FEATURED ARTICLES

The Slow But Almost Certain Demise of Nonsolicitation of Employees Covenants Under California Law (Part 2)

Tyler M. Paetkau

Post-*Edwards* Case Law Considering the Enforceability of Postemployment Nonsolicitation of Employees Provisions

Although there is no published precedential decision yet, several courts have considered the enforceability of employee nonsolicitation provisions after the Supreme Court's 2008 decision in *Edwards v Arthur Andersen* (2008) 44 C4th 937, rejecting the common law "rule of reasonableness." The emerging trend has been to find that they unlawfully restrain competition and are void on their face in violation of Bus & P C §16600.

Then Northern District of California Chief Judge Marilyn Patel considered the enforceability of four types of postemployment nonsolicitation covenants in *Thomas Weisel Partners LLC v BNP Paribas* (ND Cal, Feb. 10, 2010, No. C 07–6198 MHP) 2010 WL 546497 at *3:

> One type of provision is a classic covenant not to compete between an employer and an employee in which the employee agrees not to work for competitors for a certain amount of time after termination of the employment. These covenants are, with narrow exceptions, unlawful under section 16600. A second type of provision is one forbidding the solicitation of the employer's customers by the employee for a certain period of time after the termination of employment. Such a clause may also run afoul of section 16600 if it restrains the employee's ability to engage in her profession. A third sort of agreement is a "no hire" provision between a business and its customer. A business that provides the services of its employees directly to a customer may seek to deter the customer from hiring the employees away. In using the third type of agreement, the employer, instead of attempting to bind an employee with a covenant not to compete, attempts to obligate customers not to hire its employees. California law equates this type of "no hire" provision with a covenant not to compete because, like a covenant not to compete, such a provision restricts the ability of the employees in question to engage in their profession. A fourth type of provision restricts an employee or former employee from soliciting the employer's other employees, *i.e.*, approaching them for the purpose of encouraging them to leave their present employer for a competitor. (Citations omitted.)

Judge Patel first noted that "[u]nder California precedent, restrictions on the solicitation of employees are not necessarily treated in the same way as restrictions on the solicitation

of customers," citing *Loral Corp. v Moyes* (1985) 174 CA3d 268, which "appears to have construed the prohibition on 'raiding' to proscribe the solicitation of employees." 2010 WL 546497 at *4. Judge Patel distinguished *Edwards,* which "articulates the broad principles and policy considerations behind section 16600; however, the facts of that case did not involve a 'no hire' or even a 'no solicitation' clause pertaining to the company's employees." 2010 WL 546497 at *5 (citing *Edwards,* 44 C4th at 948). Moreover, Judge Patel noted, "[t]he challenged provisions included, rather, an eighteen-month covenant not to compete and a provision precluding the solicitation of the company's customers for a period of one year," both of which the Supreme Court held void. 2010 WL 546497 at *5.

"Although not controlling," Judge Patel found *VL Sys., Inc. v Unisen, Inc.* (2007) 152 CA4th 708 instructive: "As noted, the [*VL Systems*] court equated [a no-hire] agreement with a covenant not to compete because the agreement restricted the opportunities of the company's employees. Moreover, the agreement did so without the employees' knowledge or consent since the employees were not parties to it." 2010 WL 546497 at *5. (The agreement in question was between VL Systems and one of its clients, in which the client agreed not to hire any VL Systems employee for a period of 1 year after the contracted work was concluded.) The *VL Systems* court noted, however, that "[t]he facts of this case sharply contrast with the situations in which such contractual provisions have been upheld, including *Loral*." 152 CA4th at 715. Among those differences were the following:

- The client did not solicit the employee's application for the position; it posted the job opening on an Internet site, and the employee responded to the posting;
- The employee chose to apply independently of any connection between VL Systems and the client; and
- The employee worked for VL Systems for only a short time, and he did no work at all for the client while he was employed.

