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LEGAL ALERT

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Beware of Noncompete Agreements for California Employees

By Christy Joseph

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California has long upheld the principle that it wants to encourage fair competition. In furthering this principle the California Supreme Court recently tolled the death knell for noncompete agreements in *employment* contracts and held, "this court generally condemns noncompetition agreements."[1] In *Edwards v. Arthur Andersen*[2], the court also makes clear that nonsolicitation agreements as to the company's clients or customers, will be considered to be illegal noncompete agreements, unless the nonsolicitation agreement is necessary to protect a trade secret or confidential proprietary information.

Some multistate companies may not be aware of these restrictions, or some may have chosen to develop employment agreements with standard uniform terms that are enforceable in many other states knowing that as to particular terms they may not be able to enforce the provision for California employees. More and more however, such practices could expose the company to the risk of litigation and liability in excess of any potential contract damages. Former employees have brought and successfully litigated actions that allege they were retaliated against or terminated for refusing to sign an employment agreement with a noncompete or overly broad nonsolicitation agreement. Employees may also characterize themselves as whistle blowers and allege they

1 California has limited exceptions to its bar on noncompete agreements. These exceptions are generally associated with the sale of goodwill or ownership interests in a business or partnership.

2 SC S147190 August 7, 2008.

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complained about such provisions in company contracts and suffered some detriment in their employment relationship. There is also a risk where an employee leaves an employer that implemented a noncompete or overly broad nonsolicitation agreement and then claims that another company refuses to hire them because of the fear of the risk of litigation involving the original employer—i.e., an interference with prospective economic advantage claim. Moreover, it is likely that similar complaints might be included under California's "unfair business practice" statute, which allows for a private right of action. And behind the specter of these various causes of action is the employee's ability to request tort damages—e.g., emotional distress and punitive damages—which go beyond any damages strictly related to the contract damages. With these risks in mind, companies should consider seriously whether to keep or insert such provisions in agreements with California employees. What to do?

- Review and modify agreements that contain noncompetes with employees.
- For noncompetes that are tied to the sale of a business or one part of a company—include the noncompete provisions in a separate agreement to clearly show they qualify for one of the limited exceptions.
- Review and modify nonsolicitation agreements that are not necessary to protect the company's trade secret or confidential proprietary information.

If you have nonsolicitation agreements that are necessary to protect the company's trade secrets or confidential proprietary information—make sure the company is taking steps to ensure the confidentiality of that information. Too frequently what a company would like to consider confidential information not generally known to the marketplace is discussed, used and disseminated to those outside the company in such a way that it may be difficult to assert its confidential nature. Once that occurs the nonsolicitation agreement could be viewed as an illegal noncompete agreement.

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