UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re DOCUMENT TECHNOLOGIES LITIGATION

17-cv-2405
17-cv-3433
17-cv-3917

MEMORANDUM ORDER

JED S. RAKOFF, U.S.D.J.

In three originally separate actions now consolidated before this Court, plaintiffs Document Technologies, Inc., Epiq Systems, Inc., and Epiq eDiscovery Solutions, Inc. (collectively, "DTI") allege that their former employees, defendants Steve West, John Parker, Seth Kreger, and Mark Hosford (collectively, the "Individual Defendants"), conspired with a competitor, co-defendant LDiscovery, LLC ("LDiscovery"), to misappropriate plaintiffs' trade secrets. The Individual Defendants' employment agreements with DTI require the signatories to arbitrate "all disputes relating to all aspects of the employer/employee relationship," with the exception of any claims seeking to enjoin the breach or threatened breach of the covenants in the employment contracts. The Individual Defendants therefore moved to stay the proceedings in this Court and compel arbitration of DTI's claims against them with the exception of those claims seeking injunctive relief for breach of contract. Defendant LDiscovery, a non-signatory, also moved to compel arbitration or, in

the alternative, for the Court to dismiss the complaint against it pursuant to Rule 12(b)(6), Fed. R. Civ. P.

On May 30, 2017, at the outset of the evidentiary hearing on plaintiffs' request for preliminary injunctive relief, the Court issued a bench order granting the motion by the Individual Defendants to compel arbitration of all of plaintiffs' non-injunctive and non-contractual claims against them, but the Court reserved judgment on the motions by LDiscovery. This Memorandum Order not only explains the reasons for the bench order, but also now reaches LDiscovery's motions and, for the reasons set forth below, denies LDiscovery's motion to compel arbitration but grants its motion to dismiss the complaint under Rule 12(b)(6).[1]

On a motion to compel arbitration, the Court accepts as true the allegations in the complaint that relate to the underlying dispute between the parties. Schnabel v. Trilegiant Corp., 697 F.3d 110, 113 (2d Cir. 2012) (citing Fensterstock v. Educ. Fin. Partners, 611 F.3d 124, 127-28 (2d Cir. 2010)). Similarly, for the purposes of a motion to dismiss, the Court accepts all well-pleaded factual allegations as true and draws all reasonable inferences in favor of the non-moving party. See Goldstein v. Pataki, 516 F.3d 50, 56 (2d Cir. 2008). The allegations of the complaints relevant to the instant motions are as follows:

[1] By order dated June 16, 2017, the Court denied plaintiffs' motion for preliminary injunctive relief. The reasons for that order are the subject of a separate Memorandum that will be issued shortly.

As part of their employment with DTI, each Individual Defendant signed an employment agreement containing non-disclosure, noncompetition, and non-solicitation covenants, and agreed to a variety of company policies restricting dissemination of confidential information.[2] See Complaint against Seth Kreger, John Parker, Steven West ("SDNY Compl."), 17-cv-2405, ECF No. 1, ¶¶ 29-45; Complaint against Mark Hosford ("NDIL Compl."), 17-cv-3917, ECF No. 1, ¶¶ 29-45. The employment agreements also contained arbitration clauses stating that "any dispute or controversy . . . arising out of, relating to, or concerning any . . . breach of this agreement, shall be settled by arbitration," and that "this arbitration clause relates to the resolution of all disputes relating to all aspects of the employer/employee relationship."[3] See, e.g., SDNY Compl., Ex. A at 2-3. The clauses created a limited exception for the signatories "to obtain an injunction from a court of competent jurisdiction restraining [a] breach or threatened breach . . . of any [covenant] of this agreement." Id. at 3.

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[2] Although the Individual Defendants signed their agreements with various different corporate entities that would later become DTI, DTI does not dispute that they are binding on it in the present dispute.

[3] The arbitration clause specifies that such disputes include, but are not limited to, "any and all claims for . . . breach of contract, both express and implied; breach of the covenant of good faith and fair dealing, both express and implied; . . . negligent or intentional interference with contract or prospective economic advantage . . . [and] any and all claims for violations of any federal, state or municipal statute." Id. at 3.

