EDWARDS V. ARTHUR ANDERSEN LLP: THE END OF JUDICIALLY CREATED RESTRAINTS ON COMPETITION

By Todd M. Malynn*

Introduction

Employers have a strong incentive to restrain competition by former employees. The use of restrictive covenants in employment contracts protects existing and future business. It protects employers' reliance on and investment in employees to nurture customer goodwill and grow their business. It reduces employee turnover and recruitment and training costs. It enables employers to maintain lower wages and provide fewer benefits because employees have fewer realistic employment alternatives. It protects information and industry know-how from spilling over to competitors. It creates barriers to entry into an employer's market.

Three types of restrictive covenants are often found in employment contracts: non-disclosure,[1] non-solicitation,[2] and non-competition[3] provisions.[4] From an employer's point of view, these provisions protect its business and notify others of what the employer might consider unfair competition by former employees. From the point of view of competitors, consumers,

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1 Also referred to as confidentiality agreements, non-disclosure agreements prohibit employees from using or disclosing, without consent, information identified by their former employers as confidential or trade secret. The restraint is on the use of information, not on competition.

2 Non-solicitation agreements prohibit employees from soliciting former customers or colleagues for a specified period of time after their employment is terminated. They restrain competition, but do not prohibit customers or employees from working with or for a competing business.

3 Non-competition agreements prohibit competition, *i.e.*, employees from working for a competitor in a particular field or geographic market, on particular products, or with particular clients, or from hiring former colleagues for a specified period of time after their employment is terminated.

4 California courts have used the terms "covenants not to compete" and "non-competition agreements" interchangeably to refer to both covenants that prohibit competition and covenants that prohibit the solicitation of customers. Different terminology has been used to refer to covenants that prohibit the hiring or recruitment of employees. Covenants that prohibit the hiring of a company's employees, whether by a client or former employee, have been referred to as "no-hire" provisions, and employee non-solicitation provisions have been referred to as "non-interference" provisions.

and employees, they restrain competition, limit the providers of goods and services, and restrict the freedom of employees to engage in a profession, trade, or business of their choosing.[5]

Restrictive covenants enable employers to restrain competition through: (1) enforcement litigation; (2) the threat of enforcement litigation – the so-called "*in terrorem* effect" (the risk and likely expense of challenging a covenant and suffering the deployment of the former employer's resources to enforce the covenant compared to the perceived benefit of working for a competitor or hiring an individual employee); and (3) deception (a belief in the employer's representation that a restrictive covenant is valid and enforceable, when it is not).[6]

Non-competition agreements, whether by design (their plain language) or by effect (the threat of enforcement litigation), restrain lawful competition by their mere existence. Employees are not as free to compete against their former employer as they would have been in the absence of the agreements. Some employees and prospective employers will likely believe that the agreements are enforceable; others will not have the wherewithal or resources to risk challenging the restraints in court.[7]

In contrast, non-disclosure agreements are anticompetitive only to the extent they are improperly used to restrain lawful competition.[8] On their face they do not purport to restrain lawful competition; they merely condition the use of an employer's trade secret or confidential information. They are akin to license agreements that restrict the use of another person's intellectual property.[9] California's Uniform Trade Secret Act ("UTSA") defines the scope of

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5 For example, a confidentiality agreement may state that information is confidential, when it is not, and a former employee may lawfully use or disclose it without the employer's consent. A non-solicitation provision may prohibit the solicitation of customers when their identities are not trade secret or confidential, and therefore customer solicitation would not be unfair or unlawful. Similarly, a non-competition agreement may state that competitive activity will threaten the use or disclosure of confidential information, when it would not. Each of these provisions restrains competition by a former employee. Whether written in conclusive or presumptive terms, a restrictive covenant is not binding on a court and would not shift the burden of persuasion in enforcement litigation. The employer claiming breach of a restrictive covenant must still prove that the covenant is valid and enforceable.

6 The anticompetitive effect of restrictive covenants is often compounded by choice-of-law, consent-to-venue, forum-selection, and arbitration clauses that point to the laws of jurisdictions or seek to direct litigation to forums where restraints on competition are valid and enforceable. The United States Supreme Court has observed that California courts may enforce California's public policy against restraints of trade and decline to enforce choice-of-law clauses, as well as choice-of-forum provisions when coupled with choice-of-law clauses. *See Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware*, 414 U.S. 117, 139-40 (1973) (California courts may apply California law to covenants not to compete that call for application of another state's laws); *Mitsubishi Motors Corp. v. Soler Chrysler, Plymouth, Inc.*, 473 U.S. 614, 637 n.19 (1985) ("[I]n the event the choice-of-forum and choice-of-law clauses operated in tandem as a prospective waiver of a party's right to pursue statutory remedies for antitrust violations, we would have little hesitation in condemning the agreement as against public policy.").

7 *See D'Sa v. Playhut, Inc.*, 85 Cal. App. 4th 927, 935 (2000) (discussing *de facto* compliance); *Kolani v. Gluska*, 64 Cal. App. 4th 402, 407 (1998) (same); *Latona v. Aetna U.S. Healthcare, Inc.*, 82 F. Supp. 2d 1089, 1097-98 (C.D. Cal. 1999) (discussing *in terrorem* effect).

8 *See, e.g.*, *Herzog v. "A" Co.*, 138 Cal. App. 3d 656, 660 (1982) (letter threatening to enforce confidentiality provision, not to protect trade secrets or confidential information but to restrain lawful competition, would be contrary to public policy and support claim for tortious interference).

9 *See King v. Gerold,* 109 Cal. App. 2d 316, 317 (1964), *disapproved on other grounds by Edwards*, 44 Cal. 4th at 950 n.5 (prohibition against use of licensor's trade-secret house-trailer design after expiration of license is not an illegal restraint but is enforceable to prevent unfair competition, *i.e.*, use of trade secrets to produce substantially similar house-trailer designs).

trade-secret protection afforded to an employer, and provides remedies for actual or threatened misappropriation. Similarly, California's unfair competition laws define the obligation of parties that accept confidential information under the condition that, without consent, they will not use or disclose it for their own benefit, or the benefit of a third-party, and provide remedies for actual or threatened breach of that obligation. Non-disclosure agreements simply (a) evidence conditions under which information is provided to an employee and steps taken to maintain the information as confidential, and (b) afford contractual remedies for conduct already proscribed by California law.[10] The employer must still prove that the information is trade secret or confidential and that its use is an actual or threatened misappropriation or breach of a legal duty. In such cases, litigation is based on the parties' underlying legal rights and obligations, *not* on any rights allegedly created by the restrictive covenant.

Non-solicitation provisions, which do not completely bar competitive activity like non-competition agreements, but prohibit a form of competition by former employees, fall within both paradigms. Non-solicitation provisions, on their face, can plainly overreach and restrain lawful competition.[11] Moreover, even if narrowly drawn and less restrictive than traditional covenants not to compete, they are still "anticompetitive."[12] They enable employers to threaten litigation and restrain competition if a customer is contacted, even if customer information is not confidential or trade secret or the customer contacted the former employee first. If an employer's customer list is a trade secret, of course, an obligation prohibiting the solicitation of the employer's customers would be necessary to protect the employer's trade secret. Viewed this way, a non-solicitation provision, like a non-disclosure agreement, is anticompetitive only to the extent the employer is overreaching, *i.e.*, is trying to prevent either (a) the solicitation of customers in an "open market" where the identities, needs and preferences of customers are generally known or readily ascertainable, or (b) any contact with former customers in a closed market where customer lists are protectable. On their face, non-solicitation provisions merely "delimit" how an employee may compete.[13] If litigation to prevent solicitation ensues, it follows that it should be based on the parties' underlying legal rights and obligations, *not* on any rights allegedly created by the non-solicitation provision.

In 1872, the California Legislature adopted its first antitrust law, which is now Business & Professions Code section 16600 ("Section 16600"). Section 16600 is part of a statutory scheme favoring free competition and employee mobility. It voids any contract in restraint

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10 *See Empire Steam Laundry v. Lozier*, 165 Cal. 95, 99 (1913) ("Equity always protects against the unwarranted disclosure and unconscionable use of trade secrets and confidential business communications. So little does this equitable jurisdiction depend upon an express contract that it has been said by high authority that equity will extend this protection in every contract of service 'in the absence of a stipulation to the contrary.' . . . Therefore the question of the contract between the parties becomes immaterial, except that its consideration plainly evinces the intent of the parties, the one to protect itself against the doing, the other to abstain from doing the very things which the court finds that defendant upon the termination of his employment immediately proceeded to do.") (citation omitted).

11 *See, e.g., Kolani,* 64 Cal. App. 4th at 407 (overly broad non-solicitation provision void on its face); *Morris v. Harris,* 127 Cal. App. 2d 476, 478 (1962) (non-solicitation provision that prohibited solicitation of and rendering of services to former customers overly broad because it prohibited competition even when customers sought out former employee's services).

12 *See Thompson v. Impaxx, Inc.*, 113 Cal. App. 4th 1425, 1429 (2003).

13 *See Loral Corp. v. Moyes*, 174 Cal. App. 3d 268, 276 (1985) (upholding facial validity of non-interference provision, finding that it was more akin to customer non-solicitation provisions, which have been upheld, than employee non-competition agreements, which are void).

of trade, except as provided by statute. It was enacted for a public policy reason to protect the interests in free competition and employee mobility of all Californians, including consumers, competitors, and employees. Section 16600 and its enumerated statutory exceptions define what constitutes a valid and enforceable covenant not to compete. The Legislature's statutory scheme was intended to eliminate post-employment restraints on competition and prevent litigation based on covenants not to compete.[14]

Since its enactment, employers have sought to erode the protections afforded by Section 16600. They have advocated for judge-made exceptions to Section 16600's broad prohibition against post-employment restraints on competition. Two judge-made exceptions eventually found support in case law. The first judge-made exception, the so-called "trade-secret" exception, seemed to authorize narrow restraints if necessary to protect trade secrets. The second judge-made exception, the narrow-restraint exception created by the United States Court of Appeals for the Ninth Circuit ("Ninth Circuit"), authorized "limited" or partial restraints if reasonable.

