



The Litigation Reporter

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Business Law

Co-Shareholders Violated Shareholders Agreement

Plaintiff, one of three equal shareholders of a closely-held corporation, sued the other shareholders for, among other things, breach of a provision of the parties' shareholders agreement which required unanimous approval for all major decisions and insider transactions. Even though the agreement bore the legend "Draft #2," the court found that a binding agreement had been reached: the parties had agreed to its terms, executed the draft and never mutually consented to any contrary terms. As a result, defendants' unilateral actions, over plaintiff's objections, in demoting plaintiff and disbursing loan proceeds to themselves, were improper. (*Sullivan v. Johns*, N.Y.L.J., Nov. 10, 2004, at 18 (Sup. Ct. N.Y. Co. Nov. 10, 2004))

Civil Procedure

Failure To Serve Summons Precludes Enforcement Of Foreign Judgment

Plaintiff filed a petition in California to enforce a money judgment obtained in France. Although plaintiff served a petition and other court documents, defendant objected that it had not received proper notice of the California action because no summons was served. On appeal from the denial of defendant's motion to set aside a judgment in plaintiff's favor, the Court of Appeal reversed. It rejected plaintiff's argument that defendant's obvious awareness of the California petition satisfied any notice requirements, reasoning that a summons was necessary to establish the court's jurisdiction over the foreign defendant. (*Renoir v. Redstar Corp.*, 20 Cal. Rptr. 3d 603 (2004))



Creation And Dissemination Of Press Releases Supports Venue

Plaintiffs alleged that defendant's press releases describing the results of clinical drug trials contained materially false and misleading statements. Although defendant's principal place of business was in Illinois, the statements in question were issued by defendant's California offices. In opposing defendant's motion to transfer venue to California, plaintiffs argued that the clinical trials, held throughout the country, were the material events underlying the claims at issue. In granting defendant's motion, the court held that the material events were the creation and dissemination of the press releases containing the statements at issue, which occurred in California, and not the clinical trials, the receipt of any misleading statements, or the actual stock purchases. (*Morris v. Am. Bioscience, Inc., Am. Pharm. Partners, Inc.*, No. 03 C 7525 (N.D. Ill. Nov. 3, 2004))

Franchising

Arbitration Provision Enforceable Despite Lack Of Franchisor Registration

Plaintiff filed an action to rescind a franchise agreement on the ground that defendant was not registered with the state as required by the Franchise Disclosure Act of 1987 (the "FDA"). Defendant moved to stay the action and to compel arbitration pursuant to a provision in the franchise agreement. The trial court's denial of defendant's motion to stay was affirmed on the ground that the franchise agreement was unenforceable because defendant had failed to register with the State as required in the FDA. On appeal, the Illinois Supreme Court reversed, holding that registration was not a condition precedent to an enforceable franchise agreement. The Court noted that the FDA provides for rescission for failure to register, a remedy that presumes the existence of an otherwise valid and enforceable contract. It also concluded that a contrary result would undermine public policy favoring arbitration as a means of dispute resolution. (*Jensen v. Quik Int'l*, No. 97704 (Nov. 18, 2004))

Franchisor's Promotions Did Not Interfere With Franchisees' Customer Relations

The N.Y. Court of Appeals has held that a franchiser did not tortiously interfere with its franchisees' customer relationships by selling a product in supermarkets at bargain prices, even though, in doing so, it induced customers not to purchase the product from the franchisees. Customer relationships that have matured into enforceable contracts are entitled to extensive protection. However, relationships that have not yet blossomed into contracts -- such as franchisees' relationship with consumers generally -- are given less protection. To establish a claim for interfering with prospective business relationships, one must show that the conduct at issue was: (i) criminal or an independent tort; or (ii) engaged in solely to cause harm. The court suggested (but did not hold) that it might also protect prospective economic relationships from other 'more culpable' conduct, such as violence, fraud, abusive litigation or



unfair economic pressures. As the franchisor's supermarket program was lawful and designed to improve the franchisor's business (not to hurt the franchisees), the tortious interference claim was not viable. (*Carvel Corp. v. Noonan*, 3 N.Y.3d 182 (2004))

Insurance

Employer's Policy Did Not Cover Motorist Injured While Assisting Other Victim

After an employee involved in an accident while driving his employer's truck exited the truck to offer assistance to the occupants of the other vehicle, he was injured by an uninsured motorist. The employee tendered his claim under the policies covering the employer's truck and the other vehicle. The trial court determined that the employee was covered by the other vehicle's policy, not his employer's policy, and the Court of Appeal affirmed, reasoning that at the time the employee was injured by the uninsured motorist, he was no longer "occupying" his employer's vehicle and, instead, was upon the other vehicle within the meaning of the policy. (*Atlantic Mut. Ins. Co. v. Ruiz*, 20 Cal. Rptr. 3d 628 (2004))

