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# $2.6M on the line over employment contract question

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The Minnesota Supreme Court recently had occasion to consider whether a 25-plus-year employee's failure to return all his employer's property immediately upon termination justified the forfeiture of $2.6 million in compensation.

The case of *Capistrant v. Lifetouch National School Studios Inc.*, No. A16-1829, 2018 BL 263415 (July 25, 2018), reminds us once again that employment agreements will not always be enforced as drafted.

Specifically, John J. Capistrant's employment contract with his longtime employer, defendant Lifetouch National School Studios, entitled him to hefty residual commissions via an addendum titled "Residual Commissions and Payments for Restriction Against Competition," suggesting that the commissions were specific consideration for the employee and customer nonsolicitation restrictions contained in Paragraph 11 of the contract.

However, Paragraph 11 (titled "Restrictions Against Competition") also contained a nondisclosure provision and a stand-alone return of property provision, the latter of which obligated Capistrant to "immediately deliver to Lifetouch all of [its] property" upon cessation of employment.

The contract also provided that should Capistrant breach any of the provisions of Paragraph 11, Lifetouch could "terminate [its] obligation to make any payments of residual commission that have not yet been paid."

Capistrant retired from Touchstone in March 2015, but did not return Lifetouch's customer lists, sales data, payroll records, financial statements and business plans until almost four months later, after Capistrant's counsel disclosed the documents during discovery in his declaratory judgment action regarding the proper calculation of his residual commissions.

Although Capistrant did return these documents (albeit belatedly) and there was no suggestion that he had disclosed them, misused them or violated any of the restrictive covenants of Paragraph 11, the trial court granted Lifetouch summary judgment, concluding that the return-of-property clause was a condition precedent to Lifetouch's obligation to pay the commissions and that Capistrant had failed to fulfill it.

The court of appeals, however, reversed.

Although it agreed that the return of property clause was a condition precedent to Lifetouch's duty to pay the commissions, it found that the trial court erred in failing to recognize that, read as a whole, Paragraph 11 and the residual commissions addendum operated as a noncompete agreement with a forfeiture clause, which should have been subject to its precedent regarding "the unenforceability of disproportionate forfeiture clauses and overbroad noncompete agreements."

The court of appeals also applied Section 229 of the Restatement (Second) of Contracts and held that the timing of the return of property was not a material part of the contract and the forfeiture of $2.6 million for retaining the documents without evidence of dissemination or an intent to compete was a "disproportionate forfeiture."

The court of appeals, therefore, concluded that Capistrant's failure to immediately return the documents was excused as a matter of law.

On review, the Minnesota Supreme Court largely sidestepped the issue of enforceability of forfeiture for competition clauses generally, stating that to the extent the return of property clause was part of a restrictive covenant, it was not overly broad in duration or scope.

The court then appeared to agree with both lower courts' view of the return of property clause as a condition precedent to Lifetouch's obligation, conceding the "general rule" was that such conditions must be "literally met or exactly fulfilled" before liability on the obligation qualified by the condition could arise.

The *Capistrant* court noted, however, that the return of property condition was unique in that the "parties had been performing under the contract for 28 years before the condition become operative" and unique in terms of the size of the forfeiture.

Noting that its own precedent disfavored "forfeitures of all kinds," the Minnesota Supreme Court agreed that Section 229 of the Restatement was helpful in resolving the dispute at hand. That section provides: "To the extent that the nonoccurrence of a condition would cause disproportionate forfeiture, a court may excuse the nonoccurrence of that condition unless it was a material part of the agreed exchange."

According to the Supreme Court, however, the court of appeals erred in finding that both portions of Section 229 — whether the occurrence of the condition was a material part of the agreed exchange and a proportionality analysis that balances the risk to be protected with the amount to be forfeited — favored Capistrant as a matter of law.

In this regard, Lifetouch argued that the immediacy requirement in the return of property clause was material because it was necessary to prevent its confidential information and trade secrets from passing out of its control.

Capistrant, of course, argued that his retention of Lifetouch's documents for a matter of months was a minor and immaterial delay: One that did not go to the "very root or essence of the contract."

In finding that the existing record did not permit resolution of the materiality issue as a matter of law, the *Capistrant* court found conflicting inferences. On the side of materiality, the condition was a stand-alone obligation of Paragraph 11, and Capistrant agreed that a breach of that obligation would end his right to the residual commission.

On the other hand, the return-of-property clause, a onetime obligation, was contained in a provision imposing ongoing post-employment noncompetition obligations on Capistrant.

According to the court, this suggested that the clause was only material to Capistrant's noncompetition, meaning that so long as he did not use Lifetouch's documents to compete with Lifetouch, his brief retention of the documents may not be material to his receipt of the residual commissions.

The court, therefore, remanded the case for the trial court to resolve the materiality question and only then consider the separate issue of disproportionality. What parole evidence might be relevant to that materiality determination, apart from what is sure to include the parties' self-serving, post hoc explanations of their precontract intent, the court did not say.

Regardless, had the condition precedent Capistrant breached been his compliance with the nonsolicitation or nondisclosure covenants of his contract, we expect that the materiality issue would have been resolved in Lifetouch's favor, particularly in light of the court's view on their enforceability.

At the end, those drafting employment agreements should consider forfeiture provisions carefully, as the more draconian provisions may not pass legal muster.