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Federal Circuit Friday

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In *Whitewater West Industries v. Alleshouse* (November 19), the Federal Circuit answered a question of first impression regarding the scope of California employee mobility laws as to post-employment patent assignment obligations.

Background: Facts & The Issue

Richard Alleshouse worked as an engineer for Whitewater[1] for almost five years, working on and learning quite a bit about "large-scale, sheet wave attractions" – artificial planar sheets of water that reproduce the characteristics of real waves and that can be used, for example, in surfing attractions at waterparks. He left and formed a new company where he developed and patented new wave-based attractions and implementing technology (*i.e.,* specialized water nozzles).

It was undisputed that the patented technology (i) was conceived *after* Alleshouse was no longer employed by Whitewater; and (ii) was *not* based on, and did *not* utilize, any Whitewater trade secrets or confidential information. But Whitewater sought assignment of the patents based on Alleshouse's employee assignment agreement, which, among other things, provided that Alleshouse would assign inventions conceived *after* his employment if those inventions were *"suggested"* by his work for Whitewater or were *"in any way connected to"* Whitewater's existing or contemplated business.

The issue on appeal was whether the patent assignment provision was valid under California law relating to post-employment restraints on former employees' pursuit of otherwise lawful professions, trades, or businesses.

Background: Relevant Black Letter Law

1. California Business and Professions Code § 16600
   a. Text:
      > Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void.
   b. Interpretation:
      i. Broad scope – applies to any "restraint," not merely to situations where person is prohibited or prevented from engaging in their trade or profession.[2]
         1) The statute "evinces a settled legislative policy in favor of open competition and employee mobility" and "embodies the original, strict common law antipathy toward restraints of trade." [3]
         2) Not limited to non-compete agreements/provisions – issue is one of restraint on person's ability to engage in lawful trade or profession regardless of the form of the restraint.[4]
         3) Per *Erie* guesses in California district courts, patent assignment provisions can be unlawful restraints under § 16600 if, for example, they require assignment of inventions (i) conceived after termination of employment that (ii) did not utilize the former employer's trade secrets or confidential information.[5]

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[1] Technically, he worked for Wave Loch, predecessor-in-interest to Whitewater.

[2] *Edwards v. Arthur Andersen LLP*, 189 P.3d 285 (Cal. 2008).

[3] *Id.* at 291-93.

[4] *Chamberlain v. Augustine,* 156 P. 479 (Cal. 1916)("the crux of the inquiry under section 16600 is not whether the contract constituted a covenant not to compete, but rather whether it imposes 'a restraint of a substantial character' regardless of 'the form in which it is cast.'"). *See also Golden v. Cal. Emergency Physicians Med. Grp.,* 782 F.3d 1083 (9th Cir. 2015)(holding that § 16600 is not limited to non-competition provisions, noting that "the legislature adopted categorical language: 'every contract' that 'restrain[s]' anyone 'from engaging in lawful profession . . . of any kind' is 'void.'").

[5] *E.g., Armorlite Lens Co. v. Campbell,* 340 F. Supp. 273 (S.D. Cal. 1972), *Applied Materials, Inc. v. Advanced Micro-Fabrication Equipment (Shanghai) Co.,* 630 F. Supp. 2d 1084 (N.D. Cal. 2009), *Conversion Logic, Inc. v. Measured, Inc.,* No. 2:19-cv-05546, 2019 WL 6828283, at *6

ii. Legal Standard: Section 16600 prohibits, and renders void, any contract provision that imposes restraint of a "substantial character" on a former employee's ability to engage in a legal trade or profession.[6]

2. California Labor Code § 2870(a)

a. Text:

> Any provision in an employment agreement which provides that an employee shall assign, or offer to assign, any of his or her rights in an invention to his or her employer shall not apply to an invention that the employee developed entirely on his or her own time without using the employer's equipment, supplies, facilities, or trade secret information except for those inventions that either:
>
> (1) Relate at the time of conception or reduction to practice of the invention to the employer's business, or actual or demonstrably anticipated research or development of the employer; or
>
> (2) Result from any work performed by the employee for the employer.

What *Whitewater v. Alleshouse* Adds or Changes:

The Federal Circuit determined that the assignment provision was a substantial restraint on Alleshouse's post-employment professional opportunities and that Labor Code § 2870(a) can be harmonized with Business & Professions Code § 16600 without narrowing the scope of the latter.

The Assignment Provision Represents a Substantial Restraint Under Business and Professions Code § 16600.

The Federal Circuit determined that the patent assignment provisions imposed a substantial restraint on Alleshouse's ability to work as an engineer in the field of large-scale water attractions, reasoning as follows:

- Alleshouse's career was steeped in "large-scale, sheet wave attractions" – *e.g.,* "[a]nyone in his position would have developed useful, specialized knowledge of the business of water attractions, wholly apart from any confidential information." Thus, "[w]ork in the same line of business was necessarily among the best and likeliest prospects for such an individual to pursue when leaving the employer."
- By requiring assignment of post-employment inventions that were "suggested" by his work for Whitewater or that were "in any way connected to" Whitewater's existing or contemplated business, the assignment provision was not limited to inventions that were either (i) conceived during the period of employment, or (ii) made after termination using the former employer's trade secrets or confidential information.
- The assignment provision significantly impaired Alleshouse's ability to work in the field in which he was "particularly fitted" by extracting "a heavy price" in the form of compelled assignment of patent rights developed after termination of his employment and without use of his former employer's trade secrets or confidential information.
    - For example, a "wide range of inventions made after leaving [Whitewater], for all time, would have to be assigned to that (now former) employer" and "[Alleshouse], and the [Alleshouse's] new employer or enterprise, would lose the likely competitive benefits of the exclusivity rights provided by patents on such new inventions—or, worse, could be subject to being sued by [Whitewater], as assignee, for infringement of those very patents."

