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Ensuring Fair Competition When A Former Employee Has No Restrictive Covenants:
Common Law Protections for Employers

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Here is the situation: A high-level executive has worked for your company for ten years. She recently developed marketing and strategic plans for the company's new products. She has had access to documents concerning the company's strategic plans to compete, financial goals, pricing strategy and promotional events for the next few years. And she has participated in recent meetings at which the company discussed this information. The executive has never signed any restrictive covenant agreement and is an at-will employee. The executive abruptly tenders her resignation and announces her intent to assume a similar position with one of the company's main competitors. This situation is not just hypothetical, it was the basis for a lawsuit between two major competitors in the beverage industry.[1]

Does the company have any protection from unfair competition by the executive even though she never signed a restrictive covenant? Absolutely. This article discusses the company's rights and protections. But first, the former employer needs to understand the executive's rights.

Employee's Rights In The Absence Of Any Restrictive Covenant

An employee may apply for a competitive job or even form a competing business while still working for the employer, so long as he or she does so on his own time and with his own resources, absent specific contractual restrictions.[2] Likewise, an employee without a restrictive covenant is free to resign and immediately begin working for a competitor of his former employer and immediately begin soliciting his former employer's customers and employees. Furthermore, at his or her new job, the employee is free to use the skills and knowledge acquired by the overall experience of his previous employment.[3] Mere knowledge of the intricacies of a business will not justify restricting a former employee from full-blown competition.[4]

So, in the absence of a restrictive covenant agreement, how can an employer protect itself from unfair competition by a former employee?

A Current Employee's Duty Of Loyalty

The common law duty of loyalty provides the employer with significant protections. This duty imposes obligations on both current and former employees, as a matter of law, regardless of any restrictive covenant agreement that may exist between the employee and employer.

Under New York law, an employee must exercise the "utmost good faith and loyalty" in the performance of his or her duties. As a general matter, an employee may not, while employed, act contrary to the employer's interests. More specifically, under New York's common law duty of loyalty, a current employee:

- May not compete with his or her employer.
- May not solicit customers or employees for a rival business.
- May not use the employer's confidential information for his or her own benefit or to the detriment of the employer.
- May not divert or fail to disclose a corporate opportunity.
- May not lessen his workload in anticipation of resigning and competing.
- May not form a competing business during regular business hours and with the use of the employer's resources.

All of these restrictions arise from the employee's common law duty of loyalty, and govern an employee's conduct even in the absence of a restrictive covenant agreement.[5]

There is thus a significant temporal element to the current employee's duty of loyalty. Employees planning on resigning to work for a competitor must continue to fulfill all work obligations until the moment of resignation. Before resigning, employees may not solicit customers to line up business following the termination of employment. Likewise, they may not solicit fellow employees to join them in a competing venture. Additionally, under the "corporate opportunity doctrine," employees may not conceal a new project, potential assignment or a change in the relationship with an existing customer in the hope of pursuing it once they start working at another firm.

A resigning employee should not take any company property with him when he leaves the company. Before resigning, he should return all files that he may have accumulated at home pertaining to his current employer. If the employee has a home computer, he should take whatever was on the home computer relating to the business of his current employer, print it out and/or put it on a disk, delete it from his home computer and leave the disk with his current employer on the date of his res-

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ignation. An employer should reinforce these obligations by stating them in an employee handbook or similar document.

A Former Employee's Duty Of Loyalty

The common law duty of loyalty continues to restrict an employee's conduct after the termination of his or her employment.[6] Even in the absence of a restrictive covenant, a former employee may not use confidential information belonging to the former employer to form a new business or to solicit the former employer's customers or employees.[7] More generally, a former employee may not use confidential information belonging to his or her former employer in any way in competition with the former employer.[8]

Thus, courts will enjoin a former employee from using or disclosing a former employer's trade secrets or confidential information. Likewise, the "corporate opportunity doctrine," which prohibits an employee from diverting to himself or another company a business opportunity that he learned about only by virtue of employment, applies even after the employee leaves the employment.[9]

What Information Is Confidential?

In determining whether information constitutes a trade secret or is otherwise protectible as confidential information, New York courts consider:(1) the extent to which the information is known outside the business; (2) the extent to which the information is known to employees and others involved in the business; (3) the extent that measures are taken to guard the secrecy of the information; (4) the value of the information to the business and its competitors; (5) the amount of effort and money expended in developing the information; and (6) the ease or difficulty with which the information could properly be acquired or duplicated by others.[10]

The most important factor in determining whether particular information is confidential is straightforward and simple: has the employer kept the information secret? In this regard, the court will consider whether the employer has taken reasonable measures to protect the secrecy of the information and the ease or difficulty with which the information can be obtained from other sources. Courts will consider, for example, whether the employer limited access to the confidential information to employees who needed to know the information, whether the employer required employees who had access to the confidential information to sign confidentiality agreements, and whether the employer labeled and/or treated the information as confidential.[11]

It is, therefore, advisable that employers require employees who have access to the employer's confidential information to sign confidentiality agreements. The agreement will remind employees of their common law duties of confidentiality while also subjecting them to contractual obligations, it will allow the employer to identify, with specificity, what kind of information it considers confidential and it will demonstrate the employer's commitment to keeping the information secret. It may also be advisable to include in the confidentiality agreement a discussion of the employee's duty of loyalty.

