STATUTORY BAN ON NON-SOLICITATION PROVISIONS BETWEEN SERVICE PROVIDERS AND CUSTOMERS

By Cody Nickel

On July 1, 2023, Minnesota became the fourth state to ban non-compete agreements. This past session, in S.F. 3852, the legislature sought to close a loophole it had identified in the 2023 ban: non-solicitation provisions between service providers and their customers, referred to by some as "shadow" non-compete agreements.

Effective July 1, 2024, this legislation banned the inclusion of restrictive employment covenants in contracts between service providers and their customers. Minn Stat. § 181.9881, Subd. 1, 2(a). The provision is retroactive. Any existing provision in violation of this statute is void and unenforceable. Minn. Stat. § 181.9881, Subd. 2(b). Furthermore, service providers with any such existing provisions have an affirmative obligation to inform their employees of this section and to notify them of the violative provision. Minn. Stat. § 181.9881, Subd. 2(c). This prohibition is not applicable to workers providing business consulting for computer software development and related services who are seeking employment through a service provider with the knowledge and intention of being considered for a permanent position of employment with the customer as their employer at a later date. Minn. Stat. 181.9881, Subd. 3.

In summary, this statute prohibits companies that perform services from including restrictions in their agreements with their customers, stating that the customers shall not hire the company's employees or independent contractors. The definition of "service providers" is very broad and includes any company that provides services, subject to the limited exception noted above.

According to the law's proponents, shadow non-competes limit the mobility of employees, often without their consent or knowledge. The statute's purpose was to promote freedom of choice and workplace mobility for employees, as well as to permit customers to have freedom in choosing their service providers without the risk of losing experienced staff. For example, one proponent of the new provision testified that due to shadow non-competes, a homeowner's association looking to hire a new property management company could not retain its staff directly or indirectly through a new property management company without risking litigation. The employees of the property management company were unaware these restrictions existed; they did not know they could not remain with the association if they so chose due to the ban in the contract between the management company and the association.

However, this new legislation introduced some uncertainty in industries that provide labor to customers, such as staffing and temp agencies, construction labor, or certain healthcare industries, such as travel nurse agencies. Prior to the enactment of section 181.9881, it was common in these industries to include provisions that restrict their customers from simply hiring away the workers that they provide. These staffing agencies view such restrictions as a necessary measure to ensure they are paid for their services and that their customers do not simply cut them out of the deal.

It seems clear from the statutory text that section 181.9881 will prevent staffing companies from enforcing contractual provisions that prohibit their customers from hiring their employees. What is less clear is whether any other provision regarding the hiring of their employees will be enforceable. Take, for example, a temp agency that has contracts which state the customer is free to hire the temp workers it places at any time, but if the customer does so, the agency is entitled to a hiring fee. The statute prohibits any restrictions on customers from directly or indirectly soliciting or hiring employees of service providers. The statutory ban is a total prohibition and makes no exceptions for reasonable or necessary restrictions. Accordingly, the validity of such provisions will rest entirely upon whether Minnesota courts determine they are restrictions on the customer.

Service providers will likely argue that provisions such as hiring fees are not restrictions because customers are free to hire the employees at any time, and simply must pay an agreed-upon fee just like any other business arrangement. However, a customer seeking to avoid enforcement of such provisions would likely respond that a contract with an unreasonable hiring fee would be the same as an outright ban, and thus, any such fee is a restriction of some amount, even if nominal, and thus prohibited by the statute.

As of the writing of this article, there are no decisions from Minnesota's appellate courts interpreting this statute. Furthermore, opinions addressing restrictive covenants more generally will likely be unhelpful in interpreting section 181.9881, as the question is whether the contractual provision is a restriction on the customer, not the employee.

Accordingly, litigation is likely to arise because of questions left open by the ban on non-solicitation agreements between service providers and their customers. Courts will likely be called upon in the near future to address these questions and to provide guidance to Minnesota employers, particularly those in the staffing industry.

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