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From Courtship to Breakup: Reducing Trade Secret and Other Legal Risks When Hiring Employees and Terminating the Employment Relationship

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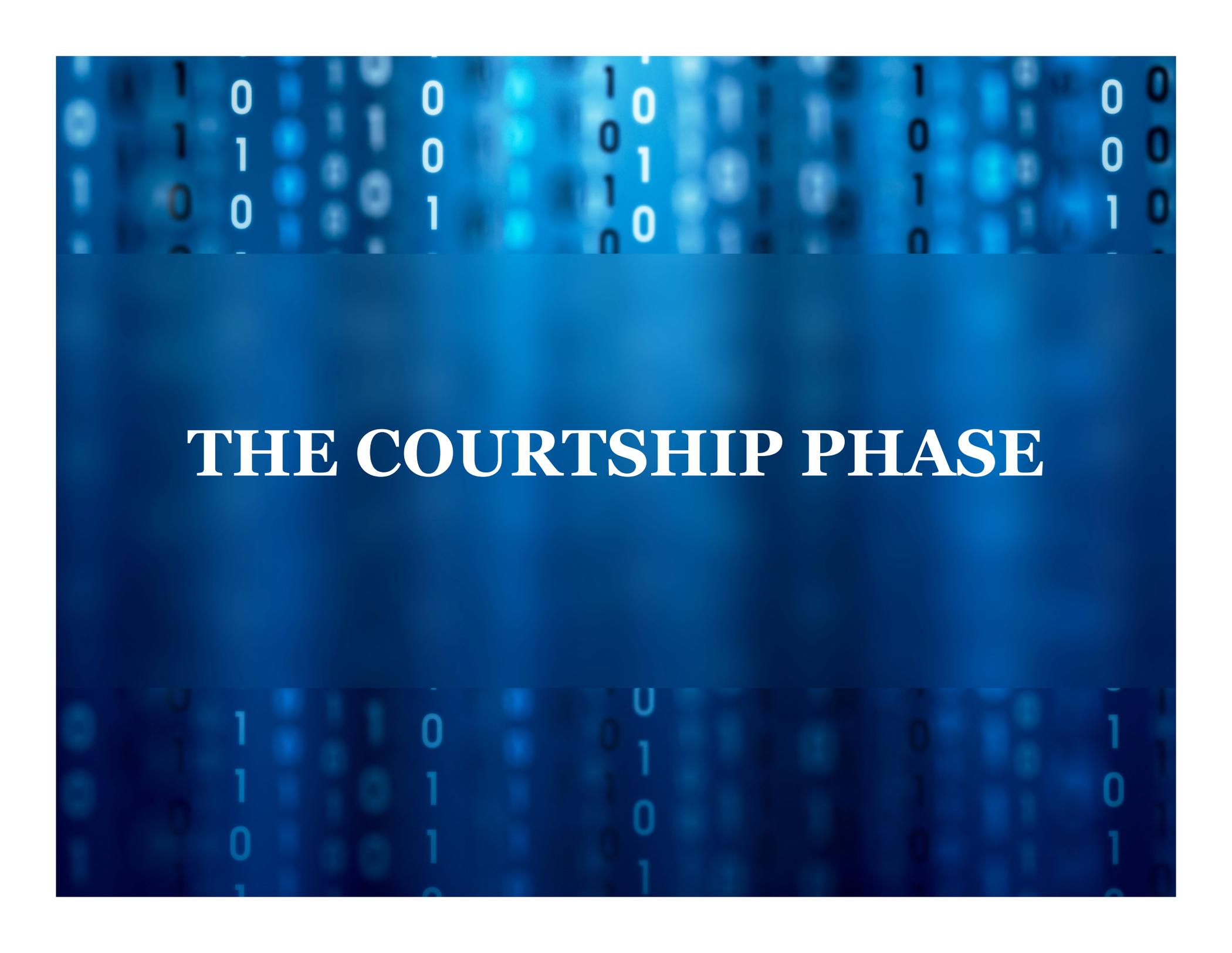
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Overview

