INSIGHT: Push-Back on Using Delaware Law to Limit Noncompetes in California Contracts

By Dan Morgan, Blank Rome LLP

Companies incorporated in Delaware but operating in California may want their employment contracts to be governed by Delaware noncompete-friendly law, but recent Delaware court decisions won't help their cases, writes Dan Morgan, a partner with Blank Rome.

In California, an employer generally cannot prevent an employee from competing with the employer. Some companies incorporated in Delaware, but operated in California, seek to avoid the California limitation by providing that their employment contracts are governed by Delaware's more noncompete-friendly law.

In a series of opinions, in the case of *Nuvasive Inc. v. Patrick Miles*, the Delaware Chancery Court considered the enforceability of a noncompete provision in an employment agreement addressing this very issue.

Among the key decisions by the court:

1. Because the employee worked in California, and because enforcing the noncompete would conflict with a "fundamental policy" of California, the choice of law provision was unenforceable and California law should apply.
2. California's policy against noncompetes extends to prohibitions on soliciting a former employer's customers and prohibitions on soliciting a former employer's employees. Until recently, a question existed whether the California limitation on noncompetes precludes an employer from prohibiting an employee from soliciting the employer's employees. The court reviewed the Nov. 1, 2018, opinion by the California Court of Appeal in *AMN HealthCare Inc. v. Aya Healthcare Services Inc.* and concluded that this opinion resolved the uncertainty in favor of employee nonsolicitation restrictions being unenforceable in California.
3. In one of its opinions, the court discussed Section 925, which was added to the California Labor Code in 2016, and was aimed at choice of law and forum selection provisions intended to avoid California's noncompete rules. Section 925 enables an employee who primarily resides and works in California to void a contract, if the contract requires the employee to adjudicate employment claims arising in California in a state other than California or requires the employee to give up the protection of California law.

Section 925(e), however, has a significant exception, which makes Section 925 inapplicable to "a contract with an employee who is in fact individually represented by legal counsel in negotiating the terms of an agreement to designate either the venue or forum in which a controversy arising from the employment contract may be adjudicated or the choice of law to be applied."

Although the employee in the *Nuvasive* case was not represented by counsel when he negotiated his contract, the court stated that, if he had been, the company could have relied upon Section 925(e) to argue that the contract's choice of law provision was valid.

Interpreting Section 925(e) Exception

The legal counsel exception in Section 925(e) may present some interpretive challenges. Notably, courts will need to sort out what it means to "be represented by legal counsel in negotiating the terms of an agreement to designate either the venue or forum . . . . or the choice of law to be applied."

For example, will a company that would like to avail itself of this exception be required to demonstrate that the venue or forum and choice of law provisions of an employment contract were specifically negotiated, or will it suffice to show that the employee who signed the contract had counsel and, therefore, had the opportunity to negotiate those provisions?

The recent case, *Lyon v. Neustar Inc.*, decided by the District Court for the Eastern District of California on May 3, provides an example of the ambiguous nature of Section 925(e). *Neustar* involved litigation over, among other things, whether Section 925(e) permitted a company to use a Virginia choice of law provision in an employment agreement to enforce a noncompete against an employee working in California.

The company pointed to an email sent by the employee in which the employee referenced "my lawyers" during contract negotiations. The court found, however, that the employee credibly testified that this reference "was merely a form of negotiation posturing" and, therefore, the Section 925(e) exception was not available.

Another potentially problematic aspect of Section 925 is the effective date. Section 925(f) states: "This section shall apply to a contract entered into, modified, or extended on or after January 1, 2017."

In the *Neustar* case, the employment agreement was entered into before Jan. 1, 2017. During the process of terminating the employee's employment, a separation agreement was executed in June 2018, which specified a forum for resolving disputes arising from the separation agreement that was different than the forum specified in the employment agreement.

The court determined that this difference between the two agreements constituted a modification after Jan. 1, 2017, of the employment agreement, resulting in the employment agreement being subject to Section 925.

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