Efficiently Resolving Non-Compete Cases Via Declaratory Judgment Actions in Colorado

By Patricia S. Bellac

Last year, our law firm participated in a declaratory judgment proceeding in which the question of the enforceability of a non-compete agreement was resolved on motion for declaratory judgment before any discovery was taken by either side. Particularly in a case where a former employee is threatened with an injunction, or her new employer is possibly liable for damages, resolving this controversy quickly and efficiently is in the interests of all parties. Employees and their future employers want a definitive answer to the question of whether a non-compete agreement is enforceable, and this question is urgent in terms of the employees' future employment. This article covers how the declaratory judgment trial experience proceeded in our case, the legal standards for the proceedings, and the substantive law regarding non-compete agreements in Colorado.

In recent years, there has been a trend toward requiring all employees of an organization to sign non-competes—even low wage workers with no managerial authority—which agreements prevent them from obtaining future employment. Attorneys General from New York and Illinois, among others, have successfully obtained injunctive relief in the most grievous of cases, on behalf of those workers.[1]

Summary of Recent District Court Case

Our firm represented a physician assistant who had practiced exclusively in dermatology for nearly 20 years.[2] She had been employed with a locally based dermatology practice in Colorado for over ten years before her practice was purchased by a national practice group which required her to sign a non-compete as a condition of continuing employment. She was later transferred to a practice in a remote, rural area, where she relocated with her family. Her work at her former employer consisted almost exclusively of practicing her craft as a physician assistant; she was only very occasionally involved in any marketing or firm management activities. Eventually, she was laid off from that practice for lack of work, and in order to support her family without having to move, she sought and accepted work with another dermatology practice that was within the 50-mile radius proscribed by her non-compete agreement.

After issuance of cease-and-desist letters, her former employer sued our client and her new employer, who was separately represented. The employee was sued for breach of her non-compete agreement and her new employer was sued for tortious interference with contractual relations. An injunction against competition was not expressly pled, however significant damages were sought against both defendants. The initial complaint was filed in late November 2019. Answers and counterclaims were filed in January 2020, including counterclaims for declaratory judgment.

Counsel for the new employer worked with us to obtain declaratory judgment in our mutual favor, declaring the non-compete agreement to be unenforceable against our client.

The non-compete defense strategy centered around obtaining a speedy hearing on the counterclaims for declaratory judgment pursuant to C.R.C.P. 57(m),[3] We requested the Court's guidance as to how to advance this issue on the court's calendar. In early March 2020, the Court issued an order requiring that we file a separate motion for declaratory judgment, which was filed jointly with counsel for her new employer in late March 2020.

The Court held an evidentiary hearing via Web Ex over two separate full days, in May and June 2020. Witnesses included the leaders of both medical practices at issue, our employee client, three patients who had been treated at both locations and had sought out our client's services at her new employer, for various reasons, and administrators from both employers. The Court also received approximately 100 exhibits, the majority of which were stipulated.

Even with delays due to COVID and the need to hold hearings over multiple days and months, the case was resolved in

around nine months without the need for any discovery. Thus, the declaratory judgment proceedings led to final resolution in a speedier and more economical way than if the case had proceeded through discovery and trial.

Legal Authority Regarding Non-Compete Agreements in Colorado

Colo. Rev. Stat. § 8-2-113, titled "Unlawful to intimidate worker – agreement not to compete" states, in relevant part:

> (2) Any covenant not to compete which restricts the right of any person to receive compensation for performance of skilled or unskilled labor for any employer shall be void, but this subsection (2) shall not apply to:
>
> (a) any contract for the purchase and sale of a business or the assets of a business;
>
> (b) protection of trade secrets;
>
> (c) providing for recovery of the expense of educating and training an employee who has served an employer for a period of less than two years;
>
> (d) Executive management personnel and officers and employees who constitute professional staff to executive and management personnel.

