NONCOMPETE AGREEMENTS IN CALIFORNIA: SHOULD CALIFORNIA COURTS UPHOLD CHOICE OF LAW PROVISIONS SPECIFYING ANOTHER STATE'S LAW?

Christina L. Wu*

Unlike most states, California generally prohibits noncompete agreements between an employer and its employees through section 16600 of the California Business and Professions Code. In recent years, state and federal courts in California have encountered noncompete agreements that contain choice of law clauses specifying the law of a state that allows reasonable noncompete agreements. When deciding whether to uphold choice of law provisions in such agreements, California courts apply various but similar tests. In a typical evaluation, courts will look to whether the application of the chosen state's law would violate fundamental California public policy and which state has a materially greater interest in the outcome.

California state and federal courts have reached conflicting decisions concerning whether to uphold choice of law clauses in noncompete agreements. While a case-by-case analysis can be sensitive to factual distinctions, it can also result in arbitrary and inconsistent outcomes. This Comment argues that, rather than applying a case-by-case analysis to choice of law clauses in noncompete agreements, California courts should instead apply a bright line rule that upholds choice of law provisions for employees who have not worked in California. While a bright line rule would reduce the sensitivity to factual distinctions, it would nevertheless produce fair and consistent outcomes.

INTRODUCTION 594
I. BACKGROUND: CALIFORNIA CASE LAW 596
A. California State Court Decisions 597
B. Federal Court Decisions 601
C. State and Federal Court Decisions Compared 604
II. THE IMPLICATIONS OF UPHOLDING CHOICE OF LAW PROVISIONS IN OUT-OF-STATE NONCOMPETE AGREEMENTS 606
A. The Materially Greater Interest Analysis 607

---

* Senior Editor, UCLA Law Review, Volume 51. J.D. Candidate, UCLA School of Law, 2004; A.B., Harvard College, 2001. I would like to thank Professor Gillian Lester for her guidance and advice in the preparation of this Comment. I would also like to express my gratitude to the members of the *UCLA Law Review*, especially Tracy Casadio, Khaldoun Shobaki, Vanessa Au, Kamran Mirrafati, Laura Best, Lesley Wasser, and Pei Pei Tan. Thanks are also due to my parents, Michael and Patricia Wu; my sisters, Catharine, Jessica, and Emily Wu; and David Ryu for their support.

1. California Public Policy Interests Against Noncompete Agreements 607
2. Possible Interests of Other States in Favor of Noncompete Agreements 609
3. Would California Public Policy Interests Actually Outweigh Other States' Interests? 612
B. The Comparative Impairment Analysis 614
C. Application of a Bright Line Rule 616
1. A California Employer Hiring an Out-of-State Employee 616
2. An Employee Working in California Under an Out-of-State Noncompete Agreement 617
3. Telecommuting Across State Lines 618
4. Limits on the Application of a Bright Line Rule 619
CONCLUSION 619

INTRODUCTION

Should an employee be allowed to work for a California employer in violation of a noncompete agreement entered into in another state? The California Supreme Court recently faced this question in *Advanced Bionics Corp. v. Medtronic, Inc.*[1] Medtronic, a biotech company based in Minnesota, had a noncompete agreement with marketing employee Mark Stultz stating that, should Stultz accept employment with a competitor, he would be prohibited for two years from working on products similar to those he worked on at Medtronic. In 2000, Stultz left Medtronic for Advanced Bionics, a California-based competitor.[2] Stultz and Advanced Bionics obtained a temporary restraining order in a California court, preventing Medtronic from enforcing the noncompete agreement in a parallel Minnesota court action.[3] On appeal, the California Supreme Court held that the California court could not prevent Medtronic from pursuing relief in the Minnesota court.[4]

The issues raised by *Advanced Bionics* highlight a dilemma that has received varying treatment by California state and federal courts. Many other states allow noncompete agreements, provided they meet certain requirements of reasonableness. California, however, takes a strong stance against noncompete agreements through section 16600 of the California Business

1. 59 P.3d 231 (Cal. 2002).
2. *Id.* at 233.
3. *Id.* at 234.
4. *See id.* at 238. The California Supreme Court also held that the California action could go forward until Medtronic could show that a Minnesota judgment was binding on the parties. *Id.*

and Professions Code,[5] which has been interpreted by California courts as invalidating noncompete agreements.[6] The public policy behind section 16600 includes concern for employee mobility and for employers' ability to compete for the most talented employees.

Noncompete agreements often include choice of law provisions. A choice of law clause specifies that the agreement should be interpreted under a particular state's law. When a California employer recruits an employee from a competitor in another state, and that employee has signed a noncompete agreement under the other state's law, should the noncompete agreement be enforced by California courts? California state and federal courts use different but similar tests to resolve such situations. Under both tests, a court looks at each situation on a case-by-case basis, which demands that the court weigh the public policies of California against those of the other state to determine which state has a stronger interest in having its law applied. In addition, state courts use a comparative impairment analysis to determine which state would be more seriously impaired by nonapplication of its law.

In a recent decision, *IBM Corp. v. Bajorek*,[7] the Ninth Circuit upheld the application of New York law to a noncompete agreement for an employee who had been working mostly in California during a twenty-five year period. In contrast, in *Application Group, Inc. v. Hunter Group, Inc.*,[8] the Court of Appeal for the First District applied California law to a noncompete agreement for an employee who moved to California from Maryland to work for a California employer. One of the advantages of a case-by-case analysis is that a court can be sensitive to the facts of each case, such that California law can be applied when it would be just to do so, but not in instances in which it would produce an unfair result. However, the current analyses of state and federal courts have not produced this outcome. Instead, the state and federal court rulings have been arbitrary and inconsistent, with different notions of California's public policy being applied.[9]

This Comment suggests that, rather than engaging in a case-by-case public policy analysis, California should adopt a bright line rule that choice of law provisions in noncompete agreements should always be upheld when an employee moves to California from another state. A bright line rule would obviate the impossible determination that one state's public policy genuinely

5. CAL. BUS. & PROF. CODE § 16600 (West 1997).

6. *See* Muggill v. Reuben H. Donnelley Corp., 398 P.2d 147, 149 (Cal. 1965) (finding that section 16600 prohibits noncompete clauses in employment contracts).

7. 191 F.3d 1033 (9th Cir. 1999).

8. 72 Cal. Rptr. 2d 73 (Ct. App. 1998).

9. *See* the discussion *infra* Part I.

outweighs that of the other. It also avoids the question of which state would be more greatly impaired by nonapplication of its law. Finally, application of a bright line rule would result in consistent rulings in these types of cases. While a bright line rule would be less sensitive to factual distinctions, it would nevertheless satisfy the ultimate goal of producing fair and consistent outcomes.

Part I discusses the California state and federal case law surrounding choice of law provisions in noncompete agreements, as well as the analysis that courts use to determine whether to uphold a choice of law provision. Part II further explores the choice of law analysis used by courts. This part also analyzes the application of a bright line rule and shows that such a rule should be limited to cases in which the employee has been working outside of California under a noncompete agreement. It should not apply in cases where an out-of-state employee has been working in California for a substantial amount of time.

