Does *Edwards v. Arthur Andersen* Bar the Use of Employee Confidentiality Agreements?

By Jennifer G. Redmond and Adam J. Tullman

Introduction

In *Edwards v. Arthur Andersen*, the California Supreme Court reaffirmed California's strong public policy against covenants not to compete.[1] The primary issue in *Edwards* was whether the Ninth Circuit's "narrow restraint" exception was a proper interpretation of California law. Under the narrow restraint exception, employers could enforce noncompetition agreements that did not "entirely preclude" an employee from practicing his or her trade, such as an agreement not to solicit specified customers for a limited period of time after employment. The agreement in *Edwards* was drafted to fall under this judicially-created exception. Nevertheless, the supreme court rejected the "narrow restraint" exception, expressed a stark disapproval for judicially created exceptions to section 16600 of the California Business and Professions Code, and held that any time an agreement restricts an employee's "ability to practice his [] profession" in any way not explicitly excepted by the statute, it is void.[2]

Enforceability of Restrictions on the Use of Non-Trade Secret, Confidential Information After *Edwards*

The court's austere prohibitions against restrictive covenants bring even standard employee confidentiality agreements into question. How? In a typical employee confidentiality agreement, employees agree to maintain the confidentiality of, and refrain from using, a long list of business information that is considered confidential, often including customers lists, customer contact information and customer preferences. Under trade secret law, a customer list that could be compiled through general knowledge and public sources (i.e., the phone book) does not qualify as a trade secret, but may be considered confidential business information. As a result, broadly-worded confidentiality agreements restricting an employee's ability to use or disclose confidential information can, and often do, encompass a restriction against using non-trade secret information

to solicit customers. In the wake of *Edwards*, an employer must carefully analyze the scope and utility of confidentiality agreements, and draft them precisely to avoid implicating California's statutory ban on restrictive covenants.

One option is to limit confidentiality agreements to protection of trade secret information. Practitioners and courts, thus far, agree that nothing in *Edwards* prevents an employer from protecting information that qualifies as a trade secret under the California Uniform Trade Secrets Act.[3] Another option would be to carve out solicitation of customers using non-trade secret information from an otherwise standard form confidentiality agreement.

But, can employers still protect confidential information that is not a trade secret without running afoul of *Edwards*? Maybe. An employer has rights and interests in its own confidential information, including the right to protect itself from unfair competition by ex-employees or competitors, which balance against an employee's rights to mobility under Section 16600. An employer also has a property interest, pursuant to Labor Code section 2860, in "everything which an employee acquires by virtue of his employment," including confidential information.

So, how do courts balance the employer's right to protect confidential information with the strong public policy of Section 16600, and do those balancing tests survive *Edwards*?

Pre-*Edwards* Protection of Non-Trade Secret, Confidential Information

In the past, courts have suggested that confidentiality agreements are enforceable even where they are not limited to trade secrets. For example, in *Kolani v. Gluska*, the court struck down a non-competition agreement but noted that "narrower contractual restraints on a departing employee, which prohibit him/her from

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[1] 44 Cal. 4th 937 (Aug. 7, 2008). To view California Supreme Court briefs available on Lexis.com, go to 2006 CA S. Ct. 47190A.

[2] *Id.* at 945–48.

[3] Cal. Civ. Code §§ 3426–3426.11; *see* Bank of America, N.A. v. Lee, No. CV 08-5546 CAS(JWJx) (C.D. Cal. Sept. 22, 2008) (not reported in F. Supp. 2d) ("[T]he trade secret exception to § 16600 still applies. Nothing in *Edwards* is to the contrary.").

using confidential information taken from the former employer, have been held to be lawful."[4] Other courts have indicated they would uphold such an agreement if it was "reasonable," without explaining what that means.[5] A federal district court in Nevada, applying California law, went so far as to say that, in terms of enforcing employee agreements, "the rule as to the use of confidential information or trade secrets is similar."[6] However, no court has addressed the issue in the wake of *Edwards*, and no California court has undertaken a rigorous examination of the issue.