These exceptions are intended to be narrowly construed.[4]

Under Colorado law, a non-compete covenant is considered void ab initio unless one of the above exceptions is established by the party seeking to enforce the non-compete.[5] The most commonly applicable exceptions are discussed in more detail below. A covenant that qualifies under one of these exceptions must also be reasonable in terms of duration and geographic scope.[6] To determine reasonableness, the court must examine the terms and circumstances of each case,[7] and thereby determine whether the requirements: 1) are reasonable; 2) do not impose undue hardship on a party; and 3) are no greater than necessary to afford the required protection.[8] Any restriction must be reasonably related to the activities performed by the former employee and cannot restrict an employee from performing activities that are not related to the employment. That said, it is difficult for an employee to prevail on a non-compete case by arguing that the covenant is overbroad or unreasonable. There are no reported cases rejecting a duration of five years or less, few that discuss the proper scope of restricted business activities and the only cases in which a covenant not to compete that was enforceable was found to be unreasonable are cases in which the court narrowed the geographical scope of a customer-facing employees' non-compete.[9]

The determination of whether a non-compete is enforceable is made based on the position held **at the time of signing**. If an employee does not qualify under one of the exceptions to the non-compete statute based on their position at the time of signing the non-compete, it is void ab initio and cannot be revived if the employee is later promoted.[10] In that situation, a new non-compete must be signed.

An agreement that only proscribes active solicitation of current employees of a former employer is valid in Colorado and may be enforced even if none of the exceptions to the non-compete statute apply.[11]

Which Law Applies?

Larger, nationally based employers are more likely to require that employees sign non-compete agreements. Those agreements often specify that they are subject to choices of law and venue other than in Colorado. In most states, any restrictive covenant may be enforced if it is reasonable; Colorado is in the minority of states that have enacted statutory restrictions on non-competes.[12] An employee living and working in Colorado may be entitled to the benefit of Colorado's law limiting restrictive covenants despite contrary contractual language contained in the non-compete agreement. The questions considered by the court in this situation are whether the application of the law of the chosen venue would be contrary to a fundamental policy of Colorado and whether Colorado has a materially greater interest in the issue.[13] Colorado has a fundamental policy of voiding noncompete provisions that do not fall within one of the statutory exceptions, and is "clearly different" than that of other states, such as New Jersey, which will enforce any restrictive covenant that is reasonable.[14]

Colorado's Non-Compete Statute Also Precludes Non-Solicitation Agreements

In *Phoenix Capital v. Dowell*, the Colorado Court of Appeals considered whether an agreement by an employee to not solicit customers of the former employer was, by itself, enforceable even if an employee could not otherwise be subjected to a non-compete agreement due to statutory limitations. There, the employee signed a one-year agreement that precluded him from competing with his employer OR soliciting its customers, at a time when he did not hold a management position at the company. He was later promoted but not asked to sign a new agreement.[15] The Phoenix case resulted in two important rulings. First, the validity of a restrictive covenant is determined at the time of signing and if the employee at issue may not be bound by a non-compete at that time, the covenant may

not be later revived by a subsequent promotion or otherwise.[16] The second important ruling is that if an employee does not fall under one of the four statutory exceptions to Colorado's non-compete statute, then that employee may not be enjoined from soliciting customers because the non-solicitation clause also has the effect of restricting a former employee's ability to work for a new employer and is a restraint of trade. Thus, an employee who may not be bound by a non-compete agreement under Colorado law is free to both actively and passively solicit customers of the former employer, provided that the employee does not use the employer's trade secrets to do so.[17]

Distinction Between Temporary Restraining Order and Declaratory Judgment

Many Colorado non-compete cases begin with a motion for temporary restraining order ("TRO"). A motion for TRO may also be made early in the proceedings and if granted, permits the court to *temporarily* order relief related to the restrictive covenant (typically, to enjoin competition by enforcing the non-compete). A preliminary injunction will not be issued unless the trial court finds that the moving party has demonstrated each of the following six factors: (1) the moving party has a reasonable probability of success on the merits; (2) a danger of real, immediate, and irreparable injury exists that may be prevented by injunctive relief; (3) the moving party has no plain, speedy, and adequate remedy at law; (4) the granting of a preliminary injunction will not disserve the public interest; (5) the balance of equities favors granting the injunction; and (6) the injunction will preserve the status quo pending a trial on the merits.[18] Thus, a TRO holds the party seeking this relief to a considerably higher standard than is otherwise applicable AND is only a temporary remedy, pending and anticipating that the parties will engage in discovery and trial as usual. Seeking a TRO is likely to lengthen and increase the costs of litigation, whereas a declaratory judgment, has the full effect of a final judgment on the merits and is quicker than more conventional court proceedings.[19]

