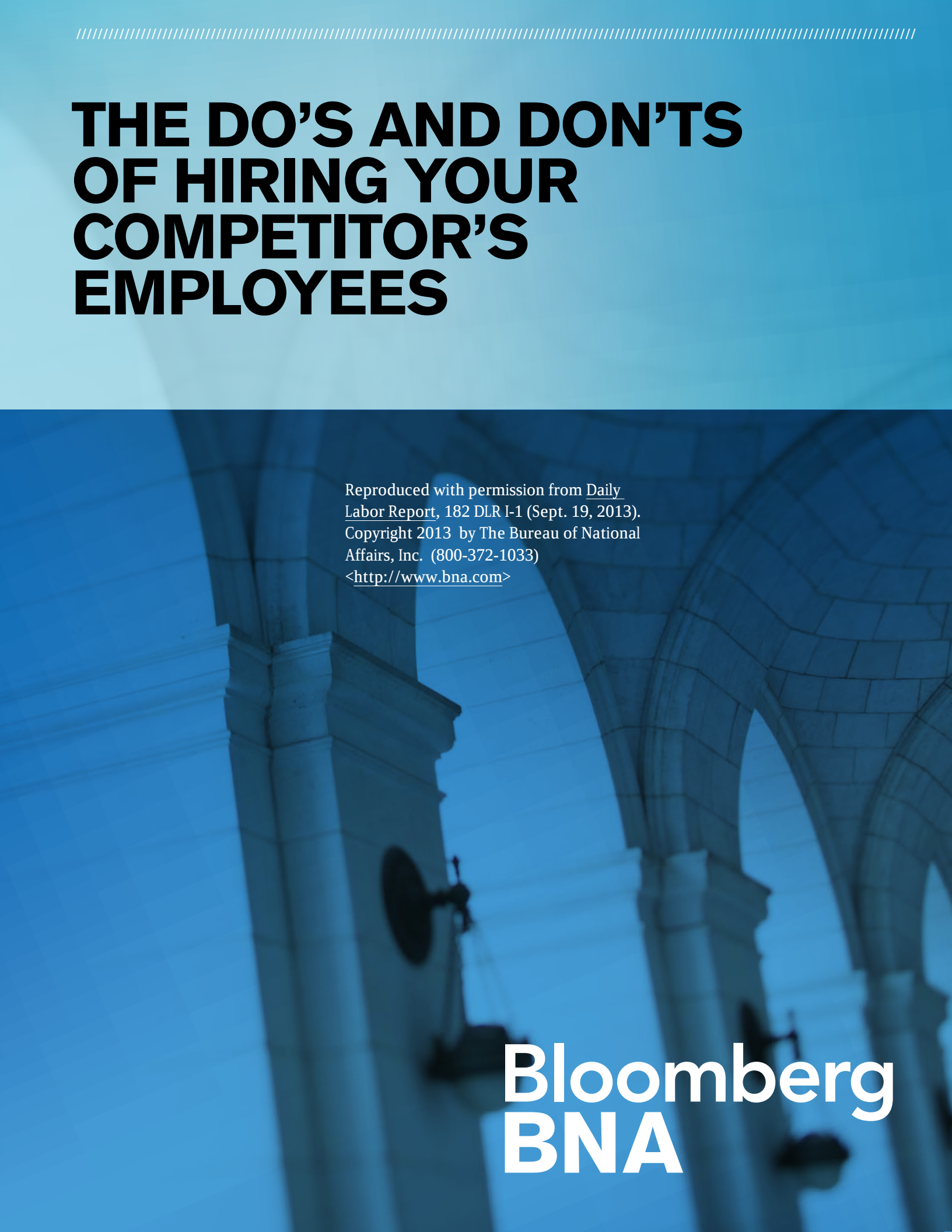
THE DO'S AND DON'TS OF HIRING YOUR COMPETITOR'S EMPLOYEES



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NONCOMPETITION AGREEMENTS

Hiring a competitor's workers can bring the new employer more than the typical staffing issues, and the potential problems often vary depending on the state of employment.

In this BNA Insights article, author Jeffrey W. Rubin offers new employers some do's and don'ts on how to bring the new person onboard but leave the opportunity for trade secret and other litigation behind.

The Do's and Don'ts of Hiring Your Competitor's Employees

BY JEFFREY W. RUBIN

Bringing on employees from a direct competitor brings challenges beyond those routinely encountered in the hiring process. The previous employer worries that its information may walk out the door with the departing employee, not only giving a direct competitor an advantage, but also potentially taking its business from clients who remain loyal to the departing employee.

