

Non-Compete Agreements

Jeffrey W. Kramer
September 2006

New Court Decision Strengthens California's Prohibition On Employee Non-Compete Agreements and Rejects Broad Releases Waiving Employee Rights to Indemnification

In a decision filed on August 30, 2006, the California Court of Appeal rejected the "narrow restraint exception" to California's statutory prohibition on employer-employee non-compete agreements. Generally, California law prohibits non-compete agreements, pursuant to California's public policy to ensure that every citizen retains the right to pursue any lawful employment and enterprise of his or her choice. This statutory prohibition is subject to statutory exceptions for a person selling the goodwill of a business or withdrawing from a partnership or limited liability company, and to a judicially-created exception where necessary to protect an employer's trade secrets.

Federal courts interpreting California law had created an additional exception for non-compete agreements where the restraints imposed are narrow and leave a substantial portion of the market open to the employee. This "narrow restraint exception" was rejected by the California appellate court as "a misapplication of California law when applied to an employee's non-competition agreement." The particular agreement invalidated by the court was an Arthur Andersen agreement prohibiting former employees, for 18 months, from performing professional services of the type provided for Andersen for any client on whose account the employee had worked during the 18 months prior to termination.

The court also held that requiring an employee to sign a broad general release that purports to release an employee's statutory right to indemnification by the employer also violates California public policy. By statute, California requires employers to indemnify current and former employees for all necessary expenditures or losses, including attorneys' fees, incurred by an employee as a direct consequence of discharging employment duties. Also by statute, any agreement by which an employee waives these indemnification rights is null and void. The agreement in question was a broadly drawn, but typical, mutual general release that was silent as to the employee's right to indemnification. The court held that requiring an employee to sign such a release, even though the release was by law ineffective as a waiver of the employee's right to indemnification, was a violation of California public policy.

The case is *Edwards v. Arthur Andersen LLP*, 2006 DJDAR 11780 (August 20, 2006), disapproving the "narrow restraint" exception articulated in *General Commercial Packaging v. TPS Package Engineering, Inc.*, 126 F.3d 1131 (9th Cir. 1997).