

Court Rejects Non-Solicitation Provisions

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September 2006

Customer and Employee Non-Solicitation Provisions Related to Sale of Businesses Held Invalid Because They Were Not Narrowly Limited to the Business Being Sold

In general, California law prohibits agreements that restrict competition. However, Business and Professions Code Section 16601 creates an exception: a seller of a business “may agree with the buyer to refrain from carrying on a similar business within a specific geographic area” in which the business operates. Applying this exception narrowly, on September 11, 2006, the California Court of Appeal held that a contract may not lawfully prevent the seller of a business from soliciting customers and employees who were not affiliated with the business at the time of the sale.

The case involved the sale of the goodwill and substantially all of the assets of a business. As part of the transaction, the buyer and seller entered into a consulting agreement, which included provisions prohibiting the seller from soliciting *the buyer’s* customers and employees for one year after the end of the consulting relationship. The Court of Appeal held that the provision was unenforceable because it was not limited to the customers and employees of the business that was sold. The court reasoned that the purpose of Section 16601 is “to permit the purchaser of a business to protect himself or itself against competition from the seller which competition would have the effect of reducing the value of the property right that was acquired.” Because the provisions extended to customers and employees who were not associated with the business being sold, the restrictions were not necessary to protect the value of the assets being purchased. The Court of Appeal therefore concluded that the provisions were unlawful because they “extend[ed] their anticompetitive reach beyond ‘the business so sold.’”

The court also refused the buyer’s request to enforce the lawful aspects of the prohibition, i.e., the prohibition on soliciting the customers and employees of the business being sold. The court refused to “blue pencil” the agreement to render it valid, explaining, “courts will not strike a new bargain for the parties for the purpose of saving an illegal contract.”

While the decision provides a new and significant limitation on the scope of Section 16601, California courts frequently invalidate contracts restricting solicitations of a competitor’s customers. Yet previous cases have declined to hold that provisions precluding solicitation of employees violate California’s restrictions on non-competition agreements. Such provisions appear in many employment agreements and in other contexts. For this reason, the decision may have important implications in circumstances beyond the sale of a business.

The case is *Strategix, Ltd. et al. v. Infocrossing West, Inc., et al.*, 2006 DJDAR 12186 (September 11, 2006).