

CBA Labor & Employment Law
Saturn Systems, Inc. v. Militare: Employers Run Rings Around Employees,
and Other Recent Cases from the Non-Compete Solar System
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I. Introduction

The employment landscape has changed dramatically over the years, and it is quite common during a person's professional career to move from one organization to another. From the employer's standpoint, the good will that has appreciated can be quickly compromised if steps are not taken to limit the employee's ability to aggressively compete upon departure. From the employee's perspective, they may find a promising career path blocked by an agreement that meant little to them when they signed it. A common agreement involves a prohibition on the disclosure of confidential information or trade secrets, followed by prohibitions on soliciting customers or clients, or other employees. The application of Colorado's non-compete statute to these agreements has left lingering questions that recent case law has attempted to answer. However, these cases also illustrate the shifting line between the enforceability and unenforceability of such agreements.

II. *Phoenix Capital, Inc. v. Dowell*, 176 P.3d 835 (Color. App. 2007)

Before addressing the *Saturn Systems*, *DISH Network*, and *Lucht's Concrete* cases and their implications on employers and employees, it is important to look back at this holding from 2007, in which the Colorado Court of Appeals further defined the contours of Colorado's non-compete statute, C.R.S. § 8-2-113. *Phoenix Capital* involved the enforcement of a non-solicitation clause in an employment agreement against a senior portfolio analysis from an analytics division of an investment bank. The finding of *Phoenix Capital* included:

- The enforceability of a non-compete clause in an employment agreement is determined when the agreement was executed. Employers are free to enter into new employment agreements as employees take on additional responsibilities, and the employer, rather than employee, has the obligation to protect the employee's best interests.
- The phrase "professional staff" is limited to those persons who, while qualifying as "professionals" and reporting to managers or executives, primarily serve as key members of the manager's or executive's staff in the implementation of management or executive functions.
- Non-solicitation of customers clause is a form of an agreement not to compete. This is because in order to make a living, a former employee needs to be free to solicit (actively and passively) former customers as long as he or she does not use employer's trade secrets to do so.
- Non-solicitation of employees clause is not treated the same as non-solicitation of customers clause under the non-compete statute.

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- Court determined that a non-compete contract is assignable by employer if agreed to by the employee in the employment agreement.

III. The Saturn Systems Case

On February 17, 2011, the Colorado Court of Appeals issued its decision in *Saturn Systems, Inc. v. Militare*, 2011 Colo. App. LEXIS 224 (Colo. App. February 17, 2011).

A. Facts

- Saturn is a debt collection agency that offers numerous types of debt collection services, including recovery of commercial, consumer, medical, government, and retail accounts, both domestically and abroad.

- Saturn provided services to 1,600 clients since 1997, and spent significant time and money to develop a proprietary website to provide its clients access to its database of client and debtor information.

- Saturn assigns each client a unique username and password that can be used to log in to the website and view *real-time* information related to that client's account.

- Saturn only releases the usernames and passwords to the client and, if needed, to the sales agent assigned to that client's account.

- Militare was hired in 2003 as an independent contractor sales agent. He was authorized to sell Saturn's services, receive funds on Saturn's behalf, and make sales presentations to prospective clients. He agreed to provide ongoing customer care to the clients that he signed up for Saturn's services. In return, Saturn agreed to pay Militare a commission on each sale that he made.

- His agreement included the following "Confidentiality" provision:

Confidentiality: Agent agrees that any client lists, sales materials and proprietary information will be considered confidential and not revealed to outside persons with the exception of clients and prospective clients during the sales or service of Company's services and that he will not solicit Company clients on behalf of his/her self or any other entity. This provision is to last for the duration of this agreement and for 1 year following the termination of this agreement.

The confidentiality provision of the Agreement did not contain a specific geographic limitation, the parties agreed at trial that its geographic scope was limited to Colorado.

- As a Saturn sales agent, Militare was provided access to and was taught how to use the confidential database on the Saturn website.

- Saturn terminated the Agreement with Militare approximately two years after he was hired. Shortly thereafter, Militare accepted a position with CB Solutions, LLC, a direct competitor of Saturn. After Militare commenced his employment with CB Solutions, he solicited one of Saturn's primary clients, who alerted Saturn.

- A computer investigation confirmed that Militare repeatedly accessed several client accounts, including the notes associated with those accounts, subsequent to his termination from Saturn.

Saturn filed suit alleging misappropriation of trade secrets, breach of the non-solicitation provision of the Agreement and sought injunctive relief. The trial court found in Saturn's favor, finding Militare liable for misappropriation of Saturn's trade secrets and breach of the nondisclosure and non-solicitation clauses set forth in the confidentiality provision of the Agreement. The Court of Appeals upheld the trial court

B. Misappropriation of Trade Secrets

1. Legal Principles

The Court of Appeals referred to the following factors to make a determination as to whether a trade secret² exists under the statute:

- (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, such as 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.

