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Employees can be an organization's most valuable resource. But when they leave, some employees may pose a serious threat by joining the competition or soliciting customers for a new business. Recognizing this, employers sometimes require certain employees to sign agreements prohibiting them from working for a competitor, or soliciting customers or clients for another entity for a limited time period after they quit or are fired. Colorado disfavors these types of agreements, commonly referred to as noncompetes or non-solicitation agreements. As a result, courts will enforce them only in limited circumstances. The key is to recognize when they might be enforceable--whether you are relying on them for your own employees or analyzing a prospective employee's agreement to determine if the employee can work for your company. A recent case in Colorado sheds some light on what types of employees may be bound by these types of agreements, and the case contains important lessons for employers using such agreements.

Facts

Robert Dowell worked for an investment bank as a senior portfolio analyst. When he was hired, he signed a contract that prohibited him from competing with the investment bank, or soliciting its customers or employees, for one year after he ended his employment. Over time, Dowell was promoted, and eventually he was transferred to manage a division at a new company formed by the bank. Dowell continued in that position for about three years. He then resigned and joined with one of the bank's competitors to form a new company. The new company directly competed with the bank, and Dowell began actively soliciting the bank's clientele. Dowell also tried to convince two of the bank's key employees to join his new business venture.

In response, the bank sued Dowell to enforce the agreements he had signed. Neither party was happy with the result at the trial court level, so they both appealed.

Court of Appeals' Analysis

At the outset, the court of appeals noted that Colorado public policy disfavors noncompete agreements. Such agreements are void unless they meet one of four statutory exceptions, and the geographic scope and time limitations placed on the individual's ability to compete must be reasonable. In Dowell's case, the court of appeals concluded that the agreement prohibiting him from competing with, or soliciting clients of, the bank did not meet any of the four statutory exceptions. As a result, the agreements were not enforceable. In reaching this conclusion, the court addressed a number of issues that frequently arise in these situations, including: (1) whether an agreement must meet a statutory exception at the time it is signed to be enforceable, (2) the definition of the statutory exception for "professional staff to executive or management personnel," and (3) whether agreement prohibiting the solicitation of customers and clients must meet the same tests as a noncompete agreement to be enforceable.

Agreement Must Be Valid When Signed

By statute, Colorado allows reasonable noncompete agreements for "professional staff to executive or management personnel." These types of employees are often in key positions in an organization and have access to critical information that could be extremely valuable to a competitor. The bank argued that Dowell fit within this category at the time he quit and began violating his noncompete. The court, however, concluded that to be enforceable, a noncompete must be valid when signed. Thus, Dowell's noncompete could not become valid by virtue of his promotions to a higher level position. Instead, the critical inquiry was whether Dowell fit the definition of "professional staff to executive or management personnel" *when he signed the agreement*. Of course, other courts have refused to enforce noncompete agreements which were valid when signed, but due to changed circumstances (*e.g.*, a demotion), the employee no longer fit within one of the statutory exceptions.

Court Defines "Professional Staff to Executive or Management"

Unfortunately for employers utilizing noncompete agreements, Colorado's legislature did not define the term "professional staff to executive or management personnel." In Dowell's case, the court of appeals provided a definition, albeit one that is, at best, ambiguous. According to the court, "professional staff to management and executive personnel" are those employees who "primarily serve as key members of the manager's or executive's staff in the implementation of management or executive functions." Dowell did not fit this definition at the time he signed the agreement. Although he reported to executives or managers, and he performed highly skilled duties, he did not serve executives or managers in terms of implementing management functions. Instead, he spent eighty to ninety percent of his time in a sales support role.

Nonsolicitation of Customers is Equivalent to a Noncompete

The court also concluded that the portion of the agreement prohibiting Dowell from soliciting clients or customers was void. Such agreements, according to the court, are just another form of a prohibition on competition. As a result, a ban on soliciting customers must meet the same strict standards as a general ban on working for a competitor to be enforceable. Because Dowell's noncompete was invalid, his nonsolicitation agreement was void as well. However, the court did hold that an employer may prohibit an employee from soliciting other *employees*, as opposed to customers. *Phoenix Capital, Inc. v. Dowell*, 2007 WL 2128330 (Colo. App. July 26, 2007).

Lessons Learned

It's possible that one or both parties will try to take this case to the Colorado Supreme Court. If that occurs, the outcome could easily change. But for now, the case contains some important lessons for employers. First, noncompete and nonsolicitation agreements must be valid when the employee signs them. In other words, don't count on a promotion to save a noncompete that might not have been valid when signed. Instead, consider drafting a new one and require the employee to sign the agreement as a condition of receiving the promotion. Second, make sure that any bans on solicitation of customers will pass muster under the same rigorous standards that apply to noncompete agreements. On the other side of the coin, if you are about to hire someone who signed a noncompete (or a nonsolicitation) agreement, be aware that your organization, along with the person you hire, could be sued for breaching the agreement. And even if you firmly believe the agreement is unenforceable, your competitor might not, and then it could be up to a court or jury to decide your fate.

For more information on this case or noncompetition agreements generally, contact Mark Wiletsky at mbwiletsky@hollandhart.com.
