CLIENT ALERTS & INSIGHTS

First Circuit Declines to Enforce California's Out-of-State Noncompete Ban

OCTOBER 2, 2024

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On September 26, 2024, a Boston-based federal appeals court refused to extend California's sweeping noncompete ban to agreements that were signed outside the state and governed by another state's law.

The California law-Cal. Bus. & Prof. Code §§ 16600-16607-generally bans noncompetes absent a few narrow exceptions (for example, in the sale of a business). It purports to outlaw noncompetes "regardless of where and when the contract was signed" and "whether . . . the employment was maintained outside of California." Cal. Bus. & Prof. Code § 16600.5(a), (b). In *DraftKings, Inc. v. Michael Hermalyn*, however, the First Circuit declined to enforce the California statute, finding that it did not override the subject noncompete's governing law of Massachusetts.

By way of background, Hermalyn was a New Jersey resident and former marketing executive for Massachusetts-headquartered online sports betting giant, DraftKings. Hermalyn resigned from DraftKings to take a similar job in Los Angeles with DraftKings-rival, Fanatics. DraftKings promptly sued Hermalyn in federal court in Massachusetts for breach of contract, contending that his new role violated a one-year noncompete he had signed before quitting - an agreement that was governed by Massachusetts law. Unlike California, Massachusetts is one of at least 11 states plus Washington, D.C., that allow reasonable noncompetes for higher-level employees.

The District Court sided with DraftKings, holding the noncompete enforceable and preliminarily enjoining Hermalyn from competing against DraftKings in the United States for one year. Hermalyn appealed the District Court decision to the First Circuit, arguing that Massachusetts law did not govern the noncompete and that even if Massachusetts law did govern, the District Court should have excluded the State of California from the scope of the preliminary injunction.

The First Circuit disagreed with Hermalyn's initial position that the District Court erred in applying Massachusetts law. It analyzed both states noncompete laws, noting that-unlike California's complete ban-Massachusetts has a policy of enforcing reasonable noncompetes for higher-level employees like Hermalyn who, unlike lower-level employees, often have business-sensitive information and deep ties with company customers. For this reason, the Court explained, Hermalyn failed to show, as he was required to do, that "that 'California's public policy' eclipses 'the parties' clear and unambiguous agreement to apply [Massachusetts] law.'"

The First Circuit also declined to adopt Hermalyn's alternative position, that California's public policy against noncompetes should exclude it from the scope of the District Court's preliminary injunction. The Court reasoned that Hermalyn's new role would inevitably require him to interact with clients outside of California because online sports betting remains illegal in the state. Thus, his requested

California carveout would completely undercut the effectiveness of the District Court's one-year, nationwide injunction.

In short, California's ability to void employee noncompetes brokered in other states is not as absolute as some employers feared. Employees working in other states and bound by reasonable noncompetes cannot simply move to California to void their postemployment restrictions. However, Hermalyn's appeal might have gone differently had he moved to California for work that could clearly be performed within that state. The First Circuit's analysis also leaves open the possibility that courts in states without detailed noncompete laws could defer to California's strict policy against them. Choice-of-law provisions in noncompete agreements and the facts surrounding the new and previous roles of the subject employee will therefore continue to make these disputes fact-specific inquiries, with outcomes that are difficult to predict.

For more information, please contact a member of Benesch's Labor & Employment Practice Group.

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