

# Non-Compete Litigation and Trends<sup>®</sup>

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## I. BASICS OF NON-COMPETE AGREEMENTS

### A. Non-Compete Agreements are Disfavored, but Enforceable in Minnesota.

In order for a non-compete agreement to be enforceable in Minnesota, it must serve a legitimate business interest and be no broader than necessary to protect that interest.<sup>1</sup> The agreement must also be supported by adequate consideration.<sup>2</sup>

Although enforceable, non-compete agreements are generally disfavored by courts for two public policy reasons. First, courts support an employee's right to make a living and are concerned that unequal bargaining power between an employer and an employee might result in an employee signing away his/her right to work in employment for which he/she is most qualified.<sup>3</sup> Second, courts recognize that non-compete agreements have the ability to negatively impact competition in the marketplace.<sup>4</sup> Because of these public policy concerns, Minnesota courts often interpret non-compete agreements narrowly and construe any ambiguities in the agreements against the drafter, typically the employer.<sup>5</sup>

### B. Non-Compete Agreements Must be Reasonable in Time, Geography, and Scope.

In determining the enforceability of a non-compete agreement, the primary consideration is whether the agreement is a reasonable balance between (i) the legitimate business interests of the employer, and (ii) the employee's right to work.<sup>6</sup> This balancing test arose out of a 1965 Minnesota case titled Bennett v. Storz Broadcasting Co.<sup>7</sup> The most often quoted passage from that opinion sets forth the "Bennett Test:"

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<sup>1</sup> Kallok v. Medtronic, Inc., 573 N.W.2d 356, 361 (Minn. 1998).

<sup>2</sup> Overholt Crop Ins. Serv. Co. v. Bredeson, 323 N.W.2d 736, 740 (Minn. 1982); cf. Nat'l Recruiters, Inc. v. Cashman, 323 N.W.2d 736, 740 (Minn. 1982); Sanborn Manuf. Co. v. Currie, 500 N.W.2d 161, 164 (Minn. App. 1993).

<sup>3</sup> Jim W. Miller Constr., Inc. v. Schaefer, 298 N.W.2d 455, 458 (Minn. 1980)

<sup>4</sup> Id.

<sup>5</sup> Ecolab, Inc. v. Gartland, 537 N.W.2d 291, 295 (Minn. App. 1995).

<sup>6</sup> 3M v. Kirkevold, 87 F.R.D. 324, 332 (D.Minn. 1980) (citing Bennett v. Storz Broadcasting Co., 134 N.W.2d 892, 898 (Minn. 1965)).

<sup>7</sup> Bennett v. Storz Broadcasting Co., 134 N.W.2d 892, 898 (Minn. 1965).

The test applied is whether or not the restraint is necessary for the protection of the business or good will of the employer, and if so, whether the stipulation has imposed upon the employee any greater restraint than is reasonably necessary to protect the employer's business, regard being had to the nature and character of the employment, the time for which the restriction is imposed, and the territorial extent of the locality to which the prohibition extends.<sup>8</sup>

As part of this test, courts have generally held that businesses have two legitimate, protectable interests: good will and confidential information. In this context, "good will" typically relates to the good name and reputation that a business enjoys over time, as well as the customer relationships that develop when an employee has substantial contact with an employer's customers.<sup>9</sup> In addition to good will, employers must be allowed to protect the confidential information, trade secrets, and customer lists in which they have invested time, money, and expertise to develop.

Generally, if the court determines that a non-compete agreement furthers a legitimate business interest, then the court applies the "Bennett Test" of reasonableness. This analysis has typically been three-fold:

1. Is the time restriction of the agreement reasonable?
2. Is the geographic restriction reasonable?
3. What is the nature and character of the employer-employee relationship?<sup>10</sup>

For each factor, the Court will consider whether the specific restrictions are drawn such that they restrict the employee only to the extent necessary to protect the legitimate interests of the employer.<sup>11</sup>

Minnesota courts have used one of two tests to determine the reasonableness of the duration of a non-compete agreement.<sup>12</sup> The court will either consider the length of time necessary to obliterate the identification between the employer and the employee in the minds of the employer's customers, or the court will look to the length of time necessary for the employee's replacement to learn the fundamentals of the business.<sup>13</sup> A one-year non-compete restriction is generally considered reasonable under Minnesota law, but time restrictions beyond two years are less likely to be upheld as reasonable.

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<sup>8</sup> Id. at 899.

