



Committee Cochairs

Vernon F. Dunbar
Turner Padgett
Greenville, SC
(864) 552-4601
vdunbar@turnerpadgett.com

Kenneth R. Berman
Nutter McClennen & Fish LLP
Boston, MA
(617) 439-2532
kberman@nutter.com

Mark S. Davidson
Williams Kastner
Seattle, WA
(206) 628-6648
mdavidson@williamskastner.com

Journal Editors

C. Pierce Campbell
Turner Padgett
Florence, SC
(843) 656-4429
pcampbell@turnerpadgett.com

Thomas A. Dye
Carlton Fields
West Palm Beach, FL
(561) 650-0337
tadye@carltonfields.com

Gerardo R. Barrios
Baker Donelson
Mandeville, LA
(985) 819-8416
gbarrios@bakerdonelson.com

ABA Publishing

Jason Hicks
Associate Editor
Sonya Taylor
Designer

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Using the Inevitable Disclosure Doctrine as a De Facto Noncompetition Agreement

By J. Rushton McClees
and Meaghan E. Ryan

The inevitable disclosure doctrine provides an employer with a method to prove a claim of misappropriation of trade secrets without proving *actual* misappropriation by the former employee. Instead of proving that the former employee has actually given trade secrets to his or her new employer, the former employer may demonstrate that, given the employee's former and new positions, it is inevitable that the employee will rely on his or her knowledge of the former employer's trade secrets in working for the new employer. Thus, the doctrine allows the former employer to enjoin the employee from beginning work for the new company. Some jurisdictions that recognize the inevitable disclosure doctrine permit this type of injunction even in the absence of any specific noncompetition agreement.

Courts use the following justification for the inevitable disclosure doctrine: Unless the employee has an "uncanny ability to compartmentalize information," as the Seventh Circuit noted in *PepsiCo v. Redmond*,¹ the employee will necessarily rely (whether consciously or subconsciously) on his or her knowledge of the former employer's trade secrets in performing new job duties for the competitor company. When considering whether to employ the doctrine, courts examine: (1) the degree of similarity between the employee's former and new positions; (2) the degree of competition between the former and new employer; (3) the new employer's efforts to safeguard the former employer's trade secrets; and (4) the former employee's lack of forthrightness in his or her activities before accepting the new job and in his or her testimony.²

PepsiCo Inc. v. Redmond is one of the leading cases on the inevitable disclosure doctrine. In *PepsiCo*, Redmond, who had been employed in a high-level position with PepsiCo, accepted a job with Quaker Oats Company to market Gatorade and Snapple drinks. During his employment with PepsiCo, Redmond had become very familiar with PepsiCo's information regarding pricing, strategy, and delivery systems. Redmond had signed a confidentiality agreement with PepsiCo; however, he had not signed a noncompetition agreement. After Redmond announced his intentions to leave PepsiCo for Quaker Oats, PepsiCo sought an injunction to prevent Redmond from beginning work with Quaker Oats and from disclosing PepsiCo's trade secrets to
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Vernon F. Dunbar



Kenneth R. Berman



Mark S. Davidson

Message from the Chairs

Many of your Committee leaders and colleagues attended the Section of Litigation's Annual Conference in New York, April 21–23, 2010. A dinner on the first evening, at which Committee members were joined by members from the Woman Advocate, Minority Trial Lawyer, and Commercial and Business Litigation Committees, was a highlight of the conference.

The Committee also chaired two excellent CLE programs: "From Ethics to Tactics: Deposition Do's and Don'ts," and "Pitfalls and Pratfalls: Ethical Considerations When Interviewing Witnesses." The programs were very well received, and they enhanced the Committee's reputation for presenting programs that are both educational and entertaining.

The next opportunity to attend Committee programs will come at the ABA Annual Meeting in San Francisco, August 5–7, 2010. The Committee will present two programs at the Annual Meeting: "One Step Over the Line: From Civility to Hardball and Beyond," on Thursday, August 5, at 2 p.m., and "Complaint vs. Indictment: Litigating at the Crossroads of Civil and Criminal Liability," on Saturday, August 7, at 2 p.m. The Committee chairs also welcome you to a no-host dinner on the evening of Thursday, August 5, and to a networking reception on Friday, August 6, at 5 p.m. We look forward to seeing many of you in San Francisco this summer.

We would like to take this opportunity to invite you to submit articles and case notes of interest to business torts practitioners for the committee's webpage. Fresh content is enthusiastically received, and we will provide a link to your firm's website when your submission is posted. This is one area we would like to improve upon in the months ahead, and we can do it best with submissions from our members in the trenches and in the know. Submitting material for publication on the webpage is also an excellent way to get more involved in Committee activities and

to interact with Committee colleagues. Submissions should be directed to Betsy Hyatt (ehyatt@starrslaw.com) or Dan Kaufmann (dkaufmann@babac.com).

It's not too early to block the dates of next winter's joint CLE with the Corporate Counsel, Woman Advocate, and Minority Trial Lawyer Committees on your calendars. The meeting will run February 17–20, 2011, at the Naples Grand Beach Resort in Florida. As always, this meeting will offer lots of sun, fun, networking, and programming.

Please help us in growing the Committee. If you have friends or colleagues who practice in the area of business torts litigation, spread the word. To join the Committee, ABA members need only access our Committee webpage at www.abanet.org/litigation/committees/business_torts.

The Committee is always looking for new and enthusiastic leaders, and for those of you who would like to participate more actively or serve as subcommittee cochairs or editors, please contact our Committee and Subcommittee cochairs. Many of the leaders of our Committee and the Section of Litigation worked their way up through the Subcommittee structure. We know from our own experience that actively participating in Committee meetings and activities provides excellent opportunities for networking and making lifelong friends around the country.

We invite you to participate in the Committee's monthly conference calls. They are conducted on the third Thursday of each month at 1 p.m. EST. The call-in number is 800-504-8071, and the passcode is 9885457.

We welcome your suggestions on ways in which the Business Torts Committee can help you—with networking, substantive content, or otherwise. Feel free to drop a line to any or all of us at the email addresses on the front cover.

Finally, the chairs wish to thank both the authors and the Committee's newsletter editors for another informative issue. ■

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C. Pierce Campbell



Thomas A. Dye



Gerardo R. Barrios

Message from the Editors

Summer has begun, the kids are out of school, soccer and baseball little leagues are in full swing, and, regrettably, the lawn mower beckons. Amid these changes in the weather, our schedules, and the rhythms of our business litigation practices, we are pleased to present this issue of the *Business Torts Journal*, which focuses on remedies.

This issue presents four interesting, informative, and timely articles that address remedy issues often encountered in business litigation. A bonus fifth article provides practical pointers for the persuasive researcher and writer.

The first article, written by J. Rushton McClees and Meaghan E. Ryan of Sirote & Permutt, P.C., involves the inevitable disclosure doctrine, which allows an employer to prove a claim of misappropriation of trade secrets against a former employee without proving actual misappropriation by the former employee. The article analyzes the use of the inevitable disclosure doctrine as a de facto noncompetition agreement and describes how the inevitable disclosure doctrine has been used to enjoin former employees from beginning new employment with a competitor, how some jurisdictions have limited the use of the inevitable disclosure doctrine, and how a few states have rejected the doctrine outright.

The next article, by Mark S. Davidson (one of our cochairs) and Michael I. White of Williams Kastner, examines whether a party should be permitted to contractually limit its liability for economic damages that may result from its negligence or intentional conduct. The article discusses recent cases that consider whether the limitation of liability provisions constitutes a proper exercise of the parties' common-law contracting rights, or if it's unenforceable, as against public policy, as reflected in various state anti-indemnity statutes.

In the third article, Zachary G. Newman and Anthony P. Ellis of Hahn & Hessen, LLP, provide a useful and timely refresher course on the provisional remedies available to safeguard, preserve, and, in some cases, repossess collateral pledged to

secure loans and additional assets of the borrower. The authors use the hypothetical fact pattern of a commercial lending dispute to effectively illustrate the various available provisional remedies.

The fourth article, submitted by Ladd Hirsch and Jason Fulton of Diamond McCarthy, LLP, explores the remedies available to minority shareholders who want to leave a business and cash out. The authors examine the business tort of minority shareholder oppression, remedies for shareholder oppression, issues regarding the buyout remedy, and other nonbuyout remedies that may be available.

Our final article comes to us from Eric P. Voigt of Faruki, Ireland & Cox, P.L.L., and it provides five important tips for the persuasive researcher and writer. Young associates and seasoned lawyers alike will find these practical pointers extremely useful as they approach their next persuasive piece to be submitted to a court.

We hope this issue will be a valuable tool in your business litigation practice. Please visit the Business Torts Committee website, www.abanet.org/litigation/committees/business_torts, for many additional articles on remedies and other business litigation topics. We encourage you to contact our substantive subcommittee chairs or our editors with ideas for articles you may wish to author for upcoming issues. We're currently seeking articles on the following topics:

Winter 2011 Fraud

Spring 2011 Technology

If you would like to contact the editors, please email us: Pierce Campbell at pcampbell@turnerpadget.com; Tom Dye at tadye@carltonfields.com; or Gerry Barrios at gbarrios@bakerdonelson.com.

We hope to see you at the ABA Annual Meeting in San Francisco, California, in August. ■

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Getting What You Bargained For: The Enforceability of Contractual Limitations of Liability

By Mark S. Davidson and Michael I. White

Should a party be permitted to limit, by contract, its liability for economic damages that may result from its negligence or intentional conduct? Recent cases have discussed whether limitation of liability provisions¹ in contracts between design professionals and owners or developers constitute a proper exercise of the parties' common-law contracting rights or whether they are, instead, unenforceable as against public policy, as reflected in various state anti-indemnity statutes.

Judicial decisions on this issue have been far from uniform. Even where there appears to be no conflict between state contract law, public policy, or an anti-indemnity statute, some courts construe limitation of liability provisions liberally so as to foster the rights of private parties to contract freely,² while other courts view provisions that limit liability as exculpatory clauses requiring strict construction against the design professional.³ Another factor can be the jurisdiction's view of the scope of the economic loss rule. As a result, it is often difficult to harmonize the courts' decisions. Nevertheless, most often the outcome turns on the wording of the parties' limitation of liability provision or the language of the state anti-indemnity statute at issue.

