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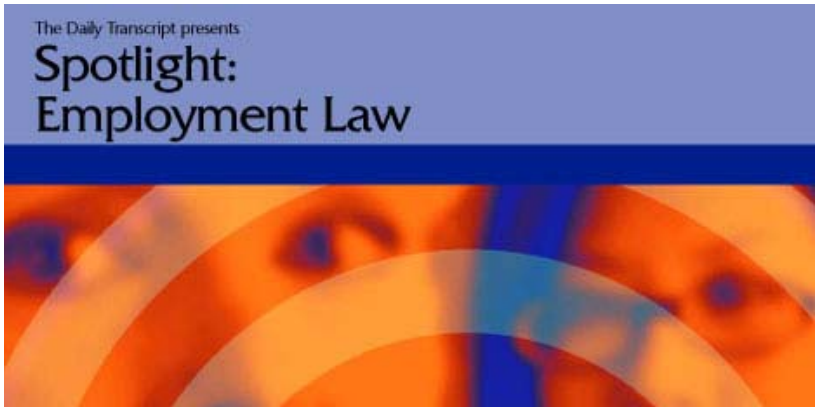

Enforcing and evading non-competition agreements in California

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They say the more things change, the more they stay the same. That is certainly true with respect to non-competition agreements under California law. With limited exceptions, non-competition agreements remain void and unenforceable in California.

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California has a deeply rooted public policy ensuring that every Californian has the right to pursue any lawful employment. A former employee is free to solicit business from a former employer's customers if the competition is "fairly and legally conducted" and so long as the individual does not misappropriate any contact information constituting a bona fide trade secret. That same public policy ensures that California employers can compete effectively for the most talented employees in their industries. See Cal. Bus. & Prof. Code § 16600, "Every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void."

Nevertheless, some companies continue to insert non-competition agreements into their run-of-the-mill employment documents. That is ill advised for both legal and practical reasons.

Legally, this exposes the company to potential liability for unfair competition claims under California Business & Professions Code section 17200. See Application Group Inc. v. Hunter Group Inc. (1998) 61 Cal.App.4th 881. Pragmatically, this practice overlooks the fact that most departing employees do not really present a significant competitive challenge.

Whatever the perceived benefits of non-compete agreements, in the case of most employees, these provisions are not normally worth the risk of liability, or worth the time, trouble or expense that non-competition lawsuits typically involve.

For those departing employees who actually pose a serious competitive risk, there are alternative strategies the former company can use to protect itself. To the extent the departing employee attempts to compete unfairly by using the former employer's trade secrets, California's Uniform Trade Secrets Act (Civil Code section 3426 et. seq.) provides for injunctive relief, as well as damages, royalties and possible punitive damages. To prevail in such lawsuits, the company normally has to have clearly identified its trade secrets and taken reasonable steps to maintain its confidentiality. See e.g., Thompson v. Impaxx Inc. (2003) 113 Cal.App.4th 1425.

Another option is to negotiate a post-termination consulting agreement under which the departing employee agrees not to work for competitors. The employer continues to pay the individual in exchange for that person's agreement to consult on an as-needed basis and, more importantly, not to engage in any competitive employment. Such contracts should be drafted to

provide that the installment payments shall cease if the individual breaches the agreement.

Lump sum payments at the front end should not be used because it is unlikely that California courts will enforce "claw back" provisions (under which the individual is obligated to return all of the money paid to date). California courts have treated "claw back" provisions as impermissible forfeitures prohibited by Section 16600.

California employers can also get some protection from agreements that limit a former employee's ability to solicit his or her former co-workers into leaving the company. If the restrictions are reasonable in scope, such non-solicit agreements are valid. See Loral Corp. v. Moyes (1985) 174 Cal.App.3d 268: upholding an "anti-raiding" provision for a one-year period in an employee's termination agreement.

The few companies that (1) have a legitimate basis to include a favorable choice-of-law provision in their agreements (selecting a state that enforces non-competition agreements), and/or (2) have a factual and procedural basis to litigate outside of California have another strategy available to them. This select group of companies has had some success in taking former employees to court out-of-state in order to enforce a non-compete agreement. (See Advanced Bionics Corp. v. Medtronic (2002) 29 Cal.4th 697, Biosense Webster v. Superior Court (2006) 135 Cal.App.4th 827 and Google v. Microsoft (2005) 415 F.Supp.2d 1018.) As the relatively complex procedural histories in those cases suggest, this strategy still only makes business sense if the departing employee actually warrants these kinds of litigation expenses.

Where applicable, another strategy is to take advantage of the exceptions to Section 16600. There are statutory exceptions to the rule against non-competes in connection with the sale of a business, and the dissolution of a partnership or limited liability company. See Business & Profession Code sections 16601, 16602 and 16602.5. However, California courts will not recognize sham "deal non-competes." See Bosley Medical Group v. Abramson (1984) 161 Cal.App.3d 284.

Other potential pitfalls include where the business being carried on is not actually a like business (see Cal. Bus. & Prof. Code § 16602), or "two-way non-solicitation" agreements. See Strategix Ltd. v. Infocrossing West Inc. (2006) 142 Cal.App.4th 1068: nonsolicitation covenant wrongfully barred the sellers from soliciting the employees and customers of the purchaser, rather than the former employees and customers of the seller.

The California Supreme Court currently has at least three cases pending that involve issues related to non-competition and non-solicitation agreements. While the California Supreme Court is not going to reverse California's statutory prohibition against covenants not to compete, the court could provide guidance as to whether there are yet other strategies to accomplish the same business goal.

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