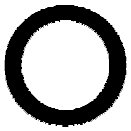

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CALIFORNIA LAW ON RESTRICTIVE COVENANTS AND TRADE SECRETS

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A. Under California Law, Employee Covenants Not to Compete upon Termination of Employment Are Void

1. The California Rule and Its Application

California (along with Montana, North Dakota and Oklahoma) does not follow the general rule that covenants not to compete are valid if they are reasonable in purpose and scope. California Business and Professions Code section 16600 provides that, "[e]xcept as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade or business of any kind is to that extent void." California courts have rigorously applied this provision in the employment context and have routinely invalidated agreements purporting to preclude employees (either expressly or implicitly through penalties) from working for competitors upon completion of their employment. *See*, *e.g.*, *Application Group, Inc. v. Hunter Group, Inc.*, 61 Cal. App. 4th 881, 895 (Cal. Ct. App. 1998); *Metro. Traffic Control, Inc. v. Shadow Traffic Network*, 22 Cal. App. 4th 853, 859-60 (Cal. Ct. App. 1994); *Scott v. Snelling & Snelling, Inc.*, 732 F. Supp. 1034, 1042-43 (N.D. Cal. 1990). Employee non-compete covenants are void in California even if they are reasonably limited in time and geographic scope. *See Scott*, 732 F. Supp. at 1042-43.

Not only are non-compete covenants void in California, but an employer may be liable in tort for wrongful termination if it fires an employee who refuses to sign an employment agreement that contains an unenforceable covenant not to compete. *D'Sa v. Playhut, Inc.*, 85 Cal. App. 4th 927 (Cal. Ct. App. 2000). This rule holds even if the agreement contains a choice-of-law or severability provision. *Id*. at 934. The concern is that the presence of an unenforceable non-compete covenant in an employment agreement may have an undesirable deterrent effect on employees who do not know their rights under California law. "[I]t is not likely that [the defendant's] employees are sufficiently versed in California's law of contracts such that they would know (1) that the covenant not to compete is invalid and therefore not enforceable by [the defendant] and (2) that they could sign the agreement without fear they would be bound by the covenant not to compete." *Id*.

The California rule embodied in section 16600, however, invalidates only those restraints that apply after termination of employment. During the term of employment, of course, each employee owes a common-law duty of loyalty to the employer (which may be underscored by a contract to that effect) precluding the employee from competing with the employer in any way, whether by soliciting the employer's customers or employees, by using the employer's trade secrets, or otherwise.

a. The Policy Behind the California Rule

California has a "strong public policy" against the enforcement of restrictive covenants in the employment context. *Scott*, 732 F. Supp. at 1039-40. According to the California Supreme Court:

> *Every individual possesses as a form of property, the right to pursue any calling, business or profession he may choose. A former employee has the right to engage in a competitive business*

> *for himself and to enter into competition with his former employer, even for the business of those who had formerly been the customers of his former employer, provided such competition is fairly and legally conducted.*

Cont'l Car-Na-Var Corp. v. Moseley, 24 Cal. 2d 104, 110 (Cal. 1944). "The interests of the employee in his own mobility and betterment are deemed paramount to the competitive business interests of the employers, where neither the employee nor his new employer has committed any illegal act accompanying the employment change." *Diodes, Inc. v. Franzen*, 260 Cal. App. 2d 244, 255 (Cal. Ct. App. 1968).

b. Choice-of-Law Provisions Cannot Be Used to Avoid the California Rule

Employers cannot avoid the application of the California rule by inserting a choice of law provision into the employment agreement purporting to select the law of another state to govern disputes arising out of the agreement. If the term of employment is to be carried out substantially in California, section 16600 will apply, regardless of any choice of law provision. *See, e.g., Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 20 Cal. App. 3d 668, 673 (Cal. Ct. App. 1971); *Scott*, 732 F. Supp. at 1039-41.

California's interest in enforcing section 16600 is so strong that in *Application Group, Inc. v. Hunter Group, Inc.*, 61 Cal. App. 4th 881 (Cal. Ct. App. 1998), a California court of appeal invalidated and refused to enforce an *out-of-state* non-compete agreement signed by an *out-of-state* employee who quit his job and took a new job with a California employer. In other words, the California court invalidated a non-compete agreement that was unquestionably valid in the state in which it was entered, just because the employee planned to move to California to take the new job. Likewise, in *Robinson v. Jardine Ins. Brokers Int'l Ltd.*, 856 F. Supp. 554 (N.D. Cal. 1994), the court issued a preliminary injunction enjoining the defendant (the plaintiff's former employer) from enforcing in the United States a temporary restraining order issued by the English courts that prohibited the plaintiff from doing business with the defendant's clients, regardless of who initiated contact, on the ground that the restriction was invalid under section 16600. As discussed in the following section, however, the court may not have had the power to issue such an injunction if the temporary restraining order had been issued by a state court rather than an English court.

The California Supreme Court, however, has since softened somewhat the harsh effect of this rule in *Advanced Bionics Corp. v. Medtronics, Inc.,* 29 Cal. 4th 697 (Cal. 2002). In *Advanced Bionics*, the Supreme Court reversed the lower California court's issuance of a temporary restraining order that prohibited a former employer in Minnesota from taking any steps to further its Minnesota action against the former Minnesota employee that had moved to California. The Court held that section 16600 was not so strong as to constitute an exceptional circumstance warranting enjoining proceedings that were initiated in Minnesota *before* the California action had been initiated. The court noted, however, that the employee was free to continue the California action while the Minnesota action proceeded.

