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No Noncompetes In Calif. – So What Else Is New?

Law360, New York (September 18, 2008) -- It is well known in the employment world that California is not the state to try out your new noncompete language. In the state that created the legislative Task Force to Promote Self-Esteem, employee interests have always been paramount to those of the employer; and nowhere is this better reflected than in California's venerable 136-year-old statutory prohibition on noncompete agreements.

In refreshingly clear and concise language (for a law drafted by politicians anyway), California's Business and Professions Code Section 16600 stands out like a sentinel, protecting the right of California's workers to find the best work available to them, and barring any contracts that seek to prevent workers from engaging in healthy, lawful competition.

In plain English, Section 16600 reads: "Every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void."

However, the apparent clarity of this statutory proclamation has not stopped employers (or more likely their clever legal counselors) from looking for loopholes. After all, employers have rights too, even in California, and it seems unjust to allow employees to simply take all of the information and knowledge they have learned at a job and use it against the employer by engaging in a competing business.

In other states employers are allowed to impose at least small "reasonable" noncompetes on employees in order to protect themselves and their investment in their workforce. Surely there must be some way to approximate the same type of protection in California.

The Rise And Hard Fall Of Non-Solicitation Agreements

Hence was born the non-solicitation agreement – and the "narrow restraint" exception to Section 16600.

Looking for at least a modicum of protection, many employers imposed on their workforce a limited post-employment non-solicitation covenant. In exchange for employment, the employee had to agree that he or she would not work for, or solicit, any customer or client of the employer for a period of time, often a year or 18 months.

Of course this was a technical "restraint" on the employee's ability to "engage in a lawful profession, trade, or business," but it was such a small restraint (after all, the employee could compete for the business of everyone else in the world), and there was such a good reason for it, that surely it would be allowed ... even in California.

And allowed it was, for a time, though only according to the federal court.

A series of federal court decisions, ostensibly interpreting Section 16600, held that there existed a "narrow restraint" exception to Section 16600 such that narrowly-tailored non-solicitation agreements were lawful. (See Campbell v. Trustees of Leland Stanford Jr. Univ. (9th Cir. 1987) 817 F.2d 499.)

California employers were quick to latch on to this new exception, and non-solicitation agreements flourished.

The Supreme Court: "We Really Mean It, No Noncompetes Allowed"

However, the exception was short-lived (at least as measured by the 136-year history of the applicable statute).

In Edwards v. Arthur Andersen (2008) 2008 Cal. LEXIS 9618, the California Supreme Court reined in its wayward federal brethren and rejected the "narrow restraint" doctrine, holding it improper for a court to imply an exception to a simply-drafted 136 year old proclamation of a firmly held public policy.

The law means what it says – "an employer cannot by contract restrain a former employee from engaging in his or her profession, trade, or business" (unless the agreement falls within one of the express exceptions set out in the statute).

With impeccable logic, the court noted that (a) non-solicitation agreements, narrowly tailored or not, restrain an employee's ability to engage in his or her chosen work; (b) they are not within the statutory exceptions; and (c) therefore they are unlawful. The court reiterated that if exceptions are to be created to this statute, they will have to come from the Legislature.

There will surely be employers who will nonetheless consider leaving their non-solicitation (or even noncompete) provisions in their California employment agreements under the theory that, even if the clauses are unenforceable, employees may not know it, and the very existence of the noncompete language may discourage employees from subsequent competition.

"We won't seek to enforce it," they may rationalize, "and if pushed, we will rely on the severability clause of our agreement which states that any unlawful provisions should be severed and the rest of the agreement enforced." These employers are counting on the in terrorem effect of the noncompete to keep employees in line.

The Supreme Court in Edwards had an answer to this practice: knowingly imposing an unlawful contract provision on an employee is an "independently wrongful act" that can support a tort claim against the employer (interference with prospective economic advantage).

In so ruling, the Court approved the language in D'sa v. Playhut, Inc. (2000) 85 Cal.App.4th 927, 933, in which the appellate court held it against public policy for an employer to "make the signing of an employment agreement, which contains an unenforceable covenant not to compete, a condition of continued employment."

