NONCOMPETE CLAUSES IN NEVADA[1] - TERMINATION FOR CAUSE AND EQUITY BASED RESTRICTIONS

By Bruce A. Leslie

This article concerns non-compete clauses in Nevada employment contracts.[2] It is commonplace that many gaming companies utilize non-compete clauses in employment agreements with highly valued executives. This article ignores the recent FTC announcement April 23, 2024 prohibiting most restrictions, assuming that the individuals who are the primary focus of this article fall within its exceptions.

We start with the proposition that Nev. Rev. Stat. § 613.195(1) provides that non-competes must be supported by valuable consideration, not impose restraints greater than is needed to protect the employer, not impose undue hardships on the employee, and that the restrictions are "appropriate" in relation to the consideration supporting the restriction. Otherwise, such clauses are void and unenforceable.[3]

Our timeline starts pre-statute with *Camco v. Baker*,[4] considers *Golden Road Motor Inn Inc v. Islam*,[5] moves to Nev. Rev. Stat. § 613.195 (the legislation in response that went into effect on June 3, 2017[6]), and follows some of the cases thereafter that interpret the statute. We assume there are few employment contracts today that are outside its effective date.[7]

Camco offered two principles: one, continued employment is consideration for a non-compete, and two, limits on geographic, time and business activities must be reasonable. The first point is worthy of discussion as some lawyers believe continued employment alone still meets the "consideration" requirement of Nev. Rev. Stat. § 613.195.[8] Generally we do not agree, as we view the intent of Nev. Rev. Stat. § 613.195, and the language in subsection 4, as requiring some relativity between the consideration and restriction. In other words, the argument is that valid consideration requires something more than the payment of market rate compensation for services rendered where there is no, or a different, restriction. We believe generally that monetary severance is required for appropriate consideration to exist.

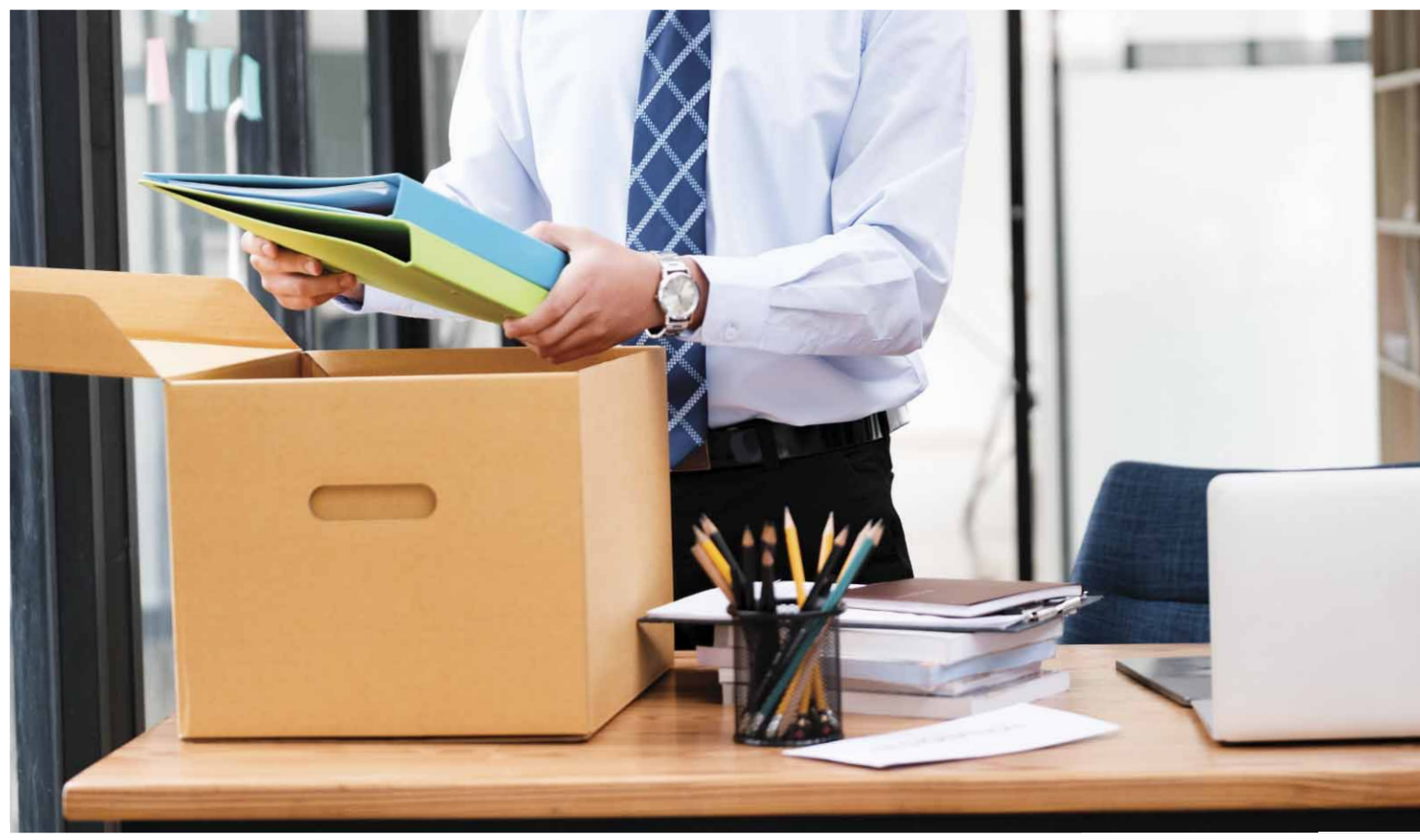
Golden Road, which involved the Atlantis Casino Resort Spa in Reno, Nevada, held: one, that absolute industry prohibitions are unreasonable, and two, if the covenant is unreasonable, the Court will not blue pencil, but rather throw out the entire restriction. On the second point, Nev. Rev. Stat. § 613.195(6) provides that if the covenant is supported by valuable consideration, the court "shall revise" the covenant.[9] We think *Golden Road* continues to add guidance to what restrictions are greater than needed to protect the employer, or impose undue hardships on the employee.

