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2024 Virtual Solo & Small Firm Summit

MCLE: 1.0 Hour of which includes .25 Hour Legal Ethics

What Solo & Small Firm Attorneys Need to Know Before You Dabble in Employment Law: Key Ethics Issues & Practice Insights from Employment Law Practitioners

13, June, 2024
12:30 PM – 1:40 PM

Speakers:

Daphne Pierre Bishop

Tryphena Y. Liu

Ireneo A. Reus III

Timothy G. Williams

Conference Reference Materials

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CALIFORNIA LAWYERS ASSOCIATION

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Learning Objectives

1) Key ethical issues at intake and client retention stage of an employment law case

2) How to issue spot key state and federal employment law issues

3) Basics of prosecuting and defending employment claims

Key Practical & Ethical Issues at Client Intake & Retention Stage

- Identifying the client(s)
  - Duty of loyalty
  - Joint representation
  - Conflict Waivers
- Assessing client credibility
  - Red flags/green flags
- Non-native speakers

Key Practical & Ethical Issues at Client Intake & Retention Stage (cont.)

- Assessing claim(s)
  - Duty of competence
  - Workplace investigation
    - Selection/managing
    - Scope
    - Investigations/interviews
    - Reports
    - Admissibility/privilege
    - Ethical issues
  - Statute of limitations
  - Assessing damages/remedies

Key Practical & Ethical Issues at Client Intake & Retention Stage (cont.)

- Ethical Billing
  - Costs & fees
  - Litigation budget
  - Is claim covered by insurance?
  - Contingency fees
    - Hourly vs. contingency vs. blended vs. flat fee compensation arrangements
      - See Bus. & Prof. Code §§ 6146-6149.5, principally 6147 and 6148
      - See Rules of Professional Conduct, Rule 1.4.2 *Disclosure of Professional Liability Insurance*, and Rule 1.5 *Fees for Legal Services*

Key Practical & Ethical Issues at Client Intake & Retention Stage (cont.)

- Referral Fees
  - See Rules of Professional Conduct, Rule 1.5.1 *Fee Divisions Among Lawyers*
- Co-counseling
- Duty to Supervise Staff

Employment Law Considerations

- Wage & Hour
  - Minimum wage
  - Meal/rest periods
  - Overtime
  - Salaried/exempt classifications
  - Expense reimbursement
  - Independent contractors
- Harassment/discrimination/retaliation
  - Protected classes (gender/sex, age, race, etc.)
  - Hostile work environment
  - Sexual harassment
  - Retaliation/wrongful termination
- Equal Pay Act

Employment Law Considerations (cont.)

- Employment Applications
  - Applicant rights
- Employment Contracts
  - Executive agreements
  - Stock
  - Restrictive covenants
  - Severance and separation agreements
- Workplace Policies
  - Injury and Illness Prevention Program
  - Workplace Violence Prevention Plan
  - Sexual harassment training
  - National Labor Relations Board's *Stericycle* decision
- Workers' compensation claims

Employment Law Considerations (cont.)

- Leave Laws
  - Paid sick leave
  - Family Medical Leave Act
  - California Family Rights Act
  - Other California leaves (paid and unpaid)
    - Pregnancy disability leave
    - Bereavement leave
    - Reproductive loss leave
  - Unemployment/disability
  - Uniform Services Employment and Reemployment Rights Act

Prosecuting/Defending Employment Claims – A Case Study

- Sexual harassment case
- Investigation
- Pre-litigation demand
  - Personnel and payroll records request
  - Tolling agreement
- Pre-litigation mediation
- Administrative remedies (Civil Rights Department and Equal Employment Opportunity Commission)
- Litigation after failed mediation

Prosecuting/Defending Employment Claims – A Case Study

- Settlement agreements
  - General vs. mutual releases
  - ADEA waivers
  - NLRB limitations on non-disparagement provisions: “While general non-disparagement bans are unlawful, it is permissible to restrict employee statements that are ‘maliciously untrue, such that they are made with knowledge of their falsity or with reckless disregard for their truth or falsity.’ ” (See https://www.nlrb.gov/news-outreach/news-story/board-rules-that-employers-may-not-offer-severance-agreements-requiring)
  - California limitations on confidentiality provisions, non-disparagement agreements, no re-hire provisions, and non-compete agreements (See https://calcivilrights.ca.gov/wp-content/uploads/sites/32/2022/11/Employment-Separation-and-Settlement-Agreements-Limitations-FAQ_ENG.pdf)

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- **Motion Practice From A to Z** (2024 New Employment Practitioner Conference)
- **Nuts & Bolts of seeking & responding to requests for ESI** (39th Annual Meeting of the Labor and Employment Law Section)
- **Competition and Cooperation: 2023 Advance Mediation Conference: Practical Skills for Experienced Employment Litigators**
- **Terminating an Employee with Dignity and Respect**
- **Disciplinary Arbitrations: When the Tail Wags the Dog: When should investigative or procedural errors affect the merits?; 2023 Public Sector Conference**
- **Labor Law for Employment Attorneys**
- **Coordinated Labor Agency Enforcement Efforts at the Federal and State Levels** (38th Annual Meeting of the Labor and Employment Law Section)
- **Retaliation, Whistleblowing and Wrongful Termination Claims** (2023 New Employment Law Conference)

State of California

BUSINESS AND PROFESSIONS CODE

Section 6146

6146. (a) An attorney shall not contract for or collect a contingency fee for representing any person seeking damages in connection with an action for injury or damage against a health care provider based upon such person's alleged professional negligence in excess of the following limits:

(1) Twenty-five percent of the dollar amount recovered if the recovery is pursuant to settlement agreement and release of all claims executed by all parties thereto prior to a civil complaint or demand for arbitration being filed.

(2) Thirty-three percent of the dollar amount recovered if the recovery is pursuant to settlement, arbitration, or judgment after a civil complaint or demand for arbitration is filed.

(3) If an action is tried in a civil court or arbitrated, the attorney representing the plaintiff or claimant may file a motion with the court or arbitrator for a contingency fee in excess of the percentage stated in paragraph (2), which motion shall be filed and served on all parties to the action and decided in the court's discretion based on evidence establishing good cause for the higher contingency fee.

The limitations shall apply regardless of whether the recovery is by settlement, arbitration, or judgment, or whether the person for whom the recovery is made is a responsible adult, an infant, or a person of unsound mind.

(b) If periodic payments are awarded to the plaintiff pursuant to Section 667.7 of the Code of Civil Procedure, the court shall place a total value on these payments based upon the projected life expectancy of the plaintiff and include this amount in computing the total award from which attorney's fees are calculated under this section.

(c) For purposes of this section:

(1) "Recovered" means the net sum recovered after deducting any disbursements or costs incurred in connection with prosecution or settlement of the claim. Costs of medical care incurred by the plaintiff and the attorney's office-overhead costs or charges are not deductible disbursements or costs for such purpose.

(2) "Health care provider" means any person licensed or certified pursuant to Division 2 (commencing with Section 500), or licensed pursuant to the Osteopathic Initiative Act, or the Chiropractic Initiative Act, or licensed pursuant to Chapter 2.5 (commencing with Section 1440) of Division 2 of the Health and Safety Code; and any clinic, health dispensary, or health facility, licensed pursuant to Division 2 (commencing with Section 1200) of the Health and Safety Code. "Health care provider" includes the legal representatives of a health care provider.

(3) "Professional negligence" is a negligent act or omission to act by a health care provider in the rendering of professional services, which act or omission is the

proximate cause of a personal injury or wrongful death, provided that the services are within the scope of services for which the provider is licensed and which are not within any restriction imposed by the licensing agency or licensed hospital.

(Amended by Stats. 2022, Ch. 17, Sec. 2. (AB 35) Effective January 1, 2023.)

State of California

BUSINESS AND PROFESSIONS CODE

Section 6147

6147. (a) An attorney who contracts to represent a client on a contingency fee basis shall, at the time the contract is entered into, provide a duplicate copy of the contract, signed by both the attorney and the client, or the client's guardian or representative, to the plaintiff, or to the client's guardian or representative. The contract shall be in writing and shall include, but is not limited to, all of the following:

(1) A statement of the contingency fee rate that the client and attorney have agreed upon.

(2) A statement as to how disbursements and costs incurred in connection with the prosecution or settlement of the claim will affect the contingency fee and the client's recovery.

(3) A statement as to what extent, if any, the client could be required to pay any compensation to the attorney for related matters that arise out of their relationship not covered by their contingency fee contract. This may include any amounts collected for the plaintiff by the attorney.

(4) Unless the claim is subject to the provisions of Section 6146, a statement that the fee is not set by law but is negotiable between attorney and client.

(5) If the claim is subject to the provisions of Section 6146, a statement that the rates set forth in that section are the maximum limits for the contingency fee agreement, and that the attorney and client may negotiate a lower rate.

(b) Failure to comply with any provision of this section renders the agreement voidable at the option of the plaintiff, and the attorney shall thereupon be entitled to collect a reasonable fee.

(c) This section shall not apply to contingency fee contracts for the recovery of workers' compensation benefits.

(d) This section shall become operative on January 1, 2000.

(Amended (as amended by Stats. 1994, Ch. 479, Sec. 3) by Stats. 1996, Ch. 1104, Sec. 9. Effective January 1, 1997. Section operative January 1, 2000, by its own provisions.)

State of California

BUSINESS AND PROFESSIONS CODE

Section 6147.5

6147.5. (a) Sections 6147 and 6148 shall not apply to contingency fee contracts for the recovery of claims between merchants as defined in Section 2104 of the Commercial Code, arising from the sale or lease of goods or services rendered, or money loaned for use, in the conduct of a business or profession if the merchant contracting for legal services employs 10 or more individuals.

(b) (1) In the instances in which no written contract for legal services exists as permitted by subdivision (a), an attorney shall not contract for or collect a contingency fee in excess of the following limits:

(A) Twenty percent of the first three hundred dollars ($300) collected.

(B) Eighteen percent of the next one thousand seven hundred dollars ($1,700) collected.

(C) Thirteen percent of sums collected in excess of two thousand dollars ($2,000).

(2) However, the following minimum charges may be charged and collected:

(A) Twenty-five dollars ($25) in collections of seventy-five dollars ($75) to one hundred twenty-five dollars ($125).

(B) Thirty-three and one-third percent of collections less than seventy-five dollars ($75).

(Added by Stats. 1990, Ch. 713, Sec. 1.)

State of California

BUSINESS AND PROFESSIONS CODE

Section 6148

6148. (a) In any case not coming within Section 6147 in which it is reasonably foreseeable that total expense to a client, including attorney fees, will exceed one thousand dollars ($1,000), the contract for services in the case shall be in writing. At the time the contract is entered into, the attorney shall provide a duplicate copy of the contract signed by both the attorney and the client, or the client's guardian or representative, to the client or to the client's guardian or representative. The written contract shall contain all of the following:

(1) Any basis of compensation including, but not limited to, hourly rates, statutory fees or flat fees, and other standard rates, fees, and charges applicable to the case.

(2) The general nature of the legal services to be provided to the client.

(3) The respective responsibilities of the attorney and the client as to the performance of the contract.

(b) All bills rendered by an attorney to a client shall clearly state the basis thereof. Bills for the fee portion of the bill shall include the amount, rate, basis for calculation, or other method of determination of the attorney's fees and costs. Bills for the cost and expense portion of the bill shall clearly identify the costs and expenses incurred and the amount of the costs and expenses. Upon request by the client, the attorney shall provide a bill to the client no later than 10 days following the request unless the attorney has provided a bill to the client within 31 days prior to the request, in which case the attorney may provide a bill to the client no later than 31 days following the date the most recent bill was provided. The client is entitled to make similar requests at intervals of no less than 30 days following the initial request. In providing responses to client requests for billing information, the attorney may use billing data that is currently effective on the date of the request, or, if any fees or costs to that date cannot be accurately determined, they shall be described and estimated.

(c) Failure to comply with any provision of this section renders the agreement voidable at the option of the client, and the attorney shall, upon the agreement being voided, be entitled to collect a reasonable fee.

(d) This section shall not apply to any of the following:

(1) Services rendered in an emergency to avoid foreseeable prejudice to the rights or interests of the client or where a writing is otherwise impractical.

(2) An arrangement as to the fee implied by the fact that the attorney's services are of the same general kind as previously rendered to and paid for by the client.

(3) If the client knowingly states in writing, after full disclosure of this section, that a writing concerning fees is not required.

(4) If the client is a corporation.

(e) This section applies prospectively only to fee agreements following its operative date.

(f) This section shall become operative on January 1, 2000.

(Amended (as amended by Stats. 1994, Ch. 479, Sec. 5) by Stats. 1996, Ch. 1104, Sec. 11. Effective January 1, 1997. Section operative January 1, 2000, by its own provisions.)

State of California

BUSINESS AND PROFESSIONS CODE

Section 6149

6149. A written fee contract shall be deemed to be a confidential communication within the meaning of subdivision (e) of Section 6068 and of Section 952 of the Evidence Code.

(Added by Stats. 1986, Ch. 475, Sec. 8.)

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Expert Q&A on the FTC's Final Rule Banning Post-Employment Non-Competes

by Practical Law Labor & Employment

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An Expert Q&A with Peter A. Steinmeyer and Erik W. Weibust of Epstein Becker & Green, P.C. regarding the Federal Trade Commission's (FTC) final rule banning post-employment non-competes.

