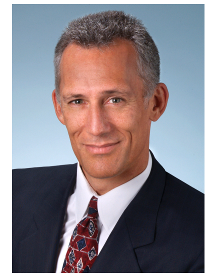
CALIFORNIA CRYIN'

Employer hit for $1 million in punitive damages for imposing a covenant not to compete on California employees



By Michael D. Young *

You have got to love California. Sunny skies. Dolphins frolicking in the surf. Unsullied mountains. Million dollar punitive damage awards against unsuspecting employers engaging in conduct that is perfectly legal in most of the country. Ahhh, California.

While Californians may relish the fact that this State is like no other place on the planet, at least one large employer surely disagrees. For Aetna U.S. Healthcare, a covenant not to compete imposed on its workforce that is *perfectly legal* in other parts of the country will cost the employer over $1 million in *punitive damages* here in California. And a single former employee who stood up for herself will reap the rewards.

What was Aetna's million dollar mistake? Call it the result of arrogance, ignorance, or just bad legal advice, the fact is, Aetna failed to pay attention to the California culture: When California employee Anita Walia refused to sign a new employment agreement that Aetna sought to impose on much of its workforce, claiming that the "non-compete" provision was illegal in California, *Aetna fired her*. The California jury was unsympathetic to Aetna's plea that these types of restrictions are lawful in other states and hit the company with a million dollar punitive damage verdict. The award was upheld on appeal in its entirety.

How was this individual account manager able to take a million dollar bite out of Aetna's bottom line? The recent appellate court opinion in *Walia v. Aetna, Inc.*, (2001) 93 Cal.App.4th 1213, explains. [Since the original publication of this article, the Supreme Court has ordered the *Walia* opinion depublished. Not reversed, mind you; merely depublished.]

THE COVENANT NOT TO COMPETE

A player in the competitive health care field, Aetna wanted to discourage its employees from working with competitors, while at the same time making it more difficult for competitors to cherry-pick Aetna's better performers. So Aetna did what companies have been doing successfully for over a hundred years all over the country, it required many of its employees to sign – as a condition of continued employment – an agreement not to later work for a competitor.

Known as a restrictive covenant, or a covenant not to compete, this type of agreement typically prevents an employee from accepting later employment with any competitor for a certain amount of time and within a certain geographical area. The Aetna agreement, for example, sought to prohibit some of its employees around the country from working for a competitor in the same state for six months after leaving Aetna's employ.

EMPLOYER V. EMPLOYEE – EACH STATE STRIKES A BALANCE

There is nothing inherently wrong with a covenant not to compete. Indeed, they are arguably good for business. Established employers, or companies dependent on the skills of key individuals, like them because they help maintain a stable workforce, which is always good for efficiency and profitability; and they discourage corporate raiding by upstart competitors seeking to hire away key employees with promises of inflated salaries.

On the other hand, employees are not too keen on restrictive covenants because they do exactly what they are designed to do, discourage employees from jumping ship. These types of agreements force employees to either stay put, take a job in an entirely new field of work, or move out of the geographical limitation of the agreement, which is often out of the only neighborhood the employee and his or her family has ever known. It is the time-worn balancing act between the generally conflicting interests of the employers and the employees.

And each state gets to decide how to strike that balance. In most states around the country, that balance is struck somewhere in the middle, allowing the employer to place some restrictions on the subsequent movement of its workforce, so long as the restrictions are reasonable (in time and geographical scope), do not create an undue hardship, and are aimed at protecting a legitimate interest of the employer. In those parts of the country, limited reasonable restrictions on an employee's ability to change jobs are considered a perfectly legitimate way to balance the competing interests of worker and employer.

CALIFORNIA'S BALANCE TILTS HEAVILY TOWARDS THE EMPLOYEES

But then there is California. Not completely unique in this regard, but certainly at the forefront, California strikes a balance that is heavily weighted in favor of employees.

Not surprisingly, in the State that created the Task Force to Promote Self-Esteem it is the employee's interests in remaining employed, maximizing his or her economic self worth, and having the freedom to change jobs at will that reign supreme. Indeed, since 1872, the law in California has been that (with a few exceptions) "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void." (Business and Professions Code Section 16600.)

