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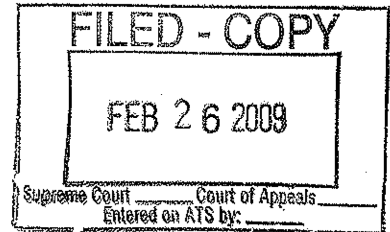
IN THE SUPREME COURT OF THE STATE OF IDAHO

T.J.T., INC., a Washington corporation, Plaintiff/Appellant, vs. ULYSSES MORI, an individual, Defendant/Respondent.	Supreme Court No. 35079



APPELLANT'S OPENING BRIEF

Appeal from the District Court of the Fourth Judicial District
of the State of Idaho in and for the County of Ada

Honorable Ronald J. Wilper, presiding

COPY

John C. Ward, ISB No. 1146
Tyler J. Anderson, ISB No. 6632
MOFFATT, THOMAS, BARRETT, ROCK & FIELDS, CHARTERED
101 S. Capitol Blvd., 10th Floor
Post Office Box 829
Boise, Idaho 83701
Telephone (208) 345-2000
Facsimile (208) 385-5384
jcw@moffatt.com
tya@moffatt.com
17432.0031

Attorneys for Plaintiff/Appellant

Stephen C. Smith
HAWLEY TROXELL ENNIS & HAWLEY LLP
877 West Main Street, Suite 1000
Post Office Box 1617
Boise, Idaho 83701-1617
Facsimile (208) 342-3829

Attorneys for Defendant/Respondent

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Telephone (208) 345-2000
Facsimile (208) 385-5384
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tya@moffatt.com
17432.0031

Attorneys for Plaintiff/Appellant

Stephen C. Smith
HAWLEY TROXELL ENNIS & HAWLEY LLP
877 West Main Street, Suite 1000
Post Office Box 1617
Boise, Idaho 83701-1617
Facsimile (208) 342-3829

Attorneys for Defendant/Respondent

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I. STATEMENT OF THE CASE

A. Nature of the Case.

The nature of this case arises from the execution of a Non-Competition Agreement between appellant, T.J.T., Inc. ("TJT"), and appellee Ulysses Mori ("Mori") in connection with the purchase and sale Mori's business located in Northern California known as Leg-it Tire Company, Inc. The Non-Competition Agreement involved in that sale included a California choice of law provision and is presumptively valid pursuant to well recognized California law permitting parties to enter a covenant not to compete in connection with the sale of a business. Because of Mori's several breaches of the Non-Competition Agreement—including going to work for and opening a local facility on behalf of a long-time TJT competitor in the same Northern California market—TJT filed suit in the district court on May 31, 2007, to enforce the agreement.

B. Course of Proceedings Below.

On September 21, 2007, TJT filed a Motion for Preliminary Injunction and for Partial Summary Judgment. ER 000001 (ROA). Specifically, TJT sought to enjoin Mori from competing with TJT in violation of the Non-Competition Agreement and to obtain partial summary judgment on the issue of Mori's liability for breach of the Non-Competition Agreement. At the time of the filing of TJT's Motion for Preliminary Injunction and for Partial Summary Judgment, there was no dispute that Mori was working for a long-time TJT competitor, West States Tire & Axle. At the close of the October 22, 2007, hearing on TJT's motion, the district court denied TJT's request for injunctive relief and the district court entered

an order reflecting the same on October 24, 2007. ER 000217-000218. Because Mori had filed his own motion for summary judgment days before the October 22, 2007, injunction hearing, the district court did not address TJT's motion for partial summary judgment and, instead, continued the hearing so that both summary judgment motions could be heard on the same day.

On November 26, 2007, the district court heard oral argument on TJT's motion for partial summary judgment as to liability, and on Mori's motion for summary judgment on all counts. On January 31, 2008, the district court issued its Memorandum Decision and Order on the Parties' Summary Judgments wherein the district court denied TJT's request for partial summary judgment and granted Mori's motion for summary judgment in its entirety. ER 000229-000235. In support of its rulings, the district court held that the Non-Competition Agreement was void as a matter of California law. *Id.* at 000232-00234.

Mori filed a motion for attorney's fees and TJT opposed that motion, arguing that because the district court declared the underlying Non-Competition Agreement void under California law, Mori could not enforce an attorney's fee provision contained within the voided agreement. TJT also argued that Mori's claimed attorney's fees were unreasonable and excessive. On June 2, 2008, the court entered a Judgment awarding defendant Mori his requested attorney's fees and costs in the amount of $107,236.85. ER 000265-000267. The same day, the Court subsequently issued an Order granting defendant Mori's motion for attorney's fees and costs under Idaho Code Section 12-120(3) for the same amount. On June 16, 2008, TJT filed a Motion for Reconsideration or, in the Alternative, Motion to Alter or Amend Judgment. Specifically, TJT requested the district court to reconsider its prior order granting

attorney's fees and make specific rulings regarding: (a) whether California law or Idaho law governs Mori's fee request; and (b) to determine the reasonableness of the fee award, together with the other Idaho Rule of Civil Procedure 54 factors, in connection with its $100,000-plus fee award to Mori. Alternatively, TJT requested the district court to amend an error in the June 2, 2008 Judgment to strike the incorrect reference that "[n]o opposition has been filed" by TJT in response to Mori's request for attorney's fees and costs given that TJT has filed a detailed objection. *See* ER 000246-000264 (TJT's 3/10/08 Memorandum in Opposition).

On October 16, 2008, the district court heard TJT's Motion for Reconsideration or, In the Alternative, to Alter or Amend Judgment. On November 21, 2008, the district court entered an order acknowledging the error in the June 2, 2008 Judgment, but denying TJT's motion for reconsideration. ER 000270-000274. Specifically, the district court found that both Idaho and California law provide for an award of attorney's fees and, thus, no conflict of laws analysis was necessary. *Id.* at 000271-000272. Additionally, the district court concluded that Mori's claimed attorney's fees were not unreasonable. *Id.* at 000272.

TJT appeals from the district court's grant of summary judgment to Mori, the district court's denial of TJT's Motion for Partial Summary Judgment, and the district court's award of attorney's fees to Mori.

C. Statement of Facts.

1. Nature of TJT's business.

TJT is an Idaho publicly traded company whose core business involves purchasing axles and tires that have been used to transport manufactured homes from factory to

home sites and which, pursuant to certain federal regulations, must be inspected and refurbished or replaced after each trip. The tires and axles purchased from manufactured housing dealers and independent brokers (individuals or companies that simply gather up and sell used axles and tires to recyclers like TJT) are refurbished and recertified by TJT, and then sold to manufactured home factories for reuse. ER 000006 (Verified Complaint and Demand for Jury Trial ("Verified Complaint") ¶ 5); ER 000024 (Answer ¶ 6). In addition to the refurbishing of axles and tires, TJT also distributes vinyl siding, skirting, and other aftermarket "set-up" products to manufactured housing dealers and "set-up" contractors. TJT serves customers in a thirteen-state area from its recycling facilities located in: (1) Emmett, Idaho; (2) Centralia, Washington; (3) Platteville, Colorado; (4) Phoenix, Arizona; and (5) Woodland, California. *Id.*

2. TJT's *purchase of its competitor*, Leg-it Tire Company, Inc.

In 1980, Mori started a business known as Leg-it Tire Company, Inc. ("Leg-it") to purchase tires and axles and sell them to manufactured home factories. ER 000041 (Deposition of Ulysses Mori ("Mori Depo."), p. 18, LL. 1-6). Leg-it was initially located in Thornton, California, and had a starting operating budget of $1,500.00. *Id.* (Mori Depo., p. 18, LL. 13-20). From 1980 to 1997, defendant Mori grew the business of Leg-it by purchasing tires and axles from retailers of manufactured homes, and refurbishing and reselling those tires and axles for purchase by manufactured home factories. *Id.* (Mori Depo., p. 19, L.7 – p. 20, L. 15). As such, in 1997 TJT and Leg-it were competing in the same line of business.

In June 1997, defendant Mori was a shareholder, officer and director of Leg-it, which had been relocated to Woodland, California. At that time, Leg-it continued to be engaged

in the same type of business as TJT and was doing business in the states of California, Oregon, Washington, Nevada, Idaho, Montana, Nebraska, Arizona, and Texas. ER 000007 (Verified Complaint ¶ 8); ER 000025 (Answer ¶ 9). In 1997, Mori approached TJT to discuss the possibility of the sale of Leg-it to TJT. TJT was interested in the transaction, as it desired to expand its business into California and to strengthen its competitive position in the Oregon and Washington markets. *Id.* At the time of the contemplated merger between Leg-it and TJT, Leg-it had seventeen employees, and annual sales ranging between $3 and $4 million. ER 000042 (Mori Depo., p. 22, LL. 4-13). Moreover, Leg-it's balance sheet as of June 7, 1997, reflected total equity in the amount of $510,718.00. ER 000074-000075 (1997 Leg-it Balance Sheet); ER 000045 (Mori Depo., p. 35, LL. 6-9).