Similarly, the court in *Jones v. Humanscale Corp.*, 130 Cal. App. 4th 401 (Cal. Ct. App. 2005), recognized that a New Jersey arbitrator did not exceed his authority by enforcing a non-compete clause. Here, the parties agreed to arbitrate "any dispute involving the performance, interpretation of [sic] breach of this agreement or the relationship created hereby, including…disputes involving…discrimination and other rights and protections afforded by … law." *Id*. at 409. The agreement further includes a New York choice-of-law provision, and expressly authorized an arbitrator to modify any part of the non-compete covenant found unenforceable. The court opined that none of the cases on which plaintiff attempted to rely, including *Application Group*, involved judicial review of an arbitrator's findings as to the enforceability of a covenant not to compete in a contract containing a choice-of-law provision applying the law of another state. Additionally, the court found that the arbitrator's findings and decision were not palpably erroneous under California law. For discussion of specific instances where California courts have enforced non-compete clauses that limited, but did not prohibit competition, *see* Section III.E.2.a., *infra*.

In *Bennett v. Medtronic, Inc.*, 285 F.3d 801 (9th Cir. 2002), several employees of a Tennessee company, Medtronic, sought to ignore the non-compete covenants in their employment agreements and move to NuVasive, a competing company in California. Medtronic sued NuVasive in Tennessee state court and, on the same day, the employees sued Medtronic in California state court. After Medtronic moved the California case to federal court, the employees sought, and the federal court granted, a temporary restraining order (characterized by the Ninth Circuit as a preliminary injunction) prohibiting Medtronic from proceeding with the Tennessee action. The Ninth Circuit held that this order violated the Anti-Injunction Act, 28 U.S.C. § 2283, which prohibits a federal court from enjoining state court proceedings except in limited circumstances. The court found that "[t]he Act creates a presumption in favor of permitting parallel actions in state and federal court" and that none of the exceptions applied. *Id*. at 805-07. In particular, the court found that the injunction was not "necessary in aid of the federal court's jurisdiction." *Id*. at 807.

Finally, a 2010 decision by a New York court in *Marsh USA, Inc. v. Hamby*, No. 600306-2010, 2010 WL 2927261 (N.Y. Sup. Ct. July 22, 2010), provides another example of a typical cross-border dispute involving New York and California. In *Marsh*, the plaintiff Marsh brought an action in New York State Supreme Court against one of its competitors, Dewitt Stern Group, Inc., and two of its former employees who had joined Dewitt, alleging that the former employees had breached their non-compete agreements and that Dewitt and the two former employees had misappropriated trade secrets. At all relevant times the two former Marsh employees had worked for Marsh in California, had resided in California, and went to work for Dewitt in California. However, the non-compete agreements had New York choice of law and venue provisions. Dewitt and the two employees filed a declaratory judgment action in California state court, arguing that California law should apply to the agreements and that the non-compete agreements were unenforceable under California law. The California court rejected this argument and granted Marsh's motion to quash and stay the California action, allowing the action to proceed in New York. Meanwhile, the New York court denied Dewitt's motion to dismiss on *forum non conveniens* grounds and held that the New York choice of law and venue provisions were enforceable because (a) both Marsh and Dewitt had a global presence and maintained their principal places of business in New York, and (b) the two former employees were sophisticated individuals who were compensated for signing the non-compete agreements.

Most recently, a 2012 decision by a California Southern District court in Arkley v. Aon Risk Services Companies, Inc., 2012 U.S. Dist. LEXIS 96330 (C.D. Cal. June 13, 2012) held that California law applied to the Illinois employment agreements because California's "strong policy interest" in employee mobility outweighs Illinois' stated interest of fostering predictability for companies. The court further reasoned that California has a strong interest in "enforcing its laws to protect California-resident employees." The court acknowledged that the plaintiffs had many business connections with the state of Illinois. However, because all three plaintiffs were residents of California and had their main offices in California before and after they switched jobs, the court held that California law applied to their employment contracts, making the non-compete clause invalid.

c. California Courts Will Not Rewrite an Overly Broad Non-Compete Provision to Make It Valid

The burden is on the employer to draft a noncompetition provision that will pass muster under section 16600. California courts will not rewrite an overly broad provision to make it valid. *See Kolani v. Gluska*, 64 Cal. App. 4th 402, 408 (Cal. Ct. App. 1998); *D'Sa*, 85 Cal. App. 4th at 934-35;[1] *but see Armendariz v. Found. Health Psychcare Servs., Inc.*, 24 Cal. 4th 83, 123, 124 n.13 (Cal. 2000) abrogated, in part, on other grounds by *AT&T Mobility LLC v. Concepcion ,* 131 S.Ct. 1740 (U.S. 2011) ("overbroad covenants not to compete may be restricted temporally and geographically," citing *Gen. Paint Corp. v. Seymour*, 124 Cal. App. 611, 614-15 (Cal. Ct. App. 1932), and will be invalidated only upon showing of bad faith). Rewriting a covenant would undermine the policy underlying section 16600. *Kolani*, 64 Cal. App. 4th at 408. If rewriting were permitted:

> *Employers could insert broad, facially illegal covenants not to compete in their employment contracts. Many, perhaps most, employees would honor these clauses without consulting counsel or challenging the clause in court, thus directly undermining the statutory policy favoring competition. Employers would have no disincentive to use the broad, illegal clauses if permitted to retreat to a narrow, lawful construction in the event of litigation.*

Id. For tips on drafting a narrow, enforceable covenant not to use or disclose an employer's trade secrets, *see* Section VI.A.1., *infra*.