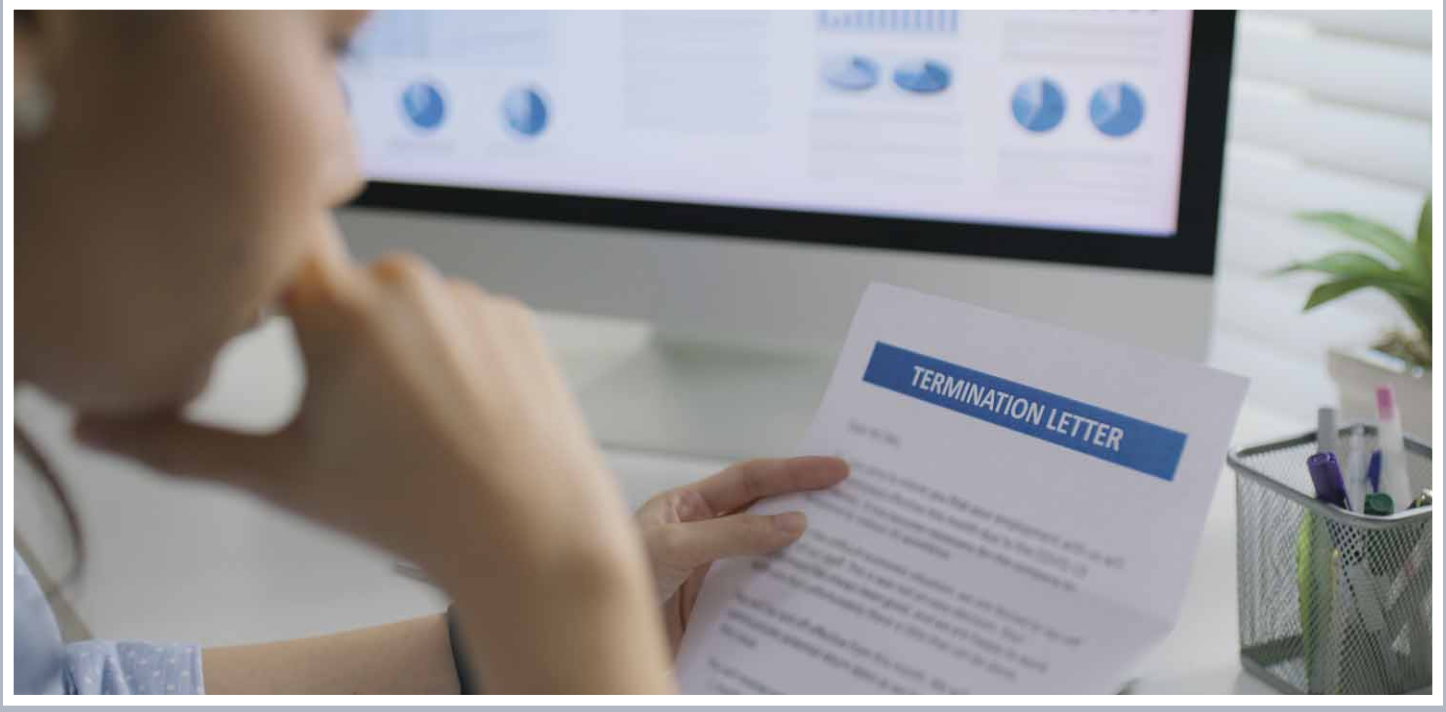
Decided after adoption of Nev. Rev. Stat. § 613.195, in *Tough Turtle Turf, LLC v. Scott*,[10] the Nevada Supreme Court found the scope of the geographic limitation overbroad and therefore "substantively unconscionable." It is common in gaming to see a competitor defined to be any company offering casino gaming within 20 miles of the "Strip." To us that seems excessive and unsupportable, as one wonders how many Dotty's customers frequent Wynn, for example?[11] It further held, Nev. Rev. Stat. § 613.195(6) overruled *Golden Road* insofar as the court *never* revising an over broad noncompete covenant[12] and, that reading Nev. Rev. Stat. § 613.195(1) & (6) together the district court must revise the covenant, when possible, which may not be always.[13]

