

Dealing With Employees Who “Switch Sides”

Daniel E. Johnson

MCKENNA LONG & ALDRIDGE
LLP

Like the free agents of professional sports, corporate employees are switching “teams” at an unprecedented rate. Today’s employee may be tomorrow’s competitor, and his loyalty may “switch sides” even before he formally changes companies. He might misuse his current employer’s confidential information and solicit co-workers and customers to switch sides with him, severely injuring his employer. Once at his new employer, he might capitalize on his disloyalty, leading to greater damage. What can you do to minimize the damage?

Conversely, an employee of your competitor may want to join your company, and he could face the same temptation to breach his obligations to his current employer. In that situation, what can you do to avoid hiring someone who gets your company sued?

“An Ounce Of Prevention Is Worth A Pound Of Cure”

That is an old adage, of course, but when it comes to protecting corporate assets from a disloyal employee or former employee, truer words were never spoken. Taking a few practical steps now can avoid significant losses later.

One common method of preventing an employee from capitalizing on the company’s assets is to require him to sign a covenant not to compete, and not to solicit customers or co-workers, during employment and for a period of time after employment. In most states, the company can impose these covenants on new employees as a condition of employment, and in some states it can impose a covenant on current employees as a condition of continued employment.¹

The enforceability of restrictive covenants, however, varies widely from state to state.² Where state law permits a covenant, it must be no greater than is necessary to protect the employer’s

Daniel E. Johnson is a Partner in McKenna Long & Aldridge’s Washington, DC office and a member of the firm’s Employment and Litigation practice groups. He represents companies and associations in employment and litigation matters and has particular expertise in “switching sides” cases. His expertise in employment matters also includes employment agreements, covenants not to compete, confidentiality agreements, personnel policies and practices, wage, leave and disability issues, discrimination claims (including race, gender, age disability and pregnancy discrimination claims), fiduciary duty claims, wrongful discharge claims, defamation claims and “whistleblower” claims. He has, in addition, extensive experience in internal investigations of employee misconduct, as well as EEOC investigations. He can be reached at (202) 496-7786.



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legitimate business interests in preserving its confidential data, customer goodwill and the like. A restriction also may not unduly curtail the employee’s legitimate efforts to earn a livelihood. The most important practical rule for non-compete agreements, however, is to tailor them to your business’s particular needs, to the employee’s anticipated role, and to the relevant jurisdiction. There is no “one-size fits all” covenant.

Further, you cannot always assume that, if the restriction is too broad, a court will enforce a narrower restriction. In some jurisdictions, the courts may modify an overly broad covenant and enforce a reasonable restriction.³ In other jurisdictions, however, the courts will enforce only the valid portions that are neatly severable from the rest of the document.⁴ Other courts apply an “all or nothing” rule and simply declare an overly broad covenant completely unenforceable.⁵

If a covenant not to compete or solicit is not your corporation’s cup of tea, you can take other steps. The company should have each employee sign a confidentiality and work product disclosure/ownership agreement. Courts routinely enforce confidentiality agreements (practical tip seldom followed: write them in plain English). The enforcement of work product ownership agreements, however, varies by state.⁶

In addition, the company should have a policy and code of conduct governing the handling of its proprietary information. Meaningful provisions for such policies may include: limiting access to data on a “need to know,” password-protected basis; stamping proprietary data with a proprietary legend; and, keeping materials under lock and key.⁷

Training and rigorous enforcement of confidentiality agreements and policies is important. If the policy mandates marking proprietary information, for example, then you must mark all such information. Otherwise, a disloyal employee will argue that the unmarked information was not truly proprietary. Remind each departing employee of his confidentiality obligations and have him certify in writing that he has taken

no company property or kept copies on home computers or PDA’s.

Is There Immunity Against Poison?

Now let’s put the shoe on the other foot for a moment. Suppose you want to hire an employee from a competitor. This can be a gamble because an employee who “leaks” proprietary information from his former employer can potentially poison his new employer and cost the new employer the opportunity to compete for certain opportunities. What can you do to avoid becoming entangled in a lawsuit between a new hire and his former employer? Is there any immunity available against this poison? There is no complete immunity, but the company can take simple steps to minimize its exposure.

First, the prospective new employer must understand that, even in the absence of a covenant not to compete or solicit, virtually every employee owes his current employer a duty of loyalty or fiduciary duty.⁸ He may prepare for future competition with his employer (in the absence of a non-compete agreement), but he may not compete with the employer for customers or employees.⁹ Thus, an employee breaches his duty of loyalty if he solicits co-workers or customers for himself or a competitor.¹⁰ Further, even former employees owe their former employer a duty not to disclose or misuse confidential information.¹¹

The employer seeking to hire a new employee must be mindful of the restrictions on the candidate’s conduct, lest the employer find itself liable for interfering with the employment relationship, for conspiring in a breach of that relationship, or for other torts or statutory violations.¹² The interviewing and screening process is the time to deal with these potential problems.

