

Noncompetition Agreements Invalidated

By Kurt Kappes and Robert Milligan

California law favors open competition and employee mobility. While in most of the country a “rule of reason” applies—where a noncompetition clause that is narrowly drafted in its duration, geographic scope and prohibited activities is typically enforceable—this is not the case in California. California law is unique and ensures that every individual retains the right to pursue any lawful employment opportunity he or she chooses. A recent California Supreme Court decision reaffirmed that noncompetition agreements are invalid in California.

California vs. Federal Law

California Business and Professions Code §16600 states: “every contract by which anyone is restrained from engaging in a lawful profession, trade or business of any kind is to that extent void.”

In contrast, the 9th Circuit, the federal appellate court covering California, has applied a “narrow restraint exception” to §16600, allowing noncompetition agreements that have a limited impact on employee mobility. Thus, there used to be a split in authority between the California state court and the federal 9th Circuit, which prompted the California Supreme Court to take the *Edwards* case to settle the issue and reaffirm that noncompetition agreements are invalid in California (see the online sidebar, “The Case: *Edwards v. Arthur Andersen*”).

What to Do

Following *Edwards*, employers should take several steps to ensure compliance with California law on noncompetition agreements.

Audit policies and procedures

After *Edwards* it is very important for employers to have counsel review all proprietary information and proprietary information agreements and protections to assess the nature and scope of the trade secrets and how best to protect such secrets. It is not a good idea for employers to leave in noncompetition language hoping that simply having the language there

will discourage employees from competing after leaving.

Even the existence of a severability clause may not be enough protection.

Consider national vs. individualized agreements

National employers should seriously consider whether to use standardized forms. Companies also should consider drafting a separate agreement for prohibiting solicitation of customers and employees upon leaving a job.

Protect your trade secrets

Contracts that protect trade secrets are upheld and statutory protections of trade secrets exist in the vast majority of states. First, consider whether the information is truly a trade secret (e.g., customer list, marketing plans, business plans, formulas, methods of manufacture, know how, custom performances, buying patterns, cost and pricing information). Next, look at whether the company has made reasonable efforts to maintain secrecy (e.g., access only as needed, documents marked “confidential,” sufficient protection agreements, effective computer usage policies). Also, consider whether the trade secret protections extend beyond the employment relationship (e.g., to independent contractors, vendors, or joint contractors).

National companies should be aware that California permits injunctive relief for actual or even threatened misappropriation of trade secrets.

However, California courts have rejected the theory of “inevitable disclosure”—that a former employee’s new employment will “inevitably” lead him or her to rely on the trade secret.

Consider creative work-arounds

Although California law is strict, there are creative work-arounds that national employers can consider. The Employee Retirement Income Security Act (ERISA) allows forfeiture clauses. Employers can use ERISA plans to enforce noncompetition agreements by requiring employees who compete after leaving to forfeit a por-

tion of their pensions, though they will be subject to ERISA’s vesting requirements. Also, under ERISA top hat plans, employers can include a clause that benefits will be forfeited if the employee competes after leaving. It is an open question whether ERISA would preempt California law.

Employers also can consider using arbitration, forum selection and choice of law provisions to have the agreement enforced in a jurisdiction that looks more favorably on noncompetition agreements; however, they run the risk of finding themselves in a race to judgment where the employee and new employer sue in California to invalidate the agreement and the former employer sues outside of California to enforce the agreement.

California is a pro-employee state. The statute declaring noncompetition agreements invalid has been on the books since the 19th century.

Thus, the *Edwards* decision merely reaffirmed California’s long-held policy in favor of employee mobility. It also did away with the federal court’s attempt to whittle away at this statute through its narrow restraint doctrine.

Audit Agreements

Employers should stay tuned to see what happens next. Will federal courts find a way to distinguish *Edwards* and apply its narrow restraint exception? In the meantime, every national employer should carefully audit its agreements with California employees and remove any noncompetition and nonsolicitation of customers, clients and employees provisions. ♦

Kurt Kappes is an attorney in the Sacramento, Calif., office of Seyfarth Shaw LLP. Robert Milligan is an attorney in Seyfarth Shaw’s Los Angeles office.

