One Year of California's New Non-Compete Law: 5 Tips for All Employers to Stay Compliant

Insights
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California is well-known for prohibiting most non-compete agreements in the employment context, but the state took things to the next level a year ago. On January 1, 2024, California introduced a new statute that makes non-competes unlawful "regardless of where and when the contract was signed." This law has produced new uncertainty for employers around the country, and, predictably, litigation has taken off. Although no California appellate court has had the chance to chime in yet, there are several informative federal decisions. We summarize the key cases below and provide tips for employers to navigate this uncertain terrain.

Quick Background and Conflicting Interpretations

California Business and Professions Code § 16600.5 states that a void non-compete under California law is "unenforceable *regardless of where and when the contract was signed*." It also prohibits employers from enforcing a void provision "*regardless of whether the contract was signed and the employment was maintained outside of California*."

We've seen several competing interpretations of this new language:

- One interpretation is that section 16600.5 allows California-based employees to invalidate non-compete agreements they signed while previously living and working outside of California. The idea being, as soon as they begin living or working in California, they can avail themselves of California law.
- Another interpretation is that section 16600.5 prohibits California-based employers from using non-competes with any employees, even those who never lived or worked in California.
- Finally, a less common argument is that any employee can file suit in California to invalidate their non-compete agreement under section 16600.5, even if both the employee and the employer are based outside California.

Not only are there competing interpretations of section 16600.5, but there are constitutional issues in play as well. The reach of section 16600.5 may be limited by the so-called Dormant Commerce Clause doctrine, which prevents states from passing laws that unduly burden interstate commerce. An employer might argue, for example, that California has no right to impose its non-compete ban

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on other states that choose to allow some non-competes, but with careful regulation, like Massachusetts or Illinois.

Some Instructive Court Decisions From the Past Year

Given the competing interpretations, it's no surprise that courts around the country have begun to weigh in on the reach and scope of California's section 16600.5. Here are three of the most interesting cases from the past year.

DraftKings Inc. v. Hermalyn – 1st Circuit Draws Line

Massachusetts-based DraftKings sued a former executive (Hermalyn) in Massachusetts for allegedly violating his non-compete when he moved to California to work for a competitor. Hermalyn primarily worked for DraftKings in New Jersey, New York, and Massachusetts, but argued his non-compete was void under California law due, in part, to the strong policy articulated in section 16600.5.

The 1st Circuit Court of Appeals affirmed the preliminary injunction enforcing the non-compete under Massachusetts law. The court held California did not have a "materially greater interest" in regulating non-competes than Massachusetts, partly because Massachusetts has a complex statute regulating these covenants that took a decade of negotiation to come to fruition.

As to section 16600.5, the 1st Circuit noted that "[t]he drafting committee for these statutes conceded that while they 'express[ed] California's strong desire to enforce its public policy,' they 'cannot dictate to courts outside of its jurisdiction.'"

Takeaway – California law did automatically not trump Massachusetts law on the regulation of non-competes, notwithstanding the enactment of section 16600.5.

Bowser v. Foundation Building Materials, LLC – California Court Kicks Case Out of State

A Tennessee resident (Bowser) sued his California-based employer (Foundation) in California, seeking to invalidate his restrictive covenants under section 16600.5. The California federal court granted Foundation's motion to transfer the case to Tennessee.

The court said it had "no particular interest in the parties," because:

- the relevant facts occurred in Tennessee;
- Bowser lived and worked in Tennessee;
- the parties entered into the Employment Agreement in Tennessee;
- the Employment Agreement restricted activities in Tennessee; and

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- the Employment Agreement contained a Tennessee choice-of-law provision.

The court also noted it was "less than clear that the California Legislature's recent prohibition against non-compete clauses [in section 16600.5] applies to Plaintiff's Agreement," because Bowser did not provide services in California or seek employment in California.

Takeaway – The court was not persuaded that section 16600.5 mechanically invalidates all non-competes entered by California-based employers, regardless of where the employee lived and worked.

Poer v. FTI Consulting, Inc. – California Court Limits Reach of Statute

A Nevada-based employee (Poer) sued his Maryland-based former employer (FTI) in California, seeking a preliminary injunction under section 16600.5 prohibiting FTI from enforcing Poer's restrictive covenants.

The California federal court denied Poer's motion, concluding that Poer was not a "Californian" entitled to the protections of California law. Poer had neither lived nor worked in California for several years. And the court held Maryland had a "materially greater interest" in the dispute because FTI was incorporated and organized under Maryland law.

But the court made an interesting observation about section 16600.5 from the employer perspective. The court stated "implicit in the provision is that the employer who cannot enforce the noncompete is a California-based employer. To interpret the provision otherwise would mean section 16600.5 protects a non-California citizen working for a non-California-based employer at an office outside California. There is no indication the California legislature intended such a result, let alone that it has the authority to require such a result for non-California employers."

Takeaway – The court shut down the argument that section 16600.5 invalidates non-competes where both the employee and the employer are based outside California. But it arguably suggested the result could have been different had the employer been based in California, even if the employee was not.

5 Tips for All Employers to Comply with California Law

Given how these early cases have shaken out and the continuing uncertainty regarding the reach of California's new law on non-competes, here are some tips to help you navigate the foreseeable future.

1. **For California Employers**. Of course, you should use California-compliant agreements for California employees. For employees outside California, you have more leeway to use covenants, like non-competes, that California law prohibits. But you should continue to monitor this issue.

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Again, no binding decision has interpreted section 16600.5, so there is still some uncertainty about how it will be applied.

2. **For Non-California Employers.** You should also use California-compliant agreements for California employees, even if your company is based elsewhere. For non-California employees, discuss choice-of-law strategies with counsel. Several states that passed restrictive covenant statutes in the last few years also ban foreign choice-of-law provisions, so the "one size fits all" approach doesn't work anymore.
3. **California Agreements.** Although non-competes are banned by California law, you can still have robust protections for confidential information and trade secrets. These provisions are critical and should be tailored enough to avoid being considered "de facto" non-competes.
4. **Duty of Loyalty.** California common law imposes a duty of loyalty on all employees to act faithfully to their employer during employment. If you suspect an employee may be competing while still employed, you may have claims against them. Discuss options and strategies with experienced counsel.
5. **Trade Secrets.** Trade secret litigation is very common in California, since employers cannot use non-competes to protect trade secrets. Work with your counsel to ensure you have sufficient protections in place to establish trade secret status over your most valuable information.

Conclusion

We constantly monitor new cases, legislation, and regulatory developments to keep you at the cutting edge of the law. Make sure you are subscribed to Fisher Phillips' Insight System to gather the most up-to-date information directly to your inbox. Check out Blue Pencil Box for our daily updates on restrictive covenant law. If you have questions, please contact the author of this Insight, your Fisher Phillips attorney, or any attorney in our Employee Defection and Trade Secrets Practice Group.

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