On June 24, 1997, TJT and Leg-it executed an Agreement and Plan of Merger ("Merger Agreement"), whereby Leg-it merged with TJT. ER 000079 (Merger Agreement ¶ 2.1 at 4); ER 000045-000046 (Mori Depo., p. 37, L. 16 – p. 38, L. 11). The corporate entity, TJT, became the "surviving corporation," and continued its corporate existence under the laws of the state of Washington. ER 000007 (Verified Complaint ¶ 10); ER 000025 (Answer ¶ 11). In connection with the merger, TJT paid to Mori, the sole shareholder of Leg-it, $412,500.00 in cash, and issued 291,176 shares of restricted TJT common stock to Mori valued at the time at approximately $600,000.00. ER 000046 (Mori Depo., p. 38, L. 12 – p. 39, L. 3); ER 000079 (Merger Agreement ¶ 2.1 at 4). Thus, TJT paid Mori in excess of $1 million for his Leg-it business. TJT also gave Mori a seat on TJT's board of directors, and Mori became responsible for day-to-day management of the Woodland, California, facility as a senior vice president of

TJT. ER 000007 (Verified Complaint ¶ 11); ER 000025 (Answer ¶ 12); ER 000048 (Mori Depo., p. 47, L. 25 – p. 48, L. 5).

As part of the Leg-it merger with TJT, Mori was required to execute and did execute a separate Employment Agreement with TJT. Ancillary to the Leg-it merger with TJT, Mori was also required to execute and did execute a Non-Competition Agreement with TJT. The execution of the Non-Competition Agreement was a material term in the parties' Merger Agreement and assured TJT that Mori would not compete in the same business as TJT during a defined period and within a defined territory. ER 000007-000008 (Verified Complaint ¶ 13); ER 000050 (Mori Depo., p. 56, L. 15 – p. 57, L. 2); ER 000111-000118 (Non-Competition Agreement).

The Non-Competition Agreement that Mori signed as the seller of Leg-it contained a covenant not to compete, which provides:

> (a) For the period beginning on the Effective Date and ending two (2) years following Seller's [Mori's] termination of employment with the Company [TJT] for any reason (such period being the "Term"):
>
> (i) [Mori] shall not, directly or indirectly, either for himself or any other Person, engage or invest in, own, manage, operate, finance, control, or participate in the ownership, management, operation, financing, or control of, be employed by, associated with, or in any manner connected with, lend [Mori's] name or any similar name to, lend [Mori's] credit to, or render services or advise to, any business whose products or activities compete in whole or in part with the products or activities of the Company and/or Leg-it, anywhere within 1000 miles of any facility owned or operated by the Company or Leg-it; provided, however, [Mori] may purchase or otherwise acquire up to (but not more than) five percent (5%) of any class of securities of any

enterprise (but without otherwise participating in the activities of such enterprise) if such securities are listed on any national or regional securities exchange or have been registered under Section 12(g) of the Securities Exchange Act of 1934; provided, further, that [Mori] may continue his involvement with SAC Industries, Inc. ("SAC"), so long as SAC restricts its operations to its current line of business and does not expand its activities to compete with the Company in any other business area.

(ii) [Mori] shall not, directly or indirectly, either for himself or any other Person, (A) solicit, induce or recruit, attempt to solicit, induce or recruit any employee of the Company or Leg-it to leave the employ of the Company or Leg-it, (B) in any way interfere with the relationship between the Company or Leg-it and any employee thereof, (C) employ, or otherwise engage as an employee, independent contractor, or otherwise, any employee of the Company or Leg-it or (D) induce or attempt to induce any customer, representative, supplier, licensee, or business relation of the Company or Leg-it to cease doing business with Company or Leg-it, or in any way interfere with the relationship between any customer, representative, supplier, licensee, or business relation of the Company or Leg-it.

(iii) [Mori] shall not, directly or indirectly, either for himself or any other Person, do business with or solicit the business of any Person known to [Mori] to be a customer of, or potential customer of, the Company or Leg-it, whether or not [Mori] had personal contact with such Person, with respect to products, services or other business activities which compete in whole or in part with the products, services or other business activities of the Company or Leg-it.

(b) In the event of a breach by [Mori] of any covenant set forth in Section 4(a) above, the term of such covenant shall be extended by the period of the duration of such breach;

* * *

(e) The time, scope, geographic area and other provisions hereof are reasonable and are necessary under the circumstances to protect the Company and to enable the Company to receive the benefit of its bargain under the Merger Agreement.

ER 000008-000009 (Verified Complaint ¶ 14); ER 000113-000114 (Non-Competition Agreement).

3. Mori's employment with TJT.

Immediately following the execution of the Merger Agreement, Mori became and served in the capacity as a director and officer of TJT. In those capacities, Mori participated in the management of TJT and he regularly attended board and management meetings in the state of Idaho. ER 000052 (Mori Depo., p. 63, L. 21 – p. 64, L. 10). During the board and management meetings that Mori attended, the direction and strategy of TJT's business was discussed, and confidences were shared. *Id.* (Mori Depo., p. 64, L. 11 – p. 65, L. 7). Additionally, during TJT board and management meetings, TJT's business plans, strategy, pricing information and price lists, marketing plans, market studies, sales methods and processes, product specifications, know-how, processes, ideas, customer lists and accounts, current and anticipated customer requirements, computer information systems, and other competitively sensitive information were regularly discussed. ER 000010 (Verified Complaint ¶ 16).

Mori moved to Idaho in 2000 and continued in his officer, director, and vice president role at TJT. ER 000049 (Mori Depo., p. 50, LL. 20-22). Mori served as senior vice president of marketing and corporate sales manager. In his capacity as sales manager, Mori became familiar with TJT's customer accounts in each of the regions in which TJT did business and also learned of several dealers from which TJT purchased used tires and axles. ER 000051 (Mori Depo., p. 59, L. 18 – p. 60, L. 15). Moreover, as the senior vice president of marketing and corporate sales manager, Mori created a directory of TJT customers for use in connection

with TJT's marketing efforts. ER 000010 (Verified Complaint ¶ 16); ER 000050-000051 (Mori Depo., p. 57, L. 22 – p. 58, L. 11). Additionally, as corporate sales manager, Mori's charge was to improve the sales of the company, which included mentoring TJT's employees in connection with the purchase and sale of tires and axles in facilities located in Washington, Oregon, Arizona, and Idaho. *Id.* (Mori Depo., p. 58, L. 12 – p. 59, L. 11). Mori was also involved in new business development for TJT while he was an employee of TJT. ER 000048 (Mori Depo., p. 48, L. 21 – p. 49, L. 24). Specifically, Mori participated in securing an important contract for TJT to provide Oakwood Homes, a larger manufacturer, with tires and axles. ER 000049 (Mori Depo., p. 50, L. 22 – p. 52, L. 14).

4. Mori's departure from and competition with TJT.

At times during this employment with TJT, Mori considered making an attempt to remove TJT's chief executive officer, Terry Sheldon. ER 000053 (Mori Depo., p. 66, L. 24 – p. 67, L. 8). Moreover, Mori had his own ambitions about running TJT one day. ER 000052 (Mori Depo., p. 63, LL. 5-20). Mori also sought to gain control over TJT by having discussions with a major shareholder of TJT regarding the purchase of 800,000 shares of TJT stock. ER 000069 (Mori Depo., p. 130, L. 14 – p. 132, L. 16). After his efforts to remove TJT's chief executive officer Terry Sheldon and/or to purchase a controlling interest of TJT failed, Mori devised a plan by January 2007 to exit his employment with TJT and return to a business that would directly compete with every aspect of TJT's core business, including its tire and axle business. ER 000054 (Mori Depo., p. 71, LL. 4-24). During the time that he devised his plan to compete with TJT, Mori was a director and an employee of TJT. *Id.* (Mori Depo., p. 71, LL. 4-

10). Specifically, Mori testified in his deposition that, during the time that he was a TJT employee, he planned to go to work for TJT's competition, West States Recycling, Inc. and West States Tire & Axle. *Id.* (Mori Depo., p. 70, LL. 18-21); ER 000056 (Mori Depo., p. 80, LL. 10-14). West States Recycling, Inc. holds itself out as a leading supplier of certified mobile home axles and tires. Moreover, West States Recycling, Inc. and West States Tire & Axle conduct the same lines of business as TJT in the Western United States and have locations in California, Utah, Arizona and Idaho, and seek to do business in Oregon and Washington. ER 000011 (Verified Complaint ¶ 21); ER 000027 (Answer ¶ 22). As Mori testified in his deposition, just like TJT, West States Tire & Axle is in the business of recovering and selling tires and axles. ER 000056 (Mori Depo., p. 78, LL. 22-25).