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[1] For a non-California decision holding a federal court had no obligation to fix a flawed non-competition agreement, *see Cintas Corp. v. Perry*, 517 F.3d 459 (7th Cir. 2008) (finding that "judicial modification of unreasonable or overbroad non-compete provisions … is discretionary, not mandatory," and therefore refusing to "blue-pencil" the agreement to make it enforceable).

2. California Courts May Enforce Certain Types of Non-Compete Clauses That Limit, But Do not Prohibit, Competition

a. Covenants by Employees Not to Use or Disclose Their Employers' Trade Secrets Are Enforceable in California

Agreements not to use or disclose the company's trade secrets during and after the term of employment or contractual engagement are fully enforceable. *See, e.g., Muggill v. Reuben H. Donnelley Corp*., 62 Cal. 2d 239, 242 (Cal. 1965); *Am. Credit Indem. Co. v. Sacks*, 213 Cal. App. 3d 622, 633-34 (Cal. Ct. App. 1989). In *Morlife, Inc. v. Perry*, 56 Cal. App. 4th 1514 (Cal. Ct. App. 1997), the court affirmed an injunction prohibiting two former employees from: (1) doing business with any company that switched its business to the employee's new business as a result of the employee's use of the former employer's trade secret customer information, and (2) soliciting any business from any entity that did business with the former employer before the employees stopped working there.

An employer cannot, however, prevent an employee from using or disclosing non-trade secret information simply by defining the information as a trade secret in the employee's non-disclosure agreement. *See, e.g., American Paper*, 183 Cal. App. 3d at 1325 ("An agreement between employer and employee defining a trade secret may not be decisive in determining whether the court will so regard it"). Nevertheless, there are at least two reasons why an employment agreement that contains a covenant not to use or disclose the employer's trade secrets should attempt to define the trade secrets being protected, and with some degree of specificity (but not in so much detail that unlisted trade secrets will be deemed not to be protected by the agreement).

First, putting employees (and others) on notice as to what information the employer considers a trade secret is an important step in the process of establishing a trade secret. Second, the courts are disinclined to enforce agreements requiring employees to keep confidential vaguely defined information the company later decides it would like to protect. *See generally Motorola, Inc. v. Fairchild Camera & Instrument Corp*., 366 F. Supp. 1173, 1185 (D. Ariz. 1973) (applying California law and refusing to enforce agreements in which employees agreed to "maintain strictly confidential during [and for two years after] my employment all ... information of the company ... which is of a confidential or secret nature").

However the protected information is defined in the agreement, it should be coupled with an acknowledgment by the employee that the information is owned by the employer, is secret, is the subject of reasonable efforts by the employer to keep it secret, and has value because of its secrecy. (These are the standards for establishing under the Uniform Trade Secrets Act that the information is a trade secret.)

The contract should, of course, provide that the employee will not use or disclose the information during or after employment, and should expressly provide that the employee's duties extend until the information becomes generally known through proper means. It should also require the return of all notebooks, documents, computer disks, and the like upon the termination of employment.

Further, although not necessary, a non-disclosure agreement is a useful tool for helping to protect an employer's trade secrets. While the courts have held in numerous cases that an employer may prevent an ex-employee from using or disclosing its trade secrets under the tort theory of trade secret misappropriation even in the absence of a non-disclosure agreement, *see, e.g., Morlife, Inc. v. Perry*, 56 Cal. App. 4th 1514, 1522 (Cal. Ct. App. 1997); *Klamath-Orleans Lumber, Inc. v. Miller*, 87 Cal. App. 3d 458, 465 (Cal. Ct. App. 1978), such agreements are useful for many reasons.

First, by notifying the employee of the existence of trade secrets, the employer diminishes the risk of inadvertent disclosure to others and serves to deter the employee (and his or her new employer) from using the information. Second, an agreement helps to eliminate disputes and misunderstandings about the trade secret status of confidential information. Third, as noted above, a contractual obligation to preserve the secrecy of information is evidence of the employer's "reasonable efforts" to maintain the secrecy of its confidential information, and thus helps to establish its status as a trade secret under the Uniform Trade Secrets Act.

b. Prohibition Against a Limited Subset of Activities

In *Edwards v. Arthur Andersen LLP*, 44 Cal. 4th 937 (Cal. 2008), the plaintiff challenged the enforceability of a non-compete agreement that he signed when he was hired in 1997. The California Supreme Court held that the non-compete agreement was unenforceable. The court considered the "narrow restraint" exception that had found support in a handful of federal court decisions. In those cases, the courts had held that non-compete agreements that resulted in only a "partial" or "narrow" restraint on an employee's ability to work in his or her chosen profession were reasonable and enforceable. The court rejected this exception, finding that the state's public policy—expressed in California Business and Professions Code section 16600—does not permit such a restraint, even if it is narrow or limited.