On April 24, 2024, the Federal Trade Commission (FTC) announced the issuance of a final rule banning employers from entering into, enforcing, or attempting to enforce post-employment non-compete clauses with workers, subject to limited exceptions, and invalidating all existing non-competes with a narrow exception for certain senior executives (FTC: Non-Compete Clause Rule). If and when it becomes effective, the FTC's rule would create a new subchapter J, Part 910 of the rules promulgated under Section 5 of the Federal Trade Commission Act (16 C.F.R. §§ 910.1 to 910.6). The premise for the rule is that it "is an unfair method of competition for an employer to enter into or attempt to enter into a non-compete clause with a worker" and therefore falls within the FTC's domain. The final rule broadly prohibits traditional post-employment non-competes and is a sea change for employers that routinely use non-competes to protect their valuable assets, including trade secrets and goodwill. The final rule is scheduled to be published in the Federal Register on May 7, 2024, and to become effective 120 days later (on or about September 4, 2024).

The Final Rule is being issued after a review and comment period on the FTC's notice of proposed rulemaking (NPRM), about which the FTC received thousands of public comments. The final rule largely tracks the NPRM, with a few significant modifications. For more on the NPRM, including grounds for legal challenges to the FTC's authority to issue this rule, see Article, Expert Q&A on the FTC's Proposed Rule Banning Employee Non-Competes.

Practical Law Labor & Employment reached out to Peter A. Steinmeyer and Erik W. Weibust of Epstein Becker & Green, P.C. for their insights about the final rule, changes from the FTC's proposed rule, legal challenges to the new rule, and what employers should be doing now to protect their trade secrets and other valuable assets amidst this uncertain legal landscape.

Pete and Erik are Members of Epstein Becker & Green, P.C. and Co-Chairs of the firm's Trade Secret & Employee Mobility practice group. They both focus on trade secrets and employee mobility issues and are two of the co-hosts of EBG's *Spilling Secrets* podcast on trade secrets and non-compete law. Pete also is a valued member of the Practical Law Labor & Employment Advisory Board.

What Are the Key Provisions of the Final Rule?

The final rule prohibits employers from entering into, enforcing, or attempting to enforce post-employment non-compete agreements with workers, with limited exceptions. Among other things, the final rule:

- Declares that an entity under the FTC's authority engages in unfair competition and therefore violates Section 5 of the Federal Trade Commission Act (FTC Act) if, regarding a worker, it:
  - enters into or attempts to enter into a non-compete clause;
  - enforces or attempts to enforce a non-compete clause; or
  - represents that a worker is subject to a non-compete clause.
- Creates a limited exception allowing for the enforcement of existing non-compete agreements with certain senior executives that were entered into

before the rule's effective date, but prohibits employers from entering into new non-competes with all workers, including senior executives, after the effective date.

- Defines non-compete clause as a term or condition of employment prohibiting a worker from, penalizing a worker for, or functioning to prevent a worker from:
  - seeking or accepting work in the US with a different person after the employment relationship ends; or
  - operating a business in the US after the employment relationship ends.
- Clarifies that a non-compete may be:
  - a contractual term or workplace policy; and
  - either written or oral.
- Broadly defines worker as including:
  - employees;
  - independent contractors;
  - externs, interns, volunteers, and apprentices;
  - sole proprietors who provides a service to a person; and
  - natural persons working for a franchisee or franchisor, but not including franchisees in the franchisee-franchisor relationship context.
- Defines senior executive as a worker who both:
  - is in a policy-making position; and
  - earned at least $151,164 in the preceding year (or the equivalent annualized for partial year employment).
- Narrowly defines policy-making position as a business entity's:
  - president;
  - chief executive officer or the equivalent;
  - any other officer who has policy-making authority; or
  - any other natural person who has policy-making authority for the business entity similar to an officer with policy-making authority.
- Defines policy-making authority as:
  - having final authority to make policy decisions that control significant aspects of a business entity or common enterprise;
  - not including authority limited to advising on or exerting influence over policy decisions or having final authority to make policy decisions for only a subsidiary or affiliate of a common enterprise.
- Requires that a covered entity, by the rule's effective date, provide notice to workers who are parties to a non-compete agreement that is prohibited by the rule (that is, any workers other than "senior executives") that the non-compete cannot and will not be enforced. Notice can be on paper, by mail, by email, or by text.
- Provides model language to be used when notifying workers about existing non-competes. The FTC published sample notices on its website in multiple languages, including:
  - Arabic;
  - English;
  - Korean;
  - Simplified Chinese;
  - Spanish;
  - Tagalog; and
  - Vietnamese.
- Includes limited exceptions for and does not apply to:
  - non-competes entered into in connection with a bona fide sale of business; or
  - causes of action regarding an existing non-compete that arose before the rule's effective date.
- Includes a good faith exception, which provides that it "is not an unfair method of competition to enforce or attempt to enforce a non-compete clause or to make representations about a non-compete clause where a person has a good-faith basis to believe that" the rule is inapplicable.
- Does not preempt state law, except to the extent state law allows conduct that is deemed a method of unfair competition under the final rule.
- Does not apply to industries over which the FTC does not have statutory authority, including nonprofits and certain banks, savings and loan institutions, and federal credit unions, among others (see Does the Final Rule Cover All Employers?).

(16 C.F.R. Part 910 (new).)

The final rule is also notable in that it is not limited to non-competes with employees, but includes all workers, including independent contractors, interns, externs, and volunteers.

The FTC has published frequently asked questions to help employers navigate the rule's scope of coverage, prohibitions, requirements, and exceptions (see FTC: Noncompete Clause Rule: A Guide for Businesses and Small Entity Compliance Guide).

Does the Final Rule Make Any Changes from the Proposed Rule?

The final rule largely tracks the NPRM, with a few notable exceptions. Most significantly, the final rule expands the sale of business exception by eliminating the requirement that the sale must be for at least 25% ownership of the business. The rule now allows non-competes in connection with the "bona fide sale of a business entity, of the person's ownership interest in a business entity, or of all or substantially all of a business entity's operating assets" (16 C.F.R. § 910.3(a)).

Second, the final rule creates an exception allowing the enforcement of existing agreements with certain specified senior executives. The exception and the definition of senior executive, comprised of both a salary threshold and "policy-making" duties test, was not in the NPRM, and therefore was not subject to public comment.

Third, the final rule includes an exception for causes of action that accrued before the rule's effective date (meaning the breach occurred before that time). The FTC purportedly included this exception to address concerns about the rule being impermissibly retroactive (Final Rule, p. 344; but see Is the Final Rule Retroactive?). While this is a substantive change, its impact may be relatively minor given that there will be a finite number of accrued or pending claims as of the effective date.

Some other changes appear substantive but practically speaking may be merely semantic. For example, the NPRM would have:

- Banned both non-competes and "de facto" non-competes, without defining de facto non-competes. While the final rule eliminates the "de facto" language, it still incorporates a functional test and bans clauses that "function to prevent" a worker from seeking or accepting work or operating a business. As explained in the supplementary information, while non-solicits and confidentiality provisions are not per se banned by the final rule, they may be violative if "they restrain such a broad scope of activity" that they "function" like a non-compete (Final Rule, § III.D.2.b., p. 77). So this change from the NPRM is more of a distinction than a material difference.
- Required employers to rescind (that is, legally modify) existing agreements with prohibited non-compete clauses. While the final rule eliminates the rescission requirement, it still prohibits enforcing those clauses and requires that employers provide notice to workers who are subject to prohibited non-competes (except certain senior executives) stating that the agreements are not valid and will not be enforced. The final rule requires that the notice be sent by the effective date, rather than 45 days after rescinding the agreement, as provided in the NPRM. Other than the timing, eliminating the rescission requirement does not meaningfully alter the parties' rights, as it renders void nearly all non-compete agreements. (Final Rule, § IV.E, p. 324.)

Does the Final Rule Cover All Employers?

The final rule covers all employers within the FTC's jurisdiction, which includes most for-profit entities. Certain employers are not subject to the FTC's rulemaking jurisdiction under the FTC Act, including:

- Certain banks.
- Savings and loan associations.
- Federal credit unions.
- Common carriers.
- Air carriers.
- Persons covered by the Packards and Stockyards Act of 1921 (15 U.S.C. § 45(a)(2)).
- Non-profit organizations.

(15 U.S.C. §§ 44-45; see also NPRM, 88 Fed. Reg. 3482, 3509 (Jan. 5, 2023).)

While the precise boundaries of the FTC's jurisdiction and rulemaking authority is subject to debate, it appears that the FTC is taking a broad view of its own authority. For example, in the supplementary information accompanying the final rule, the FTC recognizes it lacks jurisdiction over any corporation "not organized to carry on business for its own profit or that of its members." However, after an extensive discussion of the health care industry and, among others, non-profit hospital systems, the FTC warned that "not all entities claiming tax-exempt status as nonprofits fall outside the [FTC's] jurisdiction." The FTC noted that in making this determination it looks to both:

- The source of the income, such as "whether the corporation is organized for and actually engaged in business for only charitable purposes;" and
- The destination of the income, such as "whether either the corporation or its members derive a profit."

(Final Rule, p. 52.)

The FTC takes the position that an organization must satisfy both elements of this two-prong test to be exempt

from coverage under the final rule, regardless of its claimed tax-exempt status. In comments at the hearing in which the FTC adopted the final rule, Commissioner Slaughter drew a similar distinction between "true non-profits," which are beyond the FTC's jurisdiction, and organizations nominally claiming tax-exempt status but operating for the profit of their members, which are within FTC jurisdiction (see Remarks of Commissioner Rebecca Kelly Slaughter Supporting the Final Rule Banning Non-Compete Agreements, Apr. 23, 2024) ("If you claim non-profit tax status but are really organized for the profit of your members, you are within our jurisdiction and covered by the rule. But true non-profits are not.")

Is the Final Rule Retroactive?

In effect, yes. The final rule invalidates all existing non-competes other than those with certain specified senior executives.

Presumably to bolster its assertion that "the final rule is not impermissibly retroactive" (Final Rule, p. 344), the FTC made some changes to the NPRM by:

- Eliminating the proposed rule's requirement that employers affirmatively rescind existing non-competes (though employers still must notify current and former employees who are not senior executives that their non-competes cannot and will not be enforced).
- Providing that the final rule does not apply where a cause of action related to a non-compete accrues (that is, the provision has been breached) before the rule's effective date.

Can Employers Still Use Non-Solicits and Other Restrictive Covenants?

Yes, generally, unless they have the functional effect of preventing a person from seeking or obtaining other employment. For example, the final rule **does not** purport to ban:

- **Restrictive covenants other than "pure" non-competes**. The final rule is limited to traditional "pure" non-competes. It does not per se prohibit other restrictive covenants, such as customer or employee non-solicits, unless they are so broad that they have the effect of preventing a worker from seeking other employment or starting a business. However, the final rule is ambiguous about precisely how the FTC will make that determination.
- **Confidentiality agreements**. The final rule similarly does not per se prohibit confidentiality agreements, unless they are so broad that they functionally prevent a worker from working in the same field for another employer or in business for themselves.
- **Fixed-term employment contracts**. In the supplementary information, the FTC notes that fixed-term employment contracts remain an available tool to protect an employer's trade secrets and investment in employee training and development. This is consistent with California law, where employment contracts for fixed durations are permitted, even though post-employment non-competes are not. If an employee with a fixed-term employment agreement leaves for a competitor before the contract term ends, the former employer can sue the departing employee for damages arising from the contract breach, but cannot bar them from taking the new job.
- **Concurrent employment restraints.** In the supplementary information regarding the final rule, the FTC specifically "declines to extend the reach of the final rule to restraints on concurrent employment" (Final Rule, p. 92). The non-compete ban therefore only applies to post-employment restraints, leaving employers free to impose restraints on workers' activities during the employment relationship.
- **Garden leave provisions.** The supplemental information also explains that a "garden leave" clause, where the worker remains employed and is being paid, but may be relieved of some or all of their duties during a specified garden leave period, is not governed by the non-compete rule because it is not a post-employment restriction. Although the "functional" noncompete test would still apply to garden leave clauses, the supplementary information states that "where a worker does not meet a condition to earn a particular aspect of their expected compensation, like a prerequisite for a bonus, the Commission would still consider the arrangement 'garden leave' that is not a non-compete clause under this final rule even if the employer did not pay the bonus or other expected compensation." (Final Rule, p. 83.)

  It is unclear what remedies would be available for breach of a garden leave provision if the final rule becomes effective. Traditionally, courts have been reluctant to specifically enforce garden leave provisions because doing so requires the court to order employees to continue an at-will employment relationship against their will (see, for example, *Bear, Stearns & Co., Inc. v. Sharon*, 550 F. Supp. 2d 174 (D. Mass. 2008)). However, courts have been willing to issue an injunction prohibiting competition during the garden

leave period (see, for example, *Smiths Grp., plc v. Frisbie*, 2013 WL 268988, at *3 (D. Minn. Jan. 24, 2013) and *Ayco Co., L.P. v. Feldman*, 2010 WL 4286154, at *10 (N.D.N.Y. Oct. 22, 2010) (issuing preliminary injunction enforcing a combined 90-day notice and non-compete period but acknowledging that the court would not issue an injunction forcing the employee to continue working for the employer)). But issuing an injunction against competition would render the garden leave the functional equivalent of a non-compete, and therefore likely be void under the final rule. Nonetheless, even if injunctive relief were unavailable, an employer could still sue the worker for breach of contract for violating the garden leave clause and potentially sue the hiring employer for tortious interference.

