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Federal Circuit Upholds Choice Of Delaware Law For Non-Compete

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One of the first questions that comes up in reviewing any non-compete agreement is what law will govern the parties' contract. In most cases, the choice of law is laid out by the parties in the agreement and typically is fixated on the home base of the employer.

Occasionally, however, contracting parties get creative and write in a state that doesn't outwardly make a lot of sense. This is a risky move, because a court reviewing the agreement may not accept the foreign choice of law on the grounds that it has no reasonable relationship to the parties or is barred by the public policy of the state from having jurisdiction over the matter. Indeed, readers may recall that California enacted legislation not long ago which effectively prohibits companies from inserting foreign choice of law provisions into contracts affecting California based employees.

In *York Risk Services Group, Inc. v. John Couture*, the U.S. Court of Appeals for the Sixth Circuit was tasked with evaluating whether injunctive relief was properly granted on several restrictive covenants that were subject to Delaware law. However, Delaware had no substantial relationship with either the employee, a Michigander, or his former employer, a New York insurance company with its principal place of business in New Jersey.

What ultimately led the court to support the choice of Delaware law is that, in exchange for entering into the restrictive covenants, the employee received stock options with the employer's parent company – which happened to be a

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Delaware corporation. The stock option contract provided that the parent and its subsidiaries (which included the employer) could seek injunctive relief for any violations of the restrictive covenants. This was enough, in the court's view, to establish a substantial relationship and reasonable basis for proceeding under Delaware law.

With the selection of law out of the way, the court turned to the facts and the terms of the restrictive covenants. The key provisions of the covenants (the non-compete and non-solicit) were fairly straightforward:

- The non-compete provided that during his employment and for one year after his departure, the employee could not "directly or indirectly, own (beneficially or otherwise), manage, operate, control, participate in, or render services for (including as a consultant or advisor) for any Person that is engaged in (or provide financial assistance to or otherwise be engaged in any manner in the operation of) any business that offers any product or service that competes with any product or service that is offered by the Company."

- The non-solicitation provision stated that during his employment and for two years after his departure, the employee could not solicit any of the company's employees or its customers on behalf of another company.

The employee in question had been with the company for about 13 years, rising up in the ranks from an adjuster to the company's vice president of field operations. In the waning days of his employment, he took a similar job with a direct competitor and simultaneously worked at both companies over the course of four days. In his new job, he was vice president of field operations and had similar duties to his position with his prior employer. In his role at the new company, he also was responsible for interviewing and hiring new employees, which included about seven of his former colleagues.

The district court granted injunctive relief to the former employer, which the appellate court affirmed. Evaluating the terms of the covenants and the facts, the court focused on the employee's experience, reputation and the connections he forged in a personalized business that was dependent upon client goodwill and safeguarding confidential information. In its view, these factors were sufficient to provide a protectable interest in enforcing the covenants.

Stepping back from the case at hand, there are a few takeaways from this decision.

Choice of law provisions in agreements are best if drafted with the assumption that a court will look at them skeptically. Here, the court accepted Delaware law, but largely did so because the parent company (whose contract contained the relevant covenants) was based there. Barring that connection, the result might have been different. Also, the fact that the forum state was Michigan played a role here. The result would have been very different in a state which treats these covenants much more harshly, such as California, North Dakota, Oklahoma or a host of others.

The fact the employee had overlapping employment with both his former employer and its direct competitor was a significant red flag and likely played a key role in the district court's decision (and also on appeal). Irrespective of the non-compete terms in the contract, working simultaneously for both entities would constitute a breach of the employee's duty of loyalty to his

employer. It stands to reason that working for both competitors simultaneously would facilitate the misuse of confidential information or the misappropriation of trade secrets. Given that threat, an injunction makes sense.