

**STATE OF MINNESOTA
HENNEPIN COUNTY DISTRICT COURT**

TELLURIDE ASSET MANAGEMENT, LLC,

Plaintiff,

vs.

ERIC FALKENSTEIN

Defendant.

Civil Action No. _____--

**MEMORANDUM OF LAW IN SUPPORT OF PLAINTIFF'S EX PARTE MOTION FOR
TEMPORARY RESTRAINING ORDER AND TEMPORARY INJUNCTION**

Pursuant to Minnesota Rule of Civil Procedure 65, Telluride Asset Management, LLC ("Telluride") has moved the Court to (1) enter a temporary restraining order, restraining Defendant Eric Falkenstein ("Falkenstein") from: (a) using or disclosing Telluride's confidential or proprietary information; and (b) misappropriating Telluride's trade secrets; and (2) issue a temporary injunction following a hearing until a full trial on the merits can take place. In support of its motion, Telluride submits this memorandum of law and its Verified Complaint that it incorporates herein by reference.

I. INTRODUCTION

Telluride operates hedge funds and Falkenstein is a former portfolio manager for Telluride who was entrusted with Telluride's trade secrets to conceive, develop and implement systematic trading strategies, concepts and models for Telluride. Falkenstein resigned from Telluride on September 1, 2006, and now is offering a proposed trading strategy that is remarkably similar to and derived from his work at Telluride.

By his own words, Falkenstein has admitted that his proposed trading strategy bears “significant similarities” to the trading strategies that he used at Telluride. He further admitted that he intends to apply the same set of factors (accruals, profitability, volatility and capital issuance) and the same algorithm (mean-variance optimization) to his proposed strategy as he did to the “sub-strategies at Telluride.” His only defense is his claim that these significant similarities, factors and algorithm are widely know and in the public domain. Armed with Telluride’s trade secrets and confidential and proprietary information as a roadmap, however, it is not surprising that Falkenstein can now locate “the needles” of Telluride’s trade secrets in the vast “haystacks” of the public domain. But when Telluride asked Falkenstein to prove that the “significant similarities,” the factors and the algorithm that he purportedly implemented in his proposed trading strategy were indeed part of the public domain by providing actual copies of the significant similarities, factors and algorithm, Falkenstein refused to do so.

Further, it is irrelevant if certain general concepts are in the public domain. Falkenstein is contractually obligated to return to Telluride everything that he made, conceived or developed for Telluride and everything that he developed on his own that is related directly to Telluride’s business, that is related to Telluride’s anticipated development or that is a result of his work for Telluride. By his own admission, Falkenstein’s strategy is related directly to his work at Telluride and is a result of his work at telluride. He simply cannot, with 20/20 hindsight, recreate Telluride’s trade secrets from the public domain. While a third party has the freedom to create trade secrets from information in the public domain without risk of liability, a former employee who has had access to, used and developed trade secret information and is contractually bound cannot. Thus, Falkenstein has violated Telluride’s trade secrets and breached his employment contract.

II. FACTS

Telluride operates hedge funds. Both individuals and institutions invest in Telluride's hedge funds. Telluride has extensive experience in operating hedge funds and in creating investment strategies, managing risk and successfully operating investment businesses.

Telluride has developed valuable trade secrets during the course of its business. These trade secrets give Telluride a distinct advantage over its competitors. Telluride has taken reasonable steps to protect its trade secrets from disclosure including the use of multiple layers of security, specific user access control and auditing. In addition, Telluride requires all employees to sign confidentiality agreements containing confidentiality provisions that require the protection and non-disclosure of Telluride's trade secrets and confidential business information.

On January 22, 2004, Telluride hired Eric Falkenstein as a Portfolio Manager. As a Portfolio Manager, Falkenstein's primary job responsibilities were to conceive, develop, implement, monitor and maintain systematic investment trading models for Telluride.