- **Sale of business non-competes.** The final rule includes an express carve-out for non-competes entered into in connection with a person:
  - selling a business entity;
  - otherwise disposing of all of the person's ownership interest in the business entity; or
  - selling all or substantially all of a business entity's operating assets.

  The final rule eliminates the requirement in the NPRM that the seller must own at least 25% of the equity in the company at the time of entering into the non-compete.

Does the Final Rule Address Non-Competes in Benefit Plans and Other Agreements?

The final rule does not expressly discuss non-competes in benefit plans or other agreements other than in connection with the sale of a bona fide business. According to the FTC, however, an example of a contractual term that "penalizes" a worker, and is thus an impermissible non-compete, may include:

- A forfeiture for competition clause which gives an employee the choice of receiving a defined benefit and refraining from competition or opting to compete and forfeiting the benefit. Because these clauses impose "adverse financial consequences on a former employee" for seeking or accepting other work post-termination, they are impermissible.
- A severance agreement which conditions the right to severance on compliance with a non-compete clause.

According to the FTC, "[t]he common thread that makes each of these types of agreements non-compete clauses . . . is that on their face, they are triggered where a worker seeks to work for another person or start a business after they leave their job" and they therefore "prohibit or penalize" the employee from working for another employer or business.

Moreover, the FTC makes it clear that employers should not attempt to use the sale of a business exception to impose non-competes on workers. As explained in the supplementary information, "[s]o-called 'springing' non-competes [where a worker must agree at the time of hire to a non-compete if there is a future sale] and non-competes arising out of repurchase rights or mandatory stock redemption programs are not entered into pursuant to a bona fide sale because . . . the worker has no good will that they are exchanging for the non-compete or knowledge of or ability to negotiate the terms or conditions of the sale at the time of contracting." (Final Rule, p. 342.)

How Will the Final Rule Be Enforced?

If and when it goes into effect, the rule can be enforced in two ways -- through FTC enforcement actions and civil litigation.

First, the FTC could initiate either an administrative proceeding or seek an injunction in federal district court against any defendant that "is violating, or is about to violate" the final rule where an injunction is in the public's interest. The FTC is unlikely to be able to seek monetary relief for violations of this rule because, under the FTC Act, it may not have the authority to seek penalties for unfair method of competition. The FTC can, however, obtain civil penalties in court if a party fails to cease and desist from a violation after being ordered to do so.

Second, although there is no private right of action under the FTC Act, an aggrieved employee can file an action seeking a judgment from the court declaring that any illegal non-compete is unenforceable. There may also be other potential claims, including claims for actual and punitive damages, depending on whether an employer attempts to enforce an illegal non-compete.

Does the FTC Even Have the Authority to Make This Rule?

Unclear, but two FTC commissioners and the US Chamber of Commerce, among others, think the answer is no, and the issue is currently being litigated, as described below.

Section 5 of the FTC Act empowers the FTC, among other duties, to prevent unfair methods of competition and unfair or deceptive acts or practices affecting interstate commerce. It gives the FTC authority to investigate possible violations, seek monetary damages, prescribe rules to prevent unfair or deceptive practices, and make reports and recommendations to Congress and the public. (15 U.S.C. §§ 41-58). The final rule purports to ban non-competes as an "unfair method of competition" under Section 5. But the FTC's rulemaking authority is limited to prescribing rules and policy statements regarding unfair or deceptive acts or practices, not unfair methods of competition. For more on the FTC Act, see Practice Note, FTC Act Section 5: Overview.

For over 200 years, non-compete agreements have been governed by state laws that vary widely across jurisdictions. Until recently, the FTC has not actively engaged in regulating non-compete agreements between employers and their workers. That changed in late 2022 with the FTC's policy announcement about non-competes, followed by its announcement that it had entered into consent decrees arising out of two enforcement actions accusing employers of engaging in unfair methods of competition by using non-competes, and capped off with the NPRM in January 2023 that ultimately led to the final rule.

Since the NPRM's publication, there have been questions about the FTC's authority to issue a rule of this scope. Commissioners Melissa Holyoak and Andrew N. Ferguson dissented from the issuance of the final rule, expressing the view that this "broad rulemaking exceeds congressional authorization and will likely not survive legal challenge" (Oral Statement of Commissioner Holyoak in the Matter of Non-Compete Clause Rule, Apr. 23, 2024; see also Oral Statement of Commissioner Andrew N. Ferguson In the Matter of the Non-Compete Clause Rule, Apr. 23, 2024 ("I do not believe we have the power to nullify tens of millions of existing contracts; to preempt the laws of forty-six States; to declare categorically unlawful a species of contract that was lawful when the Federal Trade Commission Act (FTC Act) was adopted in 1914; and to declare those contracts unlawful across the whole country irrespective of their terms, conditions, historical contexts, and competitive effects.")).

And as predicted, almost immediately after its issuance, three lawsuits have been filed challenging the FTC's authority to issue and enforce the final rule, especially given its breadth and scope.

In the first suit, Ryan, LLC, a global tax services and software provider that uses non-competes with its shareholder principals and certain other employees with access to particularly \ sensitive business information, filed a challenge to the final rule on April 23, 2024 in the Northern District of Texas (*Ryan, LLC v. Fed. Trade Comm'n*, Case No. 3:24-cv-00986-E (N.D. Tex. Apr. 23, 2024)). The Ryan lawsuit alleges that the final rule:

- Contravenes the FTC Act.
- Violates the US Constitution.
- Is arbitrary, capricious, and otherwise unlawful.

In the second suit, the US Chamber of Commerce and other business associations seek a declaration that the FTC's final rule is unlawful and an injunction against its enforcement (*U.S. Chamber of Commerce v. Fed. Trade Comm'n*, Case 6:24-cv-00148 (E.D. Tex. Apr. 24, 2024)). The lawsuit alleges that the FTC's promulgation of the final rule should be set aside and enjoined because it is:

- Not in accordance with law because:
  - the FTC lacks the authority to issue binding regulations regarding "unfair methods of competition;"
  - the rule exceeds the FTC's authority under Section 5 of the FTC Act;
  - Section 5 of the FTC Act violates the US Constitution's nondelegation principle; and
  - the FTC lacks the authority to issue retroactive regulations.
- Arbitrary and capricious because the FTC:
  - does not support its decision to categorically ban all noncompete agreements;
  - relied on a flawed cost-benefit analysis; and
  - failed to consider alternate proposals.

The plaintiffs filed a motion asking the court to stay the effective date of the final rule or preliminarily enjoin its enforcement, or both.

On April 25, 2024, ATS Tree Services sued the FTC in the Eastern District of Pennsylvania. As alleged, "ATS uses reasonable non-compete agreements to ensure that it can provide its employees with necessary and valuable specialized training while minimizing the risk that employees will leave and immediately use that specialized training and ATS's confidential information to benefit a competitor." ATS challenges the final rule on similar grounds to the other lawsuits and is represented by a public interest law firm. (*ATS Tree Servs, LLC v. Fed. Trade Comm'n*, Case 2:24-cv-01743 (E.D. Pa. Apr. 25, 2024)).

We believe that legal challenges to the final rule are likely to succeed and that the final rule will most likely be enjoined before it ever goes into effect.

What Should Employers Do Now?

While the ultimate fate of the final rule remains uncertain, there are several steps employers should consider taking during this period of flux:

- **Determine the company's approach to compliance before the effective date.** While expected legal challenges play out, employers are not legally required to make any immediate changes in their non-compete practices. Many employers are taking a "wait-and-see" approach before making sweeping changes to their agreements and plan documents.
- **Review existing non-compete agreements and plans and policies with restrictive covenants.** While no immediate changes are required, employers generally should take stock of their existing agreements, plans, and policies that contain non-competes and other restrictive covenants. Determine whether the company has entered into non-competes with any senior executives or wants to enter into agreements with those individuals before the final rule's effective date.
- **Consider entering into garden leave agreements with key executives and sales personnel**. Because "pure" garden leave provisions are not covered by the non-compete ban, employers may consider entering into these agreements with certain key employees and sales personnel who do not qualify as "senior executives" under the final rule. Employers should balance the cost of these agreements with the benefit they are seeking to protect their valuable assets. For more on garden leave, see Practice Note, Garden Leave Provisions in Employment Agreements: Advantages and Disadvantages of Garden Leave Provisions.
- **Be prepared for continued regulatory activity.** Even if the final rule never becomes effective, the FTC may continue to flex its regulatory muscle with enforcement actions on a case-by-case basis, likely targeted at companies that use non-competes with low wage workers or in other ways that the FTC may consider to be abusive. Given the current climate, employers should review and evaluate the nature and scope of their non-compete agreements and ensure they are being used to protect legitimate business interests and comply with applicable state laws.
- **Monitor and comply with evolving state law.** Employers should focus on compliance with state non-compete laws, which have been evolving substantially over the past few years and are increasingly restricting the enforceability of non-competes. Many states now include compensation thresholds and notice requirements, among other due process-type protections. Employers should ensure that they are in compliance with all applicable laws and pay particular attention with their remote workers who may be entitled to greater protections than those available where the business is primarily located. To view and customize an up-to-date comparison of state non-compete laws, see Quick Compare Chart, State Non-Compete Laws.
- **Consider a trade secret audit.** Employers should evaluate what they are doing to protect their trade secrets and what they can do better, for example, by:
  - identifying and labelling trade secrets;
  - securing them through limited access and contractual protections; and
  - training employees about the importance of protecting them.

  For more on trade secret audits, see Practice Note, Trade Secret Audits. For customizable training materials, see Standard Document, Protecting a Company's Confidential Information and Trade Secrets: Presentation Materials.
- **Take a holistic approach.** Non-competes are just one tool employers can use to protect confidential information, customer relationships, and workforce stability. Employers should consider alternative methods, including:
  - garden leave clauses;
  - confidentiality agreements;
  - non-solicitation agreements;
  - employee training; and
  - employee onboarding and offboarding procedures.
- **Don't panic.** Although the announcement of the final rule brings us one step closer to the FTC's desired ban, given the current and expected future legal challenges, the final rule is unlikely to become the law of the land, at least not any time soon. But employers should use this opportunity to stay ahead of the legal and regulatory trend toward limiting when and against whom non-competes are enforceable and use their non-compete agreements wisely.

EPSTEIN BECKER GREEN

California Makes Its Strict Noncompete Law Even Stricter

October 26, 2023 | Publications | 4 minute read

California's Business and Professions Code (the "Code") has long been the nation's strictest law on restrictive covenants, essentially prohibiting employee noncompetition agreements except in limited circumstances.

Two bills recently signed into law by Governor Gavin Newsom reiterate and broaden the state's restrictions on employee noncompetes. SB 699, which goes into effect January 1, 2024, and which we previously wrote about here, broadens the Code's restrictions and provides individuals with new legal remedies. AB 1076 codifies existing California case law and establishes a significant notice obligation for employers.

With AB 1076's February 14, 2024, notice deadline quickly approaching, it is vital that employers with California workforces take steps now to understand and prepare to comply with the new law.

AB 1076's Enhanced Prohibition and Notice Requirement

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SERVICES

Employment Compliance Counseling

AB 1076 adds a new Section 16600.1 to the Code. Beginning January 1, 2024, Section 16600.1 makes it *unlawful* for an employer to include a noncompete clause in an employment agreement or to require an employee to enter into a noncompete agreement. It also codifies existing case law that a violation of Section 16600 constitutes "an act of unfair competition." In addition, Section 16600.1 also establishes a new employer notice requirement giving employers until February 14, 2024, to notify employees—both current and former employees who were employed after January 1, 2022—who are subject to an unlawful noncompete agreement or clause, that such agreement or clause is void. Importantly, these notices must be in writing, individualized, and delivered to the individual's last known physical address and email address.

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AB 1076's Declarative Amendments

Currently, Section 16600 of the Code voids contracts that restrain an individual from engaging in a lawful profession, trade, or business of any kind unless the restriction meets one of the Code's three statutory exceptions, i.e., restrictive covenants relating to the sale of a business or dissolution of a partnership or limited liability company. AB 1076 clarifies Section 16600 in two important ways. First, it explicitly codifies the California Supreme Court's decision in *Edwards v. Arthur Anderson LLP*, 44 Cal. 4th 937 (Cal. 2008), which held that, no matter how narrowly tailored they are, noncompete agreements and clauses are void under California law in the employment context. Second, AB 1076 confirms that Section 16600's prohibitions apply even when the person being restrained from engaging in lawful competition is *not* a party to the contract at issue. Previously, there was ambiguity surrounding this issue arising from the California Supreme Court's decision in *Ixchel*

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Employment, Labor &

Pharma, LLC v. Biogen, Inc., 9 Cal. 5th 1130 (Cal. 2020). That ambiguity is now eliminated.

