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Multiple Issues In Corporate Raiding of Employees; Outside Counsel

Now that bankruptcy proceedings have replaced mergers and acquisitions, poaching key employees rather than buying a division can be cost effective. Corporate raiding of employees, however, raises serious legal and financial concerns for everyone involved, but particularly for employees and their counsel.

Poaching a coveted employee or raiding a team is bound to leave behind an angry employer who wants revenge. The hardest job for employee-side counsel is to keep the client from becoming a defendant in a lawsuit against both the employee and the new employer.

Knowing how to prevent or minimize an employee's liability in this situation is critical. Counseling employees on terms and conditions to be negotiated with the new employer before departure will protect them from economic loss and protracted and costly litigation.

Here is a list of common issues to remember when advising and representing the "raided" employee and members of her team:

- **Independent, Conflict-free Representation.** Employees, particularly those who leave their employer as a team, will need independent counsel. Relying on the new employer's counsel or an HR professional whose interests are not necessarily aligned with your client's may be problematic. For starters, your clients may need certain legal and nonlegal guarantees, including indemnification and possible defense (see below) if the former employer sues.

Advising a team of employees about confidentiality and conflict issues should begin before they are hired. If you plan to represent the whole team, you need to ensure that the rules for joint representation are carefully followed and understood by each member of the team. While an attorney is permitted to represent a group, it is critical to follow the state's disciplinary rules to avoid a conflict of interest or malpractice claim. For example, the clients must be advised that if a conflict or potential conflict arises, you may not be able to represent one or all of them.

The ethical rules governing joint representation are based upon two distinct duties of an attorney to her clients. The first is the duty to maintain client confidences[1] and the second is the duty of loyalty,[2] that prohibits the attorney from doing anything materially adverse to the client's interests. In this respect, joint representation is permissible if the attorney reasonably believes that the representation will not adversely affect the interest of each client and each client consents after consultation.[3]

Further, while the ABA Model Rules prohibit the disclosure of confidential communications absent consent, they require counsel to share confidential communications between or among joint clients about facts material to the representation.[4] A joint retainer should incorporate these rules so that the individual clients fully understand their relationship not only to counsel but to one another.

Following these rules can be difficult if individual team members have divergent interests and if each member is subject to different rules on departure. It can also be challenging if the financial packages offered are not identical for all members. For example, while it is possible to carve out certain issues surrounding the sharing of confidential information (such as compensation), it may put an attorney in a potential conflict situation when she is negotiating individual compensation packages. Working through these issues is key in a lift-out situation.

- **Solicitation of Team Members, Restrictions and Indemnification.** When representing a team of employees (or just an individual), counsel your client not to solicit or raid other employees from her team or be involved in the recruitment process of other team members while still employed by the old company. Even without a non-solicitation restriction during or after employment, soliciting other employees to leave a company while still employed is a common-law breach of the employee's duty of loyalty in most states.[5] Your client should avoid giving lists of potential hires to the new employer or acting as a recruiter. The new employer can recruit the team on his own or hire an outside recruiter.

The employee must be told that a common law duty of loyalty or even a fiduciary duty prohibits her from taking any actions against the interests of her current employer while still employed. If she is a high-level executive, she is under a higher duty not to act in any manner inconsistent with her employment and must exercise the utmost good faith and loyalty in the performance of her job.[6]

Proper diligence includes finding out exactly what kinds of restrictions your client is subject to. If your client has a non-compete, while they are disfavored in New York, it may be enforced if a court finds that it is reasonable in duration and scope and was entered into voluntarily. In determining whether to enforce a non-compete agreement, courts usually balance the employer's legitimate business interests with the employee's ability to earn a living. The "legitimate interests" of an employer are generally limited to the protection of trade secrets and confidential information, and in some cases, protection from competition by a unique or extraordinary employee.[7]

If one or more of your clients has a non-solicitation agreement, it is important to inform them that courts may give non-solicitation provisions more deference because they are often narrowly tailored to an employer's legitimate business interest.[8] In most states, courts uphold non-solicitation agreements when they seem reasonably necessary for an employer to protect its investment in training and maintaining a competent workforce.[9] Make sure your client understands that urging other employees to join the lift-out or telling the new employer whom to recruit can be construed as direct and indirect solicitation, respectively, and may result in a claim for breach.

It is also advisable to tell your client not to commit to leaving the current position without a full indemnity and defense provision in writing from the new employer. In this situation, while you can't always protect your client against becoming a defendant in an action for breach, the best insurance is full indemnification and defense.

