Simpson Thacher

Memorandum

California Enacts Private Right of Action and Notice Requirement for Unlawful Non-Competes

November 2, 2023

California has enacted two new non-compete laws in as many months, each of which reinforces the state's longstanding public policy prohibiting post-termination non-competes and certain other post-termination restrictive covenants with employees, unless such covenants satisfy one of the three express statutory exceptions (*e.g.*, in connection with the sale of a business or the termination of partnership or limited liability company interests, discussed further below). While these new laws do not substantively change what is permissible under California law, they do raise the stakes for noncompliance in California and create a near-term notice obligation which may present challenges for some employers. These new laws clearly apply to traditional non-compete provisions—*i.e.*, those which expressly prevent a former employee from working for an employer's competitors—but may also cover agreements restricting a former employee's ability to solicit customers and clients and employee no-hire covenants, as California courts historically have read and applied California's non-compete statute broadly to cover such agreements. In addition, while post-termination non-solicitation of employees covenants have long been treated as permissible in California (distinguished from no-hire covenants), starting in 2019, some lower California and federal courts also concluded that such covenants are impermissible non-competes under the non-compete statute (but currently there is no binding authority to this effect from a higher court). Accordingly, even though they are not expressly addressed in the text of the laws, post-termination customer and client non-solicit and employee no-hire covenants may also be within the scope of these laws.

Senate Bill 699

Signed into law on September 1, 2023, Senate Bill 699 amends California's ban on non-competes, which is found in Business and Professions Code § 16600, in the following ways:

- Provides that all contracts that are void under Section 16600 are unenforceable regardless of where and when the contract is signed;
- Expressly prohibits employers from entering into employment contracts which include a provision that is void under Section 16600;
- Expressly provides that an employer who enters into a void restrictive covenant agreement or attempts to enforce such an agreement commits a civil violation (potentially triggering penalties under California's Private Attorneys General Act); and

- Establishes a private right of action for injunctive relief and/or the recovery of actual damages and a right for prevailing employees to recover reasonable attorney's fees and costs.

Senate Bill 699 will be effective beginning January 1, 2024. On its face, the law is silent with respect to retroactivity, but it remains to be seen how courts will interpret it in that regard with respect to agreements already in place before January 1, 2024. Employers with impermissible restrictive covenants who may have been comfortable relying on the fact that they can choose not to enforce such agreements at the time they are challenged, now must face the prospect of additional consequences if they do not affirmatively remove those impermissible covenants. Importantly, SB 699 appears to be designed to invalidate, as of the moment an employee becomes a California resident, any post-termination restrictive covenants that were entered into by the employee while working in a state in which such covenants are permissible. Although California's attempted extraterritorial application of its non-compete prohibition may be open to legal challenge, including on constitutional grounds, employers whose employees have moved into California following termination of their employment will need to take a position on the continuing validity of the covenants that are impermissible under California law in light of the notice requirement in AB 1076 discussed below, and the private right of action in both laws.

Assembly Bill 1076

On October 13, 2023, California enacted a second new non-compete law which, in addition to confirmation and codification of existing law, creates an affirmative obligation for employers who currently have agreements in place that include impermissible post-termination restrictive covenants. Specifically, Assembly Bill 1076:

- Requires employers to send a written notice, no later than February 14, 2024, to current employees, and any former employees who were employed after January 1, 2022, who have agreements with impermissible restrictive covenants to advise the employee or former employee that these covenants are void;
- Updates Section 16600 to codify the California Supreme Court's 2008 holding in *Edwards v. Arthur Andersen LLP* that California's ban on post-termination non-competes is to be read broadly such that it voids the application of any non-compete agreement in an employment context, no matter how narrowly tailored, that does not satisfy one of the three express statutory exceptions discussed below;
- Confirms that California's non-compete ban is not limited to contracts where the person being restricted is a party to the contract (which may be intended to address post-termination employee no-hire covenants and, depending on how the case law develops, non-solicitation of employees covenants); and
- Further confirms that it is unlawful to include a post-termination non-compete clause in an employment contract, or otherwise to require an employee to enter a non-compete agreement, that does not satisfy one of the three express statutory exceptions discussed below.

AB 1076 will also be effective beginning January 1, 2024. However, there does not seem to a be a strong practical justification to wait to begin sending any notices that may be required, and sending notices early, before SB 699's

private right of action goes into effect, may mitigate the risk of a claim being filed. A violation of AB 1076's notice requirement is considered an act of unfair competition. Under California's Unfair Competition Law, the remedies are civil penalties of up to $2,500 per violation, injunctive relief and restitution. Damages (including punitive damages) and attorneys' fees are not recoverable.

Neither SB 699 nor AB 1076 modifies the existing statutory exceptions to California's ban on post-termination non-competes, which are: (1) those covenants executed in connection with the sale of a business, (2) those covenants given by a partner upon, or in anticipation of, the dissolution of a partnership or his or her disassociation from the partnership, or (3) those covenants given by an LLC member upon, or in anticipation of, the dissolution of an LLC or the termination of his or her interest in the LLC, which exceptions are set forth in Business and Professions Code § 16601, 16602 and 16602.5, respectively. Post-termination non-competes that meet the requirements for one of these exceptions remain permissible and would not be the basis for a claim or cause of action under SB 699 or trigger notice under AB 1076. However, with respect to no hire covenants, given their impact on third parties who are not able to get hired as a result of the covenant (and not on the individual who agreed to the covenant), such covenants may nonetheless be deemed an illegal non-compete even if they otherwise meet the partnership or LLC member exceptions. The same concern would also apply to a non-solicitation of employees covenant given by a partner or LLC member if a higher court ultimately concludes that these covenants are also non-competes.

As next steps, employers should:

- Review template California employment and other restrictive covenant agreements to remove any impermissible post-termination restrictive covenants while ensuring that those agreements provide the maximum possible protection of confidential information and trade secrets;
- Review and identify any noncompliant agreements with current or former employees who are California residents with a view to amending the agreements with current employees and notifying the former employees that the employer will not seek to enforce any covenant that is impermissible under Business and Professions Code § 16600. Given the private right of action under SB 699, it may be prudent to extend this notice to all California resident former employees still subject to an impermissible restrictive covenant and not just those former employees who are required to receive a notice under AB 1076.
- If an AB 1076 notice is determined to be required, make sure that it is individualized, in writing and sent to the last known address and email address of each affected individual by February 14, 2024. While not expressly required by AB 1076, as a best practice we recommend identifying the relevant agreement by

name and directing the employee to the specific sections or paragraphs that contain the impermissible post-termination restrictive covenants.

For further information regarding this memorandum, please contact one of the following authors:

NEW YORK CITY

Andrew Blau
+1-212-455-2380
andrew.blau@stblaw.com

Gregory T. Grogan
+1-212-455-2477
ggrogan@stblaw.com

Jamin R. Koslowe
+1-212-455-3514
jkoslowe@stblaw.com

Caitlin A. Lucey
+1-212-455-2775
caitlin.lucey@stblaw.com

Jeannine McSweeney
+1-212-455-3349
jeannine.mcsweeney@stblaw.com

Laurence M. Moss
+1-212-455-2280
larry.moss@stblaw.com

Brian D. Robbins
+1-212-455-3090
brobbins@stblaw.com

David E. Rubinsky
+1-212-455-2493
drubinsky@stblaw.com

Andrew M. Kofsky
+1-212-455-7437
andrew.kofsky@stblaw.com

Daniel J. Venditti
+1-212-455-7387
daniel.venditti@stblaw.com

PALO ALTO

Tristan Brown
+1-650-251-5140
tbrown@stblaw.com

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