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COMPLEX LITIGATION QUARTERLY

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In this Issue:

In this inaugural issue of the Complex Litigation Quarterly, we highlight interesting developments in three litigation settings. We first present a Special Report (p. 2) on the willingness of courts to reject claims for trade secret protection for ill-defined or vague categories of information and the judicial reluctance to enforce overly restrictive employment covenants.

We turn next to the New York Court of Appeals' recent decision in *Borden v. 400 East Fifty-Fifth St. Assoc., L.P.* (p. 4) which deals with New York's important but often overlooked statutory protection against state court class action lawsuits to recover statutory penalties.

Finally, Mike Billok reports on a recent decision addressing whether tennis umpires at the U.S. Open should be considered employees of the U.S. Tennis Association or independent contractors in the context of a collective action under the Fair Labor Standards Act and the analogous provisions of New York Labor Law.

We hope you find these highlights interesting and useful. In upcoming issues we will be exploring how courts are analyzing claims of attorney-client privilege and work product protection in the context of internal and external corporate investigations, the proposed federal trade secret legislation, and the contours of retaliation claims under SOX.

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SPECIAL REPORT

Increased Judicial Scrutiny for Restrictive Covenants and Claimed Trade Secrets

By Kate I. Reid and Lucy S. Clippinger*

Two decisions from last year reflect the readiness of courts in the Second Circuit to rigorously analyze claims of "protectable interests" proffered by parties seeking to enforce non-compete agreements, and the reluctance of courts to enforce restrictive covenants that are more restrictive than necessary to protect a former employer's legitimate interests.

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In February 2014, Senior District Judge Lawrence E. Kahn of the Northern District of New York declined to preliminarily enjoin Donald Teich, a former employee and VP of Davis-Standard, from working for his new employer, SAM North America, LLC.[1]

DS Parent, Inc. and Davis-Standard-Standard, LLC (collectively "Davis-Standard"), build and sell converting and extrusion machines, including "liquid coating" equipment, based on Davis-Standard's customers' specifications. Mr. Teich worked for Davis-Standard and its predecessors from 1987 to 2013, first as a salesman, and eventually as Vice President for Davis-Standard's Liquid Coating division. In 2012, Mr. Teich entered into an employment agreement that contained a two-year domestic non-compete provision, a two-year non-solicitation provision, and an indefinite nondisclosure provision. Subsequently, Mr. Teich executed a "joinder agreement" and a "participation election form" by which he became a party to an undisclosed Stockholder Agreement that contained a second restrictive covenant that prohibited Mr. Teich from working for *any* competitor or soliciting any of Davis-Standard's customers for a one-year period.

When Mr. Teich resigned from Davis-Standard in November 2013 to work for SAM, Davis-Standard's competitor, Davis-Standard commenced litigation to enforce both restrictive covenants and moved for a preliminary injunction.

In denying the motion, Judge Kahn undertook a nuanced review of each of the alleged "protectable interests" proffered by Davis-Standard and found each to be insufficient to support preliminary injunctive relief. Judge Kahn's discussion of each of Davis-Standard's purported trade secrets, in particular, is an analytical gold mine that will be helpful for those defending non-compete and trade secret misappropriation claims in courts in the Second Circuit.

First, Davis-Standard charged that Mr. Teich's employment exposed him to trade secrets regarding the "technical processes involved in the production of Davis-Standard's machines." But, as Judge Kahn noted, Davis-Standard pointed to "no specific technology" that qualified as a trade secret, and had failed to rebut the showing by SAM's expert that the technology involved in liquid coating is mature, uniform, and "widely shared in technical papers and industry publications." Additionally, while Davis-Standard argued that its customized solutions were trade secrets, Judge Kahn was persuaded by Defendants' proof that these customized designs belonged not to Davis-Standard, but to its *customers*.

Judge Kahn's decision is also notable for its rejection of Davis-Standard's claim that its business strategies constituted trade secrets. While Davis-Standard argued that Mr. Teich authored Davis-Standard's 2012 and 2013 strategic plans, Davis-Standard failed to describe the contents of these plans in sufficient detail to convince Judge Kahn that the plans contained any trade secrets. Additionally, Judge Kahn credited Mr. Teich's unrefuted assertion that Davis-Standard did not follow any of his recommendations in the strategic plan, a fact that undermined the notion that these plans contained trade secrets, as "there is little value to Davis or a competitor in plans that Davis does not carry out." Judge Kahn distinguished prior federal cases affording trade secret status to strategic plans, observing that in all of these prior cases, the strategic information was accompanied by either legitimate technological trade secrets, or detailed information about new products.

