PROTECTING INFORMATION IN THE INFORMATION AGE: EMPLOYMENT CONCEPTS AND EMPLOYER TECHNIQUES IN THE INFORMATION AGE

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EMPLOYMENT CONCEPTS AND EMPLOYER TECHNIQUES IN THE INFORMATION AGE

I. IMPLICATIONS OF THE INFORMATION AGE

- In the Information Age, the most important asset is an employee's brain. Employees have essentially become intellectual property. Thus, companies are trying harder to make it more difficult for knowledgeable employees to leave.

- Given the increasing value of intangible assets like know-how in the Information Age, there has been a significant amount of recent litigation in which corporations—which are vitally interested in protecting their secrets—are willing to seek injunctive and monetary relief when key employees go to competitors.

II. EMPLOYER TECHNIQUES IN THE INFORMATION AGE

A. CONFIDENTIALITY AGREEMENTS

1. Confidentiality provisions in employment contracts and stand-alone confidentiality agreements can provide broad protection to employers.

   a. But provisions should not be written so broadly as to cover public information.

2. Courts look more favorably upon confidentiality agreements than non-compete agreements. Courts understand the employer's interest in protecting its trade secrets and confidential business information, while the employee has no countervailing interest in that information.

3. Available legal theories

   a. Against employee: Breach of contract; trade secret misappropriation; conversion; breach of duty of loyalty

b. Against competitor: Tortious interference with contract/prospective economic advantage; trade secret misappropriation; unfair competition

B. NON-COMPETE AGREEMENTS

1. Non-compete agreements can prevent former employees from going to work for a competitor or starting a competing business.

2. Each state has its own unique rules pertaining to non-compete agreements. It is important to note that even though a non-compete agreement can specify that a particular state's law will govern, courts may choose to ignore the specification and hold that another state's law is applicable because that state has a materially greater interest.

3. Examples of State Law:

- Under Virginia law, a non-compete agreement undergoes a three-pronged test: (1) Is the restraint, from the standpoint of the employer, reasonable in the sense that it is no greater than necessary to protect the employer in some legitimate business interests?; (2) From the standpoint of the employee, is the restraint reasonable in the sense that it is not unduly harsh and oppressive in curtailing the employee's legitimate efforts to earn a livelihood?; (3) Is the restraint reasonable from the standpoint of a sound public policy?

- Under Maryland law, a non-compete agreement is valid if: (1) There is adequate consideration; (2) The non-compete agreement is confined to reasonable time and geographical limits; and (3) The agreement does not impose undue hardship on the employee or disregard the interests of the public.

- Under District of Columbia law, non-compete agreements are valid so long as they are reasonably tailored. Reasonability

is determined by examining the terms of the agreement. The time and geographical limit of the agreement is particularly scrutinized.

- California has a fairly strong policy against non-compete agreements, but non-compete agreements have been upheld to the extent trade secrets are not imperiled.[1]

- New York law subjects a non-compete agreement to an overriding limitation of reasonableness. Assuming an agreement is reasonable in time and geographic scope, enforcement will be granted to the extent necessary (1) To prevent an employee's solicitation or disclosure of trade secrets; (2) To prevent an employee's release of confidential information regarding the employer's customers, or (3) In those cases where the employee's services to the employer are deemed special or unique. Unique services are dependent on an employee's special talents. In *Ticor Title Insurance Co. v. Kenneth Cohen*, 173 F.3d 63, 70 (2nd Cir. 1999), the Second Circuit determined that individuals who perform unique services include musicians, athletes, actors, and the like.

4. What should a company do when constructing its own non-compete agreement?

While no company can write a non-compete agreement that withstands all judicial scrutiny, courts tend to uphold non-compete agreements that are:

- Narrowly tailored:

  The agreement should detail how an employee's knowledge about the employer

[1] The definition of "trade secret" is largely open to interpretation and each state has its own laws reflecting different policy interests with respect to the protection of trade secrets.

will harm that employer. If the employee is privy to trade secrets, detail the specific technology that is involved. Simply claiming that a former employee understands a company's general methods is not sufficient. If the employee dealt with financial-planning products, the agreement should prevent him from working with any company that is a substantial and direct competitor. An attempt to prevent him from working with companies that are only peripherally involved in financial planning is less persuasive. Courts have demonstrated that vague agreements are not likely to survive judicial scrutiny.