The new employer wants to ensure that the new hire is able to excel on the job. The new employer doesn't want to see its new hire—or worse yet, itself—embroiled in workplace litigation with the previous employer. Following the few do's and don'ts highlighted below can go a long way in reducing the risk of litigation and putting the hiring employer in the best possible position if litigation ensues, whether hiring one employee from a competitor, or a group of them.

Do Determine the Candidate's Contractual Restrictions

In an environment of ever-increasing competition where information can be obtained and disclosed by employees with the click of a mouse or tap of a tablet, more employers are requiring that employees sign restrictive covenant agreements. When hiring from a direct competitor, being involved in the breach of a restrictive covenant can be a costly mistake. The individual employee can be liable for breach of contract or enjoined from working for the new employer. And when the new employer knows of the contractual obligation, it can be liable to the former employer for among other things, tortious interference with contract.

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Be sure you understand the lay of the contractual landscape. . . . Restrictive covenants can hide in a variety of documents.

To avoid any surprises, be sure you understand the lay of the contractual landscape. Before making an offer of employment, ask candidates whether they have signed any type of agreement with the current employer. Ask the candidate to think long and hard, and to search high and low. Restrictive covenants can hide in a variety of documents. Not only do they appear in employment agreements, but they can also be inserted into stand-alone agreements, equity participation plans and agreements, or even in codes of conduct that the employee may have signed. Restrictive covenants can take various forms, including protection of confidential information provisions, protection of intellectual property provisions, noncompetition obligations, and nonsolicitation obligations.

If the employee has signed a contract that contains restrictive covenants, do request a copy of the agreement and determine whether the restrictions are enforceable.[1] Because the enforceability of restrictive covenants is a matter of state law, the same restrictive covenant may be enforced in one state but rejected in

[1] Although employers often want their employees to share restrictive covenants with prospective employers, a restrictive covenant may occasionally be included in a contract with a confidentiality obligation. In that case, the candidate should be asked to provide a copy of only the restrictive covenants and any affiliated language.

another. Half the battle can be determining which state's law applies. This is especially true where the candidate worked in multiple states, but no state's law was specified as governing in the applicable contract. Once the state whose law will govern is identified, examine the restrictive covenant under the state's precedents. States such as Pennsylvania, New Jersey, Delaware and New York will generally enforce confidentiality obligations. Noncompetition and nonsolicitation obligations will generally be enforced in these states if they serve one or more legitimate business interests; are part of a valid contract; and are reasonable in terms of time, geography, and activity restrictions. If the restrictions are overbroad, courts following the law of these states have the discretion to, and often do, reform the restrictions and then enforce them as modified.

Do pay careful attention to the language of the restrictions. The agreement may contain only a noncompetition obligation, a customer nonsolicitation obligation, an employee nonsolicitation obligation, or some combination of restrictions. If the agreement contains a customer nonsolicitation obligation, without a general noncompetition obligation, it is especially critical to understand the scope of the restriction. Does the agreement prohibit ''solicitation,'' ''inducement'' and/or ''accepting business'' from a customer? The exact wording used can make a significant difference in terms of which activities are prohibited.

Pay careful attention to the language of the restrictions. The agreement may contain only a noncompetition obligation, a customer nonsolicitation obligation, an employee nonsolicitation obligation, or some combination of restrictions.

In *American Family Mutual Insurance Co. v. Hollander*, No. 08-1039 (N.D. Iowa Mar. 3, 2009), *report and recommendation adopted* (N.D. Iowa May 06, 2009), involving an insurance company, the contract provided that the employee would not ''induce'' or ''attempt to induce'' any of his customers to cancel or replace their insurance coverage. The court thought it was ''significant'' that the agreement did not prohibit only solicitation, which the court found ''suggests initiating contact with another person to attempt to persuade them.'' *Id.* ''Induce,'' on the other hand, is broader and does not distinguish based on which party initiated contact. The court found that the employee's actions in responding to customer inquiries, providing quotes for insurance products in response to customer inquiries, and assisting customers who had contacted the employee to complete paperwork necessary to cancel their insurance with the previous employer was likely to be a violation of the agreement. *Id.* Had the agreement only prohibited ''solicitation,'' the court may have reached a different conclusion.

Once the restrictions are understood, do determine whether the proposed job at the new employer would violate the enforceable obligations in the agreement. If so, consider whether the job can be modified for the duration of the restriction so that the candidate can work for the new employer without violating his or her contractual obligations. If no such option is possible, consider whether the offer of employment should be conditioned on a waiver from the current employer or whether the candidate could be hired with the understanding that he or she will not perform work until the restrictive period has expired. In certain circumstances, it may be appropriate for the candidate to file a declaratory judgment action seeking to have all or part of the restrictions declared unenforceable by a court.