Finally, although Davis-Standard argued that its pricing information was entitled to trade secret protection, Judge Kahn found that Davis-Standard failed to rebut Mr. Teich's evidence

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1 *DS Patent, Inc. v. Teich*, No. 5:13-cv-1489, 2014 U.S. Dist. LEXIS 16116 (Feb. 10, 2014). Brian J. Butler and Kate I. Reid of Bond's Litigation Department and Laura H. Harshbarger of Bond's Labor and Employment Law Department represented SAM North America, LLC.

that Davis-Standard's bids were not treated as confidential, either internally at Davis-Standard or in the broader liquid coating industry. Once again, Judge Kahn relied on defendants' evidence regarding the nature of the liquid coating industry, and the lack of competitive value in the information for which Davis-Standard was claiming trade secret protection. As customers in the industry "almost always" seek quotations from "several manufacturers," Judge Kahn noted that Davis-Standard's pricing was of limited utility to competitors: "SAM, were it to raise or lower its bids so as to achieve maximum profitability while still under-bidding Davis, would risk over–or under–bidding other manufacturers."

* * *

A decision from the Western District of New York, also holding that a non-compete provision relied upon by a former employer was likely void and unenforceable in its entirety, contains a similarly nuanced analysis of an employer's claim that a former employee's work for a competitor would irreparably harm the former employer's legitimate interests. In April 2014, District Judge Elizabeth A. Wolford, appointed to the Western District of New York bench in December 2013, denied a motion for a preliminary injunction brought by Veramark Technologies, Inc. and its parent company.[2]

Following the departure of Veramark's highest-ranking salesman, Mr. Bouk, Veramark sought to preliminarily enjoin Mr. Bouk from commencing employment with and providing services to his new employer, Cass Information Systems, Inc. In support of its motion, Veramark pointed to Mr. Bouk's employment agreement, which contained a broad non-compete provision, and provisions prohibiting any solicitation of employees or customers.

In support of its motion, Veramark relied solely on the non-compete provision, which stated:

> [Mr. Bouk] shall not engage . . . in competition with, or directly or indirectly, perform services . . . for . . . any enterprise that engages in competition with the business conducted by [Veramark] or by any of its affiliates, anywhere in the world.

Judge Wolford relied on the overbreadth of the non-compete provision both in concluding that Veramark had not shown irreparable harm and in concluding that it had not shown a likelihood of success on the merits (or even sufficiently serious questions going to the merits).

First, Judge Wolford rejected Veramark's argument that it would be irreparably harmed by the loss of customer relationships. She pointed out that Veramark's interest in preserving its customer relationships would be adequately protected by the non-solicitation of customers provision in Mr. Bouk's contract. She also observed that no argument had been offered "as to how [the non-compete's] broad restriction on Mr. Bouk's ability to earn a living is necessary to protect [Veramark's] customer relationships," and there was no evidence that "customer relationships have been or will be damaged simply by Mr. Bouk's presence at Cass."

Veramark next argued that because Mr. Bouk is a "unique" employee, his employment by a competitor would necessarily cause irreparable harm. The court rejected Veramark's premise, holding that "Mr. Bouk's knowledge of the intricacies of the sales operation at Veramark, or even his status as its highest ranking executive, does not transform him into a unique employee for purposes of a restrictive covenant analysis." In particular, the court pointed out that Veramark's customer base seemed to be broad, which showed that its salespersons' relationships with customers, while important, were not as important as in cases where a salesperson was found to be "unique" because he or she functioned in an industry in which the customer base was limited and therefore customer relationships were more important.[3]

In analyzing Veramark's likelihood of success on the merits, Judge Wolford not only held that the non-compete provision in Mr. Bouk's agreement was unjustifiably broad, but also declined to partially enforce the provision, holding that it was likely void in its entirety.

Judge Wolford explained that it has been clear to employers since the New York Court of Appeals decision in *BDO Seidman*[4] in 1999 that a non-compete provision will be void in its entirety if it is overbroad and if the provision suggests coercion or overreaching on the part of the employer. Judge Wolford pointed out that the agreement was imposed as a condition of Mr. Bouk's employment, suggesting coercion. She also reasoned that the sweeping non-compete could not have been entered into "in good faith . . . to protect a legitimate business interest" since Veramark already had the protections of the customer non-solicitation provision, and because the geographical scope of the non-compete, which was global, was obviously broader than necessary. Accordingly, she held that the provision was overreaching and coercive, and that partial enforcement was therefore inappropriate.

Employers hiring employees subject to restrictive covenants should note that there were no allegations that Mr. Bouk was going to breach his non-solicitation of customers provision, a fact upon which Judge Wolford heavily relied. Had there been evidence that Mr. Bouk had breached or would breach either the non-compete or non-solicitation provisions, the court might have reached a very different conclusion.

