D&G | Davis & Gilbert LLP
ATTORNEYS AT LAW

PRACTICE GROUP
NEWSLETTER
WINTER 2011

LITIGATION

1740 BROADWAY NEW YORK, NY 10019 | WWW.DGLAW.COM | P: 212.468.4800

IN THIS NEWSLETTER:

In this Winter issue, we report on some recent developments in the areas of commercial law, intellectual property and employment law, along with some practical advice that may help you avoid litigation.

The D&G family wishes a joyous New Year to all of our clients, colleagues and their families.

"Our tradition is based on unparalleled client service, individual attention, adding value and a strategic approach to every situation."

Previous Davis & Gilbert LLP newsletters can be found at www.dglaw.com/press-publications.cfm

COMMERCIAL LAW:

WHEN IS AN EARLY TERMINATION FEE CONSIDERED UNJUST ENRICHMENT?

Contracts often contemplate periodic payments over a fixed term, and frequently require the payment of a pre-determined early termination fee if the client terminates the contract early. For some time, New York courts enforced these types of liquidated damage provisions, especially if the provision was negotiated at arms-length by sophisticated parties when the contract was signed. Recently, however, a federal court held that a party terminating a contract prior to the end of the fixed term of the contract might be entitled to recover the early termination fee it paid if the fee operated as a penalty. This case could be a signal that courts will more carefully scrutinize early termination fees.

Spirit Locker, Inc. v. EVO Direct, LLC involved a dispute between a retailer, Spirit Locker, and a credit card processing company, EVO. Spirit Locker agreed to pay EVO a monthly fee for processing services over a three-year period. Spirit Locker agreed to pay an early termination fee of $395 if it, without cause, terminated the contract before the expiration of the term. The contract provided that the early termination fee was not a penalty, and stated that $350 was a reasonable estimate of EVO's damages, but did not explain why. Three months into the contract, Spirit Locker terminated without cause, and EVO automatically debited the early termination fee from Spirit Locker's on-file account. Spirit Locker filed suit on behalf of itself and other similarly situated companies, seeking recovery of all early termination fees they paid and claiming that these fees unjustly enriched EVO. The court ruled against EVO's motion to dismiss the complaint as a matter of law, holding that Spirit Locker could have a claim for unjust enrichment if the early termination fee was an unenforceable penalty.

Although the court was not asked to determine whether the early termination fee was a penalty, it quoted heavily from a 1977 New York Court of Appeals decision, *Truck Rent-A-Center*. In that case, the court carefully scrutinized the liquidated damage provision. Recognizing a strong public policy against the imposition of penalties, the court enforced the damage provision only because of its reasonableness. In the years since that case, New York courts have moved away from rigidly interpreting liquidated damages provisions,

>> *continued on page 5*

INTELLECTUAL PROPERTY LAW:

IMPLIED BREACH OF CONTRACT CLAIM: A POTENTIAL TRAP FOR THE UNWARY

A possible way to decrease the risk of a breach of implied contract claim is, where applicable, to put in place a non-disclosure agreement between the parties before any information is shared.

A person reviewing a screenplay, script, or other creative work might understand the risk of a future copyright claim if the copyright holder believes his material was used without permission. However, there is an additional risk of other claims that a copyright holder might bring in this situation: one claim is breach of an implied contract. Although a breach of an implied contract claim may appear as if it is of secondary importance to the primary copyright claim, it can be a trap that leads to significant litigation expenses.

In many instances, the Copyright Act bars or "pre-empts" state law claims brought by the same party concerning the same copyrighted work at issue. However, in a recent decision, *Benay v. Warner Bros. Entm't Inc.*, a federal appeals court determined that an alleged breach of implied contract claim was not preempted by the Copyright Act because the plaintiff had asserted an "extra element." The extra element was the allegation that there was an implied agreement between the parties that the defendants would pay for the plaintiff's ideas. This left the defendant defending two different claims with different standards to determine liability. As a result, the costs of defending the lawsuit will likely be significantly higher than if it had to only defend a single copyright infringement claim.

A possible way to decrease the risk of a breach of implied contract claim is, where applicable, to put in place a non-disclosure agreement between the parties before any information is shared. The non-disclosure agreement should not only include the standard provision not to disclose each parties' intellectual property, but also clarify whether or not there is an agreement to pay for the ideas within the subject work. Of course, a non-disclosure agreement creates a contractual obligation with respect to that agreement, but at least the parties will have control over its terms, as well as its duration, and, as a result, any dispute concerning it would likely be less costly than litigating a breach of implied contract claim.

