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SUPERIOR COURT FOR THE STATE OF CALIFORNIA

IN AND FOR THE COUNTY OF CONTRA COSTA

-- UNLIMITED CIVIL JURISDICTION --

MERRILL LYNCH PIERCE FENNER and SMITH, INC.

Plaintiff

v.

CLARENCE W. HOUGHTON, LEWIS F. MACE II, STEVEN T. KOBAYASHI, and Does 1 through 30, inclusive,

Defendants.

Case No.:

MEMORANDUM OF POINTS AND AUTHORITIES IN OPPOSITION TO APPLICATION FOR TEMPORARY RESTRAINING ORDER

Hearing Date: January 14, 2000
Time: 2 p.m.
Dept.: 38

I. INTRODUCTION

Under California law, an employee who leaves one firm for another has the right to announce his change of employment to customers whom he served at his former employer. He also has the right to discuss doing business at his new firm with those customers who inquire about that possibility in response to his announcement. All the defendants, Bill Houghton ("Houghton"), Lewis Mace ("Mace"), and Steven Kobayashi ("Kobayashi") (collectively, "defendants"), have done in this case is to exercise their rights under California law: Upon joining Morgan Stanley Dean Witter ("MSDW"), Houghton, Mace and Kobayashi arranged for a printed announcement of their change of employment to be sent to clients whom they had served at Merrill Lynch Pierce Fenner & Smith ("Merrill Lynch"). They have responded to telephone calls from clients who received this announcement and have notified other clients by telephone about their new job. Because defendants

acted within their rights under California law, Merrill Lynch has no reasonable likelihood of prevailing on the merits of its claims, and for this reason alone its application for a temporary restraining order should be denied. In addition, Merrill Lynch will be unable to show that issuance of a TRO is necessary to prevent irreparable harm to Merrill Lynch. And no injunction should be entered that would interfere with the right of clients to do business with the broker of their choice. For these reasons as well, the application should be denied.

II. STATEMENT OF FACTS

Defendants Lewis Mace and Steve Kobayashi met when both were working for David White & Associates, a financial planning firm in San Ramon, in 1994. Declaration of Lewis F. Mace II ("Mace Decl.") ¶ 3; Declaration of Steven T. Kobayashi ("Kobayashi Decl.") ¶ 2. Mace left David White to join Merrill Lynch in August 1995, Mace Decl. ¶ 2, and Kobayashi followed him a few months later. Kobayashi Decl. ¶2. Believing that their talents complimented each other, Mace and Kobayashi decided to work together as a team and eventually formed a formal partnership. Mace Decl. ¶ 3; Kobayashi Decl. ¶ 3. They developed their client base through cold calls, direct mail, referrals, and seminars, and every year they personally paid for lists of potential clients and for temporary employees to call them. Mace Decl. ¶ 4; Kobayashi Decl. ¶ 3. Ultimately, they came to serve about 150 households. Id.

Last year, Mace and Kobayashi began to focus their marketing efforts on providing business financing services to start-up companies in the technology and Internet fields. Mace Decl. ¶ 4. They came to believe, however, that Merrill Lynch was not interested in this market. Id. A number of brokerage firms had contacted Mace and Kobayashi about changing employers, but they initiated contact with MSDW themselves. Mace Decl. ¶ 5; Kobayashi Decl. ¶ 4. Believing that MSDW was the firm that would support their business the best, they decided to resign from Merrill Lynch and join MSDW. Id.

Defendant Bill Houghton also worked at Merrill Lynch's San Ramon office. Declaration of Bill Houghton ("Houghton Decl.") ¶ 2. He had begun his securities career with E. F. Hutton in 1984, then worked for MSDW's predecessor firm, Dean Witter Reynolds Inc., from 1988 through 1992, when he joined Merrill Lynch. Id. Houghton developed a client base of approximately 200 households,

primarily through referrals from existing clients. Id. ¶ 3. Approximately 50 or 60 of these clients have come to rely on him regularly for investment advice, and most of these have been his clients for four or more years. Id.

During the latter part of his employment with Merrill Lynch, Houghton became increasingly disenchanted, especially with the system used in the San Ramon office for distributing accounts. Id. ¶ 4. In addition, many of his clients were interested in participating in initial public offerings and other syndicate issues, an area in which MSDW is known as a leader. Id. Through a friend who was an MSDW broker, Houghton contacted MSDW about the possibility of returning to Dean Witter. Id. Ultimately, he decided to make the move. Although Houghton resigned from Merrill Lynch and joined MSDW the same day as Mace and Kobayashi, he was not part a "package deal" with them, and the two partners and Houghton, respectively, made their decisions independently. Houghton Decl. ¶ 4; Mace Decl. ¶ 5; Kobayashi Decl. ¶ 4.

