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New Limits on Agreements Not to Hire Another Company's Employees

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Appeals Court Invalidates Contract Provision Prohibiting Consulting Firm's Clients From Hiring Its Personnel

The California Court of Appeal has imposed new limitations on contracts prohibiting one company from hiring away the employees of another. Consulting firms frequently include such provisions in their contracts with clients in order to prevent the clients from hiring directly the consultants that the firms provide. Similar provisions appear in a variety of other contexts, including employment agreements, distribution agreements, and non-disclosure agreements. In a June 25, 2007 decision, *VL Systems, Inc. v. Unisen, Inc.*, the appellate court invalidated one such "no-hire" provision and provided guidance as to the types of restrictions that are and are not enforceable.

The case involved a consulting company that provided software consultants to businesses. The consulting company's agreement with its clients included a provision prohibiting the clients from hiring any of the consulting company's personnel for one year after they left the consulting company's employment. The Court of Appeal decided that "such a broad provision is not necessary to protect [the consulting company's] interests and is outweighed by the policy favoring freedom of mobility for employees. It is therefore unenforceable."

Two aspects of the no-hire provision at issue made it particularly vulnerable to legal challenge. First, the provision prohibited the client from hiring any of the consulting firm's personnel, not just those who had performed work for the client. Second, the provision did not merely prohibit the client from soliciting the consulting firm's personnel; it applied even if an employee sought out employment with the client. While the Court of Appeal was careful to "take no position on whether a more narrowly drawn and limited no-hire provision would be permissible under California law," these factors seem to have been decisive. In fact, in a footnote, the court wrote, "perhaps a more narrowly drawn clause limited to soliciting employees who had actually performed work for the client might pass muster."

The *VLS Systems* decision is likely to trigger further legal challenges to no-hire provisions, and may lead those who have signed such agreements to ignore them in the belief that they are unenforceable. In the meantime, businesses that rely on no-hire provisions should make sure that they are drafted to address the limitations the Court of Appeal has now imposed.