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Minnesota Set to Ban Most Noncompete Agreements Beginning July 1, 2023

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Minnesota has joined a number of other states in cracking down against noncompete agreements – a trend growing increasingly common. On May 24, 2023, Minnesota Gov. Tim Walz signed SF 3035, a bill that prohibits most covenants not to compete between employers and employees or independent contractors. Nondisclosure agreements, nonsolicitation agreements, agreements designed to protect trade secrets or confidential information, and noncompete agreements agreed to as part of a sale or dissolution of a business are explicitly exempted from the law. Upon a violation of the law, SF 3035 provides for injunctive relief and reasonable attorneys' fees. The prohibition on noncompete agreements goes into effect on July 1, 2023.

This alert reviews the main requirements of the law and highlights key considerations.

Individuals covered by SF 3035

SF 3035 is broadly written and bans all noncompetes between an employer and an employee or independent contractor – unless, as described below in further detail, the noncompete is tied to sale or dissolution of a business. The statute defines a "covenant not to compete" as an agreement that would restrict a former employee or independent contractor from:

- Working for another employer within a certain time frame.
- Working in an agreed-upon geographic area.
- Working for another employer that is in the same field as the former employer.

The statute defines an "employee" as "any individual who performs services for an employer, including independent contractors." Pursuant to the statute, an "independent contractor" is "any contracted individual for whom the employer does not complete a W-2," as well as "any corporation, limited liability corporation, partnership, or other corporate entity when an employer requires an individual to form such an organization for purposes of entering into a contract for services as a condition of receiving compensation under an independent contractor agreement." The inclusion of independent contractors within the scope of the noncompete ban renders Minnesota's noncompete restrictions broader than those of most other states, which exclude independent contractors from the scope of their noncompete restrictions.

In addition, unlike other states that limit their noncompete restrictions to individuals who earn less than a designated minimum earnings threshold, Minnesota's law encompasses all employees, regardless of compensation level.

Agreements not covered by SF 3035

SF 3035 does not apply to agreements that fall outside of Minnesota's definition of a "covenant not to compete." Minnesota's noncompete statute either affirmatively lists or appears to permit several types of agreements that are not noncompete agreements and that remain valid under the law, including:

- Customer nonsolicitation agreements that prohibit departing employees from soliciting a former employer's clients and customers.
- Employee nonsolicitation agreements that prohibit departing employees from soliciting the services of, or recruiting, their former co-workers.
- Nondisclosure and confidentiality agreements, including those agreements regarding trade secrets and inventions.

The continued enforceability of confidentiality and nondisclosure agreements gives employers the ability to protect their trade secrets, customer relationships, confidential information, business reputation and goodwill from competitors. Additionally, the ongoing validity of employee and customer nonsolicitation agreements allows employers to prohibit departing employees from poaching clients or other employees post-termination. Generally, employers in Minnesota will have the continued ability to limit some risks associated with competition from a departing employee.

Effective date, nonretroactive effect of Minnesota noncompete ban

As of July 1, 2023, nearly all noncompete agreements between an employer and an employee or independent contractor will be rendered void and unenforceable (except for such agreements falling within the statute's exceptions, as described below).

Notably, Minnesota's noncompete statute is not retroactive – any noncompete agreements entered into prior to the July 1, 2023, effective date will continue to be evaluated pursuant to Minnesota common law, which provides for the enforcement of covenants not to compete that are reasonable in scope.

Sale of business and dissolution of business exceptions

As noted above, noncompete agreements related to the sale of a business, or in anticipation of the dissolution of a business, continue to be valid and enforceable under the statute as long as they are reasonably limited in duration and geographic scope.

This provision bears some resemblance to California's noncompete ban, which includes similar exceptions for agreements entered into in relation to the sale of a business interest or the dissolution of a partnership or limited liability company.

Severability and blue penciling

Importantly, an unenforceable noncompete provision within a Minnesota agreement will be severable and should not render the rest of the agreement void and unenforceable.

In addition, SF 3035 is silent on blue penciling, a practice by which a court modifies or rewrites a contested contract. This type of modification is allowed in Minnesota and has been utilized in the past to narrow overly broad noncompetes into "reasonable" restrictions. In circumstances that meet the statute's exceptions for permissible noncompetes, it is possible that Minnesota courts may still modify and narrow existing agreements.

Choice of law and venue

SF 3035 prohibits employers from including contractual provisions that would require an employee who "primarily resides and works in Minnesota" to adjudicate claims elsewhere or deprive them of the "substantive protection of Minnesota law." This prohibition applies to litigation and arbitration and is designed to foreclose creative attempts to circumvent the law. Any such provision within a contract agreed upon after July 1, 2023, is void and unenforceable.

Consequently, all disputes involving Minnesota noncompete agreements will be adjudicated in Minnesota and under Minnesota law. While it appears that choice of law and venue provisions were meant to apply only to prohibited noncompetes, these restrictions could be interpreted to apply more broadly to all employment agreements – even those without noncompete provisions.

Penalties for noncompliance

SF 3035 is largely silent on specific penalties or remedies for noncompliance. However, the statute does

specifically authorize “injunctive relief and any other remedies available” in the event of a violation. In addition, the law provides that any employee or independent contractor who seeks to enforce their rights under the law may receive “reasonable” attorneys’ fees.

Next steps and practical considerations for employers

Employers should promptly review their employment-related agreements and remove any noncompete and venue provisions that would violate Minnesota law. Employers also should evaluate any customer or client nonsolicitation provisions to assess whether a court might consider such provisions overreaching and de facto noncompetes. Additionally, employers should focus on alternative methods to protect their confidential and trade secret information, such as confidentiality and nondisclosure provisions, as well as narrowly tailored nonsolicitation restrictions.

Finally, employers with national workforces, which include employees in many states, should make it a priority to stay abreast of changes in the permissibility of restrictive covenants in the states where they have employees. On June 20, 2023, the New York Legislature passed a bill that would ban all noncompete agreements for all workers, regardless of salary level or job function. If signed into law, a ban on noncompetes in New York would become effective within 30 days. We expect to see more states crack down on nonsolicit and noncompete restrictions in the future.

If you have any questions about Minnesota’s prohibition on noncompete agreements, please contact a member of Cooley’s employment group.

*Cooley summer associate **Patrick Northrup** also contributed to this alert.*

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Key Contacts

Carly E. Gibbons Chicago	cgibbons@cooley.com +1 312 881 6613
Miriam Petrillo Chicago	mpetrillo@cooley.com +1 312 881 6612
Anna Matsuo New York	amatsuo@cooley.com +1 212 479 6827

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