How Employers Can Prepare For Minn. Noncompete Ban

By **Jeremy Sosna, Kurt Erickson and Margaret Fitzpatrick** (June 21, 2023)

On May 24, Minnesota Gov. Tim Walz signed into law a sweeping statute banning virtually all covenants not to compete, commonly referred to as noncompete agreements, between companies and their employees.

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With the enactment of the law banning noncompete agreements, Minnesota joined California, Oklahoma and North Dakota as only the fourth state to make employee noncompete agreements completely void and unenforceable by statute. This development materially impacts Minnesota employers' ability to protect their trade secrets, confidential business information and other intellectual property.

Kurt Erickson

In light of this new law, which takes effect July 1, Minnesota employers will need to take immediate action to address this seismic change and implement new strategies to protect their invaluable intellectual property, customer relationships and investment in employee training.

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An Expansive Scope For Minnesota's Noncompete Ban

The scope of Minnesota's law is breathtaking. The law creates a blanket prohibition on all noncompete agreements between an employer and an "employee," a term that is defined broadly under the statute as any individual who performs services for an employer. In fact, the definition of an employee is so expansive that it extends the statute's coverage to expressly include independent contractors that perform services for a company.

And unlike states such as Oregon and Virginia, which have passed laws that only restrict noncompete agreements with employees earning below a certain salary or income threshold, the Minnesota law, similar to California's, creates a wholesale prohibition on noncompete agreements between the employer and workers, regardless of the person's income or level within the organization.

This means that employers may no longer have the ability to restrict even C-suite executives or key employees from working for a competitor — despite the fact that these employees are the ones most likely to have access to the trade secrets and highly sensitive information that would be most valuable to a competitor.

As a result, the Minnesota law is likely to dramatically disincentivize businesses from making and keeping their headquarters in Minnesota, where companies will have far more difficulty safeguarding trade secrets and highly sensitive information from competitors.

Importantly, Minnesota's law also provides for remedies that could conceivably entice employees, or their lawyers, to proactively challenge allegedly impermissible covenants — even before the employer actually seeks to enforce the terms of such an agreement.

Minnesota's law allows a court to award attorney fees to an employee that seeks to enforce their rights under the law. This means that employers that do not remove impermissible noncompete agreements from contracts with employees could face exposure to an attorney fees award. The fee-shifting provision also creates real financial risks for employers that attempt to creatively draft around the ban.

It remains to be seen how the Minnesota courts will apply the attorney fees provision, but employers need to be aware of the provision as they evaluate the strategy moving forward and assess the corporation's tolerance for risk.

Two Limited Exceptions to the Statute

Minnesota law provides for only two limited exceptions to the ban on noncompete agreements. The statute specifically permits noncompetition agreements that are arranged:

- During the sale of a business where the agreement prohibits the seller or partners, members, or shareholders from carrying on a similar business within a reasonable geographic area for a reasonable period of time; or
- In anticipation of the dissolution of a business during which the dissolving partnership or entity agrees that the partners, members or shareholders will not carry on a similar business in a reasonable geographical area for a reasonable period of time.

In all other respects, the law makes clear that any covenant not to compete that restricts an employee's post-termination right to work for any other employer is void and unenforceable.

It is important to emphasize the very limited nature of these exceptions. Although the law allows for the seller of the business to enter into agreements that effectively prohibit the owners from engaging in competition after the sale or dissolution, these exceptions do not extend to employees of the company that is being acquired. In other words, the employees of the company being sold cannot be prevented from resigning employment immediately upon the closing of the sale and begin working in a competing capacity.

This creates significant risks in the context of an acquisition, where the acquiring entity decides on a valuation and purchase price based on, among other things, the value of customer relationships that are maintained by the sales team and the trade secrets or confidential information to which competitors do not have access. Employees of the acquired entity can quickly destroy that value, thereby depriving the purchaser the benefit of the bargain, by picking up and moving to a competitor after the sale.

Thus, businesses engaging in Minnesota M&A activity will need to implement strategies to retain key employees of the target after the acquisition to mitigate the risk of losing the confidential information and commercial relationships that are a key part of the valuation of the acquired company.

Customer Nonsolicitation and Confidentiality Nondisclosure Agreements Remain Enforceable

There may be one silver lining in which Minnesota employers can take some comfort. The law's definition of an impermissible "covenant not to compete" does not include

nondisclosure, confidentiality, trade secret or customer nonsolicitation agreements. Minnesota's law expressly permits agreements restricting an employee's ability to use client contact lists or to solicit customers after employment ends.

This is an important point, as it leaves intact a powerful tool that employers commonly use to protect customer relationships, namely, post-employment restrictive covenants that prohibit the employee from stealing customers that they solicited on behalf of the employer.

Further, the ability to protect a company's confidential information by contract allows employers to mitigate the risk of losing business-critical information that may not otherwise merit protection as a trade secret. This will make it easier for companies to protect their intellectual property by contract and allow enforcement through breach of contract claims, which are generally easier to prove than trade secret claims under either the federal Defend Trade Secrets Act or the Minnesota Uniform Trade Secrets Act.