DTI filed three complaints in federal court after the Individuals Defendants collectively resigned on January 5, 2017: a complaint in the Southern District of New York against defendants West, Kreger, and Parker (the "SDNY Compl."), an complaint in the Northern District of Illinois against defendant Hosford (the "NDIL Compl."), and a complaint in the Eastern District of Virginia against LDiscovery (the "EDVA Compl.").[4] The allegations in the complaints are substantially similar and assert that the LDiscovery used the Individual Defendants as its agents and conspired with, induced, and aided and abetted them to misappropriate DTI's trade secrets. See SDNY Compl. ¶¶ 84, 91, 132; NDIL Compl. ¶¶ 61, 78, 114; EDVA Compl., 17-cv-3733, No. 1, ¶¶ 46, 95, 98, 187.

In particular, DTI alleges that LDiscovery's CEO communicated extensively with the Individual Defendants prior to their resignations and offered them substantial remuneration if they resigned from DTI and joined LDiscovery after the expiration of their one-year non-competition agreements. SDNY Compl. ¶¶ 94-97. LDiscovery also proposed to indemnify the Individual Defendants should DTI bring suit in connection with their departures. Id. at ¶ 108.

In return for these promises, defendants West and Hosford allegedly transferred large numbers of DTI's files to jump drives,

[4] In addition to its complaints, DTI filed motions for preliminary injunctions enjoining the Individual Defendants from violating the terms of their employment agreements and motions for expedited discovery.

including "customer pricing proposals, scope of work proposals, customer billing rates, and customer work flow information." Id. at ¶¶ 113-118; NDIL Compl. ¶¶ 82-84. Defendant Parker then allegedly used a Dropbox account to copy DTI files and, three days prior to resigning from DTI, used an anti-forensic software, "CCleaner," to delete all files from his DTI-issued laptop computer and thereby "cover up his nefarious deeds." SDNY Compl. ¶¶ 119-129. Defendant Kreger then "failed to return his DTI-issued phone upon his resignation" in order to "deprive DTI of the benefit of trade secret, confidential, and proprietary information therein." Id. at ¶¶ 130-131. After leaving DTI's employ, defendants Parker, Kreger, and Hosford allegedly solicited DTI's existing and prospective customers on LDiscovery's behalf and in breach of the non-solicitation covenants in the employment agreements. SDNY Compl. ¶ 166; NDIL Compl. ¶ 124.

The Court held an initial pretrial conference on April 12, 2017, during which counsel for all the defendants agreed to common discovery plan applicable to all the actions. Two days later, on April 14, 2017, the Individual Defendants in the SDNY action moved to transfer the case to the Eastern District of Virginia, and on April 25, 2017, the Court issued an Opinion and Order denying that motion. On May 1 and May 10, 2017, respectively, the courts presiding over the EDVA and NDIL actions issued orders transferring their cases to this District. This Court consolidated the actions by Order dated May 19, 2017, and held a three-day evidentiary hearing

on DTI's motion for a preliminary injunction from May 30 to June 1, during which the Court also heard oral argument on the defendants' instant motions.

The Court begins with the Individual Defendants' motion to stay the proceedings in this Court and compel arbitration of DTI's claims with the exception of any claims seeking to enjoin the breach or threatened breach of their employment agreements. DTI opposed the motion, arguing solely that the Individual Defendants had waived their right to arbitrate.

A party waives its right to arbitration when it engages in protracted litigation that results in prejudice to the opposing party, Kramer v. Hammond, 943 F.2d 176, 179 (2d Cir. 1991), such as taking discovery not available in arbitration or engaging in motion practice on the merits. See PPG Indus., Inc. v. Webster Auto Parts, Inc., 128 F.3d 103, 109 (2d Cir. 1997). DTI contends that it has suffered such prejudice because the Individual Defendants, in DTI's view, unreasonably delayed in filing their motions to compel arbitration, engaged in protracted discovery, and "evidenced a preference for litigation" by filing their motions to transfer.