What Employers Should Do Now

- Consult with counsel regarding agreements with current and former employees to determine whether any contain provisions that may operate as noncompetes even if they do not include that term. California law is broad, and Section 16600 covers other provisions that may not be termed as a noncompete but may nevertheless be intended to restrain individuals from engaging in a lawful profession or business.
- Review and revise template offer letters, employment and proprietary information agreements, and other form agreements for California employees to ensure that they do not contain unlawful restrictive covenants. This is especially important due to the enactment of SB 699, which adds Section 16600.5 to the Code, entitling plaintiffs to actual damages and attorneys' fees for being subject to any unlawful noncompete provision or restrictive covenant in violation of Section 16600.
- Identify any current employees or former employees who were employed after January 1, 2022, who may be subject to an unlawful restrictive covenant. These would include:
    - current and former employees who are or were working remotely and residing in California, even if the employer had no physical offices in California, and
    - former employees who may have never worked in California during their employment but have since moved to California.
- As to any employees who are entitled to notice, work with counsel to draft a compliant notice for affected individuals.

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- Establish a procedure and designate and train the personnel who will be responsible for providing the required notice by the February 14, 2024, deadline.

- Establish a document retention policy for retaining records documenting compliance with AB 1076's notice requirements, including a copy of the notice, the date it was sent, and the physical and email addresses to which it was sent.

* * *

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EPSTEIN BECKER GREEN

California Expands Noncompete Restrictions

Trade Secrets & Employee Mobility

September 13, 2023 | Blogs | 3 minute read

Categories: Non-Compete Agreements, Trade Secrets and Confidential Information

Jennifer L. Nutter, Phillip K. Antablin

This year, California was one of many states to enact legislation restricting noncompetes. California has long had the strictest noncompete law, and employee noncompetes are already void under California Business and Professions Code § 16600 ("Section 16600"). On September 1, 2023, California passed new legislation ("SB 699") that further broadens Section 16600 and provides employees with new legal remedies.

The Current Law

Unless one of the narrow statutory exceptions applies, Section 16600 provides that any contract restraining a person from "engaging in a lawful profession, trade, or business of any kind" is void. As such, employee noncompete agreements and several other types of restrictive covenants are generally unenforceable in California. Importantly, Section 16600 by itself does not provide employees with a private right of action through which a court may award damages.

SB 699

Over half of the text of SB 699 is dedicated to legislative findings regarding the prevalence and negative impact of noncompetes across the United States. It is this nationwide context that underscores SB 699's substantive amendments, which are codified in new California Business and Professions Code § 16600.5 and update the current law in three significant ways.

First, SB 699 explicitly provides that any agreement that is void under Section 16600 is unenforceable in California regardless of where and when the agreement was signed. This means that even if an employee worked and resided outside of California, to the extent the employee subsequently obtains employment in California, any prior noncompete to which the employee is subject will not be enforceable. This is consistent with the historical approach taken by California courts in refusing to enforce such a restrictive covenant, based on the reasoning that California's fundamental public policy interests outweigh the interests of another state. SB 699 all but eliminates the need for this analysis.

Second, while Section 16600 currently only *voids* unlawful restrictive covenants, SB 699 explicitly makes it *unlawful* for:

- Employers and former employers to *attempt to enforce* a noncompete, regardless of whether the agreement containing the noncompete was signed outside of California or if the employee was employed outside of California; and
- Employers to *enter into* a noncompete with an employee or prospective employee.

SB 699 treats an employer's unlawful efforts to enforce or enter into unlawful restrictive covenants as a civil violation, which is significant given the new relief available under SB 699 (described below).

Third, SB 699 provides current, former, and prospective employees with a private right of action to seek injunctive relief and/or actual damages against employers that enter into or attempt to enforce an unlawful restrictive covenant. Prior to SB 699, there was no specific entitlement to actual damages under Section 16600. Employees or prospective employees that prevail in such actions are now also entitled to reasonable attorney's fees and costs. Previously, employees would typically seek declaratory relief when challenging an unlawful noncompete and then could only recover attorney's fees if they also alleged and proved a claim of unfair competition in violation of California Business and Professions Code § 17200 (and a court exercised its discretion to award such fees).

Next Steps

SB 699 is scheduled to take effect on January 1, 2024, codified as Business and Professions Code Section 16600.5. The California legislature also continues to debate additional restrictive covenant legislation that would further strengthen Section 16600 protections. For now, employers should begin reviewing and revising their restrictive covenant agreements for compliance with SB 699

and seek advice from counsel before attempting to enforce such agreements against current, former, or prospective employees in California.

Tags: California, California Business & Professions Code Section 16600, Jennifer Nutter, Michelle Hamamah, Noncompete Restrictions, Noncompetes, Phillip K. Antablin, SB 699

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Employment, Separation, and Settlement Agreements: Limitations on Confidentiality and Non-Disparagement Clauses

FAQ

California laws prohibit certain terms in employment, separation, and settlement agreements between employers and employees, former employees, and job applicants. These laws aim to ensure that individuals are able to speak out about discrimination, harassment, and other types of unlawful conduct in the workplace. This document contains answers to common questions about these laws. This guidance only addresses the requirements of Government Code section 12964.5 and Code of Civil Procedure sections 1001 and 1002.5, and does not address other limitations.

EMPLOYMENT AGREEMENTS

Sometimes employers ask employees to sign agreements as a condition of employment. There are restrictions on what these agreements may include. The following three questions address what is allowed and what is not allowed in employment agreements under Government Code section 12964.5.

1 Can an employment agreement prohibit an employee from talking about discrimination, harassment, retaliation, or other unlawful acts at work?

No. If an employment agreement contains a "non-disparagement" clause, it cannot stop the employee from speaking about discrimination, harassment, retaliation, or other "unlawful acts" at work.[1] Unlawful acts include, but are not limited to, acts that an employee reasonably believes to be unlawful.[2] If the employment agreement contains a non-disparagement clause, it must state the following (or something substantially similar): "Nothing in this agreement prevents you from discussing or disclosing information about unlawful acts in the workplace, such as harassment or discrimination or any other conduct that you have reason to believe is unlawful."[3] If a non-disparagement clause in an employment agreement violates these rules, the clause is unlawful and unenforceable, and the employer violates the Fair Employment and Housing Act.[4]

- *Example:* The following non-disparagement clause would be unlawful under Government Code section 12964.5: "Employee agrees that she will not make any statement, directly or indirectly, verbally or in writing, that would cause harm or embarrassment to the Company."

1 Gov. Code § 12964.5(a).
2 Gov. Code § 12964.5(c).
3 Gov. Code § 12964.5(b).
4 Gov. Code § 12964.5(a).

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2 | Can an employment agreement include language requiring a job applicant or employee to give up claims or rights in exchange for employment or an employment benefit?

No. An employment agreement cannot require an employee to give up their rights or their claims against the employer in exchange for employment, continuing employment, a raise, or a bonus.[5] Further, an employment agreement cannot require an employee to state that they do not have any injuries or claims against the employer.[6]

- *Example:* The following language in an employment agreement would be unlawful under Government Code section 12964.5: "Employee hereby acknowledges that continued employment is contingent upon a release of both current and future claims against the Company, known and unknown, including any claims under the California Fair Employment and Housing Act. By signing below, Employee acknowledges the above and agrees to release any such existing or future claims."

In addition, an employment agreement cannot require an employee to release their right to file a court or administrative complaint, or to notify a state agency, law enforcement agency, or any other governmental entity about complaints against the employer.[7]

- *Example:* The following provision in an employment agreement would be unlawful under Government Code section 12964.5: "In the event Employee believes they have been subjected to discrimination, harassment, retaliation, or other unlawful conduct, Employee agrees that they shall not report any such alleged conduct to a state or federal administrative department or agency, including the California Civil Rights Department. In the event a state or federal administrative department or agency contacts Employee regarding alleged unlawful conduct against Employee or another individual employed by the Company, Employee agrees not to grant an interview with or provide testimony before any such department or agency."

Any provision in an employment agreement that violates these rules is unlawful and unenforceable, and the employer violates the Fair Employment and Housing Act.[8]

3 | Can an employment agreement prohibit the employee from disclosing the employer's "trade secrets" or other proprietary information?

Yes. An employment agreement may prohibit the employee from disclosing the employer's trade secrets, proprietary information, or confidential information that is unrelated to unlawful acts in the workplace.[9]

5 Gov. Code § 12964.5(a).
6 Gov. Code § 12964.5(a).
7 Gov. Code § 12964.5(a).
8 Gov. Code § 12964.5(a).
9 Gov. Code § 12964.5(f).

SEPARATION AGREEMENTS

Sometimes when an employee is separating from employment (leaving a job), the employer and employee work out a separation agreement. These are also known as severance agreements. There are restrictions on what these agreements may include. The following five questions address what is allowed and not allowed in separation agreements under Government Code section 12964.5.

4 | Can a separation agreement prohibit a separating employee from talking about discrimination, harassment, retaliation, or other unlawful acts at work?

No. If a separation agreement contains a "non-disparagement" clause, it cannot stop the employee from speaking about discrimination, harassment, retaliation, or other "unlawful acts" at work.[10] Unlawful acts include, but are not limited to, acts that an employee reasonably believes to be unlawful.[11] If the separation agreement contains a non-disparagement clause, it must state the following (or something substantially similar): "Nothing in this agreement prevents you from discussing or disclosing information about unlawful acts in the workplace, such as harassment or discrimination or any other conduct that you have reason to believe is unlawful."[12]

- *Example:* The following non-disparagement clause would be unlawful under Government Code section 12964.5: "Former Employee agrees that they will not make any statement, directly or indirectly, verbally or in writing, that would cause harm or embarrassment to the Company."

If a non-disparagement clause in an separation agreement violates these rules, the clause is unlawful and unenforceable, and the employer violates the Fair Employment and Housing Act.[13]

5 | Can a separation agreement include a general release and waiver of claims in a separation agreement?

Yes. Assuming the release is otherwise lawful and valid, an employer may include a general release or waiver of claims related to an employee's separation from employment.[14]

6 | Can an employer require a separating employee to sign a separation agreement on the same day it is offered?

No. An employer offering a separation agreement to an employee must both (1) notify the employee of their right to consult an attorney about the agreement and (2) provide the employee at least five business days to do so.[15]

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10 Gov. Code § 12964.5(b).
11 Gov. Code § 12964.5(c).
12 Gov. Code § 12964.5(b).
13 Gov. Code § 12964.5(b).
14 Gov. Code § 12964.5(b).
15 Gov. Code § 12964.5(b).

7 | Can a separation agreement prohibit the employee from disclosing the employer's "trade secrets" or other proprietary information?

Yes. A separation agreement may prohibit the former employee from disclosing the employer's trade secrets, proprietary information, or confidential information that is unrelated to unlawful acts in the workplace.[16]

8 | Can a separation agreement prohibit the employer and employee from disclosing the amount paid by the employer to the employee?

Yes. A separation agreement may prohibit disclosure of the amount paid in a severance agreement.[17]

SETTLEMENT AGREEMENTS

When someone files a complaint with CRD, another agency, or in court against an employer, or notifies the employer that they have a complaint prior to filing it, the law restricts which terms can be included in an agreement to settle the complaint. The following five questions address what is allowed and what is not allowed under California Code of Civil Procedure sections 1001 and 1002.5.

9 | Can a settlement agreement prohibit the employee or job applicant from disclosing factual information related to unlawful discrimination and harassment?

No. A settlement agreement that resolves a CRD or other administrative complaint or a court case cannot restrict or prevent the complainant/plaintiff from disclosing factual information related to any of the following:

- An act of sexual assault;
- An act of workplace harassment or discrimination based on race, religious creed, color, national origin, ancestry, physical disability, mental disability, medical condition, genetic information, marital status, sex, gender, gender identity, gender expression, age, sexual orientation, veteran or military status, or any other characteristic(s) protected by the Fair Employment and Housing Act;
- Failure to prevent an act of workplace harassment or discrimination based on any characteristic(s) protected by the Fair Employment and Housing Act; or
- An act of retaliation against a person for reporting or opposing harassment or discrimination based on any characterstic(s) protected by the Fair Employment and Housing Act.[18]

Any settlement agreement that restricts or prohibits any of these disclosures is unlawful and unenforceable.[19]

16 Gov. Code § 12964.5(f).
17 Gov. Code § 12964.5(e).
18 Code Civ. Pro. § 1001(a).
19 Code Civ. Pro. § 1001(d).

10 | Can a settlement agreement prohibit a party from disclosing the amount of the settlement?

Yes. A settlement agreement may prohibit disclosure of the amount paid in a settlement agreement.[20]

11 | Can a settlement agreement prohibit a party from disclosing the identity of the complainant or plaintiff?

Yes. A settlement agreement may prohibit disclosure of the identity of the complainant/plaintiff as well as facts that could lead to the identification of that person.[21] However, that is lawful only if (1) it is at the request of the complainant/plaintiff and (2) a government agency or public official is not a party to the settlement.[22]

12 | Can a settlement agreement include a "no-rehire clause"?

Usually, no. According to California Code of Civil Procedure section 1002.5, clauses in settlement agreements that prohibit, prevent, or restrict an individual from obtaining future employment with an employer against whom they have asserted a claim are unlawful and unenforceable, unless either of the following apply:

- The employer has determined in good faith that the individual engaged in sexual harassment or sexual assault; or
- A legitimate, non-discriminatory reason exists for terminating and refusing to rehire the individual.[23]

If you think you have been a victim of employment discrimination, please contact CRD.