Two courts recently reached different outcomes: The Arizona Supreme Court enforced a limitation of liability provision, while the Georgia Supreme Court invalidated a nearly identical term. Alaska and Nebraska courts relied on state anti-indemnity statutes to bar the parties' attempts to limit contractually liability for their own negligent or intentional actions as violative of state public policy. As more states enact anti-indemnity legislation, attacks on the enforceability of limitation of liability clauses are likely to become more frequent. An understanding of the issues and how the recent decisions dealt with them should aid contract drafters and commercial litigators as they advise clients on the use of limitation of liability clauses in their clients' commercial agreements.

The Historical Context

The early courts that considered the impact of anti-indemnity statutes on limitation of liability clauses did so in response to the question of whether architects and engineers should be permitted to limit their liability to an owner for economic damages resulting from their own design professional negligence. A 1994 decision of the Alaska Supreme Court provides an early

example of a court declining to enforce a limitation of liability provision. *City of Dillingham v. CH2M Hill Northwest, Inc.*⁴ concerned a contract between the city and an engineering firm with plans for the construction of a sewage treatment plant. The contract included a provision limiting the firm's liability for its "sole negligent acts, errors, or omissions" to \$50,000 or its total fee, whichever was greater. When the general contractor encountered differing site conditions during construction, it brought an action against the city, which, in turn, filed a third-party claim against the engineering firm for breach of contract, breach of duty of care, and breach of fiduciary duty. The Alaska trial court enforced the limitation of liability provision, refusing to apply Alaska's anti-indemnity statute on the basis that it was meant to protect contractors, not owners and engineers.

On review, the Supreme Court of Alaska held that a limitation of liability provision could never limit an engineering firm's liability for the "knowing" breaches of contract and fiduciary duty that the city had alleged. The court also held, based on legislative intent, that the anti-indemnity statute prohibited engineers from limiting their liability to their clients even for negligent acts. Noting that the legislature had considered and rejected a proposed amendment, similar to that enacted in California,⁵ which would have expressly permitted limitations of liability for design defects, the court stated that the rejection of the amendment evidenced the legislature's intent to prohibit such provisions.

The Alaska Supreme Court rejected the argument advanced by the engineering firm that indemnity agreements and limitation of liability provisions are not synonymous and that the statute referred only to indemnity agreements. It held that the terms were required to be considered synonymous to effectuate the legislature's intent to prevent parties to a construction contract from bargaining away liability for their own negligent conduct.⁶ Finally, to buttress its conclusion, the court, in dicta, observed that if design professionals are permitted to limit contractually their liability, while third parties are permitted to recover in tort for economic losses, the anomalous result might be that a third party, not in privity of contract with the design professional, might recover more damages than a party that contracted with the design professional, i.e., the contractor might recover more from the city than the city could recover from the engineering firm.⁷

GEORGIA'S ANTI-INDEMNITY STATUTE



A covenant, promise, agreement, or understanding in or in connection with or collateral to a contract or agreement relative to the construction, alteration, repair, or maintenance of a building structure, appurtenances, and appliances, including moving, demolition, and excavating connected therewith, purporting to indemnify or hold harmless the promisee against liability for damages arising out of bodily injury to persons or damage to property caused by or resulting from the sole negligence of the promisee, his agents or employees, or indemnitee is against public policy and is void and unenforceable.

GA. CODE § 13-8-2(b).

In stark contrast is *Valhal Corp. v. Sullivan Associates, Inc.*,⁸ in which the United States Court of Appeals for the Third Circuit applied Pennsylvania law to enforce a provision in a contract between an architect and a developer that capped the architect's liability at \$50,000.⁹ The appellate court relied on the facts that the parties were sophisticated business entities dealing at arm's length, the limitation was reasonable in relation to the professional's fee, and the developer's damages were purely economic. The court rejected the developer's arguments that the limitation of liability provision violated the Pennsylvania anti-indemnity statute and that, even if enforceable, the limitation should be applied only to negligence claims. Significantly, the court emphasized the difference between indemnification, which holds the indemnitee harmless from all liability, and a limitation of liability, which merely caps the amount of liability. The court also observed that indemnity clauses are disfavored in Pennsylvania and therefore subject to stringent standards, while limitation of liability provisions are not. The court concluded that "[s]o long as the limitation which is established is reasonable and not so drastic as to remove the incentive to perform with due care, Pennsylvania courts uphold the limitation."¹⁰

In addition to case law that distinguishes limitation of liability provisions from indemnity clauses barred by anti-indemnity statutes, some states, like California, have specific statutory exceptions to their anti-indemnity statutes for limitations of liability, under which contracting parties may agree "to the allocation, release, liquidation, exclusion, or limitation as between the parties of any liability (a) for design defects, or (b) of the promisee to the promisor arising out of or relating to the construction contract."¹¹ In *Markborough California, Inc. v. Superior Court*,¹² the California Court of Appeals considered whether a limitation of liability clause fell within this exception to the anti-indemnity statute. The court held that "a provision in a construction contract limiting a party's liability to the developer of the property for damages caused by the engineer's professional errors and omissions is valid under [the exception to the anti-indemnity statute] if the parties had an opportunity to accept, reject or modify the provision."¹³

The Current Landscape

In recent cases, two courts invalidated limitation of liability provisions under their respective state anti-indemnity statutes, while two other courts enforced limitation of liability clauses. Attempting to reconcile these apparently contradictory decisions sheds some light on the permissible contours of an enforceable limitation of liability provision.

Beware of Overreaching

Clauses that seek to limit liability to third parties may be invalidated. In *Lanier at McEver, L.P. v. Planners and Engineers Collaborative, Inc.*,¹⁴ a developer contracted with a civil engineer to design a storm water drainage system for an apartment complex. After the developer discovered damage in the system, it sued the engineer, alleging damages of \$500,000 for negligent design. The parties' contract included a limitation of liability clause capping the engineer's exposure at \$80,514, the amount of its fee.¹⁵ The engineer moved for partial summary judgment, seeking to enforce the limitation. The Georgia trial court granted partial summary judgment, and the Georgia Court of Appeals affirmed. However, the Georgia Supreme Court reversed.

In the Georgia Supreme Court's opinion, the case fell squarely within Georgia's anti-indemnity statute,¹⁶ the purpose of which is to prevent an owner, contractor, or subcontractor from contracting away liability for accidents caused by its sole negligence. The court rejected the engineer's argument that the clause was a liability limitation provision and not an indemnity clause. Even though the limitation did not excuse the engineer from all liability, the court found the clause to be an indemnity provision within the meaning of the statute: "This is because the clause applies to 'any and all claims' by third parties and shifts all liability above the fee for services to [the developer] no matter the origin of the claim or who is at fault."¹⁷ The court found it significant that once liability exceeded the engineer's fee, the provision shifted the risk to the developer for all judgments, even those on third-party claims based on the engineer's sole negligence.¹⁸ The court rejected the engineer's reliance on

(Continued on page 17)



A Refresher Course in Provisional Remedies

By Zachary G. Newman and Anthony P. Ellis

Following the recent economic tumult, lenders and financial institutions across the country have seen a staggering rate of defaulting loans. These institutions are increasingly looking to counsel to employ judicial measures to safeguard, preserve, and even repossess collateral pledged to secure the loans and additional assets of the borrower that could satisfy the debt. There are a variety of provisional remedies at a lawyer's disposal, many of which are codified in the Federal Rules of Civil Procedure and in state procedural rules.

To aid our discussion, we'll use a hypothetical commercial lending dispute involving a bank and one of its major clients, although the remedies discussed below are available in a wide variety of business torts litigation and other matters. In our hypothetical, Acme Bank, a Connecticut financial institution, has retained you in connection with a dispute with one of its lending clients, Buy-Mart, a New York-based superstore that specializes in "rock-bottom" prices. Buy-Mart is privately owned by Frank G. Reed, reigning patriarch of the Reed family, which owns substantial real estate assets in Brooklyn, New York.

About five years ago, Acme provided Buy-Mart with a \$75 million loan, which Buy-Mart claimed it sought to expand its operations in New Jersey and Connecticut. Under the loan agreement, Buy-Mart was required to make monthly principal and interest payments of some \$1 million per month for 10 years. Financial information submitted by Buy-Mart showed that Buy-Mart had substantial cash flow and net income, as well as significant projected growth, and both Reed and Buy-Mart represented in the loan documents that they had no preexisting debt. Buy-Mart collateralized the loan by granting the bank a senior security interest in certain valuable equipment and inventory. Reed, who owns a collection of valuable American memorabilia, provided an absolute and unconditional personal guaranty.

The lending relationship progressed smoothly until December 2009, when Buy-Mart missed its first loan payment. When Acme's account manager contacted Buy-Mart to discover what happened, he was told it was merely a clerical error, and payment was submitted approximately two weeks later. In January and February, however, Buy-Mart missed both monthly payments. Moreover, numerous articles appeared indicating that Buy-Mart's senior executives dramatically overstated Buy-Mart's earnings over the past five years and engaged in

serious accounting fraud. The articles also indicated that Buy-Mart was suffering significant losses as a result of its expansion plans; that Buy-Mart had numerous trade creditors, all of which were holding Buy-Mart in default and seeking repayment; and that Reed was suspected of seeking to transfer his American memorabilia on his private jet to buyers located outside the United States.

The following discussion addresses the avenues of provisional relief that are available to Acme Bank to safeguard its collateral and to protect its rights.

Preliminary Injunctions and Temporary Restraining Orders

The injunction is the most commonly used remedy available to creditors. Because an injunction is designed to maintain the status quo during the course of any litigation, it is most appropriate where the defendant threatens to breach, or is suspected of breaching, an existing agreement or otherwise acting to impair his or her financial status, which ultimately would render a judgment ineffectual. Courts have broad discretion in deciding both whether to grant an injunction and, given that injunctions can come in all shapes and sizes, how to fashion the type of relief to best protect the moving party's interests.

