

New York City – Law Firms

Non-Compete And Trade Secrets Cases On The Rise In New York

The Editor interviews **Gayle Rosenstein Klein**, Principal in the New York Office of **McKool Smith, PC**, a national commercial litigation and intellectual property law firm with offices in Dallas, Austin, Marshall, New York and Washington, DC. Ms. Klein is an experienced courtroom lawyer who regularly handles litigation involving non-compete agreements and trade secret claims in state and federal courts throughout the United States.



Gayle Rosenstein Klein

Editor: You recently joined the New York office of McKool Smith after working as a commercial litigator at a top 10 international, full-service firm. What made you decide to go with a boutique that only recently entered the New York market?

Klein: I married a practice group leader at my former firm, and wanted to continue to develop my practice without any appearance that my successes were the result of my marriage. Having begun my career in Dallas, I was familiar with McKool Smith and knew the firm had excellent trial lawyers with the same high-caliber practice that I enjoyed at my former firm. I'm also excited about the flexibility we have as a boutique litigation firm. I now have more opportunity to do plaintiff's work, offer creative fee arrangements, and take on matters where I would have had a conflict at my former firm. A lot of people know McKool Smith as patent litigation experts, but the firm started as a commercial litigation firm, and it has top-notch commercial litigators. Our growth in New York reflects a firmwide effort to fill what we believe is a growing client need.

Editor: Why do you think that there is a growing client need for boutique litigators in New York?

Klein: As the economy continues on its bumpy ride, we are experiencing a rise in commercial disputes, particularly those between companies where sophisticated deals have gone sour, as well as litigation over non-competes, trade secrets, and confidential information. On any given day, I spend time dealing with issues relating to either employee raiding or some other alleged misappropriation of trade secrets. These are important issues for blue-chip clients, but the fact is that many large firms can't accept these cases because of conflicts.

Editor: Specifically, what types of cases are included in this increased need for commercial litigators?

For example, the situation where a company hires an employee or group of employees away from a competitor seems to be popping up with regularity these days. Companies involved in these cases also seem to be more willing to take a hard-line approach. That's really no surprise when companies begin weighing the costs and benefits of legal fees versus quelling what could be the loss of one of their key assets – their employees.

Editor: Is there any interplay between

these cases and intellectual property litigation?

Klein: Absolutely. A company's key assets necessarily include its employees and its intellectual property. In this high-tech age, the two often are intertwined. Right now, I'm working on cases where it's alleged that a company has used former employees to misappropriate technology. And, of course, there is the occasional case where a former employee is exploiting a technology that he or she has developed or refined when the technology actually belongs to the company.

Editor: With the downturn in the economy, wouldn't you expect to see less litigation regarding covenants not to compete?

Klein: Not necessarily. As companies tighten their belts and become more focused on the bottom line, particularly in businesses that rely on a sales force, the need for revenue-generating employees becomes even more essential. So it does not come as a surprise that companies in a difficult economy look to recruiting their competitors' employees as a method of increasing their ability to generate revenue.

Editor: Is this perceived rise in non-compete and trade secret issues peculiar to New York?

Klein: Covenants not to compete are prevalent in the insurance and financial services sectors, and those industries have a large presence in New York. So I actually expect an uptick in these cases in New York. However, many New York-based employers also have offices and employees outside the state, and we are seeing an increase in these issues everywhere. And often these disputes are multi-jurisdictional. I am licensed and have practiced in Texas, California, and New York, so I know first-hand that the law affecting the outcome varies depending upon the jurisdiction. For example, there are still few cracks in the public policy of California that non-competes are unenforceable except in very limited situations. So, in that jurisdiction, a company more likely

would look to California's unfair competition or trade secrets act laws to protect its confidential and proprietary information. Conversely, in New York, courts are more likely to enforce a covenant not to compete if the necessary factors are met.

Editor: Doesn't much of New York law disfavor non-compete clauses in employment contracts?

