PROSKAUER ROSE LLP

The Non-Compete and Trade Secrets Newsletter

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The Non-Compete and Trade Secrets Practice Group at Proskauer Rose LLP is pleased to introduce this newsletter which focuses on recent and significant developments in litigation related to non-competition, non-solicitation, trade secrets, employee movement and unfair competition.

This inaugural issue addresses cases of interest from January through June, 2008.

Proskauer Wins Non-Compete Case Allowing Employees To Work for The Red Bulls

NASC Services, Inc. d/b/a MLS Camps v. Jervis, 2008 U.S. Dist. LEXIS 40502 (D.N.J. May 19, 2008)

Between August and November of 2007, six MLS Camps employees resigned and went to work within the youth player development system of Major League Soccer team, the New York Red Bulls. The six employees had agreements with MLS Camps, which included one-year non-competition and non-solicitation provisions, as well as open-ended nondisclosure agreements. MLS Camps applied for a preliminary injunction seeking to enforce the restrictive covenants. Proskauer attorneys, on behalf of the six employees (and the Red Bulls), convinced the court to deny MLS Camps' application for a preliminary injunction.

What this decision means for employers: Courts often will refuse to enforce non-competition agreements (i) that attempt to prevent the disclosure of publicly available information (the court found that the teaching methods used by the employees at MLS were not confidential or proprietary), and (ii) when there is an unexcused delay in taking action (here, four months), as it demonstrates a lack of imminent harm. Additionally, employers should be wary of restrictive covenants that apply to any comparable business around the world, as such provisions often are struck down as overly broad.

New York Appellate Court Upholds Client Non-Solicitation and Liquidated Damages Claims under Accounting Firm Partnership Agreement

Weiser LLP v. Jeffrey S. Coopersmith, et al., 2008 NY Slip Op. 04772 (May 30, 2008) (See the Proskauer Rose Client Alert cited below.)

On July 30, 1999, Jeffrey Coopersmith, Michael Simon and William Vogel (the "Former Partners") entered into a merger agreement to combine their accounting firm with Weiser and become Weiser partners. In addition to the Merger Agreement, the Former Partners

signed the 1998 Weiser Partnership Agreement ("WPA") which included, among other things, client non-solicitation, employee no-raid and liquidated damages provisions. In April 2005, the Former Partners gave notice of withdrawal from Weiser and stated their intent to continue to service the clients they had brought to the firm, clients referred to them by these clients, and clients from referral services utilized prior to the date of merger—approximately 482 clients in total. The Appellate Division found that Weiser had established a *prima facie* case for enforcing the restrictive covenant and $3 million liquidated damages claim.

What this decision means for employers: By characterizing the litigation case as a "sale of business case" rather than an employment agreement dispute, the Appellate Division rejected the application of *BDO Seidman v. Hirshberg*, 93 N.Y.2d 382 (1999), which recognized a carve-out to a restrictive covenant with respect to "personal clients" of an employee who came to the firm solely to avail themselves of the employee's services and as a result of the employee's own "independent recruitment efforts." Also, while it remains to be seen whether, on remand, the Former Partners will be able to rebut the *prima facie* case for $3 million in liquidated damages, the Appellate Division did recognize this stipulated amount as having some evidentiary basis and tied to an arm's-length transaction. Finally, in reversing the dismissal of claims that the Former Partners violated their fiduciary duties and duties of loyalty, the Appellate Division noted that the alleged conduct went beyond permissible conduct limited to merely informing clients and employees of an impending departure.

Click here to view the Client Alert which provides more detailed information.

Employer Cannot Enforce "Missing" Non-Compete

Titan Capital Group II, LLC v. Raghavan, 2008 NY Slip Op. 50722(U) (March 27, 2008)

Plaintiff, a hedge fund specializing in volatility arbitrage, sued its former trader, Raghavan, alleging, among other things, that he breached a one-year non-compete agreement when he left the company in 2006 to join another company engaged in the same business. The plaintiff was unable to produce any document evidencing the non-compete agreement. The Court granted the employee-defendant's application for summary judgment dismissing the complaint.

What this decision means for employers: You are only as good as your documentation. Oral agreements and written agreements that cannot be located may be no better in court than no agreement at all.

Memorized Client List Can Form the Basis of a Trade Secrets Violation

Al Minor & Associates, Inc. v. Martin, 117 Ohio St. 3d 58, 881 N.E.2d 850 (Feb 6, 2008)

Employer Al Minor & Associates ("AMA") hired employee-defendant as a pension analyst, but did not require him to sign an employment contract or a non-compete agreement. In 2002, while still employed by plaintiff, employee organized his own company, which would provide the same services as AMA. In 2003, Martin resigned from AMA and, without taking any documents containing confidential client information, successfully solicited 15 AMA clients using information he had memorized. After learning of his competing business, AMA filed suit claiming Martin had violated Ohio's Trade Secrets Act by using confidential information to solicit AMA's clients. Martin argued that a memorized list could not constitute a trade secret. The trial court and Court of Appeals disagreed, and after analyzing the language of the Trade Secrets Act and Ohio's associated six-factor test for determining whether information constituted a trade secret, held that memorized information could give rise to a trade secret violation.