- Between the seller of a business and the buyer.

- Necessary to protect an employer's trade secrets:

  The question of what constitutes a "trade secret" is vague and courts have interpreted the term both broadly and narrowly. A Massachusetts court held that an Internet corporation's Web page "content management techniques" amounted to a trade secret. *See New England Circuit Sales v. Scott Randall,* 1996 U.S. Dist. Lexis 9748 (Mass. Dist. Ct. 1996). The Seventh Circuit determined that a company's pricing, distribution, and marketing strategies are trade secrets. *See Pepsico, Inc. v. William Redmond,* 54 F.3d 1262 (7th Cir. 1995).

- Limited in time and geographic scope.

- Created for valid reasons:

  If an employer's main objective for the agreement is to intimidate other employees and make them stay, a court may be less likely to uphold the agreement.

- Supported by additional compensation:

A court may be influenced by whether an employee got something in return for signing an agreement not to compete. Most courts require an employee to receive something more than just the job he is seeking for the agreement to be held valid. While monetary compensation is a common form of consideration, in *Hekiman Labs v. Domain Systems*, 664 F. Supp. 493 (S.D. Fla. 1987), a court held that consideration need not be in the form of monetary payments. Benefits such as special training usually suffice.

5. How can a company avoid entangling itself with another company's non-compete agreement?

Since few employees today work at one company throughout their careers, companies inevitably hire individuals who must abide by non-compete agreements. To protect against suits from the employee's former employer, a company should:

- Require its managers and executives fill out conflict-of-interest forms outlining any activities or previous obligations that might conflict with their jobs.

- Avoid actions that can be interpreted as excessively interfering with a competing company's employees.

6. How can a company negotiate a fair non-compete agreement?

- Negotiate the agreement during the courtship when everyone is happy and the employee is interested in coming to work for the corporation.

- Negotiate "carve outs" or specific jobs and places for which the clause does not apply should the employee leave the company. For example, if the employee is going to work in public relations, the company should allow him to pursue work in a similar, but not directly competitive field, such as marketing communications.

7. What can a company do to protect itself when an employee under a non-compete agreement leaves?

   - A company should make sure that the exiting employee takes nothing other than his personal belongings.

   - A company may want to prohibit the employee from taking his Rolodex or files.

   - Before the employee leaves, make sure he has transferred his responsibilities to others. It is important that he not leave his co-workers and projects in the lurch.

B. PUNITIVE "BAD BOY" CLAUSES

1. Bad boy clauses are attached to executive compensation agreements and make it difficult for a former employee to recruit employees from his former workplace. For instance, under one bad boy clause, Compaq's chief executive officer could lose millions in benefits and a special pension fund if he recruits just one Compaq employee when he leaves.

2. An open question is whether the clauses will be upheld in court. While it may be difficult to enforce such clauses because people generally have a right to work where they want, some courts are upholding such agreements. For instance, in *John Johnson v. MPR Associates*, 894 F. Supp. 255, 256-257 (E.D. Va. 1994), the court upheld a company's punitive clause ordering the employee to tender his stock to the corporation in the event that he becomes employed with a client of the corporation within three years of leaving.

C. "GOLDEN HANDCUFF" PROVISIONS

1. Like punitive bad boy clauses, the golden handcuff provisions are aimed at inducing employees to stay with the company. The

theory behind the provisions is that a company's secrets are safe as long as its executives stay put. It thus makes sense to give the employees incentives to remain. Golden handcuff provisions may spread executive annual bonuses over a number of years to keep executives from job hopping or order an executive to surrender his stock options if he departs.

