

EMPLOYING IN CALIFORNIA? BEWARE OF RISKS IN EMPLOYMENT AGREEMENTS

By Michael L. Rosen and Robert A. Fisher

Massachusetts-based NewTech Inc. has a promising product, a new round of financing and now is looking to hire sales and technical employees in California. New employees are required to sign a standard confidentiality, inventions, noncompetition and nonsolicitation agreement. To avoid any problem that might arise under California law, the agreement states that Massachusetts law will apply to any disputes.

While many employers are aware that noncompetition agreements are unenforceable in California, the implications of having California-based employees sign agreements containing noncompetition provisions can extend beyond the question whether that provision will be enforced. Employers must be sensitive to the uniqueness of California law and must maximize their interests wherever they operate.

The risks

California, by statute, prohibits post-employment restrictions on a former employee's right to compete with her former employer. With few exceptions, noncompetition agreements between an employer and a California-based employee, including those who transfer to that state after signing such an agreement, are null and void.

The risks of using a noncompetition provision with California-based employees are not limited to the provision being found unenforceable. For example, a California appeals court recently upheld a \$1.26 million verdict for a California employee who was terminated after refusing to sign a non-compete and confidentiality agreement. In that case, a Pennsylvania-based company had merged with a California company and continued its usual practice of requiring employees (including those in California) to enter into a generic agreement containing a noncompete provision.

An employee refused to sign the agreement and ultimately was terminated. A jury awarded \$1.26 million on her claim of wrongful termination, of which more than \$1 million represented punitive damages.

In another case, a California court found that requiring a California employee to sign a noncompete agreement could constitute a violation of the state's unfair trade practices law and expose the employer to multiple damages and attorneys' fees.

The risks in imposing these provisions are not only monetary; they could place in jeopardy a company's lifeblood — its intellectual property. One California appellate court, finding that a noncompete provision imposed on a California employee was unenforceable, found that the inclusion of an unlawful noncompete provision meant that the entire agreement was unenforceable, including lawful provisions relating to trade secrets and invention rights.

Many employers have sought to avoid the impact of California law by including a “choice of law” provision, designating some other state’s laws as controlling, or a “choice of forum” provision, naming some other state as the forum for any legal proceeding relating to the agreement.

California courts generally have refused to enforce such provisions on the grounds that the state has a strong public policy against noncompetition agreements, which is greater than the interests of other states. This means that a California-based employee who is subject to a noncompete provision has an incentive to have the agreement deemed void and unenforceable.

A similar problem created by California law is that employees who are not based in California may become a citizen of that state in order to circumvent an otherwise valid noncompetition provision when undertaking new employment.

Possible strategies

At the very least, Massachusetts-based companies should use agreements specifically tailored to California law or that expressly exempt California-based employees from certain provisions in generic agreements.

Most important, employers should modify their agreements with California employees to focus on interests and provisions that are enforceable in that state.

For example, confidentiality, nondisclosure and invention assignment provisions generally are enforceable. Similarly, customer nonsolicitation provisions may be enforceable in California, if the employer can show that the provision is necessary to protect confidential information and trade secrets.

In Massachusetts, such provisions are easier to enforce, because Massachusetts courts recognize that the valuable relationship between employee and customer — known as customer good will — itself can justify enforcement.

With respect to Massachusetts-based employees who leave to take jobs in California with competing companies, Massachusetts employers must recognize that they will need to act quickly and aggressively if they are to win the race to the courthouse that such cases often become.

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