Slumping Economy Drives Employee-Defection Lawsuits

Insights
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Competition to obtain more customers, sell more products, and make more profits is a motivating factor that drives every company. With new revenue hard to find in the present economy, retaining what business you do have, or that you have lined up in the pipeline, is at a premium. In a situation like this, the ramifications from employee defections can be crippling – i.e., years of hard work and "fair competition" can be quickly undone by a former employee who takes the benefits of those efforts to a competitor. Now is the time to make sure that you have maximized all means of protecting your client relationships and confidential information.

No employer wants to invest time and money in hiring, training and developing an employee only to have that employee quit, taking with him valuable information and contacts which allow a competitor to, in effect, steal customers and hire away the employer's workforce. Even in this economy, and arguably because of this economy, lawyers across the country are receiving calls from panicked clients when employees depart and begin working for a competitor. Often, the call goes something like this:

This is the owner of Canned Ham Catering. My best meeting planner, Darrell Departed, was recently recruited away by my competitor, Cut-Rate Catering. I just learned five minutes ago that our best account is leaving us and going to the competitor. I've heard through the grapevine that Darrell went to the account offering lower pricing and bad-mouthing us.

I just checked Darrell's former office. Confidential files and documents are missing. After looking at his old computer, I'm convinced that he copied some of our customer information databases before he left. Something I found on his computer also suggests that he was diverting business away from my company to the competitor months before he resigned. I want Darrell arrested and I want to go after Cut-Rate too. Okay, what do we do next?

Put Out An APB?

While the "let's arrest Darrell" demand is rarely a realistic option, there are several potential avenues to pursue both against him and Cut-Rate Catering. The starting point for determining exactly where to go next is usually tied to whether or not Darrell had signed any type of contract with Canned Ham restricting his post-employment competitive activities. Some of the more common provisions include non-competition, non-solicitation of customers, non-recruitment of employees,

confidentiality, and return of property. These protections are generally referred to as "restrictive covenants."

The laws in virtually every state have long provided at least some protection for companies against theft and acts which amount to conversion of corporate property and proprietary information. That focus has expanded somewhat as the result of technological advances which have made theft of much information virtually undetectable. For example, a disgruntled employee may abscond with a company's confidential information simply by downloading it onto a disk or emailing the information to a competitor.

Employees and competitors may also compromise competitive information by gaining unauthorized access to computer systems, deleting data, or releasing a computer virus into an employer's operating system. Fortunately, recent federal and state laws have been enacted to address this growing problem.

Even with growing statutory protection available, simple contracts remain an invaluable tool for companies to use to protect their corporate assets in today's business climate. There are a variety of basic types of restrictive covenants to protect your interests. The different types of covenants may appear together in one document, or they may appear in any combination.

Surveying The Legal Landscape

Non-Competition

In its purest sense, a non-competition provision prohibits a departing employee from competing with the former employer after termination for a limited period of time. This type of covenant can prevent the former employee from working for a competing business even if the new company does not necessarily injure the business of the former employer. Since this is the most restrictive type of contract, it is also the one that courts scrutinize most strictly. Many states highly restrict their use.

Non-solicitation

Non-solicitation provisions allow an employee to work for a competitive business, but prohibit the solicitation of specific customers. The employee is free to compete and is free to work in whatever territory he or she desires, so long as the employee does not solicit business from a specific group of customers.

Non-recruitment

A non-recruitment (or no-raiding) clause is designed to protect your employees from being hired away by former employees. Your former employees know the strengths and weaknesses of your workforce. Non-recruitment covenants restrict departing employees from trying to take others with them.

Of course, as a practical matter, employees are free to leave on their own, even if it is to join a departing employee who has signed a no-raid agreement.

Non-disclosure

A confidentiality (or non-disclosure) provision usually limits the employee's ability to disclose information learned about customers, suppliers, or the employer's operations. While non-disclosure agreements often include the term "trade secrets," most states have a trade-secrets statute that prohibits misappropriation of such information even without a contract. But only certain types of information rise to the level of a "trade secret." You need to define and protect confidential information carefully.

Return of property

A return of property agreement typically states that the employee must return all company property and all documents related to the company upon termination of employment. While all employers expect their employees to return company property upon termination of employment, there is oftentimes a dispute as to what is company property and what is the employee's property.

For example, many employees may claim that their rolodex or list of business prospects is their "property," despite the fact that such information was assembled on company time and with company resources. A return of property agreement may help an employer avoid such disputes by defining via contract what the company considers to be its property rather than the employee's.

Unfortunately, there is no uniform federal law governing restrictive covenants. Rather, because these are contractual issues, the validity of such agreements is determined by state law. Nearly every state has unique and distinct requirements for restrictive covenants. Accordingly, a contract that is lawful in one state may be completely unlawful in a neighboring state. For a company operating in multiple states, the differences in state laws can make drafting and enforcement of restrictive covenants a challenge. Regardless of whether you operate in one state or multiple states, care must be taken to draft these agreements so they will hold up in court if challenged.

The Rest Of The Story

So back to the frantic call from fictional Canned Ham Catering. What happens next? If Darrell Departed had signed an agreement that included a non-compete or a non-solicit provision, filing a lawsuit in court asking for an injunction preventing further conduct in violation of the contractual restraints is an option. In addition to claims against Darrell, Cut-Rate Catering could be joined in the lawsuit.

Before rushing to court, it's often advisable to write a "cease and desist" letter to see if the departed employee and the hiring company will voluntarily comply with your restrictions. Oftentimes the warning letter will prompt settlement talks between the parties. A negotiated settlement might be an attractive option, particularly where the contractual provisions that would be scrutinized by the

court have potential flaws. The cost-savings of avoiding a protracted legal battle are another positive factor to securing settlement terms that may be short of a homerun but still offer sufficient protection.

What about the employee-defection scenario where there are no post-employment restrictive covenants in place or where you discover that the ones in place are clearly unenforceable? The Darrell Departed hypothetical above includes other potential causes of action.

Darrell's "bad-mouthing" to the customer might give rise to a claim for defamation (slander or libel) depending on exactly what he said, and to whom. If Darrell had diverted business from Canned Ham Catering to Cut-Rate Catering prior to his resignation, Canned Ham might be able to pursue a claim for something called "breach of duty of loyalty." If Cut-Rate was involved in such misconduct, it could be sued for tortious inducement of Darrell's misconduct.

Any misuse of the company's computer system or theft of information from the computer might give rise to federal and state statutory claims for computer abuse. Taking documents and hard copy files could constitute common law conversion (basically the civil claim for theft). Use of confidential or proprietary information would support a breach of contract claim if Darrell had signed a confidentiality agreement. It is also possible that the information taken could rise to the level of a trade secret under state statutory law which in turn would support a misappropriation of trade secrets claim.

To Sum It Up

The list could go on. The main point is that you are not without protections when departing employees leave in a cloud of smoke and do not behave themselves after they are gone – good economy or bad. Before you find yourself in a situation like this, review your existing agreements to make sure they still comply with governing law. And if you do not currently utilize restrictive covenants, you should reconsider. Maybe it's time to do so.

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