Plaintiff also argued that he was wrongfully terminated for refusing to execute a general release of all claims that arguably would have involved non-waivable statutory claims. The court rejected the lower court's ruling that general releases that contain a release of "any and all claims" are invalid. The court found it unreasonable to read such a general release as purporting to release indemnification rights, which are expressly made non-waivable by statute. To do otherwise would be to interpret the contract as unlawful, violating basic principles of contract interpretation. Accordingly, the court found that the "any and all claims" release was not unlawful.

Edwards clarifies and reaffirms California's longstanding public policy in favor of open competition and employee mobility, and it rejects non-compete agreements drafted to comply with the "narrow restraint" exception. The decision did not address other limited exceptions to the general prohibition on post-employment non-compete agreements such as the so-called trade exception, which allows employers to use non-compete or non-solicitation provisions if their purpose is to protect trade secrets. To the extent that existing non-compete agreements were drafted to comply with the "narrow restraint" exception, employers should re-examine these agreements, refrain from attempting to enforce them, and consider replacing them altogether with appropriate and enforceable agreements.

c. The Trade Secrets Exception

Many courts have suggested a "trade secrets exception" to section 16600 whereby a covenant not to compete might be upheld if its purpose is to protect trade secrets. The California Supreme Court in *Edwards* expressly declined to address this exception. The California court of appeals in *Retirement Group*, however, squarely addressed the issue and held that any such contractual provision is void.

In *Ret. Grp. v. Galante*, 176 Cal. App. 4th 1226 (Cal. Ct. App. 2009), a dispute arose between investment advisers and their former employer over customer contact information. When advisers entered into an independent contractor relationship with The Retirement Group ("TRG"), they signed an agreement that defined TRG's confidential information to include the client information in its database, and required advisers to not disclose or use this information except as provided by the agreement. When Galante and other advisers left TRG to work for a competitor, they advised their TRG clients of the move, which provided the customer with the opportunity to retain the adviser's services and to designate their new employer, rather than TRG, as their securities brokerage.

TRG filed an action alleging that (1) the departing advisers misappropriated confidential information from TRG's database, which allegedly constituted trade secrets, and (2) the advisers were using the information to solicit existing TRG clients and other prospective customers to place their accounts with TRG's competitor, in violation of their agreements. The court held that customer lists can qualify for trade secret protection under unfair competition law and the Uniform Trade Secrets Act, Civil Code section 3426 *et seq.*, such that a former employee may be barred from using trade secret information to solicit their former employer's customers. However, the court considered this protection from tortious conduct existing independently from the enforcement of any contractual obligations not to compete. *Citing Thompson v. Impaxx, Inc.*, 113 Cal. App. 4th 1425, 1429 (Cal Ct. App. 2003) (information about customers could be protected because it was "confidential, proprietary, and/or a trade secret"; not because the non-solicitation covenant "passed muster under section 16600").

The *Retirement Group* court held that section 16600 bars enforcement of a non-compete covenant, without exception. The court further held that trade secret protection was not available for TRG's client contact information, because TRG did not dispute that names and contact information of existing customers were readily available from independent third-party sources such as rival brokerages. *See also Dowell v. Biosense Webster, Inc.*, 179 Cal.App.4th 564, 577 (Cal. Ct. App. 2009) (citing *Retirement Group* and questioning continued validity of trade secret exception).

On the other hand, there are several courts pre-*Edwards*, and at least two courts post *Edwards*, that suggest the trade secrets exception is still alive and well. *See Whyte v. Schlage Lock Co*., 101 Cal. App. 4th 1443, 1462 (Cal. Ct. App. 2002) ("the California Supreme Court recognized covenants not to compete are enforceable notwithstanding Business and Professions Code section 16600 if 'necessary to protect the employer's trade secrets,'" citing *Muggill v. Reuben H. Donnelley Corp*., 62 Cal. 2d 239, 242 (Cal. 1965)); *Fowler v. Varian Assocs.*, 196 Cal. App. 3d 34, 44 (Cal. Ct. App. 1987) ("agreements designed to protect an employer's proprietary information do not violate Section 16600"); *Loral Corp. v. Moyes*, 174 Cal. App. 3d

268, 276 (Cal. Ct. App. 1986) ("Section 16600 does not invalidate an employee's agreement not to disclose his former employer's confidential customer lists or other trade secrets or not to solicit those customers"); *ReadyLink Healthcare v. Cotton*, 126 Cal. App. 4th 1006, 1022 (Cal. Ct. App. 2005) ("If a former employee uses a former employer's trade secrets or otherwise commits unfair competition, California courts recognize a judicially created exception to section 16600 and will enforce a restrictive covenant in such a case"); *Latona v. Aetna U.S. Healthcare, Inc*., 82 F. Supp. 2d 1089, 1096 (C.D. Cal. 1999) ("Employment restrictions that serve to protect a former employer's trade secrets, proprietary information, and confidential information are valid in California."); *cf.*, *Bank of Am., N.A. v. Lee*, No. CV 08-5546 CAS(JWJx), 2008 U.S. Dist. LEXIS 110410, at *6 (C.D. Cal. Sept. 22, 2008) (the "'trade secret exception' to § 16600 still applies. Nothing in *Edwards* is to the contrary."); *Applied Materials, Inc. v. Advanced Micro-Fabrication Equip. (Shanghai) Co.*, 630 F. Supp. 2d 1084, 1090 n.7 (N.D. Cal. 2009) ("case law amply supports the existence of [a trade secret] exception").

