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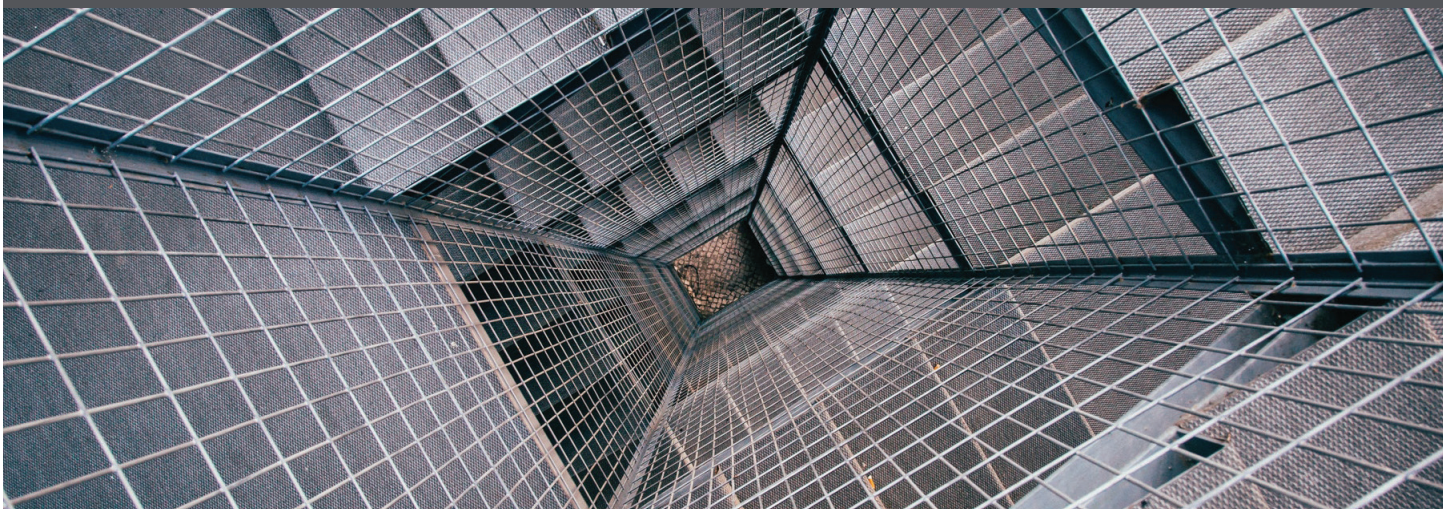

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Minnesota Joins the "Ban"-wagon, Barring Most Non-Competes with Workers

Many jurisdictions have recently passed legislation restricting the use of non-competes through compensation thresholds and other procedural hurdles and limitations, but they have avoided adopting a full-throated ban on non-competes. That changed on May 16, 2023, when the Minnesota legislature hastily passed a statute banning most non-competes with workers "entered into on or after" July 1, 2023. And since Governor Tim Walz has now signed the bill, companies with operations or employees in Minnesota should reassess their restrictive covenant practices with Minnesota workers as the effective date of the statutes nears, including in the context of pending sales and acquisitions.

WHAT TYPES OF PROVISIONS ARE IMPACTED BY MINNESOTA'S NEW STATUTE?

Non-Compete Provisions

The new statute bans provisions that restrict employees and independent contractors (after the termination of their working relationship) 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."

The statute applies to both individuals and any entity "an employer requires an individual to form . . . for purposes of entering into a contract for services as a condition of receiving compensation under an independent contractor agreement."

Significantly, there is no compensation threshold, or any exception for executives or other "exempt" employees. This statute is a total ban on non-competes with workers, with limited statutory exceptions.

Out-of-State Choice-of-Law and Forum-Selection Provisions

Companies with multi-state operations or a dispersed workforce commonly use out-of-state forum-selection and choice-of-law provisions in agreements with workers in an attempt to establish a uniform national standard for the enforcement of their restrictive covenants.

But, for workers "primarily" residing and working in Minnesota, the new statute renders these provisions "voidable at any time" as to claims and controversies arising in Minnesota. The statute even purports to ban arbitration provisions mandating arbitration outside of Minnesota, raising a conflict with the Federal Arbitration Act likely to lead to a preemption showdown in the courts.

