March 29, 2021

Second Circuit Affirms Injunction Enforcing Employment Noncompete Against Executive with Knowledge of Trade Secrets

On January 22, 2021, the Second Circuit affirmed a preliminary injunction barring a former IBM executive from working in a similar executive role at Microsoft.[1] The former executive, Rodrigo Kede de Freitas Lima, signed a Non-Competition Agreement ("NCA") with IBM in December 2019. The NCA, governed by New York law, prohibited Lima for 12 months after leaving IBM from working for a competitor in a position in which he could disclose IBM's confidential information. Lima resigned from IBM in May 2020 and accepted an executive position at Microsoft, with plans to commence the new role immediately.

Judge Philip M. Halpern of the Southern District of New York enjoined Lima from taking the position he was offered at Microsoft until May 2021. The district court held that enforcement of the NCA was reasonable under the circumstances, finding that Lima was exposed to and responsible for IBM trade secrets, and that IBM established a risk that Lima inevitably would use, disclose or rely upon those trade secrets in his proposed role at Microsoft. The Second Circuit affirmed, ruling that the district court did not clearly err in enforcing the NCA against Lima and that Lima's assertions of legal error were without merit.

New York law permits enforcement of employment noncompete agreements[2] to the extent that the restriction is "reasonable," meaning that it: "(1) is no greater than is required for the protection of the legitimate interest of the employer, (2) does not impose undue hardship on the employee, and (3) is not injurious to the public."[3] The Second Circuit has rarely had occasion to review injunctions enforcing such agreements under New York law.[4] Other circuits applying state laws similar to New York's have declined to enforce certain employment noncompetes.[5] Over the past six years, no fewer than 14 states have amended their laws either to restrict the enforceability of noncompetes, such as by limiting the maximum duration, or to ban their enforceability as to entire categories of workers.[6] For example, Hawaii barred the use of noncompetes for workers in a "technology business," and seven states barred noncompetes for employees earning less than a certain amount.[7] The stated policy rationales for enacting such restrictions include promoting the growth of new businesses, encouraging workforce mobility and discouraging unreasonable contracts of adhesion.[8]

Accordingly, the Second Circuit's decision in *IBM* v. *Lima* provides a useful precedent for employers seeking to enforce employment noncompetes against high-level executives with access to trade secrets intending to switch sides to work for a competitor in an overlapping position.

Background

Rodrigo Lima joined IBM in 1995 and rose to several high-ranking executive positions at the company. In the years preceding his departure from IBM, Lima ran IBM's Latin America business, then oversaw a large segment of IBM's services business in North America, and finally served as the global head of IBM's largest and most significant client accounts. Lima also served on high-ranking executive teams responsible for overseeing IBM's global strategies. In his final years at IBM, Lima earned millions of dollars per year in total compensation from IBM.[9]

Lima first signed an employee noncompete with IBM in 2013, and he signed his most recent NCA in December 2019. In the NCA, Lima agreed that, for 12 months after terminating employment with IBM, he would not work for a competitor in any geographic area for which he had been recently responsible at IBM if performing the duties and responsibilities of the new position "could result in" Lima "intentionally or unintentionally using, disclosing, or relying upon" IBM's confidential information.[10]

In May 2020, Lima resigned from IBM, having accepted an offer of employment in the position of Corporate Vice President, Latin America ("CVP, LATAM") at Microsoft, one of IBM's direct competitors, including in Cloud computing.

On June 15, 2020, IBM filed a complaint in the U.S. District Court for the Southern District of New York asserting that Lima had breached his NCA by accepting Microsoft's employment offer. On June 18, 2020, IBM moved for a temporary restraining order and a preliminary injunction barring Lima from working in his new role at Microsoft until the expiration of the term of his NCA in May 2021. On June 19, 2020, the district court issued a temporary restraining order prohibiting Lima from starting work in the CVP, LATAM position pending its decision whether to issue a preliminary injunction.

