

12-1-2005

A Secret in One District Is No Secret in Another: The Cases of Merrill Lynch and Preliminary Injunctions Under the FAA

Anahit Tagvoryan

Follow this and additional works at: <https://digitalcommons.pepperdine.edu/drlj>



Part of the [Civil Procedure Commons](#), [Dispute Resolution and Arbitration Commons](#), [Intellectual Property Law Commons](#), and the [Legal Remedies Commons](#)

Recommended Citation

Anahit Tagvoryan, *A Secret in One District Is No Secret in Another: The Cases of Merrill Lynch and Preliminary Injunctions Under the FAA*, 6 Pepp. Disp. Resol. L.J. Iss. 1 (2005)

Available at: <https://digitalcommons.pepperdine.edu/drlj/vol6/iss1/5>

This Article is brought to you for free and open access by the Caruso School of Law at Pepperdine Digital Commons. It has been accepted for inclusion in Pepperdine Dispute Resolution Law Journal by an authorized editor of Pepperdine Digital Commons. For more information, please contact bailey.berry@pepperdine.edu.

A Secret in One District is No Secret in Another: The Cases of Merrill Lynch and Preliminary Injunctions Under the FAA

Anahit Tagvoryan¹

I. INTRODUCTION

Many laws protect and foster intellectual property. One such body of law concerns arbitration of intellectual property disputes. Emerging forms of intellectual property are said to “be worth hundreds of billions of dollars of national income and produce millions of jobs.”² Because of these calculations, there has been a “recent dominant trend in commercial transactions” causing “intellectual property disputes to be frequently resolved through private commercial arbitration.”³ Admittedly, arbitration offers numerous measurable advantages over litigation, including cheapness, speed, flexibility, confidentiality, and the trade and technical expertise of arbitrators.⁴

1. Anahit Tagvoryan is a 2006 juris doctorate candidate at the Pepperdine University School of Law, a member of the Center for Entrepreneurship and Technology Law, and the Straus Institute for Dispute Resolution. The views expressed in this article are those of the author alone, and do not necessarily reflect the opinions of Pepperdine University or its institutes. The author would like to thank the Pepperdine staff of the Dispute Resolution Journal, friends who couldn't wait to read the finished piece, family whose support is always unwavering, and her “klupnik.”

2. John A. Fraser, III, *Congress Should Address the Issue of Provisional Remedies for Intellectual Property Disputes Which are Subject to Arbitration*, 13 OHIO ST. J. ON DISP. RESOL. 505, 505 (1998).

3. *Id.* See also Alison C. Wauk, *Preliminary Injunctions in Arbitrable Disputes: The Case for Limited Court Jurisdiction*, 44 UCLA L. REV. 2061, 2063 (1997) (“Throughout this century, arbitration agreements have become increasingly prevalent in commercial business contracts.”).

4. See Nancy Neal Yeend & Cathy E. Rincon, *ADR and Intellectual Property: A Prudent Option*, 36 IDEA 601, 604 (1996):

Traditionally, most forms of [alternative dispute resolution] are considered faster and more cost effective than going to trial. These processes facilitate settlement before hostilities escalate and litigation is initiated. . . . For intellectual property disputes, the most

Public policy favors protecting intellectual property in arbitration, and both Congress and the courts support, and in fact encourage, arbitration of intellectual property disputes.⁵ This support stems from the history of favoritism toward private arbitration agreements and other alternative dispute resolution in lieu of judicial adjudication.⁶ Because intellectual property disputes often involve commercial parties transacting business across state lines, arbitration is governed by the Federal Arbitration Act (FAA).⁷

Availability of provisional remedies⁸ such as injunctions has also proven effective in the area of intellectual property disputes.⁹ However, unlike the option and process of private arbitration where there is little to no court involvement, provisional remedies can be awarded either by the arbitral panel or by court order.¹⁰ As a result, complications arise when parties decide to involve the courts when seeking provisional remedies pending arbitration of disputes. Courts are split as to whether parties can seek provisional remedies such as preliminary injunctions in disputes that are subject to arbitration under the FAA.¹¹ This paper will demonstrate the consequences of the unavailability of provisional remedies by examining the cases involving Merrill Lynch, Pierce, Fenner & Smith, Inc. (Merrill Lynch), an investment firm, in the field of trade secret disputes with former employees. In short, the cases illustrate how this split in the Circuit Courts

significant benefits often are conservation of resources, confidentiality, control over selecting and tailoring the process, selecting the neutral, and determining the outcome.

5. Fraser, III, *supra* note 2, at 506. See also Yeend & Rincon, *supra* note 4, at 601 (“By the 1990s, the courts actively encouraged the use of [alternative dispute resolution] to resolve disputes.”); H.R. REP. No. 97-542, at 13 (1982).

6. See *infra* section III and accompanying notes discussing the Federal Arbitration Act. See also, Yeend & Rincon, *supra* note 4, at 606:

In addition to the many benefits that [alternative dispute resolution (ADR)] provides to an attorney’s clients, judges are seriously looking for new ways to reduce their case loads and are turning to ADR to assist with case management. Referring a case to ADR means that between sixty to eighty percent of the time the case will settle, thus relieving the judge’s caseload. Also, many judges who may not have the subject-matter expertise required for intellectual property matters are assigning these cases to neutrals who possess the requisite knowledge.

7. See 9 U.S.C. §§ 1-14. In cases involving interstate commerce, the Federal Arbitration Act (FAA) governs arbitration of disputes in all federal and state courts. *Id.* See *infra* section III, discussing the FAA history and provisions.

8. Examples of provisional remedies include injunctions, restraining orders, status quo orders, seizures, arrests, attachments, stays, and bonds. They are pre-judgment on the merit awards designed to prevent some future harm to a party by either enjoining a specific act or requiring one.

9. See *infra* section II(C) discussing why preliminary injunctions are important in the area of intellectual property disputes.

10. See generally Fraser, III, *supra* note 2.

11. See *infra* Section V(A).

[Vol. 6: 1, 2006]

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

can have an unwarranted impact on the enforceability of protective covenants in employment agreements. This paper suggests that the courts should not only be uniform in their interpretation of the extent of their authority to issue preliminary injunctions under the FAA, but they should also adopt a common standard for issuing such injunctions.

This paper will introduce the concept of trade secrets in section I(A). Section II will introduce preliminary injunctions under Federal Rule of Civil Procedure 65 and its relationship to trade secret disputes. The Federal Arbitration Act will be discussed in section III. Section IV will give the background information on Merrill Lynch, including a summary of the dispute that typically arises. Section V will summarize the main issues to be discussed in the rest of the paper. Section VI will discuss and analyze the Merrill Lynch cases. Section VII will discuss further implications as evident from the history of this issue, and Section VIII will conclude with a final thought as to why this issue should be resolved by the Supreme Court.

A. Trade Secrets

Trade secrets are but one field of intellectual property.¹² In one type of trade secret case, a confidential customer list is taken without permission and utilized by either a former employee or other competitor.¹³ This solicitation of clients is said to be a misappropriation of intellectual property because the secret customer list, constituting “trade secrets,” is converted from one form of property to another.¹⁴ What relief can an owner of trade secrets receive when such information is taken illegally? Given the transitory nature of trade secrets and the passage of time before an arbitration panel assembles, the most expedient form of relief is a court ordered injunction prohibiting use of client lists.¹⁵

12. A “trade secret” is defined by the original Restatement of Torts and by the Uniform Trade Secrets Act. Generally, the key characteristics of a trade secret are that the information or material is not generally known or ascertainable by the public or competitors, has commercial or economic value from not being so known and, consistent with that value, is kept confidential through affirmative steps to maintain secrecy. See RESTATEMENT OF TORTS § 757 cmt. b (1939); UNIF. TRADE SECRETS ACT § 1, 14 U.L.A. 437 (1979). Other fields of intellectual property involve patents, trademarks and service marks, and copyright matters.

13. See Fraser, III, *supra* note 2, at 515 (listing examples illustrating “the critical importance of provisional remedies in defining what is or is not intellectual property.”).

14. *Id.* at 515-16.

15. “Trade secrets often are protected by means of injunctions prohibiting competitive activity, even in the absence of a non-compete agreement.” Linda K. Stevens, *Special Litigation Issues Pertaining to Trade Secrets – Introduction*, in TRADE SECRETS 2002: HOW TO PROTECT

II. PRELIMINARY INJUNCTIONS

Federal courts follow the procedures set forth in Rule 65 of the Federal Rules of Civil Procedure when ruling on an application for a preliminary injunction. The language of Rule 65 gives general authority to United States District Courts to issue injunctions with only a few prerequisites limiting such authority.¹⁶ There is no limiting language as to their authority in cases of alternative dispute resolution. The limiting rules as to the courts' authority stem from other federal statutes (such as the FAA) and case law.¹⁷

A. Function

A preliminary injunction prohibits a party from taking, or requires a party to take, certain actions awaiting further order of the court.¹⁸ Because it can take days or weeks before a court can determine the merits of a dispute, a party may move for a preliminary injunction immediately after filing the complaint when there is threat of irreparable harm to that party.¹⁹ In other words, the endangered party may move for a preliminary injunction to maintain the status quo pending final resolution on the merits of the dispute.²⁰ It is said to be one of the most important remedies pending final judgment, yet the most difficult to obtain.²¹ It usually requires a live

CONFIDENTIAL BUSINESS & TECHNICAL INFORMATION, 719 PLI/Pat 197 (2002). *See infra* section II(C) discussing why preliminary injunctions are important in the area of trade secret disputes.

16. Rule 65(a) states that courts cannot issue a preliminary injunction "without notice to the adverse party" or "giving of security by the applicant," and generally defines the form and scope of the injunction. FED. R. CIV. P. 65(a)-(d). It also notes that a hearing on an application for a preliminary injunction can be consolidated with the trial on the merits given that any evidence introduced in aid of the application for injunction can be used for the trial on the merits. FED. R. CIV. P. 65(a)(1), (2).