Prior to their resignation from Merrill Lynch on January 7th, neither Mace and Kobayashi, nor Houghton removed any documents, originals or copies, containing confidential financial information about customers who had Merrill Lynch accounts. Mace Decl. ¶ 6; Kobayashi Decl. ¶ 5; Houghton Decl. ¶ 5. Nor did they download any such information from Merrill Lynch's computer system. Id.

Upon joining MSDW, Mace and Kobayashi arranged for the firm to send a printed announcement to their clients about their change of employment. Mace Decl. ¶ 7; Kobayashi Decl. ¶ 7. Houghton arranged for a separate announcement to be sent to *his* clients. Houghton Decl. ¶ 6. Mace and Kobayashi provided MSDW with mailing labels that had been created from a database of names and addresses maintained on Kobayashi's personal computer. Mace Decl. ¶ 7; Kobayashi Decl. ¶¶ 6-7. Houghton provided MSDW with a printout of names and addresses that was used to create mailing labels. Houghton Decl. ¶¶ 5-6.

A copy of the announcements sent by Mace and Kobayashi and by Houghton is attached as Exhibit A to their respective declarations. As can be seen, the announcement simply states that the broker has joined MSDW and provides his new address and telephone number. It does not solicit any client to transfer his or her account to MSDW.

During the last week clients who received the printed announcement have called Mace,

Kobayashi, and Houghton to inquire about transferring their accounts to MSDW. Mace Decl. ¶ 8; Houghton Decl. ¶ 6. In addition to responding to these calls, Mace, Kobayashi, and Houghton have placed calls themselves to some of their clients to notify them personally of their change of employment. Mace Decl. ¶ 9; Kobayashi Decl. ¶ 8; Houghton Decl. ¶ 7. In none of these calls did any of the brokers solicit clients to transfer their accounts to MSDW. Id. Rather, in their different ways, the three men simply informed the clients about their move, and, if asked by the client (as they invariably were), explained the alternatives for the future handling of his or her account: reassignment to a new broker at Merrill Lynch or transfer to MSDW. Id. Kobayashi went as far as offering to recommend a new broker to ask for if the client expressed an interest in staying at Merrill Lynch. Kobayashi Decl. ¶ 3.

III. ARGUMENT

As of this writing, defendants have not seen the complaint filed by Merrill Lynch or its application for a TRO. Their counsel understands, however, that Merrill Lynch will be applying for an order prohibiting them from "misappropriating" Merrill Lynch's "trade secrets" and from "soliciting" the customers whom they served at Merrill Lynch. In deciding whether to issue injunctive relief, a court must weigh two "interrelated" factors: (1) the likelihood that the moving party will ultimately prevail on the merits and (2) the relative interim harm to the parties from issuance or non-issuance of the injunction. Butt v. State of California, 4 Cal.4th 668, 677-678 (1992). Since a TRO is a drastic remedy, the party seeking injunctive relief must establish its entitlement to such relief by admissible evidence. See Chico Feminist Women's Health Center v. Scully, 208 Cal. App. 3d 230, 247 (1989).

In this case, Merrill Lynch will be unable to make the necessary showing. Since Mace, Kobayashi, and Houghton have done nothing more than exercise the rights of a departing employee under California law, Merrill Lynch is not likely to prevail on the merits of any of its claims against them. Moreover, since Merrill Lynch has an adequate damage remedy for any alleged misconduct, it has not shown irreparable injury. In addition, no TRO should be entered that would have the effect of depriving defendants' clients of their right to do business with the broker of their choosing.

I. Merrill Lynch Cannot Show That It Is Likely To Prevail On The Merits

As the moving party, Merrill Lynch bears the burden of proving that Mace, Kobayashi,

and Houghton are unlawfully using Merrill Lynch's "trade secrets" to induce clients to move to MSDW. Merrill Lynch will be unable to meet that burden.