Citing Network Telecomms. Inc. v. Boor-Crepeau, 790 P.2d 901, 902 (Colo. App. 1990); and *Porter Indus., Inc. v. Higgins*, 680 P.2d 1339 (Colo. App. 1984).

² Colorado Uniform Trade Secrets Act, C.R.S. § 7-74-101, et. seq. defines a trade secret as: "[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."

The alleged secret must be the subject of efforts that are reasonable under the circumstances to maintain its secrecy, but extreme and unduly expensive measures need not be taken. *Citing Colo. Supply Co. v. Stewart*, 797 P.2d 1303, 1306 (Colo. App. 1990).

2. Focus of Court of Appeals trade secret analysis was upon the “dynamic nature” of Saturn’s information

The Court of Appeals upheld the trial court’s findings that Saturn’s client and debtor information stored within its proprietary database qualified as trade secrets under Colorado law based on the following: (1) the information was confidential and not known outside of the business, either by competitors or the general public; (2) the real-time information was available only through the use of a client’s username and password; (3) access to Saturn’s database was strictly limited on a “need to know” basis; (4) Saturn has taken reasonable efforts to maintain the secrecy of the information stored within its database, including password protected and encrypted website and policy of limited access; (5) significant money had been spent developing and monitoring the database; and (6) the substance of the information in the database allowed for development of a competitive marketing strategy when client was at renewal stage.

Due to the “dynamic nature of the information” constituting a trade secret, the Court of Appeals found it unnecessary for Saturn to identify specifically the confidential information. The Court reasoned that it would be impractical to impose a burden on Saturn to identify the exact information misappropriated when was continually updated.

3. Accessing the Confidential Website Sufficient to Demonstrate Misappropriation

The Court of Appeals held that misappropriation includes the “[a]cquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means.” § 7-74-102(2)(a), C.R.S. 2010. “‘Improper means’ includes theft, bribery, misrepresentation, breach or inducement of a breach of a duty to maintain secrecy, or espionage through electronic or other means.” *Id.* at § 7-74-102(1), C.R.S. 2010. The Court of Appeals observed “[t]here is no requirement in Colorado’s [UTSA] that there be actual use or commercial implementation of the misappropriated trade secret for damages to accrue. Misappropriation consists only of the improper disclosure or acquisition of the trade secret.” *Citing Sonoco Prods. Co. v. Johnson*, 23 P.3d 1287, 1290 (Colo. App. 2001). The Court of Appeals held that because Militare repeatedly accessed and viewed Saturn’s website without permission to review the privileged information, this was sufficient to demonstrate misappropriation.

C. Non-Solicitation Contained Within Confidentiality Agreement is Enforceable

The Court of Appeals upheld the restriction on Militare contained in the Confidentiality Provision above:

1. Court of Appeals applied two-part test to determine whether non-compete clause fits within the trade secrets exception of section 8-2-113(2)(b): (a) the trial court must first examine the factual situation to determine whether a restrictive covenant is justified at all; and (b) the trial court must then examine the specific terms of the noncompetition clause to determine the reasonableness of their effect. A non-competition clause designed to protect trade secrets must be narrowly drafted.

Nevertheless, an agreement not to solicit an employer's customers is enforceable so long as its purpose is to protect the employer's trade secrets and it is reasonably limited in time and geographic scope. *Gold Messenger, Inc. v. McGuay*, 937 P.2d 907, 910-11 (Colo. App. 1997).

2. The Confidentiality clause met the test, because: (a) Saturn's information, including client lists, customer contracts, pricing information, detailed debtor information, client information and customer log-in codes, all of which could only be accessed through a password protected website, qualifies as trade secrets; (b) the clause is necessary to prevent employees and independent contractors from using their knowledge of Saturn's confidential information – such as unused pre-purchased collection accounts, a debtor's personal information, percentage of debt recovered per client – to solicit Saturn clients, especially those clients who were ripe for renewal; (c) it was "instructive" that Saturn included non-solicitation clause within a single confidentiality provision in the agreement.

3. The Court of Appeals distinguishes *Colorado Accounting Machines, Inc. v. Mergenthaler*, 609 P.2d 1125 (Colo. App. 1980); which held that: employees may not use permitted exception for trade secret protection to transform otherwise naked covenant not to compete, which is void under the statute, into an enforceable agreement. (a) Non-solicitation clause is not separate from the non-disclosure clause; (b) non-solicitation clause is not a "naked" covenant not to compete, rather, it is focused on Saturn's clients.

