ASSOCIATION OF CORPORATE COUNSEL

TITLE: **Employee Defection and the Multi-Jurisdictional Employer: Practical Advice on Enforcing Non-Competes and Other Restrictive Covenants**

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PRESENTED BY: **ACC New To In-House Committee and ACC's Employment & Labor Law Committee**

SPONSORED BY: **Womble Carlyle Sandridge & Rice, PLLC**

FACULTY: **Michelle Adams**, Senior Employment Counsel, Accredited Home Lenders, Inc.
Dennis Stryker, General Counsel, Rick Engineering Company
Dennis Browne, Associate General Counsel, Capital One Financial Corporation

MODERATOR: **Tom Sawyer**, Labor & Employment Practice Group Leader, Womble Carlyle Sandridge & Rice, PLLC in Tyson's Corner, VA

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Operator: Welcome to this ACC Web cast. Tom, please go ahead.

Tom Sawyer: Hello, everybody. My name is Tom Sawyer, and I am the moderator for today's Web cast on Employee Defection and the Multi-Jurisdictional Employer – Practical Advice for In-House Counsel on Using Non-Competes.

A couple preliminary matters I've been asked to address. First is that if you have any questions regarding today's Webcast, you can send them by going to the lower left hand box and typing in your questions and then hitting the send button. Also at the end of today's Web cast we would ask that you fill out the Web cast evaluation which can be found in the link box which is on the left hand side of your screen, and it's link box number six.

Joining me today on the panel are Michelle Adams, who is a Senior Employment Counsel with Accredited Home Lenders in San Diego, California; Dennis Stryker, who is General Counsel of Rick Engineering also in San Diego; and Dennis Browne, who is Associate General Counsel for Litigation with Capital One Financial in Richmond, Virginia.

Michelle, can you take a moment to discuss your background, particularly with respect to non-competes and related employment issues?

Michelle Adams: Sure. I'm Michelle Adams. I have been an employment lawyer for a little bit over 10 years. I started my career at Pillsbury, what used to be Pillsbury Madison & Sutro, now Pillsbury Winthrop, where I specialized in non-compete agreements and solicitation of customer-type agreements.

I left private practice and went in-house at Accredited Home Lenders in February of '05. And Accredited Home Lenders Mortgage Company has a large contingent of sales employees, or did at one time. And so non-compete agreements were a large focus of our company trying to prevent our employees from stealing or taking our customers and leads and going to a different mortgage company.

And so we have definitely used non-compete agreements and have a wide invest experience with dealing with all types of issues that come up and arise out of non-compete agreements.

Tom Sawyer: Thank you, Michelle. Dennis Stryker, Dennis, can you take a moment to discuss your background? And again, particularly with respect to non-competes and related employment issues.

Dennis Stryker: Dennis Stryker. Rick Engineering Company is a multi-faceted civil engineering firm that performs basically in the West Coast and the Southwest. Over the years that I've been associated with Rick Engineering, we have acquired various entities, acquired portions of entities, and also spun various entities off to create other opportunities.

During the course of that we have acquired employees and moved employees from an entity that may either be part of an existing corporation of Rick Engineering or a subsidiary and spun those out within that framework. Because some of those entities had along their path probable capability to compete with Rick Engineering, non-competes and those kinds of things became paramount to how we were (either acquiring) based upon whether we were acquiring only portions of the company or when we were divesting ourselves of various units or entities.

So we've had to deal with the non-compete issues and those kinds of sundry issues as we've done both of those types of activities over the past 15 years.

Tom Sawyer: Thank you, Dennis. Dennis Browne, how about you? Can you take a moment to discuss your background also with respect to non-competes and related employment issues?

Dennis Browne: Sure. I've been with Capital One for about eight and a half years. Prior to that I was an associate with the intellectual property firm of Finnegan Henderson in Washington, D.C.

Non-compete protection is very important to Capital One because we consider intangible assets to be our most important assets. We have a non-compete program that has several hundred associates on it. And I'm responsible for administering that program as well as taking any enforcement actions in connection with it.

Tom Sawyer: Thank you, Dennis. As I mentioned at the start of the Webcast, my name is Tom Sawyer. I head up the Labor Employment Practice for Womble Carlyle, which is a 550-attorney firm with offices throughout the Mid Atlantic and Southeastern United States. A majority of my practice is focused on non-competes and related employee defection issues.

I'd like to start the discussion today with the fundamental question of why is this issue important or should be important to in-house counsel, particularly those at multi-jurisdictional employers.

And the first point that we would make is that employees are practically challenging their non-competes and other restricted covenants. And they're doing this through declaratory judgments, and as we will hear later from Michelle and Dennis Stryker, in some instances actually filing tort actions against their former employers.

They increasingly are not waiting for the employers to sue them. And then there is a significant variation among the states with respect to the enforceability of non-competes and other restrictive covenants, including some states, as we will hear later, rejecting even choice of law provisions in favor of their own law.

There is a clear trend towards stricter scrutiny of employment-based non-competes. And a large part of this has originated out in California.

So with that said, I'd like to turn to Michelle Adams. And Michelle, can you start the discussion about California law and really the genesis of this issue in talking about California and its statutory prohibition on non competes.

Michelle Adams: Sure. The business and professions code section 16600 essentially provides 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.