First, whether certain information constitutes a trade secret is a question of fact on which the party asserting the existence of the trade secret -- in this case Merrill Lynch -- bears the burden of proof. See Scott v. Snelling and Snelling, Inc., 732 F. Supp. 1034, 1038 (N.D. Cal. 1990). The bare assertion that information about defendants' clientele is a trade secret belonging to Merrill Lynch proves nothing. Morlife, Inc. v. Perry, 56 Cal. App. 4th 1514, 1522 (1997) ("labeling information "trade secret" or "confidential information" does not conclusively establish that the information fits this description").

Defendants do not know exactly what information Merrill Lynch contends is a "trade secret." The declarations submitted by defendants establish that, prior to their resignations, none of them removed any documents, originals or copies, containing confidential financial information about their clients. Nor did they download any such information from Merrill Lynch's computers. Each man did have in his possession a list of names, addresses, and telephone numbers of his clients, but any contention that such lists alone constitute trade secrets would be incorrect. Under California law, the expenditure of time, effort and expense by the party asserting trade secret protection is a prerequisite to a finding that such party owns, and is entitled to protection of, the allegedly confidential information. See, e.g., Greenly v. Cooper, 77 Cal. App. 3d 382, 392 (1978) (a customer list "built up by ingenuity, time, labor and expense of the owner over a period of many years is property of the employer, [and] knowledge of such a list, acquired by an employee by reason of his employment, may not be used by the employee as his own property or to his employer's prejudice.") (emphasis added); Klamath-Orleans Lumber, Inc. v. Miller, 87 Cal. App. 3d 458, 464 (1978) (trade secret established because plaintiff compiled customer information at great expense to itself).

Here, all three brokers brought clients with them from their prior firms when they joined Merrill Lynch, and they expanded their client base through their own efforts, Mace and Kobayashi by paying personally for lists of potential clients and for temporary employees to call them and Houghton by getting referrals from existing clients. Under these circumstances, Merrill Lynch will be unable to show that it has any legally protectable property rights in the lists of defendants' clients' names,

addresses, and telephone numbers.

Second, and most importantly, even if the names, addresses and telephone numbers of customers served by Mace, Kobayashi, and Houghton could be considered a trade secret, defendants nevertheless had the right to use that information to announce their change of employment. Indeed, their right to announce their new affiliation to clients with whom they personally dealt at Merrill Lynch, and to do business with them should they choose to do so, is indisputable under California law:

> Merely informing customers of one's former employer of a change of employment, without more, is not solicitation. Neither does the willingness to discuss business upon invitation of another party constitute solicitation on the part of the invitee. Equity will not enjoin a former employee from receiving business from the customers of his former employer, even though the circumstances be such that he should be prohibited from soliciting such business.

Hilb, Rogal & Hamilton Ins. v. Robb, 33 Cal. App. 4th 1812, 1821, 39 Cal. Rptr. 2d 887, 892 (1995) (quoting Aetna Bldg. Maintenance Co. v. West, 39 Cal. 2d 198, 204 [1952]). That is so, regardless of whether the names and addresses of customers may be characterized as "trade secrets." See American Credit Indemnity Co. v. Sacks, 213 Cal. App. 3d 622, 636 (1989) (". . . the right to announce a new affiliation, even to trade secret clients of a former employer, is basic to an individual's right to engage in unfair competition"); Moss, Adams & Co. v. Shilling, 179 Cal. App. 3d 124 (1986) (recognizing right of former employee to use company rolodex to ascertain names and addresses of clients personally serviced by former employee, and to send announcements of former employee's new business to such individuals).

Here, Mace, Kobayashi, and Houghton did nothing more than they were entitled to do under California law. The written announcements sent to clients simply states that Mace and Kobayashi on the one hand and Houghton on the other have moved to Dean Witter and provides their new office address and phone number. This hardly can be construed as an unlawful "solicitation." Nor did the telephone calls made by defendants go beyond lawful announcement. As their declarations establish, each broker simply informed the client of his change of employment and, *if asked by the client*, explained the alternatives for the future handling of his or her account, including the possibility of remaining at Merrill Lynch with a new broker. This, too, they also have the right to do under California law. It is no less lawful to announce a change of employment by telephone or in person than to

announce it by mail. See Aetna Bldg. Maintenance Co., 39 Cal. 2d at 202 (defendant's personal visit to customer of former employer held not to constitute solicitation). Moreover, it is not unlawful to respond to customer questions about future business. See Hilb, 33 Cal. App. 4th at 1821 (finding no solicitation where defendant announced change of employment and "then responded to the clients' lawful business requests"). As the California Supreme Court stated long ago, neither informing clients of a change of employer, nor "the willingness to discuss business upon invitation of another party" constitutes unlawful solicitation. Aetna Bldg. Maintenance Co., 39 Cal. 2d at 204.

