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## Edwards v. Arthur Andersen: Non-Compete Agreements and General Releases

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California law is tough on agreements that restrain an individual from engaging in his or her profession, trade or business. The only statutory exceptions to this strict rule are non-competition agreements associated with certain business sales transactions and dissolution of partnerships. There are common law restrictions as well. For example, employees usually cannot directly compete with a current employer where doing so would constitute a conflict of interest. Additionally, employees may be restricted from certain post-termination activities to protect the former employer's trade secrets. Employers also may use financial disincentives to dissuade employees from leaving, such as requiring repayment of training costs, and bonuses that require employment on a certain date.

Although California law is fairly settled in this area, the California Supreme Court's recent decision in Edwards v. Arthur Andersen was highly anticipated. The interest was generated by Arthur Andersen's argument that the Court should follow Ninth Circuit Court of Appeals precedent that agreements that narrowly restrain an individual's right to engage in his or her profession are valid and enforceable. The primary question presented in Edwards was whether the California Supreme Court would adopt this "narrow restraint" exception. Answering in the negative, the California Supreme Court held that even limited restraints on post-termination competition are unlawful under California law.

### Permissible Restraints on Competition

Generally, restraints on the practice of an individual's profession are valid so long as they are reasonable imposed. These permissible restraints come in different forms:

Non-solicitation agreements to protect trade secrets. While most non-solicitation agreements are prohibited under Business and Professions Code section 16600, agreements that prohibit an employee or former employee from using the employer's trade secrets to solicit customers are currently enforceable. The definition of "trade secret" is contained in California's version of the Uniform Trade Secrets Act. Employers should be cautious when requiring their employees to enter into these types of agreements. Some confidential information will not qualify as "trade secrets" and many employees do not have access to an organization's most prized confidential information.

Conflict of interest policies. Employees owe undivided loyalty to current employers. A conflict of interest compromising that loyalty may arise, for example, when an employee "moonlights" or even starts a competing business on the side. While an employer cannot prevent an employee from operating his or her own business, the employer may discharge the employee for creating a conflict between the employee's and the organization's interests. The law recognizes claims for breach of duty of loyalty to remedy any harm caused by the conflict. Employees also may be liable for using employer assets, including trade secrets, for their own benefit.

### Disincentives to Leaving Employment.

Some employers provide financial benefits to its employees that, at the same time, are disincentives to leaving employment. For example, in Oakland v. Hassey, a 2008 California Court of Appeal decision, the Oakland Police Department had a policy that required employees who left the police department before completing five years of service to reimburse the police department for certain training costs. When an employee left before the five-year mark, the police department was permitted to enforce its policy of reimbursement. Notably, in this case, the police department illegally deducted the employee's final paycheck in an attempt to recover these costs. Nevertheless, court ruled that the police department had a right to recover the costs so long as it did so in a legal manner.

Another example is Californians for Population Stabilization v. Hewlett-Packard, a 1997 California Court of Appeal decision. In that case, the employer paid relocation costs for employees who temporarily relocated from India to California to work on certain projects. The employees agreed to repay the relocation costs if they left the company within a certain time frame. The court held that the former employees failed to establish the employer had engaged in unfair business practices as a result of requiring the reimbursement of such costs.

### Impermissible Restraints on Competition

California's Business and Professions Codes section 16600 is the statutory authority prohibiting most agreements

restraining employees' competition. Section 16600 states that "[e]xcept 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."

In Edwards v. Arthur Andersen, Edwards signed an employment agreement prohibiting him from soliciting Arthur Andersen's clients or performing any services of the type he had previously provided to any of the Andersen's clients. The agreement applied for one year after Edwards' termination. Notably, the agreement expressly stated that Edwards was not prohibited from accepting employment with any of these clients. As such, it was not a "non-compete" agreement per se, although it certainly restricted Edwards' post-termination options.

In connection with Andersen's troubles over the Enron debacle, the firm sold some of its practice groups. Edwards's practice group was sold to HSBC. HSBC offered to hire Edwards so long as he signed a "Termination of Non-Compete Agreement." One of the terms of the Agreement required Edwards to release all claims against Andersen. Edwards refused to sign the Agreement. Andersen subsequently terminated Edwards's employment and HSBC withdrew its employment offer.

