CHOICE OF LAW AND FORUM SELECTION IN NON-COMPETITION AGREEMENTS

Employers frequently have their employees, particularly senior executives, sign non-compete agreements that restrict their ability to compete against the employer after the employment relationship ends. All courts view such agreements with at least some degree of skepticism because they have the ability to impede a former employee’s ability to earn a living and companies do not always have a legitimate business interest in restricting their former employees’ activities. However, courts in different jurisdictions take very different approaches on whether, and under what circumstances, such agreements will be enforced. In fact, in few areas does the law differ by jurisdiction as significantly as it does with respect to the enforceability of non-compete agreements.

In some states, such as California, non-compete agreements are essentially prohibited outside of the context of the sale of a business. Other states, such as Georgia, do not categorically prohibit non-compete agreements, but they impose severe restrictions on them. In practice, most courts are generally reluctant to enforce non-compete agreements against lower level employees, but Colorado specifically limits non-compete agreements to executive or management personnel by statute. Other states, such as New York, are more willing to enforce agreements that seek to protect customer relationships and goodwill. However, New York, unlike some states, generally will not enforce a non-compete agreement if the employee in question was terminated by the employer without cause.

In many jurisdictions, non-compete agreements longer than two years are often viewed skeptically but will be enforced under certain circumstances. However, in Louisiana, non-competes are statutorily restricted to two years. States likewise differ on whether an employer is required to make any additional payment or consideration to the employee, beyond providing the employee continued employment, to render a non-compete enforceable. The above highlights only some of the critical differences that exist among various state laws.

State courts likewise take very different approaches on how to handle non-compete agreements that are overbroad. Most courts require a non-compete agreement to be reasonable with respect to its duration, geographic scope, and scope of the restriction. But, what occurs if a court believes a non-compete is overbroad in one or all of these respects varies tremendously. The strictest approach, adopted by Virginia among other jurisdictions, is that the entire agreement will be unenforceable if any part of it is overbroad or ambiguous. In contrast, some states, such as North Carolina, allow a court to “blue pencil” a non-compete agreement, meaning a court will strike out an overbroad provision but will not modify it to
make it reasonable. Other states allow a court to reform the overbroad provision. The important difference between blue penciling and reformation is illustrated by the following example.

Let's say that a non-compete provision states that an employee will not compete within 100 miles of his former employer’s office, but the court believes only a 50 mile restriction is reasonable. A court in a state that allows reformation would be able to modify the agreement so that it only covers 50 miles and enforce it as a reasonable restriction. A court that only blue pencils could not make that change, invalidating the entire agreement. But, if the agreement said that the employee could not compete in Montgomery County (where the employer is located) and Howard County, a court could blue pencil (or strike out) the provision that applied to Howard County and still enforce it as to Montgomery County. Whether, and if so how, the applicable law permits a court to modify an overly broad agreement greatly influences the parties’ respective leverage in non-compete disputes, many of which are settled by the parties without resorting to litigation.

Consequently, choice of law and forum selection clauses are often critical to the enforcement of non-competition agreements. However, the inclusion of a choice of law or choice of forum provision in non-compete agreements raises a host of legal issues that are often not considered by employers when they draft them.

**Enforcement of Choice of Law Provisions**

Because the determination of which law governs the non-compete is often dispositive of whether it will be enforced, employers often identify in the agreement the state law that governs the agreement and where any disputes must be resolved. A provision that identifies the applicable law is referred to as a “choice of law” clause. Similarly, a “choice of forum” provision or “forum selection clause” refers to a provision that sets forth where a dispute must be resolved. However, choosing a law and forum provides no comfort if the court hearing the dispute refuses to honor those choices. Just as with the substantive law applied, courts take differing views as to whether the choice of law and forum specified in the agreement will respected.

Some courts simply will not apply the law of a foreign jurisdiction if it would lead to enforcement of a non-compete that would be invalid under the law of the state where the court is located. For example, in South Carolina if an “agreement is invalid as a matter of law or contrary to public policy in South Carolina, our courts will not enforce the agreement.”

*Stonehard, Inc. v. Carolina Flooring Specialists, Inc.*, 366 S.C. 156, 159 (2005). Most courts, however, have adopted, at least in some form, the test set forth in the Restatement (Second) of Conflicts (hereinafter “Restatement”) Section 187. Section 187 of the Restatement provides that a court will generally enforce a contractual choice of law provision so long as (a) there is a substantial relationship to the parties or the transaction and the law selected; and (b) the law chosen is not contrary to the fundamental public policy of a state with a materially greater interest than the chosen state in the dispute. Courts differ considerably in how they apply these factors, however.
A “substantial relationship” will usually be found where there is a rational reason for the parties to have chosen that state’s law to apply and it does not appear that the parties (or the employer who sometimes unilaterally drafts these agreements) chose a state’s law simply because it was more favorable. However, courts differ on whether the fact that a company is incorporated in a particular state, often Delaware, provides a sufficient basis to apply that law if the company does not actually operate there. For example, the Seventh Circuit held that there was “insufficient connection between the contract and the State of Delaware” where the defendant was incorporated in Delaware but had no operations there. Curtis 1000, Inc. v. Suess, 24 F.3d 941 (7th Cir. 1994). In contrast, the Fourth Circuit stated that “a party’s state of incorporation provides the necessary ‘substantial relationship’ for choice-of-law rules.” Ciena Corp. v. Jarrard, 203 F.3d 312, 324 (4th Cir. 2000) (applying Delaware law to a non-competition agreement).