Now, there are certain exceptions that are applied to that statute. Basically if you're selling the good will of a business you can certainly provide for some restraint on trade there. But I think rather than spending a lot of time on those exceptions, given the purpose of this discussion, I think the focus is just simply that courts have taken this statute especially – and obviously it's – and in California, California courts. And as Dennis Stryker is going to talk about the Supreme Court case that just came down, it essentially provides that it makes it very difficult for California employers to restrain California employees from basically engaging in their profession.

Tom Sawyer: Well, why don't we talk about that case? Dennis Stryker, can you talk about the Edwards versus Arthur Anderson?

Dennis Stryker: Sure. Briefly, Edwards was an employee of Arthur Anderson prior to the government's investigation after the fallout of Enron. At the end of all of that, his unit, which was based in Los Angeles, was being purchased by HSBC. HSBC and Anderson had entered into certain agreements that required the employees that were transferring from Arthur Anderson into the HSBC unit to sign certain documents that also required that Edwards and Arthur Anderson enter into an agreement dealing with the non-compete that Edwards had previously entered when he was first employed by Arthur Anderson.

During the course of all that, Edwards refused to enter into the new agreement with HSBC and actually filed – and this is where Tom Sawyer brought in the issue of tort – actually filed a complaint against Arthur Anderson for intentional interference with respect to economic advantage.

And at the short side is that the trial court basically didn't find that Edwards could proceed with regard to that tort. But the trial court allowed bifurcation of the issue of enforcement of the non-compete then dealt with that as a matter of law, listened to some argument and then found in favor of Edwards saying that the non-compete was not enforceable, that he had signed when he was an employee of Arthur Anderson.

That got appealed. The Court of Appeals likewise went through the issues associated with intentional interference with respective economic advantage. But the upshot came when the Appellate Court said that BP, business profession code 16600 basically eliminated the non-compete. And then this got appealed to the Supreme Court.

And the Supreme Court went through its analysis. The case is actually very easy to read because at the bottom of all this, the Supreme Court basically said in California where the prohibition and the prohibition has been around for a very long time. Courts continue to enforce that. And other than the specific exceptions in the statute, non-competes are against public policy, they violate the statute, the statute's lawful, and they are not going to be enforceable.

Tom Sawyer: Well, Dennis – this is Tom Sawyer. Dennis and Michelle, I guess prior to Edwards there had been the perception that there was a difference of opinion as to whether non-competes were

just across the board dead in California between the Ninth Circuit, the federal courts, and the California state courts.

Do you think Edwards resolves this dispute? I mean, are non-competes dead in California? Or is there still some wiggle room?

Dennis Stryker: This is Dennis Stryker. When you read the Edwards case, actually the justices go in and talk about the various cases the Ninth Circuit had previously used to say that, "Well, there may be a few areas where, and a couple of wrinkles where, you may be able to have a non-compete if it's similar to some of the other ones that happen in some other states."

But the court went on to say that as they looked at all of those, there's not one California case that supports – ever since the statute's been enacted – that supports the Ninth Circuit's opinion with regard to those exclusions or exceptions and therefore believe that, in fact, they're effectively trying to put to bed the whole issue by saying that Ninth Circuit simply got the California law wrong.

Tom Sawyer: OK. Michelle, do you see any wiggle room? Or do you think non-competes, as does Dennis, you think that non-competes are effectively dead in California?

Michelle Adams: Well, I think that the wiggle room comes from sort of the idea that you can still protect your trade secrets. I don't think it was the intent of the Edwards court to eliminate the protection that are afforded trade secrets. The issue is if you're going to try to prevent you – because as we know, if you're familiar enough with California law then you know you were drafting your non-compete agreements such that you were basically limiting employees from accessing your customers. And you're probably – your customer list. And you're probably already trying to overlay that customer list with a trade secret protection so that you were getting almost a dual – protection because it really was unclear in California whether this sort of narrow restraint idea, narrow carve-out, was going to be accepted by the California Supreme Court.

I think the California Supreme Court has addressed that, as Dennis indicated. But the California Supreme Court doesn't – The argument regarding those customers or clients being trade secrets wasn't something that was raised, so it's not addressed.

So I think the only wiggle room that I see is if you can legitimately – and I mean legitimately – argue that your clients are trade secrets and protected, then you know you could prevent your employee from taking that list and thereby prevent that employee from contacting those clients.

Tom Sawyer: OK. Well, Michelle and Dennis Stryker, what effect, if any, do you see Edwards having on other types of restricted covenants out in California? And by that I mean customer non-solicitation provisions, confidentiality provisions. Any effect?

Michelle Adams: This is Michelle. I can speak to the customer solicitation. I think that Edwards didn't – again, didn't really address that issue. And so I know the lower court case, which is the one that we all rely on for non-solicitation of employees, is still a valid restraint: It's still something that you would be able to enforce.

I think the difficulty in enforcing that is – and we all know – is that you can have a non-solicitation, but if the employee contacts you first or contacts the employee that has left and gone to a new employer; if your current employee contacts them first or makes the effort to try to follow your employee that's leaving then – you can prevent that. You can't have a no-hire provision.

There's actually a case that came down not too long ago called VL Systems. And that was a Court of Appeal case where basically two – a business-to-business compete or consulting agreement, so two businesses, had tried to basically contain a no-hire clause saying that the one

company wouldn't hire the consultants from the other company. And the court struck that down because it was too overly broad.

So I think you have to be careful with your non-solicitation provisions. They have to be very limited in that you're just preventing: you're having your employee agree that they will not try to solicit or steal away your employees. But it couldn't go so far as you would not hire them.