DTI overstates the record. The Individual Defendants filed their motions to compel arbitration just three and a half weeks after DTI filed suit. They engaged in modest expedited discovery at DTI's own request and in order to prepare for the evidentiary hearing on DTI's motion for a preliminary injunction. See Plaintiffs' Motion for Expedited Discovery and Incorporated

Memorandum of Law, 17-cv-2405, ECF No. 10. Moreover, while it is true that the Individual Defendants moved to transfer their respective litigations to the Eastern District of Virginia, these motions do not address the merits of the complaints and therefore are not evidence that the Individual Defendants were using arbitration "as a means of aborting a suit that did not proceed as planned in the District Court." Louisiana Stadium & Exposition Dist. v. Merrill Lynch, Pierce, Fenner & Smith Inc., 626 F.3d 156, 161 (2d Cir. 2010).

Accordingly, for the foregoing reasons, the Court issued its bench order on May 30, 2017 granting the Individual Defendants' motion to compel arbitration and stay the proceedings in this Court on DTI's claims against them with the exception of any claims seeking to enjoin the breach or threatened breach of the employment agreements.

Turning to defendant LDiscovery's motion to compel arbitration, on which the Court previously reserved judgment, it is undisputed that LDiscovery was not a signatory to any arbitration agreement. It is true, of course, that under principles of estoppel, a non-signatory to an arbitration agreement may nonetheless compel arbitration "where a careful review of the relationship among the parties, the contracts they signed . . . , and the issues that had arisen among them discloses that the issues the nonsignatory is seeking to resolve in arbitration are intertwined with the agreement that the estopped party has signed." JLM Industries v. Stolt-Nielsen

SA, 387 F.3d 163, 177 (2d Cir.2004) (internal quotation marks omitted). Several courts in this district have distilled these requirements into a two-part "intertwined-ness" test in which they "examine whether: (1) the signatory's claims arise under the 'subject matter' of the underlying agreement, and (2) whether there is a 'close relationship' between the signatory and the non-signatory party."[5] In re A2P SMS Antitrust Litig., 972 F. Supp. 2d 465, 476 (S.D.N.Y. 2013) (quoting Ragone v. Atlantic Video at Manhattan Ctr., No. 07 Civ. 6084 (JGK), 2008 WL 4058480, at *8 (S.D.N.Y. Aug. 29, 2008)).

The parties here do not dispute that DTI's claims against LDiscovery relate to the "subject matter" of the Individual Defendants' employment agreements. They disagree, however, that LDiscovery possesses the requisite "close relationship" with DTI and the Individual Defendants to permit it to compel arbitration of DTI's claims here. LDiscovery contends that such relationship exists because the complaints allege that the Individual Defendants acted as "agents of LDiscovery" and an agent-principal relationship is sufficient to meet the second prong of the "intertwined-ness" test. LDiscovery is mistaken for two reasons.

[5] This two part test is a simplification of the broader collateral estoppel standard and is not universally used in this Circuit. Nonetheless, the parties agree to use this simplified test here, and so the Court adopts it for the purposes of the instant motion.

First, although an agency relationship may permit a non-signatory to compel arbitration, see, e.g., Astra Oil Co. v. Rover Navigation, Ltd., 344 F.3d 276, 280-81 (2d Cir. 2003), this Circuit has held that such a relationship is insufficient where it is formed as a result of the wrongdoing alleged in the pleadings. Sokol Holdings, Inc. v. BMB Munai, Inc., 542 F.3d 354, 362 (2d Cir. 2008). For example, in Sokol Holdings, the plaintiff agreed to purchase a controlling interest in a company from a third party. Id. The third party breached and instead sold its interest to the defendant, who made the company a wholly-owned subsidiary. Id. The plaintiff filed a suit for tortious interference, and the defendant moved to compel arbitration on the theory that the underlying agreement contained an arbitration clause and that the defendant had formed a "close corporate and operational relationship" with the third-party signatory. The district court denied the motion and the Second Circuit affirmed, ruling that where the non-signatory "has become aligned or associated with [a signatory] . . . , and has done so by wrongfully inducing [the signatory] to breach its obligation under that contract . . . , there would be no unfairness in allowing [the plaintiff], the victim of the tortious interference, to insist that, while he agreed to arbitrate with his contractual counterparty [], he in no way consented to extend that agreement to an entity which tortiously subverted his rights under the agreement." Id.

