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FAQs: Colorado Further Limits Restrictive Covenants

Services

Labor & Employment

Non-Competes & Restrictive Covenants

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Last week, Colorado's General Assembly passed major revisions to Colorado's statutory limitations on restrictive covenants, which include covenants limiting competition, the solicitation of customers, and the use and disclosure of confidential information. In recent years, many states and the federal government have applied increased scrutiny to employers' aggressive use of restrictive covenants and their potential negative impact on competition and wage growth. While never approaching California's near complete ban on restrictive covenants, Colorado was already among the states most protective of employees' rights to earn a living in their chosen fields and held a narrow view regarding the enforceability of restrictive covenants. Under C.R.S. § 8-2-113, Colorado had for decades declared noncompetes and nonsolicitation of customer covenants void unless one of four exceptions were met, and even then, only if the covenants were reasonable with respect to duration, scope and geography. Colorado's update to its law, assuming it is signed by Governor Polis as expected, will solidify its status as one of the most difficult states in which to enter enforceable restrictive covenants.

The new law does not ban restrictive covenants, but it does create obstacles to their enforcement, some of which will be surprising and less than intuitive. Multistate employers are likely to be frustrated by some of the more unique provisions, such as separate notice provisions that if not met, void the agreements. We have prepared the following FAQs to summarize the key elements of the changes that employers with Colorado-based workers should know as they update their agreements.

1. Does the new law void existing agreements with restrictive covenants?

No. The new law restricts covenants not to compete entered or renewed after the effective date, which is August 8, 2022, assuming the law is signed by the

Governor and no referendum petition is filed. Employees with covenants pre-dating the effective date will be subject to different restrictions than employees with covenants that post-date the law. Employees often depart in groups, meaning that two employees engaging in the same conduct and working for the same employer may have different outcomes depending on when they signed their employment agreements.

2. Are covenants not to compete still allowed?

Yes, but with significant limitations. As under the current law, the new law voids covenants not to compete unless a specific exception is met. The new law further limits the exceptions.

The new law's primary exception is for persons who earn annualized cash compensation as "Highly Compensated Workers" (currently $101,250) when the covenant is "for the protection of trade secrets and is no broader than is reasonably necessary to protect the employer's legitimate interest in protecting trade secrets." This exception appears to be a slight restriction on the current law's trade secret exception. The interpretation of "for the protection of trade secrets" will remain a hotly contested issue in litigation.

While the income threshold may seem to introduce a new barrier to enforcement, in practice, it was unlikely that restrictive covenants against employees making less than that amount were enforceable even under the old law. This new bright-line threshold provides clarity and is a major improvement over current law.

The new law continues the exceptions for the purchase and sale of a business and for the recovery of training expenses.

3. What change to the law is the most surprising?

The new law's notice requirements will create the biggest obstacles to enforcement. Restrictive covenants are void unless an employer provides separate notice to workers of the terms of the covenants before they accept an offer of employment, or 14 days before the covenant goes into effect for current employees. In other words, even when a restrictive covenant is appropriately limited in scope, duration and geography, narrowly tailored to an employer's legitimate business interest, and fits within one of the statutory exceptions, the agreement could still be declared void if it is not presented to workers in the correct format.

Agreements with restrictive covenants must be accompanied by a notice, signed by the worker and contained in a separate document, that describes the covenant in "clear and conspicuous terms." The notice requirements are met by (a) providing a copy of the agreement; (b) identifying the agreement by name; (c) stating that the agreement contains a covenant not to compete that could restrict the workers' options for subsequent employment following their separation from the employer; and (d)

directing the worker to the specific sections or paragraphs of the agreement that contain the covenant not to compete.

Employers will be surprised that the General Assembly thought it worthwhile to dictate how Highly Compensated Workers, who presumably have the capacity to understand their employment agreements, receive notice about their restrictive covenants. Multistate employers, who are not subject to these kinds of requirements in other jurisdictions, will be frustrated by this tripwire to enforcement. As with other recent changes in Colorado law (such as the compensation job posting requirements), the new law places a premium on the professionalism of human resource departments and their implementation of best practices.