D. Food for Thought

1. What about *Phoenix Capital*? Non-solicitation clause = naked non-compete under the law.

2. Is distinction between naked non-compete and non-solicitation dependent on the nature of the business product? The nature of the trade secret?

3. Why does it matter that non-solicitation clause is included in single confidentiality provision?

4. In order to violate non-solicitation clause, must you also violate confidentiality clause? No, since Court of Appeals does not reach issue. Do you have to appropriate a trade secret?

5. Does the case turn on the dynamic nature of the particular trade secrets? Does it turn on access to the trade secrets after separation by independent contractor?

6. What does this case tell us about cases involving less dynamic information employer claims to be proprietary, such as a client or contact list, containing only email addresses and phone numbers?

7. Does this case solidify principle that non-solicitation clause must have specific geographic scope?

8. How is case instructive with regards to drafting "naked" non-compete and non-solicitation agreements?

- a. Better chance of enforcing non-solicitation clause than a naked non-compete covenant for purpose of protecting trade secrets;
- b. Minimizes the *Mergenthaler* quandary, at least for non-solicitation clauses.
- c. Different considerations for management employees;
- d. Combining non-disclosure and non-solicitation clause as one provision;
- e. Specificity of non-disclosure clauses;
- f. Utilizing non-solicitation clauses with everyone, not just sales personnel, who is exposed to trade secrets.
- g. An ability to use with independent contractors; and
- h. Importance of attorneys' fee provision.

V. DISH Network Corp. v. Altomari, 224 P.3d 362 (Colo. App. 2009)

A. Facts

- Altomari was hired to be the “Commercial Director” at DISH. As part of his employment, Altomari signed a non-compete agreement as part of a stock option agreement.
- As one of nine directors, he directly supervised fifty of the employer’s 22,000 employees nationwide. His division had a \$10 million annual budget.
- Although he was several layers under the CEO, he was at the top level of compensation (unclear whether in the entire company or at the director level) and at least at the “start” of the decision-making level. Specifically, Altomari, had some supervisory functions, even though they were closely constrained. He was the only director, out of nine directors employed by DISH to perform installation and service work, who worked on the commercial side of the business, which was approximately five percent of the total of DISH’s business.
- Altomari decided to leave DISH six months after joining to work for a competitor, DirecTV.

The trial court granted in part DISH’s motion for preliminary injunction and enjoined Altomari from disclosure of DISH’s confidential information, but refused to enjoin Altomari from working for the competitor. The trial court found that the employee was a mid-level manager at best, and therefore was not “management personnel” within the meaning of Colo. Rev. Stat. § 8-2-113(2).

The trial court observed that Altomari had “a certain amount of autonomy” in performing his functions, but “had to go through a lot of hoops to get authority to do many, many things.” The

trial court relied on *Harrison v. Albright*, 577 P.2d 302 (1977); *Porter Industries, Inc. v. Higgins*, 680 P.2d 1339 (Colo. App. 1984); *Atmel Corp. v. Vitesse Semiconductor Corp.*, 30 P.3d 789 (Colo. App. 2001), abrogated in part on other grounds by *Ingold v. AIMCO/Bluffs, L.L.C. Apartments*, 159 P.3d 116, 124 (Colo. 2007); and *Doubleclick Inc. v. Paikin*, 402 F. Supp. 2d 1251 (D. Colo. 2005), and concluded that the case law required it to “look at whether [Altomari] acts autonomously, is the key man and is in charge of and constitutes the heart of [DISH's] business.”

The Court of Appeals reversed on the basis that the trial court erred in relying on “selected phrases in decisions that simply applied section 8-2-113(2)(d)” and limiting the phrase “management personnel” to key personnel at the heart of a business.

B. Interpretation of “Management Personnel”

1. There is no legislative definition of “management personnel”

3. Nevertheless, the Court of Appeals found that decisions relied on by the trial court were distinguishable because they did not “interpret the plain meaning of section 8-2-113(d).” In its own interpretation, the Court of Appeal noted that “management” and “personnel” are ordinary words of common usage that have unambiguous meanings. “Management” has been defined as the conducting or supervising of something, such as a business. Thus, persons who conduct or supervise a “business” would be considered “management personnel.” Court further found that the term “undoubtedly encompasses ‘key personnel,’ employees who are ‘in charge,’ those at ‘the heart of the business,’ and ‘those few executives at the highest echelons of a company’ ...” Finally, the Court held that “to exclude from the definition of ‘management personnel’ those managers like Altomari who ‘direct, control, and supervise’ approximately fifty people nationwide in a division of a business with a ten million dollar budget, inappropriately narrows the statutory language and is inconsistent with the plain language of the statute.”