d. Other Statutory Exceptions Allowing Restraints on Competition

As recognized by the *Edwards* court, there are statutory exceptions to section 16600 where parties may enter into enforceable covenants not to compete. These exceptions include the sale of goodwill or corporate stock of a business, Cal. Bus. & Prof. Code § 16601, or the dissolution of a partnership, Cal. Bus. & Prof. Code § 16602. Under these statutes, covenants have been upheld where the defendant arguably only had a limited ability to compete with the plaintiff. For instance, in *Vacco Indus., Inc. v. Van Den Berg*, 5 Cal. App. 4th 34 (Cal. Ct. App. 1992), the court upheld a non-compete agreement that the defendant entered into when he sold his stock, which totaled only 3% of the outstanding shares, to an acquiring company. The court found that the "purchaser of a business is entitled to negotiate and enforce an agreement by the seller(s) of the business imposing a reasonable restriction on competition by the seller(s) on the theory that such competition would diminish the value of the business which had been purchased." *Id*. at 48.

California courts will not enforce a non-compete covenant in a stock purchase agreement if it appears that the agreement is merely "a sham devised to circumvent California's policy against such agreements as expressed in section 16600." *Hill Med. Corp. v. Wycoff*, 86 Cal. App. 4th 895, 905 (Cal. Ct. App. 2001). "[T]here must be a clear indication that in the sales transaction, the parties valued or considered goodwill as a component of the sales price, and thus, the share purchasers were entitled to protect themselves from 'competition from the seller which competition would have the effect of reducing the value of the property right that was acquired.'" *Id*. at 903 (quoting *Monogram Indus., Inc. v. Sar Indus., Inc.*, 64 Cal. App. 3d 692, 701 (Cal. Ct. App. 1976)). In *Hill Medical*, for example, the court invalidated a non-compete covenant that applied when the defendant physician quit his job and sold his shares in the practice back to the corporation, where there was no evidence that the repurchase price compensated the defendant for the sale of goodwill. *Id*. at 906-07.

On August 24, 2012, a California Court of Appeal clarified when an employment agreement can satisfy the "sale of business" exception to California's general ban on post-employment non-compete provisions. *See Fillpoint, LLC v. Maas*, 208 Cal. App. 4th 1170

(2012). The Court held that when a stock purchase agreement's non-compete clause already adequately protects the goodwill of the sold business, any inconsistent and additional non-compete protection in a related employment agreement with the purchasing company may not be enforceable. The holding signals that an employment agreement's non-compete covenant does not automatically qualify for the "sale of business" exception simply because it is part of the same transaction as a stock purchase agreement.

The Court of Appeal held that the trial court erred by reading the stock purchase and employment agreements separately. Rather, when these types of agreements are entered into at or around the same time, they should be treated as one transaction. Nevertheless, reading these two agreements as part of the same transaction did not automatically render both covenants enforceable and subject to the Section 16601 business purchase exception. Because the non-compete in Maas' stock purchase agreement sufficiently protected the goodwill consideration of the business purchase, the employment agreement's additional and different protection was overly broad and unenforceable. In dictum, the Court postulated that a covenant not to compete in an employment agreement, even when absent from the parallel stock purchase agreement, could fall within the exception if it was, in fact, entered into as consideration for the sale of business.

The Court of Appeal carefully distinguished the facts and legal principles from several prior cases, and this decision is essential reading for structuring non-compete provisions as part of a business sale.

3. Enforcement of Non-Solicitation Clauses

a. What Is "Solicitation"?

Even California courts are willing to enforce narrowly crafted non-solicitation clauses. The case law, however, does not clearly define "solicitation." Nonetheless, some guidelines have emerged regarding the types of conduct that may and may not be enjoined by a non-solicitation agreement. First, an employee may passively accept business from the former employer's clients despite a non-solicitation agreement. *See, e.g., Golden State Linen Serv., Inc. v. Vidalin*, 69 Cal. App. 3d 1, 8 (Cal. Ct. App. 1977). Second, "merely informing customers of one's former employer of a change of employment, without more, is not solicitation." *Aetna Bldg. Maint. Co. v. West*, 39 Cal. 2d 198, 204 (Cal. 1952). Note, however, that if the customers' identities are trade secrets, merely calling them to announce a change of employment may be a misappropriation of trade secrets. *Moss, Adams & Co. v. Shilling*, 179 Cal. App. 3d 124, 128-30 (Cal. Ct. App. 1986).