- The courting phase: hiring candidates
 - Areas that employers often overlook
 - Why doing due diligence on candidates is important
 - Strategies for protecting against allegations of theft of trade secrets/other proprietary information
- The break-up phase: terminating the employment relationship
 - Refer back to restrictive covenants
 - Rely on applicable policies
 - Reclaim possessions
 - Cease & desist letters/litigation



THE COURTSHIP PHASE

The Courtship Phase: Attraction and Infatuation

- Typical areas of focus when hiring:
 - Reputation in the field
 - Cultural fit
 - Profitability potential
 - Just because

The Courtship Phase: What Can Happen When Love is Blind?



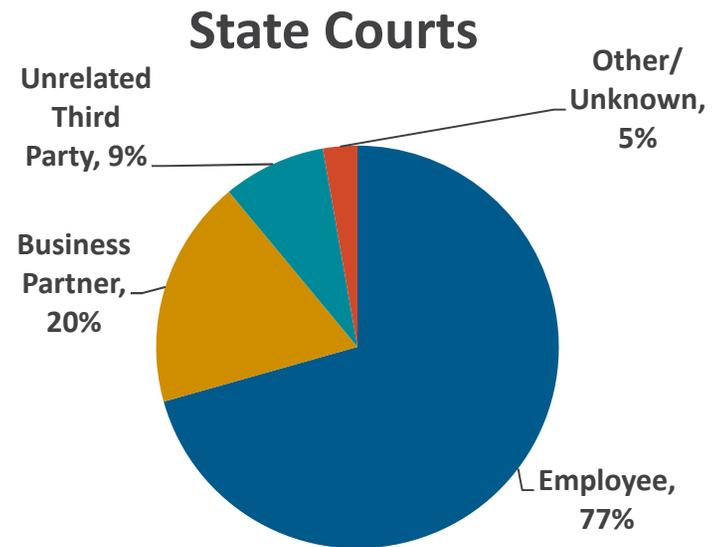
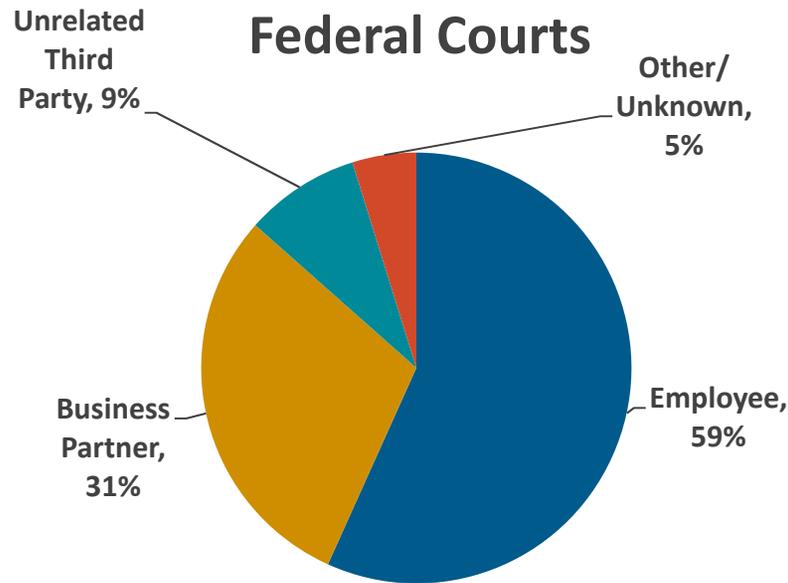
The Courtship Phase: What Can Happen When Love is Blind? (cont'd)

Not considering restrictive covenants from an applicant's former employment can result in liability under federal and state law

- Defend Trade Secrets Act and related state laws
- State common law claims

The Courtship Phase: What Can Happen When Love is Blind? (cont'd)

