

Corporate, Tax & Benefits

E-ALERT

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California Supreme Court Affirms Limitations on NonCompetition Covenants

The California Supreme Court recently issued an opinion addressing the validity of noncompetition covenants in California and the permissible scope of employment release agreements. The Court's decision (*Edwards v. Arthur Andersen*, 44 Cal. 4th 937¹) rejected the "narrow restraint" interpretation of California's statutory ban on noncompete agreements employed by the Ninth Circuit, and found instead that Section 16600 of the Business and Professions Code² prohibits employee noncompetition agreements unless the agreement falls within a statutory exception. The Court also found that an employee's release of "any and all" claims does not encompass nonwaivable statutory protections.

Background

In 1997, plaintiff Raymond Edwards was hired as a tax manager by Arthur Andersen LLP. Andersen's employment offer was contingent upon Edwards signing a non-competition agreement which prohibited him from working for or soliciting certain categories of Andersen clients for limited periods after his termination. In 2002, Andersen went out of business and sold the division where Edwards worked to HSBC. As a condition of employment, HSBC required that Edwards sign a release agreement that purported to terminate the noncompetition agreement. The termination agreement also contained a broad release of "any and all" claims against Andersen.

When Edwards refused to sign the termination agreement, Andersen terminated his employment and withheld severance benefits and HSBC withdrew its employment offer. Edwards sued for intentional interference with prospective economic advantage and anticompetitive business practices under the Cartwright Act. Edwards alleged that the noncompetition agreement violated Section 16600 and further alleged that the agreement's release of "any and all" claims violated Labor Code Sections 2802 and 2804, which make an employee's right to indemnification from his or her employer nonwaivable.

Noncompetition Covenants

In its decision, the Supreme Court found that, despite the fact that many other states permit "reasonable" restraints on trade, in California, covenants not to compete are void, subject to several statutory exceptions such as noncompetition agreements in the sale or dissolution of corporations, partnerships and limited liability corporations. The Supreme Court noted that

¹ Hereinafter referred to as *Andersen*.
Available at <http://www.courtinfo.ca.gov/opinions/documents/S147190.PDF>.

² Which provides:
Except 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.

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California law protects the important legal right of persons to engage in businesses and occupations of their choosing.

The Supreme Court specifically rejected the Ninth Circuit's earlier findings of a narrow-restraint exception to Section 16600, which would permit restraints upon the ability to pursue a profession so long as those restraints do not preclude one from engaging in a lawful profession, trade or business. The Supreme Court noted that "no reported California state court decision has endorsed the Ninth Circuit's reasoning, and we are of the view that California courts 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 (*internal quotations omitted*)."³

The Supreme Court declined to address the applicability of the so-called "trade secret exception" to Section 16600, because Edwards did not dispute that portion of his termination agreement or contend that the provision of the noncompetition agreement prohibiting him from recruiting Andersen's employees violated Section 16600. The Supreme Court acknowledged that Section 16600 does not invalidate covenants not to compete where necessary to protect the employer's trade secrets⁴ as permitted by the California Uniform Trade Secrets Act.⁵

Release Agreements

The release agreement Edwards was asked to sign was quite broad, providing that Edwards must release and discharge Andersen from "any and all actions, causes of action, claims, demands, debts, damages, costs, losses, penalties, attorneys' fees, obligations, judgments, expenses, compensation or liabilities of any nature whatsoever, in law or equity, whether known or unknown, contingent or otherwise, that Employee now has, may have ever had in the past or may have in the future" by reason of any act or omission of Andersen.

The Court of Appeal found the broad language in the release, while not requiring that Edwards waive rights of indemnity under the Labor Code, constituted an implicit waiver of Labor Code Section 2802(a).⁶ Labor Code Section 2804 voids any agreements which waive the protections of Labor Code Section 2802 as against public policy. The Supreme Court disagreed, finding that under Section 2802, a contract provision releasing "any and all" claims generally does not encompass nonwaivable statutory protections, and in particular does not implicitly apply to an employee's right to indemnification from the employer.⁷ The Court relied on general rules of contract interpretation (as well as a presumption that Andersen knew Edwards's indemnity rights were statutorily nonwaivable) and refused to read in an implicit waiver of Edwards's nonwaivable rights.

³ *Id.* at 13 (citing *Scott v. Snelling and Snelling, Inc.* (N.D.Cal. 1990) 732 F.Supp. 1034, 1042)).

⁴ *Edwards v. Andersen* (2006) 142 Cal. App. 4th 603, 615 (citing *Muggill v. Reuben H. Donnelley Corp.* (1965) 62 Cal.2d 239, 242).

⁵ Civ. Code § 3426 available at <http://www.leginfo.ca.gov/cgi-bin/displaycode?section=civ&group=03001-04000&file=3426-3426.11>.

⁶ Which provides:

An employer shall indemnify his or her employee for all necessary expenditures or losses incurred by the employee in direct consequence of the discharge of his or her duties, or of his or her obedience to the directions of the employer, even though unlawful, unless the employee, at the time of obeying the directions, believed them to be unlawful.

Labor Code § 2802(a) available at <http://www.leginfo.ca.gov/cgi-bin/displaycode?section=lab&group=02001-03000&file=2800-2810>.

⁷ Andersen, *supra* at 18.

Conclusion

The Supreme Court's decision in *Andersen* settles any disagreement about whether the Ninth Circuit's "narrow-restraint" exception applies to noncompetition agreements in California. Unless the California legislature elects to broaden the exceptions to Section 16600, it appears unlikely that California courts will elect to imply any additional exceptions.

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