In January 2007, Mori met with Heath Sartini, who is the owner of West States Tire & Axle and a significant shareholder of West States Recycling, Inc., to discuss the eventual hiring of Mori as a salesman of tires and axles. ER 000054 (Mori Depo., p. 71, L. 21 – p. 72, L. 23). Mori believed he could be an effective salesman of tires and axles as a result of his past experience, which included his experience with Leg-it and TJT. *Id.* (Mori Depo., p. 72, L. 24 – p. 73, L. 23). On January 12, 2007, Mori resigned as a director of TJT and, on February 7, 2007, Mori resigned as an employee of TJT and announced to TJT that he was leaving to become a full-time real estate agent with TJT Realty, LLC. ER 000010 (Verified Complaint ¶ 18); ER 000027 (Answer ¶ 19); ER 000050 (Mori Depo., p. 57, LL. 3-12).

However, in February 2007, Mori did not become a full-time real estate agent, but rather West State Tire & Axle hired Mori as an employee and Mori later became an employee of

West States Recycling, Inc. ER 000055 (Mori Depo., p. 76, L. 24 – p. 77, L. 2); ER 000056 (Mori Depo., p. 78, LL. 16-21); ER 000027 (Answer ¶ 22). Mori's position with West States Recycling, Inc. was salesman, and he was paid a base salary of $150,000.00 per year. ER 000046 (Mori Depo., p. 39, LL. 21-23); ER 000056 (Mori Depo., p. 78, LL. 2-3); ER 000059 (Mori Depo., p. 91, LL. 9-12). Together with Heath Sartini, Mori devised a business plan to accumulate, process, and sell axles in facilities located in Idaho and TJT's back yard. ER 000056-000057 (Mori Depo., p. 81, L. 17 – p. 82, L. 12). To that end, Mori facilitated the opening of a West States Recycling, Inc. warehouse facility in Idaho to support local Idaho customers who purchase tires and axles. ER 000057 (Mori Depo., p. 82, L. 18 – p. 84, L. 3). *Mori testified during his deposition that he alone selected the facility and that he intended to personally run the new Idaho facility.* *Id.* (Mori Depo., p. 85, LL. 14-17); ER 000062 (Mori Depo., p. 105, LL. 5-12). After Mori opened the Idaho facility, he sent e-mails to officials at the Oregon Manufactured Housing Association and the Idaho Manufactured Housing Association with a picture of the facility to promote the business of West States Recycling, Inc. ER 000119-000121 (7/31/07 Mori e-mail).

During his deposition, Mori readily admitted that he is attempting to compete with TJT and is approached TJT's customers immediately after leaving TJT:

> Q. You do admit that today you are competing with TJT; is that correct?
> A. ***I am doing sales for West States Recycling.***
>
> Q. Are you doing that in competition to TJT?
> A. ***West States Recycling is in competition with TJT.***

Q. In doing so, ***you are competing in markets in which TJT is operating***; correct?
A. ***Correct.***

Q. In markets that TJT was operating in at the time that you sold your business to TJT; correct?
A. Yes.

Q. You are competing in Idaho and TJT sure was in Idaho in 1997; was it not?
A. I said yes.

Q. TJT is in Washington and Oregon; correct?
A. Yes.

Q. And was at the time Leg-it was purchased by TJT?
A. Yes.

Q. You are also competing in northern California where your business was located; is that correct?

* * *

THE WITNESS: I have not made any contacts at factories, that I can recall, in northern California. I did call on Mike Bettleyon, so if Mike Bettleyon as a supplier is competition, yes.

Q. (BY MR. WARD) ***You plan on continuing to compete in northern California, I presume***; correct?
A. ***As long as the company directs me that way.***

Q. ***You have contacted factories that are present customers of TJT in Idaho, Washington, and Oregon***; correct?
A. ***And others, correct.***

ER 000061 (Mori Depo., p. 99, L. 3 – p. 100, L. 21) (interruption by counsel omitted) (emphasis added).

As an employee of either West States Recycling, Inc. or West States Tire & Axle, Mori also admitted soliciting the business of the following known TJT customers: Champion

Homes, KIT Homebuilders, Skyline Corporation, Guerdon Industries Idaho, Nashua Homes of Idaho, and Fleetwood Homes of Idaho. ER 000063 (Mori Depo., p. 108, L. 21 – p. 109, L. 16); ER 000064 (Mori Depo., p. 112, L. 4 – p. 113, L. 25); ER 000064-000065 (Mori Depo., p. 113, L. 24 – p. 114, L. 11); ER 000065-000066 (Mori Depo., p. 117, L. 8 – p. 118, L. 7); ER 000066 (Mori Depo., p. 118, L. 9 – p. 120, L. 10); *id.* (Mori Depo., p. 120, L. 12 – p. 121, L. 3). In addition to telephone contacts, Mori solicited a number of these entities by e-mail. ER 000119-000131.

The covenant not to compete in the Non-Competition Agreement does not end until two years after the termination of Mori's employment with TJT. Accordingly, Mori's admitted competition within two years of the termination of his employment with TJT constituted a breach of the Non-Competition Agreement. The district court failed to recognize Mori's breach and, instead, found the Non-Competition Agreement void. Accordingly, TJT appeals to this Court.

II. ISSUES PRESENTED ON APPEAL

1. Whether the district court erred in concluding that the Non-Competition Agreement between TJT and Mori was void and therefore unenforceable under California law.

2. Whether the district court erred in concluding that California law permits Mori to recover attorney's fees.

3. Whether the district court erred in granting Mori's motion for attorney's fees without considering, addressing, or analyzing all factors presented under Idaho Rule of Civil Procedure 54(e)(3) to determine the proper amount of a fee award.

III. ARGUMENT

A. The District Court Erred in Granting Summary Judgment to Mori Because the Non-Competition *Agreement* Is Enforceable Under California Law.

1. Standard of review.

Upon review of an order of the district court granting summary judgment, the standard of review is the same standard used by the district court in ruling on the motion. *Watson v. Weick*, 141 Idaho 500, 504, 112 P.3d 788, 792 (2005). Summary judgment is appropriate when "the pleadings, depositions, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law." IDAHO R. CIV. P. 56(c). If there is no genuine issue of material fact, "only a question of law remains, over which this Court exercises free review." *Watson*, 141 Idaho at 504.

2. The district court's analysis of the Non-Competition Agreement.

The district court's conclusion that the Non-Competition Agreement was unenforceable and its subsequent grant of summary judgment to Mori was based on a mixture of legal errors and overlooking genuine factual disputes that preclude summary judgment in Mori's favor. Those errors are more fully detailed throughout this brief, but are briefly summarized below.

The district court first found that the geographic scope of the Non-Competition Agreement was overly broad based on its conclusion—at the summary judgment stage—that the business of Leg-it was almost "exclusively limited" to Northern California. ER 000232 (1/31/08 Order). As demonstrated below, Mori testified during the preliminary injunction hearing that the

business of Leg-it was carried on in 11 Western states in 1997. ER 000212-000213 (10/22/08 Tr. p. 26, L. 20 – p. 30, L. 20); *see also* ER 000216. At a minimum, there exist genuine issues of material fact as to whether the business of Leg-it was, in fact, almost exclusively limited to Northern California.

The district court also found that the term of the Non-Competition Agreement was tied to Mori's employment and was therefore void pursuant to Section 16600. ER 000233-000234 (1/31/08 Order). Embedded in this determination is the district court's conclusion that the Non-Competition Agreement was more akin to an "employment" non-compete as opposed to a non-compete made ancillary to the sale of a business. *Id.* As more fully demonstrated below, the district court committed several factual and legal errors in reaching this conclusion.

First, the district court ignored well established authorities under California law regarding the permissible duration of a covenant not to compete made ancillary to the sale of a business and instead relied two reported cases from Nebraska. Additionally, the district court also went outside of the four corners of the Non-Competition Agreement by noting extraneous evidence that, during negotiations, TJT and Mori initially discussed a six-year term for the Non-Competition Agreement. There can be no doubt that the parties ultimately agreed that the two-year covenant not to compete would begin to run beginning the day after Mori's employment with TJT terminated. Even if such extraneous evidence during negotiations could be considered under California law, given the basic and genuine factual dispute as to the parties intent regarding the reasonableness of the period of time necessary to protect the goodwill of Leg-it purchased by TJT, it was error for the district court to grant summary judgment on this basis.

