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California Pushes the Boundaries of Its Ability To Limit Employer Use of Restrictive Covenants Agreements

The Bottom Line

- Two California laws that take effect on Jan. 1, 2024, expand the geographic reach of California's strict prohibitions against restrictive covenants.
- Employers must affirmatively notify employees that such contracts are void.
- Given the laws' extra-territorial application to employees who signed restrictive covenants while living and working in other states, litigation is expected to determine the laws' ability to invalidate those agreements.

California already has among the strictest limitations in the United States on the use of employee restrictive covenants agreements. Specifically, California Business and Professions Code Section 16600 voids "every contract by which anyone is restrained from engaging in a lawful profession, trade or business." This provision has been broadly interpreted as prohibiting not only pure non-compete agreements, but also other types of agreements that place restrictions on employees, such as client and employee non-solicitation and non-servicing agreements, collectively referred to as "restrictive covenants."

California recently enacted two more laws – Senate Bill 699 and Assembly Bill 1076 – which further limit the enforceability of restrictive covenants. The laws both take effect on January 1, 2024. SB 699 seeks to extend California's general ban on restrictive covenants to contracts executed by current Californians while living and/or working in other states and AB 1076 provides robust private enforcement provisions and requires that employers affirmatively notify employees that any existing restrictive covenants are unenforceable.

Current California Non-Compete Law

Unlike many states where reasonable restrictive covenant agreements may be enforced, California courts have interpreted Business and Professions Code Section 16600 as broadly prohibiting restrictive covenants for people employed in California except in the following contexts:

1. the sale of a business
2. the dissolution/disassociation of a partnership and
3. the dissolution of a limited liability company.

The Extra-Territorial Scope of SB 699

SB 699 expands the geographic scope of California's prohibition against restrictive covenants beyond the state. Specifically, SB 699 adds Section 16600.5 to the Business and Professions Code to include, among other things, the following provisions:

1. Any contract that is void under this chapter is unenforceable regardless of where and when the contract was signed;
2. An employer or former employer shall not attempt to enforce a contract that is void under this chapter regardless of whether the contract was signed and the employment was maintained outside of California;
3. An employer shall not enter into a contract with an employee or prospective employee that includes a provision that is void under this chapter.

Thus, SB 699 makes clear that restrictive covenants affecting California-based employees are prohibited, regardless of whether the employee signed the agreement outside of California or while they worked outside of California.

Take, for example, a hypothetical individual living in Connecticut who entered into a non-competition agreement with a Connecticut-based employer governed by, and enforceable under, Connecticut law. If that individual then sought new employment in California that violated the terms of their Connecticut non-competition agreement, SB 699 would void that agreement. Indeed, Section 1 of SB 699 provides that "California's public policy against restraint of trade 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."

Given SB 699's extra-territorial applicability and the impact it may have on employers located outside of California, litigation challenging SB 699's constitutionality is expected.

Private Enforcement and Employee Notification

The new laws also empower employees to pursue legal actions against their employers and impose an affirmative notification obligation on employers.

SB 699

SB 699 provides that an employer who enters into restrictive covenants that are void under California law, or attempts to enforce such restrictions, commits a civil violation. SB 699 further creates a private right of action for an impacted employee, former employee or prospective employee, with that person authorized to seek injunctive relief and/or actual damages. Significantly, a prevailing employee, former employee or prospective employee will also be entitled to recover reasonable attorney's fees and costs in connection with such actions.

AB 1076

In addition, AB 1076 includes the following provisions:

1. For current employees, and for former employees who were employed after January 1, 2022, whose contracts include a noncompete clause, or who were required to enter a noncompete agreement, that does not satisfy an exception to this chapter, the employer shall, by February 14, 2024, notify the employee that the noncompete clause or noncompete agreement is void.
2. Notice made under this subdivision shall be in the form of a written individualized communication to the employee or former employee, and shall be delivered to the last known address and the email address of the employee or former employee.
3. A violation of this section constitutes an act of unfair competition.

We interpret reference to a "noncompete agreement" as a reference to any restrictive covenants that are unlawful and unenforceable under current California law. Thus, any employer who required an employee to sign unenforceable restrictive covenants must notify that employee that the agreement is "void" by February 14, 2024.

California Labor Code Section 925

A separate California provision, Labor Code Section 925, provides that a California-based employee may not agree to a non-California choice of law or forum selection provision unless the employee *is actually represented by counse*l in negotiating such a provision.

The laws do not reference California Code Section 925. Given SB 699's extraterritorial application of California law, it is unclear whether employers, either in California or elsewhere, may still avoid the application of California law by ensuring that the employee is represented by counsel when entering into any restrictive covenants.

For More Information

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