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Minnesota Reforms Law to Ban (Almost) All Noncompete Agreements

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Agreements not to compete have existed as part of the common law for hundreds of years.[1] These restraining agreements are designed to reduce economic harm to an employer when a “key” employee departs and are often required at the time of obtaining a job or as a condition of receiving a monetary payment in a severance arrangement. As the use of noncompete agreements has increased over time, so too has the controversy surrounding them.

Imprudent efforts by employers to enforce noncompete agreements against former low-level or modestly compensated employees with little bargaining power have led to political scrutiny. On May 16, 2023, the Minnesota Legislature passed SF3035, a measure that bans nearly all post-termination noncompete agreements with employees and independent contractors in the state of Minnesota. SF3035, part of a broader labor regulation initiative entitled the “Omnibus Jobs and Economic Development and Labor Funding Bill,” was signed into law by Gov. Tim Walz on May 24, 2023. The legislation represents a significant shift in Minnesota's labor and employment law.

Anatomy of a noncompete agreement

Noncompete agreements typically have three central features: first, the “noncompetition” provision, also known as a “covenant not to compete,” which precludes an employee from engaging in specific activities that may, or do, compete with the employer's business; second, the “nonsolicitation” provision, which restricts the employee from soliciting other workers or customers from the former employer; and third, in most cases, a “nondisclosure” provision that limits an employee's unauthorized use and disclosure of confidential information, which can include a broad range of information and data related to an employer's business operations.

Courts have historically balanced the interests of the employer and the employee when faced with challenges to the scope and enforceability of noncompete agreements—the interests of the business owner in protecting information, trade secrets, and customers from the activities of the departing worker; the interests of the worker in having the freedom to

pursue individual interests and employment opportunities.[2] A rule of "reasonableness" has developed to address this balance. Courts have, despite the language and after consideration of all facts, determined whether the agreement at issue operates as a "restraint on trade generally," which is considered void, or one that is reasonably tailored with respect to matters such as scope, duration, and geography, which is valid and enforceable.[3] Courts have historically had the authority to "blue pencil" and modify an existing noncompete provision if it is found to impose unreasonable requirements.

Legislative developments

Minnesota and many other states have grappled with a range of workplace challenges. Noncompete restrictions are viewed as a focal point of concern due to the changing employment landscape. These agreements are now common throughout the labor market and have evolved beyond their historic purpose of addressing the special situations of executives and other high-wage earners.[4]

Noncompetes have traditionally been the province of state regulation, with each state making policy decisions appropriate for its population relative to the needs of the state's workforce, predominant industries, and economy. In recent years, states have begun to reevaluate their noncompete laws to address the power imbalance and inequities resulting from overbroad noncompete agreements that prevent large numbers of individuals from seeking employment in the same sector. Minnesota recently joined the ranks of California,[5] North Dakota,[6] Oklahoma,[7] and Washington, DC[8] in banning practically all noncompete agreements, with a few narrow exceptions. Colorado, Illinois, Maine, Maryland, New Hampshire, Oregon, Rhode Island, Virginia, and Washington prohibit noncompete agreements unless the worker earns above a certain specified monetary threshold.[9] In the jurisdictions that either ban or significantly curtail noncompetes, the rationale is premised on the view that noncompetes are harmful to workers at all income levels and across industries because they limit mobility and depress wages. Additionally, noncompetes can be harmful to businesses that are restricted from hiring talented workers.

At the federal level, the issue of competitive restraints and labor rights has also received a lot of recent attention. On July 9, 2021, President Biden issued an Executive Order on Promoting Competition in the American Economy that encouraged the Federal Trade Commission "to curtail the unfair use of non-compete clauses and other clauses or agreements that may unfairly limit worker mobility."[10] On January 5, 2023, the FTC proposed a rule that "would ban employers from imposing noncompetes on their workers, a widespread and often exploitive practice that suppresses wages, hampers innovation, and blocks entrepreneurs from starting new businesses."[11] Similarly, on May 30, 2023, the general counsel for the National Labor Relations Board issued a memo to all regional directors, officers-in-charge, and resident officers setting forth her view that noncompete provisions in employment contracts violate the National Labor Relations Act except in limited circumstances.[12]

Minnesota's new statewide ban on covenants not to compete

Minnesota is the first state in 100 years to implement a complete ban on employee noncompete agreements. Minnesota's new law is codified at Minnesota Statutes §181.988 and is comprehensive. The statute's heading signals its scope: “COVENANTS NOT TO COMPETE VOID IN EMPLOYMENT AGREEMENTS; SUBSTANTIVE PROTECTIONS OF MINNESOTA LAW APPLY.”