In short, according to the *VL Systems* court, "[t]his is not a case where the happy client of a consulting firm attempts to poach an employee. [The employee], like any other applicant, chose to seek the job with [the client]." The *VL Systems* court focused on the effect of the no-hire provision in rejecting VL Systems' form-over-substance attempt to distinguish the no-hire provision from more traditional covenants not to compete (152 CA4th at 715):

> While [VL Systems] claims that enforcing [the no-hire provision] would not have limited [the client's] ability to hire [the employee] or his mobility, logic and common sense tells us otherwise. If [the client] had known at the time that it hired [the employee] that it either had to pay $60,000 or face a lawsuit, would it have hired [the employee] over another applicant? The answer strikes us as obvious, and just as obviously, upholding such a contractual provision would unfairly narrow the mobility of an employee who had never worked for [the client] as a [VL Systems] employee and had independently sought out [the client's] job opportunity. Thus, contrary to [VL System's] arguments, we find that enforcing this clause would present many of the same problems as covenants not to compete and unfairly limit the mobility of an employee who actively sought an opportunity with [the client].

The plaintiff in *Thomas Weisel Partners* relied principally on *Loral*. Judge Patel ruled that the covenant was void to the extent that it amounted to a "no-hire" restriction, observing (2010 WL 546497 at *5):

> Thus, even though the court cited with approval a Georgia case, *Lane Co. v Taylor* [citation], which the court described as upholding a restriction on "hiring," [citation], the *Loral* court appears to have considered the "no raiding" clause to be equivalent to a "no solicitation" clause rather than a "no hire" clause. As [defendant] Chakravarty points out, the case does not squarely hold that a "no hire" clause between a company and its employee is permissible.
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> Reading *Loral* together with *VL Systems*, and considering the underlying policy concerns of section 16600 as articulated in the California Supreme Court's recent *Edwards* case and other cases, this court concludes that California courts would hold the provision at issue in this case unenforceable to the extent that it attempts to restrain a person from hiring his former colleagues after the cessation of his employment with their employer. An employer has a strong and legitimate interest in keeping current employees from raiding the employer's other employees for the benefit of an outside entity. Such a restriction "only slightly affects [Thomas Weisel Partners (TWP)] employees," who were not hampered from seeking employment with BNP Paribas Asia of their own accord before Chakravarty joined BNP Paribas Asia. [Citation.] When, however, an employee has already made the transition from one employer to another, the same interests at issue in *VL Systems* are at play, particularly if the employee in question is a manager with hiring responsibilities. If the "no hire" provision were enforceable as to Chakravarty after he left TWP's employ and began running BNP Paribas Asia's operation, BNP Paribas Asia would likely consider itself restrained from hiring any former TWP employees for a year. This would restrain the mobility of current TWP employees as they would be precluded from obtaining a position with BNP Paribas Asia because Chakravarty would be the person hiring them. A *former employee* "no hire" agreement would serve to restrain mobility in much the same way as a covenant not to compete, albeit perhaps less directly than a customer "no hire" provision. Accordingly, the Agreement is void under section 16600 to the extent that it purports to prohibit Chakravarty from hiring TWP employees following Chakravarty's transition from TWP to another company.

Judge Patel ruled, however, that the employee nonsolicitation provision was enforceable under *Loral,* and also rejected the defendant former employee's argument that the court should invalidate the entire agreement rather than severing the unenforceable employee "no hire" provision. 2010 WL 546497 at *6.

On the other side of the debate over whether *Edwards* effectively abrogated or overruled *Loral* regarding the enforceability of nonsolicitation of employees provisions, U.S. District Judge Lucy Koh invalidated a similar nonsolicitation of employees provision in *SriCom, Inc. v eBisLogic, Inc.* (ND Cal, Sept. 13, 2012, No. 12-CV-00904-LHK) 2012 WL 4051222:

