Minnesota bans new employee covenants not to compete

What has changed and the implications for employers

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The Minnesota Legislature's 2023 session was one of the most active in many years for employers, with legislators adopting new laws in multiple areas that made significant changes impacting the employer-employee relationship.

Among the changes, Minnesota legislators categorically rejected the state's longstanding approach to employee covenants not to compete. An employee covenant not to compete is a provision in an agreement between an employer and an employee in which the employee pledges not to work in a specified geographic area or for a similar employer for a period of time after termination of employment. Per the new law, these covenants will no longer be valid or enforceable in Minnesota if they are contained in an agreement with an employee or contractor that is signed on or after July 1, 2023, the effective date of this change.

Legislators also made other related law changes designed to protect workers. For example, Minnesota now forbids employers from entering into agreements with Minnesota employees that require the employee to bring any claim against the employer in a jurisdiction other than Minnesota and from using agreements that purport to apply another state's law to a Minnesota employee. These developments create a need for Minnesota employers to review and update their policies, agreement forms and practices.

While the July 1, 2023, law changes are prospective and are not intended to impact employee covenants not to compete in agreements with employees that were in place before July 1, 2023, Minnesota's new approach — which forbids employee covenants not to compete in new agreements for most employees — reflects a marked change in Minnesota public policy.

Minnesota's change on this point of law is in line with a current national trend. Multiple federal officials have recently signaled that they or their agencies disfavor these types of covenants, and multiple states other than Minnesota have recently moved or indicated an intent to move in this direction. Other states that have already decided that employee covenants not to compete are inconsistent with their public policy include California, North Dakota and Oklahoma. In these jurisdictions — and now in Minnesota — employers must do their best to protect themselves against the threat of unfair competition through other routes, such as employee covenants not to solicit customers and employees, employee confidentiality agreements, and measures to secure access to confidential company information.

What has changed in Minnesota?

In the recent law changes, the Legislature first defined the term "covenant not to compete," saying that such covenants are "void and unenforceable" if they are in an agreement with an employee signed on or after July 1, 2023, according to Minn. Stat. Sec. 181.988, subd. 2(a).

In a related change, which also represents a first in Minnesota, the Legislature also expressly extended the prohibition against employee covenants not to compete in new agreements to non-employee independent contractors as well.

Based on these changes, employers with Minnesota-based employees or contractors that have included covenants not to compete in their agreement forms for those workers are well-advised to review those forms with counsel and to update them for future use. Provisions that "restrict" an individual — after the individual leaves the company — from working for another company for a period of time or from working in a defined geographic area should be scrutinized and either removed or rewritten.

Covenant exceptions

Note that the new law includes exceptions for covenants not to compete that are "agreed upon during the sale of a business" or "in anticipation of the dissolution of a business," per Minn. Stat. Sec. 181.988, subd. 2(b). In these narrow contexts, employee and contractor covenants not to compete are permitted in agreements even after July 1, 2023.

While most employee covenants not to compete are now prohibited, the Minnesota Legislature also made clear in Minn. Stat. Sec. 181.988, subd. 1(a) that employers remain free to include the following types of covenants in agreements with their employees and contractors: nondisclosure agreements; agreements designed to protect trade secrets or confidential information; agreements restricting the ability to use client or contact lists; and nonsolicitation agreements.

Protections for Minnesota employees

The Minnesota Legislature also implemented changes, effective July 1, 2023, that are designed to protect and confirm the ability of Minnesota employees to rely on and exercise their rights under Minnesota's new covenant not to compete law. The Legislature directed employers "must not" require Minnesota employees, as a condition of employment, to agree to a provision in an agreement that would require the employee to adjudicate any claim against the employer outside Minnesota or that would apply the substantive law of a jurisdiction other than Minnesota, per Minn. Stat. Sec. 181.988, subd. 3. These developments mean that many multistate employers based outside Minnesota may need to modify the choice of law and choice of forum provisions in their "standard" employee and contractor agreement forms for their Minnesota workers.

In line with the goal of protecting employees, the Minnesota Legislature also provided, in Minn. Stat. Sec. 181.988, subd. 3(c), that a district court may award to an employee who is enforcing their rights under the new law their "reasonable attorney fees." With this one-sided attorney-fee provision included, employers are at increased risk if they do not modify for future use any legacy agreement forms that may include covenants not to compete.

