

Across the Line

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TO COVENANT OR NOT TO COVENANT?

There are many differences between California and Nevada employment law. A notable one is California's general prohibition against "non-compete" clauses in employment agreements after the employment relationship has ended. "Non-compete agreement" and "covenant not to compete" are broadly used to cover contractual clauses drafted to restrain an employee's or former employee's right to perform his or her profession or trade. Both employer and employee clients consistently raise questions of enforceability after the employment relationship is over. Employees want to earn a living without threat from a former employer turned bully while employers want to protect their proprietary business assets and information from theft; especially with the increasing value placed on corporate intellectual property. California and Nevada both view post employment non-compete clauses as restraints of trade, but most Nevada practitioners (not to mention California employers) are stunned to learn such agreements are generally not enforceable in California.

Under Nevada law, a non-compete agreement is an enforceable restraint of trade only "if the agreement is supported by valuable consideration and is otherwise reasonable in its scope and duration." NRS 613.200. In regards to

consideration, the Supreme Court of Nevada has adopted the majority rule that “an at-will employee’s continued employment is sufficient consideration for enforcing a non-competition agreement.” *Camco, Inc. v. Baker*, 113 Nev. 512, 516-17 (1997) (citations omitted). Further, agreements not to compete are strictly construed in the post employment context because Nevada considers “the loss of a person’s livelihood [] a very serious matter.” *Id.* at 517 (citations omitted). Applying the rule of strict construction, an agreement not to compete may be found enforceable only if it is a *reasonable* restraint of trade under the circumstances. Consequently, to ensure reasonableness the restrictive terms must not impose any greater restraint on the employee “than is reasonably necessary to protect the business and good will of the employer.” *Id.* at 518. Three critical factors analyzed under Nevada’s reasonable test are time, geographic area, and scope of the restricted conduct. *Id.* at 518-19. Thus, despite the proclamation that barring a former employee’s ability to earn a living “is a very serious matter,” it remains permissible in Nevada if the employer acts in reasonable protection of his or her business and good will. *Id.* at 517.

Now, compare Nevada’s “so long as it’s reasonable” approach with California’s general rule of prohibition. Practitioners researching the topic in California may go blind reading unfathomable amounts of material, including ever witty employment law blogs that extend far beyond most attention spans. Yet despite the heaps of information, non-compete clauses are unwavering in the quest to remain one of the most commonly misused employment agreement provisions. Like all interesting topics of legal conversation, factually intensive

minutia may affect the enforceability analysis of agreements not to compete in California. But, contractual provisions that prohibit an employee from working for another employer after the employment relationship has ended, or provisions imposing a penalty on the former employee for doing so, are generally illegal restraints of trade. Cal.Bus.&Prof.Code §§16600-16607. Additionally, an employer who includes an illegal non-compete clause in an employment contract may also encounter claims of unfair competition. See *Application Group, Inc. v. Hunter Group, Inc.*, 61 Cal.App.4th 881 (1998).

There are, however, two exceptions when reasonable agreements not to compete may be enforceable in California: dissolution of partnerships or limited liability companies, and the sale of an ownership interest in a company. Cal.Bus.& Prof.Code §§16601, 16602, 16602.5. These two, narrow exceptions are not applicable to most California employers who require employees to sign post employment non-compete agreements. Most employers are attempting to prevent an employee with knowledge of the employer's confidential, proprietary business information from joining a competitor or establishing a competing business and unfairly profiting from that proprietary information. Non-compete clauses are ineffective to address such concerns because California courts are unwilling to construe illegal covenants not to compete as narrow restraints against the disclosure of trade secrets solely to avoid illegality. *D'Sa v. Playhut*, 85 Cal.App.4th 927, 935 (2000).

In *D'Sa*, a former employee alleged that he was terminated for refusing to sign a illegal covenant not to compete and the trial court granted summary

judgment for the employer. *Id.* at 930. The Court of Appeals reversed summary judgment and remanded. *Id.* at 936. The court held that the covenant not to compete could not be narrowly construed as a trade secret provision because it “would not be reforming the contract based on a mistake of the parties; rather [it] would be saving a statutorily proscribed and void provision.” *Id.* at 935. Further, the court held that the employer’s action constituted a wrongful termination in violation of public policy despite the severability of the covenant not to compete clause. *Id.* at 933-34. The court reasoned that an employer cannot make a covenant not to compete a condition of continued employment because the covenant violates “a clear legislative declaration of public policy.” *Id.* at 933. Thus, employers who go so far as to actually terminate an employee for failure to sign a post employment agreement not to compete expose themselves to general tort and punitive liability for wrongful termination in violation of public policy. *Id.* at 932-33.

California employers’ legitimate business concerns may be properly addressed with limited risk of illegality or exposure to tort liability through confidentiality or non-solicitation agreements. Employers should determine what business interests they want to protect that the employee is likely to be exposed, and include a confidentiality clause in the employment agreement that defines trade secrets to include those valuable and protectable interests. For example, employers may want to include current and prospective customer and vendor lists, research and development information, pricing and sensitive financial information, product specifications, testing, marketing, and strategic information.

The employment contract should also include a provision that requires departing employees to return all trade secrets and company property, including electronic versions or copies. Under the Uniform Trade Secrets Act, California employers should also be advised that absent such a provision trade secrets still receive some protection from misappropriation. Cal.Civ.Code §3426.

Finally, employers should include a contractual provision that prohibits a former employee from soliciting the employer's current or prospective customers. To be an enforceable restraint of trade, a non-solicitation covenant must be necessary to protect the employer's trade secrets. Consequently, it is important that the post employment covenant specifically state that the employee agrees not to use protected trade secrets to solicit the employer's current or prospective customers. A non-solicitation covenant may also protect key employees with an agreement not to solicit the employer's personnel for a specified, reasonable period of time following the employee's departure.

This is another of a series of articles on California law - for Nevada lawyers - authored by members of the Truckee, South Lake Tahoe, Incline Village and Reno law firm of Porter Simon.

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