

***First Wednesday — A Monthly Discussion of Employment
Law Issues and Other Hot Topics for
Management***

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**California Supreme Court Invalidates Non-Competition
Agreement Prohibiting Employee from
Working for Former Clients**

Non-competition agreements governed by California law are commonly described as “unenforceable.” Last month, the California Supreme Court affirmed this widely-held belief, ruling that unless there is a statutory exception permitting a post-employment restriction, non-competition agreements are invalid in California. It is important to note that the agreement in *Edwards v. Arthur Andersen* (2008) 44 Cal.4th 937 prohibited the former employee from working for clients of his former employer for a certain period of time. The court held this type of restraint was unenforceable.

The Court’s ruling resolved an existing conflict between state and federal courts. The Court expressly held that attempts by the Ninth Circuit federal courts to create a “narrow restraint” exception to the general rule regarding non-competition agreements were not supported by statute or any California state court decisions.

The *Edwards* Facts

When he was hired in 1997 as an accountant, Edwards signed a non-competition agreement in which he agreed not to work for or solicit certain Arthur

Andersen clients for a certain period of time after his employment ended. In 2002, as a result of the Enron Corporation scandal, Arthur Andersen was indicted by the United States government and stopped performing accounting services in the United States.

Edwards' group at Arthur Andersen was sold to HSBC USA. As part of the acquisition, HSBC USA asked some Arthur Andersen employees to sign a "Termination of Non-Compete" agreement, which required that the employees release Arthur Andersen from any and all claims they might have against their former employer. If Edwards had signed the agreement with HSBC USA, he would have been released from the non-competition agreement he signed with Arthur Andersen in 1997.

Because of the existing legal claims against Arthur Andersen and the likelihood that Edwards would need the company to indemnify him, Edwards did not want to sign an agreement releasing his former employer. When he did not sign the new agreement, HSBC USA rescinded its offer of employment.

Edwards filed a lawsuit against Arthur Andersen, HSBC USA, and WTAS, a subsidiary of HSBC USA, for intentional interference with prospective economic advantage and anti-competitive business practices. He alleged that the companies' practices violated Business and Professions code section 16600 which states: "[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." Edwards also made a claim based on the indemnification issue and a potential violation of Labor Code sections 2802 and 2804, which is not the subject of this article.

The claims against all parties except Andersen were settled. The trial court held that the non-competition agreement did not violate California Business and Professions Code section 16600 because it was narrowly tailored and did not restrict Edwards from working as an accountant. Edwards appealed the decision, and the Court of Appeal reversed. The Court of Appeal held that the non-competition agreement was invalid, and the companies' attempts to make

Edwards sign the new agreement in order to be released from the invalid non-competition agreement constituted an independently wrongful act for purposes of evaluating a claim for intentional interference with prospective economic advantage.

The Supreme Court Ruling

The California Supreme Court affirmed the Court of Appeal's decision. Explicitly rejecting a "narrow restraint" exception, the Court held that the statutory language of Business and Professions Code section 16600 is clear and unambiguous - California employers cannot restrict former employees from working in their profession unless one of the statutory exceptions to this general rule applies.

The non-competition agreement prohibited Edwards from 1) performing professional services like the ones he performed at Arthur Anderson for any client he had performed services for in the 18 months prior to his termination, and 2) prevented him from "soliciting," which in this case was defined as performing professional services for any client of the Arthur Andersen Los Angeles office within one year of his termination. The California Supreme Court expressly interpreted these restrictions as an unlawful restraint on Edwards' ability to work in his profession, a direct violation of Business and Professions Code section 16600.

The Narrow Restraint Exception

The California Supreme Court also rejected the "narrow restraint" exception to Business and Professions Code section 16600, which it suggested had been created by "judicial fiat." "Section 16600 is unambiguous, and if the Legislature intended the statute to apply only to only to restraints that were unreasonable or overbroad, it could have included language to that effect." (*Edwards*, at 949-50). The court rejected Arthur Andersen's suggestion that it adopt the narrow restraint exception created by federal courts interpreting California law, and said it would leave such decisions to the state legislature.

Conclusion

The Supreme Court's decision in *Edwards* resolves the ambiguity in California's approach to non-competition agreements and a narrow-restraint exception to the statutory rule. While federal courts may have interpreted state law as allowing for a limited restraint in certain circumstances, the Court dispelled this notion. Unless there is a specific statutory authorization for a restraint, the law and policy of California prohibits post-employment restrictions and favors the ability of employees to work in their chosen profession.

The Court's ruling does not mean that ex-employees can do no wrong. For example, the theft of trade secrets or other misuse of confidential or proprietary information can still be unlawful. The decision does, however, make non-competition agreements that restrain ex-employees from working in their chosen profession in California invalid.

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