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Client Alert Commentary

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New Minnesota Law Bans Most Post-Employment Non-Competes: 6 Key Takeaways

The law bans nearly all post-employment non-competes entered into on or after July 1, 2023.

Key Points:

- The law applies to post-termination covenants not to compete ("non-competes") entered into between employers and employees, and broadly defines the term "employee" to include individual independent contractors (including those operating through entities the employer required the individuals to form).
- Nondisclosure agreements and non-solicitation agreements are excluded from the definition of a non-compete.
- Under the law, a post-termination non-compete with an employee or independent contractor is void and unenforceable unless it is agreed upon during the sale of a business or in anticipation of the dissolution of a business.
- An employer may not require an employee or independent contractor who primarily resides and works in Minnesota to agree, as a condition of employment, to adjudicate non-compete claims outside of Minnesota or to have any other state's law apply to a non-compete.
- Aggrieved individuals may be able to collect reasonable attorneys' fees in enforcing their rights under the law.

Minnesota has enacted one of the strictest state non-compete laws in the US, banning almost all post-termination non-competes between employers and their employees and between employers and certain independent contractors entered into on or after July 1, 2023. Below are six key takeaways from the new Minnesota law on non-competes.

6 Key Takeaways

1. The law does not apply to confidentiality or non-solicitation provisions

The law defines a non-compete as an agreement between an employer and an employee (which is defined to include certain independent contractors, as discussed in the second takeaway below) that

restricts the individual from engaging in any of the following activities after the termination of their employment (or, presumably, engagement, in the case of an independent contractor):

- working for another employer for a specified period of time;
- working in a specified geographical area; or
- working for another employer in a capacity that is similar to the employee's (or independent contractor's) work for the employer that is party to the non-compete.

However, the law makes clear that a non-compete does not include: (i) a nondisclosure agreement, (ii) an agreement designed to protect trade secrets or confidential information, (iii) a non-solicitation agreement, or (iv) an agreement restricting the ability to use client or contact lists or solicit customers of the employer. These exceptions do create a few questions, including what the term "non-solicitation agreement" means (e.g., employee non-solicitation, customer non-solicitation, etc.) and where the line is drawn between a permissible non-solicitation provision and an unlawful non-competition provision.

2. The law applies to agreements with employees and certain independent contractors

The law applies to non-competes between an employer and an employee, but broadly defines the term "employee" to be "any individual who performs services for an employer, including independent contractors." The law defines an "independent contractor" as an individual whose engagement is governed by a contract and whose pay is not reported on a Form W-2, and specifically includes any entity that an individual formed for purposes of entering into a contract for services, when the employer required such entity formation as a condition of receiving compensation under an independent contractor agreement. As used throughout this Client Alert, the term "independent contractor" has this meaning.

3. The law bans all non-competes with employees and independent contractors, with two exceptions

Under the law, any non-compete with an employee or independent contractor is void and unenforceable, except for non-competes that are agreed upon:

- during the sale of a business; or
- in anticipation of the dissolution of a partnership, limited liability company, or corporation.

More specifically, when there is a sale of a business, the buyer and "the person selling the business and the partners, members, or shareholders" may agree on a non-compete that prohibits the "seller" of the business from carrying on a similar business in a reasonable geographic area and for a reasonable length of time. However, the level/type of interest that one must hold in the business to be considered a "seller" is unclear under the law. For example, the law does not address whether a "seller" would include individuals who dispose of only a small interest in the business, or who are option holders or other holders of derivative securities.

When the dissolution of a business is anticipated, the partners, members, or shareholders may agree that any or all of them will not carry on a similar business in a reasonable geographic area where the business has been transacted.

The law does not provide guidance as to what would be a reasonable geographic scope or length of time for a permissible non-compete.

4. Employers generally may not avoid the law by having the parties agree to apply another state's law or litigate or arbitrate disputes in another state

The law provides that an employer may not require an employee or an independent contractor who primarily resides and works in Minnesota, as a condition of employment, to agree to a provision in an agreement that would: (i) require the employee or independent contractor to adjudicate outside of Minnesota a claim arising in Minnesota under the non-compete law, or (ii) deprive the employee or independent contractor of the substantive protection of Minnesota law with respect to a controversy arising in Minnesota under the non-compete law. Any provision that requires the above is voidable at the employee's or independent contractor's request, in which case the dispute would be adjudicated in Minnesota under Minnesota law.

Based on the foregoing, the law does not seem to require adjudication in Minnesota and application of Minnesota law for non-compete disputes if an employee or independent contractor: (i) primarily resides or works in a state other than Minnesota, and/or (ii) is not required as a condition of employment to execute the non-compete. In such circumstances, an employer may be able to avoid application of Minnesota's non-compete ban if another state's law can properly apply. However, if an employee or independent contractor resides or works in Minnesota for any period of time, an employer should consult with legal counsel before entering into a non-compete that is governed by the laws of or requires adjudication of disputes in a state other than Minnesota. The employer will need to confirm whether the application of another state's law is appropriate under the circumstances, ensure proper drafting, and assess the risk that Minnesota law will nonetheless apply under conflicts of law principles.

5. Employees and independent contractors can recover attorneys' fees in enforcing their rights under the law

An employee or independent contractor who "is enforcing rights under [the law]" may obtain injunctive relief, other available remedies, and reasonable attorneys' fees. Thus, merely requiring an employee or independent contractor to sign a non-compete that violates Minnesota law, even if the employer does not try to enforce it, may give rise to liability if the employee or independent contractor seeks relief.

6. The law will take effect on July 1, 2023

The effective date is fast approaching. The law is not retroactive, so it applies only to agreements that are entered into on or after July 1, 2023. Thus, employers should review their agreements and consult with legal counsel to make any edits that may be needed to comply with the new law starting July 1, 2023.

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