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Trade Secret Exception Redux: What the Court in 'Techno Lite' Got Wrong

Just as courts have recognized that the "trade secret exception" does not square with 'Edwards', the same should be true for the "while employed" exception of 'Techno Lite'.

By Cheryl Cauley and Jonathan Patchen

Employee noncompete agreements are generally invalid under California Business & Professions Code §16600, which says that "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void." Courts have periodically created exceptions to §16600's ban on anticompetitive covenants—from the so-called "trade secret exception" to, under *Techno Lite v. Emcod*, a "while employed" exception. 44 Cal. App. 5th 462 (2020); *Dowell v. Biosense Webster*, 179 Cal. App. 4th 564 (2009). But such exceptions violate the statute's plain text and policy, and the California Supreme Court's direction that §16600 "should not be diluted by judicial fiat." *Edwards v. Arthur Andersen*, 44 Cal. 4th 947, 949 (2008). Just as courts have recognized that the "trade secret exception" does not square with *Edwards*, the same should be true for *Techno Lite's* "while employed" exception.

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Violation of Ban on Judicially Created Exceptions to §16600

The California Supreme Court's decision in *Edwards* set the bar for evaluating (and invalidating) anticompetitive agreements. There, the Court invalidated an agreement that barred an employee "from working for or soliciting certain" of his employer's clients following his departure. Id. at 942. The Court explained that the agreement violated §16600 as an unlawful restraint on the former employee's lawful profession. Id. at 955. In doing so, the Court made clear that "Section 16600 represents a strong public policy of the state which should not be diluted by judicial fiat"—it is up "to the Legislature, if it chooses, [to] adopt additional exceptions." Id. at 949-50.

In *Techno Lite*, however, the court deviated from *Edwards's* instruction and created a "while employed" exception to §16600.

44 Cal. App. 5th at 470-74. In the case, Techno Lite sued two former employees who ran their own business while still working for Techno Lite, though both promised Techno Lite that they would do so on their own time and would not compete with the company. Id. at 464. After a breakdown in the relationship, Techno Lite sued the employees, accusing them of fraud by falsely promising not to compete and misappropriating trade secrets, among other alleged wrongs. Id. at 465. The employees argued that the fraud claim failed because the underlying promise—an agreement not to compete—was void under §16600. Id. at 470-71. The court rejected this argument, holding that "the statute does not affect limitations on an employee's conduct or duties *while employed*." Id. at 471 (emphasis in original).

In doing so, the *Techno Lite* court upheld the at-issue agreement by effectively creating an exception to §16600 for noncompetes operative only during the term of employment. But neither §16600 nor the limited statutory exceptions to it permit restraints effective "while employed"—the statute applies to "every contract" that restrains "anyone"—and *Techno Lite* reflects the type of "dilut[ion] by judicial fiat" that *Edwards foreclosed*.

Employers' Interests Are Protected by Other Law

To reach its holding, the *Techno Lite* court distinguished *Edwards* as only applicable to post-employment restraints and relied on cases that describe an employee's duty of loyalty. Id. at 472-73. That duty of loyalty comes from a mix of statutes (e.g., Labor Code §§2860, 2863) and common law, and stands separate and apart from *contractual* restraints subject to §16600. Indeed, as the court explained, §16600 does not invalidate the duty of undivided loyalty "by employees not to undermine their employers by surreptitiously competing with it while being paid by their employer." *Techno Lite*, 44 Cal. App. 5th at 472. But the court conflated *duty of loyalty* principles in order to make an exception to §16600's categorical ban on *contractual restraints*.

In this way, the *Techno Lite* decision makes the same type of error that courts made before *Edwards* to create a "trade secret exception" to §16600. Under the so-called "trade secret exception," some courts allowed contracts prohibiting employees' post-employment competition if designed to protect trade secrets. See *Dowell*, 179 Cal. App. 4th at 575-76 (collecting cases). But courts since *Edwards* have found that—under the California Supreme Court's prohibition on judicially created exceptions—there is no trade secret exception to §16600. See *Retirement Grp. v. Galante*, 176 Cal. App. 4th 1226, 1238 (2009); *Power Integrations v. De Lara*, No. 20-CV-410-MMA (MSB), 2020 WL 1467406, at *14 (S.D. Cal. March 26, 2020). In other words, employers cannot by contract restrain competition in the name of "trade secret" protection; instead, the wrongs purportedly guarded by such contracts are prohibited by other law (e.g., the Uniform Trade Secrets Act). See *Retirement Grp.*, 176 Cal. App. 4th at 1238 (concluding that "conduct is enjoinable not because it falls within a judicially-created 'exception' to section 16600's ban on contractual nonsolicitation clauses, but ... because it is wrongful independent of any contractual undertaking") (emphasis in original). Similarly, §16600's plain text prohibits contracts, like the one in Techno Lite, that ban employees from concurrent "outside" work, although that conduct can be remedied as a violation of the duty of loyalty.

Techno Lite does not discuss this parallel strand of cases and erred by creating a new exception to §16600 for agreements *during* (rather than *after*) employment.

The *Techno Lite* court should have held that §16600 barred the contractual promise not to compete while employed, but that such conduct can be evaluated under employees' duty of loyalty.

Implications of 'Techno Lite'

Although seemingly innocent, because the Techno Lite decision rests on parallel duty-of-loyalty principles, diluting §16600 in this way has implications beyond just preventing an employee from becoming "his employer's competitor while still employed." *Techno Lite*, 44 Cal. App. 4th at 474. For example, employers may use *Techno Lite* to contractually prohibit the very "preparations to compete" that are permissible under the duty of loyalty (e.g., circulating resumes, applying for jobs, and conducting interviews). Even if eventually rejected, such "while employed" clauses could have a substantial chilling effect on employee mobility. Cf. *Kolani v. Gluska*, 64 Cal. App. 4th 402, 407 (1998) (recognizing that "[m]any, perhaps most, employees would honor [non-compete] clauses without consulting counsel or challenging the clause in court.").

Moreover, even if merely "contractualizing" the duty of loyalty, such clauses could work mischief. Contracts can carry attorneys' fees clauses and longer statutes of limitations, which increase the risk (and thus the chilling effect) for employees considering new job opportunities. More contracts also means more arbitration clauses, which would further deprive courts of the disputes necessary to develop the law and define the acts that are (and are not) permissible preparations to compete.

California strongly favors the ability of individuals to practice any lawful business, trade or profession. Section 16600 has been rightly interpreted to preclude contractual arrangements that vary—or mimic—the baseline, positive law governing employee conduct, both pre- and post-departure. Judicially created exceptions, such as the *Techno Lite* decision, and the ripple effect of employers utilizing such exceptions, undermine that public policy.

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