Schulte Roth & Zabel

Employment & Employee Benefits Developments

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Non-Compete Developments

In this time of technological advances, rapidly moving information and economic difficulties, employers increasingly are turning to non-competition agreements to protect their businesses. At the same time, individuals are growing more concerned about career mobility and employability. Although New York courts historically were loathe to enforce non-competes because of the strong public policy in favor of free competition and against restricting an individual's ability to earn a living, those courts are now focused on balancing those competing interests — resulting in increasingly fact-specific (and divergent) results.

Earlier this year, the U.S. District Court for the Southern District of New York refused to enforce the one-year non-compete of one of IBM's former executives. SRZ, together with Morgan Lewis & Bockius LLP, successfully represented that individual, Giovanni Visentin, resulting in Chief Judge Loretta Preska ruling that the risk of Visentin's use or disclosure of IBM's allegedly confidential information was minimal (and by no means inevitable).

On Jan. 19, 2011, Visentin notified IBM of his intention to leave IBM to work for HP, an IBM competitor. IBM filed a complaint against Visentin one day later, including claims for breach of contract and misappropriation of trade secrets. IBM simultaneously moved for a preliminary injunction preventing Visentin from working at HP. Following a four-day hearing, the court denied IBM's motion in a 62-page opinion, substantially crediting Visentin's testimony.

Visentin worked for IBM for 26 years, serving in a variety of managerial (as opposed to technical) roles. Prior to his resignation, Visentin served as general manager of IBM's Integrated Technology Services ("ITS") business, which works with clients to outsource various technological services. In addition, Visentin was a member of IBM's Integration and Values Team (the "I & VT"), a leadership group that develops IBM's corporate strategy. In connection with his membership on IBM's I & VT, he signed two non-competition agreements (one in 2008 and one in 2009), whereby he agreed to refrain from

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working for an IBM competitor for one year following his resignation. Nevertheless, Visentin accepted a position with HP and became employed there immediately.

In its motion for preliminary injunction, IBM asserted that, by virtue of his position as a general manager and his membership on the I & VT and other strategic teams, Visentin learned IBM's confidential information and trade secrets, including new service offerings (and cloud computing services), client "pipelines," pricing and marketing strategies relating to outsourcing deals and projects, information regarding "troubled" IBM client accounts and information regarding a potential IBM acquisition.

The court rejected IBM's assertions, finding that, at IBM, Visentin's primary job was to be a "general manager" and that "although trade secrets may have lurked somewhere on the periphery, the real thrust of his position was to manage his teams to make them as efficient as possible." In essence, the court found that Visentin lacked technical knowledge of IBM's service offerings and, although he was privy to certain strategic information regarding pricing and competition with entities like HP, he, like IBM's witnesses, could not recall the details of that information and was, therefore, not at risk of disclosing it to HP.

The court focused on a number of key issues and arguments in finding that IBM failed to establish that it had demonstrated a legitimate interest (i.e., confidential information or trade secrets) that it now needed to protect:

- As a senior executive and manager, Visentin was not intimately familiar with the details of the outsourcing deals in which his team was engaged.
- Visentin and HP demonstrated good faith by attempting to design Visentin's position at HP to limit or eliminate the need or desire to disclose or use IBM confidential information or trade secrets, including by restricting him from working with customers with whom he worked at IBM. In addition, Visentin refrained from removing any IBM confidential information or property from IBM's offices or systems before his resignation.
- IBM failed to show that the information it claimed Visentin's non-compete was designed to protect was truly confidential or proprietary; much of it was "information that is either applicable to all large corporations, in the public domain, or outdated."
- The head of IBM's human resources, the draftsperson of the non-compete, testified that the agreement was "designed not to protect a legitimate business interest but, rather, to keep the leadership talent of IBM from leaving."

The court also found IBM's non-competition agreement overbroad on its face because it prohibited competition in areas in which IBM had no legitimate business interest. It prohibited Visentin from "working for a competitor in a business in which IBM does not even participate — for example, retail laptop and printer sales." "The agreement also prohibit[ed] Visentin from owning even one share of stock in a competitor."

Finally, the court found that the IBM agreement, if enforced, would impose an undue hardship on Visentin because a "protracted absence could alienate" HP and because sidelining him for a year would place him at a disadvantage in an industry that evolves quickly.