17. Once an application for an injunction has been ruled on, however, the judge's discretion will not be disturbed on appeal without a showing that it has been abused. *See Planned Parenthood League of Massachusetts v. Bellotti*, 641 F.2d 1006, 1009 (1st Cir. 1981) ("The decision to grant or deny a preliminary injunction is a matter for the discretion of the district court and is reversible [by the federal circuit court of appeals] only for an abuse of discretion.") (quoting *Charles v. Carey*, 627 F.2d 772, 776 (7th Cir. 1980)).

18. *See* William L. Schaller, *Some Preliminary Thoughts about Preliminary Injunctions*, 85 ILL. B.J. 12, 12 (Jan. 1997).

19. *See infra* note 28.

20. *See Pharm. Mfrs. Ass'n v. Weinberger*, 401 F. Supp. 444, 449 (D.D.C. 1975) ("The purpose of granting a preliminary injunction is to protect the plaintiff from irreparable injury by preserving the status quo *pendente lite*." (citing *Green v. Kennedy*, 309 F. Supp. 1127 (D.D.C. 1970)); *Grier v. Bowker*, 314 F. Supp. 624, 625 (S.D. N.Y. 1970) ("A preliminary injunction is an extraordinary remedy. . . whose purpose is to preserve the status quo and prevent irreparable injury until the case can be ultimately resolved.").

21. *See, e.g., Greater Iowa Corp. v. McLendon*, 378 F.2d 783, 799 ("Injunctions are extraordinary legal remedies and are granted sparingly and under strict rules for protection of all

[Vol. 6: 1, 2006]

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

evidentiary hearing “amounting to a mini-trial.”²² If it is later reversed on appeal, it may lead to a “wrongful injunction” finding, which in turn may trigger liability for damages under the bond.²³

B. *The Traditional Test*

Generally, in order to obtain injunctive relief, the party seeking an injunction must satisfy the traditional requirements for the granting of such relief.²⁴ The courts that apply a slightly different test do so in order to comply with the limits placed on their authority by the FAA.²⁵ All of the

parties.”). *See also* Schaller, *supra* note 18. The party seeking an injunction should do it “as soon as possible after discovering the wrongful conduct” because “[d]elay may result in a ruling that the status quo cannot be maintained or restored.” *Id.* at 13. “In true emergencies, the court can issue a temporary restraining order, with or without notice, which is similar to but shorter than a preliminary injunction.” *Id.* at 12. *See* FED. R. CIV. P. 65(b) on temporary restraining orders.

22. Schaller, *supra* note 18, at 13.

23. FED. R. CIV. P. 65(c) states:

No restraining order or preliminary injunction shall issue except upon the giving of security by the applicant, in such sum as the court deems proper, for the payment of such costs and damages as may be incurred or suffered by any party who is found to have been wrongfully enjoined or restrained

See infra note 153 discussing *Blumenthal v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 910 F.2d 1049, 1052 (2d Cir. 1990) on the issue of bonds.

24. *See* *Compuserve, Inc. v. Vigny Int'l Fin. Ltd.*, 760 F. Supp. 1273, 1281 (S.D. Ohio 1990) (the preliminary injunction standard is the proper test to employ in determining whether to issue an injunction for purposes of maintaining the status quo pending arbitration); *Dice v. Clinicorp, Inc.*, 887 F. Supp. 803, 808 (W.D. Pa. 1995) (the federal district court will “utilize a federal standard in evaluating whether preliminary injunctive relief is appropriate,” even though the employer’s request for relief was based on a state law cause of action).

25. I believe that the courts that apply a different test for the granting of injunctive relief for disputes that are subject to arbitration do so in order to comply with the limits placed on their authority by the FAA. For example, when courts are asked to authorize provisional remedies in aid of arbitration, they consider only the effectiveness of the ultimate arbitration award in light of the injunction, instead of the traditional test. *See e.g.*, *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Shubert*, 577 F. Supp. 406, 407 (M.D. Fla. 1983); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Thomson*, 574 F. Supp. 1472, 1478 (E.D. Mo. 1983). This is because they do not want to consider the merits of the case, which they say is better left to the arbitrators. *Id.* Some scholars identify these inquiries made by courts and designate them as “different” tests. *See e.g.*, Cynthia J. Butler, *The Propriety of Judicially Granted Provisional Relief in Pending Arbitration Cases*, 9 OHIO ST. J. ON DISP. RESOL. 145 (1993); *Caz Hashemi, Preliminary Injunctions Pending Arbitration under the Federal Arbitration Act: Judicial Misinterpretation, Judicial Intervention, and Confusion*, 75 WASH. U. L.Q. 985 (1997). These court approaches, however, do not apply different tests. One approach is the “hollow formality” inquiry (or availability of redress approach) as applied by *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bradley*, 756 F.2d 1048 (4th Cir. 1985), but this inquiry is made in addition to the traditional test. The second approach is the “express injunction clause” inquiry

Merrill Lynch court decisions that have considered preliminary injunctions pending arbitration have applied the traditional four-part test for preliminary injunctions.²⁶ The traditional standard for obtaining injunctive relief pursuant to Rule 65 of the Federal Rule of Civil Procedure (also known as the “balance of hardships” test) requires the movant to establish that: 1) there is some likelihood that the movant will ultimately prevail on the merits of the claim;²⁷ 2) the movant will suffer irreparable injury unless the injunction is issued;²⁸ 3) the threatened injury to the movant outweighs whatever damage the proposed injunction may cause the opposing party;²⁹ and 4) the public interest will not be harmed if the injunction is issued.³⁰ Especially in trade secret disputes where injunctions are sought, “the key is the threat of irreparable harm, meaning harm for which there is no adequate remedy at law.”³¹

C. Why the Need for a Preliminary Injunction in Intellectual Property Disputes?

Judicial proceedings are stayed under the FAA so that parties can arbitrate their dispute as agreed, thereby maintaining the status quo of the agreement.³² However, business disputes require more than the stay of

(contractual language test), to which the traditional test is made *conditional*. See *infra* discussion on the “hollow formality” test as applied by *Bradley*, 756 F.2d at 1048.

26. See *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. De Liniere*, 572 F. Supp. 246, 247 (N.D. Ga. 1983); *Bradley*, 756 F.2d at 1054-55; *Merrill Lynch, Pierce, Fenner, & Smith, Inc., v. Salvano*, 999 F.2d 211, 214 (7th Cir. 1993); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Shubert*, 577 F. Supp. 406, 407 (M.D. Fla. 1983). Even in *Bradley* where the court applied a second “hollow formality test,” it considered the traditional test when reviewing the lower district court’s decision. See *infra* notes 136-41 and accompanying text.

27. While all the courts in the *Merrill Lynch* cases considered the traditional test for preliminary injunctions, they differ as to *how* likely the ultimate victory should be. This is not a different test, but a variation of the second prong of the test. Two courts required “substantial” likelihood. *Shubert*, 577 F. Supp. at 407; *De Liniere*, 572 F. Supp. at 247. One court required “reasonable” likelihood. *Salvano*, 999 F.2d at 214. One court required mere “likelihood” without a qualifying adjective. *Bradley*, 756 F.2d at 1054-55. Note that the higher the likelihood of the victory, the more potential for courts to dive into the merits of a dispute, thereby undermining the arbitration procedure and decision.

28. *De Liniere*, 572 F. Supp. at 247.

29. *Id.* This is the ‘balance of harms’ prong and it simply considers “the harm to the petitioner without an injunction versus the harm to the opponent from an injunction.” Schaller, *supra* note 18, at 13.

30. *De Liniere*, 572 F. Supp. at 247.

31. Schaller, *supra* note 18, at 12. Harm for which there is “no adequate remedy at law” essentially means “harm that money damages would not fully compensate.” *Id.*

32. See *infra* Section III discussing the objectives of the FAA.

judicial proceedings if the objective is to maintain the status quo.³³ Compelling the arbitration to go forward as agreed does not do the job of protecting the status quo either.³⁴ While arbitration is pending, parties may need to be enjoined from violating non-competition agreements and misappropriating trade secrets.³⁵ Parties seek preliminary injunctions because they do not want to be irreparably harmed to the extent that any damages later awarded are inadequate to compensate for the harm caused.

The ability to exclude others from unprivileged use or possession is what defines ownership or other interest in intellectual property.³⁶ What makes trade secrets commercially valuable is the exclusive use of that property. Where the disputed issue is the right of the owners to control possession and use of the property, normal legal remedies such as monetary damages or restitution are inadequate.³⁷ This is due to the special intangible nature of intellectual property and its value to the owner.³⁸ There is simply no guarantee that those secrets will remain inviolate. Only affirmative injunctive remedies will defend the property owner's rights.³⁹ If a timely legal remedy is unavailable to enforce an aspect of ownership, then it will "practically eliminate[] that aspect of ownership."⁴⁰ But when is injunctive relief available⁴¹ and how effective is it at remedying the wrong?⁴²

33. Laurie A. Kamaiko, *Reinsurance Arbitrations*, in 14TH ANNUAL INSURANCE, EXCESS AND REINSURANCE COVERAGE DISPUTES, 557 PLI/Lit 201, 263 (1997).

34. *Id.*

35. See Fraser, III, *supra* note 2, at 511-18. Cases typically giving rise to preliminary injunctions include: executive and key employee unfair competition claims, general unfair competition claims, asset ownership disputes, business interruption disputes, government injunction cases, and parallel litigation proceedings (request to enjoin another pending proceeding). Schaller, *supra* note 18, at 13-27.

36. Fraser, III, *supra* note 2, at 513.

37. *Id.* at 512.

38. *Id.* at 513.

39. *Id.* See also Stevens, *supra* note 15, at 212 ("A common remedy granted to the successful trade secrets plaintiff is an injunction prohibiting use and disclosure of the trade secrets at issue.")

40. Fraser, III, *supra* note 2, at 514.

41. "[T]he availability (or lack thereof) of provisional remedies will precisely define the boundaries of the property in question." Fraser, III, *supra* note 2, at 516. "[W]ithout provisional remedies to prevent opportunistic erosion and destruction of intellectual property, a commitment to arbitrate intellectual property disputes in the United States could be a poor strategic choice for investors in intellectual property." *Id.* at 519.