Don't Accept or Request Confidential Information

Regardless of whether an employee is contractually bound to keep secret a former employer's confidential information, such an obligation may be imposed by law. All but a few states have enacted legislation (often patterned on the Uniform Trade Secrets Act) to protect an entity's ''trade secrets.'' New Jersey recently enacted such a statute, the New Jersey Trade Secrets Act, which became effective in 2012. Pennsylvania enacted its Uniform Trade Secrets Act in 2004.

A trade secret is generally any information that ''[d]erives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use'' and is ''the subject of efforts that are reasonable under the circumstances to maintain its secrecy.'' *See, e.g.*, N.J. Stat. Ann. § 56:15-2; 12 Pa. Cons. Stat. § 5302. A new employer may be liable if it obtains the previous employer's trade secrets and knows or has reason to know that the employee brought the information in violation of a contractual duty. *See, e.g.*, N.J. Stat. Ann. § 56:15-2; 12 Pa. Cons. Stat. § 5302; *PNC Mortg. v. Superior Mortg. Corp.*, No. 09-5084 (E.D. Pa. Feb. 27, 2012) (denying summary judgment to new employer on trade secrets claim where new employer's own policy required similar information to be returned before termination, suggesting the new employer may have known the information was obtained by improper means). These statutes frequently authorize a court to enter an injunction if the former employer can show a ''threatened'' misappropriation. *See, e.g.*, N.J. Stat. Ann. § 56:15-3; 12 Pa. Cons. Stat. § 5303.

Employers may seize upon this authority of the courts to seek to impose a de facto noncompetition obligation upon a departing employee, even absent a contractual noncompetition obligation, arguing a ''threatened'' misappropriation of the employer's trade secrets. One such case was *Bimbo Bakeries USA, Inc. v. Botticella*, 613 F.3d 102, 30 IER Cases 1767 (3d Cir. 2010) (147 DLR A-4, 8/2/10). In *Bimbo*, the trial court prohibited the defendant from working for a competitor based on a threatened misappropriation of Bimbo's trade secrets, although the defendant's contract with Bimbo contained no noncompetition obligation.

Bimbo Bakeries is one of the nation's largest producers and distributors of bakery items, operating under well-known brand names including Thomas', Entenmann's, Stroehmann, and Freihofer's. Defendant Chris Botticella was one of Bimbo's senior executives and had

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access to the company's most confidential information. He was one of only seven individuals, for example, who knew the secret behind Thomas' English Muffin's famous ''nooks and crannies.''

While still working at Bimbo, Botticella accepted a similar position with Hostess Brands Inc., one of Bimbo's largest competitors. Hoping to receive his 2009 year-end bonus, Botticella deferred his start date at Hostess and continued to work for Bimbo. Botticella did not inform Bimbo of his plans to resign and continued to have access to its trade secrets and other confidential information. He knew Bimbo would have cut off such access if it had known of his intention to join Hostess. Bimbo eventually learned that Botticella intended to join Hostess through a news release issued by the latter. Bimbo asked Botticella to vacate its offices.

Before leaving, he accessed a large volume of Bimbo's confidential information and copied it to external drives. Botticella contended that he copied files from his Bimbo computer to ''practice'' his computer skills.

Even where information doesn't constitute a ''trade secret,'' but is confidential, many states provide protection.

Noting Botticella's ''suspicious'' actions, the Third Circuit affirmed the district court's injunction enjoining him from working for Hostess. The Third Circuit found that, under Pennsylvania law, a court can enjoin a defendant from beginning new employment if the facts demonstrate a ''substantial threat'' of trade secret misappropriation. *Id.* at 113. This ''substantial threat'' standard is less rigorous than the ''inevitable disclosure'' doctrine often followed by other jurisdictions. The ''inevitable disclosure'' doctrine allows a court to prevent an employee from working for a competitor, even absent a contractual obligation, if his or her new job will ''inevitably'' cause the employee to use the former employer's trade secrets.

As the Third Circuit noted, an injunction prohibiting an individual from working in a particular industry or soliciting certain customers based on a threatened misappropriation of a trade secret is ''atypical.'' Rather, the appeals court said, ''the usual injunction merely prevents the employee from disclosing specified trade secrets.'' *Victaulic Co. v. Tieman*, 499 F.3d 227, 234, 26 IER Cases 890 (3d Cir. 2007) (165 DLR A-1, 8/27/07). Since announcing the ''substantial threat'' standard, courts remain unwilling to impose a noncompete upon a departing employee based upon a threatened misappropriation theory absent unusual circumstances. In *Centimark Corp. v. Jacobsen*, No. 11-1137 (W.D. Pa. Nov. 29, 2011), a federal court refused to preliminarily enjoin a departing employee from working for the new employer based on the threat of trade secret misappropriation. The employee's return of the former employer's confidential information prior to departure and his repeated assurances that he intended to comply with his contractual obligations were key considerations in the court's conclusion.