I. BACKGROUND: CALIFORNIA CASE LAW

At the heart of the issues surrounding enforcement of noncompete agreements is section 16600 of the California Business and Professions Code.[10] Section 16600 states 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."[11] A covenant not to compete constitutes a contract between employee and employer and therefore is subject to section 16600. In 1965, the California Supreme Court interpreted section 16600 as invalidating a noncompete clause in *Muggill v. Reuben H. Donnelley Corp.*[12] Employee Michael Muggill left his employer after qualifying for retirement benefits.[13] A provision of the retirement plan stated that Muggill would forfeit his benefits if he went to work for a competitor. After leaving, he accepted employment with a competitor, and the company terminated his benefits. Muggill then brought an action for reinstatement

10. CAL. BUS. & PROF. CODE § 16600.

11. *Id.* The full text of section 16600 is: "Except 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." *Id.* Section 16601 contains a narrow exception to section 16600: covenants not to compete are allowable in connection with a sale of goodwill. *Id.* § 16601; *see* Hill Med. Corp. v. Wycoff, 103 Cal. Rptr. 2d 779, 786 (Ct. App. 2001) ("[I]n order to uphold a covenant not to compete pursuant to section 16601, the contract for sale of the corporate shares may not circumvent California's deeply rooted public policy favoring open competition.").

12. 398 P.2d 147, 149 (Cal. 1965).

13. *Id.* at 148.

of his benefits.[14] The California Supreme Court held that section 16600 "invalidates provisions in employment contracts prohibiting an employee from working for a competitor after completion of his employment or imposing a penalty if he does so, unless they are necessary to protect the employer's trade secrets."[15] The pension program was part of the employment contract, and the court found that the forfeiture provision would restrain him from "engaging in a lawful business."[16] Therefore, the forfeiture provision was void.[17]

The *Muggill* decision formed the basis for subsequent decisions concerning noncompete agreements that include provisions mandating interpretation under another state's law. As this part explains, state and federal courts have interpreted *Muggill* differently in terms of defining fundamental California public policy. They have also used different tests for determining whether to uphold choice of law provisions or to apply California law instead. This shows the need for clarification from the California Supreme Court.

A. California State Court Decisions

In the 1971 decision of *Frame v. Merrill Lynch, Pierce, Fenner & Smith Inc.*,[18] the Court of Appeal for the First District declared a forfeiture provision invalid under *Muggill*.[19] Merrill Lynch denied former employee Ronald Frame's claim to benefits under a profit-sharing plan because of a forfeiture provision. The forfeiture provision was triggered when Frame left Merrill Lynch to work for a competitor.[20] The contract included a New York choice of law provision.[21] In its holding, the court found that the forfeiture provision was analogous to the forfeiture provision in *Muggill*. Given the California Supreme Court's invalidation of the forfeiture provision in *Muggill*, the Court of Appeal for the First District found that section 16600 must represent strong California public policy against contracts that act as a

14. *Id.*
15. *Id.* at 149. While section 16600 prohibits noncompete agreements that prevent an employee from working for a competitor, it does not prohibit clauses where an employee agrees "not to disclose his former employer's confidential customer lists or other trade secrets or not to solicit those customers." Loral Corp. v. Moyes, 219 Cal. Rptr. 836, 841 (Ct. App. 1985).
16. *Muggill*, 398 P.2d at 149.
17. *Id.*
18. 97 Cal. Rptr. 811 (Ct. App. 1971).
19. *Id.* at 814.
20. *See id.*
21. *Id.*

restraint of trade.[22] Therefore, the court held the forfeiture provision to be ineffective, and applied California law instead.[23]

More than twenty-five years later, in *Application Group, Inc. v. Hunter Group, Inc.*,[24] the Court of Appeal for the First District applied California law to a noncompete agreement between a non-California employer and a non-California employee who was hired by a competitor for employment in California.[25] Both Hunter Group, Inc. (Hunter) and Application Group, Inc. (AGI) provided computer consulting services.[26] Employee Dianne Pike worked for Hunter in Maryland as a computer consultant.[27] Her noncompete agreement prevented her from working for Hunter's competitors, including AGI, within one year after termination.[28] Nonetheless, AGI recruited Pike to work in California, and Pike accepted AGI's offer.[29]

On appeal, the court applied a test based on section 187 of the Second Restatement of Conflicts of Laws[30] and the Ninth Circuit's decision in *S. A. Empresa v. Boeing Co.*[31] The test can be broken down into two prongs. The first prong involves a pair of threshold questions: Does the chosen state have a substantial relationship to the parties or transaction, or does another reasonable basis exist for choosing this state's law? If the answer to both of these questions is "no," then the choice of law clause is invalidated. If the answer to either of these questions is "yes," then the court moves to the second part of the test, which breaks down into three parts: (1) Is application of the chosen state's law contrary to a fundamental policy of California? (2) Does

22. *See id.*

23. *Id.* The court also noted that "[a] latent question exists as to whether the agreements of the parties may be construed as applying only to such permissible subjects of restraint as breaches of confidence and misappropriation of trade secrets." *Id.* at 815. Such questions were left to arbitration. *Id.*

24. 72 Cal. Rptr. 2d 73 (Ct. App. 1998).

25. *Id.* at 75.

26. *Id.*

27. *Id.* at 76.

28. *See id.* at 75.

29. *See id.* at 76.

30. Restatement section 187 provides that the law of the designated state will be applied unless:

> (a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or
>
> (b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which . . . would be the state of applicable law in the absence of an effective choice of law by the parties.

RESTATEMENT (SECOND) OF CONFLICTS OF LAW § 187 (1971).

31. 641 F.2d 746 (9th Cir. 1981). *S. A. Empresa* stated that California would apply the substantive law designated by the contract, unless either of two exceptions applied. *Id.* at 748. One exception is when "the chosen state has no substantial relationship to the parties." *Id.* The other exception is when "application of the law of the chosen state would be contrary to a fundamental policy of [California]." *Id.*

California have a materially greater interest than the chosen state in the outcome of the case? (3) Would California's interests be more seriously impaired by application of the chosen state's law, than would the chosen state's interests by application of California law?[32] If the answer to all three questions is in the affirmative, then California law is applied. However, if any of these three questions is answered in the negative, the choice of law provision is upheld.

In *Application Group*, the chosen state, Maryland, had a substantial relationship to the parties and the transaction, and a reasonable basis existed for permitting Maryland choice of law.[33] The court thus turned to whether Maryland's law was contrary to a fundamental policy of California, and if so, which state had a materially greater interest in the outcome and which state's interests would be more greatly impaired by application of the other state's law.[34]

Ultimately, the court found that, under section 16600, "California has a strong interest in protecting the freedom of movement of persons whom California-based employers . . . wish to employ to provide services in California, regardless of the person's state of residence or precise degree of involvement in California projects."[35]

California also has a public policy interest in ensuring that its employers can "compete effectively for the most talented, skilled employees in their industries, wherever they may reside."[36] This includes not only those California employers who recruit out-of-state employees to move to California, but also California employers who employ through telecommuting:

> In this day and age—with the advent of computer technology and the concomitant ability of many types of employees in many industries to work from their homes, or to "telecommute" to work . . . an employee need not reside in the same city, county, or state in which the employer can be said to physically reside. California employers

32. *See Application Group*, 72 Cal. Rptr. 2d at 83. The court explained the second prong:

> [A] court can decline to enforce the parties' contractual choice-of-law provision only if the interests of the forum state are "materially greater" than those of the chosen state, *and* the forum state's interests would be more seriously impaired by enforcement of the parties' contractual choice-of-law provision than would the interests of the chosen state by application of the law of the forum state.

Id. at 84.

33. *Id.* The court also noted that the fact that Hunter was incorporated in Maryland was sufficient to form a substantial relationship to Maryland, and that the fact that Hunter was located in Maryland was a reasonable basis for choosing Maryland. *Id.* This suggests that it would be easy for an out-of-state corporation to negate the first prong of the test, because its choice of law provision need only be related to the company to form a substantial relationship or a reasonable basis.

34. *Id.* at 84–85.