42. Because evidence of infringement of the owner's rights is ephemeral and transitory and impermissible copies can be secreted, memorized, or transported in seconds, "the continued ability of unlicensed users to use the property without danger of loss from effective short term remedies greatly reduces the value of the property." Fraser, III, *supra* note 2, at 517.

III. FEDERAL ARBITRATION ACT (FAA)

In the past, courts were averse to the enforcement of private arbitration agreements.⁴³ In enacting the Federal Arbitration Act in 1925, Congress intended to overrule all common law hostility toward arbitration and wanted to enlist the courts in assisting in the maintenance and enforcement of the arbitration system and arbitration agreements.⁴⁴ The Supreme Court then interpreted the act as evidencing a strong federal policy favoring arbitration.⁴⁵ Today, “courts recognize that the court system benefits from the resulting conservation of judicial resources, and alternatives to litigation for dispute resolution are favored by all federal circuits.”⁴⁶

Because the purpose of the Act is to ensure judicial enforcement of private arbitration agreements, the substantive rules of the Act apply to both state and federal courts with respect to arbitrations within the scope of the Act.⁴⁷ The FAA governs proceedings on agreements to arbitrate when the agreement is in writing and the contract involves interstate commerce.⁴⁸ It requires courts to enforce all arbitration agreements when one party either sues in court on an arbitrable dispute or otherwise does not cooperate with the arbitration proceedings.⁴⁹ When considering whether to enforce an arbitration agreement, a court must determine: 1) whether there is a valid written agreement to arbitrate and 2) whether the dispute falls within the scope of the arbitration agreement.⁵⁰ “Any doubts about the scope of an

43. See *Kulukundis Shipping Co. v. Amtorg Trading Corp.*, 126 F.2d 978 (2d Cir. 1942) (discussing the history of the hostility of courts to arbitration).

44. TO VALIDATE CERTAIN AGREEMENTS FOR ARBITRATION, H.R. REP. NO. 68-96, at 1-2 (1924); TO MAKE VALID AND ENFORCEABLE CERTAIN AGREEMENTS FOR ARBITRATION, S. REP. NO. 536, at 1-2, 2-3 (1924).

45. See, e.g., *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983); Wauk, *supra* note 3, at 2064.

46. Wauk, *supra* note 3, at 2063.

47. Because it is federal law, it “preempts state law and is to be applied by both federal and state courts.” *Id.* at 2064.

48. 9 U.S.C. §§ 1-2 (2005).

49. *Id.*

50. Section 2, titled “Validity, irrevocability, and enforcement of agreements to arbitrate,” reads:

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a *controversy thereafter arising out of such contract or transaction*, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 2 (emphasis added). See also *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Hovey*, 726 F.2d 1286, 1288 (8th Cir. 1984).

arbitration clause must be resolved in favor of arbitrability,” given the strong federal policy favoring arbitration.⁵¹

If the court determines that a dispute is subject to arbitration as agreed in the contract, it has two principal ways of enforcing the arbitration clause. It can either stay the court proceedings pending arbitration under Section 3,⁵² or issue an order compelling arbitration under Section 4.⁵³ In other words, if a party to a contract containing an arbitration clause brings an action in court, the other party may petition the court to either “stay the trial of the action” pending arbitration of the dispute or petition the court for an order directing the arbitration to proceed in the manner agreed. Thus, it is clear that the FAA reserves certain powers to the courts when the dispute is arbitrable.⁵⁴ The question then becomes whether courts can exercise other powers not exclusively reserved to them by the Act, specifically their equitable power of granting provisional remedies over arbitrable disputes.

51. Wauk, *supra* note 3, at 2065. See also *Moses*, 460 U.S. at 24-25 ([Q]uestions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration.”).

52. Section 3, titled “Stay of proceedings where issue therein referable to arbitration” reads:

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties *stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement*, providing the applicant for the stay is not in default in proceeding with such arbitration.

9 U.S.C. § 3 (2005) (emphasis added).

53. Section 4 reads:

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an *order directing that such arbitration proceed in the manner provided for in such agreement* . . .

9 U.S.C. § 4 (2005) (emphasis added).

54. Other powers exclusively reserved to the courts include: enforcement of any summons issued by an arbitrator, enforcement of judgments by the arbitrator, vacating arbitration awards in cases of fraud or other misconduct, modification or correction of an award by the arbitrator in certain specified circumstances (reason of legal error is not a mentioned circumstance). 9 U.S.C. §§ 7, 9-11 (2005).

Under California state law, parties can seek a preliminary injunction to maintain the status quo pending arbitration.⁵⁵ Federal law is less clear.⁵⁶

IV. MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.

Merrill Lynch, Pierce, Fenner & Smith, Inc. (Merrill Lynch), a Delaware corporation, “is one of the world’s leading financial management and advisory companies,”⁵⁷ doing business in investment banking.⁵⁸ Founded in 1914, it now has offices in thirty-six countries and has total client assets of approximately \$1.6 trillion.⁵⁹ As of 2004, it had over 50,000 employees and drew a net revenue of about \$22 billion.⁶⁰ Merrill Lynch prides itself on its client relationships, seeing them as one of its greatest competitive assets.⁶¹

A. “Account Executive Trainee Agreement”

Because it is “difficult to restrict information access to only certain employees [when] the information is of a type that must be used on a daily basis by all employees or in close quarters,” companies adopt and enforce confidentiality policies and agreements.⁶² In the case of Merrill Lynch, it has its account executives sign an “Account Executive Trainee Agreement.”⁶³ By signing this agreement, the employee agrees that the names and addresses of clients are the property of Merrill Lynch and that

55. CAL. CIV. PROC. CODE § 1281.8(b) (West Supp. 2005) (“A party to an arbitration agreement may file . . . an application for a provisional remedy in connection with an arbitrable controversy, but [usually] only upon the ground that the arbitration award . . . may be rendered ineffectual without provisional relief.”). In some situations where a clear right to relief has been demonstrated, and a showing made that irreparable injury will result unless preliminary injunctive relief is granted, the court may grant such relief even though the parties have agreed to submit their underlying dispute to arbitration. The Uniform Arbitration Act also explicitly allows courts to grant provisional remedies in circumstances in which the arbitration award would otherwise be ineffectual but forbids the courts from deciding the merits of the case. UNIF. ARBITRATION ACT § 8 (2000); Wauk, *supra* note 3, at 2065-66 (1997).

56. See Kamaiko, *supra* note 33, at 263.

57. See Merrill Lynch’s website, http://www.ml.com/index.asp?id=7695_8134 (last visited Jan. 10, 2006). On the Fortune 500 list, Merrill Lynch is ranked 58. *Id.*

58. “As an investment bank, the company is a leading global underwriter of debt and equity securities and strategic advisor to corporations, governments, institutions and individuals worldwide.” *Id.*

59. *Id.*

60. *Id.*

61. “We’re growing our business by helping clients grow theirs.” *Id.*

62. Stevens, *supra* note 15, at 251 n.20.

63. See, e.g., Merrill Lynch, Pierce, Fenner & Smith, Inc. v. DeCaro, 577 F. Supp. 616, 617 (W.D. Mo. 1983).

[Vol. 6: 1, 2006]

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

during and after his employment he cannot communicate client information nor take client records (or duplications thereof) from Merrill Lynch offices.⁶⁴ The employee further agrees that he will not solicit Merrill Lynch clients for a year, for any reason, if he leaves the employ of Merrill Lynch.⁶⁵ This clause is referred to as the “nonsolicitation clause” of the employment contract, protecting trade secrets.⁶⁶

B. The Dispute

The account executive (or other similar employee) either resigns or is terminated from employment with Merrill Lynch and joins a rival investment firm that competes directly with Merrill Lynch.⁶⁷ Merrill Lynch then files a complaint in a district court alleging that, prior to termination of the defendant’s employment, the defendant employee obtained and removed confidential information concerning Merrill Lynch’s clients from its business premises, and used this information to solicit its customers in an attempt to have those customers switch their investment accounts from Merrill Lynch to the rival investment firm.⁶⁸ The complaint further alleges that such activity violates the defendant’s employment contract (such as the “Account Executive Trainee Agreement”).⁶⁹ Merrill Lynch usually brings a breach of contract claim, breach of fiduciary duty, and violation of a state code section against the employee, along with a tortious interference with contract claim against the competing firm.⁷⁰ It also asks for “a temporary restraining order, a preliminary and permanent injunction, damages, [and/or]

64. See, e.g., *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. DeCaro*, 577 F. Supp. 616, 618 n.1 (W.D. Mo. 1983); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. District Court of Denver*, 672 P.2d 1015, 1016 n.1 (Colo. 1983). This is usually paragraph 1 of the agreement. In *District Court of Denver*, the employee was a securities broker, not an account executive. However, as such, he was still required to sign the same agreement. *District Court of Denver*, 672 P.2d at 1016.

65. This is usually paragraph 2 of the agreement. See, e.g., *DeCaro*, 577 F. Supp. at 618 n.2; *District Court of Denver*, 672 P.2d at 1016 n.2.

66. See, e.g., *Applebaum v. Applebaum*, 823 N.E.2d 1074, 1078 (Ill. App. 2005).

67. See, e.g., *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Hovey*, 726 F.2d 1286, 1287 (8th Cir. 1984).

68. See, e.g., *DeCaro*, 577 F. Supp. at 618.

69. See *id.*

70. See, e.g., *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bradley*, 756 F.2d 1048, 1051 (4th Cir. 1985).

a constructive trust.”⁷¹ Its main requested relief is an injunction “to prevent [the former employees] from further use of the confidential information and any further solicitation of [its] customers.”⁷²

After termination, the employee who has allegedly solicited and/or agreed to offer services to former Merrill Lynch clients in breach of his employment agreement, will respond to the motions by moving the court to order the parties to arbitrate their disputes and to stay the action pending the arbitration, pursuant to the FAA.⁷³ In order to stay the proceedings and compel arbitration, the court has to find that arbitration is proper because the employment contract provides for arbitration of the subject matter of the complaint.⁷⁴

1. Arbitration Clause?

Some of these employee agreements contain express arbitration clauses, while others are silent as to arbitration. Where the agreement has an arbitration clause, it provides that “any controversy [with] Merrill Lynch arising out of [the executive’s] employment or the termination of [his] employment . . . shall be settled by arbitration at the request of either party in accordance with . . . the New York Stock Exchange [(NYSE)].”⁷⁵ Even without this express arbitration clause, the dispute alleging breach of contract in violation of the non-solicitation agreement has been ruled to be subject to arbitration because, as a condition of their employment, account executives sign a document known as a “U-4 Form” as required by the NYSE.⁷⁶ Both the U-4 form and NYSE Rule 347 provide for arbitration of

71. See, e.g., *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Shubert*, 577 F. Supp. 406, 406 (M.D. Fla. 1983). For purposes of this paper, only preliminary injunctions and damages will be discussed.