> As Defendants point out, nonsolicitation and no-hire agreements are generally void under this provision. [Citations.] *In its recent decision in* Edwards [citation]*, the California Supreme Court confirmed the continued viability and breadth of Section 16600. The Court explained that by enacting Section 16600, the California legislature intended to further "a settled legislative policy in favor of open competition and employee mobility."* Thus, Section 16600 is a broad prohibition on "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind." [Bus & P C §16600].
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> This broad prohibition has, however, been occasionally subjected to specific exceptions. In particular, *SriCom* relies on [*Webb v West Side Dist. Hosp.* (1983) 144 CA3d 946], in which the Court held that an agreement requiring a hospital to pay an additional fee if it directly hired any doctors originally placed there by a staffing agent was not void under Section 16600. In *Webb*, the Court noted that the staffing agent's "economic interest was … valuable and protectable: without recoupment of the recruitment expenses he had incurred, [the consultant] became vulnerable to unfair exploitation of his labors." [Citation.] SriCom argues that *Webb* created an exception to Section 16600 where staffing agencies are involved.
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> Defendants rely on *Edwards* for the proposition that even if that were once a generally applicable exception, now, "[n]oncompetition agreements are invalid under section 16600 in California even if narrowly drawn, unless they fall within the applicable statutory exceptions." Since the *Webb* exception was judicially created, Defendants argue, it cannot continue to exist post-*Edwards*. [Citation.] The contract term at issue here, however, is not a noncompetition agreement like that discussed in *Edwards*, but rather a nonsolicitation and no-hire provision. [2012 WL 4051222 at *4, citing *Thomas Weisel Partners LLC v BNP Paribas*, *supra*, which distinguished among five separate types of provisions potentially implicating Bus & P C §16600).] The plain language of *Edwards*, then, does not necessarily eliminate the exception recognized in *Webb*.
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> The reasoning in *Edwards*, however, forecloses continued reliance on *Webb*. Specifically, *Edwards* rejects the contention that Section 16600 "embrace[s] the rule of reasonableness in evaluating competitive restraints." [2012 WL 4051222 at *5, quoting *Edwards*, 44 C4th at 947.] *Webb* is premised on the notion that restraints on direct hiring in the staffing agent context were unreasonable when weighed "by balancing, in the light of all the circumstances, the respective importance to society and the parties of protecting the activities interfered with on the one hand and permitting the interference on the other." [2012 WL 4051222 at *5, quoting *Webb,* 144 CA3d at 951.] Without the rule of reasonableness, *Webb* cannot stand.
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> Thus, the question here is whether, under the literal terms of the statute, "anyone is restrained from engaging in a lawful profession, trade, or business of any kind." [Bus & P C §16600.] The contract at issue here unequivocally purports to restrain the consultants SriCom had placed with eBisLogic from working directly for eBisLogic. Accordingly, Section 16600 voids the provision.

In *Tivoli LLC v Targetti Sankey S. P. A.* (CD Cal, Feb. 3, 2015, No. SA CV 14–1285-DOC (JCGx)) 2015 WL 12683801, a sale of business case, the defendant seller argued that customer and employee nonsolicitation provisions were invalid under California law. The plaintiff buyers argued that the nonsolicitation agreement fell within the sale of "goodwill" exception of Section 16601. The "Covenant of Nonsolicitation" attached to the purchase agreement provided that Targetti Poulsen would not "solicit any person" who at the time was employed by Tivoli to leave Tivoli, or to become employed by any other entity engaged in competition with Tivoli. The plaintiffs contended that "this covenant is valid as part of the bargained-for consideration received upon Targetti Poulsen's sale of its shares of Tivoli—and that the restriction validly prevents the reduction of the value of the property acquired by Neo-Neon USA and American Lighting." U.S. District Judge David O. Carter framed the issue as "whether a nonsolicitation clause which restrains the selling party (Poulsen) from later offering employment to the buyer's (Tivoli) employees is void under Section 16600 and not within the exception provided by Section 16601." 2015 WL 12683801 at *6.