Telluride and Falkenstein executed a written agreement on January 22, 2004, entitled Employee Confidentiality and Non-Solicitation Agreement ("Confidentiality Agreement"). A copy is attached to the Verified Complaint as Exhibit A and is incorporated herein in its entirety by reference. The Confidentiality Agreement provides that "Employee agrees that all inventions, discoveries, computer software programs, trade concepts, designs, patents, ideas and copyrightable and/or patentable materials made, conceived or developed by Employee during the term of this Agreement shall be owned in full by the Firm." Verified Complaint, Ex. A § 2 (emphasis added). It further provides that the Firm's ownership of an invention would not apply to "an invention for which no equipment, supplies, facility or trade secret information of the Firm was used and which was developed entirely on the Employee's own time, and (1) which

does not relate (a) directly to the business of the Firm or (b) to the Firm's actual or demonstrably anticipated research or development, or (2) which does not result from any work performed by the employee for the firm." Id.

The Confidentiality Agreement informed Falkenstein that "[d]uring and by reason of employment with the Firm, Employee shall receive or have access to trade secrets, patents, copyrights and other confidential or proprietary information (collectively referred to in this Agreement as 'Confidential Information')." It defines Confidential Information as information "used in the Firm's business which is not known or otherwise available by proper means through sources outside the Firm, and which therefore has value to the Firm and provides an actual or potential advantage over competitors, including, but not limited to, information of either a technical or commercial nature including, financial information, customer or client lists, employee or consultant information, market information, trading information, models, formulae, strategies, methodologies and the like and other specific financial and trading information." Id. § 3.

The Confidentiality Agreement further provides that "Employee acknowledges that Confidential Information is a valuable, special, and unique asset of the Firm and that the sole and exclusive right, title and interest in and to Confidential Information is owned by the Firm." Id. It further required that Falkenstein, during the course of his employment with Telluride, "shall not use or disclose [Telluride's] Confidential Information to any person or entity except as necessary for the proper performance of duties and responsibilities prescribed by the Firm." Id. § 4. And, it requires that Falkenstein, after the termination of his employment for whatever reason, "shall not use or disclose Confidential Information to any person or entity other than the Firm for any reason" unless compelled to by court order or subpoena. Id. The Confidentiality

Agreement further required that Falkenstein “shall immediately and unconditionally surrender to the Firm all Confidential Information and all property belonging to the Firm” upon termination of his employment. Id. § 5.

When Falkenstein began his employment with Telluride he brought with him a systematic fundamental domestic single stock equity trading model that he had previously developed (the “Original Model”). The Original Model used profitability and accruals as factors for estimating the expected returns of equities.

Falkenstein and Telluride agreed that if and when Falkenstein left his employment with Telluride, both he and Telluride were free to continue using the Original Model. However, as required by the Confidentiality Agreement, any and all modifications, revisions, additions, refinements, or improvements made to the Original Model (including all of its factors) while Falkenstein was employed by Telluride would belong to Telluride. Telluride, as the “full” owner of any and all such modifications, revisions, additions, refinements and improvements, was free to continue using any and all such modified models after Falkenstein’s termination. Falkenstein, however, could not use any of the modifications, revisions, additions, refinements or improvements made to the Original Model once he left Telluride’s employ.

While employed by Telluride, Falkenstein was responsible for monitoring, analyzing, diagnosing and further developing, modifying, revising, adding to, refining, and improving the Original Model. In collaboration with Telluride and during the course of his employment with Telluride, Falkenstein worked on, monitored, analyzed, diagnosed, modified, revised, added to, refined, and improved the Original Model (hereinafter all such modifications, revisions, additions, refinements, and improvements to the Original Model will be collectively called the “Telluride Modified Model”).

Falkenstein was also responsible for researching new trading models, strategies and concepts for Telluride. Falkenstein developed and implemented at least three new trading models, concepts and strategies for Telluride (hereinafter collectively called the "New Telluride Models"). The New Telluride Models used, among other things, volatility and capital issuance as factors for estimating the expected return of equities.

