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ALERT

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Ninth Circuit Broadens California's Rule Against Non-competes: Says it Also Includes *Any* Restraint of a 'Substantial Character' on the Ability to Engage in a Lawful Profession, Trade or Business of any Kind

Drafting an effective employment agreement or release has become a challenging endeavor for a new reason. In *Golden v. California Emergency Physicians Medical Group*, the U.S. Court of Appeals for the Ninth Circuit added another source of concern to those employers who deploy "no re-hire" provisions in releases. Following *Golden*, a fact-intensive inquiry may be required into the particular provision to determine if it constitutes "a restraint of a substantial character," — here, whether or not there was a restraint of a substantial character of Dr. Golden's medical practice. And, given the Ninth Circuit's reading of California law, *Golden* may also have implications well beyond the employment context, possibly extending to certain commercial contracts as well, to the extent they can be said to restrain anyone from engaging in a lawful profession, trade or business.

Background

It is not uncommon for employers settling employment claims to desire final peace. Sometimes that peace comes in the form of an agreement by the settling employee to never return to the employer to be rehired. Such agreements come in a variety of flavors and degrees of breadth. On one end of the spectrum, they can be simple agreements to not apply to the settling employer again. On the other end of the spectrum, they can include staying away from any and all companies related to the employer, including parent and brother sister companies and future acquisitions. Some agreements can even authorize termination if the former employer buys a company the settling employee is subsequently hired to work for after the settlement was entered. There can be a variety of collateral issues with such agreements.

The Ninth Circuit's Decision in *Golden*

In *Golden*, the Ninth Circuit added California Business and Professions Code section 16600 (section 16600) to the list of concerns. That statute provides that:

> [E]very contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void.

Corporate attorneys, in-house counsel and labor and employment lawyers associate this language as the formulation of the general rule that non-competition covenants in California employment agreements are void. In *Golden*, the Ninth Circuit ruled that the statute has impacts in other contexts as well.

The procedural context of *Golden* is significant precisely because it is so banal. Dr. Golden became embroiled in a dispute with his employer who insisted on a very broad "no re-hire" provision, complicated somewhat by how large the employer's share of the emergency medical services market was. Dr. Golden agreed reluctantly to the settlement terms before a Magistrate Judge, including the "no re-hire" language. Golden then refused to sign the agreement. After more proceedings before the Magistrate Judge, the District Court accepted the Magistrate Judge's findings and again ordered Dr. Golden to sign the agreement. He again refused. By this time, Dr. Golden's own lawyer was allowed to intervene and also insisted that the court order his client to sign. The District Court granted that request, upheld the agreement as enforceable and entered judgment dismissing the case. Dr. Golden appealed.

This was a one-issue appeal on the question of whether section 16600 rendered the settlement agreement with its broad "no re-hire" provision void.

Noting the consensus that section 16600 regulates non-competition agreements, the Ninth Circuit made this factual observation:

> Nowhere either in the no-employment provision or in the remainder of the agreement does Dr. Golden arguably surrender any right to practice his profession generally, nor any right to seek employment with CEP's competitors or at facilities in which CEP does not have an ownership interest or with which it does not contract for services. Rather, the no-employment provision solely governs the terms on which CEP agrees to do business with Dr. Golden in the future.

The District Court, having reviewed the agreement, reasoned that, because nothing about the provision inhibited Dr. Golden from competing with CEP, section 16600 was not violated. In other words, because it was not a covenant not to compete, and Dr. Golden could practice his profession outside of working for his former employer, the District Court concluded that it was excluded from the ambit of section 16600.

The Ninth Circuit disagreed, going so far as to find that the District Court abused its discretion by mischaracterizing the appropriate legal rule.

First, the Ninth Circuit noted that the decisive question was whether the District Court erred by categorically excluding the settlement agreement from the ambit of section 16600, solely because it did not constitute a covenant not to compete.

Having thus framed the issue, the Ninth Circuit next reviewed California case law on whether a contract can run afoul of section 16600 if the agreement does not prevent a former employee from seeking work from a competitor and does not penalize the former employee from doing so.

Noting that the California Supreme Court had not reached the issue, the Ninth Circuit then attempted to discern California law on this issue. It was not writing on a blank slate. In addition to the statute, there is some earlier case law, as well as the California Supreme Court's most recent discussion of section 16600 in *Edwards v. Arthur Andersen, LLP* (*Edwards*), 189 P.2d 285 (Cal. 2008).