The most serious threat to a company's trade secrets comes from a business's employees and business partners



Source: A Statistical Analysis of Trade Secret Litigation in State Courts, 46 Gonz. L. Rev. 57; A Statistical Analysis of Trade Secret Litigation in Federal Courts, 45 Gonz. L. Rev. 291

The Courtship Phase: What Can Happen When Love is Blind? (cont'd)

Defend Trade Secrets Act

- New federal, private (civil) cause of action for trade secret misappropriation
 - Amends Economic Espionage Act of 1996 (18 U.S.C. §§ 1831-39)
- Covers acts of misappropriation on or after the enactment date (May 11, 2016)
- Trade secret must be related to a product used in, or intended to be used in, interstate or foreign commerce

The Courtship Phase: What Can Happen When Love is Blind? (cont'd)

Defend Trade Secrets Act (cont'd)

- Remedies
 - Civil seizure (*ex parte*)
 - Damages (including for actual loss, unjust enrichment, or reasonable royalty and exemplary)
 - Attorneys' fees to prevailing party under certain circumstances
 - Injunction
- Protection of trade secret during litigation
- Increased criminal liability
- Immunity for certain disclosures

The Courtship Phase: What Can Happen When Love is Blind? (cont'd)

- Other potential state law claims against the employee or you
 - Breach of contract
 - Tortious interference with contract
 - Tortious interference with economic advantage
 - Unfair trade
 - Unfair competition
 - Raiding

The Courtship Phase: What Can Happen When Love is Blind? (cont'd)

- *Howmedica Osteonics Corp v. DJO Global Inc. et al.*, 2:16-cv-02330, in the U.S. District Court for the District of New Jersey
 - Complaint for injunctive relief
 - Claims against the new employer and ex-manager
 - Count I (corporate raiding)
 - Count II (tortious interference with contract)
 - Claims against ex-employees
 - Count III (breach of contract)
 - Claims against new employer, ex-manager and ex-employees
 - Count IV (tortious interference with prospective economic advantage)
 - Count V (unfair competition)

The Courtship Phase: What Can Happen When Love is Blind? (cont'd)

- *Howmedica Osteonics Corp v. DJO Global Inc. et al.*
 - Motion to dismiss briefing
 - Emergency motion for order to show cause for temporary restraining order, preliminary injunction and expedited discovery
 - Time and \$\$\$

The Courtship Phase: What Can Happen When Love is Blind? (cont'd)

- *B.G. Balmer & Co. Inc. v. Frank Crystal & Co. Inc. et al.*, 3444 EDA 2013 in the Superior Court of the State of Pennsylvania

- 11-count complaint, claims against the new employer and ex-employees

Count I (breach of employment agreements); Count II (breach of non-solicitation provision); Count III (improper solicitation of Balmer clients); Count IV (improper inducement of Balmer clients to discontinue or cancel business); Count V (breach of fiduciary duty against employees); Count VI (breach of fiduciary duty against officers); Count VII (tortious interference with contractual relations); Count VIII (unfair competition); Count IX (misappropriation of proprietary, confidential and trade secret information); Count X (conspiracy); and Count XI (unjust enrichment and constructive trust)

- \$6.9M in compensatory and punitive damages non-solicitation verdict upheld

The Courtship Phase: What Can Happen When Love is Blind? (cont'd)

- *Getty Images Inc. v. Motamedi*, 2:16-cv-01892 in the U.S. District Court for the Western District of Washington at Seattle

- Complaint for temporary restraining order, 10 counts

Count I (breach of contract); Count II (violation of Economic Espionage Act, as amended by the DTSA); Count III (misappropriation of trade secrets); Count IV (unfair competition); Count V (conversion and/or trespass of chattel); Count VI (unjust enrichment); Count VII (tortious interference); Count VIII (breach of fiduciary duty and duty of loyalty); Count IX (civil conspiracy); Count X (accounting)

The Courtship Phase: What Can Happen When Love is Blind? (cont'd)

