DOES EDWARDS V. ARTHUR ANDERSON BAR THE USE OF EMPLOYEE CONFIDENTIALITY AGREEMENTS?

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In *Edwards v. Arthur Andersen*, the California Supreme Court reaffirmed California's strong public policy against covenants not to compete. 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 specified period of time after employment. The agreement in *Edwards* was drafted to fall under this judicially-created exception. The Court rejected the "narrow restraint" exception, expressed a stark disapproval for judicially created exceptions to California Business and Professions Code Section 16600, 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.

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, as affirmed by *Edwards.*

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. *See*, *Bank of America v. Lee*, 2008 WL 4351348 (C.D. Cal. 2008) ("the trade secret exception to § 16600 still applies. Nothing in *Edwards* is to the contrary.") 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 that balance against an employee's rights to mobility under Section 16600. An employer has the right to protect itself from unfair competition by ex-employees or competitors. It 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 rights to protect confidential information with the strong public policy of Section 16600, and do those balancing tests survive *Edwards*? 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*, 64 Cal. App. 4th 402, 407 (1998), the court struck down a non-competition agreement but noted that "narrower contractual restraints on a departing employee, which prohibit him/her from using confidential information taken from the former employer, have been held to be lawful." (citing *Gordon v. Landau*, 49 Cal. 2d 690 (1958)). Other courts have indicated they would uphold such an agreement if it was "reasonable" without explaining what that means. *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). 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." *Cambridge Filter Corp. v. International Filter Co.*, 548 F.Supp. 1301, 1305 (D. Nevada, 1982). 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 practices is any practice which "significantly threatens or harms competition." *Puentes v. Wells Fargo*, 160 Cal. App. 4th 638, 646 (2008) (citing *Cel Tech Communications, Inc. v. Los Angeles Celular Telephone Co.*, 20 Cal. 4th 163, 187 (1999)). In fact, a single breach of contract (in this case a confidentiality agreement) can be considered "unfair." *Puentes*, 160 Cal. App. 4th at 645. However, under the *Cel-Tech* test, the court must measure the social utility of the conduct in question against the harm caused by that conduct. Given the 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 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." *Cel-Tech*, 20 Cal. 4th at 187. Section 2860 provides such a policy as it relates to confidential information. *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).

In *Alex Foods v. Metcalfe*, 137 Cal. App. 2d 415, 423-24 (1955) 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. Thus, the court noted, the question came down to whether the use of confidential information in soliciting customers was unfair competition. *Id.*; *See also*, *Reid v. Mass Co.*, 155 Cal. App. 2d 293, 300 (1957) (competition must be fairly and legally conducted). Again, that question involves a balance of the competing "property" rights of employers in confidential information, and employees in mobility.

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*, 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*, 39 Cal. 2d 198 (1952), 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." The Court examined the information in question, customer identities and janitorial methods, and determined that it was publicly available and generally known and, therefore, neither a trade secret or 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. *Rigging International Maintenance Co. v. Gwin*, 128 Cal. App. 3d 594, 611 (1982). The information in question was the former employer's methods for evaluating and making a proposal to a client. The 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, it 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.

These cases leave open the possibility that confidential information, even if not a trade secret, is protectable. *See 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"); *Hollingsworth Solderless Terminal Co. v. Turley*, 622 F. 3d 1324, 1340 (9th Cir. 1980) (holding that "the fundamental test is whether in a given case the knowledge gained by an employee is secret and confidential" and that unfair competition can be found "where trade secrets *or confidential information* is used in the solicitation")(emphasis supplied); *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…")(emphasis supplied). But, of course, all of these decisions predate *Edwards*.

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 *coverage* not 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 attorney's fees." *See Hollingsworth*, 622 F. 3d at 1340. Along with a contractual right to attorney's fees, an executed confidentiality agreement can tie an employee's later actions to other contractual provisions, such as arbitration, choice of law, and choice of venue clauses. Finally, the *King* decision suggests that an employer might be able to expand what is confidential through the use of an agreement. *King*, 256 Cal. App. 2d at 849 (noting that an employer may protect information that is "confidential in fact, *or by agreement*.")(emphasis supplied). Of course, the *King* decision is 42 years old, and has not been reexamined in the wake of more recent developments.

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 balance between Section 16600, on the one hand, and unfair competition and Labor Code section 2860, on the other.

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