So what kind of information may a court deem as confidential: "any information that can be used in the operation of a business or other enterprise and that is sufficiently valuable and secret to afford an actual or potential economic advantage over others."[12] This may include, among other things:

- Customer names and contact information
- Customer preferences
- Former employer's costs and profit margins
- Marketing and selling plans and practices
- Business opportunities
- Computer software programs
- Business methodologies
- Financial information and projections
- Product formula or specifications
- Information about proposed new products or services
- Personnel information

Inevitable Disclosure

In very rare cases, a court may enjoin an employee who has not signed any restrictive covenant agreement from competing where it is "inevitable" that the former employee would divulge or use his former employer's confidential information in his new employment. Such inevitable disclosure need not be intentional; a high risk of "inadvertent" disclosure may justify injunctive relief, even if the employee proceeds in good faith.[13]

But the doctrine of "inevitable disclosure" is highly disfavored in New York and applied very sparingly. The mere fact that a person assumes a similar position with a competitor does not make it "inevitable" that he will use a disclosure of the former employer's confidential information. Indeed, New York courts are unlikely to enjoin an employee who is not a party to a restrictive covenant agreement under the doctrine of inevitable disclosure, absent evidence that the employee actually misappropriated the employer's confidential information. In assessing whether to apply the doctrine of inevitable disclosure, courts will consider whether:(1) the employers... are direct competitors providing the same or very similar products or services; (2) the employee's new position is nearly identical to his old one, such that he could not reasonably be expected to fulfill his new job responsibilities without utilizing the trade secrets of his former employer; ... (3) the trade secrets at issue are highly valuable to both employers. [The court will also consider] (4) the nature of the industry and [its] trade secrets.[14]

Conclusion

So, our hypothetical executive is free to compete, unless the inevitable disclosure doctrine applies to her. But even if she can compete, she is bound by a duty of loyalty both before and after her resignation.

That duty goes a long way to ensuring that the executive does not unfairly compete with her former employer. And the employer could have further protected itself by having the executive sign a confidentiality agreement that went beyond boilerplate and specifically identified the kind of information the employer considers confidential and reminded the executive of her ongoing duty of loyalty.

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[1] See Pepsico, Inc. v. Redmond, *54 F.3d 1262 (7th Cir. 1995).*

[2] Frederic M. Reed & Co. v. Irvine Realty Group, Inc. *723 N.Y.S.2d 19, 20 (1st Dep't*), app. denied, *96 N.Y.2d 720 (2001).*

[3] Marietta Corp. v. Fairhurst, *754 N.Y.S.2d 62, 66 (3d Dep't 2003) (quoting* Reed, Roberts Assoc. v. Strauman, *40 N.Y. 2d 303, 307 (1976)).*

[4] Colonize.com v. Perlow, *2003 U.S. Dist. LEXIS 20021, *16 (N.D. N.Y. Oct. 23, 2003).*

[5] See, e.g., A&L Scientific Corp. v. Latmore, *696 N.Y.S.2d 495 (2d Dep't 1999);* American Fed. Group v. Rothenberg, *136 F.3d 897, 906 (2d Cir. 1998);* Great American Trucking Co. v. Swiech, *700 N.Y.S. 2d 632 (4th Dep't 1999).*

[6] North Atlantic Instruments, Inc. v. Haber, *188 F.3d 38 (2d Cir. 1999).*

[7] Cosmos Forms v. American Computer Forms, *596 N.Y.S.2d 862, 864 (2d Dep't 1993).*

[8] ABKCO Music, Inc. v. Harrisongs Music, Ltd., *722 F.2d 988, 995 (2d Cir. 1983).*

[9] American Fed. Group, *136 F.3d at 911, 914*; Inflight Newspapers, Inc. v. Magazines In-Flight, L.L.C., *990 F. Supp. 119, 137 (E.D.N.Y. 1997);* Town & Country House & Home Service, Inc. v. Newbury, *3 N.Y.2d 554, 561, 170 N.Y.S.2d 328, 333-34 (1958).*

[10] Ivy Mar Co., Inc. v. C.R. Seasons, Ltd., *907 F. Supp. 547, 556-56 (E.D.N.Y. 1995).*

[11] A.F.A. Tours, Inc. v. Whitchurch, *937 F.2d 82, 89 (2d Cir. 1991);* Geritrex Corp. v. Dermarite Indus., LLC, *910 F. Supp. 955, 961 (S.D.N.Y. 1996).*

[12] Wiener v. Lazard. Freres & Co., *672 N.Y.S.2d 8, 15 (1st Dep't 1998) (quoting Restatement (Third) of Unfair Competition § 39).*

[13] See, e.g., Pepsico, Inc. v. Redmond, *54 F.3d 1262 (7th Cir. 1995)*; Lumex Inc. v. Highsmith, *919 F. Supp. 624, 627, 634-35 (E.D.N.Y. 1996).*

[14] EarthWeb, Inc. v. Schlack, *71 F. Supp. 2d 299,310 (S.D.N.Y.1999*)