The new statute makes “void and unenforceable” “any covenant not to compete” between employers and employees as well as employees and certain independent contractors that, in either case, restricts future employment with another employer.[13] The law bans noncompetes irrespective of a person's income or position, so even high-ranking executives cannot be restrained from seeking competitive employment with this type of agreement. It is significant to note that the law banning noncompete agreements provides that only the impermissible covenant would be rendered void, not the entire contract that may contain the noncompete.

The law defines a “covenant not to compete” as “an agreement between an employee and employer that restricts the employee, after termination of employment, from performing: (1) work for another employer for a specified period of time; (2) work in a specified geographical area; or (3) work for another employer in a capacity that is similar to the employee's work for the employer that is party to the agreement.”[14]

Moreover, “employee” is broadly defined in the statute to include “independent contractors.”[15] While not yet tested in courts, this appears to encompass business-to-business noncompete agreements between companies contracting with each other—vendors, suppliers, distributors, and sales rep companies.

EXCEPTIONS TO BAN
The law contains several important exceptions. All of the exceptions to the new ban on noncompetes strive to maintain protection for what the legislators deemed to be narrow categories of legitimate employer interests.

First, it does not prevent employers from prohibiting employees from competitive work *while employed*. Second, the statute makes express exception for a “nondisclosure agreement”[16] or other agreements designed to protect an employer's trade secrets or confidential information, and a “nonsolicitation agreement.”[17] These broad carve-outs to the ban are particularly important in a digital age that affords workers ready access to and transmission of proprietary information. Third, covenants not to compete are legal when the agreement or provision is part of an agreed-upon arrangement for the sale of a business or its dissolution, provided it is reasonable in geographic and temporal scope.[18] A purchaser of a business should be entitled as part of an arm's-length bargaining process to restrict the former owners from competing and undermining expectations, particular when adequate consideration is being paid for the enterprise.

PROHIBITION ON ATTEMPTS TO CIRCUMVENT LAW

The Legislature recognized that employers might attempt to escape the reach of the Minnesota ban by making agreements subject to the jurisdiction of another state. The new law expressly prohibits agreements that purport to apply the law and venue of a state other than Minnesota. And an employee has the right, upon election, to void choice of law and forum selection provisions of a contract required as a condition of employment.[19]

EXISTING AGREEMENTS REMAIN ENFORCEABLE

The ban on noncompete agreements applies to agreements entered into on or after July 1, 2023. It will not apply retroactively to agreements entered into before that date. Minnesota courts should therefore continue to evaluate noncompete agreements entered into prior to the effective date based on the established body of law in the state providing for the enforcement of noncompete agreements that are reasonable in scope. However, future litigation with respect to pre-existing agreements may well be influenced by the prohibitions of the new law.

COSTS OF ENFORCEMENT

Not only will covenants not to compete be unenforceable in Minnesota—the new statute expressly both provides for injunctive relief and permits a court to award attorneys' fees against an employer when the employee is required to enforce his or her rights under the statute.[20]

Implications of the new law

Minnesota employers who have traditionally used noncompete provisions as part of a strategy to protect legitimate business interests cannot ignore the breadth of the new law. Effective July 1, 2023, new employment-related contracts and independent contractor agreements must be structured to eliminate noncompete provisions. Business owners should also consider revisiting, and perhaps updating, existing agreements and internal policies in light of the new law.

Going forward, employers will need to use tailored confidentiality and nonsolicitation agreements to protect their interests. Although the new noncompete ban does not prohibit nondisclosure or nonsolitication agreements, the ban would extend to provisions in agreements that operate as *de facto* noncompete clauses, written so broadly as to have the functional effect of prohibiting workers from seeking or obtaining new employment.

Courts will certainly look beyond labels and narrowly construe restrictive covenants and forfeiture provisions. Employers should avoid over-broad language and narrowly tailor restrictive covenants in employment-related agreements to protect legitimate and identifiable business interests. The ban on noncompetes was enacted to rebalance the employment power dynamic, so employers should refrain from a one-size-fits-all mentality: It's important to consider carefully which employees have responsibilities or access to confidential information that justify the restrictions imposed in any agreement.