- *Getty Images Inc. v. Motamedi*
 - Ex-Vice President required to turn over Getty trade secrets and confidential information and restrained her from unfairly competing
 - Ex-Vice President ordered to hand over electronic devices used since January 1, 2015, along with passwords for her email accounts and messaging applications

The Courtship Phase: Strategies for Protecting Yourself From a Fatal Attraction Scenario

- Tips for limiting misappropriation exposure at the hiring stage:
 - Train hiring personnel (HR and management)
 - Establish a protocol for identifying issues
 - Be conscious of email communication content
 - Conduct due diligence on candidates
 - Carefully consider interview questions
 - Consider addressing trade secret/confidential information in the offer letter
 - Consider follow-up letter after offer acceptance
 - Carefully craft press release

The Courtship Phase: Strategies for Protecting Yourself From a Fatal Attraction Scenario (cont'd)

- Candidate due diligence: who are you courting?
 - What is the candidate's job title?
 - What are all of the candidate's responsibilities?
 - How much decision-making authority does the candidate have? Where does the candidate sit in the corporate hierarchy?
 - How much customer contact does the candidate have? What is the scope of the contact?
 - How much does the candidate know about the former employer's "secret sauce"?

The Courtship Phase: Strategies for Protecting Yourself From a Fatal Attraction Scenario (cont'd)

Candidate due diligence (cont'd)

- Make sure all cards are on the table
 - Does the candidate have an existing employment agreement?
 - Is the existing candidate bound by existing restrictive covenants?
 - Non-compete
 - Non-solicitation
 - Confidentiality
- Consider tying full disclosure to (a) employment or (b) assistance with the defense of potential claims

The Courtship Phase: Strategies for Protecting Yourself From a Fatal Attraction Scenario (cont'd)

- Consider conducting an analysis of existing restrictive covenants
 - Type
 - Scope
 - Legal analysis of enforceability

The Courtship Phase: Strategies for Protecting Yourself From a Fatal Attraction Scenario (cont'd)

