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Litigation Stemming From Hiring Decisions: The Defense Perspective

IN TODAY'S competitive environment, ordinary hiring decisions can present litigation risks, especially when a company hires directly from a competing firm, hires individuals involved in strategy or research and development, or hires several employees from the same employer.

Along with a new employee, the hiring company may find that it has acquired a lawsuit - against the individual, the new employer, or both. The suit may accuse the defendant of breach of contract, inducing breach of contract, intentional interference with contract and/ or prospective business opportunities, trade secret misappropriation, unfair competition and other related torts.

The suit may seek injunctive relief - including an order prohibiting the employee from working for the new employer in a specified job, a specified territory, or at all - as well as damages, or a combination of injunctive relief and damages.

Such a suit may be filed even if the employee in question had no written covenant not to compete nor a confidentiality agreement with the former employer.

While there is no way to protect against all litigation risk, there are steps any employer can take to reduce the chance that litigation will be filed, and to increase the chance of a successful defense against such a suit.

When seeking to hire employees from competing firms, employers should be careful not to use the recruiting process as a method to gain access to the competitor's trade secrets or confidential information.[1] To avoid the pitfalls of obtaining improper information during the recruiting process, the recruiting company should be careful not to solicit more information than necessary from a prospective employee about his or her current firm or position.

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The focus of the interview should be on the applicant's ability to perform the job for which she is applying, and not on the specifics of the business in which she is currently engaged.

Some subjects to avoid during the interview include:

- The existence of products or services not yet publicly announced;
- Nonpublic information concerning announced products or services;
- Company financial data;
- Strategic planning information such as sales or marketing strategies, planned advertising campaigns or new business initiatives;
- Specific methods used to contact prospects, lists of current customers or prospects, and information concerning other employees at the same company.

The recruiting company should not use one prospective hire to recruit or to obtain information about her fellow employees. This is because the common law imposes upon every employee an absolute duty of loyalty to her employer while in its employ.[2]

While this duty does not prohibit an at-will employee from planning to leave her employment to compete with her current employer, it does prohibit the employee from soliciting her fellow workers while she is still on the company's payroll.[3]

Thus, as long as the prospective hire remains an employee of her old company, she should not be asked to: evaluate her co-workers' strengths and weaknesses, furnish an organizational chart or employee list, collect resumes from co-workers, tell co-workers that good jobs are available at the new company, or even tell co-workers that she is interviewing with the new company.

In fact, a prospective hire should be proactively cautioned not to discuss the fact that she may be leaving to work at a competing firm with any of her fellow employees, with her supervisors, or with her current employer's management - until an offer has been made and accepted, and the employee is ready to resign from her old job.

The duty of loyalty discussed above also prohibits employees from soliciting their employer's clients or customers while still on the payroll. This principle was recently reconfirmed by the Second Circuit in *Ticor Title Insurance Co. v. Cohen*, 173 F3d 63 (2d Cir. 1999). Although the holding in *Ticor* turned upon a post-employment restrictive covenant, the court found as significant evidence of wrongdoing on the part of the individual defendant that he solicited approximately 20 of the plaintiff's customers, on behalf of his new company, while he was still working for the plaintiff.

Prospective hires, therefore, also

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should be affirmatively cautioned not to violate their duties to their current employers by soliciting customers while still on the payroll. Ideally, they should not even engage in conduct that could look like solicitation, such as informing their customers, ahead of time, that they will or might be leaving to work for a new company.

While such conduct may or may not rise to the level of solicitation found to violate an employee's duty of loyalty, the question of where that particular line is drawn is unclear and invites litigation on the subject.[4]

Changing Jobs

Once a decision has been made to hire an employee from a competing firm, there are additional steps that should be taken to ensure that the new employee does not expose his new employer to misappropriation or unfair competition liability.

For example, even if there is no applicable noncompete covenant and no intent to misappropriate trade secrets, an employee still faces the risk of being enjoined from working for a new employer if a court finds that there is a significant risk that, in the course of performing his duties for the new employer, he will "inevitably" disclose or rely upon trade secret information belonging to his former firm.[5]

The applicability of the inevitable misappropriation doctrine depends on the nature of the employee's prior job, his presumed knowledge, and the nature of his new job. The less the new job resembles the old one, the less risk there is that this doctrine will apply.

Thus, for example, a salesman is less likely to be enjoined if he is given a new territory, or a new class of customers, at his new job. Therefore, to the extent consistent with accuracy, a new employee's job description should be as dissimilar as possible from the description used for his old job.