35. *Id.* at 85.

36. *Id.*

> in such sectors of the economy have a strong and legitimate interest in having broad freedom to choose from a much larger, indeed a "national," applicant pool in order to maximize the quality of the product or services they provide, as well as the reach of their "market." California has a correlative interest in protecting its employers and their employees from anti-competitive conduct by out-of-state employers such as Hunter . . . .[37]

Therefore, California's section 16600 policy interests include both protecting employees' freedom of mobility and protecting employers' ability to compete and recruit non-California employees, regardless of whether those non-California employees ever actually set foot in California.[38] Application of Maryland law would violate these fundamental policy interests.[39]

Second, the court found that California had a materially greater interest in the determination of this case.[40] According to the court, Maryland's public policy interests included preventing trade secret misuse and protecting Maryland employers from the recruitment of employees who provide unique services.[41] However, given California's interest in employee mobility, the court stated, "[W]e see no reason why these employees' interests should not be 'deemed paramount to the competitive business interests' of out-of-state as well as in-state employers."[42]

Finally, the court found that California's interests would be more seriously impaired by declining to apply its law.[43] Nothing in the record suggested that Maryland's public policy interests would be impaired by refusing to enforce the covenant not to compete.[44] Pike had not performed unique services for Hunter, nor was there a showing that she had misused trade

---

37. *Id.*

38. The facts of the case are unclear as to whether *Application Group* is a telecommuting case. The discussion of telecommuting could be dictum.

39. *See id.* at 86.

40. *Id.*

41. *Id.* at 85. California Civil Code section 3426.1(d) provides the following definition of a trade secret:

> information, including a formula, pattern, compilation, program, device, method, technique, or process, that:
>
> (1) Derives independent economic value, actual or potential, from not being generally known to the public or to other persons who can obtain economic value from its disclosure or use; and
>
> (2) Is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

CAL. CIV. CODE § 3426.1(d) (West 1997).

42. *Application Group*, 72 Cal. Rptr. 2d at 85.

43. *Id.* at 86.

44. *See id.*

secrets. Therefore, California's interests would have been more seriously impaired if Maryland law had been applied.[45]

B. Federal Court Decisions

In a 1983 opinion, *Roesgen v. American Home Products Corp.*,[46] the Ninth Circuit upheld application of New York law to a forfeiture provision in a stock plan.[47] As a benefit of their employment at American Home Products in New York, appellants John Roesgen and John Brincko received contingent stock credits in a stock plan. The stock plan included terms that, if appellants were to accept employment with a competitor, they would be forced to forfeit their rights to their stock. After Roesgen and Brincko left American Home Products to work for California competitors, they brought suit to invalidate the forfeiture provision under section 16600. The Ninth Circuit applied a comparative impairment analysis to determine which law to apply according to which state would be more impaired by application of the other state's law.[48] The court found that New York would be more greatly impaired by application of California law than would California by application of New York law.[49] New York has a strong interest in protecting freedom to contract and this interest would be impaired if the parties' expectations were not met.[50] Since the appellants joined the stock plan when they were New York residents working in New York, their expectation was that New York law would apply. If the court had applied California law instead, it would have invited forum shopping, since any New York employee would be able to escape New York law simply by moving to California.[51]

The Ninth Circuit reached a similar conclusion in *IBM Corp. v. Bajorek*.[52] IBM was a New York corporation.[53] Christopher Bajorek worked for IBM for twenty-five years, mostly in California.[54] Under Bajorek's stock options agreement, if he were to work for a competitor within six months of exercising his options, he would forfeit his profits.[55] The agreement provided that

45. *Id.*
46. 719 F.2d 319 (9th Cir. 1983).
47. *Id.* at 320.
48. *Id.* Although the Ninth Circuit applied the comparative impairment test in *Roesgen*, in subsequent cases it has not.
49. *Id.* at 321.
50. *Id.*
51. *Id.*
52. 191 F.3d 1033 (9th Cir. 1999).
53. *Id.* at 1036.
54. *Id.*
55. *Id.* at 1035.

disputes were to be resolved under New York law.[56] After Bajorek exercised more than $900,000 worth of options, he went to work for a competitor.[57] Subsequently, Bajorek brought suit against IBM in California for a declaratory judgment that IBM could not cancel his options.[58] Bajorek argued that since California law did not allow employers to restrict an employee from accepting employment with a competitor, he was not bound by the restrictive covenant of the stock option agreement.[59] IBM argued that he was paid more than $900,000 not to work for a competitor, and that when he did so, he was obligated to pay it back.[60]

On appeal, the court looked to section 187 of the Second Restatement of Conflict of Laws to determine whether the contractual choice of law should be applied.[61] Section 187 states that the contractual choice of law provision applies unless there is no relationship and no reasonable basis to apply the chosen state's laws, or unless application of the chosen state's law would violate a fundamental policy of a state with a materially greater interest.[62] Under the first prong, New York had a substantial relationship to both the parties and the transaction, and there was a reasonable basis to choose New York law.[63]

---

56. *Id.*

57. *Id.* at 1035–36.

58. *Id.* at 1035. IBM originally brought suit in New York, and the New York case was transferred to California. *Id.* IBM also alleged that Bajorek committed fraudulent misrepresentation by certifying upon exercise of his stock options that he was in compliance with the agreement, while knowing that he would not comply. *Id.*

59. *Id.* at 1036.

60. *Id.*

61. *Id.* at 1037.

62. RESTATEMENT (SECOND) OF CONFLICTS OF LAW § 187 (1971). Other states also apply section 187 to choice of law provisions in noncompete agreements. For cases that apply section 187, see, for example, Unisource Worldwide, Inc. v. S. Cent. Ala. Supply, L.L.C., 199 F. Supp. 2d 1194, 1200 (M.D. Ala. 2001), in which the court defined the issues as:

> 1) whether application of Florida law would be contrary to a fundamental policy of a state which; 2) has a materially, greater interest than the chosen state in the determination of the particular issue; and (3) under the rule of § 188 [of the Restatement (Second) of Conflicts of Laws], would be the state of the applicable law in the absence of an effective choice of law by the parties.

Id. *See also* Elec. Distribs., Inc. v. SFR, Inc., 166 F.3d 1074, 1084 (10th Cir. 1999) (applying Utah conflicts of laws analysis to a choice of law provision in a covenant not to compete between the sellers and the buyer of a corporation); Am. Express Fin. Advisors, Inc. v. Topel, 38 F. Supp. 2d 1233, 1238 (D. Colo. 1999) ("Generally, Colorado enforces contractual choice of law provisions, and follows the Restatement (Second) of Conflict of Laws for Contracts, § 187, in determining the enforceability of these provisions.").

63. *Bajorek*, 191 F.3d at 1038. New York had a substantial relationship to the parties and the transaction because IBM's headquarters are in New York. *Id.* There was a reasonable basis to choose New York law because IBM stock is traded on the New York Stock Exchange, and because a New York corporation has an interest in having all of its options agreements construed under one state's law instead of the laws of the various states in which its employees reside. *Id.*

Under the second prong of section 187, to apply California law, Bajorek needed to show: (1) The application of New York law violates a policy of California, (2) the policy being asserted is fundamental, and (3) California has a materially greater interest than New York in the determination of the issue.[64] Unlike the *Application Group* test, the section 187 test does not include a comparative impairment analysis, under which the court would consider which state would be more impaired by application of the other state's law.

