PROSKAUER ROSE LLP

The Non-Compete and Trade Secrets Newsletter

SPRING 09

The Non-Compete and Trade Secrets Practice Group at Proskauer Rose LLP is pleased to announce the publication of the Spring 2009 issue of its newsletter.

This issue focuses on a number of important cases involving New York law, including:

- The Marsh v. Karasaki decision, which upheld broad customer non-solicitation provisions that restricted a departing senior executive from soliciting the customers of employees he supervised (and not merely customers with whom he had a direct relationship)
- The IBM v. Papermaster decision, which applied the "inevitable disclosure doctrine" to prohibit a senior engineer who left IBM from joining Apple.
- The Naden v. Numerex Corp. decision, where former executives unsuccessfully sought injunctive relief to invalidate non-compete provisions that had been entered into as part of the sale of their business.

Just to show that law firms are not immune from litigation in this area, we also highlight some recent non-compete cases involving law firms, both as plaintiffs and defendants.

As always, if you have any questions or comments, our Practice Group would like to hear from you, so feel free to contact us—our names and e-mail addresses are set forth at the end of the newsletter.

****

NY Court Prohibits Hawaii-Based Executive from Soliciting Clients (Including Clients of Employees in His Chain of Command) and Awards Attorneys Fees to Employer – Important Case Extending Scope of Non-Solicitation Clauses

Marsh USA Inc., et al. v. Chad W. Karasaki, Case No.: 1:08-CV-04195 (S.D.N.Y., November 18, 2008).

This case involves the rise and fall of a senior executive in the insurance brokerage business, who jumped ship from Marsh to Aon and found himself subject to an extensive client non-solicitation provision.

Chad W. Karasaki ("Karasaki"), a citizen and resident of Hawaii, commenced employment with Marsh USA, Inc. ("Marsh") in 1989 and transferred to Marsh's Hawaii office in 1990 as a Client Executive. In November 2003, Karasaki was promoted to Managing Director and in April 2005 he became head of Marsh's Hawaii office. In this position, he supervised or worked directly with most of Marsh's 36 employees in Hawaii.

In order to receive benefits under Marsh's Discretionary Bonus Plan, Karasaki entered into a non-solicitation agreement ("NSA") in November 2003. Among other things, the NSA provided that for one year following his termination he would not directly or indirectly: (i) solicit or accept business of the type offered by Marsh from or for any clients or prospects who "were solicited or serviced directly by [Karasaki] or where [Karasaki] supervised, directly or indirectly, in whole or in part, the solicitation or servicing activities related to such clients or prospects" and (ii) solicit employees.

In June 2007, Karasaki entered into a Restrictive Covenant Agreement ("RCA") which contained a non-solicitation clause similar to that contained in the NSA except that it only prohibited him from soliciting clients with whom he came into contact during the last two years of his employment. The RCA also provided for the recovery of "all reasonable sums and costs, including attorneys' fees, incurred by the Company in seeking to enforce" the RCA.

All of Karasaki's agreements with Marsh provided that they are to be governed by New York law. The RCA also contained a New York exclusive choice of forum provision.

He resigned on March 11, 2008 to become the Chairman and CEO of Aon's Hawaii office.

Marsh sued to enforce its post-termination provisions, first in Hawaii and then in the United States District Court for the Southern District of New York. Following his motion for a preliminary injunction, Honorable John G. Koeltl conducted a hearing and heard oral argument on September 24. On December 8, Judge Koeltl issued a lengthy and comprehensive opinion.

Marsh Demonstrated a Likelihood of Success on the Merits

In considering whether Marsh had shown a likelihood of success on the merits, thecourt carefully assessed whether the agreements were valid and enforceable.

One-Year Time Period: Karasaki did not dispute that the one-year time period was reasonable, which is not surprising given that the post-termination restrictions in his employment agreement with Aon was governed by a two-year restriction.