TO FILE A COMPLAINT

Civil Rights Department
calcivilrights.ca.gov
Toll Free: 800.884.1684
TTY: 800.700.2320

Have a disability that requires a reasonable accommodation?
CRD can assist you with your complaint.

For translations of this guidance, visit: www.calcivilrights.ca.gov/posters/employment

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20 Code Civ. Pro. § 1001(e).
21 Code Civ. Pro. § 1001(e).
22 Code Civ. Pro. § 1001(c).
23 Code Civ. Pro. § 1002.5.

THE STATE BAR OF CALIFORNIA
STANDING COMMITTEE ON
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PRACTICAL GUIDANCE FOR THE USE OF GENERATIVE ARTIFICIAL INTELLIGENCE IN THE PRACTICE OF LAW

EXECUTIVE SUMMARY

Generative AI is a tool that has wide-ranging application for the practice of law and administrative functions of the legal practice for all licensees, regardless of firm size, and all practice areas. Like any technology, generative AI must be used in a manner that conforms to a lawyer's professional responsibility obligations, including those set forth in the Rules of Professional Conduct and the State Bar Act. A lawyer should understand the risks and benefits of the technology used in connection with providing legal services. How these obligations apply will depend on a host of factors, including the client, the matter, the practice area, the firm size, and the tools themselves, ranging from free and readily available to custom-built, proprietary formats.

Generative AI use presents unique challenges; it uses large volumes of data, there are many competing AI models and products, and, even for those who create generative AI products, there is a lack of clarity as to how it works. In addition, generative AI poses the risk of encouraging greater reliance and trust on its outputs because of its purpose to generate responses and its ability to do so in a manner that projects confidence and effectively emulates human responses. A lawyer should consider these and other risks before using generative AI in providing legal services.

The following Practical Guidance is based on current professional responsibility obligations for lawyers and demonstrates how to behave consistently with such obligations. While this guidance is intended to address issues and concerns with the use of generative AI and products that use generative AI as a component of a larger product, it may apply to other technologies, including more established applications of AI. This Practical Guidance should be read as guiding principles rather than as "best practices."

PRACTICAL GUIDANCE

Applicable Authorities	Practical Guidance
Duty of Confidentiality Bus. & Prof. Code, § 6068, subd. (e) Rule 1.6 Rule 1.8.2	Generative AI products are able to utilize the information that is input, including prompts and uploaded documents or resources, to train the AI, and might also share the query with third parties or use it for other purposes. Even if the product does not utilize or share inputted information, it may lack reasonable or adequate security. A lawyer must not input any confidential information of the client into any generative AI solution that lacks adequate confidentiality and security protections. A lawyer must anonymize client information and avoid entering details that can be used to identify the client. A lawyer or law firm should consult with IT professionals or cybersecurity experts to ensure that any AI system in which a lawyer would input confidential client information adheres to stringent security, confidentiality, and data retention protocols. A lawyer should review the Terms of Use or other information to determine how the product utilizes inputs. A lawyer who intends to use confidential information in a generative AI product should ensure that the provider does not share inputted information with third parties or utilize the information for its own use in any manner, including to train or improve its product.
Duties of Competence and Diligence Rule 1.1 Rule 1.3	It is possible that generative AI outputs could include information that is false, inaccurate, or biased. A lawyer must ensure competent use of the technology, including the associated benefits and risks, and apply diligence and prudence with respect to facts and law. Before using generative AI, a lawyer should understand to a reasonable degree how the technology works, its limitations, and the applicable terms of use and other policies governing the use and exploitation of client data by the product. Overreliance on AI tools is inconsistent with the active practice of law and application of trained judgment by the lawyer. AI-generated outputs can be used as a starting point but must be carefully scrutinized. They should be critically analyzed for

Applicable Authorities	Practical Guidance
	accuracy and bias, supplemented, and improved, if necessary. A lawyer must critically review, validate, and correct both the input and the output of generative AI to ensure the content accurately reflects and supports the interests and priorities of the client in the matter at hand, including as part of advocacy for the client. The duty of competence requires more than the mere detection and elimination of false AI-generated results. A lawyer's professional judgment cannot be delegated to generative AI and remains the lawyer's responsibility at all times. A lawyer should take steps to avoid over-reliance on generative AI to such a degree that it hinders critical attorney analysis fostered by traditional research and writing. For example, a lawyer may supplement any AI-generated research with human-performed research and supplement any AI-generated argument with critical, human-performed analysis and review of authorities.
Duty to Comply with the Law Bus. & Prof. Code, § 6068(a) Rule 8.4 Rule 1.2.1	A lawyer must comply with the law and cannot counsel a client to engage, or assist a client in conduct that the lawyer knows is a violation of any law, rule, or ruling of a tribunal when using generative AI tools. There are many relevant and applicable legal issues surrounding generative AI, including but not limited to compliance with AI-specific laws, privacy laws, cross-border data transfer laws, intellectual property laws, and cybersecurity concerns. A lawyer should analyze the relevant laws and regulations applicable to the attorney or the client.
Duty to Supervise Lawyers and Nonlawyers, Responsibilities of Subordinate Lawyers Rule 5.1 Rule 5.2 Rule 5.3	Managerial and supervisory lawyers should establish clear policies regarding the permissible uses of generative AI and make reasonable efforts to ensure that the firm adopts measures that give reasonable assurance that the firm's lawyers and non lawyers' conduct complies with their professional obligations when using generative AI. This includes providing training on the ethical and practical aspects, and pitfalls, of any generative AI use. A subordinate lawyer must not use generative AI at the direction of a supervisory lawyer in a manner that violates the subordinate lawyer's professional responsibility and obligations.

Applicable Authorities	Practical Guidance
Communication Regarding Generative AI Use Rule 1.4 Rule 1.2	A lawyer should evaluate their communication obligations throughout the representation based on the facts and circumstances, including the novelty of the technology, risks associated with generative AI use, scope of the representation, and sophistication of the client. The lawyer should consider disclosure to their client that they intend to use generative AI in the representation, including how the technology will be used, and the benefits and risks of such use. A lawyer should review any applicable client instructions or guidelines that may restrict or limit the use of generative AI.
Charging for Work Produced by Generative AI and Generative AI Costs Rule 1.5 Bus. & Prof. Code, §§ 6147–6148	A lawyer may use generative AI to more efficiently create work product and may charge for actual time spent (e.g., crafting or refining generative AI inputs and prompts, or reviewing and editing generative AI outputs). A lawyer must not charge hourly fees for the time saved by using generative AI. Costs associated with generative AI may be charged to the clients in compliance with applicable law. A fee agreement should explain the basis for all fees and costs, including those associated with the use of generative AI.
Candor to the Tribunal; and Meritorious Claims and Contentions Rule 3.1 Rule 3.3	A lawyer must review all generative AI outputs, including, but not limited to, analysis and citations to authority for accuracy before submission to the court, and correct any errors or misleading statements made to the court. A lawyer should also check for any rules, orders, or other requirements in the relevant jurisdiction that may necessitate the disclosure of the use of generative AI.
Prohibition on Discrimination, Harassment, and Retaliation Rule 8.4.1	Some generative AI is trained on biased information, and a lawyer should be aware of possible biases and the risks they may create when using generative AI (e.g., to screen potential clients or employees). Lawyers should engage in continuous learning about AI biases and their implications in legal practice, and firms should establish policies and mechanisms to identify, report, and address potential AI biases.

Applicable Authorities	Practical Guidance
Professional Responsibilities Owed to Other Jurisdictions Rule 8.5	A lawyer should analyze the relevant laws and regulations of each jurisdiction in which a lawyer is licensed to ensure compliance with such rules.

Lost In Translation: Non-English Fee Agreements

By Omar S. Anorga

Omar Anorga represents businesses and individuals with various legal problems, and he strives to always resolve these problems in a smart, and cost-effective manner. Mr. Anorga has vast experience with litigating legal disputes in both state and federal court. Lastly, The Anorga Law Firm, Inc., has a large stable of Spanish-speaking business owners, and Mr. Anorga is able to communicate with them in their native language.

A bilingual or multilingual attorney can be a valuable resource to your law firm. I have found that communicating with potential clients in their native Spanish language immediately promotes in them a sense of trust, comfort and confidence in my legal abilities.

Not only do language skills enhance the attorney-client relationship, but it also allows the attorney to increase his or her market-share by carving out a legal niche with a certain language-speaking community. Additionally, the globalizing economy is making it imperative for California attorneys to be able to communicate with individuals from all over the world, especially those in the Asian financial markets. More locally, Spanish is by far the most widely spoken language in California other than English. Without a doubt, California attorneys are leaving money on the table if they cannot communicate with potential clients in a language other than English.

Not surprisingly, state law requires certain fee agreements be translated from English into a different language. Acute knowledge of the requirements of Civil Code section 1632 *et seq.* is important before you sign up that next well-heeled foreign speaking client.

Civil Code section 1632 (b)(6) states that any attorney who negotiates legal services primarily in Spanish, Chinese, Tagalog, Vietnamese, or Korean, shall deliver to his or her potential client a written translation of the fee agreement in the language in which it was negotiated. This translation must be provided before the client executes the agreement. Say an exclusively Spanish speaking potential client walks through your door seeking legal representation. During the client in-take, you and the potential client agree to the terms of the fee agreement. You present the potential client with your standard English written fee agreement, which the client signs. Now your firm has a valuable new matter. Under most circumstances, congratulations are in order; however, you have just violated Civil Code section 1632, and potentially exposed yourself to a malpractice lawsuit affording the client the right to rescind the fee agreement. Not good.

A natural inclination for most lawyers is to look for an exception to section 1632(b)(6). Translating your reliable English fee agreement sounds complex and risky. The primary exception is Civil Code section 1632(h), which applies when your client negotiates the terms of the fee agreement through his or her own interpreter. The interpreter must be a "person, not a minor, able to speak fluently and read with full understanding both the English language and any other languages in which the fee agreement was negotiated, and who is not employed" by you. So, if your client brings their child in with them to translate, no matter how competent and capable the minor may be, the exception does not apply. And, your assistant who is fluent in the client's native language may assist in interpreting, but this will not allow you to circumvent the translation requirement.

In most situations, you simply need to comply with the translation requirement. So, after negotiating the terms in the client's language, your next step is to

have your fee agreement translated into that language. Here are a couple of tips to keep in mind:

First, the most cost-effective way to translate a written fee agreement is by plugging into Google Translate or any of a number of other free online translation tools. I recently cut and pasted my eight-page fee agreement into Google Translate, and I was astonished at how remarkably accurate Google translated my English fee agreement into Spanish. There were minor issues with the translation, but I was able to rectify them without any problem.

There were some issues with Google Translate word choices. For example, my English fee agreement collectively refers to me as an attorney; presumably, the common translation of that word should have been abogado. Google Translate, for some reason, used the word fiscal, which means district attorney or prosecutor. This word choice problem is a likely specific to the Spanish language, which is the official language of 21 countries, each having their own nuanced dialect.

Since you should only be translating your fee agreement into a language that you speak well enough to have conducted the negotiation in it, you should be able to read the translated document and pick up on issues like these. If you do not speak the language well enough to find these errors, then you probably should not be negotiating in it. If you use a translator like one of your staff members to assist in negotiating, make sure they read the translated document to help fix these errors.

Google Translate is probably best for those attorneys with a decent grasp of one of the covered languages under Civil Code section 1632. With some moderate editing, the attorney should be able to easily present the potential client with a properly worded and translated fee agreement.

Second, there is a thriving market dedicated to translating professional documents. A simple online search for these types of services will bring up several different providers. Legal document translation generally costs in between 14 to 26 cents per word, depending on the language. Chinese and Spanish tend to be on the lower end of cost, while Korean and Vietnamese are middle of the road, and Tagalog being the most expensive. Also, note that translating English into these languages can either expand or contract text. Generally, all romantic languages, like Spanish, expand the text from an English translation. This is also true for Vietnamese, but not necessarily so for Korean. It varies with Chinese and Tagalog.

When selecting a company to translate your fee agreement, determine whether it is an accepted member of the American Translators Association, which establishes a high standard of translating competency. Also, make sure to determine if someone other than the translator will review your document for accuracy. Two sets of eyes are better than one.

Since a translation service is not going to be instant, if you are conducting business in a community where a foreign language agreement is going to be a recurring need, consider having your standard fee agreement translated and keep it on hand for the times that you need it. If you ever negotiate with a new client a change to your standard language, you can always edit the foreign language template for that client.

So for all you talented linguistic attorneys seeking to build your practice with non-English speaking clients, or for those attorneys who already are, make sure to comply with the requirements of Civil Code section 1632, et seq., and have your fee agreement translated into the language in which it was negotiated. Because after you have obtained that favorable result for your client and its time for them to pay up, you do not want anything to suddenly get lost in translation.

Rule 1.4.2 Disclosure of Professional Liability Insurance
(Rule Approved by the Supreme Court, Effective November 1, 2018)

(a) A lawyer who knows* or reasonably should know* that the lawyer does not have professional liability insurance shall inform a client in writing,* at the time of the client's engagement of the lawyer, that the lawyer does not have professional liability insurance.

