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Fenwick Employment Brief

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CALIFORNIA COURT OF APPEALS STRIKES DOWN NONSOLICITATION AGREEMENT THAT BARRED SELLER OF BUSINESS FROM SOLICITING BUYER'S CUSTOMERS AND EMPLOYEES

In *Strategix v. Infocrossing West, Inc.*, the court held that a nonsolicitation covenant prohibiting the seller of a business from soliciting ***all*** of the purchaser's employees and customers was overbroad and unenforceable. Strategix agreed to sell its goodwill and substantially all of its assets to Infocrossing. In addition to an asset purchase agreement, the parties entered into a consulting services agreement. The consulting agreement contained two nonsolicitation covenants, prohibiting Strategix from soliciting both Infocrossing's employees and customers for one year after the termination of the consulting relationship. Infocrossing claimed Strategix breached the nonsolicitation covenants and sought an injunction against further solicitation. The trial court found the covenants enforceable and issued a preliminary injunction enjoining Strategix from soliciting Infocrossing's customers or employees, whether or not they were former customers or employees of Strategix.

The Court of Appeal reversed. The court found the nonsolicitation covenants unenforceable because they were broader than permitted by Business and Professions Code section 16601. Section 16601 permits the seller of a business to agree not to compete with the buyer in the geographic location where the seller had carried on its business. Extrapolating from this principle (with its inherent focus on the business conducted by the ***seller***), the court found that the at-issue nonsolicitation covenants unlawfully barred the seller from soliciting ***all*** employees and customers of the buyer, even those who were not former employees or customers of the sold business.

The court declined Infocrossing's request to modify (or "blue pencil") the nonsolicitation covenants (and, thus, the preliminary injunction) to prohibit solicitation only of Strategix's former customers or employees who became "assets" of Infocrossing through the acquisition. Although courts sometimes "blue pencil" noncompetition agreements with overbroad or unlimited geographic and temporal scopes, the court here refused to do so. According to the court, limiting the covenants as Infocrossing requested would effectively strike a new bargain for the parties for the purpose of saving an illegal contract. Instead, the court struck down the covenants in their entirety.

This case serves as a reminder that the "sale of business" exception set forth in Section 16601 does not eviscerate the well-settled California public policy prohibiting covenants not to compete. While there is some latitude in the context of the sale of a business, a seller nevertheless must ensure that any noncompetition and nonsolicitation covenants are carefully drawn within the parameters of Section 16601.

EMPLOYER'S "CHARGEBACK" OF SALES EMPLOYEES' UNEARNED COMMISSIONS UPHELD

In *Koehl v. Verio*, the California Court of Appeals ruled in favor of the employer in an action alleging failure to pay wages to salespersons who received both base pay and commissions. Verio is an Internet service provider that sells Internet access and web hosting services. The company's compensation plans provided for payment of commissions when an order was booked, but allowed Verio to recover the payments, or "chargeback," if certain conditions were not met (such as the customer's failure to pay). Plaintiffs alleged that the commissions were wages, therefore making the chargebacks unlawful under California Labor Code section 221. After a bench trial, the trial court found in favor of Verio, concluding that the commissions were not wages.

The Court of Appeal affirmed. The court noted that while commission payments can constitute wages as defined under the Labor Code, an "advance" is not a wage because all conditions for performance have not been satisfied. The commission plans between plaintiffs and Verio provided that although commissions would be paid at booking, they were not in fact earned at that time. Plaintiffs admitted at trial that they signed these commission plans and understood them. However, notwithstanding their understanding and the signed agreements, plaintiffs argued that the commissions were wages because Verio did not specifically refer to these payments as "advances." The court disagreed, finding that plaintiffs expressly agreed and understood that commissions were not earned until certain conditions were met and that Verio was paying them in advance of when the commissions were earned. Therefore, Verio was entitled to the chargebacks even though the word "advance" was not used in the commission plans.

The court also found an independent basis to uphold the chargebacks in Labor Code section 224, which permits wage deductions that are authorized in writing and do not reduce the standard wage. Verio's chargebacks were made pursuant to written commission plans which expressly authorized recovery of advances. In addition, the chargebacks were not taken against the employee's standard wage because each salesperson received "base pay" each month regardless of whether he or she made any sales.