2. Some golden handcuff provisions even contain retroactive statements that seek forfeiture of profits realized before an executive's departure. It is questionable not only whether such provisions are legal, but also whether they are wise from a business standpoint. Some critics argue that the provisions do not increase loyalty, but rather encourage executives to start mapping out their departures even further in advance.

III. EMPLOYMENT CONCEPTS IN THE INFORMATION AGE

A. INEVITABLE USE THEORY/ARGUMENT

1. The inevitable use theory is based on the idea that ex-employees will inevitably disclose confidential information to new employers. The theory gained ground after a federal appeals court in Chicago in 1995 blocked a Pepsico Inc. executive from going to work for Quaker Oats for six months and permanently barred him from divulging Pepsico trade secrets. The executive had signed a confidentiality agreement, but no non-compete agreement.

2. The inevitable use argument is powerful (and controversial). As noted, it has been used by courts to restrict future employment in cases where the executive never signed a non-compete agreement.

3. The inevitable use argument has become forceful in the Information Age because the contents of one's knowledge is increasingly important. Top mangers today are usually too

sophisticated to make obvious mistakes like taking secret documents or computer disks with them when they quit. The law, however, cannot require departing executives to erase their memory banks. The inevitable use argument provides companies with a tool to prevent departing executives from sharing their knowledge with rival corporations.

4. Last year, Bayer employed the inevitable use argument to contend that one of its former executives now working for GE would "inevitably" use Bayer secrets in his new job. While the case was settled on confidential terms, the issues at the heart of the case remain alive for any company that loses an important executive or technical employee to a rival.

B. RAIDING

1. While the concept of raiding a rival company's employees is not new, the practice increasingly is being called into question. Companies today are more apt to file suit, and courts subsequently have begun scrutinizing the practice more closely.

2. For instance, last month Tyson Foods filed suit against ConAgra accusing ConAgra of stealing trade secrets and systematically raiding its management. Tyson Foods is seeking an injunction, arguing that the legal system cannot stand idly by while ConAgra is looting Tyson Food's intellectual property.

3. A couple of years ago a federal bankruptcy-court judge issued an unusual order—a temporary restraining order blocking a hiring raid of Montgomery Ward executives by Sears. Though Sears had not yet acted, an e-mail sent by a Sears executive encouraging the raid of its bankrupt competitor was sufficient action for a court to enjoin Sears from actively hiring Montgomery Ward employees. While a court order blocking a hiring raid is rare, bankruptcy-court judges are empowered to block any actions that interfere with the bankruptcy reorganization process. The temporary

restraining order did not prohibit Montgomery Ward managers from applying for jobs at Sears on their own, nor did it apply to hourly workers.

4. Corporations are not the only targets of raiding practices. The California law firm of Haight, Brown & Bonesteel lost 23 of its 130 lawyers and 22% of its $28 million in annual billings when a former partner started a competing law practice across the street. The law firm sued the partner claiming that he breached his non-compete agreement and the partner counter-sued alleging the agreement was an illegal restraint of competition. The California Superior Court ruled that the agreement was valid. *See Haight, Brown & Bonesteel v. Superior Court,* 234 Cal. App. 3d 963 (Cal. Super. Ct. 1991).

5. The question f who owns the customer is a hotly contested issue in raiding cases because the clients an employee can bring with him may be as important as is his knowledge. Some companies have attempted to bar employees who have gone to work for competitors from taking clients with them. In fact, some courts take into account the issue of whether clients will follow an employee in determining whether the employer can restrict the employee's post-employment work. For instance, in *Source Services Corp. v. Michael Bodgan,* 1995 U.S. App. Lexis 3352 (4th Cir. 1995), the Fourth Circuit held that under Maryland law unless strong business or personal ties between employees and customers generate good will, employers do not have a protectable interest and should not be able to restrict post-employment competition. A company only has a protectable interest in an employee's post-employment activities if the employee uses the contacts he established with clients during the employment to pirate the employer's customers. *Id.* at *10-12.