This article discusses the impact of the California Supreme Court's watershed decision, *Edwards v. Arthur Andersen LLP*,[15] which rejected the Ninth Circuit's "narrow-restraint" exception and held that there are no judicially created exceptions to Section 16600. The court affirmed that Section 16600's plain language, legislative history, and statutory scheme do not permit judge-made exceptions to Section 16600. However, the court did not decide what remains of the so-called "trade-secret" exception. It noted that this judicially created exception was not properly before it.

Section I of this article discusses the legislative history and objectives of Section 16600, which were presented to the Supreme Court and underlie and support the *Edwards* decision. It explains the California Legislature's binding policy choice in favor of free competition and employee mobility, and how Section 16600 works to protect not only individual employees, but also consumers and competitors.

Section II addresses how, over time, California courts and federal courts applying California law lost sight of the Legislature's binding policy choice and the important objectives of Section 16600. Employers seized upon loose language in case law to push judicially created "exceptions" to restrain the very competition and employee mobility Section 16600 was enacted to protect.

Section III summarizes the three interpretations of the so-called "trade-secret" exception supported by *dictum* in pre-*Edwards* case law. In its broadest form, it is simply an application of the Ninth Circuit's broader "narrow-restraint" exception.

Section IV discusses the holding in *Edwards v. Arthur Andersen LLP*, which rejected the Ninth Circuit's "narrow-restraint" exception to Section 16600, and strongly reaffirmed the

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14 *See City Carpet-Beating, etc., Works v. Jones*, 102 Cal. 506, 511 (1894) ("*City Carpet*") (Section 16600's sweeping prohibition against contracts in restraint of trade and its statutory exceptions "eliminate[] from the controversy arising upon such restriction the question as to what is a reasonable covenant, by specifically defining it, and thus preventing litigation; and in this the statute is wise and salutary . . . ."); *Application Group, Inc. v. Hunter Group, Inc.*, 61 Cal. App. 4th 881, 901 (1998) (Section 16600 is intended to protect Californians, including employers and employees, "from anticompetitive conduct . . . including litigation based on a covenant not to compete . . . .").

15 44 Cal. 4th 937 (2008).

Legislature's settled policy in favor of free competition and employee mobility.[16] The Supreme Court made three significant rulings: (1) Section 16600's "prohibition-against-restraint rule" is "*unambiguous*";[17] (2) the rule plainly "prohibits employee noncompetition agreements *unless the agreement falls within a statutory exception*";[18] and (3) California courts "have been clear in their expression that section 16600 represents a strong public policy of the state *which should not be diluted by judicial fiat*."[19]

Section V discusses what, if anything, remains of the so-called "trade-secret" exception after *Edwards*. By rejecting any reasonableness inquiry under Section 16600 and the creation of non-statutory exceptions restraining lawful competition, the Supreme Court's decision effectively overrules *dictum* in cases like *Whyte v. Schlage Lock Co.*,[20] which suggested that employers might be able to "bargain for" more protection than provided by California's unfair competition laws, and thereby avoid having to *actually prove* that a former employee is engaged in *wrongful conduct* in order to restrain competition in California. The article provides reasons why the Supreme Court should reverse or clarify the "trade-route" and non-solicitation cases, which originally led to confusion in the law, and expressly adopt the only interpretation of the so-called "trade-secret" exception that is consistent with Section 16600's plain language and objectives – that non-disclosure agreements are valid, but *all* covenants not to compete are anticompetitive and void. They are not necessary to protect trade secrets or to prevent unfair competition. They are redundant of the protections already afforded by California law. They simply enable employers to restrain lawful competition through anticompetitive conduct that Section 16600 was enacted to avoid.

I. The California Legislature's Binding Policy Choice in Favor of Free Competition and Employee Mobility

A. California's First Antitrust Law (Bus. & Prof. Code § 16600)

Business & Professions Code section 16600 is California's first antitrust law.[21] It was enacted in 1872 as Civil Code section 1673, and has remained virtually unchanged for more than 136 years.

Since the enactment of this statute, California courts have consistently held that Section 16600 broadly protects "one of the most cherished commercial rights we possess" – "the important legal right of persons to engage in businesses and occupations of their choosing."[22] Section 16600 ensures that "every citizen shall retain the right to pursue any lawful employment

16 *Id*. at 945-46.

17 *Id*. at 950.

18 *Id*. at 955 (emphasis added).

19 *Id*. at 949-50 (citation omitted, emphasis added).

20 101 Cal. App. 4th 1443 (2002).

21 Until the 1907 enactment of the Cartwright Act (Bus. & Prof. Code §§ 16700 *et seq*.), Business & Professions Code section 16600 was California's only antitrust law regulating trade in California. *See* Von Kalinkowski & Hanson, *The California Antitrust Laws: A Comparison With Federal Antitrust Laws*, 6 UCLA L. Rev. 533, 540 & n.50 (1959).

22 *Morlife, Inc. v. Perry*, 56 Cal. App. 4th 1514, 1520 (1997).

and enterprise of their choice."[23] It provides every Californian with a form of immutable "property right,"[24] one created for a "public reason" that cannot be "waived" by contract,[25] and that should be "broadly"[26] construed and "zealously"[27] guarded by the courts.

B. Section 16600 Was Meant to Prohibit Contractual Restraints on Competition in Employment Contracts

Historically, courts have dealt with contractual restraints on competition in two distinct contexts: restraints in employment agreements; and restraints associated with the sale of a business and its goodwill.[28] In the earliest reported decisions, contractual restraints in employment agreements were always found void without regard to their duration or scope.[29] In contrast, subsequent cases dealing with restraints in contracts for the sale or transfer of a business were upheld if "reasonable."[30]

Prior to the enactment of Civil Code section 1673, California courts, like courts in other jurisdictions, had begun to erode this distinction and relaxed the common law rule against restraints on competition in the employment context, stating that partial restraints might be valid, as long as they were reasonably imposed.[31] This change led commentators and reformers to observe that "[c]ontracts in restraint of trade have been allowed by modern decisions to a very dangerous extent."[32]

The distinction between contractual restraints in employment agreements and restraints associated with the sale of a business and its goodwill, and the concerns leading to the enactment

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23 *Metro Traffic Control, Inc. v. Shadow Traffic Network*, 22 Cal. App. 4th 853, 859 (1994).

24 *Continental Car-Na-Var Corp. v. Moseley*, 24 Cal. 2d 104, 110 (1944) ("Every individual possesses as a form of property, the right to pursue any calling, business or profession he may choose.").

25 Civ. Code §§ 1668, 3513; *Armendariz v. Found. Health Psychcare Servs., Inc.*, 24 Cal. 4th 83, 100-01, 123 n.12 (2000) (noting that parties cannot waive right enacted for "public reason," and that contracts in restraint of trade are "illegal"); *Weber, Lipshie & Co. v. Christian*, 52 Cal. App. 4th 645, 659 (1997) ("[S]ection 16600 was adopted for a public reason. It follows that Christian could not by agreement waive the benefit afforded by California law.").

26 *S. Bay Radiology Med. Assocs. v. Asher*, 220 Cal. App. 3d 1074, 1080 (1990) (Section 16600 "broadly applies to all types of contracts"); *Scott v. Snelling and Snelling,* 732 F. Supp. 1034, 1042 (1990) ("California courts have repeatedly held that section 16600 should be interpreted as broadly as its language reads" and "should not be limited by judicial fiat.").

27 *New Method Laundry Co. v. MacCann*, 174 Cal. 26, 31 (1916) ("This right of a citizen to pursue any calling, business, or profession he may choose is a property right to be guarded by equity as zealously as any other form of property.").

28 *See Monogram Indus., Inc. v. Star Indus., Inc.*, 64 Cal. App. 3d 692, 697 (1976) (contractual restraints on competition have their "genesis in either an employer-employee relationship, or in the sale of the 'goodwill' of a business"); *see also* Blake, *Employee Agreements Not To Compete* 73 HARV. L. REV. 625, 631-37 (1960) (distinction dates back to fifteenth century *Dyer's* case).

29 *See* Blake, *supra*, note 29 at 631-32.

30 *Id.* at 629-31.

31 *See, e.g., Wright v. Ryder*, 36 Cal. 343, 357 (1868) (relaxing rule that all post-employment restraints were invalid in recognition of increasing population and competition in trade).

32 Civ. Code § 1673 (1872), Code Comm'n cmt.

of Civil Code section 1673, are significant given the statutory scheme chosen by the Code Commission, and adopted by the Legislature, back in 1872. Civil Code section 1673 – the direct predecessor to Section 16600 – spoke in sweeping terms with two exceptions. It broadly provided, "Every contract by which any one is restrained from exercising a lawful profession, trade or business of any kind, otherwise than is provided by the next two sections, is to that extent void." The "next two sections," sections 1674 and 1675, dealt respectively with the sale of "the goodwill of a business" and the rights of partners upon the dissolution of a partnership. Both exceptions related to the sale or transfer of goodwill; neither addressed restraints in an employment agreement.

With the enactment of the Business & Professions Code in 1941, the sweeping prohibition in Civil Code section 1673 was adopted virtually verbatim in what is known today as Section 16600, which reiterates: "*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."[33] Sections 16601 and 16602 of the Legislature's statutory scheme incorporated the same two exceptions provided in the initial legislation. Since that time, the Legislature could have enacted, but unlike in other jurisdictions has *not* enacted,[34] *any* exception to Section 16600 authorizing restraints in employment contracts. The only pertinent change to the Legislature's statutory scheme was the addition, in 1994, of Section 16602.5, which essentially replicates the partnership provisions of Section 16602 for limited liability companies in recognition of more modern forms of business organization.

The conclusion that flows ineluctably from this historical overview is simple: The Legislature intended no exceptions to Section 16600 that would authorize restraints on competition in employment agreements. Given that (a) contractual restraints historically fell into one of two categories – restraints in employment agreements, and restraints attendant to the sale of a business, and (b) that the use of the "rule of reason" to uphold partial restraints on competition in the employment context led to the enactment of Section 16600's predecessor statute, *by expressly incorporating exceptions into Section 16600's sweeping prohibition but limiting those exceptions to the latter category of restraints of trade*, the Legislature made it clear that Section 16600's broad, sweeping prohibition against restraints of trade applies, *without exception*, to restraints in *employment agreements*.