72. See, e.g., *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Thomson*, 574 F. Supp. 1472, 1473 (E.D. Mo. 1983).

73. See, e.g., *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dutton*, 844 F.2d 726, 727 (10th Cir. 1988). The FAA applies to written arbitration provisions in “a contract evidencing a transaction involving commerce.” 9 U.S.C. § 2 (2000). The “Account Executive Trainee Agreement” between Merrill Lynch and its employee involves interstate commerce. *Thomson*, 574 F. Supp. at 1475.

74. In other words, the court has to make sure that Sections 1-4 of the FAA are satisfied, meaning 1) an express written agreement to arbitrate exists; 2) the subject matter of the dispute is within the scope of arbitrable issues; and 3) the agreement to arbitrate has been breached. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Hovey*, 726 F.2d 1286, 1288 (8th Cir. 1984). Once it does so, it has to “stay its hand” and move all matters to arbitration. *Id.* at 1289. This is where the courts are split as to whether they still have the authority to review preliminary injunction requests.

75. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. DeCaro*, 577 F. Supp. 616, 618 n.3 (W.D. Mo. 1983). This is usually paragraph 5 of the agreement. *Id.*

76. See, e.g., *Thomson*, 574 F. Supp. at 1474-75. Both the applicant and the sponsoring NYSE member (here Merrill Lynch) have to sign this form. *Id.* As members of the NYSE, they agree to comply with the NYSE rules, including the dispute resolution procedures detailed in Rule 347. *Id.*

controversies “arising out of the employment or termination of employment” between the employee and any member organization.⁷⁷ Thus, the courts always find that an enforceable written arbitration agreement exists, even without an express clause.

Before Merrill Lynch inserted an express arbitration clause in the non-solicitation agreement, it argued that the violation of the solicitation agreement was not within the scope of arbitrable issues because the events surrounding the dispute took place *after* the employee’s termination.⁷⁸ However, the courts have ruled that the post-employment breach of contract claim for violating the non-solicitation agreement is arbitrable because it is within the scope of the arbitration clause of the trainee agreement and NYSE Form U-4.⁷⁹ They have rejected the temporal argument and have held that the dispute is “integrally related to the terms and conditions of [the] employment contract” although the dispute arises over actions taken after the termination of the employment.⁸⁰ Accordingly, a dispute involving post-termination violation of the solicitation clause is an arbitrable one, “arising under” the contract arbitration clause and NYSE Rule 347.⁸¹

Once an arbitration proceeding has commenced, Merrill Lynch then has concerns about the status quo until an arbitrator is appointed.⁸² In such a posture, Merrill Lynch initiates an injunction action to enjoin the employee’s

Under the NYSE rules, Merrill Lynch cannot employ the executive as a registered representative without adhering to Rule 347 or signing the U-4 forms. *See* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Hovey, 726 F.2d 1286, 1288 (8th Cir. 1984).

77. *Thomson*, 574 F. Supp. at 1474-75.

78. *See* Smith v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 575 F. Supp. 904, 905 (N.D. Tex. 1983); *Hovey*, 726 F.2d at 1289. Merrill Lynch probably argued this in order to consolidate its request for preliminary injunctions with that of damages in federal district court, where the court will not have trouble considering the injunction question where no arbitration is pending.

79. *Hovey*, 726 F.2d at 1290-91. This is the case even if there is a state choice of law clause which makes the violations arising after termination of employment fall outside the arbitration provisions of the agreement or NYSE rules. *See e.g.*, *DeCaro*, 577 F. Supp. at 619 n.7 (stating that “[w]hen the arbitration agreement satisfies the requirements of the [Federal] Arbitration Act then federal law applies to the question of arbitrability even though the parties have selected New York or any other state law to control the interpretation and enforcement of their agreement”) (citing Bell Canada v. ITT Telecomms. Corp., 563 F. Supp. 636, 638 (S.D.N.Y. 1983)).

80. *Smith*, 575 F. Supp. at 905. *See also Hovey*, 726 F.2d at 1290 (“The language of the agreement is broad and the term ‘arising out of’ contemplates that for some controversies the arbitration agreement will survive the employment relationship.”). Remember also that the Supreme Court has ruled that any doubts about the scope of an arbitration clause must be resolved in favor of arbitrability. *See supra* note 51 and accompanying text.

81. *See Hovey*, 726 F.2d at 1290-91.

82. *See, e.g.*, Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dutton, 844 F.2d 726, 727 (10th Cir. 1988).

extension of services to clients pending disposition of the matter by arbitration.⁸³ It argues that the court “should at least enjoin the employee from continuing to violate the employment contract while arbitration proceeds.”⁸⁴ It asserts that “without an injunction pending arbitration it will be left without an adequate remedy at law and will be irreparably harmed.”⁸⁵ In essence, Merrill Lynch argues that the traditional test for issuing a preliminary injunction is satisfied in this situation⁸⁶ and that the courts have the authority to issue one under the FAA.

V. DO COURTS HAVE THE AUTHORITY TO ISSUE A PRELIMINARY INJUNCTION PENDING ARBITRATION?

A. *The Circuit Courts Are Split*

The FAA applies to the Merrill Lynch controversies because the agreement involves interstate commerce, there is a valid enforceable arbitration agreement, and the specific dispute falls within the scope of arbitrable issues.⁸⁷ However, there is a split as to whether the FAA (specifically Sections 3 and 4) absolutely precludes a court from granting one party a preliminary injunction to preserve the status quo pending arbitration of a dispute that is clearly subject to arbitration. The majority of the federal circuit courts addressing the issue have held that the FAA does not preclude a district court from issuing a preliminary injunction in an arbitrable dispute.⁸⁸ The First, Second, Third, Fourth, Fifth, Sixth, Seventh, and Ninth Circuits have ruled that a court may grant a preliminary injunction in certain situations,⁸⁹ while the Eighth and Tenth Circuits have held that

83. See *Thomson*, 574 F. Supp. at 1478.

84. *Id.*

85. *Id.*

86. See *supra* section II(B) discussing the elements of the traditional test.

87. See *supra* section IV(B) discussing why the FAA applies to the Merrill Lynch cases.

88. See *Performance Unlimited, Inc. v. Questar Publishers, Inc.*, 52 F.3d 1373, 1378-79 (6th Cir. 1995); *Ortho Pharm. Corp. v. Amgen, Inc.*, 882 F.2d 806, 812 (3d Cir. 1989); *PMS Distrib. Co. v. Huber & Suhner, A.G.*, 863 F.2d 639, 642 (9th Cir. 1988); *Teradyne, Inc. v. Mostek Corp.*, 797 F.2d 43, 51 (1st Cir. 1986); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bradley*, 756 F.2d 1048, 1052 (4th Cir. 1985); *Roso-Lino Beverage Distribs., Inc. v. Coca-Cola Bottling Co.*, 749 F.2d 124, 125 (2d Cir. 1984); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Scott*, No. 83-1480, 1983 WL 407976, at *1 (10th Cir. May 12, 1983) (unpublished opinion).

89. See, e.g., *Teradyne, Inc.*, 797 F.2d at 51; *Bradley*, 756 F.2d at 1052; *Roso-Lino Beverage Distribs., Inc.*, 749 F.2d at 125; *Sauer-Getriebe KG v. White Hydraulics, Inc.*, 715 F.2d 348, 351 (7th Cir. 1983), *cert. denied*, 464 U.S. 1070 (1984); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dutton*, 844 F.2d 726, 728 (10th Cir. 1988). In one Fifth Circuit case, *RGI, Inc. v. Tucker & Assoc., Inc.*, the court suggested that the availability of a status quo injunction may be dependent on a

injunctive relief is impermissible unless clearly contracted for by the parties, reasoning, among other things, that the congressional purpose in allowing arbitration is to encourage the speedy arbitration of disputes.⁹⁰

In sum, courts either rule that judicial preliminary injunctions are absolutely prohibited under the FAA, unless specifically contemplated by the arbitration agreement,⁹¹ or that they have jurisdiction to grant an injunction under the FAA even where the arbitration agreement is silent on judicial provisional remedies.⁹²

B. The Supreme Court Has Not Addressed This Issue

The Supreme Court avoids reviewing the issue of the availability of provisional relief under the FAA due to “the passage of time and decision of arbitrators.”⁹³ That is, “[b]y the time trial and appeals court proceedings are complete and a certiorari petition has been filed, the vast majority of commercial arbitrations are complete or settled . . . [making it] unlikely that the Court will have an opportunity to address [this] matter in the normal course of commercial arbitration.”⁹⁴ In fact, the Supreme Court has denied certiorari on this issue, despite Justice White’s dissent on the denial of certiorari in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. McCollum*.⁹⁵

VI. THE CASES

Because jurisdictions are split as to whether courts have authority under the FAA to grant injunctive relief in a dispute that is subject to arbitration,

contractual clause contemplating maintenance of the status quo pending arbitration. *RGI, Inc. v. Tucker & Assoc., Inc.*, 858 F.2d 227, 230 (5th Cir. 1988).

90. See, e.g., *Hovey*, 726 F.2d at 1291-92; *Scott*, 1983 WL 407976, at *1.

91. I have found no cases where the court refuses to entertain an application for injunctive relief pending arbitration even where the agreement clearly contemplates it.

