Another Setback for Non-Competition Clauses

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The California Court of Appeal recently concluded, in *D'Sa v. Playhut, Inc.,* that it is a violation of public policy for an employer to terminate an employee who refuses to sign an unlawful covenant not to compete.

Summary Of The Case

In *D'Sa*, the employer hired Mr. D'Sa and then later asked him to sign a confidentiality agreement. In part, the confidentiality agreement provided, "Employee will not render services, directly or indirectly, for a period of one year after separation of employment with Playhut, Inc. to any person or entity in connection with any Competing Products." Mr. D'Sa refused to sign the confidentiality agreement because he felt the quoted provision constituted an improper covenant not to compete. The employer then fired Mr. D'Sa based on his refusal to sign the confidentiality agreement.

Mr. D'Sa sued the employer, claiming that the employer violated public policy when it terminated his employment for refusing to sign an unlawful covenant not to compete. The *D'Sa* court agreed stating, "California law would protect [Mr. D'Sa] if defendants sought to overreach by trying to enforce the covenant not to compete, and California law will also protect him from a termination of his employment brought on by his refusal to sign an agreement containing the illegal covenant."

In its defense, the employer made an interesting argument. It noted that the confidentiality agreement contained a "severability" clause, which stated that if any provision of the agreement was illegal, the illegal provision would be void, but the rest of the contract would remain enforceable. Based on the severability clause, the employer argued that the illegal covenant not to compete could never be enforced. Therefore, the employer had not violated public policy when it fired an employee who refused to sign a confidentiality agreement that merely contained an unenforceable covenant not to compete.

The *D'Sa* court rejected this argument because it felt the mere existence of the illegal covenant not to compete could undermine employee rights. The court noted that most employees probably would not know that the covenant not to compete was illegal. Consequently, the court speculated, employees might in fact refrain from competing even though they had no obligation to do so.

Impact Of The Case

Many California employers include overbroad covenants not to compete in their employment agreements, knowing that the covenants will probably be unenforceable but hoping the covenants may nonetheless deter post-separation competition. The *D'Sa* decision establishes that employers may not fire employees who refuse to sign unenforceable covenants not to compete. It remains to be seen whether California courts will further conclude that the mere inclusion of an unenforceable covenant not to compete in an employment contract is

actionable as an unfair business practice because of the potential deterrent effect the covenant could have on lawful competition. However, a cautious employer would assume that would be the outcome.

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