To recap: under the statute and case law, if there is no valuable consideration, the covenant is void. If there is consideration, the court must balance the hardship to the employee, the employer's needed protection, and the relativity of both to the consideration provided. If there is an imbalance, the court must modify the provisions if doing so is a mere revision but throw it out if a rewrite is needed.

With this background, we consider two circumstances normally encountered in the gaming industry that are anchored to covenants not to compete that to us raise the questions of is there "valuable consideration," and is it "appropriate" in relation to the restriction? Those are: terminations for cause, and terminations where the executive has compensation-based equity in the company.

TERMINATION FOR CAUSE: Nev. Rev. Stat. § 613.195 makes no distinction based on the nature of the termination. However, it is common to find provisions in employment agreements that provide the non-compete covenant applies regardless of the nature of the termination, and that the severance is forfeited on a termination for cause.[14] We are unable to find a basis to suggest that no consideration is required when the termination is "for cause" other than the practical problem of an employee doing wrong to be released from a covenant if no severance equals no consideration.[15]





We acknowledge the argument that initial employment, a titled promotion or increased compensation can be consideration. Sometimes the promotion can require the employee's licensure or finding of suitability calling for regulatory engagement, review and approval.

A promotion involves additional duties so one would expect more compensation for the new job. Absent an additional bump in pay for the restriction (as opposed to the bump for greater responsibility), isn't severance theoretically the appropriate and only consideration for the non-compete?

