Non-Competition Agreements and Trade Secrets

By Craig W. Trepanier, Trepanier MacGillis Battina P.A. and
Laura A. Pfeiffer, Winthrop & Weinstine, P.A.

Minnesota HF 506 (Feb. 11, 2013)

On February 11, 2013, HF 506 was introduced in the Minnesota House of Representatives and referred to the Labor, Workforce, and Regulated Industries Committee. The bill would have voided non-compete agreements except in three situations: (1) the sale of a business' goodwill; (2) the dissolution of a partnership; and (3) the dissolution of a limited liability company. No companion bill was introduced in the State Senate and no hearing was held in the House committee. The 2013-2014 Legislature adjourned sine die without any action taken on HF 506. The Legislature convened for a new Legislative Session on January 5, 2015. As of January 28, 2015, a similar bill to HF 506 had not be introduced in the House or Senate. It remains unclear whether such a bill will be reintroduced in the current legislative session. Given the current political climate and lack of action on the original bill, it seems unlikely that such legislation will be passed in the State of Minnesota at this time.

<u>Non-Compete Agreements</u>

Role of Attorney's Counsel in Avoiding Tortious Interference Claim

Sysdyne Corp v. Rousslang, No. A13-0898, 2014 WL 902713 (Minn. Ct. App. Mar. 10, 2014): Appellant sued its former employee for breaching a non-compete contract and his new employer for tortious interference with contractual relations and tortious interference with a prospective business relationship. The district court blue-penciled the employment agreement to exclude the employee's pre-existing customers from the non-competition clause. The court of appeals affirmed.

The district court also dismissed Appellant's claims against the new employer because it was "justified in interfering with the non-compete agreement because, based on its attorney's advice, it 'honestly believed the [non-compete agreement] was unenforceable.'" The court of appeals affirmed, holding that Respondent Xigent made "a reasonable inquiry before hiring [the employee], which provided justification for interfering in the contract." The court of appeals noted that Xigent provided its attorney with the individual's employment contract and its own offer letter to him. Xigent testified that he viewed the attorney "as an expert in the area of non-compete clauses" and "routinely had [the attorney] review non-compete clauses." Based on this testimony, the court of appeals upheld the district court's finding that Xigent had justification for interfering with the contract.

The Minnesota Supreme Court granted certiorari. At oral argument on November 4, 2014, Appellant argued that the court of appeals incorrectly interpreted the attorney-advice defense as applied to justification. Appellant argued that to justify tortious interference with a contract, the justification must be based on a legally recognized equal or superior right.

Non-Compete Unenforceable for Lack of Consideration

Nott Co. v. Eberhardt, No. A13-1061, 2014 WL 2441118 (Minn. Ct. App. June 2, 2014): Plaintiff sued its former employee for breach of a non-compete contract and tortious interference. Plaintiff argued that a new compensation plan constituted consideration for the non-compete agreement, as employees were required to sign the new non-compete agreement in order to participate in the new plan. One salesperson, however, was allowed to participate in the compensation plan without signing the new non-compete agreement.

The Minnesota Court of Appeals ruled that the agreement was unenforceable for lack of consideration, affirming the district court's holding. Under Minnesota law, non-compete agreements entered into with current employees must generally be supported by independent consideration beyond continuation of employment. The new compensation plan did not serve as independent consideration because another employee was able to participate in the compensation plan without signing the same non-compete agreement (even though he was already bound by a shorter non-compete agreement). The compensation package was not contingent on signing the new non-compete agreement, as Plaintiff intended on implementing the new compensation package regardless of who signed it. Consequently, Defendant did not bargain for the new non-compete agreement.

Non-Compete Unenforceable for Vagueness

Gavaras v. Greenspring Media, LLC, 994 F. Supp. 2d 1006 (D. Minn. 2014); *Gavaras. V. Greenspring Media, LLC,* Civil No. 13-3566, 2014 WL 1386308 (D. Minn. Apr. 9, 2014): Plaintiff, a former employee of Defendant Greenspring Media, brought a motion for a temporary restraining order to bar the enforcement of his non-competition agreement. The court treated the motion as a request for a declaratory judgment. The court granted the declaratory judgment and denied the motion for a TRO as moot.

First, the court found that the agreement suffered a fundamental flaw, because its enforceability was explicitly contingent on the terms of a "written employment agreement" that did not exist. The court rejected the employer's argument that its offer letter was the written employment agreement referenced in the non-compete agreement.

Second, the court found the non-compete agreement was invalid for other facial reasons. The agreement contained a blank space next to the word "effective" that was never filled in by the parties. The agreement contained contradictory language concerning the circumstances under which the non-competition restrictions would apply. The agreement lacked any geographic limitations, making it potentially overbroad. The contract terms lacked necessary details to put the Plaintiff on fair notice of his non-compete obligations.

Third, the court declined Defendant's request to blue-pencil the agreement, which would have rendered it reasonable and thus valid. Minnesota law permits courts to modify a restrictive covenant to make its duration and territorial scope reasonable. The court declined to apply the blue-pencil doctrine, however, because it would be required to re-write the agreement wholesale and divine the parties' intent at the time of contracting, seventeen years after the fact, and with a different employer.