Tom Sawyer: OK. Dennis Stryker, do you agree? I mean, is there still – can you get customer non-solicitation agreements enforced, confidentiality agreements enforced? Or do you see it as being affected by Edwards as well?

Dennis Stryker: I think that Michelle has it right with regard to the so-called, within 16600, the trade secret exception that sort of floats around and the concept of issues associated with solicitation of employees by a former employee.

The issue of solicitation of customers and those kinds of things I think may be a little bit up in the air because of the way that the court drafted its opinion in terms of how broadly it basically wanted to make clear that as California law goes, the only exceptions to the non-compete are those that are specified within the statute.

I still think that you may be able to protect – and obviously you can protect trade secrets, but you have to make sure that in fact it falls within the trade secret exception and then you follow all the rules about the protections that the entity was trying to protect those trade secrets followed and those kinds of things.

Tom Sawyer: Well, Dennis Stryker and Michelle, what about the effect, if any, on common law claims such as tortious interference or breach of fiduciary duty? And by this I mean what happens if you have a situation where you've got an employee who doesn't use trade secrets or confidential information per se while working for an employer in California but goes out and starts soliciting clients for business that he or she is going to start up? Can the employer do anything about that?

Dennis Stryker: Michelle, do you want to try or do you want me to go first?

Michelle Adams: Yes. No, I think that the employer still can because you can argue that it's a trade secret. Whether you could bring a tortuous interference claim, might be difficult unless the clients have some sort of contract that this employee knows about and is interfering with.

And a breach of the fiduciary duty, I mean, that's tough in California to try to enforce. It would have to be a fairly high up employee, such that they had that duty, and, again, was doing something that involved something more than just a customer or soliciting clients to come over. They would need to be using trade secret information that you've gone to great, great links to protect.

I mean, I – Dennis and I, have talked about this. I think a lot of us just have trade agreements that say our clients have trade secrets and it sort of ends there. I think you need a lot more than just that. You need to actually have the agreement, each employee sign something, you have to have some sort of computer system in place so you're actually protecting that information so not everybody gets access to it, really be able to demonstrate that you, as a company, is going to great lengths to protect that information.

So in terms of going back to your question of whether tortuous interference or breach of fiduciary duty applies, I mean, as a defense lawyer for 10 years, I never think it's a good position to yourself in trying to sue former employees. It never really is – it's bad publicity. Nobody wants to go work for an employer whose suing their employees.

And I think it would be a difficult lawsuit to win, ultimately, if – based on Edwards, it seems Edwards is basically saying that unless an exception applies to 16600, you can't prevent somebody from engaging in their lawful profession. So I think it goes back to only if you can establish really that they're using your confidential trade secret information.

Dennis, what do you think? Do you agree with that?

Dennis Stryker: Yes. Actually I do agree. I think Michelle is correct that if you consider trade secrets exceptions, then you're fine. But if you're trying to do something other than that and if the court appears or thinks that in fact you're trying to do something other than that, which means interfering with a (former) employee's ability to work in his or her lawful profession, then that is not going to be enforceable in California.

Tom Sawyer: Well, Dennis Stryker and Michelle, I mean, does that apply in the situation where you've got a former employee and you find out, let's say, through e-mail or otherwise that while the former employee was working for you, they weren't misappropriating confidential information but they were actually taking their work time to go out and build their new business and soliciting your clients? Is there nothing that the employer in California can do about that situation?

Michelle Adams: Well, I think in that situation, I mean, you obviously have kind of almost a staff to time case that you could bring against them, I mean, because you can't – all employees have an obligation, provided it wasn't sort of… There's also the labor code section in California that you can't discriminate against somebody from engaging in lawful off-duty conduct.

So you know your argument would be that they've breached – probably I'm not familiar with the labor code section off the top of my head, but they do have a duty of loyalty to the employer. So I think in that situation, you know they're working on your time, using your resources; you would certainly be able to bring a lawsuit against the employee for doing that.

Tom Sawyer: OK. And Michelle, on that basis would you be able to pursue against the claim against the former employee beyond just simple loss of time that you were paying them and they were working for you but actually for lost profits based on the clients that they took while they were supposed to be working for you being a breach of their fiduciary duty because those clients were a protectable interest as they would be in other states?

Michelle Adams: Yes, I'm not sure what damages you'd be entitled to. I mean, I think you could certainly make the argument – I'm just curious – I'd just query – I don't know the answer to that question. I think it would depend on what statutes you're relying on to bring the lawsuit and what damages are available under that statute.

I would think that you could certainly try to make that argument.

Tom Sawyer: OK.

Dennis Stryker: This is Dennis Stryker. I think that in addition to looking at the labor statute with regard to the duty of loyalty employees have or owe employers. But if an employee is, during the course of his or her employment with the current employer, out soliciting similar type of work and effort from an existing client, then if you can fit the typical elements of the intentional interference of prospective economic advantage then you have those kinds of cause of action. And at a minimum, you may be able to enjoin the activity of the employee.

I don't think those actions have gone away because I don't think that the intent of Edwards was to say that current employees can't be made to provide their full time benefit to the employer. I think Edwards was talking about when an employee departs from the employer, the employer can't keep the employee from practicing in his or her profession

Tom Sawyer: OK. Well, Michelle, let's say I'm an out-of-state employer and I happen to have an office in California. And why do I care if I'm drafting non competes that have a choice of law provision that say my state's law applies even to these California's employees? Won't that work in California?

