

LAW REVIEW

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AGREEMENTS NOT TO COMPETE GENERALLY ILLEGAL IN CALIFORNIA

It's not uncommon for employers to ask new employees to sign an agreement that they will not work for a competing business when they leave the company. Must would-be employees sign such an agreement restricting them from working for any competitor after their employment is terminated?

Are these so-called non-competition agreements legal in California? Inquiring minds want to know.

Arthur Andersen Case

You remember Arthur Andersen, the huge accounting firm that was indicted in 2002 in connection with the investigation into Enron Corporation. Three months later Arthur Andersen went out of business in the United States, but sold its practice groups to different entities. The Andersen demise shows just how vulnerable U.S. businesses are in today's world.

When Raymond Edwards, a CPA, was hired as a tax manager by the Los Angeles office of Arthur Andersen, he was required to sign a non-competition agreement which prohibited him from working for or soliciting Arthur Andersen clients for 18 months following his termination with the company.

With the closing of Andersen, Raymond Edward's non-competition agreement came into question. Was it legal and enforceable against him or an improper restraint of trade?

Section 16600

Business and Professions Code section 16600 states: "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." Quite explicit.

California courts have upheld this statute since 1872. One court wrote, "It represents the strong public policy of the State of California that the interest of the employee and his own mobility and betterment are deemed paramount to the competitive business interests of the employer."

The two exceptions are, (1) the buyer of an existing business may require that the seller not compete with the buyer, and (2) a partnership, corporation or LLC may prevent the departing partner, shareholder or member from competing after the entity dissolves. In those limited situations, a person may be prohibited from competing.

Federal v. State Law

The California Court of Appeal upheld section 16600 but the *Andersen* case was appealed to the California Supreme Court because of conflicting federal law. A federal court had allowed a company to restrict an employee from competing after he left the firm. So with federal cases at odds with state cases, the *Andersen* case made it to the California Supreme Court.

California Supreme Court

The Supreme Court wrote, "The non-competition agreement that Edwards was required to sign before commencing employment with Andersen was invalid because it restrained his ability to practice his profession."

So California law remains unchanged, competition among businesses is healthy and non-competition agreements are void - except in business sales where the seller is restricted from competing and in business entity dissolutions so that a departing partner, shareholder or member of an LLC. may be restricted from competing.

Additionally; carefully drafted agreements prohibiting employee theft of trade secrets and restricted use of confidential information are legal.

It is expected with this California Supreme Court decision in *Arthur Andersen*; federal courts in California will henceforth follow California state law on non-competition agreements.

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