

# Customers, Co-workers and Competition: Employee Covenants in California after *Edwards v. Arthur Andersen*

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## I. Introduction

This Note addresses an open question in California employment law—whether an employer can contractually prevent an employee from soliciting former co-workers. This question is particularly interesting because of employee turnover in California’s high-technology companies.<sup>1</sup> It is not unusual for a new start-up to have several employees who worked together at a previous employer, often recruited by a former co-worker.

California Business and Professions Code section 16600 declares that any contract by which anyone is restrained from pursuing a lawful profession or trade is void.<sup>2</sup> Case law is well settled that prohibitions on merely competing with a former employer or soliciting the business of former customers without using trade secrets or confidential information are unenforceable.<sup>3</sup> But the sparse case law addressing co-worker solicitation—principally 1985’s *Loral Corp. v. Moyes*—indicates that a restriction on recruiting or hiring

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1. For a lengthy discussion of the effects of California’s legal regime on the Silicon Valley economy, see Ronald 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, 607–13 (1999).

2. CAL. BUS. & PROF. CODE § 16600 (West 2011).

3. See, e.g., *Muggill v. Rueben H. Donnelly Corp.*, 62 Cal. 2d 239, 242 (1965) (“[Section 16600] invalidates provisions in employment contracts prohibiting an employee from working for a competitor after completion of his employment . . . unless they are necessary to protect the employer’s trade secrets.”) (citations omitted).

employees of the former employer might be permitted.<sup>4</sup> The 2008 California Supreme Court decision in *Edwards v. Arthur Andersen LLP* calls this case law into question both in dicta casting doubts on the judicially created trade secret “exception” to section 16600, and in its holding that restraints on an employee are not valid simply by virtue of being reasonable and narrowly tailored.<sup>5</sup>

In some of the earliest decisions involving section 16600’s predecessor—Civil Code section 1673—the California Supreme Court held that the statute had replaced the common law rule of reason, and that the statute did not permit even partial or limited restraints.<sup>6</sup> During the second half of the twentieth century, jurisprudence developed that contractual restraints on unlawful post-employment activity were enforceable. This typically took the form of a specific exception for use of trade secrets or confidential information, or other forms of unfair competition. In some cases, courts relied on section 16600 in situations where it arguably did not (or need not) apply, such as deed-based restrictions in use of land,<sup>7</sup> wholesale and retail distributorship agreements,<sup>8</sup> and manufacture of licensed designs.<sup>9</sup>

As state claims involving section 16600 began to be raised more frequently in the federal courts, California district courts and the Ninth Circuit Court of Appeals attempted to unify the sometimes inconsistent mass of California state precedent. In doing so, they arrived at the “narrow restraint doctrine”—that section 16600 permitted restraints on former employees if reasonable, carefully limited and narrowly tailored.<sup>10</sup> California state courts acknowledged this interpretation, but generally declined to apply it, and in 2008 the California Supreme Court explicitly rejected it.<sup>11</sup>

Re-examining the rationale of *Loral Corp. v. Moyes*—the 1985 decision which upheld a co-worker non-solicitation covenant—shows it to be at odds with subsequent decisions. The *Loral* court compared

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4. 174 Cal. App. 3d 268, 279 (1985).

5. 44 Cal. 4th 937, 955 (2008).

6. See, e.g., *Chamberlain v. Augustine*, 172 Cal. 285, 289 (1916); *Morey v. Paladini*, 187 Cal. 727, 738 (1922).

7. *Boughton v. Socony Mobil Oil Co.*, 213 Cal. App. 2d 188, 192–93 (1964).

8. *Great Western Distillery Prods. v. John A. Wathen Distillery Co.*, 10 Cal. 2d 442, 446 (1937).

9. *King v. Gerold*, 109 Cal. App. 2d 316, 318 (1952).

10. See *Int’l Bus. Machs. Corp. v. Bajorek*, 191 F.3d 1033, 1040–41 (9th Cir. 1999).

11. See *Edwards v. Arthur Andersen LLP*, 44 Cal. 4th 937, 949 (2008).

solicitation of employees to solicitation of customers, but allowed a restriction on employee solicitation without any showing that trade secrets or confidential information was involved, which *was* a requirement for enjoining solicitation of customers. The *Loral* court further reasoned that imposing a one-year restriction on soliciting former employees was reasonable and placed only a small and limited restraint on business—a rationale mirroring the federal narrow restraint doctrine which was rejected in *Edwards*. In light of these developments, *Loral* is probably no longer good law.

Solicitation of co-workers might still be unlawful in some situations. For example, if soliciting a former co-worker involved the use of trade secrets, was a breach of the duty of loyalty or fiduciary duty, or constituted unfair competition, this would be independently wrongful. An employer could attempt to define this conduct and prohibit it in an employee covenant, but in practice drafting such an agreement would be difficult, and attempting to enforce it would be little more effective than bringing a cause of action directly for the tortious conduct. Although the notion that employees' identities and skills could be a protectable trade secret might be used as justification for employee non-solicitation clauses, this argument is substantially weakened by social and business networking sites such as LinkedIn.com, where employees post their resumes and expertise, often linked to company pages maintained by the employers themselves. Despite this, an employee covenant remains valuable in the broader trade secret context by helping to define the scope of the employers' trade secrets and demonstrate measures to maintain their secrecy.

## II. The Problem

The provisions in employment agreements most commonly contested under section 16600—outright non-competition, misuse of trade secrets and confidential information, and solicitation of customers—are addressed in a substantial body of case law.<sup>12</sup> But very little case law directly addresses covenants prohibiting solicitation of employees and former co-workers. For example, in a 1969 case, *Buskuhl v. Family Life Ins. Co.*, a court found a provision not to induce agents of a life insurance company to represent another company “not such an inhibition upon a former employee’s right to

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12. See *Thomas Weisel Partners LLC v. BNP Paribas*, No. 07-6198 MHP, 2010 WL 546497, at \*3-5 (N.D. Cal. Feb. 10, 2010) (discussing various types of provisions in employee covenants which implicate section 16600).

engage in a trade, business, or profession as to be within the proscription of section 16600.”<sup>13</sup> However, the case most often cited for authority is *Loral Corp. v. Moyes* from 1985, where an employee non-solicitation clause was allowed, but constrained to a one-year duration.<sup>14</sup> The *Buskuhl* and *Loral* courts evaluated employee non-solicitation covenants by analogy to customer non-solicitation agreements, and permitted the clauses because of their narrow impact. But case law even at that time was fairly settled that customer non-solicitation clauses were only valid to the extent they protected trade secrets,<sup>15</sup> and the California Supreme Court in *Edwards v. Arthur Andersen LLP* explicitly rejected the theory that a post-employment restriction is acceptable if it is narrowly drawn.<sup>16</sup> Subsequent to *Edwards*, a court suggested that a contractual restriction is valid only if the conduct would be independently tortious.<sup>17</sup> In light of these developments, the validity of employee non-solicitation covenants is uncertain. Is the rationale underlying precedent like *Loral* still solid? Are employee non-solicitation agreements defensible on some other theory, such as enjoining an independent tort? Even if allowed, what are the practical difficulties with employee non-solicitation agreements in today’s well-connected society? And finally, given the hostility towards employee covenants in California, are they more trouble than they are worth?

### III. *Loral Corp. v. Moyes* and Employee Non-Solicitation Covenants

The proposition that an employer may restrain a former employee from soliciting former co-workers was largely established by a 1985 case, *Loral Corp. v. Moyes*.<sup>18</sup> Moyes was a former officer and director of a Loral subsidiary, who had signed an agreement to not “now or in the future disrupt, damage, impair or interfere with the business” of his former employer, by “interfering with or raiding its employees, disrupting its relationships with customers, agents,

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13. 271 Cal. App. 2d 514, 522–23 (1969).

14. 174 Cal. App. 3d 268, 279 (1985).

15. See, e.g., *Muggill v. Rueben H. Donnelly Corp.*, 62 Cal. 2d 239, 242 (1965); *Thompson v. Impaxx, Inc.*, 113 Cal. App. 4th 1425, 1429 (2003).

16. 44 Cal. 4th 937, 955 (2008).

17. See *Retirement Grp. v. Galante*, 176 Cal. App. 4th 1226, 1238 (2009) (“[C]onduct is enjoined . . . because it is wrongful independent of any contractual undertaking.”).