Michelle Adams: No. And actually it's a quite simple answer because California is going to apply their own law because of the effect on public policy. You know they want to protect their employees. They're working here in California and they're very protective of their employees.

So even if you have a choice of law provision that chooses what Pennsylvania law or New York law would include, they're still going to apply California law. And in all likelihood, your non-compete will be deemed unenforceable.

Tom Sawyer: What happens if you have a situation, Michelle, where, let's say, the employee has worked in the home office out of state for many years and then just moves to California and is only there a short time? Does it matter that California's contacts may not be as significant as the home state's contacts? Or will California still apply its public policy and override the choice of law provision?

Michelle Adams: California would still apply their own choice of law – their own law and would override that. And I think what you kind of hinted to earlier, what you're likely going to have is this employee has just moved to California and wants to go work for another employer. They're going to be well aware of their non-compete agreement. And it's going to be a race to the court house. And so they'll go in and file a declaratory release from their action from their non-compete and get a judgment basically saying that they can work here in California.

Tom Sawyer: So, Michelle, when you say race to the court house, does that literally mean that the employee files a declaratory judgment in California and then the employer files its own lawsuit trying to enforce the non-compete in its home state?

Michelle Adams: Right.

Tom Sawyer: OK. And how does that typically get resolved?

Michelle Adams: Well, typically it's where you file your lawsuit first. So if you file – and certainly if you filed in California state court, that's the judgment that the courts are going to look at and enforce. So that's why it's really important that if you think that's going to be an issue, especially out in California, you know you want to try to file your action before the adverse party.

Tom Sawyer: Well, Dennis Stryker, would it make any difference if you had a form selection provision? Would California courts honor that? Or would it be treated the same as the choice of law provision?

Dennis Stryker: I'm not aware exactly where California – if you take a look at any of the cases, but if you go through the scenario and the logic that Michelle just provided, which is how California views those things, that if you look at form selection, if the employee had been here for a period of time, I think that the California courts are going to find a way to figure out how its public policy laws are going to affect the employee because California courts have now a long tradition of protecting employees with regard to their capabilities to pursue their profession and their work.

So even with the form selection clause, I can foresee California stepping up and basically saying that public policy outweighs those issues or crafting a way to say that somehow they've got to protect the employee that is now resident in California.

Tom Sawyer: OK. Well, why don't we turn to other states? Dennis Browne, what are you seeing in other states? I know one state in particular, Georgia, there's been a fair amount of litigation that have come out on the choice of law issue. What are you seeing there?

Dennis Browne: I'm seeing it much like you had talked about earlier, a clear trend toward strict scrutiny in non-compete covenants. And I'd like to talk to you a little bit about cases under Georgia and Virginia law.

The first case I wanted to talk to you about was, Keener versus Convergys Corporation, an 11th Circuit opinion from 2003. It's got a pretty interesting procedural history, including a certification from the 11th Circuit to the Georgia Supreme Court. But I'll spare you the gory details.

Suffice it to say that the parties entered into a non-compete agreement that was governed by Ohio law. Mr. (Keener) then relocated from Ohio to Georgia and sought a declaratory judgment that his non-compete was not enforceable. Even though the contract expressly stated that Ohio law applied, the district court in Georgia refused to apply it on the grounds that the non-compete violated Georgia public policy.

Instead it applied Georgia law, which is far more restrictive regarding permissible non-compete covenants. Not surprisingly, the federal district court invalidated the non-compete covenant. And it also enjoined the company from seeking to enforce the injunction anywhere in the world.

On appeal, the 11th Circuit found that the district court was within its discretion to apply Georgia law even though the contract expressly designated Ohio law under the public policy argument. But it vacated that part of the injunction that prohibited the company, Convergys, from seeking an injunction outside of Georgia regarding the non-compete covenant.

So about two years after that, the 11th Circuit revisited the issue of whether an injunction decided under Georgia public policy should have application outside that state. And that was in a case called Palmer and Kay versus Marshin McClennan. This is a pretty interesting case.

In this case, the defendant sought a declaratory judgment that its non-compete was invalid under Georgia law because, among other reasons, it stopped him from doing business with former customers even if he didn't solicit business from them.

The court in that case found that federal common law determines whether the scope of judgments sitting in diversity jurisdiction. And under the federal common law, the court should apply the law of the state court where that federal court is sitting, in this case, Georgia.

Since the Georgia law didn't attempt to limit judgments solely to Georgia, the 11th Circuit in this case found that it shouldn't either. In the end, what it did was it vacated the part of the declaratory judgment that limited enforcement to Georgia, and it found that it was applicable throughout the United States.

I guess you could have gotten to the same answer through a collateral estoppel argument if the company attempted to enforce the non-compete elsewhere. But the court I guess wanted to clarify what it had said regarding injunctions in the Keener case.

In short, Keener, found it appropriate that the Keener injunction was limited only to Georgia because it was an injunction case but that the order in the Palmer and Kay case should not be so limited because it wasn't so much an injunction as a declaratory judgment order.

Tom Sawyer: Well, Dennis Browne, does that mean because it's a declaratory judgment that it's entitled to full faith and credit in other states?

Dennis Browne: Yes. That's my reading of that case.

Tom Sawyer: OK. One other thing that I know with respect to those two Georgia cases is – and I think particularly in the Convergys case – they talk about how Georgia, unlike other states, has not adopted the second restatement conflicts, section (187) to standard, of most significant contacts and takes the position that sufficient contacts is enough.