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Notes

[1] *See* Harlan M. Blake, *Employee Agreements Not to Compete*, 73 Harv. L. Rev. 625, 626 (1960) (providing a detailed history with respect to the enforcement of noncompete agreements from the 16th Century in England up to the 20th Century in the United States). *See also Alger v. Thacher*, 36 Mass. 51, 53 (1837) (noting that an agreement not to compete that was limited in geographic scope was enforced in the 1621 decision of *Broad v. Jollyffe*, Cro. Jac. 596).

[2] *See, e.g., Bennett v. Storz Broadcasting Co.*, 270 Minn. 525, 134 N.W.2d 892 (1965) (enforcing a noncompete agreement when "the restraint is necessary for the protection of the business or good will of the employer" and when the agreement does not impose "greater restraint [on the employee] than is reasonably necessary to protect the employer's business"). "Legitimate interests that may be protected include the company's good will, trade secrets, and confidential information." *Medtronic, Inc. v. Advanced Bionics Corp.*, 630 N.W.2d 438, 456 (Minn. Ct. App. 2001). *See Lapidus v. Lurie LLP*, No. A17-1656, 2018 WL 3014698 (Minn. Ct. App. 6/18/2018) (direct access and knowledge with respect to confidential information is a legitimate interest to be protected when reasonable in scope and in duration).

[3] *Bennett*, 134 N.W.2d at 899. The element of "reasonableness" is not limited to the consideration set forth in the contract but extends to all facts relevant to the issue of "whether such restraint is such only as to afford a fair protection to the interests of the party in favour of whom it is given, and not so large as to interfere with the interests of the public." *Horner v. Graves* [131 Eng. Rep. 284, 287 (C.P. 1831)], Tindal, C.J.

[4] An estimated 350,000 workers in Minnesota are currently subject to noncompete covenants. Testimony of Mary Hogan, Senior Policy Analyst, Federal Reserve Bank of Minneapolis, before House Commerce Finance & Policy Committee on HF295 (1/31/2023). In 2014, it was revealed that the sandwich chain Jimmy John's had required sandwich makers to sign noncompete agreements. The revelation resulted in enforcement action by state attorneys general. *https://www.nytimes.com/2014/10/15/upshot/when-the-guy-making-your-sandwhich-has-a-noncompete-clause.html.*

[5] *See* Cal. Civ. Code §1673; *Edwards v. Arthur Andersen LLP*, 44 Cal. 4th 937, 945 (2008) (employee noncompetes banned since 1872).

[6] *See* N.D. Cent. Code §9-08-06; *Werlinger v. Mutual Serv. Cas. Ins. Co.*,

495 N.W.2d 26 (N.D. 1993) (employee noncompetes banned since 1865—before North Dakota was a state).

[7] *See* Okla. Stat. tit. 15, §§217, 219A (employee noncompetes banned since 1890—before Oklahoma was a state).

[8] *See* D.C. Official Code §32-581.01 *et seq.*

[9] *A Brief History of Noncompete Regulation*, Fair Competition Law (2021), *https: //faircompetitionlaw.com/2021/10/11*.

[10] Executive Order on Promoting Competition in the American Economy, *https://www.federalregister.cov/documents/2021/7/14/2021-15069*.

[11] FTC Proposes Rule to Ban Noncompete Clauses, Which Hurt Workers and Harm Competition, Press Release (1/5/2023), *https://ftc.gov/news/press-releases/2023/01*.

[12] NLRB General Counsel Issues Memo on Non-competes Violating the National Labor Relations Act, Press Release (5/30/2023), *https://nlrb.gov/news-outreach/news-story*.

[13] Minn. Stat. §181.988 subd. 2.

[14] *Id*. §181.988 subd. 1(a) (emphasis added).

[15] *Id*. §181.988 subd. 1(c) & (d). The term “independent contractor” is broadly defined in the statute to include individuals as well as corporations, limited liability companies, and partnerships that provide services.

[16] *Id*. §181.988 subd. 1(a). Nondisclosure agreements prohibit the employee from using confidential information acquired during an employee's time on the job. Unlike other restrictive covenants, confidentiality provisions with employees often do not include time limitations and therefore can continue indefinitely.

[17] *Id*. Nonsolicitation agreements prohibit the use of client or contact lists and restrict former employees from initiating contact with the former employer's customers, vendors, or other employees for a period of time with a view to move the relationship to new employer. Initial versions of the proposed legislation did *not* exclude nondisclosure or nonsolicitation from the scope of the law's ban.

[18] *Id*. §181.988 subd. 2(b)(1) & (2).

[19] *Id*. §181.988 subd. 3 (such provisions in employment contracts are voidable at the option of the employee).

[20] *Id*. §181.988 subd. 2(c).

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