92. This is where some courts differ in the test they apply for issuing a preliminary injunction pending arbitration. See *supra* note 25, commenting on the different tests but focusing on the traditional test for preliminary injunctions.

93. *Fraser, III, supra* note 2, at 532.

94. *Id.*

95. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. McCollum*, 469 U.S. 1127, at 1130 (1985):

The importance of resolving the question of the availability of preliminary injunctive relief in cases subject to arbitration is underscored by the confusion over the issue among the Federal District Courts—courts whose decisions on the issuance of preliminary relief are often effectively final, given that the imminence of arbitration may sharply limit a party’s incentives to appeal an adverse decision.

Merrill Lynch has experienced unnecessary confusion as to where, when, and how its trade secrets are protected.⁹⁶ The Merrill Lynch cases illustrate the impact this indecision is having on companies' rights to protect their trade secrets and control their ownership interests.

A. *The Decisions*

1. Should Preliminary Injunctions be Considered?

Courts that have refused to hear motions for preliminary injunctions pending arbitration have done so in light of the fact that the employment agreements of Merrill Lynch had not expressly contemplated judicial preliminary injunctions.⁹⁷ These courts believe that once a determination is made that a controversy is arbitrable under the FAA, its role is limited only to compelling arbitration or staying the proceedings pending arbitration, and it cannot do anything further on the merits.⁹⁸ These courts have looked to the language of Section 3 of the FAA (the stay clause) and concluded that because it is stated in "mandatory terms," the court cannot "concern itself with the merits of the dispute" once a stay is issued.⁹⁹ That is, if the court is satisfied that the dispute is arbitrable, "the court . . . shall . . . stay the trial of the action until such arbitration has been had . . ."¹⁰⁰ The courts have

96. See *McCullum*, 469 U.S. at 1129.

97. In fact, these courts have differentiated cases in which the courts have retained their equitable power to issue an injunction by stating that the contracts in those cases contained injunction clauses or at minimum, contemplated maintenance of the status quo pending arbitration. See e.g., *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. DeCaro*, 577 F. Supp. 616, 623 (W.D. Mo. 1983) (comparing *Erving v. Virginia Squires Basketball Club*, 468 F.3d 1064 (2d Cir. 1972), and *Guinness-Harp Corp. v. Joseph Schlitz Brewing Co.*, 613 F.2d 468 (2d Cir. 1980)). See also *Merrill Lynch, Pierce, Fenner & Smith v. Hovey*, 726 F.2d 1286, 1291 (8th Cir. 1984) ("The parties have not alleged that the contract provides for or contemplates injunctive relief. . ."). See *supra* section VII(A) discussing reasons as to why this express clause requirement is illogical.

98. See, e.g., *Merrill Lynch, Pierce, Fenner & Smith v. Thomson*, 574 F. Supp. 1472, 1478 (E.D. Mo. 1983); *Hovey*, 726 F.2d at 1291; *DeCaro*, 577 F. Supp. at 622-25; *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Maghsoudi*, 682 S.W.2d 593, 595 (Tex. App. 1984) (affirming *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. McCollum*, 666 S.W.2d 604 (Tex. App. 1984)); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Shubert*, 577 F. Supp. 406, 407 (M.D. Fla. 1983). These courts have limited their authority to the powers expressly reserved to them by the FAA, refusing to exercise any unreserved powers.

99. *Thomson*, 574 F. Supp. at 1478. See also *McCullum*, 666 S.W.2d at 605 (The trial court compelled arbitration and in connection with its order staying the case under Section 3 of the FAA, denied plaintiff's request for a temporary injunction without conducting an evidentiary hearing.), *cert. denied*, 469 U.S. 1127 (1985); *DeCaro*, 577 F. Supp. at 624 ("In ruling on the propriety of a stay under section three of the Act, the court is . . . limited to questions pertaining to the making and performance of the arbitration agreement; all other questions are for the arbitrator.").

100. See 9 U.S.C. § 3 (2000) (emphasis added).

interpreted this language to require a stay of all further “proceedings” before the court and not merely the actual “trial” of the action.¹⁰¹ Consequently, because a hearing on a motion for a preliminary injunction is a “proceeding,” these courts refuse to stay the trial but not the hearing.

Proponents of this interpretation have also found support from Section 4 of the FAA. They have argued that because this section presents a situation where the district court would have jurisdiction in the absence of an agreement to arbitrate,¹⁰² a court loses jurisdiction to issue an injunction pending arbitration when such an agreement exists. That is, “the words ‘save for such agreement’ operate to divest the district court of jurisdiction over a dispute [subject to arbitration] . . . except to order arbitration or to exercise other powers explicitly provided for in the FAA.”¹⁰³ However, “neither Section 4 nor any other section of the FAA precisely addresses [this] issue. . . .”¹⁰⁴

The majority of the circuit courts have argued that because Section 3 states only that the court shall stay the “trial” of the action, it does not contain a “clear command abrogating the equitable power of district courts to enter preliminary injunctions to preserve the status quo pending arbitration.”¹⁰⁵ That is, they read the phrase “trial of the action” literally. They turn to the statute’s legislative history and conclude that “nothing in [it] suggests that the word ‘trial’ should be given a meaning other than its common and ordinary usage: the ultimate resolution of the dispute on the merits.”¹⁰⁶ This is because “Congress [would] know[] how to draft a statute which addresses all actions [or all proceedings] within the judicial power.”¹⁰⁷ Also, Congress would not have enacted a statute “intended to have the *sweeping effect* of stripping the federal judiciary of its equitable powers in all arbitrable commercial disputes without undertaking a comprehensive discussion and evaluation of the statute’s effect.”¹⁰⁸ That is, Congress did

101. See *DeCaro*, 577 F. Supp. at 622-23. Of course, “some courts have not interpreted section three as mandating a cessation of all judicial activity during pendency of arbitration.” *Id.* at 623. See *infra* notes 105-109 and accompanying text.

102. See *supra* note 52 and accompanying text. See also *Blumenthal v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 910 F.2d 1049, 1052-53 (2d Cir. 1990).

103. *Blumenthal*, 910 F.2d at 1052.

104. *Id.* at 1053.

105. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bradley*, 756 F.2d 1048, 1052 (4th Cir. 1985).

106. *Id.*

107. *Id.*

108. *Id.* (emphasis added).

not intend to “tie a district court’s hands while one party . . . deliberately and irreversibly altered the status quo and thereby deprived the other party of a meaningful arbitration process.”¹⁰⁹

Courts have also rejected the contention that Section 4 of the FAA divests the district courts of jurisdiction to issue injunctions pending arbitration, arguing that this interpretation is inconsistent with judicial precedent and congressional intent.¹¹⁰ They have argued that a court does not lose jurisdiction to issue injunctions when an arbitration agreement is present, despite the fact that the statute recognizes a situation where a district court would have jurisdiction in the absence of an arbitration agreement.¹¹¹

A minority of courts have argued that exercising the equitable power of granting injunctions will “violate not only ‘the plain meaning of the statute but also the unmistakably clear Congressional purpose that the arbitration procedure, once started by the parties to a contract, be speedy and not subject to delay and obstruction in the courts.’”¹¹² If the district courts had authority to grant an injunction on an issue that is the subject matter of arbitration, it would “add yet another weapon in a litigant’s arsenal of delaying tactics.”¹¹³ Judicial consideration of injunctions is also said to be a “duplication of efforts” which is contrary to the FAA’s pre-supposition of “a dispositive adjudication by arbitrators rather than the courts.”¹¹⁴ Thus, “the delay and the additional resources required [for duplicate action] deprive the party demanding arbitration of the benefits of the contracted for arbitration agreement.”¹¹⁵

109. *Id.* at 1054.

110. *See, e.g.*, *Blumenthal v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 910 F.2d 1049, 1053-54 (2d Cir. 1990).

111. *Id.* at 1052-53.

112. *Merrill Lynch, Pierce, Fenner & Smith v. Thomson*, 574 F. Supp. 1472, 1478 (E.D. Mo. 1983) (citing *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 (1967)). *See also* *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. DeCaro*, 577 F. Supp. 616, 624-25 (W.D. Mo. 1983) (“Arbitration was viewed as a quick means to resolve disputes. Allowing a party to pursue injunctive relief where arbitration is appropriate and has been demanded by the other party can only serve to delay the arbitration process.”).

113. *Thomson*, 574 F. Supp. at 1479. The court illustrated this argument by suggesting that even if a recalcitrant party knows its dispute is subject to arbitration . . . it will file a motion for a preliminary injunction in federal district court in an attempt to delay arbitration and divert its opponent’s attention and resources away from expeditiously presenting the substance of the controversy to the arbitrators.

Id.

114. *Id.*

115. *DeCaro*, 577 F. Supp. at 625. *See also Thomson*, 574 F. Supp. at 1478 (“[Court] involvement would deny the party seeking arbitration the benefit of its bargain, which is to have the controversy resolved by arbitrators.”).

The courts that have reserved power to grant this equitable relief have argued that it “permit[s] a district court to preserve the meaningfulness of the arbitration through preliminary injunction[s],” furthering the pro-arbitration policies reflected in Supreme Court decisions.¹¹⁶ Due to the fact that the Supreme Court has identified Congress’ intent in passing the FAA as one meant to enforce private valid agreements to arbitrate, “[t]he issuance of [a preliminary] injunction to preserve the status quo . . . fulfills the court’s obligation under the FAA.”¹¹⁷ Moreover, the appropriateness of preliminary injunctions is particularly apparent “where arbitration would be futile if the status quo is not preserved pending the arbitrator’s determination.”¹¹⁸

Courts can prevent “delay tactics” by the moving party by ordering expedited arbitration and issuing an injunction of limited duration.¹¹⁹ Because the moving party is seeking to enjoin the opposing party from committing a certain act, there is no reason why that party would want to delay the hearing on the motion for a preliminary injunction. If the court orders immediate arbitration, at least as to the issue of an injunction, it will eliminate the moving party’s reliance on the courts for such relief, thereby keeping the courts within their “limited” jurisdiction. In fact, the Tenth Circuit Court in *Dutton* allowed the district court to enter a preliminary injunction and “[a]t the same time, the [district] court ordered the parties to ‘proceed with haste to arbitration’”¹²⁰ The Second and Fourth Circuits also allowed the district courts to order an expedited arbitration before the NYSE while temporarily enjoining the plaintiffs from using Merrill Lynch’s customer lists and records.¹²¹

116. *Blumenthal*, 910 F.2d at 1053. See also *Bradley*, 756 F.2d at 1054.

