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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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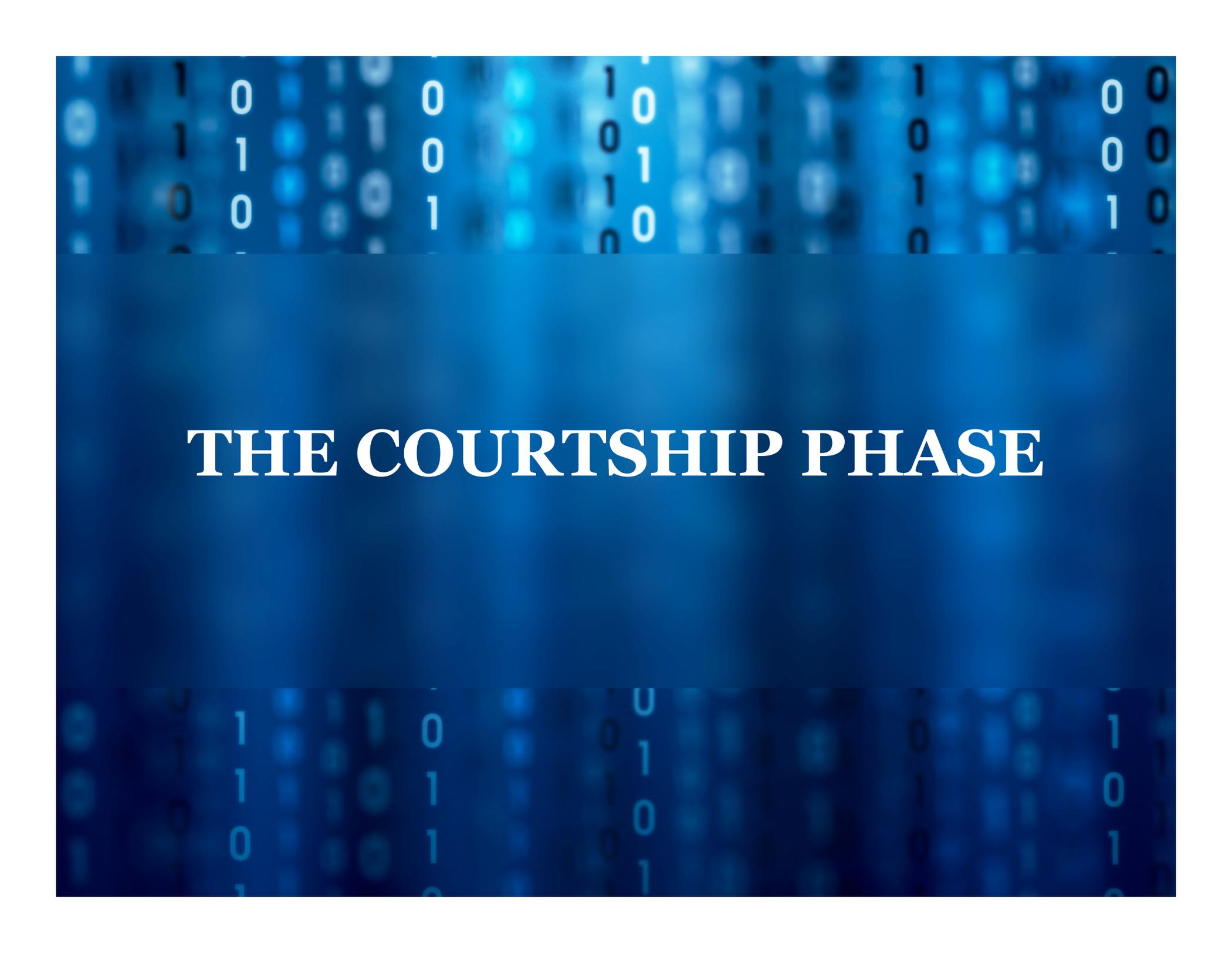
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# Overview

- 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?