After the order, Defendant moved for a stay pending appeal, which the court denied. The court ruled that it was unlikely any Minnesota court would find the non-compete agreement enforceable. In addition, Defendant was not likely to suffer irreparable harm, because any knowledge Plaintiff had was likely not confidential.

Preliminary Injunction to Enforce Covenant Denied

Bison Advisors LLC v. Kessler, Civil No. 14-3121, 2014 WL 5489289 (D. Minn. Oct. 30, 2014): Plaintiff, a computer-based commodities and equities trading firm, brought suit against its founding members and another company they formed for breach of contract and interference with a non-compete agreement. Plaintiff brought a motion for preliminary injunction to enforce the non-compete agreement prohibiting Defendants from engaging in "pairs trading." The court denied the motion for several reasons.

First, as to likelihood of success on the merits, the court rejected Plaintiff's interpretation of the agreement, which would have prohibited any trading of a certain type; rather the agreement could be enforced to protect an interest such as misuse of confidential information. The court found that Plaintiff's allegation that Defendants incorporated confidential models and algorithms into their trading strategies was speculative. Second, the court found that the existence of contractual language stipulating that a breach of the non-compete agreement would result in irreparable harm was not conclusive. The court determined that Plaintiff failed to meet its burden of showing that it could not be adequately compensated through money damages based on Defendants' evidence of common methods that could be utilized to calculate such damages. Third, an injunction would frustrate, rather than preserve, the status quo as the trading was commonplace. Fourth, the court cited the public interest in promoting competition.

Successful Claim of and Damages Award for Tortious Interference

St. Jude Medical, S.C., Inc. v. Biosense Webster, Inc., 994 F. Supp. 2d 1033 (D. Minn. 2014); *St. Jude Medical, S.C., Inc. v. Biosense Webster, Inc.*, Civil No. 12-621, 2014 WL 3573620 (D. Minn. July 18, 2014); *St. Jude Medical, S.C., Inc. v. Biosense Webster, Inc.*, Civil No. 12-621, 2014 WL 6673664 (D. Minn. Nov. 24, 2014): Plaintiff St. Jude Medical brought an action for breach of contract and tortious interference against Defendants: its former employee, de Castro, and its competitor and de Castro's new employer, Biosense Webster. The court found in favor of Plaintiff on both claims, holding that de Castro's term-of-years employment contract with Plaintiff was valid and that Biosense tortiously interfered with it. Plaintiff recovered damages for replacement costs and lost profits, plus interest, as well as attorney's fees.

The court found that de Castro breached the term-of-years agreement by quitting before the end of the term. The court rejected the Defendants' argument that the agreement was an invalid restrictive covenant because "a term of years contract does not function as a restrictive covenant because the contract 'is enforceable by damages only,' and not injunctive relief."

The court found that Biosense tortiously interfered with the contract for several reasons. Plaintiff and de Castro had a valid term-of-years employment agreement. Biosense knew of the agreement prior to hiring de Castro. Biosense intentionally procured a breach by having continued contact with de Castro, facilitating an in-person meeting, and offering legal counsel to de Castro in the event of a lawsuit. Lastly, the court determined that Biosense had no justification for its interference, because Biosense sought to compete with Plaintiff and discussed hiring de Castro in an effort to take Plaintiff's accounts.

The case came before the court again to determine attorney's fees damages. Under the third-party litigation exception to the American Rule, which provides that "a third party who interferes with and causes the breach of a contract may be held liable for damages," the court held that Plaintiff could recover attorney's fees "for the costs it incurred in enforcing its contract rights," but not for fees incurred by litigating its tortious interference claim. As a result, the court awarded Plaintiff $662,018.94 in attorney's fees.

After a trial, damages were awarded in the amount of $47,680.52 against de Castro and in the amount of $47,680.52 against Biosense for replacement costs; $550,952.00 against Biosense for lost-profits damages; and prejudgment interest in the amount of $4,514.62 against de Castro and $298,412.22 against Biosense.

Interaction with Shareholder Redemption Agreement

Ochsner v. Relco Unisystems, No. A13-2399, 2014 WL 4957617 (Minn. Ct. App. Oct. 6, 2014): Respondent sued his former employer for breach of a shareholder-redemption agreement after Appellant withheld payment for Respondent's stock based on his alleged breach of non-compete and confidentiality agreements. Respondent was hired by Relco Unisystems in 2001 and signed a non-compete and confidentiality agreement. In 2007 Relco converted to RELCO, a limited-liability company; Respondent then signed a shareholder-redemption agreement with RELCO. The shareholder-redemption agreement contained a forfeiture clause providing that Appellant could "withhold payment for [Respondent's] stock in the event that he breached his non-compete and confidentiality agreements."

The district court granted summary judgment in favor of the employee-shareholder, concluding that the non-compete agreement and confidentiality agreements were entered into with Relco, and therefore the forfeiture clause did not apply to RELCO.