The District Court Decision

In July 2020, the district court held a three-day, in-person evidentiary hearing on IBM's motion for a preliminary injunction – one of the first in-person trial proceedings in the Southern District of New York after the court reopened following the onset of the COVID-19 pandemic. IBM called four witnesses, including Lima, to testify.[11]

On September 3, 2020, the district court issued a 33-page order granting IBM's motion and prohibiting Lima from starting in the CVP, LATAM role at Microsoft until May 2021.[12] Applying New York's three-part "reasonableness" test for NCAs, the district court held that Lima's NCA was reasonable under the circumstances.[13]

First, the district court ruled that IBM had a legitimate interest in enforcing the NCA because Lima possessed IBM's trade secrets and confidential business information. Although Lima's position at IBM was

not a technical one, the district court found that his knowledge of IBM's Cloud computing business, including information about "strategic initiatives," "competitive business and pricing strategies, the identity of new client targets, anchor clients," and "IBM's competitive strategies with respect to 'head-to-head' competition with Microsoft," constituted trade secrets.[14] The district court determined that all of this information is private, closely guarded by IBM, and of great value to IBM and its competitors.[15] The district court found that Lima's knowledge of IBM's "strategies and methodologies" was particularly valuable because the nature of the Cloud industry is "very competitive" and "80% of the market is open for competition . . . as only 20% of business applications and processes have moved to the cloud."[16]

Second, the district court ruled that enforcing the NCA would not impose an undue hardship on Lima.[17] The district court noted that Lima had received a multimillion-dollar compensation package from IBM, and that "[s]ome of that compensation paid for [Lima's] Non-Compete obligations."[18] The district court explained that Lima's NCA did not bar him from "all gainful employment within [his] industry" – it would have allowed Lima to work, for example, in roles at Microsoft that "would not place him in direct competition with IBM," such as in Microsoft's Office 365, gaming, personal computing, and LinkedIn units.[19] The district court also noted that, based on his net worth and real estate holdings, Lima would be able to comfortably "pay his expenses until the end of the non-compete period."[20]

Third, the district court ruled that enforcing Lima's NCA would not injure the public.[21] Rather, because Lima and IBM are "sophisticated parties," and Lima "accepted good and valuable consideration" in exchange for agreeing to the terms of his NCA, the district court held that the public interest would be advanced by enforcing Lima's NCA.[22]

The district court held that Lima likely would inevitably use, disclose or rely on IBM's confidential information in his new CVP, LATAM role at Microsoft.[23] The district court did not accept Microsoft's argument that IBM is not its "direct competitor," as the evidence and testimony from IBM's witnesses established that the two companies compete "head-to-head," "including in cloud computing."[24] "Comparing apples to apples," the district court found that Lima's recent responsibilities at IBM "overlap significantly" with the work he would do in his new role at Microsoft.[25] In both his new and old positions, Lima's responsibilities included executing global strategies, participating on global leadership teams and "increasing revenue and gaining market share of cloud."[26] The district court further declined to adopt the argument that Lima's confidentiality agreement was sufficient to protect IBM's interests, finding that, notwithstanding a lack of evidence that Lima intended to misappropriate trade secrets, the nature of Lima's responsibilities in the CVP, LATAM role could result in him intentionally or unintentionally doing so.[27] The district court concluded that, absent enforcement of the NCA, Lima could use, disclose or rely upon his knowledge of IBM's confidential strategies for securing clients and growing its share of the cloud market against IBM in his new role at Microsoft.[28]

Based on these findings, the district court enjoined Lima from working as Microsoft's CVP, LATAM, and from otherwise "working or providing any services in violation of [his NCA]," through May 18, 2021.[29]

The Second Circuit Decision

The Second Circuit panel unanimously affirmed the district court's order. The Second Circuit noted that, "[u]nder New York law, 'negative covenants restricting competition are enforceable only to the extent that they satisfy the overriding requirement of reasonableness.'"[30] The Second Circuit held that the district court did not abuse its discretion in finding the NCA reasonable as applied to the circumstances of the case.

First, the Second Circuit rejected Lima's argument that the district court "committed legal error in enforcing an overbroad covenant."[31] The Second Circuit held that the district court's conclusions that "Lima's job at IBM provided him with access to IBM's trade secrets" and that "Lima would perform substantially similar work at Microsoft in an arena where IBM was a direct competitor" were factual findings, and that Lima "fail[ed] to demonstrate any of the district court's findings of fact is clearly erroneous."[32] Accordingly, the Second Circuit held that the district court did not clearly err "in concluding, as a predictive matter, that Lima would inevitably disclose IBM's confidential information" in the CVP, LATAM role.[33]

Second, the Second Circuit agreed with the district court that the NCA "does not impose undue hardship on Lima, as he is currently on Microsoft's payroll."[34]

Implications

The Second Circuit's decision in *IBM* v. *Lima* provides greater clarity on scenarios in which an employer may enforce an employment noncompete agreement governed by New York law. The Second Circuit has issued few opinions regarding such provisions, making this a significant decision.

Protection of Legitimate Business Interests.