C. Section 16600 Embodies the Legislature's Policy Choice Favoring Free Competition and Employee Mobility Over an Employer's Competitive Interests

California courts have repeatedly affirmed that Section 16600 establishes a definitive ordering of competitive 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."[35]

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33 Bus. & Prof. Code § 16600 (emphasis added).

34 *See, e.g.*, Colo. Rev. Stat. § 8-2-113(2); Fla. Stat. § 542.335(1)(b); Nev. Rev. Stat. § 613.200; Or. Rev. Stat. § 653.295.

35 *Diodes, Inc. v. Franzen*, 260 Cal. App. 2d 244, 255 (1968); *Application Group, Inc.,* 61 Cal. App. 4th at 900; *Metro Traffic Control, Inc.*, 22 Cal. App. 4th at 859-60.

To the extent employers need protection from unfair competition, employers must avail themselves of laws intended to protect their rights. They may *not* resort to the expedient of contractual restraints on competition. The California Supreme Court has affirmed the Legislature's balancing of policy concerns and definitive ordering of interests:

> Equity will to the fullest extent protect the property rights of employers in their trade secrets and otherwise, but public policy and natural justice require that equity should also be solicitous for the right inherent in all people, *not fettered by negative covenants upon their part to the contrary*, to follow any of the common occupations of life. . . . 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 business of those who had formerly been the customers of his former employer*, provided such competition is fairly and legally conducted.[36]

D. California's Public Policy Protects Both Consumers and Competitors in Addition to Individual Employees

Section 16600's flat prohibition against restraints on competition in employment agreements results in benefits that extend far beyond the interests of individual workers in their own careers and in bettering themselves. Section 16600 was enacted for the collective benefit of *all* Californians.[37] Like the Cartwright Act, Section 16600 rests "'on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions.'"[38]

Section 16600 protects not only a cherished commercial right of every Californian to pursue a calling of their choosing, but also a fundamental liberty interest of *all* consumers to engage in business with those of their choosing.[39] Section 16600 vindicates this fundamental liberty by removing restraints on competition, thus ensuring that consumers will have broad access to all the goods and services, and to all the *providers* of goods and services, that are available in a free market.

Section 16600 also promotes an efficient labor market, allowing human resources to move to their highest and best use. It does so by protecting the right of employers in California "to compete effectively for the most talented, skilled employees in their industries . . . ."[40] Like other

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36 *Cont'l Car-Na-Var Corp.*, 24 Cal. 2d at 110 (emphasis added).

37 *See* Civ. Code § 1673 (1872) Code Comm'n cmt. (condemning contractual restraints on competition because they "manifestly tend[] to enforce idleness, and deprive[] the State of the services of its citizens."); *Swenson v. File*, 3 Cal. 3d 389, 394 (1970) (Section 16600's prohibition against contractual restraints is "not based upon any consideration for the party against whom the relief is sought, but upon considerations of sound public policy.'") (citation omitted).

38 *Cianci v. Superior Court*, 40 Cal. 3d 903, 918 (1985) (citation omitted).

39 *New Method Laundry Co.*, 174 Cal. at 32 ("[C]onstitutional guaranties of liberty include the privilege of every citizen to freely select the tradesman to whom he may desire to extend his patronage, and equity cannot invade or take away this right, either directly or indirectly.").

40 *Application Group, Inc.,* 61 Cal. App. 4th at 901.

antitrust and unfair competition laws, Section 16600 protects the rights of both consumers and competitors in addition to those who would fall prey to a violation of public policy.

E. Section 16600 Works

Professor Ronald J. Gilson of Stanford and Columbia Universities attributes the unparalleled success of California's economy, particularly its high-technology industries, to the legal infrastructure created by Section 16600's flat prohibition against post-employment restraints on competition, which enables labor resources to freely flow to their highest and best use, rewards innovation, and allows new businesses to grow, flourish, and mutually benefit from innovative ideas.[41] He notes, however, that in the absence of a prohibition against post-employment restraints on competition, this extraordinary success would not be realized:

> [T]he problem is that what is optimal for a single firm is also optimal for every firm. Therefore, without a means to assure that all firms allow employee mobility, California high technology industries would be locked into a suboptimal pattern of exacting covenants not to compete from their employees. While each firm would be better off by assuring employee mobility provided that all firms did the same thing, on the individual firm level, the incentive is to restrict employee mobility. [¶] Business and Professions Code section 16600 solves this coordination problem. By flatly prohibiting post-employment covenants not to compete, individual firms are prevented from pursuing a selfish strategy that undermines what is best for the industry.[42]

Professor Gilson explains why there should be no exception made for the use of post-employment restraints on competition to protect trade secrets. After discussing the benefits of a legal infrastructure that protects innovators and the transfer of institutional knowledge, he plainly describes the effect of the competing policy decision made in other states where covenants not to compete are enforceable to protect an employer's trade secrets:

> [Of course a] covenant not to compete is the most effective way to protect an employer's trade secrets – if the employee cannot work for a competitor, the potential for the disclosure of trade secrets is eliminated. *In this sense, covenants not to compete are effective in the same sense that burning down a house to eliminate termites is effective: the problem is eliminated but the collateral damage from the solution is worse than the problem itself.*[43]

Professor Gilson's scholarly conclusions were recently corroborated in a Harvard Business School paper by Professor Matt Marx, Deborah Strumsky, and Lee Fleming. The paper documents the state of technological innovation in Michigan before 1985 – when

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41 *See* Ronald J. Gilson, *The Legal Infrastructure of High Technology Industrial Districts: Silicon Valley, Route 128, and Covenants Not to Compete*, 74 N.Y.U. L. REV. 575, 603-09 (1999); *see also* Mark A. Glick, Darren Bush & Jonathan Q. Hafen, *The Law and Economics of Post-Employment Covenants: A Unified Framework*, 11 GEO. MASON. L. REV. 357, 407-08 (2002).

42 Gilson, *Amicus Curiae* Brief filed in *Advanced Bionics Corp. v. Medtronic, Inc.*, 29 Cal. 4th 697 (2002), at 8.

43 *Id*. at 11 (emphasis added).

Michigan's law was virtually identical to California's – and after 1985 when Michigan adopted a "rule of reason" similar to that followed by other states. The authors empirically found that the enforcement of non-competition agreements tended to reduce innovation and hinder vibrant economies as Professor Gilson concluded:

> Constraining the flow of people and thus knowledge, enforcing [jurisdictions] may fail to develop entrepreneurial and technologically dynamic economies. Consistent with Gilson's arguments, industry growth may be attenuated as startups fail to condense in enforcing [jurisdictions]. The networks of small companies so crucial to Silicon Valley's growth would be less likely to develop in [jurisdictions] that enforce noncompetes.[44]

In short, California's public policy of free competition and employee mobility works. It has stood the test of time and played an important role in the success of California's economy.

II. California Courts Lost Sight of the Legislature's Policy Choice and Created Contradictions in the Law, Which Can Be Easily Corrected

A. The Legislature's Sound Policy Choice in Favor of Free Competition and Employee Mobility Is Implemented by Section 16600's Bright-Line Rule Against Contractual Restraints on Competition

Section 16600 is an "absolute bar to postemployment restraints."[45] Except as provided by statute, it invalidates "every contract by which one is restrained from engaging in a lawful profession, trade or business . . . ." [46] By its plain terms Section 16600 does not differentiate between complete or partial, [47] reasonable or unreasonable[48] restraints, but invalidates *every* contract by which one is restrained unless it falls within a statutory exception.

The test for invalidity is simple: A contract is void if, by enforcing it, the employee "is not *as free* to [engage in a competing business] as he would have been if he were not bound by it."[49] Consistent with the Legislature's intent and definitive ordering of interests, the Supreme Court has recognized that Section 16600 contemplates the absolute and unfettered freedom to compete, so long as the competition is lawful.[50] Any diminution of that freedom – even if partial

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44 Matt Marx, Deborah Strumsky & Lee Fleming, *Noncompetes and Inventor Mobility: Specialists, Stars, and the Michigan Experiment*, at p. 23, http://www.hbs.edu/research/pdf/07-042.pdf (citations omitted).

45 *KGB, Inc. v. Giannoulas*, 104 Cal. App. 3d 844, 848 (1980).

46 Bus. & Prof. Code § 16600.

47 *See, e.g., Chamberlain v. Augustine*, 172 Cal. 285, 289 (1916) ("The statute makes no exception in favor of contracts only in partial restraint of trade."); *Morey v. Paladini*, 187 Cal. 727, 736 (1922); *Morris v. Harris,* 127 Cal. App. 2d 476, 478 (1954).

48 "In 1872 California settled public policy in favor of open competition, and rejected the common law 'rule of reasonableness.'" *Edwards,* 44 Cal. 4th at 945 (citing *Bosley Med. Group v. Abramson*, 161 Cal. App. 3d 284, 288 (1984)); *Howard v. Babcock*, 6 Cal. 4th 409, 416 (1993) (same); *Hill Med. Corp. v. Wycoff*, 86 Cal. App. 4th 895, 901 (2001) (same).

49 *Chamberlain*, 172 Cal. at 288 (emphasis added).

