agreements.

While recognizing that "if anything, [Section 925] strengthens an analysis of California's interest in preventing contractual end-runs around its public policy", the court ultimately held that California, in enacting Section 925, "made a policy decision that when contracting parties' rights are protected by representation, freedom of contract trumps this interest." Though the court stated that the exception applied only in "narrow circumstances," the court held that applying Delaware law would not violate California's public policy and thus refused to find the non-compete unenforceable under California law.

A significant question left open by *NuVasive* is what effect, if any, the decision has on whether an employer who is a party to a non-compete agreement with California employees violates Sections 16600, 17200 or 432.5, and/or is exposed to remedies provided by PAGA. While the *NuVasive* court based its ruling, in part, on the idea that the Represented Employee Exception was a change in California's public policy, California courts are not bound by the Delaware state court's pronouncements regarding the meaning of Section 925. As a result, employers are at risk that a future court could depart from *NuVasive*'s ruling, apply California law and find an employer liable for violating Sections 16600, 17200 or 432.5.

Strategies for Employers

The extent to which the ruling in *NuVasive* provides a basis for employers to enforce non-compete agreements in California will undoubtedly be the subject of further litigation. However, the combination of *NuVasive* and Section 925 appears to have opened the door for employers with California employees to enforce non-competition agreements that may previously have been thought to be unenforceable. *NuVasive* may support a reasonable argument that California's public policy against non-competition agreements has softened. However, future courts may question the precedential value of a Delaware court construing California public policy. We also anticipate that future courts will analyze the legislative history behind Section 925 to consider the extent to which the legislature intended to modify California's public policy regarding non-compete agreements.

Another strategy is to include a mandatory arbitration clause in addition to choice of law favoring Delaware. At least one Delaware court has held that even if California has a strong public policy against non-competes, Delaware has an equally strong public policy in favor of enforcing contracting parties' expectations. *See*, *e.g.*, *DGWL Investment Corp. v. Giannini,* C.A. No. 8647-VCP (Del. Ch. 2013).

To the extent employers believe *NuVasive* properly construed Section 925 and California public policy,

employers may consider seeking to meet the requirements of the Represented Employee Exception. If employers decide that enforcement of non-competes in California is of paramount importance, *NuVasive* would suggest that employers should negotiate their choice of law and forum selection clauses with employees represented by counsel. If a California employee does not have counsel when entering into a non-compete agreement, employers may wish to consider whether to reimburse the employees for legal fees. While such an action may be cost prohibitive in most cases, in certain cases employers may decide the benefits of applying non-California law outweigh the costs.

Employer Update is published by the Employment Litigation and the Executive Compensation & Benefits practice groups of Weil, Gotshal & Manges LLP, 767 Fifth Avenue, New York, NY 10153, +1 212 310 8000, www.weil.com.

If you have questions concerning the contents of this issue, or would like more information about Weil's Employment Litigation and Executive Compensation & Benefits practices, please speak to your regular contact at Weil, or to the editors or practice group members listed below:

Editors:

Lawrence J. Baer	lawrence.baer@weil.com	+1 212 310 8334
Millie Warner	millie.warner@weil.com	+1 212 310 8578

Practice Group Members:

Jeffrey S. Klein
Practice Group Leader
New York
+1 212 310 8790
jeffrey.klein@weil.com

Frankfurt
Stephan Grauke
+49 69 21659 651
stephan.grauke@weil.com

London
Ivor Gwilliams
+44 20 7903 1423
ivor.gwilliams@weil.com

Miami
Edward Soto
+1 305 577 3177
edward.soto@weil.com

New York
Lawrence J. Baer
+1 212 310 8334
lawrence.baer@weil.com

Sarah Downie
+1 212 310 8030
sarah.downie@weil.com

Gary D. Friedman
+1 212 310 8963
gary.friedman@weil.com

Steven M. Margolis
+1 212 310 8124
steven.margolis@weil.com

Michael Nissan
+1 212 310 8169
michael.nissan@weil.com

Nicholas J. Pappas
+1 212 310 8669
nicholas.pappas@weil.com

Amy M. Rubin
+1 212 310 8691
amy.rubin@weil.com

Millie Warner
+1 212 310 8578
millie.warner@weil.com

Paul J. Wessel
+1 212 310 8720
paul.wessel@weil.com

Silicon Valley
David Singh
+1 650 802 3010
david.singh@weil.com