Although both the federal courts and each state court have specific standards for granting injunctions, courts generally evaluate a wide range of factors, including: (1) whether the movant has demonstrated that it will likely succeed on the merits of its claims,¹ (2) whether the movant has shown an irreparable injury (one that cannot be compensated in money or for which compensation cannot be measured),² (3) whether a balance of the equities favors granting the injunction, (4) the adequacy of other remedies, and (5) the practical significance and enforceability of the injunction.³

To support the injunction request, the moving party will need to submit an affidavit or declaration from someone who has personal knowledge (in the Acme dispute, this would likely be a bank officer who had account responsibility or supervision), establishing each of the elements noted above to support the injunction request. In addition, the moving party generally should submit any documentary evidence available to substantiate the request and include news articles or publicly available records indicating high-risk, unauthorized transfers or a diminution in value of the

collateral, although most courts require more substantive documentation of immediate harm.⁴ If the bank in our hypothetical succeeds in obtaining an injunction, most courts will require it to post a bond that protects the defendant from potential harm, should the defendant prevail in litigation.

An additional consideration is whether the bank needs immediate relief and, thus, should move for a temporary restraining order (TRO).⁵ Again, although each state and the federal courts have their own specific standards for granting a TRO, certain common questions involve: (1) whether the bank can obtain a TRO ex parte or whether it will need to provide notice to the defendant, (2) the effective period of the TRO (e.g., a TRO is effective in federal court for 10 days),⁶ (3) the burden on the moving party, and (4) the type of hearing that will be required by the court (which may differ from judge to judge). Some judges merely require a proffer (an informal presentation of evidence), while others may require a full evidentiary hearing with live testimony and the admission of evidence.

Finally, counsel should be aware of whether there are any specific injunctions available in the applicable jurisdiction that may either help or harm his or her cause. For instance, New York law recognizes “Yellowstone Injunctions,” which a commercial tenant may use to retain control of the leased space after an owner declares a default.⁷

Turning back to our hypothetical, in determining whether an injunction was an appropriate remedy for Acme Bank, counsel should determine in consultation with the bank the type of injunction that may be most appropriate to accomplish the bank’s goals, such as an injunction prohibiting Reed from transferring any assets to third parties, an injunction to prohibit Buy-Mart from engaging in any additional expansion operations that could have a material adverse change, or requiring Buy-Mart to immediately begin making loan payments to the bank.

Replevin and Its Relative, the Attachment

To the extent that any specific assets are pledged as collateral to the bank or are identified as property of the borrower and guarantor, state and federal courts may permit lenders to take either actual or constructive possession of those assets before a judgment has been entered.⁸

Repossessing pledged collateral is known commonly as *replevin* or an “order of delivery”⁹ and is usually accomplished through a complaint in the jurisdiction where the property is located for replevin and a concurrent motion requesting immediate possession of the property.¹⁰ The issue to be resolved on these motions is strictly whether Acme Bank, on the one hand, or Buy-Mart, on the other, has a superior possessory right to the collateral.¹¹ To succeed, the bank will need to demonstrate its indisputable right to seize and take possession of the collateral for the purpose of reducing the bank’s outstanding indebtedness, which usually is satisfied by demonstrating a default under the loan agreement.¹² Like the injunction remedy, there is generally a

bond requirement in most state’s statutory schemes.

Repossessing noncollateral assets is generally referred to as “attachment” and is available in nearly all actions (matrimonial litigation being one notable exception in some states) after a complaint has been filed. Attachment differs from replevin in that the primary question is not whether the bank has a senior possessory right in the assets; instead, the question is whether the property could be transferred beyond the jurisdiction of the court and, thus, become unavailable to satisfy any potential judgment.¹³ Moreover, an attachment is usually available only in an action on a claim for money. Some states even require the claim to be based in a contract.¹⁴

The decision of whether attachment should be awarded is within the discretion of the judge, provided the moving party can meet the statutory grounds applicable in that forum.¹⁵ Courts consider a variety of factors when determining whether to grant a motion for attachment, including the probability of success on the merits, whether the amount demanded from the defendant exceeds potential counterclaims against the plaintiff, and whether there is evidence of intent to defraud on the part of the defendant, among others.

The method for obtaining an attachment is generally through a motion for attachment, and, again, the moving party may be required to post a bond. In connection with the motion, the moving party may be able to obtain limited disclosure concerning the debtor’s assets and property.¹⁶ Most states’ statutes also permit the moving party to request a TRO if there is a threat that the defendant will move or attempt to move assets before the motion can be heard and determined. In terms of what can be attached, state law governs the issue, and it is important to determine the specific state limitations at issue.¹⁷ However, in general, a court can attach only property that is located within its jurisdiction.

In our hypothetical, Acme Bank may be able to replevy the equipment and inventory, and attach Reed’s memorabilia collection. Depending upon where such property was located, the bank may be able to apply for a mandatory injunction requiring Reed and Buy-Mart to bring the property to New York. However, if Buy-Mart can demonstrate that there is more than 100 percent collateral coverage, the bank may face an uphill battle to convince the court that the bank should receive additional security through an attachment or other available provisional remedies.

Acme Bank also should be counseled that, upon taking possession of collateral, it has the obligation to act in a commercially reasonable manner with respect to the collateral. This includes, but isn’t limited to, safeguarding the collateral and preserving its value. Care must be given to the act of repossession, as well as the storage and disposition of the collateral, which is governed by article 9 of the Uniform Commercial Code, state law, and decisional authority. A bank’s failure to act in a commercially reasonable manner with respect to collateral could have an impact on its ability to recover the indebtedness and could subject the bank to additional lender-liability claims.

Receivership

Receivership is a provisional remedy whereby a third party is appointed by the court to identify, marshal, preserve, and often liquidate property at issue in a litigation during the pendency of the litigation. Notably, most commercial loan agreements provide for this right, although lenders rarely invoke it for a variety of reasons. The option to order receivership, like other provisional remedies, is often left up to the broad discretion of the trial judge, along with how such a remedy should be imposed. Typically, courts view receivership as an extreme remedy and are not generally inclined to grant it.¹⁸

An order appointing a receiver may dramatically alter the litigation in favor of the creditor and encourage the debtor to discuss settlement.

Because a receiver is charged with representing the interests of all parties to the litigation, not just the creditor or party you represent, it is appropriate primarily in situations involving allegations or evidence of potential fraud in an otherwise legitimate business operation. It is also often useful in situations in which property or business operations are spread throughout multiple jurisdictions because the scope of the receivership can extend beyond jurisdictional boundaries. For example, in federal court, the receiver can exercise jurisdiction over property located in other jurisdictions merely by filing a copy of the complaint in the jurisdiction where the property is located and the order of appointment of the receiver.¹⁹

Ultimately, parties should carefully weigh the pros and cons of seeking a receivership. An order appointing a receiver may dramatically alter the litigation in favor of the creditor and encourage the debtor to discuss settlement. Receivership also offers the benefit of being a fluid remedy that can be crafted by the court to meet the needs of all parties. However, it can also be an extremely costly and burdensome remedy for all parties.

In our hypothetical, given Buy-Mart's competing creditors and the financial morass the company is in, the receivership may be an attractive option for Acme Bank. And it's likely that the bank has the contractual right to appoint a receiver under the terms of the loan agreement. However, numerous considerations have to be weighed with Acme Bank before pursuing this action. For example, under a court-appointed receiver, the bank may lose a certain amount of control over the proceeding, and the receiver may add a layer of costs the bank is unwilling to fund. Furthermore, the receiver could review the bank's course of

conduct and make recommendations to the court that aren't in the bank's interests or that are in the interests of unsecured creditors or creditors that hold interests subordinate to the bank.

Notice of Pendency

The last potential provisional remedy is a notice of pendency (commonly referred to as "lis pendens"). A notice of pendency is a constructive notice filed in the real estate records that informs potential purchasers and creditors that the property at issue is subject to a lawsuit or claim and that the claim or eventual judgment could affect the title.

This filing does not require court authorization but typically requires there be a pending action that affects or impacts real property. Of note, there are risks that are associated with a filing, in that the filing party can be liable for the damages resulting from the filing and fees. These fees can be substantial if the filing impacts a potential sale of the property.

In our hypothetical, to determine whether a notice of pendency could be helpful to Acme Bank, it would need to consider whether any of its claims affect the title to real property. For those properties over which it held a duly recorded mortgage, there would be no need to file a notice of pendency. But, if Acme Bank discovered that Reed had transferred his homes not covered by the mortgages to his spouse the day after they signed the guaranties for \$1, the transfer may be fraudulent as to the bank and may provide the bank with a claim that the transfer was a fraudulent conveyance. In this case, the bank may have a claim to set aside the transfer, and the bank would have the ability to file the notice of pendency to place the world on notice that there is a claim pending that could affect title to that real property.

Conclusion

Provisional remedies offer an avenue of immediate relief and protection for a creditor or plaintiff, but counsel must fully weigh the benefits and risks of such a strategy from legal, business, and procedural perspectives before fully pursuing these paths. ■

Zachary G. Newman is a litigation partner and Anthony P. Ellis is a litigation associate with Hahn & Hessen LLP in New York.

Endnotes

1. To demonstrate the likelihood of success on the merits, a plaintiff need not show certainty of success. For example, under New York law, a prima facie showing of a right to relief is sufficient; actual proof of the case should be left to further court proceedings. *See, e.g., Terrell v. Terrell*, 279 A.D.2d 301, 303, 719 N.Y.S.2d 41, 43 (N.Y. App. Div. 1st Dep't 2001) (citation omitted). Moreover, "[i]t is well settled that a likelihood of success on the merits may be sufficiently established even where the facts are in dispute and the evidence is inconclusive." *Four Times Square Assocs., L.L.C. v. Cigna Invs., Inc.*, 306 A.D.2d 4, 5, 764 N.Y.S.2d 1, 2 (N.Y. App. Div. 1st Dep't 2003).

