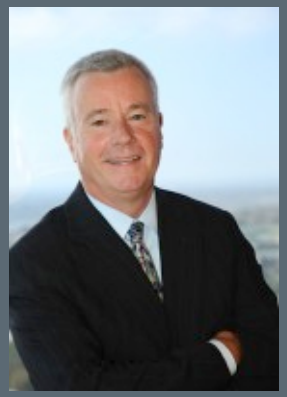
Stuart Kane
present
LLP

HIRING EMPLOYEES FROM YOUR COMPETITORS:

An Employment Law Workshop

Bruce D. May



CALIFORNIA'S LAW AGAINST NON-COMPETES

California Business and Professions Code

Section 16600

CALIFORNIA'S LAW AGAINST NON-COMPETES

California Business and Professions Code

Section 16600

"Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void."

EXCEPTIONS FOR THE SALE OF A BUSINESS

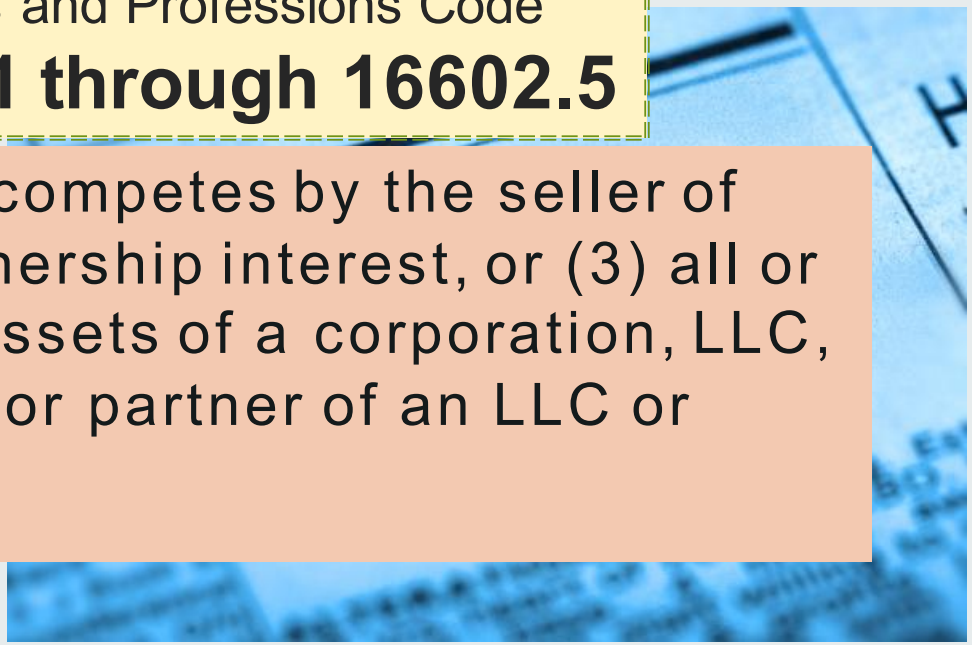
California Business and Professions Code

Sections 16601 through 16607

EXCEPTIONS FOR THE SALE OF A BUSINESS

California Business and Professions Code

Sections 16601 through 16602.5



Allows reasonable non-competes by the seller of the (1) goodwill, (2) ownership interest, or (3) all or substantially all of the assets of a corporation, LLC, or LLP, or by a member or partner of an LLC or partnership.

THE HISTORY OF SECTION 16600

Enacted in 1872 as part of California's original Civil Code.

1872

THE HISTORY OF SECTION 16600

An early anti-trust statute intended to prevent monopolies created by unreasonable non-competes between businesses.

See Morey v. Paladini 187 Cal. 727 (1922)(relying on Section 16600 to invalidate agreement among competitors not to compete in certain markets.)

1922

THE HISTORY OF SECTION 16600

1924

By judicial fiat, Section 16600 has morphed into a public policy favoring the free movement of labor.

Davis v. Jointless Fire Brick Co. (9th Cir. 1924) 300 F. 1

(first decision invalidating non-compete in employment contract based on Section 16600)

THE HISTORY OF SECTION 16600

1994

"California courts have consistently declared [Section 16600] an expression of public policy to ensure that every citizen shall retain the right to pursue any lawful employment and enterprise of their choice."