Judge Carter first observed that "California's court[s] have not squarely addressed this question. Indeed, there is a dearth of case law addressing so-called 'anti-raiding' clauses, especially in the context of Section 16601." 2015 WL 12683801 at *6. Judge Carter then analyzed and quoted *Edwards*' explicit rejection of the common law "rule of reasonableness:" "Fairly read, the foregoing authorities suggest section 16600 embodies the original, strict common law antipathy toward restraints of trade, while the section 16601 and 16602 exceptions incorporated the later common law 'rule of reasonableness' in instances where those exceptions apply." 2015 WL 12683801 at *6, quoting *Edwards,* 44 C4th at 948. Judge Carter recognized that "*Edwards* **does draw into question previous authority on the issue of employee nonsolicitation provisions**." Judge Carter observed that "[i]n reaching its determination, the [*Loral*] court noted that '[t]he potential impact on trade must be considered before invalidating a noninterference agreement,'" and that "**[s]uch a reasonableness assessment may be vulnerable under the holding in** *Edwards*." 2015 WL 12683801 at *6, citing and quoting *Loral,* 174 CA3d at 278 (emphasis added); also citing as "but see" *Sunbelt Rentals, Inc. v Victor* (ND Cal, Feb. 5, 2014, No. C 13–4240 SBA) 2014 WL 492364 (finding provision prohibiting former employee from recruiting company's employees was not void under section 16600) and *Arthur J. Gallagher & Co. v Lang* (ND Cal, May, 23, 2014, No. C 14–0909 CW) 2014 WL 2195062 (same).

Judge Carter found the nonsolicitation of employees provision enforceable, however, under the "sale of business" exception to §16600, Bus & P C §16601 (2015 WL 12683801 at *7, citing *Loral,* 174 CA3d at 279):

> Regardless, the facts and reasoning in *Loral* are still of assistance to this Court. *Loral* involved a termination agreement that prohibited the terminated employee from soliciting employees of his former company. As to the impact on the company's employees, rather than the terminated party, the court found:
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> This restriction only slightly affects [the current] employees. They are not hampered from seeking employment with [the subsequent employer] nor from contacting [the terminated employee]. All they lose is the option of being contacted by him first.... Equity will not enjoin a former employee from receiving and considering applications from employees of his former employer, even though the circumstances be such that he should be enjoined from soliciting their applications.
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> As to the goals of the provision, the [*Loral*] court noted, "The restriction presumably was sought by plaintiffs in order to maintain a stable work force and enable the employer to remain in business," and "[a]lthough not considering the exception, these goals are entirely consistent with the underlying purposes of Section 16601."

Judge Carter observed that only one California case (*Strategix, Ltd. v Infocrossing W., Inc.* (2006) 142 CA4th 1068, 1073) appears to discuss nonraiding provisions at the intersection with Section 16601. He found that "[a]lthough the case predates [*Edwards v Arthur Andersen* (2008) 44 C4th 937], *Edwards* does not undermine the court's analysis, as *Edwards* did not consider nonsolicitation agreements in the context of Section 16601." 2015 WL 12683801 at *7. Thus, *Tivoli* held that "the nonsolicitation clause in the purchase agreement falls within the exception of Section 16601":

> Under California law, Section 16601 encompasses agreements whereby the seller is restricted from soliciting the company's employees. As written, Targetti Poulsen is restrained from pursuing Tivoli's employees, thereby eroding the goodwill that Plaintiffs paid for in their acquisition of the remaining shares of Tivoli. [¶] Significantly, Tivoli's employees are not restrained from working for Targetti or its affiliates, so long as the employees are not solicited by Defendants. They are free to seek out employment with Targetti Poulsen or its affiliates. The restriction imposed on non-signatories to the agreement is de minimis, and does not interfere with California's strong public policy favoring open competition.

2015 WL 12683801 at *7, citing *Loral,* 174 CA3d at 279 ("This restriction only slightly affects [the current] employees"), and *Thomas Weisel Partners LLC v BNP Paribas* (ND Cal, Feb. 10, 2010, No. C 07–6198 MHP) 2010 WL 546497 at *5 (distinguishing no-hire provisions from nonsolicitation provisions).

In *Arthur J. Gallagher & Co. v Lang* (ND Cal, May 23, 2014, No. C 14–0909 CW) 2014 WL 2195062, the employment agreement contained various noncompetition and nonsolicitation provisions governing the former employee-defendant Lang's relationships with Gallagher's clients and employees for up to 2 years after he ceased working for the firm. One of these provisions precluded Lang from soliciting any "insurance related business with any individual, partnership, corporation, association or other entity or Prospective Account about which [he] received trade secrets of [Gallagher] or any of its affiliates." Another provision stated that Lang would not "directly solicit, induce or recruit any employee of [Gallagher] or its affiliates to leave the employ of [Gallagher] or its affiliates."

