

CALIFORNIA SUPREME COURT CLARIFIES LAW ON NON-COMPETITION

The recent California Supreme Court decision in *Edwards v. Arthur Andersen L.L.P.*, No. S147190 (Aug. 7, 2008), clarified the confusion that has long lingered between California state and federal courts regarding enforceability of non-competition agreements that have “partial” or “narrow” restrictions. *Edwards* reaffirmed California’s longstanding public policy in favor of open competition, and confirmed that any restraints on lawful competition would be unenforceable in California, unless they qualify under one of the recognized statutory exceptions to Business and Professions Code Section 16600 discussed below.

In another significant development, the Court also held that broad release language that is typically found in employee severance agreements, releasing the employer from “any and all claims,” does not release unwaivable indemnity rights provided under the California Labor Code.

CASE BACKGROUND

Edwards was hired as a tax manager by Arthur Andersen L.L.P. (“Andersen”) in 1997. As a condition of his employment, he signed a non-competition agreement which restrained him from (1) performing work for clients he had previously serviced at Andersen for 18 months following the termination of his employment; (2) soliciting any client of his office for 12 months after his termination; and (3) soliciting away any of Andersen’s professional employees for 18 months following his departure.

In May 2002, Andersen ceased practicing public accounting and began selling portions of its tax practice to its competitors. In connection with the sale, Andersen required Edwards to sign a termination of the non-competition agreement (“TONC”) containing a general release of “any and all claims” against Andersen. Edwards refused to sign that agreement, in part because he did not want to release his statutory indemnity rights for potential liability and legal fees related to Andersen’s Enron troubles. As a result, Andersen terminated Edwards and withdrew his severance benefits.

Edwards sued Andersen alleging that (1) the 1997 non-competition agreement violated California Business and Professions Code Section 16600, and (2) the general “any and all claims” release violated California Labor Code sections 2802 and 2804, which render an employee’s indemnification rights nonwaivable. The trial court decided all issues of law in favor of Andersen; however, the California Court of Appeal reversed on both issues, holding that California law did not recognize the federal exception of “narrow restraint” on trade, and that the release agreement was void under California Labor Code Section 2804 because it purported to waive Edward’s indemnification rights.

THE SUPREME COURT’S DECISION

After a thorough analysis of California law governing restraints of trade and covenants not to compete, the California Supreme Court concluded that California’s policy against non-competition agreements, codified in Business and Professions Code Section 16600, is unambiguous, and does not recognize a “narrow restraint” exception. The only statutory exceptions are those contained in the Business and Professions Code pertaining to agreements in connection with the sale or dissolution of corporations (section 16601), partnerships (section 16602) or limited liability corporations (section 16602.5). The Court held, that to the extent federal decisions were in conflict with its ruling, they were disapproved. In conclusion, the Court held that the restrictive covenants contained in Edwards’s employment agreement were unlawful and unenforceable because it restricted Edward’s ability to engage in his chosen profession.

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Although the Court touched on the judicially created “trade secrets exception” to section 16600, it did not address the issue fully, leaving lower courts and practitioners to continue operating under the body of law which provides that non-competition and non-solicitation agreements are enforceable to the extent that misuse of trade secrets are involved.

With respect to the release language of the termination agreement, the Court held that an employee’s rights under Labor Code section 2802 are unwaivable, and the broad release language of the TONC which included the language releasing “any and all claims” did not release the employee’s unwaivable indemnity rights under section 2802.

PRACTICAL IMPLICATIONS OF THE DECISION

The Court’s rejection of the “narrow restraint” doctrine now provides clarity for both employers and employees: In California, *any* restraint on lawful competition will be held unenforceable.

This decision should prompt employers to review and revise all employment related and proprietary information agreements to ensure that non-competition or non-solicitation provisions are compliant with the new law. Compliance would minimize the risk of claims for interference with contract or economic advantage that may be brought by employees who claim to have lost opportunities because of non-competition provisions in their employment agreements.

Furthermore, employers and practitioners would be well advised to review any release or severance agreements to ensure that such agreements do not contain express waivers of an employee’s indemnity rights.

If you have any questions regarding this decision or would like to discuss issues relating to labor and employment, please contact:

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