3. Covenant not to compete made ancillary to the sale of a business *versus* an "employment" covenant not to compete.

California Business and Professions Code Section 16601[1] governs the enforceability of covenants not to compete made ancillary to the sale of a business under California law and provides:

> ***Any person who sells the goodwill of a business***, or any owner of a business entity selling or otherwise disposing of all of his or her ownership interest in the business entity, ***or any owner of a business entity that sells (a) all or substantially all of its operating assets together with the goodwill of the business entity***, (b) all or substantially all of the operating assets of a division or a subsidiary of the business entity together with the goodwill of that division or subsidiary, or (c) all of the ownership interest of any subsidiary, ***may agree with the buyer to refrain from carrying on a similar business within a specified geographic area in which the business so sold, or that of the business entity, division, or subsidiary has been carried on, so long as the buyer, or any person deriving title to the goodwill or ownership interest from the buyer, carries on a like business therein.***

CAL. BUS. & PROF. CODE § 16601 (emphasis added).

Although California public policy prohibits "employment" non-competition agreements (*compare* California Business and Professions Code Section 16600), the covenant at issue in this case without question was made ancillary to the sale of a business, i.e., Leg-it. Since before the turn of the 20th Century, California courts have enforced non-compete provisions

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[1] The Non-Competition Agreement between TJT and defendant Mori contains a California choice of law provision. Accordingly, TJT will analyze the enforceability of the Non-Competition Agreement under California law. ER 000115 (Non-Competition Agreement ¶ 10(a) at 5) ("This Agreement shall be governed by, construed, interpreted and applied in accordance with the laws of the state of California, without giving effect to any conflict of laws rules that would refer the matter to another jurisdiction.").

made ancillary to the sale of a business. *See Franz v. Bieler*, 126 Cal. 176 (1899) (enforcing covenant under predecessor to Section 16601); *see also Stephens v. Bean*, 65 Cal. App. 779 (1924) (same); *Mahlstedt v. Fugit*, 79 Cal. App. 2d 562 (1947) (same). Accordingly, the public policy in favor of allowing a party to enforce a covenant not to compete made ancillary to the sale of a business is equally as strong.

In the seminal case addressing the enforceability and breach of a covenant not to compete made ancillary to the sale of business under California law, the California Court of Appeal stated that "[c]ovenants arising out of the sale of a business are more liberally enforced than those arising out of the employer-employee relationship." *Monogram Indus., Inc. v. SAR Indus., Inc.*, 64 Cal. App. 3d 692, 697, 134 Cal. Rptr. 714 (1976). Moreover, the California Court of Appeal noted:

> ***In the case of the sale of the goodwill of a business it is "unfair" for the seller to engage in competition which diminishes the value of the asset he sold.*** In order to protect the buyer from that type of "unfair" competition, a covenant not to compete will be enforced to the extent that it is reasonable and necessary in terms of time, activity and territory to protect the buyer's interest.

Id. at 698 (citation omitted and emphasis added). Additionally, in defining the restricted area within which the seller of a business could not engage in competition, the *Monogram* court held:

> We hold that in the provisions of Business and Professions Code section 16601 the area where a business is "carried on" is not limited to the locations of its buildings, plants and warehouses, nor the area in which it actually made sales. ***The territorial limits are coextensive with the entire area in which the parties conducted all phases of their business including production, promotional and marketing activities as well as sales.***

Id. at 702 (emphasis added).

Against these principles expressly recognized by the California statute and controlling case law, there can be no doubt that the Non-Competition Agreement executed by Mori is enforceable. In 1997, TJT purchased all of Leg-it's outstanding shares from Mori and merged Leg-it into TJT. ER 000046 (Mori Depo., p. 38, L. 12 – p. 39, L. 3); ER 000079 (Merger Agreement ¶ 2.1 at 4). Accordingly, TJT purchased the entire business of Leg-it, *including its* goodwill. In connection with TJT's purchase of Leg-it, Mori and TJT entered into the Non-Competition Agreement. At the time that Mori sold Leg-it to TJT, Leg-it "conducted phases" of its tire and axle recycling business in California, Oregon, Washington, Nevada, Idaho, Montana, Nebraska, Arizona, and Texas. ER 000007 (Verified Complaint ¶ 8); ER 000025 (Answer ¶ 9). Indeed, Mori testified during the preliminary injunction hearing in this matter that Leg-it conducted business in 11 Western states. ER 000212-000213 (10/22/08 Tr. p. 26, L. 20 – p. 30, L. 20); *see also* ER 000216. At the same time, TJT conducted its tire and axle recycling business in Idaho, Washington, Oregon, and California. ER 000006 (Verified Complaint ¶ 7); ER 000024 (Answer ¶ 8). The facts are undisputed; indeed, they were admitted in Mori's Answer and in Mori's deposition testimony. ER 000024-000025 (Answer ¶¶ 8-9, and 11); ER 000050 (Mori Depo., p. 56, L. 15 – p. 57, L. 2); ER 000061 (Mori Depo., p. 99, L. 3 – p. 100, L. 21); ER 000065 (Mori Depo., p. 114, LL. 8-12). Accordingly, the covenant not to compete contained in the Non-Competition Agreement is valid and enforceable under California law.

Because the Non-Competition Agreement is enforceable under California law, it was error for the district court to grant summary judgment to Mori; likewise, it was error for the

district court to deny TJT's motion for partial summary judgment[2] on the issue of liability for breach of the Non-Competition Agreement.

4. Covenants not to compete are enforceable as a matter of California law for so long as the buyer continues to carry on a like business.

California Business and Professions Code Section 16601 provides that the seller of a business "may agree with the buyer to refrain from carrying on a similar business . . . ***so long as the buyer . . . carries on a like business*** . . . ." (Emphasis added.) In other words, so long as the buyer of a business (TJT) continues to operate that business (Leg-it), the seller (Mori) may be prevented from competing with the buyer (TJT) for an otherwise indefinite amount of time.

This has been the law in California for over a hundred years and the cases so holding are legion. *See, e.g.*, *Ragsdale v. Nagle*, 106 Cal. 332, 39 P. 628 (1895) (enforcing covenant made by seller of an abstracting business not to carry on a similar business so long as the purchasers should carry on a like business); *Gregory v. Spieker*, 110 Cal. 150, 42 P. 576 (1895) (same; medical supply business). Indeed, over the past century, the California appellate courts have affirmed this general rule on at least seven different occasions. *See id.*; *Shafer v. Sloan*, 3 Cal. App. 335, 85 P. 162 (1906) (same; secondhand furniture business); *Stephens v. Bean*, 65 Cal. App. 779, 224 P. 1022 (1924) (same; partnership interest); *Johnston v. Blanchard*,

[2] TJT seeks, as it did before the district court, partial summary judgment on the issues of the enforceability of the Non-Competition Agreement as well as breach of that agreement. There is no dispute that Mori has competed with TJT contrary to the terms of the Non-Competition Agreement. However, TJT leaves the question of damages and remedies for resolution by the district court.

16 Cal. App. 321, 116 P. 973 (1911) (same; advertising business); *Martinez v. Martinez*, 41 Cal. 2d 704, 263 P.2d 617 (1953) (same; ship supply business); *see also Brown v. Kling*, 101 Cal. 295, 35 P. 995 (1894) (stating that covenant not to compete made ancillary to the sale of a business under predecessor to Section 16601 can be enforced so long as the buyer carries on a similar business).[3]

Notably, in *Johnston v. Blanchard*, 16 Cal. App. 321, 116 P. 973 (1911),[4] the seller of an advertising distribution business agreed to a non-compete with a term of ***thirty years*** from the date of the sale of the business. *Id.* at 324. On appeal, the California Court of Appeal enforced the thirty-year covenant, stating that a violation of the restriction would necessarily result in depriving the buyer of the goodwill of the business purchased and hinder and obstruct the buyer's successful pursuit and management of such business. Importantly, the court of appeals held that the buyer was "entitled to have the [thirty-year covenant in the] contract enforced for his protection so long as he carries on a like business . . . ." *Id.* at 328.