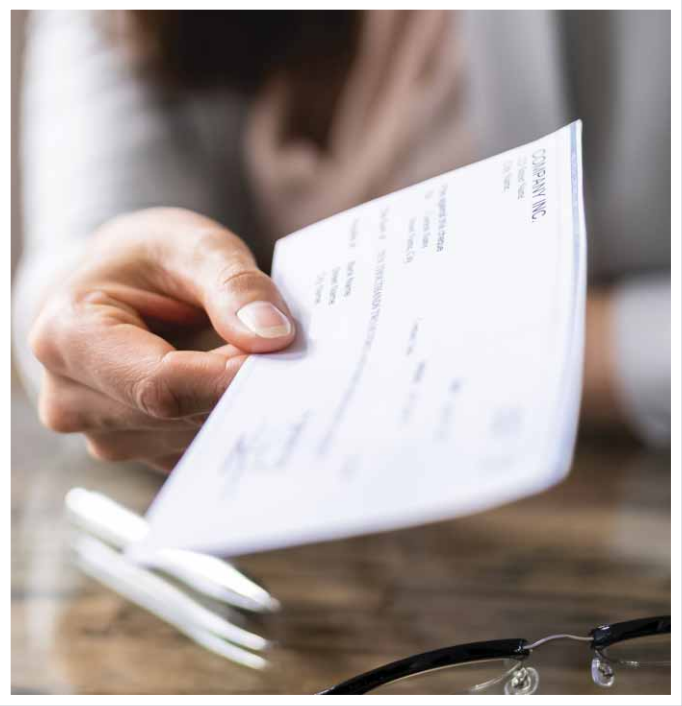
Sometimes severance is forfeited or offset if the executive finds other employment (non-competing of course). How should a court value the consideration when finding a job reduces or terminates severance? Because the consideration is for not competing, does no severance in these events mean the consideration was illusory to begin or not appropriately balanced since the ex-employee is still prohibited from competing, even though employed?

And, what about the definition of "cause?" It is common to see provisions allowing the company to fire the gaming executive for cause for "failing to perform her duties and responsibilities." What does that mean? If someone doesn't show up at work, well, that's easy (absent a disability addressed in the contract or employee handbook). But what if an executive is assigned a budget and for reasons beyond her control (world economy, national economy, the industry's economy, etc.) the company doesn't make its numbers? Termination for "cause" then sounds like "severance is optional" employment. This is also true for "poor performance,"[16] or activities outside work that "harms the company's reputation," when both are determined by the company in its sole discretion. The above are in one piece or another common to the gaming industry.

To us there are two types of "cause" terminations for restrictive covenants that should influence valuing the consideration, those where there really is bad behavior, and those where there isn't. We assume the courts will find some different standard of "appropriate" consideration for bad behavior, as opposed to events beyond one's control or simply being human.

So, if there are types of terminations for which no post termination monetary payment is made, is there consideration, and if consideration exists is it appropriate? Lastly, do inappropriate portions poison the validity of the entire covenant?[17]

EXECUTIVE WITH "EQUITY": Does the executive's possession of, or right to, "equity" in the company constitute "valuable consideration," or is it an independent contract that is outside the protections of Nev. Rev. Stat. § 613.195? Normally grants of such rights are pursuant to a plan, and those plans normally include separate covenants for non-competition. Under those plans the treatment of both vested and unvested rights differs substantially in terminations for cause



and without cause. The statute does not distinguish employees with equity rights from those without. We think that "equity," whose function is compensation based, should be held to the statute's scrutiny. Subsection 5, dealing with certain terminations, says the covenant is enforceable only so long as the employee is paid salary, benefits or "equivalent compensation." Aren't "equity" grants to managers just that, another form of equivalent compensation designed to "align" owners with managers? And, if on a resignation or termination they are forfeited, or cashed out at a reduced value, what is the valuable consideration for the covenant in the plan? Going further down the rabbit hole, if the plan is referenced in the employment agreement, is plan participation "consideration" for the employment agreement's non-compete?

Contrasted to traditional equity are "profits interests"[18] which can have none of the equity rights, and yet their non-compete covenants can be very robust. Most of the time, the total vested equity is forfeited on termination for cause. So where is the boundary between where a non-compete is protecting the needs of the company, and the statute's need to protect employees, when this is really just another form of compensation that doesn't carry any of the traditional benefits of equity ownership?[19]

End note: We do not envy Nevada courts in their tasks of 1) as the initial step, finding consideration exists,[20] and then 2) balancing the value of that consideration to the restrictions placed on the executive. We think that the greatest friction occurs on a termination for cause, or an employer's assertion that the equity plan requires forfeiture of the equity/profits, but in either case, the company asserts that noncompete still applies.[21]