Unlimited Geographic Limitation: Karasaki likewise did not challenge the NSA and RCA as being overbroad because they did not contain any geographic limitation. This, too, was not surprising because his agreement with Aon likewise did not contain a geographic limitation. Judge Koeltl further noted that the restriction did not prevent Karasaki from working in the insurance brokerage business in Hawaii or elsewhere so long as he adhered to the non-solicitation restriction.

No Personal Client Relationships: Karasaki argued that "his relationships with his former Marsh clients are personal and based on the clients' desire to work specifically with him" and they thus fell within the exception to the employer's protectable interest in its client relationships as established by New York's highest court in BDO Seidman v. Hirshberg, 712 N.E.2d 1220 (N.Y. 1999). Judge Koeltl noted that the standard is "whether Karasaki developed those relationships independently of any efforts or expenditures made by Marsh" and found that he had not, based on the following:

- Karasaki did not bring any clients with him to Marsh,
- seven of Marsh's former clients who defected to Aon had been Marsh clients before Karasaki joined the Hawaii office,
- Karasaki entertained clients with a generous expense account provided to him by Marsh,
- he serviced clients with the support of other Marsh employee, and
- he performed all of these activities in the course of his employment with Marsh for which he received a salary and discretionary bonuses.
- Judge Koeltl rejected Karasaki's argument that clients with whom he had a personal relationship should be excluded from protection.

Karasaki Was Also Barred from Soliciting Clients Developed or Maintained within His Chain of Command: Karasaki's non-solicit with Marsh was more expansive than typical non-solicit clauses which restrict employees from calling upon clients they personally serviced. The NSA also prohibited his contact with client relationships "where [Karasaki] supervised, directly or indirectly, in whole or in part, the solicitation or servicing activities related to such clients or prospects." As interpreted by Marsh, this meant that all client relationships developed or maintained by Karasaki's direct reports were likewise off-limits. Karasaki argued that Marsh's expansive reading of the clause extended beyond its legitimate interests.

In assessing the differing interpretations advanced for the clause, Judge Koeltl relied heavily upon the clause's language and prior case law. Judge Koeltl cited two opinions for the proposition that an employer had a legitimate interest in protecting client relationships developed by employees who were supervised by the former executive. Johnson Controls, Inc. v. A.P.T. Critical Sys., Inc., 323 F. Supp. 2d 525, 542 (S.D.N.Y. 2004) (granting a preliminary injunction to enforce a non-solicitation agreement which prohibited the defendants from directly or indirectly servicing any of the plaintiff's customers who had been served or solicited by the defendants, or by another employee under the defendants' supervision). Spinal Dimensions, Inc. v. Chepenuk, No. 4805-07, 2007 WL 2296503, at *7 (N.Y.Sup. Ct. Aug. 9, 2007) (holding that the employer's legitimate interest in protecting its client relationships extended to clients of sales representatives whom the defendant supervised). Given this case law, when coupled with the plain language of the agreement, Judge Koeltl held that "to the extent that Marsh can show that Karasaki solicited or serviced

any of the clients who were supervised by [his direct reports], Marsh has shown that it likely has a legitimate interest in the relationships between clients and former employees who Karasaki supervised at Marsh." (We note that other case law in New York, such as the holding in Silipos Inc. v. Bickel, 2006 U.S. Dist. LEXIS 54946 (S.D.N.Y., Aug. 8, 2008), suggested a much narrower construction of client "non-solicit" restrictions, limited to situations where the former executive had a significant relationship with the client – so the holding in Marsh suggests that employers should review their existing non-solicit arrangement to add broader supervisory language.)

Prospective Clients: Marsh argued that Karasaki should be prohibited from calling on certain prospective customers because Karasaki was privy to Marsh's "strategic plans" for winning those accounts. Judge Koeltl rejected the extension of the agreements to prospective accounts because Marsh had not explained what the "strategic plans" were or how they were confidential and proprietary. (We note that generally New York law has not enforced non-solicitation restrictions against "prospective" clients absent a showing that the former executive was involved in developing confidential "pitch" material or a strategy to "prospect" the client. In this respect, the Marsh holding is mainstream.)