As the California courts have repeatedly explained, this statute represents the "strong public policy" of the State that "the interests of the employee in his own mobility and betterment are deemed paramount to the competitive business interests of the employers." (*Application Group Inc. v. Hunter Group, Inc.* (1998) 61 Cal.App.4th 881, 900.)

AETNA'S MILLION DOLLAR MISTAKE

So when Aetna chose to *fire* California employee Anita Walia for refusing to sign the restrictive covenant, it was essentially firing her for refusing to engage in unlawful conduct. This was bad enough, but Aetna compounded the error by following up the termination by placing a notice in Walia's employment file that Walia was terminated for a "failure to meet the requirements of [her] position."

Aetna had its opportunity to do right. Walia, a law school graduate before she became an Aetna Account Manager in San Francisco, spoke to four Aetna managers at increasing levels of seniority expressing her view that the restrictive covenant was illegal in California. Each manager dismissed Walia, coming up with one poor excuse after another as to why the restriction was proper.

Walia next had an attorney write a letter to the president of Aetna informing the president that covenants not to compete were illegal in California, and that any adverse job action taken against an employee who refused to sign an illegal contract could subject the company to liability. This warning too was ignored by Aetna. Or if not ignored, at least disregarded, since the president testified that he was assured by his own attorney that notwithstanding the letter, the restrictive covenant was lawful in California.

(This attorney was the same one who, when asked whether the non-compete agreement might interfere with an employee's livelihood, ever-so-delicately responded: "'Livelihood' means what it says. It means they starve to death with the non-compete. No human being could possibly lose their livelihood with a non-compete." The California jury, like the appellate court that reviewed the decision, was none too pleased with the cavalier attitude reflected in this response.)

The jury was never asked to decide whether the restrictive covenant was lawful. Why? Because the trial court, which decides questions of law, *ruled that the Aetna agreement violated Section 16600 as a matter of law*. Accordingly, the only question left for the jury was (a) whether Walia was fired for refusing to sign the illegal contract (it found that she was); and (b) what damages flow from the illegal firing. In this case, the jury awarded Walia over $50,000 in lost wages, $125,000 for emotional distress, *and $1,080,000 in punitive damages*. The verdict was appealed and the appellate court had no trouble affirming the decision.

THE LESSONS

What lessons flow from this decision? Most obviously for the employer, don't ignore California (or any other applicable State) law when drafting employment agreements. The rules are different in each jurisdiction, and those differences must be respected.

Equally significantly, don't fire an employee for refusing to engage in an illegal act, such as refusing to sign a contract that violates public policy. If an employee is refusing to follow a company directive based on a claim that the directive is unlawful, take the time and invest the effort to determine up front whether the employee's complaint has merit. Some quick legal advice on the front side sure beats a million dollar punitive damage award on the back end.

On a more subliminal level, don't simply ignore letters from an employee's attorney. While such letters may often be filled with dogma and hot air, they may also contain a kernel of truth. They may disclose a legitimate problem that, addressed early, could save the company substantial money – in the *Aetna* case, over a million dollars in punitive damages, not to mention the untold sums in legal fees and costs.

Similarly, when dealing with employment issues in particular, professionalism and courtesy in correspondence, even internal e-mails by in-house attorneys, will serve the employer well. Nothing inflames the embers of a jury's passion like an arrogant or insensitive e-mail tending to trivialize an individual's simple desire to earn a living.

Employers and employees can coexist in California, much the way skiers and snowboarders share the California slopes, surfers and boogie boarders share the coastline, hikers and mountain bikers share the backcountry. They may not always agree on things, and there are bound to be occasional conflicts. But some basic attention to the rules, along with a little common courtesy, should allow everyone, even employers, to enjoy the uniqueness of California.

* ***Michael D. Young*** *is a full time neutral with Judicate West in California, focusing on intellectual property and employment disputes, among other complex civil matters. He taught Negotiations and Mediation at USC Law School for close to a decade, and is a Distinguished Fellow with the International Academy of Mediators. Previously, he was an intellectual property and employment litigator with Alston & Bird (formerly Weston Benshoof). He welcomes your comments at Mike@MikeYoungMediation.com, or feel free to add to the conversation at www.MikeYoungMediation.com/ask-a-mediator.*