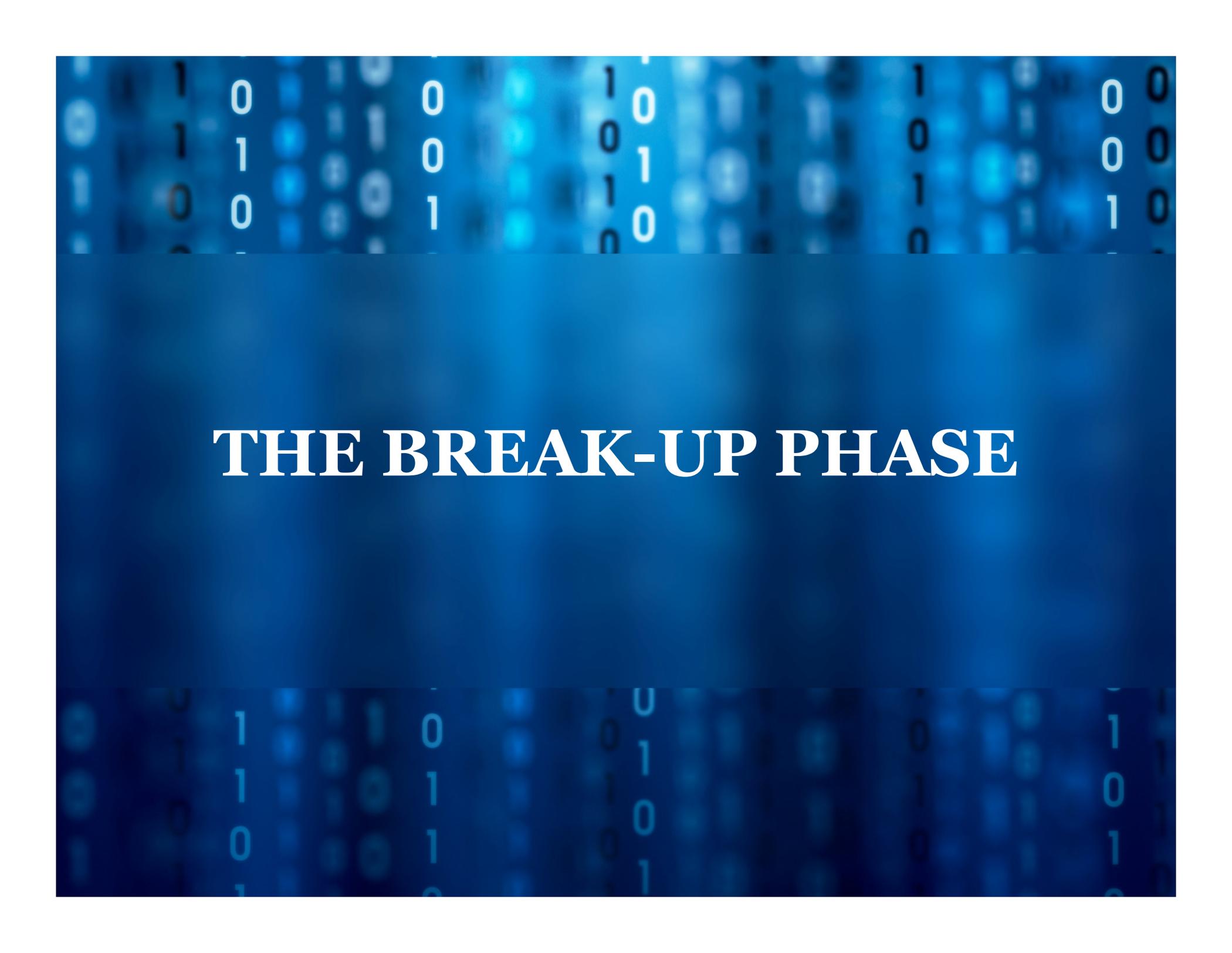
- Consider investigating the former employer's prior enforcement actions
 - No action to enforce
 - Weak threats with no follow-up
 - Deliberate enforcement
 - Scorched earth enforcement

The Courtship Phase: Strategies for Protecting Yourself From a Fatal Attraction Scenario (cont'd)

- Paper the new relationship: warranties and representations
 - Have the employee warrant that accepting employment will not violate any existing relationship
 - Have the employee warrant that he/she will not use the former employer's confidential information or trade secrets
 - Have the company represent that it is not asking the employee to disclose any confidential information or trade secrets of the former employer
- Assign work in non-competitive departments/areas
- Set up information barriers

The Courtship Phase: Strategies for Protecting Yourself From a Fatal Attraction Scenario (cont'd)

- Make sure the candidate's break-up with the old employer isn't messy. Advise your candidate to:
 - Give proper notice
 - Not copy and/or dump files to home computers
 - Return all company property and files
 - Not divert opportunities
 - Not solicit customers
 - Not start work on your behalf
 - Act professionally



THE BREAK-UP PHASE

The Break-Up Phase: Are You Prepared? Use of Prenuptial Agreements

- Think about the end at the beginning of the relationship:
 - Confidentiality/non-disclosure agreements
 - Non-solicitation/no-hire agreements
 - Non-compete agreements
 - Employment policies

The Break-Up Phase: Are You Prepared? Use of Prenuptial Agreements (cont'd)

- Confidentiality or Non-Disclosure Agreements

- Least scrutiny

- But keep in mind...

- Section 21F of the Dodd-Frank Wall Street Reform and Consumer Protection Act

No person shall take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement ... with respect to such communicators.