Colorado's Declaratory Judgment Act Allows for Speedy Determination of Rights and Duties

Colorado follows the Uniform Declaratory Judgment Act, codified in Colorado Revised Statute § 13-51-101 et seq. Thereunder, declaratory judgments are intended to be remedial, the purpose being to settle and afford relief from uncertainty and insecurity with respect to rights, status and other legal actions. "[I]t is intended to be liberally construed and administered."[20] According to the Act,

> Courts of record within their respective jurisdictions have power to declare rights, status, and other legal relations whether or not further relief is or could be claimed. No action or proceeding shall be open to objection on the ground that a declaratory judgment or decree is prayed for. The declaration may be either affirmative or negative in form and effect; and such declarations shall have the force and effect of a final judgment or decree.[21]

Mirroring the Declaratory Judgment Act, C.R.C.P. 57 provides that

> District and superior courts within their respective jurisdictions shall have power to declare rights, status, and other legal relations whether or not further relief is or could be claimed. No action or proceedings shall be open to objection on the ground that a declaratory judgment or decree is prayed for.[22]

The declaration may be either affirmative or negative in form and effect; and such declarations shall have the force and effect of a final judgment or decree.

Either party can move for declaratory judgment at any time; it is advisable to include a request for declaratory judgment claim in the initial pleadings. There must be a presently existing controversy; the fact that there may arise some controversy in the future is not sufficient to allow a party to invoke the court's declaratory jurisdiction.[23] The ultimate test to determine whether plaintiff may seek a declaratory judgment, therefore, is whether that plaintiff can "demonstrate that there is an existing legal controversy that can be effectively resolved by a declaratory

judgment, and not a mere possibility of a future legal dispute over some issue."[24] In exercising its discretion to determine whether to allow an anticipatory declaratory judgment action to proceed, the trial court applies a three-part test: (1) there must be an actual, justiciable controversy, not the mere possibility of a future controversy; (2) the declaratory judgment must fully and finally resolve the uncertainty and controversy as to all parties to the dispute; and (3) the declaratory action must be independent of and separable from the underlying action.[25]

Declaratory judgment in a case involving the validity of a non-compete agreement may proceed even before discovery occurs if the judge determines that the factual disputes that exist may be resolved at the hearing.[26] The presiding judge has discretion to decide when declaratory judgment may be issued,[27] and cases that present substantial or material factual disputes may require discovery before the judge is willing to consider the motion.[28]

The party requesting relief typically has the burden of proof.[29] However, under Colorado law and in disputes concerning the validity of a non-compete agreement, the burden is on the party seeking to prove that an exception to the general unenforceability of a non-compete agreement applies.[30] In Colorado courts and in cases where a party seeks declaratory judgment that a noncompete clause **does not apply**, it remains unclear if the typical burden of proof would apply to the party seeking the relief or if the abovementioned statute flips the burden to an employer.[31]

In a Rule 57 proceeding, judges are fully empowered to engage in fact-finding and to weigh the credibility of the parties' respective witnesses, to make credibility determinations, where needed.[32] The credibility of the witnesses and the inferences and conclusions to be drawn from the evidence are within the province of the trial court, and its findings will not be disturbed on appeal unless they are manifestly erroneous.[33]

In our case, the judge noted that our client carried the burden of proof because she and her new employer had moved for declaratory judgment. Despite this burden shift, use of this procedure was advantageous to the former employee and her new employer because the judge appeared to take seriously, the reality that the question of enforceability of the restrictive covenant was a significant issue in the business and personal lives of the parties, and was motivated to decide the case so that the parties would be informed regarding their contractual obligations.

Colorado's Trade Secrets Exception

A trade secret, according to the Colorado Uniform Trade Secrets Act (UTSA), C.R.S. §§ 7-74-101 to -110, is:

> [T]he whole or any portion or phase of any scientific or technical information, design, process, procedure, formula, improvement, confidential business or financial information, listing of names, addresses, or telephone numbers, or other information relating to any business or profession which is secret and of value.[34]

"A trade secret 'may consist of any formula, pattern, device, or compilation of information which is used in one's business, and which gives [the possessor] an opportunity to obtain an advantage over competitors who do not know or use it.'"[35] "To be a "trade secret" the owner thereof must have taken measures to prevent the secret from becoming available to persons other than those selected by the owner to have access thereto for limited purposes."[36]