More difficult questions generally arise when assessing whether the chosen state’s laws conflict with a fundamental public policy of the forum state and whether the forum state has a materially greater interest in the matter. Here, approaches vary considerably by state. Many courts, like those in Virginia and Pennsylvania, will generally enforce a non-compete agreement even if it would be unenforceable under the law of the forum state. These courts recognize that rejecting a choice of law provision on public policy grounds should be the exception, not the rule. If courts determined that a fundamental public policy was violated any time there was a conflict between the chosen law and the forum’s law, the exception would swallow the rule. Yet, that is precisely the approach taken by other states, like Alabama and California, which purportedly follow the Restatement but in fact will not enforce a non-compete that would be unenforceable under its own laws.

These different approaches which can and do result in divergent outcomes, demonstrate the critical importance of where a lawsuit is filed. Different courts will weigh the competing public policy interests differently, leading to different results as to which law to apply and whether the non-compete will be enforced. Because of the importance of the forum deciding the dispute, it is a best practice to include a forum selection provision, which states where any dispute must be resolved, in the non-compete agreement. An employer will generally want to, and probably should, select the courts in the state where they are headquartered as the forum for resolution of any dispute, unless that forum is particularly hostile to non-competes and a different state’s law was chosen to govern the agreement. But, if the employee has rarely worked at or visited that location, particularly if he or she is a relatively low level employee, there is a question as to whether a court will enforce such a provision.

**Enforcement of Forum Selection Clauses**

As a general matter, courts are more willing to enforce a forum selection clause than a choice of law clause. Forum selection clauses are presumptively valid. However, a choice of forum clause will be unenforceable if it is the product of fraud or overreaching, it would be so inconvenient so as to effectively deny a litigant his or her day in court, or its enforcement would contravene a fundamental policy of the forum in which the suit was brought.
Swenson v. T-Mobile USA, Inc., 415 F. Supp. 2d 1101 (S.D. Cal. 2006) exemplifies how courts, even in states that are quite hostile to non-compete, are more willing to enforce forum selection than choice of law clauses, even if the end result may be the same. Swenson, a California resident, signed a non-compete that had a Washington choice of law and forum selection provision. When Swenson left to join a competitor, T-Mobile filed a lawsuit in Washington state court. Swenson, in turn, filed a declaratory judgment action in California seeking to have the non-compete agreement held unenforceable. Even though the Washington state court enforced the non-compete, that did not mean that “[e]nforcement of the forum selection clause itself here [] contravene[s] a strong public policy of California.” Id. at 1104. The court further stated:

While the Court notes that a Washington court’s application of Washington law to the matter at hand may arguably lead to a result conflicting with the provisions of § 1600 [the California statute that prohibits non-competes], Swenson was free to, and in fact, did argue for the application of California law. The fact that the Washington court ruling resulted in a decision unfavorable to Swenson does not mandate a finding that the clause requiring the case be litigated in Washington is invalid. Notwithstanding Swenson’s contention that forum states apply their own law in “virtually every case,” supp. opp’n at 1, the Washington court could have applied California law if it found application appropriate. The Washington court dutifully considered whether to apply Washington or California law to the agreement in question and its determination was based on an application of each state’s choice of law standards.

Id. Certain states, however, are more hostile to forum selection clauses. For example, a South Carolina statute permits a party to ignore an otherwise valid forum selection clause and bring a claim in South Carolina, so long as bringing the claim in South Carolina would be proper under normal civil procedure rules. Other courts that have refused to enforce forum selection clauses in employment agreements have generally focused on the unequal bargaining power between the employee and employer and the inconvenience and expense of litigating in a distant forum, not that the forum selected could lead to a different result in the litigation.

Conclusion

Because the law that applies to a non-compete dispute, and where that dispute is heard, can be dispositive as to its enforceability, it is critical that employers include choice of law and forum selection provisions in their non-compete agreements. But, they must also recognize that their selection may not be respected and should take steps, both in drafting the agreements and otherwise, to try to increase the chance that the provisions will be enforced, and to make the non-compete provisions enforceable if the choice of law and/or forum selection clause is not honored.