

California Appeals Court Upholds Broad Non-Competition Agreement

Russell I. Glazer
April 2008

California courts have a well-deserved reputation of hostility towards agreements that restrict competition. Yet in a recent decision, *Alliant Insurance Services, Inc. v. G. Scott Gaddy*, the California Court of Appeal upheld contract provisions preventing an individual from competing with his former employer anywhere in the State of California for five years. The decision shows that courts will enforce well drafted non-compete agreements in California, provided that the agreements comply with statutory requirements.

The case involved the following facts. Gaddy sold his insurance brokerage business to Alliant for \$4.1 million. As part of the purchase agreement, Gaddy agreed "to refrain from carrying on a business, directly or indirectly, which provides any [of Alliant's] business" anywhere in California. Gaddy also signed an employment agreement with Alliant in which he agreed that he would not solicit or accept business from any of Alliant's clients or prospective clients. The restrictions were to last five years after the sale of the company, or two years after Gaddy stopped working for Alliant, whichever came later. In addition, as part of his employment agreement, Gaddy agreed that he would not solicit his former customers for three years after termination of his employment. Two years after the sale of the business, Gaddy left Alliant, started an insurance consulting business, and began contacting some of his former customers. Alliant filed suit and obtained a preliminary injunction preventing Gaddy from engaging in a competing business. Gaddy appealed, claiming that the trial court's order "enforces illegal restraints on trade."

The Court of Appeal rejected Gaddy's challenge to the agreements. While acknowledging that "California's public policy affirms a person's right to pursue the lawful occupation of his or her choice," the appellate court held that two exceptions to this policy justified upholding the restriction. First, California Business and Professions Code section 16601 allows the seller of a business to "agree with the buyer to refrain from carrying on a similar business within a specified geographic area in which the business so sold...has been carried on." Even though the business Gaddy sold to Alliant had customers in just four counties, the appellate court found that the statewide prohibition was valid because the insurance companies that supplied the policies that Gaddy sold to his clients were located throughout California. Second, the Court of Appeal found that the provisions of the employment agreement preventing Gaddy from calling on his former customers were appropriate because Alliant had shown that its "confidential client information constituted trade secrets." In particular, Alliant showed that because Gaddy had access to customers' policy expiration dates, he would have an unfair advantage in determining when to solicit the customers.

As the *Gaddy* decision demonstrates, California courts will uphold non-competition provisions that rely on recognized exceptions to California's policy against such provisions, so long as they are tailored to the particular facts and circumstances surrounding the transaction or employment relationship involved.