California Unique, Not So Chic: Legal Issues Affecting Companies Doing Business in California

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California is the most populous state in the Union, has the largest state economy in the country, and the eighth-largest economy in the world. California is simply too big to ignore, and every company of any significant size finds itself at one time or another doing business in California or with Californians.

California's legal and political environment has given rise over the years to a number of laws and regulations that, while not totally unique to California, may not have been widely adopted in other jurisdictions. As a result, out-of-state companies that are doing business in California often come across laws that surprise in-house counsel or management and that severely impact business strategy and business decisions in the state.

Being aware of some of the more significant issues can help management and counsel avoid potential missteps and alert companies as to when they should seek the advice of California counsel. The discussion below highlights five issues that repeatedly seem to surprise and frustrate out-of-state companies.

1. **Covenants Not to Compete** or "What do you mean I can't stop my top salesperson from going to my biggest competitor?"

California Business and Professions Code Section 16600 prohibits any contract which restrains anyone from engaging in his or her chosen profession, trade or business. As a result, any employment agreement, separation agreement or other contract that puts any restraint on a former employee's ability to change employers is void.

Say that your No. 1 salesperson, Violet, decides to leave your company. When she was first employed, she signed an employment agreement saying that she wouldn't work for a competitor for one year after she left your employ. That agreement is not enforceable in California. So, you enter into a severance agreement with her that pays her a sum of money and, in return, she agrees not to work for a competitor for three months.

That agreement is *also* not enforceable.

What if you change the agreement so that she can work for a competitor, but agrees not to solicit certain customers she sold to while at your company? That agreement is also not enforceable! See, *Edwards v. Arthur Andersen LLP*, 44 Cal.4th 937 (2008).

Are you entirely without recourse if she goes to a competitor and starts soliciting your customers? Not necessarily.

Depending on the specific conduct, you may have recourse under the trade secret laws to at least chill, if not entirely stop, her attempts to solicit your customers. However, be careful here, as an improper attempt to prevent a former employee from engaging in a lawful trade, business or profession could lead to liability under California's unfair competition laws.

2. **Wage and Hour Class Actions** or "What do you mean our independent sales representatives have been re-classified as employees, costing the company $20 million in overtime and expense reimbursement?"

California has experienced an explosion in recent years of wage and hour class actions.

California law employs unique distinctions between exempt and non-exempt employees and between employees and independent contractors. As a result, jobs that one might normally think would be exempt from certain wage and hour laws have been found to be subject to those laws, including store managers, IT professionals such as systems administrators and network technicians, financial services professionals such as mortgage loan officers, and pharmaceutical sales representatives.

The damages in these cases can be significant: In the last few years Citigroup paid $98 million for overtime and expense reimbursement claims; and UPS paid $87 million for various wage and hour violations. As recently as April of this year, Home Depot paid $25.5 million for meal and rest period claims.

Defense of these cases is challenging. The better approach is to avoid them or, if necessary, plan for them in order to minimize potential damages. Proactive management with the help of experienced counsel is the best way to deal with this issue.

3. **Proposition 65** or "Why do I have to tell everyone that my grilled chicken, which is made the same way as my grandmother used to make it, may cause cancer?"

At some level, it seems that virtually everything causes cancer.

Proposition 65, a consumer lawyers-backed initiative, requires warning labels on products that contain certain levels of listed carcinogens or chemicals that threaten reproductive health. Certain types of products like paints, gasoline, and solvents are obvious targets of Prop. 65. But other products, like potato chips, dental fillings, fried chicken, latex gloves, fish oil supplements (and the list goes on), have all been found to have chemicals that make their manufacturers and vendors targets for class action lawsuits and state and local law enforcement.

It is not unusual to walk into an office building in Los Angeles and see a placard warning that there may be hazardous chemicals known to the State of California to cause cancer inside. There are more than 700 chemicals, many naturally occurring in their respective products, that may require warning. Proposition 65 litigation can be frustrating and expensive and can significantly affect business operations.

4. **Anti-Deficiency Statutes** or "What do you mean we lost our real property security when we took $5 from the debtor's bank account?"

Lenders who hold real property security in California are subject to strict anti-deficiency statutes and other laws designed to protect borrowers from depreciating property values. These Depression-era laws have been resurrected in recent years with the declining real estate market.

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The two major areas of surprise to foreign lenders are the statutes regulating deficiency judgments after a foreclosure sale (Code of Civil Procedure Sections 580a-580d) and the one form of action rule (Code of Civil Procedure Section 726). These are highly technical statutes, and the repercussions for violating them can be severe, as one lender found out: It seized $3,000 from its borrower's bank account and in the process lost the real property securing its $1 million loan. *Security Pacific Nat'l Bank v. Wozab*, 51 Cal. 3d 991 (1990).

5. **State Antitrust Laws** or "Why can't I tell my distributors the price they can charge for my product?"

The Supreme Court decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007), has provided significant comfort to manufacturers and other product suppliers who seek to control their distribution networks and the prices charged for their products.

Leegin essentially allows some vertical price fixing arrangements between suppliers and distributors, provided that there is sufficient economic rationale or "rule of reason" to justify the restraint. However, California's antitrust laws are independent from the federal antitrust laws and have broad language prohibiting any acts by two or more persons to control or establish a price for a product in the state. The state legislature has not adopted the Leegin standard and no case has yet addressed the issue. Distributors need to take care that their pricing practices, which are often engaged in on a nationwide basis, do not run afoul of the California law.

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