<sup>9</sup> See Saliterman v. Finney, 360 N.W.2d 175, 177-78 (Minn. App. 1985).

<sup>10</sup> Id.; Lexis-Nexis v. Beer, 41 F. Supp. 2d 950, 95 (D.Minn. 1999).

<sup>11</sup> Kallok, 573 N.W.2d at 361.

<sup>12</sup> Davies & Davies Agency, Inc. v. Davies, 298 N.W.2d 127, 131 (Minn. 1980).

<sup>13</sup> Id.

A geographic restriction typically must be limited to the geographic area in which the employee actually worked.<sup>14</sup> It may also be reasonable, however, to limit an employee from competing in the area in which the employer does business. As stated above, the reasonableness of the restriction will turn on whether it is broader than necessary to protect the legitimate interests of the employer.<sup>15</sup> At least one Minnesota appellate court has held, however, that even a non-compete agreement lacking any geographical limitation is not necessarily *per se* unenforceable.<sup>16</sup> In that case, the court reasoned that it was conceivable for a non-compete agreement involving a multi-national company to reasonably exclude geographical restrictions.<sup>17</sup>

In considering the reasonableness of the scope of the non-compete agreement, courts may focus on many different factors in the employer-employee relationship. For example, courts may weigh the employee's bargaining power in the employment market,<sup>18</sup> the likelihood of grievous harm to the employee if the non-compete agreement is enforced,<sup>19</sup> the amount of access the employee had to the employer's confidential information and future plans,<sup>20</sup> and the amount of access the employee had to the employer's customers.<sup>21</sup>

### **C. Minnesota Courts Have Discretion to Re-write Otherwise Unenforceable Non-Compete Agreements to Make them Reasonable.**

If a Minnesota court determines that a non-compete agreement is unreasonable, the court may generally do one of two things: (1) invalidate the agreement altogether, or (2) modify the agreement to make it reasonable. Several courts around the country exercise the latter option and employ the "blue pencil doctrine," a doctrine which allows a court to strike portions of a non-compete agreement that it finds unreasonable. Minnesota courts have gone a step farther with the "blue pencil doctrine" and will not only delete unreasonable terms, but they will also sometimes re-write, insert, and/or substitute unreasonable terms with reasonable terms based on the specific facts of the case.<sup>22</sup> Although Minnesota courts typically "blue pencil" agreements rather than invalidate them on their face, district courts have the discretion not to employ the "blue pencil doctrine."<sup>23</sup>

### **D. Injunctive Relief and Damages are Possible Remedies for an Employee's Breach of a Non-Compete Agreement.**

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<sup>14</sup> Bennett, 134 N.W.2d at 894.

<sup>15</sup> See Kallok, 573 N.W.2d at 361; Bennett, 134 N.W.2d at 894.

<sup>16</sup> Dynamic Air, Inc. v. Bloch, 502 N.W.2d 796, 800 (Minn. App. 1993).

<sup>17</sup> Id.

<sup>18</sup> Roth v. Gamble-Skogmo, 532 F.Supp. 1029, 1032 (D.Minn. 1982).

<sup>19</sup> Id.

<sup>20</sup> Alside v. Larson, 220 N.W.2d 274, 280 (Minn. 1974).

<sup>21</sup> Id.

<sup>22</sup> Davies, 298 N.W.2d at 131-32; Dynamic Air, 502 N.W.2d at 800 (Minn. App. 1993).

<sup>23</sup> Klick v. Crosstown State Bank of Ham Lake, 372 N.W.2d 85, 88-89 (Minn. App. 1985); Berdie v. Anderson, Neibuhr & Assoc., Inc., 1989 Minn. App. LEXIS 904, at \*6 (1989) (unpublished).

An employer who believes that a former employee has breached his/her non-compete agreement may seek injunctive relief and/or damages. The type of relief sought and the litigation strategy utilized to obtain that relief will depend on the specific facts in the case.