- In the Matter of KBR, Inc.
- Contexts other than the SEC (e.g., EEOC, NLRB)
- DTSA whistleblower immunity provision

- Know the law and drafting, drafting, drafting

The Break-Up Phase: Are You Prepared? Use of Prenuptial Agreements (cont'd)

- Non-solicitation/No-hire Agreements
 - Less scrutiny
 - But keep in mind...
 - No-hire provisions
 - ***VL Systems inc. v. Unisen Inc.***, 152 Cal.App.4th 708 (2007) and California Business and Professions Code Section 16600
 - Customers
 - ***Edwards v. Arthur Anderson, LLP***, 44 Cal.4th 937 (2008)
 - ***Novus Partners Inc. v. Vainchenker***, 32 Misc. 3d 1241(A), (Sup.Ct. N.Y.Cty. 2011)
 - Know the law and drafting, drafting, drafting

The Break-Up Phase: Are You Prepared? Use of Prenuptial Agreements (cont'd)

- Non-Compete Agreements

- Greatest scrutiny

- Are your non-competition agreements enforceable under state law?

- Are you in California?

- Does your state have a statute that generally governs the enforceability of a non-compete?

- Statute exists (e.g., Florida (Fla.Stat.Ann. §542.33), Missouri (Mo.Rev.Stat. §431.202))

- No statute (e.g., Illinois, New York)

The Break-Up Phase: Are You Prepared? Use of Prenuptial Agreements (cont'd)

- Non-Compete Agreements (cont'd)
 - What does your state identify as a protectable interest?
 - Confidential information and trade secrets
 - Customer relationships and its variations
 - Customer lists and contacts
 - Specialized skills
 - Goodwill
 - Not: Ordinary competition

The Break-Up Phase: Are You Prepared? Use of Prenuptial Agreements (cont'd)

- Non-Compete Agreements (cont'd)
 - Is the non-compete supported by sufficient consideration?
 - \$\$
 - Employment—States have differing views
 - Illinois—Continued employment of two years needed to serve as sufficient consideration, *Fifield v. Premier Dealer Servs.* and its progeny
 - Georgia, New York, Missouri—At the beginning, changes in employment, continued employment is sufficient

The Break-Up Phase: Are You Prepared? Use of Prenuptial Agreements (cont'd)

- Non-Compete Agreements (cont'd)
 - Is the non-compete reasonable in scope?
 - Geographically?
 - Temporally?
 - Does your state recognize activity or customer restrictions?

The Break-Up Phase: Are You Prepared? Use of Prenuptial Agreements (cont'd)

- Non-Compete Agreements (cont'd)
 - Will courts in your state modify an overbroad non-compete?
 - Blue-pencil or strike-out (e.g., Colorado (discretionary), Indiana (same, not compelled))
 - Modify to be reasonable (e.g., Florida, Illinois, Massachusetts)
 - Not change (e.g., California, Louisiana, Nebraska)
 - Other (e.g., Maryland—if bad intent, strike all; if simply unreasonable, modify)
 - Undecided

The Break-Up Phase: Are You Prepared?

Use of Prenuptial Agreements (cont'd)

- Non-Compete Agreements (cont'd)
 - What happens if you, the employer, terminate the employment relationship?
 - Generally still enforced (e.g., Ohio)
 - Still enforced except if the termination was the result of bad faith by the employer or the employer committed a prior breach (e.g., Illinois, Massachusetts)
 - No, not if terminated without cause (e.g., New York); if the contract is breached (e.g., Minnesota)
 - Other
 - Jimmy John's Non-compete suit and the Illinois Freedom to Work Act
 - Know the law and drafting, drafting, drafting

The Break-Up Phase: Are You Prepared?

