**Employment & Labor Law Alert**

July 2023

# As States Nationwide Limit Employee Restrictive Covenants, California Court Ruling Further Complicates Matters

Ever-increasing state limits on employee restrictive covenants, coupled with a recent decision by the California Court of Appeal, should serve as a clear and unambiguous wake-up call to employers to immediately check the enforceability of all their onboarding documents.

## Increasing State Limits on Restrictive Covenants

Over the past several years, states have increasingly passed legislation regulating employer use of restrictive covenant agreements with their workforce. Most recently, in May, Minnesota enacted SF 3035 and joined California, North Dakota and Oklahoma in banning virtually all noncompete agreements between employers and their employees or independent contractors. This new law became effective July 1, 2023, and does not apply retroactively, so any restrictive covenant agreements signed before the effective date will remain enforceable.

Specifically, SF 3035 prohibits agreements that restrict, after termination of employment, an employee's or an independent contractor's ability to work for another employer for a specified period of time, work in a specified geographical area or work for another employer in a capacity that is similar to the employee's work for the employer that is a party to the agreement. The law does not apply to reasonable limits related to the sale or dissolution of a business and also carves out nondisclosure agreements designed to protect an employer's trade secrets, confidentiality agreements, and nonsolicitation agreements that restrict the ability to use client or contact lists or solicit an employer's customers after termination of employment.

Additionally, while the new law generally makes agreements "not to compete contained in a contract or agreement [] void and unenforceable," it clarifies that any noncompete provision within an otherwise lawful contract will not invalidate the entire agreement. If an employee or an independent contractor challenges the validity of a noncompete agreement, a court may award reasonable attorneys' fees.

Finally, SF 3035 also prohibits employers from requiring employees living and working primarily in Minnesota, as a condition of their employment, to agree to provisions that would (1) require the employees to adjudicate outside Minnesota a claim arising in Minnesota or (2) deprive the employees of the substantive protection of Minnesota law with respect to a controversy arising in Minnesota. This apparent prohibition against forum selection clauses appears to apply to employment agreements generally, not only noncompetes.

While Minnesota is now the fourth state to expressly ban employee noncompete agreements, several other states have enacted limitations on employer use of restrictive covenants. Colorado, Illinois, Maine, Maryland, Massachusetts, Nevada, New Hampshire, Oregon, Rhode

Island, Virginia and Washington—plus Washington, D.C.—all have very specific compensation threshold requirements that must be met before post-employment noncompete agreements are permitted. These thresholds are updated periodically—most recently, Maryland announced that beginning Oct. 1, 2023, noncompete agreements are enforceable only with employees earning at least 150% of the state minimum wage—and employers must be careful to monitor ongoing developments. A few states also bar employee nonsolicitation agreements or similarly establish minimum compensation thresholds that must be met before nonsolicitation agreements are valid.

Employers must be aware of these state-specific limitations when utilizing restrictive covenant agreements with their workforces. Recent case law from California has further complicated the issue by indicating that unenforceable restrictive covenant agreements contained in standard employee onboarding materials may invalidate all related employee agreements, including, critically, arbitration agreements.

## The Alberto Case

The case, *Alberto v. Cambrian Homecare*, saw the plaintiff employee file a complaint against her employer, alleging multiple wage-and-hour violations. The defendant employer responded that the employee had signed an enforceable arbitration agreement and could not litigate her claims in court. The court, however, denied the petition to compel arbitration, and the Court of Appeal recently affirmed that ruling.

While the denial of an employer request to compel arbitration of employee claims is not in itself novel or surprising, the courts here looked beyond the arbitration agreement in finding that agreement unconscionable. Specifically, the court determined that onboarding documents may be considered in total when considering unconscionability, meaning that if one onboarding agreement is deemed unenforceable, all other onboarding documents agreed to by the same employee may also be invalidated. Here, the court found that the separate arbitration agreement should be read together with a confidentiality agreement the plaintiff employee was also required to sign. The court then held that because the confidentiality agreement was unconscionable, so too was the arbitration agreement.

While the court's decision in *Alberto* was quite fact-specific, the situation is a typical one. As a condition of employment, the plaintiff employee was required to execute a variety of agreements during the onboarding process, among them a stand-alone arbitration agreement and a separate confidentiality agreement and addendum. The arbitration agreement required claims or controversies arising out of the employment relationship to be submitted to final and binding arbitration, and it contained a class and representative action waiver. The confidentiality agreement required the employee to consent to an injunction, without bond, from any court of competent jurisdiction for any violation or threatened violation of the agreement. Additionally, the confidentiality agreement allowed the employer to receive attorneys' fees and costs if it prevailed on an injunction, which would exclusively benefit the employer.

The court reasoned that pursuant to California Civil Code Section 1642, it is the general rule that several papers relating to the same subject matter and executed as part of substantially one transaction are to be construed together as one contract. Although the two agreements were stand-alone documents and did not reference each other, the court nevertheless ruled that the arbitration and confidentiality agreements:

- Were executed on the same day as part of the orientation
- Were part of substantially one transaction during the hiring process
- Both governed employment matters and the dispute resolution process

Accordingly, the appeals court concurred with the trial court in its analysis that the arbitration agreement was unconscionable and unenforceable because, in reading the two agreements as a single contract, there was:

- Nonmutual language. The carve-outs in the confidentiality agreement permitting the employer to obtain an injunction were one-sided in favor of the employer, while claims significant to the employee were relegated to arbitration.
- A prohibition on the discussion of wages. The confidentiality agreement prohibited the employee from discussing her wages and salary information, which violated California law, and therefore, if the employee wanted to avail herself of her rights, she would not be able to discuss or disclose wage or salary information for fear of litigation, including potential liability for attorneys' fees and costs.

- A blanket waiver of Private Attorneys General Act (PAGA) claims. Because the arbitration agreement contained a class and representative action waiver, the court found that blanket waivers of PAGA claims are unconscionable.

Both the trial court and the Court of Appeal further refused to sever these unenforceable provisions from the rest of the parties' agreement to arbitrate and ultimately concluded that the entire arbitration agreement must be struck down.

## Considering These Developments, What Employers Should Do Now

The *Alberto* decision creates further uncertainty regarding the enforceability of employment arbitration agreements in California. Indeed, it highlights the potential threat of losing the benefits of the arbitration process for employers that require the execution of multiple employment-related agreements if any of them is found by a court to be unenforceable. This is especially important in the context of employer restrictive covenant agreements—which, as discussed, many states have increasingly limited.

As a result of *Alberto* and the increasing number of limitations on noncompete agreements in other states, employers in California and beyond should immediately take steps to ensure the enforceability of all their onboarding documents and agreements.

This process should include the following:

- Review all onboarding documents to ensure reasonableness and enforceability in all respective jurisdictions.
- Determine whether any onboarding document conflicts with the language of employee arbitration agreements.
- Ensure that all onboarding documents have consistent language that is mutual and does not violate specific California legal requirements or any other state's unconscionability standards.
- Review post-employment restrictive contracts, remove all impermissible noncompete provisions and further evaluate the enforceability of any forum selection or choice of law provisions.
- Develop strategies to limit access and protect against the disclosure of trade secrets, confidential information, and client or contact lists, including the expanded use of those types of agreements.
- Develop strategies to enhance customer and employee relationships and retention to avoid post-termination competition situations.
- Remain aware that given the ever-changing restrictive covenant landscape and the plethora of state-specific requirements for enforceability, all such agreements need to be periodically evaluated to ensure ongoing compliance.

## Related Professionals

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7386 REV1 07-28-2023