What this decision means for employers: A departing employee need not abscond with company information in tangible form to constitute a trade secret violation. Memorized information is subject to the same protections as any other trade secret. Employers should make their employees aware that memorized confidential information, including customer lists, is subject to the same restrictions as any other confidential information.

Employee Wins – 7th Circuit Finds Power To "Blue-Pencil" Discretionary

Cintas Corp. v. Perry, 517 F.3d 459 (7th Cir. 2008)

Perry, a National Account Manager for Cintas, resigned to join Aramark, the company's largest competitor. Perry had a two-year non-compete which identified 30 companies (including Aramark) that Perry could not—directly or indirectly—work for following cessation of employment for any reason. The agreement also included prohibitions on solicitation of employees and clients, and disclosure of confidential information. Cintas sued for breach of contract and moved for a preliminary injunction, which was denied by the district court. Perry then moved for summary judgment and for fees. Cintas opposed, asking that the district court blue-pencil (i.e., judicially narrow) the non-compete so as to protect Cintas's legitimate business interests. The district court chose not to blue-pencil the agreement, and granted Perry's motion for summary judgment. Even worse for Cintas, several months later the court ordered Cintas to pay Perry's attorney fees and litigation costs in an amount exceeding $300,000 pursuant to the agreement's requirement that such fees and costs be paid to the "prevailing party."

On appeal to the Seventh Circuit, Cintas argued that the district court was required to modify the agreement to render it reasonable and enforceable. The Seventh Circuit disagreed, holding that the power to modify an overbroad agreement is discretionary with the district court, subject only to an "abuse of discretion" standard of review. It also upheld the district court's decision and assessment of attorney fees and costs.

What this decision means for employers: Employers cannot rely on the courts' blue-penciling power to rescue overbroad non-competition agreements. While a court may, in its discretion, narrow an overbroad restrictive covenant, it may instead simply render the entire agreement void. Also, rethink "prevailing party" fee-shifting provisions. The $300,000 "bill" for Perry's attorney fees and litigation costs made this litigation particularly painful for Cintas. Although some courts may not enforce a provision that is not reciprocal, Cintas may have avoided this result had the agreement merely provided for the payment of reasonable attorney fees and litigation costs incurred in enforcing the agreement, rather than payment to the "prevailing party."

Employer Wins – California Court of Appeal Okays Three-Year Statewide Non-Compete/Non-Solicitation Agreement

Alliant Ins. Services, Inc. v. Gaddy, 159 Cal. App. 4th 1292 (2008)

Alliant Insurance Services purchased a competing insurance brokerage company from Gaddy for $4.1 million and then employed him under a senior management agreement. Both the purchase and employment agreements contained covenants whereby Gaddy agreed not to compete with Alliant or to solicit Alliant's or his own clients in any of California's 58 counties for three years following termination of employment. Once Gaddy's employment was terminated, he immediately began soliciting clients in violation of the non-solicitation provision. The trial court granted a preliminary injunction against Gaddy on the ground that the non-solicitation covenant was enforceable and in view of the evidence that Gaddy had misappropriated Alliant's trade secrets in violation of California's Uniform Trade Secrets Act ("CUTSA"). Gaddy appealed, contending that that the geographic scope of the injunction should be limited to the four counties in which Alliant had clients. The California Court of Appeal affirmed the lower court's decision.

What this decision means for employers: While California is generally hostile to restrictive covenants, there is a well-recognized statutory exception in the context of the sale of a business. When one company buys the goodwill of another, the purchaser may obtain and enforce a relatively broad non-compete/non-solicitation covenant in a specified geographic area that may extend to all counties within the State of California.