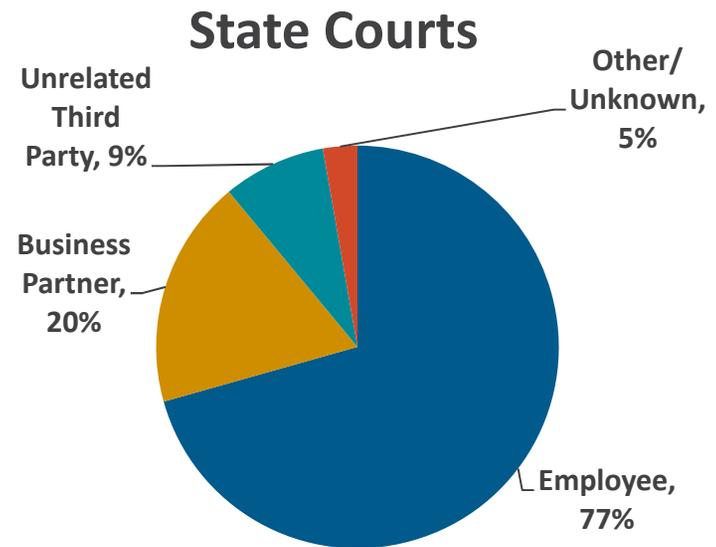
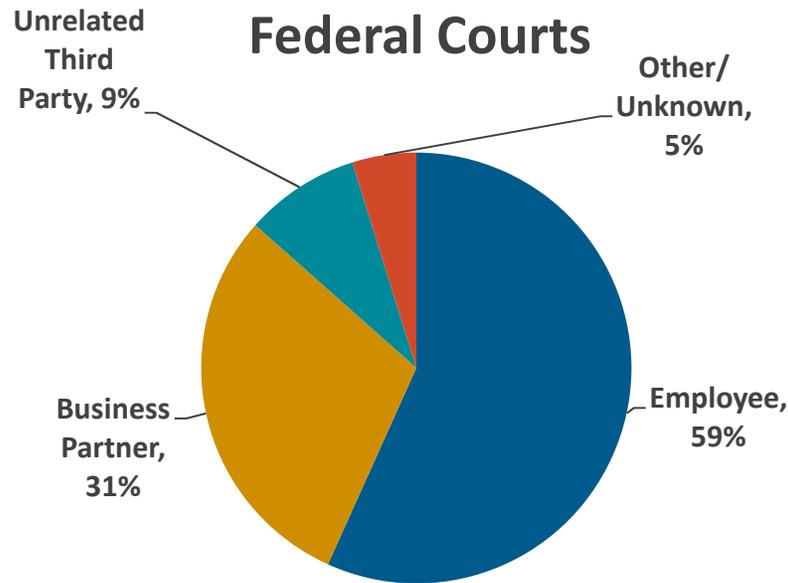
## The Courtship Phase: What Can Happen When Love is Blind? (cont'd)

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)

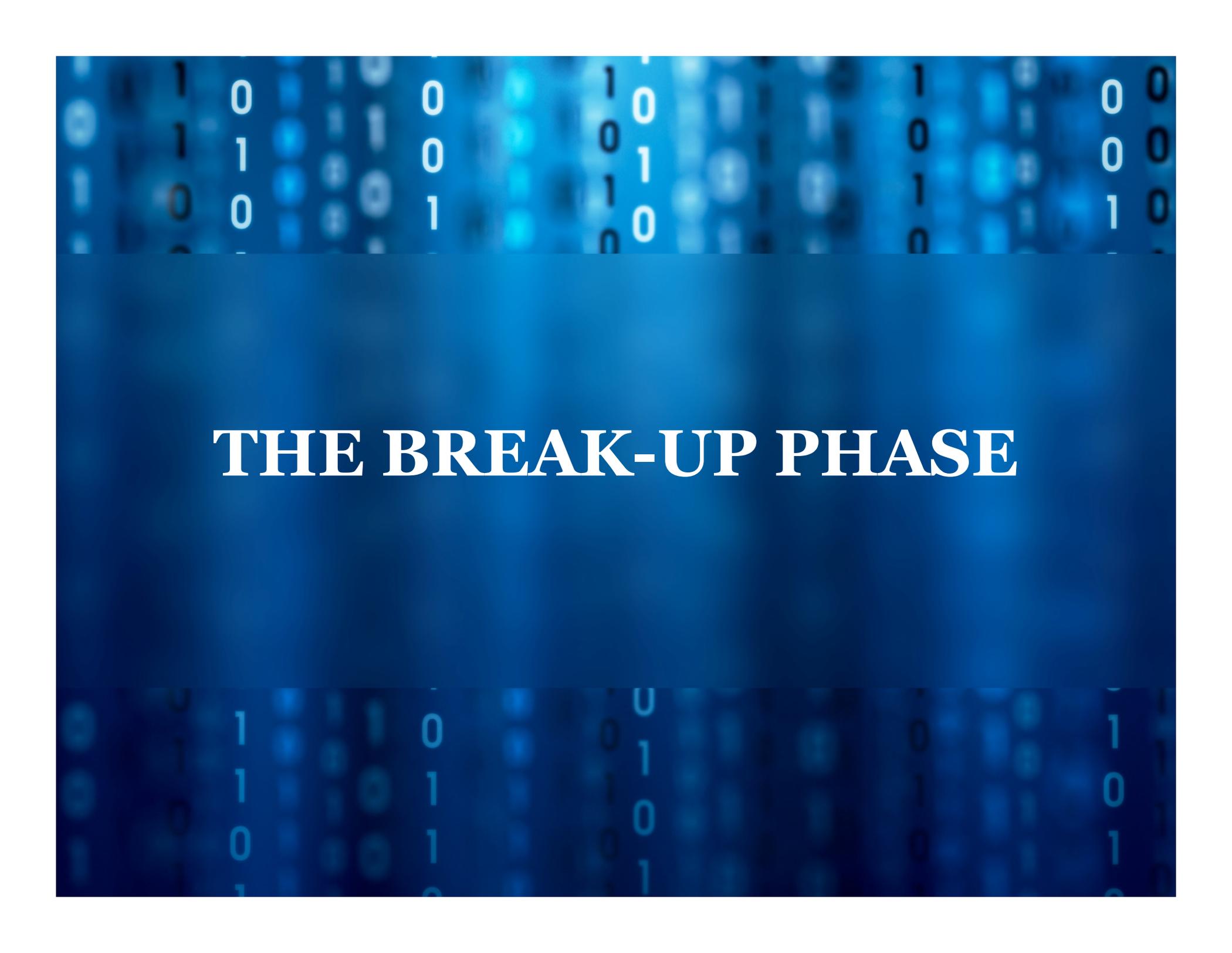
- Consider investigating the former employer's prior enforcement actions
  - No action to enforce
  - Weak threats with no follow-up
  - Deliberate enforcement
  - Scorched earth enforcement

