COURTS COMPETE TO RULE ON NON-COMPETES

Whether a Non-competition Clause Will Be Enforced In California May Depend on Who Wins the Race to the Courthouse

By Michael D. Young *

Can an employer prevent its employee from working for a competitor by inserting a "covenant not to compete" provision into an employment contract? The answer used to be so easy in California: Of course not! In California, the right of employees to change jobs has been of near-Constitutional stature.

Or so it seemed.

While it can't be said that the tide it turning, the recent depublication of two California appellate court opinions, and an unusual Ninth Circuit ruling, has certainly made the law of restrictive covenants in California a little murkier. And these changes are forcing practitioners not only to stay on \their toes, but to dance quickly.

WHAT IS A RESTRICTIVE COVENANT?

Covenants not to compete (also called non-compete agreements or restrictive covenants), are clauses in employment agreements that contractually forbid an employee from accepting later employment with any competitor, usually for a certain amount of time and within a certain geographical area. A typical example might be a clause that prohibits a software engineer in Los Angeles from working for any competing software company in California for a year following the termination of employment.

THE EMPLOYER'S VIEW

There is nothing inherently wrong with a non-compete agreement; indeed, many companies are convinced they are good for business. Established employers, or companies dependent on the skills of key individuals, support restrictive covenants because they help maintain a stable workforce (by discouraging job shopping), 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.

They also help keep labor costs depressed because, as noticed in *Application Group Inc. v. Hunter Group, Inc.*, 61 Cal.App.4th 881 (1998), they prevent workers from shopping "for a potential offer from a competitor to obtain leverage in salary negotiations" with the employer.

With covenants not to compete tending towards lower turnover, lower labor costs, retention of key employees, and discouragement of corporate raiding, is there any wonder why employers favor them.

THE EMPLOYEES' VIEW

Needless to say, employees take a much dimmer view of non-compete clauses, not surprisingly opposing them for the same reasons employers support them. These contractual provisions force unhappy employees to stay put even though they might be able to find a much higher paying job next door, 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. Moreover, for industries that are national in scope, a broad restrictive covenant could prevent the employee from taking a competitive job anywhere in the country.

CALIFORNIA'S "BALANCE"

Coming as no surprise to anyone who has practiced law in this State, California does not balance these competing interests of employer and employee quite the same way other States do. Not completely unique in this regard, but certainly at the forefront, California strikes a balance that is heavily weighted in favor of employees. 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 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." (Bus. & Prof. Code § 16600.) As the California courts have often 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*, supra, 61 Cal.App.4th 881.

CONFLICTING POLICIES AROUND THE COUNTRY

But other States do not balance these competing interests in quite the same way. Indeed, in many States, Minnesota being one glaring example, it is the *employer's* interests that prevail, with the courts routinely upholding non-compete agreements against employees seeking to prematurely switch over to a competitor.

For the most part, these two divergent views of restrictive covenants exist without conflict. Employers in Minnesota, for example, are permitted to impose non-compete agreements on their employees, and the employees are compelled by the Minnesota courts to abide by those agreements. Conversely, employers in California are not permitted to impose restrictive covenants, and California employees are free to work for whichever competitor will pay the most for his or her services.

However, as the country becomes more of a national society, with workers willing to relocate across the country for better jobs, conflict between these competing policies is inevitable . . . and ugly. What happens, for instance, when that Minnesota worker, despite being subject to a non-compete provision in Minnesota, nevertheless takes a job in California with a competing California employer? In other words, what happens when the Minnesota company's legitimate interest in enforcing its employment contract comes in direct conflict with the new California employee's legitimate interest in working at the job of his choice? And what happens when the courts of both States get involved in the same dispute, at the same time, with the same parties, applying irreconcilably opposite laws?

CALIFORNIA v. MINNESOTA IN *ADVANCED BIONICS*

The result, as evidenced by the nearly unbelievable legal labyrinth described by the Court in *Advanced Bionics Corp. v. Medtronic, Inc*., 87 Cal.App.4th 1235 (2001), is neither pretty nor cheap. One must read the opinion to fully appreciate the legal ping pong match played out by these parties, assisted by their respective courts of choice.

The employees filed in California seeking an order that the restrictive covenant was unlawful and against public policy; the employer filed the next day in Minnesota seeking to enforce the agreement. With oft-times daily hearings in one court and then the other, utilizing TROs, preliminary injunctions, temporary injunctions, ex parte applications, and more, the employees were able to convince the California court *to enjoin the employer from further pursuing the Minnesota case*. Not to be outdone, the employer convinced the Minnesota Court *to enjoin the employees from further using the California action* to interfere with the Minnesota action. One can even see the two courts dueling with one another through the issuance of competing and conflicting orders with unprecedented speed.

When the smoke cleared, the California appellate court held that the trial court correctly enjoined the employer from participating in the Minnesota action because California's fundamental public policy as expressed in B&P Section 16600 and *Application Group* was so strong that it essentially trumped Minnesota's policy to the contrary. For those who practice in this area, this result was no surprise and appeared consistent with a Century of California precedent.

