Allen Matkins

Labor & Employment Legal Alert

California Supreme Court Confirms Limited Enforceability of Non-Competition Agreements in California

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In many states, covenants not to compete are considered valid so long as they are "reasonably" imposed in terms of duration, geography and other factors. California, however, has not followed this rule of reasonableness for more than a century.

IMPORTANT TIP to California Employers:

Employers should reevaluate existing agreements with California employees in light of the Edwards Decision by the California Supreme Court.

Instead, Section 16600 of the California Business and Professions Code (which can be found here) 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." California courts have interpreted Section 16600 as evidencing a settled legislative policy in favor of open competition and employee mobility. The legislature has enacted only a handful of statutory exceptions to Section 16600. These include exceptions for the sale or dissolution of corporations, partnerships and limited liability companies. Until now, it has been debated whether a limited non-competition agreement could be valid if it did not fit into one of these very specific statutory exceptions. Now, the Supreme Court has resolved the question by holding that employee non-competition agreements are prohibited by Section 16600 unless they fall within a statutory exception.

In *Edwards v. Arthur Andersen*, a former employee, Mr. Edwards, challenged a non-competition agreement that he had signed when he was hired. Arthur Andersen later sold its practice groups to various entities. Edward's practice group was sold to HSBC USA, Inc., which offered to hire him provided he signed an agreement terminating his non-competition agreement with Arthur Andersen and releasing his former employer from "any and all" claims. Edwards refused to do so. He argued that the non-competition agreement was unlawful and that it was against public policy for Arthur Andersen to demand consideration for the termination of the non-competition agreement. Edwards, of course, grounded his argument on Section 16600. Arthur Andersen countered that the word "restrained" in Section 16600 should be understood as meaning "prohibited." In other words, a limitation on an employee's ability to practice his vocation would be permissible under Section 16600 so long as it was reasonably based. The Supreme Court

rejected Arthur Andersen's interpretation.

The case is noteworthy because the Supreme Court has now decisively shut the legal door on non-competition agreements that do not fit within specific statutory exceptions. The federal courts interpreting California law had permitted some non-compete agreements under a narrow-restraint exception. The Supreme Court's opinion makes it clear that the federal courts' narrow-restraint exception is not California law.

The Supreme Court's decision upholds the values of free competition and employee mobility. The inability to enter into valid non-competition agreements, however, makes it more difficult for employers to protect legitimate property interests in trade secrets, proprietary information and goodwill.

The Supreme Court also answered another very important question. Mr. Edwards was asked to release "any and all" claims against Arthur Andersen. He argued that this waiver was unlawful because it included a waiver of his rights to indemnification under the California Labor Code. Because these indemnity rights are not waivable by statute, the Supreme Court concluded that a release of "any and all" claims does not encompass indemnity rights under the Labor Code. Had the Supreme Court determined otherwise, the validity of releases that did not expressly carve out nonwaivable statutory rights may have been called into question.

In light of the Supreme Court's holding, employers should evaluate whether existing employment agreements run afoul of Section 16600's proscription. This should include a review of employment contracts themselves, as well as Non-Disclosure Agreements, Confidentiality Agreements, Offer Letters and Inventions Agreements.

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