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california bans most "stay-or-pay" provisions in employment contracts, effective jan. 1, 2026

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It is relatively commonplace for employers to make payments to employees that are subject to repayment in certain circumstances. Many employment contracts require full and immediate repayment of these amounts when an employee separates from the employer. However, California has recently taken a groundbreaking step with the enactment of Assembly Bill 692 ("AB 692"), designed to promote worker mobility by prohibiting most "stay-or-pay" contractual provisions. Beginning January 1, 2026, when AB 692 takes effect and Section 16608 is added to the California Business and Professions Code, California employers' ability to include debt-repayment clauses in employment contracts—or in any similar oral or written, express or implied agreements—will be significantly restricted.

The California Labor Commissioner's Office has not yet issued guidance clarifying whether AB 692 extends to certain independent contractors or freelancers. By its text, the law applies to contracts with "workers," a term that includes—but is not limited to—employees and prospective employees. Although explicit references to freelancers and independent contractors were removed from earlier drafts of AB 692, the final law does not clearly exclude these categories from its reach.

AB 692 will have no retroactive effect. Accordingly, repayment clauses contained in current California employment contracts will continue to be valid and enforceable. The new law's prohibitions will apply prospectively only, to contracts entered into on or after January 1, 2026.

Expansive Repayment Prohibitions

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In terms of what, exactly, AB 692 bans – employers will soon be prohibited from including any provision in a contract with California workers that requires a worker to pay an employer, a training provider or a debt collector for a debt, should the worker's employment relationship terminate, absent narrowly defined exceptions. The law also will prohibit an employer, training provider or debt collector from initiating or resuming collection of a debt if the worker's employment terminates, and will also prohibit imposing any penalty, fee or cost on the worker if the worker's employment terminates.

Examples of a prohibited "penalty, fee or cost" include "a replacement hire fee, retraining fee, replacement fee, quit fee, reimbursement for immigration or visa-related costs, liquidated damages, lost goodwill, and lost profit." The term "debt" is given equally broad meaning under the law: it includes money due or owed, or allegedly due or owed, for "employment-related costs, education-related costs, or a consumer financial product or service, regardless of whether the debt is certain, contingent, or incurred voluntarily."

AB 692 applies equally to workers who terminate voluntarily and those who are involuntarily terminated.

Exceptions

The law contains five exceptions to its general prohibition on repayment provisions, though two in particular—the tuition-repayment exception and the upfront discretionary-bonus exception—are likely to have the most significant impact on employers. Importantly, there is no exception for the repayment of an employee's share of medical insurance premiums (or any other insurance premiums) that went unpaid during a covered leave of absence and were voluntarily paid by the employer.

Exception 1: Tuition Repayment Exception

Employers should proceed with caution if they intend to utilize the tuition repayment exception to AB 692 to recoup continuing education or work certification tuition payments from workers. A contract that relates to a worker repaying tuition for a "transferable credential" (i.e. tuition for a degree from an accredited, state-authorized institution that is not required for the worker's current job but is useful for future employment), will only be enforceable under the law if it:

- is offered separately from any employment contract;
- does not require the credential as a condition of employment;
- specifies the repayment amount before worker agrees to the contract, and the repayment amount must not exceed employer's cost;
- allows prorated repayment over the required employment period, with no accelerated repayment on early exit; *and*
- does not require repayment if the worker is terminated, unless for misconduct.

Exception 2: Upfront Discretionary Bonus Exception

Employers also should exercise caution if they plan to use AB 692's upfront discretionary bonus exception to recoup sign-on, retention and/or relocation bonuses provided to California workers. The law allows for repayment of upfront discretionary payments that are not tied to specific job performance (e.g., sign-on, retention and/or relocation bonus) only if all of the below requirements are met:

- The repayment terms must be in a separate agreement from the main employment contract;
- The worker must be informed of the right to consult an attorney and given five business days to do so;
- Repayment for early exit must be interest-free, prorated, and tied to a retention period not exceeding two years;
- The worker may defer payment until completing the full retention period to avoid repayment; and
- Separation from employment prior to the retention period was at the sole election of the worker, or at the election of the employer for misconduct.

Exception 3: Governmental Loan Program Exception

AB 692 does not apply to contracts entered into under any federal, state or local loan repayment assistance and forgiveness programs.

Exception 4: Apprenticeship Program Exception

AB 692 does not apply to contracts related to enrollment in an apprenticeship program approved by the Division of Apprenticeship Standards.

Exception 5: Residential Property Transaction Exception

AB 692 does not apply to contracts related to the lease, financing or purchase of residential property.

Penalties for Violations

If a contract or a contract term entered into on or after January 1, 2026 violates this law, it will be void as contrary to public policy. The law also establishes a private right of action for monetary damages equal to either the worker's actual losses or $5,000, whichever amount is greater, as well as injunctive relief and reasonable attorneys' fees and legal costs for the worker, other persons similarly situated to the worker, or both.

Next Steps

Moving forward, employers need to proceed with caution as they get their employment contract templates ready for use in 2026 (and beyond), removing or revising repayment and recoupment provisions that do not conform to AB 692's requirements. Unfortunately, there are several provisions in the new law that are less than clear, and a there are a number of complicated issues that the new law raises (hopefully, forthcoming guidance from the Labor Commissioner, which is expected to be issued soon, will prove helpful in interpreting the new statute).

Employers are also reminded to carefully examine each requirement of the new law's tuition repayment exception and/or upfront discretionary bonus exception, should they wish to take advantage of these permissible repayment carve-outs. MSK's Labor & Employment team is, of course, abreast on all AB 692 updates and is ready to assist in preparing agreements compliant with this new law.

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