Another pitfall that employers will want to avoid is allowing new employees to bring confidential and/or trade secret materials with them when they begin their new jobs. New employees should therefore be told to take as little as possible from their desks, offices, and files at their old company. The greater the chance of misappropriation litigation, the less they should take. If feasible, nothing should physically come with them except personal items and their own personnel-type documents - such as payroll and insurance records. Every additional document or diskette poses a litigation hazard, and few of them are ultimately worth the risk.

One important exception to this prohibition may apply to employees who are greatly attached to their rolodexes, Palm Pilots or equivalent "personal" address books, and believe they cannot conduct business without them. Many employees also find it difficult if not impossible to separate personal from business entries, or believe many of the business-related entries are "theirs" because of the great personal time and effort they put into developing those relationships. The courts often agree.

Many courts, faced with claims that a rolodex, card collection, or the like constitutes a trade secret or protectible confidential information, reject those claims - usually on the ground that the names and addresses are public information and that the entire file could be recreated from public sources.[6]

However, the New York Court of Appeals recently explained that customer relationships and goodwill created by an individual employee - on company time and using company resources - are the property of the employer, and may not be appropriated by the employee when he leaves.[7]

Accordingly, while the rolodex itself may not constitute trade secret or confidential information, the fact that the employee takes it with him may be used as evidence that he intends to solicit his former employer's clients on behalf of his new firm, which may in turn be unlawful - either because it is prohibited by a valid noncompete covenant or because the solicitation will entail the use of other, nonpublic information - such as the individual clients' needs, peculiarities, buying histories, etc. - that may be deemed trade secret or confidential in nature. On balance, therefore, the employee should be asked - if feasible - either to leave his rolodex behind or to take only the truly "personal" entries and leave the remainder.

Once the new employee is on board, he must use caution in soliciting his former customers and colleagues on behalf of his new employer. The extent to which such solicitation will be permitted will depend, in large part, on the existence and content of any noncompete or nonsolicitation agreements the employee signed at his old firm.

Customer Solicitation

At common law, an employee's duty of loyalty is co-terminous with the employment relationship. Once employees leave their jobs, they are entitled to use any lawful means to compete with their former employers. Thus, as long as they do not take advantage of or misappropriate trade secret or confidential information belonging to their former employers, employees are free, once they change jobs, to solicit their former employer's customers on behalf of any competing business.[8]

However, employees who compete by improperly using misappropriated information - as well as their new employers - may be subject to claims for both damages and injunctive relief.[9]

Most customer solicitation cases turn on the existence and enforceability of express noncompete covenants. Such covenants are disfavored under the common law because they act in restraint of trade and operate to deprive individuals of their choice of livelihood.[10]

In New York and many other states, however, such covenants will be enforced to the extent they serve a legitimate interest of the former employer and are deemed "reasonable."[11]

A former employer is generally held not to have a legitimate interest in prohibiting competition per se.[12] However, a former employer does have a right to prevent the improper use of its

trade secrets or other confidential customer information.[13]

The courts have also held that a former employer has a legitimate interest in protecting itself against competition where the employee furnishes special or "unique" services. These cases tend to involve performers and media personalities or members of "learned professions."[14]

As for the reasonableness prong of the test, reasonableness is judged based on the individual circumstances of the parties entering into the contract and the particular industry in which they are involved, but at the very minimum, the New York courts require that a noncompete contract be limited in its scope of prohibited activity, its geographic area of operation, and its temporal duration.[15]

However, since each employment situation is unique, there are no hard and fast rules as to the scope, duration and geographic restrictions that are acceptable in noncompete contracts. Rather, courts use their common sense judgment to determine what is reasonable under the circumstances.

An appropriate scope may depend on factors such as the specialization of the industry and types of customers, an appropriate time may depend on the speed at which information in the industry becomes obsolete, and an appropriate geographic location may depend on the location of the market and the type of service provided.

These factors should be reviewed by counsel before a determination as to the enforceability of a new employee's noncompete agreement can be made.

Employee Solicitation

Nonsolicitation agreements - contracts prohibiting employees, even after they leave their jobs, from soliciting other employees from the same company - do not present the public policy issues inherent in noncompete covenants and are generally enforceable. Absent such a contract, however, at-will employees have no corresponding common-law duty to their former employers after the employment relationship has terminated.

Therefore, they are free to contact their former fellow employees and solicit them to join their new company, provided they do not run afoul of the law of trade secret misappropriation or unfair competition. In order to steer clear of liability, the recruiting employee should not utilize any documents or information obtained from the former employer, such as organizational charts, the target employees' personnel files and annual reviews, bonus information, and the like.

