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A Colorado court in *Phoenix Capital, Inc. v. Dowell* provides guidance on several open issues concerning the enforcement of covenants not to compete, covenants not to solicit employees, and covenants not to solicit customers. Colorado employers should review their noncompete agreements for enforceability in light of the court's decision.

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A Littler Mendelson Newsletter specifically for the Unfair Competition and Trade Secrets Industry

Colorado Court Clarifies When Covenants Not to Compete and Solicit Customers and Employees May Be Enforced Against Executives, Managers and Their Professional Staff

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Like many states, Colorado will not enforce a covenant not to compete unless it fits within a specific exception to the general rule of unenforceability. Unlike most states, however, Colorado permits agreements not to compete with executives, management level employees, or "professional staff to executive and management level personnel" even if the employer is unable to show that the employee possesses trade secrets. Colo. Rev. Stat. § 8-2-113(2)(d).

The Colorado Court of Appeals in *Phoenix Capital, Inc. v. Dowell*, 2007 Colo. App. LEXIS 1401, (Colo. App. July 26, 2007) provided much needed guidance concerning: (1) the applicability of the "executive or management" exception to individuals who become executives or managers only after signing an agreement not to compete; (2) the meaning of the phrase "professional staff to executive and management personnel;" (3) whether Colorado's noncompete statute applies to covenants not to solicit customers; and (4) whether Colorado's noncompete statute governs covenants not to solicit employees.

Factual and Procedural Background

Phoenix Capital, Inc. (PCI) is an investment bank that provides analytic and brokerage assistance to financial institutions. PCI initially employed defendant Robert Dowell as a senior portfolio analyst. In 2000, Dowell signed an agreement with PCI under which he was prohibited, in the event he left PCI, from competing with PCI or soliciting its customers or employees for one year. In 2002, Dowell was made the head of PCI's analytics division. Soon thereafter, PCI formed PAS, as an independent company, and transferred Dowell to manage its analytics division.

In March 2005, Dowell resigned from PAS to join one of PCI's competitors in forming a new company. In response, PCI and PAS (collectively referred to as "Phoenix") sought to enforce the noncompetition and nonsolicitation provisions in Dowell's employment agreement. After a hearing, the trial court determined that Phoenix had not established a reasonable probability of success on the merits with respect to the non-competition provision. However, the trial court held that Phoenix was entitled to enforce the provisions addressing non-solicitation of customers and non-solicitation of employees. Both parties appealed the trial court's preliminary injunction rulings.

The NonCompetition Provision

A. Operative Date of the Covenant

There is no doubt that Dowell was a management level employee by the time he left his employment. He was not, however, a management level employee at the time he signed the agreement. The question, then, was whether an agreement that is unenforceable at the time it is signed can become enforceable later when the employee is promoted into the managerial ranks. The court in *Phoenix* ruled that it could not. A noncompete agreement that is unenforceable at the time it is signed is void and not merely voidable. It, therefore, cannot be rehabilitated.

In reaching its conclusion that the validity of the agreement is measured at

the time it is signed, the appellate court was careful to point out that employers can enter into new restrictive covenant agreements as employees advance. Therefore, Colorado employers are wise to enter into new agreements with employees as they are promoted into the managerial or executive ranks.

The fact that Dowell was not an executive or management level employee at the time he signed the agreement did not end the inquiry, however. The court of appeals was next tasked with determining whether Dowell fit within the definition of "professional staff to executive and management personnel" at the time he signed the agreement.

B. Professional Staff to Executive and Management Personnel

In deciphering the meaning of the phrase "professional staff to executive and management personnel," the court began by acknowledging that the purpose of the statutory exception is to protect Colorado employers from the disruption of operations caused by the loss of an employee who has key strategic responsibilities. The court, therefore, came up with a two part test to determine the meaning of "professional staff to executive and management personnel." First, the employee must be a professional. Second, the employee must work with his or her supervisor on developing strategies and business goals rather than merely implementing them.

Applying the analysis to Dowell, the court determined that Dowell reported to management or executive level employees, but that his role was to implement strategic initiatives and business plans, not to develop them. The court, therefore, affirmed the trial court's ruling Dowell did not fit within the definition of "professional staff to executive and management personnel" at the time he signed the agreement not to compete.

Nonsolicitation Provisions

Given that Dowell did not fit within any exceptions to the general rule that covenants not to compete are unenforceable, the *Phoenix* court next had to analyze the enforceability of the covenants not to solicit customers and covenants not to solicit employees contained in his employment agreement. The court ruled that the provision prohibiting solicitation of customers was unenforceable whereas the agreement not to solicit Phoenix's employees was enforceable.

The court reasoned that an agreement not to solicit customers is merely a form of an agreement not to compete. The core policy underlying the unenforceability of noncompetition provisions is a prohibition on the restraint of trade or, as pertinent here, the right to make a living. In order to make a living, former sales employees benefit heavily from being able to solicit former customers. Because Dowell did not fit within any of the statutory exceptions that permit agreements not to compete, the agreement not to solicit customers was void.

On the other hand, agreements not to solicit employees do not directly impair a former employee's ability to make a living. Thus, the court concluded that the noncompete statute was not meant to apply to agreements not to solicit former coworkers, and upheld the validity of that agreement.

Practical Effects For Employers

Colorado employers should have employees sign new agreements as they rise into the management ranks within the company. Simply having a nonmanagement employee sign a covenant not to compete agreement at the beginning of his or her employment may ultimately result in the agreement being void. However, agreements prohibiting solicitation of the company's employees may be enforceable even against nonmanagers.

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