It is notable (and, as the court observed, unusual) that IBM sought specific enforcement of Visentin's non-compete agreement *as written*, rather than requesting the court to "blue pencil" or reform and revise the agreement to make it valid and enforceable. Nevertheless, the court ruled, even though it need not have done so, that even if IBM sought partial enforcement of the agreement, this remedy would be "unavailable" because IBM failed to carry its burden for the "extraordinary remedy."

In November 2011, the U.S. Court of Appeals for the Second Circuit affirmed Judge Preska's decision in a summary order crediting her analyses and ruling.

* * *

Employers won favorable verdicts as well this year relating to extremely short non-competes. For example, in *The Ayco Company, L.P. v. Wolfgana K. Frisch*, the U.S. District Court for the Northern District of New York granted a temporary restraining order and preliminary injunction to the Ayco Company (a subsidiary of Goldman Sachs), enforcing Ayco's non-compete with its employees and enjoining those employees from working for UBS (an Ayco competitor) for 90 days and from disclosing any confidential information. Unlike Visentin, the

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WTPA Obligations

The first New York Wage Theft Prevention Act (the "WTPA") annual notices must be provided by New York employers to *all employees* between Jan. 1, 2012 and Jan. 31, 2012. For previous *Alerts* on the requirements of the WTPA, please see the discussion of New York's Wage Theft Prevention Act, available at http://www.srz.com/022311_New_Yorks_Wage_Theft_Prevention_Act/, and the update on New York's Wage Theft Prevention Act, available at http://www.srz.com/041111_Update_on_New_Yorks_Wage/. ■

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defendant-employees in Ayco engaged in wrongdoing prior to their respective resignations, including taking Ayco's confidential information and advising their clients that they were moving their accounts to UBS. In finding that Ayco would suffer irreparable harm, the court noted that such harm was suggested by language in the employees' non-competition agreement that provided that breach of the restriction would leave the employer without adequate remedy at law and would entitle it to injunctive relief.

Similarly, in *Alliancebernstein, L.P. v. William Clements*, the New York State Supreme Court enforced the 60-day notice provision in Alliancebernstein's agreement with the defendant-employee and enjoined the defendant-employee from soliciting Alliancebernstein's employees or clients. The defendant-employee in *Alliancebernstein* resigned without providing the requisite notice and immediately began working for Barclays Global Wealth Management, a competitor. Notably, Alliancebernstein continued to pay the defendant-employee during the required notice period in compliance with the agreement. In addition, the defendant-employee engaged in misconduct, misappropriating an Alliancebernstein contact list and using it to solicit Alliancebernstein clients on the day he resigned.

These recent cases indicate that an individual's misconduct in connection with his or her departure may tip the scales in favor of enforcement of his or her non-competition agreement or similar restriction. They also suggest that courts may be more inclined to enforce non-competition restrictions if they are of limited duration, when the employer can point to irreparable harm it will suffer as a result of the breach. Although these short non-competes may be suitable in some industries and for certain types of employees, for some businesses, brief non-competition covenants will be insufficient to meet the employers' goals, including the desire to protect confidential information and trade secrets. ■

Employers Beware: Broad Protections of Employees' Social Media Posts

Within the past year alone, almost 100 complaints implicating social media have been filed with the National Labor Relations Board ("NLRB"). The NLRB's Office of the General Counsel has responded by broadly interpreting employee rights under the National Labor Relations Act ("NLRA"), putting employers at risk of monetary fines, reinstatement of terminated employees, payment of lost wages, and criticism of internet and blogging policies. SRZ has regularly advised its clients and has been active in litigation involving issues related to social media.

Employers who contemplate disciplining employees who post work-related comments or criticisms to social media sites, and those employers who institute internet or social media policies, must be aware of recent NLRB guidance on potential liability for unfair labor practices.

Proper and Improper Discipline of Employees Engaging in Social Media Activities

Section 7 of the NLRA applies to *both* unionized and non-unionized employees, and protects employees' rights to engage in protected concerted activities, including those in which employees seek mutual aid or protection; seek to initiate, induce or prepare for group action; bring group complaints to management's attention regarding the terms and conditions of their employment; or address a workplace issue of concern to employees. Employees' postings to social media sites often constitute protected activity, and discipline of employees for social media postings may garner an unfair labor practice charge to the NLRB.