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2 *Veramark Techs., Inc. v. Bouk*, 14-cv-6094 EAW, 2014 U.S. Dist. LEXIS 46198 (W.D.N.Y. Apr. 2, 2014).

3 See, e.g., *Ticor Title Ins. Co. v. Cohen*, 173 F.3d 63 (2d Cir. 1999).

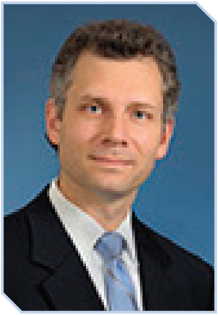
4 *BDO Seidman v. Hirshberg*, 93 N.Y.2d 382 (1999).

Judge Kahn's decision in *Davis-Standard* and Judge Wolford's decision in *Veramark* underscore that applications for preliminary injunctive relief to protect trade secrets or enforce restrictive covenants require detailed, industry-specific proof of a real world threat to a former employer's protectable interest, whether that interest is based on exposure to trade secrets or employee uniqueness. The decisions also serve as a warning to employers and counsel drafting non-compete provisions to ensure that such provisions are appropriate, given the employee's role in the company, and that the provisions are narrowly tailored to protect only the employer's legitimate business interests. Otherwise, employers run the risk that their restrictive covenants will be held unenforceable in their entirety, regardless of whether more narrowly tailored provisions would have been reasonable.

CLASS ACTION UPDATE

Don't Overlook CPLR § 901(b): New York's Protection Against Class Actions for Statutory Penalties

By Louis Orbach*



A company served with a class action complaint in New York state court may reflexively remove the case to federal court as its first defensive maneuver, if, for example, one or more of the claims in the case is based on federal law, or the case meets the threshold requirements for removal under the federal Class Action Fairness Act. And in some cases, removal to federal court may indeed be the best first thing to do. But before removing a putative class action to federal court, a company should consider a unique protection that staying in New York state court may afford: the protection from class-wide awards of statutory penalties found in section 901(b) of New York's Civil Practice Law & Rules ("CPLR").

CPLR § 901(b) does not always get a lot of notice, and some attorneys, especially out-of-state attorneys or those without much experience in New York class actions, might overlook it at the outset of a case, when the critical decision about removal must typically be made. But its prohibition against class-wide recovery of statutory penalties can be a game-changer. CPLR § 901(b) provides:

> Unless a statute creating or imposing a penalty, or a minimum measure of recovery specifically authorizes the recovery thereof in a class action, an action to recover a penalty, or minimum measure of recovery created or imposed by statute may not be maintained as a class action.

Simply put, "CPLR 901(b) prohibits any claim for penalties to be brought as a class action," absent express statutory authorization. *Borden v. 400 E. 55th St. Assoc., L.P.*, 2014 N.Y. LEXIS 3346, at *7 (N.Y. Nov. 24, 2014). New York's legislature enacted CPLR § 901(b) to address the concern that "plaintiffs would receive penalties far above their 'actual damages sustained'" if class-wide penalty awards went unchecked. *Id.* at *9. Thus, in most cases, CPLR § 901(b) will "limit class actions to actual damages." *Id.*

In the *Borden* decision issued just last month, the New York Court of Appeals affirmed what New York's lower courts have held for some time: class representatives will generally be able to overcome CPLR § 901(b) by waiving any demand for statutory penalties on behalf of themselves and the class, provided that (1) the statutory penalty at issue is neither mandatory nor the sole measure of recovery, and (2) class members retain the right to opt out of the class to pursue the punitive relief on an individual basis. But such a waiver will effectively reduce the defendant's exposure by half, or even two-thirds in some cases. *See id.* at *14 (tenants' class actions to recover rent overcharges permitted to proceed under Rent Stabilization Law, provided classes waived any claim for treble damages available under that statute); *Picard v. Bigsbee Enterprises, Inc.*, 2014 N.Y. Misc. LEXIS 3241 (N.Y. Sup. Ct. June 24, 2014) (employees' class action for back pay permitted to proceed under New York Labor Law, provided class waived any claim for double damages available under the Labor Law).

CPLR § 901(b) is not without its critics. Some, including Justices Thomas A. Dickerson and Leonard B. Austin of New York's Appellate Division, Second Department, have called for its repeal. *See* Dickerson & Austin, New York Law Journal, *Class Actions in 2013 and Call to Repeal CPLR § 901(b)* (Dec. 24, 2013). Still, CPLR § 901(b) stands for now as a significant shield against class-wide awards of statutory damages – but only in state court.

