Is My Noncompete With An Independent Contractor Enforceable?

Insights
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[Ed. note: This entry ran on our firm's fantastic Non-Compete And Trade Secrets Blog last week, and I thought it would be of interest to gig businesses and those advising gig businesses. It's an interesting concept we have not yet discussed on this blog, and I'm sure it will come up more frequently in the coming years. My thanks to author Kevin Burns for agreeing to our re-posting it here, and of course for writing it in the first place.]

The 8th Circuit Court of Appeals recently addressed this question in *Ag Spectrum Co. v. Elder*, Case No. 16-3113 (8th Cir. August 2, 2017). In that case, Ag Spectrum contracted with Vaughn Elder to work as an independent contractor. Elder also agreed to a three-year non-compete whereby he would not compete with Ag Spectrum by "marketing to, selling to, or consulting with its customers about similar products for three years after terminating the Agreement." Elder argued that the Agreement was unenforceable under Iowa law.

The 8th Circuit agreed, affirming the lower court's decision finding the non-compete unenforceable. Notably, the court did not hold that non-compete provisions with independent contractors are unenforceable *per se*, expressly rejecting Elder's argument. Rather, the court engaged in a fact-intensive inquiry determining that the non-compete was unreasonable under Iowa law. For one, the non-compete was unnecessary to protect Ag Spectrum's business. Elder did not have an "advantage" over Ag Spectrum as a result of confidential information or training provided by Ag Spectrum that would allow him "to unfairly compete against Ag Spectrum." Ag Spectrum only provided minimum support to Elder as he merely "bought Ag Spectrum product and sold it at a markup." Elder also did not benefit from Ag Spectrum's goodwill and customer base because he developed the customers, not Ag Spectrum. Lastly, the burden on Elder was "out of proportion" with the benefit to Ag Spectrum. Elder would have to "build a customer base from scratch" – a customer base he had developed over the course of his career.

The key takeaway from *Elder* for employers is not simply that a non-compete with an independent contractor was held unenforceable. The court refused to invalidate the non-compete on that basis alone. The takeaway is in why the non-compete was unenforceable. Elder was running his own business and merely selling the company's product at a "markup" to a customer base he had developed himself; i.e., no one handed him an existing book of business of client list. Under these circumstances, the non-compete was found to be unreasonable and unenforceable.

Employers who are considering whether to enter into a non-compete with an independent contractor may want to consider the facts in *Elder*. To how much confidential information will the independent contractor have access? Will the contractor interact with the customer base and who is responsible for developing those customers? Was the contractor provided sophisticated training on the employers' business model? Employers might also consider the level of protection they legitimately need. Is a full-blown non-compete necessary to protect my business interests or will a well-drafted non-solicit or nondisclosure agreement sufficiently protect them? Finally, companies will want to consider and then re-consider whether the independent contractor is properly classified in the first place. If not, even if the non-compete is ultimately deemed enforceable, the employer may be facing counterclaims, including claims for penalties and attorneys' fees, for violations of federal and state wage laws.