In its complaint, the former employer, Gallagher, alleged that Lang breached the employment agreement by, among other things, soliciting its clients and employees; failing to provide written notice of his resignation 60 days before leaving the firm; refusing to meet with the firm's legal counsel after leaving the firm; and failing to return certain materials to the firm, as required by the agreement. Lang contended that the noncompetition and nonsolicitation provisions were void as a matter of California public policy, citing Bus & P C §16600. Gallagher contended that §16600 did not apply because the agreement contained an Illinois choice-of-law provision.

U.S. District Judge Claudia Wilken first found the Illinois choice-of-law provision unenforceable: "Applying Illinois law to the parties' contract would contravene California's fundamental public policy against the enforcement of non-competition and non-solicitation agreements." 2014 WL 2195062 at *3. Judge Wilken next ruled that "[u]nder California law, to the extent that the provisions of the agreement preclude Lang from soliciting business from Gallagher's clients, they are void." 2014 WL 2195062 at *4, citing *Edwards,* 44 C4th at 948. Relying exclusively on *Loral* and *Thomas Weisel Partners,* however, Judge Wilkin ruled that the nonsolicitation of employees provision was enforceable under California law:

> Although California courts recognize that an employer may not prohibit its former employees from hiring the employer's current employees, an employer may lawfully prohibit its former employees from actively recruiting or soliciting its current employees. See [*Loral Corp. v Moyes* (1985) 174 CA3d 268, 280] ("Equity will not enjoin a former employee from receiving and considering applications from employees of his former employer, even though the circumstances be such that he should be enjoined from soliciting their applications."); [*Thomas Weisel Partners LLC v BNP Paribas* (ND Cal, Feb. 10, 2010, No. C 07–6198 MHP) 2010 WL 546497 at *6] (recognizing that section 16600 precludes restraints on hiring former colleagues but permits restraints on solicitation).

In *Sunbelt Rentals, Inc. v Santiago Victor* (ND Cal, Feb. 5, 2014, No. C 13–4240 SBA) 2014 WL 492364, Judge Wilken, again relying exclusively on *Loral,* rejected the

defendant-former employee's argument that the nonsolicitation of employees provision in his employment agreement violated §16600 (although, on the facts, she found that the defendant had not breached it and denied the plaintiff-former employer's motion for preliminary injunctive relief) (2014 WL 492364 at *8, citing *Loral,* 174 CA3d at 281):

> *Victor* also challenges the restriction against soliciting Sunbelt employees for employment. Section 5.2(i) of the Agreement provides that: "Employee shall not directly or indirectly … solicit the employment of … any person who at any time during the twelve (12) calendar months immediately preceding the termination or expiration of this Agreement was employed by [Sunbelt]." A contractual provision preventing a departing employee from "raiding" his former employer's employees is "not void on its face under Business and Professions Code section 16600." *Loral* [citation]. Victor argues that *Loral* is distinguishable on the ground that there is no evidence that he actually lured any Sunbelt employees to seek employment with Ahern. However, whether there is evidence that Victor solicited Sunbelt employees is a separate and distinct issue from whether the Agreement's restriction on soliciting Sunbelt's [employees] for employment violates section 16600. Thus, based on the arguments presented thus far, the Court is not persuaded by Victor's contention that the non-solicitation clause is invalid. The Court therefore addresses whether there is compelling evidence that Victor breached this non-solicitation provision.

