Choice of Law and Forum Selection Issues in Employment Agreements

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Forum selection and choice of law provisions are essential in today's contracts. This is particularly true for employment agreements, where the proper forum can save employers thousands of dollars by allowing them to litigate claims close to home, and the right choice of law can give them a leg up under law more favorable to their interests.

While many issues can arise from employment contracts, one of the most commonly litigated is the enforcement of restrictive covenants. Employers use restrictive covenants to protect their trade secrets and confidential information, and to prevent the loss of clients and employees to competitors. These covenants often come in the form of confidentiality, non-competition, and non-solicitation provisions. Because employment agreements are governed by state law, employers should be cautious of how their choice of law and forum selection provisions may affect the enforceability of their restrictive covenants. Here are some factors for employers to consider:

I. Enforceability of Restrictive Covenants and the Differing Approaches

State courts take varying approaches to deal with restrictive covenants that they find too broad or overly restrictive. Most courts have adopted one of three methods to deal with these provisions: the red pencil approach, the blue pencil approach, or the reasonable alteration approach.

In states that have adopted the red pencil approach, the courts will refuse to reform or edit any overbroad provisions within the employment agreement, even when the agreement explicitly provides that the court may do so. The reasoning behind such a rigid application of the law is that the court is not a party to the agreement and, therefore, should not interject itself into the parties' agreement. States that have adopted the red pencil approach include Nebraska, Arkansas[1], and Virginia. Employers operating within these states may be best served by a choice of law selecting another state with some relationship to the business. For example, multi-state employers may choose the state of incorporation or the state in which the company's principal place of business is located. Even then, employers may face procedural and substantive challenges to the choice of law provision, particularly if the court finds that revising restrictive covenants flies in the face of the forum state's public policy of applying the red pencil approach. Fortunately, several courts have rejected such an argument.[2]

States adopting the blue pencil approach allow the courts to strike those provisions of the employment agreement that are unenforceable, while enforcing the remainder of the contract to the extent it is considered reasonable. For example, a non-solicitation covenant may read "Employee is prohibited from soliciting for employment any current employee of Employer or anyone employed by Employer during the previous ten years." The court could reasonably find

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[1] Recent legislation in Arkansas has allowed for blue-penciling of non-competition provisions only.

[2] *See, e.g., Edwards Moving & Riggings, Inc. v. W.O. Grubb Steel Erection, Inc.*, Civil Action No. 3:12CV146-HEH, 2012 WL 1415632, *4 (E.D. Va. Apr. 23, 2012)

the latter part of the covenant overbroad and strike the offending portion, leaving the rest of the covenant intact. The revised covenant would then read, "Employee is prohibited from soliciting for employment any current employee of Employer." This is a basic example of the blue-pencil rule in action. Some state courts conflate the blue pencil test with the reasonable alteration approach, discussed below. States adopting the blue pencil method include New York, North Carolina, and Maryland.

States that have adopted the reasonable alteration approach will often modify overbroad restrictive covenants to render them reasonable and, therefore, enforceable. In other words, the court will interject and add terms to the agreement that were not there before, provided that the modification results in a reasonable restriction. Using the same example from above, the Court could modify the offending portion of the covenant as follows: "Employee is prohibited from soliciting for employment any current employee of Employer or anyone employed by Employer during the previous *six months*." The reasonable alteration approach gives courts wide latitude in fashioning appropriate restrictions and can often leave employers guessing as to what restrictions will result. However, the likelihood of a covenant's enforcement, at least to some extent, rises substantially in reasonable alteration states. States that have adopted the reasonable alteration approach include Florida, Delaware, and Georgia.

II. Forum Selection and State Procedural Considerations

The most common method used to enforce restrictive covenants is the filing of a motion for temporary restraining order (TRO) and/or preliminary injunction.[3] To obtain a TRO or preliminary injunction, most courts require that the employer demonstrate it has suffered or stands to suffer irreparable harm due to the employee's breach of the agreement. However, there are variations of the rule. In Florida, irreparable harm is presumed under Florida statute whenever there is a breach of a restrictive covenant entered into after July 1, 1996. § 542.335(j). This presumption can make or break the employer's ability to obtain an injunction, as it is often difficult for employers to prove imminent irreparable harm at such an early stage of the litigation.

In addition, employers should carefully consider whether to proceed with enforcement of their employment agreements in federal or state court. While many employers instinctively choose federal court for its streamlined processes and the increase in probability of prevailing on summary judgment, it may be easier to obtain preliminary injunctive relief in state court. In fact, employers are often surprised to learn that a Florida choice of law does not always result in a presumption of irreparable injury in federal court. Rather, the determination of irreparable harm is a procedural issue that is governed by the federal rules of civil procedure in diversity actions.[4] For a routine enforcement action against an employee not likely to cause significant damage, state court may be a more attractive forum for litigation.

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[3] While temporary restraining orders and preliminary injunctions may be used interchangeably in some states, other states may use one or the other to refer to *ex parte* proceedings (proceedings handled without providing notice to the other party). It is imperative that you seek competent counsel familiar with the laws of the chosen law *and forum* when deciding to enforce a restrictive covenant.

[4] *See Arthur J. Gallagher Serv. Co. and Risk Placement Servs., Inc. v. Egan,* Case No. 12-80361-Civ-Rykamp, 2012 WL 12839373, *10 (S.D. Fla. Jun. 29, 2012)(citing *Budget Rent A Car Corp. v. Harvey Kidd Automotive,* 249 F.Supp.2d 1048, 1049-50 (D. Ill. 2003)("[t]he propriety of a preliminary injunction, of course, is to be determined

III. Beware of the All-Inclusive Employment Agreement

Far too often employers will place all of the terms governing an employee's position in one comprehensive document, covering everything from profit distributions to confidentiality. With high-level employees in particular, employers are often advised to choose Delaware law due to the state's mature body of law on shareholder distributions, modern corporate statutes, and the relative predictability of court rulings. However, other states, such as Florida, are more favorable to employers with respect to the enforcement of restrictive covenants. In these situations, separating the company's restrictive covenants from the remaining terms of employment may be advisable.

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by the rules and decisions of federal courts…' [therefore,] irreparable harm is not governed by Illinois law and its presumptions, but rather by federal law.").