18. 174 Cal. App. 3d 268 (1985).

representatives or vendors.”<sup>19</sup> After Moyes left Loral to become president of a competitor, he recruited and hired several people away from his former employer.<sup>20</sup> The California Court of Appeal ultimately upheld the contract, but limited its enforcement to only one year following Moyes departure.<sup>21</sup>

Commentators criticized *Loral* soon afterwards for basing its decision in large part on distinctions between contractual restrictions on “solicitation” versus “interference,” without satisfactorily explaining how they differ.<sup>22</sup> *Loral* was also criticized for using non-California cases, and applying precedent based on sections 16601 and 16602 (relating to sale of business or goodwill) which was inapplicable in this post-employment covenant situation.<sup>23</sup> In light of developments in the twenty-five years since *Loral* was decided, two additional aspects of the decision are questionable: first, the court’s analogy of employee solicitation to customer solicitation (while sidestepping any requirement for protection of trade secrets),<sup>24</sup> and second, the apparent decision to permit the restriction because of its reasonableness, its allegedly narrow impact, and its court-imputed one-year duration not present in the original contract.<sup>25</sup>

#### **IV. Business and Professions Code Section 16600 and Its Judicial Exceptions**

To properly re-evaluate *Loral* and its holding on employee non-solicitation agreements, it is necessary to review section 16600’s history and more recent statutory interpretations, not only in California state courts, but also in the federal courts.

In 1872, California’s legislature expressed a strong state policy in favor of open competition and free trade in Civil Code section 1673. The language of the statute dictates broad application: “Every

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19. *Id.* at 274.

20. *Id.*

21. *Id.* at 279.

22. James H.A. Pooley, *Restrictive Employee Covenants in California*, 4 SANTA CLARA COMPUTER & HIGH TECH. L.J. 251, 269 (1988).

23. *Loral Corp.*, 174 Cal. App. 3d at 267–68.

24. *Id.* at 279 (“This does not appear to be any more of a significant restraint on his engaging in his profession, trade or business than a restraint on solicitation of customers or on disclosure of confidential information.”).

25. *Id.* (“[E]nforceability depends upon its reasonableness, evaluated in terms of the employer, the employee, and the public. . . . [T]here is no statutory problem in applying it to Moyes’ conduct within a year of its execution.”).

contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind . . . is to that extent void.”<sup>26</sup>

In early decisions, the California Supreme Court confirmed that the legislature had abandoned the common law “rule of reason” in this area. In 1892 in *Vulcan Powder Co. v. Hercules Powder Co.*,<sup>27</sup> the court noted that the common rules allowing reasonably limited restraints on trade had been “uncertain” and “perplexing” and were now overruled by statute.<sup>28</sup> In 1916 in *Chamberlain v. Augustine*<sup>29</sup> and again in 1922 in *Morey v. Paladini*,<sup>30</sup> the court reiterated that the statute was absolute, permitting no exceptions for partial or limited restraints.<sup>31</sup>

### A. An Alternative Way to Classify Section 16600 Cases

Commentators and judges have classified cases applying section 16600 in a variety of sometimes inconsistent ways—narrow exceptions, trade secret or confidential information exceptions, exceptions as to property, geographic or temporal restriction, and so on—basing the classification on the facts of the case, specifically the nature of the contractual restriction.<sup>32</sup> It is also useful to classify them at a more abstract level relative to the text of the statute itself. First, where section 16600 was inapplicable—that is, where there was no applicable contract. Second, where there is a contract which involves trade, but does not restrain a profession, trade or business. Third, where there is a contract, but it does not restrain *lawfully* engaging in

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26. CAL. CIV. CODE § 1673 (Deering 1924), *repealed by* ch. 526, § 2, 1941 Cal. Stats.1847 *and enacted as* CAL. BUS. & PROF. CODE § 16600, Act of May 31, 1941, ch. 526, § 1, 1941 Cal. Stats. 1834. Civil Code section 1673 was accompanied by sections 1674 and 1675, providing exceptions for persons selling the goodwill of a business, and partners dissolving or dissociating from a partnership, which were contemporaneously repealed and reenacted as Business and Professions Code sections 16601 and 16602.

27. 96 Cal. 510 (1892).

28. *Id.* at 513 (“The [common law] rule, however, was uncertain, and led to much perplexing legislation; and the law upon the subject in this state is now declared in section 1673 of the Civil Code.”); *see also* *Bosley Med. Grp. v. Abramson*, 161 Cal. App. 3d 284, 288 (1984) (explaining that the rule of reasonableness in context of trade restraints was rejected in California in 1872).

29. 172 Cal. 285 (1916).

30. 187 Cal. 727 (1922).

31. *Id.* at 738 (“The statute [Civ. Code, sec. 1673] makes no exception in favor of contracts only in partial restraint of trade.”) (citing *Chamberlain*, 172 Cal. 285 at 289).

32. For a history of the statute and a comprehensive list of cases, see Tait Graves, *Nonpublic Information and California Tort Law: A Proposal for Harmonizing California’s Employee Mobility and Intellectual Property Regimes Under the Uniform Trade Secrets Act*, 2006 UCLA J. L. & TECH. 1, 5–7 (2006).

a profession, trade or business. This last category is informed by the notion that unlawful or tortious conduct is wrongful independent of any contractual duty, and should not be excused because of an unenforceable contract against it.<sup>33</sup> As this Note focuses on employee covenants, it is also important to analyze where precedent involving section 16600 in a non-employment context is applied in a case which concerns an employer-employee relationship. While this does not necessarily render the precedent suspect, different and sometimes conflicting public policy concerns are implicated—employee mobility versus free trade versus fair competition, for example.

### B. Restrictions Outside the Scope of Section 16600

In 1964 in *Boughton v. Socony Mobil Oil Co.*<sup>34</sup> the Court of Appeal appeared to permit a narrow exception to section 16600 for a land-use condition. A deed contained a restriction that prohibited using the land as a service station for a period of time, and appellants argued it violated section 16600.<sup>35</sup> The Court first concluded that the deed restriction did not fall within section 16600 at all, because it was not a personal covenant or contract as to the appellants, but a restriction on the land they owned.<sup>36</sup> This would have been sufficient to dispense with the section 16600 issue, but with perhaps an overabundance of judicial caution, the Court held alternatively that the restriction would also not violate section 16600 because the plaintiffs were barred from operating a service station “merely . . . on those premises and then only for a limited time.”<sup>37</sup> Although it is true that the effect of the deed was to restrain the plaintiffs from engaging in a specific trade in a specific location for a specific period of time (which certainly *sounds* like a narrow restraint), this restraint did not arise out of a contract within the ambit of section 16600. Despite this,

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33. See Robert Hays, *Unfair Competition – Another Decade*, 51 CALIF. L. REV. 51, 69 (1963) (employer can only restrain by contract conduct that would otherwise be considered unfair competition). *But see* Kate O’Neill, ‘*Should I Stay Or Should I Go?—Covenants Not to Compete In a Down Economy: A Proposal for Better Advocacy and Better Judicial Opinions*, 6 HASTINGS BUS. L.J. 83, 90 (2010) (arguing that a contract claim is the cheapest, simplest and fastest way for employers to protect their interests, and thus employers have incentive to use covenants wherever possible).

34. 213 Cal. App. 2d 188 (1964) (*disapproved of by* *Edwards v. Arthur Andersen LLP*, 44 Cal. 4th 937, 950 n.5 (2008)).

35. *Id.* at 190.

36. *Id.*; *see also* *L.A. Land & Water Co. v. Kane*, 96 Cal. App. 418, 420 (1929) (noting that restrictions on use of property are valid unless imposed for an unlawful purpose, such as a monopoly).