- **Confidential and Proprietary Information.** Always advise the employee against transferring company information, or even his own information produced in the scope of employment, to a home computer or disk or, worse, to the new company. This action, as extreme as it may sound, can result in a criminal allegation for the theft of corporate information, or at the very least give the former company a claim for theft or misappropriation of trade secrets or confidential information.[10] In addition, whether or not an employee signed a confidentiality agreement, courts may still find that the employee converted confidential information under common law.[11]

Confidential information can include trade secrets, forms, charts, schematics, client lists, client data, marketing material, pitches, and virtually any other information that is not known or available to the public.[12] While a former employee may be free to solicit her former employer's clients whose identities are easily ascertainable,[13] even in the absence of a non-compete she is not free to use the former employer's trade secrets in doing so.[14]

- **Client Solicitation.** Often, less senior members of a team will not be subject to the same length of "garden leave,"[15] notice period or non-solicitation clause as a senior team member. However, asking another employee to solicit your client's customers or get customer information can create the same liability as if your client solicited the customer directly.

An employee on "garden leave" or a notice period owes the same duty of loyalty to her former employer as if she were actively employed, including not poaching or soliciting its customers and current employees. Again, in many states this is common law and does not require a written restriction of any kind. Therefore, advise your client not to call customers or respond to phone messages from customers while on garden leave or during a notice period even if they are personal friends.

Further, your client should be counseled to resist pressure from the new employer to work during a notice period or garden leave and not to do anything to interfere with her prior obligations. Even if she was escorted out of the building when she gave notice, stripped of her passkey and told never to return, she is still an employee if she is on the payroll. It is far more prudent for her to take a vacation and explain to the new employer that she must wait out her notice period before beginning her new position.

- **Making Your Client Whole.** It is standard in the financial services industry as well as other highly competitive businesses for new employers to make new employees whole by replacing what they lose by leaving employment. The new employer benefits by gaining new business at a minimal expense, so an investment in the process is rarely refused or considered unreasonable.

Make sure, however, that all benefits, equity and compensation plans of your client's current employer are thoroughly read before coming up with a dollar amount, since many plans contain different restrictions for situations when an employee leaves to work for a competitor or solicits clients and/or employees.[16] Your client may think that she can keep her vested shares even if she has been soliciting colleagues to join her, but she may well end up forfeiting them along with the unvested ones.

- **Timing and Manner of Departure.** There is no right or wrong time to resign; it is usually a personal preference. However, when it comes to an entire team of employees leaving, the timing gets complicated. Often a new employer will poach an entire division consisting of junior and senior level employees. The damage to the old employer in this circumstance may be great, as the employer will lose the revenue from an entire division and cannot replace the team quickly. Therefore, as discussed above, if your client is subject to a notice period, a non-solicitation or a non-compete, she may choose to leave at the same time as the other similarly situated employees but after more junior employees, in order to avoid the inference that she left first, then solicited her junior staff.

Often, counseling your clients to stay beyond their notice period or to complete deals that are in progress may mollify the soon-to-be-former employer, which may even "bless" the departure rather than plot your client's demise. Even if giving the employer more time than required may not avoid liability for your client, or stop the employer from trying to enjoin him and suing the competitor, it may provide evidence in court for mitigating and reducing the employer's damages. It may even sway a judge to deny an injunction by eliminating the "irreparable harm" claim against the employer's protected interest, or to reduce damages at a future trial.

Conclusion

Counseling employees to comply with the law and to follow informed rules of conduct is imperative in these situations. Giving this advice early on can help your clients avoid litigation.

While competition is fierce, particularly in lean economic times, one sure thing is that the corporate raider of today may be the victim of a raid tomorrow. The same, however, may be true of your co-counsel; tomorrow's raid may make him your adversary. Therefore, maintaining a good faith negotiation and the highest standard of lawyering will serve you and your clients' needs in this negotiation as well as in the next.

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Endnotes:

1. ABA Model R. Prof'l Conduct 1.6.

2. ABA Model R. Prof'l Conduct 1.7, cmts. 1-7.

3. ABA Model R. Prof'l Conduct 1.7(b) serves as a guide for attorneys involved in joint representation of clients.

4. ABA Model R. Prof'l Conduct 1.6 provides that a lawyer shall not reveal information relating to the representation of a client unless the client consents after consultation. ABA Model R. Prof'l Conduct 1.4 requires counsel to inform each client subject to the joint representation arrangement of anything the client needs to know in order to make knowledgeable decisions.