2. Some courts have held that a showing of irreparable harm is usually considered the single most important requirement in determining whether to issue a preliminary injunction. *See Anacom v. Shell Knob Servs., Inc.*, No. 93-4003, 1994 U.S. Dist. LEXIS 223, at *16 (S.D.N.Y. Jan. 10, 1994). This prong also can be the most difficult to establish given that the case law uniformly provides that if there is an available legal remedy, irreparable harm cannot be established. *See, e.g., Interbake Foods, LLC v. Tomasiello*, 461 F. Supp. 2d 943 (N.D. Iowa 2006) (harm is irreparable if there is no adequate remedy at law).

3. *See Tempur-Pedic Int'l, Inc. v. Waste To Charity, Inc.*, No. 07-2015, 2007 WL 535041, at *9 (W.D. Ark. Feb. 17, 2007) (finding that the defendants would not experience harm if they were enjoined from the distribution and sale of misappropriated mattresses). As articulated in *Universal Marine Ins. Co. Ltd. v. Beacon Ins. Co.*, 581 F. Supp. 1131 (D.N.C. 1984), courts have an interest in enjoining acts that are in violation of contracts and that support conversion and possible fraud claims. *See id.* at 1138 (finding overriding public interest in the prevention of fraud and that the public interest against encouraging or tolerating fraud can be protected only if an injunction is issued); *Tempur-Pedic Int'l*, 2007 WL 535041, at *9 (noting that injunctions have been issued throughout the country to protect plaintiffs in matters where fraud is involved); *Marsellis-Warner Corp. v. Rabens*, 51 F. Supp. 2d 508 (D.N.J. 1999) (granting preliminary injunction based on state law claims of fraud).

4. Notably, a likelihood of success on the merits in many jurisdictions may sufficiently be established even where the facts are in dispute and the evidence is inconclusive. *See Hamilton Watch Co. v. Benrus Watch Co.*, 206 F.2d 738, 740 (2d Cir. 1953).

5. *See, e.g., Ma v. Lien*, 198 A.D.2d 186, 187, 604 N.Y.S.2d 84, 85 (N.Y. App. Div. 1st Dep't 1993) (court concluding sub silencio that denying the injunctive relief sought would render the final judgment ineffectual); *Bass Bldg. Corp. v. Vill. of Pomona*, 142 A.D.2d 657, 659, 530 N.Y.S.2d 595, 597 (N.Y. App. Div. 2d Dep't 1988) (injunctive relief granted where victory on the merits would otherwise be meaningless); *see also Nat'l Bank of Detroit v. Michael Kaufman Cos.*, No. 95-1788, 1996 U.S. App. LEXIS 25283, at *8 (6th Cir. Aug. 30, 1996) (“[T]he whole point of a security interest is to limit the debtor’s rights to dispose of assets after default on credit obligations.”).

6. FED. R. CIV. PROC. 65(c).

7. *See First Nat'l Stores v. Yellowstone Shopping Ctr.*, 21 N.Y. 2d 360 (N.Y. 1968).

8. *See, e.g., N.Y. U.C.C. § 9-601 cmt. 2* (“The rights of a secured party to enforce its security interest in collateral after the debtor’s default are an important feature of a secured transaction.”).

9. Numerous cases have enforced a lender’s fundamental and critical right to repossess collateral following a default. *See Nat'l Bank of Detroit*, No. 95-1788, 1996 U.S. App. LEXIS 25283, at *8 (“[T]he whole point of a security interest is to limit the debtor’s rights to dispose of assets after default on credit obligations.”); *Roberge v. Bankers Trust Co.*, 84 A.D.2d 8, 446 N.Y.S.2d 443 (N.Y. App. Div. 3d Dep't 1981) (finding a lender has the ability to take possession of collateral and sell it to a third party following borrower’s default of a security agreement).

10. By way of example, the procedure in Arkansas is called an “order of delivery.” ARK. CODE ANN. § 18-60-101. Each state has its own statutory scheme for replevin, and that scheme should be consulted before counsel takes pen to paper to determine the statutory requirements for this type of relief. Under Federal Rule of Civil Procedure 65(a), replevin in federal actions is governed by the home forum’s state substantive law.

11. *Honeywell Info. Sys., Inc. v. Demographic Sys., Inc.*, 396 F. Supp. 273, 275 (S.D.N.Y. 1975) (plaintiff’s right to the immediate possession of the collateral is sufficient to grant replevin).

12. Sequestration is a statutory remedy available in the case where multiple creditors are asserting claims against a single asset. It is available only after a lawsuit has been filed and does not alter the ownership of the property. It is a useful remedy in certain states to ensure that the value of the property is preserved until the litigation is concluded.

13. By way of example, California Code of Civil Procedure Section 483.015 provides, in pertinent part, that the amount to be secured by an attachment is the sum of “[t]he amount of the defendant’s indebtedness claimed by the plaintiff” and “[a]ny additional amount included by the court under Section 482.110,” less “[t]he value of any security interest in the property of the defendant held by the plaintiff to secure the defendant’s indebtedness claimed by the plaintiff, together with the amount by which the value of the security interest that has decreased due to the act of the plaintiff or a prior holder of the security interest.”

14. California Code of Civil Procedure Section 483.010 provides as follows: “Except as otherwise provided by statute, an attachment may be issued only in an action on a claim or claims for money, each of which is based upon a contract, express or implied, where the total amount of the claim or claims is a fixed or readily ascertainable amount not less than five hundred dollars (\$500) exclusive of costs, interest, and attorney’s fees.”

15. *See, e.g., N.Y. C.P.L.R. Art. 62* (identifying statutory grounds for attachment under New York law); *IND. CODE § 34-25-2-I* (noting that attachment is available only when there is a claim for monetary damages and additional statutory factor is met).

16. An additional consideration in determining whether to seek an order of attachment is whether the bank should move for the order of attachment ex parte, i.e., without notice to the defendant. Special rules and requirements may be required in order to move ex parte, and state law generally requires a party to move to confirm an order of attachment shortly after the property is attached.

17. Like attachment and sequestration, prejudgment garnishment is another available remedy designed to preserve the value of a debtor’s assets pending the outcome of the litigation. It is generally available to a creditor when a party wishes to preserve the value of assets belonging to the debtor that are in the possession of a third party for the benefit of the debtor, such as a bank. This remedy also is available ex parte and is governed by state law.

18. Some courts also take a hostile view of using the receivership remedy to effectuate a foreclosure sale and liquidation of assets. *See SEC v. Am. Bd. of Trade*, 830 F.2d 431 (2d Cir. 1987).

19. *See 28 U.S.C. § 754.*



A Pound of Cure: Remedies for Minority Shareholders Without an Exit Strategy

By Ladd Hirsch and Jason Fulton

In most states, it is relatively easy to start a new business, and people who start private companies generally want to keep things simple. State statutes help by requiring minimal paperwork, minimal capital requirements, and little red tape. But how to handle the departure of one or more owners who desire to exit the business—one of the key long-term issues for any company—is often overlooked when a new company is formed, particularly when it is started by a group of friends or family. Unfortunately, there is no requirement that people forming a new business decide at the time of formation how to deal with the financial issues that arise when a minority shareholder wants to leave the business and be cashed out.

This article considers what remedies *may* be available to minority shareholders who want to cash out of the business but who did not secure a redemption agreement or any other contractual buyout right, either at the time of their investment or prior to their decision to cash out. Minority shareholders in this position may find that no remedy of any kind is available or, at best, that the available remedies are limited to some type of equitable relief depending on the ability to establish that the majority shareholders engaged in improper, oppressive conduct.

The Closely Held Corporation

Large public corporations dominate the financial news, but the private, closely held company is the business form of choice for many new businesses. While investors in large public corporations are typically passive investors who have no role of any kind in the business, in closely held corporations the investors are often active participants who serve as directors, officers, and employees. While investors in large public companies can sell their shares at any time and for any reason in the public market, investors in closely held companies lack a ready market for their shares. As a result, shareholders in private, closely held corporations often find that it is much easier to get into (and become an owner of) the business than it is to get out of it (and sell their minority, noncontrolling interest).

In many, if not most, instances, the owners of closely held companies do not enter into shareholder agreements or redemption provisions that ensure that minority interest owners can monetize or liquidate their ownership interest in the business.

Indeed, one of the important negatives associated with ownership of a minority interest in a closely held company is the lack of a defined exit process for minority shareholders.

Another complexity and potential problem area for a closely held corporation is that the typical rule of majority control still applies. Shareholders elect the board of directors, thereby giving the majority shareholder the ability to control the board. The board, in turn, selects the officers and decides the officers' compensation and whether the company should declare any dividends or distributions to its owners. Using the power of the board of directors, a majority shareholder can deny a minority shareholder the right to participate in the business and the right to receive financial benefits from the business. In most cases, the successful functioning of a closely held corporation depends on the relationship of trust between the shareholders. When trust ends, problems follow.

The Business Tort of Minority Shareholder Oppression

When a majority shareholder uses the power of his or her controlling interest to deny a minority shareholder the right to participate in, or enjoy financial returns from, the closely held company, the minority shareholder may file a lawsuit claiming shareholder oppression. This claim is based in tort, but there is no one set of definitive actions that give rise to the claim. Instead, the minority shareholder must establish that the majority shareholder engaged in oppressive actions of the following types (and this is not an exhaustive list):

- terminating the minority shareholder's employment;
- removing the minority shareholder from the board of directors;
- removing the minority shareholder from management;
- refusing to declare dividends when the company is profitable;
- denying the minority shareholder access to information;
- siphoning off earnings to the majority shareholder through de facto dividends or excessive compensation;
- entering into favorable contracts with affiliates of the majority shareholder;
- engaging in recapitalizations or mergers designed to reduce or eliminate the minority shareholder's interest;

- usurping corporate opportunities;
- using corporate assets for personal benefit;
- making loans to family members.

A typical pattern of behavior by the majority shareholder that fits this tort, often referred to as a “squeeze-out” or “freeze-out,” includes terminating the minority shareholder’s employment, removing the minority shareholder from the board of directors or from management, refusing to provide financial information, and refusing to declare dividends or declaring de facto dividends where the majority shareholder takes a disproportionate share of profits, and the pattern culminates in an offer from the majority shareholder to buy the minority shareholder’s interest at an unfairly low price. Through this scheme, the majority shareholder effectively freezes the minority shareholder out of the business, leaving the minority shareholder with no benefit from his or her ownership in the entity and no recourse other than to file a lawsuit alleging shareholder oppression.