This case is a reminder that employers who utilize commission advances and chargeback structures need to carefully draft commission plans to include several key provisions necessary for such agreements. The agreement should clearly set forth what conditions must be satisfied before commissions will be deemed earned. The agreement must also explicitly state what commissions will be paid in advance and how these advances will be reconciled against earned commissions. Finally, the agreement should include a provision stating that the employee has read and understood the commission advance and chargeback system and authorizes deductions from commissions for chargebacks.

NEWS BITES

On August 29, 2006, the Fair Employment & Housing Commission (the "Commission") adopted revised proposed regulations on sexual harassment training and education, interpreting Government Code section 12950.1 (A.B. 1825), which requires harassment training for supervisors of employers with 50 or more employees. These latest revisions clarify that supervisors who are located outside of California and supervise employees within California are ***not*** subject to the sexual harassment training requirements under the proposed regulations. On October 2, 2006, the Commission will decide whether to adopt the August 29, 2006, modified regulations or make further changes to its proposed regulations.

In *Clark v. Johannes*, Lisa Clark sued under Title VII, alleging that her employer failed to renew her temporary position in retaliation for protected activity. Title VII's anti-retaliation provision protects employees who make a charge, testify, assist or participate in any manner in proceedings or hearings under the statute or oppose acts made unlawful by the statute. In *Clark*, a male co-worker of Clark filed a complaint with the EEOC claiming his supervisor had engaged in sexual harassment against female employees, including Clark. The court concluded that Clark did not engage in activity protected under Title VII, noting that she did not file a complaint or otherwise publicly oppose a discriminatory practice. Clark argued that her male co-worker's complaint should be attributed to her, and that she therefore did "participate" in protected activity as the subject of her co-worker's grievance. The Federal Eighth Circuit Court of Appeals (covering Arkansas, Missouri, Iowa, and other states) disagreed. The court held that a plaintiff must ***personally*** engage in the protected conduct. An employee's status as an unknowing "subject" of someone else's grievance does not give rise to protected status under the anti-retaliation provision of Title VII. The court noted that the events referenced in the co-worker's complaint did not occur in Clark's presence and there was no evidence that the supervisor attributed to Clark the grievance filed by the male employee.

In *Recinos-Recinos v. Express Forestry Inc.*, the court sanctioned the defendant company $36,000 in attorneys' fees for discovery violations. Plaintiffs, a class of 300 migrant workers, sued the company for its alleged failure to properly compensate them and also for failure to keep proper records. During the course of the lawsuit, the company refused to provide written records relating to pay stubs and timekeeping, as well as the names and addresses of workers. The company alleged that its business records were taken to a house on the Gulf Coast during the late summer of 2005 and that the records were destroyed by Hurricane Katrina. The court sanctioned the company for its negligent handling of the documents, noting that the company transferred ***all*** of their copies of critical employment records to a beach house 600 miles away from the company office in Arkansas at the height of hurricane season.

On **April 14, 2005**, we reported on *McRae v. Department of Corrections*, in which the California Court of Appeals overturned a jury verdict, finding the employer's alleged retaliatory acts were insufficient to rise to the level of an actionable wrong. Recently, the Court of Appeals was asked to revisit this case and affirmed its previous ruling. In *McRae*, Plaintiff Margie McRae was an African American physician working for the state prison system. She alleged that after filing an administrative complaint against the state for failure to promote her on account of her race, the department retaliated against her. She complained about (1) a "letter of instruction" because she left an emergency room unattended, (2) an internal investigation into McRae's alleged failures to follow instructions by management, and (3) a transfer to another prison. While a claim of adverse action may be based on a continuous course of conduct, the court found that the conduct McRae complained of was in fact a series of events, each bearing little relationship to the others. The allegedly wrongful acts were taken by many different persons, for different reasons, some of which had nothing to do with McRae's protected conduct. With respect to McRae's transfer to another facility, the court stated that a transfer can be an adverse employment action when it results in "substantial and tangible harm." Here, however, McRae's transfer did not result in a demotion, reduction in pay or loss of benefits. It also did not involve a change in status or a less distinguished title. Nor was there any evidence that the transfer involved any significant change in job responsibilities, in work hours, or commute time.