Colorado courts also use a six-factor test, supplementary to the UTSA, to determine whether something qualifies as a "trade secret":

> (1) the extent to which the information is known outside the business;
>
> (2) the extent to which it is known to those inside the business, i.e., by the employees;
>
> (3) the precautions taken by the holder of the trade secret to guard the secrecy of the information;
>
> (4) the savings effected and the value to the holder in having the information as against competitors;
>
> (5) the amount of effort or money expended in obtaining and developing the information; and
>
> (6) the amount of time and expense it would take for others to acquire and duplicate the information. [37]

There are no reported decisions in Colorado addressing the issue of whether a medical database or patient list is a trade secret in Colorado. In other circumstances, Colorado courts have held that a customer list may be a trade secret[38] while a list of potential employers is not. For example, a professional recruiter's—or "headhunter's"—list of employer-clients was held to not be a trade secret because such a list could be ascertained by the public; however, the recruiter's list of possible employee candidates looking for work, was a trade secret in that case.[39] In the United States District Court case *Doubleclick, Inc. v. Paikin,* the District Court noted that a list of customers targeted for a certain sales strategy is a "potential" trade secret, but the existence of other trade secrets was the determining factor in that case, with the court finding that the employer there had met its burden of showing

that the employer had trade secrets and that the former executive employee at issue in that case, knew of them.[40]

In our recent physician assistant case, the district court found that the employee accessed the medical database of the practice on a daily basis but did not access other practice information and had no need to access those items to perform her duties. The employer there relied on *DoubleClick, Management Recruiters of Boulder,* and authorities from other jurisdictions that had expressly decided that the medical "patient list" may be a trade secret. Another fact found, of apparent significance, was that the employer, while asserting the primacy of database access in its claim that the covenant was necessary to protect trade secrets, did not turn off her access after she was terminated, allowing her access until nearly a week after her departure. This fact demonstrated that the employer did not take reasonable measures to keep the information secret, thus undermining the argument of secrecy. Second, there was no testimony or evidence to demonstrate that the employee ever accessed the patient list database at any time other than in the course of her work.

Managerial Employee Exception

Determining whether the "executive and management personnel" exception applies is a question of fact for the court.[41] While there is no clear test to determine whether the "management personnel" exception applies, the court in *McQuate* announcing that the following factors should be considered: 1) whether the employee exercised supervisory capacity or was "in charge"; 2) whether the employee acted in an unsupervised capacity; 3) whether the employee was paid based on production; 4) and whether the employee had hiring or firing capacity.[42] The language of this exception is very loose, however courts have insisted that an employee must have genuine control over management of the business, and/or significant supervisory duties, for this exception to apply.

For example, in *Optimus Corp. v. Starck*,[43] an employee was found to be professional staff where he was a project lead for the company's largest contract, and the company "valued [his] opinions and knowledge, perhaps, above those of any of its other employees;"[44] however, in *ACCU, Inc. v. Hardman*,[45] one of the company's property managers did not meet this exception. In *Digital Globe, Inc. v. Paladino*, [46] the court considered a former employee to fit the management exception due to his high salary, his level and position within the company, his authority to hire, and the extent of the responsibility placed with him to manage a critical aspect of the company's business.[47] In yet another example, the Tenth Circuit Court of Appeals had difficulty ascertaining whether industrial hygienists constituted professional staff when they performed services for their former employer's clients instead of the employer; in the face of that challenge, the court remanded for further analysis.[48]

In our case, the court found that our client performed clinical dermatology services only; she did not manage any aspect of the business. Despite some testimony to the contrary, the court found that she did not have the authority to hire or fire employees, supervise medical assistants or anyone else, conduct performance reviews, discipline employees, initiate performance improvement plans, recommend promotions, demotions or raises, set or implement company policies, or otherwise engage in administrative company functions other than complete patient charts. The fact that the practice she worked in had been purchased by a national management company before she signed the non-compete, may have helped the employee here, to the extent that after the practice was purchased, some management functions were handled by a centralized office established to support the various medical practices owned by the conglomerate interest. While not discussed in the case, being purchased by a national practice would come with an explicit or implicit benefit for the medical practitioners, of no longer having to run the business in addition to practicing medicine.