Labor and Employment

Issues Of Fact Preclude Summary Judgment On Restrictive Covenant Claim

A court refused to dismiss an action by a company against a former employee to enforce a non-competition agreement. The court held that a restrictive covenant reasonable in geographic and temporal scope will be enforced to the extent necessary to protect the company's legitimate business interests, such as preventing former employees from exploiting customer relationships developed at the company's expense. Companies do not, however, have any interest in customer relationships that former employees develop entirely with personal resources. Here, while the former employee claimed that he had cultivated the client relationships at issue at his own expense, the company claimed that it had subsidized and otherwise supported those relationships. Accordingly, triable issues of fact existed as to the matters in issue. (*Milbrandt & Co., Inc. v. Griffin*, N.Y.L.J., 2004 (Sup. Ct. West. Co. Oct 20, 2004))

FEHA Amendment Imposing Co-Worker Liability Not Retroactive

Plaintiff sued her employer and a non-supervisor co-worker for sexual harassment in violation of the Fair Employment Housing Act ("FEHA"). The Court of Appeal affirmed the trial court's award of summary judgment for the employer but reversed as to the individual employee, citing an amendment to FEHA providing personal liability for co-workers. On appeal, the California Supreme Court reversed, holding that because the conduct underlying



the lawsuit preceded the amendment, it would be unfair to subject individuals without an opportunity to know the law and to conform their conduct to that law to possible liability. In addition, the Supreme Court noted that the Legislature had not manifested any intention to make the amendment retroactive. (*McClung v. Employment Devel. Dept.*, 20 Cal. Rptr. 3d 428 (2004))

Securities

Claims Dismissed On *Res Judicata* And Causation Grounds

Plaintiffs, minority shareholders in a privately held company that creates secure Internet environments, claimed that their holdings were significantly diluted as a result of a private share offering and recapitalization made in violation of applicable federal and state law. In dismissing their amended complaint with prejudice, the court held that the securities fraud claims were either barred by *res judicata*, because a previous action challenging the private share offering had been dismissed; or lacked causation, because the minority shareholders' consent was not necessary to accomplish the recapitalization. In addition, the court declined to exercise jurisdiction over the remaining state law claims. (*Adams v. Buck-Luce*, No. 04 Civ. 1485 (JSR), 2004 WL 2375800 (S.D.N.Y. Oct. 22, 2004))

NASDAQ Trading Halt Did Not Provide Inquiry Notice Of Fraud

Plaintiff alleged that defendants opened margin accounts in the names of two shell companies, used those accounts to obtain a controlling interest in Health Risk Management, Inc. ("HRMI"), and were liable for an unpaid \$2.9 million margin all triggered when NASDAQ discontinued trading of HRMI stock. According to plaintiff, defendants' scheme first came to light when NASDAQ halted trading of HRMI common stock. Defendants sought dismissal on limitations grounds, arguing that plaintiff was on inquiry notice of the alleged scheme prior to the trading halt. The court disagreed, holding that allegations regarding the trading halt that precipitated the margin call did not put plaintiff on inquiry notice of the alleged securities fraud as of that date; rather, plaintiff needed "information about the relationships between [defendants and the shell companies], their percentage of ownership of HRMI stock, and the cause of the drop in value of HRMI stock" before it could be deemed on inquiry notice. Because there were no allegations in the complaint supporting an inference of such knowledge prior to the trading halt, the court denied the motion to dismiss. (*Wachovia Sec. v. Neuhauser*, No. 04 C 3082 (N.D. Ill. Nov. 5, 2004))



Torts

Warning Of Danger Of Diving Into Shallow Pool Not Open And Obvious To Minor

An 11-year old injured after diving head first into a shallow pool despite warnings, filed a product liability claim against the manufacturer of the pool. At the trial, experts testified that the warnings were insufficient. On the manufacturer's appeal from a jury award of \$12 million in favor of plaintiff, the Court of Appeal affirmed, reasoning that the age of a plaintiff could be considered in determining whether a danger is sufficiently open and obvious to relieve a defendant's duty to warn, noting that even though the warnings may have been sufficient for an adult, they were insufficient to cause a minor to appreciate the danger of spinal injuries. (*Bunch v. Hoffinger Indus., Inc.*, 20 Cal. Rptr. 3d 780 (2004))



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