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## PROTECTING YOUR COMPANY'S INTERESTS FROM ACTIONS OF DEPARTING EMPLOYEES IN THE ABSENCE OF A RESTRICTIVE COVENANT OR CONFIDENTIALITY AGREEMENT

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### 1. **Breach of Fiduciary Duty - Breach of Duty of Loyalty**

Active steps to compete prior to resigning, *i.e.*, soliciting employer's customers for benefit of new employer, soliciting fellow employees to join new employer or taking employer's property or information to use for own benefit or that of new employer.

- Solicitation of employer's customers or accounts prior to resigning

Dames & Moore v. Baxter & Woodman, Inc., 21 F. Supp. 2d 817 (N.D. Ill. 1998) (Gettleman, J.) (employer has claim of breach of fiduciary duty against former employee based on alleged pre-resignation solicitation of clients to transfer to competitor).

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The firm has extensive experience in employment-related litigation in the federal and state courts, in particular in the areas of trade secret misappropriation, covenants not to compete, unfair competition, employment discrimination, sexual harassment, wrongful discharge and ERISA. The firm represents several large national and international corporations, in matters arising in the Chicago area and in other jurisdictions, as well as mid-size companies and professional entities such as law firms.

- The “Corporate Pied Piper” -- Solicitation of co-workers or subordinates

In re Golden Distributors, Ltd., 134 B.R. 750, 758-59 (Bankr. S.D.N.Y. 1991) (applying Massachusetts law) (sales manager breached fiduciary duty of loyalty that he owed to his employer when, while still employed by employer, he actively solicited employer’s sales people to join him in move to competitor).

- Not limited to managers and board members -- All employees owe their employers a fiduciary duty of loyalty with respect to any and all matters within the scope of their agency.

Regal-Beloit Corp. v. Drecol, 955 F. Supp. 849, 858 (N.D. Ill. 1996) (Marovich, J.) (“All employees owe their employers a fiduciary duty of loyalty . . . It is well settled that an agent is a fiduciary with respect to all matters within the scope of his agency. The very relation implies that the principal has reposed some trust or confidence in the agent. Therefore, the agent or employee is bound to the exercise of the utmost good faith and loyalty toward his principal or employer.”).

## 2. State Trade Secrets Acts

Most states have a trade secrets act under which employer has potential action for misappropriation of trade secrets, recovery of damages and/or an injunction prohibiting the former employee from using or disclosing the employer’s trade secrets.

- Action to enjoin the use or disclosure of trade secrets

Surgidev Corp. v. Eye Technology, Inc., 648 F. Supp. 661, 695 (D. Minn. 1986), aff’d, 828 F.2d 452 (8th Cir. 1987) (even absent valid covenant not to compete, court entered injunction against former employees under Uniform Trade Secrets Act, where former employees’ solicitations of plaintiff’s customers and retention of plaintiff’s documents established intent to use and disclose plaintiff’s trade secrets).

- Action for damages stemming from the use or disclosure of trade secrets

Jet Spray Cooler, Inc. v. Crampton, 385 N.E. 2d 1349 (Mass. 1979) (Jet Spray II) (court awarded plaintiff damages against its former employees who entered into competing business in which they used plaintiff’s trade secrets, and plaintiff allowed to recover the greater of its lost profits or former employees’ wrongfully obtained profits).

- Inevitable disclosure - prohibiting the activities of a former employee on the theory that the former employee will inevitably disclose the employer's trade secrets in his new role.

PepsiCo, Inc. v. Redmond, 54 F.3d 1262 (7th Cir. 1995) (affirming injunction prohibiting former high level employee from divulging pricing information, sales strategies and promotion methods to competitor and from assuming any duties with competitor where disclosure or use of that information was inevitable despite the absence of any evidence of actual use or disclosure by former employee).

- Threatened use or disclosure
- Probable use or disclosure

Conley v. DSC Communications Corp., 1999 WL 89955 (Tex. Ct. App., Feb. 24, 1999) (unpublished) (court expanded the inevitable disclosure doctrine to limit a rival corporation's use of a newly hired employee where it was "probable" that the employee would use or disclose confidential information learned while working for prior employer).

- Illinois Trade Secrets Act preempts common law claims to the extent common law claims are based on the misappropriation of trade secrets, but does not preempt if an independent basis for the claim exists, such as soliciting customers prior to resigning or pirating subordinates.

