

New Rules for Noncompete Provisions and Releases in California

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In *Edwards v. Arthur Andersen LLP*, the California Supreme Court has confirmed that even limited noncompetition agreements are not enforceable in California. The Supreme Court also held that release agreements are valid even though they do not exclude nonwaivable statutory claims.

On August 7, the California Supreme Court issued its long-awaited opinion in *Edwards v. Arthur Andersen LLP*. The Supreme Court held that section 16600 of the Business and Professions Code means what it states—that noncompete agreements are void under California law unless they fall within the limited exceptions expressly set forth in sections 16601, 16602, and 16602.5 involving the sale of a business or a partnership or limited liability company interest. The court also held that a release of “any and all claims” is enforceable even when it does not contain an express exclusion of statutory claims that cannot be waived.

The Facts

In connection with his employment as a manager at Arthur Andersen, Raymond Edwards II had signed an agreement under which he promised to comply with two post-employment restrictive covenants. Edwards agreed that for 18 months following his departure from the firm, he would not perform for any Andersen client the same type of work he had done for that same client while he had been employed by Andersen. Edwards also agreed that for 12 months following his departure from the firm, he would not solicit business (defined as the same type of services he had provided while employed by Andersen) from any person or entity that had been a client of his particular Andersen office during the 18 months prior to his departure from the firm.

After Andersen ceased operations in the United States and proceeded to sell its various lines of business, HSBC agreed to buy the Andersen group in which Edwards was employed. Edwards was offered employment with HSBC. As a condition of the offer, Andersen would release Edwards from his noncompete agreement if, in turn, Edwards would release Andersen from any and all claims he might have against the firm.

Edwards refused to sign the release agreement because of concerns about releasing his right to seek indemnification against Andersen. As a result, HSBC refused to employ Edwards.

Edwards sued Andersen, HSBC, and a subsidiary, for intentional interference with prospective business advantage. He alleged that the restrictive covenants were void under Business and Professions Code section 16600. In addition, he alleged that it was unlawful to require him to sign a release under which he would be waiving his right, under Labor Code section 2802, to seek indemnification from Andersen.

Results Before the Lower Courts

The trial court ruled against Edwards and in favor of Andersen on the grounds that the restrictive covenants were narrowly tailored and did not deprive Edwards of his right to practice his “profession,” and that the release could not result in a waiver of Edwards’s indemnification rights. Edwards appealed. The court of appeal reversed, concluding that the noncompete agreement was void and unenforceable. It also concluded that the release violated California public policy because it implicitly sought a waiver of Edwards’s statutory indemnification rights. The court held that requiring Edwards to sign the invalid noncompetition agreement and the invalid release were “wrongful acts” for purposes of the tort of interference with prospective economic advantage.

The Supreme Court’s Opinion

Noncompete agreements

The California Supreme Court reaffirmed longstanding appellate court opinions that had strictly construed Business and Professions Code section 16600 to prohibit all noncompete agreements, even those that sought only to partially restrain an individual in his or her trade or profession. The court expressly rejected case law, developed by federal courts in the Ninth Circuit, that interpreted section 16600 to permit limited noncompete agreements if they did not totally prohibit an individual from engaging in his or her trade or profession. The Court noted that prior to adoption of section 16600, California law permitted reasonable restraints on competition. By adopting section 16600, however, the California Legislature established a public policy prohibiting any restraint on competition, other than those specifically set forth in the statute and trade secrets law.

Release agreement

The state Supreme Court held that a release of “any and all claims” did **not** cover nonwaivable statutory claims. Accordingly the release was valid, and was not a “wrongful act” for purposes of Edwards’s interference with prospective economic advantage claim.

In dissent, Justice Kennard noted that the language of the release did include Edwards’s indemnification claim and was therefore invalid.

Practical Implications

The implications of this decision for businesses with employees in California make it important for business to do the following:

1. Check employment agreements and confidential information, nondisclosure, and inventions agreements and revise them, if necessary, to ensure that they do not contain any post-termination restrictions that are in the nature of an invalid covenant not to compete. Be sure that your agreements contain only these provisions that are expressly lawful under California law:
 - a. A prohibition against competitive employment or business activities during employment with the company
 - b. A prohibition against using or disclosing the company’s confidential, proprietary, and trade secret information
 - c. A prohibition against soliciting employees and contractors of the company to reduce or terminate their relationship with the company

- d. A prohibition against soliciting customers, if the customer information is a trade secret, to reduce or terminate their relationship with the company
2. Check your stock, stock option, compensation, and other benefit plans and revise them as necessary to ensure that they do not impose an invalid penalty, forfeiture or “clawback” of any otherwise vested entitlement if the employee goes to work for a competitor.
3. Develop strategies to lessen the hardship on California employers caused by California’s prohibition of noncompete agreements, including term agreements, retention agreements, and Employee Retirement Income Security Act (ERISA) plans. California employers are often at a competitive disadvantage because of their inability to hire competitors’ employees in other states who have signed noncompete agreements, but whose own California employees are free to work for competitors because they cannot be required to sign noncompetition agreements.
4. Tailor employment agreements on a state-by-state basis to comply with and take advantage of local law. California employment law is different from the employment laws of other states in many respects besides the enforceability of noncompetes.
5. Review the forms of waivers and release agreements used with California employees and revise them as necessary to ensure that they do not expressly waive nonwaivable statutory rights.

Morgan Lewis has a nationwide team of attorneys who specialize in designing and implementing noncompete and trade secret programs that protect some of the most valuable assets of any business. These attorneys regularly seek injunctions in state and federal court to prevent disclosure and misuse of trade secrets and other confidential information, and to challenge contractual and fiduciary breaches by departing executives.

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