During his employment at Telluride, Falkenstein was given access to Telluride's Confidential Information, resources and employees in developing trading models, strategies and concepts for Telluride, including Telluride's trade secrets and other confidential and proprietary information. Falkenstein used Telluride's trade secrets, proprietary information and resources in monitoring, analyzing diagnosing and developing, improving, revising and refining the Telluride Modified Model and in researching the new trading models, strategies and concepts for the New Telluride Models. In performing his work at Telluride, Falkenstein discussed and vetted proposed improvements, concepts, ideas, strategies, methodologies, and algorithms with Telluride. Many of these concepts, ideas, strategies, methodologies, and algorithms were incorporated into the Telluride Modified Model and the New Telluride Models. Telluride provided Falkenstein with the funds and all the resources necessary to develop, operate, and manage the Telluride Modified Model and the New Telluride Models.

In addition to his normal business hours at Telluride, Falkenstein often worked for Telluride from his home on weekends and evenings. Upon information and belief, Falkenstein carried out his work on computer(s) that he owned using information, data series, and other resources supplied by Telluride.

Falkenstein resigned from his position at Telluride on September 1, 2006. In his resignation letter, Falkenstein said that he had reviewed his agreements with Telluride and

understood his continuing obligations. Verified Complaint, Ex. B. However, he failed to return Telluride's property including the Telluride Modified Model and the New Telluride Models.

On or about February 16, 2007, Telluride learned that Falkenstein was planning on starting his own hedge fund and was proposing an equities trading strategy very similar to the Telluride Modified Model and the New Telluride Models. Telluride contacted Falkenstein to confirm that he did not intend to use or disclose Telluride's trade secrets and confidential information in connection with the proposed strategy or use or disclose the Telluride Modified Model or the New Telluride Models.

In a telephone conversation on or about February 16, 2007, Falkenstein assured Telluride that he was not using or disclosing any of Telluride's trade secrets or confidential information. He also agreed to send to Telluride all presentations and back tests that he had submitted to any prospective employers or business partners. Falkenstein never followed through on this promise.

By letter dated February 20, 2007, Falkenstein instead asserted that "I have and will continue to fully comply with every provision" of the Confidentiality Agreement. Verified Complaint, Ex. C. But Falkenstein admitted that he intended to use trading strategies that have "significant similarities . . . to what [he] did at Telluride." Id. He further claimed that the similarities "include practices that I consider to be in the public domain . . ." Id. However, having had access to, learned of, and helped to develop Telluride's trade secrets and proprietary information and practices, Falkenstein can now, after the fact, conveniently look for and find various isolated pieces of Telluride's trade secrets and proprietary information and practices in the public domain. Knowing exactly where to look, Falkenstein now claims that each such piece can be found in the public domain. As but one example, Falkenstein admitted in his letter that he intended to use an algorithm that he used in the "sub-strategies at Telluride," but claimed that

this algorithm was widely described in introductory MBA finance. Id. Yet, this algorithm was provided to Falkenstein by Telluride. It was not in the Original Model that Falkenstein brought to Telluride and did not come from Falkenstein's prior experience. Telluride instructed Falkenstein to implement that algorithm into the Telluride Modified Model.

On February 22, 2007, Telluride asked Falkenstein to "identify all similarities between your proposed strategy and to what you did at Telluride not just the similarities that are in the public domain." Verified Complaint, Ex. D. Telluride also asked Falkenstein to "identify the similarities with detailed particularity including by providing [Telluride] with copies of any computer software programs, excel spreadsheets and back testing information." Id. Falkenstein failed to respond to Telluride's request. Telluride also asked Falkenstein to "identify the specific algorithms that you used on 'my sub-strategies at Telluride' and that you intend to use in your proposed strategy. Please further provide [Telluride] with copies of those algorithms." Id. Falkenstein failed to respond to Telluride's request. Telluride also asked Falkenstein to confirm that "you have surrendered all Confidential Information and all property belonging to Telluride as required by Paragraph 5 of the agreement." Id. Falkenstein again failed to respond to Telluride's request.