One court explained that any customer contact that "personally petitions, importunes and entreats … customers to call … for information about the better [products or services] [the departing employee] can provide and for assistance during the … transition period … is endeavoring to obtain their business [is] …, in a word, solicit[ation]." *Am. Credit Indem. Co. v. Sacks*, 213 Cal. App. 3d 622, 636 (Cal. Ct. App. 1989) (enjoining employee where former employee's "announcement letter" said "if you would like to learn more about the [new

employer's product], I will be happy to discuss it with you when you are ready to review your ongoing credit insurance needs at renewal time."); *see also Robert L. Cloud & Assocs., Inc. v. Mikesell*, 69 Cal. App. 4th 1141, 1150 (Cal. Ct. App. 1999) (holding similarly); *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Chung*, No. CV 01-00659, 2001 WL 283083 (C.D. Cal. Feb. 2, 2001) (personal follow-up phone calls constituted solicitation).

b. Customer Solicitation

In California, an employee's covenant not to solicit the employer's customers after termination of employment is generally unenforceable under section 16600. However, as noted above, it is unclear whether a trade secrets exception would apply. *Compare Thompson v. Impaxx*, *Inc.*, 113 Cal. App. 4th 1425, 1429 (Cal. Ct. App. 2003) (non-solicitations are void "*except where their enforcement is necessary to protect trade secrets*"); *Loral Corp. v. Moyes*, 174 Cal. App. 3d 268, 276 (Cal. Ct. App. 1985) ("Section 16600 does not invalidate an employee's agreement not to disclose his former employer's confidential customer lists or other trade secrets or not to solicit those customers"), *and Bank of Am., N.A. v. Lee*, No. CV 08-5546 CAS(JWJx), 2008 U.S. Dist. LEXIS 110410, at *6 (C.D. Cal. Sept. 22, 2008) (the "'trade secret exception' to § 16600 still applies. Nothing in *Edwards* is to the contrary."), *with Ret. Grp. v. Galante*, 176 Cal. App. 4th 1226 (Cal. Ct. App. 2009) (denying enforcement of non-competes without exception); *and Dowell v. Biosense Webster, Inc.*, 179 Cal.App.4th 564, 577 (Cal. Ct. App. 2009) (questioning continued validity of trade secret exception). On the one hand, companies typically contend in these contexts that information regarding the identities, addresses, and key contact people of customers, as well as the customers' peculiar needs, desires, and pricing/bidding constraints, are trade secrets and, therefore, necessitate a non-compete. *Impaxx*, 113 Cal. App. 4th 1425. On the other hand, *Retirement Group* stated that non-competes are barred, regardless of the context, although it acknowledged that trade secrets could be protected independent of non-competes and non-solicitations.

In addition, there is some California authority, pre-*Edwards*, that upholds covenants not to solicit customers regardless of whether confidential information is involved, *See John F. Matull & Assocs., Inc. v. Cloutier*, 194 Cal. App. 3d 1049, 1054-55 (Cal. Ct. App. 1987) (enforcing non-solicitation covenant that made no mention of trade secrets, and stating that, unlike agreements not to compete, agreements "delimiting how … employee can compete" are not automatically invalid under 16600); *Golden State Linen Serv., Inc. v. Vidalin*, 69 Cal. App. 3d 1, 9 (Cal. Ct. App. 1977) (finding non-solicitation agreement "valid and enforceable" without even addressing whether the employee's solicitation involved trade secrets). However, this authority may no longer be valid in light of *Edwards* and other more recent cases. *See Retirement Group*. There is also authority in California, however, that appears to require trade secrets as a condition to enforcement of the non-solicitation covenant. *See, e.g., Thompson v. Impaxx*, *Inc.*, 113 Cal. App. 4th 1425 (Cal. Ct. App. 2003); *Loral Corp. v. Moyes*, 174 Cal. App. 3d 268 (Cal. Ct. App. 1985); *Moss, Adams & Co. v. Shilling*, 179 Cal. App. 3d 124, 130 (Cal. Ct. App. 1986) ("Anti-solicitation covenants are void as unlawful business restraints except where their enforcement is necessary to protect trade secrets"); *Gordon Termite Control v. Terrones*, 84 Cal. App. 3d 176, 179 (Cal. Ct. App. 1978) (refusing to enforce non-solicitation covenant where no trade secrets were used); *Fortna v. Martin*, 158 Cal. App. 2d 634, 639 (Cal. Ct. App. 1958) (same).

In *Thompson v. Impaxx,* defendant Impaxx purchased in September 2000 Pac-West Labels, which was at the time the employer of plaintiff Daniel Thompson. After acquiring Pac-West, Impaxx asked Thompson to sign a covenant that read: "For a period of one (1) year following the termination of employment, I will not (1) call on, solicit, or take away any of Pac-West Label's customers or potential customers with whom I have had any dealings as a result of my employment by Pac-West Label." *Id*. at 1427. After refusing to execute the contract, Thompson was terminated by Impaxx. Thompson then sued Impaxx alleging wrongful termination for refusal to sign what he alleged was an unenforceable covenant not to compete. Impaxx's motion for judgment on the pleadings, claiming the contract was enforceable as written, was granted by the trial court. In reversing the decision, the appellate court repeated the rule that "[a]nti-solicitation covenants are void as unlawful business restraints *except where their enforcement is necessary to protect trade secrets*." *Id.* at 1429 (emphasis added, citing *Moss, Adams & Co. v. Shilling*, 179 Cal. App. 3d 124, 129 (Cal. Ct. App. 1986)). However, the court held that judgment on the pleadings was inappropriate because the complaint stated that the customer information at issue was not trade secrets. *Id.* at 1430 ("the issue of whether information constitutes a trade secret is a question of fact."). Had Impaxx established that this customer information constituted a trade secret, its restrictive covenant might very well have been enforced.