Similarly, in *Akers v. Rappe*, 30 Cal. App. 290, 158 P. 129 (1916), the seller of a jewelry store agreed to a covenant not to compete with a term of ***twenty years*** from the date of the sale of the business. On appeal, the California Court of Appeal noted that it was practically undisputed that the seller of the business had reopened a jewelry store and was competing with

[3] *See also Akers v. Rappe*, 30 Cal. App. 290, 158 P. 129 (1916) (enforcing twenty year covenant not to compete made ancillary to the sale of a jewelry store); *Franz v. Bieler*, 126 Cal. 176, 180 (1899) (upholding ten year covenant not to compete); *Mahlstedt v. Fugit*, 79 Cal. App. 2d 562, 566 (1947) (upholding ten year covenant not to compete).

[4] Overruled on another point in *Graca v. Rodrigues*, 33 Cal. App. 296, 165 P. 1012 (1917).

the buyer. *Id.* at 292-93. As a result, the court of appeals reversed the judgment in favor of the defendant seller. In so doing, the court of appeals expressly rejected the seller's argument that the twenty-year non-compete provided for an unreasonable length of time, stating:

> We cannot agree with this contention. Section 1674 of the Civil Code [the predecessor to Section 16601] provides that "One who sells the goodwill of a business may agree with the buyer to refrain from carrying on a similar business within a specified county, city or a portion thereof ***as long as the buyer*** or any person deriving title to the goodwill from him ***carries on a like business therein***." ***The evidence shows that the plaintiff is still engaged in conducting the original business under a title thereto and to the goodwill thereof derived from the persons to whom the defendant sold the same, and with whom such contract was made, and that about six years intervened between the time of such original sale and the time of the opening of the second store.*** We think that these facts bring the case clearly within the provisions of the above section of the code, and also within the line of cases holding similar contracts to be valid.

Id. at 293-94 (emphasis added; citations omitted).

In view of the foregoing authorities, there can be no doubt that so long as TJT continues to operate the tire and axle recycling business it purchased from Mori, the duration of the parties' non-competition covenant is *per se* reasonable under the plain terms of Section 16601. Indeed, California law would clearly have allowed TJT to prohibit Mori from seeking competing employment within the tire and axle recycling industry for the remainder of his *entire lifetime*, so long as TJT continued to carry on a similar business during that period. Accordingly, the term of the Non-Competition Agreement must be enforced as written.

5. Mori's subsequent employment with TJT does not invalidate or limit the duration of the covenant as a matter of law.

The fact that the covenant does not go into effect until the day after Mori leaves his employment with TJT is irrelevant to the Court's determination as to the reasonableness of the duration of the covenant. The only salient factual inquiry is whether TJT is currently, and has at all times relevant to this dispute, continued to operate its tire and axle tire recycling business within the same geographic region as that previously occupied by Leg-it, the business that Mori sold to TJT. Because the fact of TJT's continued business operation within these parameters is undisputed in this case, the covenant continues to be enforceable as a matter of California law.

Indeed, the California Court of Appeal has made it clear that covenants not to compete made ancillary to the sale of a business are enforceable under circumstances where the buyer purchases the seller's business, chooses to employ the seller for a period of time, and then the seller ultimately leaves his employment and attempts to compete with the buyer. *See Vacco Indus. Inc. v. Tony Van Den Berg*, 5 Cal. App. 4th 34, 6 Cal. Rptr. 2d 602 (1992); *Hilb, Rogal & Hamilton Ins. Servs. v. Robb*, 33 Cal. App. 4th 1812, 39 Cal. Rptr. 2d 887 (1995).

In *Vacco*, the California Court of Appeal enforced a covenant not to compete made ancillary to the sale of a business where the seller, like Mori, sold all of his shares of stock in the business to the buyer, and as part of the sale of the business, executed, like Mori, an employment agreement and a separate non-competition agreement. 5 Cal. App. 4th at 42-43. After the termination of his employment with the buyer, the seller/employee began to compete

with his former employer. *Id.* at 43-44. Ultimately, the buyer commenced an action against the seller/employee for breach of the non-competition agreement. *Id.* at 44. A jury found that the seller/employee breached the non-competition agreement, but also found that the buyer breached the employment agreement by terminating the seller/employee without cause. *Id.* at 45.

On appeal, the California Court of Appeal held the non-competition provision was enforceable. *Id.* at 47-48. The court of appeals rejected the seller/employee's argument that he was excused from breaching the non-competition agreement because the buyer breached the employment agreement by terminating him without cause. *Id.* at 49. In finding that the employment agreement and the non-competition agreement were two separate agreements with independent obligations, the court of appeals stated that:

> Indeed, the noncompetition agreement, as a practical matter, necessarily contemplated that [the seller/employee's] employment would at some point be terminated. . . . ***There is no justification for also excusing him from performing his promise not to compete with [the buyer] for a reasonable period following the sale of his stock which was given in exchange for the purchase of that stock, <u>a matter quite apart from his employment</u>.***

Id. (emphasis added).

Similarly, in *Hilb*, the seller of an insurance agency transferred all of his shares to the buyer in exchange for $245,000.00. 33 Cal. App. 4th at 1817-18. As part of the merger transaction, the seller executed a merger agreement and a separate employment contract. Included within the employment contract was a covenant not to compete, "which provided that ***for a three-year period <u>after</u> the termination of employment***, [seller] would not solicit or accept the business of his employer's [the buyer's] customers or prospective customers and would not

engage in a competing business" in designated areas. *Id.* at 1017 (emphasis added). As consideration for the covenant, the seller received $52,500. *Id.*

Approximately three years after the sale of the business in *Hilb*, the seller left his employment with the buyer and began to work for a competing insurance agency. *Id.* at 1018. The buyer sued the seller for breach of the covenant not to compete contained in the employment agreement. The district court refused to grant a preliminary injunction, finding that the buyer was not likely to prevail on "asserting the viability of the covenant." *Id.* at 1818-19.

On appeal, the California Court of Appeal held that the covenant not to compete was indeed enforceable and viable. The court of appeals concluded that the seller sold all of his interest in the insurance agency purchased by the buyer and, thus, the transaction fit within Section 16601. *Id.* at 1824-25. The court of appeals also rejected the seller's argument that the covenant not to compete was invalid because it was contained in the employment agreement. *Id.* at 1825-26. In rejecting this argument, the court of appeals stated:

> Nothing in section 16601 requires that the covenant be contained in a particular type of document. ***The purpose of the statute is served as long as the covenant is executed in connection with the sale or disposition of all of the shareholder's stock in the acquired corporation.*** Section 16601 does not prescribe a format for a covenant not to compete, and we can find no reason to impose one.

Id. (emphasis added). As further indicia that the covenant was made ancillary to the sale of a business, the court of appeals noted that the seller executed the covenant not to compete in his capacity as a seller shareholder, not solely as an employee. *Id.* at 1827. Notably, in *Hilb*, the California Court of Appeal did not take any issue with regard to the fact that the parties

bargained for a covenant that did not go into effect until *after* the seller terminated his employment with the buyer for a period of three years.

The *Hilb* case applies nearly on all fours to the facts presented here. Mori sold all of his shares in Leg-it for the consideration in excess of $1 million. As part of the merger, Mori executed a Merger Agreement, a Non-Competition Agreement, and an Employment Agreement. Like the seller in *Hilb*, Mori expressly signed the Non-Competition Agreement in his capacity as "seller" of Leg-it. Also like the seller in *Hilb,* the Non-Competition Agreement prohibits Mori from competing in the tire and axle recycling business for two years *after the termination of his employment* with TJT.

In light of holdings of the court in *Vacco* and *Hilb,* the parties' decision to structure the covenant to coincide with the termination of Mori's employment with TJT does not impair the validity or enforceability of the covenant as a matter of California law.[5] Accordingly,

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[5] In addition to the clear authority that exists on this issue as a matter of California law, other states with statutes similar to California Business and Professions Sections 16000 and 16001 also recognize that a seller of a business who remains employed by the buyer after the sale is subject to the enforcement of a covenant not to compete. *See, e.g., Target Rental Towel, Inc. v. Byrd*, 341 So. 2d 600, 603 (La. Ct. App. 1977) (clause enforceable against seller of going concern who remained employee of purchaser after sale).[5] In *Neeb-Kearney & Co., Inc. v. Rellstab*, 593 So. 2d 741 (La. Ct. App. 1992), the Louisiana Court of Appeals succinctly stated:

> When a person (shareholder) sells a business and remains an employee after the sale, an agreement not to compete may be enforced against him. ***The concept is to protect those who are in a poor bargaining position, therefore the form of the agreement and the label tacked to the individual (employee, partner, shareholder) are immaterial.***

Id. at 748 (emphasis added; citation omitted).

the district court erred in concluding that the Non-Competition Agreement was an "employment" covenant not to compete and therefore void pursuant to California Business and Professions Code Section 16600.