Thomas & Betts Corp. v. Panduit Corp., 108 F. Supp. 2d 968 (N.D. Ill. 2000) (Moran, J.) (interpreting preemption clause of Illinois Trade Secrets Act in case where claims were all viewed as premised on former employee's taking of physical items which were significant only to the extent they contained confidential information and the use of that information).

- General Motors Corporation lawsuit against Lopez & Volkswagen AG

### 3. **Confidential Business Information Not Rising to Trade Secret**

Action to protect the use or disclosure of confidential business information that does not rise to the level of a protectable trade secret.

Warner-Lambert Co. v. Execuquest Corp., 427 Mass. 46, 691 N.E. 2d 545, 547 (1998) (court recognized that confidential business information, such as a list of employees is entitled to protection from misappropriation, even if such information cannot claim trade secret protection).

Eastern Marble Products Corp. v. Roman Marble, Inc., 372 Mass. 835, 364 N.E. 2d 799, 803 (1977) (a former employee’s duty not to use or disclose confidential information belonging to his former employer is grounded in basic principles of equity and upon an implied contract, growing out of the nature of the employer-employee relationship, and a former employee may be enjoined from using or disclosing such information for his own benefit or that of a rival employer).

#### 4. **Economic Espionage Act**

Making trade secret misappropriation a federal crime. Prohibits the theft of trade secrets and provides for fines of up to \$10 million and prison terms of up to 15 years.

- The Economic Espionage Act of 1996, 18 U.S.C. §1831 et seq.

#### 5. **Employee Piracy**

Action against former employee or competitor for leading a mass exodus of employees or targeting a specific office or division.

- Resigning employee induces resignation of co-workers in breach of fiduciary duty

Augat, Inc. v. Aegis, Inc., 409 Mass. 165, 565 N.E. 2d 415 (1991) (Augat I) (competitor and its president were held liable for participating in resigning employee’s solicitation of key managerial employees of plaintiff in breach of his fiduciary duty).

- Solicitation of at-will employees through improper means or for improper purpose

B. R. Paulsen & Co. v. Lee, 95 Ill. App. 2d 146, 153, 237 N.E. 2d 793 (1968) (“[t]he malicious inducement of an employee to terminate his existing employment and enter the employ of a competitor gives rise to a cause of action . . . and the fact that the contract of employment is terminable at will does not bar recovery”).

- Systematic Pirating - departing employee or competitor targeting a specific office or division with the intent to harm, not just obtain competitive advantage.

G.M. Brod & Co. v. U.S. Home Corp., 759 F. 2d 1526 (11th Cir. 1985) (employer has valid claim for tortious interference with a business relationship with its employees as a result of defendant's solicitation of employees and inducement of resignations, notwithstanding at-will employment relationships, where defendant exhibited intent to harm employer's business, i.e., intent to harm proven by internal memorandum from defendant's division manager to vice president stating that defendant could force out plaintiff and "cut his knees out from under him").

E.D. Lacey Mills, Inc. v. Keith, 183 Ga. App. 357, 359 S.E. 2d 148 (1987) (claim for tortious interference with employment relationships with sales representatives where former employees started a competing business and then targeted and hired 17 of former employer's 21 sales representatives).

Wear-Ever Aluminum, Inc. v. Townecraft Indus., Inc., 75 N.J. Super. 135, 182 A. 2d 387 (1962) (defendant corporation, which systematically recruited key sales personnel of rival corporation and caused personnel to terminate, was liable for malicious interference with rival corporation's existing contractual and advantageous relationship with such personnel).

- Damages - employer may recover response costs incurred as a result of the mass exodus of pirated employees.

Chelsea Indus., Inc. v. Gaffney, 389 Mass. 1, 449 N.E. 2d 320, 329-330 (1983) (court awarded employer the costs of special services performed by its executive group to mitigate the damage of a mass exodus and to minimize future damage from defendants' breaches of their fiduciary duty).

## 6. Usurping a corporate opportunity

The corporate opportunity doctrine is rooted in the principle that corporate directors and officers are bound by their duty of loyalty to subordinate their self-interests to the well-being of the corporation. A person who owes a fiduciary duty to a corporation is prohibited from taking, for personal benefit, an opportunity or advantage that belongs to the corporation.

Demoulas v. Demoulas Super Markets, Inc., 424 Mass. 501, 529 (1997) (applying claim of usurping corporate opportunity, former employee required to transfer all wrongfully appropriated assets back to his prior employer and to repay the prior employer all monies received from the operation of the misappropriated corporate opportunity plus interest).