Conclusion

Colorado's declaratory judgment statute and procedures allow for faster and more economical resolution of the important question of whether a non-compete is enforceable. The controversy presented by a non-compete is significant and relatable, so a presiding judge is likely to prioritize your case on declaratory judgment and assist in bringing it to final resolution. ▲▲▲

Since 1999, Ms. Bellac has owned and managed Patricia S. Bellac Law Firm (PSB Law), which has recently expanded to include three employees. Emphasizing excellence in employment and business law, she brings an extraordinary amount of compassion into her work and experiences joy in helping clients through difficult situations. She has represented thousands of individuals and businesses and brings a balanced and unique perspective to her practice.

Endnotes:

[1] *Non-Compete Agreements: What Every Company and Employee Should Know,* American Bar Association, July 26, 2016 Practice Points (https://www.americanbar.org/groups/litigation/committees/business-torts-unfair-competition/practice/2016/noncompete-agreements/)

[2] The case was decided in Larimer County District Court in August 2020. Because these proceedings did not result in a published decision, we are not publishing the names of the parties or other

identifying information, in this article. Additional information may be provided upon request to the undersigned.

[3] COLO. R. CIV. PROC. 57(m) states, in pertinent part, that "[t]he court may order a speedy hearing of an action for a declaratory judgment and may advance it on the calendar."

[4] *See Phoenix Cap., Inc. v. Dowell,* 176 P.3d 835, 842 (Colo. App. 2007).

[5] C.R.S. § 8-2-113(2)(a)-(d).

[6] *Nat'l Graphics Co. v. Dilley*, 681 P.2d 546, 547 (Colo. 1984).

[7] *Knoebel Mercantile Co. v. Siders*, 439 P.2d 356, 358 (Colo. 1968); *see Mgmt. Recruiters of Boulder, Inc. v. Miller*, 762 P.2d 763, 766 (Colo. App. 1988).

[8] *Whittenberg v. Williams*, 135 P.2d 228, 229 (Colo. 1943).

[9] *Rocky Mountain Chocolate Factory, Inc. v. SDMS*, Inc., No. 06-CV-01212-WYD-BNB, 2006 WL 8251823, at *4 (D. Colo. Dec. 8, 2006); *see Gulick v. A. Robert Strawn & Assocs., Inc.*, 477 P.2d 489, 493 (Colo. App. 1970) (upholding a trial court's reformation of a non-compete agreement that restricted competition from 35 miles outside of Denver to just 10 miles).

[10] "Covenants not to compete, with some narrow exceptions, are contrary to the public policy of Colorado and are void." *DBA Enters., Inc. v. Findlay,* 923 P.2d 298, 302 (Colo. App. 1996).

[11] *Phoenix Cap., Inc. v. Dowell,* 176 P.3d 835, 844 (Colo. App. 2007); *Atmel Corp. v. Vitesse Semiconductor Corp.*, 30 P.3d 789, 796 (Colo. App. 2001), *abrogated in part on other grounds by Ingold v. AIMCO/Bluffs, L.L.C. Apartments*, 159 P.3d 116 (Colo. 2007).

[12] State Surveys 23, Non-Compete Agreements, November 2020, available at www.faircompetitionlaw.com/wp-content/uploads/2020/12/Noncompetes-50-State-Survey-Chart-20201218.pdf.

[13] RESTATEMENT (SECOND) OF CONFLICT OF LAWS *187; See Haggard v. Synthes Spine, 2009 U.S.Dist LEXIS 54818 *11* (D.Colo. June 12, 2009)(application of Pennsylvania law could violate fundamental public policy of Colorado; *cf. American Exp. Fin. Advisors, Inc. v. Topel,* 38 F. Supp. 2d 1233, 1238 (D. Colo. 1999) (enforcement of Minnesota law did not violate Colorado fundamental policy because the trade secret exception to the Colorado non-compete statute applied).

[14] *King v. PA Consulting Grp., Inc.*, 485 F.3d 577, 586–87 (10th Cir. 2007).

[15] *Phoenix Cap., Inc.*, 176 P.3d at 838.

[16] *Id.* at 840.

[17] *Id.* at 844.

[18] *Rathke v. MacFarlane,* 648 P.2d 648, 653–54 (Colo.1982); *see Bloom v. Nat'l Collegiate Athletic Ass'n,* 93 P.3d 621, 623 (Colo. App. 2004) (applying the six-part test of *Rathke v. MacFarlane*).

