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Walking The Line: Using Non-Solicitation Agreements

by D. Gregory Valenza

In Employment Law 101, we learn California's public policy favors free and open competition for employees' talent. Business and Professions Code Section 16600, concisely provides: "Except 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."

That public policy collides with other laws' protection of competing businesses by, for example, safeguarding intellectual property and prohibiting unfair competition. California's version of the Uniform Trade Secrets Act authorizes strong remedies against trade secret misappropriation, for example. The unfair competition law, Business and Professions Code Section 17200, authorizes injunctions against a wide variety of illegal, fraudulent and unfair business practices. But employment agreements restricting departing employees' activities - to deter them from leaving or using confidential information - are void under Section 16600, except in very limited circumstances. Employers also wish to retain talented workers, in whom they have invested training, recruiting costs and the like.

So, employers and their lawyers must walk the line between unlawful restrictions on competition and lawful measures designed to protect trade secrets and other assets. An agreement not to solicit customers and other employees has been a common way to reduce the damage departing employees may cause by their using and disclosing

trade secrets and other confidential information. The goal is to thwart misuse of employers' valuable customer preferences, employee compensation and training methods, and disruption of employers' valuable investments in customer and employee relationships, without restraining former employees' competition in violation of Section 16600.

The courts in a series of recent decisions have moved the goal posts. With the Court of Appeal's recent decisions in The Retirement Group v. Galante, 176 Cal. App. 4th 1226 (2009) and Dowell v. Biosense Webster, Inc., 2009 DJAR16327, the prophylactic non-solicitation agreement likely no longer is an effective play.

Many employers compile valuable information about customers and employees. They invest time and money sourcing clients and keeping them happy, as well as recruiting, training, and retaining workers. Some confidential information, including data customers and employees, is a competitive advantage only if kept secret. To obtain protections under trade secret protection laws, employers are required to make reasonable efforts to keep such information confidential.

Yet, employers naturally must share with their employees such valuable, confidential information. In the modern business climate, employee turnover is high and loyalty is not always assured. Therefore, when workers depart for new employment, there is risk confidential information will be used against the

former employer or disclosed to third parties, whether intentionally or not.

Until lately, courts have recognized that non-solicitation agreements are valid to protect against misuse of trade secrets and other bona fide confidential information. In particular, such agreements have been enforced against sales persons who leave one employer for another and then use their knowledge of and relationships with customers developed over time.

To reconcile such agreements with Section 16600, the courts have limited the use of non-solicitation agreements to when specific customer information has been held worthy of protection as a trade secret. In Thompson v. Impaxx, Inc., 113 Cal. App. 4th 1425 (2003), for example, the Court of Appeal held that a non-solicitation clause would be upheld only to the extent necessary to protect trade secrets, and not merely customer relationships. The court noted the long line of cases permitting prophylactic non-solicitation agreements necessary to protect confidential customer information that merited protection as trade secrets. This line of authority sometimes is called the "trade secrets exception" to Section 16600.

But the California Supreme Court in Edwards v. Arthur Andersen, 44 Cal.4th 937 (2008), made clear that Section 16600 voids both partial and total limitations on competition. Non-solicitation agreements are one form of partial restraint, in that they preclude an ex-employee from asking the former employers' customers for business, or

seeking to hire away employees. The Court in a footnote refused to hold that a "trade secrets" justification for non-solicitation agreements was valid, or that courts could carve-out any such exception to Section 16600 general prohibitions on "restraints."

Following Edwards, the Court of Appeal in Galante, held that an injunction against solicitation would be upheld only as a remedy for misappropriation of trade secrets: "[S]ection 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 (Civil Code Section 3426 et seq.) and/or the unfair competition law) by banning the former employee from using trade secret information...."

Then, in Dowell v. Biosense Webster, Inc., the court followed Galante and also refused to enforce a non-solicitation agreement in advance of a finding the former employee misappropriated trade secrets. The court found that Biosense Webster's confidentiality agreement went far beyond protection of trade secrets, by prohibiting activities unrelated to using them, and by protecting information that could not be called trade secrets. Therefore, the court did not find it necessary to declare the "trade secrets exception" to Section 16600 officially dead. But after Edwards,

Galante, and Dowell, the prognosis for the exception's survival is not good.

Although non-solicitation agreements designed to prevent misuse of confidential information may not be enforceable, employers may pursue alternative strategies. As stated, a court may enjoin a departed employee from soliciting as a remedy for past misappropriation of trade secrets. The court in ReadyLink Healthcare v. Cotton, 126 Cal. App. 4th 1006 (2005), upheld such an injunction after Cotton stole ReadyLink's trade secrets concerning its staffing business. However, suing a former employee is expensive and, by the time a court enters an injunction, much damage will have been done. So, this avenue is cold comfort to highly competitive businesses seeking to protect trade secrets.

Additionally, employers may sue competitors who intentionally target their employees for hire. "Raiding" a competitor's talent to intentionally injure a competitor is likely an unfair business practice, which may be enjoined, or a tortious interference with contract or, at least, prospective economic advantage. Again, though, litigation is not always an efficient or effective solution to a talent drain caused by a motivated competitor.

Employers may and should take extra measures to protect intellectual property from unauthorized disclosure. These steps should include, among others, limiting access to secret information, effective management of

electronic and other confidential data, and ensuring copyrights and trademarks are valid. Employers should train employees with access to confidential information regarding their obligations both during and after employment, and the consequences of unauthorized use and disclosure of trade secrets. They also should have policies and procedures in place for recovering confidential information from departing employees, and for solidifying customer relationships to thwart ex-employees' and competitors' solicitations.

Those companies concerned with recouping investments in special training, education, or other extraordinary costs - at least for now - may enter into reimbursement agreements with employees. Employees may agree to repay training, relocation or other investments, if they depart before sufficient time passes for the employer to recoup their costs. The Court of Appeal in City of Oakland v. Hassey, 163 Cal. App. 4th 1477, 1491 (2008), rejected the former employee's argument that his agreement to repay training expenses if he left the Oakland Police Department within five years of hire was a de facto "non-compete."

Finally, employers may use carrots rather than sticks to induce employees not to compete. These include retention bonuses and contracts for a term (as well as positive employee relations practices, competitive pay, and the like). Such practices may dissuade employees from leaving for greener pastures, or from following a former employee's solicitation to join her there.

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D. Gregory Valenza is the managing partner of Shaw Valenza LLP. Greg is resident in the Firm's San Francisco office. He practices in all areas of labor and employment law and devotes most of his practice to counseling employers, employment litigation and appeals.

gvalenza@shawvalenza.com



300 Montgomery Street, Suite 788
San Francisco, California 94104
Tel: (415) 983-5960
Fax: (415) 983-5963

520 Capitol Mall, Suite 630
Sacramento, California 95814
Tel: (916) 326-5150
Fax: (916) 497-0708

<http://shawvalenza.com>