Starting with the statute's plain language, the Court noted that there is nothing in the plain language of section 16600 that limits it to covenants not to compete, that the text does not include any form of the word "compete" or "competition," nor does it "explicitly constrain itself to employment contracts."

Parsing the statute still further, the Court also noted that the narrow exceptions to section 16600 seem to correspond to the conventional non-compete covenants, suggesting that the ban in section 16600 must therefore extend outside that context, to other contracts. According to the Court, the general rule in section 16600 contains categorical language that "every contract" that restrains anyone from engaging in lawful profession "of any kind" is void.

This latter point is noteworthy, as the inclusion of non-compete clauses in certain commercial contracts is somewhat common (e.g., merger & acquisitions agreements, commercial real property leases and commercial licenses), leaving some commentators to argue that, as a result of section 16600's broad language, any restrictions on a trade or business thereunder must also fall within the exceptions to section 16600 in order to be enforceable. The Ninth Circuit's reference to the specific language of section 16600 and its application outside the strict employment context will be used to support that view.

Having examined the statutory language, the Ninth Circuit then went all the way back to *Chamberlain v. Augustine*, 156 P. 479 (1916), for the California Supreme Court's view. *Chamberlain* involved a provision imposing $5,000 in liquidated damages if the employee accepted employment with a new employer in a specified geographic area. The Ninth Circuit then noted that in voiding the agreement the California Supreme Court found "the necessity of paying $5,000 . . . is clearly a restraint of a substantial character and the form in which it is cast does not make it less a restraint."

The Ninth Circuit next turned to the California Supreme Court's opinion in *Edwards*. Noting that *Edwards* involved a more traditional variety of non-compete covenants — an employment agreement that forbid a former employee from poaching clients and personnel — the Ninth Circuit noted that *Edwards* was a strong statement of California's public policy against restraints to professional practice, disavowing even narrow case law exceptions that federal courts prior to the *Edwards* decision had been developing.

And, in discussing *Edwards*, the Ninth Circuit also questioned the result of an earlier case, where police officers were required to reimburse the department for training expenses if they voluntarily left their jobs before completing five years of service. *City of Oakland v. Hassey*, 163 Cal. App. 4th 1477 (2008). According to the Ninth Circuit, a requirement to reimburse training expenses could impose a meaningful obstacle to employee mobility and therefore limit one's ability to engage in one's chosen line of work.

Therefore, the Ninth Circuit ruled "the crux of the inquiry under section 16600 is not whether the contract constituted a covenant not to compete but rather whether it imposes 'a restraint of a substantial character' regardless of 'the form in which it is cast.'" As the District Court did not make an assessment on this issue, the case was remanded so it could do so.

Implications

Golden has a number of potential implications. First, it created what may be a very fact-specific inquiry for enforcement of every form of post-employment covenants. The issue is whether, in regulating post-

employment former employee behavior (and related contexts) by agreement, the limitation created imposes a "restraint of substantial character."

Second, it creates uncertainty in two respects: what constitutes a "restraint of a substantial character," and what must be shown to demonstrate that the provision is a "restraint of a substantial character."

The first uncertainty is what section 16600 might include. The Ninth Circuit in *Golden* notes that, while California Courts have not clearly indicated the boundaries of section 16600's "stark prohibition" they have nevertheless intimated that they extend "to a considerable breadth." What exactly this might entail is not developed.

The second uncertainty is how it is to be resolved. Having left section 16600's ambit open-ended, the Court provided no guidance on the other end. In refraining from addressing the ultimate question because of the relatively undeveloped record, the Court did not indicate what additional fact-finding might be appropriate to determine if, in fact, the restriction is a restraint of a substantial character. Courts and practitioners will be left to determine this.

Fortunately, there may be some distinguishing features. *Golden* involved a professional in private practice. It is also true that the provision in question in *Golden* was a very broad "no-rehire" restriction by a business with large market share. However, future courts applying *Golden* may not feel so constrained.

Also, for Courts who are inclined to limit *Golden*, the decision was not without a vigorous dissent, which noted, among other things, that the agreement did nothing to restrain Dr. Golden from working elsewhere; that it was not ripe; that section 16600 should not be construed as preserving an unfettered right to employment in all future circumstances, no matter how remote or contingent; and that the California Supreme Court would not likely reach such a result.

Finally, future cases will reveal whether these features make this case of limited application but, until then, it may be worth examining other documents purporting to regulate post-employment activities, subsequent invention reporting requirements and the like, as well as a variety of other limitations on engaging in a lawful business, trade or business of any kind, placed into a variety of agreements and policy statements, to see if the ruling in *Golden* has created a potential issue.

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