

Employment Agreements and Restrictive Covenants – 2018 Year in Review

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Introduction

2018 was a busy year for non-compete litigation and disputes involving employment agreements. Minnesota state and federal courts issued several published and un-published decisions involving the reasonableness of restrictive covenants, the appropriateness of injunctive relief, the application of the doctrine of good faith and fair dealing, the interpretation of choice-of-law provisions and other issues that practitioners contend with on a regular basis.

Minnesota Supreme Court

Contractual Provision Mandating Equitable Relief Not Enforceable

In a widely anticipated decision, the Minnesota Supreme Court overruled the Court of Appeals and held that a non-compete agreement stating that the employer would suffer irreparable injury upon breach by the employee was not enough to establish irreparable harm and thus could not compel the court to grant equitable relief. *St. Jude Medical, Inc. v. Carter*, 913 N.W.2d 678 (Minn. 2018). In other words, parties to an agreement cannot contractually force a court to issue an injunction. The ruling is notable primarily for overturning what was viewed as an aberrant decision by the intermediate Court of Appeals.

Minnesota Court of Appeals

Court of Appeals Endorses Tolling Provision of Non-Compete

Medical device companies in Minnesota have generated many of the landmark cases in the area of non-competes. The unpublished decision in *Medtronic, Inc. v. Petitti*, No. A18-0010, 2018 WL 3520858 (July 23, 2018) may be another one. In *Petitti*, three Medtronic sales people in Alabama left simultaneously and joined St. Jude Medical as a “team.” Each of them had a one-year non-compete with provision stating that if the employee breached the non-compete, “the duration of the restrictions contained therein shall be extended by the number of days the Employee remains in breach or violation thereof.” An Anoka county district judge issued a TRO and then, while the matter was still pending, issued a second order enjoining the former employees (Appellants) for an additional one year. The judge also enjoined Appellants from soliciting each other’s customers as a “team.” The facts suggesting a clear breach of the non-compete, and no dispute as to consideration or competition, may have driven the result.

The Minnesota Court of Appeals technically ruled against Medtronic by reversing and remanding the district court’s order but buried in its analysis was a partial victory for Medtronic and other employers seeking to enforce so-called tolling provisions. The appellate court held that the language of the agreements (and Medtronic’s own briefing) did not support an injunction on soliciting each other’s customers as a team. It also held that the one-year

extension was improper but remanded to the court to determine the actual number of days the Appellants were in breach and directed it to extend the injunction accordingly pursuant to the tolling agreement. (The Court of Appeals acknowledged but distinguished the Supreme Court's decision in *St. Jude Medical, Inc. v. Carter*, discussed above.) Until now there were few cases in Minnesota interpreting tolling provisions one way or another, so for now this unpublished decision from the Court of Appeals provides some guidance and suggests that employers may want to include these provisions in their agreements.

Declaratory Judgment Appropriate to Order Former Employer to Identify Restricted Customers

The Minnesota Court of Appeals reviewed a decision resulting from a former employee's declaratory judgment action seeking to invalidate a non-compete in *Manufacturing Solutions of Minnesota v. Abrasive Specialists, Inc.*, No. A18-0388, (Minn. Ct. App. Sept. 4, 2018). The district court in this case denied the former employee's motion for declaratory judgment and the Court of Appeals reversed.

The restriction at issue purported to prohibit the employee from providing similar services to any "client" of Abrasive Specialists, Inc. ("ASI"). Employee found potential employment with another company, Manufacturing Solutions of Minnesota ("MSI"), and proposed that he would work only with MSI customers. ASI refused to agree to this proposal. Employee and MSI filed for declaratory judgment identifying 42 customers of MSI that they thought were not ASI customers. ASI said that 18 of the identified MSI customers were also ASI customers but refused to identify which ones. On appeal, the court held that the district court erred in refusing to declare that Ray could work for MSI without violating the non-compete if his customers were limited to the 24 MSI customers who were not in the scope of the restriction. It further held that the district court erred by refusing to order ASI to disclose the 18 customers it claimed were subject to the non-compete. Few employees take the affirmative step to challenge a non-compete before they are sued, but this decision stands as a good model for litigants contemplating such an action.