50 *See* Bus. & Prof. Code § 16600; *Chamberlain*, 172 Cal. at 288; *Cont'l Car-Na-Var Corp.*, 24 Cal. 2d at 110.

and reasonable – is contrary to the plain language of the statute because then the employee, even if only in a "small" segment of the market,[51] would not be "as free" to lawfully compete as he otherwise would have been, but would be "restrained from engaging in a lawful profession, trade or business." It would encourage the use of restraints and fuel anticompetitive litigation over whether a restriction on competition falls within a judicially created exception for partial and/or reasonable restraints on competition – contrary to the "wise and salutary" purpose of Section 16600 – that is, to "eliminate[] from the controversy arising upon such restriction the question as to what is a reasonable [restraint], by specifically defining it, and *thus preventing litigation* . . . ."[52] Section 16600 would lose its ability to protect employees, consumers and competitors in California, not just from restraints on competition, but also "from anticompetitive conduct . . . *including litigation based on a covenant not to compete* . . . ."[53]

B. Judicially Created Exceptions That Restrain Competition Are Contrary to the Plain Language and Objectives of Section 16600

1. The Ninth Circuit's Judicially Created "Narrow-Restraint" Exception

In a series of decisions over the course of two decades, the Ninth Circuit undercut the "wise and salutary" effect of Section 16600's bright-line rule by creating "exceptions" for "narrow restraints." In the process, the Ninth Circuit ignored several things: the plain language of the statute; binding precedent interpreting the statute;[54] the Legislature's intent in enacting the statute (*i.e.,* to subordinate the competitive interests of employers, even if reasonable, to protect rights of employees, consumers, and competitors, so as to effectuate California's overriding interest in free competition and employee mobility);[55] and the statute's "wise and salutary" purpose of preventing controversies over which restraints are valid and enforceable and which restraints are not.[56]

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51 Of course, the "small" segment of the market that employers will try to protect with contractual restraints invariably would be the precise segments of the market where Section 16600 is needed and was enacted to protect. As explained by James P. Stoneman II, *Amicus Curiae* Brief filed in *Advanced Bionics Corp.*, 29 Cal. 4th 697, on behalf of California Lawyers Employment Association (at 6):

> An employee gives the best years of his or her life to the development and advancement of the business of a corporation. When such employees are terminated, they frequently are left with few viable employment options. In many cases, these people have no employment skills other than those acquired in their chosen trade or profession. To compound the problem, many of them are in their forties, fifties, or sixties, ages at which, for many reasons including age and the onset of medical problems, they are perceived to be less desirable to prospective employers outside their chosen trade or business. . . . The only attribute of real value many older employees bring to their employment interview is their experience in their chosen line of work. . . . (¶) . . . [Section 16600 ensures] that termination of employment does not mean termination of one's livelihood and contribution to economic progress.

52 *City Carpet*, 102 Cal. at 511 (emphasis added).

53 *Application Group, Inc.*, 61 Cal. App. 4th at 901 (emphasis added).

54 *See, e.g., Davis v. Jointless Fire Brick Co.*, 300 F. 1, 3 (9th Cir. 1924) (stating that Section 16600 makes "'no exception in favor of contracts in partial restraint of trade,'" citing *Chamberlain*, 172 Cal. at 288); *Muggill v. Reuben H. Donnelley Corp.*, 62 Cal. 2d 239, 242 (1965) (invalidating partial restraint, citing *Chamberlain*, 172 Cal. at 288).

55 *See supra* notes 34-41, and cases cited therein.

56 *See City Carpet*, 102 Cal. at 511.

The "narrow-restraint" exception derived from the Ninth Circuit's decision in *Campbell v. Board of Trustees of Leland Stanford Junior University*,[57] where the Ninth Circuit adopted the view that Section 16600's rule against contractual restraints applies only to contracts that *prohibit* a departing employee from engaging in an *entire* profession, trade or business, but does not invalidate restraints "where one is barred from pursuing only a small or limited part of the business, trade, or profession."[58] In addition to authorizing all but the *most onerous* non-competition agreements, the Ninth Circuit presumed that the restraint in *Campbell* was valid and put the burden on the employee to prove that it completely prohibited him from pursuing a profession, trade, or business,[59] contrary to the rule requiring the employer to prove unfair competition – the rule the Ninth Circuit had previously followed.[60]

In *General Commercial Packaging, Inc. v. TPS Package Engineering, Inc.*,[61] the Ninth Circuit retreated somewhat from its "entire" market position by holding that Section 16600 would invalidate a restraint that "plac[ed] a *substantial segment* of the market off limits."[62] Nonetheless, the Ninth Circuit maintained that Section 16600 would permit restraints that merely limited access to a "narrow segment" of the market, and opined that the pertinent inquiry is on "the *breadth* of the restraint."[63] Although the court disclaimed the "rule of reasonableness" approach rejected by the Legislature and California case law,[64] its market-analysis approach had no other touchstone, and was no less offensive. Contrary to California precedent, [65] the Ninth Circuit affirmed the use of "negative covenants" to prohibit competition, so as to protect customer goodwill. The court upheld a restraint with the sole purpose of protecting the employer's "business relationships with Disney and other California customers." [66]

The Ninth Circuit's departure from California law climaxed in *International Business Machines Corp. v. Bajorek*,[67] a case involving a forfeiture of stock options if the former employee engaged in competition. The Ninth Circuit ignored its erroneous market-segment test in *General Commercial Packaging*, and upheld a restraint that required a forfeiture of stock options if the employee worked for *any* competitor, in *any* capacity, *anywhere* in the world.[68] The Ninth

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57 817 F.2d 499 (9th Cir. 1987).

58 *Id.* at 502.

59 *Id.*

60 *See Hollingsworth Solderless Terminal Co. v. Turley*, 622 F.2d 1324, 1338 (9th Cir. 1980) ("'[T]he employer will be able to restrain by contract only that conduct of the former employee that would have been subject to judicial restraint under the law of unfair competition, absent the contract.'") (citation omitted).

61 126 F.3d 1131 (9th Cir. 1997).

62 *Id.* at 1134 (emphasis added).

63 *Id.* at 1133-34 (emphasis added).

64 *Id.*

65 *See Cont'l Car-Na-Var Corp.*, 24 Cal. 2d at 110; *Golden State Linen Service, Inc. v. Vidalin*, 69 Cal. App. 3d 1, 12-13 (1977) (under Section 16600 "goodwill" in customer base cannot be protected with post-employment covenant not to compete).

66 *Gen. Commercial Packaging, Inc.*, 126 F.3d at 1132.

67 191 F.3d 1033 (9th Cir. 1999) ("*Bajorek*").

68 *Id.* at 1040.

Circuit described this restraint as "limited,"[69] although the basis for this characterization is dubious. In reaching this conclusion, the Ninth Circuit side-stepped California precedent directly on point, which held that monetary penalties or forfeitures predicated on an employee's decision to work for a competitor, although possibly less onerous than a complete prohibition on competition, are nonetheless illegal.[70] The Ninth Circuit upheld the "limited" restraint, purportedly relying upon its own precedent in *Campbell* and *General Commercial Packaging*, rather than on precedent set by California's highest court on issues of California law.

The triumvirate of Ninth Circuit cases promoting the "narrow-restraint" doctrine directly supported two fact-intensive, judicially created exceptions to Section 16600's prohibition against employee non-competition agreements – one based on the "breadth" of the restraint if the employee is not prohibited from working in the "entire" relevant market; the other based on the alleged "limited" nature of a restraint if it is triggered by *any* type of competition whatsoever. The underlying rationale utilized by the Ninth Circuit (that the restraint was narrow or limited), however, would justify other judicially created exceptions, including so-called "narrow restraints" to protect trade secrets.

Contrary to the Legislature's intent when it rejected the "rule of reason" and enacted Section 16600's predecessor statute, the Ninth Circuit's narrow-restraint doctrine introduced different types of "reasonableness" inquiries into the Section 16600 analysis. While the Ninth Circuit presented its narrow-restraint approach as factual inquiries that could be applied with mathematical precision, in reality there is no exact formula for determining whether a restraint is appropriately "limited" in scope (*Bajorek*), whether it restricts a "substantial segment" as opposed to a "narrow segment" of a market (*General Commercial Packaging*), or whether it only prevents an employee from pursuing "a small or limited part of [his] business, trade or profession" (*Campbell*). To answer each of these questions, courts necessarily would have to make judgment calls, and those calls would undoubtedly be guided by the court's view of what is "reasonable" given the facts and circumstances of the case.

The Ninth Circuit's approach encouraged employers in California to use non-competition agreements against their employees and competitors and to litigate in every case, as the threat, risk and expense of litigation would result in *de facto* compliance. The Ninth Circuit's narrow-restraint doctrine thus turned the Legislature's sound policy decision on its head by endorsing the self-interests of employers as paramount over California's interests in free competition and employee mobility, and by establishing a legal environment in which employers were likely to use, and employees were likely to adhere to, restraints – even patently unlawful restraints – in the majority of cases.

2. Non-Solicitation Cases and the So-Called "Trade-Secret" Exception

The Ninth Circuit's "narrow-restraint" doctrine is not the only judicially created exception to Section 16600 that has proven troublesome for employees, competitors, and courts. Equally problematic is the so-called "trade-secret" exception, which arose in non-

69 *Id*.

70 *See Chamberlain*, 172 Cal. at 289 (because liquidated damage clause deterred competition, it constituted an unlawful restraint); *Muggill*, 62 Cal. 2d at 243 (applying rationale of *Chamberlain* to void pension forfeiture clause); *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 20 Cal. App. 3d 668, 672-74 (1971) (forfeiture of benefits under profit sharing plan contrary to public policy and void under Section 16600).

solicitation cases, but which employers have cited in support of an even broader exception authorizing "narrow" non-competition agreements that are "reasonably" necessary to prevent unfair competition.

The precursor to the so-called "trade-secret" exception was a series of "trade-route" cases, wherein the California Supreme Court upheld customer non-solicitation provisions to protect an employer's trade-secret customer list from misappropriation. The polestar of the trade-route cases is *Gordon v. Landau*.[71] In *Gordon*, the Supreme Court upheld the employment contract of a "house-to-house installment sales[person]," which prohibited him from calling on his former customers after termination.[72] Central to the court's holding was its finding that the employer's customer list "is *a valuable trade secret* and that plaintiffs were damaged by defendant's unlawful use thereof."[73] As observed in *Thompson v. Impaxx, Inc.*, the "core" reasoning of the trade-route cases is that "information about the customer could be protected because it was confidential, proprietary, and/or a trade secret."[74] Thus, prohibiting the solicitation of former customers was necessary to protect a trade secret, and therefore the contractual provision was coextensive with existing California law.[75]

After *Gordon*, the Supreme Court decided *Muggill v. Reuben H. Donnelley Corp.*,[76] a case that did *not* involve any trade secret or confidential information, but which referred to *Gordon* in *dictum* and is cited as authority for a judicially created "trade-secret" exception to Section 16600. In *Muggill*, while stating the rule of Section 16600, the Supreme Court remarked that the statute "invalidates provisions in employment contracts prohibiting an employee from working for a competitor after completion of his employment or imposing a penalty if he does so . . . *unless they are necessary to protect the employer's trade secrets*."[77]

In an attempt to reconcile *Gordon*, *Muggill*, and Section 16600's sweeping prohibition against restraints of trade, the "trade-secret" exception has been interpreted different ways. Some courts have upheld non-solicitation provisions as "narrowly tailored"[78] to protect trade-secret or confidential information when "necessary"[79] to prevent "unfair competition."[80] As reiterated in *Metro Traffic Control, Inc. v. Shadow Traffic Network*, the prevailing view is that under Section 16600, an "employer will be able to restrain by contract only that conduct of

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71 49 Cal. 2d 690 (1958).