Ultimately, the court found that application of New York law would not violate a fundamental policy of California.[65] Section 16600 makes illegal only those restraints that prohibit an individual from working in a lawful trade or business.[66] If a noncompete agreement prevents an individual from working in a limited part of the business or profession, it is acceptable.[67] Bajorek's noncompete agreement prevented him from working for competitors for six months, and IBM sought to prevent him from working for only one particular competitor, Komag.[68] This would exclude him from a small part of the market, but would not prevent him from working in his profession. Therefore, there was no violation of section 16600.[69]

The court also found that Bajorek's position was extremely different from the situation in *Muggill*.[70] In *Muggill*, the California Supreme Court held invalid a noncompete agreement that made an employee pension plan forfeitable if the employee "at any time enters any occupation or does any act" that would compete with the employer.[71] The loss of pension funds would have been absolute in *Muggill*.[72] In *Bajorek*, the court emphasized, the restriction on Bajorek was much more limited. Bajorek could have exercised his options six months before leaving IBM, and then gone to work immediately for a competitor. He also could have worked in the same profession and same industry for a company that was not a competitor.[73] As the court explained:

> It is one thing to tell a man that if he wants his pension, he cannot ever work in his trade again, as in *Muggill*, and quite another to tell

64. *Id.*
65. *See id.* at 1042.
66. *Id.* at 1040.
67. *Id.* The court noted that this analysis is in accord with an old California Court of Appeals case. *Bajorek*, 191 F.3d at 1040 n.26 (citing Boughton v. Socony Mobil Oil Co., 41 Cal. Rptr. 714 (Ct. App. 1964)).
68. *Id.* at 1041.
69. *Id.*
70. *See id.*
71. *Id.* (quoting Muggill v. Reuben H. Donnelley Corp., 398 P.2d 147, 148 n.1 (Cal. 1965)).
72. *See id.*
73. *Id.*

> him that if he wants a million dollars from his stock options, he has to refrain from going to work for a competitor for six months.[74]

Thus, because the restriction in *Bajorek* was limited in nature, it did not violate section 16600.[75]

C. State and Federal Court Decisions Compared

On the surface, there is certainly an argument that *Bajorek* and *Application Group* were decided correctly, and that the case-by-case analysis provided by the conflicts of laws test was sensitive to the factual distinctions between them. However, a closer look at the facts of the cases shows that the situation is not so clear. While an executive earning a large amount of money in stock options is not a sympathetic individual, Bajorek worked in California for IBM for several years. Stock option agreements can account for significant portions of an executive's pay, and, in *Bajorek*, the options had accumulated over at least the previous few years.[76] The court presumed that the stock options were given merely as an inducement to stay at IBM.[77] This assumption, however, is difficult to believe.[78] Stock options provide other incentives.[79] For example, since stock options are valuable only if the stock value rises, and the stock value usually rises if the company performs well, companies will often pay their executives in stock options to encourage them to improve company performance. Bajorek's stock options were not simply payment for refraining from working for a competitor, they were also payment for his hard work in improving company performance.[80] When the court upheld the choice of law provision in his options agreement, the court

74. *Id.*

75. *Id.*

76. *See id.* at 1039 n.19 (detailing the years in which some of the stock options at issue were granted).

77. *Id.* at 1036.

78. The options stated that Bajorek could not work for a competitor for six months after cashing out the options. *Id.* As the court noted, if Bajorek had paid more attention to this clause, he could have simply cashed out six months before leaving IBM, and he would have kept the money. *Id.* at 1047. If IBM really wanted to prevent employees from working for competitors, IBM could have included a more effective clause. For example, IBM could have included a forfeiture provision in the event that Bajorek worked for a competitor during the six month period after leaving, as opposed to after cashing out the options.

79. *See, e.g.*, Arthur H. Dean, *Employee Stock Options*, 66 HARV. L. REV. 1403, 1404 (1953) (noting that stock options may align the incentives of management with those of shareholders); Randall S. Thomas, *Should Directors Reduce Executive Pay?*, 54 HASTINGS L.J. 437, 448–49 (2003) (noting the increasing role of stock options in executive compensation).

80. The court probably would not agree that companies give their executives stock options to encourage them to improve company profitability. In a separate argument concerning section 200 of the California Labor Code, the Ninth Circuit declared that stock options are not wages, and that stock value is affected as much by market behavior as by company performance. *Id.* at 1039.

essentially allowed IBM to take back a few years' worth of compensation, which Bajorek earned for working toward the improvement of company performance.

On the other hand, perhaps *Application Group* was decided incorrectly. Employee Pike had never set foot in California before accepting employment with AGI. Is it proper to allow individuals to escape their noncompete agreements simply by accepting employment with a California company? As a computer consultant, she could have easily found a job with a company who was not a competitor.[81] If she had gone to a competitor located in Maryland or another state that enforced reasonable noncompete agreements, the choice of law provision would have been enforced. This decision not only allows Pike to break her contract without penalty, it also rewards California companies for raiding out-of-state competitors and puts non-Californian competitors, who are required to honor the noncompete agreements, at a disadvantage.[82] Once it becomes known that California does not enforce out-of-state noncompete agreements, raiding of out-of-state competitors may increase, and non-Californian tech employees may flock to California to avoid their noncompete agreements.

There is also a discrepancy between the reasoning of the *Bajorek* and *Application Group* decisions. Both cases required the courts to determine whether application of the chosen state's law would violate fundamental public policy. *Bajorek* held that it would not, while *Application Group* held that it would. Perhaps the holdings should have been the same. Just as IBM in *Bajorek* sought to exclude Bajorek from working for only one particular competitor, Hunter in *Application Group* sought to exclude Pike from working for one particular competitor, AGI. Just as the Ninth Circuit found that Bajorek would have been excluded from only a small part of the market, Pike likewise would have been excluded from only a small part of the market, not from her entire profession. Applying the Ninth Circuit's reasoning to *Application Group*, Pike's noncompete agreement would not have violated fundamental California public policy, and consequently California law would not have applied. Granted, an argument can be made that *Bajorek* and *Application Group* are different because Pike would have possibly been subject to an injunction not to work for AGI, whereas Bajorek was not subject to such an injunction. However, a court could have simply imposed damages on Pike instead of an injunction and allowed her to work for AGI. Furthermore, *Bajorek* is distinguishable from *Muggill* in that *Muggill* involved

81. For example, she probably could have found a job in a computer consulting firm that serviced a different type of client, and therefore was not a competitor.

82. This will be discussed more *infra* Part II.

a restriction in which the employee was not allowed to ever work in his entire trade, whereas *Bajorek* restricted an employee from working for a competitor for only six months. A similar distinction could be made between *Muggill* and *Application Group*: Pike's restriction was for a year, not forever, and it was only against working for competitors. The restriction on Pike is much closer in nature to the limited, narrow restriction in *Bajorek* than to the extensive, far reaching restriction in *Muggill*. Therefore, the reasoning behind the *Bajorek* and *Application Group* decisions is not entirely in accord.

II. THE IMPLICATIONS OF UPHOLDING CHOICE OF LAW PROVISIONS IN OUT-OF-STATE NONCOMPETE AGREEMENTS

The disparity between the state and federal court decisions indicates a need for a bright line rule defining whether to invalidate an out-of-state noncompete agreement's choice of law provision. As discussed earlier, there are differing, but related tests for determining whether to uphold a choice of law clause in a noncompete agreement. The federal court in *Bajorek* used the test from section 187 of the Second Restatement of Conflicts of Law: (1) Does the chosen state have a substantial relationship to the parties or the transaction, or is there another reasonable basis for the parties' choice? If yes, then: (2) Will application of the chosen state's law be contrary to a fundamental policy of California? Does California have a materially greater interest than the chosen state in the determination of the issue?