## 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.4<sup>th</sup> 708 (2007) and California Business and Professions Code Section 16600
  - Customers
    - ***Edwards v. Arthur Anderson, LLP***, 44 Cal.4<sup>th</sup> 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

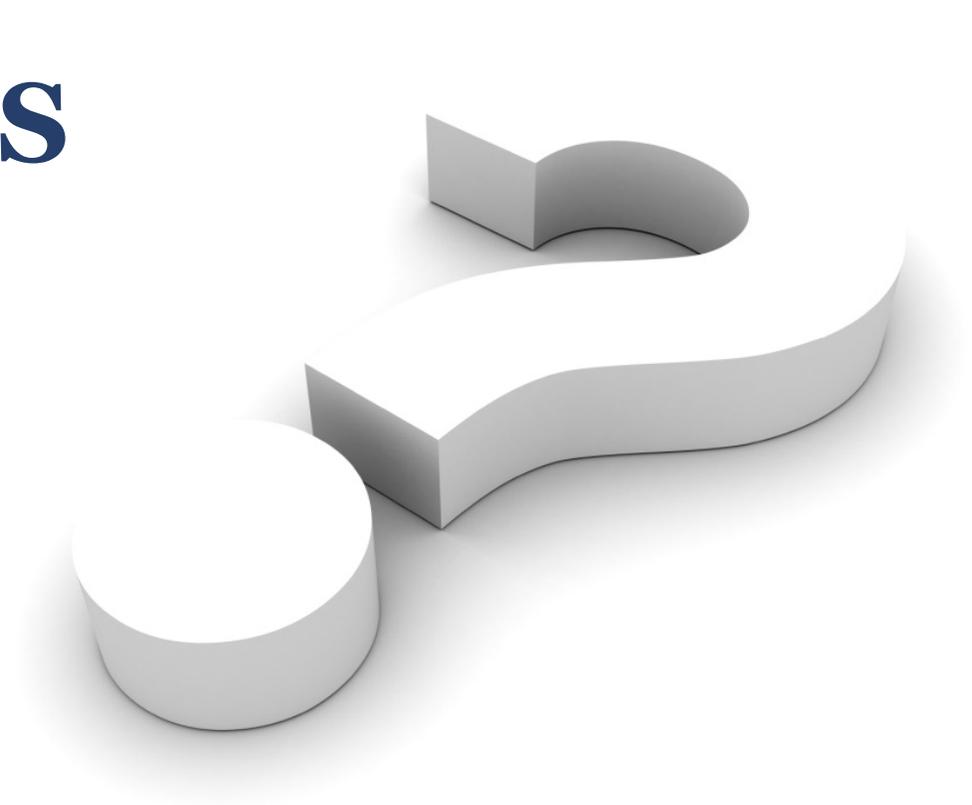
## The Break-Up Phase: Strategies to Protect Your Interests When an Employee Leaves (cont'd)

- 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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