Metro Traffic Control v. Shadow Traffic (1994)

22 Cal.App.4th 853

EARLY CASES ON TORTIOUS INTERFERENCE WITH EMPLOYMENT CONTRACT

1853

Lumley v. Gye (1853) 2 El. & Bl. 216 [118 Eng.Rep. 749]: Defendant theater owner liable for "maliciously" inducing opera singer to breach contract with competitor which required competitor's consent to perform elsewhere.

EARLY CASES ON TORTIOUS INTERFERENCE WITH EMPLOYMENT CONTRACT

1944

Buxbom v. Smith *(1944)* 23 Cal.2d 535, 548: Defendant contracted to have plaintiff distribute its handbills, and plaintiff then built up its sales force and turned down other business opportunities. Defendant then hired away plaintiff's sales employees. Recovery allowed for tortious interference with contracts between plaintiff and its employees. "[I]t is not ordinarily a tort to hire the employees of another for use in the hirer's business….This immunity against liability is not retained, however, if unfair methods are used in interfering in such advantageous relations."

ELEMENTS OF TORTIOUS INTERFERENCE WITH CONTRACT:

"[A] plaintiff seeking to recover for an alleged interference with prospective contractual or economic relations **must plead and prove** as part of its case-in-chief that the **defendant not only knowingly interfered with the plaintiff's expectancy**, but **engaged in conduct that was wrongful by some legal measure other than the fact of interference itself**."

- Della Penna v. Toyota Motor Sales USA, Inc. (1995) 11 Cal.4th 376.

MODERN CASES ON TORTIOUS INTERFERENCE WITH CONTRACT

2004

Tort will lie for interference with an at-will employee if defendant engaged in an “independently wrongful act” — i.e., an act "proscribed by some constitutional, statutory, regulatory, common law, or other determinable legal standard.“ Reeves v. Hanlon (2004) 33 Cal. 4th 1140.

UNIFORM TRADE SECRETS ACT

Trade secret is any information that meets two requirements:

ONE: It is subject to reasonable security measures, such as passwords and confidentiality agreements with users.

TWO: It has actual or potential value because it is not generally known to others who can obtain economic value from its use.

ARE COVENANTS NOT TO SOLICIT CUSTOMERS LAWFUL?

The "Route Salesman" cases

Gordon v. Landau (1958) 49 Cal.2d 690 (upholding covenant not to solicit customers as necessary to prevent trade secret misappropriation.)

THE INEVITABLE DISCLOSURE DOCTRINE

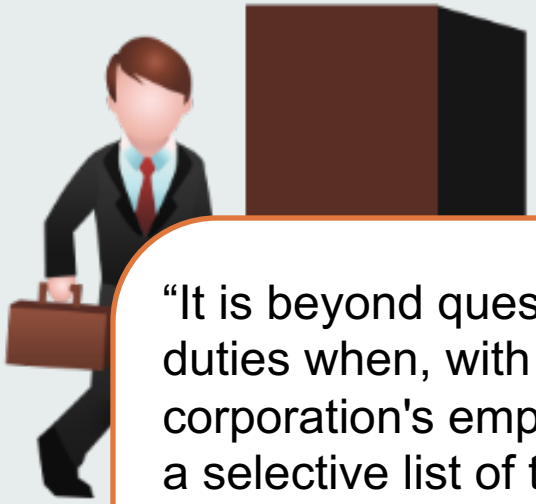
Not recognized in California.

BREACH OF FIDUCIARY DUTY

Bancroft-Whitney Company v. Glen
(1966) 64 Cal.2d 327

Senior executive for legal publisher held liable for breach of fiduciary duty by soliciting co-employees to leave and join his new venture, using inside information about their salary to induce them to leave.

BREACH OF FIDUCIARY DUTY



Bancroft-Whitney Company v. Glen
(1966) 64 Cal.2d 327

"It is beyond question that a corporate officer breaches his fiduciary duties when, with the purpose of facilitating the recruiting of the corporation's employees by a competitor, he supplies the competitor with a selective list of the corporation's employees who are, in his judgment, possessed of both ability and the personal characteristics desirable in an employee, together with the salary the corporation is paying the employee and a suggestion as to the salary the competitor should offer in order to be successful in recruitment. This conclusion is inescapable even if the information regarding salaries is not deemed to be confidential."