When screening a candidate, ask her whether she is subject to any covenant not to compete or solicit. Also, beware if she suggests she can bring co-workers, customers or data with her to your company. These are red flags that the candidate may breach her duty of loyalty to her current employer and perhaps poison your company in the process.

Instruct all candidates not to talk to their co-workers or customers about “switching sides.” Instruct all new hires that they may bring nothing with them from their former employer (“not even a pencil”) beyond personal mementos.

Require each new employee to certify in writing that she is not subject to any contractual restriction that would prohibit her from performing her duties. Make the certification a condition of employment so that a false certification is cause for termination. Have her certify in writing that she will not use or disclose at your company any proprietary data belonging to a former employer.

Train the company managers, interviewers and human resources personnel in these steps so that they will know the

company’s potential exposure, the red flags of potential misconduct, and the steps they must take to protect the company from hiring a lawsuit.

Addressing Disloyal Conduct

If an employer learns that a departing employee may have breached his duty of loyalty, may disclose proprietary information to a competitor, or may breach a restrictive covenant, counsel should take immediate action to investigate and seek legal relief if necessary. A thorough investigation, including witness interviews and detailed searches of email, IM’s and PDA’s of potential witnesses, should uncover any damage the company has sustained, or is about to suffer. Immediate relief – in the form of a TRO against the former employee and his new employer – is often necessary to prevent further damage.

For the company on the receiving end of such a claim, an immediate and thorough investigation also is necessary. Witness interviews and searches of public databases may reveal that the complaining party’s “confidential” data is really not so secret after all, or that employees and customers switched sides as the result of legitimate competition. Prepare for the likely injunction proceedings as if they will determine the outcome of the case, because they often have that practical effect.

Conclusion

There are several practical steps you can take to minimize potential damage from the employee who “switches sides.” If these steps fail, act quickly and decisively to minimize further damage to the corporation’s assets.

¹ See, e.g., *Paramount Termite Control Co., Inc. v. Rector*, 238 Va. 171, 176 (1998).

² For example, *Virginia and New York courts impose a reasonableness test focusing largely on the employer’s legitimate needs to restrict competition. Modern Environments, Inc. v. Stinnett*, 263 Va. 491 (2002); *BDO Seidman v. Hirschberg*, 93 N.Y.2d 382, 712 N.E.2d 1220, 690 N.Y.S.2d 854 (1999). Louisiana allows only covenants that list particular parishes where competition is prohibited. *La. Rev. Stat. § 23:921* (2006). A California statute appears to prohibit employee non-competition agreements altogether. *Cal. Bus. & Prof. Code § 16600* (2005), but some courts have upheld narrow restrictions on post-employment competition in California. *International Business Machines Corp. v. Bajorek*, 191 F.3d 1033 (9th Cir. 1999).

³ *A.N. Deringer, Inc. v. Strough*, 103 F.3d 243 (2d Cir. 1996).

⁴ *Deutsche Post Global Mail, Ltd. v. Conrad*, No. 03-2504, 2004 U.S. App. LEXIS 24249 (4th Cir. Nov. 19, 2004) (Maryland law).

⁵ *Northern Va. Psychiatric Group v. Halpern*, 19 Va. Cir. 279 (Fairfax Co. 1990).

⁶ In California, for example, an invention ownership agreement is unenforceable unless it includes certain provisions prescribed by statute. *Cal. Labor Code §§ 2870-72* (2005).

⁷ Taking “reasonable” steps to preserve the secrecy of data also is a *sine qua non* of trade secret protection. See, e.g., *Unif. Trade Secrets Act § 1* (amended 1985), 14 U.L.A. 437 (1990). Further, each government contractor must add specific restrictive legends to data delivered to the government if the contractor asserts proprietary rights in the data. See *Night Vision Corp. v. United States*, 68 Fed. Cl. 368 (2005).

⁸ *Restatement (Third) of Agency § 8.01* (2005).

⁹ *Id.*

¹⁰ *Id.* § 8.04.

¹¹ *Id.* § 8.05.

¹² See *Advanced Marine Enterprises, Inc. v. PRC Inc.*, 256 Va. 106 (1998).

Please email the author at djohnson@mckennalong.com with questions about this article.