Edwards sued, claiming Andersen's noncompetition agreement violated section 16600 of the Business and Professions Code. Andersen argued its agreement did not preclude Edwards from working for any employer whatsoever, reasoning that the term "restrain" in section 16600 actually means "prohibit." Andersen urged the court to apply the "narrow restraint" exception to section 16600 that the Ninth Circuit adopted in Campbell v. Trustees of Leland Stanford Jr. Univ., a 1997 decision. In that case, the court ruled that only restraints precluding an individual from engaging in a profession, trade, or business were unlawful under section 16600. Other federal cases have since followed Campbell, essentially carving out a

"narrow restraint" exception to section 16600.

The California Supreme Court rejected the federal case law, which no California court had endorsed. The Court firmly held the language of section 16600 did not permit a relaxation of California's noncompetition laws. The Court made clear that only the legislature may authorize exceptions to section 16600's general prohibition against non-competition agreements. Therefore, Andersen's noncompetition agreement, which may have only narrowly restrained Edwards from engaging in his profession, was unlawful. The Court was careful to note that its opinion did not invalidate restraints necessary to protect trade secrets. And, the Court did not rule on the issue of financial disincentives, such as repayment of training or relocation costs.

#### Agreements to Release "Any and All" Claims

The Court in Edwards also had to decide whether the Agreement at issue was unlawful because of its broad release of claims. Edwards claimed that the Agreement's broad, general release would effectively require him to waive indemnification rights available under Labor Code section 2802. Edwards understandably wished to preserve his right to have Andersen indemnify him if he was later sued as a result of the Enron investigation.

Labor Code section 2802 provides that an employer is required to indemnify an employee "for all necessary expenditures or losses, incurred by the employee in direct consequence of the discharge of his or her duties . . . ." Section 2804 prohibits any releases of those indemnification rights.

The Agreement presented to Edwards required him to release "any and all" claims against Andersen, including "claims that in any way arise from or out of, are based upon or relate to [his] employment by, association with or compensation from" Andersen.

The Court found that the language of the release did not expressly waive Edwards's indemnification rights. This finding was supported by Andersen's argument that it had not expressly excluded indemnification because the company knew such rights could not be released. The court mentioned that the situation might be different if Edwards could show that Andersen intended the language to include a waiver of indemnification (something Edwards had not argued).

Noting that section 2804 invalidates any agreement that waives an employee's rights under section 2802, the Court held that the broad general release language cannot be read as a waiver of rights that are statutorily unwaivable. Thus, the release language was lawful.

#### Other Claims That Cannot Be Released

The Court's holding in Edwards has a practical effect for employers who obtain separation or settlement agreements containing general releases. After Edwards, employers need not "carve out" claims (at least under California law) that are unwaivable. These include claims for wages due, which cannot be released under Labor Code section 206.5 and workers' compensation claims, the release of which must be approved by the Workers' Compensation Appeals Board under Labor Code section 5001. However, employers should not draft releases to specifically include non-waivable claims. A court may find that the employer specifically intended to include them, creating potential vulnerability.

Additionally, Edwards does not affect releases of unwaivable claims under federal law. These include claims for wages due under the Fair Labor Standards Act, which cannot be released absent supervision by the U.S. Department of Labor or court approval. Some courts have held that claims under the federal Family and Medical Leave Act cannot be released either. Age discrimination waivers must follow the Older Workers Benefit Protection Act.

Employers should ensure releases are drafted with these provisions in mind.

### Conclusion

Many employers use confidentiality or non-disclosure agreements to protect their assets and hard-won competitive

advantages. These agreements often contain restrictions on post-termination competition. In light of the Edwards decision, employers should review these agreements to ensure they are drafted to comply with Business and Professions Code section 16600.

The Edwards decision makes it easier to draft effective releases. However, courts continually issue opinions interpreting these important agreements. Employers should therefore update “form” releases frequently to reflect new developments in the law.

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