72 *See* 49 Cal. 2d at 691-92.

73 *Id*. at 694 (emphasis added).

74 113 Cal. App. 4th at 1429.

75 *See id*.; *accord Moss, Adams & Co. v. Shilling*, 179 Cal. App. 3d 124, 130 (1986).

76 62 Cal. 2d 239 (1965).

77 *Id*. at 242 (emphasis added, citations omitted).

78 *See Kolani*, 64 Cal. App. 4th at 406 (only "narrowly tailored" restrictions are lawful); *Metro Traffic Control, Inc.*, 22 Cal. App. 4th at 861 (restrictions must be "carefully limited" or they are invalid); *Latona*, 82 F. Supp. 2d at 1095 (only "carefully limited" restrictions are valid).

79 *Thompson*, 113 Cal. App. 4th at 1429; *Moss, Adams & Co.*, 179 Cal. App. 3d at 130; *cf. Great Western etc. v. J.A. Wathen D. Co.*, 10 Cal. 2d 442, 448-49 (1937) (restriction cannot be "greater than" protection "require[d]"); *Grogan v. Chaffee*, 156 Cal. 611, 614-15 (1909) (same).

80 *Metro Traffic Control, Inc.*, 22 Cal. App. 4th at 861 (citation omitted).

the former employee that would have been subject to judicial restraint under the law of unfair competition, *absent the contract*.'"[81]

Other courts have suggested that employers may go even further and supplement the protections afforded by California unfair competition law, provided that the restriction is *not* a non-competition agreement and is "reasonably" necessary to prevent unfair competition. A leading case espousing this view is *Loral Corp. v. Moyes*, which considered an issue of first impression: "[W]hether a noninterference agreement not to solicit former coworkers to leave the employer is more like a noncompetition agreement which is invalid, or a nondisclosure or nonsolicitation agreement which may be valid."[82] In upholding the facial validity of a noninterference provision, the court broadly interpreted the *dictum* in *Muggill*,[83] stating that non-solicitation provisions are generally enforceable under the so-called "trade-secret" exception as "reasonably limited restrictions which tend more to promote than restrain trade and business [and therefore they] do not violate the statute."[84]

Instead of enforcing the plain language of Section 16600, the *Loral Corp.* court applied a judicial gloss limiting the statute. In doing so, the court distinguished cases that expressly limited the enforcement of non-solicitation provisions to the protection of trade secrets or confidential information, as cases that involved *customer* non-solicitation provisions.[85] It then *balanced competing policies and interests according to what it thought was reasonable*. It noted the then-existing uncertainty in California's unfair competition law pertaining to the solicitation of *employees* and the emerging claims of company "raiding";[86] it consider the interests of an employer in maintaining a "stable work force" and "remain[ing] in business";[87] it considered the "potential impact on trade" if non-interference provisions were valid and enforceable;[88] it found that an employee non-solicitation provision would have "no overall negative impact on trade or business";[89] and it held that the employee non-solicitation provision was "not void on its face,"[90] but could be reasonably applied to prohibit a former client or employee, "within a year of its execution," from soliciting

81 *Id.* (citation omitted); *accord Hollingsworth Solderless Terminal Co.*, 622 F.2d at 1338-39.

82 *Loral Corp.*, 174 Cal. App. 3d at 276.

83 *See id.* at 275 ("Cases suggest that when permissible solicitation of an employer's customers is at issue, a contract may prohibit more than the law of the marketplace otherwise would."); *id.* (citing *Aetna Bldg. Maint. Co. v. West*, 39 Cal. 2d 198, 203 (1952) ("*In the absence of an enforceable contract containing negative covenants to the contrary*, equity will not enjoin a former employee from soliciting business from his former employer's customers, provided his competition is fairly and legally conducted. *Thus, contractual restrictions may have more impact in a nonsolicitation case than a nondisclosure case.*") (emphasis added, internal footnote omitted)).

84 *Loral Corp.*, 174 Cal. App. 3d at 275 (citing *Great Western*, 10 Cal. 2d at 446, 448-49; *Keating v. Preston*, 42 Cal. App. 2d 110, 123 (1940); *Centeno v. Roseville Cmty. Hosp.*, 107 Cal. App. 3d 62, 69-70 n.2 (1979); *cf. Grogan*, 156 Cal. at 614).

85 *See Loral Corp.*, 174 Cal. App. 3d at 277-78 (citing *Hollingsworth Solderless Terminal*).

86 *Id.* at 276-77 ("We note that the law of unfair competition has struggled with the recurrent problem of when solicitation of another's employees gives rise to tort liability.")

87 *Id.*

88 *Id.* at 278.

89 *Id.* at 279-80.

90 *Id.* at 280.

employees for new jobs.[91]

The upshot of *Loral Corp.* is two-fold: First, *employee* non-solicitation provisions are valid on their face and enforceable *if reasonable*, even if *customer* non-solicitation provisions are enforceable only *if necessary* to protect trade secrets or confidential information. Second, if *Loral Corp.* were followed in *customer* non-solicitation cases, then *all* non-solicitation provisions would be generally enforceable. Of course, neither formulation comports with the plain language or objectives of Section 16600, but simply would result in restraints on competition and anticompetitive litigation.

3. *Whyte v. Schlage Lock Co.*: The Inevitable Disclosure Restraint

There is a basic distinction between cases applying the so-called "trade-secret" exception and the Ninth Circuit's "narrow-restraint" exception. The former cases involve non-solicitation provisions; the later involved non-competition provisions. This distinction arguably is put in doubt by *dictum* in cases like *Whyte v. Schlage Lock Co.*,[92] a case that involved neither type of provision.

In *Whyte*, an employee (Whyte) possessed confidential and trade-secret information about a customer (The Home Depot) and the business of his former employer (Schlage Lock Co.). The trial court denied a motion for a preliminary injunction that sought to enjoin Whyte from using or disclosing 20 categories of information, and selling door locks to The Home Depot.[93] The court found insufficient evidence of actual or threatened misappropriation and rejected the employer's reliance upon the inevitable disclosure doctrine.[94] The Court of Appeal affirmed the trial court's findings of no misappropriation, and published a decision against the inevitable disclosure doctrine.[95]

Unfortunately, after noting the correct rationale that federal courts in California had used to reject the inevitable disclosure doctrine (that it is contrary to California's settled policy of free competition and employee mobility),[96] the *Whyte* court arguably suggested in *dictum* that the so-called "trade-secret" exception permits narrow restraints on competition.[97] Consistent with this point of view, the court adopted a rationale to reject the inevitable

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91 *Id*. at 279.

92 101 Cal. App. 4th 1443 (2002).

93 *See id*. at 1448, 1462.

94 *See id*. at 1448.

95 *See id*. at 1447 ("In this opinion, we reject the inevitable disclosure doctrine.").

96 *See id*. at 1461-62 ("The decisions rejecting the inevitable disclosure doctrine correctly balance competing public policies of employee mobility and protection of trade secrets. The inevitable disclosure doctrine permits an employer to enjoin the former employee without proof of the employee's actual or threatened use of trade secrets based upon an inference (based in turn upon circumstantial evidence) that the employee inevitably will use his or her knowledge of those trade secrets in the new employment. *The result is not merely an injunction against the use of trade secrets, but an injunction restricting employment*.") (emphasis added); *accord GlobeSpan, Inc. v. O'Neill*, 151 F. Supp. 2d 1229, 1235 (C.D. Cal. 2001) ("'[doctrine] creates a *de facto* covenant not to compete [and] run[s] counter to the strong public policy in California favoring employee mobility'") (citation omitted); *Bayer Corp. v. Roche Molecular Sys.*, 72 F. Supp. 2d 1111, 1120 (N.D. Cal. 1999) (same); *Danjaq LLC v. Sony Corp.*, 50 U.S.P.Q. 2d (BNA) (C.D. Cal. 1999) 1638, 1640 (same).

97 *See Whyte*, 101 Cal. App. 4th at 1462 (under *Muggill,* Section 16600 "does not invalidate a noncompetition agreement that merely prohibits solicitation of the former employer's customers.").

disclosure doctrine *relied upon by courts in other jurisdictions, where restraints on competition are valid and enforceable*.[98] Relying on cases upholding non-solicitation provisions,[99] the opinion *in dictum* suggested that Schlage Lock (the employer) could have "bargained for" a narrow covenant designed to protect it from the inevitable disclosure of trade secrets that would have supported "[t]he injunction proposed by Schlage" – one "which only would proscribe Whyte from selling door locks to The Home Depot" – under a theory that such a restraint would be "narrowly tailored to protect Schlage's trade secrets."[100]

The *Whyte* court apparently realized it had moved well beyond the issues actually before the court. It was quick to point out that the law of Section 16600, not its *dictum* concerning the inevitable disclosure doctrine, should be relied upon in cases actually involving a covenant not to compete. The *Whyte* court stressed: "Lest there be any doubt about our holding, our rejection of the inevitable disclosure doctrine is complete. If a covenant not to compete . . . is part of the employment agreement, *the inevitable disclosure doctrine cannot be invoked to supplement the covenant, alter its meaning, or make an otherwise unenforceable covenant enforceable. California law concerning enforcement of noncompetition agreements, not the inevitable disclosure doctrine, would measure the covenant's scope, meaning, and validity. Our opinion does not change that law.*"[101]

Nevertheless, while the *Whyte* court specifically referenced non-solicitation provisions, its *dictum* might be read more broadly to extend to any "narrow restraint" that is "reasonably" necessary to protect trade secrets or confidential information. Employers in California might rely upon *Whyte's dictum* to restrain competition based on nothing more than a recital that the employee had access to trade secrets or confidential information. It might spawn new restraints that rely on a contractual presumption that competition by a former employee would inevitably result in or threaten the use or disclosure of trade secrets or confidential information. With the use of a presumption, they might seek to distinguish cases such as *D'Sa v. Playhut, Inc.*,[102] which rejected prior attempts to justify the use of non-competition agreements to protect trade secrets or

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98 *See id*. at 1447 ("We hold this doctrine is contrary to California law and policy because it creates an after-the-fact covenant not to compete restricting employee mobility."); *id*. at 1462-63 ("The chief ill in the covenant not to compete imposed by the inevitable disclosure doctrine is its after-the-fact nature: The covenant is imposed *after* the employment contract is made and therefore alters the employment relationship without the employee's consent. When, as here, a confidentiality agreement is in place, the inevitable disclosure doctrine 'in effect convert(s) the confidentiality agreement into such a covenant (not to compete).' (*PSC, Inc. v. Reiss* (W.D.N.Y. 2000) 111 F.Supp.2d 252, 257.) Or, as another federal court put it, 'a court should not allow a plaintiff to use inevitable disclosure as an after-the-fact noncompete agreement to enjoin an employee from working for the employer of his or her choice.' (*Del Monte Fresh Produce Co. v. Dole Food Co., Inc.* (S.D.Fla. 2001) 148 F.Supp.2d 1326, 1337; *see also* Matheson, *Employee Beware: The Irreparable Damage of the Inevitable Disclosure Doctrine* (1998) 10 Loyola Consumer L.Rev. 145, 162 ('the inevitable disclosure doctrine transforms employee access to trade secrets into a *de facto* non-competition agreement').").

