

## Non-Compete Related to Business Sale Not Enforceable, California Court of Appeal Rules

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Affirming the dismissal of an employer's claim for breach of a non-competition agreement, the California Court of Appeal has held that the agreement was void and unenforceable under California law although the parties entered into the agreement in connection with a business sale. *Fillpoint, LLC v. Maas*, No. G045057 (Cal. Ct. App. Aug. 24, 2012). Significantly, the Court found the agreement overbroad and not limited to protecting the buyer's interest in the goodwill of the business.

### Background

Michael Maas was an employee and stockholder in Crave Entertainment Group, Inc., a business that distributed and published video games. Crave was acquired by Handleman Company in 2005. As part of the acquisition, Maas sold his stock to Handleman and signed a stock purchase agreement containing a three-year non-competition provision. When Maas became a Handleman employee a month later, he entered into an employment agreement that contained another non-competition provision. This provision prohibited Maas from competing for a period of one year following his termination of employment, whenever that might occur. The stock purchase agreement and the employment agreement cross-referenced each other.

Maas satisfied the three-year term of the non-compete provision in the stock purchase agreement, staying with Handleman for three years before resigning. About six months after he resigned, he began working for a direct competitor. Meanwhile, Fillpoint, LLC, purchased the Crave assets from Handleman. Fillpoint sued Maas for violation of the one-year non-compete provision in the employment agreement. It claimed the one-year non-compete was part of the goodwill interest in its acquisition of the Crave assets.

At trial, Maas asked the trial court to dismiss Fillpoint's claim because the non-competition agreement unenforceable. The trial court agreed. Fillpoint appealed.

### Applicable Law

Covenants not to compete are generally void and unenforceable in the employment context under California law (Bus. & Prof. Code § 16600). However, a limited exception is permitted in connection with the sale of a business (Bus. & Prof. Code § 16601). The purpose of this exception is to protect the goodwill or ownership interest acquired by the buyer. Section 16601 "serves an important commercial purpose by protecting the value of the business acquired by the buyer. In the case of the sale of the goodwill of a business it is 'unfair' for the seller to engage in competition which diminishes the value of the asset he sold." *Strategix, Ltd. v. Infocrossing West, Inc.*, 142 Cal. App. 4th 1068, 1072-73 (Cal. Ct. App. 2006) (citations omitted).

### Non-Compete is Unenforceable

Fillpoint argued that the stock purchase agreement and the employment agreement must be read together and, consequently, Section 16601's exception for a sale of business applied to the one-year non-compete agreement. Although the appellate court agreed that the two agreements should be read together as part of the same transaction, it disagreed that Section 16601 applied to the one-year non-compete agreement. According to the Court, the exception is limited and may not be used to circumvent "California's deeply rooted public policy favoring open competition."

The Court noted the differences between the agreements' restrictions. The stock purchase agreement's non-competition provision prevented Maas, as a shareholder, from competing with Crave during the three-year period after Handleman acquired Crave. The Court concluded that the agreement protected the goodwill of Crave for three years, served the purpose of Section 16601, and was fully performed.

The employment agreement's additional one-year non-compete provision, by contrast, was not sufficiently tied to the sale of the business. The Court found this agreement affected Maas's rights to be employed in the future and had nothing to do with protecting the buyer's interest in the value of the purchase.

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Accordingly, the Court concluded that the one-year non-compete agreement was void and unenforceable.

### Implications

This case reminds employers that courts will carefully scrutinize a non-competition agreement under California law. While the case does not preclude an employer from enforcing a non-competition agreement contained in a separate employment agreement executed with the sale of a business, it may be difficult to do so unless the agreement's language demonstrates that the non-competition provision was intended to protect business goodwill.

Jackson Lewis attorneys are available to answer inquiries regarding this case and other workplace laws.

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