## 7. Conversion - Theft

Action against former employee for conversion of employer's property, seeking return of the converted property and damages.

- Damages claim more powerful by seeking value of the converted property at the time of the conversion and disgorgement of former employee's profits obtained through use of the converted property.

Welch v. Kosasky, 24 Mass. App. Ct. 402, 509 N.E. 2d 919, 921-22 (1987) (general rule for recovery on action for conversion is the value of the converted property at the time of the conversion, with interest from that time, but where the converted property was used by the defendant to make a profit, plaintiff's damages should not be capped at the value of the property at the time of the conversion).

- No preemption by Uniform Trade Secrets Act

Powell Products, Inc. v. Marks, 948 F. Supp. 1469 (D. Colo. 1996) (plaintiff's claim against former employee for conversion is not completely preempted by the Uniform Trade Secrets Act where claim also seeks recovery of the physical items stolen, including blueprints and drawings, which would not be the subject of a misappropriation claim under UTSA).

## 8. Civil Conspiracy

- Veco Corp. v. Babcock, 243 Ill. App. 3d 153, 611 N.E. 2d 1054 (1st Dist. 1993) (former employer can recover on claim of common law civil conspiracy where officers-employees intentionally act in concert to breach their fiduciary duties and cause injury to former employer, and former employer not required to establish actual malice or ill will).

## 9. Trade Disparagement/Defamation

- Marcam Corp. v. Orchard, 885 F. Supp. 294, 298 (D. Mass. 1995) (former employee enjoined from working for competitor where his promoting of competitor's product would be directly or indirectly disparaging plaintiff's product - whether defendant publicly criticizes plaintiff's product, or simply promotes competitor's product without explicit criticism, his association with competitor's product would be enough to raise doubts in the eyes of plaintiff's customers as to the relative value of plaintiff's product).

10. **Tortious Interference with Expected Economic Advantage - Interference with Customer Relationships**

- Expected or prospective economic advantage

E.J. McKernan Co. v. Gregory, 252 Ill. App. 3d 514, 623 N.E. 2d 981 (2d Dist. 1993) (former employer recovered under claim for tortious interference with business expectancy where defendants, former corporate officers and employees, solicited former employer's customers and employees and used former employer's confidential business information during the course of those solicitations to divert business from former employer to rival corporation).

- Customer goodwill - former employer may have a protectable interest in its relationships with customers.

Marcam Corp. v. Orchard, 885 F. Supp. 294 (D. Mass. 1995) (former employer entitled to preliminary injunction against departing employee to protect former employer's reputation and its relationships with its customers).

11. **Unfair Competition**

- Cause of action under state unfair and deceptive practices act

Peggy Lawton Kitchens, Inc. v. Hogan, 18 Mass. App. Ct. 937, 466 N.E. 2d 138 (1984) (plaintiff cookie manufacturer stated cause of action under Massachusetts Unfair and Deceptive Practices Act, where it sued former employee for misappropriation of trade secrets).

- Common law tort

GAB Business Services, Inc. v. Lindsey & Newsom Claim Services, Inc., 83 Cal. App. 4th 409, 99 Cal. Rptr. 2d 665 (4th Dist. 2000) (former employee who solicited 17 key co-workers to resign *en masse* and go to work for competitor engaged in unfair competition, where competitor's president either knew or should have known that former employee was contemplating bringing co-workers with him when he joined competitor, and competitor benefited from former employee's breach of his fiduciary duty).

**12. Interference with Contract**

Former employee or competitor inducing another to breach a duty of loyalty or confidentiality owed to former employer.

**13. Liability of Third Party Beneficiary**

Third party beneficiaries may be liable where they are aware of or ratify an employee's breach of his fiduciary duties.

Conant v. Karris, 165 Ill. App. 3d 783, 520 N.E. 2d 757, 762 (1st Dist. 1987) ("A third party who participates in a breach of a fiduciary's duty of loyalty, or knowingly accepts any benefit from such a breach, becomes directly liable to the aggrieved party."); Bancroft-Whitney Co. v. Glen, 64 Cal.2d 327, 353, 411 P.2d 921 (1966) ("They encouraged the sowing and reaped the benefit.").

**14. Various Issues Related to Measure and Recovery of Damages**

- Rule of disgorgement - An employee can be forced to disgorge the compensation (salary and benefits) earned during the period of disloyalty, with no right to set-off. No evidence of harm to employer is required.