6. The geographic boundaries of the Non-Competition Agreement are lawful and reasonable.

Under California law, it was error for the district court to conclude that the Non-Competition Agreement was geographically overbroad. ER 000232-000233 (1/31/08 Order). For example, since before the turn of the 20th Century, California courts have enforced broad non-compete provisions. In *Franz v. Bieler*, 126 Cal. 176 (1899), the California Supreme Court enforced, pursuant to Section 16601's predecessor, a non-compete provision in which the defendant agreed he would not engage in the wine and liquor business "within the radius of ten miles in either direction from 809 East Fourteenth Street, in the city of Oakland, for the period of 10 years." *Id.* at 180. The defendant argued that the provision was invalid, because the described area included three separate counties. The appellate court, however, found that the exact territory being described was ascertainable, and the agreement was enforceable to the extent the property fell within the county where the defendant conducted business. The supreme court explained "that the inclusion of territory greater than that sanctioned by the code ***is void only as to the excess***." *Id.* at 181 (emphasis added).

In *Mahlstedt v. Fugit*, 79 Cal. App. 2d 562 (1947), as in *Stephens*, the California Court of Appeal enforced an agreement under Section 16601 that contained no geographical limitation at all. In *Mahlstedt*, the seller of a heater business agreed not to enter into that

business as a manufacturer, owner, or salesman for ten years. The seller later argued that the agreement was void, because it did not contain a geographical limit, as required by Section 16601. *Id.* at 566. The court of appeal, however, found that a contract with no geographical limit will be enforced to the extent permitted by law. Because the heating business was located in Los Angeles County, the court prohibited the seller from competing with the entire county.

In *Mahlstedt*, the California Court of Appeal succinctly stated the rules regarding enforcement of noncompetition provisions made ancillary to the sale of a business:

> On the date of the contract sections 1673 and 1674 of the Civil Code were in effect. (These provisions with slight modifications are now sections 16600 and 16601 of the Business and Professions Code.) As authorized by said sections of the Civil Code appellant, having transferred the good will of his business, agreed to refrain from carrying on a similar business for a period of ten years. He contends that that portion of his agreement was void because it did not, as required by section 1674, specify the territory within which he agreed not to carry on his business. ***If such a contract is indefinite as to time or territory the court will construe it in such manner as to make it valid. If the contract is unrestricted as to the territory in which the seller agreed to refrain from competition with the purchaser of his business, or if it includes more territory than that provided by law it will be construed to be operative within the county or portion thereof in which the business is located*** (*City Carpet etc. Works* v. *Jones,* 102 Cal. 506, 512 [36 P. 841]; *Stephens* v. *Bean,* 65 Cal. App. 779, 783 [224 P. 1022]; *General Paint Corp.* v. *Seymour,* 124 Cal. App. 611, 614 [12 P.2d 990]), and if the agreement is indeterminate as to the period of its operation, or is without time limit, the court will construe it to cover the time permitted by law. (*Gregory* v. *Spieker,* 110 Cal. 150, 153 [42 P. 576, 52 Am.St.Rep. 70]; *Brown* v. *Kling,* 101 Cal. 295, 298 [35 P. 995].)

79 Cal. App. 2d at 566-67 (emphasis added); *Kolani v. Gluska*, 64 Cal. App. 4th 402, 407-08 (1998) (stating in dictum that several courts have "saved" covenants not to compete which were valid under § 16601, but simply overbroad in scope).

Although Mori relied on the case of *Strategix, Ltd. v. Infocrossing West, Inc.*, 142 Cal. App. 4th 1068 (2006), in arguing that the geographic scope of the Non-Competition Agreement is too broad, it is important to note that, in *Strategix*, the California Court of Appeal in no way overruled the vast body of California law summarized above in *Mahlstedt*. Indeed, the *Strategix* court cited *Mahlstedt* in recognizing that "Courts have 'blue penciled' noncompetition covenants with overbroad or omitted geographic and time restrictions to include reasonable limitations." 142 Cal. App. 4th at 1074. Accordingly, the result in *Strategix* appears to be limited to the specific facts presented in that case.

Consistent with the policy expression demonstrated above, the California courts have routinely interpreted non-compete covenants and validated the same even though the covenants employed language overbroad in scope. Indeed, once the clause's general validity is established, no reason exists not to give weight to the parties' intentions, as expressed in the contract. *See, e.g., Stephens v. Bean*, 65 Cal. App. 779, 783 (1924) ("No sound reason appears . . . why the intention of the parties may not be ascertained, as in other agreements, from a consideration of the terms of the contract as a whole."); CAL. CIVIL CODE § 1648 ("However broad may be the terms of a contract, it extends only to those things concerning which it appears that the parties intended to contract.").

Most recently, the California Court of Appeal found that an insurance broker carried on phases of its business in both the locations from which it sold insurance and the locations from which it procured insurance products to sell. *See Alliant Ins. Svcs., Inc. v. Gaddy*, 159 Cal. App. 4th 1292 (2008). In *Gaddy*, the purchaser of an insurance brokerage acknowledged that the purchased business sold insurance "mostly in Northern California," but also argued that the purchased business conducted phases of its business outside of Northern California because another part of that business involved relationships with insurance companies that provided insurance products for the broker to sell. *Id.* at 1303. In other words, the insurance brokerage had two phases to its business: a supply side and a demand side. The California Court of Appeal agreed that the locations from which the purchased business obtained insurance products to broker or sell to customers constituted a location in which some phase of its business was conducted, noting there were two components to the business: "(1) selling insurance to . . . clients, and (2) procuring insurance from insurance companies." *Id.* at 1305. Accordingly, the California Court of Appeal enforced the non-compete in all locations from which the purchased business procured insurance from insurance companies.

By analogy to *Gaddy*, although Mori argues that the Leg-it production facility was located in Northern California, he unquestionably admitted during sworn testimony at the preliminary injunction hearing that Leg-it procured tires and axles from locations throughout 11 Western states. ER 000212-000213 (10/22/08 Tr. p. 26, L. 20 – p. 30, L. 20); *see also* ER 000216. Thus, by support of the clear weight of California law, even if Leg-it's production facilities were "almost exclusively limited" to Northern California, that does not mean that the

Non-Competition Agreement is unenforceable in locations outside of Northern California. At a minimum, the Non-Competition Agreement is operative in the areas in which Leg-it conducted some phase of its business, i.e., procured tires and axles to sell from its plant in Northern California. As a result, it was clear error for the district court to conclude—at the summary judgment stage—that the business of Leg-it was "almost exclusively limited" to Northern California. And, in light of *Gaddy*, it is clear that the district court erred, as the Non-Competition Agreement can be lawfully enforced in every location in which Leg-it formerly conducted some phases of its business, including the locations from which it procured tires and axles.

7. The public policy justifications for limiting the duration of a covenant not to compete in an employment context do not apply where the covenant is made ancillary to the sale of a business.

In enacting Section 16601, the California legislature articulated a conscious and well-reasoned distinction between the law of covenants not to compete as it applies to employers and employees, and the law as it applies to the buyers and sellers of a business. Although California law prohibits outright the use of non-competition agreements as a condition to employment, it expressly allows such agreements ancillary to the sale of a business to the reasonable extent necessary to allow the purchaser to obtain the benefit of his bargain, including the entire period of time in which the buyer continues to operate the same or similar business.

The reason for this distinction is because the public policy reasons that justify the restriction of the use of such covenants in the employment context—unequal bargaining power

between employer/employee; unfair restrictions on trade; etc.—do not generally apply in the context of the sale of a business. As one commentator has succinctly explained:

> A transfer of good will cannot be effectively accomplished without an enforceable agreement by the transferor not to act so as unreasonably to diminish the value of that which he is selling. The same is true in regard to any other property interest of which exclusive use is part of the value. The restraint on the transferor in such a case necessarily runs concurrently with the use of the property by the covenantee. . . .
>
> ***Unlike a restraint accompanying a sale of good will, an employee restraint is not necessary for the employer to get the full value of the thing being acquired-in this case, the employee's current services.*** . . . A sale of good will implies some obligation to deliver the thing sold by refraining from competition, just as an employment contract implies some obligation not to impair the value of the services rendered by competitive activity during the period of employment. But no such commitment not to compete after employment can be implied from an ordinary employment contract . . . .
>
> . . . ***the parties to an employee covenant are often of unequal bargaining power and, thus, that there is less likelihood that the covenant was actually bargained for. They may find that the employee has improvidently given up his only valuable economic asset, specialized proficiency arising from experience or training. On the other hand, a seller of property is more likely to have other sources of income or, in any event, income from the capital arising from the sale.*** Finally, they find that ***an employee covenant has an inevitable tendency to reduce an employee's mobility and bargaining power during his employment.*** Because of these differences, courts are more likely to declare an employee covenant invalid as unreasonable, or, in giving injunctive relief, they are more likely to require that an employer settle for less thoroughgoing protection than that accorded a transferee of a property interest.