The state court in *Application Group* used a similar test, but also included a comparative impairment prong: (1) Is there a substantial relationship between the state specified in the choice of law provision and the issue? (2) Would application of the other state's law violate a fundamental policy of California? (3) Which state has a materially greater interest in having its law applied? (4) Which state would be more impaired by application of the other state's law? For the purposes of this part, this Comment relies on the *Application Group* test. The materially greater interest analysis, however, would nevertheless be relevant to the section 187 test.

The disparity between *Bajorek* and *Application Group* arose in the question of whether fundamental California public policy was violated, as discussed earlier. Part II assumes that application of the chosen state's law would violate fundamental California public policy, and focuses on the materially greater interest prong and comparative impairment prong. A bright line rule to always uphold the choice of law provisions of out-of-state noncompete agreements assumes that California public policy can never be deemed stronger than the other state's public policy, or that California cannot be deemed more seriously impaired by application of the other state's

law.[83] As this part shows, courts cannot truly determine whether one state's public policy is stronger than that of another, or whether one state would be more impaired by nonapplication of its law.

A. The Materially Greater Interest Analysis

As the Ninth Circuit noted in *Bajorek*,

> The multi-factor test [in Restatement section 187] is highly indeterminate in application, both because of the number of factors to be considered, and because of the indeterminacy of each of them. For example, in this case, California has a considerable interest in protecting its citizens from oppressive contracts imposed by employers. New York has a considerable interest in providing coherent, predictable uniform law governing exchange of stock by corporations headquartered there and trading stock on its great exchange. Which interest is "materially greater?"[84]

It is extremely difficult to determine which state's interest is stronger. As discussed earlier, the *Application Group* court found that California had a materially greater interest than Maryland in having its law applied. The *Application Group* public policy comparison was somewhat troubling because the court only summarily discussed Maryland's interests.[85] As this part shows, when California public policy interests against noncompete agreements are compared to other states' public policy interests in enforcing noncompete agreements, it is not clear whose interests are genuinely stronger.

1. California Public Policy Interests Against Noncompete Agreements

The strongest public policy interest against noncompete agreements involves the mobility of employees. Section 16600 of the California Business and Professions Code protects an employee's right to pursue any trade or

---

83. This does not imply that the other state's public policy is necessarily stronger. The public policies of California and the other state could be equally important, or the relative importance could be indeterminate. Likewise, the comparative impairment of California and the other state could be equally serious, or the relative seriousness could be indeterminate.

84. IBM Corp. v. Bajorek, 191 F.3d 1033, 1041–42 (9th Cir. 1999).

85. The court noted that Maryland's interests include preventing trade secret misuse and the recruitment of employees providing unique services, and preventing solicitation of a former employer's customers for a new employer. Application Group, Inc. v. Hunter Group, Inc. 72 Cal. Rptr. 2d 73, 85 (Ct. App. 1998). The court, however, dismissed these interests, stating that "there is nothing in the record of this case to support a finding that failure to enforce Hunter's noncompetition covenant would significantly impair either of the asserted interests." *Id.* at 86; *see* Mark A. Kahn, Note, Application Group, Inc. v. Hunter Group, Inc., 14 BERKELEY TECH. L.J. 283, 283 (1999) (arguing that the *Application Group* court erred in not applying Maryland choice of law and that it failed to properly weigh Maryland's interests in having its law applied).

profession that the employee desires.[86] An employee should be able to change employers whenever he or she wishes. That right is stronger than an employer's competitive business interests.[87] The employee's mobility is hindered only when necessary to protect trade secrets.[88] Protecting the employee's mobility becomes particularly important when an employee has little bargaining power and is forced to accept a noncompete agreement in order to gain employment.[89]

The mobility of employees has been an asset to California, in part because it contributed to the rise of Silicon Valley. Silicon Valley grew quickly in the early 1990s, partly because of the rapid dissemination of information. Because of the restraints on noncompete agreements, employees were able to move quickly and freely from employer to employer, and were also able to start up their own companies. Information migrated with the employees, who passed on their knowledge to coworkers. Senior employees learned from younger employees and became more productive. The rapid spread of information thus led to rapid development.[90] California's strong public policy toward employee mobility therefore contributed to swift economic and technological development in the state.

California public policy interests also include the notion that noncompete agreements prevent employers from hiring the best employees available. The ability to hire the best employees promotes learning and growth. Similarly, restrictions on hiring the best employees available would slow

86. *See* Metro Traffic Control, Inc. v. Shadow Traffic Network, 27 Cal. Rptr. 2d 573, 577 (Ct. App. 1994) ("California courts have consistently declared this provision [section 16600] an expression of public policy to ensure that every citizen shall retain the right to pursue any lawful employment and enterprise of their choice."); Kahn, *supra* note 85, at 290.

87. *See* Kahn, *supra* note 85, at 290.

88. Muggill v. Reuben H. Donnelley Corp., 398 P.2d 147, 149 (Cal. 1965). Even this exception is limited. An employer cannot rely on the doctrine of inevitable disclosure, which would allow for an argument that an employee, in the course of his duties under his new employer, is bound to rely on his former employer's trade secrets. Whyte v. Schlage Lock Co., 125 Cal. Rptr. 2d 277, 291 (Ct. App. 2002). The fact that employers cannot rely on the doctrine of inevitable disclosure demonstrates how important the policy of employee mobility is to the State of California.

89. Harlan Blake argues:

> Every postemployment restraint, for whatever reason imposed, has inevitable effects which in some degree oppose commonly shared community values. In view of our feeling that a man should not be able to barter away his personal freedom, even this small degree of servitude is distasteful. It is particularly distasteful if there is no effective bargaining between the parties—as in the situation in which the employer knows that everyone else in the industry insists on the covenant too, or when the employment officers have no authority to change the provisions of the employment contract form.

Harlan M. Blake, *Employee Agreements Not to Compete*, 73 HARV. L. REV. 625, 650 (1960).

90. *See* Kahn, *supra* note 85, at 290–91; Kristina L. Carey, Comment, *Beyond the Route 128 Paradigm: Emerging Legal Alternatives to the Non-Compete Agreement and Their Potential Effect on Developing High-Technology Markets*, 5 J. SMALL & EMERGING BUS. L. 135, 137–38 (2001).

growth because employers would not have access to some of the more knowledgeable employees. Furthermore, employees would not have as much opportunity to learn from other employees.

Additionally, noncompete agreements promote anticompetitive behavior. Competition among employers for employees leads to better wages and working conditions for employees, because employers feel obliged to give their employees good working environments and salaries to induce them to stay. Competition can also lead to better work product. Freedom from noncompete agreements allows companies to hire employees from competitors who produce superior products. Those employees may then apply their knowledge to the company's product in order to improve it.

2. Possible Interests of Other States in Favor of Noncompete Agreements

As discussed in Part II.A.1, California public policy interests against noncompete agreements include protecting employee mobility, allowing employers to hire the best employees available, preventing anticompetitive behavior, enabling senior employees to learn from new employees, and protecting employees who have little bargaining power. While these interests are strong, other states also have strong, countervailing interests in upholding noncompete agreements.

One of the most common state interests in protecting noncompete agreements is to prevent trade secret misuse.[91] Because noncompete agreements create greater certainty that trade secrets will not be misappropriated, there is more of an incentive for businesses to create.[92] Noncompete agreements may also give employers the security of not having to hide as much confidential information from employees. This reduces the costs of hiding information from employees and may also lead to greater operating efficiency because the employee is given more information helpful for productivity.[93]

---

91. For example, in *Application Group*, the court recognized that Maryland may have an interest in preventing the "misuse of trade secrets, routes, or lists of clients." *Application Group*, 72 Cal. Rptr. 2d at 85; *see* Kahn, *supra* note 85, at 287–88. For a discussion of the use of noncompete agreements to protect confidential information, see generally Blake, *supra* note 89, at 667–74. Again, it should be noted that California public policy itself favors protection of trade secrets. As stated in *Muggill*, the section 16600 prohibition on noncompete agreements does not extend to instances involving trade secret misappropriation. *Muggill*, 398 P.2d at 149.