BREACH OF FIDUCIARY DUTY:

"We conclude an officer who participates in management of the corporation, exercising some discretionary authority, is a fiduciary of the corporation as a matter of law. Conversely, a 'nominal' officer with no management authority is not a fiduciary. Whether a particular officer participates in management is a question of fact."

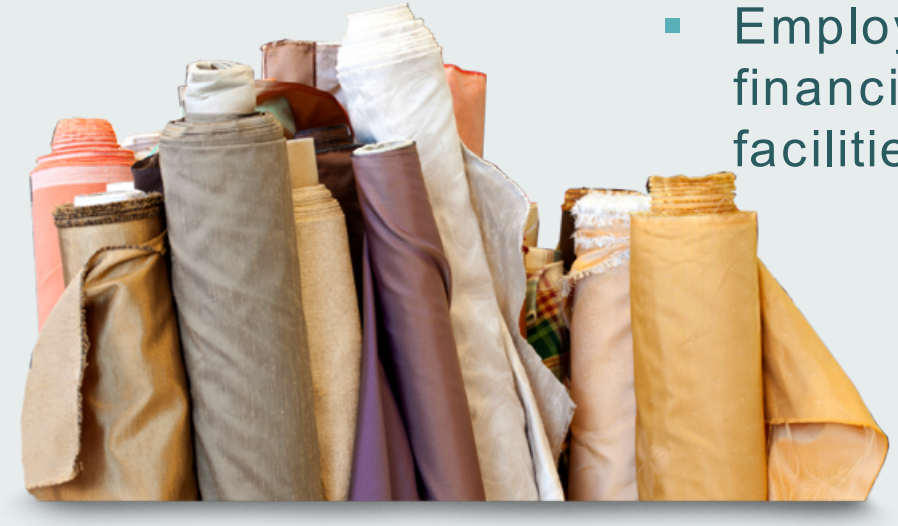
"Even when an officer loses power or authority, that officer still owes a fiduciary duty to the corporation. To divest himself or herself of the duty, the officer must resign the office."

GAB Business Services, Inc. v. Lindsey & Newsome Claim Services, Inc. (2000) 83 Cal. App. 4th 409, 420-21

WHAT CONSTITUTES A BREACH OF FIDUCIARY DUTY?

Angelica Textile Services Inc. v. Park (2013) 220 Cal. App. 4th 495:

- Regional vice president created business plan for his company to form new laundry with two customers. When company declined proposal, employee secretly implemented plan on his own while still employed.



- Employee helped new venture obtain financing, and disparaged company's facilities as outdated.
- Before leaving, employee granted customers "below market" provisions for cancellation of their contacts with the company.

WHAT ABOUT COVENANTS NOT TO RAID FELLOW EMPLOYEES?

"Section 16600 entitles competitors to solicit another's employees, who are not under contract, if they do not use unlawful means or engage in acts of unfair competition."

- Diodes Inc. v. Franzen (1968) 260 Cal.App.2d 244, 255

COVENANTS WITH EMPLOYEES NOT TO RAID FELLOW EMPLOYEES.

- **Loral Corp. v. Noyes (1985) 174 Cal.App.3d 268:**
  - Provision in severance agreement forbade former employee from "raiding" plaintiff's employees.
  - The provision is valid and enforceable, but only if employee actually solicits other employees, and not if other employees voluntarily seek employment.