Blake, *Employee Agreements Not To Compete,* 73 HARV. L. REV. 625, 646-48 (1960) (emphasis added).

Another commentator has observed that covenants not to compete made ancillary to the sale of a business are commonplace, as buyers of a business "would not invest in the enterprise unless the seller was restricted from competing with him." Gary P. Kohn, Comment, *A Fresh Look: Lowering the Mortality Rate of Covenants Not to Compete Ancillary to Employment Contracts and to Sale of Business Contracts in Georgia*, 31 EMORY L.J. 635, 639 (1982). When a seller is paid compensation for the covenant not to compete ancillary to the sale of his business, such

> capital that the seller receives from the transaction enables him to earn a livelihood in an alternate enterprise or at a different location, [and therefore] he is relatively unaffected by the covenant's restraints and does not have any substantial interest in need of protection. . . .
>
> . . . the bargaining powers of the seller of a business and the purchaser are likely to be more equal. The seller invariably is ***represented by an attorney*** during the sale of business transaction. Unlike an employment covenant, ***a sale of business covenant is more likely to be drafted only after extensive negotiations by the attorneys for both parties.*** Moreover, the seller is typically in a stronger bargaining position than the employee because ***the seller's business is usually of greater relative value to the buyer than are the services of one employee to the employer***. As a result of the comparative differences in the bargaining positions, ***the seller receives additional compensation for entering into a covenant not to compete that he may utilize after his business is sold.*** In contrast, by signing a post-termination covenant, the employee divests himself of his primary means of earning a living—his specialized skills developed from his prior knowledge and experience—and receives nothing in return. Therefore, the surrender of one's right to complete is much more burdensome to the employee than it is to the seller of a business.

Id. at 640-42 (emphasis added).[6]

Simply put, the kind of equitable concerns that exist in the context of an employer-employee covenant are not relevant to the Court's consideration of the covenant at issue here. Mori, as a businessman, negotiated the TJT/Leg-it merger and the parties conducted due diligence for approximately one year with representation by counsel. ER 000043-000044 (Mori Depo., p. 29, LL. 7-14 and p. 29, L. 19 – p. 30, L. 13); ER 0000222-000228. The Non-Competition Agreement that resulted from that extensive, year-long negotiation and due diligence was generated through open and knowledgeable bargaining. There is nothing in the record to indicate a disparity in bargaining power between the parties during the course of those negotiations. TJT's insistence on the execution of a covenant not to compete was critical to its decision to consummate the TJT/Leg-it merger. Had Mori refused to execute such a covenant,

[6] Courts have also traditionally recognized the public policy distinctions between the two different categories of non-compete agreements. *See Golden State Linen Servs., Inc. v. Vidalin*, 69 Cal. App. 3d 1, 12, 137 Cal. Rptr. 807 (1977) (recognizing the validity of the "status" distinction as drawn between an ex-employee and the seller of a business in enforcing a covenant not to compete) (citing the RESTATEMENT OF CONTRACTS § 515, cl. (a), com. b and illus. 1 and Comment, *Employee Agreements Not To Compete*, 73 HARV. L. REV. 625, 648 nn.75 and 76 (1960)); *Monogram Indus., Inc. v. SAR Indus., Inc.*, 64 Cal. App. 3d at 697 ("[c]ovenants arising out of the sale of a business are more liberally enforced than those arising out of the employer-employee relationship."). *See also Baker v. Starkey*, 259 Iowa 480, 491, 144 N.W.2d 889, 895 (1966) (stating that non-competition clauses in employment contracts are scrutinized differently than similar clauses in contracts for the sale of a business because goodwill is more important in the latter and because there is less risk of a disparity of bargaining power in contracts for the sale of a business); *Jacobsen & Co. v. Int'l Env't Corp.*, 427 Pa. 439, 452, 235 A.2d 612, 619 (1967) (stating that "'a more stringent test of reasonableness' is imposed [on employment non-competition clauses] than would be applied to such restrictive covenants ancillary to the sale of the business") (citation omitted).

the deal would not have gone through, because TJT knew it would have been purchasing a business without the ability to reap the benefits of the goodwill it was paying for.

Moreover, Mori was gainfully employed at the time of the 1997 merger and could easily have chosen to remain so employed by declining TJT's offer of purchase. Mori was not required to "succumb" to the condition of the covenant in order to get/keep his job, in the way an ordinary employee might have been. Indeed, it was Mori who approached TJT to initiate discussions regarding the purchase of Leg-it. ER 000043-000044 (Mori Depo., p. 29, LL. 7-14, p. 29, L. 19 – p. 30, L. 13). To the extent that Mori may not be able to put his work experience to use during the period of enforcement of the covenant without moving outside of his former business territory, this fact was both entirely ***foreseeable*** and ***objectively quantified*** at the time of the Leg-it merger in 1997, when Mori negotiated the price that he required TJT to pay him for the likelihood of that eventuality.

In addition, the absence of any inequitable injury stemming from the enforcement of the covenant is further underscored by the fact that Mori negotiated for the equivalent of ***five years***' salary in exchange for his promise not to compete for ***two years***. ER 000043 (Mori Depo., p. 29, LL. 15-18). Thus, should Mori choose not to pursue a career outside of the tire and axle recycling industry and/or outside of the region where TJT conducts its business during the two-year term of the Non-Competition Agreement, Mori still cannot legitimately claim an economic injury here.

Therefore, there is nothing either unique or compelling about this argument under the facts of this case requiring the district court to invalidate the Non-Competition Agreement.[7] The Non-Competition Agreement must be enforced as a valid covenant not to compete made ancillary to the sale of a business pursuant to California Business and Professions Code Section 16601.

B. The District Court Erred in Awarding Attorney's Fees to Mori.

1. Standard of review.

An award of attorney fees is "within the discretion of the trial court and subject to review for an abuse of discretion." *Ransom v. Topaz Mktg., L.P.*, 143 Idaho 641, 643, 152 P.3d 2, 4 (2006). Whether a statute awarding attorney fees applies is a question of law over which this Court exercises free review. *Id.* at 644, 152 P.3d at 5.

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[7] Indeed, in prior sworn deposition testimony in 2001, defendant Mori recognized the enforceability of his Non-Competition Agreement with TJT, stating:

> Q. During the time that you were employed at TJT, ***have you ever had discussions with anybody about starting a new business that would compete with TJT***?
> A. Compete how, with what?
>
> Q. In the tire and axle business, in the general area that TJT does business.
> A. ***I can't do that.***
>
> Q. Did you ever have any discussions about doing that?
> A. ***I can't do that.***

ER 000161 (2001 Deposition of Ulysses Mori, p. 119, LL. 1-12) (emphasis added).

2. The parties chose California law to govern the Non-Competition Agreement.

Mori's reliance on Idaho law to support his claim for attorney's fees is fundamentally misplaced. Specifically, Mori claimed in the district court entitlement to attorney's fees by relying on Idaho Code Section 12-120(3). In his briefing before the district court, Mori acknowledged the validity of this contractual choice of law provision and previously cited Idaho authorities to support the proposition that parties can agree to choose the law that will apply to their agreement in both commercial and non-commercial settings. ER 0000195. Because the parties selected a valid and enforceable California choice of law provision in the Non-Competition Agreement, there can be no question that California law—not Idaho law—applies to all aspects of any dispute regarding the Non-Competition Agreement, including Mori's claim of entitlement to attorney's fees under that agreement.

3. Under California law, Mori is not entitled to claim an award of attorney's fees pursuant to a provision in the Non-Competition Agreement.

Although the district court found the Non-Competition Agreement to be void, Mori hoped to resuscitate the voided contract one last time in the district court to claim the benefit of a provision allowing for recovery of attorney's fees. ER 000238-000239 (Mori's Memorandum for Attorney Fees and Costs at 3-4). In other words, Mori wanted it both ways. He first argued to the district court that the Non-Competition Agreement is void and illegal, but then argued that certain provisions that inure to his benefit survive the district court's ruling voiding the contract. California law does not permit Mori to take such inconsistent positions and eliminates Mori's claim to fees under the Non-Competition Agreement. *See Geffen v. Moss*, 53

Cal. App. 3d 215 (1975). The black letter rule in California is that when a court declares a contract void, the contract is void *ab initio* and neither party to that contract can point to an attorneys' fee provision in the voided contract to claim entitlement to an award of fees. *Id.* Here, this Court has declared the Non-Competition Agreement to be <u>void</u> and, under *Geffen* and the California cases following its holding, the attorney fee provision is also void.