I guess the concern would be there that it could encourage, employees realizing that they don't have to demonstrate a declaratory judgment action that if they were to move to Georgia and take a position in Georgia would not have to demonstrate that Georgia has the most significant contacts, just that it has sufficient contacts.

What have the Georgia courts done about that issue, if anything?

Dennis Browne: I think you're right. There is a real risk that folks can merely move down to Georgia and then seek a declaratory judgment invalidating an agreement that's governed by the law of another state. I guess you could even go further and say that they might even, say, telecommute into another state, just merely move down to Georgia and then telecommute, for example, or work from home in another jurisdiction, perhaps even the very jurisdiction whose law governs the non-compete in question.

And as far as I can tell, Georgia would be willing to apply its own law in that case to invalidate the non-compete covenant.

Tom Sawyer: OK. What else have you seen in Georgia, Dennis?

Dennis Browne: Well, one of the big issues in Georgia – and this is contrary to their desire to apply their own public policy even when the law states to the contrary – they are willing to consistently enforce mandatory and exclusive forum selection clauses in employment agreements such as those found in Palmer and Kay as well as in the Keener case.

One of the big cases there is (EO) versus Mohawk Finishing Products. They get around that distinction by finding that these were the exclusive venue and forum selection clauses involve procedural rather than substantive rights.

Just to come full circle on the Marshin McClennan case that we just spoke about a few moments ago, ironically the non-compete agreement in that case had a forum selection clause where the parties agreed to the exclusive jurisdiction of the state and federal courts in New York, New York, or Manhattan.

The lower court in that case found that muse, the employee in question, had waived that provision by bringing an action in the southern district of Georgia and that Marshin McClennan, his former employer, had waived the exclusive forum and venue provisions by answering, counter claiming, and litigating the merits without challenging venue.

So in short, given Georgia's consistent enforcement of exclusive forum selection clauses, the – Marshin McClennan could likely have averted the application of Georgia's non-compete laws by challenging venue under Rule (12 B3) of the federal rules of civil procedure. Because it failed to do so, it waived that right.

Tom Sawyer: Well, Dennis, would it make – would it make any difference in Georgia if the forum selection provision were merely a consent to jurisdiction and non exclusive?

Dennis Browne: That's a good question. I know, of the cases that I've studied, they have discussed only the issue of exclusive jurisdiction. I guess they would turn to public policy in order to answer that argument. And my guess would be that they would say the overwhelming interest in Georgia public policy against non-compete covenants would trump the consented jurisdiction. It wouldn't,

however, trump the public policy in enforcing contracts regarding an exclusive forum selection clause.

Tom Sawyer: OK. Well, Dennis, what are you seeing in other states? You had mentioned Virginia. I mean, are you seeing similar trends or what's happening with non-competes in restrictive covenants?

Dennis Browne: Well, Virginia is sort of near and dear to my heart because I'm located there. And our read on the case law in Virginia is that in the not too distant past, Virginia appeared to have more expansive non-compete protections than many other states, like Georgia.

But in the past five to 10 years, in particular, states and federal courts in Virginia have continually whittled away at the scope of non-compete protection under Virginia law. In Virginia, like many other states, your non-compete had better be narrowly tailored as to: functional scope, geographic scope, and duration.

And the Supreme Court of Virginia and several federal district courts here have in the past few years paid particular attention to the functional limitation.

Tom Sawyer: Dennis, when you say functional limitation, do you mean of the employer, its scope, or do you mean actually of the employee?

Dennis Browne: The functional limitation I refer to that as the actual non-compete restraint, whether it be, say, attempting to prohibit somebody from competing in any capacity, attempting to prohibit somebody from competing directly or indirectly with competitors, or attempting to apply non-compete beyond the services that the employee provided for the employer during the period of employment.

That's what I'm referring to as the functional limitation. And the courts in Virginia in the recent past have consistently stricken non-compete covenants that have over-broad functional limitations.

In fact, there's an emerging trend in the eastern district of Virginia that courts there are increasingly willing to grant motions to dismiss under Rule (12(B)6) if a non-compete covenant is (spatially) over broad. There are at least three cases decided in the last three years that have found just that.

So you don't even get to argue the facts.

Tom Sawyer: So they'll be similar to what Georgia courts do: where it's almost a bifurcated process. You go in first on the non-compete and it has to pass facial muster before you even get, as you were putting it, Dennis, to argue the facts with respect to the non-compete.

Dennis Browne: Yes. Yes. So if your non-compete is suspect and a potential defendant can establish jurisdiction and venue in the eastern district, I think it would be relatively cheap and easy and quick to get your non-compete and validate it there under rule (12(B)6).

So one thing to consider in order to avert that is an exclusive jurisdiction or venue provision to allay these concerns. That's sort of the lesson in the Marshin McClennan case as well. There, however, the follow-on lesson of that case is: if there is an exclusive jurisdiction and venue provision, you should seek to enforce it.

Tom Sawyer: OK.

Dennis Browne: So speaking of other restrictive covenants in Virginia, courts there are – have made it clear, and continue to make it clear, that the increasingly restricted scope of non-compete protection in Virginia applies to other restrictive covenants like non solicit of employee provisions.

For example, in Strategic Resources versus Nevin, another reported 2005 case from the Eastern district of Virginia, a Judge Cashers noted that – and I'm quoting – "Solicitation clauses are reviewed under the same standards as those developed for non-competition clauses because solicitation is a form of competition."