117. *Blumenthal*, 910 F.2d at 1053-54. “A district court must ensure that the parties get what they bargained for—a meaningful arbitration of the dispute.” *Id.* at 1053. See also Elizabeth A. Phillips, *Injunctions Pending Arbitration: Do the Courts Really Have Jurisdiction?*, 1991 J. DISP. RESOL. 381, 394-95 (1991):

The FAA was enacted to ensure that arbitration agreements be given full effect. If the courts are not vested with the power to issue preliminary injunctive relief pending arbitration, then in some situations the entire spirit of the Act is crushed. A party should not be allowed to irredeemably alter the status quo in such a manner that would render the arbitrator’s ultimate decision meaningless.

118. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. District Court of Denver*, 672 P.2d 1015, 1018 (Colo. 1983). See also *Bradley*, 756 F.2d at 1053-54 (Fourth Circuit’s “hollow formality” inquiry).

119. See discussion *infra* Section VI.6.A.2.b addressing the significance of the duration of preliminary injunctions.

120. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dutton*, 844 F.2d 726, 727 (10th Cir. 1988).

121. *Blumenthal*, 910 F.2d at 1051; *Bradley*, 756 F.2d at 1050.

Another reason some courts have felt uncomfortable entertaining a request for a preliminary injunction is because the traditional test for such injunctions requires the courts to consider the likelihood of success on the merits.¹²² This means that the court has to consider issues that will also be considered by the arbitrators in rendering a final decision because the matter of the preliminary injunction is part of the underlying controversy subject to arbitration.¹²³ This “deep” involvement in the factual issues of the case is said to “deny the party seeking arbitration the benefit of its bargain, which is to have the controversy resolved by the arbitrators.”¹²⁴ Furthermore, the courts are apprehensive about the possibility that the arbitrators will be influenced by these findings when ruling on the issues themselves.¹²⁵ Thus, “if courts begin to hear and rule on preliminary injunction motions pending arbitration it could expand their role”¹²⁶ to an extent not visualized by Congress under the Arbitration Act.¹²⁷

When seeking an injunction, Merrill Lynch argues that the status quo would be changed if the former employee was allowed to solicit its clients.¹²⁸ Although this position has merit, if the injunction is allowed to stand, the former employee would have to return all client information to its employer and refrain from offering services to former clients of Merrill Lynch even though the question of whether this conduct is a breach of the

122. Prong 1 of the traditional test.

123. This is inevitable in the Merrill Lynch cases because the issues to be addressed by the court to determine the appropriateness of injunctive relief (to enjoin solicitation of clients) are the same ones that would ultimately be determinative of the merits of the dispute (whether the solicitation was a breach of the agreement). See *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. DeCaro*, 577 F. Supp. 616, 624 (W.D. Mo. 1983) (“The merits of an arbitrable dispute are for the arbitrator to decide. A court, however, in ruling on a motion for preliminary injunction must consider the merits of the movant’s claim and his chances for success.”).

124. *Merrill Lynch, Pierce, Fenner & Smith v. Thomson*, 574 F. Supp. 1472, 1478 (E.D. Mo. 1983). An adjudication of the claim for injunctive relief is said to “disserve the public interest in arbitration where the adjudication would necessitate a ruling on the major issues, which are subject to arbitration.” *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Shubert*, 577 F. Supp. 406, 407 (M.D. Fla. 1983).

125. See e.g., *DeCaro*, 577 F. Supp. at 624 (“The Court’s findings . . . would be cited by the parties and could interfere with the arbitrator’s independent determination of the issues.”); *Shubert*, 577 F. Supp. 407 (“Were this court to adjudicate the probability of the . . . success of the merits of the very issues which are subject to arbitration, the judicial process might well interfere with the ability of the arbitration panel to fashion appropriate relief . . .”). But see *Beverage Distribs., Inc. v. Olympia Brewing Co.*, 395 F.2d 850, 850 (9th Cir. 1968) (“[T]emporary injunction does not necessarily reflect what the ultimate disposition [of suit] will be.”).

126. *DeCaro*, 577 F. Supp. at 624.

127. *Id.* (“Congress did not visualize the courts having even this large a role under the Arbitration Act. Furthermore, when a court becomes this deeply enmeshed in an arbitrable dispute it is undermining the purpose of the Act.”).

128. *Thomson*, 574 F. Supp. at 1478.

[Vol. 6: 1, 2006]

PEPPERDINE DISPUTE RESOLUTION LAW JOURNAL

employment agreement would be the central issue at arbitration. In other words, the injunction is affecting the precise conduct that is the arbitrable issue—whether the servicing of Merrill Lynch clients was in violation of the restrictive covenant. In effect, this constitutes a temporary “win” for Merrill Lynch in enjoining the former employee. It also means that the court is delving into the merits of the case. If the injunction is not granted, however, and Merrill Lynch loses clients as a result, the damage may be so irreparable as to render an arbitration decision in favor of Merrill Lynch ineffectual, especially if money damages do not compensate for the loss of clients.¹²⁹ Knowledge of trade secrets such as client information cannot be “reversed.” Thus, irrespective of the final arbitration decision, the court’s holding would in essence mean that Merrill Lynch had effectively already lost the case, given that such information is no longer “secret.”

One district court that denied a hearing on a preliminary injunction nevertheless admitted that “[t]he problem of stockbrokers soliciting former clients is endemic to the stockbroking industry.”¹³⁰ However, even in recognition of this fact, it refused to grant an injunction, leaving the issue to the NYSE arbitrators because they “have arbitrated many of these disputes” and “are more familiar with industry custom and practice and they possess expertise in these matters that the courts lack.”¹³¹ The “expertise” of the arbitrators, however, is of no use if they conclude that there was a breach of the employment agreement but cannot redress the damages caused by the employee’s solicitation of clients pending arbitration.¹³² In addition, if they are “expert” arbitrators as the court contends, then it is unlikely that they will be influenced by the court’s consideration of the merits when issuing an injunction. Because “arbitrators are sworn to render a decision based solely on the evidence presented to them . . . [courts] assume that they perform their task conscientiously.”¹³³

129. See *Thomson*, 574 F. Supp. at 1478 (Merrill Lynch asserts that it “will be left without an adequate remedy at law and will be irreparably harmed.”).

130. *Id.* at 1476.

131. *Id.* Courts have also stated that “[h]aving the arbitrator rule on the necessity of a preliminary injunction keeps the court’s role to a minimum, avoids unnecessary delay and duplication, and interjects greater expertise into the decision making process.” *DeCaro*, 577 F. Supp. at 625.

132. See *infra* notes 149-54 and accompanying text discussing the inadequacy of money damages for infringement of trade secrets.

133. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bradley*, 756 F.2d 1048, 1054 (4th Cir. 1985).

In sum, some courts conclude that the principle of judicial economy, the strong judicial policy favoring arbitration expressed by the Supreme Court, the plain language of the FAA, and the policies embodied in the FAA warrant a stay of “all proceedings” pending arbitration, including a preliminary injunction hearing. However, the majority of courts have held that district courts do have the authority to consider the merits of a requested preliminary injunction not only when the contract expressly so provides, but even when the contract is silent as to this issue.

2. How Should Preliminary Injunctions be Considered?

a) Application

Admittedly, the ‘likelihood of prevailing on the merits’ inquiry affects the extent to which the courts consider the merits of the case. Courts that have refused to grant injunctions pending arbitration have used this as a reason, stating that this interferes with the arbitrators’ exclusive right to consider the merits and ultimately conflicts with the purposes of the FAA. In order to comply with the limits placed on their authority by the FAA, courts should apply the least intrusive form of the prong, namely the mere likelihood standard as applied by the Fourth Circuit.¹³⁴ A mere likelihood of prevailing on the merits should mean “simply raising a ‘fair question’ or showing a ‘better than negligible chance’ of prevailing.”¹³⁵

The Fourth Circuit in *Bradley* held that a district court has the discretion to grant a preliminary injunction to preserve the status quo pending arbitration if the enjoined conduct would render that process a “hollow formality.”¹³⁶ The arbitration process would be a “hollow formality” where the rendered arbitral award could not “return the parties substantially to the *status quo ante*.”¹³⁷ The court realized that it “may be impossible for the arbitral award to return the parties substantially to the status quo ante because the prevailing party’s damages may be too speculative.”¹³⁸ In the case of Merrill Lynch, a non-solicitation clause “requires immediate application to have any effect” especially when an account executive breaches his employment contract by soliciting former clients.¹³⁹ The court agreed that any delay in issuing an injunction would be “unsatisfactory”

134. *See id.* at 1054.

135. Schaller, *supra* note 18, at 13 (internal citations omitted).

136. *Bradley*, 756 F.2d at 1053.

137. *Id.* at 1053-54.

138. *Id.* at 1054.

139. *Id.*

because the damage would already have been done—“[t]he customers cannot be ‘unsolicited.’”¹⁴⁰ Once the court determined that Merrill Lynch’s situation passed the hollow formality inquiry, then it applied the “balance of hardships” test (traditional test) before granting an injunction. When applying this test, the *Bradley* court used the “mere” likelihood standard for determining success on the merits.¹⁴¹

When courts contend that considering the merits of the case at any level will interfere with the arbitrator’s decisions, they fail to recognize that the employee’s alteration of the conditions pending arbitration may interfere with the arbitrator’s award in the event they find for Merrill Lynch. The employees will already have transferred their accounts, and the projected client assets from these accounts will be unquantifiable and too speculative to render a compensatory damage award.¹⁴² The courts can avoid considering the essential merits of the dispute when awarding injunctions by applying a slightly different test—that is, by only requiring a showing of mere likelihood as opposed to “substantial” likelihood, or exclusively adopting the Fourth Circuit’s “hollow formality” test.¹⁴³ At least this way, they can stay within the limits set on their jurisdiction by the FAA.