An employer may seek a temporary restraining order (“TRO”) or a preliminary injunction at the beginning of litigation to try to immediately stop the former employee from continuing in his/her current competitive employment until the case can be decided. To be successful in obtaining immediate injunctive relief, the employer must demonstrate that there is no other adequate legal remedy and that the injunction is necessary to prevent irreparable harm.<sup>24</sup> The state court considers five factors when determining whether to issue a temporary injunction:

- (1) The nature and background of the relationship between the parties before the dispute giving rise to the request for relief;
- (2) The harm to be suffered by the moving party if the temporary restraint is denied as compared to that inflicted on the non-moving party if the injunction is granted pending trial;
- (3) The likelihood that one party or the other will prevail on the merits;
- (4) The aspects of the fact situation, if any, which permit or require consideration of public policy; and
- (5) The administrative burdens involved in judicial supervision and enforcement of the temporary decree.<sup>25</sup>

The federal court applies slightly different factors in determining entitlement to injunctive relief and requires the posting of a bond.<sup>26</sup>

The court may issue a permanent injunction after trial if it determines that the non-compete agreement is enforceable, there was a breach, and irreparable harm will result in the absence of a permanent injunction.<sup>27</sup> A court may use its discretion to extend the injunction beyond the specified time period in the non-compete agreement if further harm to the employer is likely to occur.<sup>28</sup>

Monetary damages may also be available for breach of a non-compete agreement. Such damages are generally measured by showing either (1) the employee’s actual gain in breaching

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<sup>24</sup> Cherne Indus., Inc. v. Grounds & Associates, Inc., 278 N.W.2d 81, 92 (Minn. 1979).

<sup>25</sup> Id.; see also Dahlberg Bros., Inc. v. Ford Motor Co., 137 N.W.2d 314, 321-22 (Minn. 1965); Medtronic, Inc. v. Advanced Bionics Corp., 630 N.W.2d 438, 451 (Minn. App. 2001);

<sup>26</sup> See Dataphase Systems, Inc. v. CL Systems, Inc., 640 F.2d 109, 114 (8<sup>th</sup> Cir. 1980); Fed.R.Civ.P. 65(c) (2004).

<sup>27</sup> Menter Co. v. Brock, 180 N.W.2d 553, 555 (Minn. 1920).

<sup>28</sup> Cherne Indus., 278 N.W.2d at 93.

the non-compete agreement; or (2) the employer's lost profits as a result of the breach of the agreement.<sup>29</sup> Alternatively, monetary damages can be dictated by a liquidated damages clause in the non-compete agreement itself (provided that it is deemed reasonable).<sup>30</sup> The employer has the burden of demonstrating that the monetary loss resulted from conduct prohibited by the non-compete agreement.<sup>31</sup>

## II. WAYS TO PROTECT LEGITIMATE BUSINESS INTERESTS WITHOUT A NON-COMPETE AGREEMENT

Although having a non-compete agreement is usually preferable from an employer's standpoint, there are other protections that may be available to an employer to guard its legitimate business interests even if there is no enforceable non-compete agreement. For example, an employee has a common law duty of loyalty to her employer.<sup>32</sup> This duty prohibits the employee from soliciting the employer's customers, or from otherwise competing with the employer while he/she is employed there.<sup>33</sup> Depending on the circumstances, there may be fiduciary duties implied in the employment relationship that further restrict what an employee may do after leaving his/her employment.<sup>34</sup> Another example is the common law duty of confidentiality that prohibits an employee from using confidential information if an employer gives notice of the confidential nature of the information and the employee breaches that confidence.<sup>35</sup> Various theories of unfair competition may be viable options for an employer to protect its interests.<sup>36</sup>

Minnesota's Uniform Trade Secrets Act ("MUTSA")<sup>37</sup> is another important statutory vehicle by which an employer can protect its trade secrets. A claim arising out of MUTSA does not preempt non-compete claims, but it does preempt claims for common law misappropriation of trade secrets.<sup>38</sup> To prevail on a MUTSA claim, the employer must show that information rises to the level of trade secret. This requires a showing that: (1) the information is not generally known, nor readily ascertainable; (2) the information derives independent economic value from secrecy; and (3) the owner of the trade secret has taken reasonable efforts to maintain its secrecy.<sup>39</sup> The employer must then show

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<sup>29</sup> Id. at 94.

<sup>30</sup> Laurie & Harbeck, *Balancing Business Protection with Freedom to Work: A Review of Non-compete Agreements in Minnesota*, 23 WM. MITCHELL L. REV. at 128-129 (citing Dean Van Horn Consulting Assocs., Inc. v. Wold, 367 N.W.2d 556, 560 (Minn. App. 1985)).

<sup>31</sup> B & Y Metal Painting, Inc. v. Ball, 279 N.W.2d 813, 816- 817 (Minn. 1979).

