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PERSPECTIVE

Open competition: Trending noncompete litigation

By Nick Kanter and Tal Yeyni

Many states in the United States permit contractual restraints on trade, provided the restraints are reasonable. California was one of these states until 1872, when the Legislature enacted a statute favoring open competition and rejecting the "rule of reasonableness." *Edwards v. Arthur Andersen, LLP*, 44 Cal. App. 4th 937, 945 (2008).

Since the enactment of its "open competition" laws, California has promoted a strong public policy of protecting the right of its citizens to pursue lawful employment and enterprise of their choice. The employee's interest in mobility and betterment are deemed paramount to the competitive business interests of the employer, in the absence of any illegal act accompanying the employment change. *AMN Healthcare, Inc. v. Aya Healthcare Services, Inc.*, 28 Cal. App. 5th 923, 935-36 (2018).

California's strong public policy is embodied in Business & Professions Code Section 16600 which states: "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."

The exceptions in 16600 pertain to the following limited circumstances:

1. In connection with the sale of a business or goodwill, within a specified geographical area. This exception is to prevent the seller from depriving the buyer of the full value of its acquisition. *Alliant Ins. Services, Inc. v. Gaddy*, 159 Cal. App. 4th 1292, 1301 (2008).

2. In connection with dissolution of a partnership or limited liability company. Cal. Bus. & Prof. Code Section 16602-16602.5.

Even if an exception applies, the noncompete covenant must be reasonable to be enforceable. *Howard v. Babcock*, 6 Cal. 4th 409 (1993), 416. For example, factors such as duration of the restrictive covenant and limits on geographic areas are considered to determine the reasonableness of the restriction. *See, e.g.*, *Monogram Indus., Inc. v. Sar Indus., Inc.*, 64 Cal. App. 3d 692, 702 (1976).

The Broad Scope of Section 16600 Reaches Beyond Strict Noncompete Provisions

California courts generally interpret the term "restrain" broadly and have extended Section 16600 to invalidate agreements prohibiting solicitation of clients, the use of confidential information, and no re-hire provisions.

For example, in *Edwards v. Arthur Anderson*, the court invalidated an agreement which prevented Edwards, a former accountant of a (then) international accounting firm, from providing services or soliciting clients of the firm for a period of 12-18 months post-separation. The court opined that although the agreement did not explicitly bar Edwards from working for a competitor, the agreement was invalid under Section 16600 because it restrained Edward's ability to practice his profession.

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In *Golden v. California Emerg. Physicians Med. Grp.*, 896 F.3d 1018 (2018), the 9th U.S. Circuit Court of Appeals held that a "no-rehire" provision placed a substantial restriction on an emergency room physician's ability to practice his profession, and therefore, was in violation of Section 16600. *Golden*, 896 F.3d at 1019.

There, Dr. Donald Golden refused to sign a settlement agreement with California Emergency Physicians Medical Group, despite the parties' oral agreement to settle Golden's lawsuit. Golden claimed the agreement's "no-rehire" provision, which prohibited Golden from working "at any CEP-contracted facility" or permitted CEP to "terminate Golden from any work" if the facility later contracted with CEP, was contrary to Section 16600.

The 9th Circuit agreed with Golden and held: "This interference with Dr. Golden's ability to seek or maintain employment with third parties easily rises to the level of a substantial restraint, especially given the size of CEP's business in California … Moreover, CEP appears to be growing … These facts persuade us that [the no-rehire clause] effect on Dr. Golden's medical practice is substantial, and that section 16600 therefore applies." *Id.* at 1026.

Finally, in *AMN Healthcare*, the court held that a confidentiality agreement, which prevented former recruiters from soliciting employees, was void because it prevented employees from engaging in their trade (recruiting).

AMN and Aya competed in the temporary nurse services business. AMN required its employees to sign a confidentiality agreement that prohibited them from soliciting AMN employees to leave AMN for a period of at least one year following separation from AMN.

Four AMN recruiters resigned from AMN to work for Aya. AMN alleged the former employees contacted several of AMN's travel nurses and recruited them to join Aya. *AMN*, 28 Cal. App. 5th at 936. AMN sued for breach of the confidentiality agreement.

The court held the confidentiality agreement restrained the travel nurse recruiters from practicing their chosen profession (i.e., it restricted the ability to recruit) and determined that information about individuals who worked as temporary nurses was not a secret, and therefore not a trade secret.

When Section 16600 Does Not Apply

Section 16600 does not invalidate certain agreements that tend to more promote than restrain trade.

For example, in *Loral v. Moyes*, 174 Cal. App. 3d 268 (1985), an ex-employee was prohibited from "raiding" his former employer's employees.

There, Robert M. Moyes, a former TerraCom employee, was hired as an executive at Aydin Corporation — TerraCom's competitor. Moyes' signed a separation agreement with TerraCom which required Moyes to preserve the confidentiality of TerraCom's trade secrets and confidential information, and not disrupt TerraCom's operations by interfering with or raiding its employees. *Loral*, 174 Cal. App.3d at 274.

Moyes offered employment to several key TerraCom employees, which resulted in TerraCom spending over $400,000 to recruit new employees and delayed performance on a project. TerraCom sued Moyes for breach of the separation agreement. Moyes claimed the agreement was void under Section 16600.

The court rejected Moyes' defense, finding the agreement did not restrain Moyes' ability to engage in his profession. In reaching this conclusion, the court noted that a potential impact on trade must be considered before invalidating a noninterference agreement, finding the agreement had "no overall negative impact on trade or business." *Id.* at 280.

In addition to agreements protecting confidential information and trade secrets, Section 16600 does not (currently) prevent an employer from seeking reimbursement from an employee upon early departure from employment.

In *USS-Posco Industries v. Case*, 244 Cal. App. 4th 197 (2016), UPI faced a shortage of skilled employees and implemented a training program that was estimated to cost UPI $46,000 per trainee. UPI required employees who participated in the program to reimburse UPI for a portion of the training if an employee decided to leave UPI within 30 months of completing the training.

Floyd Case, a UPI employee, participated in the program but resigned his employment only two months after completing the training. Case refused to reimburse UPI and UPI sued. Case filed a cross-complaint alleging the reimbursement agreement was an invalid restraint on employment in violation of Section 16600.

The court rejected Case's claim finding the agreement with UPI was an agreement concerning advanced costs of a voluntary education program. Moreover, the benefits of the program transcended any specific employment and were readily transportable, and therefore the obligation to repay the advanced costs was not a restraint on employment.

Section 16600 Does Not Permit Current Employees to Compete with their Employer

The cases discussed above all concern the impact of Section 16600 on contractual restrictions pertaining to former employees. Recently, a California Court of Appeal resolved an alleged conflict between Section 16600 and the agreement of current employees not to compete with their employer.

In *Techno Lite, Inc. v. EMCOD, LLC*, 2020 WL 289084, two Techno Lite employees attempted to use Section 16600 to invalidate their promise not to compete with Techno Lite during their employment.

The Court of Appeal rejected the employees' position finding Section 16600 only applies to noncompete agreements after the employee's employment has ended. It does not permit a current employee to "transfer his loyalty to a competitor" during employment.

The court further clarified that: "[N]o firmly established principle … authorizes an employee to become his employer's competitor while employed. Section 16600 is not an invitation to employees to bite the hand that feeds them."

Conclusion

Whether a restrictive covenant that attempts to govern a former employee's new employment or trade runs afoul of Section 16600 often involves an in-depth analysis of the specific terms of the covenant and the former employee's conduct. However, the Techno Lite decision appears to clearly carve out restrictions on the conduct of current employees from Section 16600's reach. ■

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