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California Governor Signs Law Prohibiting Employers From Entering Noncompete Agreements

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On September 1, 2023, California Governor Gavin Newsom signed Senate Bill (SB) 699 into law, prohibiting employers from entering into or attempting to enforce noncompete agreements, which are void under state law. The law is set to go into effect on January 1, 2024. Meanwhile, another bill, Assembly Bill (AB) 1076, which would reinforce the state's broad ban on noncompete agreements, nears passage in the state legislature. Together, the bills come amid a nationwide push to ban noncompete agreements and other restrictive covenants in employment and further California's leading public policy stance against such agreements.

Quick Hits

- Governor Newsom signed SB 699, making it unlawful for employers to enter into or attempt to enforce noncompete agreements and establishes that noncompete agreements are void in California regardless of where the employee worked when the agreement was entered and/or where the agreement was signed.
- SB 699 is set to go into effect on January 1, 2024.
- Also under consideration is AB 1076, which would require employers to notify current and former employees in writing by February 14, 2024, that any noncompete agreements they may have signed are void.

Noncompete Agreements in California

Noncompete agreements have long been disfavored under California law. Section 16600 of the California Business and Professions Code states that "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void." Section 16600 includes three narrow exceptions where noncompete agreements are enforceable, including in the sale of a business, the dissolution of a partnership, or upon the dissolution or termination of interests in a limited liability company. Further, California courts, including the Supreme Court of California, have repeatedly reaffirmed the state's strong public policy against such noncompete agreements or clauses.

SB 699

While noncompete agreements are already largely void in California, SB 699 is significant for employers as it expands the ways in which employees can challenge noncompete agreements in the state. The legislative findings set forth in the bill give some insight into the aims of the new law. According to those findings, "California employers continue to have their employees sign noncompete clauses that are clearly void and unenforceable under California law." The findings suggest that the litigation that may arise from enforcement of those provisions "has a chilling effect on employee mobility." The findings further note that "California employers increasingly face the challenge of employers outside of California attempting to prevent the hiring of former employees" although "California's public policy against restraint of trade law trumps other state laws when an employee seeks employment in California, even if the employee had signed the contractual restraint while living outside of California and working for a non-California employer."

Against this backdrop, the law provides that "[a]ny contract that is void under this chapter is unenforceable *regardless of where and when* the contract was signed." (Emphasis added.) It prohibits an employer, or former employer, from enforcing a void contract "whether the contract was signed and the employment was maintained outside of California." This presumably applies to any current or former employer located anywhere that attempts to enforce a noncompete in California. The law also prohibits an employer from "enter[ing] into a contract with an employee or prospective employee that includes" a void noncompete provision, which appears to be aimed at current employers with California employees or employers looking to hire California residents.

The law allows "[a]n employee, former employee, or prospective employee" to "bring a private action to enforce" the law and would allow a prevailing plaintiff to recover injunctive relief or actual damages, or both, and "reasonable attorney's fees and costs." Until now, many of these claims were litigated as declaratory relief actions focused on obtaining a declaration that the alleged offending provision was void. The inclusion of a private right of action with statutory attorneys' fees raises the risk of litigation that employers may face in this arena. An issue that could be explored under the new law is the continued viability of employee nonsolicitation agreements, which for years had been treated as permissible under California's 1985 Sixth District Court of Appeal's decision in *Loral Corp. v. Moyes.* In 2019, however, California's Fourth Appellate District issued a decision that (along with subsequent federal court decisions) called into question the continued viability of employee nonsolicitation agreements in California. Employers that continue to use such clauses may face heightened risks from those seeking to challenge them under SB 699.

What also remains unclear is how other states faced with actions to enforce agreements alleged to be void under this law will respond. In 2017, California attempted to limit the ability to move these disputes out of state through California Labor Code Section 925, which prohibits the use of such clauses except when specifically negotiated by the employee's legal counsel. But that law applies only to employees who "primarily reside[] and work[] in California." It remains to be seen how courts will harmonize Section 925 with the requirements under SB 699, which by its terms applies much more broadly.

SB 699 will be codified as Section 16600.5 of the California Business and Professions Code. The law is set to go into effect on January 1, 2024.

AB 1076

Another bill on noncompete agreements is working its way through the state Senate after being

passed unanimously by the California State Assembly in May 2023. AB 1076 would add a provision to Section 16600 that purports to codify the 2008 California Supreme Court in *Edwards v. Arthur Andersen LLP* and void noncompete agreements in employment "no matter how narrowly tailored."

Notably, the legislature stated in AB 1076's legislative counsel's digest that the bill is not meant to be a change in the law but to be "declaratory" of existing law. In the *Edwards* case, the California high court ruled that even a narrowly drawn noncompete agreement that does not completely prohibit a former employee from engaging in the former employee's profession, trade, or business, still violates Section 16600 unless the agreement specifically falls within one of the statute's narrow exceptions. The Fourth Appellate District relied heavily on *Edwards* in its challenge of *Loral v. Moyes*.

Additionally, AB 1076 would impose a potentially burdensome notification requirement on employers. The bill would require employers to notify current and former employees in writing by February 14, 2024, that any noncompete agreements that they had reached are void. That notice would be required to be sent to the last known address and email address of each former employee. Of course, if the law is enacted, it will raise a number of questions about the scope of its application.

Other Bills

SB 699 and AB 1076 have progressed, while another bill, AB 747, which would make more substantive changes, did not gain traction in the legislature. As first proposed, AB 747 would have made it unlawful to use a "covenant not to compete," which the bill broadly defined; set a specific monetary penalty of $5,000 penalty for each employee or prospective employee harmed by a violation; opened attorneys up to potential discipline by the state bar for presenting an employee a covenant not to compete to an employee or prospective employee; and placed restrictions when an employee is considered to be "individually represented" under Section 925.

Looking Ahead

Taken together, the bills highlight the distrust of noncompete agreements under California law. Further, California's expansion of its noncompete ban comes in the context of a national trend against noncompete agreements and restrictive covenants in employment. In addition to California, North Dakota, Oklahoma, and most recently Minnesota curtail the use of noncompete agreements, while in June 2023, the New York State Legislature sent a bill to ban employers from using noncompete agreements to the governor for signature. On the federal level, the Federal Trade Commission (FTC) has proposed a rule to prohibit the use of noncompete clauses and preempt all lesser state law protections, following up on an executive order signed by President Biden.

Employers based both in and outside of California may want to consider the distrust of noncompete agreements in California, and how that may impact them nationally, given the new potential legal risks under SB 699, when drafting and negotiating employment agreements moving forward.

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