37. *See Boughton*, 213 Cal. App. 2d at 193–94.

and even though *Boughton* was not a decision in an employment context, it was nonetheless used as authority for narrow restraints in later decisions involving employer-employee agreements.<sup>38</sup>

### C. Contracts Involving Trade, but Not Restraining It

In 1937 the California Supreme Court held, in *Great Western Distillery Products v. John A. Wathen Distillery Co.*,<sup>39</sup> that contracts whose main purpose is to promote and increase business are not invalid just because they might “in some theoretical way incidentally and indirectly restrict trade.”<sup>40</sup> The contract at issue, however, was a type of exclusive distribution agreement between two businesses. The court found that the intent of this contract was to promote and increase trade benefiting both parties, rather than restrict trade to the benefit of one and the detriment of the other.<sup>41</sup> This case appears to support the proposition that small or incidental (i.e., narrow) restraints are permissible despite section 16600. However, underlying the court’s holding was the determination that the contract was not a restraint of trade at all, rather than it being an exception to the statute.<sup>42</sup> This case was cited in *Loral* in support of “reasonably limited restrictions” in an employment agreement even though, like *Boughton*, it did not involve any sort of employer-employee relationship.<sup>43</sup>

### D. Contracts Restricting Unlawful Acts

In *King v. Gerold*,<sup>44</sup> decided in 1952, the California Court of Appeal appeared to permit a partial exception to section 16600 when it allowed an agreement prohibiting manufacture of a licensed trailer design after the license period expired.<sup>45</sup> The court found that the agreement barred manufacturing and selling only the licensed design,

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38. See *Int’l Bus. Machs. Corp. v. Bajorek*, 191 F.3d 1033, 1040 (9th Cir. 1999); *Campbell v. Bd. of Trs. of Leland Stanford Junior Univ.*, 817 F.2d 499, 502 (9th Cir. 1987); *Latona v. Aetna U.S. Healthcare, Inc.*, 82 F. Supp. 2d 1089, 1094 (C.D. Cal. 1999); *Scott v. Snelling & Snelling, Inc.*, 732 F. Supp. 1034, 1042 (N.D. Cal. 1990).

39. 10 Cal. 2d 442 (1937).

40. *Id.* at 446.

41. *Id.* at 449–50.

42. *Id.* at 446 (“The contract does not restrain anyone from exercising a trade or business of any kind within the purview of section 1673 of the Civil Code.”).

43. See *Loral Corp. v. Moyes*, 174 Cal. App. 3d 268, 276 (1985).

44. 109 Cal. App. 2d 316 (1952).

45. *Id.* at 318–19.

and did not prohibit carrying on an entire business or profession.<sup>46</sup> The court's reasoning might imply that the restraint on manufacturing the trailer was permissible under section 16600 because it was merely a narrow limitation.<sup>47</sup> However, the plaintiff licensed the right to manufacture and sell the trailer only for a limited time; once the license expired there was no longer a right to do so.<sup>48</sup> Consequently, manufacturing and selling the trailer (without the license) was engaging in an unlawful profession, business or trade—entirely outside the scope of 16600's protection.

### E. The “Trade Secret Exception” as a Prohibition on Unlawful Trade

In 1913 the California Supreme Court noted that preventing “unwarranted disclosure and unconscionable use of trade secrets” (i.e., misappropriation) was so fundamental a part of every business relationship that no contract was required to prohibit it.<sup>49</sup> The corollary to this is that misusing or misappropriating trade secrets cannot somehow become lawful simply because a contract not to do so is unenforceable. Stated in the language of section 16600, misusing trade secrets would not be *lawfully* engaging in one's profession, trade or business; therefore a contract to that effect is valid.<sup>50</sup>

Once a court determines that at least part of a contract enjoins misuse of trade secrets or confidential information, that portion tends

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46. *Id.*

47. Like *Boughton v. Socony*, *King v. Gerold* was used to support decisions articulating the narrow restraint doctrine, until the California Supreme Court disapproved of it in *Edwards*. See, e.g., *Campbell v. Bd. of Trs. of Leland Stanford Junior Univ.*, 817 F.2d 499, 503 (9th Cir. 1987) (noting that the defendant in *King* was narrowly restrained only from producing a particular licensed design, and but was free to produce other models).

48. The *King* decision does not elaborate on the type of intellectual property covered by the license, but describes respondent King as the “inventor and designer of a house trailer.” *King*, 109 Cal. App. 2d at 317. Nowhere does appellant Gerold appear to have challenged the contract as void because the subject design was in the public domain, and trade secrets are not mentioned anywhere in the decision. The license may have been predicated on copyright, as the case predates federal copyright preemption (17 U.S.C. § 301 enacted in 1978). The decision also uses some copyright language, for example noting that Gerold manufactured and sold “a trailer substantially similar to that designed” by King. *Id.* at 317. But regardless of the basis, the court accepted that the trailer design was licensable, and as such, manufacturing it without license would be unlawful. *Id.* at 319.

49. *Empire Steam Laundry v. Lozier*, 165 Cal. 95, 99 (1913).

50. See, e.g., *Fortna v. Martin*, 158 Cal. App. 2d 634, 638–41 (1958) (finding a covenant not to compete with a former employer invalid under section 16600, and no evidence showing independent misuse or misappropriation of trade secrets to otherwise merit an injunction).

to be upheld.<sup>51</sup> For example, in 1958 in *Gordon v. Landau*, the California Supreme Court held that a list of preferred customers is a “valuable trade secret” and that a contract prohibiting a former employee from using that list is valid and enforceable.<sup>52</sup> In 1965 the California Supreme Court, in *Muggill v. Rueben H. Donnelly Corp.*, held emphatically that section 16600 invalidates non-competition agreements or penalties such as forfeiture of retirement benefits for competitive employment, unless necessary to protect trade secrets.<sup>53</sup> A federal court shortly afterwards in *Armorlite Lens Co. v. Campbell* invalidated a post-employment invention assignment agreement to the extent that the invention was not based on trade secrets.<sup>54</sup> Subsequently, courts consistently allowed contractual restrictions on former employees when the court agreed that the restriction involved trade secrets or confidential information, but, with a few notable exceptions such as *Loral*, disallowed them where trade secrets were not implicated.<sup>55</sup>

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51. The tests used to determine if trade secret are implicated have varied (and in some instances the court was entirely conclusory). This Note does not consider whether the courts’ factual determinations were correct—but observes that courts generally enforce any portion of a contract that in their opinion serves to protect secrets or confidential information.

52. 49 Cal. 2d 690, 694 (1958). The *Gordon* Court did not apply a test for a trade secret, such as whether the information was in the public domain or whether the plaintiff took measures to maintain secrecy. *Id.* Instead, the court concluded that “[p]laintiffs’ preferred customers are a real asset to their business and the foundation upon which its success, and indeed its survival, rests. It thus logically follows that a list of such customers is a valuable trade secret.” *Id.*

53. 62 Cal. 2d 239, 242 (1965).

54. 340 F. Supp. 273, 275 (S.D. Cal. 1972). The decision in *Armorlite Lens* was not based on California precedent from *Muggill*, but rather used the principles of *Winston Research Corp. v. Minnesota Mining & Mfg. Co.*, 350 F.2d 134 (9th Cir. 1965), to determine that making use of the former employer’s secrets and confidential activity would be unlawful.

55. See, e.g., *Golden State Linen Serv. Inc. v. Vidalin*, 69 Cal. App. 3d 1, 9–10 (1977) (holding non-solicitation of former customers enforceable, but invalidating a broad provision not to carry on a similar business); *Gordon Termite Control v. Terrones*, 84 Cal. App. 3d 176, 178–79 (1978) (contracts not to compete are invalid except where necessary to protect trade secrets); *Moss, Adams & Co. v. Schilling*, 179 Cal. App. 3d 124, 130 (1986) (“Antisolicitation covenants are void as unlawful business restraints except where their enforcement is necessary to protect trade secrets.”); *John F. Matull & Assocs., Inc. v. Cloutier*, 194 Cal. App. 3d 1049, 1054–55 (1987) (contract that prohibits using trade secrets or confidential information from the former employer to compete with that employer is valid, as such activity is unfair competition); *Metro Traffic Control Inc. v. Shadow Traffic Network*, 22 Cal. App. 4th 853, 863–64 (1994) (covenants unenforceable as no trade secrets existed).

## V. Section 16600 in the Federal Courts and the Narrow Restraint Doctrine

Many cases involving section 16600 have been heard in the federal courts, either because of diversity jurisdiction or because the section 16600 claim is heard under pendent jurisdiction alongside federal claims. Federal courts may hear an increasing number of claims involving section 16600 due to the recent adoption of the “nerve center test” for purposes of federal diversity jurisdiction in *Hertz Corp. v. Friend*.<sup>56</sup> Before *Hertz Corp.*, a corporation headquartered out-of-state bringing a state claim in federal court risked dismissal (or remand to state court) if they did more business in California than in any other state—a fair possibility given the size of California’s economy.<sup>57</sup>

### A. The Emergence of the Narrow Restraint Doctrine in the Federal Courts

The narrow restraint doctrine in the federal courts can be seen as an attempt to unify the sometimes inconsistent and contradictory California state decisions (including those arguably decided wrongly) under a single doctrinal umbrella. In doing so, the federal courts arrived at a rubric: contracts in restraint of trade were allowed if they were “carefully limited,” “narrowly tailored,” and did not preclude access to a “substantial segment of the market.”<sup>58</sup> But although the restraints permitted by state courts could be described as narrow and meeting these criteria as discussed above, their narrowness was not the reason why they were allowed: They were outside the scope of 16600, or restrained only unlawful pursuit of a profession, business or trade. The narrow restraint doctrine as expressed was also uncomfortably close to the “rule of reason” which Civil Code section 1673 was enacted to abandon, and ran counter to the California

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56. 130 S. Ct. 1181, 1186 (2010) (overruling Ninth Circuit precedent that a corporation’s principal place of business was the state with the largest proportion of the corporation’s commercial activity).

