

Monthly Memo

A NEW TWIST TO NON-SOLICITATION AGREEMENTS IN CALIFORNIA

In recent years, Employers were dealt damaging decisions from California State courts, restricting what they can and cannot do to protect their business interests. On August 20, 2009, the California Court of Appeal for the Fourth District helped clarify what interests can be protected and how the employer can do so in case of The Retirement Group v. Galante. The Appeals Court was forced to address the tension between California's strong public policy favoring competition (i.e., the basic ban on covenants not to compete) and trade secret case law providing that former employees may not misappropriate the former employer's trade secrets to compete unfairly with the former employer.

In Galante, the plaintiffs, The Retirement Group (TRG) provided investment advice and securities sales service to customers on a fee for service basis. TRG provided these services through the use of independent contractors. TRG utilized extensive marketing efforts to build its clientele base. So much so that 95% of TRG's customers were obtained via marketing. TRG's list of customers and potential customers was maintained in a secure database designed to prevent copying by others of information from the database.

In order to access the database, TRG required all users to execute a Marketing and License Agreement (MLA). The MLA defined what TRG considered "confidential information" and provided that during the term of the relationship and thereafter, the signing party agreed to keep the information he/she was accessing confidential and would not "disclose or use" the information, except as the MLA permitted.

One of TRG's principals, with the assistance of some independent contractors who were previously employed with TRG, formed a new and competing business called Monarch. Allegedly, these individuals began contacting TRG's customers, asking them to switch their business to Monarch and Monarch's new broker/dealer. Upon learning of the information, TRG sought a preliminary injunction to stop Monarch employees from contacting their clients. The injunction was granted and an appeal by Monarch was filed.

The court concluded that an employer who seeks to prohibit a former employee from soliciting former customers to transfer their business away from the former employer to the employee's new business, cannot specifically enforce a "covenant not to complete" without showing that the employer's business would be harmed. The employer must show more than that the former employee had access to customer lists that qualified as trade secrets while employed and solicited customers once the employee left. Instead, the ***former employer must show that the former employee actually used the trade secret list to identify or facilitate the solicitation of existing customers.*** The court reasoned that any client information that was readily accessible was free game for competition. Customer and potential customer names and/or lists that were formed as a result of TRG marketing however, especially TRG seminars, were considered trade secrets and were strictly protected.