Liability for Oppressive Conduct under Statutes and Case Law

Most states provide a cause of action for shareholder oppression, which is typically based on rights granted to shareholders in a corporate dissolution statute or on theories of a fiduciary duty that exists between shareholders. For example, Texas, California, and New York all allow shareholders to sue for dissolution of the corporation when the majority shareholder has engaged in oppression or other bad conduct.¹ What constitutes “oppression” is usually a function of the case law in a particular state.

For example, courts in Delaware, New York, and Texas have examined allegations of oppression under two common-law theories:

- [O]ppression should be deemed to arise only when the majority’s conduct substantially defeats the expectations that objectively viewed were both reasonable under the circumstances and were central to the minority shareholder’s decision to join the venture.
- [Oppressive conduct refers to] burdensome, harsh and wrongful conduct, a lack of probity and fair dealing in the affairs of a company to the prejudice of some of its members, or a visible departure from the standards of fair dealing and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely.²

By contrast, California follows a statutory approach to each of the two common-law alternatives. Section 1800(b)(4) of the California Corporate Code permits a shareholder in a closely held corporation, or any shareholder group owning more than one-third of the shares of a corporation that is not closely held, to file suit for dissolution if those in control have engaged in “persistent and pervasive fraud, mismanagement or abuse of

authority or persistent unfairness toward any shareholders.”³ Because this right is available to shareholders in all corporations, California law does not consider the minority shareholder’s expectations in applying this section and focuses only on the conduct of the majority.⁴ However, Section 1800 (b)(5) of the California Corporate Code focuses on the minority shareholder’s interests and expectations. It gives a minority shareholder in a closely held corporation the right to seek dissolution if “reasonably necessary for the protection of the rights or interests of the complaining shareholder or shareholders.”⁵

The wide variety of factual circumstances giving rise to a claim and the variations in the legal standard make it difficult to predict whether a particular court in a particular state will find oppression under a given set of circumstances. Minority shareholders tend to have more success by showing that the majority has engaged in many oppressive acts. But even when the shareholder can show oppressive actions, obtaining the right remedy can be an equal challenge.

Remedies for Shareholder Oppression

The most common statutory remedy for shareholder oppression is dissolution of the corporation. But many courts resist dissolving a profitable corporation. Instead, they have invoked their equitable powers to permit them to respond broadly to shareholder oppression claims—holding that if they are empowered to enact the harsh remedy of dissolution, then they are also empowered to order other, less drastic equitable remedies.⁶ Using their equitable powers, courts state that they will tailor the remedy to fit the specific factual situation presented in a particular case.⁷

Given the harshness of the dissolution remedy and the reluctance of courts to apply it, a far more common remedy for shareholder oppression is a court-ordered buyout of the minority shareholder’s interest by the majority shareholder(s). Courts order buyouts under their general equitable powers as a remedy that is less harsh than dissolution and also pursuant to specific statutory schemes authorizing buyouts. For example, courts in Alaska, Iowa, Minnesota, New Jersey, New Mexico, New York, Oregon, and Texas, among others, have all ordered a corporation or majority shareholder to buy out a minority shareholder’s interest.⁸

Issues Regarding the Buyout Remedy

A central issue in any buyout case is the standard of value to be applied. Should the shares be valued at “fair value” or “fair market value?”⁹ Public company data are more readily available to valuation experts, and these experts generate valuations of private closely held companies using data from comparable public companies.¹⁰ Private companies and public companies have important differences, however, and valuation experts and courts have therefore developed techniques to adjust for those differences.

The fair market value is “the price at which property would

REMEDIES OTHER THAN BUYOUTS AVAILABLE TO MINORITY SHAREHOLDERS

There are many potential remedies available to minority shareholders other than dissolutions and buyouts, although these two options are the most common. Some states seek to encourage the creative judicial resolution of shareholder oppression claims by codifying equitable options. For example, South Carolina's statute includes nine separate equitable options other than a buyout or dissolution.ⁱ Illinois's statute identifies 11 alternatives.ⁱⁱ California law simply instructs its courts to do equity.ⁱⁱⁱ In states lacking specific statutory authority, courts have nonetheless picked up the mantle of equitable creativity in addressing shareholder oppression.

The list of other potential remedies for shareholder oppression includes at least the following:

- altering or setting aside an action of the corporation, its shareholders, or directors;
- cancelling a provision in the articles of incorporation or bylaws;
- ordering payment of dividends;
- appointing a custodian to manage the business;
- appointing provisional directors;
- appointing an individual to be an officer or director;
- removing a director or officer from office;
- ordering an accounting;
- awarding damages;
- reinstating the minority as an employee;

- requiring repayment of sums wrongly siphoned from the corporation;
- limiting the salary of the majority or defining certain amounts of compensation as a constructive dividend;
- ordering issued stock to be cancelled or redeemed;
- permitting the minority to purchase additional shares.^{iv}

Endnotes

- i. S.C. CODE § 33-18-410 (West 2010).
- ii. 805 ILL. COMP. STAT. 5/12.56 (West 2010).
- iii. CAL. CORP. CODE § 1804 (West 2010) (“After hearing the court may decree a winding up and dissolution of the corporation if cause therefore is shown or, with or without winding up and dissolution, may make such orders and decrees and issue such injunctions in the case as justice and equity require.”).
- iv. *See, e.g.,* Brodie v. Jordan, 857 N.E.2d 1076, 1082 (Mass. 2006) (discussing prospective injunctive relief to allow minority to participate in the business, including reinstatement of employment and/or back pay); Hirsch v. Cahn Elec. Co., 694 So. 2d 636, 643 (La. Ct. App. 1997) (ordering return of \$200,000 in excessive compensation and payment of a dividend); Brenner v. Berkowitz, 634 A.2d 1019, 1033 (N.J. 1993) (discussing alternatives to dissolution); Balvik v. Sylvester, 411 N.W.2d 383, 388–89 (N.D. 1987) (same); Masinter v. Webco Co., 262 S.E.2d 433, 441 & n.12 (W. Va. 1980) (same); Baker v. Commercial Body Builders, Inc., 507 P.2d 387, 395–96 (Or. 1973) (same); *see also* 805 ILL. COMP. STAT. 5/12.56 (West 2010); S.C. CODE § 33-18-410 (West 2010); MODEL STATUTORY CLOSE CORPORATION SUPPLEMENT (1993).

change hands between a willing buyer and a willing seller when neither party is under an obligation to act.”¹¹ A fair market value will usually discount a minority interest in a close corporation for lack of marketability and lack of control.¹² The discount for lack of control simply reflects a reduction in price for the inability to control the corporation's actions because the buyer is buying less than a controlling interest in the company. But many courts refuse to include a lack-of-control discount in a buyout valuation because it would “deprive minority shareholders of their proportionate interest in a going concern”¹³ and would undermine the remedial goal of protecting “minority shareholders from being forced to sell at unfair values imposed by those dominating the corporation while allowing the majority to proceed with its desired corporate action.”¹⁴

The discount for lack of marketability, however, is more debatable, and courts will consider adjusting the valuation to reflect the fact that close corporation shares lack liquidity.¹⁵ While majority shareholders argue in favor of applying discounts and using a fair market value standard to determine the value of the minority shareholder's interest, minority shareholders seek buyouts at fair value, a valuation that includes no

discounts and in which the minority shareholder receives a full, proportionate share of the entire enterprise value based on the percentage of ownership.¹⁶

As an alternative to a court-imposed equitable award, some states offer the majority shareholder the option to buy the minority owner's shares as an alternative to dissolution. For example, California permits the corporation or the shareholder with more than a 50 percent ownership interest to avoid dissolution by buying the dissenters' stock for “fair value.” If the parties cannot agree on a fair value, the court can order evidence submitted to a panel of three disinterested appraisers selected by the court. The court enters a decree based on its review of and affirmation of the valuation of the appraisers. The decree gives the corporation, or, if it declines, the majority shareholder, the right to avoid dissolution by purchasing the minority's shares for the price stated in the decree.¹⁷

Conclusion

The fact patterns that give rise to claims for shareholder oppression are as limitless as the human capacity for greed and fraud. Fortunately, the judicial system has responded

with equal creativity. Recognizing the limited protections for minority shareholders in a typical corporation under majority rule, legislatures and courts have developed flexible remedies that are designed to address the problems unique to each case. Whether representing majority or minority shareholders, attorneys would do well to think creatively about a resolution that will effectively preserve maximum value for their clients and take advantage of the tools available to them. ■

Ladd Hirsch and Jason Fulton are litigation partners in the Dallas, Texas, office of Diamond McCarthy, LLP.

Endnotes

1. TEX. BUS. ORGS. CODE §§ 11.404(a)(1)(C), 11.405 (West 2008), CAL. CORP. CODE § 1800(a) and (b) (West 2010), N.Y. BUS. CORP. LAW § 1104-a(a)(1) (West 2010).
2. *Davis v. Sheerin*, 754 S.W.2d 375, 377–80 (Tex. App.—Houston [1st Dist.] 1988) (writ denied); *Gimpel v. Bolstein*, 477 N.Y.S.2d 1014, 1017–18 (N.Y. Sup. Ct. 1984); *Litle v. Waters*, No. 12155, 1992 WL 25758, at *7–8 (Del. Ch. Feb. 11, 1992). See also *In re Kemp & Beatley, Inc.*, 473 N.E.2d 1173, 1179 (N.Y. 1984).
3. CAL. CORP. CODE § 1800 (b)(4) (West 2010).
4. *Bauer v. Bauer*, 46 Cal. App. 4th 1106, 1113 (Cal. Ct. App. 1996).
5. CAL. CORP. CODE § 1800 (b)(5) (West 2010).
6. See *Shirmer v. Bear*, 672 N.E.2d 1171, 1176 (Ill. 1996) (affirming remedy of a buyout in a freeze-out and noting that in addition to a buyout, the court possessed many other equitable powers); *Brenner v. Berkowitz*, 634 A.2d 1019, 1033 (N.J. 1993) (finding the power to dissolve necessarily includes less drastic remedies); *Davis*, 754 S.W.2d at 380 (same); *In re Kemp & Beatley*, 473 N.E.2d at 1179 (a court has

other remedies but can still order dissolution).