To tie this back to the gaming industry, the Nevada Gaming Control Board and Nevada Gaming Commission clearly have a public policy mandate to encourage competition in the gaming industry. This would include ensuring that the industry generates maximum tax revenue to the state and localities as a matter of public interest and benefit. Certainly, having qualified executives available to operate casino resort properties is in the public interest. While we are not advocating that gaming regulators replace the legislature or courts in developing law, we ask if the gaming industry (the employees and other employers) can't be benefitted by the adoption of regulations guiding the practice of using non-competes? Additionally, and put provocatively, could certain equity compensation tied to a non-compete misalign a licensee's incentive to place a company's stock price above regulatory compliance? Perhaps the Gaming Policy Committee should be tasked with considering whether it would be beneficial to potentially address non-compete agreements, either by statute or regulation, so as to ensure that their provisions do not have an adverse impact on the availability of seasoned executives to operate Nevada's gaming properties, especially in these times of multi-jurisdictional gaming companies and differing market segments even within the Las Vegas metro area (resort casinos vs neighborhood casinos).[22]

A special thanks to Gregg Kamer, Esq., of Kamer Zucker Abbott, he is the dean of employment law in Nevada, representing the other side, employers. Also, my longtime friend, Sean McGuinness of Butler Snow for his gaming thoughts. Their contributions were invaluable.

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Bruce is a sole practitioner; with more than 40 years of experience whose legal practice includes gaming related business law and executive employment and severance agreements. He has represented gaming resorts, and their suppliers, restaurants, nightclubs, retail, senior executives, and entertainment venues. He has served as an expert witness and arbitrator. His formal education includes a BSBA from Miami University (Oxford, OH), a Master of Management from Northwestern University (Evanston, IL), a JD from Denver University, and a Master of Law, Taxation from New York University. His recent authorship includes articles on shareholder primacy and the business judgment rule, fiduciary duties & executive compensation, the alter ego doctrine, and non-compete covenants, all of which can be accessed at http://www.bleslielaw.com. He presently serves on the State Bar Fee Dispute panel and served for 12 years on the State Bar of Nevada's Disciplinary Committee (lawyers). For 13 years, he was a member of the Board of Directors of Pinnacle Entertainment, Inc. (a medium cap NYSE casino resort company), and was a member or chairman of the Audit, Compliance, Governance & Nominating, Independent Directors' Litigation, CEO & Board Member Search, Indemnity Trust & Risk Oversight, and Executive Committees. He chaired compliance originated independent director investigations. He was licensed or found suitable by 14 state, tribal and international gaming authorities. He is an honorary citizen of, and was awarded a key to, the City of New Orleans.

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[1] Not addressed is choice of law. Consider, *Terrier, LLC v. HCA Franchise Corp., 2:22-cv-01325-GMN-EJY (D. Nev. Sep 15, 2022)* which although the contract was controlled by Nevada law, looked to confirm that the covenant would be enforceable under New Mexico law, because the imposition of the covenant was applied to activities within that state. See also Greenberg Traurig's Year-End 2023 discussion of Delaware law (https://gtlawinfo.com/cv/93b9a96e751f801ed665a256a88d22df52f09216): "In one case, a Delaware court strongly urged that such disputes be channeled to other venues (e.g., principal place of business or jurisdiction of employment activities/residence) as a policy matter and recommended that the Delaware Supreme Court accept an interlocutory appeal to rule on the foregoing legal and policy issues." The implications of choice of law are beyond the scope of this article but do raise interesting questions of the available breadth of review that Nevada regulators might be offered.

[2] This article is also not about other restrictive covenants (non-solicitation of employees, customers, or suppliers), or about non-competition provisions in the sale of a business.

[3] Nev. Rev. Stat. § 613.195(1).

[4] 113 Nev. 512, 517 (1997),

[5] 132 Nev. 476, 376 P.3d 151, 159 (2016).

[6] Note that in 2021 the Nevada legislature adopted amendments which prohibit restrictions on hourly employees, exclusive of tips or gratuities. We note our past experiences where resort employers felt it important to have bartenders sign 60-90 day non-competes, which is pretty hard duty for persons living paycheck to paycheck.