Statute of Limitations for Trade Secrets Claim Runs from Time of Owner's Knowledge

CypressSemiconductor Corp. v. Superior Court, 163 Cal. App. 4th 575 (2008)

The trade secret owner in this case, Silvaco Data Systems ("Silvaco"), develops and licenses electronic design automation software. In late 1998, a former Silvaco employee working for Circuit Systems, Inc. ("CSI") incorporated Silvaco's "SmartSpice" trade secrets into CSI's product, "DynaSpice." Silvaco sued the employee as well as CSI and in 2003 entered into a settlement agreement and stipulated judgment. CypressSemiconductor ("Cypress") (one of CSI's customers that had purchased DynaSpice) learned of the judgment in August 2003. In September 2003, Silvaco contacted Cypress directly and demanded that it cease its use of Silvaco's trade secrets (as incorporated in the DynaSpice software). When Cypress continued to use the product after receiving notice from Silvaco, the latter company sued the former for trade secret misappropriation under the California Uniform Trade Secrets Act ("CUTSA"). Cypress defended in part based on CUTSA's three-year statute of limitations, which it contended commenced running in 2000 when Silvaco discovered CSI's misappropriation. Silvaco, however, argued that because Cypress did not know of CSI's misappropriation until August of 2003, the statute of limitations did not commence running until that date because one of the elements of a trade secret misappropriation claim is the defendant's knowledge of the wrongfulness of its conduct. The Court of Appeal held that a plaintiff may have more than one claim for misappropriation, each with its own statute of limitations, when more than one defendant is involved. However, the court further held that the statute commences running when the plaintiff knows or has reason to know the third party has knowingly acquired, used or disclosed its trade secrets. In this case, the court held that Cypress was entitled to a jury trial to determine when Silvaco first had reason to know that a CSI customer such as Cypress had obtained or used DynaSpice knowing, or with reason to know, that the software contained Silvaco's trade secrets.

What this decision means for employers: While it is significant that the statute of limitations for misappropriation claims runs from the point at which the owner knew or had reason to know of the misappropriation by a particular person/entity, the court's decision to require a trial on this point is disappointing. Accordingly, employers would be well-advised to document instances relating to the discovery of misappropriation and to aggressively prosecute trade secret misappropriation claims against any and all possible defendants (including, if appropriate, a competitor's customers) as soon as possible.

In Brief

Thomas Weisel Partners Group, Inc. v. Milner, Index No.: 08-106093 (Sup. NY 2008)

On April 30, 2008, Thomas Weisel Partners Group ("TWP") filed a petition in New York State Supreme Court for a temporary restraining order and a preliminary injunction against

Brent Milner, a former Managing Director and Head of TWP's Healthcare Banking Group, who on April 17, 2008 and with no prior notice left TWP with three other Principals to join Stanford Financial Group ("SFG"), one of TWP's competitors. TWP amended this petition on May 5, 2008.

The employment agreement Milner signed in 2006 provided that the employment relationship between Milner and TWP could be terminated only on 90 days' written notice. During this 90-day period, TWP could elect to place Milner on paid leave. TWP sought to enforce this garden leave provision as written, enjoining Milner from providing any services to SFG pending expiration of the 90-day notice period, and to direct Milner to accept compensation and benefits provided by TWP during this period.

While there is nothing contained in the court's docket as of this writing, *Financial Services Law 360* has reported that, on May 8th, Judge Lewis Stone granted the TRO enforcing the garden leave provision, and further ordered Milner to show cause at a May 21st hearing as to why a preliminary injunction forbidding him from joining SFG until the expiration of the 90-day notice period ("or until such later date as may be determined by an arbitration panel appointed by the Financial Industry Regulatory Authority") should not be issued. We are awaiting further developments.

Profit Concepts Mgmt., Inc. v. Griffith, 162 Cal. App. 4th 950 (2008)

Profit Concepts sued its former employee, Greg Griffith, for breach of contract in California Superior Court. The employment contract provided that in any litigation involving the contract, the prevailing party would be entitled to recover its attorney fees and costs. Griffith, who was an Oklahoma resident at the time the litigation was commenced, moved to quash service for lack of personal jurisdiction. After Profit Concepts filed a notice of non-opposition to the motion to quash, the trial court granted the motion and awarded attorney fees to Griffith as the prevailing party; Profit Concepts appealed.

Profit Concepts, which also had initiated an action against Griffith in Oklahoma, argued that a determination on the merits of the contract claim was necessary before attorney fees could be awarded. The California Court of Appeal disagreed, holding that California law does not require resolution of the merits of a contract claim in another state's proceeding before a prevailing party could be determined when, as here, the matter had been completely resolved vis-à-vis the California courts. Because the company's California action was dismissed in its entirety, Griffith was the prevailing party in the California suit and was, therefore, entitled to recover his reasonable attorney fees and costs.

Non-Compete and Trade Secrets Practice Group

Questions or Comments

The Proskauer Rose Non-Compete and Trade Secrets Practice Group is an interdisciplinary practice group throughout the national and international offices of the Firm which specializes in non-competition, non-solicitation, trade secret, employee movement and unfair competition matters; counseling and executive compensation plan design; and all aspects of litigation.

If you have any questions about any of the cases highlighted in this newsletter, or any questions regarding developments in non-compete or trade secrets law, please do not hesitate to contact the leaders of Proskauer's Non-Compete and Trade Secrets Practice Group, who are listed below:

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