

The Nexsen Pruet Fiduciary Duty & Trade Secret Newsletter deals with topics of current interest in these two areas of the law that are critical to businesses and the people who manage, own, and direct businesses. The economic events of the past several months are bringing fiduciary duty and trade secret issues into the spotlight, as massive financial dislocation creates new potential plaintiffs, searching for legal theories to wield in search of assets and recoveries; and as greater numbers of terminated, laid-off, furloughed and otherwise departed employees pose dramatically elevated risks of violating non-compete agreements or abusing trade secrets. In this newsletter, Marc Manos and

Manton Grier discuss some of the theories of liability that you can expect to see emerging from the financial crisis, and Grainger Pierce discusses a recent North Carolina case finding a non-compete clause unenforceable, as overly restrictive. The landscape for legal exposure is changing as a result of the economic crisis, and we hope this newsletter will give you some insight into what is emerging in this landscape.



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HARD TIMES LEAD TO EXTENSION OF THEORIES OF LIABILITY

by Marcus A. Manos

Business failures and loan/security collection actions rose dramatically across the Carolinas in 2008. The owners, guarantors and even customers of these failed ventures will turn to legal recourse to try and recover their losses. The breach of fiduciary duty claim, with its terminology of “violation of trust” and the availability of punitive damages will be a popular vehicle for recovery. Lenders and other interested parties in a transaction can expect potential plaintiffs to try and extend claims related to fiduciary conduct to reach defendants who have assets.

Lenders and other “arms length” parties to business transactions generally do not need to fear claims for breach of fiduciary duty. *Burwell v. South Carolina Nat'l Bank*, 288 S.C. 34, 340 S.E.2d 786 (1986); *Branch Banking and Trust Co. v. Thompson*, 107 N.C.App. 53, 418 S.E.2d 694 (1992). In addition to attempts to characterize the transaction as one of trust rather than arms length, plaintiffs will attempt to use other theories to draw lenders and third-parties into fiduciary duty lawsuits. Two theories predominate in recent lawsuits—aiding and abetting a breach of fiduciary duty and conspiring to breach a fiduciary duty.

Aiding and abetting a breach of fiduciary duty requires that another person or entity breached a fiduciary

duty to the plaintiff and that the aiding party knowingly assisted that breach and the breach caused damage to the plaintiff. *Vortex Sports & Entertainment, Inc. v. Ware*, 378 S.C. 197, 662 S.E.2d 444 (2008); *Blow v. Shaughnessy*, 88 N.C.App. 484, 364 S.E.2d 444 (1988). An example of this type of claim against a lender can be found in cases involving loans to trusts. The trustee borrows money from a lender as allowed by the trust document. Beneficiaries claim, however, that the loan proceeds allowed the trustee to make unsuitable investments not allowed by the trust and that the loan officer knew the purpose of the loan and the substance of the trust agreement. The lender finds itself defending a breach of fiduciary duty (plaintiff's prefer the term breach of trust claim) as if the lender made the investment decisions.

Another avenue being used by creative plaintiffs in these hard times is combining a claim for civil conspiracy with a claim of breach of fiduciary duty. See, e.g., *Mills v. Wachovia Bank NA*, 663 S.E.2d 14 (Table) (N.C. Ct. App. Case No. COA07-365, July 15, 2008); *Plyler v. Burns*, 373 S.C. 637, 647 S.E.2d 188 (2007). In cases like these traditional breach of fiduciary duty claims against the personal representatives of estates or conservators appointed to protect minor's and incompetent's assets are combined

with a conspiracy allegation including lenders, investment advisors, lawyers and others. The plaintiff gets to sound the theme of “breach of trust” along with the evil sound of “conspiracy.” The nature of conspiracy claims, if they survive initial motions to dismiss, allows for broader discovery during the pre-trial phase.

These claims often seem far fetched to the lender, investment advisor, broker or attorney who knows the full story of the transaction. They do not seem far fetched to courts and juries, however. When faced with one of these claims, the third-party being linked to the allegedly disloyal fiduciary needs to get prompt, competent legal help from a team with experience dealing with these types of cases. The consequences of not taking the case seriously can go beyond monetary judgments for actual and punitive damages. Losing a case on these grounds can do long term damage to business and professional reputations.



