CLIENT ALERT

District Court Carves Out "Trade Secret Exception" to California Ban on Enforcement of Non-Compete Agreements

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It is common knowledge that California is somewhat of an outlier when it comes to trying to enforce contracts which prohibit employees from competing with their former employer. The recent federal decision in *Richmond Technologies, Inc. v. Aumtech Business Solutions, et al*., No. 11-CV-02460-LHK, 2011 WL 2607158 (N.D. Cal. July 1, 2011), now provides an argument that non-competes are not automatically void at least where they prohibit a former employee from competing using his former employer's trade secrets. This is significant news in California and smart employers ought to be revisiting their agreements -- proprietary information, employment and third party agreements alike -- to tie non-compete prohibitions directly to the use of trade secrets.

The *Richmond Technologies* decision answered the hotly debated question the California Supreme Court passed on in *Edwards v. Arthur Andersen LLP,* 44 Cal.4th 937, 946, n.4, 189 P.3d 285 (2008), when it declined to address the still unverified "trade secret exception" to California's Business and Professions Code Section 16600. *Richmond Technologies* also takes on, and definitively answers in the affirmative, whether Section 16600 applies to non-employment-based contracts (*i.e.*, contracts between corporations).

Based on a rather egregious set of facts, which include spoliation through the use of three different programs designed to "wipe" or erase data from the former employer's company-provided laptops, the Court held that the non-compete clause would be enforceable if the plaintiff proved that the alleged competition with the former employer was based on the "use" of the former employer's trade secrets. On the other hand, the Court rejected, as unenforceable, non-solicitation and non-interference clauses contained in that same contract because they were not narrowly tailored to the use of the former employer's trade secrets.

Plaintiff Richmond Technologies, Inc., d/b/a ePayware ("EPI"), a provider of enterprise resource planning software to financial services companies, entered into a "Teaming Agreement" with Defendant Aumtech I-Solutions ("Aumtech"), an Indian-based software development company. Under that agreement, Aumtech developed software for EPI and maintained EPI's customer service modules. The parties also entered into a Confidentiality and Non-Disclosure Agreement that prohibited Aumtech from entering into any agreements with EPI's customers, using or disclosing EPI's confidential information, or offering similar products or services for a period of one year following termination of the agreement. The provision that the Court ultimately concluded was enforceable, based on the evidence submitted, provided as follows:

> "Recipient will not compete with EPI with similar product and or [sic] Service using its technology for a period of one year thereafter. Recipient will not use any of the [sic] EPI's technical knowhow or Source Code for the personal benefit other than the employment and to meet the customer needs defined by EPI."

EPI entered into a similar agreement with its employee Jennifer Politico.

EPI alleged that Politico "hatched a plan" with Aumtech to open an U.S.-based branch to compete directly with EPI. Prior to resigning her position with EPI, Politico began communicating with EPI's customers using an Aumtech email account and used three different programs to delete data from her EPI issued computer (before returning it to EPI) to conceal their activities. Upon resigning, Politico promptly joined the newly-formed Aumtech America as its President, and solicited EPI's clients to terminate their contracts and sign up with Aumtech America instead.

Relying on a line of cases finding that "a former employee may be barred from soliciting existing customers to redirect their business away from a former employer and to the employee's new business *if the employee is utilizing trade secret information to solicit those customers*," the Court granted EPI's request for a temporary restraining order. *Id*. at 28 (Emphasis added.) The Court enjoined the Defendants from contacting EPI's clients regarding competitive software and using EPI's information to solicit agreements from those clients, but ruled that Defendants "may enter into agreements with EPI's customers if the customer initiates the contract and none of EPI's confidential information will be used in negotiating, executing, or performing the agreement." *Id*. at 35.

Citing the void left by *Edwards*, the District Court relied on several other state and federal court decisions in explaining that various contractual provisions could withstand a challenge under Section 16600, including provisions barring the post-employment solicitation of customers by former employees. The *Richmond Technologies* Court then wrote that even if there was no trade secret exception to Section 16600, existing law could be construed "enjoin[ing] the misuse of trade secrets as an independent wrong, either as a tort or a violation of the Unfair Competition law." Thus, although the Court did not definitively answer the question of whether or not there is a trade secret exception to Section 16600, it went a long way to support that proposition.

What can be learned from the *Richmond Technologies* decision is that if companies have not revisited the restrictive covenants contained in employment agreements or agreements they have or may enter into with teaming partners, suppliers, or other entities with whom they would like to ensure will not be able to use trade secrets disclosed during their employment/business relationship, they should do so now. And, in re-drafting those restrictive covenants, companies should tie the restriction on solicitation or competition to the "use" of trade secrets.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

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