This principle applies with full force here. The theory of the complaint is that LDiscovery improperly induced the Individual

Defendants to act as its agents in order to misappropriate DTI's trade secrets. EDVA Compl. ¶¶ 46, 53-55, 130. While LDiscovery contends that DTI chose this theory because it lacked any "actual facts" of wrongdoing by LDiscovery and was seeking "a hook for liability," see Transcript dated June 1, 2017 at 561-562, this argument goes only to whether the allegations are sufficiently plead under Rule 12(b)(6). LDiscovery concedes that "for purposes of the estoppel analysis it is the allegation that matters," Defendant LDiscovery, LLC's Reply Memorandum in Support of its Motion to Compel Arbitration or, in the Alternative, to Dismiss, ECF No. 43, at 4, and there is nothing unfair about permitting DTI to litigate a theory that the Court must assume is true for the purposes of the instant motion. Accordingly, since LDiscovery allegedly formed its "close relationship" with the Individual Defendants as a result of its own wrongful conduct, it lacks a basis to compel arbitration under a theory of estoppel.

Second, LDiscovery lacks a sufficient relationship with DTI to assert its theory of estoppel. Since "arbitration is a matter of contract, . . . a party cannot be required to submit to arbitration any dispute which [it] has not agreed so to submit." Ragone v. Atl. Video at Manhattan Ctr., 595 F.3d 115, 126 (2d Cir. 2010) (quoting JLM Indus., 387 F.3d at 171)). A non-signatory seeking to compel arbitration therefore must possess more than just a relationship with a signatory defendant: there must exist the "further necessary circumstance of some relation between [the non-signatory] and the

plaintiffs sufficient to demonstrate that the plaintiffs intended to arbitrate this dispute."[6] Id. at 127-28 (quoting Ross v. Am. Exp. Co., 547 F.3d 137, 148 (2d Cir. 2008)).

Such a relationship is absent here. LDiscovery is and has been a competitor of DTI, and DTI has never treated LDiscovery as a party to the Individual Employees' employment agreements. To the contrary, DTI has affirmatively sought to exclude competitors like LDiscovery from forming agency relationships with its employees by including conflicting employment and non-competition provisions in its employment contracts. See, e.g., SDNY Compl., Ex. A, ¶¶ 10-11. LDiscovery's position in this litigation is therefore that of a third party allegedly attempting to subvert the integrity of the agreements between DTI and the Individual Defendants, which is insufficient to warrant estoppel. Ross, 547 F.3d at 146.

For the foregoing reasons, the Court finds that LDiscovery lacks the requisite "close relationship" with the parties to allow

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[6] This principle applies equally to an agent-principal relationship because, no matter the context, "the obligation to arbitrate depends on consent." See Sokol Holdings, 542 F.3d at 361; id. at 359-360 (citing JLM Indus., 387 F.3d at 178; Astra Oil, 344 F.3d at 280-281). Accordingly, district courts in this Circuit have held that a non-signatory principal must at least have controlled its signatory agent at the time of the arbitration clause's formation. See Ross, 547 F.3d at 144 (citing cases). Whether the plaintiff must have also known of this relationship at the time of formation, or have taken some additional affirmative step to manifest consent, are issues that the Court of Appeals has yet to answer.

it to compel arbitration, and denies LDiscovery's motion to compel arbitration.[7]

The Court accordingly has jurisdiction to address LDiscovery's motion to dismiss. As previously noted, DTI's complaint asserts several theories of liability including that LDiscovery used the Individual Defendants as its agents and conspired with, induced, and aided and abetted them to misappropriate DTI's trade secrets. Id. at ¶¶ 84, 91, 132. These theories each rely on the same set of factual allegations to establish their plausibility: (1) LDiscovery and the Individual Defendants communicated extensively prior to the Individual Defendants' resignations; (2) LDiscovery proposed to indemnify the Individual Defendants should DTI bring suit; and (3) LDiscovery offered to pay the Individual Defendants "extraordinary amounts of money" for their services. EDVA Compl. ¶¶ 54-55, 62, 110. Contrary to DTI's assertions, these facts do not move DTI's theories from the conclusory into the "realm of plausible liability." Bell Atl. Corp. v. Twombly, 550 U.S. 544, 557 (2007).