57. See, e.g., *Tosco Corp. v. Cmtys. for a Better Env’t*, 236 F.3d 495, 497 (9th Cir. 2001) (affirming dismissal for lack of subject matter jurisdiction where a Nevada corporation, which sued a California non-profit, was found to be a California citizen for diversity purposes because the corporation’s business activity in California substantially predominated over that in any other state).

58. See *Latona v. Aetna U.S. Healthcare, Inc.*, 82 F. Supp. 2d 1089, 1094 (C.D. Cal. 1999) (discussing the “Narrow Restraint Exception” but rejecting the contract in question as overbroad).

Supreme Court's original holdings that section 1673 permitted no partial restraints.

Initially, federal courts applying section 16600 or its predecessor limited exceptions to trade secrets, and followed California precedents. As early as 1924, the Ninth Circuit, in *Davis v. Jointless Fire Brick Co.*,<sup>59</sup> vacated part of an injunction that prevented the appellant from selling a product that competed with his former employer's products, but left intact prohibitions on using his former employer's customer lists, interfering with existing contracts, or misleading the public to think that he still represented his former employer.<sup>60</sup> In effect, the court voided the contract as a restraint of trade, but enjoined independently tortious misappropriation of trade secrets and unfair business practices. And in *Aarmorlite Lens Co. v. Campbell*,<sup>61</sup> the district court held that a one-year post-employment invention assignment agreement was valid and enforceable only to the extent of ideas and concepts based on the former employer's trade secrets or confidential information.<sup>62</sup> The court based its decision in part on the Ninth Circuit decision in *Winston Research Corp. v. Minnesota Mining & Manufacturing Co.*,<sup>63</sup> which enforced a one-year invention assignment provision for inventions based on confidential information,<sup>64</sup> despite the contract also having an invalid two-year non-competitive employment provision.<sup>65</sup>

The narrow restraint doctrine may have first explicitly surfaced in *Smith v. CMTA-IAM Pension Trust*,<sup>66</sup> where the Ninth Circuit allowed a restraint if it was "limited in nature and further[ed] sound public policies."<sup>67</sup> *Smith* involved suspension of pension benefits under a multi-employer pension plan if a retiree later returned to work for any of the participating employers.<sup>68</sup> The Ninth Circuit agreed that section 16600 did not apply, but remanded on Federal

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59. 300 F. 1 (9th Cir. 1924).

60. *Id.* at 4–5.

61. 340 F. Supp. 273 (S.D. Cal. 1972).

62. *Id.* at 274–75.

63. 350 F.2d 134 (9th Cir. 1965).

64. *Id.* at 145.

65. *Id.* at 141.

66. 654 F.2d 650 (9th Cir. 1981).

67. *Id.* at 660.

68. *Id.* at 653.

ERISA claims.<sup>69</sup> The court distinguished *Muggill*, asserting that the contract in *Muggill* required an absolute forfeiture of benefits, and the employer's underlying motivation was to limit business competition by dissuading retirees from returning to work for competitors.<sup>70</sup> By contrast, the pension plan in *Smith* suspended benefits only while the employee worked for any employer contributing to the same union-administered pension plan.<sup>71</sup> The court concluded that it was "confident" that California courts would not use section 16600 to void a suspension clause "limited in time and scope," and which was part of a "collective bargaining agreement implemented [to fairly allocate] retirement benefits [and] serve public polic[y]."<sup>72</sup> But as the dissent in *Smith* forcefully argued, the *Smith* court improperly read limitations into section 16600 from the California precedent: first, section 16600 does not require inhibition of business competition, and second, the contract provision invalidated in *Muggill* permitted not only absolute forfeiture, but also suspension.<sup>73</sup>

In 1987, in *Campbell v. Board of Trustees of Leland Stanford Junior University*,<sup>74</sup> the Ninth Circuit held that section 16600 only applies if a person is *completely* restrained from practicing his profession, trade, or business.<sup>75</sup> In doing so, the court considered recent California state court holdings that section 16600 bans "any and all restraints" and found that the district court had incorrectly imputed a reasonableness standard into section 16600.<sup>76</sup> However, the court then used *Boughton*, which dubiously applied section 16600

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69. *Id.* at 659. This case is also notable and more complex because the time period at issue spanned ERISA's implementation—the court had to consider the time period before ERISA was implemented, as well as an intermediate period of time before certain ERISA provisions took effect. In his dissent, Judge Tashima notes that the majority's dismissal of section 16600 greatly simplified the analysis of what law governed during each of the three time periods. *Id.* at 663–64 (Tashima, J., dissenting).

70. *Id.* at 660.

71. *Id.* at 660–61.

72. *Id.* at 661.

73. *Id.* at 662 (Tashima, J., dissenting). According to Judge Tashima's dissent, any state cause of action under section 16600 would now be preempted by ERISA. *Id.* at 663–64. Note also that the contractual language providing for either suspension or termination of benefits is not found in the California Supreme Court decision, but rather in the Court of Appeal decision it reversed. *See Muggill v. Rueben H. Donnelly Corp.*, 39 Cal. Rptr. 753, 754 (1964).

74. 817 F.2d 499 (9th Cir. 1987).

75. *Id.* at 503.

76. *Id.* at 502.

to a deed restriction, as a springboard to find that California defines “profession, business, or trade” narrowly, and remanded the case to allow the plaintiff to show that he was completely restrained from pursuing his narrowly-defined profession.<sup>77</sup> In doing so, the Ninth Circuit inverted section 16600’s precedents: whereas California courts generally accepted the employee’s own definition of his profession and invalidated even partial restraints of it,<sup>78</sup> *Campbell* now required the employee to define his profession narrowly and show a total restraint. The eventual outcome may be the same—a complete restraint of a narrowly defined profession could restrain as much as a limited restraint of a broadly defined profession—but *Campbell*’s reliance on *Boughton* to find that a complete restraint was required to trigger section 16600 would gain a life of its own.<sup>79</sup>

In 1997, the Ninth Circuit reiterated the narrow restraint doctrine in *General Commercial Packaging, Inc. v. TPS Package Engineering, Inc.*,<sup>80</sup> finding that a shipping contractor could contractually prohibit a subcontractor from working directly with the end customer, because the limitation applied only to that particular customer, and not to the subcontractor’s entire business.<sup>81</sup>

*General Commercial Packaging* was a dispute between businesses; the Ninth Circuit applied the narrow restraint doctrine to an employment case two years later in *International Business Machines Corp. v. Bajorek*.<sup>82</sup> In *Bajorek*, a stock option plan provided that purchases under the plan could be rescinded if the employee worked for a competitor within six months of exercise.<sup>83</sup> The *Bajorek* court found, following *Campbell* and *General Commercial Packaging*, that since the restriction was limited in both time and scope it was

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77. *Id.* at 502–03.

78. *See, e.g.*, *Hunter v. Superior Court*, 36 Cal. App. 2d 100, 114–15 (1939) (holding that a clause providing that a company would not design or produce machines to make Venetian blinds except for one particular party was an unlawful restraint under section 16600’s predecessor).

79. *See, e.g.*, *Armed Forces Commc’ns, Inc. v. Cass Commc’ns, Inc.*, Nos. 93-56373, 94-55336, 1995 WL 398719, at \*3 (9th Cir. July 5, 1995) (unpublished opinion) (finding a covenant invalid under section 16600 because it had a substantial impact on plaintiff based on her narrow definition of her profession, rather than only a partial impact based on defendant’s definition).

80. 126 F.3d 1131 (9th Cir. 1997).

81. *Id.* at 1132–34.

82. 191 F.3d 1033 (9th Cir. 1999).