7. *Davis*, 754 S.W.2d at 380.

8. *Alaska Plastics, Inc. v. Coppock*, 621 P.2d 270, 275 (Alaska 1980); *Sauer v. Moffitt*, 363 N.W.2d 269, 275 (Iowa Ct. App. 1984); *Pooley v. Mankato Iron & Metal, Inc.*, 513 N.W.2d 834, 836 (Minn. Ct. App. 1994); *McCauley v. Tom McCauley & Son, Inc.*, 104 N.M. 523, 537 (N.M. Ct. App. 1986); *Lund v. Krass Snow & Schmutter, P.C.*, N.Y.S.2d, 2009 N.Y. slip op. 03996, 2009 WL 1406312 (N.Y. App. Div. 1st Dep't, May 21, 2009) (affirming trial court judgment ordering a buyout of the minority shareholder, plus post-judgment interest); *Delaney v. Georgia-Pacific Corp.*, 278 Or. 305, 325 (Or. 1977); *Davis*, 754 S.W.2d at 380 (affirming trial court buyout order).

9. See Douglas K. Moll, *Shareholder Oppression and "Fair Value": Of Discounts, Dates, and Dastardly Deeds in the Close Corporation*, 54 DUKE L.J. 293 (Nov. 2004); *Balsamides v. Protameen Chems., Inc.*, 734 A.2d 721, 734–35 (N.J. 1999).

10. See generally SHANNON P. PRATT, VALUING A BUSINESS: THE ANALYSIS AND APPRAISAL OF CLOSELY HELD COMPANIES 261–309 (5th ed. 2008) (outlining valuation methodologies for closely held companies by comparison to public companies).

11. *Pueblo Bancorporation v. Lindoe, Inc.*, 63 P.3d 353, 362 (Colo. 2003).

12. See PRATT, *supra* note 10, at 397–459; DOUGLAS K. MOLL & ROBERT A. RAGAZZO, THE LAW OF CLOSELY HELD CORPORATIONS § 8.02[B][3] (2009).

13. *In re Friedman*, 661 N.E.2d 972, 976–77 (N.Y. 1995).

14. *Id.* See also *Balsamides*, 734 A.2d at 734–35.

15. *Pueblo Bancorporation*, 63 P.3d at 357 n.2; *Advanced Comm'n Design, Inc. v. Follett*, 615 N.W.2d 285, 291 (Minn. 2000).

16. See Moll, *Shareholder Oppression and "Fair Value," supra* note 9.

17. CAL. CORP. CODE § 2000 (West 2010).

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Five Tips for the Persuasive Researcher

By Eric P. Voigt

You just received an assignment to prepare your first persuasive brief. This is your big opportunity to demonstrate your ability to persuade through the written word. Before you begin, you must understand that the quality of a motion strongly correlates with the quality of the research.

Writing persuasively for a client is different from objective writing. Unlike a research memorandum, where the cases may or may not be reviewed by your boss or client, the cases relied on in a motion will be analyzed by the judge and law clerks. You (not the assigning lawyer) are responsible for the arguments made and the cases cited. Accuracy trumps overzealous advocacy.

These tips for drafting a persuasive piece will make you shine.

1. Do not cite cases unless you have read them entirely. Read cases from the first to last word. When preparing motions, many young associates find the “smoking gun” quote supporting their argument and stop reading. Unknown to the associate, the court may have rejected the quoted proposition five paragraphs later or ruled on a different issue in the same opinion that is adverse to your client. You don’t want a call from a partner asking why you did research for opposing counsel and billed your client for it.

2. Know the holding of a case. The persuasive value of a case often rests with what the court actually did. One type of persuasive holding is where an appellate court ruled that the lower court abused its discretion for doing the same thing that your opponent is asking your judge to do. Alternatively, you may diminish the strength of your opponent’s cited cases by knowing the applicable legal standard. A Supreme Court decision upholding a jury verdict (under the deferential manifest-weight-of-the-evidence standard) is far less persuasive than an opinion affirming the issuance of summary judgment (under *de novo* review).

3. Research opinions drafted by your judge. If the presiding judge has addressed the subject matter of your persuasive work, you won’t need to convince your judge that the prior opinion is well reasoned. By citing a decision favorable to your client, you also force the opposing party into the uncomfortable position of having to argue that the judge was wrong.

My firm once represented an employer in federal court against a former employee who contended that the employment

handbook altered his at-will status. I found an opinion from our judge (when he was a state appellate judge) where he specifically concluded that employment is presumed to be at will and may be terminated for good cause or no cause.

4. Use the West Digest System. Yes, you can research effectively without a computer. Digests are excellent book sources to find published cases addressing a specific legal topic. They contain summaries of federal and state judicial opinions organized by date and subject matter (e.g., torts or damages). Although good starting points, summaries aren’t substitutes for reading entire cases.

Digests have several practical uses, such as brainstorming. Many times, I have developed creative strategies to defeat class certification by analyzing case summaries and learning which facts courts weigh heavily in evaluating the predominance and superiority requirements of Rule 23(b). Digests can also be used to research the elements of a claim under federal or state law. In addition, the digests’ case summaries can shed light on various discovery issues, including when discovery is relevant or when good cause exists for a protective order.

5. Use the ABA website. ABA members have access to free resources on its website. The ABA Sections publish numerous articles on procedural and substantive issues. For example, committees under the Section of Litigation publish quarterly newsletters on topics ranging from the admissibility of evidence for motions for summary judgment to the enforceability of non-competition agreements.¹ These newsletters provide concise summaries of and unique insights into particular subjects.

By applying the above tips, you will be on the path to successful motion practice. Importantly, if you have reached this point in the article, then you have already learned tip No. 1. ■

Eric P. Voigt (evoigt@fclaw.com) is an associate with Faruki Ireland & Cox P.L.L. in Dayton, Ohio.

“Five Tips for the Persuasive Researcher,” by Eric P. Voigt, 2009, PP&D 17:4, p. 9. Copyright 2009 © by the American Bar Association. Reprinted with permission.

Endnote

1. See, e.g., www.abanet.org/litigation/committees/pretrial.

THE INEVITABLE DISCLOSURE DOCTRINE

(Continued from page 1)

Quaker Oats. PepsiCo argued that the information held by Redmond would inevitably be disclosed, not because Redmond would try to appropriate the marketing and advertising information, but because he would be able to anticipate PepsiCo's distribution, packaging, pricing, and marketing decisions.

The United States Court of Appeals for the Seventh Circuit agreed, finding that "a plaintiff may prove a claim of trade secret misappropriation by demonstrating that defendant's new employment will inevitably lead him to rely on the plaintiff's trade secrets."³ The appellate court described PepsiCo's position as that "of a coach, one of whose players has left, playbook in hand, to join the opposing team before the big game."⁴ Thus, the court effectively converted the defendant's confidentiality agreement into a noncompete agreement by preliminarily enjoining him from working for a direct competitor for a six-month period.

Pennsylvania's Lower Burden on Employers

Recently, the U.S. District Court for the Eastern District of Pennsylvania considered the use of the inevitable disclosure doctrine in the absence of a noncompete agreement in the case of *Bimbo Bakeries USA, Inc. v. Botticella*.⁵ Botticella was a vice president for Bimbo Bakeries, one of the four largest baking companies in the United States. In March 2009, Botticella signed a confidentiality agreement as a condition of his employment with Bimbo.

Among other products, Bimbo bakes and markets Thomas's English Muffins. As a part of his job, Botticella was very familiar with the process for baking Thomas's English Muffins, including the method for creating their "nooks and crannies" texture. There are three secret components for the famous "nooks and crannies" texture of Thomas's English Muffins: the recipe, the engineering, and the process. Botticella was one of just seven people at Bimbo who had knowledge of all three secrets. In addition, Botticella was one of a handful of individuals to have extensive access to Bimbo's financial data, strategic plans, and product development information.

In September 2009, Botticella received an offer to work in a similar position for Hostess Brands, Inc., one of Bimbo's three major competitors. Botticella accepted the offer with Hostess in mid-October 2009 but did not inform Bimbo of his new employment with Hostess until January 13, 2010. During the interim period, Botticella continued to have access to confidential information through documents he received and meetings he attended. In particular, Botticella attended a strategy planning meeting with Bimbo's president during which confidential information was discussed. In addition, Botticella accessed highly confidential strategic information of Bimbo through his

laptop, and it appeared that the access to this information was consistent with copying files to an external device. Botticella testified, however, that he personally avoided looking at confidential sales information and deleted such documents whenever he received them, and that he connected an external drive to his laptop to learn how to use it.

The district court found that Botticella's testimony regarding the use of an external hard drive on his laptop was not credible, nor was Botticella's testimony that he did not look at confidential documents after accepting the employment with Hostess. The court then considered whether Botticella's employment with Hostess constituted threatened misappropriation of trade secrets and applied the inevitable disclosure doctrine. Under Pennsylvania law, the doctrine permits an employer to enjoin a former employee from engaging in new employment "where that employment is likely to result in the disclosure of the information, held secret by a former employer, of which the employee gained knowledge as a result of his former employment situation."⁶

The court effectively converted the defendant's confidentiality agreement into a noncompete agreement by preliminarily enjoining him from working for a direct competitor for a six-month period.