In the district court's analysis of the enforceability of the Non-Competition Agreement, it began by recognizing that California Business and Professions Code Section 16600 declares covenants not to compete to be void. ER 0000231 (1/31/08 Order at 3). The district court relied on Mori's repeated arguments that the Non-Competition Agreement was void and the district court ultimately found "as a matter of law that the scope of the non-competition agreement . . . is ***<u>void as a matter of law</u>***." ER 000232 (emphasis added); ER 000234 ("Because the Court ruled as a matter of law that the non-compete agreement is ***<u>void</u>***, TJT's motion for partial summary judgment is moot.") (emphasis added).

Under California law and a common legal understanding, the word "void" means illegal. *See Geffen*, 53 Cal. App. 3d at 227; *Yuba Cypress Hous. v. Area Developers*, 98 Cal. App. 4th 1077, 1081-82 (2002); *Edwards v. Arthur Andersen LLP*, 44 Cal. 4th 937, 946, 189 P.3d 285, 289 (Cal. 2008) ("restraints on trade are 'illegal.'"); BLACK'S LAW DICTIONARY 1573 (6th ed. 1990). When a contract is declared void or illegal, the California courts will not allow any party to enforce any of its provisions, including a provision allowing for the recovery of attorney's fees. *See Geffen*, 53 Cal. App. 3d at 227; *Yuba Cypress Hous.*, 98 Cal. App. 4th at 1081-82. Specifically, in *Geffen*, an attorney sold his law practice to another attorney, which

included physical assets, a lease for office space, existing client files, and the expectation of future business from the existing clients of the selling attorney. *Id.* at 219-20. The district court concluded that the terms of contract for sale included the goodwill of the law practice and that such sale was void against public policy under California law. *Id.* at 221. Although the district court declared the contract against public policy, the district court allowed the buying attorney to recover attorney's fees pursuant to the contract for sale. *Id.*

On appeal, the California Court of Appeal affirmed the district court's conclusion that the contract for sale of the law practice was illegal. *Id.* at 222-26. The appellate court then addressed the selling attorney's argument that, because the contract was illegal, no party could enforce its terms, including an attorneys' fee provision in the contract. *Id.* In reversing the district court's award of attorney's fees, the California Court of Appeal stated:

> ***Geffen [the selling attorney] argues that, if the contract is held to be illegal, the award of attorney's fees in favor of Moss [the buying attorney] as the prevailing party would be improper. We must agree.*** In paragraph IB the agreement provides for the payment of the $12,500 in installments and, in the event of default and the filing of suit to enforce payment, for attorney's fees to Geffen [the selling attorney]. Civil Code section 1717 renders the obligation to pay attorney's fees mutual. However, ***since we have decided that the obligation to pay the $12,500 is contrary to public policy and unenforceable the right to attorney's fees created by this provision never matured.***

Id. at 227. Accordingly, the Court of appeals modified the judgment by striking the award of attorney's fees. *Id.*

The *Geffen* rule continues to exist today and has never been overruled. In 1988, the California Court of Appeal reaffirmed the *Geffen* rule, stating:

> Ordinarily, in an action on a contract which provides for an award of attorney's fees, the prevailing party in the action is entitled to attorney's fees. (Civ. Code, § 1717, subd. (a).) This is so even when the party prevails on grounds the contract is inapplicable, invalid, unenforceable or nonexistent, if the other party would have been entitled to attorney's fees had it prevailed.
>
> * * *
>
> ***However, a different rule applies where a contract is held unenforceable because of illegality. Geffen v. Moss (1975) 53 Cal. App. 3d 215 is directly on point. In that case, the court held a party may not recover attorney's fees when it successfully defends an action on a contract on the ground the contract violated public policy.*** In *Geffen*, the contract was declared void as violative of public policy. The court refused to award attorney's fees, explaining, "Civil Code section 1717 renders the obligation to pay attorney's fees mutual. However, since we have decided that the obligation to [perform under the contract] is contrary to public policy and unenforceable the right to attorney's fees created by this provision never matured."
>
> ***A party to a contract who successfully argues its illegality stands on different ground than a party who prevails in an action on a contract by convincing the court the contract is inapplicable, invalid, nonexistent or unenforceable for reasons other than illegality.*** "The effect of the *Geffen* decision is that where neither party can enforce the agreement there is no need for a mutual right to attorney's fees."
>
> Consistent with our decision that the contract is illegal and void, we affirm the trial court's order denying [the prevailing party's] claim for attorney's fees.

Bovard v. Am. Horse Enters., Inc., 201 Cal. App. 3d 832, 842-43 (1988) (citations omitted; emphasis added).

Accordingly, there can be no doubt that *Geffen* and its progeny defeat Mori's claim for attorney's fees pursuant to the Non-Competition Agreement. Specifically, the *Geffen*

case is on all fours with the facts presented here. Like *Geffen*, the instant case involves the purchase and sale of a business, including the goodwill of the business. The district court declared the Non-Competition Agreement made ancillary to the purchase and sale of Leg-it to be void as a matter of law and therefore illegal under California law. Because the district court declared the Non-Competition Agreement to be void, Mori's claimed right to attorney's fees created by the Non-Competition Agreement never matured and is likewise void.

4. The district court erred in failing to consider all factors under Idaho Rule of Civil Procedure 54(e)(3) in connection with the award of attorney's fees to Mori.

Under clearly existing Idaho law, a district court is required to analyze all applicable factors under Idaho Rule of Civil Procedure 54(e)(3) prior to issuing an award of attorney's fees. *Parsons v. Mut. of Enumclaw Inc., Co.*, 143 Idaho 743, 747, 152 P.3d 614, 618 (2007). The district court need not specifically address each of the factors, so long as the record indicates that it considered them all. *Id.*

Taken as a whole, the record clearly indicates that the district court did not analyze or even consider the appropriate Rule 54(e)(3) factors prior to awarding Mori attorney's fees in excess of $100,000 and prior to ruling on TJT's motion for reconsideration. First, the district court first granted Mori's request for attorney's fees without the benefit of a hearing, stating in a two page Order the following, but nowhere in the district court's did it indicate that it considered the Rule 54(e)(3) factors in connection with awarding attorney's fees to Mori. ER 000268 (6/2/08 Order).

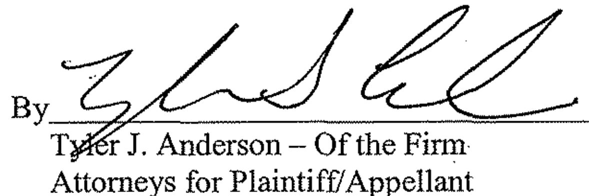
And, upon TJT's request for reconsideration, the district court simply analyzed the "time and labor required" under Rule 54(e)(3)(A) to the exclusion of all other Rule 54(e)(3) factors. ER 000272 (11/21/08 Order). Apart from the lone reference to the "time and labor" factor under Rule 54(e)(3)(A), there is no indication in the record that the district court considered *all* Rule 54(e)(3) factors in connection with its award of attorney's fees to Mori. Accordingly, in the event this Court affirms the district court's holding that the Non-Competition Agreement is void, and further affirms the district court's award of attorney's fees, Mori requests this Court to remand the determination of the amount of the fee award to the district court so that all applicable Rule 54(e)(3) factors may be properly considered.

IV. CONCLUSION

For the foregoing reasons, TJT respectfully requests this Court to reverse the district court's grant of summary judgment to Mori, to grant partial summary judgment in favor of TJT, and to reverse the district court's award of attorney's fees to Mori.

DATED this 26th day of February, 2009.

MOFFATT, THOMAS, BARRETT, ROCK & FIELDS, CHARTERED



By____________________
Tyler J. Anderson – Of the Firm
Attorneys for Plaintiff/Appellant

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this 26th day of February, 2009, I caused a true and correct copy of the foregoing **APPELLANT'S OPENING BRIEF** to be served by the method indicated below, and addressed to the following:

Stephen C. Smith HAWLEY TROXELL ENNIS & HAWLEY LLP 877 W. Main St., Suite 1000 P.O. Box 1617 Boise, ID 83701-1617 Facsimile (208) 342-3829	( ) U.S. Mail, Postage Prepaid (✓) Hand Delivered ( ) Overnight Mail ( ) Facsimile

Tyler J. Anderson