Even where the information at issue doesn't constitute a ''trade secret,'' but is confidential, many states provide protection. Pennsylvania and New Jersey are two such states.

Preventive measures can go a long way in reducing the likelihood of litigation that could result in liability to the departing employee (not to mention the new employer) and render the candidate unable to commence work with the new employer. After deciding to hire a candidate, do clearly and unambiguously instruct the new hire that he or she is not to use or disclose any confidential information of third parties, including previous employers, in the new employment or use such information for the benefit of the new employer.

The new employer should go one step further and direct the departing employee to return all property and confidential information of the current or former employer. The employee should not retain any such property or information. This directive applies to information in whatever form and wherever located that is in the employee's possession, custody or control. The employee should not access any of the previous employer's systems or information following departure, even if the former employer has neglected to block access. The departing employee cannot use or disclose information he doesn't have.

An offer letter is a good place to include these instructions. They could also be put in a restrictive covenant agreement that the new hire will be required to sign as a condition of employment. In any case, the instructions should be in a written document that the new employee will sign before beginning work at the new job. This simple step can go a long way in assuaging any concerns of the previous employer. Equally important is that this obligation be scrupulously met—by both the new employer and the employee—after the commencement of employment.

Do Consider Whether the New Hire Should Disclose Plans to the Current Employer

As demonstrated by *Bimbo*, it may be appropriate for a new hire to inform the current employer of the new position at a competitor. This step is especially appropriate where the employee will continue to have access to highly confidential materials or where the current employer makes a request of the employee that it would not be expected to make if it had known of the employee's plans.

If the departing employee is the ''face'' of the company to the employer's customers, the employer may request that the employee contact his or her customers to inform them of the departure, or may request that the employee introduce his or her replacement to the customers, prior to departure. The employer may not want the employee to engage in these activities if it is known that the person will be competing against the company at the new employer.

Do Encourage the Employee to Leave on Good Terms

There are countless examples where hurt feelings or other emotions are the driving force behind litigation, especially against a departing employee. Do not allow the employee to use his or her departure as an opportunity to lambast the current employer.

Do instruct the employee to remain loyal to the current employer until the end of that employment. Employees have a legal duty to do so. Do not allow the employee to perform any work for the new employer while still employed by the previous employer. It could be a breach of the employee's duty of loyalty. ''The duty of loyalty requires that an employee 'refrain from competing with the [employer] and from taking action on behalf of, or otherwise assisting, the [employer's] competitors throughout the duration of the agency relationship, as well as a duty not to use property or confidential information of the [employer] for the [employee's] own purpose or those of a third party.' '' *PNC Mortg. v. Superior Mortg. Corp.* (quoting *Frontier Constr. Co. v. Mazzella*, No. 09–0794 (W.D. Pa. Nov. 13, 2009) (quoting Restatement (Third) of Agency, §§ 8.04 & 8.05 (2006))). The departing employee should not be soliciting the current employer's customers (regardless of whether he or she is explicitly prohibited from doing so by contract) or engaging in similar tasks prior to departure.

Do instruct the employee to be honest in the exit interview. Many employers conduct exit interviews with departing employees, and they can serve various functions. They can provide valuable information to the employer to improve working conditions and give the employer an opportunity to remind the employee of certain contractual or other obligations. Many employers routinely ask about the employee's plans after separation, if such plans have not already been disclosed. If asked, the employee should be directed to disclose his or her future employment plans. Where there are particular concerns, the new employer should discuss an appropriate response with the employee in advance of the employee's notice of resignation or exit interview. The employee should not lie.

Do Use Extra Caution When Hiring Multiple Employees

Hiring multiple employees from the same competitor at once—the classic ''raid'' or ''lift out'' scenario—can expose the hiring employer to additional liability, depending on the purpose of the hiring. In Pennsylvania, for example, the new employer could be liable for unfair competition if the purpose of such systematic hiring is to cripple a competitor (rather than to obtain the special skills of each employee), or to induce the employee to disclose the former employer's trade secrets or commit other wrongs. *See, e.g.*, *PNC Mortg. v. Superior Mortg. Corp.* (quoting *Reading Radio, Inc. v. Fink*, 833 A.2d 199, 212 (Pa. Super. Ct. 2003) (quoting *Albee Homes, Inc. v. Caddie Homes, Inc.*, 207 A.2d 768, 771 (Pa. 1965))).

''Lift outs'' are especially likely to lead to litigation. As a result, it is especially important that the above practices be followed and documented where possible. This can reduce the likelihood of litigation and put the hiring employer in the best position possible if litigation becomes inevitable.

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