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California Supreme Court Rejects "Narrow-Restraint" Exception to Prohibition on Noncompetition Agreements

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Bringing clarity to California law regarding employee noncompete agreements, the California Supreme Court ruled that California's prohibition on employee noncompetition agreements does not allow exceptions for so-called narrow restraints on competition. The case is *Edwards v. Arthur Andersen LLP*, in which Arthur Andersen unsuccessfully argued that its noncompetition agreement with its employees was enforceable because its limitations on competition were tailored to regulate limited aspects of post-employment conduct, and did not entirely prohibit an employee from engaging in his chosen business, trade or profession.

The Arthur Andersen noncompetition agreement limited former employees from engaging in three specific types of competition for periods of time ranging from 12 to 18 months: (1) performing professional services of the type the employee performed for any Arthur Andersen client on which the employee worked during the eighteen months before the termination of employment, but not from accepting employment with a client; (2) soliciting any client of the office in which the employee worked to perform professional services of the type the employee provided while employed by Arthur Andersen; and (3) soliciting away any of Arthur Andersen's professional personnel. Arthur Andersen argued that this limited noncompetition agreement was enforceable under federal (Ninth Circuit) case law recognizing a "narrow restraint" exception to California's prohibition on employee noncompetition agreements.

The California Supreme Court rejected the "narrow restraint" exception, holding that California's statutory prohibition on employee noncompetition agreements (Business & Professions Code section 16600) was unambiguous in its prohibition, and that "if the Legislature intended the statute to apply only to restraints that were unreasonable or overbroad, it could have included language to that effect." In a footnote, the Court stated that it was not addressing the "so-called trade secret exception" to California's noncompetition law or the Arthur Andersen prohibition on recruiting employees because those issues were not before the Court in the *Edwards* case.

In the same case, the Supreme Court rejected the argument that Arthur Andersen had committed a wrongful act by obtaining releases from its employees of "any and all" claims, without making a specific exception for an employee's right to indemnification under Labor Code section 2802. Under section 2802, an employer must indemnify its employees for necessary expenditures and losses incurred by the employee "in direct consequence of the discharge of his or her duties." The Court reasoned that because Labor Code section 2804 voids any agreement to waive the protections of section 2802, and because the Arthur Andersen release did not purport to release Arthur Andersen from any nonwaivable statutory claims, the release was not unlawful.

Analysis. In general, employers may not restrict former employees from engaging in any form of post-employment competition, whether involving the solicitation of the employer's customers, clients or employees, unless the agreement falls within statutory exceptions, such as in connection with the sale of a business. Under California Court of Appeal decisions, which the California Supreme Court did not address in *Edwards*, such restrictions might be upheld to the extent necessary to protect an employer's trade secrets. In connection with settling employee disputes, employers may continue to use typical language releasing "any and all" claims, as long as the employer does not purport by such language or otherwise to obtain releases of non-waivable statutory employee rights.

Citations: *Edwards v. Arthur Andersen LLP*, 2008 DJDAR 12286, filed August 7, 2008); Business and Professions Code sections 16600 et seq.; California Labor Code sections 2802, 2804.