Notably, the statute states that the restriction on the use of these provisions "applies only to claims arising under this section," potentially indicating that the legislature intended to address the use of the provisions only in the context of the non-competes banned by the statute, and not the provisions' application to other restrictive covenants or similar provisions in ancillary employment agreements.

Time will tell whether courts apply this restriction more broadly

WHAT TYPES OF PROVISIONS ARE NOT IMPACTED BY MINNESOTA'S NEW STATUTE?

There are a number of exclusions in the Minnesota statute that clarify its limited application to non-competes, and there are narrow exceptions for non-competes in the context of equityholders.

Confidentiality and Non-Disclosure Provisions

The statute does not apply to "a nondisclosure agreement" or an "agreement designed to protect trade secrets or confidential information." That statutory clarification does not seem to permit any type of restriction other than traditional confidentiality and non-disclosure provisions, but there is a question about whether a springing non-compete (a noncompete triggered by a violation of such provisions) may still be enforceable under that language.

Non-Solicitation Provisions

The statute does not apply to "a nonsolicitation agreement" or an "agreement restricting the ability to use client or contact lists or solicit customers." Because the statute does not define "nonsolicitation agreement," that exclusion would appear to permit restrictions on workers' solicitation of employees/contractors, customers, and other business partners.

It is, however, unclear whether provisions that prohibit former workers from servicing customers or from hiring or facilitating the recruitment of workers are permissible if the customers or workers initiate the contact without prior solicitation by the former worker.

Non-Competes in Connection with Sale or Dissolution of Businesses

As to worker equityholders, the statue excludes from the ban non-competes "agreed upon during the sale of a business" and non-competes "agreed upon in anticipation of the dissolution of a business, provided, in both contexts, that they are reasonable in duration and scope and limited to "carry[ing] on a similar business."

The absence of any ownership threshold in those exceptions provides companies flexibility to restrict workers who are minority equityholders in connection with the sale or dissolution of the business. That approach stands in contrast to a similar exception in Massachusetts' 2018 statute (which applies only to "significant" owners receiving "significant" consideration from the transaction) and to the arbitrary 25-percent-ownership threshold floated in the Federal Trade Commission's Notice of Proposed Rulemaking earlier this year.

Because the statutory exceptions apply only to owners (including members of a limited liability company), it would not appear to apply to workers holding only unvested or unexercised stock options or phantom equity (*i.e.*, workers without any actual equity stake).

Additionally, because the statutory exception for sale-related restrictions applies only to those "agreed upon during the sale," there is an apparent timing requirement that raises doubts as to the viability of non-competes agreed upon in exchange for equity but either before any actual sale is pending or even anticipated or after a sale to promote post-closing stability. For instance, the exception does not appear to apply to non-competes with worker equityholders whose equity is subject to

redemption upon termination of service or otherwise outside the context of a true third-party sale, which is a common provision in equity awards and limited liability company agreements. Nor does the exception appear to apply to non-competes that are embedded within the types of equity awards or change-in-control bonuses commonly used by companies as incentivizing or retention tools.

Finally, because the statute (and its exceptions) applies only to workers, there should be no impact on the implementation or enforcement of non-competes (or forum-selection or choice-of-law provisions) entered into with sellers who are not workers, whether they be in by-laws, operating agreements, or other governing documents or in ancillary sale-related documents.

WHAT SHOULD IMPACTED COMPANIES DO GIVEN THE JULY 1, 2023, EFFECTIVE DATE?

Existing agreements are not impacted, but companies with operations or employees in Minnesota should reassess their current restrictive covenant agreements and practices in order to comply with the new statute going forward.

This process should include ensuring any potentially unenforceable provisions are designated as severable and shifting focus to tailored confidentiality and non-disclosure provisions and non-solicitation provisions.

Companies involved in transactions closing on or after July 1, 2023, should also take stock and consider relying upon existing non-compete protections pre-dating the July 1 effective date of the statute for workers who do not hold equity, rather than having workers sign on to new agreements in connection with or following the closing of the transaction.

For those workers that do hold actual equity (or whose equity will vest in advance of or simultaneously with the closing), companies should consider how to comply with the statute's requirement that non-competes with such worker equityholders be "agreed upon during" the deal and, in doing so, ensure they are appropriately tailored in scope and duration.

For more information, contact Kevin M. Passerini or another member of Blank Rome's Labor & Employment practice group.

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