Public Harm: Karasaki argued that the non-servicing provisions of his agreements should not be enforced because doing so would result in the public harm of restricting clients' freedom of choice. Judge Koeltl noted that the cases cited by Karasaki which rendered non-competition clauses unenforceable involved circumstances where there had been no solicitation of the customer by the employee. Here, by contrast, not only had Karasaki admitted to his role in soliciting clients but the overall evidence further demonstrated that he "played a central role in orchestrating the pursuit of his former clients and those of other Marsh employees whom he had supervised." Accordingly, the court rejected this argument.

Attorneys Fees and Costs: Because the RCA made it "unmistakably clear" that Marsh and Karaski agreed that, in the event Karaski breached the agreement, Marsh would be entitled to the recovery of attorneys' fees and costs in seeking to enforce the agreement, Judge Koeltl ruled that Marsh was entitled to reasonable attorneys fees and costs that it incurred in bringing the preliminary injunction application. Employers would be well served to review their existing forms and add such attorneys fees provisions.

Enforcement of One-Year Time Period: Given its conclusion that Karasaki had been in flagrant breach of the agreements since his resignation, the court did not give Karasaki "credit for time served." Rather, Judge Koeltl ruled that the one-year time period would run from the filing date of the Preliminary Injunction Order that would accompany his opinion.

What this decision means to employers:

There is much to be taken away from this decision:

- An employer's legitimate interest in client relationships can include not only an executive or manager's direct and personal clients, but it also can extend to the clients of employees whom the executive or manager supervised. In this case, the Court relied heavily upon the language of the executive's agreement which expressly provided that

he would be prohibited from soliciting client relationships where he "supervised, directly or indirectly, in whole or in part, the solicitation or servicing activities related to such clients or prospects." It remains to be seen whether this notion of an employer's legitimate interest will expand at common law by, for example, a broad reading of "direct or indirect" language absent some more express chain of command reference as existed in this case. Employers seeking to protect client relationships within a manager's chain of command would be well advised to make sure that non-solicitations clauses do not make this a subject of debate. And to further the proofs in this regard, employers should have other documents (such as offer letters, job descriptions and/or performance reviews) that reflect the importance and involvement of managing or supervising subordinates in the development and/or maintenance of client relationships.

- Employers seeking to protect prospective client relationships should take note that the odds are stacked against them – courts are skeptical of recognizing such prospective relationships as legitimate protectable interests. Restrictions on soliciting prospective clients generally are justifiable only by the need to protect trade secrets and confidential information. Accordingly, to the extent such pitches involve trade secret or confidential information, it would be prudent to prominently reference as much somewhere in the proposal, such as in a header or footer.
- In defending against challenges to "overbroad" restrictions, it is critical to obtain the former employee's restrictive covenants with his new employer. Under the well-accepted and oft-cited maxim of "what's good for the goose is good for the gander," the former employee and new employer will be hard-pressed to argue that your company's restrictive covenants are unreasonable when they require the employee to comply with the very same (or more expansive) requirements in his new job.
- Don't forget to allow for the recovery of attorneys fees in the event you are compelled to commence an action to enforce the company's restrictive covenants. In doing so, keep in mind that (i) some courts are loathe to allow for the recovery of attorneys fees when a provision only runs in favor of the employer, and (ii) if the provision does allow for either the departing employee or employer to recover attorney fees, be forewarned that such a provision also may be used against the company. In such circumstances, care should be taken to limit such clauses to the recovery of "reasonable" attorneys fees.

Inevitable Disclosure Doctrine Cited as Basis for Enjoining High-Level Executive from Working for Alleged Competitor

International Business Machines Corp. v. Papermaster, Case No. 7:08-CV-9078 (S.D.N.Y.)

This case involves a former engineer of IBM whose efforts to join Apple were delayed based on the inevitable risk that he would disclose confidential technical and strategic secrets.

