Employer Update

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November 2020

Whitewater Industries, Ltd. v. Alleshouse: The Federal Circuit Invalidates Assignment Provision's "Broad Restraining Effects" on Former Employee

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The United States Court of Appeals for the Federal Circuit recently issued a decision in *Whitewater West Industries, Ltd. v. Alleshouse*, Nos. 19-01852, 19-02323 (Fed. Cir. Nov. 19, 2020), invalidating a non-compete agreement containing an assignment provision, which required a former employee to assign post-employment inventions to his previous employer. This opinion clarifies the limits of assignment provisions and confirms that such provisions cannot be drafted to require post-employment assignments in light of California's broad ban on agreements that prohibit an employee from engaging in his or her profession.

The Allegations and District Court Decision

Whitewater West Industries, Ltd. ("Whitewater"), the maker of waterpark attractions, sued its competitor Pacific Surf Designs. Inc. ("Pacific Surf") and its owners, Richard Alleshouse and Yong Yeh, over the ownership of three patents used to simulate surfing in wave attractions at amusement parks.[1] Prior to co-founding Pacific Surf, Alleshouse worked for Wave Loch, Inc. ("Wave Loch"), Whitewater's predecessor and the company that created the popular "FlowRider®" surfing attraction. While working at Wave Loch, Alleshouse signed a non-compete agreement that included an assignment provision requiring Alleshouse to assign to Wave Loch—and future successors of Wave Loch—any inventions, improvements and developments Alleshouse conceived of or may conceive of in the future solely or jointly with others as long as the invention, improvement or development was in any way connected to any subject matter within the existing or contemplated business of Wave Loch.

Alleshouse subsequently left Wave Loch, founded Pacific Surf—a similar wave-surf simulation company—and applied for three patents. Two of the patents claim certain waterpark surfing attractions and the third patent claims nozzle configurations for regulating water flow in such surfing attractions. Whitewater sued Alleshouse and Yeh for breach of contract and correction of inventorship, asserting that, pursuant to the non-compete agreement, Alleshouse was required to assign the patents to Whitewater. Defendants challenged the validity of the non-compete agreement under California Business Professions Code §16600 and California Labor Code § 2870.[2]

In finding that Alleshouse breached the non-compete agreement and Yeh was improperly named as an inventor, the District Court first ruled that Section 2870 permitted the assignment of inventions conceived after

employment as long at the inventive idea related to the employer's business or results from work performed by the employee for the employer. The District Court then rejected the defense of invalidity under Section 16600 on the basis that the non-compete agreement did not restrain Alleshouse from engaging in the sheet wave profession, but instead only required him to assign inventions resulting from his work at Wave Loch or relating to Wave Loch's business at the time he was there.

The Federal Circuit's Reversal

On appeal, the Federal Circuit reversed the District Court. In evaluating the validity of the non-compete agreement, the Federal Circuit acknowledged that neither the California Supreme Court nor any intermediate California appellate courts has addressed whether an employer can require assignment of inventions conceived post-employment and without use of the former employer's confidential information.

After discussing the broad nature of the non-compete agreement, the court emphasized that, as written, the assignment provision required that Alleshouse assign to Wave Loch a wide range of inventions made after leaving Wave Loch, for all time, despite the fact that Alleshouse no longer worked for the company. The Federal Circuit relied on Section 16600's broad prohibition on the restraint of trade, as reflected in California jurisprudence, to conclude that "invention-assignment provisions that go beyond protection of proprietary information and ensnare post-employment inventions" are invalid under Section 16600's strict standards governing restraints on former employees.

Regarding Section 2870, which Whitewater argued authorized the assignment provision, the Federal Circuit found that because Section 2870 does not clearly cover agreements requiring assignments of post-employment inventions, the proper way to harmonize Sections 2870 and 16600 is to read Section 2870 in a way that does not override what is a clear application of Section 16600. In other words, Section 2870 should not be read as authorizing post-employment assignments.

The Federal Circuit also distinguished its previous holding in *Board of Trustees of the Leland Stanford Junior University v. Roche Molecular Systems, Inc*., 583 F.3d 832 (Fed. Cir. 2009), which rejected a seemingly similar Section 16600 challenge to an assignment provision. The Federal Circuit noted that the key difference in *Stanford* was that there was no evidence of a restraining effect on the employee's profession. The employee, a Stanford researcher, had signed a confidentiality agreement with a similar assignment provision when he briefly spent time at a second lab as part of his ongoing work for Stanford. The Federal Circuit pointed out that he had freely continued his research upon his return to Stanford and even published articles using the information he had learned during his time at the second lab. Additionally, the Federal Circuit noted that, unlike Alleshouse, the employee was a visitor, working as part of a larger relationship between the two labs, which did not require a strict approach under Section 16600.

The holding in *Whitewater West Industries, Ltd. v. Alleshouse* clarifies the reach of California's broad ban on agreements that prohibit an employee from engaging in his or her profession and confirms that employers cannot require employees to assign future inventions post-employment without potentially running afoul of Section 16600.

We will continue to monitor the case, including any appeals, and will update you on any developments.

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[1] *Whitewater West Industries, Ltd. v. Alleshouse*, No. 17-cv-00501, 2019 WL 4261884 (S.D. Cal. Mar. 26, 2019).

[2] Section 16600 provides that "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void." Cal. Bus. & Prof. Code § 16600 (West). Section 2870 provides that any provision in an employment agreement that assigns rights in an invention to an employer will not apply to an invention developed on an employee's personal time, except when it "relate[s] 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 "result[s] from any work performed by the employee for the employer." Cal. Lab. Code § 2870 (West).

Employer Update is published by the Employment Litigation and the Executive Compensation & Benefits practice groups of Weil, Gotshal & Manges LLP, 767 Fifth Avenue, New York, NY 10153, +1 212 310 8000, www.weil.com.

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