(b) If notice under paragraph (a) has not been provided at the time of a client's engagement of the lawyer, the lawyer shall inform the client in writing* within thirty days of the date the lawyer knows* or reasonably should know* that the lawyer no longer has professional liability insurance during the representation of the client.

(c) This rule does not apply to:

(1) a lawyer who knows* or reasonably should know* at the time of the client's engagement of the lawyer that the lawyer's legal representation of the client in the matter will not exceed four hours; provided that if the representation subsequently exceeds four hours, the lawyer must comply with paragraphs (a) and (b);

(2) a lawyer who is employed as a government lawyer or in-house counsel when that lawyer is representing or providing legal advice to a client in that capacity;

(3) a lawyer who is rendering legal services in an emergency to avoid foreseeable prejudice to the rights or interests of the client;

(4) a lawyer who has previously advised the client in writing* under paragraph (a) or (b) that the lawyer does not have professional liability insurance.

Comment

[1] The disclosure obligation imposed by paragraph (a) applies with respect to new clients and new engagements with returning clients.

[2] A lawyer may use the following language in making the disclosure required by paragraph (a), and may include that language in a written* fee agreement with the client or in a separate writing:

> "*Pursuant to rule 1.4.2 of the California Rules of Professional Conduct, I am informing you in writing that I do not have professional liability insurance.*"

[3] A lawyer may use the following language in making the disclosure required by paragraph (b):

> "*Pursuant to rule 1.4.2 of the California Rules of Professional Conduct, I am informing you in writing that I no longer have professional liability insurance.*"

[4] The exception in paragraph (c)(2) for government lawyers and in-house counsels is limited to situations involving direct employment and representation, and does not, for example, apply to outside counsel for a private or governmental entity, or to counsel retained by an insurer to represent an insured. If a lawyer is employed by and provides legal services directly for a private entity or a federal, state or local governmental entity, that entity is presumed to know* whether the lawyer is or is not covered by professional liability insurance.

NEW RULE OF PROFESSIONAL CONDUCT 1.4.2
(Former Rule 3-410)
Disclosure of Professional Liability Insurance

EXECUTIVE SUMMARY

The Commission for the Revision of the Rules of Professional Conduct ("Commission") evaluated current rule 3-410 (Disclosure of Professional Liability Insurance) in accordance with the Commission Charter, including consideration of the ABA Model Court Rule on Insurance Disclosure. The Commission also reviewed relevant California statutes, rules, and case law relating to the issues addressed by the proposed rules. The result of the Commission's evaluation is proposed rule 1.4.2 (Disclosure of Professional Liability Insurance).

Rule As Issued For 90-day Public Comment

Current rule 3-410 requires a lawyer who does not have professional liability insurance to disclose that fact to the lawyer's clients. The current rule exempts government lawyers and in-house counsel with regard to the representation of their employer. There is no counterpart to rule 3-410 in the ABA Model Rules. In addition, the ABA Model Court Rule on Insurance Disclosure employs a different approach in not requiring a lawyer to disclose the fact that he or she lacks professional liability insurance directly to his or her client but rather requires a report to the highest court (of the respective jurisdiction) whether he or she is currently covered by professional liability insurance. The reported information is then made available to the public. The Commission does not support the indirect approach of the ABA Model Court Rule. The Commission believes that clients ought to receive direct disclosure from a lawyer.

The Commission is not recommending any substantive changes to the current rule. However, the Commission is recommending non-substantive amendments that are intended to make the rule easier to understand. These changes include combining into one paragraph all of the current provisions that identify situations where the rule is not applicable. Another clarifying change is to substitute the phrase "reasonably should know" for "should know" as the former is a term that is defined in proposed rule 1.0.1 (Terminology). Similarly, non-substantive, mostly stylistic, amendments are recommended in the Comments.

Post-Public Comment Revisions

After consideration of comments received in response to the initial 90-day public comment period, the Commission made only non-substantive stylistic changes and with these changes, voted to recommend that the Board adopt the proposed rule.

The Board adopted proposed rule 1.4.2 at its November 17, 2017 meeting.

Supreme Court Action (May 10, 2018)

The Supreme Court approved the rule as submitted by the State Bar to be effective November 1, 2018. But see, stylistic changes made by the Court in Comments [2] and [3].

Rule 1.4.2 ~~3-410~~ Disclosure of Professional Liability Insurance
(Redline Comparison to the California Rule Operative Until October 31, 2018)

(~~A~~a) A ~~member~~lawyer who knows* or reasonably should know* that ~~he or she~~the lawyer does not have professional liability insurance shall inform a client in writing,* at the time of the client's engagement of the ~~member~~lawyer, that the ~~member~~lawyer does not have professional liability insurance ~~whenever it is reasonably foreseeable that the total amount of the member's legal representation of the client in the matter will exceed four hours~~.

(b) If notice under paragraph (a) has not been provided at the time of a client's engagement of the lawyer, the lawyer shall inform the client in writing* within thirty days of the date the lawyer knows* or reasonably should know* that the lawyer no longer has professional liability insurance during the representation of the client.

(c) This rule does not apply to:

~~(B) If a member does not provide the notice required under paragraph (A) at the time of a client's engagement of the member, and the member subsequently knows or should know that he or she no longer has professional liability insurance during the representation of the client, the member shall inform the client in writing within thirty days of the date that the member knows or should know that he or she no longer has professional liability insurance.~~

(1) a lawyer who knows* or reasonably should know* at the time of the client's engagement of the lawyer that the lawyer's legal representation of the client in the matter will not exceed four hours; provided that if the representation subsequently exceeds four hours, the lawyer must comply with paragraphs (a) and (b);

(~~C~~2) ~~This rule does not apply to a member~~a lawyer who is employed as a government lawyer or in-house counsel when that ~~member~~lawyer is representing or providing legal advice to a client in that capacity~~.~~;

(~~D~~3) ~~This rule does not apply to~~a lawyer who is rendering legal services ~~rendered~~ in an emergency to avoid foreseeable prejudice to the rights or interests of the client~~.~~;

(~~E~~4) ~~This rule does not apply where the member~~a lawyer who has previously advised the client in writing* under ~~Paragraph (A~~paragraph (a) or (~~B~~b) that the ~~member~~lawyer does not have professional liability insurance.

Comment~~Discussion~~

[1] The disclosure obligation imposed by ~~Paragraph (A) of this rule~~paragraph (a) applies with respect to new clients and new engagements with returning clients.

[2] A ~~member~~lawyer may use the following language in making the disclosure required by ~~Rule 3-410~~paragraph (~~A~~a), and may include that language in a written* fee agreement with the client or in a separate writing:

> *"Pursuant to rule 1.4.2 of the California Rules of Professional Conduct ~~3-410~~, I am informing you in writing that I do not have professional liability insurance."*

[3] A ~~member~~lawyer may use the following language in making the disclosure required by ~~Rule 3-410~~paragraph (~~B~~b):

> *"Pursuant to rule 1.4.2 of the California Rules of Professional Conduct ~~3-410~~, I am informing you in writing that I no longer have professional liability insurance."*

[4] ~~Rule 3-410(C) provides an exemption for a "government lawyer or in-house counsel when that member is representing or providing legal advice to a client in that capacity." The basis of both exemptions is essentially the same. The purpose of this rule is to provide information directly to a client if a member is not covered by professional liability insurance. If a member is employed directly by and provides legal services directly for a private entity or a federal, state or local governmental entity, that entity presumably knows whether the member is or is not covered by professional liability insurance. The exemptions under this rule are~~The exception in paragraph (c)(2) for government lawyers and in-house counsels is limited to situations involving direct employment and representation, and ~~do~~does not, for example, apply to outside counsel for a private or governmental entity, or to counsel retained by an insurer to represent an insured. If a lawyer is employed by and provides legal services directly for a private entity or a federal, state or local governmental entity, that entity is presumed to know* whether the lawyer is or is not covered by professional liability insurance.

Rule 1.5.1 Fee Divisions Among Lawyers
(Rule Approved by the Supreme Court, Effective November 1, 2018)

(a) Lawyers who are not in the same law firm* shall not divide a fee for legal services unless:

(1) the lawyers enter into a written* agreement to divide the fee;

(2) the client has consented in writing,* either at the time the lawyers enter into the agreement to divide the fee or as soon thereafter as reasonably* practicable, after a full written* disclosure to the client of: (i) the fact that a division of fees will be made; (ii) the identity of the lawyers or law firms* that are parties to the division; and (iii) the terms of the division; and

(3) the total fee charged by all lawyers is not increased solely by reason of the agreement to divide fees.

(b) This rule does not apply to a division of fees pursuant to court order.

Comment

The writing* requirements of paragraphs (a)(1) and (a)(2) may be satisfied by one or more writings.*

NEW RULE OF PROFESSIONAL CONDUCT 1.5.1
(Former Rule 2-200)
Fee Divisions Among Lawyers

EXECUTIVE SUMMARY

The Commission for the Revision of the Rules of Professional Conduct ("Commission") evaluated current rule 2-200 (Financial Arrangements Among Lawyers) in accordance with the Commission Charter, including the national standard of the ABA counterpart, Model Rule 1.5(e) (concerning fee divisions among lawyers) and the Restatement of Law Governing Lawyers counterpart, Restatement § 47 (Fee Splitting Between Lawyers Not In The Same Firm). The result of the Commission's evaluation is proposed rule 1.5.1 (Fee Divisions Among Lawyers). Refer to proposed rule 7.2(b) for a discussion of current rule 2-200(B).

Rule As Issued For 90-day Public Comment

A key topic addressed by this proposed rule is the regulation of fee sharing by lawyers who are not in the same law firm, including typical referral fees. Most states follow Model Rule 1.5(e) that permits lawyers to divide a fee only to the extent that the referring lawyer is compensated in proportion for work actually done on the matter or if the referring lawyer assumes joint responsibility for the matter. The California rule is one of a minority of states that permits a "pure referral fee," i.e., California permits lawyers to be compensated for referring a matter to another lawyer without requiring the referring lawyer's continued involvement in the matter. In *Moran v. Harris* (1982) 131 Cal.App.3d 913, the California Court of Appeal held that the payment of referral fees is not contrary to public policy. The court stated, "If the ultimate goal is to assure the best possible representation for a client, a forwarding fee is an economic incentive to less capable lawyers to seek out experienced specialists to handle a case. Thus, with marketplace forces at work, the specialist develops a continuing source of business, the client is benefited and the conscientious, but less experienced lawyer is subsidized to competently handle the cases he retains and to assure his continued search for referral of complex cases to the best lawyers in particular fields." (*Id*. at 921-922.) The Commission's study found that no case since *Moran* had questioned the policy of permitting pure referral fees. In fact, the ABA's Ethics 2000 Commission itself had recommended that the Model Rules permit pure referral fees, but that position was rejected by the ABA House of Delegates.

That is not to say that the proposed rule remains the same as the current rule. Rather, proposed rule 1.5.1 implements two material changes intended to increase protection for clients. First, the agreement between the lawyers to divide a fee must now be in writing and second, the client must consent to the division after full disclosure at or near the time that the lawyers enter into the agreement to divide the fee. Under current rule 2-200, there is no express requirement that the agreement between the lawyers be in writing and case law has held that client consent to the fee division need not be obtained until the fee is actually divided, which might not occur until years after the lawyers have entered into their agreement. These changes were made because an underlying reason for the rule is to assure that the client's representation is not adversely affected as a result of an agreement to divide a fee. Deferring disclosure and client consent to the time the fee is divided denies the client a meaningful opportunity to consider the concerns the rule is intended to address. (See *Mink v. Maccabee* (2004) 121 Cal.App.4th 835.)

Post-Public Comment Revisions

After consideration of comments received in response to the initial 90-day public comment period, the Commission made a non-substantive change to clarify that compliance with paragraphs (a)(1) and (a)(2) may be satisfied in either a single document, or through separate documents. The Commission also made other non-substantive stylistic changes.

With these changes, the Commission voted to recommend that the Board adopt the proposed rule.

The Board adopted proposed rule 1.5.1 at its November 17, 2016 meeting.

Supreme Court Action (May 10, 2018)

The Supreme Court approved the rule as modified by the Court to be effective November 1, 2018. In the enumerated list in subparagraph (a)(2), semicolons were substituted for commas.

Rule ~~2-200 Financial Arrangements~~1.5.1 Fee Divisions Among Lawyers
(Redline Comparison to the California Rule Operative Until October 31, 2018)

(~~A~~a) ~~A member~~Lawyers who are not in the same law firm* shall not divide a fee for legal services ~~with a lawyer who is not a partner of, associate of, or shareholder with the member~~ unless:

(1) the lawyers enter into a written* agreement to divide the fee;

(~~1~~2) ~~The~~the client has consented in writing ~~thereto~~,* either at the time the lawyers enter into the agreement to divide the fee or as soon thereafter as reasonably* practicable, after a full written* disclosure ~~has been made in writing~~to the client of: (i) the fact that a division of fees will be made ~~and the terms of such~~; (ii) the identity of the lawyers or law firms* that are parties to the division; and (iii) the terms of the division; and

(~~2~~3) ~~The~~the total fee charged by all lawyers is not increased solely by reason of the ~~provision for division of fees and is not unconscionable as that term is defined in rule 4-200~~agreement to divide fees.