On November 7, 2008, Judge Kenneth M. Karas, of the Southern District of New York, granted International Business Machines Corporation ("IBM") preliminary injunctive relief, ordering its former top microprocessor executive, Mark D. Papermaster ("Papermaster"), to immediately cease working for rival Apple, Inc. ("Apple"). Three months after the decision, the parties settled their differences by (i) shortening the length of the non-compete period from one year to six months and (ii) requiring Papermaster to submit two declarations during the first six months of his employment with Apple that he has not used or disclosed any confidential information from IBM.

Papermaster spent most of his 26-year career with IBM in product design and development roles. He eventually became Vice President of Microprocessor Technology Development and, in 2006, he was selected for membership in the 300-person Integration & Values Team ("I&VT"). I&VT members are considered "key leaders" who develop corporate strategy and are given access to strategic plans, marketing plans, product development and long-term business opportunities. Papermaster also served on the Technical Leadership Team, which works to attract, develop and retain a talented and diverse workforce.

As a condition of his I&VT membership, Papermaster was required to execute a Noncompetion Agreement ("Agreement"), which placed a one-year restriction on his ability to accept a position with an IBM competitor, anywhere in the world, upon his termination. In executing the Agreement, Papermaster acknowledged the "intensely competitive" nature of the business, his access to confidential information, his "extraordinary, special and unique" services to the company, that IBM would be irreparably harmed by any violation of the Agreement and the reasonableness of the Agreement's provisions.

After Papermaster informed IBM of his intent to accept the position at Apple, IBM counter-offered with a "substantial increase" in his compensation package. IBM also reminded Papermaster of his non-compete and offered to pay him not to work for the duration of the non-compete period. The next business day, Papermaster officially resigned.

Irreparable Harm and the Inevitable Disclosure Doctrine

While there was no proof that Papermaster had misappropriated trade secrets to Apple, IBM argued that there was a substantial risk that he would "inevitably" do so in his new employment. Judge Karas agreed, noting that (1) Papermaster "ha[d] been inculcated with some of IBM"s most sensitive and closely-guarded technical and strategic secrets";
(2) Papermaster had acknowledged that IBM would suffer "irreparable harm" if he violated the Non-Competition Agreement; and (3) Apple's recent purchase of another company

which sells or planned to sell a product that was competitive with IBM. Thus, while the Court "ascribes no ill-will to Mr. Papermaster, [but] the court finds that the likely inevitability of even inadvertent disclosure is sufficient to establish a real risk of irreparable harm [to IBM]."

What this decision means for employers:

- The inevitable disclosure doctrine remains a viable theory for demonstrating irreparable harm caused by the departure of high-level executives.
- The term "competitor" in non-compete agreements is generally broadly defined and can extend far beyond the most significant or obvious competitive entities. The degree or amount of competitive overlap between large corporate entities need not in all circumstances be particularly significant to satisfy the definition of "competition" and thereby trigger a non-compete provision.

Former Executives Cannot Show Irreparable Harm from Non-Competition Clause

Naden v. Numerex Corp., Case No. 08 Civ. 11195 (S.D.N.Y., January 20, 2009)

This case involves an unsuccessful effort by two former executives to "undo" their non-competes, after they sold their business and then quit their employment with the acquiror.

Gary Naden, David Ronsen and Scott Rosenzweig ("Plaintiffs") developed and sold a satellite business to Numerex Corp. In exchange for over $5.5 million, the individuals agreed to run the business for Numerex and to employment agreements with restrictive covenants. A non-competition provision in their respective employment agreements set forth that, for a period of one year (if termination without "good reason") or six months (with "good reason"), they could not be connected in any manner with the ownership, management, operation or control of any business in which Numerex was engaged during the one year preceding their terminations. Plaintiffs subsequently resigned and then brought this action.