In *Cap Gemini Am., Inc. v Judd* (Ind Ct App 1992) 597 NE2d 1272, an Indiana Court of Appeal, applying California law pre-*Edwards,* held that a nonsolicitation of employees provision was overbroad and unenforceable, even under *Loral*. The trial court determined that the nonsolicitation of employees for 1 year after termination was invalid. The nonsolicitation clause in Judd's employment agreement stated: "Employee agrees that he will not … aid or endeavor to solicit or induce then remaining employees of [CGA] … to leave their employment with [CGA] … in order to accept employment with another person, firm or corporation[.]" In invalidating the nonsolicitation of employees provision, the *Cap Gemini* court distinguished Loral (597 NE2d at 1287):

> We find the facts of this case to be distinguishable from *Loral* and conclude that the nonsolicitation clause was an unreasonable restriction on business. CGA attempted to prevent Judd from hiring CGA employees regardless of their location. Judd had primarily worked in California for CGA, but the nonsolicitation covenant was not limited to CGA employees in California. It was unreasonable to extend the protection of maintaining a stable work force to CGA's branch in Indianapolis when Judd was based in California. Therefore, we agree with the trial court that the nonsolicitation covenant was invalid.

In *Atmel Corp. v Vitesse Semiconductor Corp.* (Colo Ct App 2001) 30 P3d 789, a former employer sued its former employees and their new employer to enforce nonsolicitation clauses in the former employees' employment agreements. The nonsolicitation of employees covenant stated: "**Solicitation of Employees.** I agree that I shall not for a period of one year following the termination of my relationship with the Company … either directly or indirectly … solicit, recruit or attempt to persuade any person to terminate such person's employment with the Company." 30 P3d at 793. The trial court issued an injunction prohibiting the former employees from having any involvement, direct or indirect, in their new employer's hiring process. The Colorado Court of Appeal reversed, opining that "if the nonsolicitation clauses were interpreted as broadly as the preliminary injunction provides, they would be void as violative of the Colorado and California statutes that prohibit agreements in restraint of trade." 30 P3d at 794. Based on *Loral,* the *Atmel* court ruled that "the non-solicitation clause is void and unenforceable to the extent it can be interpreted to prohibit those defendants from doing anything other than initiating contacts with Atmel's employees." 30 P3d at 794.

In *Sonic Auto., Inc. v Younis* (CD Cal, May 6, 2015, No. 15–CV–00717 RGK (AGRx)) 2015 WL 13344624, the restrictive covenant in the defendant-former employee's employment agreement stated that he could not "[s]olicit, hire, offer to hire, employ, engage, or knowingly permit or cause any company or business directly or indirectly controlled by [the defendant-former employee] … to solicit, hire, offer to hire, or employ any person who is or was employed by [the plaintiff-former employer]." The court once again relied heavily on *Loral* and *Thomas Weisel Partners*:

> The Court finds that to the extent the provision purports to restrict Defendant from hiring Plaintiff's employees, the provision is unenforceable. [¶] However, unlike the no-hire restriction, the no-solicitation aspect of the provision is valid and enforceable. The Court finds no authority to the contrary. Indeed, in *Loral*, the court found that a noninterference agreement not to solicit former co-workers to leave the employer was considered a no-solicitation agreement, which was valid. *Loral* [citation]. Further, in *Thomas Weisel Partners LLC*, the court found a no-hire provision unenforceable only to the extent that it restricted hiring, not soliciting. *Thomas Weisel Partners LLC* [citation]. Therefore, the Court rejects Defendant's argument and finds that the restrictive covenant is valid to the extent it prohibits no-solicitation of Plaintiff's employees.

Conclusion

As U.S. District Judge Lucy Koh determined in *SriCom, Inc. v eBisLogic, Inc.,* the reasoning in *Edwards* forecloses continued reliance on *Webb* (and *Loral*). Specifically, *Edwards* rejects the contention that Bus & P C §16600 "embrace[s] the rule of reasonableness in evaluating competitive restraints." *Webb* is "premised on the notion that restraints on direct hiring in the staffing agent context were unreasonable when weighed 'by balancing, in the light of all the circumstances, the respective importance to society and the parties of protecting the activities interfered with on the one hand and permitting the interference on the other.'"

Similarly, *Loral* is premised on the rejected common law "reasonableness" analysis. Without the common law "rule of reasonableness," neither *Loral* nor *Webb* remain good law in California. Under the literal terms of §16600, an agreement is "to that extent void" if "anyone is restrained from engaging in a lawful profession, trade, or business of any kind." The typical, broad nonsolicitation of employees covenant unequivocally restrains former employees from soliciting their former colleagues, whom they may know very well. Moreover, there is no logical or principled reason why postemployment nonsolicitation of customers contractual restraints should be treated differently from broad nonsolicitation of employees contractual restraints. And, just like nonsolicitation of customers covenants, there is no statutory exception for nonsolicitation of employees covenants. Accordingly, §16600 voids these postemployment contract restraints.