The fact that LDiscovery engaged in extensive communications with the Individual Defendants says nothing about the content of these communications, particularly when the complaint admits that LDiscovery and the Individual Defendants were negotiating prospective employment agreements during this period. The proposed

[7] The Court does not reach the issue of whether LDiscovery waived its right to arbitrate by participating in the preliminary injunction hearing.

indemnification agreement likewise states that the Individual Defendants commit "not to take, use, or in any way misappropriate any of the confidential or proprietary information of [DTI] now or in the future," and that LDiscovery's "obligation and commitment to indemnification will end . . . if it is determined by a court . . . that the [Individual Defendants] materially deceived and/or defrauded [LDiscovery] with regard to their actions in connection with the contemplated transitions."[8] Ex. 5, ECF No. 45, at ¶ 11. The offer of indemnity thus could not have induced the Individual Defendants to commit their alleged wrongdoing because such misconduct would forfeit their contractual protections.[9]

Lastly, the payments offered by LDiscovery were not so "extraordinary" as to raise an inference that they were a quid pro quo for the Individual Defendants' alleged wrongdoing. While the complaint alleges that LDiscovery promised the Individual Defendants "nearly $24 million in guaranteed payments," the bulk of this compensation was, in fact, not guaranteed. The complaint admits that the Individual Defendants would receive $14 million of this sum only

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[8] While the complaint against LDisocvery does not attach the proposed indemnification agreement or incorporate it by reference, "the court may nevertheless consider it where the complaint relies heavily upon its terms and effect, thereby rendering the document integral to the complaint." Tessler v. Paterson, 451 Fed. Appx. 30, 32 (2d Cir. 2011).

[9] Indeed, the proposed agreement further establishes more broadly that "material misconduct by the [Individual Defendants] relating directly to the issues of their contemplated transitions . . . can trigger the loss of the [LDiscovery's] commitment and obligation as to indemnification as set forth herein." Id.

in the event of a change in control of LDiscovery within the first two years of employment, and there is no allegation that such change was likely to occur. See NDIL Compl. ¶ 51. As for the remaining $10 million in salary and signing bonuses, the complaint fails to establish how it compares to the compensation earned by the Individual Defendants prior to their leaving DTI. Without this baseline, it is impossible for the Court to determine whether LDiscovery's proposed compensation was so "extraordinary" and without rational business justification that it plausibly raises an inference that it was in return for the Individual Defendants' alleged misconduct.

The Court accordingly dismisses the complaint against LDiscovery for failing to allege facts plausibly showing that LDiscovery engaged in wrongdoing.[10] However, since it is still conceivable that DTI could allege such facts in timely fashion, the dismissal is without prejudice for now.

In sum, the Court (a) reaffirms its bench order on May 30, 2017 granting the motion by the Individual Defendants to compel arbitration and stay the proceedings in this Court of DTI's claims against them with the exception of any claims seeking to enjoin the

[10] The conclusory nature of DTI's allegations is corroborated by the fact that after extensive pre-trial discovery, depositions, and a three-day preliminary injunction hearing, DTI adduced no evidence that LDiscovery used the Individual Defendants as its agents or otherwise conspired with, induced, aided and abetted them to misappropriate DTI's confidential information. See Order dated June 16, 2017.

breach or threatened breach of their employment agreements; (b) denies LDiscovery's motion to compel arbitration of the claims raised against it by DTI; and (c) grants LDiscovery's motion to dismiss the complaint under Rule 12(b)(6), without prejudice to DTI's possibly amending the pleadings in timely fashion. The Clerk of Court is hereby ordered to close docket 17-cv-2405 at numbers 33 and 50, docket 17-cv-3917 at number 48, and docket 17-cv-3433 at number 43.

Dated: New York, NY
June 26, 2017

JED S. RAKOFF, U.S.D.J.