COVENANTS WITH CUSTOMERS NOT TO RAID EMPLOYEES:

VL Systems, Inc. v. Unisen, Inc. (2007) 152 Cal.App.4th 708

- Plaintiff provided IT outsourcing services to Star Trac. Contractual provision forbade Star Trac from hiring any of plaintiff's employees for one year after termination of contract, or else pay a "recruiting" fee equal to 60% of base salary. Star Trac terminated the contract and posted job openings. A former employee of plaintiff named Rohnow who had not worked on the Star Trac contract applied and was hired by Star Trac. Plaintiff sued for the 60% recruiting fee.
- Held: Recovery denied, as the no-hire clause is void under Section 16600:

MORE ON COVENANTS NOT TO RAID EMPLOYEES:

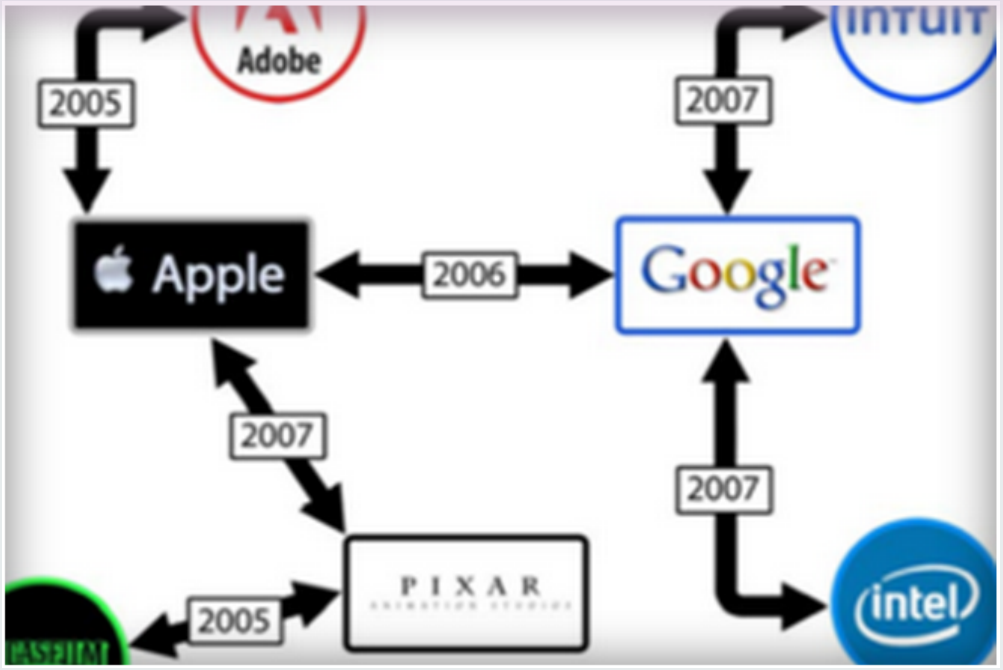
VL Systems, Inc. v. Unisen, Inc. (2007) 152 Cal.App.4th 708

"[N]o actionable wrong is committed by a competitor who hires away his competitor's employees who are not under contract, so long as the inducement to leave is not accompanied by unlawful conduct, and no action in tort would lie against Star Trac."

"The interests of the employee in his own mobility and betterment are deemed paramount to the competitive business interests of the employers, where neither the employee nor his new employer has committed any illegal act accompanying the employment change."

THE SILICON VALLEY NO-HIRE PACT CLASS ACTION

Workers in Silicon Valley no-hire scandal granted class-action status



THE RISK OF INCLUDING ILLEGAL NON-COMPETES

D'Sa v. Playhut, Inc.
(2000) 85 Cal. App. 4th 927

Employee terminated for refusing to sign employment agreement with an illegal non-compete has tort claim for wrongful termination.

THE RISK OF HONORING ANOTHER EMPLOYER'S NON-COMPETE

Silguero v. Creteguard, Inc. (2010) 187 Cal. App. 4th 60:

Employee signed non-compete with prior employer, who sent warning letter to new employee.

To maintain good relationships with competition, new employer chose to honor the non-compete, and terminated the employee.

Held: New employer liable for wrongful termination in violation of the public policy of free mobility of labor expressed in Section 16600.

WHAT ABOUT COVENANTS THAT IMPOSE A PENALTY FOR COMPETITION?

Muggill v. Reuben H. Donnelley Corp. (1965) 62 Cal.2d 239

(invalidating contract that forfeited employee's pension for competing after termination.)

DO'S AND DON'TS WHEN RECRUITING EMPLOYEES WHO SIGNED NON-COMPETES IN OTHER STATES

Will the new employment actually violate the non-compete?

Caveat re: attorney-client privilege and conflicts of interest

What about venue and choice of law?

