

## California Supreme Court Rejects Ninth Circuit's "Narrow Restraint" Exception to California's General Prohibition on Post-Employment Competition Restrictions

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The California Supreme Court held on August 7, 2008 that post-employment restrictions that in any way limit an employee's ability to compete with a former employer are void and unenforceable under Section 16600 of California's Business and Professions Code (the "California Noncompete Statute") unless they fall within the statute's express exceptions involving the sale of a business. *Edwards II v. Arthur Andersen LLP*, No. S147190, 2008 WL 3083156 (Cal. Aug. 7, 2008). By this holding, the court flatly rejected the Ninth Circuit's judicially created "narrow restraint" exception, which had interpreted the California Noncompete Statute to permit limited, narrowly drawn post-employment restrictions on an employee's ability to compete while still leaving a substantial portion of the market available to that employee.

The *Edwards* decision represents a major shift in the legal landscape of non-competition agreements in California and significantly affects California employers that rely on such agreements to protect their interests.

### **CALIFORNIA BUSINESS AND PROFESSIONS CODE SECTION 16600**

The California Noncompete Statute provides that "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void." CAL. BUS. & PROF. CODE § 16600 (2008). Excepted from this general prohibition are restrictive covenants entered into in connection with the sale of a business, or dissolution of a partnership or limited liability company. *See id.* at §§ 16601 – 16602.5. Based on this statute, California state courts have routinely rejected attempts by employers to restrain employee mobility post-termination. *See, e.g., Bosley Med. Group v. Abramson*, 207 Cal.Rptr. 477, 482 (Ct. App. 1984) ("We conclude that any agreement by defendant not to compete with plaintiffs is void under section 16600 and is not enforceable.").

### THE NINTH CIRCUIT'S "NARROW RESTRAINT" EXCEPTION

Despite its unambiguous language, the Ninth Circuit has over the past several decades carved out an additional exception to the California Noncompete Statute, known as the "narrow restraint" exception. Reasoning that the California Noncompete Statute prohibits only broad agreements that prevent a person from engaging entirely in his chosen business, trade or profession, the Ninth Circuit has held in a series of decisions that the statute is inapplicable where an employee is restricted from pursuing only a small or limited part of his business, and where a substantial segment of that market remains available to him. *See, e.g., Int'l Bus. Machs. Corp. v. Bajorek*, 191 F.3d 1033, 1041 (9th Cir. 1999) (enforcing a non-compete that required forfeiture of stock options if the employee worked for a competitor within six months of termination because of the "limited scope of the restriction"); *Gen. Commercial Packaging, Inc. v. TPS Package Eng'r, Inc.*, 126 F.3d 1131, 1134 (9th Cir. 1997) (enforcing a one-year non-solicitation covenant between a contractor and subcontractor where the restraint barred access only to a specific named customer and did not entirely preclude the subcontractor from pursuing its trade or business); *Campbell v. Bd. of Trustees of Leland Stanford Jr. Univ.*, 817 F.2d 499, 503 (9th Cir. 1987) (covenant restricting a psychologist from developing a particular product in competition with his former employer not illegal as a matter of law where there was an issue of fact as to whether the covenant completely restrained the psychologist from practicing his profession, trade or business within the meaning of Section 16600).

### THE EDWARDS DECISION

In *Edwards*, the California Supreme Court considered the validity of a post-employment agreement that restricted the employee, Raymond Edwards II ("Edwards"), from competing with his employer, Arthur Andersen ("Andersen"), in the following manner: After Edwards's departure from Andersen, he was restricted, for a limited time period, from (i) performing services of the type he provided for any client whom he worked for during the 18 months prior to his departure; (ii) soliciting any client (to perform the type of services of the type he had provided) of any office to which he was assigned during the 18 months prior to his departure; and (iii) soliciting Andersen professional personnel.

The California Supreme Court, affirming the decision of the court of appeal, held that the restrictions were void under the California Noncompete Statute. The court refused to embrace the Ninth Circuit's "narrow restraint" exception and categorically rejected Andersen's argument that the restrictions were enforceable because they merely prevented Edwards from soliciting or working for a limited group of customers and did not entirely preclude Edwards from practicing his profession. The court, noting that "no reported California state court decision ha[d] endorsed the Ninth Circuit's reasoning," declared 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." *Edwards II*, 2008 WL 3083156 at \*7.

Leaving no room for doubt, the court stated that “[we] leave it to the Legislature, if it chooses, either to relax the statutory restrictions or adopt additional exceptions to the prohibition-against-restraint rule under section 16600.” *Id.*<sup>1</sup>

### POST-EDWARDS

The *Edwards* decision makes clear what the California Legislature had already tried to make clear: Post-employment noncompete agreements of any kind are void under California law. Employers can now expect state and federal courts in California to strike down non-competition agreements ranging from broad prohibitions on competitive employment to narrow, more precise restrictions of specified competitive activities.

Less certain is whether the *Edwards* decision is also a death knell for another tool used by employers to prevent competition — the forfeiture for competition agreement. In *Bajorek*, the Ninth Circuit held that a forfeiture agreement was enforceable, reasoning that it fell within the “narrow restraint” exception. *See Bajorek*, 191 F.3d at 1041. The California Supreme Court’s unequivocal rejection of the “narrow restraint” exception will likely undermine that reasoning as well.

And, finally, substantial questions exist about the validity of employee non-solicitation agreements in California. While the court in *Edwards* made reference to the employee solicitation restriction in its recitation of Andersen’s “narrow restraint” argument, (*see Edwards II*, 2008 WL 3083156 at \*5), the validity of that restriction was not addressed directly by the court because *Edwards* did not raise it before the intermediate court. *See Edwards v. Arthur Andersen, LLP*, 47 Cal.Rptr.3d 788 (Ct. App. 2006). However, the breadth of the California Supreme Court’s language in rejecting the “narrow restraint” exception and embracing unfettered employee mobility gives little comfort to employers seeking to secure non-solicitation of employee covenants.

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<sup>1</sup> The *Edwards* Court mentioned, but did not specifically address, a judicially created “trade secret” exception, which recognizes that restrictive covenants may be permissible under California law when necessary to protect trade secrets. *See Edwards II*, 2008 WL 3083156 at \*4 n. 4 (“We do not here address the applicability of the so-called trade secret exception to section 16600, as *Edwards* does not dispute that portion of his agreement...”). For now, this leaves intact lower state court decisions recognizing the trade secret exception to the prohibition on non-compete agreements. *See, e.g., Edwards v. Arthur Andersen, LLP*, 47 Cal.Rptr.3d 788, 796 (Ct. App. 2006) (citing cases and stating: “Additionally, it has long been recognized that section 16600 does not invalidate covenants not to compete where necessary to protect the employer’s trade secrets.”).

## CONCLUSION

Employers are advised to review their employee agreements and policies to ensure they do not run afoul of the now bright (or, shall we say, 'brighter') lines established by the *Edwards* decision. Also, insofar as *Edwards* leaves intact, for now, decisions recognizing the trade secret exception to the prohibition on non-compete agreements, employers should give careful thought to the extent to which noncompete agreements can be used appropriately to protect trade secret information.

*For further information about this ruling, please feel free to contact members of the Firm's Labor and Employment Law Group, including:*

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