

## *California Supreme Court Upholds the General Ban on Noncompetition Agreements While Leaving Intact the "Necessary to Protect Trade Secrets" Exception*

BY BRADFORD NEWMAN

In *Edwards v. Arthur Andersen*, one of the most significant employee-mobility decisions in recent years, the California Supreme Court rejected the Ninth Circuit's "narrow restraint" exception to California's broad prohibition of noncompetition agreements. The court's decision is clear: California Business and Professions Code section 16600 means exactly what it says. Except as provided by the statute, "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void." There is no exception for "narrow" restraints on competition.

However, perhaps the most notable but potentially overlooked aspect of the court's decision comes in footnote 4 of the opinion: **"We do not here address the applicability of the so-called trade secret exception to section 16600, as Edwards does not dispute that portion of his agreement or contend that the provision of the noncompetition agreement prohibiting him from recruiting Andersen's employees violated section 16600."** Thus, the court did not disturb those cases recognizing the judicially-created exception to the prohibition on noncompetition agreements where "*necessary to protect trade secrets*." This exception will continue to be an important safe harbor to protect the interests of

many employers.

At issue in *Edwards* was an Arthur Andersen noncompetition agreement that imposed only "narrow" restraints on Edwards's ability to engage in post-employment competition. The agreement purported to restrain Edwards for eighteen months from performing services for the clients he had personally served at Andersen during the prior eighteen months, and to bar him for twelve months from soliciting the business of clients of the Andersen office where he had worked. After Andersen collapsed following the Enron scandal, it offered to relieve Edwards of his noncompetition agreement if he agreed to release "any and all" claims against Andersen. Because Edwards did not want to relinquish his right to seek indemnification from Andersen for third-party claims, he refused to give the release. As a result he lost a job offer from the company that had acquired the Andersen unit where he worked.

Andersen defended the noncompetition agreement on the basis that it imposed only a limited restraint on Edwards's activities, not a complete ban on competitive employment, citing to Ninth Circuit decisions that recognized a "narrow restraint" exception to section 16600. But the California Supreme Court held that since the express language of section 16600 only

provides statutory exceptions to the general prohibition on noncompetition agreements for agreements related to the sale of a business or to the dissolution of a partnership or limited liability company, there is no statutory exception for “narrow” restraints. Since none of the statutory exceptions applied and Andersen did not invoke the judicially-created trade-secrets exception to section 16600, the noncompetition agreement was unenforceable.

The court also ruled that a general release of “any and all” claims does not implicitly release a non-waivable claim for indemnification of employee expenses and losses under California Labor Code section 2802. (The decision did not consider whether under some circumstances the provisions of section 2802 can be waived, such as when there is a *bona fide* dispute over whether indemnification is owed.) Therefore, the court concluded, on its face the release was neither unlawful nor null and void. That part of the court’s ruling comes as good news for employers concerned that unless their releases specifically exempt non-waivable claims, they are subject to attack.

**Recommendations for California employers and employers outside of the state who employ individuals in California:**

- Review all contracts restraining competitive activity to ensure that they comply with *Edwards*.

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- Multi-jurisdictional employers should assess whether their standard agreements need to be modified to comply with California law.

- If a company wishes to use a restrictive covenant to protect its trade secrets, it should conduct an internal trade secrets audit to assess the nature and scope of the entity’s trade secrets, the appropriate measures to protect those trade secrets, and whether contractual activity restraints are necessary to protect them. **This is an extremely complex process that routinely involves human resources, in-house legal, audit, business, information technology, research and development, and other intra-corporate functions, and requires experienced trade secrets counsel.**

- In a global economy where employees are “virtually” present in many jurisdictions, a multi-jurisdictional perspective can be critical. Where California-based employees have responsibilities outside California, the laws of other states may also affect the enforceability of any restraints on competition in a specific situation.

- Employee releases should be drafted to ensure that they do not purport to release non-waivable claims, although *Edwards* gives comfort that general release language should not be viewed as purporting to waive non-waivable claims and therefore should not be subject to a successful attack.