Marcus A. Manos

FIDUCIARIES FACE HEIGHTENED SCRUTINY DURING A FINANCIAL CRISIS

by Manton M. Grier, Jr.

Unless modified by a court or legislature, fiduciary duties do not change during a financial crisis. Although the duties remain static, the scrutiny placed on those duties does not. In the wake of the economic collapse, a number of investors are pointing fingers at the fiduciaries who manage their investments and naming them in a wave of lawsuits alleging breaches of fiduciary duties.

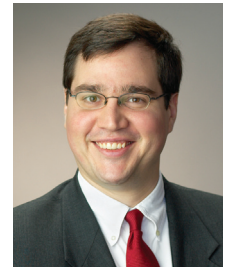
One theme in these lawsuits is less tolerance of risk. Risk is inherent in most investments, because few investments are guaranteed. But with the benefit of hindsight, many investors now complain that their fiduciaries pushed too hard, turned a blind eye to red flags, and placed too much money in shaky investments such as subprime mortgages. In *In re Merrill Lynch & Co.*, Case Nos. 07-cv-9633 and 07-cv-9696 (S.D.N.Y. May 21, 2008), investors have sued Merrill Lynch and its leaders primarily because Merrill Lynch stayed in the subprime market too long and ignored internal, anticipatory warnings that the market would suffer dramatic

losses.

Another area under scrutiny is the misrepresentation of market value. In *Louisiana Municipal Police Employees' Retirement System v. Willumstud*, Case 08-cv-7019 (S.D.N.Y., Aug. 6, 2008), shareholders of AIG have sued members of its board of directors for misrepresenting the value of AIG's subprime mortgage assets. The shareholders claim that AIG failed to write down the value of its assets tied to subprime mortgages when the market first collapsed in late 2007. And in *Romain v. Wachovia Corp.*, Case No. 08-cv-6981 (S.D.N.Y. Aug. 5, 2008), Wachovia faces similar allegations, including allegations that it was slow to react to changes in the market and maintained the value of its subprime mortgage assets at a time when the market suggested they were overvalued.

The above cases are only a small example of the cases that are crowding the dockets of the Southern District of New York and other jurisdictions. Fair or not, fiduciaries who manage money are in the cross-hairs of investors

who, with the benefit of hindsight, demand accountability for poor market decisions. For now the cases consist only of allegations. Eventually, the courts will resolve those allegations and clarify the scope of a fiduciary's duty during a financial crisis.



Manton M. Grier, Jr.

OVERLY BROAD RESTRICTIVE COVENANTS RISK UNENFORCEABILITY

by C. Grainger Pierce, Jr.

The current financial crisis has led to an unprecedented number of layoffs. Approximately 2.6 million U.S. jobs were lost in 2008 alone. This explosion in layoffs and job changes heightens the need for employers to consider the role of restrictive covenants in protecting their legitimate business interests.

Many companies seek to protect their investments in research and development, marketing, and other potentially sensitive areas through the use of restrictive covenants with their employees. "Restrictive covenants" is a broad term, and can include non-compete, non-solicitation, and confidentiality agreements, among others. While each of these agreements serves a different purpose, they share a common characteristic: overreaching restrictive covenants may not be enforceable. A January 2009 case from the North Carolina Court of Appeals

underscores this point.

In *Medical Staffing Network, Inc. v. Ridgway*, the court held that non-compete and non-solicitation agreements were unenforceable because they were overly broad. The non-compete agreement at issue attempted to prevent the employee from competing with "any parent, division, subsidiary, affiliate, predecessor, successor, or assignee" of the employer. Moreover, the non-solicitation agreement purported to extend to clients other than those with whom the employee would have had contact during his employment.

As the *Ridgway* court noted, restrictions "must be no wider in scope than is necessary to protect the business of the employer" in order to be valid. Among other things, they must also be reasonable as to time and territory.

The law governing restrictive

covenants varies from state to state. What is enforceable in one state may be unenforceable in another. Likewise, what may be enforceable by one company may not be enforceable by another. Businesses should take care to only use restrictive covenants that have been tailored for their specific situations, and restrictions to meet the needs of their situations. Otherwise, the agreements may not be enforceable.



C. Grainger Pierce, Jr.