On appeal, the Minnesota Court of Appeals disagreed with the district court's conclusion that RELCO and Relco Unisystems were separate and distinct entities as to the stock-redemption agreement and promissory note. The court found that the transfer of assets and operations from Relco Unisystems to RELCO amounted to nothing more than a corporate name change, and the transfer did not result in any change to the nature of Ochsner's employment. The court also noted that restrictive covenants can be assignable. The court of appeals found that, after Respondent breached the confidentiality agreement, Appellant was justified in withholding payment for Respondent's stock under the forfeiture clause and remanded the case with instructions that the district court should apply the offset.

__**Trade Secrets**__

Insufficient Showing to Support Preliminary Injunction

Bay Side Recycling Co., LLC v. SKB Env't, Inc., No. 14-CV-4550, 2014 WL 6772908 (D. Minn. Dec. 1, 2014): Plaintiffs brought a variety of claims against two former employees, including misappropriation of trade secrets. Plaintiffs brought a Motion for Temporary Restraining Order and Preliminary Injunction seeking to protect as trade secrets their (1) pricing information and methods, (2) margins, (3) company suppliers, (4) customers, and (5) other information concerning Plaintiff's contractual relationships.

Defendants argued that Plaintiffs failed to sufficiently identify their trade secrets under the Minnesota Uniform Trade Secrets Act ("MUTSA"). The court agreed, stating that Plaintiffs failed to provide details about the information in specific categories. Therefore, the court was unable to determine if the information derived independent economic value from its secrecy. In addition, Plaintiffs failed to identify efforts to maintain the secrecy of such information. Thus Plaintiffs failed to show a sufficient likelihood of misappropriation of their trade secrets to justify the imposition of injunctive relief against Defendants.

Rotary Systems, Inc. v. TomoTherapy Inc., No. A14-0186, 2014 WL 7236996 (Minn. Ct. App. Dec. 22, 2014): Rotary, a manufacturer and supplier of rotary unions, sold and serviced a custom rotary union for TomoTherapy. Rotary later learned that Dynamic Sealings, founded by a former Rotary employee, was producing a product substantially similar to the design Rotary created for TomoTherapy. Rotary brought claims against both for, among other things, misappropriation of the designs, specifications, and prints for the custom rotary union in violation of the Minnesota Uniform Trade Secrets Act ("MUTSA"). The district court granted summary judgment in favor of Defendants on the MUTSA claim, finding that Rotary failed to take reasonable steps to preserve the secrecy of the custom product.

On appeal, the Minnesota Court of Appeals reversed and remanded. The court noted that under MUTSA, the applicable standard is whether, considering all of the circumstances, "the employee or other person [must know or have] reason to know that the owner intends or expects the secrecy of the type of information comprising the trade secret to be maintained." It found that Rotary presented sufficient evidence to create a genuine issue of fact on whether it made reasonable efforts to maintain confidentiality. The court noted (1) the lack of a formal, written confidentiality agreement is not fatal to a trade-secrets claim as Defendants were aware of the confidential nature of Rotary's proprietary information; (2) the confidentiality label on the design prints were prominently displayed and expressly stated the documents contained proprietary information that was to be kept confidential; and (3) any tours of Rotary's facilities provided to Defendant employees, as well as any information provided to Defendants and their suppliers, were conducted as part of the development process of the custom rotary union.

Summary Judgment Motions on Five Interlocking Claims

AgInformationData, LLC v. Integrated Solutions Grp., Inc., 2014 WL 4348209 (D. Minn. Sept. 8, 2014): Though involving two companies rather than employees, this case usefully covers a range of claims. Plaintiff brought claims against multiple Defendants on multiple theories, and the Defendants moved, successfully and not successfully, for summary judgment.

The court denied Defendant's motion for summary judgment regarding Plaintiff's claim for breach of non-disclosure and non-use provisions, finding that Plaintiff presented sufficient evidence to create a genuine issues of material fact as to disclosure and use of Plaintiff's confidential information. Plaintiff produced evidence that (1) AgTrax's representative inquired about Plaintiff's pricing strategy; (2) Defendant's sales records reflected a change in pricing models similar to Plaintiff's; and (3) Defendant's website reflected use of Plaintiff's information.

The court, however, granted Defendant's motion for summary judgment on Plaintiff's claim for breach of the non-compete provision, concluding that the non-disclosure and non-use provisions protected Plaintiff's legitimate interest, so the non-compete provision of the NDA was not needed to protect Plaintiff's legitimate business interests.

Regarding the claim for violations of MUTSA, the court denied Defendant's motion for summary judgment. Plaintiff identified software capabilities, customer information, and coding features as the information it wanted to protect. The court concluded that Plaintiff adequately identified its trade secrets. The court also found that Plaintiff demonstrated that the information derived independent economic value when kept secret because no other company created a similar product and because Defendant lacked the know-how or capability of re-creating a similar product. Finally, the court found that Plaintiff made reasonable efforts to maintain the information's secrecy by ensuring Defendant signed an NDA, requiring all employees to sign confidentiality agreements, and prohibiting the disclosure of information to only those who have signed NDAs.

The court also granted summary judgment to Defendants on a common law claim for misappropriation of confidential information, on the grounds it is displaced by the MUTSA.