<sup>32</sup> Rehabilitation Specialists, Inc. v. Koering, 404 N.W.2d 301, 304 (Minn. App. 1987).

<sup>33</sup> Id.

<sup>34</sup> Bellboy Seafood Corp. v. Nathanson, 410 N.W.2d 348, 353 (Minn. App. 1987); see also Sanitary Farms Dairies v. Wolf, 112 N.W.2d 42, 49 (Minn. 1961).

<sup>35</sup> Aries Info. Sys. Inc. v. Pacific Mgmt. Sys., 366 N.W.2d 366, 369 (Minn. App. 1985).

<sup>36</sup> Midwest Sports Marketing, Inc. v. Hillerich & Bradsby of Canada, Ltd., 552 N.W.2d 254, 267 (Minn. App. 1996).

<sup>37</sup> Minn. Stat. §§ 325C.01- 325C.08 (2004).

<sup>38</sup> Minn. Stat. § 325C.07(b)(1); Micro Display Sys., Inc. v. Axtel, Inc., 699 F. Supp. 202, 204 (D.Minn. 1988).

<sup>39</sup> Strategic Directions Group, Inc. v. Bristol-Myers Squibb Co., 293 F.3d 1062, 1064 (8<sup>th</sup> Cir. 2002).

“misappropriation” (*i.e.*, “disclosure or use of a trade secret”).<sup>40</sup> Remedies under MUTSA allow for injunctive relief, compensatory damages, punitive damages, and attorneys’ fees if either party acted in bad faith.<sup>41</sup>

These are just some examples of the different types of claims available to employers to protect their business interests outside of a non-compete agreement. If there is a concern that a former employee may or has disclosed confidential or trade secret information, these alternate forms of protection should be considered by the employer and its legal counsel.

### III. CURRENT BATTLES IN NON-COMPETE LITIGATION

There continues to be a significant amount of non-compete litigation filed in Minnesota and across the country. In all instances, the facts and circumstances, including the specific language of the subject non-compete agreement and its reasonableness, dictate the strength or weakness of the respective litigants’ positions.

In addition, new arguments are being made in non-compete litigation. This seminar will highlight some of the latest developments.

#### A. “Reasonable” Restrictions May Be Changing.

Over the last couple of years, three specific trends have developed within the context of “reasonable” non-compete restrictions. First, more employers are asserting the argument that their product competes in a global market and therefore a non-compete agreement may reasonably lack any type of geographical restriction. Although Minnesota appellate courts have, in the majority of cases, rejected that argument,<sup>42</sup> Minnesota district courts have been receptive to this argument in some instances.

Second, given the more global nature of some industries, Minnesota courts are demonstrating a willingness to substitute a geographic restriction with customer-specific restrictions. For example, it may be unreasonable to limit a former employee from working in an entire state, but the non-compete could be interpreted to prevent that employee from interacting or working with customers with whom he/she developed relationships while working at his/her former employer’s workplace.

Third, arguments are being made that even a one-year restriction in a non-compete agreement may be an unreasonably long period of time in the technology industry, because of rapid advancements and staleness of information after short periods of time. New York district court decisions finding a one-year restriction in the information technology industry

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<sup>40</sup> Minn. Stat. § 325C.01.

<sup>41</sup> Minn. Stat. § 325C.04.

<sup>42</sup> Bennett, 134 N.W.2d at 894.

unreasonable are being cited as examples supporting this position.<sup>43</sup> Minnesota courts have not yet published any decisions that deal with the technology-related duration issue directly, but they may do so in the next few years.

#### **B. The Focus of “Confidential Information” in Litigation May Be Evolving.**

As discussed above, “good will” is a legitimate business interest that non-compete agreements may protect. In the past, many non-compete cases have been based on theories of protecting that interest. Some recent cases, however, are focusing on theories relating to the other court-recognized business interest of confidential information. Consequently, not only are claims for misappropriation of trade secrets being alleged, but employers are aggressively pursuing enforcement of their non-compete agreements on grounds that their confidential information is at risk if an employee is allowed to violate his/her non-compete agreement. This argument is less tenable where employers are not consistently treating confidential information as trade secrets in practice.

In addition, employers are frequently arguing that non-compete agreements legitimately protect confidential information to which the former employee had access. Although it is clear that there is a legitimate interest in protecting types confidential information that an employee used in his/her former employment, it is less clear if and how much of the confidential information to which an employee simply had access is reasonably protected by a non-compete agreement. Again, this area still remains gray, and protection of such confidential information by way of a non-compete agreement will depend on the industry, factual context, and even the judge to whom a case is assigned.