ABC Trans National Transport, Inc. v. Aeronautics Forwarders, Inc., 90 Ill. App. 3d 817, 413 N.E. 2d 1299 (1980) (plaintiff corporation's former president and vice-president forfeited their right to all compensation during four-month period in which they breached their duties by conspiring to take employees and customers away from the corporation, regardless of whether the corporation was injured by defendants' breaches of their duties).

- Recovery of plaintiff's lost profits

Vendo Co. v. Stoner, 58 Ill. 2d 289, 321 N.E. 2d 1 (1974) (Illinois Supreme Court affirmed judgment of \$7,345,500 in lost profits suffered by employer as a result of former employee's breach of fiduciary duty, where total lost profits was the sum of employer's lost profits during the period of former employee's breach (\$2,135,000), and the diminution in the value of employer's business attributable to former employer's wrongful conduct (\$5,210,500)).

- Accounting of defendant's profits - disgorge wrongfully obtained profits

USM Corp. v. Marson Fastener Corp., 392 Mass. 334, 338, 467 N.E. 2d 1271, 1276 (1984) (USM II) (as a result of defendant's misappropriation of plaintiff's trade secrets, court implemented an accounting of defendant's profits over 16 years and plaintiff obtained disgorgement of the profits defendant unlawfully obtained over that period).

- Rule of constructive trust - very significant potential remedy in Illinois and other states that permits former employer, in breach of fiduciary duty or usurpation of a corporate opportunity case, to recover its measurable lost profits *and* the profits earned by former employee (and new employer).

Hill v. Names & Addresses, Inc., 212 Ill. App. 3d 1065, 571 N.E.2d 1085 (1st Dist. 1991) (court implemented equitable remedy of constructive trust on profits wrongfully earned by former employee and employee's new employer where former employee breached duty of loyalty to her former employer and exploited information she gained in her position with former employer to benefit of new employer, and former employer was also awarded damages based on its specific proven lost profits).

- Recovery for loss of goodwill

Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bishop, 839 F. Supp. 68, 75 (D. Me. 1993) (finding that former employer may recover money damages from departing employee based on loss of customer goodwill, even though such money damages are not supported by traditional strict proof).

- Price erosion

Roton Barrier, Inc. v. Stanley Works, 79 F. 3d 1112 (Fed. Cir. 1996) (former employer entitled to recover its actual damages under Illinois Trade Secrets Act that resulted from defendant's misappropriation of former employer's trade secrets, including former employer's lost sales as a result of defendant's entry into the relevant marketplace, historical price erosion, and future price erosion, where former employer lost market share and reduced its prices as a result of defendant's entry into the marketplace, and would need substantial period of time to reestablish prices and margins).

- Exemplary damages and attorneys' fees under misappropriation of trade secrets statutes, such as Illinois Trade Secrets Act

Mangren Research and Development Corp. v. National Chemical Co., 87 F. 3d 937, 946 (7th Cir. 1996) (court upheld award of exemplary damages under ITSA, which was double the amount of compensatory damages, where jury found an intentional misappropriation as well as a misappropriation resulting from the conscious disregard of the rights of another).

- Punitive damages

SHV Coal, Inc. v. Continental Grain Co., 587 A. 2d 702 (Pa. 1991) (court upheld award of punitive damages against former employee and his new employer in action for breach of fiduciary duty and tortious interference with prospective business relationship, where actions of former employee and new employer were of such an outrageous nature as to demonstrate intentional, willful, wanton or reckless conduct).

- Shifting evidentiary burdens - Once evidence of misappropriation has been introduced, plaintiff may need only introduce evidence of defendant's gross profits and the burden shifts to defendant to show that the profits were not attributable to the misappropriation.

USM Corp. v. Marson Fastener Corp., 392 Mass. 334, 338, 467 N.E. 2d 1271, 1276 (1984) (USM II) (after plaintiff introduced evidence that defendant profited from improper use of plaintiff's trade secret, burden shifted to defendant to show that the profits were not attributable to the misappropriation).

- Application of an adverse inference

Knightsbridge Marketing Servs., Inc. v. Promociones Y Proyectos, S.A., 728 F. 2d 572, 575 (1st Cir. 1984) (holding that court entitled to draw adverse inference against defendant in determining plaintiff's lost commissions based on defendant's failure to produce evidence of its earnings figures, and finding defendant's argument that court's determination of damages too speculative is not credible where defendant's failure to furnish necessary information could have eliminated or greatly reduced any speculation).