Plaintiffs sought injunctive relief to restrain enforcement of the restrictive covenants on the grounds that: (i) the existence of the restrictive covenants were preventing them from taking advantage of current employment and business opportunities, and (ii) their expertise and skill set would become obsolete during the non-compete period, rendering them unemployable if that had to sit on the sidelines for the full restricted period.

District Judge Lewis A. Kaplan denied Plaintiffs' motion for injunctive relief, on the grounds that there was no concrete evidence that they would suffer irreparable harm if the non-compete provisions were enforced. He emphasized that the plaintiffs had failed to (i) reference specific business opportunities that would be lost if the restrictive covenants were enforced or (ii) make a showing that their technical expertise would become obsolete during the remaining five months of the restricted period.

Law Firms In The News

"Non-Solicitation" Agreement Related to Law Firm Merger Discussions Not Enforced

Nixon Peabody v. Taylor Wessing France, Case No.: 08-10374, 2008 WL 4256476 (N.Y. Sup. Ct. 2008)

The firm of Nixon Peabody were found not to have acted illegally when it hired a dozen Taylor Wessing partners this summer – less than a year after agreeing to a two-year moratorium on soliciting attorneys from Taylor when the firms were engaged in merger discussions (which failed).

In July 2007, the two firms began merger discussions and executed a "Mutual Non-Disclosure Agreement" which contained a non-solicitation provision barring both firms for two years from "employ[ing] or offer[ing] partnership directly or indirectly . . . to any person who at the date of this agreement is a partner, lawyer or an employee of [the other firm]."

In September 2007, merger talks collapsed. Nearly 10 months later, Taylor learned that Nixon was having discussions with Taylor partners concerning the prospect of their joining Nixon. Taylor therefore reminded Nixon of the non-solicitation provision in the Agreement. Nixon responded by filing suit in New York state court along with a motion for summary judgment to declare the non-solicitation provision null and void, and to enjoin Taylor from endeavoring to curtail further discussions regarding the hiring of its former partners. The Court granted Nixon's motion for summary judgment.

What this decision means for law firms as employers:

This case adds an additional wrinkle to the already well-established principle, in New York, that restrictive covenants, even if executed in good faith, will not be enforceable if they place restrictions, in any way, on an attorney's right to practice law. Specifically, even in the context of a prospective merger and acquisition, where both sides might be particularly concerned about a potential raid or poaching of their attorneys in the event that discussions are terminated, restrictive covenants will not be enforceable.

"Poaching" Claims Which Led to Demise of Law Firm To Be Determined in Upcoming Trial – Stay Tuned

Ravin Sarasohn Cook Baumgarten Fisch & Rosen PC v. Lowenstein Sandler PC, Case No. ESX-L-6327-00 (N.J. Super. Ct.)

In June 2000, New Jersey law firm Ravin Sarasohn Cook Baumgarten Fisch & Rosen PC filed suit against Lowenstein Sandler PC, accusing the firm of unfair competition,

intentional interference with existing contract and interference with prospective economic advantage, among other claims. The claims arose out of what Ravin Sarasohn alleges was Lowenstein's scheme to entice 15 bankruptcy attorneys and 16 staff to move to Lowenstein. Ravin Sarasohn contends that this "poaching" led to the eventual destruction of the firm, and seeks $42 million in damages plus punitive damages. Earlier this month, an Essex County justice of New Jersey's Superior Court denied Lowenstein's motion for summary judgment. The case is scheduled to proceed to trial on April 6.

What this case means for law firm employers:

In the current environment of lateral partner moves, and law firm mergers and dissolutions, the case raises important ethical and legal issues of how far law firms can go when recruiting lawyers from another firm. This is not a question of preventing lawyers from serving their clients when they switch firms; the issue involves the exposure that a poaching firm may have in connection with a "lift-out" of a practice group and the poaching firm's receipt and use of alleged confidential information in that process.

