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Unsettled Law for 10 Years, the Employee Non-Solicit Covenant Debate Might Finally Be Over

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A recent decision from the California Court of Appeal — *AMN Healthcare, Inc. v. Aya Healthcare Servs., Inc.*[1] — could significantly affect employers' ability to prevent California-based former employees from soliciting their former co-workers to change jobs.

California Business & Professions Code § 16600 invalidates contracts to the extent that "anyone is restrained from engaging in a lawful profession, trade, or business of any kind[.]" Whether that invalidates post-employment covenants not to solicit former co-workers to change jobs has been unsettled in California law for about a decade.

In 1985, in *Loral Corp. v. Moyes*,[2] the California Court of Appeal held that an employee non-solicit covenant was enforceable because it was reasonable and narrowly drawn. But that rationale is difficult to reconcile with the California Supreme Court's landmark 2008 decision in *Edwards v. Arthur Andersen LLP*.[3] In *Edwards*, the court read § 16600 literally, holding that § 16600 sets out a per se rule that invalidates any post-employment restraints on an employee's ability to engage in his or her chosen profession, unless the contract falls within one of the statutory exceptions addressed to the sale or dissolution of business entities.[4] The court rejected prior attempts to articulate reasonableness or balancing tests for these provisions.

On November 1, 2018, the California Court of Appeal published a decision that may resolve the issue of employee non-solicit covenants, which had been unsettled for 10 years.

Edwards disapproved two Court of Appeal cases that arguably rested on a narrow restraint rationale. But it did not expressly disapprove of *Loral Corp.* Indeed, Edwards actually cited *Loral Corp.*, albeit for an unrelated rule of contract interpretation. The ongoing validity of *Loral Corp.* has been a subject of debate within academia and the California employment bar in the 10 years since Edwards was decided.[5] But no published California decision since *Edwards* addressed whether *Loral Corp.* remains good law.[6] On November 1, 2018, however, the California Court of Appeal issued a published decision that likely resolves the issue, unless the California Supreme Court grants review.

In *AMN Healthcare, Inc.*, a panel of the Court of Appeal, Fourth District, Division One in San Diego held that an employee non-solicit was invalid as an unlawful restraint and thus invalid under §16600. The court further held that the plaintiff's NDA provisions preventing the post-employment use of "confidential information" could not be enforced in manner that impedes employee mobility. Any post-employment protection of the employer's confidentiality interests would require an actionable tort claim under the California Uniform Trade Secrets Act or the Unfair Competition Law.

AMN Healthcare involved competing providers of temporary "travel nurses" to the healthcare industry. The providers employed recruiters to locate and hire the nurses. The recruiters employed by the plaintiff had employment agreements that included restrictive covenants prohibiting them from soliciting any of the plaintiff's employees — including travel nurses — for at least a year. The contracts also included NDA provisions that prohibited the post-employment use or disclosure of "confidential information," defined extremely broadly.
Over a six-month period in 2015, four of the plaintiff's recruiters left to join the competitor. Three were alleged to have recruited travel nurses to leave the plaintiff's network and join the competitor's. The fourth allegedly obtained some "confidential information" about travel nurses from the plaintiff and emailed it to herself, allegedly for use after she joined the competitor.

The court found that the non-solicit covenant, if enforced, "restrained [the recruiters] from engaging in their own profession, even in a 'narrow' manner or a 'limited' way," which meant that it was "void under section 16600."

The plaintiff sued the four departing recruiters and the competitor for breaches of the employee non-solicits and the NDAs, as well as a number of related torts. The trial court granted the competitor's summary judgment motions. It ruled that § 16600 rendered the non-solicits invalid and protected the use of non-trade secret information by a former employee. The plaintiff appealed.

The Court of Appeal affirmed. Analyzing both *Loral* and *Edwards*, it recognized that *Loral*'s "use of a reasonableness standard in analyzing the nonsolicitation clause there at issue thus appears to conflict with *Edwards*'s interpretation of section 16600, which, under the plain language of the statute, prevents a former employer from restraining a former employee from engaging in his or her 'lawful profession, trade, or business of any kind,' absent statutory exceptions not applicable here." The court further noted that *Edwards* rejected a non-statutory "narrow restraint" exception that had been applied in some federal courts, finding the standard to be inconsistent with the plain meaning of § 16600. The court thus expressed its doubt about "the continuing viability of [*Loral*] post-*Edwards*."

The court buttressed its argument, however, by finding in the alternative that *Loral* was "factually distinguishable to our case." The recruiters "were in the *business* of recruiting and placing" travel nurses. Thus the covenant, if enforced, "restrained [the recruiters] from engaging in their own profession, even in a 'narrow' manner or a 'limited' way," which meant that it was "void under section 16600."

> **Unless and until the California Supreme Court grants review or the Legislature amends the statute, the safest bet would be to assume that trial courts in California will begin to hold that employee non-solicit covenants are unenforceable under § 16600.**

Moving on to the NDA, the court relied on its 2009 decision in *The Retirement Group v. Galante*,[7] to hold that a contractual limit on the use of "confidential information" cannot save a restraint that is otherwise unlawful under § 16600. Section "16600 precludes an employer from restraining an employee from engaging in his or her 'profession, trade, or business,' even if such an employee uses information that is confidential but not a trade secret." Of course, that does not prevent a court from

enjoining conduct that is independently tortious, such as the misappropriation of trade secrets. But that conduct is "enjoinable [only] because it is wrongful independent of any contractual undertaking." Thus, any causes of action that were premised on a duty of nondisclosure created by only the NDA necessarily failed.

We expect that parties may argue that *Loral* continues to be good law because *AMN Healthcare* did not expressly say "*Loral* is overruled," and alternatively decided to distinguish it on the facts. But the court's alternative rationale likely has more to do with its institutional posture as an intermediate appellate court than any true doubt of the ongoing validity of a reasonableness test post-*Edwards*. Moreover, in California, "[w]hen an appellate court bases its decision on alternative grounds, none is dictum."[8] So unless and until the California Supreme Court grants review or the Legislature amends the statute, the safest bet would be to assume that trial courts in California will begin to hold that employee non-solicit covenants are unenforceable under § 16600. This could diminish one contract-based avenue that former employers in employee-mobility litigation have used to circumvent *Edwards*, placing an even greater emphasis on arguments under UTSA and the UCL.

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1. No D071924 (Nov. 1, 2018), *available at* https://www.courts.ca.gov/opinions/archive/D071924.PDF.↩

2. 174 Cal. App. 3d 268 (1985).↩

3. 44 Cal. 4th 937 (2008).↩

4. *See* Cal. Bus. & Prof. Code §§ 16601 (sale of goodwill or interest in a business), 16602 (dissolution of partnership),
16602.5 (dissolution or sale of LLC).↩

5. *See generally* David L. Simson, *Customers, Co-Workers and Competition: Employee Covenants in California After Edwards v. Arthur Andersen*, 4 Hastings Sci. & Tech. L.J. 239 (2012).↩

6. Read closely, a pair of post-*Edwards* Court of Appeal decisions appear to invalidate employee non-solicits under their particular facts, but neither addresses *Loral Corp*. *See Fillpoint, LLC v. Maas*, 208 Cal. App. 4th 1170, 1183 (2012); *Strategix, Ltd. v. Infocrossing W., Inc*., 142 Cal. App. 4th 1068, 1074 (2006).↩

7. 176 Cal.App.4th 1226, 1233 (2009).↩

8. *People v. Rolon*, 160 Cal. App. 4th 1206, 1214–15 (2008) (quotation omitted).↩

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