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PRESIDENT'S MESSAGE

Restrictive Covenants and the California Supreme Court

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On August 7, 2008, in the case of *Edwards v. Arthur Andersen LLP,* the California Supreme Court affirmed its previous interpretations of California law by declaring restrictive covenants, or "noncompetition agreements," invalid.[1] In this case, Edwards worked for Arthur Andersen as an accountant, later becoming a manager. Significantly, he never became a partner in the firm. His original contract included a noncompetition agreement. When Arthur Andersen went out of business as a result of the Enron scandal, it sold part of its firm to HSBC USA. The terms of the sale required enforcement of some aspects of the noncompetition agreement. Edwards filed suit to have the noncompetition agreement declared unlawful.

The trial court held for Andersen, stating the noncompetition agreement only applied a "narrow restraint" on Edwards' ability to practice his profession. The Court of Appeal and Supreme Court disagreed. They stated no "narrow restraint" exception to the law existed. The noncompetition agreement in this case only prevented Edwards from working for Andersen's clients for an 18 month period after termination of Edwards' employment contract with Andersen. It also prohibited Edwards from soliciting Andersen's clients for a one year period. The noncompetition agreement had no geographic restrictions, allowing Edwards to practice wherever he desired. Regardless, the court reasoned, the noncompetition agreement "restrained his ability to practice his profession."

A post-contractual restrictive covenant, or noncompetition agreement, prohibits an employee or contractor from working in a defined geographical location for a specified period of time after termination of the contract. Seven states either have an absolute or near-absolute ban on restrictive covenants in physician contracts. Tennessee has a law prohibiting restrictive covenants in emergency physician contracts. The other 42 states use a "rule of reason" to evaluate the legality of restrictive covenants. Under this rule, a court may uphold a restrictive covenant if (1) the employer or contract holder has a legitimate business interest and (2) if the restrictions are reasonable. Courts usually hold that the prevention of competition is not a legitimate business interest. Earlier editions of this publication have a more detailed explanation of restrictive covenants.[2]

Under California law, the general rule states ". . . every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void."[3] Unlike laws in some other states that specifically ban restrictive covenants in physician contracts, the California law applies to all contracts. Exceptions to this rule exist only for the sale or dissolution of businesses, including partnerships, corporations and limited liability enterprises.[4]

In conclusion, even though the *Edwards* case dealt with an accounting firm, the holding in this case and the court's analysis apply to any "profession, trade, or business."[1] Within the context of emergency medicine, contracts cannot restrain the work of an emergency physician in California after termination of a contract unless the physician served as a partner, owner or shareholder of the practice. As a matter of public policy, California law prohibited restrictive covenants since 1872. Like their model legislation dealing with medical liability, this reflects yet another instance of California serving as a fine example for other states in our country.

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(Endnotes)

1 Edwards v. Arthur Andersen LLP, No. S147190 (Cal. 2008).
2 See, e.g.: Common Sense 2006; 13(5):1, 3.
3 Cal. Bus. & Prof. Code §16600.
4 Cal Bus. & Prof. Code §§16601-16602.

INSIDE THIS ISSUE