Representation of Executive on Non-Compete Matter Gives Rise To Action Against Law Firm for Aiding and Abetting Executive's Breach of Fiduciary Duty

McCagg v. Schulte Roth & Zabel LLP, Index. No. 601566/04 (N.Y. Sup. Ct. 2008)

This case is clearly "off the beaten track" when it comes to non-compete matters, but indicative of the tangled web of conflicts that law firms face these days. The case involves claims against Schulte Roth and Zabel ("Schulte") that its representation of a former CEO (Client 1) in the sale of his equity back to his former employer (which included a non-compete agreement) breached its legal obligations to another client (Client 2), when Client 1 pulled out of his deal with Client 2 and repudiated his proposed position as CEO of Client 2, relying on the non-compete negotiated by Schule.

Manhattan Supreme Court Justice Bernard Fried granted Schulte's motion for partial summary judgment, dismissing legal malpractice and breach of fiduciary duty claims brought against Schulte by Client 2, but allowed claims that Schulte aided and abetted Client 1 in breaching his fiduciary duties as CEO to Client 2.

Here are the facts:

Plaintiff McCagg had entered into an agreement with Alan Clingman (Schulte Client 1), co-founder and former CEO of Marquis Jet, to launch Clearjets Inc.(Schulte Client 2), a company in the fractional jet rental business that competed with Marquis, Clingman's former employer. Clingman agreed to serve as CEO of Clearjets and in fact assumed that position.

Clingman's longtime counsel, Schulte, handled Clearjet's incorporation in 2002, but several months later, Clingman backed out of his agreement with Clearjets, citing a two-year non-

compete agreement which he had signed with Marquis after leaving Marquis and which he had agreed to as part of a settlement when he sold his equity back to Marquis. Schulte had also represented Clingman in his settlement with Marquis, which included the non-compete that was subsequently relied upon by Clingman.

McCagg alleged that Schulte facilitated the signing of the non-compete agreement and, in doing so, committed malpractice by withholding that information from him and Clearjets. Justice Fried disagreed, finding no attorney client relationship existed between McCagg and Schulte, individually, and that Schulte was under no obligation to McCagg or Clearjets to prevent Clingman's departure as CEO of Clearjets or disclose the impending departure to other executive officers of Clearjets.

As to McCagg's remaining claim, that Schulte had aided and abetted Clingman in the breach of his fiduciary duty to Clearjets, Justice Fried found that a genuine issue of material fact existed as to whether Schulte "rendered substantial assistance" to Clingman in the execution of the non-competition agreement with Marquis, and that by signing thenon-compete Clingman could be found to have breached his fiduciary duty as CEO of Clearjets. Judge Fried pointed to Schulte's time-keeping statements, which indicated that the firm advised Clingman on "all aspects of [the] Marquis relationship including . . . non-competition and release agreements."

What this decision means for employers:

Clearly this case involves unique facts but it does serve as an example of how multiple representations present risks. Who would have thought that representing a client in negotiating a non-compete provision could give rise to claims of aiding and abetting that client in his breach of fiduciary duties to his subsequent employer.

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:

New York

Michael J. Album
212.969.3650 – malbum@proskauer.com

Steven M. Kayman
212.969.3430 – skayman@proskauer.com

Newark

John P. Barry
973.274.6081 – jbarry@proskauer.com

Boston

Mark W. Batten
617.526.9850 – mbatten@proskauer.com

Los Angeles

Anthony J. Oncidi
310.284.5690 – aoncidi@proskauer.com

Boca Raton

Allan H. Weitzman
561.995.4760 – aweitzman@proskauer.com

Paris

Yasmine Tarasewicz
33.1.53.05.60.18 – ytarasewicz@proskauer.com

Special thanks to associate, Gershom R. Smith for his assistance in drafting this newsletter.

This publication is a service to our clients and friends. It is designed only to give general information on the developments actually covered. It is not intended to be a comprehensive summary of recent developments in the law, treat exhaustively the subjects covered, provide legal advice, or render a legal opinion.

© 2009 PROSKAUER ROSE LLP. All Rights Reserved. Attorney Advertising.