The argument that non-trade secret confidential information is protectable comes from the "unfair" prong of California's unfair competition law. In the context of competitor actions, an "unfair" business practice is any practice which "significantly threatens or harms competition."[7] In fact, a single breach of contract (in this case a confidentiality agreement) can be considered "unfair."[8] However, under the test articulated in *Cel-Tech Communications, Inc. v. Los Angeles Cellular Telephone Co.*, the court must measure the social utility of the conduct in question against the harm caused by that conduct.[9] Given the California Supreme Court's recent reaffirmation of the strength of California's protection of worker mobility, it may be a hard sell to convince a court that the harm of using confidential information outweighs the social utility of employee freedom and mobility. Essentially, the argument would be as follows: While employee mobility and ability to compete are protected by the public policies expressed in *Edwards* and Section 16600, the improper use of confidential information tips the balance too far and causes too much harm to free competition between businesses and the business utility of developing and maintaining confidential information.

Labor Code Section 2860

Labor Code section 2860 provides some extra support for protecting confidential business information from unfair competition. The *Cel-Tech* Court noted that apart from a threatened impact on competition, a finding of "unfairness" could be "tethered to some legislatively declared policy."[10] Section 2860 provides such a policy as it relates to confidential information.[11]

In *Alex Foods, Inc. v. Metcalfe*,[12] the court held that confidential information was "property" under Section 2860, even though the employee in that case did not actually take any physical information with him, but instead re-created a customer and route list from memory. However, the court noted that the employer's property rights must be balanced against the individual's right to "pursue any calling, business or profession he may choose," which is also a form of property.[13] Thus, the court noted, the question came down to whether the use of confidential information in soliciting customers was unfair competition.[14] Again, that question involves a balance of the competing "property" rights of employers in confidential information, and employees in mobility.

Misuse of Confidential Information as Unfair Competition

Courts often analyze the alleged misuse of confidential business information in the context of an unfair competition action, but rarely focus on the difference between a "trade secret" and "confidential information." In both *Alex Foods* and *Reid v. Mass Company*, the courts did not separate their "confidential" and "trade secret" analyses, but examined the information to determine whether it was actually "confidential." In *Aetna Building Maintenance Company v. West*, the California Supreme Court addressed the question indirectly in the context of a contract that included both a non-compete and an agreement not to use trade secrets or "business information acquired as an employee."[15] The court examined the information in question, i.e.,

[4]   64 Cal. App. 4th 402, 407 (1998) (citing Gordon v. Landau, 49 Cal. 2d 690 (1958)).

[5]   Weissensee v. Chronicle Publishing Co., 59 Cal. App. 3d 723, 728 (1976) (holding that a "reasonable agreement not to use confidential lists is valid and enforceable," but not addressing the issue of whether such "lists" constituted trade secrets).

[6]   Cambridge Filter Corp. v. Int'l Filter Co., 548 F. Supp. 1301, 1305 (D. Nevada, 1982).

[7]   Puentes v. Wells Fargo Home Mortgage, Inc., 160 Cal. App. 4th 638, 646 (2008) (citing Cel-Tech Commc'ns, Inc. v. Los Angeles Cellular Tel. Co., 20 Cal. 4th 163, 187 (1999)).

[8]   *Puentes*, 160 Cal. App. 4th at 645.

[9]   20 Cal. 4th at 187.

[10]   *Id.*

[11]   King v. Pacific Vitamin Corp., 256 Cal. App. 2d 841, 849 (1967) (Section 2860 protects against the use of confidential information by an ex-employee.).

[12]   137 Cal. App. 2d 415, 423–24 (1955).

[13]   *Id.* at 424.

[14]   *Id.; see also* Reid v. Mass Co., 155 Cal. App. 2d 293, 300 (1957) (competition must be fairly and legally conducted).