Bimbo and Botticella argued over the correct standard for evaluating the likelihood that Botticella would disclose Bimbo's trade secrets. Bimbo argued that, under existing Pennsylvania law, it needed only prove that Botticella's employment with Hostess was "likely" to result in the disclosure of Bimbo's trade secrets. Botticella, however, argued that the proper standard for the court to apply was whether disclosure was "inevitable" in the course of Botticella's employment with Hostess, "or, in other words, if it would be impossible for [Botticella] to work at Hostess without disclosing Bimbo's trade secrets," and claimed that many Pennsylvania cases had misapplied the standard by lowering the burden on the party seeking the injunction.⁷

Examining Pennsylvania case law on the doctrine, the court

noted that the seminal Pennsylvania opinion on the doctrine, *Air Products & Chemicals, Inc. v. Johnson*,⁸ had not specifically declined to adopt the term “inevitable.” Thus, the court found that under Pennsylvania law, “sufficient likelihood or substantial threat of disclosure of a trade secret need not amount to its inevitability.”⁹ Furthermore, the court noted that, because it would be difficult for a court to prove a future event to the degree of “inevitability” or “impossibility,” the standard for proving threatened misappropriation of trade secrets should be practical and that the appropriate standard was whether there existed ample evidence of a substantial threat of disclosure.¹⁰ Thus, because the court concluded that *Bimbo* had sufficiently established a substantial threat that *Botticella* would disclose *Bimbo*’s trade secrets if he was permitted to begin work for *Hostess*, it preliminarily enjoined *Botticella* from beginning his employment with *Hostess* pending the court’s ruling on the case after trial.¹¹

Limited Use of the Doctrine in Some Jurisdictions

The lower standard for proving the inevitable disclosure doctrine as expressed in *Bimbo Bakeries* does not appear to have widespread support. Several jurisdictions that permit use of the doctrine recognize the criticisms of the doctrine and attempt to limit its use to particular circumstances. For example, the United States District Court for the Southern District of New York has held that, absent proof of actual misappropriation of trade secrets by a former employee, the inevitable disclosure doctrine should be applied in only very rare situations.¹² This is because to use the doctrine to prevent the former employee from accepting employment with a competitor in the absence of an explicit noncompete agreement would be to find an implied noncompete agreement, which is contrary to New York public policy, which disfavors such agreements. Specifically, the court found that one of the greatest risks in the use of the inevitable disclosure doctrine in the absence of a noncompete agreement is

the imperceptible shift in bargaining power that necessarily occurs upon the commencement of an employment relationship marked by the execution of a confidentiality agreement. When that relationship eventually ends, the parties’ confidentiality agreement may be wielded as a restrictive covenant, depending on how the employer views the new job its former employee has accepted. This can be a powerful weapon in the hands of an employer; the risk of litigation alone may have a chilling effect on the employee. Such constraints should be the product of open negotiation.¹³

Other jurisdictions allow the use of the doctrine only where the former employer can demonstrate that the employee is unwilling to preserve confidentiality. For example, Michigan appears to require that the former employer demonstrate that the employee is untrustworthy and that, absent evidence of dishonesty, an employer cannot establish threatened misappropriation.¹⁴

Rejection of the Doctrine in Some States

At least a few courts to consider the doctrine have rejected it outright. The California courts have found that

[t]he decisions rejecting the inevitable disclosure doctrine correctly balance competing public policies of employee mobility and protection of trade secrets. The inevitable disclosure doctrine permits an employer to enjoin the former employee without proof of the employee’s actual or threatened use of trade secrets based upon an inference (based in turn upon circumstantial evidence) that the employee will use his or her knowledge of those trade secrets in the new employment. The result is not merely an injunction against the use of trade secrets, but an injunction restricting employment.¹⁵

Those courts take issue with the doctrine’s “after-the-fact nature”: “The covenant is imposed after the employment contract is made and therefore alters the employment relationship without the employee’s consent.”¹⁶ Where there is a confidentiality agreement in place, the inevitable disclosure doctrine “in effect convert[s] the confidentiality agreement into . . . a covenant [not to compete].”¹⁷ These courts have reasoned that plaintiffs should not be allowed to use the inevitable disclosure doctrine as an after-the-fact noncompetition agreement. Otherwise, “the employer obtains the benefit of a contractual provision it did not pay for, while the employee is bound by a court-imposed contract provision with no opportunity to negotiate terms or consideration.”¹⁸ In addition, courts may find that to adopt the theory also would permit a court to infer some inevitable disclosure of trade secrets merely from an individual’s exposure to them.¹⁹

Preventing Employment with a Competitor in the Absence of a Noncompetition Agreement

From a practical standpoint, a company that wishes to prevent a former employee from beginning work with a competitor is better positioned to obtain an injunction if it can present evidence of dishonesty on the employee’s part. The *Bimbo Bakeries*²⁰ opinion demonstrates the importance of showing the former employee’s improper conduct in enjoining the employee from working for a competitor. In issuing the preliminary injunction, the court appeared to rely heavily on the fact that the former employee, *Botticella*, had not informed *Bimbo Bakeries* that he planned to begin work at *Hostess*.²¹ Combined with *Botticella*’s suspicious behavior in downloading *Bimbo* documents to an external hard drive, the court found that *Bimbo* had demonstrated a substantial threat that *Botticella* would disclose its trade secrets through his new employment with *Hostess*.²²

Evidence of bad faith on the part of the departing employee will weigh in favor of the former employer and may encourage

a court to apply the inevitable disclosure doctrine to enjoin temporarily the new employment in the absence of a noncompetition agreement. ■

J. Rushton McClees is a partner with Sirote & Permutt, P.C., which has three offices in Alabama. Meaghan E. Ryan is an associate with Sirote & Permutt, P.C., in Birmingham, Alabama.

Endnotes

1. PepsiCo, Inc. v. Redmond, 54 F.3d 1262, 1279 (7th Cir. 1995).
2. See *id.* at 1269.
3. *Id.* at 1269.
4. *Id.* at 1270.
5. No. 10-CV-0194, 2010 WL 571774 (E.D. Pa. Feb. 9, 2010).
6. *Id.* (citing Air Prods. & Chems., Inc. v. Johnson, 442 A.2d 1145, 1120 (Pa. Super. Ct. 1982)).
7. *Id.*
8. 442 A.2d 1114 (Pa. Super. Ct. 1982).

9. *Bimbo Bakeries*, 2010 WL 571774 at *12.
10. *Id.*
11. *Id.* at *12, *17.
12. *EarthWeb, Inc. v. Schlack*, 71 F. Supp. 2d 299 (S.D. N.Y. 1999) (applying New York law).
13. *Id.* at 310.
14. *CMI Int'l, Inc. v. Internet Int'l Corp.*, 649 N.W.2d 808 (Mich. App. Ct. 2002).
15. *Whyte v. Schlage Lock Co.*, 125 Cal. Rptr. 2d 277, 291 (Cal. Ct. App. 2002).
16. *Id.* at 293.
17. *Id.* (quoting *PSC, Inc. v. Reiss*, 111 F. Supp. 2d 252, 257 (W.D.N.Y. 2000)).
18. *Id.* at 293.
19. See *LeJeune v. Coin Acceptors, Inc.*, 849 A.2d 451, 471 (Md. 2004).
20. No. 10-CV-0194, 2010 WL 571774 (E.D. Pa. Feb. 9, 2010).
21. *Id.* at *13–14.
22. *Id.* at *14.

GETTING WHAT YOU BARGAINED FOR

(Continued from page 5)

decisions from other jurisdictions that enforced liability limitations, including *Valhal* and *Ocotillo v. WLB*.¹⁹ The court distinguished those decisions on the basis that the clauses at issue there did not apply to third-party claims.

Similarly, in *Omaha Cold Storage Terminals, Inc. v. The Hartford Insurance Co.*,²⁰ an unreported case from the United States District Court for the District of Nebraska, the court considered whether a contract's indemnification and risk-allocation clauses violated Nebraska's anti-indemnity statute prohibiting indemnification for one's own negligence.²¹ The court concluded that the anti-indemnity statute did not apply to the indemnification clause²² because the clause did not insulate or hold the breaching party harmless from its own negligence. However, the court also held that the statute did apply to the contract's risk-allocation clause²³ because it contained language that purported to limit liability for negligent acts. Ultimately, the court invalidated both the indemnification clause (to the extent it limited liability for claims arising out of negligence) and the risk-allocation clause.

The Role of Reasonableness

Clauses that limit liability to a reasonable amount, rather than completely shift liability, stand a better chance of being upheld. In *Ocotillo v. WLB*,²⁴ the Arizona Supreme Court recently weighed in on the issue. WLB prepared a survey of Ocotillo's project property but failed to identify an existing right-of-way owned by a third party. As a result of the inaccurate survey, the City of Phoenix refused to issue construction permits, and Ocotillo was required to procure a redesigned site layout from other engineering and survey

firms. The parties' contract contained a limitation of liability provision that limited WLB's liability resulting from its negligent acts, errors, or omissions to the fees it received for its services. Ocotillo sued WLB for breach of contract and professional negligence. The Arizona trial court's order enforcing the limitation of liability provision was affirmed by both the Arizona Court of Appeals and the Arizona Supreme Court on the basis that liability limitation clauses generally, and the clause at issue in *Ocotillo* in particular, do not conflict with any judicially identified public policy.

Ocotillo had urged the courts to follow the *City of Dillingham* and *Lanier* decisions and invalidate the clause. The Arizona Supreme Court distinguished *City of Dillingham* because of the unique legislative history of Alaska's anti-indemnity statute and the decision's reliance on the Alaska legislature's express rejection of a proposal to exempt liability limitation provisions when it enacted its anti-indemnification statute. And, unlike the provision at issue in *Lanier*, the clause litigated in *Ocotillo* was "devoid of any reference to liability for third-party claims brought by the general public."²⁵ Significantly, the court offered some insight as to the circumstances under which it would invalidate a limitation of liability provision. Acknowledging the public policy need to ensure the exercise of due care, it recognized that a low dollar amount limitation could be void if it effectively eliminated the professional's incentive to take precautions. As to the case before it, the court found the liability cap not impermissibly low because the potential loss of the fees, the main incentive for the work, ensured the exercise of due care.

In *Blaylock Grading Co., LLP v. Smith*,²⁶ the plaintiff

NEBRASKA'S ANTI-INDEMNITY STATUTE



In the event that a public or private contract or agreement for the construction, alteration, repair, or maintenance of a building, structure, highway bridge, viaduct, water, sewer, or gas distribution system, or other work dealing with construction or for any moving, demolition, or excavation connected with such construction contains a covenant, promise, agreement, or combination thereof to indemnify or hold harmless another person from such person's own negligence, then such covenant, promise, agreement or combination thereof shall be void as against public policy and wholly unenforceable.