99 *See Whyte*, 101 Cal.App. 4th at 1463-64 (citing *John F. Matull & Assocs., Inc. v. Cloutier*, 194 Cal.App. 3d 1049, 1054 (1987) and stating that "an employer might prevent disclosure of trade secrets through, for example, an agreed-upon and reasonable nonsolicitation clause that is narrowly drafted for the purpose of protecting trade secrets.").

100 *Whyte*, 101 Cal. App. 4th at 1463.

101 *Id* at 1463-64 (emphasis added).

102 85 Cal. App. 4th 927 (2000).

confidential information.[103] Essentially, employers might try to use contractual restraints to shift the burden of proof and treat former employees as guilty under California's unfair competition laws until proven innocent, thus enabling them to seek a temporary restraining order and preliminary injunction, not only against the use of information but also against competition, based on nothing more than a contractual recital.

III. The Three Possible Interpretations of the So-Called "Trade Secret" Exception Supported by Pre-*Edwards* Case Law

No California court ever adopted the Ninth Circuit's "narrow-restraint" exception, under which "limited" or partial post-employment restraints on competition were upheld. Similarly, no California court ever upheld a non-competition agreement under the so-called "trade-secret" exception. However, California courts have discussed in *dictum* whether employers may use post-employment restrictions to restrain competition in California. As discussed above, three different interpretations of the so-called "trade-secret" exception find support in pre-*Edwards* case law:

- First, the so-called "trade-secret" exception could mean that non-disclosure agreements, which condition the use of trade-secret or confidential information, are valid and enforceable, but that *all* covenants not to compete are void in California;[104]

- Second, it could mean that non-competition agreements are *per se* illegal, except *narrowly tailored* non-solicitation provisions, like non-disclosure provisions, are facially valid and enforceable *if necessary* to protect a trade secret or confidential information; [105] or

- Third, it could mean that *any* covenant is valid if *narrowly tailored* to protect a trade secret or confidential information, and is enforceable if *reasonably necessary* to prevent unfair competition.[106]

Under the third interpretation the so-called "trade-secret" exception would basically be an application of the Ninth Circuit's broader "narrow-restraint" exception. It would be based on a judicial gloss limiting the plain language of the statute. It would conflict with California cases holding *non-competition* agreements void on their face. It would be inconsistent with cases upholding non-solicitation provisions *only if* the employer proves an actual or a threatened misappropriation of a trade secret or breach of a legal duty. It would encourage rather than discourage the use of non-competition agreements and litigation based on restraints on competition. It would blur the basic distinction between a claim

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103 In *D'Sa*, the Court of Appeal reviewed a non-competition agreement that prohibited an employee from working "directly or indirectly" on a "Competing Product," defined as a product about which the employee had "Confidential Information." *Id.* at 930-31. The court held that merely requiring California employees to *sign* an agreement with this type of provision violated the strong public policy expressed in Section 16600. *Id.* at 933. The court flatly rejected the employer's argument that the restraint could be narrowly construed as "necessary" to protect trade secrets. *Id.* at 935.

104 *See* Bus. & Prof. Code §§ 16600 *et seq.*; *Cont'l Car-Na-Var Corp.*, 24 Cal. 2d at 110; *Chamberlain*, 172 Cal. at 288; *City Carpet,* 102 Cal. at 511.

105 *See Muggill*, 62 Cal. 2d at 242; *Gordon,* 49 Cal. 2d at 694.

106 *See Whyte*,101 Cal. App. 4th at 1462-64 (suggesting rationale could apply to justify *de facto* non-competition agreements); *but see D'Sa*, 85 Cal. App. 4th at 935 (non-compete agreement does not fall within so-called "trade-secret" exception); *Kolani*, 64 Cal. App. 4th at 407 (same); *Loral Corp.*, 174 Cal. App. 3d at 276 (same).

under the UTSA or California's unfair competition laws to enjoin an actual or a threatened misappropriation of a trade secret or breach of a confidentiality obligation, and a claim by an employer to enforce a covenant not to compete, whether to protect a trade secret or otherwise.

California courts recognize the basic difference between relief sought to prevent the use of confidential information, and to enjoin competition. In *Hilb, Rogal & Hamilton Insurance Services of Orange County, Inc. v. Robb*,[107] for example, the court plainly explained that the sought-after relief "is quite different under the two claims. The trade secret claim, at most, prevents [an employee's] use of certain information [of the former employer], but it does not bar [the employee] from competing with [his former employer] . . . ; he can still compete provided he does not use [the former employer's] trade secrets. [¶] In contrast, [a] covenant not to compete, if enforced, would prevent [the employee] from engaging in any competitive activities altogether in [a specified area] for the [specified] period after his termination. As a practical matter, the covenant not to compete acts as a complete bar to [the employee's] engaging in [at least some part of] his profession while the trade secret limitation simply regulates the manner in which he can compete. Thus, the harm [engendered by] an injunction enforcing the covenant not to compete is significantly greater than the harm under a trade secret injunction."[108]

The "bargained for" rationale suggested in cases like *Whyte* to justify a *de facto* covenant not to compete ignores that restraints on competition are contracts of adhesion – no bargaining really occurs. While some high-level employees may have the ability to negotiate their salary or other benefits, post-employment restraints are invariably offered on a "take-it or leave-it" basis.[109]

Moreover, a "bargained for" rationale ignores that employees cannot negotiate away the rights of consumers and competitors in California, let alone the protections afforded by Section 16600. The law was enacted for a public reason, *not* just to protect the individual interests of an employee, but also to protect California's overriding interests in favor of free competition and employee mobility. California's interests cannot be waived or restrained by contract.[110]

Finally, an "inevitable disclosure" justification for a restraint on competition suggested in cases like *Whyte* would be *more offensive* to California's interests than if such a doctrine were simply adopted under the UTSA. Under the guise of a bargained for exchange, employers would file non-compete litigation, restrain trade, and state a *prima facie* case by simply pointing to a contract, which recites that there are trade secrets and that misappropriation would be inevitable. Such provisions would thereby accomplish precisely what Section 16600 was enacted to prevent. In contrast, in most jurisdictions where the inevitable disclosure doctrine has been adopted under the UTSA, the law requires *more* than just an allegation that an employee had access to trade-secret or confidential information; they require employers to actually prove that the former employee

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107 33 Cal. App. 4th 1812 (1995).

108 *Id*. at 1822-23.

109 This practical reality has led to numerous lawsuits after employees are terminated for refusing to sign a non-competition agreement. *See, e.g., Thompson*, 113 Cal. App. 4th at 1432 (employee fired for refusing to sign non-solicitation agreement); *D'Sa*, 85 Cal. App. 4th at 935 (employee fired for refusing to sign non-compete agreement); *Latona*, 82 F. Supp. 2d at 1096 (same).

110 *See* Bus. & Prof. Code § 16600; Civ. Code §§ 1668, 3513; *Armendariz*, 24 Cal. 4th at 100-01; *Weber, Lipshie & Co.*, 52 Cal. App. 4th at 659.

likely possesses trade secrets or confidential information, and that unfair competition by the former employee would be "inevitable."[111]

IV. *Edwards V. Arthur Andersen LLP*—The California Supreme Court Eliminates Judicially Created Restraints on Competition

The California Supreme Court's *Edwards v. Arthur Andersen* decision is a watershed victory for free competition and employee mobility. In rejecting the Ninth Circuit's narrow-restraint exception as contrary to long-standing California precedent, the Supreme Court agreed with the positions advanced by Edwards and *amicus curiae*, and strongly reaffirmed Section 16600's sweeping prohibition against post-employment restraints on competition.

A. The Supreme Court Expresses No Tolerance for Judicially Created Exceptions to Section 16600

Edwards' employment agreement with Arthur Andersen restrained him from: (1) performing work for clients he had previously serviced at Andersen for 18 months following the termination of his employment; and (2) soliciting any client for 12 months, and any Andersen employee for 18 months, after termination of his employment.[112] After Andersen was acquired by another company, Edwards was terminated for refusing to sign an agreement releasing Andersen from claims in connection with his non-competition agreement. As a predicate for a claim for intentional interference with prospective economic advantage, Edwards argued that Andersen had violated California public policy, asserting that its non-competition agreement violated Section 16600.[113] In its defense, Andersen relied upon the Ninth Circuit's "narrow-restraint" exception; in its briefs, it also cited the so-called "trade-secret" exception as a type of justifiable narrow restraint. Edwards did not challenge the customer non-solicitation provision "or contend that the provision . . . prohibiting him from recruiting Andersen's employees violated section 16600."[114]

In rejecting the Ninth Circuit's narrow-restraint exception as contrary to long-standing precedent, the Supreme Court expressed no tolerance for judicially created exceptions. After reaffirming the Legislature's settled policy in favor of free competition and employee mobility,[115] the Supreme Court held that Section 16600's "prohibition-against-restraint rule" is "unambiguous,"[116] and that "[n]oncompetition agreements are invalid under section 16600

111 *PepsiCo, Inc. v. Redmond*, 54 F.3d 1262, 1267 (7th Cir. 1995) (requiring evidence, such as "out and out lies" and "lack of forthrightness," to prove inevitable disclosure).