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CPLR § 901(b) may provide no protection whatsoever to a class action defendant in federal court. In *Shady Grove Orthopedic Associates, P.A. v. Allstate Ins. Co*, 559 U.S. 393 (2010), a divided United States Supreme Court held, in a plurality opinion, that CPLR § 901(b)'s prohibition against class-wide statutory penalty awards was inapplicable to a class action brought in federal court based on diversity jurisdiction, even though the substantive claim in the action arose under New York state law. In light of *Shady Grove*, a company facing a putative class action for statutory penalties in New York state court should give serious thought to CPLR §901(b) before removing the case to federal court.

FLSA ALERT

Court Calls a Fault on Tennis Umpires' Misclassification Argument

By Michael Billok*

There has been a recent wave of collective actions under the Fair Labor Standards Act (and class actions under the analogous provisions of the New York Labor Law) on the basis of misclassification—that is, that workers should have been classified as employees instead of independent contractors, and therefore should have been paid time-and-a-half for any week in which they worked over 40 hours. Various employers have recently begun reviewing their agreements and arrangements with independent contractors in order to determine whether they should be reclassified as employees. And while there are several factors for an employer to consider—whether the worker bears the risk of profit or loss, the degree of skill required to perform the work, and the permanence or duration of the working relationship—courts have repeatedly held that the "greatest emphasis" must be placed on the factor of *control*: whether the employer controls the manner and means of how the employee does the work.

So when a number of tennis umpires, who had already obtained class and collective certification moved for summary judgment on the basis that their work at the U.S. Open was controlled by the U.S. Tennis Association ("USTA"), their case should have been a slam dunk, right? (Sorry, wrong sport.) Not necessarily. On September 11, 2014, weighing both plaintiffs' and defendant's motions for summary judgment in the case of *Meyer v. United States Tennis Association*, Case No. 11-6268, 2014 U.S. Dist. LEXIS 128209, District Judge Andrew L. Carter, Jr. of the Southern District of New York issued a decision finding plaintiffs' arguments wide of the mark—the U.S. Open tennis umpires are independent contractors, and not employees of the USTA.

The court acknowledged that the USTA had "some degree of control" over the tennis umpires, in that the USTA required them to wear uniforms and adhere to its best practices and code of conduct, and also evaluated the tennis umpires, making decisions as to which matches an umpire could officiate based on those evaluations. However, the court ultimately found that the USTA did not exert enough control over the umpires to classify them as employees. In reaching this conclusion, the court relied heavily on a Northern District of Illinois case, *Yonan v. U.S. Soccer Federation, Inc.*, 833 F. Supp. 2d 882 (N.D. Ill. 2011), which addressed the same question regarding the relationship of referees to the U.S. Soccer Federation. In *Yonan*, the court had found that having the ability to evaluate a worker is not necessarily evidence of control; parties retaining independent contractors are free to judge their performance. Moreover, the *Yonan* court found that because the referees could call the games at their discretion, turn down assignments, control the days in which they worked, and could referee other games for other organizations, the referees controlled the manner in which they worked.

In *Meyer*, Judge Carter found that the USTA did not exert much control over the tennis umpires for the same reasons articulated in *Yonan*: the umpires had the independent discretion and authority to make calls during matches, and they also had the freedom to turn down assignments and determine the days on which they would work, as well as the ability to officiate at other, non-USTA events. (It is, perhaps, noteworthy that the named plaintiffs were attorneys and executives; indeed, one named plaintiff works part time as a District Attorney in Louisiana.)

As went the court's control analysis, so went the ultimate decision. The court noted that some factors weighed in favor of finding an employment relationship: that "the USTA invested more into the US Open than plaintiffs did into officiating," and that "umpires are integral to the success of the US Open."

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A greater number of factors, however, weighed against an employment relationship: the umpires bore some of the profit/loss risk by deciding how much training they elected to receive and how many days to work; there was no question that officiating demanded a high degree of skill; and the duration of the work—only a few weeks per year—was limited. The court therefore found the balance of these factors to weigh against an employment relationship under the FLSA and, after an extremely short consideration of the additional state law factors, under the NYLL as well.

While it may be tempting to dismiss this holding as limited to situations in which referees or umpires are involved, the court's focus on the plaintiffs' ability to turn down assignments and set their own schedule is highly instructive. To the extent employers may be reviewing their arrangements with independent contractors, or are facing actual or threatened litigation from individuals classified as independent contractors, if the contract allows the contractor to set his or her own schedule and/or turn down offered assignments, decisions like *Meyer* and *Yonan* may allow the employer to remain on the right side of the fault line.

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