[19] *Patton v. Denver Post Corp.*, 379 F. Supp.2d 1114, 1116 (2005).

[20] C.R.S. § 13-51-102.

[21] C.R.S. § 13-51-105.

[22] COLO. R. CIV. PROC. 57(a).

[23] *Cmty. Tele-Commc'ns, Inc. v. Heather Corp.*, 677 P.2d 330, 335 (Colo. 1984).

[24] *Bd. of Cty. Comm'rs, La Plata Cty. v. Bowen/Edwards Assocs., Inc.*, 830 P.2d 1045, 1053 (Colo. 1992); *see also Villa Sierra Condominium Ass'n v. Field Corp.*, 878 P.2d 161, 164 (Colo. App. 1994) (declaring that the ultimate test of whether a matter can be decided using declaratory judgment is by determining if there is a current, existing legal controversy).

[25] *Grange Ins. Ass'n v. Hoehne*, 56 P.3d 111, 112 (Colo. App. 2002).

[26] COLO. R. CIV. PROC. 57(c), (i).

[27] C.R.S. § 13-51-110.

[28] *See Stanczyk v. Poudre Sch. Dist. R-1*, 2020 COA 27M, ¶ 75, *cert. granted*, No. 20SC269, 2020 WL 4344546 (Colo. June 27, 2020) (indicating that declaratory judgment was premature in a case containing unresolved, material factual disputes).

[29] *Cont'l Air Lines, Inc. v. Keenan*, 731 P.2d 708, 712 (Colo. 1987).

[30] *See* C.R.S. § 8-2-113.

[31] *Cf. Haggard v. Spine*, No. 09-CV-00721CMAKMT, 2009 WL 1655030, at *5 (D. Colo. June 12, 2009) (noting that in a federal case in which a former employee sought declaratory judgment, the burden of proof to show that the contract was enforceable switched to the defendant employer).

[32] *Morris v. Belfor USA Grp., Inc.*, 201 P.3d 1253, 1258 (Colo. App. 2008).

[33] *Id*.

[34] C.R.S. § 7-74-102.

[35] *Doubleclick Inc. v. Paikin*, 402 F. Supp. 2d 1251, 1257–58 (D. Colo. 2005) (citations omitted).

[36] C.R.S. § 7-74-102(4); *Hawg Tools, LLC v. Newsco Int'l Energy Servs., Inc.*, 411 P.3d 1126, 1134 (Colo. App. 2016), *as modified on denial of reh'g* (Jan. 12, 2017).

[37] *Porter Industries, Inc. v. Higgins*, 680 P.2d 1339, 1341–42 (Colo. App. 1984); *see* RESTATEMENT (THIRD) OF UNFAIR COMPETITION 431–37 (1995).

[38] *Saturn Sys., Inc. v. Militare*, 252 P.3d 516, 521 (Colo. App. 2011).

[39] *Mgmt. Recruiters of Boulder, Inc. v. Miller*, 762 P.2d 763, 765–66 (Colo. App. 1988).

[40] *Doubleclick Inc.*, 402 F. Supp. at 1258.

[41] *See DISH Network Corp. v. Altomari*, 224 P.3d 362, 365 (Colo. App. 2009) (citing to *Phoenix Capital, Inc. v. Dowell*, 176 P.3d 835, 840 (Colo. App. 2007)).

[42] *Wells Fargo Ins. Servs. USA, Inc. v. McQuate*, 276 F. Supp. 3d 1089, 1105 (D. Colo. 2016).

[43] *See Optimus Corp. v. Starck*, No. 07 CV 1103, 2012 WL 5882219 (Colo. Dist. Ct. May 24, 2012).

[44] *Id*. at *9.

[45] *ACCU, Inc. v. Hardman*, No. 2014CV031702, 2015 WL 10014057, at *3 (Colo. Dist. Ct. Dec. 09, 2015).

[46] *Digital Globe, Inc. v. Paladino*, 269 F. Supp. 3d 1112 (D. Colo. 2017).

[47] *Id*. at 1125.

[48] *Occusafe, Inc. v. EG&G Rocky Flats, Inc.*, 54 F.3d 618, 622 (10th Cir. 1995).