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Noncompete agreements are a risky bet for businesses

Failure to comply with amendments to California Business and Professions Code Section 16600 banning noncompetes may also give rise to PAGA actions.

By Kurt A. Kappes, Michael Wertheim and Allison Blake

Noncompete agreements have long been unenforceable in California. California Governor Gavin Newsom recently signed into law additional legislation that strengthens the state's restriction on noncompete agreements. Employers should be aware of the requirements of the new laws and the penalties for noncompliance, as both laws go into effect Jan. 1, 2024.

The first bill, Senate Bill (SB) 699, was signed into law on Sept. 1, 2023. SB 699, codified in California Business and Professions Code (BPC) Section 16600.5, makes two major additions to the BPC. First, it voids unlawful noncompete agreements in California, regardless of where and when the contract was signed and whether employment was maintained outside of California. For example, if an employee who signed a noncompete agreement in another state where noncompetes are legal, subsequently moves to California, the employee may be able to void the agreement. Second, it creates a private right of action to enforce the prohibition on noncompetes.

The second bill, Assembly Bill (AB) 1076, was signed into law on Oct. 13, 2023. AB 1076 amends BPC Section 16600 by codifying existing caselaw, *Edwards v. Arthur Andersen, LLP*, 44 Cal. 4th 937 (2008), which held that even narrowly drawn noncompete agreements are prohibited, absent a statutory exception. Additionally, AB 1076 extends the restriction on noncompetes to apply to "contracts where the person being restrained is not a party to the contract."

AB 1076 also adds Section 16600.1 to the BPC. This Section makes it "unlawful to include a noncompete clause in an employment contract, or to require an employee to enter a noncompete agreement, that does not satisfy an exception." Employers must also provide individualized notice to current employees and former employees (employed after Jan. 1, 2022) that any noncompete agreements they signed are void. This notice must be provided by Feb. 14, 2024. A violation of Section 16600.1 constitutes unfair competition under BPC Sections 17200 *et seq.*

Penalties for violation

Before the enactment of these laws, noncompete agreements were void, meaning they were unenforceable in California. But AB 1076 goes a step further by making noncompete agreements unlawful. An employer commits an act of unfair competition under BPC Sections 17200 *et seq.* by including a noncompete clause in an employment agreement or requiring an employee to sign such an agreement. Employers may face a civil penalty of up to $2,500 per violation. Employers who fail to provide the required notice under Section 16600.1 are also subject to a civil penalty up to $2,500 per violation.

Additional risk under PAGA

The risk to employers does not end with the penalties under the new laws. Pursuant to the Private Attorneys General Act (PAGA), employers may be subject to additional penalties. PAGA allows aggrieved employees to take action against employers for violations of the California Labor Code. The employee steps into the shoes of the California Labor Workforce Development Agency (LWDA) to recover civil penalties on behalf of themselves, other employees, and the State of California. If the Labor Code section does not already impose a penalty, PAGA imposes a $100 fine for the first violation and $200 for each subsequent violation of the same provision on the employer.

Although the new laws are codified in the BPC, not the Labor Code, employers may still be subject to PAGA penalties for including unlawful noncompetition agreements based on a violation of Labor Code Section 432.5. That catch-all Section provides that "[n]o employer, or agent, manager, superintendent, or officer thereof, shall require any employee or applicant for employment to agree, in writing, to any term or condition which is known by such employer, or agent, manager, superintendent, or officer thereof to be prohibited by law."

Why are the new laws important? Because before AB 1076's enactment, some courts held that Section 432.5 could not be the basis for a PAGA action for including a noncompete agreement, as they found Section 432.5 only applied to contracts "specifically declared unlawful" and not void contracts. *Beebe v. Mobility, Inc.*, No. 07CV1766 BTM (NLS), at *5 (S.D. Cal. Feb. 20, 2008) ("Because § 16600 only voids restrictive covenants in restraint of trade, the Court holds that Labor Code § 432.5 does not apply."); *Hamilton v. Juul Labs., Inc.*, No. 20-cv-03710-EMC, at *12 (N.D. Cal. Sep. 11, 2020) ("Section 16600 cannot be the predicate for a Labor Code section 432.5 violation because Section 16600 makes the provision void rather than prohibited by law – and Section 432.5 requires the latter as a prerequisite for a violation."). Because AB 1076 makes it unlawful for an employer to include a noncompete agreement in an employment contract or require an employee to sign a noncompete agreement, a PAGA action based on a violation of Section 432.5 may now be viable.

Not only does the PAGA catch-all arguably encompass the new laws, but it also serves to extend their temporal scope. Even if an

aggrieved employee's individual claim is time-barred, they still can pursue a representative PAGA claim. In *Johnson v. Maxim*, 66 Cal. App. 5th 924 (Cal. Ct. App. 2021), the plaintiff signed a nonsolicitation, nondisclosure, and noncompetition agreement with the defendant. The plaintiff filed a PAGA representative action against the defendant, seeking penalties for violation of Labor Code Section 432.5. The defendant demurred to the complaint, asserting the plaintiff's individual claim was time-barred because the agreement was signed three years before she filed suit. The Court of Appeals held that the plaintiff could still pursue the representative claim under PAGA, despite the plaintiff's individual claim being time-barred. Thus, employers may not be able to defend against a PAGA action by asserting the aggrieved employee's individual claim is time-barred.

Application of PAGA also extends the potential claims and parties. Employers may be subject to PAGA penalties not only for violating Section 432.5, but for all Labor Code violations. A single violation of Section 432.5 for including an unlawful noncompete agreement in one agreement, (which might otherwise only result in one $100 penalty), makes the person an aggrieved employee. Aggrieved employees have standing to sue on behalf of all aggrieved employees, not just for the 16600 violation, but for any other qualified Labor Code violation – that is, not just violations of the same type. *Kim v. Reins Int'l Cal., Inc.*, 9 Cal. 5th 73, 85 (Cal. 2020) ("PAGA standing is not inextricably linked to the plaintiff's own injury. Employees who were subjected to at least one unlawful practice have standing to serve as PAGA representatives even if they did not personally experience each and every alleged violation."). In other words, a single violation of Section 432.5 under the new laws also exposes an employer to the risk of paying PAGA penalties for all other types of Labor Code violations, increasing the risk of potential penalties far beyond $100.

Takeaways

With the new laws going into effect Jan. 1, 2024, employers should ensure they are in compliance with both SB 699 and AB 1076. They should also be aware that noncompliance may subject them to civil penalties of up to $2,500 per violation and, perhaps more significantly, potential PAGA penalties not only for maintaining an unlawful noncompete provision, but for all other qualified Labor Code violations.

Kurt Kappes *is a shareholder, and* **Michael Wertheim** *is an of counsel at Greenberg Traurig, LLP.* **Allison Blake** *is currently a Labor & Employment Practice law clerk/JD, and recently passed the California bar exam and will become an associate at the firm.*