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North Dakota Rejects Choice of Law/Forum Selection Provisions for Non-Compete Agreements

Legal Update

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Frequently, the buyer of a business will want to ensure that the seller does not simply take the money from the sale and open up a competing business. To address this problem, buyers usually insist on covenants not to compete to prevent the seller from doing exactly that. North Dakota law broadly prohibits non-compete and non-solicitation provisions in contracts, particularly between employer and employee, but also for anyone entering into such an agreement outside of the employment context. The North Dakota Supreme Court's recent opinion in *Osborne v. Brown & Saenger, Inc.*, 2017 ND 288, takes this prohibition one step further by rejecting the enforcement of contract clauses that choose another state's law and venue in non-compete agreements.

Prohibition on Restraints of Trade

Under North Dakota Century Code § 9-08-06, "every contract by which anyone is restrained from exercising a lawful profession, trade or business of any kind is to that extent void." The statute contains two exceptions which are very important for buyers of businesses. First, a covenant not to compete is enforceable if it is executed in connection with the sale of the goodwill of a business, but only as to "a specified county, city or part thereof." Second, partners dissolving a partnership may agree to limit conducting business "within the same city where the partnership business has been transacted."

The North Dakota Supreme Court has consistently held covenants not to compete unenforceable under Section 9-08-06. See, e.g., *Werlinger v. Mutual Service Cas. Ins. Co.*, 496 N.W.2d 26 (N.D. 1993); *Spectrum Emergency Care, Inc. v. St. Joseph's Hosp. and Health Center*, 479 N.W.2d 848 (N.D. 1992). Section 9-08-06 has been characterized as representing "one of the oldest and most continuous applications of public policy in contract law" in North Dakota. *Earthworks, Inc. v. Sehn*, 553 N.W.2d 490, 493 (N.D. 1996); see also *Osborne v. Brown & Saenger, Inc.*, 2017 ND 288). Non-solicitation provisions are treated the same as covenants not to compete in the application of Section 9-08-06. See *Warner and Co. v. Solberg*, 2001 ND 156, 634 N.W.2d 65 (2001).

Most of these cases arise in the employment context. Of course, the seller of a business frequently enters into an employment or consulting agreement for some period after the sale, and these cases would apply to such a contract. Even without such an employment agreement, however, these cases would apply so that a covenant not to compete executed as part of an asset or stock purchase would also be subject to these limitations.

Choice of Law and Forum Selection Clauses

In order to try to get around Section 9-08-06, those who wish to limit someone from competing will often insert choice of law and forum selection clauses in non-compete agreements. For example, if a Minnesota company buys a North Dakota business and wishes to keep the seller from competing in North Dakota, and not just one county as allowed by Section 9-08-06, it may provide that Minnesota law governs the agreement and that the parties consent to any disputes under the agreement being determined in Minnesota, which allows non-compete agreements on a much broader basis. The *Osborne* decision flatly rejects that approach.

In *Osborne*, the subject employee was hired by a South Dakota company to work as a sales representative in its Fargo, North Dakota office. The employment contract had non-compete and non-solicitation provisions, along with a South Dakota choice of law and forum selection provision. In a unanimous decision, the North Dakota Supreme Court refused to enforce the choice of law and forum selection provision, applied North Dakota law and held that the non-compete and non-solicitation provisions were unenforceable under Section 9-08-06:

Simply put, one may not contract for application of another state's law or forum if the natural result is to allow enforcement of a non-compete agreement in violation of North Dakota's longstanding and strong public policy against non-compete agreements. Because North Dakota has an interest in protecting this public policy from evasion and North Dakota courts are more familiar with North Dakota law and public policy on non-compete agreements, we hold the Choice of Law/Forum clause is unenforceable in the context of Osborne's declaratory judgment claim. Further, we hold that the non-compete clause is unenforceable under § 9-08-06 to the extent it limits Osborne from exercising a lawful profession, trade or business in North Dakota.

Id. ¶16.

Impact of Osborne Decision

The *Osborne* decision both affirms the long-standing public policy of the state against non-compete and non-solicitation provisions and shuts the door on contracting around the issue through choice of law and forum selection provisions attempting to apply the laws of other states to North Dakota citizens in North Dakota. If a non-compete agreement is a material part of a business acquisition

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transaction, the buyer will have to find other ways to assure that the seller cannot compete as soon as the deal is closed. That task is not as simple as just applying the law of a more buyer-friendly state.