Lessons to be Learned: Federal Appeals Court Strikes Down Non-Compete Provision and Limits Non-Solicitation Provision

Insights
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A federal appeals recently addressed two important questions in a critical restrictive covenant case, providing important guidance for employers drafting non-compete and non-solicitation provisions and underscoring how the law in some states can narrow their reach. Specifically, the Eighth Circuit Court of Appeals ruled that a South Dakota non-compete provision was unenforceable following termination of an Employment Agreement and limited the reach of a non-solicitation provision that, among other things, prohibited the servicing of unsolicited business. What can you learn from the ruling, regardless of your business location?

Brief History and Background

The underlying dispute arose after the plaintiff Cara Miller filed a declaratory judgment action against her former employer in September 2020 seeking to have the restrictive covenants in her "various employment contracts" declared unenforceable. She began her employment with the defendant Honkamp Krueger Financial Services, Inc. (HKFSI) in 2006 as a financial advisor and signed an employment agreement that included non-compete and non-solicitation provisions. In July 2016, Miller signed an "Ancillary Agreement" that updated the non-solicitation provision but did not include a non-compete provision. On September 4, 2020, HKFSI was acquired by another entity. That same day, Miller terminated her employment and immediately began working for a direct competitor (Mariner Wealth Advisors). On September 7, 2020, Miller provided written notice to HKFSI that she was terminating her employment agreement.

After Miller filed her declaratory judgment action, HKFSI filed counterclaims against her and a third-party claim against Mariner, seeking a preliminary injunction to block Miller from continuing in her new role. The lower court granted a preliminary injunction, finding that HKFSI would likely prevail on its breach of contract claim against Miller. Miller and Mariner appealed the court's ruling to the Eighth Circuit Court of Appeals, which handed HKFSI a loss in its August 24 decision.

The Court's Opinion

The Eighth Circuit considered the arguments of Miller and Mariner that the non-compete provision was unenforceable – namely that "the Ancillary Agreement, which did not contain a non-compete provision, superseded the non-compete provision in the Employment Agreement" and that "the non-

compete provision did not survive her termination of the Employment Agreement." The non-compete provision of the employment agreement provided:

> Employee further covenants that for a period of one year following the termination of Employee's employment for whatever reason, Employee will not, within the Company's market area, directly or indirectly, either as a sole proprietor, partner, stockholder, director, officer, employee, consultant or in any other capacity, conduct or engage in, or be interested in or associated with, any person or entity which engages in the "Business" (as defined above), working with CPA firms. For purposes of this Paragraph, the "Company's market area" includes, but is not limited to, any state in which HKFS has conducted business at any time in the preceding twelve months.

The Court of Appeals noted that the non-compete provision survived the termination of Miller's employment but found there "is nothing in the non-compete provision to suggest the parties intended it to survive the termination of the Employment Agreement." The Court also noted that "the contract treats the term of employment and the term of the Employment Agreement as two distinct concepts." The Court of Appeals ended by stating that while HKFS may have intended the term of employment and term of agreement "to be coextensive" the contract language is unambiguous and would not be rewritten by the Court. Even if the language was ambiguous, the Court stated that it would have to be construed in Miller's favor under Iowa law. Thus, the Eighth Circuit found the District Court erred by concluding HKFS was likely to prevail on the merits of the breach of contract claim with respect to the non-compete provision and by enjoining Miller from violating that provision.

Next, the Eighth Circuit turned to consider the argument of Miller and Mariner that the non-solicitation provision "impermissibly prohibits Miller from accepting unsolicited business from her former clients." The non-solicitation provision in the Ancillary Agreement stated:

Notwithstanding and in addition to the above, during Employee's employment and for a period of two years after he/she ceases to be employed by Employer, Employee shall not, directly or indirectly, solicit, accept or divert business from, provide, or attempt to convert to other methods of using, the same or similar products or services provided by Employer, any client, account or location of Employer with which Employee has had any contact as a result of his/her employment either before or after the date hereof by Employer, including clients with respect to whom Employee performed professional services prior to his/her employment with Employer.

After examining the non-solicitation provision, the Court of Appeals examined South Dakota's choice of law rules and determined that the Ancillary Agreement's choice of Iowa law would prevail unless it violated the public policy of forum state. In examining South Dakota law, the Eighth Circuit found that that non-solicitation provision was unenforceable as a restraint of trade under state law to the extent it prohibited Miller from accepting unsolicited business. Consequently, the Court of Appeals found that "HKFS is therefore unable to prevail on its breach of contract claim to the extent that it

relied on Miller's acceptance of unsolicited business" and reversed the District Court's preliminary injunction blocking Miller from violating the non-solicitation provision.

What Does this Decision Mean for Your Business?

The Eighth Circuit's decision directly impacts employers in Arkansas, Iowa, Minnesota, Missouri

Nebraska, North Dakota, and South Dakota – but it underscores the importance for employers across the country to carefully draft restrictive covenants and protect against challenges to enforceability raised by departed employees. For example, the survivability of non-compete, non-solicitation, and non-disclosure provisions following termination of employment and the employment agreement should be stated in unequivocal terms to preclude an effective argument that the contract language is ambiguous (ambiguous contract terms are generally construed against the employer). In addition, since state restrictive covenant law varies and is rapidly evolving, you must consider how a stipulated choice of law may play in states with statutory provisions (or judicial decisions) that limit the reach of non-compete and/or non-solicitation provisions.

We will monitor these developments and provide updates as warranted, so make sure that you are subscribed to Fisher Phillips' Insights to get the most up-to-date information direct to your inbox. If you have further questions, contact your Fisher Phillips attorney, the author of this Insight, or any attorney in our Employee Defection and Trade Secrets Practice Group.

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