Prior to this case we would have thought you, perhaps, had a little bit more leeway when it came to non solicit provisions then you might with non-compete provisions. But courts are making it clear in Virginia that that's not the case. It's the same standard.

Tom Sawyer: So, Dennis, are you saying that you can't say that the employee is restricted from soliciting clients generally? You actually have to specify either a jurisdiction, a geographic limitation with respect to the client non solicitation, or at least limit the client non solicitation to clients that a particular employee had contact with?

Dennis Browne: Well, I would say: let's talk about duration. I think it would have to meet the permissive duration requirements of enforced non-competes in Virginia. For example, Virginia courts have enforced non-compete covenants that had a duration of one and sometimes even two years. I'm not familiar with any cases where Virginia has extended and enforced non-compete protection beyond a two-year limitation.

I'm not so sure about the geographic requirement. I guess it would depend on the nature of the business. If, for example, you could demonstrate that the person had customers throughout the country then I suppose the geographic restraint in that case could be nationwide.

In essence, it has to be narrowly tailored not to go beyond what the associate did when they were an associate.

I would also say, turning to an analogous functional limitation analysis of non-solicitive employee clauses, you could say that if you went beyond what that person actually did, you could have an over broad non-solicitive employee clause.

For example, although it was decided under Georgia law, I believe it was the (Marshin McClennan) case, it had an over broad non-compete because it prohibited the person from contacting and doing business – it was actually a prohibition against doing business with customers even if he did not solicit them. Which is to say: if I was a stock broker, for example, and I had a non-compete and I never contacted one of my clients but my client nevertheless wanted to work with me and called me unsolicited, I would be prohibited from doing business with that person. That would be an over broad non-solicit clause, in my mind.

Tom Sawyer: Dennis, what about common law situations? We had talked earlier with Dennis Stryker and Michelle about California's take on breach fiduciary duty and tortious interference. What happens if you had a situation, let's say, in Virginia where you have an employee who is working for his or her employer and starts developing their business during working hours and is actually going out and soliciting his or her employer's customers.

Could you bring a claim or how would you protect against that risk?

Dennis Browne: Well, you could bring a claim under a breach of the duty of loyalty. But my understanding is that that duty of loyalty extinguishes when the person terminates their employment. And so I guess if that person was still employed with you, you could bring an action against that person.

You know a best practice would be to have a non-solicitation of customers clause, presumably an enforceable one. You could couple with that tort a breach of contract claim. You probably would already have addressed this issue in your code of conduct or other HR related documents and so you also have obvious grounds to terminate the person for cause.

Tom Sawyer: Well how about after the fact? Let's say you find out – Dennis, you're at Capital One and you find out that a Capital One employee had started working for a competitor while he or she was still working for Capital One. And here the focus is not so much the lost time that you were paying this employee while they were supposed to be working for you, but that they actually went out and took one or two significant clients.

In Virginia, would you be able to bring an action against that employee for the clients that he or she solicited while they were supposed to be working for you and go after them for the lost profits with respect to the loss of those clients?

Dennis Browne: I would look closely at a potential misappropriation of trade secrets argument against that former associate. I would argue that the customer list in question would be a trade secret that the associate misappropriated when they left; they had a very limited license, so to speak, in order to use that list on our behalf, that their acts went beyond the scope of that limited license and misappropriated certain bits of information, using it to our detriment.

Tom Sawyer: OK.

Dennis Browne: I think that's something we would consider.

Tom Sawyer: Why don't we turn now to, if we can, to kind of takeaway points in terms of what in-house counsel needs to know. I think the first point that I would mention and would ask Dennis Stryker and Michelle to comment on is the one about non-competes and other restricted covenants being tailored to either the confidential information or, outside of California, the client exposure of the employee.

Michelle, what's your thought on that?

Michelle Adams: What I have done at Accredited is actually keep four different agreements. The one for California was specifically tailored to California.

And in California, or actually what we did in all of them creates a duty of loyalty, non disclosure, and non-compete agreements, addressing a full range of issues or duty of loyalty: you can't compete with us while you're employed with us. That gives you a contract claim if they do end up doing something like that.

The non-disclosures provision protects your trade secrets, your non-solicitation agreement provision must be included because that is viable still, in my opinion, in California. Obviously now you would be eliminating any sort of non-solicitation of customers provision. Given Edwards, I don't think that type of provision is going to be enforceable anymore.

And then I would have agreements to the extent they need to be tailored for other states. We had three or four different agreements, depend; we had one that was sort of applicable to the jurisdictions that follow similar law. And I believe Pennsylvania has some different carve outs. So we have an agreement specific to that.

But I did think it was important to tailor the agreements. And I know it can be more difficult to manage, but that way you can take advantage of the laws in each of the states where you can do a little bit more than you can in California.

Tom Sawyer: OK. Dennis Stryker, what about the tailoring of restrictive covenants in non-competes to confidential information in client exposure, the employee?

Dennis Stryker: I think that with California you need to take a look at what it is you're really trying to do. If the issue is that you're trying to maintain certain confidential information: that you can follow through and show (what is) good with any kind of trade secret; that you know how well you've tried to protect those types of interests; and what you're doing with those types of interest and the kinds of things that Michelle spoke about earlier in the presentation, then you can do those kinds of things in California.