The contrary conclusions of a few post-*Edwards* courts cannot withstand scrutiny. Indeed, such opinions appear to endorse a type of "narrow restraint" exception to §16000 that the Supreme Court of California expressly rejected in *Edwards,* warning courts not to create such nonstatutory exceptions by "judicial fiat." For example, even in *Loral* itself, the court both endorsed the now-rejected "narrow restraint" theory and suggested that nonsolicitation of customers provisions were lawful: "This does not appear to be any more of a significant restraint on his engaging in his profession, trade or business than a restraint on solicitation of customers or on disclosure of confidential information." *Loral,* 174 CA4th at 278. After *Edwards, Loral* cannot stand.

DEVELOPMENTS

Partnerships

Fiduciary Duty

Trial court properly allowed amendment of answer during trial to assert subsequent incorporation as defense to existence of partnership.

Eng v Brown (2018) 21 CA5th 675

In 2006, Eng, Levy, and Brown agreed to purchase a restaurant, with Brown to own 57 percent, Levy to own 33 percent, and Eng to own 10 percent. In 2007, the group purchased the restaurant under the name BLE Fish, Inc., which had been incorporated on the day the purchase offer was made. From 2007 to 2010, Eng received approximately $160,000 in distributions from BLE Fish. In 2010, Brown and Levy began to manage the business on a full-time basis, took salaries as corporate officers, and retained a management company they controlled to oversee the restaurant's operations. BLE Fish agreed to pay the management company a percentage of gross sales in exchange for its services. Based in part on these expenses, Eng received no distributions in 2011. Eng then sued Brown, Levy, and BLE Fish, asserting claims for dissolution of their partnership and an accounting, constructive fraud, and conversion based on breach of fiduciary duty.

During the proceedings, Eng brought a motion in limine to exclude any evidence or argument that a partnership was not formed to purchase the restaurant or that BLE Fish had superseded the partnership. The trial court denied the motion. After Eng moved for a directed verdict on the issue of subsequent incorporation as a defense to the existence of a partnership, the trial court permitted Brown and Levy to amend their answer to include the affirmative defense of supersession. The court reasoned that such an amendment would not cause prejudice, because Eng had notice of the defense and relevant facts had been included in the evidence. The jury found that the parties formed a partnership or joint venture, but had terminated that partnership or joint venture by forming BLE Fish. The trial court entered judgment for Brown and Levy.

The court of appeal affirmed, finding that the trial court properly allowed amendment of the answer to assert supersession. Under CCP §576, the trial court may allow the amendment of any pleading, in the furtherance of justice, at any time before or after commencement of trial. Here, Brown and Levy's position throughout the litigation was that no partnership had been formed and, alternatively, that any partnership had been superseded by the incorporation of BLE Fish. Thus, Eng had ample notice of the defenses and would not be unfairly prejudiced by the amendment.

The court of appeal also upheld the trial court's denial of Eng's motion for a directed verdict on the supersession defense. A directed verdict may only be granted when the court determines there is no evidence sufficient to support the claim or defense of the nonmoving party. *Moore v Mercer* (2016) 4 CA5th 424. Here, Brown and Levy produced evidence that any partnership formed between the parties was superseded by the formation of BLE Fish. In response, Eng asserted that the partnership survived the formation of BLE Fish based on a preincorporation contract. Accordingly, there were material questions of fact on the issue of supersession. Thus, the trial court properly denied Eng's motion for directed verdict in order for the jury to decide the issue.

Contracts

Breach of Contract

Licensing agreement for manufacture and sale of movie car replicas was supported by adequate consideration, despite pending litigation over registered trademark rights.

Eleanor Licensing LLC v Classic Recreations LLC (2018) 21 CA5th 599

H.B. Halicki wrote, directed, produced, and starred in the 1974 film *Gone in 60 Seconds,* which featured a yellow 1971