But more than this, knowingly imposing unlawful contract terms on employees is against the statutory law of the State. California Labor Code Section 432.5 states very clearly that "[n]o employer…shall require any employee or applicant for employment to agree, in writing, to any term or condition which is known by such employer… to be prohibited by law."

Indeed, Aetna was once hit with a $1 million punitive damage award for imposing an unlawful noncompete on a California employee. Walia v. Aetna Inc., (2001) 93 Cal.App.4th 1213. (The opinion was later depublished at Walia (2002) 41 P.3d 548, 117 Cal. Rptr. 2d 541, but the point is the same – don't do it!)

What this means is that all employers of California workers had better take a look at their employment policies immediately and take steps to purge from them any non-solicitation or other covenants that restrict the rights of employees to pursue post-employment work.

Trade Secrets To The Rescue

So with the outlawing of non-solicitation agreements, what's a California employer to do? Is there no way a business can hire employees, teach them the ropes, and feel

comfortable that the employees wont take that investment and turn on the employer? Must California employers be in the business of training their own competition?

Yes and no. Yes, employers will always be training their competition. Workers develop skills and knowledge of an industry by working in it. This knowledge cannot be erased from a worker's memory. They will always have that training and will rely on that training and experience to remain employed. How many law firm associates have become trained as lawyers at large firms only to leave for a new firm, eventually competing for the same clients as his or her former boss?

This is precisely the type of competition and employee mobility that Section 16600 was intended to foster and protect. 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 Inc. v. Hunter Group Inc. (1998) 61 Cal.App.4th 881.

Accordingly, employers cannot stop their workers from utilizing general information about a profession or industry learned on the job.

On the other hand, employers can protect their most sensitive information. They can protect their trade secrets. Indeed, they can prevent their employees from leaving the company and utilizing those trade secrets in any manner whatsoever, including in competition.

Further, they can protect those secrets forever. Unlike the former "limited restraint" exception to 16600 (or the "reasonableness" test utilized in other states) which require any restrictive covenant to be limited in scope and time, protection of trade secrets is unlimited.

And perhaps best of all, the protection of trade secrets is not an implied exception to any statute; it is a legislatively derived doctrine recognizing the importance of protecting business intellectual property. This is captured in the California Uniform Trade Secret Act at Civil Code Section 3426 et seq.

What this means for employers in California is that they should purposefully and carefully protect their most valuable information as a trade secret.

Besides, of course, keeping the critical blueprints or secret formula under lock and key, employers should also protect the type of information an employee might like to have in order to start competing, such as the names and contact information of clients, their business goals, their budgets, their strategies, their specific needs and preferences, the identities and contact information of the client's key personnel, and the names and identities of important independent contractors and vendors.

Even the identity of the employer's own key personnel and the special skills they have could be considered trade secrets. See e.g., Morlife Inc. v. Perry (1997) 56 Cal. App. 4th 1514 (confidential client lists constitute trade secrets); Whyte v. Schlage Lock Co. (2002) 101 Cal. App. 4th 1443, 1456 (advertising and marketing strategies, plans and techniques are trade secrets).

With former employees unable to "misappropriate" this information (i.e., use it in a manner that is outside their authority, such as in post-employment competition), it will be much harder for a former employee to subsequently compete.

Even Trade Secrets Have Their Limitations In California

One might think that forbidding California employees from utilizing trade secret customer information in their subsequent efforts at employment would run afoul of

California's otherwise lenient policies favoring employee mobility. And one would be right.

Courts have struggled mightily with how to deal with the competing interests reflected by the desire to protect employer secrets without inhibiting employee mobility. In the trade secret context, California courts have resolved this conflict (at least for now) by distinguishing between post-employment "announcements" and "solicitation."

In California, employees can be prohibited from soliciting customers whose identities have been protected by the former employer as trade secrets, but they cannot be prohibited from announcing their change of employment affiliation to those very same customers.