But I think that Michelle is accurate that you need to be mindful of what's going on and what you can do if you're in California. When you take a look at those kinds of things, we're really trying to do something probably similar to what Michelle does, although we don't necessarily use the word duty of loyalty, but we talk about the responsibility an employee has to the clients of Rick Engineering and to the employer, Rick Engineering company, and where his or her duties or obligations lie.

I've actually spoken with a couple of other large employees of different industries trying to figure out what other industries here in California are doing. I talked with two entities, both of them are large. One's a pharmaceutical company headquartered in California but nationwide, and another is an electronics firm that has its U.S. subsidiaries headquartered in California. And that's obviously a worldwide corporation and spreads its various types of electronic equipment and other things across the country.

And each of them took the same approach that Michelle was talking about with regard to their employees, in part because they're in California, even if they tried to come up with a choice of law different than the employer that lives in California, they would lose on that. And so everyone was looking at things like the confidential information that you can keep and then what exposure a particular employee's going to have with regard to the clients.

And to the extent that they have significant exposure and information associated with those clients, it is very detailed then protecting those kinds of things using the trade secret types of information.

Tom Sawyer: Well, I think that would be particularly important in California because my understanding is – certainly your comments have been consistent with this, Dennis and Michelle, that in California that only the confidential information or trade secrets are recognized as a protectable interest as opposed to client exposure, which is recognized in other jurisdictions.

So I could see that could be a real problem for a foreign employer with an office or a presence in California. Michelle, do you agree?

Michelle Adams: Definitely.

Tom Sawyer: And Dennis, do you agree with that as well, or…?

Dennis Stryker: Yes. California does look at that. And client exposure is treated differently in California than it is in many other states.

Tom Sawyer: Dennis Browne, what about with respect to other states, particularly Georgia, Virginia? What about the need to focus on non-competes and restrictive covenants to the employee's exposure to confidential information and also the employee's exposure to clients?

Dennis Browne: Yes. We have a couple of different versions of our agreement. We have one version that you know is specific to individual countries where we are located beyond the United States.

We used to have a much larger presence in California and had an agreement there that sounded an awful lot like that which Michelle described having, an acknowledgement of the duty of loyalty and confidentiality provisions among other things.

We have a version that is limited to a particular branch of our business. And that version pays particular attention to non-solicitation of employees, because that's the nature of their business. But most of our associates aren't in contact with our customers so as to warrant a broader non-solicitation clause of customers.

That being said, when it comes to tying, say, non compete restrictions to the protectable interest, we articulate just that point in the non-competition covenant. You are being granted access to trade secrets, confidential information, and other types of information that grants us a protectable interest only because you are signing up to this non-competition covenant.

Tom Sawyer: And I see the same thing when you talked about client exposure – and again, outside of California – that when you talk, let's say, sales personnel, that it really is important in terms of improving the enforceability of the non-compete and restrictive covenant to tailor the non-compete in terms of the protectable interest to the sales territory, or the actual client exposure of the employee, rather than basing it on the employer's exposure, which may be greater and therefore be over broad or could be viewed as being over broad.

A couple of other points – and I think it should be evident from today's discussion – a choice of law and exclusive forum selection divisions, obviously, are a must. Although it seems like out in California that even with forum selection provisions, there's no guarantee that, particularly when a state court could still override or preempt even a forum selection provision.

For that reason, it's obviously important that in-house counsel know the relevant law not just of their home state or where their office is, but know the law of the state where the employee that they're drafting the non-compete or the restricted covenant is based just on the off chance that you may have to do that under that state's law.

The last issue before questions and answers is with respect to when you're in-house counsel – and I'll throw this out to both Dennises and Michelle – a lot of times an issue comes up: you've got a former employee that's left and the line managers want to go out and enforce the non-compete.

We've all seen cases where you kind of wade into that or parties wade into that without really focusing on what is it we're really trying to pursue, what is it we're trying to stop, what really are the damages, and most importantly, how much will it cost?

So I would ask, maybe start with Dennis Stryker, have you been involved with a situation like that either personally or know of a situation like that and maybe could share it with the participants?

Dennis Stryker: I have not, at Rick Engineering, been involved in anything exactly like that. But when I was talking about the (two other) entities, I did speak with a number of other fellow ACC folks here in San Diego about how they would go about some of these things that are forced in.

And one of the interesting things was even in the pharmaceuticals, which I was anticipating to hear that they were, as much they could, die hard in enforcing all those things, just want a fairly large nationally known pharmaceutical company, they said no.

When you take a look at the overall fact in how much it costs and when you end up with a resolution some period of time down the road. If you look at the Edwards case, the case started back at the demise of Arthur Anderson and in Edwards, the Supreme Court decision just came out this year, and you go through the time frames and what's going on and the fact that employees are much more knowledgeable now about rights and are not afraid of stepping up and

standing in front of an employer and saying, "No. I'm not going to do this." Then you start looking at costs.

And the general counselor there said that he is very particular about how they go about enforcing these things. And when line folks come to him and – or come to his employment world within the department, they have long conversations about what it is they really think they're going to get out of this. And they typically try to sit down and actually come up with some kind of negotiated resolution of whatever they're going to do as opposed to trying to litigate.

Tom Sawyer: OK. How about you, Michelle?

Michelle Adams: Yes, I would just agree with Dennis. I've actually had several experiences with this. I always joke that the only people that come out landing are the lawyers because you know typically both sides playing attorneys the fees are based on an hourly basis, not contingent. And at the end of the day, the lawyers are the ones that get paid. And typically, as Dennis was pointing out, several years down the road you'll likely just end up settling and it'll be basically a complete walkway.