Since Altomari was a (a) mid-level manager who (b) supervised fifty employees, was otherwise at the top of the compensation scheme, was (c) employed in a decision-making capacity, and (d) had a certain level of autonomy, he was “management personnel” under § 8-2-113. Accordingly, a one-year non-compete covenant was enforced, barring him from working for Direct TV, a DISH competitor.

C. Food for Thought

1. Does Court of Appeals decision merely beg the question of how one applies “plain meaning” of “management personnel” in different contexts?

2. What does “conducting or supervising a business” mean? Can you conduct or supervise a portion of a business?

3. Does this definition apply equally to all sizes of business?

4. How relevant is the management personnel’s exposure to the employer’s clients in this analysis?

5. Can the management personnel in question be subject to the *Altomari* analysis even if he or she supervises an administrative division of the business, like human resources, and have little or no client contact?

6. How important is the income level of employee in determining management level?

7. Does every case remain a case-by-case analysis despite Court's conclusion that "management" has unambiguous meaning? If so, is it because the word "management" is by its nature ambiguous with different meaning in different contexts?

V. *Lucht's Concrete Pumping, Inc. v. Tracy Horner & Everist Materials, Inc.*, 2009 Colo. App. LEXIS 1041 (Colo. Ct. App., June 11, 2009), cert. granted, 2010 Colo. LEXIS 72 (Colo. February 1, 2010)

A. Facts

- Lucht's Concrete Pumping ("LCP") is a concrete pumping company that supplies ready-mix concrete to construction sites in the Rocky Mountain region.

- Horner began his employment with LCP in 2001 as a mountain division manager. He was responsible for building client relationships on behalf of LCP. Two years after he commenced employment, Horner was asked to sign and did sign an Employee Non-Disclosure and Confidentiality Agreement with LCP.

- Approximately one year later, Horner resigned and three days later he began working for Everist, a direct competitor of LCP.

The trial court granted summary judgment in favor of Horner on the non-compete agreement, concluding that the agreement was unenforceable due to lack of consideration. The Court of Appeals affirmed, holding that for an employee who continues his or her job without receiving additional pay or benefits when a non-compete agreement is signed, the agreement lacks consideration.

The Court of Appeals upheld the trial, imposing a requirement of new consideration.

B. The "New Consideration" Requirement

1. Covenant not to compete must be supported by consideration, *citing Int'l Paper Co. v. Cohen*, 126 P.3d 222 (Colo. App. 2005), quoting Black's Law Dictionary 324 (8th ed. 2004)

2. Consideration is something (such as an act, a forbearance, or a return promise) bargained for and received by a promisor from a promisee; that which motivates a person to do something, especially to engage in a legal act. *International Paper v. Cohen*, 126 P.3d 222, 225 (Colo. App. 2005); *Compass Bank v. Cohen*, 134 P.3d 500, 502 (Colo. App. 2006) (consideration may be "a benefit received or something given up as agreed upon between the parties" (quoting CJI-Civ. 4th 30:5 (1998))).

3. The Court distinguished *Kuta v. Joint Dist. No. 50(J)*, 799 P.2d 379 (Colo. 1990) and *Cont'l Air Lines, Inc. v. Keenan*, 731 P.2d 708 (Colo. 1987) the case dealing with benefits, rather than restrictions, construed in favor of employees, involve policies or procedures that are offered to a group of employees, and involve actions brought by employees to enforce an employer's promise. Furthermore, the Court found that those cases also require a finding that the "continued employment constituted acceptance of and consideration for" the new policies and procedures.

4. The Court notes that by continuing to employ the employee after he signed the Agreement, nothing prevented LCP from later terminating Horner's employment, and therefore did not provide any new consideration to him. On the other hand, Horner made a new promise to not compete against LCP following his termination. Non-competes are both disfavored, and require promises by the employee extending beyond at-will relationship. The Court held that additional consideration was needed, and the independent consideration requirement "reflects the fact that employers and employees have unequal bargaining power."

C. Food for Thought

1. Isn't the Court's analysis equally applicable at the commencement of employment? Can you combine "at will" employment with a non-compete?

2. If monetary consideration is sufficient, then how much?

3. Is circumscribing "at will" termination rights for any period of time into the future sufficient?

4. What other types of consideration will be sufficient? Court of Appeals in *Lucht's* alludes to "pay increase, promotion, or additional benefits." *Phoenix Capital* alludes to "additional responsibility."

5. What about an employee that was not provided access to trade secret information, but is later provided access to protected information? Would this be sufficient consideration?