When Merrill Lynch finds itself in a jurisdiction founded on diversity of citizenship, it has to remember that while state law doesn’t apply when determining arbitrability,¹⁴⁴ it does when it comes to implementing the preliminary injunction test.¹⁴⁵ Therefore, in addition to making sure that the district court will hold a hearing on the motion for the injunction, it must make sure that the law of that state (or the chosen state in a choice of law clause) will weigh the factors of the four-part test in its favor. For example, in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. De Liniere*, the court, although it had authority to consider a preliminary injunction, denied the motion because the law of that state, as it related to restrictive covenants,

140. *Id.*

141. *Id.*

142. Where courts are reluctant to grant injunctions merely to preserve conditions pending arbitration of a dispute, they cannot argue that the employee’s alteration of conditions does not necessarily interfere with the arbitral process.

143. The Second Circuit also utilized this “hollow formality” inquiry in *Blumenthal v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 910 F.2d 1049, 1053 (2d Cir. 1990).

144. *See* *Merrill Lynch, Pierce, Fenner, & Smith, Inc., v. Salvano*, 999 F.2d 211, 214 n.3 (7th Cir. 1993).

145. *See, e.g.,* *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. De Liniere*, 572 F. Supp. 246, 247 (N.D. Ga. 1983) (“Because [Merrill Lynch’s] jurisdiction is founded on diversity of citizenship of the parties, the Court must examine the law of Georgia as it relates to [restrictive] covenants. . . .”)

was unclear as to what makes a non-solicitation clause “reasonable” and as a result, it could not determine Merrill Lynch’s “substantial likelihood of prevailing on the merits.”¹⁴⁶ It is unclear whether the court in *De Liniere* was considering each factor of the preliminary injunction test to determine whether it had the authority to grant the motion or whether it was applying the test because it assumed it had such authority. Either way, the court denied the motion for the preliminary injunction after considering each part of the test.¹⁴⁷ As noted above, it was unable to consider the ‘substantial likelihood of prevailing on the merits’ prong because the state law was unclear.¹⁴⁸

Also, in addressing the possibility of “irreparable injury to the movant,” the *De Liniere* court found that any injury caused could be “adequately redressed with money damages for breach of contract,” even if the harm was loss of business.¹⁴⁹ Conversely, the irreparable injury is not the loss of business momentum, but rather the disclosure or destruction of trade secrets that are vital to the company’s financial well-being. The Fourth Circuit has declared that “irreparability of harm” includes “the impossibility of ascertaining with any accuracy the extent of the loss.”¹⁵⁰ Calculating money damages for loss of clients is too speculative because there is no way of knowing the clients’ potential account activities with Merrill Lynch. Also, these clients generate more clients through referrals and the possible future revenue derived from this is impossible to calculate.¹⁵¹ It is only through a

146. *Id.* at 247-48. The agreement in this case was different than the standard “Account Executive Trainee Agreement” described above in that this not only prohibited the employee from soliciting clients post-employment, but it prohibited him from “caus[ing] the execution of the purchase or sale of any . . . stock or any . . . bond through any stock exchange or over-the-counter market by or for any of the clients of Merrill Lynch” whom he served while employed. *Id.* at 247. The court stated that the latter part of the provision barring execution of orders from former customers would prohibit the employee from accepting employment from a client who comes to him voluntarily. *Id.* at 248. Because it “prohibits more than the active solicitation or diversion of clients,” that provision was held to be “unreasonable.” *Id.* However, because Georgia’s law was unclear as to whether one unreasonable provision in a restrictive covenant would void the entire covenant, the court was “at a loss” to determine the substantial likelihood of success on the merits under Georgia law. *Id.*

147. *Id.* at 247-48.

148. *Id.* at 248.

149. *Id.* at 249. The court further alleged that “[t]he only possibly irreparable result would be some vaguely defined loss of business momentum, but the Court finds that to be unrealistic in the securities field.” *Id.*

150. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bradley*, 756 F.2d 1048, 1055 (4th Cir. 1985) (citing *Blackwelder Furniture Co. v. Seilig Mfg. Co.*, 206 F.2d 214,216 (2d Cir. 1953)), *quoted in Foundry Servs., Inc. v. Beneflux Corp.*, 206 F.2d 214, 216 (2d Cir. 1953).

151. *Cf. Pacific Aerospace & Electronics, Inc. v. Taylor*, 295 F. Supp. 2d 1188, 1204 (E.D. Wash. 2003) (only future conduct such as threats of disclosure or destruction of employer’s trade secrets constitutes irreparable injury warranting preliminary injunctive relief; such relief is not

preliminary injunction that Merrill Lynch can have any hope of receiving an adequate remedy through arbitration.¹⁵² Moreover, the employee will not be irreparably harmed by this injunction because if it is later found by the arbitration panel that the injunction was “wrongful,” he can recover against the bond for the loss in commission revenue from customers.¹⁵³ For this same reason, the “balance of harms” analysis does not tip in the employee’s favor either.¹⁵⁴

warranted with respect to current active customers that have been solicited because any suffered injury by the employer can be remedied by awarding damages).

152. At least one court has found that because the arbitration panel can issue a judicially enforceable injunction, Merrill Lynch cannot make an adequate showing that irreparable injury will result if injunctive relief is withheld. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Shubert*, 577 F. Supp. 406, 408 (M.D. Fla. 1983). But the court in *District Court of Denver* recognized that without a preliminary injunction, there will not be a dispute left to arbitrate because Merrill Lynch will have suffered “irreparable injury to its business, its reputation and its good will, while being deprived of its ability to proceed in arbitration to protect its interests.” *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. District Court of Denver*, 672 P.2d 1015, 1018 n.7 (Colo. 1983) (quoting Merrill Lynch’s petition for mandamus). “The arbitrator will [then] be placed in the impossible position of attempting to quantify Merrill Lynch’s unquantifiable losses as the only possible remedy in arbitration, if the violation of the agreement is a *fait accompli*.” *Id.*

153. In *Blumenthal*, the district court ordered expedited arbitration before the NYSE and conditioned its issuance of an injunction upon a \$100,000 bond pursuant to FED. R. CIV. P. 65(c), which Merrill Lynch posted. *Blumenthal v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 910 F.2d 1049, 1051 (2d Cir. 1990). When the NYSE arbitrators terminated the preliminary injunction, the employees were able to recover against the bond for wrongful injunction (for damages proximately caused by the injunction). *Id.* at 1056. However, this did not mean that the district court did not have jurisdiction to issue the injunction pending arbitration. *Id.* at 1054. The employees were found to be “wrongfully enjoined” under FED. R. CIV. P. 65(c) only when the arbitrators dissolved the injunction (because it was ultimately found that the employee always had the right to do the enjoined act). *Id.* at 1054 (citing *Medafrika Lina S.P.A. v. Am. W. African Freight Conference*, 654 F. Supp. 155, 156 (S.D.N.Y. 1978)). The amount recoverable against the bond depended on the damages proximately caused by the injunction, including the loss of commissions and long time clients. *Id.* at 1055-56. Thus, it is better to award an injunction then not, because if the arbitration panel later finds that there was no breach, the injunction can be overturned as “wrongful,” triggering damages under the bond.

154. The court in *De Liniere*, however, argues that the employee will be harmed greatly if the injunction is granted because “[i]t would leave him with no client base in a business that thrives on commissions from regular clients” and “damage to [the employee] while he waited ultimately to prevail would be catastrophic as a result of the loss of most of his income.” *De Liniere*, 572 F. Supp. at 249. The court compares the effects of the parties’ loss of income and concludes that “by reason of the differing financial strength of a large brokerage firm and an individual broker,” the effect “bear[s] far more heavily on [the employee] than on Merrill Lynch.” *Id.* However, not only does this ignore the possibility that the wrongfully enjoined employee can recover against a posted bond by Merrill Lynch, it also fails to consider the realities of changing employers. Losing customers is the inevitable result of leaving a company’s employ. Also, the experienced broker will have no trouble finding alternative employment with a rival firm (in fact, this has almost always been the

Finally, the court in *De Liniere* argues that the “public interest”¹⁵⁵ is better served if the employee is not enjoined from serving Merrill Lynch’s former clients because the personal relationship between customer and broker gives rise to fiduciary duties recognized in law, given “the important role of the broker in protecting the financial welfare of his clients.”¹⁵⁶ It is true that the public has a greater interest in being able to choose whether to follow its broker to a new firm or to remain at the old firm. That is why the employment agreement with Merrill Lynch only prohibits *solicitation* of existing clients, and does not bar all execution of services to former clients.¹⁵⁷ The clients are in no way barred from voluntarily transferring their accounts to the new firm. Thus, while “[t]he public’s ability to choose the professional services it prefers is central to the consideration of this criterion of injunctive relief,”¹⁵⁸ the public’s interest in enforcing valid non-solicitation clauses in order to protect trade secrets is also central to this criterion.¹⁵⁹

b) *Duration*

Courts that have refused to grant injunctions pending arbitration have argued that it would inhibit the decision making process and remedies within the jurisdiction of the arbitration panel and would therefore be improper.¹⁶⁰ In order to avoid this, courts can very easily limit the duration of any injunction they decide to issue, especially considering that the injunction should only last as long as necessary to preserve the status quo for the arbitrators’ ultimate decision, and for the award to have any effect.¹⁶¹ For

case where courts have been asked to issue an injunction against the employee) and will not lose most of his income but will derive commission from new clientele at the new firm.

155. The final prong in the traditional injunction test.

156. *Id.* at 249.

157. *See, e.g., id.* at 247.

158. *Id.* at 249 (citation omitted) (citing *Singer v. Habif, Arogeti & Wynne, P.C.*, 297 S.E.2d 473 (Ga. 1982)).

159. The public also has an interest in preserving individual rights to enter into private contracts. *See, e.g.,* Anthony S. Fiotto, *The United States Arbitration Act and Preliminary Injunctions: A New Interpretation of an Old Statute*, 66 B.U. L. REV. 1041, 1065 (1986) (“The public interest in private dispute resolution is hardly served when a court stands idly by while the parties’ chosen method for resolving their grievances is threatened. Courts should . . . invoke their historic equity powers to fashion interim measures which will ensure the vitality of the private process.”).