112 *See Edwards*, 44 Cal. 4th at 942.

113 *Id*. at 943-44.

114 *Id*. at 946 n.4.

115 *Id*. at 945 ("in 1872 California settled public policy in favor of open competition, and rejected the common law rule of reasonableness"); *id*. at 946 ("[O]ur courts have consistently affirmed that section 16600 evinces a settled legislative policy in favor of open competition and employee mobility."); *id*. ("The law protects Californians and ensures 'that every citizen shall retain the right to pursue any lawful employment and enterprise of their choice.' . . . It protects the important legal right of persons to engage in businesses and occupations of their choosing.") (citations and internal quotation marks omitted).

116 *Id*. at 950.

in California even if narrowly drawn, unless they fall within the applicable statutory exceptions of sections 16601, 16602, or 16602.5."[117] In reaching this conclusion, the Supreme Court reiterated time and again that there is no room for judicially created exceptions that restrain lawful competition:

- "We conclude that section 16600 prohibits employee noncompetition agreements unless the agreement falls within a statutory exception . . . ."[118]

- "[I]n California, covenants not to compete are void, subject to several exceptions discussed briefly below. [¶] Section 16600 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 chapter excepts noncompetition agreements in the sale or dissolution of corporations (§ 16601), partnerships ([§] 16602), and limited liability corporations (§ 16602.5)."[119] "Under the statute's plain meaning, therefore, an employer cannot by contract restrain a former employee from engaging in his or her profession, trade, or business unless the agreement falls within one of the exceptions to the rule."[120]

- "We are of the view that California courts 'have been clear in their expression that section 16600 represents a strong public policy of the state which should not be diluted by judicial fiat.'"[121]

- "[I]f the Legislature intended the statute to apply only to restraints that were unreasonable or overbroad, it could have included language to that effect."[122]

- "[W]e leave it to the Legislature, if it chooses, either to relax the statutory restrictions or adopt additional exceptions to the prohibition-against-restraint rule under section 16600."[123]

The Supreme Court's flat rejection of any judicially created restraint that would permit the use of narrow non-competition agreements dispels the *dictum* in *Whyte*, which arguably suggested that employers could use such restraints to protect against the inevitable disclosure of protectable information. The Supreme Court has made clear that *all* employee non-competition agreements are proscribed by Section 16600, as they do not fall within one of the Legislature's statutory exceptions incorporated into the statute.

B. The Supreme Court Plainly Supports a Narrow Interpretation of the So-Called "Trade Secret" Exception—One Consistent with the Plain Language and Objectives of Section 16600

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117 *Id*. at 955.

118 *Id*. at 942.

119 *Id*. at 945.

120 *Id*. at 947.

121 *Id*. at 949 (citation omitted).

122 *Id*. at 950.

123 *Id*.

While the California Supreme Court declined to directly address the so-called "trade-secret" exception, which was not before it, that does nothing to dilute its unequivocal holding that the only exceptions to Section 16600 are the statutory ones created by the Legislature. Moreover, the Supreme Court plainly provided guidance as to what it meant in *Muggill* and where it is headed. Its flat rejection of any narrow-restraint justification for restrictions on lawful competition precludes any broad interpretation of the so-called "trade-secret" exception. The Supreme Court cited three cases involving post-employment covenants – *Metro Traffic Control, Inc. v. Shadow Traffic Network, D'Sa v. Playhut, Inc.* and *Thompson v. Impaxx, Inc.* – that support the prevailing view that under *Muggill* an "employer will be able to restrain by contract only that conduct of the former employee that would have been subject to judicial restraint under the *law of unfair competition*, *absent the contract*."[124] Based on the citation to such cases, it plainly appears that the Supreme Court will, at most, tolerate customer non-solicitation provisions where *necessary* to protect trade secrets or prevent unfair competition.[125]

The Supreme Court left the door open, though, to overrule the "trade-route" and non-solicitation cases altogether. It opined in *Edwards* that the so-called "trade-secret" exception is not really an exception at all. What it meant or what it now means by the so-called "trade-secret" exception is reflected by the case *King v. Gerold*, "an unfair competition case in which the court applied a trade secret exception to the statutory rule against noncompetition clauses. . . . In *King*, the plaintiff was not simply engaged in the manufacture and sale of goods (house trailers) but was allegedly using a trailer design substantially similar to his former employer's, the inventor of the design."[126] The *King* court upheld a license agreement restricting the use of the trade-secret design.[127] It did *not* authorize any restraint on competition, just on the use of another person's intellectual property.

Viewed through the lens of *King*, the so-called "trade-secret" exception is no different than the "exceptions" made for any contract that restricts the use of another person's property, such as restrictions found in leases that are necessary for landowners to control the use of their real property the way they see fit.[128] Under this view, the so-called "trade-secret" exception would only permit the use of non-disclosure agreements, which restrain the use of information, *not* competition.

This latter interpretation is the one that comports with the plain language and objectives of

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124 *Id*. at 946, 948.

125 With respect to the hiring and solicitation of employees, California courts have already held that broad "no-hire" provisions violate Section 16600. *See VL Sys., Inc. v. Unisen, Inc.*,152 Cal. App. 4th 708, 714-15 (2007) (distinguishing *Loral Corp.* as involving employee non-solicitation provision). Consistent with *Edwards*, California courts should now expressly limit the use of employee non-solicitation provisions, at least, to where necessary to prevent unfair competition.

126 *Edwards*, 44 Cal. 4th at 949 (citing *King,* 109 Cal. App. 2d at 318).

127 *King*, 109 Cal. App. 2d at 318 (rejecting manufacturer's argument that clause barring it from producing product after license expiration was an illegal restraint under Section 16600).

128 *See, e.g., Boughton v. Socony Mobil Oil Co., Inc.*, 231 Cal. App. 2d 188, 192 (1964) (restrictions on use of real property do not restrain trade within meaning of Section 16600), *disapproved on other grounds by Edwards*, 44 Cal. 4th at 950 n.5 (overruling *Boughton* and *King* "to the extent they are inconsistent with our analysis").

Section 16600. It is the only interpretation that prevents litigation based on post-employment restraints on competition, and does not infringe upon an employee's right to compete.

V. The California Supreme Court Should Reverse or Clarify the "Trade-Route" and Non-Solicitation Cases

California's statutory scheme regulating contractual restraints of trade makes no exception for trade-secret protection – which is in stark contrast to the statutory schemes in other states.[129] Nor has the Legislature provided an exception for any other proprietary or property right, or interest of an employer – even though the Legislature has often amended its statutory scheme.[130] Thus, there is no justification for any judicially created exception for trade-secret protection or otherwise.

Cases such as *Whyte* forget that California law is duly solicitous of an employer's right to protect its property and to be free from unfair and unlawful competition. "That equity will always protect against the unwarranted disclosure of trade secrets and confidential communications and the like is, of course, settled beyond peradventure."[131] Today, these rights are secured through a variety of different laws, including California's Uniform Trade Secrets Act (Civ. Code §§ 3426 *et seq.*), Unfair Competition Law (Bus. & Prof. Code §§ 17200 *et seq.*), and other laws prohibiting breach of fiduciary duty, tortious interference with contractual relations, and the like.

Section 16600 does absolutely nothing to undermine those rights or to prevent an employer from invoking the appropriate laws to protect itself against unfair competition. Section 16600 no more permits a departing employee to misappropriate his former employer's trade secrets or confidential customer or employee information than it permits him to steal money, kidnap his former employer's salespersons, or burn down his former employer's factory. Contractual restraints that purport to "protect" rights of an employer that are already protected by other laws are superfluous.

With this observation in mind, it is apparent that contractual restraints for the protection of trade secrets and the like are *never* "necessary" because those rights are already protected by California trade-secret and unfair competition laws without the restraint, which is precisely what the Supreme Court recognized in *Empire Steam Laundry*.[132] A good example is found in *Morlife, Inc. v. Perry*,[133] where former employees of a commercial roofing repair company started up a competing business and began calling on customers of their former employer. The employer sued them for "misappropriating confidential customer information."[134] There is no mention that the employees had contractual agreements not to solicit former customers, or that the employer was attempting to enforce any such restraint.

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129 *See supra* note 35.

130 *See Bosley Med. Group*, 161 Cal. App. 3d at 289.

131 *Empire Steam Laundry*, 165 Cal. at 100-02; *Cont'l Car-Na-Var Corp.*, 24 Cal. 2d at 110.

132 *See supra* note 11.

133 56 Cal. App. 4th 1514 (1997).

134 *Id.* at 1517.

Traveling under the UTSA, the employer pleaded and proved that its customer list was a trade secret and obtained an injunction against the use of the list by its former employees.[135]

Had this same approach been taken in *Gordon*, the so-called "trade secret" exception might never have been born. Given the California Supreme Court's finding that the customer list in *Gordon* constituted "a valuable trade secret," it is quite likely that the Court would have reached the exact same result, and afforded the exact same relief, even if there had been no contractual restraint.

A. The California Supreme Court Should Declare Customer Non-Solicitation Provisions Void

To fulfill the Legislative mandate of Section 16600 and eliminate existing abuse of the so-called "trade-secret" exception, the Supreme Court should reverse the timeworn "trade-route" cases and clarify its holding in *Gordon* and *dictum* in *Muggill*. The court should declare that customer non-solicitation provisions are void, period. They are not necessary to protect trade secrets or confidential information, and cannot be "narrowly tailored" to protect the employer's interests without violating California's interests embodied in Section 16600.

Existing California decisions lend strong support for this position. Initially, there can be no doubt that customer non-solicitation clauses are anticompetitive. As one court rhetorically observed, "[while such] clause[s] [are] less restrictive, and less anticompetitive than the broad, traditional anticompetitive clauses . . . . [they are] nevertheless anticompetitive – why else would [the employer] ask employees to sign [one]?"[136] Employers use non-solicitation provisions to protect customer relations and goodwill. Protecting customer information is just a means to an end.

