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Covenants Not to Compete in California

It is not unusual for employment contracts to contain a provision that the employee cannot compete with the employer's business for a period of time after termination. Unlike many states, California law prohibits covenants not to compete except in very limited circumstances. Pursuant to California Business and Professions Code §16600, "[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." California courts have consistently declared this code section as an expression of strong public policy to ensure that every person shall retain the right to pursue any lawful employment and enterprise of his or her choice (See Metro Traffic Control, Inc. v. Shadow Traffic Network). Given California's significant public policy against restraints on employment, employers can be assured that California courts are virtually certain to strike down such restrictive covenants.

However, the state recognizes an exception to this general rule where non-compete agreements are entered into in connection with the sale of the goodwill of a business or the shares or assets of a corporation. The first exception is codified in Business and Professions Code §16601,
which allows a buyer of an existing business to require the seller not to compete with the acquiring company. This section permits agreements not to compete made by a party selling the goodwill of a business or all of the shares of stock in a corporation. (See Vacco Industries, Inc. v. Van Den Berg). Even in this limited circumstance where a buyer sells his or her interest in the company, the covenant must still be narrowly tailored to be enforceable. The second statutory exception is found in Business and Professions Code §16602, and allows a partnership to prevent a departing partner from competing with the continuing entity at dissolution.

The exception is based on the fact that a company's value would be worth considerably less if a buyer couldn't be assured that the seller wouldn't simply open up a new shop right next store to the one he sold. For similar reasons, partnership agreements may include noncompetition clauses as part of the dissolution process. Covenants not to compete must be reasonable in geographic and temporal
scope, which may depend on the particular facts and circumstances surrounding a given non-compete agreement.

An invalid covenant not to compete could also violate Business and Professions Code §17200, which prohibits unfair business practices and unfair competition. In the case of Application Group, Inc. v. Hunter Group, Inc., the court ruled that a violation of Section 16600 can constitute such a practice and thus can form the predicate for a finding of violation of section 17200.

In sum, the one approach that an employer cannot take is to simply draft a traditional covenant not to compete that appears reasonable in geographic scope and limited in time, and hope that the restriction will pass judicial muster. Such a restriction is not only likely to be unenforceable, but may also subject the employer to liability for violating California's strong public policy in favor of employee freedoms and mobility. California employers should be

cautious when using such covenants and instead should avail themselves of the protections afforded in nondisclosure, non-solicitation, and narrowly tailored confidentiality agreements.

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