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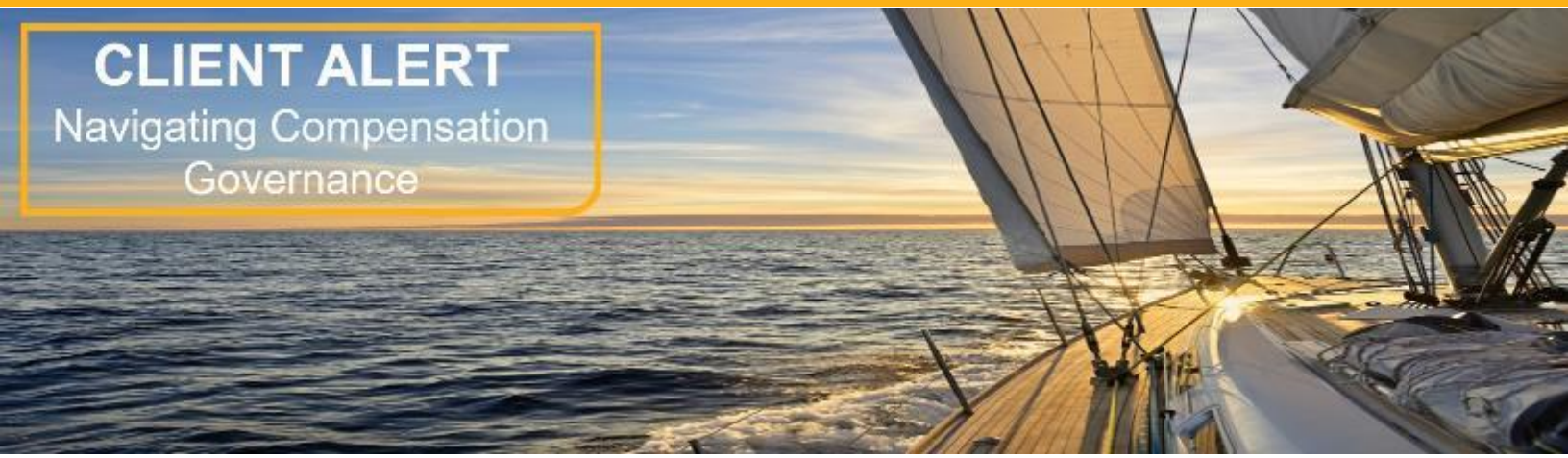
MERIDIAN COMPENSATION PARTNERS



California Bans Stay-or-Pay Contracts Effective January 1, 2026

California enacted a new law that prohibits companies from requiring employees to repay certain debts upon termination of employment, except in limited circumstances. Contracts in place prior to January 1, 2026 are grandfathered and will continue to be enforceable. However, any new contracts entered on or after January 1, 2026, that include repayment terms must comply with the new legal requirements.

Overview

California enacted Assembly Bill 692 (AB 692) which significantly restricts employers' ability to include repayment obligations in employment agreements. Effective January 1, 2026, most provisions requiring employees to repay costs upon termination – commonly known as "stay-or-pay" clauses – are prohibited. This law reinforces California's strong public policy favoring employee mobility and builds on existing bans of non-compete agreements. It closes what some had seen as a loophole where employers used financial penalties instead of formal non-compete clauses to restrict mobility.

Key Prohibitions

AB 692 makes it unlawful for any employment contract to:

- Require an employee to pay an employer, training provider or debt collector for a "debt" if the work relationship ends.
- Authorize the collection or end of forbearance on a debt upon termination of the work relationship.
- Impose any penalty, fee or cost (such as "quit fees," retraining costs or liquidated damages) on a worker due to their separation from employment.

Other Key Provisions and Applications

- **Broad Definition of "Debt":** The law broadly defines "debt" as money or property due for employment-related or education-related costs, including Training Repayment Agreement Provisions (TRAPs) and immigration/visa costs.
- **Broad Definition of "Employee":** The law broadly defines employee to mean a person permitted to work for an employer or who is permitted to participate in any other work relationship, job training program or skills training program, including a prospective employee.
- **No Repayment Obligations in Retention Arrangements Permitted:** While AB 692 provides a safe harbor for sign-on bonuses to have payback provisions (as described below), generally retention agreements made after

an employee has already been working for an employer are prohibited because they do not occur "at the outset of employment."

- **Enforcement and Liability:** Contracts and agreements that do not comply with AB 692 are deemed void and unenforceable. Employees or employee representatives can bring civil actions for actual damages or a penalty of $5,000 per worker, whichever is greater, along with injunctive relief and attorneys' fees.

Narrow Exceptions

AB 692 provides several narrow exceptions for specific types of repayment agreements, subject to certain criteria:

- **Sign-on and Discretionary Bonuses:** Repayment is permitted for discretionary or unearned monetary payments provided at the outset of employment that are not tied to performance (such as sign-on bonuses), provided that the following requirements are met:
  - The repayment terms are in a separate agreement from the employment contract,
  - The employee is notified of right to consult an attorney and given no fewer than five business days to consult counsel before signing the agreement,
  - The retention period does not exceed two years,
  - The repayment amount is prorated based on the length of the required employment period worked and does not accrue interest,
  - The employee is given the option to delay receipt of the payment until the end of the retention period with no repayment obligation and
  - The repayment is only required for voluntary terminations or terminations due to misconduct.
- **Transferable Credentials (Tuition Reimbursement):** Repayment of tuition for degrees or credentials from third-party accredited institutions may be required upon a termination due to misconduct as long as certain criteria are met.

***Meridian Comments*:** Companies doing business in California should review employment agreements, offer letters and incentive programs to ensure compliance with the new California law. However, California's stay-or-pay ban is unlikely to start a trend among other states. As a matter of fact, last year, several states, such as Florida, took action to allow employers to impose greater limits on employee competition.[1]

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The ***Client Alert*** was prepared by Meridian Compensation Partners' Governance and Regulatory Team co-led by Edward Hauder and Nathan Williams. Questions regarding this Client Alert or executive compensation technical issues may be directed to the Governance and Regulatory Team at govreg@meridiancp.com.

[1] For details on Florida's law strengthening non-compete restrictions, see Meridian Client Alert dated July 31, 2025, which is available at https://www.meridiancp.com/insights/florida-strengthens-non-compete-restrictions/.