Use of Employment Policies

- Policies governing confidential information and use of employer resources:
 - Set expectations for conduct early
 - Can be used to remind employees of obligations at time of departure as a measure of additional protection
- **Confidentiality policies** – Include language about continuing obligation, but remember DTSA and government agency concerns
- **Bring your own device policies** – Provide for employer’s ability to request inspection upon departure, ability to remotely wipe device (or portions thereof)
- **Acceptable use policies** – Notice of monitoring; prohibit use of personal email for work purposes, use of cloud, use of thumbdrives or other portable means of taking confidential or trade secret electronic information
- **Social media policies** – Address ownership of corporate social media accounts

The Break-Up Phase: Strategies to Protect Your Interests When an Employee Leaves

- Be aware of restrictions in place
 - Remind employee of obligations at time of notice
 - Provide employee with a copy of any agreements in place and applicable policies
- Request that employee return all confidential or trade secret information, including any hard copy documents



The Break-Up Phase: Strategies to Protect Your Interests When an Employee Leaves (cont'd)

- Investigate:
 - Consider a forensic investigation
 - Check social media
 - Talk to coworkers, clients, customers
- Remember to disable access to employer systems
- Draft continuing obligations letters to the former employee and/or the new employer

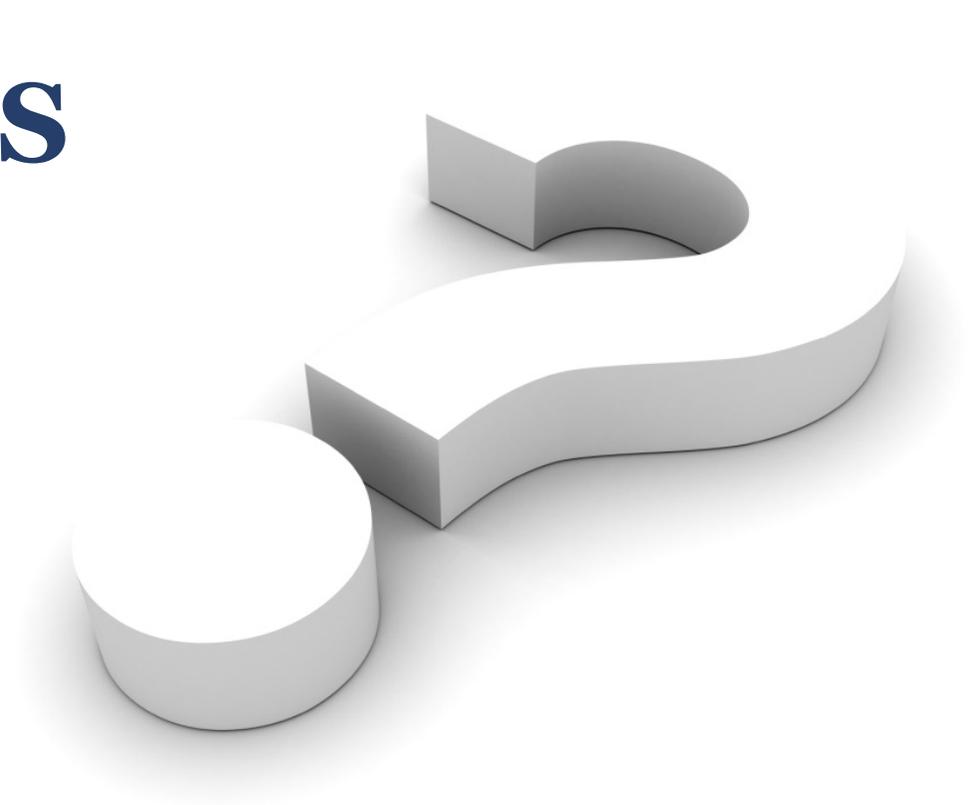
The Break-Up Phase: Strategies to Protect Your Interests When an Employee Leaves (cont'd)

- Draft cease and desist letters to both the former employee and new employer – Include a litigation hold notice in the letters
- Consider informal agreements with the former employee and/or new employer

The Break-Up Phase: Strategies to Protect Your Interests When an Employee Leaves (cont'd)

- Consider litigation
 - Evaluate claims against the former employee
 - Evaluate claims against the former employer
 - Temporary restraining order versus preliminary injunction or both
 - Advantages and disadvantages of litigation
- Consider formal settlement with the former employee and/or new employer

QUESTIONS



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