In August 2011, the NLRB's general counsel released a report summarizing its most recent social media decisions. Several trends regarding discipline of employees have emerged:

Employees' postings to social media sites that discuss the terms and conditions of employment with, or seek advice from, other employees are likely protected concerted activity: When employees discuss job performance, supervisory actions, or concerns about workplace responsibilities or policies, employers should be wary of disciplining the employees or terminating their employment, even if the postings contain insulting or offensive language. If the postings or discussions embody group complaints, may be interpreted as seeking mutual aid, contemplate bringing group action, or continue discussions or complaints about conditions of employment that employees have previously brought to the management's attention, then the postings are likely protected activity under the NLRA. For a posting to be protected, there must be some evidence that the employee is looking to his/her co-workers to engage in group action or discussion. Protected concerted activity referenced in the general counsel's report includes postings to social media sites when the postings:

- Seek opinions on job performance and staffing levels in preparation for a meeting with management;
- Complain about supervisory actions, when an employee had asked for and been denied union representation at the workplace;

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- Discuss concerns, previously voiced to management, relating to commissions and sales; or
- Discuss concerns, previously voiced to management, relating to an employer's tax withholding practices.

Employees' postings to social media sites that do NOT relate to the terms and conditions of employment, are NOT protected concerted activity: For instance, the NLRB has concluded that, when an employee posted inappropriate and embarrassing photos implicating his employer but that did not relate to the terms or conditions of his employment, termination of the employee's employment was lawful. Further, termination of an employee who complained about the "tyranny" of his boss was lawful, because the employee's postings related to an individual gripe and not to the terms and conditions of employment. Additionally, when an employee posted a derogatory term to describe his job title to a social media site and did not implicate any protected activity, and when the employer had no knowledge of the employee's unspoken complaints about the employer's overtime practices, the employee's posting was not held to be protected activity.

Employees' postings that are not directed at or do not involve other employees are NOT protected concerted activity: An employee who posts a work-related comment or engages in a discussion on a social media site and neither solicits nor receives feedback from other employees is not engaging in protected activity. In a recent case before the NLRB's general counsel, a bartender posted a Facebook response to a question from a non-employee. In his response, the bartender criticized his employer, his pay rate, the employer's tipping policy and the employer's customers. The general counsel concluded that, although the posting addressed the bartender's terms and conditions of employment, it did not constitute concerted activity, because none of the bartender's co-workers were involved in the posting and there had been no employee meetings or attempts to initiate group action based on his complaints.

Internet, Blogging and Social Media Policies

Most employers cringe at the thought of employees freely posting concerns about their employer and employment to social media sites for the world to see, and many attempt to curtail such behavior by instituting internet, blogging and social media policies. According to the NLRB's general counsel, however, many of these policies run afoul of the law by being overbroad or by inadvertently restricting employees' Section 7 rights. If a policy's language specifically prohibits employees from discussing the terms and conditions of their employment, or the policy may be *reasonably read* by employees to restrict such discussion or curtail their Section 7 rights, then the policy may be unlawful.

Overly broad policies are those that forbid very general employee behavior and may be reasonably interpreted as restricting an employee's Section 7 rights. For example, policies that prohibit employees from discussing the company, its management or its employees, prohibit employees from posting pictures depicting the employer, or prohibit employees from making any disparaging remarks or engaging in any inappropriate discussions, without defining what is inappropriate, may be unlawful. The NLRB's general counsel recently concluded that a policy prohibiting employees from posting pictures of themselves depicting the company in any way in any media was unlawful because it would prohibit them from, for example, posting photos of employees carrying picket signs, which is protected activity. The general counsel also has ruled that policies that prohibit employees from making disparaging remarks when discussing the company or the employees' superiors, co-workers, or competitors are unlawful if the policies do not contain limiting language to inform employees that the prohibition does not apply to Section 7 activity.

To draft an effective social media policy that complies with the NLRA while protecting the employer's interests, an employer should:
Review its policy to ensure that it is not overly broad;
Consider including a disclaimer that the policy will not be construed or applied to limit employees' rights under the NLRA or applicable law;
Not prohibit employees from discussing the terms and conditions of their employment, even in disparaging ways, in the absence of a disclaimer; and
Remind employees that they may not disclose the employer's or its customers' confidential information, trade secrets, or copyrighted or trademarked material on any social networking site. Social media policies should reference an employer's confidential information policy if one exists.