The decision makes clear that such agreements may be enforced where reasonable to protect legitimate business interests, particularly where a high-level executive who has acquired confidential information regarding business and pricing strategies, the identity of new client targets and other competitive strategies switches sides to work for a competitor in a similar high-level executive role with overlapping responsibilities. An employee's status as an executive may bear on the consideration of whether the employee faces an undue hardship, as the executive's past compensation may provide financial support during the noncompetition period.

Tailored Approach.

The Second Circuit's decision highlights the importance of tailoring employment noncompetes to protect legitimate business interests. Other circuits applying other state laws have refused to enforce overbroad employee noncompetes drafted to prohibit any type of employment for a competitor.[35] In contrast, the NCA in *Lima* did not prohibit all employment for competitors – it prohibited employment that could result in

using, disclosing or relying upon confidential information, or exploiting customer goodwill. The district court noted that the NCA did not bar Lima from all gainful employment within his industry. And the Second Circuit also noted that the district court permitted Microsoft to put Lima on its payroll.

Factual Support.

Finally, the Second Circuit decision illustrates the type of evidence that can result in the enforcement of an employment noncompete agreement against an employee with confidential information. The Second Circuit noted that it was "compel[led] to affirm" because the district court based its legal conclusions on its factual findings "regarding what job duties were performed by Lima, what Lima learned as he undertook those duties, as well as whether that information was highly confidential and how similar his duties were at both jobs."[36] The district court heard three days of testimony and considered volumes of documentary evidence bearing on these issues before concluding that enforcing the NCA was reasonable based on evidence that Lima was exposed to and responsible for IBM's trade secrets and confidential information and likely would inevitably use, disclose or rely on that information in his new role. For example, the witnesses at the preliminary injunction hearing testified that Lima attended team meetings in which company-wide cloud strategies were discussed, that he prepared and presented confidential information concerning IBM's financial services cloud, budget, and target clients, and that he was responsible for making sure IBM's global strategies were executed, including in Latin America.[37] The district court also requested and received into evidence a job description for the CVP, LATAM role "in an effort to line up Mr. Lima's job responsibilities at IBM against the proposed job at Microsoft."[38]

IBM v. *Lima* provides employers and employees with valuable guidance on when employee noncompetes governed by New York law may be enforced to protect confidential information and trade secrets.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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1 Paul, Weiss was counsel for IBM both in the district court and on appeal.

2 New York law applies a different standard to noncompetes that arise outside of the employment relationship, including noncompetes arising in the sale-of-business context. Such noncompetes are not addressed in this memorandum.

3 *BDO Seidman* v. *Hirshberg*, 93 N.Y.2d 382, 388–89 (2d Cir. 1999).

4 *See IDG USA, LLC* v. *Schupp*, 416 F. App'x 86 (2d Cir. 2011) (affirming preliminary injunction enforcing NCA against industrial-materials sales representative under New York law); *Ticor Title Ins. Co.* v. *Cohen*, 173 F.3d 63 (2d Cir. 1999) (affirming permanent injunction enforcing NCA against insurance salesperson under New York law).

5 *See NanoMech, Inc.* v. *Suresh*, 777 F.3d 1020, 1024–25 (8th Cir. 2015) (applying Arkansas law and refusing, under standard of reasonableness, to enforce employment noncompete generally barring employee from working for competitors of nanotechnology company); *ANSYS, Inc.* v. *Computational Dynamics N. Am., Ltd.*, 595 F.3d 75, 79 (1st Cir. 2010) (applying New Hampshire law and affirming denial of injunction seeking to enforce employment noncompete against a software developer under standard of reasonableness). Enforceability of employment noncompetes is determined on a state-by-state basis, with some states taking a stronger stance on general enforceability—particularly California, which prohibits employment noncompetes by statute, with some exceptions. Cal. Bus. & Prof. Code §§ 16600–16602.5; *see also* Cal. Labor Code § 925.

