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California's appellate court rejects overly broad customer noncompete and nonsolicitation clauses

Dowell v. Biosense Webster, Inc.: Overly Broad Restrictive Covenants and Questionable Litigation Choices Make for Difficult Outcomes

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Continuing the recent flurry of decisions refining the edges of California's general prohibition against post-employment covenants not to compete, the Court of Appeal for the Second District of California issued its opinion in *Dean Dowell v. Biosense Webster, Inc.*, 2009 Cal. App. LEXIS 1860 ("*Biosense*"). Without adding a great deal to the current body of California law governing post-employment restraints on trade, the opinion highlights the problems created by overly broad restrictive covenants and evidences the dangers of poor choices in trade secret litigation. The court's decision (in dicta) also undercuts the status of the so-called "common law trade secret exception" to California's prohibition on post-termination covenants not to compete.

Overview of Claims and Outcome at Trial

Biosense is an unfair competition dispute in which three individual plaintiffs , their employer, St. Jude Medical, Inc., and its subsidiary, Pacesetter, Inc., ("plaintiffs") sought declaratory relief against Biosense Webster, Inc.'s restrictive covenants. Specifically, plaintiffs sought a legal declaration that the agreements in question violated California Business & Professions Code section 16600, and their use and enforcement violated Business & Professions Code section 17200, *et seq*.

The three individual plaintiffs were former Biosense employees. The corporate plaintiffs, St. Jude Medical, Inc. and Pacesetter, Inc., hired the individual plaintiffs after they left Biosense. St. Jude Medical and Pacesetter are direct competitors of Biosense in the market for atrial fibrillation products, such as anatomical mapping systems and electrophysiology catheters.

From 1999 until 2005, the three individual plaintiffs worked for Biosense as engineers or professional education specialists. In these respective roles, the individual plaintiffs played a role in either the development of Biosense's electrophysiology catheters or educated physicians and their staff about Biosense's three-dimensional anatomical mapping system.

When they accepted employment with Biosense, the individual plaintiffs signed restrictive covenants containing a covenant not to compete. That covenant provided that for 18 months after termination of employment, the employee would "not render services, directly or indirectly, to any CONFLICTING ORGANIZATION" in which such services "could enhance the use or marketability of a CONFLICTING PRODUCT by application of CONFIDENTIAL INFORMATION" to which the employee "shall have had access" during employment.

The restrictive covenants defined a *conflicting product* as any product, process, technology, machine, invention or service that resembles or competes with one upon which the employee worked, or of which the employee was knowledgeable as a result of employment. A *conflicting organization* was defined as a person or organization engaged or about to become engaged in research, development, production, marketing or selling of a conflicting product. Further, *confidential information* was defined as:

> [I]nformation disclosed to [the employee] or known by [the employee] as a result of [his/her] employment by [Biosense], not generally known to the trade or industry in which [Biosense] is engaged, about products, processes, technologies, machines, customers, clients, employees, services and strategies of [Biosense], including, but not limited to ... marketing, merchandizing, selling, sales volumes or strategies, number or location of sales representatives, names or significance of [Biosense's] customers or clients or their employees or representatives, preferences, needs or requirements, purchasing histories, or other customer or client-specific information.

In addition, the restrictive covenants also contained a nonsolicitation clause that provided that the employee "recognize[s] that [Biosense's] relations with its accounts, customers and clients represents an important business asset that results from [Biosense's] significant investment of its time and resources" and that the employee has "gained or may gain relationships with the accounts, customers and clients of [Biosense], and because of such relationships, [he/she] could cause [Biosense] great loss, damage, and immediate irreparable harm" if the employee should "sell, offer for sale, or solicit or assist in the sale of a product of service that could compete with a product or service being sold or developed by [Biosense]." The employees, in turn, agreed that for 18 months after termination of their employment, they would not "solicit any business from, sell to, or *render any service to*, or, directly or indirectly, help others to solicit business from or *render service or sell* to any of the accounts, customers or clients" with whom the employees had contact during the last 12 months of their employment with Biosense.

Between April and July 2005, all three individual plaintiffs accepted positions with St. Jude Medical, Inc. or its subsidiaries, including Pacesetters. Upon learning of the individual plaintiffs' new employment, Biosense sent St. Jude cease and desist letters demanding that it terminate its "unlawful raiding" of Biosense employees. The cease and desist letters informed St. Jude that the individual plaintiffs had covenants not to compete that precluded their employment with St. Jude and possessed confidential and trade secret information relating to Biosense's business and personnel. In response, St. Jude and the individual plaintiffs filed suit, seeking declaratory relief regarding the restrictive covenants. Biosense answered and cross-complained, alleging claims for unfair competition against St. Jude.

The plaintiffs ultimately moved for summary adjudication of their claims, arguing that the noncompete and nonsolicitation clauses were void as a matter of public policy in California, and that Biosense's use and enforcement of the restrictive covenants constituted unfair competition. The trial court agreed, finding that the restrictive covenants were void and unenforceable under California Business & Professions Code section 16600, and that "they constituted unfair and unlawful competition under Business & Professions Code § 17200." The trial court also rejected Biosense's common law trade secret defense, stating that it failed as a matter of law because the restrictive covenants were not narrowly tailored or carefully limited to the protection of trade secrets and that, in any event, there was no evidence that Biosense's customer list is a trade secret because "it [appeared] that the customers for the products at issue (*e.g.*, physicians and hospitals) are easily identified from any number of publicly available directories and resources."

The plaintiffs also moved for summary judgment on Biosense's cross-complaint, arguing that its claims for unfair competition failed as a matter of law. Based upon its previous findings in favor of the plaintiffs, the trial court granted plaintiffs' motion for summary judgment on the cross-complaint, finding that no triable issues of fact existed.