92. Kahn, *supra* note 85, at 293.

93. *Id.*; Blake, *supra* note 89, at 650–51. As Blake explains:

> When a business grows past the one-man size, important business information must be entrusted to an employee; as the business grows still larger such information must be entrusted to many more. Optimum division of labor and specialization cannot take place unless confidential business information relating to technology, processes, plans, development

Furthermore, because of the greater trust and responsibility bestowed on the employees, employee morale increases, which in turn benefits the employer.

Another strong public policy interest favors freedom to contract. Underlying this interest is the notion that parties' expectations should be met.[94] An employer and employee who agree to a covenant not to compete have the expectation, at the time of contracting, that the covenant will be enforced. If covenants were routinely not enforced, individuals would stop making covenants. It is better for society that individuals intend to keep their promises, because other individuals would then feel that they could rely on them. If an employer did not feel that it could rely on an employee's promise not to compete, the benefits of such covenants would be lost. Employers would hide confidential information from employees despite the existence of noncompete agreements, and employees may not receive all the information they need for optimal performance. The benefits of increased efficiency and reduced costs would no longer exist. Furthermore, an employee's wage reflects the price of the negotiated noncompete agreement. Because an employee receives a wage that compensates him for the noncompete agreement, the contract should be enforced as quid pro quo.

Noncompete agreements can also reduce the cost of trade secret litigation. To prove misappropriation, an employer must show that it owned the trade secret. It must also demonstrate that the information at issue fulfilled the elements of a trade secret: it must "(1) derive[ ] independent economic value, actual or potential, from not being generally known to the public or to other persons who can obtain economic value from its disclosure or use, and (2) [be] the subject of efforts that are reasonable under the circumstances to maintain its secrecy."[95] Instead of claiming misappropriation of trade secrets, an employer can simply bring a contract action for breach of the covenant not to compete, which would be less costly and easier to prove. Trade secret misappropriation cases can involve extensive discovery. They also consume the time of other employees, who would otherwise be performing more productive tasks. In contrast, proving a violation of a noncompete agreement would not involve extensive discovery or exhaust other employees' time.[96]

---

activity, customers, and the like, is entrusted to appropriate employees. The optimum amount of "entrusting" probably will not occur unless the risk of loss to the employer through breach of the trust can be held to a minimum.

Id. On the other hand, since Silicon Valley has been very creative without the enforcement of noncompete agreements, and since Silicon Valley developed quickly despite a lack of noncompete agreements, perhaps noncompete agreements are not necessary to encourage creativity or to increase operating efficiency.

94. *See* Roesgen v. Am. Home Prods. Corp., 719 F.2d 319, 321 (9th Cir. 1983).

95. CAL. CIV. CODE § 3426.1(d) (West 1997); *see* JAMES POOLEY, TRADE SECRETS 4-3 (2001).

96. Kahn, *supra* note 85, at 294.

A case that focuses only on a violation of a noncompete agreement would also probably require fewer judicial resources than would be required by a trade secret misappropriations case. Therefore, both the justice system and the employer would benefit.

Noncompete agreements also protect employer investment in employees. Employers put significant resources into employee training, and they do not want to spend time and money on training only to quickly lose their employees to a competitor.[97] It is important to note that courts do not necessarily perceive this as a valid reason for enforcing a noncompete agreement. To legitimize a noncompete agreement, it is not sufficient that an employer has given an employee general training. An employer must show that an employee was exposed to trade secrets or business confidences.[98] Nevertheless, an employer may sometimes have given an employee specialized training that involves the company's confidential information, and a state may have a valid interest in protecting such an employer.

Furthermore, while non-enforcement of covenants not to compete may encourage employees to start their own companies, enforcement of noncompete agreements may be beneficial to young companies. Since young companies sometimes do not have the resources to pay their employees what the large, dominant employers pay, a dominant competitor could lure away a young company's best employees with promises of higher wages. Noncompete agreements protect young companies against this threat. Moreover, in this capacity, noncompete agreements actually encourage, rather than hinder, competition by allowing start-up companies to compete against dominant competitors.[99]

---

97. *See* Christine M. O'Malley, Note, *Covenants Not to Compete in the Massachusetts Hi-Tech Industry: Assessing the Need for a Legislative Solution*, 79 B.U. L. REV. 1215, 1217 (1999) (explaining that hi-tech companies have increasingly relied on noncompete clauses to protect their investment in employees). *Compare* Chiara F. Orsini, Comment, *Protecting an Employer's Human Capital: Covenants Not to Compete and the Changing Business Environment*, 62 U. PITT. L. REV. 175, 175 (2000) ("These covenants can aid an employer in protecting a variety of interests including their investment in human capital. Companies spend a considerable amount of money recruiting qualified employees, training them, and retaining them.") *with* Blake, *supra* note 89, at 651–52 (finding unpersuasive the claim that employers should be able to protect their investment in employee training through postemployment restraints).

98. Rachel S. Arnow-Richman, *Bargaining for Loyalty in the Information Age: A Reconsideration of the Role of Substantive Fairness in Enforcing Employee Noncompetes*, 80 OR. L. REV. 1163, 1177 (2001).

99. *See* Carey, *supra* note 90, at 145.

3. Would California Public Policy Interests Actually Outweigh Other States' Interests?

Given other states' interests in protecting trade secrets, preventing raiding, protecting the freedom to contract, avoiding the costs of trade secret litigation, and protecting young businesses, it is not clear that California public policy interests against noncompete agreements outweigh other states' interests.

It is important to note that states outside of California do not simply enforce noncompete agreements irrespective of the scope or the duration of the agreements. Most states impose a reasonableness test requiring that covenants not to compete must reasonably protect one's business.[100] Reasonableness includes reasonable temporal duration, reasonable geographic boundaries, and reasonable scope.[101] In general, the stricter the covenant, the shorter the duration that the covenant should be enforced.[102] The geographical boundaries of the noncompete agreement must be reasonably related to the protected interest.[103] Because of these limitations on noncompete agreements, employees still enjoy a significant amount of mobility.[104]

Therefore, other states do not necessarily enforce noncompete agreements in an unfair manner. The limitations placed on covenants not to compete are created because of concerns for an employee's freedom to pursue a chosen trade or profession, and because of concerns about how noncompete agreements restrict the presumption of employment at will.[105] Other states thus share the same concerns as California, but choose to give less weight to them.

---

100. *See, e.g.*, Bradford v. N.Y. Times Co., 501 F.2d 51, 55 (2nd Cir. 1974) (emphasizing that covenants not to compete with a former employer are subject to a reasonableness limitation); Diakoff v. Am. Reins. Co., 492 F. Supp. 1115, 1121–22 (S.D.N.Y. 1980) (explaining that, because of public policy concerns over causing individuals to lose their ability to pursue their professions, covenants not to compete with former employers are subject to an "overriding limitation of 'reasonableness'"). *See also* Jordan Leibman & Richard Nathan, *The Enforceability of Post-Employment Noncompetition Agreements Formed After At-Will Employment Has Commenced: The 'Afterthought' Agreement*, 60 S. CAL. L. REV. 1465, 1482 (1987) ("[M]ost jurisdictions will enforce post-employment restraints if the restraints are established to protect a recognized employer interest."); Orsini, *supra* note 97, at 176 (stating that a restrictive covenant must "protect a legitimate employer interest" to be valid).

