California Courts Weigh In On Non-Compete Agreements

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In many states, restraints on the practice of a profession, business or trade (such as non-competition agreements) are considered valid, as long as they contain reasonable geographic and time restrictions. But that has not been true in California since 1872. In that year California settled public policy in favor of open competition, and rejected non-competition agreements. In the years since then, the law has evolved substantially, and two recent appeals court cases further refined the situation there. *The Retirement Group v. Galante,* and *Dowell v. Biosense Webster.*

Although these two decisions affect only those doing business in California, employers nationwide have long known that many legal trends, for better or worse, start in California and spread to other geographic areas. This article outlines what's going on in California today.

A Little Background
Current California law states that every contract "by which anyone is restrained from engaging in a lawful profession, trade or business of any kind" is void. The law does allow non-competition agreements in the context of an owner 1) selling the goodwill of a business; 2) disposing of all shares in a corporation; 3) selling all or substantially all of the operating assets and goodwill of a business, or 4) upon a partner dissolving or withdrawing from a partnership.

In addition to these statutory exceptions, California courts have created a judicial exception for cases where a former employee uses a former employer's trade secrets or confidential proprietary information to solicit the business of the former employer's customers, or to engage in other types of unfair competition.

In the years since 1872, California courts have consistently affirmed that State law evinces a settled public policy in favor of open competition and employee mobility, and have interpreted that law broadly.

In 2008, the California Supreme Court reinforced California's prohibition of covenants not to compete in the case of *Edwards v. Arthur Andersen.* (See our Legal Alert dated August 11, 2008 entitled "California Supreme Court Rules on Non-compete Agreements and On General Release.") Prior to the *Edwards* decision, the law in California was unclear regarding the validity of covenants not to solicit customers that were not tied to the protection of trade secrets or confidential information.

The *Galante* and *Dowell* cases have seemingly expanded the Supreme Court's reasoning in *Edwards* to invalidate covenants not to solicit customers, unless they are tied to the protection of trade secrets or confidential information.

The Holding in Galante

In *Galante,* the trial court issued an injunction against the defendants prohibiting them from, among other things, directly or indirectly soliciting any of the company's current customers to transfer securities accounts or relationships to defendants**.** The defendants challenged this portion of the injunction asserting that the relief granted violated *Edwards*. After extensive analysis of *Edwards*, the court held that this portion of the injunction violated California law since it was not tied to the protection of the company's trade secrets or confidential information, but was a wholesale prohibition on the mere solicitation of customers.

The court reasoned:

[T]he courts have repeatedly held a former employee may be barred from soliciting existing customers to redirect their business away from the former employer and to the employee's new business if the employee is utilizing trade secret information to solicit those customers. * * * Thus, it is not the solicitation of the former employer's customers, but is instead the misuse of trade secret information, that may be enjoined. * * * Application of these principles here convinces us the injunctive provisions . . . on their face violate *Edwards* and . . . cannot rationally be upheld as an injunction limited in scope to the only legitimate protection (*i.e.*, enjoining the misappropriation of [plaintiff's] trade secrets) for which injunctive relief may be issued.

The Holding in Dowell

In *Dowell,* after several employees left one biotech company (Biosense Webster) to work for a competitor, the two rival biotech companies went to court over the enforceability of the restrictive covenants contained in Biosense Webster's confidentiality agreement. The agreement contained a non-solicitation provision which prohibited the employees for a period of 18 months after termination of employment from soliciting any business from, selling to, or rendering any service to Biosense Webster's clients or customers with whom the employee had contact during the last 12 months of employment.

The court ruled that the non-solicitation provision violated *Edwards* because it restrained the employees from practicing in their chosen profession. Biosense Webster argued that the provision was enforceable because it was narrowly tailored to protect trade secrets or confidential information. The employees argued that, pursuant to *Edwards*, the trade secrets exception is no longer viable. Although the court doubted the continuing viability of the trade secrets exception in California, it did not resolve that issue. Instead, the court held that because the non-solicitation provision was not narrowly tailored or carefully limited to the protection of trade secrets, but was so broadly worded as to restrain competition, the trade secrets exception did not apply.

How Galante and Dowell Affect California Employers

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It's clear that California courts are becoming increasingly reluctant to enforce covenants not to solicit customers that prohibit the mere solicitation of customers and are not narrowly tailored to protect trade secrets or confidential information, such as the ones at issue in *Galante* and *Dowell*. But California is not the only area where laws change and court rulings can modify previously settled doctrines.

If you are currently using a covenant not to solicit customers, or considering creating one, we suggest you have it reviewed by counsel to ensure that it complies with the law of your state. This is especially true for California employers. Attempting to enforce an invalid covenant not to solicit customers, not hiring an applicant because he or she refuses to sign one, or terminating current employees because they refuse to sign one, could expose your company to liability.