Recent federal initiatives against employee covenants not to compete

Prior to Minnesota's recent law change, many practitioners viewed Minnesota law relating to employee covenants not to compete as within the mainstream. For years prior to the change, Minnesota employers commonly included covenants not to compete in agreements with employees, particularly with managers and sales employees who had access to company secrets or a hold on the goodwill of company customers. Also, Minnesota courts would periodically enforce these covenants through injunction orders — orders that had the effect of "putting an employee out of a job" — if the covenant was deemed reasonable and necessary to protect a legitimate interest of the employee's original employer.

When judges were called on to decide these types of injunction motions, they had to decide between competing public and private interests. The individual employee and the employee's new employer would frequently emphasize the right of an individual to maximize their income and opportunities by applying their skills and knowledge, while also emphasizing the public policy in Minnesota that favors free and vigorous business competition. On the other hand, the employee's former employer could emphasize both the importance of courts enforcing promises made in private agreements and of protecting the customer goodwill and confidential information developed by businesses through the hard work of their employees.

Most states continue to follow Minnesota's earlier approach. In those states, employee covenants not to compete can still be enforced. In Minnesota, however, covenants not to compete in new agreements can no longer be enforced outside of narrow exceptions (i.e., the sale or dissolution of a business).

The differing approaches followed between states highlight that the law relating to employee covenants not to compete is not uniform and can vary widely. For employers with employees in a single state, this presents no issue. But, for employers with employees in multiple states, a change in the law like the one Minnesota recently adopted creates practical challenges. Some of the organization's employees may be subject to a valid covenant not to compete while the same may not be true for employees in other states. Employers should consult with counsel to analyze the applicable law and options.

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Minnesota's decision to prohibit new employee covenants not to compete followed federal initiatives earlier this year that were critical of these covenants. For example, in January 2023, the U.S. Federal Trade Commission issued a proposed rule which proposed that all employment noncompete clauses were an "unfair method of competition" under an expansive reading of a section of the Federal Trade Commission Act. In February, President Joe Biden referred to this proposed rule in his State of the Union address when he said that employee noncompete agreements unfairly prohibit employees from moving from one job to another and serve as a tool to reduce wages and stifle competition.

More recently, in May 2023, the general counsel of the National Labor Relations Board issued a memorandum in which she expressed the view that most employee noncompete agreements infringe on the mobility rights and other rights of nonmanagement employees under Section 7 of the National Labor Relations Act. Under that section, employees have the rights to organize, form a union and to engage in other concerted activities for mutual aid and protection.

Action items for employers

Minnesota employers that have included employee covenants not to compete in agreements with their workers may want to take the following steps based on the new law:

1. Remove post-employment noncompetition provisions from employment and new independent contractor agreements. Update nonsolicitation, confidentiality, and non-interference clauses to limit any gaps that may be left by the removal of the post-employment noncompetition provisions.
2. Revise forum selection clauses and choice of law clauses in contracts with Minnesota workers that are inconsistent with the new law.
3. Reevaluate deferred compensation programs, including changes to language that may be required for programs and forms. Some employers use deferred compensation programs that are based on incentives tied to an employee behaving in ways that are consistent with the employer's interests. An example is a program by which an employee may earn, or avoid forfeiture of, a deferred compensation award if the employee does not engage in competition. The law change creates a risk that a forfeiture provision of this type could be viewed as inconsistent with Minnesota law if it restricts the employee from pursuing jobs with other similar firms or from working in a particular geographic area.
4. Confirm with employment managers and with departing employees that the employer intends to continue to enforce post-employment noncompetition agreements entered into prior to July 1, 2023. It could be important that managers avoid inadvertent waiver.

Stay diligent

After employers with Minnesota workers ensure that their employment agreement and similar forms have been reviewed and revised to comply with Minnesota's new law, they will be well-advised to monitor the law relating to employee covenants not to compete in the states in which they operate for changes of the type seen this year in Minnesota. The landscape in this area is ever-shifting. ■

Please note that this article is not intended as legal advice for any particular situation. An employer confronting these issues should consult with competent counsel for guidance.