California Supreme Court Settles Law Regarding Enforceability of Non-Competition Agreements, Releases of Claims

August 08, 2008

by Kate Fritz and J. Carlos Orellana

Fenwick
FENWICK & WEST LLP

Upholding earlier California Court of Appeal decisions and disagreeing with the federal Ninth Circuit Court of Appeals, the California Supreme Court has ruled in *Edwards v. Arthur Andersen LLP*, ___ Cal. 4th ___ , 2008 Cal. LEXIS 9618 (Cal. Aug. 7, 2008) (No. S147190), that non-competition agreements in California are invalid under California Business and Professions Code Section 16600 ("Section 16600"), even if narrowly drawn, unless they fall within an express statutory exception. The Supreme Court has further held that contractual releases of "any and all" claims do not encompass nonwaivable statutory claims and are not void, reversing the existing Court of Appeal precedent.

Practical Impact

The California Supreme Court's decision on non-competition agreements may have little practical impact, as many California employers have adopted the more conservative approach set forth in the Court of Appeal's opinion and approved by the Supreme Court. However, employers should be aware that non-competition agreements fashioned on Ninth Circuit precedent allowing such agreements in situations not covered by statute are no longer valid. Employers should consult with counsel before requiring non-competition agreements as a condition of employment or continued employment. Prospective employers expecting a challenge to a strategic hire should likewise consult with counsel to evaluate whether the non-competition agreement in question is valid.

The Supreme Court's ruling that releases of "any and all" claims are no longer presumptively invalid should provide relief to employers concerned about crafting enforceable releases. Those who wish to proceed out of an abundance of caution may still choose to include a clause saying that the release is not intended to include claims that cannot be waived as a matter of law. Employers should consult with counsel to ensure their releases comply with the law and protect their interests.

Factual Background and Claims

When Arthur Andersen hired plaintiff Raymond Edwards, it required him to sign a non-competition agreement. This agreement prohibited Edwards from working on accounts for or soliciting some of Arthur Andersen's clients during his employment with the firm and for certain periods thereafter. Following the federal government's well-publicized prosecution of Arthur Andersen, the firm sold the group in which Edwards worked to HSBC. HSBC and Arthur Andersen required Arthur Andersen personnel wishing to join HSBC to sign a "Termination of Non-compete Agreement" ("TONC") under which Arthur Andersen would relieve the employee from his or her non-competition agreement and the employee would, among other things, release Arthur Andersen from "any and all" claims, including those "that in any way arise from or out of, are based upon or relate to Employee's employment by, association with or compensation from" Arthur Andersen. Edwards refused to sign the TONC, partly because he believed it required him to waive his right to indemnification from Arthur Andersen as provided by the Labor Code. Arthur Andersen fired him, and HSBC withdrew its offer of employment. Edwards sued Arthur Andersen, arguing that the firm's non-competition agreement (still in effect) violated Section16600 because it restrained him from practicing his profession. He also alleged that the TONC's release of "any and all" claims violated California Labor Code Sections 2802 and 2804, which establish an employee's right to indemnification and make that right nonwaivable.

Section 16600 Prohibits All Non-Competition Agreements Except As Explicitly Provided By Statute

Arthur Andersen argued that Section 16600's language forbids only non-competition agreements that completely prohibit an employee from engaging in his or her profession. The trial court agreed and held that, because Arthur Andersen's non-competition agreement was narrowly tailored so as not to deprive Edwards of the right to practice his profession entirely, it did not violate Section 16600. In so doing, the trial court relied on Ninth Circuit rulings that non-competition agreements can be valid — even if not authorized by a statutory exception — so long as they are "narrowly tailored." *See, e.g., Campbell v. Trustees of Leland Stanford Jr. Univ.*, 817 F.2d 499 (9th Cir. 1987). The California Court of Appeal strenuously disagreed with the trial court (and the Ninth Circuit's interpretation), holding that the plain language of Section 16600 prohibits all non-competition agreements unless the agreement is covered by a specific statutory exemption (such as agreements in connection with the sale or dissolution of a business). The Supreme Court agreed with the Court of Appeal and explicitly rejected the Ninth Circuit's analysis. The Supreme Court ruled that the only exceptions to Section 16600's prohibition of non-competition agreements are those found in California's statutes. As to Edwards, the Supreme Court stated succinctly, "The agreement restricted Edwards from performing work for Andersen's Los Angeles clients and therefore restricted his ability to practice his accounting profession. The noncompetition agreement that Edwards was required to sign before commencing employment with Andersen was therefore invalid because it restrainted his ability to practice his profession." Because Edwards did not contend that the portion of the Arthur Anderson non-competition agreement prohibiting him from recruiting employees violated Section 16660, the Court expressly declined to address the applicability of a "trade secret exception" to Section 16600.

Contractual Releases Of "Any And All" Claims Can Be Valid Even Without Qualifying Language Exempting Nonwaivable Statutory Rights

Edwards argued that the TONC's release of "any and all claims" against Arthur Andersen was invalid because it would violate the Labor Code's guarantee that employers indemnify employees. The Court of Appeal agreed and ruled that the TONC's language waiving "any and all" claims was invalid because it would include rights that cannot be waived (such as the Labor Code's guarantee of indemnification). The Court of Appeal's decision called into question many standard releases. In response to this decision, many employers clarified their releases to exclude rights guaranteed by law.

The Supreme Court disagreed, holding that the phrase "any and all" does not emcompass nonwaivable statutory protections and serves to waive only rights that legally **can be waived**. Nonwaivable rights are just that: nonwaivable. To clarify the release by making it expressly applicable "except as otherwise prohibited by law" (or in some similar fashion), as suggested by Edwards, would make no difference, said the Supreme Court, as such language is vague and would not inform the employee of what rights were and were not being waived. Nonetheless, though the language at issue was not per se unlawful, the Supreme Court left open the possibility that a plaintiff might offer proof of facts that might prove an exception to this general rule based on a defendant's conduct.

For further information, please contact:

Kate Fritz, Litigation Partner
kfritz@fenwick.com, 415.875.2328

J. Carlos Orellana, Litigation Associate
corellana@fenwick.com, 650.335-7234