>> The Bottom Line

If you are already entering into a non-disclosure agreement relating to protectable copyrighted material, or if a non-disclosure agreement is otherwise an option, you may be able to reduce your risk of additional and potentially costly claims by including a provision stating that there was not also an implied agreement to pay for the copyright holder's ideas.

By Marc Rachman, Partner, 212.468.4890/mrachman@dglaw.com
C. Andrew Keisner, Associate, 212.468.4845/akeisner@dglaw.com

INTELLECTUAL PROPERTY LAW:

BUT ONLY MY FACEBOOK FRIENDS CAN SEE THAT! SOCIAL MEDIA AND PRIVACY SETTINGS IN DISCOVERY

Facebook and other social media users may be required by the courts to produce relevant information in the course of a litigation.

No matter how strict the privacy settings, Facebook can turn a user's life into an open book. The Stored Communications Act, prohibits an entity, such as Facebook and MySpace, from disclosing information posted by users to their private pages without the account owner's consent. Therefore, in practical terms, litigants cannot obtain current or deleted Facebook or other social media pages and accounts – except for what may be publicly available online – without authorization from the account holder. Litigants may not circumvent this with clever tricks to obtain access to otherwise hidden information. In fact, the New York State Bar Association's Committee on Professional Ethics recently clarified that, while profiles and postings available to the general public are fair game, a lawyer may not view or access, or cause anyone else to access, the private Facebook or other social media website of a party other than his or her client.

To obtain Facebook or MySpace information in litigation, then, one must go to the source. New York courts are reluctant to allow litigants to hide relevant information with self-selected privacy settings. For example, in *Romano v. Steelcase Inc.*, Ms. Romano claimed she sustained permanent injuries and suffered a loss of enjoyment of life as a result of a fall from an allegedly defective office chair. Steelcase Inc., the chair manufacturer and distributor, contended that public portions of Ms. Romano's MySpace and Facebook pages revealed that she had an active lifestyle, traveled, and appeared to be happy in a photograph taken outside of her home, contradicting her claims that she was largely bed- and housebound due to her injuries. The court ordered Ms. Romano to provide authorizations to Steelcase Inc. to obtain her Facebook and MySpace pages, including archived and deleted information, which were not available to the general public, finding that the information on Ms. Romano's social media sites appeared necessary for defense of her claims, and/or could lead to admissible evidence.

Some cases have not reached this same result. In *McCann v. Harleysville Insurance Company of New York*, on the other hand, the trial court denied Harleysville's motion to compel McCann to authorize disclosure of the contents of her Facebook account. The appellate court upheld this ruling, characterizing the request as a "fishing expedition."

>> The Bottom Line

Restricting access to certain information to a relatively small group of "Facebook friends" does not always protect against disclosure in litigation. Facebook and other social media users may be required by the courts to produce relevant information in the course of a litigation.

By Jennifer Tafet Klausner, Partner, 212.468.4827/jklausner@dglaw.com
Cheryl Plambeck, Associate, 212.468.4965/cplambeck@dglaw.com

EMPLOYMENT LAW:

FEDERAL LAW EXPANDS WHISTLEBLOWER PROTECTIONS

> ...The First Circuit's interpretation of SOX's original language will likely provide important guidance as to whether the Dodd-Frank Act may be applied retroactively.

Since the Corporate and Criminal Fraud Accountability Act of 2002 (Sarbanes-Oxley or SOX) became law, its whistleblower provisions have protected employees who report information that they reasonably believe constitutes fraud upon a public company's shareholders from adverse employment action. Courts, however, have reached different conclusions about whether or not the Act protects only individuals reporting these actions if they are employed directly by a publicly held company, or if the Act also protects individuals reporting these actions employed by privately-held subsidiaries, of a publicly-held entity.

To resolve this dispute, the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 has expanded the language of Sarbanes-Oxley to provide whistle-blower protection to employees of public companies' subsidiaries or affiliates whose financial information consolidated into the public company's financial statements.

The question remaining for many public companies is whether or not courts will interpret the Dodd-Frank Act to apply retroactively and cover complaints made before the Act went into effect. A case now pending in the Court of Appeals for the First Circuit, may soon provide some guidance as to this question. The appeal stems from a decision issued by a Massachusetts federal court before the enactment of the Dodd-Frank Act. In that decision, the court considered claims by two employees of privately-held investment advisers who argued they were protected by SOX because their privately owned employer served as the investment advisers for a publicly-traded mutual fund. Mutual funds present a special case because publicly-traded funds typically have no employees of their own and instead contractually arrange for privately-held investment adviser firms to manage the funds' investments. The employers argued that SOX did not protect the individuals because they were not employed directly by a publicly-traded entity.