101. Arnow-Richman, *supra* note 98, at 1178. *See* Orsini, *supra* note 97, at 176 ("To be valid, a restrictive covenant must be reasonably limited in time and place, be accompanied by consideration, protect a legitimate employer interest, and not be unreasonably harmful to the employee or to the public.").

102. Orsini, *supra* note 97, at 177.

103. *Id.*

104. *See* Kahn, *supra* note 85, at 292.

105. Carey, *supra* note 90, at 142; Orsini, *supra* note 97, at 176 (noting the court's concern that noncompete agreements "limit an employee's freedom to change jobs").

Given the reasonableness requirements that most states place on noncompete agreements, it becomes even more difficult to make the categorical claim that California public policy should outweigh another state's public policy. As California Supreme Court Justice Joyce Kennard has stated regarding the prospect of applying California law over another state's law in *Advanced Bionics*, "In my view, this would do serious damage to the relationships between states. This would be the height of judicial arrogance."[106] How can a California court claim that California's interest in protecting employee mobility outweighs another state's interest in preventing raiding? For that matter, how could a court definitively claim that another state's interest outweighs California's interest? Any decision, either way, would manifest the problem of arbitrariness.

Problems of arbitrariness are compounded by the uncertainty resulting from the fact that this analysis is done on a case-by-case basis. For example, one court could decide that California law outweighs Maryland law for a specific type of noncompete agreement, but that it does not outweigh Maryland law for a slightly different type of noncompete agreement. While the outcome may be "correct," employees would not know what to expect, which may deter them from taking a job with a California competitor that they would have otherwise taken absent the unpredictability of California court decisions.

Additionally, there is also a risk that California courts may not give enough weight to some of the public policy concerns of the other state. *Application Group* provides a good example. The *Application Group* court ignored Maryland's interests in meeting the expectations of the parties to the contract. When Hunter made its employment contract with Pike, it presumably included the value of the negotiated covenant not to compete in Pike's wages. Under the assumption that the noncompete agreement would be enforced, Hunter also might not have hidden some trade secrets from Pike that it otherwise would have concealed. Hunter relied on their contract to make business decisions, and had a right to expect that the noncompete agreement with Pike would be upheld.[107]

A blanket decision upholding choice of law provisions in out-of-state noncompete agreements would create certainty and consistency regarding when a noncompete agreement would be enforced. The courts would not have to spend as much time on noncompete agreement litigation because

106. Jeff Chorney, *Justices Try to Untie Noncompete Clause Knot*, RECORDER (San Francisco), Oct. 10, 2002.

107. *See* Kahn, *supra* note 85, at 296 (arguing that Maryland was more greatly impaired by application of California law because it decreased the certainty that the expectations of the parties to a noncompete agreement would be met).

they would not have to weigh public policy. Indeed, they may see fewer cases concerning noncompete agreements, since former employees probably would not bother to bring suit for declaratory judgments.

B. The Comparative Impairment Analysis

A decision to make a bright line rule upholding choice of law provisions in out-of-state noncompete agreements is further bolstered through consideration of the comparative impairment test, which asks the question of which state would be more greatly impaired by imposition of the other's law. On the one hand, companies in other states are always free to hire employees from California, since California employers are not allowed to use noncompete agreements. If out-of-state covenants not to compete were enforced in California, then California companies would be at a disadvantage because they would not be able to hire non-California employees, while their employees could be freely recruited by non-California employers. On the other hand, if California law is imposed, and a noncompete agreement is not enforced, California companies would have a competitive advantage over companies in other states because California companies would be able to hire out-of-state competitors' employees while other non-California companies would not possess the same ability.

Suppose TechnoCal is located in California, and Marytech is located in a state that enforces reasonable noncompete agreements. Marytech's employees sign covenants not to compete, with a choice of law of Marytech's state. The noncompete agreement prohibits employment with any competitor, including TechnoCal, for one year after discharge. If noncompete agreements from other states were enforced in California, TechnoCal would not be able to hire Marytech employees for one year after their discharge. However, Marytech would be able to hire TechnoCal employees, who have not signed a noncompete agreement.[108] As a result, TechnoCal would be at a competitive disadvantage compared to Marytech. On the other hand, TechnoCal would not be at a disadvantage compared to third party non-California competitors. Suppose BaltiLogic is located in the same state as Marytech. BaltiLogic, like TechnoCal, cannot hire Marytech's employees for one year after their discharge.

Now suppose that Marytech's noncompete agreements were not enforced in California. TechnoCal would then be able to hire Marytech's employees directly, without waiting one year. Marytech would also be able to hire

108. *See* Application Group, Inc. v. Hunter Group, Inc., 72 Cal. Rptr. 2d 73, 88 (Ct. App. 1998) (noting that Hunter had actively recruited Application Group's employees, who were not subject to a noncompete agreement).

TechnoCal's employees directly, because TechnoCal's employees have not signed any noncompete agreement. However, unlike TechnoCal, which could directly hire Marytech's employees, BaltiLogic would not be able to hire Marytech's employees for one year after discharge. Therefore, BaltiLogic would be at a competitive disadvantage.[109]

Given this set of advantages and disadvantages, it is unclear which state is more greatly impaired by nonapplication of its law. If the out-of-state covenant not to compete is enforced, California companies will be at a competitive disadvantage. If the out-of-state noncompete agreement is not enforced, companies in the other state will be at a competitive disadvantage.

The comparative impairment analysis is plagued by the same problems of arbitrariness and uncertainty that surround the materially greater interest analysis. For example, in *Application Group*, the court arguably did not adequately consider how Maryland would be adversely affected by application of California law.[110] Maryland companies will be impaired by the uncertainty of whether their noncompete agreements will be enforced.[111] As a result, they will feel compelled to hide their trade secrets from their employees, which is costly and can lower productivity. Uncertainty over whether noncompete agreements will be enforced also lowers the value of these agreements. Since wages reflect the value of covenants not to compete, wages could fall in response to the increased uncertainty.

Therefore, because it is unclear whether California's material interests are greater than those of another state and whether California is more seriously impaired by application of another state's law, the current conflict of laws analysis is inadequate. California courts should instead apply a bright line rule upholding choice of law provisions in out-of-state noncompete agreements.

---

109. To show how employers in another state are at a competitive disadvantage under *Application Group*, Kahn offers the following example:

> [S]uppose that Employee J works for Company X in Baltimore. The employment contract between Employee J and Company X includes a reasonable non-compete clause . . . . In Company X's industry, there are two other companies that Employee J wants to work for: Company Y, another Maryland company and Company Z, a California company that will permit Employee J to telecommute from his home in Baltimore. Because of the non-compete clause, Employee J is prohibited from seeking immediate employment in a similar position with Company Y. However, according to the court in Application Group v. Hunter Group, Employee J would be free to work for Company Z. Thus, under this decision, Maryland can either force its companies to operate at a competitive disadvantage or change its laws to conform to California's laws.

Kahn, *supra* note 85, at 296–97.

110. *See id.* at 295–97 (arguing that the *Application Group* court made a fatal flaw in concluding that California would be more greatly impaired by application of Maryland law).

111. *Id.* at 296.

C. Application of a Bright Line Rule

This part presents and addresses possible scenarios to determine the strength of a bright line rule upholding choice of law provisions in out-of-state noncompete agreements. These scenarios will also better define the scope of the proposition. Whose rights are more important—the employer's rights or the employee's rights? In what areas should a bright line rule not be applied? This part suggests that application of a bright line rule should be limited to situations in which the employee has been working primarily outside of California, and that a case-by-case analysis should exist only for situations in which the employee has worked inside California.

