NonCompete Help

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Noncompete Terms in Purchase Agreements Where the Seller Also Becomes an Employee

A common scenario occurs when the person selling a business agrees to a noncompete and they also become an employee of the buyer with a noncompete in their employment agreement. This situation was the subject of the case *Fillpoint, LLC v. Maas* (2012) 208 Cal.App.4th 1170,

The *Fillpoint* court held the noncompete in the purchase agreement was enforceable but not the noncompete in the employment agreement.

A timeline will help put this case and facts in better perspective.

2005 - Maas sold his stock to a company that became Fillpoint and the purchase agreement contained a 3-year noncompete prohibiting him from engaging in a competitive business.

2005 - Maas became an employee of the new company and signed a noncompete effective for 1-year after his employment ended, not to sell to customers, solicit employees, or work in a competitive business.

2008 - Maas resigned the day the 3-year noncompete expired. He then became an owner, officer, and employee of a competing business.

Initially, the court noted noncompete restrictions in employment agreements are not unenforceable in California. (Business and Professions Code Section 16600.) However, certain restrictions against sellers of a business designed to protect the buyer can be enforced. (Business and Professions Code Section 16601.)

The trial found there were two different contracts. The noncompete in the purchase agreement had been fulfilled and was no longer in effect to restrain Maas' activities. Since a noncompete restriction in an employment agreement is unenforceable the trial court ruled it was invalid.

On appeal, the *Fillpoint* court held the trial court erred in ruling there were separate contracts, but affirmed the result there was no valid noncompete.

Initially, although there were two separate contracts the court found that they must be read together. This is a general principle of law when there are multiple contracts between the same parties during a short period of time.

However, the court observed that finding the employment contract must be considered within the context of the purchase of the business is not the end of the analysis. It does not mean the employment noncompete is valid as part of the purchase agreement. Rather, the court said this only started an analysis of the situation.

The 3-year noncompete as part of the purchase agreement had been fulfilled. The protection of the assets the buyer purchased had happened.

The 1-year noncompete in the employment agreement, however, had a different purpose in limiting Maas' future employability. It also had different terms from those in the purchase agreement. There was also a question of whether the noncompete terms were too broad.

Ultimately, since the noncompete terms in the employment contract were not protecting what had been purchased when the business was acquired, they could not be enforceable per section 16601. Instead, they were void per section 16600.

Bottom Line: There is no bright line rule about what happens when a person sells their company and then becomes an employee of the new business. It cannot be assumed a noncompete in an employment agreement will be void and a noncompete in the sales agreement will be enforced. Rather, a detailed review of the terms, dates, and the overall circumstance is required to evaluate the purposes of the noncompete terms.

Ultimately, this increases the uncertainties for both parties in knowing how a court will rule, and increases the cost of litigation. It also means more care and analysis is required when drafting purchase agreements.

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