This material may be considered a trade secret belonging to the target employees' current employer[16] and its misuse may also constitute an invasion of the target employees' privacy. Under no circumstances, therefore, should this type of material be utilized to recruit new employees. The very existence of any such materials at the premises of the recruiting firm, and/or evidence that it was removed from or copied at the premises of the former employer, can be devastating.

Another pitfall to avoid is the intentional procurement of a breach of contract by the targeted employees. This can occur if the targeted employees have employment contracts for a specified term, or valid restrictive covenants, and if the recruiting corporation asks them to take action which will constitute a breach of their contractual obligations.

In addition, "raiding" a large number of employees from one company often raises at least the appearance of impropriety. The target company may argue that, in order to carry out its "raid," the recruiting firm must have had access to proprietary personnel information, or must have used an "inside man" to solicit unlawfully, or must intend to misappropriate the target company's strategies, plans or other trade secrets.

Conclusion

Avoiding trade secret litigation is not easy. It requires the implementation of numerous safeguards at every step of the hiring process, and continued attention thereafter. It may also require consultation with counsel to determine the validity and enforceability of the relevant restrictive covenants.

The cost of these safeguards, however, is easily recouped if a single misappropriation suit is fended off or ended early.

(1) In determining what constitutes a trade secret, New York courts have generally adopted the test set forth in the Restatement of Torts §757, comment b. See *Ashland Management Inc. v. Jansen,* 82 NY2d 395, 407 (1993).

(2) See, e.g., *Frederick Chusid & Co. v. Marshall Leeman & Co,* 279 FSupp 913 (SDNY 1968).

(3) Id. See also *Duane Jones Co. v. Burke,* 306 NY 172 (1954); *In re Golden Distributors, Ltd. v. Auburn Merchandising Distributorship Corp,* 134 B.R. 750 (Bankr. SDNY 1991).

(4) See, e.g., *Ticor*, 173 F3d at 72, 73.

(5) See, e.g., *Pepsico Inc. v. Redmond*, 54 F3d 1262 (7th Cir. 1995); *Lumex, Inc. v. Highsmith*, 919 FSupp 624 (EDNY 1996); *Monovis, Inc. v. Aquino*, 905 FSupp 1205 (WDNY 1994); *Doubleclick, Inc. v. Henderson*, 1997 WL 731413 at 6 (S. Ct. NY Co. Nov. 7, 1997).

(6) See, e.g., *Innovative Networks, Inc. v. Young,* 978 FSupp 167 (SDNY 1997).

(7) *BDO Seidman v. Hirshberg,* 93 NY2d 382, 392 (1999).

(8) See, e.g., *Ticor*, 173 F3d at 70; *In re Golden Distributors, Ltd. v. Auburn Merchandising Distributorship, Inc.*, 134 B.R. 750, 757. (Bankr. SDNY 1991).

(9) See *Doubleclick, Inc. v. Henderson*, 1997 WL 731413 (S. Ct. NY Co. Nov. 7, 1997).

(10) See, e.g., *Columbia Ribbon & Carbon Manufacturing Co., Inc. v. A-1-A Corp.,* 42 NY2d 496 (1977); *Purchasing Associates, Inc. v. Weitz*, 13 NY2d 267 (1963). In some states, post-employment restrictive covenants are statutorily void as against public policy and are thus unenforceable. See, e.g., California Business & Professions Code §16600.

(11) See, e.g., *BDO Seidman*, 93 NY2d at 389; *Purchasing Associates*, 13 NY2d at 271; *Ticor*, 183 F3d at 70.

(12) See, e.g., *Reed, Roberts Associates, Inc. v. Strauman*, 40 NY2d 303, 307-08 (1976).

(13) See, e.g., *Reed, Roberts*; at NY2d at 308; *BDO Seidman*, 93 NY2d at 388-89; *Ticor*, 173 F3d at 70.

(14) See, e.g., *BDO Seidman*, 93 NY2d at 389 (accountant); *Karpinski v. Ingrasci* 28 NY2d at 45 (1971) (physician) *American Broadcasting Cos. v. Wolfski v. Ingrasci*, 28 NY2d 45 (1971) (physician); 52 NY2d 394 (1981) (sportscaster).

(15) See, e.g., *BDO Seidman*, 93 NY2d at 389; *Purchasing*
Associates, 13 NY2d at 272; *Karpinski v. Ingrasci*, 28 NY2d 45, 49 (1971); *Bankers Trust Corp. v. Ray*, No. 114208/99 (S. Ct. NY Co. 1999).

(16) See Restatement of Torts § 757.