While not nearly as effective as noncompete agreements, which prevent the employee from being in a position to disclose the information to a competitor in the first place, the ability to continue to include post-employment restrictions on solicitation of clients or customers and disclosure of confidential information is a critical victory for Minnesota employers.

Of course, there are still a number of questions that the Minnesota courts will need to answer. For example, it is not clear whether the law prohibits "non-acceptance" provisions that restrict a former employee from doing business with a customer that is not the product of the employee's solicitation.

One of the problems with a clean slate is that it will take years, and lots of legal ink, before we can answer some questions with complete clarity.

Non-Minnesota Forum Selection Clauses

Minnesota's noncompete ban also includes limitations on the right of Minnesota employers to contract with employees to have a non-Minnesota forum decide disputes with employees, or apply another state's law, in an effort to contract around the ban.

The law prohibits employers from requiring employees who reside and work in Minnesota to agree, as a condition of employment, to a provision in an employment agreement that:

- Requires the employee to adjudicate a claim arising in Minnesota outside of Minnesota; or
- Deprives the employee of the substantive protection of Minnesota law with respect to any dispute arising in Minnesota.

Notably, the ban on foreign choice-of-law and forum-selection clauses may not apply just to noncompete agreements. It could easily be interpreted to apply to all contracts between an employer and an employee — including, for example, permissible customer nonsolicitation agreements and confidentiality nondisclosure agreements. Many employers in Minnesota that do not currently use noncompete agreements may still be wise to amend template agreements to comply with this part of the law, at least until the courts interpret the scope of this provision.

Existing Noncompete Agreements With Employees

The new law is not retroactive in effect, meaning that any agreements entered into between employers and employees before July 1 remain enforceable in Minnesota.

Unlike the rule proposed by the Federal Trade Commission to ban noncompetes, Minnesota's law will not require employers to notify all employees of the rescission of noncompete agreements that were signed prior to July 1. The law prohibits employers only from prospectively requiring employees to enter into agreements containing covenants not to compete.

Thus, noncompete agreements entered into prior to July 1 will continue to be evaluated by Minnesota courts based on the established body of case law providing for enforcement of reasonable covenants not to compete.

Next Steps for Minnesota Employers With Noncompete Agreements

There are host of questions that remain unanswered by Minnesota's ban on noncompete agreements, which will likely need to be answered by the courts in the coming years. But the gravity of the new law could not be clearer — going forward, companies operating in Minnesota will no longer be allowed to rely on noncompete agreements as one of the primary means of preventing a competitor from gaining an unfair competitive advantage.

Accordingly, Minnesota employers need to take action in anticipation of the July 1 effective date. Employers should consider the following measures to ensure compliance with the new Minnesota law and protect critical information.

Assess Current Agreements

Conduct an audit of the current employee population to determine who currently is subject to a noncompete agreement and evaluate whether the company needs to take additional measures to mitigate the risk of key employees leaving for a competitor, such as, for example, by offering retention incentives or other compensation and benefits to incentivize the employee to remain. Given the risk that even pre-existing noncompete agreements may be more vulnerable to challenge than in the past, relying on preexisting noncompete agreements with key employees may not be a sound strategy

Alternate Retention Strategies

Consider different strategies for retaining talent. These might include forfeiture-for-competition clauses in nonqualified deferred compensation "top hat" plans for senior executives, the enforcement of which is governed by the Employee Retirement Income Security Act, which likely preempts the Minnesota noncompete ban.

These alternate strategies could also include garden leave provisions or notice requirements.

Update Templates

Review template agreements to remove noncompete provisions for Minnesota employees and address forum-selection or choice-of-law provisions that may apply to Minnesota employees.

Review Other Employee Agreements

Ensure that any customer nonsolicitation and confidentiality provisions are robust and provide meaningful protection of customer relationships, goodwill and the employer's trade secrets and other intellectual property.

Protect Trade Secrets and Confidential Information

Prepare for the post-noncompete world in Minnesota. Minnesota employers are no longer able to prevent employees from disclosing trade secrets and confidential information with the same certainty provided by a noncompete agreement.

Employers need to reevaluate internal processes for allowing employee access to trade secrets and consider different approaches to ensure that employees have access only to information that is truly necessary for performing their jobs. This may mean implementing new digital resources that limit, control and track access to critical company information to mitigate the risk of confidential information leaking out the door when employees leave for competitors.

This is a long-term strategy that will require patience, financial support and discipline, but one all employers should start to implement to prevent the loss of the company's most valuable information to competitors.

Conclusion

The full impact of the new law on Minnesota employers' ability to defend themselves against unfair competition will remain unclear until the Minnesota courts have their say. But one thing seems relatively certain: The passage of Minnesota's ban on noncompetes has changed the competitive landscape for employers.

All Minnesota companies may need to rethink their strategy for protecting their most valuable trade secrets, confidential information and customer relationships.

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