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NONCOMPETE NEWS

Noncompete News: California Court Finds Employers May Be Liable for Wrongful Termination When Honoring Competitors' Non-compete Agreements

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A recent decision by the California Court of Appeals, finding an employer's decision to honor a competitor's non-compete agreement tantamount to a violation of California Business and Professions Code section 16600, thus violating public policy, underscores the Catch-22 faced by employers when hiring employees subject to covenants not to compete. Given the uncertainty surrounding the enforceability of non-compete agreements in California — presumed void under California law unless found to qualify as a statutory exception — employers who endeavor to avoid litigation from former employers nonetheless may be vulnerable to wrongful termination suits by the employees subject to these agreements.

In *Silguero v. Creteguard, Inc.* (Cal. Ct. App. 2d Dist. July 30, 2010), a sales representative refused to sign a confidentiality agreement that, among other things, prevented her "from all sales activities for 18 months following either departure or termination." Shortly thereafter, Silguero was terminated by her employer and hired by competitor Creteguard. After her former employer notified Creteguard of the agreement, Creteguard terminated Silguero out of "respect and understanding [for] colleagues in the industry," notwithstanding its belief that non-compete clauses were unenforceable in California. Silguero then filed suit against both Creteguard and her former employer.

After the trial court granted Creteguard's motion to dismiss Silguero's claim for wrongful termination in violation of public policy, the Court of Appeals reversed and reinstated the claim. The Court of Appeals held that the "understanding" between Creteguard and its competitor amounted to the kind of indirect no-hire agreement found unenforceable in *VL Systems, Inc. v. Unisen, Inc.* 152 Cal.App.4th 708 (2007). The Court of Appeals emphasized that section 16600's prohibition on non-compete agreements "represents a strong public policy of the state" — which departs from the rule in most states presuming non-compete agreements to be valid and enforceable so long as they are "reasonable" — and rejected Creteguard's argument that Section 16600 does not impose liability on third party employers for non-compete agreements executed between employees and their former employers.

Employers' Bottom Line:

While the *Silguero* decision is unsurprising insofar as it is consistent with California Courts' broad interpretation of section 16600, it signals a substantial expansion of the

law that raises new red flags for California employers. First, employers must take steps to figure out what, if any, restrictive covenants employees may be subject to, and determine whether any covenants not to compete may be deemed unenforceable by a California court at some point in the future. This may be especially challenging if an agreement is executed outside California, or contains choice of law or forum selection provisions that raise questions as to which state's law controls or which court will interpret the agreement. Second, employers must be cognizant of these risks not only when terminating existing employees, but also in recruiting and hiring new employees. The previous preferred route for minimizing risk of litigation from a former employer by rejecting an applicant is now complicated by the risk of litigation from the employee. Employers now face an increasing scrutiny from California courts as to whether their actions comprise an "indirect" no-hire agreement in contravention of public policy. California employers should seek guidance when considering not hiring, or terminating, an employee subject to covenants not to compete or other restrictive covenants.

If you have any questions regarding this article, please contact the author, Naveen Kabir, nkabir@fordharrison.com, or the Ford & Harrison attorney with whom you usually work.