

NonCompete Help

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Arbitration of California Noncompete Disputes

As a general rule noncompete terms are illegal and unenforceable in California. (Business and Professions Code Section 16600.) Dozens of cases have held noncompete restrictions of any type are void. (*Edwards v. Arthur Andersen LLP* (2008) 44 Cal.3d 937.)

If a trial court makes a mistake the ruling can be appealed. Arbitration is different. It is designed to be an expedited, cost saving process for which no appeals are allowed when mistakes are made.

What happens if an arbitrator is ruling on a noncompete provision and makes a mistake?

This was the issue in *Jones v. Humanscale* (2005) 130 Cal.App.4th 401.

In *Jones* a sales manager, Kevin Jones, was working for Humanscale Corporation, which is incorporated in New York and based in New Jersey. It is unknown how a California connection occurred and the court's opinion is silent on the issue. From reading the case it appears as if Mr. Jones was working in New Jersey. But perhaps he was working in California. Or maybe Humanscale has a location in California.

As part of his employment Jones signed an agreement containing a 2-year noncompete restriction against selling competitive products to customers. The agreement said New Jersey law applied and contained an arbitration provision requiring the dispute to be arbitrated in New Jersey.

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Humanscale filed an arbitration claim in New Jersey, after which Jones filed a lawsuit in California to have the noncompete declared invalid, plus various wage claims.

Unfortunately for Jones, he filed in Orange County. The Orange court stayed Mr. Jones lawsuit so an arbitration could proceed in New Jersey.

If Mr. Jones were a California resident this was an exceptionally bad ruling for him.

California courts have held that noncompete terms referring to the law of another state will be ignored so that California law and public policy can be applied to protect the state's residents and businesses. (*Application Group, Inc. v. Hunter Group, Inc.* (1998) 61 Cal.App.4th 881.)

But since the *Jones* arbitrator was in New Jersey he naturally applied New Jersey law and ruled the noncompete was enforceable.

Humanscale then applied to enforce the arbitration award in California and Jones sought to vacate the decision since it was against California law.

The trial court vacated the arbitration ruling, holding the arbitrator made a mistake using New Jersey law.

The ruling was appealed and the Court of Appeal reversed, holding the Orange County judge made an incorrect legal ruling. In California, a court is not allowed to reverse an arbitrator's ruling because they disagree

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with the decision. Only in limited, exceptional circumstances can this occur, and the court found a noncompete issue is not one of those special situations.

Disturbingly, the court of appeal went further in noting the arbitrator's ruling was not necessarily incorrect, as California permits some restrictions on post-employment activity, such as not using a former employer's trade secrets.

This is an example of why a court should not stray into dicta and start making statements unnecessary to the decision. The legal protection of trade secrets does not make an illegal noncompete legal.

It is like saying since the law allows some physical harm -- a police officer can kill a criminal committing an armed robbery it is not necessarily wrong to rule that someone can rape kids in school. One has nothing to do with the other and a legal act involving one set of laws is hardly justification for an illegal action involving an entirely different set of laws.

All around, the *Jones v. Humanscale* case is not California's best example of judicial analysis.

The trial court should not have shunted off Mr. Jones to roll the dice on his fate 3000 miles away, if he was a California employee. The trial court then made an erroneous ruling attempting to rectify the original bad ruling. The court of appeal then overstepped when suggesting enforcement of a noncompete was not palpably erroneous.

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Bottom Line: There is a risk an arbitrator will wrongly enforce an illegal noncompete agreement and the parties are stuck with that ruling as one of the risks of arbitration.

Brian Kindsvater, Esq.
Law Office of Brian Kindsvater
1024 Iron Point Road
Folsom, California 95630
<http://kindsvater.com>
<http://noncompetehelp.com>