Because Merrill Lynch will be unable to produce any admissible, reliable evidence of solicitation, it is not likely to succeed on the merits of its claims. Accordingly, Merrill Lynch's application for a TRO should be denied.

II. Merrill Lynch Cannot Show The Existence Of Irreparable Injury If A TRO Is Denied

At stake in a case like this, where a broker leaves one firm for another, is the commission revenue generated by his clients. Presumably, Merrill Lynch has been contacting defendants' clients since their departure in an effort to convince those clients to remain with Merrill Lynch. To the extent these efforts succeed, Merrill Lynch will have suffered no injury. And to the extent that clients move their accounts to MSDW, Merrill Lynch will be able to seek compensation for its loss of revenue if it proves that any of the defendants acted unlawfully. At this point, if Merrill Lynch has suffered injury, it can be made whole by an award of damages. It is, of course, axiomatic that no equitable relief is appropriate where plaintiff has an adequate remedy at law. See Merrill Lynch Securities, Inc. v. Plunkett, 8 F.Supp.2d 514 (E. D. Va. 1998) (denying Merrill Lynch's motion for injunction on grounds, inter alia, that losses from transferred accounts are quantifiable and therefore there is no irreparable injury).

Not only is a damages remedy available to Merrill Lynch but there are securities industry forums in which it may obtain such a remedy on an expedited basis. The National Association of Securities Dealers, of which Merrill Lynch and MSDW both are members (and Mace, Kobayashi, and Houghton are associated persons), has promulgated rules providing for an expedited hearing in cases in which a brokerage firm claims that a departing broker has engaged in unlawful activity. See N.A.S.D.

Code of Arbitration Procedure § 10335. Indeed, although the N.A.S.D. rules permit a firm to seek temporary injunctive relief from a court, they require that the dispute ultimately be resolved by arbitration before an industry panel. See id. §§ 10100, 10201.

III. No Injunction Should Be Entered That Would Interfere With The Rights of Clients To Do Business With The Broker Of Their Choice

Even if Merrill Lynch were otherwise entitled to injunctive relief – which it is not – no order should be entered that would interfere with the rights of clients to do business with the broker of their choice. In cases such as this, the courts have recognized that the interests of people who want and need brokerage services deserve as much consideration as the interests of the people and firms providing those services. For example, in Merrill Lynch Securities, Inc. v. Plunkett, 8 F.Supp.2d 514 (E. D. Va. 1998), the court denied a motion to enjoin the broker from soliciting customers serviced at his former employer and stated,

> The Court must also be mindful of the interests of Plunkett's former clients. Rule 412 of the New York Stock Exchange provides that customers' accounts should be handled in such a way that coordination of activities between brokerage firms on a single account should not cause customers to endure losses as a result of firm competition. [citation omitted] If the Court interpreted "solicitation" as proscribing communication between Plunkett and his former Merrill Lynch clients, the clients might be prejudiced. A broker-client relationship, like a lawyer-client or doctor-patient relationship, is a personal relationship dependent on personal trust. Clients should be free to deal with the broker of their choosing and not subjected to the turnover of their accounts to brokers associated with the firm but unfamiliar to the client, unless the client gives informed consent to the turnover.

8 F.Supp. 2d at 519-520. Similarly, in Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Goodson, 820 F. Supp. 1128 (S. D. Indiana 1993), the court refused to enjoin the broker from servicing accounts that "have or might" transfer from his former employer. The latter relief, said the court,

> violates a client's right to obtain financial advice from the source of his choice. This public interest outweighs Merrill Lynch's interest in preventing Goodson from obtaining this business. To prohibit a client from transferring his business to Goodson would create a substantial harm. As the testimony and argument presented during the hearing, as well as all financial industry advertising, makes clear: a broker client relationship is one of trust. It is not merely the mechanical process of giving advice and accepting orders, rather it is a personal relationship which allows a client to sleep easy knowing that his financial interests are well shepherded.

820 F.Supp. at 1131.

The interests of defendants' clients mandate that they be allowed to choose the broker with whom they do business. Should Merrill Lynch seek to deprive them of this right, its application should be denied for this reason as well.

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