But then the California Supreme Court intervened. By accepting review of the case, the Court striped the *Advanced Bionics* opinion of its vitality.

IMPOSING A NATIONAL UNIFORM NON-COMPETE POLICY? NOT A GOOD IDEA IN *WALIA v. AETNA*

A few months after *Advanced Bionics Corp*. came the opinion in *Walia v. Aetna, Inc*., 93 Cal.App.4th 1213 (2001). There, the out of state employer, in an effort to discourage poaching of key employees by a rival, imposed a non-compete agreement on all of its employees nationwide . . . including those in California. When California employee Walia refused to sign the agreement on the grounds it was unlawful in California, Aetna promptly fired her. (The company then compounded the problem by placing a false notice in Walia's employment file that Walia was fired for a "failure to meet the requirements of [her] position.")

The trial court held the restrictive covenant to be unlawful in California as a matter of law, and the jury awarded the plaintiff over $1 million in punitive damages.

The appellate court, reiterating California's strong public policy against these types of employment restrictions and falling in line behind *Application Group*, affirmed. Again, because this result was consistent with the long line that preceded it, it was not a surprise.

But then the Supreme Court intervened again, first granting review, and then deferring any further action on the case pending the court's "disposition of a related issue in *Advanced Bionics Corp*." Walia v. Aetna, Inc., (2002).

CALIFORNIA v. TENNESSEE IN BENNETT

Adding to the murkiness is the recent Ninth Circuit opinion in *Bennett v. Medtronic, Inc.,* 285 F.3d 801 (March 27, 2002) (amended May 15, 2002, at 2002 DJDAR 5307). In this latest Medtronic case, the employer sued its competitor (NuVasive) in Tennessee state court for hiring or attempting to hire Medtronic's employees in violation of the employees' non-compete agreement. That case was resolved with both companies agreeing that for the next 18 months, any further suits between them over the legality of the non-compete provisions would be litigated in Tennessee.

Apparently, discussions between the companies and the departing Medtronic employees went poorly because on the exact same day some 13 months later, Medtronic sued the competitor in Tennessee and the employees sued Medtronic in California Superior Court, which was quickly removed to federal court.

Borrowing a page from the earlier Medtronic case (*Advanced Bionics Corp.*), the employees sought a declaration that the non-compete clause was unlawful in California, and an injunction

preventing Medtronic from pursuing the Tennessee litigation. The federal court issued a temporary restraining order preventing Medtronic from seeking to enforce the non-compete clause in any court other than the San Diego federal court.

Medtronic appealed. This time, Medtronic found a receptive audience. The Ninth Circuit ignored *Application Group*; it ignored B&P Section 16600; it ignored *Advanced Bionics Corp*. and *Walia*; and it ignored California's "strong public policy" favoring employee movement. Indeed, the entire opinion barely discussed the non-compete agreements at all.

Instead, the federal appellate court analyzed whether, under the "Anti-Injunction Act" (28 U.S.C. § 2283), the trial court even had the power to enjoin the Tennessee state court. (It considered an injunction preventing Medtronic from pursuing its claim in Tennessee to be tantamount to an injunction directed to the Tennessee court directly.) It determined that the district court did not have such injunction powers and reversed, sending the parties back to the federal trial court in San Diego and the state court in Tennessee.

SO WHERE ARE WE NOW IN CALIFORNIA?

With the retraction of *Advanced Bionics Corp*. and *Walia*, and the holding in *Bennett*, where does that leave California employees seeking to free themselves from the shackles of an out of state restrictive covenant?

While the employees should still be able to bring a successful action for an order declaring the clause to be unlawful and unenforceable in California, is that going to be good enough? What happens when the employer in Minnesota, or Tennessee, obtains an order from a state court there that the non-compete is lawful, binding and enforceable? By engaging in court-determined lawful employment in California, the employee may be simultaneously violating a court order in another state and subjecting himself or herself to contempt and damages.

And if the California courts are powerless to prevent the issuance of a contrary order in another state, does this not effectively eviscerate the "strong public policy" expressed in Section 16600? After all, if a California employee can be faced with contempt, or at least a judgment for damages, in another state for breaching what California declares to be an unlawful contractual provision, there would not seem to be much teeth in that court declaration.

What is the employment practitioner to do? Until the Supreme Court instructs otherwise, the answer must be file first and ask questions later. As it is now, it is a race to the courthouse of one's choice. An out-of-state employer seeking to enforce a restrictive covenant should quickly file in a friendly state and seek to enjoin the departing employee and competitor from instituting an action in any other jurisdiction.

Similarly, a California employee (or an out of state employee being hired by a competing California employer) should file a declaratory relief action in California state court (unless *Bennett* is overturned, stay out of the federal courts) and seek a similar injunction to prevent the old employer from litigating anywhere else. It is a speed contest to be sure. And at least for now, to the fleetest of foot will go the spoils of victory

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