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New Guidance for California Employers: California Court of Appeal Holds No-Hire Provision Overly Broad and Unenforceable

The Fourth District of the California Court of Appeal recently found that a no-hire provision in a consulting agreement was unenforceable because it was overly broad and constituted an impermissible restraint on trade in violation of California's law prohibiting unlawful business practices, Business and Professions Code section 16600. *See VL Systems, Inc. v. Unisen, Inc.*, 152 Cal. App. 4th 708 (Cal. Ct. App. 2007).

No-hire or non-solicitation provisions are routinely incorporated into contracts to protect an employer's investment in its employees. Consulting or temporary worker agencies use the provisions to prevent their clients from poaching employees. For the same reason, employers also use the provisions to prevent departing employees from contacting existing employees.

VL Systems, a software consulting company, entered into a short-term contract with Star Trac (a dba of Unisen) to assist Star Trac in migrating to a new server. The contract provided that Star Trac would not hire any VL Systems employee for 12 months after the termination of the contract, subject to a liquidated damages provision. Within that period, Star Trac hired a VL Systems employee (David Rohnow) who had not performed any work for Star Trac, who was not employed by VL Systems at the time the Star Trac contract was performed, and who made the decision to apply to Star Trac independent of any connection between VL Systems and Star Trac. VL Systems sued for breach of contract, and the trial court awarded a portion of the amount sought under the liquidated damages provision. Star Trac appealed, arguing that the no-hire provision was unenforceable as a matter of law. The Court of Appeal agreed, reversing the trial court's judgment.

The Court of Appeal found the no-hire provision unenforceable under Business and Professions Code section 16600, which states: "Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void." The Court noted that section 16600 has been held to invalidate employment contracts which prohibit a former employee from working for a competitor unless necessary to protect the employer's trade secrets. Here, the Court's primary focus was whether the provision unfairly limited the mobility of an employee who actively sought an opportunity with Star Trac. The Court was particularly concerned because Rohnow never performed work under the Star Trac contract and was not even employed by VL Systems at the time of the contract. The Court was also troubled by the fact that Rohnow did not enter into any agreement not to compete (which likely would be held invalid under California law); thus, the no-hire provision restricted Rohnow's opportunities without his knowledge and consent. The Court concluded that under these circumstances, the no-hire

provision was overly broad and unenforceable. In the Court's opinion, such a broad provision was not necessary to protect VL Systems' interests and was outweighed by California's strong policy of favoring freedom of mobility for employees.

The Court specifically cautioned against an inference that all no-hire or non-solicitation clauses are necessarily unenforceable: "Perhaps a more narrowly drawn clause limited to *soliciting* employees who had actually performed work for the client might pass muster." The Court noted that in prior cases, restrictions were found valid because their scope was less broad and affected a substantially smaller group of employees. *See e.g., Webb v. West Side Dist. Hosp.*, 144 Cal. App. 3d 946 (Cal. Ct. App. 1983) (limited scope of no-hire provision to employees who were provided by plaintiff temp agency and actually performed work for defendant hospital); *Loral Corp. v. Moyes*, 174 Cal. App. 3d 268 (Cal. Ct. App.1985) (upheld non-solicitation provision that did not prevent plaintiff's employees from seeking employment with defendant's new employer nor from contacting defendant, but did prevent defendant from contacting plaintiff's employees).

Following *VL Systems*, employers should consult their employment counsel to ensure that any no-hire provisions in business service agreements and non-solicitation provisions in employment agreements are sufficiently narrowly drawn to withstand the heightened scrutiny of California courts.

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Attorneys in the Employment Litigation & Policy Practice Group represent corporate employers throughout the United States in all types of employment matters. To learn more about the SHB employment group and its members, see SHB.com.