[7] But see: *EnvTech, Inc. v. Rutherford, 3:21-cv-00048-MMD-CLB (D. Nev. Dec 18, 2023)* for a very thoughtful analysis of two covenants in different pre-statute employment and non-disclosure agreements. The Court offered that 5 years is too long, it needs to see which clients are excluded to determine the reasonableness of the restriction, and that including the employer's parent entities may be too broad geographically (unclear is what the business activities of the parents were).

[8] While beyond the scope of this article, note there is a requirement of "valuable consideration" in Nev. Rev. Stat. § 613.200(4) regarding the enforceability of restrictive covenants prohibiting disclosure of trade secrets and confidential information. Putting aside the other statutes protecting trade secrets (Nev. Rev. Stat. § Chapter 600A), some lawyers think these restrictions have no time or geographic limits. On the scope of what is included in these covenants, we have seen gaming company lawyers assert that an employee's personal diary belongs to the company, preventing one authoring a life's experience memoir. What is "consideration" may become important in this normally conjoined area.

[9] Further *Duong v. Fielden Hanson Isaacs Miyada Robison Yeh, Ltd., 478 P.3d 380* (Nev. 2020) clarified that the parties can agree by contract to blue penciling (this was a pre- Nev. Rev. Stat. § 613.195 case).

[10] 139 Nev.Adv.Op. 47, 85249 (Nev. Nov 02, 2023).

[11] As to "Strip" employment and "poaching," see Annie Yong's article in the June 27, 2024, Las Vegas Review Journal- Wynn vs. Fountainebleu

[12] See *GreenbergTraurig Year-End 2023* that: "The Delaware Court of Chancery has repeatedly noted that it will not "blue-pencil" overbroad covenants and instead will refuse to enforce them."

[13] On the last point, the Court pointed out the obvious, if there is no consideration, it is unenforceable. Unclear is the later distinction that a court's rewrite is not OK, but it shall "revise" if that modification is within subparagraph (6) standards. Otherwise, toss it out. A thoughtful discussion of non-competes is found in the *Brownstein Client Alert, June 7, 2022*.

[14] We do not address voluntary resignation or disability terminations, but again, the statute does not distinguish the type of termination. We note many believe that severance supports the "consideration" requirement, and the time length of payments should mirror the term of the non-compete.

[15] This is not to suggest that an executive's behavior might influence a court's review of the "appropriateness" of the consideration to the restriction, but we believe it still must find the initial existence of consideration.

[16] How often has this applied using objective metrics? And, if the person is really that terrible, one would think the employer shouldn't care if he/she stayed in the industry, in fact would welcome it! And then there is no severance when the termination is for a disability (inability to perform one's duties). That person is now prohibited from performing any duties in the industry/market even though another employer will make accommodations or the employee recovers?

[17] Or can the court revise but not rewrite it? Also, the statute says, "noncompetition covenant." Paragraph 2 addresses solicitation of customers as within that term, a different concept from working for a competitor, suggesting an all-inclusive analysis of the entire restrictive covenant.

[18] For private equity there are normally thresholds of recovery and return on investor investment before the executives' interests have any value, in addition to vesting based on time and company performance. At the time of the grant, the value of the interest is nominally pegged at zero. For publicly traded companies there is often restricted stock & options, with phantom stock being similar to profits interests. There are incentive bonus plans, which are much the same.

[19] Perhaps as guidance, the Court in *Terrier, LLC* reviewed the two agreements independently in its evaluation.

[21] Please, please, please, do not suggest a peppercorn is adequate consideration as that makes the statute's first requirement (its existence, and that it is "valuable") ridiculous. And there remains the appropriate relationship requirement. Which is not to say what is "valuable consideration" is clear.

[21] A partial forfeiture under a plan may get the company past the initial requirement of the existence of consideration, but the valuation required for the determination of "appropriateness" is something else. Stated differently, we are uncertain a court would find consideration if the real-life effects were "you will get the benefits if we continue to like you."

[22] And in today's world of internet gaming, often the geographic restrictions become worldwide, sometimes foreclosing any industry employment.