



Client Alerts

California Compliant: California Adds Teeth to Prohibitions Against Non-Competes

October 24, 2023 | (Time to read: 5 minutes)

California's hostility to agreements restricting employees' rights to work for competing companies is not new. Except in limited circumstances, "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void," pursuant to Business & Professions Code Section 16600. Although the law (and earlier versions of it) has been in effect for more than 150 years, some California employers have continued to ask employees to sign agreements purporting to limit their ability to work for competitors after their employment ends. The Economic Policy Institute concluded in 2019 that "[e]ven though [such] agreements would not stand up if challenged in California courts, businesses still can use them to pressure employees into not going to work for competitors." This year, California's Legislature passed two bills intended to deter employers from asking their employees to sign "void" non-compete agreements.

What Is a Prohibited Non-Compete Agreement?

As a matter of public policy, California favors an open market for workers, so that they may move from one business to another as they choose. Although some states (at least for now) permit individuals and businesses to enter into contracts that "reasonably" restrict the individual's right to work for a competitor in the future (a "non-compete agreement"), California declares such agreements void, and therefore unenforceable, unless an exception applies. An individual and a company can, for example, agree to reasonably restrict the individual's ability to compete with the company in the future if the agreement is made in connection with the individual's sale of a business.

Non-compete agreements typically seek to prevent an individual from working for a company that competes directly with the first employer. These restrictions sometimes are intended to last for a fixed time period, and within a specified geographic area. But companies often ask workers to agree to additional restrictions, such as limits on the individual's ability to solicit business from customers/clients of the employer after the individual's employment ends ("non-solicit agreements") and/or limits on the person's ability to recruit co-workers to join the individual at the subsequent employer ("no poach" or "anti-raiding" agreements). Such restrictions sometimes are challenged under Section 16600 on the grounds that they allegedly restrict individuals from engaging in their profession, business, or trade.

Compare – Lawful Protection of Trade Secrets

Section 16600 does not prevent companies from protecting their legitimate trade secrets, however. Employers may contract with employees to restrict their dissemination of information entitled to protection under California's Uniform Trade Secrets Act (Civil Code § 3426, *et seq.*), or federal law (a "confidentiality" agreement). In some cases, employers may be able to show that customer lists are entitled to protection, and therefore cannot be used by a former employee. That analysis is fact-specific and beyond the scope of this discussion.

What Has Changed for Employers

California enacted two bills in 2023 affirming the state's commitment to worker mobility. Both will be effective January 1, 2024.

SB 699 – Adding Business & Professions Code Section 16600.5

First, in Senate Bill 699 (SB 699), the Legislature asserted that "as the market for talent has become national and remote work has grown, California employers increasingly face the challenge of employers outside of California attempting to

prevent the hiring of former employees” in the state. To facilitate “freedom of employment” in California, “regardless of the person’s state of residence,” SB 699 adds Section 16600.5 to the Business and Professions Code. Section 16600.5 provides that prohibited non-compete agreements are unlawful “regardless of where and when the contract was signed,” and cannot be enforced even if the worker previously was employed outside the state. The law grants current, former, and prospective employees the right to sue companies that attempt to enforce an invalid non-compete. It also will allow recovery of attorneys’ fees and damages when such claims are successful, a new risk for employers.

It may be too soon to say what could happen in cases where a challenged non-compete agreement entered into outside California provides that the governing law is that of a different state, which permits non-compete agreements. A California court presumably would hold that the agreement is void. A court of another state could go through a choice-of-law analysis to determine which state’s law should apply. For that reason, out-of-state employers hoping to enforce a non-compete agreement that would be facially invalid under Section 16600.5 may still “race to the courthouse” to file a lawsuit in a more favorable forum. How potentially conflicting rulings would be addressed remains to be seen. Yet it seems unlikely that a California resident employee would be held by a California court to be bound by a “foreign” covenant. Employers pursuing such a course face potential liability for damages and attorneys’ fees if unsuccessful.

AB 1076 – Adding Business & Professions Code Section 16600.1

Second, Assembly Bill 1076 (AB 1076) amends Section 16600 and adds a new statute, Section 16600.1. The amendment of Section 16600 clarifies that prohibited non-compete agreements are “not limited to contracts where the person being restrained from engaging in a lawful profession, trade, or business is a party to the contract.” It’s not clear what prompted this change, or what impact it could have, but the new language generally seems to indicate a legislative intent to expand the scope of situations where non-compete agreements are prohibited.

The new statute, Section 16600.1:

- makes it “unlawful” to include in an employment contract, or require an employee to sign, a prohibited non-compete agreement;
- requires employers to provide “written individualized” notice by February 14, 2024, to those current employees, or former employees who were employed after January 1, 2022, who signed or were required to enter into an unlawful non-compete agreement, informing them “that the noncompete clause or noncompete agreement is void”; and
- provides that a violation of Section 16600.1 constitutes an act of “unfair competition” within the meaning of California’s Unfair Competition Law (Business & Professions Code § 17200, *et seq.*).

Giving Required Notices

Employers who may have asked California-based workers to sign non-compete agreements, or similar provisions included in other contracts, must determine whether, and if so, to whom notice must be given by the Valentine’s Day deadline. That process may be particularly challenging when considering possible application of the new law to “non-solicit” and “no poaching” agreements, including specific clauses contained in larger agreements. When required, notices must be “delivered to the last known address and the email address of the” recipient. Affected businesses should retain records of the timing and manner in which all required notices were given, to demonstrate compliance.

Employers should carefully consider their existing forms of agreement in light of these new requirements and review whether previously-signed agreements contained provisions violating those requirements.

Other Implications for Employers

Until now, the principal risk for California employers who entered into prohibited non-compete agreements has been that a court might decline to enforce the agreement. In theory, someone who was fired (or not hired) after refusing to sign a non-compete agreement could assert a claim for retaliatory discharge or wrongful termination in violation of public policy. But Section 16600.1 adds a new deterrent, by confirming that a violation of the statute could form the basis of an unfair competition claim and by providing a damages remedy with a one-way attorneys’ fee award to affected employees. A



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disgruntled employee or applicant might pursue such a claim on behalf of a class, potentially raising the stakes for employers.

What to Watch

The battle of the states over the enforceability of non-compete agreements may be resolved at the federal level; the Federal Trade Commission (Matter No. P201200) has proposed new regulations that would both prohibit contracts that restrict workers' future employment and require employers to notify affected individuals that the offending non-compete provisions are "no longer in effect and may not be enforced against the worker." The proposed regulations would include an exception for non-compete provisions that are entered into in connection with the sale of a business.

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