83. *Id.* at 1035.

narrow and therefore permissible.<sup>84</sup> Next, the court declined to apply the California Supreme Court precedent in *Muggill*, which invalidated an absolute loss of benefits, in favor of its own precedent in *Smith*, which permitted a temporary suspension of benefits.<sup>85</sup>

At this point, the existence of the federal “narrow restraint doctrine” in interpreting section 16600 was undisputed. But as the Ninth Circuit had tacitly acknowledged, California courts did not quite agree with their interpretation.<sup>86</sup> Nor did other federal courts. In a 2003 unpublished opinion, *Budget Rent A Car Corp. v. G & M Truck Rental*, the U.S. District Court for the Northern District of Illinois denied a motion for a temporary restraining order to enforce a one-year, five-mile-radius non-competition agreement in California.<sup>87</sup> The court noted the Ninth Circuit precedent, including “possible inconsistency with California law,” and then determined that the “covenant in this case would not likely be enforceable in California.”<sup>88</sup>

## **B. The Demise of the Narrow Restraint Doctrine:**

### ***Edwards v. Arthur Andersen***

California courts acknowledged the narrow restraint doctrine but declined to apply it,<sup>89</sup> and in 2008 the California Supreme Court explicitly rejected the doctrine in *Edwards v. Arthur Andersen LLP*.<sup>90</sup>

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84. *Id.* at 1040–41. The court believed that Bajorek could have avoided the forfeiture simply by not working for a competitor, but it’s unlikely (at least in this author’s opinion) that it would have been possible to work in the computer industry in the 1990s and not somehow be competing with IBM. *Id.*

85. *Id.* But in doing so, the court also appears to have applied a type of reasonableness test: “It is one thing to tell a man that if he wants his pension, he cannot ever work in his trade again, as in *Muggill*, and quite another to tell him that if he wants a million dollars from his stock options, he has to refrain from going to work for a competitor for six months.” *Id.*

86. *Id.* The *Bajorek* court felt that because of the factual differences with *Muggill*, it was bound to follow its own precedent. *Id.* at 1040 n.23 (“As a three-judge panel, we are bound by our prior decisions interpreting state as well as federal law in the absence of intervening controlling authority.”) (citing *F.D.I.C v. McSweeney*, 976 F.2d 532, 535 (9th Cir. 1992)).

87. No. 03 C 2434, 2003 WL 21501784 (N.D. Ill. June 26, 2003).

88. *Id.* at \*4.

89. See, e.g., *Kolani v. Gluska*, 64 Cal. App. 4th 402, 406 (1998) (agreeing that a contractual clause was an outright prohibition on competition and not “narrowly tailored”); *D’Sa v. Playhut*, 85 Cal. App. 4th 927, 934–35 (2000) (declining to construe a covenant as a “narrow restraint” against disclosure of trade secrets); *Thompson v. Impaxx, Inc.* 113 Cal. App. 4th 1425, 1428–29 (2003) (rejecting respondents’ claim that a limited restrictive covenant is allowed under section 16600).

90. 44 Cal. 4th 937 (2008).

*Edwards* arose in the wake of the Enron scandal. As it wound down its U.S. operations, accounting firm Arthur Andersen sold a portion of its tax practice to a subsidiary of HSBC.<sup>91</sup> An Andersen employee, Raymond Edwards, refused to sign a “Termination of Non-compete Agreement” which required him to indemnify Andersen from any claims and indefinitely preserve confidential information and trade secrets, but also released him from a non-competition agreement he had signed when Andersen first hired him in 1997.<sup>92</sup> Andersen then terminated Edwards’ employment and HSBC refused to hire him.<sup>93</sup> In Edwards’ suit against Andersen, he alleged that the non-competition agreement was invalid under section 16600.<sup>94</sup> The trial court accepted the Ninth Circuit’s narrow restraint doctrine, concluding that the non-competition agreement did not violate section 16600 because it was narrowly tailored and did not completely deprive Edwards of the right to pursue his profession.<sup>95</sup>

The Court of Appeal reversed, and the California Supreme Court affirmed that portion of the opinion, finding that the text of section 16600 is “unambiguous,”<sup>96</sup> and holding that “non-competition agreements are invalid under section 16600 in California, even if narrowly drawn, unless they fall within the applicable statutory exceptions of sections 16601, 16602, or 16602.5.”<sup>97</sup> The *Edwards* court explicitly rejected the Ninth Circuit’s narrow-restraint exception and disapproved of the decisions in *Boughton v. Socony Mobil Oil Co.* and *King v. Gerold* in the context of section 16600.<sup>98</sup> But the holding was limited by the facts of the case to restrictions on competition and serving and soliciting customers of a former employer, so the court did not reach other previously allowed “narrow restraints”—using the former employer’s trade secrets, and soliciting former coworkers.<sup>99</sup>

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91. *Id.* at 942.

92. *Id.* at 942–43. When hired, Edwards had agreed not to provide similar professional services for or solicit clients of Andersen, or “solicit away” Andersen’s employees for a period of eighteen months after leaving. *Id.* at 942. The “Termination of Non-compete” required indefinitely preserving (i.e., not disclosing) confidential information and trade secrets. *Id.* at 943.

93. *Id.*

94. *Id.*

95. *Id.* at 944.

96. *Id.* at 950.

97. *Id.* at 955.

98. *Id.* at 948–50.

99. *Id.* at 946 n.4 (“We do not here address the applicability of the so-called trade secret exception to section 16600 . . . [or whether] the provision of the non-competition

### C. The “So-Called Trade Secret Exception” after *Edwards*

In referring to the “so-called” trade secret exception, the California Supreme Court begs the obvious questions—is an employment covenant agreeing not to use trade secrets actually an exception to section 16600? If so, on what basis? And if not an exception, what is it? Taking the Court at its literal word, there can be no trade secret exception, as the statute is silent about trade secrets.<sup>100</sup> A more nuanced and useful answer is suggested by the earlier proposition that section 16600 does not void a contract that prohibits *unlawful* acts in pursuit of one’s profession, trade or business. Thus, if an act is independently tortious or wrongful, whether for example under common law, misappropriation of trade secrets under California’s enactment of the Uniform Trade Secrets Act (UTSA),<sup>101</sup> or unfair competition under section 17200,<sup>102</sup> an employer may contractually prevent its employee from doing so without running afoul of section 16600.

In practical terms, whether otherwise restrictive covenants protecting trade secrets are upheld based on existing precedent or whether they are recognized to be outside the ambit of 16600 because of the wrongful nature of the prohibited conduct may not make a significant difference. To enforce the covenant requires proof that the former employee has breached it, which would, among other things, require proof that the information at issue really was a trade secret.<sup>103</sup> In effect, enforcing the contract would be very similar to bringing a direct action for the underlying trade-secret-based wrong.<sup>104</sup>

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agreement prohibiting [Edwards] from recruiting Andersen’s employees violated section 16600.”).

100. Admittedly, section 16606 defines the customer list of a telephone answering service as a trade secret, and section 16607 defines the list of customers (employers and applicants) of an employment agency as a trade secret (cutting off liability as to a former employee of an employment agency after one year). Any argument that these sections affect section 16600 beyond their own narrow textual scope would likely be unpersuasive.

101. See CAL. CIV. CODE §§ 3426-3426.11 (West 2011).

102. See CAL. BUS. & PROF. CODE § 17200 (West 2011).

103. See, e.g., CAL. CIV. CODE § 3426.1(d) (defining trade secrets as deriving independent economic value from not being generally known, and requiring reasonable efforts to maintain secrecy).

104. For a thorough analysis of employee non-compete agreements in an Intellectual Property and Trade Secret context, see Charles Tait Graves, *Analyzing the Non-Competition Covenant as a Category of Intellectual Property Regulation*, 3 HASTINGS SCI. & TECH. L.J. 69 (2011).