4. What happened to the executive exception?

The General Assembly eliminated the exception for the poorly-understood, frequently-litigated exception for "executives and management personnel and officers and employees who constitute professional staff to executive and management personnel." Whatever the wisdom of this change, Colorado employers must now draft their agreements to protect trade secrets and ensure that their employees meet the Highly Compensated Worker compensation threshold.

5. How is annual cash compensation calculated?

The Colorado Division of Labor Standards and Statistics within the Department of Labor already publishes its calculation for Highly Compensated Employees in the annual PayCalc Order. *7 C.C.R. 1103-1*. We are assuming the Division will treat Highly Compensated Employees as the same as Highly Compensated Workers. For 2022, the threshold was $101,250. The threshold can be determined by the employee's current pay or the pay at the time the agreement was entered.

6. Are nonsolicitation covenants covered?

Well-drafted employment agreements containing restrictive covenants typically include a noncompetition covenant – *i.e.* a general ban on any competitive activities for a period of time – and two kinds of nonsolicitation covenants, one for customers and one for employees. Under the new Colorado law, non-solicitation of customer covenants are permitted so long as the person is earning at least 60% of the Highly Compensated Worker threshold. The inclusion of this provision was a commonsense addition recognizing that sales people in particular should retain access to confidential information in performing their roles, and that confidential information is typically broader in scope than trade secrets.

The new law does not address the second type of nonsolicitation covenant, the nonsolicitation of employees. Presumably those covenants are still enforceable as they are not a covenant not to compete. Courts have historically been more likely to enforce these anti-raiding provisions than other

restrictions, and the new law provides no textual restrictions that would cause employers to believe these restrictions are unenforceable.

7. Are confidentiality covenants permitted?

Reasonable confidentiality provisions are allowed. The new law specifies that a confidentiality provision may not prohibit the disclosure of information that arises from the worker's general training, knowledge, skill or experience; information that is readily ascertainable to the public; or information that a worker otherwise has a right to disclose as legally protected conduct. This addition appears to be a codification of already existing law that limits overly broad confidentiality provisions and likely will not have a significant impact on an employer's efforts to protect their confidential information.

8. Are choice of law and venue selection provisions outside Colorado enforceable?

No. When a worker resides *and* works "primarily" in Colorado, Colorado law will govern. For workers who reside *or* work "primarily" in Colorado, the venue for adjudication of disputes must be in Colorado.

With the recent explosion of remote workers, this provision seems likely to be hotly litigated. For example, if an employee resides in Colorado but provides services to customers mainly outside Colorado, courts will be forced to determine if the worker both resides and works primarily in Colorado. The particular facts of each dispute will likely determine the outcome.

9. Are there penalties for unwary employers?

Yes. In what might be best described as a poison pill deterring aggressive HR practices and litigation, employers that present or attempt to enforce an unenforceable covenant not to compete are liable for actual damages and a penalty of $5,000. Employees can also recover their attorneys' fees. Courts, in their sound discretion, may decline or reduce the award or penalty if the employer acted in good faith and had reasonable grounds to believe they were not in violation of the law.

10. Does the new law apply to restrictive covenants with independent contractors?

Presumably yes. The new law interchangeably uses the terms "worker," "employer" and "employment," while the old law was focused only on employees and employers. Give the General Assembly's recent sensitivity to the distinction between employees and independent contractors, it appears this law will apply to all types of workers, including independent contractors. This expansion may have the most impact on partnership agreements and operating agreements among members of a limited liability corporation, where there is now no question that Colorado's aversion to covenants not to compete goes beyond just the employment setting.

Contact us

If you have any questions on how Colorado's revised statutory limitations on restrictive covenants impacts your business or other Labor & Employment questions, contact Barbara Grandjean, Ashley Jordaan, Chris Ottele, Owen Davis or your Husch Blackwell attorney.