Even if intended to protect confidential information, non-solicitation clauses are never "necessary" to protect the employer's legal rights because the employer already enjoys such protection under other laws. Insofar as an employer believes it necessary to have some type of contractual protection against the misappropriation of its trade secrets or confidential information, a simple non-disclosure clause will do.[137]

Finally, it can never be determined that a non-solicitation clause is "narrowly tailored" to protect trade secrets because the question whether a customer list is a trade secret can never be answered solely with reference to the contract. As one court correctly observed, "an agreement between employer and employee defining a trade secret may not be decisive in determining whether the court will so regard it."[138] Indeed, "[t]he issue of whether information constitutes a trade secret is a question of fact . . . . [*and] recitals [in the employment agreement] alone do not*

135 *Id*. at 1519-21. Another example is *Hollingsworth Solderless Terminal*, where the court held that it could not determine if a restraint violated Section 16600, because the employer's separate, unfair competition claim had not yet been determined. 622 F.2d at 1338-39. In other words, the contractual restraint was entirely superfluous and redundant of the employer's rights under California's unfair competition laws.

136 *Thompson*, 113 Cal. App. 4th at 1429.

137 *See Latona*, 82 F. Supp. 2d at 1096 (employer's confidentiality agreement provides "all of the protection of its trade secrets and other confidential information that the law allows.").

138 *Loral Corp.*, 174 Cal. App. 3d at 275.

establish anything. Labeling information as a trade secret or as confidential information does not conclusively establish that the information fits this description."[139]

It follows that three likely outcomes result from the use of customer non-solicitation clauses. The first outcome is litigation to determine whether the former employer's customer list is entitled to trade-secret protection. The most curious aspect of this alternative, however, is that the litigation would have nothing to do with the contractual restraint. Rather, the employer would have to demonstrate trade secret status under the pleading and proof requirements of the UTSA.[140]

A second and more likely outcome is that the employee and prospective employers will simply adhere to the contractual restraint based on what one court aptly described as the *in terrorem* effect:

> Even if they strongly suspect that [the clause] is unenforceable, . . . employees will be reluctant to challenge the legality of the contractual terms and risk the deployment of [the former employer]'s considerable legal resources against them. Thus, the *in terrorem* effect of the [a]greement will tend to secure employee compliance with its illegal terms in the vast majority of cases. Prospective future employers, too, may be reluctant to hire [the former employer]'s workers; even if secure in the knowledge of the unenforceability of [the] clause, these employers may well wish to avoid the expense and energy of defending a lawsuit in which they are likely to be joined.[141]

The third and most likely outcome is that the employee, "having no reason to familiarize [himself] with the specifics of California's employment law, will tend to assume that the contractual terms proposed by their employer . . . are legal, if draconian."[142] Such employees would likely "act on their interpretation rather than consult an attorney to find out if their interpretation is correct."[143] As a result, they would be deceived as to their rights and "honor these clauses . . . , thus directly undermining the statutory policy favoring competition."[144]

If we still lived in simpler times when milkmen, ice companies, bakeries, launderers, and all manner of salesmen plied their trades from door to door, perhaps the thinking of *Gordon* and other "trade-route" cases would retain some currency. But times have changed. Today, employers use (or more accurately, misuse) non-solicitation provisions primarily, if not solely, to protect themselves against competition. Recent decisions plainly demonstrate the penchant

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139 *Thompson*, 113 Cal. App. 4th at 1430 (emphasis added).

140 *See id*. (recognizing possibility that former employer might prove that its customer information fit the definition of a trade secret under Civ. Code § 3426.1); *see also Hollingsworth Solderless Terminal*, 622 F.2d at 1338-39 (question whether contractual restraint was enforceable turned on whether employer could prevail on its separate claim for unfair competition).

141 *Latona*, 82 F. Supp. 2d at 1097-98.

142 *Id*. at 1097.

143 *D'Sa*, 85 Cal. App. 4th at 935.

144 *Kolani*, 64 Cal. App. 4th at 407.

of California employers to use broad, illegal clauses even under existing law.[145] Moreover, a long line of California cases reveals that employers will always be willing to use such clauses to deceive and intimidate former employees from calling on their customers, even where it is readily apparent given the "open" nature of the market that customer information is *not* trade secret or confidential.[146] It follows that non-solicitation provisions, today, should be declared illegal *per se*, without having to engage in the pretense of discerning anyone's intent or the anticompetitive effect of the restraint in any given case.

Put simply, the Supreme Court should recognize that *de facto* compliance is inherent in *all* contractual restraints, and offends California's interest in preventing anticompetitive conduct, including litigation based upon the restraint. Judicially created "exceptions" to the Legislature's bright-line rule make the problem worse by encouraging or at least inviting litigation, thus fostering the *in terrorem* effect, which flies directly in the face of what Section 16600 was intended to accomplish.

B. *Loral Corp.'s* Broad Authorization of Employee Non-Solicitation Provisions Should Be Overruled

California law is clear that no actionable wrong is committed by a competitor, including a client or former employee, "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."[147] Nevertheless, in *Loral Corp.*, the court authorized employee non-solicitation provisions or "non-interference" provisions to prevent clients and/or former employees from soliciting an employer's human resources.

The holding in *Loral Corp.* should be reversed. It, too, is contrary to the plain language and objectives of Section 16600. The court engaged in a balancing of relevant interests that is contrary to the balance struck by the Legislature in favor of free competition and employee mobility. The court also relied upon the perceived reasonableness of the post-employment restraint, when the Legislature had long-ago rejected the "rule of reason" in the employment context.

Other justifications proffered in support of *Loral Corp.*'s holding either no longer apply, or never did apply. For example, there no longer is any uncertainty in the law to justify the prophylactic use of employee non-solicitation provisions. In *Reeves v. Hanlon*,[148] the Supreme Court plainly re-affirmed California's policy in favor of employee mobility and held that the solicitation of a competitor's at-will employees, while disruptive, is neither wrongful nor actionable unless the plaintiff "plead[s] and prove[s] that the defendant engaged in *an independently wrongful act* – *i.e.*, an act 'proscribed by some constitutional,

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145 *See id.* at 407; *D'Sa*, 85 Cal. App. 4th at 935; *Latona*, 82 F. Supp. 2d at 1097.

146 *See, e.g., Cont'l Car-Na-Var Corp.*, 24 Cal. 2d 104; *Am. Paper & Packaging Prods., Inc. v. Kirgan*, 183 Cal. App. 3d 1318 (1986); *Fortna v. Martin*, 158 Cal. App. 2d 634 (1958); *Mathews Paint Co. v. Seaside Paint & Lacquer Co.*, 148 Cal. App. 2d 168 (1957); *Avocado Sales Co. v. Wyse*, 122 Cal. App. 627 (1932).

147 *Diodes, Inc.*, 260 Cal. App. 2d at 255.

148 33 Cal. 4th 1140 (2004).

statutory, regulatory, common law, or other determinable legal standard.'"[149] In *Reeves*, there were many "independently wrongful acts" that accompanied the complained-of hiring. The new employers – a former name partner and the former litigation chairman of the old employer, a law firm – abruptly and simultaneously left their former firm, breached their fiduciary and ethical duties, did not assist in the orderly transition of client files, deleted and destroyed the former employer's computer files, misappropriated trade secrets in the form of confidential customer lists, and even stole a company car.[150] The Supreme Court held that these were the "independently wrongful acts" that defendants engaged in to "cripple[] plaintiffs' business and cause[] plaintiffs' personnel to terminate their at-will employment contracts."[151] There was no need to resort to any restrictive covenant; California law already protected the employer's rights.[152]

Subsequent decisions such as *Thompson v. Impaxx, Inc.* have made clear that *Loral Corp.'s* broad reading of *Muggill* was mistaken. *Muggill* did not state that employers could add to the protections already afforded to employers by California's unfair competition laws and thereby restrain lawful competition. Rather, *Muggill* stated in *dictum* that post-employment restrictions are invalid unless necessary to protect trade secrets. The Supreme Court did not inject any "reasonableness" inquiry into the analysis, or authorize the restraint of lawful competition.

California courts should not "second guess" the Legislature's policy choice in favor of free competition and employee mobility and restrain open competition for employees under the guise of promoting a profession, trade or business. "The freedom to compete necessarily contemplates the probability of harm to the commercial relations of other participants in the market."[153] That type of harm is merely "competitive strife" and must be expected in any open market for goods, services and employees, and does not give rise to any cognizable legal or equitable claim.[154] "[I]f the law were to the contrary, the result 'would be intolerable, both to such employers as could use [an] employe[e] more effectively and to such employe[e]s as might receive added pay."[155]

Conclusion

The Supreme Court in *Edwards v. Arthur Andersen* took a major step in affirming California's strong public policy in favor of free competition and employee mobility – confirming that Section 16600's sweeping prohibition against post-employment restraints affords no room for judicially created exceptions that restrain competition. It effectively

149 *Id*. at 1152-53 (citation omitted, emphasis added).

150 *See id*. at 1145, 1154-55.

151 *Id*. at 1155.

152 *See, e.g., Buxbom v. Smith*, 23 Cal. 2d 535, 545 (1944) (predatory hiring); *Bankcroft-Whitney Co. v. Glen*, 64 Cal. 2d 327, 352-53 (1966) (breach of fiduciary duty and improper use of confidential information in hiring process).

153 Restatement (Third) of Unfair Competition § 1 (emphasis added).

154 *Reeves,* 33 Cal. 4th at 1149.

155 *Id*. at 1151 (citation omitted).

overrules *dictum* in *Whyte*, which arguably suggested that a covenant not to compete may be valid and enforceable to prevent the inevitable disclosure of trade secrets, and *dictum* in *Loral Corp*., which suggested that non-solicitation provisions may be valid and enforceable even if not necessary to protect trade secrets or confidential information. The Supreme Court also provided guidance as to what it meant in *Muggill* or what it now means by the so-called "trade-secret" exception: It permits contracts, such as licenses and non-disclosure agreements, which merely restrict the use of intellectual property. This interpretation is the only one that comports with Section 16600 and the *Edwards* decision.