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An Uncertain Future for the Enforcement of Nonsolicitation Provisions in Commercial Agreements to Prevent the Solicitation of Former Employees

Given the potential uncertainty following Ixchel, parties to business to business non-solicitation agreements should be aware that such provisions may be subject to a more exacting analysis.

By Kurt Kappes and Michael Lane | May 20, 2021 | The Recorder

The California Supreme Court decision in *Ixchel* has left some uncertainty regarding whether business to business employee nonsolicitation provisions will be evaluated under the rule of reason, or deemed a per se violation of California Business and Professions Code Section 16600. See *Ixchel Pharma v. Biogen*, 9 Cal. 5th 1130, 1158 (2020); *Edwards v. Arthur Andersen*, 44 Cal.4th 937, 946 (2008).

Under Section 16600, "every contract by which anyone is restrained from engaging in a lawful profession, trade or business of any kind is to that extent void" unless the restraint falls within a statutory exception. When applying Section 16600 to a contractual restraint and in absence of a statutory exception, courts may now either invalidate the restriction under *Edwards*, without inquiring into the restraint's reasonableness, or evaluate whether the provision is unreasonable pursuant to a "rule of reason" test. Cf. *Ixchel*, 9 Cal. 5th 1130 with *Edwards*, 44 Cal.4th 937, 946 (2008)

With respect to employee nonsolicitation provisions in particular, recent decisions have followed *Edwards* and consistently refused to enforce competitive restraints, without addressing the restraint's reasonableness, where the provision comprises a post-termination obligation in an employment contract. See *AMN Healthcare v. Aya Healthcare Services*, 28 Cal.App.5th 923, 938 (2018) (rejected

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interpretation of BPC 16600 as intended to void only language that is unreasonable or overbroad); *Barker v. Insight Global*, 2019 WL 176260 at *2 (N.D. Cal. Jan. 11, 2019) (BPC 16600 invalidates employee non-solicitation clauses) (following *AMN*); *WeRide v. Huang*, 379 F.Supp.3d 834, 852 (N.D. Cal. 2019) (nonsolicitation language that employee would not "encourage or solicit" any employee or consultant to leave was void under BPC 16600).

The exceptions are generally limited to solicitation of a company's current employees and follow an appellate decision that preceded *Edwards* and *AMN* by over 20 years, *Loral v. Moyes*, 174 Cal.App.3d 268 (1985). See, e.g., *Western Air Charter v. Schembari*, 2018 WL 10157139 at *14 (C.D. Cal. Nov. 21, 2018) (provisions restraining former employees from soliciting a company's current employees are not prohibited so long as they do not restrain employees from leaving the company and seeking employment) (following *Loral*).

However, those who advise clients in this area now confront an uncertainty. Following *Ixchel*, will a court apply the rule of reason to an employee nonsolicitation provision in an overriding commercial contract between two business entities, but not in an employment contract, even though the provision implicates substantially the same policy concerns protecting employee mobility, regardless of which type of contract it appears in?

More specifically, if the nonsolicitation provision applies to employees, will the provision be struck as per se unlawful unless it falls within a statutory exception? Or, because the provision is part of a commercial contract, will a court apply the rule of reason analysis? Id. at 1158-61; see also *Quidel v. Superior Court,* 57 Cal.App.5th 155, 245 (2020) (applied rule of reason to business contract where "no individual person's liability to seek employment is impacted by the challenged portion of the agreement," and stated, "simply put, this matter falls outside the confines of *Edwards* because it does not address an individual's ability to engage in a profession, trade, or business").

As such, it is not certain whether California courts will enforce employee nonsolicitation provisions to prevent the solicitation of former employees in a commercial agreement, because *Ixchel* did not address nonsolicitation provisions that restrict a former employee's mobility and competition. In addition, prohibiting a business from soliciting another business's former employees impinges the freedom and mobility of third-party employees.

Indeed, one of the primary reasons why the California Supreme Court adopted the rule of reason analysis for the general noncompetition provision at issue in *Ixchel* was because the provision did not implicate the strong California policy considerations in favor of employee mobility and competition. Id. at 1158 (the per se rationale in prior decisions "focused on policy considerations specific to employment mobility and competition: 'The law protects Californians and ensures that every citizen shall retain the right to pursue any lawful employment and enterprise of their choice.'") (quoting *Edwards v. Arthur Andersen*, 44 Cal.4th 937, 946 (2008)).

An earlier, pre-*Edwards* appellate court decision in *VL Systems v. Unisen,* 52 Cal.App.4th 708 (2007), provides some limited guidance. In *VL Systems*, the court invalidated a "no-hire" restraint in a commercial contract between a consulting company and its client, without expressly addressing the rule of reason analysis. The "no-hire" provision at issue generally applied to all of the consulting company's employees, regardless of whether or not the employees worked for the client, and did not exclude employees that contacted the client at their own initiative, without direct solicitation. The appellate court grappled with competing policy interests between "the important principle" of contractual freedom against a noncompetitive provision that "may serious impact the rights of a broad range of third parties."

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Ultimately, the *VL Systems* court determined that the no-hire provision was not necessary to protect the consulting company's competitive interests because it was not limited to the employees who worked for the client or were even employed at the time the contract was in effect. So, perhaps a similar limitation on non solicits would be permissible between commercial entities. The court declined, however, to take a position on whether a more narrowly drawn or limited no-hire provision would be permissible.

In a case of first impression following *Edwards* and *Ixchel*, the court may, as the appellate court did in *VL Systems*, distinguish between commercial nonsolicitation provisions that are limited to employees that worked on projects for the other contracting party (and apply the rule of reason), against those that broadly encompass all of a contracting parties' employees (and invalidate the provision unless an exception applies). But even then, the point at which a non-solicit is governed by a rule of reason or a per se rule is still not clear.

Given the potential uncertainty following *Ixchel*, parties to business to business nonsolicitation agreements should be aware that such provisions may be subject to a more exacting analysis. In those cases, *Ixchel*'s rule of reason may not be applied, and instead *Edwards*' per se rule would be applied. In other words, even if the agreement would be between two commercial entities, the court may still consider that the effect the nonsolicit has on the employee, that the same policy considerations arise in the business context as those giving rise to the per se rule, and determine not to enforce them.

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About the Authors:

Kurt A. Kappes is the managing shareholder of global law firm Greenberg Traurig's Sacramento office and a leader of the firm's trade secret practice. Of Counsel **Michael D. Lane** is a member of the firm's litigation and trade secrets practices. Both are based in the firm's Sacramento and San Francisco offices.

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