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California Court of Appeal Questions Viability of Trade Secrets Exception to State's Broad Prohibition Against Noncompete Covenants

by James Goodman and Kathryn McGuigan

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In the wake of the California Court of Appeal's recent decision in *Dowell v. Biosense Webster, Inc*., No. B201439, the future of the trade-secret exception to the state's broad prohibition of non-compete agreements appears increasingly uncertain.

On November 19, 2009, the court, in *Dowell*, refused to enforce what it deemed were overly expansive non-compete and non-solicitation clauses in certain employment agreements, but did not reach the trade-secret exception issue. However, the court stated in dicta that it doubted the continued viability of the common law trade-secret exception to covenants not to compete. The court left open the question as to whether, or to what extent, state courts would enforce non-compete agreements that were more narrowly tailored to protect trade secrets.

Dowell follows the decision by the California Supreme Court in *Edwards v. Arthur Andersen*, *LLP*, 44 Cal.App. 4th 937 (2008), in which that court also indicated that the trade-secret exception to non-compete agreements was questionable.

In *Edwards*, the California Supreme Court adopted an expansive interpretation of California Business & Professions Code §16600, holding that the section prohibits employee non-competition agreements unless they fall within one of the statutory exceptions, such as those associated, for example, with certain sales of businesses or partnership dissolutions. The *Edwards* court specifically rejected the "narrow restraint" exception, which holds that a non-compete agreement is enforceable if it merely prohibits an individual from competing in a "narrow segment" of the market. The exception had been adopted by the Ninth Circuit in *Campbell v. Trustees of Leland Stanford Jr. Univ.*, 817 F.2d 499 (9th Cir. 1987) and other cases, although no California court had endorsed it, finding that even limited restraints on post-termination competition are unlawful under California law.

The *Edwards* court, however, was careful to note that its opinion did not invalidate restraints necessary to protect trade secrets, stating that it was not required to address the applicability of the so-called trade-secret exception to §16600, because it was not germane to the claims raised by the employee. *Edwards*, supra, 44 Cal.4th at 946, fn. 4.

Dowell overview

In *Dowell*, former employees of Biosense, a biotech company, signed, before being hired, agreements providing that for a period of 18 months after termination of employment the employees could not render services directly or indirectly to any competitor by using confidential information to which the employees had access during employment. "Confidential information" was broadly defined in the agreement to include information "disclosed" to, or "known" by, the employee as a result of his or her employment by the company, and such information was "not generally known to the trade or industry in which the company is engaged, about products, processes, technologies, machines, customers, clients, employees, services and strategies."

The agreement also contained a non-solicitation clause that prevented the employees for 18 months following termination from soliciting business, from selling to, or rendering service to, any customers with whom the employees had contact during the last 12 months of employment.

The court found that the non-compete and non-solicitation clauses were void and unenforceable under §16600. The court also determined that the agreements violated the California Business and Professions Code §17200 because they were unfair competition.

The court rejected the employer's argument that the agreements were tailored to protect trade secrets or confidential information and thus satisfied the "common law trade secret exception." While the court doubted the viability of the exception to §16600's prohibition of non-compete agreements, it did not resolve the issue, finding that the exception did not apply because the agreements were not narrowly tailored or carefully limited to the protection of trade secrets, but were so broadly worded as to restrain competition.

What this means to employers

Even if a court does not enforce a non-solicitation covenant tethered to even a narrow definition of trade secrets, an employer will still have protection under common law and the California Trade Secrets Act if the employee is using trade-secret information to solicit. Given the direction that the California courts appear to be headed, however, employers in California should weigh the value of including any non-solicitation covenant against the risk created by the inclusion of such a covenant, which may violate public policy.

For more information about this Client Alert, please contact:

James Goodman
Los Angeles
310-557-9519
Jgoodman@ebglaw.com

Kathryn McGuigan
Los Angeles
310-557-9570
Kmcguigan@ebglaw.com

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