As noted above, in *Retirement Group v. Galante*, 176 Cal. App. 4th 1226 (Cal. Ct. App. 2009), the court held that section 16600 bars a court from specifically enforcing (by way of injunctive relief) a *contractual* clause purporting to ban a former employee from soliciting former customers to transfer their business away from the former employer to the employee's new business, but a court may enjoin *tortious* conduct (as violative of either the Uniform Trade Secrets Act and/or the Unfair Competition Law) by banning the former employee from using trade secret information to identify existing customers, to facilitate the solicitation of such customers, or to otherwise unfairly compete with the former employer. It is not the solicitation of the customers, but is instead the unfair competition or misuse of trade secret information, that may be enjoined. *Id* at 1238 ("section 16600 bars a court from specifically enforcing (by way of injunctive relief) a *contractual* clause purporting to ban a former employee from soliciting former customers to transfer their business away from the former employer to the employee's new business, but a court may enjoin tortuous conduct").

Like California, other states that invalidate non-compete agreements, such as Oklahoma, also harshly construe non-solicitation provisions. *See Cardiovascular Surgical Specialists, Corp. v. Mammana*, 61 P.3d 210, 212 (Okla. 2002) (refusing to enforce non-solicitation clause preventing former surgeon from soliciting, diverting, or accepting referrals from any source for nine months after terminating employment).

Other states have held covenants not to solicit customers are enforceable even if the agreement is not keyed to trade secrets. The court in *John Jay Esthetic Salon, Inc. v. Woods*, 377 So. 2d 1363 (La. App. Ct. 1979), enforced a non-solicitation provision that prevented a former employee from soliciting customers from the former employer hair salon for two years. In doing so, the court held: "An agreement not to engage in competition with the employer is vastly different from an agreement not to solicit the employer's customers or employees or to engage in a business relationship with the employees or contractors." *Id.* at 1366.

c. Competitor Employee Raiding Absent a Non-Solicitation Clause

It is not uncommon for competitors to recruit or "raid" the employer's most talented employees. In fact, the California Supreme Court held that "public policy generally supports a competitor's right to offer more pay or better terms to another's employee so long as the employee is free to leave." *Reeves v. Hanlon*, 33 Cal. 4th 1140, 1151-52 (Cal. 2004).

Under ordinary circumstances, the law does not prohibit competitors, including former employees who now compete with their former employer, and who did not sign a valid non-solicitation contract, from soliciting other at-will employees to leave the employer's workforce. *Metro. Traffic*, 22 Cal. App. 4th at 860 ("As a competitor of Metro, absent a showing of unlawful purpose or means, Shadow is privileged and not liable for inducing Metro's employees to leave and move to Shadow"); *Hollingsworth Solderless Terminal Co. v. Turley*, 622 F.2d 1324, 1337 (9th Cir. 1980) ("Mere solicitation of an employee, under no contract of employment, to leave and associate with a competing firm is not illegal.").

As the court stated in *Diodes, Inc. v. Franzen*, 260 Cal. App. 2d 244, 255 (Cal. Ct. App. 1968):

> *Even though the relationship between an employer and his employee is an advantageous one, no actionable wrong is committed by a competitor who solicits his competitor's employees or who hires away one or more of his competitor's employees who are not under contract, so long as the inducement to leave is not accompanied by unlawful action . . . . In the employee situation the courts are concerned not solely with the interests of the competing employers, but also with the employee's interests. The interests of the employee in his own mobility and betterment are deemed paramount to the competitive business interests of the employers, where neither the employee nor his new employer has committed any illegal act accompanying the employment change.*

See also Reeves, 33 Cal. 4th at 1152-53 (solicitation actionable only if plaintiff proves "that the defendant engaged in an independently wrongful act that induced an at-will employee to leave the plaintiff").

As this statement makes clear, there are a number of exceptions to the general rule allowing employee solicitation (the discussion of which is beyond the scope of this chapter), which give the employer some protection against raiding by former employees and other competitors.

d. Competitor Employee Raiding in Light of a Non-Solicitation Clause

The most common way an employer can prevent raiding by former employees is by including a non-solicitation covenant in the employment contract. As discussed above, these covenants typically provide that, during the employment or contractual engagement, and for a

certain period of time thereafter, the employee or contracting company shall not solicit any of the company's employees for a competing business or otherwise induce or attempt to induce employees to leave their employment.

Under California law, a covenant not to solicit an employer's workforce may be enforceable, even in the absence of actual trade secret misappropriation, provided that there are legitimate trade secrets or other legitimate business interests that are protected by the covenant not to solicit. In *Loral Corp. v. Moyes*, 174 Cal. App. 3d 268 (Cal. Ct. App. 1985), the plaintiffs brought suit against a former executive officer claiming that he had breached his termination agreement by inducing the plaintiffs' employees to work for the defendant's subsequent employer. The termination agreement in *Moyes* provided in part that, as a condition for various salary and severance payments, the defendant would "not now or in the future disrupt, damage, impair or interfere with the business of [the plaintiffs] whether by way of interfering with or raiding its employees, disrupting its relationships with customers, agents, representatives or vendors or otherwise." 174 Cal. App. 3d at 274. The defendant later offered jobs to two key employees of the plaintiffs, and both of these employees eventually went to work for the defendant's new employer.

