There are many notable east coast-west coast rivalries. In sports (Celtics versus Lakers basketball), in leisure (Atlantic versus Pacific beaches), or in food (Shake Shack versus In-N-Out Burger), to name a few. With respect to restrictive covenants, the conflict between Delaware, which is generally considered a “pro-enforcement” jurisdiction, and California, which is generally considered an “anti-enforcement” jurisdiction, definitely stands out in the crowd. This installment of the Restricting Covenant Series looks at the competing views of the Golden State and The First State’s on the enforceability of restrictive covenants, and the critical importance of conducting a “choice of law” analysis to settle this feud.

**Freedom to Contract versus Freedom from Restraints on Trade**

In Delaware, courts generally enforce reasonable covenants not to compete post-employment consistent with that state’s general public policy in favor of parties’ freedom to contract. *NuVasive, Inc. v. Miles* (Del. Ch. Ct. Sept. 28, 2018); *Cont’l Warranty, Inc. v. Warner* (D. Del. 2015). However, under California law, specifically Business and Professions Code section 16600, non-compete agreements generally are prohibited post-employment unless they fall within a statutory exception, such
as the sale of a business. California courts have “consistently affirmed that section 16600 evidences a settled legislative policy in favor of open competition and employee mobility.” Edwards v. Arthur Andersen LLP (Cal. 2008).

A Delaware Chancery Court Declines to Enforce Delaware Choice of Law Provision, and Voids Restrictive Covenants for a California Employee

The Delaware Chancery Court’s recent decision in NuVasive, Inc. v. Miles showcases a common dilemma that employers face when trying to protect their legitimate business interests through the enforcement of reasonable non-compete or non-solicit restrictions for employees in California.

NuVasive, a Delaware corporation headquartered in California, required its president and chief operating officer, Patrick Miles, a resident of California, to sign an employment agreement with one-year post-employment non-compete and non-solicit of customers and employees clauses. The agreement had a Delaware choice of law and venue provision. Miles left NuVasive and joined a purported competitor, prompting NuVasive to sue him in Delaware in 2017. He challenged the enforceability of his covenants under California law, arguing that his Delaware choice of law provision was unenforceable. As Court of Chancery Vice Chancellor Glasscock framed the issue, “if the choice of law provision is enforced, the parties will successfully have contracted around California law, and NuVasive may proceed with this litigation to attempt to hold Miles to his bargain,” whereas “if California law is applied, the non-compete provision was illusory, and Miles is free to accept employment with a NuVasive competitor.”

The NuVasive court first decided the enforceability of Miles’s non-compete agreement. The judge looked to his earlier analysis and decision in Ascension Insurance Holdings, LLC v. Underwood (Del. Ch. Ct. Jan. 28, 2015), which involved a California resident and a Delaware company headquartered in California, and an employment agreement they negotiated in California containing a non-compete covenant and Delaware choice of law provision. In Ascension, the court applied the choice of law analysis under the Restatement (Second) of Conflict of Laws,[1] and declined to enforce the parties’ Delaware choice of law provision because “Delaware’s strong but generalized public policy in favor of freedom of contract was trumped by California’s specific policy in favor of freedom of employment.”

After Ascension, and after NuVasive and Miles had entered into their employment contract, California amended its Labor Code in January 2017, adding section 925,[2] which prohibits California employers from including choice of law and venue provisions to circumvent the protections of California labor law, except where the employee is represented by independent legal counsel in negotiation of the agreement. Cal. Labor Code § 925(e).[3] Initially, in 2018, the NuVasive court assumed that Miles was represented by counsel when he signed his employment agreement with NuVasive and enforced the Delaware choice of law provision. However, in 2019, after Miles presented evidence that he was not represented by counsel during the negotiation of his agreement with NuVasive, the court reversed course and voided the non-compete because it was against “fundamental California policy,” and “California’s policy interest materially exceeds Delaware’s interest in
freedom of contract.”