In 2009, the California Court of Appeal advanced a similar approach in *Retirement Group v. Galante*,<sup>105</sup> one of the first published cases after *Edwards*. In *Retirement Group*, the Court of Appeal analyzed *Edwards* and the line of trade secret cases and concluded that section 16600 bars enforcement of contractual clauses related to solicitation, but a court may nonetheless enjoin tortious conduct by a former employee that violates either the UTSA or unfair competition law.<sup>106</sup> As the Court explained, “the conduct is enjoined *not* because it falls within a judicially created ‘exception’ to section 16600’s ban on contractual non-solicitation clauses, but is instead enjoined because it is wrongful independent of any contractual undertaking.”<sup>107</sup> One interpretation of *Retirement Group* might be that the contract itself is irrelevant, and that only the employee’s actual conduct matters. Other courts have agreed with *Retirement Group*, but no court has yet expressed so aggressive an interpretation in its holding. For example, in *Dowell v. Biosense Webster, Inc.*, the Court of Appeal agreed with *Retirement Group*, stating in dicta that it doubted “the continuing viability of the common law trade secret exception to covenants not to compete.”<sup>108</sup> But the *Dowell* court was able to base its holding on the non-compete and non-solicitation clauses being “so broadly worded as to restrain competition.”<sup>109</sup>

Subsequently, a federal court in *Richmond Technologies, Inc. v. Aumtech Business Solutions*<sup>110</sup> applied the reasoning of *Retirement Group* and *Dowell* to find that non-solicitation and non-interference provisions in a contract were “likely to be found unenforceable under California law.”<sup>111</sup> The restrictions in the non-disclosure agreement at issue were “more broadly drafted than necessary to protect [plaintiff’s] trade secrets, and would have the effect of restraining Defendants from pursuing their chosen business and professions if enforced.”<sup>112</sup> Even so, the court found that the plaintiff had

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105. 176 Cal. App. 4th 1226 (2009).

106. *Id.* at 1238.

107. *Id.*

108. 179 Cal. App. 4th 564, 577 (2009). The Court of Appeal in *Dowell* agreed with *Retirement Group* that the trade secret exception was no longer viable, but found that the clauses in the employee covenant were too broad. *Id.* at 579.

109. *Id.* The court also affirmed the trial court’s refusal to narrow the clauses so as to make them lawful, regardless of whether or not trade secrets existed. *Id.* at 579.

110. No. 11-CV-02460-LHK, 2011 WL 2607158 (N.D. Cal. July 1, 2011) (slip opinion).

111. *Id.* at \*18.

112. *Id.* The agreement was extremely broad, providing that the defendant would not “directly or indirectly, initiate any contact or communication with, solicit or attempt to

established serious questions going to the merits of its claims of unfair competition and misappropriation of trade secrets.<sup>113</sup> The court issued a narrow temporary restraining order enjoining defendants from activities that might involve plaintiff's trade secrets, but did not mention the non-disclosure agreement, and did not enjoin defendants from soliciting, recruiting or hiring any of plaintiff's employees.<sup>114</sup> Significantly, in reaching this result, the court did not measure defendants' actions against the letter of the agreement, but rather considered whether defendant had access to plaintiff's protectable trade secrets and whether defendant was using or misappropriating these secrets.<sup>115</sup>

Given the increasing antagonism towards contractual restraints, an employer may find it more straightforward to proceed directly with a misappropriation claim, and avoid the distraction and additional expense of defending the contract from charges of invalidity under section 16600. Even under these circumstances, the signed contract would still be valuable in supporting the trade secret action by showing efforts to keep the information secret and demonstrating that the employee not only knew the information was a trade secret but also was aware of a duty to maintain its secrecy.<sup>116</sup>

A final rationale for proceeding only with a direct cause of action despite having a wholly or partially enforceable contract is the shift in court attitudes towards employee covenants. In earlier cases, courts severed and ignored unenforceable provisions; later decisions show less willingness to do so, a greater concern with the imbalance of bargaining power between employer and employee and a recognition of the chilling effect of anticompetitive provisions on employee

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solicit the employee of, or enter into any agreement with any employee, consultant, sales representative, or account manager" of plaintiff for a period of one year "unless such person has ceased its [sic] relationship with [plaintiff] for a period of not less than six months. The agreement contained a similar prohibition with respect to any "account, acquiring bank, merchant, customer or vendor" of plaintiff. *Id.* at \*15-16.

113. *Id.* at \*21.

114. *Id.* at \*23.

115. *Id.* at \*19-20. Curiously, plaintiff had not actually asserted a claim for misappropriation of trade secrets, but rather asserted breach of contract, interference with contract, and unfair competition. *Id.* at \*3. To support a restraining order on those causes of action, the court construed the non-compete clauses in the contract to bar only the use of confidential information to the extent that information was a trade secret.

116. See *Empire Steam Laundry v. Lozier*, 165 Cal. 95, 99 (1913) (existence of even unenforceably broad contract nonetheless shows intent to forbear from inequitable acts); *Morlife, Inc. v. Perry*, 56 Cal. App. 4th 1514, 1522 (1997) (labeling information "trade secret" does not conclusively establish that it is a trade secret, but helps establish the value of the information and that it might not be publicly available).

mobility.<sup>117</sup> Commentators have also suggested that employee covenants not to compete should be evaluated based on the bargaining process between employer and employee—and only rarely will employees have sufficient bargaining power to properly negotiate a non-competition agreement.<sup>118</sup>

## VI. Solicitation of Co-Workers after *Edwards*

After *Edwards* and *Retirement Group*, restrictions on customer solicitation are permitted only to the extent they protect trade secrets, and a restriction will not be upheld on the ground that it is narrow and reasonable. These holdings substantially diminish *Loral*'s value as precedent, and a bare restriction on employee or co-worker solicitation may be difficult to defend on any theory.

### A. Re-visiting the Analysis of *Loral Corp. v. Moyes*

After a lengthy evaluation of prior cases involving customer solicitation, the Court of Appeal in *Loral* concluded that a restriction on soliciting former co-workers was no more “a significant restraint on his engaging in his profession, trade or business than a restraint on solicitation of customers.”<sup>119</sup> Yet the *Loral* court failed to acknowledge that in every cited case previous courts would not enjoin the solicitation of customers unless that solicitation involved the use of trade secrets or confidential information. More recent cases addressing solicitation in any context continue to hold that anti-solicitation covenants are void except to protect trade secrets.<sup>120</sup> There was no allegation in *Loral* that the hiring of co-workers made

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117. See *Hunter v. Superior Court of Riverside Cnty.*, 36 Cal. App. 2d 100, 112 (1939) (provisions not in restraint of trade may be enforced if severable); *Buskuhl v. Family Life Ins. Co.*, 271 Cal. App. 2d 514, 523 (1969) (affirming forfeiture of commissions per employee covenant despite other unenforceable conditions). *But see* *Kolani v. Gluska*, 64 Cal. App. 4th 402, 407 (1998) (construing a covenant not to compete as a narrow bar protecting trade secrets would undermine public policy because employees would likely honor illegal clauses without challenging them); *D'Sa v. Playhut*, 85 Cal. App. 4th 927, 935 (2000) (holding that an employer may not require employees to sign agreement with unenforceable provisions, even if severable because employees cannot be expected to know their rights under section 16600).

118. See O'Neill, *supra* note 33, at 85–92.

119. *Loral Corp.*, 174 Cal. App. 3d at 279; *see also supra* notes 18–25 and accompanying text.

120. See, e.g., *Thompson v. Impaxx, Inc.*, 113 Cal. App. 4th 1425, 1429 (2003) (“Antisolicitation covenants are void as unlawful business restraints except where their enforcement is necessary to protect trade secrets.” (citing *Moss, Adams & Co. v. Shilling*, 179 Cal.App.3d 124, 129 (1986))).

use of trade secrets, perhaps making the implicit assumption that the co-workers were themselves trade secrets. Setting aside this question of whether soliciting employees might implicate trade secrets,<sup>121</sup> the decision in *Loral* appears to be based on an analysis very similar to the reasoning that led to the federal narrow restraint doctrine.

First, *Loral* had cited *Great Western Distillery Products*<sup>122</sup> for the proposition that “reasonably limited restrictions which tend more to promote than restrain trade” are valid.<sup>123</sup> The *Loral* court further considered that enforcement of a restrictive covenant could be based on its reasonableness, “evaluated in terms of the employer, the employee and the public.”<sup>124</sup> The court then determined that the original agreement, which had unlimited duration, could be made reasonable by applying it only “within a year of its execution.”<sup>125</sup>

Then, after limiting the restriction’s duration to one year, the court noted that the restriction had the “apparent impact of limiting Moyes’ business practices in a small way in order to promote [Loral’s] business.”<sup>126</sup> The court even reworded a line from *Aetna v. West* to emphasize both the similarity to customer solicitation, and the limited scope and impact of the restriction: “Equity will not enjoin a former employee from receiving *and considering applications from employees* of his former employer, even though the circumstances be such that he should be enjoined from soliciting *their applications*.”<sup>127</sup>

In light of *Edwards*, it is hard to argue that *Loral* remains good law. *Edwards* left only two avenues for a coworker non-solicitation agreement to be valid: first, statutory text, and second, protection of

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121. See *infra* Part VI.C.

