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California Court of Appeal Voids Employee Post Employment Non-Solicitation Restrictions: What Your Company Needs To Do Now

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On November 1, 2018, the California Court of Appeal for the Fourth District, which encompasses San Diego, Imperial, Orange, San Bernardino, Riverside, and Inyo counties, issued a ruling that invalidated an employer's contract that restrained former employees from soliciting current employees for a one-year period. *See AMN Healthcare, Inc. v. Aya Healthcare Services, Inc. et al*., No. D071924, 2018 WL 5669154 (Cal. App. 2018); *AMN Healthcare, Inc. v. Aya Healthcare Servs*., Inc., No. D071924, 2018 Cal. App. LEXIS 989 (Ct. App. Nov. 1, 2018). In its ruling, which specifically addressed recruiters in the medical field, the California Appellate Court called into question the continuing viability of prior case law permitting employee non-solicit provisions so long as they were reasonable, and expressed the view that employee non-solicitation provisions constitute unlawful contracts in restraint of trade under California Business and Professions Code Section 16600.

AMN Healthcare provides temporary healthcare staffing to medical care facilities (including supplying "travel nurses"). The company employed the individual defendants, who subsequently went to work for a competitor, Aya Healthcare Services, as travel nurse recruiters. AMN Healthcare sued in San Diego County Superior Court, alleging the defendants breached a post-employment non-solicitation provision in their employment contracts and further misappropriated trade secrets. The trial court issued an order: (1) enjoining plaintiffs from enforcing the employee non-solicitation provision, and (2) awarding $169,000 in reasonable attorneys' fees to defendants based on a finding that the provision violated California Business and Professions Code Section 16600. The trial court further found that there was no evidence of trade secret misappropriation.

The California Court of Appeal affirmed the trial court's ruling. Relying on California Business and Professions Code Section 16600, which provides "[e]xcept 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 of Appeal held the employee non-solicitation provision was an unlawful restraint of trade. The Court concluded that the non-solicitation provision "clearly restrained [the] individual defendants from practicing with Aya their chosen profession—recruiting travel nurses on 13-week assignments." *See AMN Healthcare*, *Inc*., No. D071924, 2018 Cal. App. LEXIS 989, at *20. The Court of Appeal expressly held "that, if a former AMN recruiter… was barred for at least one year from 'soliciting or recruiting any travel nurse listed in AMN's database,' that would restrict the number of

nurses with whom a recruiter could work" and "could limit the amount of compensation a recruiter would receive with his or her new agency." *Id*. at *21.

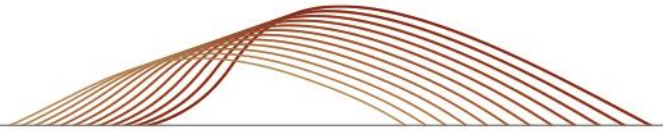
California's Historic Policy Against Non-Compete Contracts But Allowing Post Employment Non-Solicitation Contracts

In determining whether a restraint on the practice of a trade or occupation is lawful, most states (and the Ninth Circuit) apply a "rule of reasonableness." However, California state courts have rejected the so-called "rule of reasonableness", and instead adhere to California Business and Professions Code Section 16600's strict prohibition against contracts that restrain a person's trade or profession unless they fall "into one of section 16600's three statutory exceptions (§§ 16601 [sale of goodwill or interest in a business], 16602 [dissolution of a partnership], or 16602.5 [dissolution or sale of limited liability company])[.]" *AMN Healthcare, Inc.*, No. D071924, 2018 Cal. App. LEXIS 989, at *19; *Edwards v. Arthur Anderson LLP*, 44 Cal. 4th 937 (2008). California courts consistently hold that Section 16600 expresses "a settled legislative policy in favor of open competition and employee mobility," and that the interests of employee mobility are paramount to the competitive business interests of employers where no illegal conduct has occurred. *Id.*; *Diodes, Inc. v. Franzen,* 260 Cal. App. 2d 244, 255 (1968).

Despite California's prohibition on non-compete provisions, California courts historically upheld the use of non-solicitation provisions. In a case decided 23 years before *Edwards*, the Court of Appeal for the Sixth District adopted a rule of reasonableness standard in finding that an employee non-solicitation provision merely prohibited the defendant from "raiding" the plaintiff's employees. *Loral Corp. v. Moyes*,174 Cal. App. 3d 268, 279 (1985). The *Loral* Court further found that this restriction was not an invalid agreement not to compete as the "restriction only slightly affects employees. They are not hampered from seeking employment with [the defendant's new employer] nor from contacting [the defendant]. All they lose is the option of being contacted by him first." *Id*. at 279.

The *AMN Healthcare* Court rejected Plaintiff's attempt to save the non-solicitation agreement by relying on the *Loral* decision and rejected the application of any "reasonableness" standard. Although the *AMN Healthcare* Court took into account the defendants' specific profession as recruiters in making its ruling, the Court also broadly questioned the "continuing viability" of *Loral's* use of a reasonableness standard in evaluating the enforceability of non-solicitation provisions in the wake of *Edwards v. Arthur Anderson LLP*, 44 Cal. 4th 937 (2008). The Court then held that whether or not the reasonableness standard of *Loral* was expressly rejected, the "non-solicit" provision in the instant case was still unlawful. The Court reasoned that the facts of *Loral* were distinguishable because *Loral* dealt with a few key, senior executives, and the present case involved front-line recruiters.

Following the *AMN* decision, unless and until the California Supreme Court decides to review the matter, employees who are accused of breaching a non-solicitation agreement will now assert *AMN* to claim that such agreements violate Section 16600. In response, employers will argue that the decision is limited to its facts, namely that the employees' jobs and compensation were based on recruiting travel nurses, and the provision functioned more like a bar on competition or customer solicitation than traditional employee non-solicitation. To the extent trial courts interpret *AMN* as creating a split with *Loral*, then the trial courts will need to determine on an individual basis which decision to follow. There will undoubtedly be more litigation on this issue throughout California, as currently there are indistinguishable challenges to employee non-solicitation clauses pending before various state trial courts.



What Employers Should Do Immediately in the Wake of AMN

Employers doing business in California should conduct a careful review of the wording and usage of their employee non-solicitation provisions. Paul Hastings' Employee Mobility and Trade Secrets Practice Group can assist in advising if and when these provisions should be used.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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