Announcements (Good) v. Solicitations (Bad)

Does this sound like legal legerdemain? Or is there really an identifiable and practical difference between soliciting a client and announcing a new affiliation with a competitor? Certainly at the outer edges there appears to be a conceptual difference between:

a) "Hi, I used to work for you at Company X. I now work at Company Y and we are much better than X. You should give me your business over here at Company Y and we will provide you with much better service at much cheaper prices. And I'll throw in a free iPod."

and

b) "Hi, I now work at Company Y with an address and phone number of…."

Most would agree that the former is “solicitation” and the latter merely an “announcement” of new employment affiliation. But what about that murky, blurry area in the middle?

The courts, while all too happy to provide us with plenty of words in an effort to distinguish between improper solicitation and proper announcements, have only been marginally successful at providing any real practical guidance.

Announcements

In this employee-friendly state, an employee’s right to announce his or her new employment is considered “basic to an individual’s right to engage in fair competition,” even with the understanding that the purpose of announcing a change of employment or the commencement of self-employment is the hope that customers will follow. (American Credit Indemnity Co. v. Sacks, 213 Cal.App.3d 622, 636 (1989).)

This right to announce one’s new affiliation has been upheld even where the announcements are made to clients on a protected trade secret client list! (In the eyes of The Law, “announcement” is not considered a misuse or misappropriation of a trade secret client list, while “solicitation” is.) (See, e.g., Sacks, 213 Cal.App.3d at 634-36; Hilb Rogal and Hamilton Ins. Servs. of Orange County Inc. v. Robb, 33 Cal.App.4th 1812, 1822 n.6 (1995).)

California courts have routinely held that the willingness to discuss business, and receive business, when invited to do so by the former employer’s customers is not solicitation.

In other words, if the employee makes an “announcement,” and in response the customer suggests doing business together, The Law will not stand in the way. Customers get to do

business with whomever they want, trade secret list be damned. (Theodore Ins. Agency Inc. v. Morady, 2006 WL 2130295, at *8 (Cal. App. Aug. 1, 2006).)

Solicitation

Unfortunately, while "solicitation" of trade-secret-protected customers is considered unlawful, California courts have done little to help businesses and workers understand the critical distinction between "announcement" and "solicitation." Which is not to say courts haven't tried.

The California Supreme Court, for instance, has provided plenty of words to define "solicitation:"

"[t]o ask for with earnestness, to make petition to, to endeavor to obtain, to awake or excite to action, to appeal to, or to invite. ... It implies personal petition and importunity addressed to a particular individual to do some particular thing ... It means: To appeal to (for something); to apply to for obtaining something; to ask earnestly; to ask for the purpose of receiving; to endeavor to obtain by asking or pleading; to entreat, implore, or importune; to make petition to; to plead for; to try to obtain." (Aetna Bldg. Maintenance Co. v. West, 39 Cal.2d 198, 204 (1952).)

But do these words really help determine whether a former employee's flyer, sent to 35 key customers of the former employer asking the customer to "Visit me in the new location….[¶] I'll be available … for your automotive services. Please ask for Andre" is a lawful announcement or an unlawful solicitation? (Lawful; see Dalla Inc. v. Petrossian, 2004 WL 909241, at *3 (Cal. App. Apr. 29, 2004) (unpublished).)

Or do they help determine whether a personal visit to the former employer's customer will be considered "importuning" and hence unlawful? (Unlawful: MAI Systems Corp. v.

Peak Computer Inc., 991 F.2d 511 (9th Cir 1993). Lawful: Aetna Bldg. Maintenance Co. v. West, 39 Cal.2d 198, 204 (1952).)

It's A Mine Field

In reality, regardless of the words used to define the concepts of "announcement" and "solicitation," the line between permissible and impermissible conduct must always remain a blurry one. Where legitimate public policy interests hit head on, as they do here in the ceaseless conflict between employer and employee rights, bright line distinctions cannot be made without sacrificing the important rights of one segment of the workforce or the other.

And hence, employers and employees both must proceed with caution, particularly when employees are moving from one competitor to another. It is a mine field for the unwary, and you don't want to be caught stepping in the wrong place.

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