

New Protections That Shift The Balance Toward Companies

California Lawyer

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California has long been known for its strong public policy favoring the ability of employees to change jobs without restriction. Section 16600 of the Business and Professions Code outlines that policy, providing that "every contract by which anyone is restrained from engaging in a lawful profession, trade or business of any kind is to that extent void." This ban has rendered most covenants not to compete invalid – until now. Two unrelated cases, *Electro Optical Industries, Inc. v White* (1999) 76 CA4th 653 and *IBM Corp. v Bajorek* (9th Cir 1999) 191 F3d 1033, have given companies significant new means to prevent employees from jumping ship and taking valuable information and stock options with them, and to protect companies when employees do, in fact, leave.

In *Electro Optical* the second appellate district became the first court in California to adopt the "inevitable disclosure" rule. This doctrine permits an employer to enjoin a former employee from working for a competitor if the new employment "will inevitably lead [the employee] to rely on the [former employer's] trade secrets." *PepsiCo, Inc. v Redmond* (7th Cir 1995) 54 F3d 1262, 1269. The rule follows the language of the Uniform Trade Secrets Act (UTSA), which allows a court to enjoin "actual or threatened" misappropriation of trade secrets. Although California adopted the UTSA in 1984 (CC §§3426 et seq.), whether California courts would be willing to follow *Redmond* and go against the public policy favoring the ability of employees to change jobs freely was unclear.

Since *Redmond* enunciated the inevitable disclosure rule five years ago, many states across the nation have followed suit. Indeed, the decision in *Electro Optical* was considered overdue by those concerned about the inability of companies to protect themselves from former employees and corporate raiders who take trade secrets to competitors with impunity. Any fears that this new safeguard would prevent workers from pursuing their livelihoods is unfounded. *Electro Optical* made clear that a very fact-specific inquiry must be made before a court decides that disclosure of trade secrets is "likely to result" and the court may issue an injunction. In *Electro Optical* the hardships were balanced in favor of the employee's ability to change jobs. Note: As we were going to press, the California Supreme Court ordered the court of appeal's opinion in *Electro Optical* depublished. S085582 (Apr. 12, 2000). See Cal Rules of Court 976; Cal Const art VI, §14.

Although it has received little attention, the Ninth Circuit decision, *IBM Corp. v Bajorek*, has also narrowed the breadth of section 16600 of the Business and Professions Code. Employee Bajorek left IBM to work for a competitor after exercising stock options worth more than \$900,000. At the time the options were granted, Bajorek had signed a noncompete forfeiture provision that required him to return any profits to IBM if he went to work for a competitor within six months of exercising the options. The ensuing litigation involved complex conflict-of-laws principles between New York and California. In deciding these issues the Ninth Circuit found that section 16600 did not make all restrictions unenforceable: The court said the IBM noncompete provision

was limited to six months and did not preclude Bajorek from engaging in his profession. The court also found that California Labor Code section 221, which makes it unlawful "for any employer to collect or receive from an employee any part of wages theretofore paid" did not apply. Read literally, said the court, stock options are not wages, and IBM's cancellation of the stock options was upheld.

In light of *Electro Optical* and *Bajorek*, there are safeguards that employers can now implement to deter employees from going to direct competitors and that also tip the balance in the employer's favor if litigation becomes necessary. California companies can continue to use financial incentives to retain key employees and compete with raiders, including stock options, profit sharing, and bonuses. However, companies should adopt noncompete forfeiture provisions in all stock options and restricted stock grants to personnel. It is not unreasonable to insist that any windfall gains given to optionees be conditioned on allegiance to the employer.

When profit motives fail to prevent employees from leaving, employers still can try to protect their trade secrets by seeking an injunction based on the inevitable disclosure rule. Employers should require that all key employees sign confidentiality agreements, and update those agreements, to set forth the scope of coverage of the agreements. In particular, employers can specifically identify known categories of trade secret information to which employees have been or will be exposed. Employers should also consider having key employees acknowledge that working for a competitor in a similar position will inevitably lead to the disclosure of trade secret information. Even if the disclosure is inevitable, however, any restraint on switching jobs should be limited to a reasonable period of time.

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