5. See ***Maritime Fish Prods. Inc. v. World-Wide Fish Prods. Inc.***, *474 N.Y.S.2d 281 (1st Dept. 1984)* (competing with the business of employer and raiding other employees during employment is a breach of duty of loyalty under New York law).

6. See **Phansalkar v. Andersen Weinroth & Co., L.P.**, *344 F.3d 184, 200 (2d Cir. 2003)*; ***Purchasing Associates Inc. v. Weitz****, 196 N.E.2d 245 (N.Y. 1963)*; ***Duane Jones Co. v. Burke****, 117 N.E.2d 237, 245 (N.Y. 1954)*. See also ***Maritime Fish Prods. Inc. v. World-Wide Fish Prods. Inc.***, *474 N.Y.S.2d 281 (1st Dept. 1984)*.

7. See **BDO Seidman v. Hirshberg**, *93 N.Y.2d 382 (1999)*. New York courts have also limited or "blue-penciled" non-competes to make them reasonable and enforceable.

8. A non-solicitation covenant will be rejected as overly broad if it bars the employee from soliciting or providing services to clients with whom the employee never acquired a relationship through his employment. See **Scott, Stackrow & Co., CPA's P.C. v. Savina**, *9 AD 3d 805 (2004)*; **Zinter Handling Inc. v. Britton**, *46 AD 3d 998 (NY 2007)*.

9. See ***Balasco v. Gulf Auto Holding Inc.***, *707 So. 2d 858, 860 (Fla. Dist. Ct. App. 1998)* (noting importance of workforce stability); ***Natsource LLC v. Paribello****, 151 F.Supp. 2d 465 (SDNY 2001)*. See also Kenneth J. Vanko, "You're Fired! And Don't Forget Your Non-Compete . . . ": See also, Kristin Henry, Black & Decker to Pay Brotman $235,000 - Court of Appeals Declines to Take Up Long Legal Battle, BALT. SUN, Feb. 15, 2002, at 11C. Prudential Wins Court Bid to Bar Hirings, N.Y. TIMES, March 16, 2000, at C14 (Prudential won a temporary restraining order and monetary damages from Credit Suisse and its former Prudential executives).

10. Many states (except for Massachusetts, New York, New Jersey and Texas) adopted a version of the Uniform Trade Secrets Act that generally defines a trade secret or provides statutory protections in regard to misappropriation of trade secrets. New York courts rely on the definition of trade secrets found in ?757 of Restatement of Torts and New York common law protections and remedies.

11. See ***PSC Inc. v. Reiss****, 111 F. Supp 2d 252 (WDNY 2000)*; **ABKCO Music Inc. v. Harrisongs Music, Ltd.**, *722 F.2d 988, 995 (2d Cir. 1983)* (every contract of employment implies that the employee will hold sacred any trade secret or other confidential information acquired in the course of her employment. This duty survives the termination of employment).

12. See **FMC Corp. v. Taiwan Tainan Giant Indus. Co. Ltd.**, *730 F.2d 61 (2d Cir. 1984)*; ***Earthweb Inc. v. Schlack****, 71 F. Supp. 2d 299, 314 (S.D.N.Y. 1999)*; ***Ivy Mar Co. Inc. v. C.R. Sea-***

sons, Ltd., *907 F. Supp. 547, 556-57 (E.D.N.Y. 1995)*; ***Data Sys. Computer Centre v. Tempesta***, *566 N.Y.S.2d 955 (2d Dept. 1991).*

13. See ***Frederic M. Reed & Co. v. Irvine Realty Group Inc.***, *723 N.Y.S.2d 19, 21 (1st Dept. 2001)* (no liability or right to injunctive relief from a former employee's solicitation of former clients whose identities and contact information are easily ascertainable).

14. See ***Royal Carbo Corp. v. Flameguard Inc.***, *654 N.YS.2d 18, 19-20 (1st Dept. 1996).*

15. Garden leave (or gardening leave) describes the practice of requiring an employee who is leaving an employer to stay out of work during her notice period.

16. The employee choice doctrine will apply only if the departing employee "makes an informed choice between forfeiting a certain benefit or retaining the benefit by avoiding competitive employment." See **Lucente v. Int'l Bus. Machs. Corp**., *310 F.3d 243, 245 (2d Cir. 2002).*