

Colorado Poised to Further Limit Use of Non-Compete Agreements, Raise Penalties for Non-Compliance

By

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On May 3, 2022, the Colorado Senate passed [House Bill 22-1317](#) which, if enacted into law, would significantly limit the enforceability of any non-compete agreements executed after the law's effective date for employers with employees working *or living* in Colorado.

If Governor Jared Polis signs the proposed legislation, it could go into effect as early as August 10, 2022.

What Changes Would Occur?

Exceptions to General Non-Compete Prohibition

Most significantly, the bill would amend Colorado's non-compete statute, C.R.S. § 8-2-113, to eliminate most of the current exceptions to Colorado's general rule voiding most non-compete agreements. It also would make enforcement of the permitted agreements much more difficult.

The new law would eliminate the exception permitting non-compete agreements involving managers, executives, or professional staff to managers or executives, as well as the exception permitting agreements deemed necessary solely for the protection of trade secrets.

Under the new law, exceptions to the general rule will exist only for two types of agreements:

1. Those involving "highly compensated employees" (HCEs) (currently, those earning at least \$101,250), but only where the covenant in question was designed to protect trade secrets; and
2. Covenants for the non-solicitation of customers for employees earning over 60 percent of the HCE salary threshold.

For both types of agreements, the new law would require that the salary threshold be met *both* at the time the contract was executed *and* "at the time [the covenant] is enforced," which could be a reference to the employee's compensation with their next employer. This latter requirement could make enforcement unpredictably difficult, as a high wage-earner could backload the timing of their compensation with a new employer, such that their compensation falls below the required minimum HCE salary threshold during the restricted period that the covenant would otherwise be enforceable.

Employers may take some solace in that HB 22-1317 adds an exception, permitting general confidentiality provisions relevant to the company's business. The amended law also would maintain the existing exceptions for agreements related to the purchase or sale of the company and to those involving the recoupment of "educational and training" expenses.

With respect to this latter exception, HB 22-1317 clarifies that a company may only provide for recovery of the prorated amount of such expenses for employees that leave within two years of receiving such training and provided that the recoupment would not violate the Fair Labor Standards Act. Finally, as is currently the case, covenants falling within one of the exceptions will be enforceable only if deemed reasonable in geographic and temporal scope.

Notice Requirements

HB 22-1317 requires the employer to provide the employee with a *separate*, written notice of the non-compete covenant(s) and their terms, and such notice also must be signed by the employee. Failure to qualify for one of the provided exceptions, failure to craft a covenant to be “reasonable” in geographical or temporal scope, or failure to provide the required written notice would render the covenant *void*.

Potential Liability for Void Non-Compete Covenants

Aside from the obvious practical effect of rendering a non-compete covenant unenforceable, a determination that the covenant is void could expose the company to significant financial liability. HB 22-1317 provides that employers may not “enter into, present to a worker or prospective worker as a term of employment, or attempt to enforce[,] any covenant not to compete that is void.” Employers that violate this provision may be found liable for actual damages, reasonable costs, attorneys’ fees, and statutory penalties of up to \$5,000 “per worker or prospective worker harmed by the conduct.” However, the statutory penalties (but not the actual damages, costs, or fees) may be reduced or eliminated upon the employer’s showing of a good-faith and reasonable belief that its acts or omissions were not violative of the law.

The available potential damages, costs, and penalties, together with the minimum salary and written notice requirements, present a particularly troublesome conundrum for employers, given that the salary threshold must be met both at the time of contract execution and at the time the covenant is enforced, the latter event typically occurring well after the former. Absent reliable information regarding the employee’s new salary, employers would be well-advised to exercise caution before seeking to enforce any such covenant.

Forum Selection and Choice of Law Clauses

Under HB 22-1317, a forum selection clause that designates any jurisdiction other than Colorado would be unenforceable as to any employee who, at the time of termination of employment, primarily worked *or* resided in Colorado. Similarly, a choice-of-law provision designating anything other than Colorado law would be unenforceable as to any employee who, at the time of termination of employment, primarily resided *and* worked in Colorado.

The timing issue here is important to both Colorado and non-Colorado employers. For instance, if, after the effective date of this bill, an employer executed an agreement with an employee who lived and (or) worked in another state and who thereafter moved to or primarily worked in Colorado, then that could render unenforceable the existing forum-selection or choice-of-law clauses relating to the covenants. Likewise, companies with work locations in neighboring states that employ Colorado-based employees would need to assess the enforceability of forum-selection clauses in such employees’ contracts that provide for adjudication of the enforceability of such covenants in those neighboring states.

Criminal Penalties, Declaratory Judgment, Injunctive Relief

HB 22-1317 provides that it will be a Class 2 misdemeanor for a person to “use force, threats, or other means of intimidation to prevent any person from engaging in any lawful occupation at any place the person sees fit.” It is unclear whether a threat of litigation concerning a questionably enforceable covenant would constitute such a “threat.” In addition, the bill provides employees the right to request a declaratory judgment that a given covenant is void or unenforceable, as well as injunctive relief to prevent the enforcement of such covenants.

What Remains the Same?

In addition to retaining certain of the current exceptions, HB 22-1317 expressly states that the law would not affect existing state or federal case law in effect before the bill’s effective date regarding “what counts as a covenant not to compete” or that specifies the reasonableness of the scope of covenants not to compete (in terms of the duration and geographic scope) for the protection of trade secrets. Regarding the definition of a “covenant not to compete,” Colorado courts generally have held that customer non-solicitation agreements (by which an employee agrees not to solicit their former employer’s customers on behalf of their new employer) are subject to the same scrutiny as are true non-competes, which prohibit the employee from working for a competitor. *Phoenix Capital, Inc. v. Dowell*, 176 P.3d 835, 844 (Colo. App. 2007). Colorado courts have treated the “reasonableness” test for covenants not to compete as a fact-intensive question and this will not change under the bill.

The Takeaway

Importantly, HB 22-1317 has not yet been signed into law. However, if enacted as it currently exists, Colorado employers will need to ensure they comply with the increasingly stringent law on non-compete agreements.

Jackson Lewis attorneys will continue to monitor the status of this bill and will provide updates as warranted. In the meantime, if you have any questions regarding HB 22-1317, Colorado non-compete law, or anything else regarding restrictive covenants, please contact the Jackson Lewis attorney(s) with whom you regularly work or one of the authors of this article.

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