1. A California Employer Hiring an Out-of-State Employee

Suppose TechnoCal, an employer in California, hires Dave from Marytech, which is located in a state that enforces reasonable covenants not to compete. Dave has signed a noncompete agreement with Marytech, stating that Dave would not work for a competitor within one year after discharge. The noncompete agreement specifies choice of law of the state in which Marytech is located. Immediately after resigning from Marytech, Dave moves to California to work for TechnoCal, which is a stiff competitor of Marytech. Dave brings suit in California, requesting a declaratory judgment that the noncompete agreement with Marytech is unenforceable.

Under the proposed rule, a California court would uphold the choice of law provision. The result would be the same as if the litigation had taken place in the courts of the state of Marytech. This outcome would uphold the employer's interests over the employee's interests. While this is contrary to California public policy, this outcome would meet the original expectations of Marytech and Dave, from when they signed the noncompete agreement. In the event that a California court is faced with an unfair noncompete agreement governing former employment in another state, the court would uphold the choice of law provision, and then subject the noncompete agreement to the reasonableness standards of that state's law. The law of the other state will act as a barrier to unfair covenants not to compete.[112]

112. *See supra* note 100.

2. An Employee Working in California Under an Out-of-State Noncompete Agreement

Suppose Dave signs a noncompete agreement with Marytech, specifying the law of the state within which Marytech is located. Marytech then transfers him to California to serve their California clients. Dave works for Marytech in California for several years, and then accepts a position at TechnoCal, one of Marytech's direct competitors. Dave brings suit in California for a declaratory judgment of unenforceability.

Because Dave has been working for several years in California, the bright line rule of upholding choice of law provisions would not apply. The bright line rule should apply only to situations in which the employee has been working under the noncompete agreement within the state where the noncompete agreement was signed. Otherwise, California-based companies could avoid invalidation under section 16600 by entering into covenants not to compete with employees in other states, specifying another state's choice of law, and then bringing them to work in California.

Furthermore, because the employee has been working partly in California and partly in another state, California public policy interests become much stronger. The public policy behind section 16600 is intended to protect the mobility of employees working in California. Even if an employee has been working only partly in California, the state has a much stronger interest in protecting that employee's mobility by virtue of his working in California. Moreover, the goals of section 16600 are best achieved when all companies working in the state are subject to the same laws regarding noncompete agreements. When all employers within California cannot impose noncompete agreements on their employees, then all employers within California may freely hire each other's employees. However, when some companies with employees within California are allowed to use noncompete agreements, they gain a competitive advantage over California-based employers. Under these circumstances, the sensitivity provided by a case-by-case analysis is more valuable. The facts of each situation are crucial to determining a fair outcome. In some instances, a court may decide that an employee who has been working in California for the past few months should be subject to a covenant not to compete, and in other instances, a court may decide that an employee who has been working in California substantially over the past few years should not be subject to a noncompete agreement. A bright line rule cannot fairly decide such situations. Despite the arbitrariness and uncertainty, a case-by-case analysis is a better option than a bright line rule.

3. Telecommuting Across State Lines

Suppose Dave lives in California and telecommutes to Marytech, located outside of California. He has a noncompete agreement with Marytech not to work for a competitor for one year after discharge. The choice of law provision specifies the state in which Marytech is located. Dave then accepts a position at TechnoCal, located in California.

Whether the bright line rule is applied depends on the definition of "working in California." If Dave works in California, then the bright line rule does not apply. However, because he is telecommuting to a company outside of California, a court may decide he is not working in California and the bright line rule upholding the choice of law clause would apply. In this instance, the bright line rule would be somewhat dissatisfactory, because even though Dave is living in California, he does not receive the benefit of California public policy interests in favor of employee mobility. Nevertheless, when they signed the noncompete agreement, both Dave and Marytech had the expectation that it would be upheld. The state in which Marytech is located has a strong interest in making certain that those expectations are upheld.

This raises the question of whether a bright line rule should be based on whether an employee lives in California while working under the noncompete agreement, rather than whether he works in California. Many courts could easily find that the public policy interests behind section 16600 extend to all California residents regardless of where they work. This Comment takes a less aggressive stand. The state has an interest in how employers located in California contract with their employees. As discussed in Part II.C.2, California also has an interest in the mobility of employees working within the state. This interest in employee mobility is more strongly linked to the fact that they work within the state, rather than their residence within the state.

This becomes clearer when considering a scenario in which an employee telecommutes to California. Suppose Dave lives outside of California and telecommutes to SanFranTech, located in California. He signs an agreement with SanFranTech not to work for competitors within one year after his discharge. The choice of law provision specifies the state in which Dave lives. After leaving SanFranTech, he immediately accepts a position with its competitor TechnoCal, also located in California.

Because Dave is telecommuting to California, he is arguably a member of the California workforce, and the state has an interest in his mobility. The state also has an interest in the actions of employers located in California. If California employers were allowed to enter noncompete

agreements with its telecommuting nonresident employees, they would be able to restrict their employees from working for competitors while other California employers would not be able to place such restrictions on their resident employees. Employers with telecommuting employees would therefore have a competitive advantage. As discussed in Part II.C.2, the goals of section 16600 are best achieved when all California employers are subject to the same restrictions on noncompete agreements. Courts may therefore refrain from upholding a noncompete agreement when an employee has been telecommuting to California.

4. Limits on the Application of a Bright Line Rule

As shown by these scenarios, application of a bright line rule would be somewhat limited. It would apply only to those instances in which the employee has been working under a noncompete agreement outside of California. For those who believe that *Bajorek* was decided incorrectly, this bright line rule is only a partial remedy, because the current conflict of laws analysis would still apply to those instances in which the employee has been working in California for a substantial amount of time. By limiting the bright line rule to situations involving former employment outside of California, the rule will produce fair and consistent outcomes.

CONCLUSION

In *Advanced Bionics*, the California Supreme Court allowed litigation to go forward in both California and Minnesota.[113] Its decision did not reach the question of whether a California court should uphold the Minnesota choice of law provision. However, as Justice Brown discussed in his concurring opinion, "California had absolutely no interest in this matter until Stultz relocated to California, terminated his employment with Medtronic, and began employment with Advanced Bionics."[114] Under the current test, Justice Brown argues, California interests are not materially greater than Minnesota interests, and the choice of law provision should therefore be upheld.[115] The rule articulated by this Comment would reach the same outcome as would Justice Brown. Because employee Stultz did not work in California while he was employed with Medtronic, the Minnesota choice of law provision should be upheld, and California courts should analyze his noncompete agreement according to Minnesota law. Upholding the choice

113. 59 P.3d 231, 238 (Cal. 2002).
114. *Id.* (Brown, J., concurring).
115. *Id.*

of law provision would ensure that the parties' original expectations at the time of contracting are met. Additionally, if the choice of law clause is upheld, Medtronic and other Minnesota employers would benefit from greater certainty that their noncompete agreements would be upheld; they would be able to entrust their employees with their confidential information and enjoy the resulting benefits of greater operating efficiency. Medtronic and other Minnesota employers would also enjoy the benefit of avoiding expensive trade secret litigation, by instead pursuing contract actions for breach of the covenant not to compete. Yet, given the background of *Application Group*, it is not clear what the outcome will be. Just as the employee in *Application Group* was able to invalidate her noncompete agreement by simply moving to California, it may be that the employee in *Advanced Bionics* will be able to do the same.