Telluride repeated its request in a hand-delivered letter delivered on March 2, 2007. Verified Complaint, Ex. E. On March 9, 2007, Falkenstein responded to Telluride's repeated inquiries and admitted that his proposed strategy for equities used profitability, accruals, volatility, and capital issuance as factors for estimating the return of equities. Verified Complaint, Ex. F. These are the same four factors as are used in the Telluride Modified Model and in the New Telluride Models. However, Falkenstein claimed that he used public domain information to develop this same set of factors that he developed for and used at Telluride. He

further admitted using “mean-variance optimization” as he did at Telluride but claims he wrote a new algorithm from scratch using public domain information.

On March 15, 2007, Falkenstein met with Peter Hajas, Telluride’s Chief Investment Officer and Chief Executive Officer, in an effort to convince Telluride that his proposed strategy did not use or disclose Telluride’s Modified Model, the New Telluride Models or Telluride’s trade secrets. However, Falkenstein provided only selected and redacted information concerning his proposed strategy. During this meeting, Falkenstein again admitted that he was using used profitability, accruals, volatility and capital issuance as factors for estimating the return of equities but did not reveal the manner in which he was intending to implement these factors. He further admitted that he was using a “mean variance optimization” similar to what he was instructed to implement at Telluride.

III. ARGUMENT

Minnesota courts employ the same five-factor test to determine whether to issue a restraining order or temporary injunction. M.G.M. Liquor Warehouse Int’l, Inc. v. Forsland, 371 N.W.2d 75, 77 (Minn. Ct. App. 1985) (“The analysis that the trial court must complete in granting a TRO is the same as that to be shown before a temporary injunction is issued.”). These factors are: (1) the relationship of the parties before the dispute arose; (2) the likelihood of success on the merits; (3) the harm to be suffered by plaintiff if the injunction is denied as compared to that inflicted on defendant if the injunction issues pending trial; (4) public policy considerations; and (5) the administrative burdens imposed on the Court. Dahlberg Bros., Inc. v. Ford Motor Co., 137 N.W.2d 314, 321-22 (Minn. 1965). One of the goals of a temporary restraining order or temporary injunction is to preserve the status quo by enforcing employment agreements. Miller v. Foley, 317 N.W.2d 710, 712 (Minn. 1982).

In Medtronic, Inc. v. Advanced Bionics Corp., using the five-factor test the court upheld the district court's issuance of a temporary injunction that prevented Medtronic's former employee from breaching his noncompete agreement and working with Advanced Bionics, one of Medtronic's competitors. 630 N.W.2d 438 (Minn. Ct. App. 2001). The court found that the first factor—relationship between the parties—weighed in favor of the injunction because the employee entered into the noncompete of his own free will and gained valuable training and customer contacts. Id. at 451. The second factor—likelihood of success—also weighed in favor of the injunction because the harm to Medtronic as an employer—loss of customer connections, loss of goodwill, and the intellectual information taken by the employee—outweighed the harm to the corporation—a two-year noncompete on limited products. Id. at 451-54. The court explained that the employee, Stultz, “voluntarily left Medtronic’s employ, knowing that future employment may be subject to the noncompete agreement, thus creating the current situation. Moreover, the noncompete agreement has not prevented him from earning a living, as Stultz is currently living in California and working for Advanced Bionics.” Id. at 453-54. The third factor also weighed in favor of the injunction because Medtronic would likely win on the merits. Id. at 454-56. The court found that the fourth factor—public policy—weighed in favor because corporations have a legitimate interest in protecting their businesses: “restrictive covenants are enforced to the extent reasonably necessary to protect legitimate business interests. Legitimate interests that may be protected include the company’s goodwill, trade secrets, and confidential information.” Id. at 456 (citations omitted). And the final factor weighed in favor because the court found that there would be no administrative burden. Id.

As discussed below, here each of the five factors weighs in favor of granting injunctive relief.