Labor Code § 2870(a) Does Not Implicitly Narrow the Scope of Business and Professions Code § 16600.

Whitewater argued that Labor Code § 2870(a) "clearly approves an agreement like the one at issue here and, therefore, the general statutory prescription, § 16600, should be applied narrowly so as not to override that clear approval of such an agreement by the more specific statutory prescription, § 2870(a)." Whitewater's argument can be summarized in three steps:

(C.D. Cal. 2019). In these federal district court cases decided under California law, patent assignment provisions were voided under § 16600 for requiring assignment of inventions conceived after termination of employment without regard to whether the invention was based on or otherwise used any of the former employer's confidential information.

[6] *Chamberlain v. Augustine,* 156 P. 479 (Cal. 1916). *See also Golden v. Cal. Emergency Physicians Med. Grp.,* 782 F.3d 1083 (9th Cir. 2015); *Golden v. Cal. Emergency Physicians Med. Grp.,* 782 F.3d 1083 (9th Cir. 2015). Although not relevant to this case, California imposes a less stringent "reasonableness" standard under § 16600 to contractual restraints on business operations and commercial dealings (as opposed to contractual restraints on employees). *Ixchel Pharma, LLC v. Biogen, Inc.,* 470 P.3d 571, 582 (Cal. 2020).

- Section 2870(a) specifically addresses the situation at hand – the division of ownership between employer and employee where the invention is made on the employee's own time without using their employer's equipment, supplies, facilities, or trade secrets – and therefore supersedes the more general provisions of § 16600.[7]
- Section 2870(a) contains no limitation on timing of conception of the invention-at-issue and therefore approves of assignment provisions that extend to inventions conceived in the post-employment period.
- Section 2870(a) provides, through its specific exceptions, that an employer owns inventions that "[r]elate at the time of conception or reduction to practice of the invention to the employer's business, or actual or demonstrably anticipated research or development of the employer." [8]

The Federal Circuit disagreed, determining that the two statutes could be harmonized[9] in a different manner under which § 2870(a) is construed as not "not clearly cover[ing] agreements requiring assignments of post-employment inventions." Under this view, the two statutes can be harmonized "by reading § 2870(a) not to override what we think is a clear application of § 16600 (rather than, as Whitewater argues, reading § 16600 narrowly to avoid overriding § 2870(a))."

The Federal Circuit reasoned as follows:

- "[T]he exceptions in § 2870(a) cannot be broader in scope than the restriction to which they are exceptions."
- The restriction set forth in § 2870(a) is "that certain provisions of employment agreements 'shall not apply' to certain inventions."
  - That restriction relates to "an employer's default right to insist on assignments from its employees of inventions they make *while they are employees*." (emphasis added). The statute itself supports the notion that the restriction at issue is temporally limited to the employment period:
    - The "initial definition of the employee protection [in § 2870(a)] suggests a presupposition of current employee status because the definition focuses precisely on excluding use of employer resources (temporal, physical, or informational) to which current employees commonly have ready access."
    - Section 2870(a) refers to "employees" and "employers," not "former employees" or "former employers."
- The exceptions merely narrow the employer's default right for the benefit of employees. The statute itself supports the notion that the exceptions are temporally limited to the employment period:
  - "Neither exception contains any pointer toward post-employment inventions."
  - A "temporal extension (with no further temporal limit) would raise obvious issues. If such inventions were covered, the exceptions would, by their terms, seem to expand as the former employer's activities change over time (indefinitely into the future) and call for ever-less-certain determinations of the causal connection ('result from') back to work during employment."
- Neighboring § 2871, which authorizes employers to require employees to disclose "all of the employee's inventions made . . . during the term of his or her employment" is consistent with reading § 2870(a) as limited to the employment period.
  - "Although Whitewater contrasts the temporal language in § 2871 with the absence of similar words in § 2870, the language is just as easily understood as making explicit what is already implicit in § 2870, forming a coherent whole."
- Neither Whitewater nor the district court cited any cases that apply § 2870(a) to a post-employment invention.
- "[A]t a minimum, § 2870(a) is nowhere close to clear in applying to post-employment inventions."

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[7] Although not discussed expressly in the case, this is an application of the "general/specific" canon of statutory construction, under which "[i]f there is a conflict between a general provision and a specific provision, the specific provision governs." Antonin Scalia & Bryan Garner, READING LAW: THE INTERPRETATION OF LEGAL TEXTS (2012)(herein "Scalia & Garner"), p. 183. Scalia & Garner share Jeremy Bentham's rationale for this canon: "[T]he particular provision is established upon a nearer and more exact view of the subject than the general, of which it may be regarded as a correction." *Id.*

[8] Whitewater therefore asserted, implicitly at least, that the assignment provision at issue applied to nothing more than inventions that "related to" its business or actual/anticipated research and development, despite the use of facially broader language in the patent assignment provision (*i.e.,* "suggested by" and "in any way connected to"). This subordinate issue of contract interpretation was not decided in light of how the Federal Circuit approached the broader issue.

[9] This is an application of the "harmonious reading" canon of statutory construction, under which provisions "should be interpreted in a way that renders them compatible, not contradictory." Scalia & Garner, p. 180. The Federal Circuit cited a California equivalent for this rule – *State Dep't of Public Health v. Superior Court,* 342 P.3d 1217, 1225 (Cal. 2015) ("We have recently emphasized the importance of harmonizing potentially inconsistent statutes. 'A court must, where reasonably possible, harmonize statutes, reconcile seeming inconsistencies in them, and construe them to give force and effect to all of their provisions. This rule applies although one of the statutes involved deals generally with a subject and another relates specifically to particular aspects of the subject.'").