#### **C. There Are No Longer Basic Assumptions When it Comes to Motions for TRO’s.**

Traditionally, employers have filed motions for a TRO as a matter of course when commencing non-compete litigation. In doing so, the expectation by all parties was that there would be a quick resolution of the non-compete dispute. This is no longer necessarily the case. Depending on the concerns motivating suit in the first place, an employer should carefully consider whether a TRO is the most effective strategy for curtailing the employee’s conduct. In certain instances, pursuing monetary damages for breach of a non-compete agreement may be more effective in convincing the employee not to violate his agreement. Moreover, recent trends reveal that TRO rulings are not necessarily ending litigation. Rather, parties are continuing to litigate the non-compete issues even in the face of TRO decisions by the Court. As a result, parties can no longer assume that a TRO ruling will conclude the litigation by leading to a quick settlement.

#### **D. Parties are Using Other Strategies to Protect Their Business Information.**

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<sup>43</sup> Earthweb v. Schlack, 71 F.Supp.2d 299, 313 (S.D.N.Y. 1999); DoubleClick, Inc. v. Henderson, No. 97-116914, 1997 WL 731413, at 8 (N.Y. Sup. Ct. Nov. 7, 1997).

Not only are employers able to protect their business information by using non-compete agreements, but employers have other means to accomplish this objective. As discussed above in section II, statutes and common law claims may allow an employer to protect its interests even if there is no non-compete agreement in effect. Moreover, other theories, such as the inevitable disclosure of confidential and/or trade secret information are being proffered.<sup>44</sup> Nevertheless, Minnesota courts remain reluctant to rely on, and have not yet adopted, an “inevitable disclosure doctrine” to prevent individuals from working for competitors.<sup>45</sup>

A former employer may also attempt to protect its interests by filing suit against the employee’s new employer for tortious interference with a contract. In Kallok v. Medtronic, the Minnesota Supreme Court held that an employer may file suit against a prospective employer who procures a breach of an employee’s non-compete agreement.<sup>46</sup> To establish this claim, a former employer must show:

- (1) The existence of a valid contract between the former employer and the employee at issue;
- (2) The new employer knew about the valid contract before hiring the employee;
- (3) The new employer procured the employee’s breach of the non-compete agreement by offering him a position of employment;
- (4) The new employer’s conduct was unjustified in that it did not undertake a reasonable inquiry to determine whether hiring the employee would cause the employee to violate the non-compete agreement; and
- (5) The former employer incurred financial costs by protecting its rights under the non-compete agreement.<sup>47</sup>

This potential tort claim requires prospective employers to be prudent when hiring individuals who come from competing businesses. To do otherwise, not only puts the prospective employer at risk and expense of becoming a party to a lawsuit, but if a former employer can successfully establish this tortious interference claim, the prospective employer may also risk paying damages and the former employer’s attorneys’ fees related to enforcing the non-compete agreement in damages.<sup>48</sup>

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<sup>44</sup> See PepsiCo, Inc. v. Redmond, 54 F.3d 1262 (7<sup>th</sup> Cir. 1995).

<sup>45</sup> See Equus Computer Systems, Inc. v. Northern Computer Systems, Inc., 2001 WL 1636487, \*5 (D.Minn.) (“...the Court finds no precedent establishing the Eighth Circuit’s adoption of the inevitable disclosure doctrine as set forth in PepsiCo, Inc. v. Redmond.”); IBM v. Seagate Technology, Inc., 941 F. Supp 98, 100 n.1 (D.Minn. 1992) (“The Eighth Circuit has neither accepted nor rejected the ‘inevitable disclosure doctrine.’”).

<sup>46</sup> Kallok, 573 N.W.2d at 361.

<sup>47</sup> Id. at 362- 363.

<sup>48</sup> Id. at 363- 364.

#### IV. CONCLUSION

Minnesota's non-compete laws, including its statutes, case law, and common law, involve long-standing principles that have governed Minnesota employers over the years. Nevertheless, the landscape may be changing somewhat, and the prudent employer will re-examine its non-compete practices, policies, and contracts to ensure they embody the current state of the law and have significant flexibility to permit new and developing arguments. Likewise, the prudent employer seeking to hire a new employee will consider whether there are any legal or practical non-competition limitations governing that hire.