(b) This rule does not apply to a division of fees pursuant to court order.

~~(B) Except as permitted in paragraph (A) of this rule or rule 2-300, a member shall not compensate, give, or promise anything of value to any lawyer for the purpose of recommending or securing employment of the member or the member's law firm by a client, or as a reward for having made a recommendation resulting in employment of the member or the member's law firm by a client. A member's offering of or giving a gift or gratuity to any lawyer who has made a recommendation resulting in the employment of the member or the member's law firm shall not of itself violate this rule, provided that the gift or gratuity was not offered in consideration of any promise, agreement, or understanding that such a gift or gratuity would be forthcoming or that referrals would be made or encouraged in the future.~~

Comment

The writing* requirements of paragraphs (a)(1) and (a)(2) may be satisfied by one or more writings.*

Rule 1.5 Fees for Legal Services
(Rule Approved by the Supreme Court, Effective November 1, 2018)

(a) A lawyer shall not make an agreement for, charge, or collect an unconscionable or illegal fee.

(b) Unconscionability of a fee shall be determined on the basis of all the facts and circumstances existing at the time the agreement is entered into except where the parties contemplate that the fee will be affected by later events. The factors to be considered in determining the unconscionability of a fee include without limitation the following:

(1) whether the lawyer engaged in fraud* or overreaching in negotiating or setting the fee;

(2) whether the lawyer has failed to disclose material facts;

(3) the amount of the fee in proportion to the value of the services performed;

(4) the relative sophistication of the lawyer and the client;

(5) the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;

(6) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;

(7) the amount involved and the results obtained;

(8) the time limitations imposed by the client or by the circumstances;

(9) the nature and length of the professional relationship with the client;

(10) the experience, reputation, and ability of the lawyer or lawyers performing the services;

(11) whether the fee is fixed or contingent;

(12) the time and labor required; and

(13) whether the client gave informed consent* to the fee.

(c) A lawyer shall not make an agreement for, charge, or collect:

(1) any fee in a family law matter, the payment or amount of which is contingent upon the securing of a dissolution or declaration of nullity of a marriage or upon the amount of spousal or child support, or property settlement in lieu thereof; or

(2) a contingent fee for representing a defendant in a criminal case.

(d) A lawyer may make an agreement for, charge, or collect a fee that is denominated as "earned on receipt" or "non-refundable," or in similar terms, only if the fee is a true retainer and the client agrees in writing* after disclosure that the client will not be entitled to a refund of all or part of the fee charged. A true retainer is a fee that a client pays to a lawyer to ensure the lawyer's availability to the client during a specified period or on a specified matter, but not to any extent as compensation for legal services performed or to be performed.

(e) A lawyer may make an agreement for, charge, or collect a flat fee for specified legal services. A flat fee is a fixed amount that constitutes complete payment for the performance of described services regardless of the amount of work ultimately involved, and which may be paid in whole or in part in advance of the lawyer providing those services.

Comment

Prohibited Contingent Fees

[1] Paragraph (c)(1) does not preclude a contract for a contingent fee for legal representation in connection with the recovery of post-judgment balances due under child or spousal support or other financial orders.

Payment of Fees in Advance of Services

[2] Rule 1.15(a) and (b) govern whether a lawyer must deposit in a trust account a fee paid in advance.

[3] When a lawyer-client relationship terminates, the lawyer must refund the unearned portion of a fee. (See rule 1.16(e)(2).)

Division of Fee

[4] A division of fees among lawyers is governed by rule 1.5.1.

Written Fee Agreements*

[5] Some fee agreements must be in writing* to be enforceable. (See, e.g., Bus. & Prof. Code, §§ 6147 and 6148.)

NEW RULE OF PROFESSIONAL CONDUCT 1.5
(Former Rule 4-200)
Fees For Legal Services

EXECUTIVE SUMMARY

The Commission for the Revision of the Rules of Professional Conduct ("Commission") has evaluated current rule 4-200 (Fees for Legal Services) in accordance with the Commission Charter. In addition, the Commission considered the national standard of the American Bar Association ("ABA") counterpart, Model Rule 1.5 (Fees). The result of the Commission's evaluation is proposed rule 1.5 (Fees for Legal Services).

Rule As Issued For 90-day Public Comment

A fundamental issue posed by this proposed rule is whether to retain the longstanding "unconscionable fee" standard used in California's current rule 4-200. Nearly every other jurisdiction has adopted an "unreasonable fee" standard for describing a prohibited fee for legal services.[1] The Commission determined to retain California's unconscionability standard as this standard carries forward California's public policy rationale which was stated over 80 years ago by the Supreme Court in *Herrscher v. State Bar* (1934) 4 Cal.2d 399, 402-403:

> In the few cases where discipline has been enforced against an attorney for charging excessive fees, there has usually been present some element of fraud or overreaching on the attorney's part, or failure on the attorney's part to disclose the true facts, so that the fee charged, under the circumstances, constituted a practical appropriation of the client's funds under the guise of retaining them as fees.
>
> Generally speaking, neither the Board of Governors nor this court can, or should, attempt to evaluate an attorney's services in a quasi-criminal proceeding such as this, where there has been no failure to disclose to the client the true facts or no overreaching or fraud on the part of the attorney. *It is our opinion that the disciplinary machinery of the bar should not be put into operation merely on the complaint of a client that a fee charged is excessive, unless the other elements above mentioned are present*. (Emphasis added) (Citations omitted).

The Commission believes that if the foregoing policy was prudent in 1934, it is even more sound today because currently consumer protection against lawyers who charge unreasonable fees is provided through both the civil court system and California's robust mandatory fee arbitration program. (See Bus. & Prof. Code § 6200 et seq.) Under the statutory fee arbitration program, arbitration of disputes over legal fees is voluntary for a client but mandatory for a lawyer when commenced by a client. Accordingly, California's current approach to fee controversies is two-fold: (1) disputes over the reasonable amount of a fee may be handled through arbitration; and (2) fee issues involving overreaching, illegality or fraud are appropriate for initiating an attorney disciplinary proceeding. The Commission cannot perceive any benefit that would arise

[1] Only California, Massachusetts, New York, North Carolina and Texas have not adopted the Model Rules' standard of "unreasonable," the latter four having adopted (or more accurately continued from the ABA Code of Professional Responsibility) an "excessive" or "clearly excessive" standard. Michigan, Ohio and Oregon have also carried forward the "excessive" standard but define "excessive" as in excess of reasonable, so they effectively have adopted an "unreasonable" standard.

from changing to the "unreasonable fee" standard. The downsides of such a change would include potential unjustified public expectations that a disciplinary proceeding is an effective forum for addressing routine disputes concerning the amount of a lawyer's fee. Finally, with respect to the unconscionable fee standard, the Commission recommends adding two factors, proposed paragraphs (b)(1) and (b)(2), to those factors that should be considered in determining the unconscionability of a fee. Both factors are derived from considerations identified in the *Herrscher* decision for determining unconscionability.

In addition to retaining the "unconscionable fee" standard, proposed rule 1.5 adds three substantive paragraphs not found in the current rule. First, paragraph (c), which is derived from ABA Model Rule 1.5(d), identifies two types of contingent fee arrangements that are prohibited: contingent fees in certain family law matters; and contingent fees in criminal matters. Although there are other kinds of contingent fee cases that might be prohibited, these two types of contingent fee arrangements have traditionally been viewed as implicating important constitutional rights or public policy. Second, paragraph (d) prohibits denominating a fee as "earned on receipt" or "nonrefundable" except in the case of a true retainer, i.e., where a fee is paid to assure the availability of a lawyer for a particular matter or for a defined period of time. (See *T & R Foods, Inc. v. Rose* (1996) 47 Cal.App.4th Supp. 1.) Paragraph (d) is intended to increase protection for clients by recognizing that except for the specific circumstances identified, a fee is not earned until services have been provided. Paragraph (e) expressly provides that a flat fee is permissible only if the lawyer provides the agreed upon services. In part, these new provisions implement a basic concept of contract law; namely that, except for true retainers, an advance fee is never earned unless and until a lawyer provides the agreed upon services for which the lawyer was retained.

Three comments are included in the proposed rule. Comment [1] is derived from Model Rule 1.5 Comment [6] and explains that some contingent fee arrangements related to family law matters are permitted. Specifically, the comment recognizes that certain post-judgment contingent fee arrangements are permitted because they do not implicate the policies underlying the prohibition. Comment [2] provides a cross-reference to the rule governing termination of employment, including a lawyer's voluntary withdrawal from representation. This cross-reference is intended to enhance client protection by helping assure that lawyers comply with the obligation to refund unearned fees when a representation ends. Comment [3] provides a cross-reference to the fee splitting rule. In many other jurisdictions, the provision that governs fee divisions among lawyers is found in a lettered paragraph in the jurisdiction's counterpart to Model Rule 1.5. In California, the provision addressing division of fees is contained in a separate, standalone rule. Providing a cross-reference facilitates compliance.

Post-Public Comment Revisions

After consideration of comments received in response to the initial 90-day public comment, for brevity and clarity the Commission has replaced the phrase "enter into an arrangement for" in paragraph (c) with "make an agreement." The Commission also revised the language in paragraph (e) to refine the definition of a flat fee by removing language that was identified in the public comments as creating a possible ambiguity. Public comments seemed to suggest that this rule was being perceived as governing the placement of an advance fee (e.g., whether to hold such fees in a client trust account or other law firm account). The Commission added a new Comment [2] to make clear that the placement issue is governed by proposed rule 1.15(a) and (b). Other comments were renumbered accordingly. Lastly, the Commission added a new Comment [5] to provide a reference to the State Bar Act provisions that require some fee agreements to be in writing.

With these changes, the Board authorized an additional 45-day public comment period on the revised proposed rule.

Final Commission Action on the Proposed Rule Following 45-Day Public Comment Period

After consideration of comments received in response to the additional 45-day public comment period, the Commission made no changes to the proposed rule and voted to recommend that the Board adopt the proposed rule.

The Board adopted proposed rule 1.5 at its March 9, 2017 meeting.

Supreme Court Action (May 10, 2018)

The Supreme Court approved the rule as modified by the Court to be effective November 1, 2018. An omitted asterisk for a defined term was added.

Rule 1.5 ~~4-200~~ Fees for Legal Services
(Redline Comparison to the California Rule Operative Until October 31, 2018)

(~~A~~a) A ~~member~~lawyer shall not ~~enter into~~make an agreement for, charge, or collect an ~~illegal or~~ unconscionable or illegal fee.

(~~B~~b) Unconscionability of a fee shall be determined on the basis of all the facts and circumstances existing at the time the agreement is entered into except where the parties contemplate that the fee will be affected by later events. ~~Among the~~The factors to be considered~~, where appropriate,~~ in determining the ~~conscionability~~unconscionability of a fee ~~are~~include without limitation the following:

(1) whether the lawyer engaged in fraud* or overreaching in negotiating or setting the fee;

(2) whether the lawyer has failed to disclose material facts;

(~~1~~3) ~~The~~the amount of the fee in proportion to the value of the services performed~~.~~;

(~~2~~4) ~~The~~the relative sophistication of the ~~member~~lawyer and the client~~.~~;

(~~3~~5) ~~The~~the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly~~.~~;

(~~4~~6) ~~The~~the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the ~~member.~~lawyer;

(~~5~~7) ~~The~~the amount involved and the results obtained~~.~~;

(~~6~~8) ~~The~~the time limitations imposed by the client or by the circumstances~~.~~;

(~~7~~9) ~~The~~the nature and length of the professional relationship with the client~~.~~;

(~~8~~10) ~~The~~the experience, reputation, and ability of the ~~member or members~~lawyer or lawyers performing the services~~.~~;

(~~9~~11) ~~Whether~~whether the fee is fixed or contingent~~.~~;

(~~10~~12) ~~The~~the time and labor required~~.~~; and

(~~11~~) ~~The~~13) whether the client gave informed consent ~~of the client~~* to the fee.

(c) A lawyer shall not make an agreement for, charge, or collect:

(1) any fee in a family law matter, the payment or amount of which is contingent upon the securing of a dissolution or declaration of nullity of a marriage or upon the amount of spousal or child support, or property settlement in lieu thereof; or

(2) a contingent fee for representing a defendant in a criminal case.

(d) A lawyer may make an agreement for, charge, or collect a fee that is denominated as "earned on receipt" or "non-refundable," or in similar terms, only if the fee is a true retainer and the client agrees in writing* after disclosure that the client will not be entitled to a refund of all or part of the fee charged. A true retainer is a fee that a client pays to a lawyer to ensure the lawyer's availability to the client during a specified period or on a specified matter, but not to any extent as compensation for legal services performed or to be performed.

(e) A lawyer may make an agreement for, charge, or collect a flat fee for specified legal services. A flat fee is a fixed amount that constitutes complete payment for the performance of described services regardless of the amount of work ultimately involved, and which may be paid in whole or in part in advance of the lawyer providing those services.

Comment

Prohibited Contingent Fees

[1] Paragraph (c)(1) does not preclude a contract for a contingent fee for legal representation in connection with the recovery of post-judgment balances due under child or spousal support or other financial orders.

Payment of Fees in Advance of Services

[2] Rule 1.15(a) and (b) govern whether a lawyer must deposit in a trust account a fee paid in advance.