122. See *supra* notes 39–43 and accompanying text. *Great Western Distillery Products* concerned an exclusive distributor agreement between businesses, far removed from the employee covenant at issue in *Loral*.

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

124. *Id.* at 279.

125. *Id.*

126. *Id.* at 280. The Court of Appeal had applied a similar narrow-restraint, rule-of-reason analysis to a covenant not to solicit employees in an earlier case, not cited in *Loral*. In *Buskuhl v. Family Life Ins. Co.*, 271 Cal. App. 2d 514, 522–23 (1969), the court said of a provision not to induce other insurance agents to leave the former employer, “That provision is not such an inhibition upon a former employee’s right to engage in a trade, business, or profession as to be within the proscription of section 16600.”

127. *Loral Corp.*, 174 Cal. App. 3d at 280 (emphasis added); cf. *Aetna Bldg. Maint. Co. v. West*, 39 Cal. 2d 198, 204 (1952) (“Equity will not enjoin a former employee from receiving *business from the customers* of his former employer, even though the circumstances be such that he should be prohibited from soliciting *such business*.”) (emphasis added).

trade secrets. There is no statutory exception for soliciting former co-workers, and the facts of *Loral* fail to show even allegations of trade secret misuse.<sup>128</sup> As the *Loral* court appeared swayed by the narrow scope of the restriction, a line of reasoning *Edwards* explicitly disapproved of, it is especially difficult to imagine that this aspect of *Loral* has further precedential value.

### **B. A Covenant Not to Solicit Employees is Almost Always a Restraint**

If the limited prior cases involving employee solicitation are no longer good law, it is useful to evaluate a covenant not to solicit co-workers from first principles to help determine if such a covenant could ever be valid and enforceable.

Section 16600 prohibits restraints on engaging in a lawful profession, business or trade. After *Edwards* any restraint is suspect, no matter how narrow or inconsequential, and may render the contract invalid. But if the contract does not actually restrain the employee in any way, it would not be unlawful. Consider an occupation where recruitment is not a job requirement, there is no bonus or benefit gained by referring or recruiting former co-workers, and no penalty for not doing so. In this admittedly narrow factual situation, a non-solicitation agreement would arguably have no effect on the employee, and therefore is not a restraint.

While this scenario might apply to low-level individual workers in some contexts, it is unrealistic, especially in the technology industry. Although it is unlikely that an employer would penalize an employee for *not* referring or recruiting, many large corporations do pay referral bonuses.<sup>129</sup> And while such compensation is a bonus and not part of normal wages, an employee who is unable to participate has forgone potential compensation and therefore has been effectively restrained. Even without any formal compensation or recognition, an employee who is unable to approach former co-workers may feel disadvantaged relative to coworkers who are not similarly restrained.

Unfortunately for the employer, this scenario also does not apply to the very situations where recruitment *is* a vital part of the job responsibilities and where restraints would have the greatest

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128. Not only was no misuse of trade secrets alleged in *Loral*, but no actual act of "solicitation" was alleged either. See Pooley, *supra* note 22, at 266.

129. See, e.g., *Employee Referral Bonus Jackpots: 15 Companies with Awesome New-Hire Incentives*, HR WORLD (Mar. 11, 2008), <http://www.hrworld.com/features/referral-bonus-jackpot-031108>.

competitive impact. Recruiting and hiring is commonly part of the job description of most managers. Employees at smaller companies, especially startups, often play a much greater role in recruiting new hires. A senior employee or manager leaving to start or head another company will often be competing with the former employer, and might hire multiple people away from the former employer, as seen in *Loral*.<sup>130</sup>

### C. Soliciting Employees as Misappropriation of Trade Secrets

Accepting that a covenant not to solicit is a restraint, could an argument be made that it is enforceable because it prohibits an independent wrong, such as misappropriation of trade secrets, breach of fiduciary duty or unfair competition?

*Edwards* does not preclude a covenant that prohibits misuse of trade secrets, and prior cases involving customer solicitation have hinged on whether the customers' identities were trade secrets or whether soliciting them required use of trade secrets.<sup>131</sup> A covenant prohibiting employee solicitation might survive section 16600 under sufficiently similar circumstances.

However, no court has held that employees' identities and skills are trade secrets. In *Metro Traffic Control Inc. v. Shadow Traffic Network* the Court of Appeal found that an employer did not possess a trade secret in its employees' knowledge, training, qualities and capabilities.<sup>132</sup> Just as customers are not trade secrets when discoverable in commercial directories,<sup>133</sup> employee contact information might also be publicly available.<sup>134</sup> Even otherwise confidential and secret information about employees—their salaries,

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130. See *Loral Corp.*, 174 Cal. App. 3d at 274 (finding that an employer allegedly spent over \$400,000 to replace employees hired away, and the business was impacted).

131. See, e.g., *Morlife, Inc. v. Perry*, 56 Cal. App. 4th 1514, 1521–22 (1997) (finding that a customer's identity is not only a trade secret, but also their contact names, i.e., the specific person to solicit business to the customer).

132. 22 Cal. App. 4th 853, 862–64 (1994).

133. See *Aetna Bldg. Maint. Co. v. West*, 39 Cal. 2d 198, 205 (1952) (holding that customers are not trade secrets when they can easily be found in business directories).

134. See *Eastridge Personnel of Las Vegas, Inc. v. Kim Du-Orpilla*, No. 2:06-CV-00776-KJD-PAL, 2008 WL 872905 at \*3 (D. Nev. Mar. 27, 2008) (dismissing trade secret claims based on names, addresses, and phone numbers of employees and applicants because the information is readily available from the California Department of Consumer Affairs).

for example—has not been found to be a trade secret.<sup>135</sup> Of course, the lack of holding that employee information is a trade secret does not dissuade the attempt—a company has claimed a trade secret in “the skill levels, experience, specialties, performance attributes, compensation levels, and attitudes” of its employees.<sup>136</sup>

In the age of internet social media however, the statutory tests for trade secrecy appear to be an even higher bar to overcome with respect to this sort of employee information. The Uniform Trade Secret Act (UTSA) defines a trade secret as information that “(1) derives independent economic value, actual or potential, from not being generally known to the public or to other persons who can obtain economic value from its disclosure or use; and (2) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.”<sup>137</sup> Each prong of the definition poses problems to the assertion that employee information is a trade secret. As a threshold, the information must actually be secret. In the past, the employees of a given business may not have been public knowledge. But today, many companies and employees publicly identify themselves and their relationship on business-oriented social media sites such as LinkedIn or Spoke. LinkedIn, for example, claims over 120 million individual members,<sup>138</sup> and over 2 million company pages, ostensibly maintained by the company itself.<sup>139</sup> In turn, the company pages include a link to profiles of the company’s employees, which in turn often include job descriptions and titles. For example, the company page of Space Systems/Loral includes a link to over one

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135. See *GAB Bus. Servs., Inc. v. Lindsey & Newsom Claim Servs., Inc.*, 83 Cal. App. 4th 409, 428 (2000), *overruled on other grounds by* *Reeves v. Hanlon*, 33 Cal. 4th 1140, 1154 (2004).

136. *Brocade Commc’ns Sys., Inc. v. A10 Networks, Inc.*, No. 10-CV-03428-LHK, 2011 WL 1044899 (N.D. Cal. Mar. 23, 2011) (slip opinion, granting in part and denying in part motion to dismiss). The court found that, at least at the pleading stage, Brocade had defined its trade secrets with sufficient particularity, and had alleged misappropriation of them. *Id.* at \*7. Typical of employer-employee disputes in Silicon Valley, this case involves significantly more than just solicitation of former-workers. *Id.* at \*2.

137. CAL. CIV. CODE § 3426.1(d) (West 2011).

138. See *About Us: LinkedIn Facts*, LINKEDIN, <http://press.linkedin.com/about> (last visited Oct. 25, 2011) (“As of August 4, 2011, LinkedIn operates the world’s largest professional network on the Internet with more than 120 million members in over 200 countries and territories.”).

139. See *About Us: LinkedIn and Business*, LINKEDIN, <http://press.linkedin.com/about> (last visited Oct. 25, 2011) (“More than 2 million companies have LinkedIn Company Pages”).

thousand of its employees.<sup>140</sup> Not only is this information clearly not secret, but its very existence would belie any claim of reasonable measures to maintain its secrecy.

Under these circumstances, it would be difficult, if not impossible, for an employer to claim that the identities, job functions and skills of its employees were a trade secret, and it would be a losing proposition to argue that an employee non-solicitation clause was necessary to protect them.