Who will sue first?

CHOICE OF LAW ISSUES

The Application Group v. The Hunter Group (1998) 61 Cal.App.4th 881

- Employee signed non-compete with former employer in Maryland, with Maryland choice-of-law clause, then left to join California-based competitor. Former employer sent warning letter. New employer filed declaratory relief suit in California.
- Held: California law applies because public policy underlying Section 16600 trumps Maryland's interests.
- Warning letter by former employer was itself an act of unfair competition.

WHAT ABOUT CHOICE OF VENUE?

Advanced Bionics Corp. v. Medtronic, Inc. (2002) 29 Cal.4th 697

- Employees signed non-compete in Minnesota, with Minnesota choice-of-law provision, then left to join direct competitor in California. New employer immediately filed declaratory relief action in California, and old employer promptly filed suit in Minnesota. California court issued TRO purporting to enjoin former employer from pursuing the Minnesota lawsuit.

- California Supreme Court reversed: California court has no power to enjoin proceedings in another State's court.

- "We are not a political safe zone vis-à-vis our sister states such that the mere act of setting foot on California somehow releases a person from the legal duties our sister states recognize."


DO'S & DON'TS
FOR EMPLOYEES

DO'S AND DON'TS FOR EMPLOYEES

Do not use any company time or resources to conduct your job search such as company email or phone.

DO'S AND DON'TS FOR EMPLOYEES

Do not "jump the gun" by performing any tasks for the new employer while still on old company's payroll.

DO'S AND DON'TS FOR EMPLOYEES

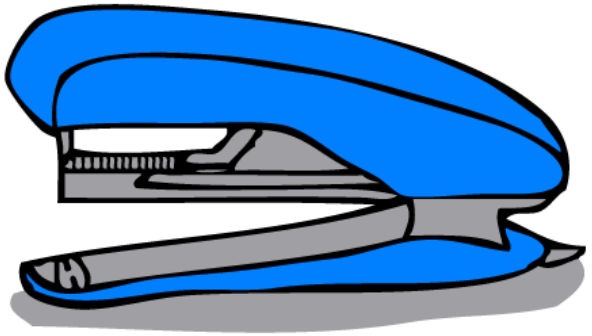
Give notice of resignation (even if you think you will be let go immediately)

DO'S AND DON'TS FOR EMPLOYEES

Tell your employer where you are going to work (because they will find out and trying to conceal it only arouses suspicion)

DO'S AND DON'TS FOR EMPLOYEES

Return all company property in your possession or control. (Clean out your home office, brief case, car trunk, etc.)



DO'S AND DON'TS FOR EMPLOYEES

Do not badmouth your old employer.

DO'S AND DON'TS FOR EMPLOYEES

Do not recruit other employees even if you do not have a non-solicitation clause. Let them come to you.

DO'S AND DON'TS FOR EMPLOYEES

Make an *announcement* to your old customers rather than a *solicitation*.

FOR

EMPLOYERS

DO'S AND DON'TS FOR EMPLOYERS

Do have all employees sign a confidentiality agreement, and include the following:

- Must give Company undivided loyalty
- No preparing to compete
- Must return all company property
- Must disclose any opportunities similar to Company business that employee learns of.
- Must not use any trade secrets

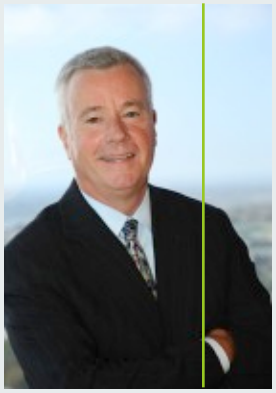
DO'S AND DON'TS FOR EMPLOYERS

Include narrow non-raiding clause in employee confidentiality agreements? If so, make it as narrow as possible:

Sample: "For a period of six months after termination of employment with the Company for any reason, Employee shall not directly or indirectly solicit or induce or attempt to solicit or induce any other employee or consultant of the Company whom Employee met through his or her employment with the Company to terminate employment or cease rendering services to the Company."

QUESTIONS AND ANSWERS

QUESTIONS?



Bruce D. May

Bmay@stuartkane.com
(949) 791-5124