160. *See supra* notes 122-127 and accompanying text.

161. In cases where the dispute is not subject to arbitration, the court can have the injunction last as long as reasonably necessary. *See, e.g.,* *Winston Research Corp. v. Minn. Mining & Mfg. Co.*, 350 F.2d 134, 142 (9th Cir. 1965) (District court did not abuse its discretion when it granted a two-year injunction against defendant’s use of trade secrets because that would be sufficient to deny

example, the Tenth Circuit in Dutton held that the district court had jurisdiction to grant injunctive relief in order to preserve the status quo but only until the arbitration panel took jurisdiction of the parties' underlying dispute.¹⁶² It stated that an "open-ended" preliminary injunction that survived initiation of the arbitration proceeding would inhibit the remedies within the jurisdiction of the panel.¹⁶³ Therefore, trial courts can modify the injunction so that it expires when the issue of preserving the status quo is presented to and considered by the arbitrators.¹⁶⁴

Once arbitration has begun, courts should not hear requests for preliminary injunctions nor should they extend any existing preliminary injunction previously awarded. Once the arbitrators begin to hear the entire controversy, they should have the exclusive power to enjoin the parties if necessary.¹⁶⁵ Especially in cases where the arbitration proceeds immediately, the district court's authority to grant injunctive relief should not extend "ad infinitum."¹⁶⁶ The reasonable limitation should be until the arbitration panel is able to decide whether the injunction should stay in effect.¹⁶⁷

defendant corporation unjust enrichment from secrets acquired by individual defendants while they were employed by plaintiff corporation, even though it could have granted either a permanent injunction or injunction that would terminate upon public disclosure).

162. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dutton*, 844 F.2d 726, 727 (10th Cir. 1988).

163. *Id.* The court agreed that

an injunctive remedy [can] deprive an arbitration panel of the full span of its broad authority over the parties and over all arbitrable issues [which] would be contrary to the purpose and limitations of the . . . [FAA] and [would] transcend the court's power to preserve the prearbitration status quo.

Id. at 728.

164. Once the court decides that an injunction is necessary to preserve the status quo, it should last only as long as necessary—until the arbitration panel hears the issue of the injunction. *See, e.g., Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Patinkin*, U.S. Dist. LEXIS 6210, at *13, 20 (N.D. Ill. May 3, 1991) (an extension of a TRO was granted under the condition that it would last "until the arbitration panel is able to address whether the TRO should remain in effect.").

165. *See Merrill Lynch, Pierce, Fenner, & Smith, Inc., v. Salvano*, 999 F.2d 211, 213 (7th Cir. 1993). In *Salvano*, the court held that the magistrate judge abused her discretion when she extended the temporary restraining order to a date that surpassed the time when the arbitrators had already ruled that the employees were permitted to solicit certain clients and granted their request to lift any pending injunctions. *Id.* The magistrate still refused to dissolve the temporary restraining order after such requests. *Id.* at 215-16.

166. *Id.* at 215.

167. *Id.*

VII. IMPLICATIONS

Given the strong policies in favor of arbitration, as well as Merrill Lynch's assertion that injunction is necessary because time is of the essence in enjoining the employee from soliciting clients, Merrill Lynch needs to show that it was unable to obtain a timely resolution through arbitration. This will be hard to do if Merrill Lynch initially argues that the dispute is not subject to arbitration, and then after arbitration is compelled, moves for an injunction. Thus, especially in jurisdictions that do not allow preliminary injunctions pending arbitration, Merrill Lynch should make a demand for arbitration immediately after discovering the employee's wrongful conduct, and request an arbitration hearing on an accelerated basis if necessary. Also, where Merrill Lynch cannot seek an injunction in court,¹⁶⁸ it should at least be allowed to move the court to order the arbitrators to bifurcate its claims for injunctive relief from claims for damages and rule upon the claims for injunctive relief on an expedited basis before proceeding on its claims for damages. This way, Merrill Lynch will still have an adequate remedy at law while preventing the employees from further damaging its interests.¹⁶⁹

A. Today, Merrill Lynch's Employment Agreements have Injunction Clauses

Courts will honor express arbitration agreements contemplating injunctive relief pending arbitration, even if without the express contemplation they refuse to extend their authority to award such relief. In view of this, parties should include these express provisions authorizing provisional remedies in their contracts.¹⁷⁰ In *Merrill Lynch, Pierce, Fenner*

168. In the unfortunate situation where the employment contract still does not contain an express preliminary injunction clause.

169. In fact, this attempt was made by Merrill Lynch in *Thomson*, but the court stated that its limited role prevented it from ordering the arbitrators to do this. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Thomson*, 574 F. Supp. 1472, 1479 (E.D. Mo. 1983). It suggested instead that Merrill Lynch bring this possibility up before the NYSE arbitrators. *Id.* However, the court failed to consider the fact that it will be "too late" by the time the arbitration panel is chosen and arbitration proceedings commence because the damage will already be done (the employee will already have converted customers to its new firm). The court rejected the argument that Merrill Lynch may be left without an adequate remedy at law by stating that "[t]he law gives Merrill Lynch the very remedy for which it contracted: arbitration under the arbitration rules of the [NYSE]." *Id.* But, of course, arbitration of the dispute was not the remedy that Merrill Lynch was seeking. It was instead concerned with the ultimate arbitral relief and damages once the arbitral panel ruled that there was in fact a violation of the solicitation clause.

170. Including an express contractual provision authorizing provisional remedies is but one attempt to "draft around the failure of some courts to provide provisional remedies to arbitral parties." Fraser, III, *supra* note 2, at 511. Other means include: "incorporation of arbitration rules

& *Smith Inc. v. Roger*, the district court enjoined three former brokers from violating the restrictive covenants in their employment contracts pending arbitration because the agreement contained express provisions concerning injunctive relief should the brokers leave the firm.¹⁷¹

Does it make sense to require the parties to add an express clause in the contract that clearly contemplates judicial equitable relief pending arbitration? Courts that deny preliminary injunctions pending arbitration in the absence of an express contractual clause stress the importance of congressional intent. But isn't this intent abrogated when the parties contract for injunctions? Does this mean that the parties are free to contract around a court's authority? As *Caz Hashemi* recognizes, "[t]he analysis of the 'contractual language' test involves inquiries that are wholly superfluous" because "Congress makes the law, not private, individual parties."¹⁷² The right to a preliminary injunction should not be made conditional to express contractual language but should be available to all parties that have arbitration agreements. In fact, the Second Circuit specifically noted, and the Eight Circuit agreed, that "the provision relative to 'obtaining an injunction or other equitable relief' is merely declaratory of existing legal rights."¹⁷³

VIII. CONCLUSION

Even the court in *Bradley* recognized that the situation of *Merrill Lynch* "represents a recurring problem."¹⁷⁴ Perhaps the text of the *Merrill Lynch*

that authorize provisional relief, contract authorization of immediate relief once arbitrators are appointed, recitations of the importance of a timely remedy and stipulations that money damages will not be an adequate remedy." *Id.* Fraser also notes that "all of these drafting solutions fail . . . when the courts deny jurisdiction to hear requests for provisional relief." *Id.*

171. See *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Roger*, 75 F. Supp. 2d 375, 377-78, 384 (M.D. Penn. 1999). See also *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dutton*, 844 F.2d 726 (10th Cir. 1988); *Sears, Roebuck & Co. v. L-M Mfg. Co.*, 256 F.2d 517 (3d Cir. 1958) (injunctive relief is appropriate where the party exploiting customer lists has entered an express agreement as to its restrictive use).

172. *Caz Hashemi, Preliminary Injunctions Pending Arbitration under the Federal Arbitration Act: Judicial Misinterpretation, Judicial Intervention, and Confusion*, 75 WASH. U. L.Q. 985, 1002 (1997). "[T]he court fails to establish why a contractual provision contemplating injunctive relief automatically authorizes the judiciary to grant that relief." *Id.*

173. *Erving v. Virginia Squires Basketball Club*, 468 F.2d 1064, 1067 (2d Cir. 1972) (quoting *Boys Markets, Inc. v. Retail Clerks Union, Local 770*, 398 U.S. 235 (1970)); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bradley*, 756 F.2d 1048, 1053 (4th Cir. 1985).

174. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bradley*, 756 F.2d 1048, 1051 n.1 (4th Cir. 1985).

employment agreement for alternate dispute resolution should expressly except actions seeking injunctive or other equitable relief and should make no distinction between preliminary and permanent injunctions. This way, the parties contemplate that an action for equitable relief might also involve a court decision on related legal claims. The employment contract should also *stipulate* that client services are exceptional and unique and that their loss would result in immeasurable damage to Merrill Lynch. Still, given the illogical reasoning behind requiring the agreement to expressly contemplate judicial remedies, it is better to have either Congress or the Supreme Court address this split in the Circuit Courts. In addition, Congress and the Court should adopt a uniform rule of allowing courts to retain this equitable power and should use one common standard in applying it to all cases under the FAA—especially those involving intellectual property disputes.

As long as the courts remain split as to this issue, claimants and respondents will end up using unnecessary resources to strategize the initialization of the case.¹⁷⁵ They will inevitably engage in forum shopping¹⁷⁶ and move to adopt preventive measures in their employment contracts *ad infinitum*. As John A. Fraser states in his article, “[l]egal certainty . . . is a basis for the most efficient allocation of resources through private contracts and private negotiations.”¹⁷⁷

175. “The costs of the present level of uncertainty include needless expenditures of attorney’s fees and other transaction and litigation costs . . .” Fraser, III, *supra* note 2, at 541.

176. “[An] instance of waste caused by the split in U.S. legal authorities is the forum shopping within U.S. jurisdictions that occurs when parties have committed to arbitration . . .” Fraser, *supra* note 2, at 541. “[A] party that believes a provisional remedy is necessary in a particular case will work strenuously to avoid those courts and find a way to file suit in other districts.” *Id.*

177. Fraser, III, *supra* note 2, at 540.