Social media law is likely to continue to evolve as employees increasingly use Facebook, Twitter, LinkedIn, MySpace and other sites to comment on or discuss work issues. To comply with the emerging interpretations regarding social media policies and employee discipline under the NLRA, employers should review their social media policies and take care not to infringe on employees' Section 7 rights when making adverse employment decisions. ■

New York's Marriage Equality Act and its Effect on Welfare and Pension Benefits

In June 2011, Governor Andrew Cuomo signed the Marriage Equality Act into law, making New York the sixth state to permit same-sex couples to marry. The law became effective on July 24, 2011.

Almost without exception, the Act provides that same-sex couples must be able to marry in New York, that the marriages of same-sex and opposite-sex couples must be treated equally in all respects under the law, and that marriages must be valid regardless of whether the parties to the marriage are of the same or opposite sex.

Employers sponsoring pension and welfare plans should review their treatment of same-sex partners. Because of ERISA's preemption of state laws that relate to employee benefit plans, employers that offer self-insured health and welfare benefits are not required to treat the same-sex spouses of their employees as "spouses" for purposes of their self-insured health and welfare plans. These employers, however, may still choose to treat same-sex spouses as "spouses" for purposes of their plans and, therefore, should decide whether they want to extend coverage to the same-sex spouses of their employees. By contrast, employers that offer fully insured health and welfare benefits must treat the same-sex spouses of their employees as "spouses" under their plans. All employers, regardless of the type of health and welfare plan they offer, should review their plans' language carefully and determine whether any amendments are necessary to clarify who is a "spouse" (and "domestic partner," as applicable) under their plans.

The Federal Defense of Marriage Act provides that, for the purposes of federal law, the term "spouse" can only mean an opposite-sex spouse. The Act, therefore, does not require employers to extend pension benefits to the same-sex spouses of their employees. Employers and other plan sponsors may, however, choose to provide their employees' same-sex spouses with similar benefits. Either way, plan sponsors should review their plan documents to revisit their definitions of "spouse" (and "domestic partner," as applicable) and determine whether a clarifying amendment is appropriate. ■

Participants' Access to Quality Investment Advice May Continue To Be Limited Under the DOL's Final Investment Advice Regulation

The Department of Labor ("DOL") has issued a final regulation intended to permit investment providers to impart investment advice to retirement plan participants and IRA beneficiaries. Congress has been concerned that individuals do not have enough access to professional investment advice to make informed decisions because, for years, rules have restricted access to investment advice. As a result, workers make investment mistakes that cost billions of dollars in forgone income. The DOL's final rule seeks to enhance retirement security by improving workers' access to quality investment advice and to reduce poor investment decisions by the 60 million active participants holding $2.2 trillion in retirement assets.

Prohibited Transaction Rules

The prohibited transaction provisions of the Employee Retirement Income Security Act ("ERISA") and the Internal Revenue Code ("Code") generally prohibit fiduciary advisers from receiving compensation from the investment vehicles that they recommend. Due to the prohibited transaction rules, investment advisers have been understandably cautious regarding the financial advice they share with retirement plan participants and individual retirement account ("IRA") beneficiaries. The Pension Protection Act of 2006 provided a remedy for this problem by amending ERISA and the Code to add a statutory exemption that allows a fiduciary to receive fees for the recommendation of investments. In an attempt to minimize conflicts of interest and promote the ability of employees to make sound financial decisions, the DOL's final regulation provides an exemption to the prohibited transaction rules enabling investment advisers to be paid for providing investment advice.

New Requirements

Under the new rules, effective Dec. 27, 2011, plan investment advisers may only receive compensation through the investment vehicles that they recommend if they meet strict requirements. Either:

(i) The investment advice provided is generated by a computer model that is certified as unbiased by an independent expert (who was not involved in the design of the computer model); or

(ii) The adviser is compensated on a "level-fee" basis, such that the compensation does not vary based on the investments selected. Although the fees paid are to be neutral, incentive compensation or bonuses based on an organization's profitability may be provided to an adviser using the fee-leveling arrangement if the investment advice and investment options are excluded from, or are a negligible element of, the organization's profits and the determination of the bonus paid.