Klein: The court cases do say that non-compete clauses are disfavored, but that does not mean that they are unenforceable. In New York, non-compete clauses in employment contracts will only be enforced to the extent reasonable and necessary to protect valid interests. The case that is most often cited for this standard is *BDO Seidman v. Hirshberg*, 93 N.Y.2d 382, 712 N.E.2d 1220, 690 N.Y.S.2d 854 (1999). In deciding whether a restrictive covenant is reasonable, a court will examine certain factors relating to the length and scope of the non-compete that bear on the employer's legitimate business interests and the extent to which the employee still can earn a living. Also, New York is a "blue pencil" state, so even if a covenant not to compete is too broad to be enforceable as written, a court has the power to modify it – particularly if the contract indicates that it was the parties' intention that the court be able to do so. In short, the recent case authority indicates that New York courts are enforcing covenants not to compete and benching employees when the legal standard is met.

Editor: Are there any facets of New York non-compete law that may be different from other jurisdictions and are particularly relevant to the current environment?

Klein: Yes. For example, many companies these days are including covenants not to compete in stock option agreements. New York courts have carved out what is known as the "employee choice doctrine" for that situation – or any situation where the restrictive covenant is tied to post-employment benefits. Under this doctrine, if an employee voluntarily leaves his or her job, the non-compete will be enforceable without regard to reasonableness, and the employee forfeits the post-employment benefits if he or she chooses to compete. The rationale underlying New York's employee choice doctrine is that the employee has made an informed choice between either forfeiting benefits or retaining benefits by avoiding competitive work. See, e.g., *Post v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 48 N.Y.2d 382, 88-89. The employee choice doctrine, however, does not apply when an employee is terminated voluntarily and without cause, and a relatively recent line of authority from the Second Circuit and New York Court of Appeals determined that involuntary termination includes constructive discharge. See *Morris v. Schroeder Capital Mgmt Int'l*, 481 F.3d 86 (2d. Cir. 2007); *Morris v. Schroeder Capital*

Mgmt Int'l, 7 N.Y.3d 616, 825 N.Y.S.2d 697 (2006). I have seen, and I expect to continue to see, employees arguing that the employee choice doctrine should not apply because they were constructively discharged.

Editor: Many companies currently have arbitration agreements with their employees or arbitration policies that they enforce. Are you finding that arbitrations are effective in this area?

Klein: Arbitrations can be effective in certain circumstances. Most often, I find that clients have been disappointed with arbitration when their counsel has treated it like a court case. Arbitrations can be faster than court proceedings and more cost effective, but only if the company's outside counsel lets go of the need for massive discovery disputes and pre-trial haranguing. If my client is the claimant and would like to seek a restraining order or injunction, being in a court of law is not only essential to getting timely relief, but the case almost always is won or lost at the preliminary injunction phase. To that end, I usually recommend that any arbitration agreement with employees allow the company to seek injunctive relief prior to initiating arbitration.

Editor: What should in-house counsel consider if their company is preparing to hire a competitor's employees?

Klein: I cannot underscore the need for early consulting with the recruit and, separately, with those company employees who come in contact with the recruit. Although determining whether the recruit has restrictive covenants and the likelihood of enforceability is important, early counseling can protect a company from unnecessary allegations of theft of confidential information and trade secrets. In this information age, key players' conduct can be tracked – whether by telephone call, personal e-mail, computer key stroke, or office key card – so their being cognizant of the kinds of actions that can be misinterpreted (or worse) can mean the difference between success and failure.

Editor: On the other side of the coin, what about in-house counsel who believe that a competitor is preparing to hire their company's employees away?

Klein: Be proactive. Talk with management so that you – and later, outside counsel – can articulate what a breach of the covenant not to compete would mean to the company, including the type of business that would be lost or the unfair advantage that the company's competitor would gain. Understand exactly what confidential and proprietary information the employee uses and has access to, particularly including key documents, and how that information is important to the company's business. Also, when seeking injunctive relief, be prepared to answer the likely first question the judge will ask: "Why aren't damages sufficient to compensate any harm?"

Please email the interviewee at gklein@mckoolsmith.com with questions about this interview.