NEB. REV. STAT. § 25-21, 187(1).

NORTH CAROLINA'S ANTI-INDEMNITY STATUTE

Any promise or agreement in, or in connection with, a contract or agreement relative to the design, planning, construction, alteration, repair or maintenance of a building, structure, highway, road, appurtenance or appliance, including moving, demolition and excavating connected therewith, purporting to indemnify or hold harmless the promisee, the promisee's independent contractors, agents, employees, or indemnitees against liability for damages arising out of bodily injury to persons or damage to property proximately caused by or resulting from the negligence, in whole or in part, of the promisee, its independent contractors, agents, employees, or indemnitees, is against public policy and is void and unenforceable.



N.C. GEN. STAT. § 22B-1.

sued the defendant land surveyor for breach of contract and negligence. The contract limited the defendant's liability to \$50,000. After the jury awarded plaintiff \$574,714, the North Carolina trial court held the liability limitation provision void as against public policy and entered judgment on the verdict. On appeal, the North Carolina Court of Appeals recognized the rights of freedom of contract and risk allocation between sophisticated, professional parties; found that the state's anti-indemnity statute²⁷ did not apply; and reversed the trial court. It reasoned: "The contract at issue involves a clause that limits a party's liability, not an indemnity clause whereby one party agrees to be liable for the negligence of the other party."²⁸ Thus, the statute is inapplicable because it "only limits a promisee from recouping damages paid to a third party as a result of personal injury or property damages when the damages were caused by the promisee."²⁹

Practice Pointers

The better-reasoned decisions hold that state anti-indemnity laws do not bar the enforcement of limitation of liability clauses. Depending on the language of the state's statute and the clause at issue, courts in jurisdictions that have not yet addressed this issue should follow the well-reasoned approach recognizing the difference between indemnification, which removes the incentive to act with due care, and a limitation of liability, which merely allows contracting parties to allocate risk. So long as the limitation is reasonable and does not remove the incentive to act with due care, it should be enforced. Nevertheless, given the importance of limiting liability as a risk

allocation device, the uncertainty and inconsistency of the law in this area is unsettling. Accordingly, practitioners would do well to advise their clients to agree to liability limits that have a reasonable relationship to the magnitude of the services rendered, the potential liability exposure, or both, and that do not limit liability for third-party claims. Doing so should increase the likelihood that the limitation will be enforced as consistent with public policy and anti-indemnification statutes. In addition, where enforceability is uncertain, in lieu of a limitation of liability clause, contracting parties should price the risk of greater exposure into the contract. ■

Mark S. Davidson is a member of Williams Kastner in Seattle and a member of the firm's Business Litigation practice group. He can be reached at mdavidson@williamskastner.com. Michael I. White is an associate in the Seattle office of Williams Kastner and a member of the Business Litigation practice group. He can be reached at mwhite@williamskastner.com.

Endnotes

1. A typical limitation of liability provision may look something like this: "Should there arise any liability on the part of the seller as a result of its breach of contract or negligence, the parties agree that the seller's liability shall be limited to X dollars."

2. See, e.g., *Wausau Paper Mills Co. v. Chas. T. Main, Inc.*, 789 F. Supp. 968, 974 (W.D. Wis. 1992), citing *Gerdman v. U.S. Fire Ins.*, 119 Wis. 2d 367, 350 N.W.2d 730 (Wis. Ct. App. 1984) (Because the anti-indemnity statute "voids agreements in construction contracts that limit or eliminate tort liability, thereby limiting the parties' common

law right to contract freely, the statute must be interpreted narrowly, placing the least possible restriction on the common law right.”).

3. *See, e.g., City of Dillingham v. CH2M Hill Nw., Inc.*, 873 P.2d 1271, 1277 (Alaska 1994) (“[W]e read the word ‘indemnify’ as used in [the anti-indemnity statute] to mean ‘exempt,’ and thus construe [the statute] to prohibit limitation of liability clauses.”).

4. 873 P.2d 1271 (Alaska 1994).

5. *See, e.g., Markborough Cal., Inc. v. Superior Court*, 227 Cal. App. 3d 705, 277 Cal. Rptr. 919 (Cal. Ct. App. 1991) (discussing CAL. CIV. CODE § 2782.5).

6. *Cf. Long Island Lighting Co. v. IMO DeLaval, Inc.*, 668 F. Supp. 237 (S.D.N.Y. 1987), *aff’d*, 6 F.3d 876 (2d Cir. 1993) (noting that under New York’s anti-indemnity statute, § 5-323 of New York’s General Obligations Law, there is a difference between an unenforceable exemption from liability and a limitation of liability provision that exempts engineers only from liability for economic losses, which is enforceable).

7. This outcome implicates the economic loss rule. For a thorough discussion of the doctrine in design service cases, see *Wausau Paper Mills*, 789 F. Supp. 968. *See also Davidson & Sorensen, Tort Damages for Breach of Contract? The Ebb and Flow of the Economic Loss Rule*, 15 BUS. TORTS J., Winter 2008.

8. 44 F.3d 195 (3d Cir. 1995).

9. The clause in *Valhal* reads as follows: “The OWNER agrees to limit the Design Professional’s liability to the OWNER and to all construction Contractors and Subcontractors on the project, due to the Design Professional’s professional negligent acts, errors or omissions, such that the total aggregate liability of each Design Professional shall not exceed \$50,000 or the Design Professional’s total fee for services rendered on this project.”

10. *Valhal Corp.*, 44 F.3d at 204.

11. CAL. CIV. CODE § 2782.5.

12. 227 Cal. App. 3d 705 (1991).

13. *Id.* at 708.

14. 284 Ga. 204, 663 S.E.2d 240 (2008).

15. The engineering contract provided as follows: “In recognition of the relative risks and benefits of the project both to [Developer] and [Engineer], the risks have been allocated such that [Developer] agrees, to the fullest extent permitted by law, to limit the liability of [Engineer] and its subconsultants to [Developer] and to all construction contractors and subcontractors on the project or any third parties for any and all claims, losses, costs, damages of any nature whatsoever, or claims expenses from any cause or causes, including attorney’s fees and costs and expert witness fees and costs, so that the total aggregate liability of [Engineer] and its subconsultants to all those named shall not exceed [Engineer’s] total fee for services rendered on this project. It is intended that this limitation apply to any and all liability or cause of action however alleged or arising, unless otherwise prohibited by law.”

16. Georgia’s anti-indemnity statute provides as follows: “A covenant, promise, agreement, or understanding in or in connection with or collateral to a contract or agreement relative to the construction, alteration, repair, or maintenance of a building structure, appurtenances, and appliances, including moving, demolition, and excavating connected

therewith, purporting to indemnify or hold harmless the promisee against liability for damages arising out of bodily injury to persons or damage to property caused by or resulting from the sole negligence of the promisee, his agents or employees, or indemnitee is against public policy and is void and unenforceable.” GA. CODE § 13-8-2(b).

17. *Lanier at McEver*, 284 Ga. at 207, 663 S.E.2d at 243.

18. The significance of the third-party risk allocation was further highlighted in the subsequent decision of *RSN Props., Inc. v. Egn’g Consulting*, 301 Ga. App. 52, 686 S.E.2d 853 (Ga. Ct. App. 2009), where the Georgia Court of Appeals upheld a limitation of liability provision in a contract between an engineer and a developer.

19. 219 Ariz. 200, 196 P.3d 222 (Ariz. 2008) (discussed *infra*).

20. No. 8:03CV445, 2006 WL 695456 (D. Neb. Mar. 17, 2006).

21. Nebraska’s anti-indemnity statute, in relevant part, provides as follows: “In the event that a public or private contract or agreement for the construction, alteration, repair, or maintenance of a building, structure, highway bridge, viaduct, water, sewer, or gas distribution system, or other work dealing with construction or for any moving, demolition, or excavation connected with such construction contains a covenant, promise, agreement, or combination thereof to indemnify or hold harmless another person from such person’s own negligence, then such covenant, promise, agreement or combination thereof shall be void as against public policy and wholly unenforceable.” NEB. REV. STAT. § 25-21, 187(1).

22. The indemnification clause provided that SSD is to be held harmless against claims only when such claims arise “in whole or in part by the negligent act, omission, and/or strict liability of [Fisco], any directly employed by [Fisco] (except SSD).”

23. The risk-allocation clause, in relevant part, stated, “SSD’s total liability to the Client for any and all injuries, claims, losses, expenses, damages or claim expenses arising out this agreement, from any cause or causes, shall not exceed the total amount of \$100,000, the amount of SSD’s fee (whichever is less) or other amount agreed upon . . . Such causes include, but are not limited to, SSD’s negligence, errors, omissions, strict liability, breach of contract or breach of warranty.”

24. *Ocotillo*, 219 Ariz. 200.

25. *Id.* at 204.

26. 189 N.C. App. 508, 658 S.E.2d 680 (2008).

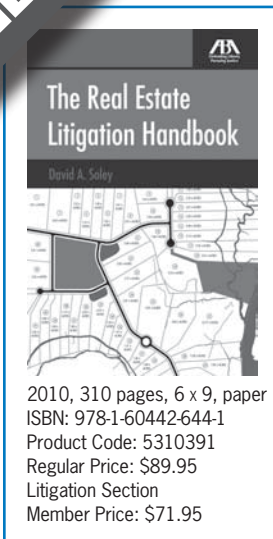
27. North Carolina’s anti-indemnity statute states, “Any promise or agreement in, or in connection with, a contract or agreement relative to the design, planning, construction, alteration, repair or maintenance of a building, structure, highway, road, appurtenance or appliance, including moving, demolition and excavating connected therewith, purporting to indemnify or hold harmless the promisee, the promisee’s independent contractors, agents, employees, or indemnitees against liability for damages arising out of bodily injury to persons or damage to property proximately caused by or resulting from the negligence, in whole or in part, of the promisee, its independent contractors, agents, employees, or indemnitees, is against public policy and is void and unenforceable. . . .” N.C. GEN. STAT. § 22B-1.

28. *Blaylock Grading*, 189 N.C. App. at 513, 658 S.E.2d at 683.

29. *Id.* (emphasis added).

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