[3] When a lawyer-client relationship terminates, the lawyer must refund the unearned portion of a fee. (See rule 1.16(e)(2).)

Division of Fee

[4] A division of fees among lawyers is governed by rule 1.5.1.

Written Fee Agreements*

[5] Some fee agreements must be in writing* to be enforceable. (See, e.g., Bus. & Prof. Code, §§ 6147 and 6148.)

EPSTEIN BECKER GREEN

The FTC Finally Pulls the Trigger on a Final Noncompete Rule, with a Few Changes, but Remains Unlikely to Ever Hit Its Target

Trade Secrets & Employee Mobility

April 24, 2024 | Blogs | 6 minute read

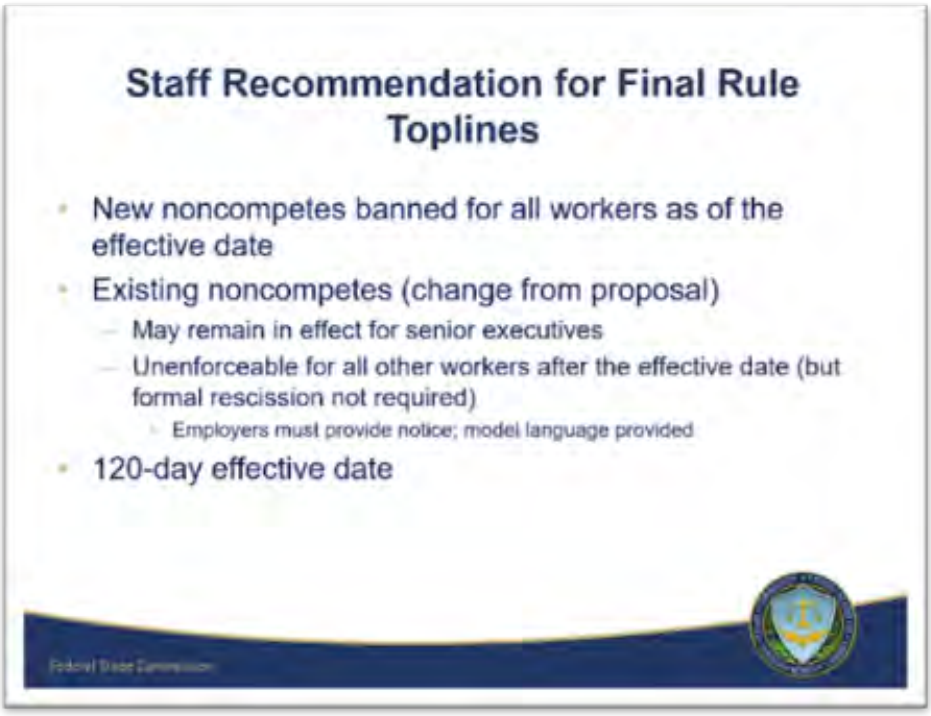
Categories: Announcements, Non-Compete Agreements

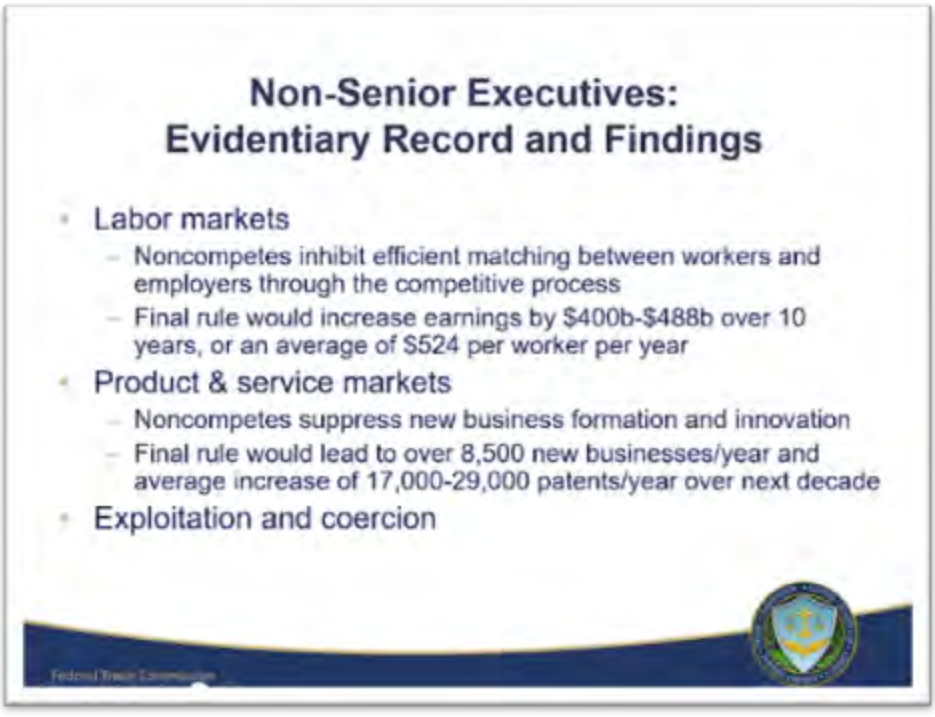
Erik W. Weibust, Peter (Pete) A. Steinmeyer, Katherine G. Rigby, Daniel R. Levy

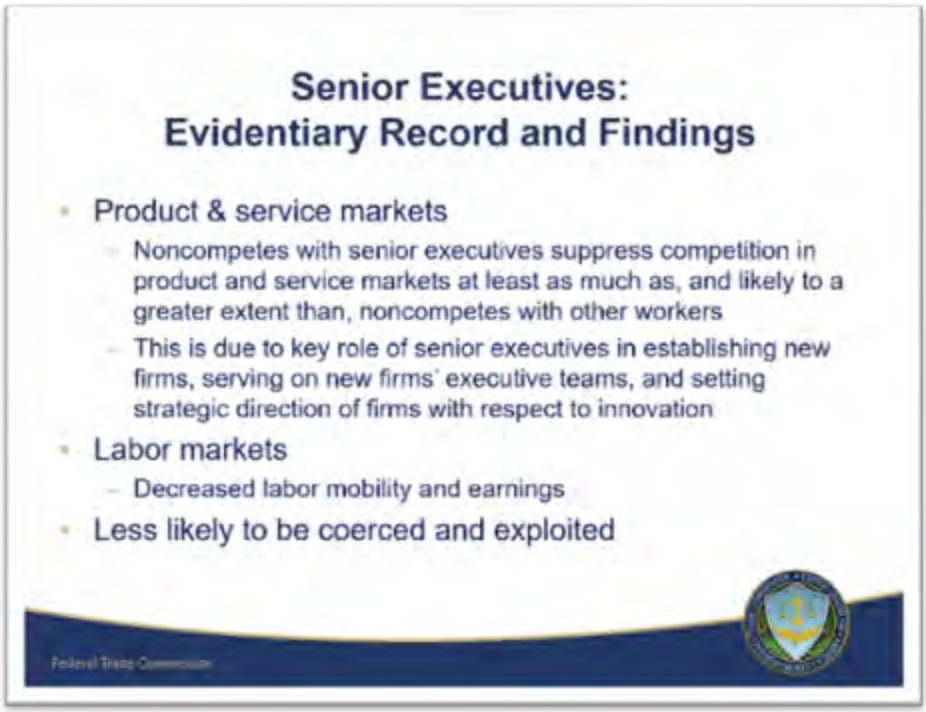
As expected, the Federal Trade Commission (FTC) voted 3-2 yesterday to issue its final noncompete rule, with only a few changes from the proposed rule that are discussed below. Unless it is enjoined, which we expect, the rule will become effective 120 days after publication of the final version in the Federal Register.

If the final rule survives the legal challenges, which are likely to make it all the way to the United States Supreme Court, all *new* non-competes would be banned. Except for existing non-competes for senior executives (as defined below), all *existing* noncompetes with employees would also be banned. A senior executive is defined as "a worker who was in a policy-making position" and who received total annual compensation of more than $151,164. Garden leave agreements, pursuant to which an individual remains an employee and is paid their regular compensation during a mandatory notice period, would be permissible, as well as confidentiality and non-solicitation agreements, provided that they do not prohibit, penalize, or function to prevent a worker from switching jobs or starting a new business. In contrast, paid noncompete periods (sometimes also called garden leave provisions, but different than paid notice periods) would be prohibited.

Prior to the vote, an FTC staffer presented on the rule. Although claiming to have read each and every one of the more than 26,000 comments submitted in response to the proposed rule, the staffer only referenced and quoted from a few proponents of the rule (i.e., some employees and small business owners). He did not quote any opponents of the rule. He then presented the following slides that explained the FTC's reasoning behind the rule, doubling down on the flawed research findings we have discussed previously, and summarily dismissing any concerns about the rule raised by its opponents:







The Commissioners each then had a chance to speak. As expected, Chair Khan and Commissioners Slaughter and Bedoya supported the rule and, indeed, suggested it does not go far enough because it does not cover franchisees in the context of a franchisee-franchisor relationship or workers at properly classified nonprofits. Commissioners Holyoke and Ferguson pointed out what we have long said: the FTC does not have the Congressional authority to promulgate the rule. Commissioner Ferguson stated that the FTC lacks "the power to nullify tens of millions of existing contracts," and stated his intention to write a dissenting opinion. Chair Khan summarily dismissed this argument.

As a reminder, the Rule would ban post-employment noncompetes nationwide. The only changes the FTC made to the proposed rule are that:

1. responding to what was perhaps the business community's biggest stated concern, and bringing the rule in line with California, the FTC removed the 25% equity threshold for noncompetes entered into in connection with the bona fide sale of a business (*i.e*, noncompetes are permissible in the context of the sale of a business irrespective of the sellers' ownership interest, provided it is a bona fide sale and not a sham transaction);

2. noncompetes entered into with "senior executives" *prior to the effective date of the rule* will remain enforceable, but not agreements with senior executives entered into thereafter;

3. the rule includes a "functional" test for what constitutes a noncompete, removing reference from the proposed rule to "de facto" noncompetes, although they are effectively one and the same (although no less ambiguous as now written in our view);

4. there is an exception for causes of action accruing prior to the effective date of the rule;

5. while employers no longer need to affirmatively "rescind" existing noncompete agreements, the FTC provided updated guidance and form language on how to provide notice to individuals that their noncompete will not be enforceable or enforced (again, effectively the same as requiring rescission, but just using different verbiage); and

6. the effective and compliance date is now 120 days after publication of the final rule in the Federal Register (previously the effective date was 60 days and the compliance deadline 180 days later).

As noted above, while the senior executive exemption is of limited import because it only applies to preexisting noncompetes with a narrow category of workers, and the pending litigation exception is likewise very limited given that all pending litigation will eventually come to an end, the sale of a business change is actually quite important because it brings the final rule in line with California and allows noncompetes to be entered into with sellers of a business provided the sale is bona fide (or, as they say in California, not a "sham" transaction).

Similarly, the functional test for what constitutes a noncompete could be a big change as it may be interpreted to cover other types of restrictive covenants such as non-solicit provisions in certain circumstances. The functional test leaves uncertainty with respect to non-solicit provisions in that the final rule "does not categorically prohibit other types of restrictive employment agreements, for example, NDAs, TRAPs, and non-solicitation agreements." Yet, the FTC later states that if an employer adopts a non-solicit "that is so broad or onerous that it has the same functional effect as a term or condition prohibiting or penalizing a worker from seeking or accepting other work … such a term is a non-compete clause under the final rule." Should the rule not be enjoined, as expected, employers should pay attention to the effective/compliance date.

The FTC recognizes it lacks jurisdiction over corporations "not organized to carry on business for its own profit or that of its members." However, after an extensive discussion of the health care industry and, among others, nonprofit hospital systems, the Commission warned, "not all entities claiming tax-exempt status as nonprofits fall outside the Commission's jurisdiction." The FTC noted that it "looks to

the source of the income, *i.e.*, to whether the corporation is organized for and actually engaged in business for only charitable purposes, and to the destination of the income, *i.e.*, to whether either the corporation or its members derive a profit." Unless an organization passes this "two-prong test," the Commission insists they are bound by the final rule regardless of their claimed tax exemption.

* * *

We do not believe the rule will ever go into effect. At the very least, it is likely to take years for the rule to work its way through the courts following pending and inevitable legal challenges. Thus, there is no reason for panic or, really, any changes to current policies and practices. That said, given that the issue is front of mind for many executives and boards, and the fast pace of change in state legislatures across the country, we recommend that employers consider taking a holistic review of their restrictive covenant and trade secret strategy to determine whether the strategy is effective, whether it can and should be tweaked in light of recent and anticipated developments, and what other options should be considered for protecting the company's most important intangible assets, including strengthening and increasing the use of non-solicitation and confidentiality clauses, using advance notice of resignation or termination clauses (i.e., traditional garden leave clauses), using employment agreements of a fixed duration, and focusing on increased trade secret protection through a trade secret audit.

Stay tuned for more as we continue to analyze the rule and the forthcoming challenges to it.

Tags: Erik W Weibust, Peter Steinmeyer, Kate Rigby, Daniel Levy, Federal Trade Commission, Federal Trade Commission (FTC), FTC, Employees, Federal Register, Final Noncompete Rule, Noncompetes

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