On appeal, the California Court of Appeal found that:

> [T]he noncompete and nonsolicitation clauses in the agreements . . . are void and unenforceable under section 16600 and that their use violates section 17200. The broadly worded noncompete clause prevents [plaintiffs], for a period of 18 months after termination of employment with Biosense, from rendering services, directly or indirectly, to any competitor in which the services they may provide could enhance the use or marketability of a conflicting product by application of confidential information to which the employee had access during employment. Similarly, [the] broadly worded nonsolicitation clause prevents the employees for a period of 18 months post employment from soliciting any business from, selling to, or rendering any service, directly or indirectly to any of the accounts, customers or clients with whom they had contact during the last 12 months of their employment. Ultimately, these provisions restrain the employee from practicing their chosen profession. Indeed, these clauses are similar to those [already] found to be void under *section 16600* [in other cases].

In its ruling, the appellate court also specifically rejected Biosense's argument that "the clauses are valid because they were tailored to protect trade secrets or confidential information, and as such satisfy the so-called trade secret exception" to Section 16600's prohibition on restrictive covenants. Specifically, the court stated:

> Although we doubt the continued viability of the common law trade secret exception to covenants not to compete, we need not resolve the issue here. Even assuming the exception exists, we agree with the trial court that it has no application here. This is so because the noncompete and nonsolicitation clauses in the agreements are not narrowly tailored or carefully limited to the protection of trade secrets, but are so broadly worded as to restrain competition.

Lessons from the *Biosense* Opinion

Overly Broad Restrictive Covenants Will Undermine a Good Case

In light of California's "strong public policy protecting the rights of its citizens to pursue any lawful employment and enterprise of their choice," California businesses should not attempt to use unenforceable covenants not to compete. Biosense's "conflicting organization" and "conflicting product" scheme was not really any different that a facially void post-termination covenant not to compete. California's courts will permit former employees to work for competitors, but will take action to guard against misappropriation and protect confidential information and trade secrets, if the latter prohibitions are written properly.

Second, to protect confidential information and trade secret information, California businesses should tailor an employee's confidentiality obligations to more specific categories of information. The court in *Biosense* criticized the "broad list" of confidential topics, and emphasized that the better practice would have been to identify more specific topics.

Third, when relying upon nonsolicitation clauses to protect customer relationships, the clauses themselves should restrict only acts of solicitation, and not collateral acts such as "selling to" or "rendering services." Those types of restrictions, which go beyond acts of solicitation, could morph an otherwise enforceable nonsolicitation clause into a void, post-termination covenant not to compete.

Poor Litigation Strategic Choices Will Undermine Good Case

In granting plaintiffs' motions for summary adjudication, the trial court specifically noted that "as a matter of law," Biosense's trade secret claim failed for various reasons, including "there was no evidence that Biosense's customer list is a trade secret, because 'it appears that the customers for the products at issue (*e.g.*, physicians and hospitals) are easily identified from any number of publicly available directories and resources.'" However, under California law, whether information can be found in directories or the internet is immaterial to California's definition of a "trade secret."[1]

Based on the appellate record, it does not appear that Biosense provided evidence showing the investment in time, money, and personnel to create its customer list. Also, based on the appellate record, Biosense apparently did not argue that while the names of certain customers may be found in directories or other public sources, the directories do not show that any of the customers actually used or purchased goods or services from Biosense. As a result, it does not appear that Biosense asserted at the trial level that the directories themselves evidence nothing about its actual customer base. Given the state of the evidentiary record, it is not surprising that the court in *Biosense* focused upon the overly broad nature of the contract terms.

Whether California Recognizes a "Common Law Trade Secret Exception" to Section 16600 Remains Unclear

The California Supreme Court in *Edwards v. Arthur Andersen, LLP* acknowledged that California flatly rejects post-termination covenants not to compete, and does not recognize even "narrow restraints" as being valid forms of restrictive covenants.[2] In doing so, the California Supreme Court passed on determining whether the protection of trade secret information could make valid a post-termination covenant not to compete. Earlier this year, the court in *The Retirement Group, Inc. v. Galante*,[3] which addressed the proper scope of an injunction, also passed on the issue of whether the protection of trade secrets could justify a post-termination covenant not to compete. Following suit, the court in *Biosense* stated "[a]lthough we doubt the continued viability of the common law trade secret exception to covenants not to compete, we need not resolve that issue here."

The viability of the so-called "common law" trade secret exception is unclear, although this court obviously is skeptical. Theoretically, the proper scope of the "exception" is limited only to post-termination covenants not to compete. Thus the handling of the "common law trade secret exception" by the court in *Biosense* should have little bearing on the enforceability of confidentiality agreements or nonsolicitation provisions. Currently, however, there is no court analysis that truly considers such subtleties.

Conclusion

At the end of the day, the overly broad contract terms at issue in *Biosense* undoubtedly influenced the outcome on appeal. Further, Biosense could not or did not justify as a matter of fact why the rather broad and over-reaching contract terms were necessary or appropriate. *Biosense* does not add much to the body of existing law, but yet again underscores the importance of making certain that a company's contracts comply with California law. The decision also underscores the need to make well-reasoned litigation decisions regarding confidentiality and trade secret issues.

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[1] *See Abba Rubber v. Seaquist* (1991) 235 Cal. App. 3d 1, 22 n.9; IMAX Corp. v. Cinema Techs., Inc. (9th Cir. 1998) 152 F.3d 1161, 1169 n.10; *SEIU v. Rosselli* (N.D. Cal. May 14, 2009) 2009 WL 1382259, at *4.

[2] *Edwards v. Arthur Andersen*, LLP, (2008) 44 Cal. 4th 937, 948-49.

[3] 2009 WL 2332008, at *6.