Non-Compete Agreement Unenforceable for Lack of Legitimate Business Purpose

In *Oberfoell v. Kyte*, A17-0575, 2018 WL 492629 (Minn. Ct. App. Jan. 22, 2018), the Minnesota Court of Appeals affirmed a district court's finding that a five-year, 150-mile radius non-compete agreement was unenforceable for lack of a legitimate business purpose. The court held that the appellant-employer, an on-line auction business, failed to show a legitimate business interest based on customer relationships, because the employer never identified which customers had regular contact with the employee, did not submit a customer list into evidence, and failed to establish the former employee was the "face" of the company or customers' exclusive contact. Not surprisingly, the court of appeals also held that the five-year duration was unreasonable but it is notable that it affirmed the district court's decision not to "blue-pencil" the agreement to provide for a shorter term. This decision suggests that almost any non-compete might be subject to challenge on the basis that it is not reasonably necessary to protect a legitimate business interest. The Court in *Oberfoell* quoted *Klick v. Crosstown Bank of Ham Lake, Inc.*, 372 N.W.2d 85, 87 (Minn. Ct. App. 1985) for the proposition that a non-compete may not be legitimate where the employer's "motivation for the restrictive covenant was not to protect its legitimate interests

in preventing unfair competition, but to protect its investment in [the employee] by forcing him to remain with the employer for a long time.”

Court Affirms Damages Award of \$2.2 million for Breach of Non-Compete Agreement

In *Lapidus v. Lurie LLP*, A17-1656, 2018 WL 3014698 (Minn. Ct. App. June 18, 2018), the Minnesota Court of Appeals affirmed a district court’s damages award of \$2.2 million against a former partner of a well-known accounting firm for breach of a non-competes agreement that he entered into in connection with his retirement and in consideration for significant retirement payments, despite finding the lower court erred by applying the “business transaction standard.” The appellate court reiterated that “Minnesota law recognizes two types of non-competes provisions: those arising out of employment contracts and those arising from the sale of a business.” In the context of an employment contract, the court analyzes whether the restrictive covenant is necessary to reasonably protect a legitimate business interest. See *Bennett v. Storz Broadcasting Co.*, 270 Minn. 525, 534 (Minn. 1965). In the context of a sale of business, however, the court analyzes whether the restriction is reasonable to secure the goodwill purchased, whether it places an undue hardship on the covenantor, and whether it has a negative effect on the public interest. See *Bess v. Bothman*, 257 N.W.2d 791, 795 (Minn. 1977). Here, “the district court blurred the lines between the two tests and erroneously applied the ‘business transaction standard’” by analyzing the *Bennett* test with “less scrutiny” based on the executive’s sophistication and equal bargaining power. The appellate court found this was harmless error, however, as the district court had closely scrutinized the executive’s non-competes agreement and made extensive findings of fact related to the reasonableness of the non-competes agreement.

8th Circuit Court of Appeals

Contradicting Provisions of Employment Agreement Regarding Termination of “Employment” and Termination of “Agreement” Precluded Summary Judgment Because Agreement was Ambiguous

In *Qwinstar Corporation v. Anthony*, 882 F.3d 748 (8th Cir. 2018), the Eighth Circuit Court of Appeals reversed a breach of contract claim granted in favor of an employee on summary judgment and remanded for trial because it found the employment agreement ambiguous. The agreement stated that if the “agreement” was terminated for any reason the employee would receive the balance of five-years of pay. The same agreement also said, however, that if the employee’s “employment” was terminated, he would get nothing. This decision highlights the importance of not confusing termination of *employment* with termination of an *agreement*.

U.S. District Court for the District of Minnesota

Covenant of Good-Faith and Fair Dealing May Apply to Agreements Involving More than Just Employment

In *Hampton v. Koehler*, No. 18-CV-541 (DWF/TNL), 2018 WL 3076018 (D. Minn. 2018), the court declined to dismiss claim of breach of implied covenant of good faith and fair dealing by former employee seeking payment under a “post-closing share agreement.” Under Minnesota law, there is an implied covenant of good faith and fair dealing on the part of both parties in most contracts. Minnesota courts have long held, however, that implied covenants of good faith and fair dealing are not read into employment contracts. *Hunt v. IMB Mid Am. Emps. Fed. Credit Union*, 384 N.W.2d 853, 858-59 (Minn. 1986) (“[W]e have not read an implied covenant of good faith and fair dealing into employment contracts.”).