[15]   39 Cal. 2d 198, 200 (1952).

customer identities and janitorial methods, and determined that it was publicly available and generally known and, therefore, neither a trade secret nor confidential business information. Thus, the court did not address the question of whether the use of confidential, but non-trade secret, information could constitute unfair competition.

A more recent court reached a similar result. In *Rigging International Maintenance Co. v. Gwin*, the information in question was the former employer's methods for evaluating and making a proposal to a client.[16] The *Gwin* Court noted that the plaintiff employer was smart to abandon its argument that these "methods" were a trade secret; they were not. However, the court went on to examine the issue of whether the former employee's use of these methods was unfair competition. Unfortunately for the question at hand, the court found that no confidential information had been used. Thus, like the *Aetna* Court, the *Gwin* Court never addressed the question of whether the employer could enforce its confidentiality agreement to prohibit an employee's use of non-trade secret, confidential information.

Several cases leave open the possibility that confidential information, even if not a trade secret, is protectable.[17] For example, in *Hollingsworth Solderless Terminal Co. v. Turley*, the Ninth Circuit held that "the fundamental test is whether in a given case the knowledge gained by an employee is secret and confidential."[18] The *Hollingsworth* Court also observed that unfair competition can be found "where trade secrets or *confidential information* is used in the solicitation."[19] But, of course, all of these decisions predate *Edwards*.

Value of Employee Confidentiality Agreements

Assuming confidential information is protectable under unfair competition law or Labor Code section 2860, is there any point in requiring California employees to sign confidentiality agreements where that information is already protected by those statutes? Yes. First, to pursue an unfair competition claim, an employer must still show that the information in question is confidential. A written agreement and other measures that demonstrate efforts to maintain confidentiality are critical. Second, if the agreement does not provide any protection beyond that already available under existing law, it may still create rights not otherwise available. Although the *Hollingsworth* Court rejected the idea that a confidentiality agreement could preclude activity not considered unfair competition, it noted that "if the court ultimately concludes that the defendant engaged in unfair competition, which would also constitute a breach of the agreement, the only additional right or remedy which could be secured under the contract would be an award of attorneys' fees."[20] Along with a contractual right to attorneys' fees, an executed confidentiality agreement can tie an employee's later actions to other contractual provisions, such as arbitration and choice of law and venue clauses. Finally, the *King* Court suggests that an employer might be able to expand what is confidential through the use of an agreement.[21] Of course, the *King* decision is 42 years old, and has not been reexamined in the wake of more recent developments.

Conclusion

In a post-*Edwards* world, California employers should carefully examine their confidentiality agreements in conjunction with their other contractual provisions to determine whether they are precisely drafted to provide value without running afoul of Section 16600. It remains to be seen whether the California Supreme Court will build on *Edwards* by striking down confidentiality agreements, or even the "trade secrets" exception. However, for the moment, carefully-crafted confidentiality clauses remain an important way to protect the rights of employers in the balancing of the competing "property" rights of employers in confidential information, and employees in mobility.

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[16]   128 Cal. App. 3d 594, 611 (1982).

[17]   *See* KGB Inc. v. Giannoulas, 104 Cal. App. 3d 844, 855 (1980) ("The language in [Labor Code section 2860] has been applied to protect employee misappropriation of trade secrets and confidential information gained during employment...."); Hollingsworth Solderless Terminal Co. v. Turley, 622 F.2d 1324, 1340 (9th Cir. 1980); California Intelligence Bureau v. Cunningham, 83 Cal. App. 2d 197, 203 (1948) (the key question is "whether in a given case the knowledge gained by an employee is secret and confidential").

[18]   *Hollingsworth*, 622 F.2d at 1331.

[19]   *Id.* at 1337. (Emphasis added).

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[20]   *Id.*

[21]   *King*, 256 Cal. App. 2d at 849 (noting that an employer may protect information that is "confidential in fact, or by agreement.").

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