

**THEY CAN'T DO THAT CAN THEY?
EMPLOYEE COMPETITION AGAINST FORMER EMPLOYERS
BLESSED BY CALIFORNIA SUPREME COURT**

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The extent to which California employees may be prohibited from competing with their former employer has been a hot and open legal topic. But no longer. The California Supreme Court has finally decided the issues strongly in favor of employee competition.

With a few stated exceptions concerning sale of a business or its dissolution, California since 1872 has prohibited noncompetition agreements, especially those involving employees. In broad and emphatic language, Cal. Business & Professions Code § 16600 states that:

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.

The referenced chapter makes an exception to the prohibition of noncompetition agreements for the sale or dissolution of corporations (§ 16601), partnerships (§§ 16601 and 16602), and limited liability corporations (§ 16602.5).

Until very recently, there had been no California Supreme Court decision concerning whether a “narrow restraint” on employee competition would be permitted, that is, a restraint that bars only some but not all competition with the former employer. In the previous absence of a definitive California decision, the U.S. Court of Appeals for the Ninth Circuit, which hears appeals from federal district courts in California and other Western states, had created a “narrow restraint” exception.

However, in the August 7, 2008 decision in *Edwards v. Arthur Andersen LLP*, the Cal. Supreme Court unanimously held that outside of the sale or dissolution of business exceptions, employee noncompetition agreements are prohibited by section 16600. The Cal. Supreme Court also flatly rejected the Ninth Circuit’s “narrow restraint” exception. This Cal. Supreme Court decision also means that an employer’s insistence that an employee sign an agreement containing prohibited noncompetition provisions, or give something of value to be released from those provisions, might well expose the employer to liability.

When Mr. Edwards, a CPA, was hired by Andersen he signed an employment agreement containing noncompetition provisions. He agreed that for 18 months post-employment he would not do similar work for an Andersen client for whom he had worked at Andersen unless he became that client’s employee. He also agreed that for 12 months post-employment he would not solicit those Andersen clients for whom he had worked.

After Andersen itself was indicted as part of the Enron scandal, Andersen sold the part of its business in which Mr. Edwards worked to an independent company called HSBC. Concerned about the Andersen employees’ noncompetition provisions, HSBC required Edwards and the

other Andersen employees it hired to sign a Termination of Non Competition Agreement (TONC), which Andersen also signed, terminating those noncompetition provisions. Andersen would not release Edwards and the other employees from those noncompetition provisions unless they signed the TONC.

Edwards signed his HSBC offer letter, but refused to sign the TONC because he was concerned that it would extinguish his right to be indemnified by Andersen if he personally was later sued by Andersen clients. Because Edwards refused to sign the TONC, HSBC terminated his employment.

Edwards sued HSBC, Andersen and others involved, ultimately settling with all the defendants except Andersen. Edwards contended that the Andersen employee noncompetition provisions violated section 16600, making Andersen's demand that he sign the TONC to be released from them against public policy. He also contended that the TONC's release of "any and all" of his claims was prohibited by Cal. Labor Code 2802 and 2804, which requires employers to reimburse their employee's business related expenses (including legal expenses arising from the employment), and voids all agreements by which employees waive their right to indemnity for those expenses.

The Cal. Supreme Court decided that Edwards was correct about his section 16600 contention, but wrong about his indemnity argument. That Court unanimously held that absent the sale or dissolution of business exceptions, section 16600 makes void all employee noncompetition provisions, and that there is no "narrow restraint" exception. By a 5-2 majority, the Cal. Supreme Court also held that the standard release language of "any and all" claims does not waive claims which by statute cannot be waived, so that language does not violate the Labor Code sections. As that Court stated in this decision's conclusion:

DISPOSITION

We hold that the noncompetition agreement here is invalid under section 16600, and we reject the narrow-restraint exception urged by Andersen. Noncompetition agreements are invalid under section 16600 in California even if narrowly drawn, unless they fall within the applicable statutory exceptions of sections 16601, 16602, or 16602.5 [i.e., sale or dissolution of a business]. In addition, we conclude that the TONC at issue in this case did not purport to release Andersen from any nonwaivable statutory claims and therefore is not unlawful under Labor Code sections 2802 and 2804.

This is an important decision for employers in California. It means that unless customer contact and contract information are deemed a "trade secret," employees are free to leave an employer to go to work for a competitor and solicit the former employer's customers for that competitor. This is now the law in California regardless of what the employee might have signed to the contrary.

Moreover, under previous California decisions, an employment agreement that conditions a benefit upon an employee's compliance with non-compete and non-solicitation provisions, or causes a forfeiture of a benefit for non-compliance with those provisions, are also in violation of section 16600 and therefore void. There are no loopholes here for the employer, none at all, outside of the "trade secret" situation or perhaps a post-employment consulting agreement with the former employee, both of which are subjects worthy of separate articles.

What to do now? California employers should look to the security of their customer contact and contract information, and treat that information in every format as a "trade secret." Among other things, this means locking that information up when it is not needed to be used, keeping employee access (paper and electronic) on only a need to know basis, and getting employees to sign a confidentiality agreement concerning such information.

An employer that leaves its customer list at every photocopying machine, permits its employees to take customer files offsite, has no confidentiality agreement with employees, and does not keep such information secure will have a difficult to impossible time proving it is a "trade secret." Without "trade secret" status, customer contact and contract information are now be fair game for competing former employees.

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