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CLIENT ALERT
December 2016

SHOW ME THE MONEY:
If you leave, you might have to pay.

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Employers often lose their investments in employees when the employees depart for a new firm. Most employers know that California severely limits the ability to restrict employees from departing and taking clients (and revenue) with them. Specifically, Business and Professions Code Section 16600 prohibits contractual provisions "by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind." "California courts take no prisoners when it comes to Section 16600," which reflects a "settled legislative policy that favors open competition and employee mobility."[1] Thus, with few exceptions, the types of restrictive covenants used in other parts of the country are simply unavailable in the Golden State.

But a California federal court recently provided a glimmer of hope for employers who want to recoup some of their investment in employees. In a pair of related cases, the U.S. District Court for the Northern District of California held that, while California employers cannot impose a *penalty* on employees for joining a competitor, they can -- in some cases -- require payments from former employees, as long as those payments protect "returns from bona fide firm investments."

The Court's opinion includes discussions of celebrities, football, and money. Sports agents receive a percentage of earnings from the athletes they represent. However, for every contract they negotiate, they get paid only when the athlete gets paid. An agent may spend a year flying back and forth across the country to negotiate a five-year, $50 million deal. But if the athlete is released from the team one month into the contract (for example, because of some off-the-field behavior), the agent will have nothing to show for his efforts. For this reason, agents often join firms that offer a guaranteed salary in exchange for the agent's fees (and a lot of the risk).

Octagon employed plaintiffs Douglas Hendrickson and Clifford LaBoy, Jr., sports agents who represented NFL athletes. Hendrickson and Laboy signed employment contracts with Octagon that addressed what would happen if they left the company. The contracts required them to pay a percentage of fees from agreements signed or negotiated while they were employed at Octagon; as well as those that were executed during a "restricted period" after they left the company (one year for Hendrickson and two years for LaBoy).

After resigning from Octagon, both Hendrickson and LaBoy sought a ruling that these provisions violated Section 16600. They argued

1 Hendrickson v. Octagon Inc. and LaBoy v. Octagon, Inc., slip op. at 13 (internal quotations and citations omitted).

that the payments were designed to "prevent" them from leaving Octagon and therefore violated Section 16600. The Court disagreed. It distinguished the fee-sharing provisions from liquidated damages provisions that may violate 16600, and explained that the fee-sharing provisions were intended to "prevent the agents from snookering Octagon out of the returns on its most lucrative investments," not to prevent them from leaving altogether.

The Court noted the significant risk that firms take in hiring agents. For every blockbuster deal, there are failed negotiations and players who get cut. Firms can only take on this risk -- and bear the cost of guaranteed salaries -- if they know they are going to get paid on the deals that do work out. The Court explained that, without the contractual fee-sharing provisions, an agent could earn a comfortable salary at Octagon, use its resources to negotiate a large deal for a player, and leave right before the deal was about to start paying out. In that situation, Octagon would be left with nothing.

Fee-sharing is not, however, without its limits under 16600. The Court distinguished between players represented by Hendrickson and LaBoy, and those who were represented by other Octagon agents. Although the employment contracts at issue required fee-sharing on new deals executed during the restricted period for *any* player who had been represented by *any* Octagon employee, the Court found that this went a bit too far. Octagon could require payments for deals related to players who Hendrickson and LaBoy personally represented while employed there. That protected Octagon's interest in not having its employees steal client revenue by timing their departures. But 16600 does not permit a requirement of payments for deals involving players represented by different agents. As the Court explained, "agents cannot cut and run with clients they do not have" – if Hendrickson and LaBoy can convince other clients to leave their agents and join them, that is protected competition.

Although the *Octagon* cases are still working their way through the system, and likely will be subject to appeal, they provide hope that employers sometimes can protect their investments in employees by requiring post-departure payments. Employers should discuss with their counsel whether to include fee-sharing or other provisions in employment agreements to recoup the investments they make in their employees.

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