So typically companies don't get the result that they tend to be seeking.

I also find that a lot of times these decisions are based on emotions. You know you're mad, you're angry, you're upset, your line manager's mad, angry, upset because this employee who they trusted and believed, has gone off and is doing something like trying to steal clients or what not. And I find that if you can get them to kind of put the emotional piece of it aside and approach it like a business decision that the benefit doesn't usually outweigh the cost because the costs are significant.

Tom Sawyer: One thought maybe, Michelle, that may be in terms of doing the initial strategizing – and particularly as in-house counsel and the courts have become more familiar with these issues is, again, right from the start, either independently or working with outside counsel to very clearly define what the business objective is. I mean, it may be getting the temporary injunction to shut down whatever the unfairly competitive behavior is. It may not be going all the way through and going to trial.

And sometimes I think that my experience has been, this gets lost or is not fully thought out, and you end up, as you and Dennis Stryker put it, six months, nine months, a year down the road, (before) people ask, what is it we're really trying to do here?

Male: Yes.

Michelle Adams: Yes.

Dennis Browne: And Tom, my experience has been that it depends on what other causes of action you may bring. So for example, if it was a mere non-compete case, that may be one thing. But if it's non-compete plus misappropriation of trade secrets plus, say, violations of the computer fraud and abuse act, or other claims, then we might take a wholly different approach there.

And it also turns on, as you mentioned, the likelihood of obtaining preliminary injunctive relief.

Tom Sawyer: Right. And my experience has been, Dennis that that what is key is: at the outset you have a clear strategy in terms of what it is we're going after and why. And also, obviously, sitting down with in-house counsel. And to the extent you can, mapping out what are the costs going to be and at what stages will we hit those cost thresholds so everybody has a good understanding of what it is they're getting into.

And I think that's particularly important for the line managers who often don't realize it and then they get the bills and have trouble equating the two.

We've gotten a couple questions. And I'd like to start first with this. This is directed to Michelle Adams and Dennis Stryker. In California, should we draft agreements in California that include non-solicitation clauses in case the law changes in the future?

Michelle Adams: I'm not sure if they mean the non-solicitation of employee clauses or non-solicitation of customers so I'll kind of answer on both. I would still include the non-solicitation clauses of employees you know to prevent them from soliciting our employees.

I don't see a court changing that because it doesn't go against what 16600's providing because you're not preventing an employee from going to work for a new company. You're just preventing your employee from actively soliciting or rating your company.

So, I still see that as being enforceable. And so I would still include that.

As for the non-solicitation of customers, I probably would not include it. And Dennis may have a different opinion on this. But I – my rational for not including it is that California court has spoken on that issue. So unless the legislature's going to come through and you know provide new statutes, on that I don't see that changing.

So my concern would be if you had an employee who didn't want to sign the agreement and started pitching a fit about it and then you didn't want to hire him because they wouldn't sign it, you're going to end up walking right into a wrongful termination case because that's the Thompson versus Impacts case: where an employee refused to sign an unenforceable agreement and he was able to maintain a cause of action against the employer.

So that's sort of my rational for why I would no longer include those.

Tom Sawyer: All right. Well, Dennis, let me ask you this. We have a second question. If you have a non-solicitation provision in a confidentiality and inventions agreement in California, will a court still uphold the rest of the agreement but not the non-solicitation clause? Or is it likely that the entire agreement can be found to be invalid?

Dennis Stryker: If the non-solicitation and inventions agreement provides that, as typically most contracts would, that if a portion of the agreement is found invalid, the rest of the agreement will remain enforceable then the California courts will in fact enforce the rest of the agreement to the extent that the rest of the agreement is enforceable.

California follows the restatement with regard those kinds of things and also has specifically – as (soon of these cases) regard to contract interpretation that if, in fact, you provide for the ability to (par) out those which are not and then sort of blue pencil out those things that are unenforceable, it would do that if the contract so provides.

Tom Sawyer: OK. Well, Michelle, I'll throw this next question at you. Will the choice of law exclusive forum selection clause help at all in California? If an employer wins the race to the court house and obtains an injunction enforcing the agreement in another state, would a California court honor that injunction?

Michelle Adams: I don't think it will. I don't think California courts will honor it. And I think it just goes back to the public policy of California and the great lengths that have already demonstrated they will go to protect its employees. I think they would find a way not to give full faith and credit to that judgment.

Tom Sawyer: OK. We have time for one more question. Dennis, it's another California question. Would it help to have a provision in California in which employees specifically waived the right to claim unenforceability under 16600?

Dennis Stryker: Probably not. I don't think 16600 is a waivable statute. I'm pretty positive that given the way the courts have interpreted it and the length of time – you have to keep in mind that the statutory (scheme) in California with regard to 16600 flows back to literally the end of the 1800s. I mean, it used to be in our civil code and it got moved over to the business and professions code.

But it's been around for a very long time. And the courts are really clear about enforcing the codes; they're not going to allow that to be a waivable option.

I don't think I can foresee a California court thinking that somehow an employee could waive away the rights of 16600.

Tom Sawyer: Thank you. We are now at or a little past 1:00 Eastern time. And that brings our Webcast to a close. I would like to thank the participants and also like to thank our panelists, Michelle Adams, Dennis Stryker, and Dennis Browne.

And with that, turn this back over to Sandy Friedman and say good-bye.

END