Most recently, on August 26, 2019, the NuVasive court determined the enforceability of Miles’s non-solicitation covenants. Using the same choice of law analysis under the Restatement (Second) of Conflict of Laws, and reviewing the enforceability of employee non-solicitation covenants under (1) the California Supreme Court’s 2008 decision in Edwards v. Arthur Anderson LLC, (2) a California Court of Appeal’s 2018 decision in AMH Healthcare, Inc. v. Aya Healthcare Services, Inc., and (3) California federal district court cases decided post-AMN Healthcare, the NuVasive court concluded that these California decisions stand for the proposition that employee non-solicitation covenants are generally void under California law (section 16600), and that California’s interest in overseeing conditions of employment relationships in that state “substantially outweighed” Delaware’s “fundamental, but general interest” in freedom of contract. The judge therefore declined to enforce the parties’ Delaware choice of law provision and ruled that NuVasive’s non-solicitation covenants were unenforceable.

There is no doubt that the Delaware Chancery Court’s rulings in NuVasive are a setback for employers who want to require their California-based employees to sign employment agreements with non-compete and non-solicit covenants post-employment and have them governed (and enforced) under Delaware law. However, there are other practical options for protecting legitimate business interests that, while not as broad as a non-compete or a non-solicit covenant, might be worth considering. For example, as explained in “Confidentiality and Non-disclosure Agreements (CA),” there are other ways companies in these situations can protect their confidential information in the employment context under California law, including the use of tailored confidentiality and non-disclosure agreements, and trade secret protection programs.

**Some Common Ground Coast-to-Coast: The Sale of Business Exception**

Despite the stark differences between Delaware’s and California’s enforceability of covenants not to compete, it is worth noting one situation where both jurisdictions seem to be aligned – courts in Delaware and California generally will enforce reasonable covenants not to compete and not to solicit in the sale of a business context.

As noted above, California’s general prohibition on non-competes has an exception for the sale of a business. Cal. Bus. & Prof. Code §16601; Fillpoint, LLC v. Maas (Cal. App. Ct. 4th Aug. 24, 2012); Monogram Indus., Inc. v. Sar Indus., Inc. (Cal. App. Ct. 1976) (“In the case of the sale of the goodwill of a business it is ‘unfair’ for the seller to engage in competition which diminishes the value of the asset he sold.”).

In March 2019, although a federal district court in California in Roadrunner Intermodal Services, LLC v. T.G.S. Transportation, Inc. (E.D. Cal.) declined to apply a Delaware choice of law provision in a stock purchase agreement between a California-based company and a California resident, it nonetheless enforced under California law a five-year temporal restriction and reformed geographically overbroad non-compete and non-solicit covenants to cover areas where the
defendant had done business or established goodwill.

In 2015, a Delaware Chancery Court, in Kan-Di-Ki, LLC v. Suer, addressed whether a California-based Delaware limited liability company could enforce a five-year non-compete contained in an asset purchase agreement (APA), against an individual California resident. The APA contained a Delaware choice of law and venue provision. The Kan-Di-Ki court conducted a choice of law analysis to determine whether Delaware or California law applied to the APA. Based on the evidence adduced at trial, the court concluded that the carve-out from California’s general rule against non-competes applied to Suer because he was a seller of the goodwill of a business under the APA, and therefore applied Delaware law. The court then determined that the restrictions were reasonable and enforceable under Delaware law.

The goal of this series is to provide a brief overview and some interesting insights and practical pointers when dealing with unique issues that might arise in the context of restrictive covenants. It is not intended to provide and should not be construed as providing legal advice. Each situation is different, including the governing state law. If legal advice is needed, you should seek the services of a qualified attorney who is knowledgeable and experienced in this area of the law to address your specific issues or needs.


© 2020 Faegre Drinker Biddle & Reath LLP. All Rights Reserved.