New Court Decision Exposes Employers to Liability For Refusing to Hire or Employ Individuals Subject to a Covenant Not to Compete With a Former Employer

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As many employers know, California is one of the relatively few states within the country that generally prohibits businesses from barring former employees from competing with them after the conclusion of their employment. Business & Profession Code section 16600 provides that, "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." Many arguments about the scope and meaning of section 16600 were settled conclusively by the California Supreme Court's decision in *Edwards v. Arthur Anderson LLP*. In *Edwards*, the Supreme Court flatly rejected the notion that contractual terms which merely imposed a "narrow restraint" upon a former employee's ability to compete, rather than fully precluding competition, might be enforceable. In the wake of *Edwards*, covenants not to compete may be enforceable only in the context of the dissolution or sale of corporations, partnerships and limited liability companies.

Despite the clearly unenforceable nature of covenants not to compete in California, such covenants still appear fairly frequently in employment contracts. When a business is interested in hiring an individual who signed a covenant not to compete with his or her former employer, the company may consider the potential for litigation with the former employer as it decides whether to offer employment to the individual. If the company believes that litigation is likely, notwithstanding the dubious validity of the covenant not to compete, it may decide to offer the job to another candidate who is not subject to a covenant not to compete, thereby eliminating its risk of becoming entangled in a lawsuit. Similarly, a company that hires a new employee and receives a letter from the employee's former employer notifying it of the existence of a covenant not to compete signed by the individual may decide that the prospect of litigation makes continued employment of the individual unattractive. A recent decision from the California Court of Appeal places employers in an uncomfortable dilemma when dealing with persons subject to covenants not to compete with a former employer- they may hire or retain the person, thereby risking litigation with the former employer, or they may avoid controversy with the former employer by honoring the covenant not to compete, which exposes them to potential liability to the individual employee.

Silguero v. Creteguard, Inc. arose from Creteguard's hiring of a former employee of one of its competitors. While working for a prior employer, plaintiff Silguero signed a confidentiality agreement that, among other things, prohibited her from engaging in "all sales activities" for 18 months following the termination of her employment. After leaving that company, Silguero found work with Creteguard. Soon after Silguero had joined the company, Creteguard's Chief Executive Officer told her he had learned that she "signed a confidentiality/non-compete agreement with your past employer." Although he expressed the belief that non-competition clauses are unenforceable in California, the Chief Executive Officer informed Silguero that

Creteguard had decided to terminate her employment because it "would like to keep the same respect and understanding with colleagues in the industry."

Silguero sued Creteguard for wrongful discharge, arguing that the Company had violated California's public policy against enforcement of covenants not to compete by terminating her employment. Creteguard argued that the rule against covenants not to compete might apply to Silguero's former employer, but that it did not provide any basis for Silguero to sue Creteguard. The court rejected Creteguard's argument summarily, holding that Creteguard's desire to maintain an "understanding" with other companies in the industry "is tantamount to a no-hire agreement" that illegally restricts the mobility of employees.

Following the *Silguero* decision, employers not only are prohibited from imposing covenants not to compete upon employees in most circumstances, they also are prohibited from discharging employees or refusing to hire applicants on the basis of an individual's execution of an unenforceable covenant not to compete with a prior employer. Employers may feel that the decision unfairly burdens them with the task of assessing the enforceability of another company's contract terms, but the *Silguero* court was not sympathetic to that argument.

Although the law regarding covenants not to compete has been clarified by recent judicial decisions, employers still confront complex issues concerning the topic, particularly when a covenant purports to be enforceable under the law of a state other than California. If you have any questions about covenants not to compete, or any other issue relating to employment law, please contact one of our attorneys:

Daniel F. Pyne, III DPyne@hopkinscarley.com
Richard M. Noack RNoack@hopkinscarley.com
Ernest M. Malaspina EMalaspina@hopkinscarley.com
Karen Reinhold KReinhold@hopkinscarley.com
Erik P. Khoobyarian EKhoobyarian@hopkinscarley.com
Shirley E. Jackson SJackson@hopkinscarley.com