California Supreme Court Rules On Non-compete Agreements And On General Releases

Insights
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The California Supreme Court recently handed down a long-awaited and significant decision addressing the nature and scope of non-competition agreements in California. The ruling also addressed the enforceability of contract provisions requiring employees to release "any and all" claims. The case has important consequences for California employers. *Raymond Edwards II v. Arthur Andersen LLP.*

Background

Noncompetition Agreements

In many states, restraints on the practice of a profession, business or trade (such as non-competition agreements) are considered valid, as long as they contain reasonable geographic and time restrictions. But that has not been true in California since 1872. In that year California settled public policy in favor of open competition, and rejected non-competition agreements.

Current California law states that every contract "by which anyone is restrained from engaging in a lawful profession, trade or business of any kind" is void. The law does allow non-competition agreements in the context of an owner 1) selling the goodwill of a business; 2) disposing of all shares in a corporation; 3) selling all or substantially all of the operating assets and goodwill of a business, or 4) upon a partner dissolving or withdrawing from a partnership.

In addition to these statutory exceptions, California courts have created a judicial exception for cases where a former employee uses a former employer's trade secrets or confidential proprietary information to solicit the business of the former employer's customers, or to engage in other types of unfair competition.

In the years since 1872, California courts have consistently affirmed that State law evinces a settled public policy in favor of open competition and employee mobility, and have interpreted that law broadly.

Contract Provisions Releasing "Any and All" Claims

When employers provide severance benefits to departing employees, they generally demand that employees sign an agreement requiring them to release "any and all" claims they may have against the employer up to the date of the agreement. Questions that often arise in this situation are 1) whether a release of "any and all" claims encompasses every conceivable claim within the scope of

whether a release of "any and all" claims encompasses every conceivable claim within the scope of the language, even those claims that cannot be waived under California law, and 2) whether a release containing such language is void and unenforceable under California law.

Many California lawyers have operated under the assumption that such a release does not encompass claims that cannot be waived under California law. But, up until now, the Supreme Court has not provided guidance to California lawyers on these questions.

Facts of the Case

Raymond Edwards, a certified public accountant, was employed as a tax manager by Arthur Anderson in its Los Angeles office. When Edwards was hired in 1997, he signed a non-competition agreement which provided that 1) for 18 months after he left Andersen, Edwards would not perform professional services of the type he performed for any client on which he worked during the 18 months prior to the day he left Andersen; and 2) for 12 months after Edwards left Andersen, he would not solicit any client of the office to which he was assigned during the 18 months preceding the date he left Andersen.

Anderson later sold its domestic accounting practice to various purchasers, including HSBC USA, Inc. As part of HSBC's purchase of Edwards' practice group, employees in that group would resign from Anderson and they would be offered employment at HSBC, where they would perform the same duties they had previously performed at Andersen. To do so, they first needed to sign a "Termination of Non-compete Agreement" (TONC). The TONC was a general release of "any and all" claims against Andersen, in exchange for which Andersen would release the employees from the non-competition agreement, thereby freeing the employees to perform professional services for the same clients on behalf of HSBC.

Not wanting to waive his right to indemnification against Andersen, Edwards refused to sign the TONC. As a result, Andersen terminated Edwards without paying him severance benefits, and HSBC withdrew its offer of employment.

Edwards then sued Andersen and HSBC claiming that the non-competition agreement violated California law, and that the TONC was invalid because it purported to waive his rights to indemnification. At the trial level, the court ultimately decided that the non-competition agreement was valid, and that the TONC did not purport to waive Edwards' right to indemnification. Edwards appealed.

The Court of Appeal held that the non-competition agreement and the TONC were both invalid. Andersen then appealed to the California Supreme Court.

The Supreme Court's Rulings

Noncompetition Agreements Are Generally Void As Against Public Policy

Andersen first argued that the non-competition agreement at issue was valid because it was reasonably imposed. The Supreme Court rejected this argument pointing out that the cases cited by

Andersen simply recognize the various statutory exceptions to the law, not a general "rule of reasonableness."

Andersen next argued that the non-competition agreement at issue was enforceable under the "narrow-restraint" exception to the law, which was created and adopted by the U.S. Court of Appeals for the 9th Circuit. The narrow-restraint exception applies to non-competition agreements which bar individuals from pursuing only a small or limited part of their business, trade or profession.

The California Supreme Court refused to adopt the narrow-restraint exception, noting that no reported California state court decision has endorsed the 9th Circuit's reasoning. More importantly, the Supreme Court determined that the narrow-restraint exception is contrary to California's strong public policy in favor of open competition and employee mobility.

The Supreme Court held that the non-competition agreement restricted Edwards from performing work for Andersen's Los Angeles clients and therefore restricted his ability to practice his accounting profession. The Court refused to address the enforceability of the trade secrets exception to the law, so, as of now, the trade secrets exception is still viable in California.

Contract Provisions Releasing "Any and All" Claims are Enforceable in California

Edwards argued that the TONC's language releasing "any and all" claims encompassed statutorily the non-waivable right to indemnification under the State Labor Code, and was therefore unenforceable as a matter of public policy. The Supreme Court disagreed, holding that the TONC did not expressly reference the indemnity rights, and refused to read the agreement as encompassing a waiver of those rights. Moreover, the Supreme Court treated the TONC as expressly incorporating the law that employees cannot waive their indemnification rights. Accordingly, the Supreme Court determined that voiding all existing releases which include the language "any and all" was inappropriate.

How These Rulings Affect California Employers

The Supreme Court's ruling affects California employers in two important respects.

First, the decision makes it abundantly clear that California employers cannot by contract restrain former employees from engaging in their profession, trade or business, unless the contract falls within one of the specific statutory or judicially created exceptions. If you are currently using a non-competition agreement, or considering creating one, you should have it reviewed by counsel to ensure that it complies with California law. Attempting to enforce an invalid non-competition agreement, or not hiring an applicant because he or she refuses to sign an invalid agreement could expose your company to liability.

On the other hand, you are free to use an agreement releasing "any and all" claims, and to the extent you have used such a provision in the past, you can be reasonably confident that it is still enforceable under California law.

For more information contact any of the California offices of Fisher Phillips:

Irvine: 949.851.2424
San Diego: 858.597.9600
San Francisco: 415.490.9000

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