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Advisers who use both types of arrangements will have to satisfy many other conditions as well, including, without limitation:

(i) A plan fiduciary, independent of the investment adviser, must expressly authorize the investment advice arrangement;

(ii) An independent auditor must perform an annual audit of the arrangement for compliance with the regulation;

(iii) The adviser must provide a comprehensive notice to plan participants;

(iv) The compensation received by the adviser must be reasonable; and

(v) The adviser must maintain records for a period of at least six years that are adequate to determine whether the requirements of the regulation have been met.

Outcomes

The DOL expects that this regulation will make high-quality fiduciary investment advice more accessible to millions of Americans who direct the investment of their defined contribution retirement plan accounts and IRAs, while providing important safeguards to minimize potential conflicts of interest. However, as a result of the new requirements, investment advisers could end up providing less advice to participants, rather than more. Investment providers that wish to offer investment advice to participants have to weigh the compliance costs against the benefits of the new business.

Employers and trustees of retirement plans, for their part, should ensure that they understand the requirements imposed by the regulation and continue to select and manage their investment advice provider prudently as they continue to have a fiduciary duty to monitor their service providers. ■

2011 Decisions of Interest

Court Denies Plaintiffs' Attorneys' Claim for Fees in ERISA Action

SRZ successfully represented the International Ladies' Garment Workers' Union ("ILGWU") Death Benefit Fund, the UNITE HERE Staff Retirement Plan, their fiduciaries, Amalgamated Services Corp., Amalgamated Life Insurance Co., Alicare Inc. and individual defendant Michael Hirsch against a claim for more than $1.7 million in attorneys' fees stemming from an ERISA action.

> "An award of attorneys' fees in an ERISA action is not automatic and necessitates more than 'trivial success on the merits' of the action or a 'purely procedural victory.' "

The ruling in *Adler, et al. v. Raynor, et al.* may impact the way that attorneys' fees are awarded to settling ERISA litigants in the future. The decision also helps clarify what success a party must achieve to receive a fee award. Attorneys' fees are available under ERISA when a party achieves "some degree of success" on the merits of a claim, a standard articulated by the U.S. Supreme Court in *Hardt v. Reliance Standard Life Insurance Co.* in 2010. The *Adler* decision is one of the first decisions within the Second Circuit to apply the *Hardt* standard in a situation in which the party seeking fees agreed to settle a case.

Adler involved multiple former officers of the ILGWU, who sued various benefit plans, the fiduciaries of those plans and others on behalf of the plans' participants for breach of fiduciary duty under ERISA. The plaintiffs alleged, among other things, that the defendants engaged in self-dealing by improperly investing the plans' money in products of the Amalgamated Bank of New York, an entity with which, the plaintiffs claimed, the defendants were closely involved. Such investments allegedly resulted in investment losses and the underfunding of the benefit plans.

The parties agreed to a settlement after the defendants moved to dismiss the complaint. The settlement agreement provided that the independent fiduciary of one of the benefit plans would be replaced, and that the defendants would continue to comply with certain recordkeeping and disclosure requirements under ERISA. After the settlement, the only remaining issue was the plaintiffs' demand for more than $1.7 million in attorneys' fees. This issue was submitted to the court. SRZ opposed the demand on behalf of its clients.

An award of attorneys' fees in an ERISA action is not automatic and necessitates more than "trivial success on the merits" of the action or a "purely procedural victory." Here, the majority of the plaintiffs' demands in their complaint, including, among others, restitution and disgorgement, statutory penalties, and declaratory relief were not met. Rather, as the court held, the settlement agreement provided merely "trivial" and "minor procedural" successes that did not rise to "some degree of success on the merits." The court further held that, even if the plaintiffs had met the requisite threshold, they would not be entitled to fees under the traditional

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five-factor balancing test courts generally use, and the fees demanded were "excessive in the extreme." Accordingly, the plaintiffs were not entitled to an award of attorneys' fees.