6 *See* Colo. Rev Stat § 8-2-113 (2018) (Colorado bars noncompetes for physicians); Ct. P.A. 16-95 (2016) (Connecticut limits duration and geography of physician noncompetes); Haw. Rev. Stat. § 480-4(d) (2015) (Hawaii bars noncompetes for employees in "technology business"); Idaho Code §§ 44-2704 (2018) (Idaho limits noncompetes to "key employees" and limits duration); 820 ILCS 90/10 (2016) (Illinois bars noncompetes for low-wage employees); 26 Me. Rev. Stat. Ann. § 599-A(1) (2019) (Maine bars noncompetes for low-wage employees); Md. Code, Lab. & Empl. § 3-716 (2019) (Maryland bars noncompetes for low-wage employees); Mass. Gen. Laws Ann. ch. 149, § 24L (2018) (Massachusetts bars noncompetes for employees who are classified as "non-exempt" under the Fair Labor Standards Act); N.H. Rev. Stat. Ann. § 275-70-a (2019) (New Hampshire bars noncompetes for low-wage employees); N.M.S.A. 1978, §§ 24-1I-1–5 (2015) (New Mexico bars noncompetes for health care practitioners); Or. Rev. Stat. § 653.295 (2016) (Oregon limits duration); R.I. Gen. Laws §§ 28-59-1 *et seq.* (2019) (Rhode Island bars noncompetes for low-wage employees and employees classified as "non-exempt" under the Fair Labor Standards Act); Utah Code Ann. §§ 34-51-101–301 (2018) (Utah limits duration and bans for "broadcasting employees"); RCW §§ 49.62.020 (2019) (Washington limits duration and bars noncompetes for employees earning less than

$100,000). In addition, the District of Columbia has passed a law prohibiting the use of noncompetition agreements, which is projected to become effective in March 2021. *See* D.C. Act 23-563 (Jan. 11, 2021) (bars noncompetes for all employees with limited exceptions for certain medical specialists, employees of religious organizations volunteers, and babysitters).

7 *See* Haw. Rev. Stat. § 480-4(d) (2015); 820 ILCS 90/10 (2016); 26 Me. Rev. Stat. Ann. § 599-A(1) (2019); Md. Code, Lab. & Empl. § 3-716 (2019); Mass. Gen. Laws Ann. ch. 149, § 24L (2018); N.H. Rev. Stat. Ann. § 275-70-a (2019); R.I. Gen. Laws §§ 28-59-1 *et seq*. (2019); R.C.W.A. § 49.62.020 (2019).

8 *See, e.g.*, Haw. H.B. No. 1090 (2015) ("Hawaii has a strong public policy to promote the growth of new businesses in the economy, and academic studies have concluded that embracing employee mobility is a superior strategy for nurturing an innovation-based economy."); R.C.W.A. § 49.62.005 (2019) ("The legislature finds that workforce mobility is important to economic growth and development. Further, the legislature finds that agreements limiting competition or hiring may be contracts of adhesion that may be unreasonable.").

9 *Int'l Bus. Mach. Corp.* v. *de Freitas Lima*, No. 7:20-cv-04573, 2020 WL 5261336, at *1, 4 (S.D.N.Y. Sept. 3, 2020).

10 *Id.* at *6.

11 *Id.* at *2.

12 *Id.*

13 *Id.* at *7–13.

14 *Id.* at *8.

15 *Id.*

16 *Id.* at *13.

17 *Id.* at *9–10.

18 *Id.* at *9.

19 *Id.*

20 *Id.* at *10.

21 *Id.* at *11.

22 *Id.*

23 *Id.* at *11–13.

24 *Id.* at *12.

25 *Id.*

26 *Id.* at *12.

27 *Id.* at *11–14.

28 *Id.* at *13.

29 *Id.* at *15.

30 *Int'l Bus. Mach. Corp.* v. *Lima*, No. 20-cv-3039, 833 F. App'x 911, 912 (2d Cir. Jan. 22, 2021) (quoting *Reed, Roberts Assocs., Inc.* v. *Strauman*, 40 N.Y.2d 303, 307 (1976)).

[31] *Id.* at 912–13.

[32] *Id.* at 913.

[33] *Id.*

[34] *Id.*

[35] *See NanoMech, Inc.* v. *Suresh*, 777 F.3d 1020, 1024–25 (8th Cir. 2015) (finding NCA unenforceable under Arkansas law where it "prohibit[ed] [the employee] from working in *any* capacity for *any* business that competes with the company"); *ANSYS, Inc.* v. *Computational Dynamics N. Am., Ltd.*, 595 F.3d 75, 79 (1st Cir. 2010) (applying New Hampshire law and affirming denial of preliminary injunction seeking to enforce NCA stating "I will not become an employee . . . or in any way engage in or contribute my knowledge to a competitor of [the company]").

[36] *Int'l Bus. Mach. Corp.* v. *Lima*, No. 20-cv-3039, 833 F. App'x 911, 913 (2d Cir. Jan. 22, 2021).

[37] *Int'l Bus. Mach. Corp.* v. *de Freitas Lima*, No. 7:20-cv-04573, 2020 WL 5261336, at *2–5 (S.D.N.Y. Sept. 3, 2020).

[38] *Id.* at *5.