In *Hampton*, the plaintiff contended, and the court agreed, that just because there at one point was an employment contract between the parties does not mean that the court should apply the holding in *Hunt* at the motion to dismiss phase, because the core claim for payment of stock arises under the Post-Closing Agreement, even if resolution of the claim might hinge on the interpretation of the employment agreement. The Court found that “it is too early to determine whether Plaintiff has stated a viable claim for breach of good faith and fair dealing because it is not that the operative agreement is, indeed, an employment agreement.”

Restriction on Solicitation of “Prospective” Customers Held to be Void Because Former Employee Could Not Determine Their Identity and the Restriction Was Not Necessary to Protect a Legitimate Business Interest.

A case captioned *Riddle v. Geckobyte*, No. 17-623 (PAM/LIB), 2018 WL 3104107 (D. Minn. June 22, 2018) concerned a non-compete and employment agreement entered into in connection with the sale of a business. The transaction was documented by both an asset purchase agreement (“APA”) and an employment agreement (“EA”). After the sale, the seller remained as an employee until the relationship “deteriorated.” The buyer terminated the seller’s employment and the seller stopped making payments under the APA. The seller sued for breach of the EA and the buyer counterclaimed for breach of a non-compete. Seller argued that the 5-year non-compete was not enforceable because it was overbroad and did not protect a legitimate business interest. Although this may seem like a stretch in the context of a sale of business, the court agreed. The court pointed to the restriction on soliciting “prospective clients” and held it was unenforceable because seller had “no way to know who Geckobyte considers a prospective client.”

Because restrictions on solicitation of “prospective” customers are commonly used by employers, this aspect of the *Riddle* holding, although a non-binding district court decision, could have significant implications for Minnesota litigants in this space. The court also held that buyer’s failure to pay a severance amount set forth in the EA was a breach that precluded enforcement of the non-compete. Regarding the breach of employment agreement claim, the court first determined that a six-year statute of limitations applied, not the two-year limitation on wage claims, because the underlining transaction was a sale of assets. It then analyzed portions of the EA asserting that seller was an “at-will” employee with contradicting provisions defining “cause.” The judge concluded that a fact issue existed to preclude dismissal of the claim. Finally, the court allowed the seller to assert claims for unjust enrichment and *quantum meruit* even though they

were inconsistent with a contract claim as “alternative” claims. The decision was a win for seller whereas buyer’s breach of non-compete claim was dismissed. A remarkable outcome for a sale of business non-compete dispute. The decision is also another good example of how virtually every non-compete might be challenged on the basis of whether it protects a legitimate business interest. (See *Oberfoell*, above.)

Injunctive Relief Granted to Employer Blindsided by Former Employee Relaying Confidential Information to Direct Competitor

In *CPI Card Group, Inc. v. Dwyer*, 294 F.Supp.3d 791 (D. Minn. 2018), the court granted injunctive relief to the plaintiff-employer that sued its former employee and his new employer, a competitor, for breach of contract and tortious interference with contract claims. Dwyer, a former Senior Account Executive, was subject to a robust one-year non-compete, non-solicitation, and confidentiality agreement (“non-compete agreement”) with his employer CPI Card Group (“CPI”). Unbeknownst to CPI, Dwyer secured employment and signed an employment agreement with CPI’s leading competitor Multi-Packaging Solutions (“MPS”) before resigning at CPI. MPS was aware of Dwyer’s non-compete obligations. While Dwyer remained at CPI for a few months to help transition clients, he shared the names of CPI clients and details of CPI’s business dealings with MPS. Dwyer also negotiated with CPI an amendment to his non-compete agreement which eliminated his non-compete obligations and significantly narrowed his non-solicitation requirements. Dwyer kept MPS updated on the progress of the negotiations, while CPI was unaware of MPS’s involvement. In granting CPI injunctive relief, the court held that Dwyer breached his non-compete agreement before the amendment was signed by forwarding confidential information to his personal e-mail minutes before he resigned and by directly sharing confidential information with MPS. The court also found that CPI showed a likelihood of success in proving that the amendment was fraudulently obtained and thus was void. This case involves classic elements of a wrongful competition case: (1) the executive e-mailed documents to his personal e-mail account; (2) the executive did not tell the truth about what he is doing, and (3) the former employer performed a forensic computer search and exposed his activities. It should stand as a warning to other executives on how not to leave your employer.