In an action like this, where the plaintiffs "abandoned the vast majority of their demands to achieve an extremely modest settlement," the court found that an award of attorneys' fees would have encouraged the improper use of the legal system by plaintiffs and discouraged defendants from settling cases out of unwillingness to pay unjustified and potentially excessive attorneys' fees. The court's analysis of the plaintiffs' demands and the net result of the settlement agreement is an important guide for courts to use in future proceedings to protect defendants in ERISA litigation.

Second Circuit Adopts Presumption of Prudence Standard in ERISA Stock Drop Litigation

For companies that offer their own publicly traded stock as an investment option in a 401(k) plan, any drop in stock prices may trigger allegations of fraud and fiduciary breaches. Given the recent economic downturn, the federal courts have heard an increasing number of these so-called "stock drop" cases. A recent opinion from the U.S. Court of Appeals for the Second Circuit, however, should help reassure employers worried about these types of lawsuits.

> "A recent opinion from the U.S. Court of Appeals for the Second Circuit should help reassure employers worried about these types of lawsuits."

On Oct. 19, 2011, the Second Circuit joined its sister circuits in adopting a presumption of prudence first articulated by the Third Circuit in *Moench v. Robertson*, as the standard of review applicable to stock drop claims. *See In re Citigroup ERISA Litig.*, No. 09-3804; *Gearren v. McGraw-Hill Cos., Inc.*, Nos. 10-792, 10-934. Prior to this decision, district court judges disagreed as to whether to apply the presumption, and whether to apply it at the motion to dismiss stage. Under the presumption, an employer's decision to retain company stock as an investment option in an ERISA-covered employee benefit plan can be reviewed only for an "abuse of discretion." The employer is not required to override plan terms that allow employees to invest in company stock unless circumstances place a company in a "dire situation" that was "objectively unforeseeable." The court explained that the presumption provides "the best accommodation between the competing ERISA values of protecting retirement assets and encouraging investment in employer stock."

The Second Circuit's decision emerged out of a class action suit against Citigroup filed in 2008 by employee participants in Citigroup's 401(k) plans, following a 50 percent decline in Citigroup's stock price. The plaintiffs alleged that the company and named defendants breached their fiduciary duties of prudence and communication by failing to divest the plans of Citigroup stock despite its unsteady value, and neglecting to provide complete and accurate information to employee participants in the plans regarding company stock and its exposure to risks associated with the subprime mortgage market.

The district court granted Citigroup's motion to dismiss the employees' claims against the company. In a divided opinion, the Second Circuit affirmed the dismissal. Applying the *Moench* presumption to the plaintiffs' prudence claims, the court found that the plaintiffs' allegations that Citigroup had made bad business decisions were not insufficient. Moreover, the court rejected claims that the employer acted imprudently, because the plaintiffs could not show that an investigation of Citigroup stock would have led the defendants to conclude that Citigroup was no longer a prudent investment.

The court's articulation of the *Moench* standard is particularly notable, as it asserts that judicial scrutiny into fiduciaries' actions should increase with the degree of discretion a plan gives its fiduciaries to invest in company stock. Accordingly, employers with benefit plans granting plan fiduciaries discretion to invest in company stock should be aware that courts in the Second Circuit may be less deferential to their decisions. The court made it clear, however, that fiduciaries may still be liable even if the plan does not grant them discretion to divest the plan of the company stock.

The *Citigroup* decision and the Second Circuit's adoption of the deferential *Moench* standard at the dismissal stage are encouraging for employers, although many questions still remain. Courts within the Second Circuit are now tasked with fleshing out the details of how the presumption of prudence should be applied in practice, including determining how plan language impacts that analysis. It is also significant that Circuit Judge Straub wrote a lengthy and strongly worded dissent, rejecting, among other things, the court's adoption of the *Moench* standard. Because of these uncertainties, and for other reasons, including public relations, many employers have chosen to settle these types of actions. In recent litigations, SRZ represented defendants in connection with similar actions brought against Merck, Merck's board, Merck's pension committee and others following Merck's withdrawal of Vioxx, an anti-inflammatory drug, from the market and the subsequent decrease in Merck stock price; and Bear Stearns and others following the collapse of the company in 2008. The parties in both of these actions reached settlements with the plaintiffs. ■

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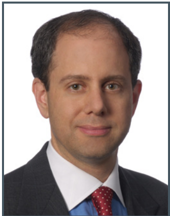

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