#### **D. Soliciting Employees as a Breach of Loyalty or Fiduciary Duty**

Many of the cases involving employee solicitation and hiring away, especially where large numbers of employees left or damages to the employer were substantial, involve managers, executives and other highly-placed employees. The defendant in *Loral* was a director and officer of the subsidiary.<sup>141</sup> In another recent case involving a mass hiring of employees to a competitor, the defendant was a director of one of the plaintiff corporations.<sup>142</sup> If the conduct in soliciting or hiring away began before employment terminated, the employee may have breached a fiduciary duty or duty of loyalty to the former employer.<sup>143</sup>

An employee covenant barring conduct which would be a breach of fiduciary duty would probably be valid to that extent, on the theory that it prohibits only unlawful acts and is not attempting to restrain by contract any more than could be judicially enjoined. But it is unclear how such a covenant would benefit the employer. The covenant would have to be carefully worded so as not to be overbroad, and even so would risk straining the initial employer-employee relationship. At least in the case of a covenant to protect trade secrets, the very existence of the contract helps demonstrate measures to maintain secrecy. But there is no analogous requirement that a fiduciary know the bounds of his duty before undertaking it, and an employee's fiduciary duty may change over time depending on the nature of his responsibilities. So while soliciting employees might be independently actionable as a breach of fiduciary duty, attempting to

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140. See *Companies: Space Systems Loral*, LINKEDIN, <http://www.linkedin.com/company/space-systems-loral>, (last visited Oct. 16, 2011) (showing, on the date visited, a link to over 1,300 employees of Space Systems/Loral).

141. See *Loral Corp. v. Moyes*, 174 Cal. App. 3d 268, 274 (1985).

142. See *Thomas Weisel Partners LLC v. BNP Paribas*, No. C 07-6198 MHP, 2010 WL 1267744, at \*5 (N.D. Cal. Apr. 1, 2010).

143. See *Bancroft-Whitney Co. v. Glen*, 64 Cal. 2d 327, 332 (1966).

save an earlier broad covenant not to solicit employees by a post-hoc narrow construction as a covenant not to breach a fiduciary duty would likely fail, just as courts refuse to construe as covenants not to solicit customers as narrowly protective of trade secrets.<sup>144</sup>

### E. Soliciting Employees as Unfair competition

Simply soliciting or hiring away an employee of a former employer is not in and of itself actionable.<sup>145</sup> But when soliciting and hiring away accompanies other unlawful or wrongful conduct it may support a cause of action, such as for unfair competition or intentional interference with prospective economic advantage.<sup>146</sup> As with breach of fiduciary duty, an employee covenant carefully worded to prohibit just this independently unlawful conduct, the contract might survive a section 16600 challenge. However, claims of unfair competition are often interwoven with claims for breaches of fiduciary duty, interference with advantageous relations or prospective economic advantage and even misappropriation of trade secrets.<sup>147</sup>

To further complicate matters, agreements not to solicit former co-workers, especially when the departing employee works for a competitor, might *themselves* be viewed as anticompetitive, running afoul not only of section 17200, but also of federal antitrust law. For example, under pressure from the Justice Department, Adobe, Apple, Intuit, Google, Intel, and Pixar agreed to abandon agreements not to solicit each other's employees.<sup>148</sup> The settlement "prohibits the companies from entering, maintaining or enforcing any agreement that in any way prevents any person from soliciting, cold calling,

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144. See *Thompson v. Impaxx, Inc.*, 113 Cal. App. 4th 1425, 1431 (2003).

145. See *Reeves v. Hanlon*, 33 Cal. 4th 1140, 1145 (2004) ("[O]ne commits no actionable wrong by merely soliciting or hiring the at-will employee of another.").

146. *Id.* at 1152-53; see also *Diodes, Inc. v. Franzen*, 260 Cal. App. 2d 244, 255 (1968) (causes of action for unjustifiably interfering with relationship between and employer and employee might include unfair competition, interference with advantageous relations, contract interference, and inducing breach of contract).

147. See, e.g., *Sci. of Skincare, LLC v. Phytoceuticals, Inc.*, No. CV 08-4470 ODW (SSx), 2009 WL 2050042, at \*6 (C.D. Cal. July 7, 2009) (granting defendant employee summary judgment as to misappropriation of trade secrets, but denying as to breach of fiduciary duty, breach of non-disclosure agreement, interference with prospective economic advantage, trade libel, defamation, and unfair competition).

148. See Press Release, U.S. Dep't of Justice, *Justice Department Requires Six High Tech Companies to Stop Entering into Anticompetitive Employee Solicitation Agreements* (Sept. 24, 2010), available at <http://www.justice.gov/opa/pr/2010/September/10-at-1076.html>.

recruiting, or otherwise competing for employees.”<sup>149</sup> An employee covenant restraining someone from soliciting her former co-workers would appear to violate this provision of the settlement.

Given this degree of complexity, drafting a defensible employee covenant that covers the many possible permutations ahead of time would be hard to justify, and as before, attempting to construe it after the fact to narrowly cover only the allegedly unlawful conduct of the former employee would likely fail.

## VII. Conclusion

The decisions in *Edwards* and *Retirement Group* suggest the following paradox: If the employee’s conduct in pursuit of their profession or occupation is lawful, contracts prohibiting it are void and unenforceable. And if it is unlawful, courts should enjoin it directly, rather than as a breach of contract. Taken together, this implies that the contract was unnecessary to begin with. And if a contract is poorly drafted so as to prohibit conduct which is not unlawful, courts are less likely to reform the contract. So do agreements attempting to delineate what an employee does post-employment have value?

They likely still do. First, the contract can serve to remind the employee of the need to protect the employer’s trade secrets. Unless the contract clearly attempts to prohibit use of non-secret or publicly available information, this would be part of the employer’s reasonable attempts to maintain secrecy. And for employees who have fiduciary or other duty, language in the employment agreement spelling out the duty in more detail would not work to defeat it. Both employer and employee benefit from a certain degree of certainty by knowing at least the boundaries of agreed-upon conduct after the employment ends.<sup>150</sup> From a practical perspective, employers should also consider that the contract might not be enforced using California law. Although California’s interest in enforcing its employment laws is strong, and often prevails in choice-of-law analysis, this is by no means guaranteed.<sup>151</sup> And federal courts, especially outside

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149. *Id.*

150. *See Hays, supra* note 33, at 69–70.

151. *See, e.g.,* *Aspect Software, Inc. v. Barnett*, No. 11–10754–DJC, 2011 WL 211644, at \*4–9 (D. Mass. May 27, 2011) (applying Massachusetts law and issuing preliminary injunction preventing employee from working for new employer in California for one year); *Ayco Co., L.P. v. Frisch*, No. 1:11–CV–0580 (LEK/DRH), 2011 WL 2413516, at \*6–9 (N.D.N.Y. June 10, 2011) (applying New York law and issuing preliminary injunction

California, appear cautious in applying *Edwards* as California state precedent, especially when there appears to be any uncertainty in the way lower courts interpret it.<sup>152</sup>

Notwithstanding any lingering confusion, after *Edwards*, courts applying California law will be increasingly unlikely to uphold non-competition agreements between employers and employees, unless they proscribe only independently unlawful conduct. For example, a contract concerning use of trade secrets should prohibit only conduct that would be misappropriation or misuse under the UTSA. Even so, courts will pay more attention to the actual conduct of the former employee and enjoin it only if independently tortious, regardless of whether it is prohibited by contractual language. A valid contract prohibiting solicitation or recruitment of employees would be difficult to draft since merely soliciting former employees is not itself wrongful but requires a concomitant wrongful act to be unlawful. And since courts will focus on the conduct rather than the contract, it may be better to enjoin any wrongful solicitation directly, rather than by contractual means.

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that prevented California employees of a New York employer from taking new employment for ninety days). The overriding factor in both *Aspect* and *Ayco* was that the employers alleged misappropriation of trade secrets; this was sufficient to overcome the employees' objections on section 16600 grounds, even though the contracts contained clear employee non-solicitation clauses in *Aspect* or non-compete clauses in *Ayco*.

152. See, e.g., *Optos Inc. v. Topcon Med. Sys., Inc.*, No. 10-12016-DJC, 2011 WL 841254, at \*9-10 (D. Mass. Mar. 7, 2011) (expressing uncertainty whether the *Edwards*' holding applies to solicitation clauses based on apparent disagreement between *Retirement Group*, and *Dowell*).