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California Supreme Court Rejects The "Narrow-Restraint" Exception To Statutory Prohibition On Noncompete Agreements

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California long has had a statute voiding noncompete agreements, implementing California's strong public policy in favor of open competition and employee mobility. Over the years, federal courts in California have applied a "narrow-restraint" exception to the rule and have permitted noncompete agreements that were narrowly tailored and did not entirely preclude an employee from pursuing his trade or business. The California Supreme Court now has ruled that such agreements are void and that noncompete agreements may be enforced only in the very limited circumstances explicitly spelled out in the statute.

The facts giving rise to the Court's decision in *Edwards v. Arthur Andersen*, 2008 Cal. LEXIS 9618 (Cal. 2008), are as follows: In the wake of the Enron collapse, the accounting firm of Arthur Andersen sold a tax practice to HSBC and, in connection with the sale, HSBC offered former Andersen employee Raymond Edwards a job. HSBC conditioned the offer on Edwards' releasing Andersen of "any and all" liability relating to Edwards' employment. Andersen, in turn, would release Edwards from his noncompete agreement. Worried about potential exposure to litigation following the Enron collapse, Edwards refused to sign the release. Andersen then refused to waive Edwards' noncompete, and HSBC withdrew its offer of employment.

Edwards filed suit against Andersen, HSBC, and others for interference with prospective economic advantage and for anticompetitive practices under California's state antitrust law, the Cartwright Act. He alleged that his noncompete agreement was unenforceable under California law and that

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Andersen's demand for consideration to release him from the agreement therefore was wrongful.

California's Business and Professions Code Section 16600 provides that "[e]xcept as provided in this chapter, 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 state courts had consistently interpreted this provision to void any agreement that placed any constraint on employment. Federal courts in California applied a "narrow-restraint" exception, however, essentially reading the term "restrain" to mean "prohibit." Thus, in the view of the federal Court of Appeals for the Ninth Circuit (whose jurisdiction includes California), only agreements that blocked all employment in a field were invalid.

The California Supreme Court rejected that position, finding that non-competition agreements that restrict an employee from performing work are unenforceable, no matter how narrowly tailored, unless they fall within one of three narrow statutory exceptions concerning the sale or dissolution of a corporation, partnership, or limited liability corporation. In reaching its conclusion, the Court expressly disapproved of the Ninth Circuit's "narrow-restraint" exception, stating that "California [state] courts have not embraced the . . . narrow-restraint exception," and "have been clear in their expression that Section 16600 represents a strong public policy of the state which should not be diluted by judicial fiat." The Court held that "Section 16600 is unambiguous, and if the Legislature intended the statute to apply only to restraints that were unreasonable or overbroad, it could have included language to that effect." 2008 Cal. LEXIS 9618 *21 (2008).

The Court did leave open one possible exception. The decision recognized, but expressly did not address, the applicability of the so-called "trade secret exception." That exception, based on the California Supreme Court's decision in *Muggill v. Reuben H. Donnelley Corp*., 62 Cal. 2d 239, 242 (1965), permits the enforcement of noncompete agreements to the extent "necessary to protect the employer's trade secrets."

It is important to note that while the decision in *Edwards* obviously impacts employers and employees who reside in California, it also may apply when a former employee later accepts employment from a California employer or moves to California. As such, employers would be well advised to seek legal counsel before implementing any policies or provisions, to ensure that they do not subject employees to any unlawful restrictions on postemployment activities.

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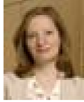
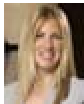


Tamar Feder Ms. Feder represents private and publicly traded companies, financial institutions, biomedical companies and individuals, including directors and officers of publicly-traded companies. She is listed in 2005 Who's Who in American Law and was named a 2005 Southern California Super Lawyer by *Los Angeles Magazine*.



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