

# Trade Secrets and Noncompete Blog

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## California Court Invalidates Non Compete Tied to the Sale of Goodwill

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In the recent California Court of Appeals decision in *Fillpoint, LLC v. Michael Maas*, \_\_\_ Cal. Rptr. 3d \_\_\_, 2012 WL 3631266 (Cal. App. 4 Dist. 2012), the court continued California courts' strict reading of California Bus. & Prof. Code section 16600, striking down a non-competition agreement in an employment agreement that was originally connected with the earlier sale of the goodwill of a business.

Defendant Michael Maas ("Maas") was a shareholder in Crave Entertainment Group, Inc. ("Crave"). In 2005, Handleman Company ("Handleman") acquired Crave. Maas and other Crave stockholders entered into a stock purchase agreement that included a covenant not to compete that prohibited Maas (and other former Crave stockholders) from competing with Handleman in Crave's line of business for three years after the purchase date.

Approximately a month later, Maas entered into an employment agreement with Crave, agreeing to work for Crave for three years. The employment agreement included a covenant not to compete or solicit, the term of which was for one year after the expiration of the employment agreement or the termination of Maas' employment. The employment agreement included an integration clause, integrating it with the earlier stock purchase agreement.

Maas resigned from his employment at Crave in 2008, after satisfying the three year term of his employment agreement.

In 2009, Crave was acquired by Fillpoint. Later that year, still during the term of the employment agreement post-termination non-competition clause, Maas became the president and CEO of Solutions 2 Go, a competitor of Crave. Fillpoint sued Maas for breach of the employment agreement and sued Solutions 2 Go for tortious interference. Maas and his co-defendants asserted that the non-competition clause in the employment agreement was not enforceable pursuant to California Bus. & Prof. Code section 16600. California Bus. & Prof. Code section 16600 generally prohibits covenants not to compete subject to two limited exceptions -- one of which, set forth in California Bus. & Prof. Code section 16601, protects covenants not to compete entered into in connection with the sale of the good will of a business. At trial, the court granted the defendant's motion for nonsuit, finding the employment agreement unenforceable. Fillpoint appealed.

On appeal, Fillpoint argued that the employment agreement's covenant not to compete must be read together with the stock purchase agreement. The court agreed, but in analyzing the two agreements found that the employment agreement was nonetheless not enforceable.

The court noted that the stock purchase agreement protected Crave's goodwill for three full years, and was fully performed. The stock purchase agreement limited Maas' right to set up a competing business during the three year period following Handleman's acquisition of Crave. In contrast, the court noted that the employment agreement was much broader, and prevented Maas -- for a year following the termination of his employment -- from making sales to Crave customers or even potential customers and from working for or owning an interest in any business that was in the same business or would compete with Crave. In addition, Maas was barred from employing or soliciting for employment Crave's employees and consultants. The court held that the employment agreement limited Maas' rights to be employed in the future. Significantly, Fillpoint conceded that the two covenants not to compete were intended to deal with different damage Maas might do as a major shareholder versus as a key employee. Thus, in reading the two agreements together, the court found that while the stock purchase agreement was targeted to protecting Crave's goodwill, the employment agreement was not.

The court's ruling indicates that the terms of the employment agreement's non-competition clause would not have been upheld even had they been included within the terms of the stock purchase agreement. In invalidating the employment agreement's non-competition agreement, the Fillpoint court held that the "nonsolicitation terms in the employment agreement are too broad and inconsistent with the purposes and terms of [Cal. Bus. & Prof. Code sections 16600 and 16601]," as the employment agreement barred sales to or solicitation of even potential Crave customers. Based on this decision, buyers should consider negotiating longer non-competition terms in the initial purchase agreement instead of relying on a separate employment agreement that contains different non-competition terms.

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