In determining whether the non-interference covenant was enforceable under section 16600 of the California Business and Professions Code, the court seemed to abandon the notion that the employer could restrain by contract only that conduct which would have been subject to judicial restraint under the law of unfair competition and trade secret misappropriation. Instead, the court applied a rule-of-reason test to the covenant, stating that "enforceability depends upon [the covenant's] reasonableness, evaluated in terms of the employer, the employee, and the public." 174 Cal. App. 3d at 279.

In applying the rule of reason, the court found that, when read to last for only one year, the non-interference covenant was not void under section 16600. The court explained:

> *The restriction presumably was sought by plaintiffs in order to maintain a stable work force and enable the employer to remain in business. This restriction has the apparent impact of limiting [the defendant's] business practices in a small way in order to promote [the employer's] business. This non-interference agreement has no overall negative impact on trade or business.*

174 Cal. App. 3d at 280.

The holding in *Loral Corp.* appears to be inconsistent with dicta in some other California cases. For example, one court has stated that "[t]he corollary to [the] proposition [that a former employee cannot be contractually barred from working for the former employer's competitors] is that competitors may solicit another's employees if they do not use unlawful means or engage in acts of unfair competition." *Metro. Traffic Control, Inc. v. Shadow Traffic Network*, 22 Cal. App. 4th 853, 859 (Cal. Ct. App. 1994); *see also Latona v. Aetna U.S. Healthcare, Inc.*, 82 F. Supp. 2d 1089, 1094-96 (C.D. Cal. 1999) (following *Metro. Traffic*'s reasoning). "The interests of the employee in his own mobility and betterment are deemed paramount to the competitive interests of the employers, where neither the employee nor his new employer has committed any

illegal act accompanying the employment change." *Metro. Traffic*, 22 Cal. App. 4th at 860 (quoting *Diodes, Inc. v. Franzen*, 260 Cal. App. 2d 244, 255 (Cal. Ct. App. 1968)).

Nevertheless, employers can use *Loral Corp.* as authority to support a practice of including covenants not to solicit fellow employees in their employment agreements. Any such covenants should be reasonably limited in time and scope.

While employee non-solicits should be valid in California, one court has suggested that no-hire agreements are invalid, except in narrow settings. In *VL Sys., Inc. v. Unisen, Inc.*, 152 Cal. App. 4th 708 (Cal. Ct. App. 2007), the appellate court found that a "no-hire" provision that broadly prevents one company from hiring any employees of another company seriously impacts the rights of a broad range of third party employees. In this case, Star Trac contracted with VL Systems ("VLS") for computer consulting. The agreement prevented Star Trac from soliciting or hiring VLS employees, regardless of whether they worked for Star Trac or were even employed at the time. Star Trac later hired a VLS employee who did not work on the Star Trac contract and was not employed at the time of the contract. The court found that such a broad provision was unenforceable under California law, and specifically under section 16600. However, the court took "no position on whether a more narrowly drawn and limited no-hire provision would be permissible."

In 2010, the California Court of Appeal's decision in *Silguero v. Creteguard, Inc.*, 187 Cal. App. 4th 60 (Cal. Ct. App. 2010), cited *Edwards* in determining that an agreement between two employers of an employee, one former and one subsequent, to not hire the employee because of an unenforceable non-compete agreement the employee signed with the former employer amounted to a "no-hire" provision and would be unenforceable, just like a non-compete.

In 2003, Silguero began working for Floor Seal Technology, Inc. (FST) as a sales representative. In August 2007, FST threatened to terminate Silguero if she did not sign a confidentiality agreement that prohibited her from all sales activities for eighteen months following departure or termination. Silguero signed the agreement. FST then terminated Silguero. Soon after, Silguero found employment with Creteguard. FST contacted Creteguard and requested cooperation in enforcing the confidentiality agreement prohibiting Silguero from sales activities for eighteen months. Creteguard's chief executive officer informed Silguero in writing that she was terminated because of the non-compete/confidentiality agreement because Creteguard "would like to keep the same respect and understanding with colleagues in the same industry" even though Creteguard did not believe that a non-compete was legally enforceable in California.

The court in *Silguero* determined that section 16600 provides the legislative declaration of public policy necessary to state that Creteguard's termination of Silguero constituted a wrongful termination in violation of public policy. Section 16600 shows legislative policy in favor of open competition and employee mobility; the law ensures "that every citizen shall retain the right to pursue any lawful employment and enterprise of their choice." In finding Creteguard, a third party to the agreement, liable for Silguero's wrongful termination, the court cited *VL Systems*. The appellate court in *VL Systems* found that a "no-hire" provision that prevents one party from hiring the employees of the other party seriously impacts the rights of a broad range of third parties, which would hinder the mobility and betterment of the employee.

This “no-hire” agreement would create the same restrictive problems as a non-compete. Since non-competes are unenforceable in California, “no-hire” agreements should be as well because “the employer should not be allowed to accomplish by indirection that which it cannot accomplish directly.”

Creteguard’s statement that it terminated Silguero because it wanted to “keep the same respect and understanding with colleagues in the same industry” was tantamount to a “no-hire” agreement because that reasoning led Creteguard to enforce FST’s non-compete agreement to the detriment of the employee, Silguero. Therefore, Silguero is able to bring a claim against Creteguard for wrongful termination because Creteguard enforced the non-compete even though Creteguard was a third party to the non-compete.