The court denied the employers' motions to dismiss and rejected the narrow reading of SOX proposed by defendants, reasoning that:

> "For the goals of SOX to be met, contractors and subcontractors, when performing tasks essential to insuring that no fraud is committed against shareholders, must not be permitted to retaliate against whistleblowers. . . [otherwise] reporting of fraud involving a mutual fund's shareholders would go unprotected, for the . . . simple reason that no "employee" exists for this . . . type of public company."

Soon after issuing this decision, the court permitted the parties to appeal to the First Circuit and the appeal is still pending. In the meantime, Congress has enacted the Dodd-Frank Act. The Dodd-Frank Act does not directly impact plaintiffs in these cases because they worked for contractors rather than for subsidiaries whose financials were consolidated into the public company's financial statements. However, the First Circuit's interpretation of SOX's original language will likely provide important guidance as to whether the Dodd-Frank Act may be applied retroactively. If the court were to find that SOX's original language protected plaintiffs in this case, it would be holding that SOX has always protected a broader class of employees than those directly employed by a publicly-traded company.

>> continued on page 5

WHEN IS AN EARLY TERMINATION FEE CONSIDERED UNJUST ENRICHMENT? *>> continued from page 1*

and have more readily enforced these provisions as long as they were fairly negotiated. *The Spirit Locker* court did not appear inclined to follow this more recent trend, possibly signaling that early termination fees may be subject to closer scrutiny in the future.

>> The Bottom Line

Liquidated damage provisions should be carefully drafted, not only to prevent a finding of an unenforceable penalty, but also to avoid an unjust enrichment claim seeking repayment of the fee. A contract that simply characterizes an early termination fee as liquidated damages may not be enough to prevent a court from construing the fee as an unenforceable penalty, even if the contract states that the fee should not be considered a penalty. Provisions establishing early termination fees should provide details regarding how the fee was calculated, and explain how this calculation provides a reasonable estimate of the non-terminating party's loss. In other words, a little bit of detail can ensure that the contract is enforced as desired.

By Jennifer Tafet Klausner, Partner, 212.468.4827/jklausner@dglaw.com
Holly Melton, Associate, 212.468.4806/hmelton@dglaw.com

FEDERAL LAW EXPANDS WHISTLEBLOWER PROTECTIONS

>> continued from page 4

That reading would support the position that the Dodd-Frank Act simply clarified SOX's original language, and therefore, should apply retroactively. Alternatively, an opposite finding by the court, would suggest that SOX's original language should be read narrowly and effect the retroactive application of the Dodd-Frank Act. For this reason, the First Circuit's decision, once issued, could have important implications, not only for investment advisors in the mutual fund industry but more broadly for public companies concerned about the reach and retroactive application of the Dodd-Frank Act.

>> The Bottom Line

In the past, companies have had considerable success defending SOX complaints on the grounds that the complaining employee worked for wholly-owned subsidiaries rather than directly for their publicly-traded parents. However, the Dodd-Frank Act was passed to close that loophole. In the future, employees who have publicly-traded parents in the chain of their ownership should assume that their employees have the protection of SOX if they make whistle-blowing complaints, which means that employers cannot retaliate against an employee for making a complaint.

By Howard Rubin, 212.468.4822/hrubin@dglaw.com
Gustavo Gonzalez, 212.468.4899/ggonzalez@dglaw.com

CONTACT US

Davis & Gilbert Litigation Partners

Michael C. Lasky
Co-Chair
212.468.4849
mlasky@dglaw.com

Howard J. Rubin
Co-Chair
212.468.4822
hrubin@dglaw.com

Jennifer Tafet Klausner
Editor
212.468.4827
jklausner@dglaw.com

Guy R. Cohen
212.468.4853
gcohen@dglaw.com

Paul F. Corcoran
212.468.4825
pcorcoran@dglaw.com

Sara L. Edelman
212.468.4897
sedelman@dglaw.com

Bruce M. Ginsberg
212.468.4820
bginsberg@dglaw.com

Neal H. Klausner
212.468.4992
nklausner@dglaw.com

James Levine
212.468.4985
jlevine@dglaw.com

Maureen McLoughlin
212.468.4910
mmcloughlin@dglaw.com

Marc J. Rachman
212.468.4890
mrachman@dglaw.com

Ina B. Scher
212.468.4937
ischer@dglaw.com