

Non-Competes and the Doctrine of Inevitability: Can You Really Hire That Employee?

By STEVEN COOPER and JANET HENSCH

You have been trying to fill a middle or upper-level management spot for months. You finally find the perfect person, who is doing precisely the same job for your main competitor. The person has all the skills and background that you need, and even better, he or she has not signed a non-competition or confidentiality agreement. You are home free, right? Not so fast.

A body of law has developed over the years that prevents an employee from assuming a position with a competitor if, by assuming that position, such employee will "inevitably" disclose or use confidential information or trade secrets. This "Doctrine of Inevitability" holds that an employee, who is familiar with the confidential information or trade secrets of his or her employer, and cannot perform his or her expected duties without disclosing or using such protected information, may be enjoined from taking that new position.

The frequent and fluid movement of executives between companies has brought the Doctrine of Inevitability to the forefront as a tool to prevent employees from working for competitors. Through use of this doctrine, employers get the benefit of a non-compete agreement without negotiating its terms, and without providing any consideration to the employee.

On the other side, executives in such fields as research and development, marketing and strategic planning, who felt untethered in the absence of a written non-competition agreement, may be surprised to learn that they may be precluded from making moves. Hence, this "end run" around the requirement of a valid written covenant not to compete has widespread implications.

Written Restrictive Covenants

Typically, employers attempt to restrict competition from, or disclosure of trade secrets by, employees through the use of written non-competition, non-solicitation and/or confidentiality agreements. These agreements may be part of more comprehensive employment agreements, or may stand on their own. Although courts generally are reluctant to prevent a person from earning a livelihood, they often will enforce such contracts if reasonable as to scope of duties, time and geography, and supported by consideration.

The earliest applications of the Doctrine of Inevitability were used to uphold such written restrictive covenants. Indeed, courts have repeatedly held that the "inevitable disclosure" of confidential information supports the enforcement of non-competition or confidentiality agreements. It is the application of the Doctrine of Inevitability absent a written agreement that presents the trickier issues for employers.

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Post-Termination Compensation Agreement Narrowed: The New York Court of Appeals narrowed an agreement whereby an employee of an accounting firm was required to compensate the firm for clients which he took with him after his departure. Rather than striking down the provision, the court analyzed it in detail and upheld the portions which it found reasonable under the circumstances. The court found that the agreement was unenforceable to the extent that it required the former employee to compensate the firm for the loss of clients for whom he had not provided any direct accounting services, or for those "personal clients of defendant" which he brought to the firm. *BDO Seidman v. Hirshberg*.

The PepsiCo Case

The Seventh Circuit's decision in *PepsiCo v. Redmond* broke ground by preventing an employee from assuming a comparable position with a competitor in the absence of a written non-competition agreement. In *PepsiCo*, the Seventh Circuit enjoined Redmond, a former PepsiCo executive, from assuming a similar position with Quaker, a fierce competitor in the market for sports drinks. Redmond had been closely involved in strategic marketing and financial planning at PepsiCo, and would have been involved in similar activities in his position with Quaker. The Seventh Circuit held that Redmond's knowledge of confidential PepsiCo information, e.g. strategic goals regarding the pricing, distribution and marketing of the product, would necessarily influence his decisions at Quaker.

A significant element of the reasoning of the *PepsiCo* court was that Redmond could not "compartmentalize" the protected information because he "cannot help but rely" on the trade secrets as he "plots" Quaker's strategy. The court noted that Redmond's ability to anticipate PepsiCo's strategic moves gave Quaker a "substantial advantage." Indeed, the court likened PepsiCo to "a coach, one of whose players has left, playbook in hand, to join the opposing team before the big game." Evidence of past employee dishonesty

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and/or the sinister intentions of the new employer are elements considered by courts. In *PepsiCo*, the court considered that Redmond had misled PepsiCo as to whether he was leaving to work for a competitor, and said that Redmond's "lack of forthrightness" with his former employer made his assertions that he was not interested in, and would not use, PepsiCo's trade secrets and confidential information "less than comforting."

Factors Determining the Application of the Doctrine of Inevitability

Other courts have also weighed in on this issue. For example, the Texas Court of Appeals has enumerated three factors weighing in favor of issuance of an injunction based on the Doctrine of Inevitability: (1) the existence of misconduct by the departing employee, (2) the new employer's ability to use the trade secret for its benefit or to the detriment of the former employer, and (3) the degree of similarity between the employee's former and current positions such that the employee will be in a position to use the former employer's confidential information.

The numerous decisions respecting the Doctrine of Inevitability employ a fact-intensive analysis. Even courts which have denied injunctive relief have pointed out that slight differences in circumstances would support an injunction. Clearly, more than mere suspicion or apprehension of injury is required. There must be a rational basis for a court to conclude that there exists an imminent threat of impending injury based on the inevitable disclosure of trade secret or confidential information.

The factors discussed above represent the factual issues most commonly considered by courts in determining whether to enjoin competitive employment in the absence of a covenant not to compete; they provide a starting point from which prospective employers may consider the risks associated with hiring a competitor's employee.

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Fraudulent Intent Pleading Standard Clarified: The U.S. Court of Appeals for the Second Circuit ruled that a pleading that corporate insiders had "unloaded large positions" of stock while making optimistic statements about the company gave rise to the "strong inference of fraudulent intent" required to state a claim for a violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. *Stevelman v. Alias Research Inc.*

Supreme Court Determines Expert Witness Admissibility: The U.S. Supreme Court held that, pursuant to Federal Rule of Evidence 702, the Daubert factors apply not only to expert testimony of scientists, but to expert testimony based on technical or other specialized knowledge. Now, expert testimony regarding technical or specialized knowledge will be admissible only if, as in *Daubert*, it is both relevant and reliable, with reliability proved by, among other things, acceptance in the relevant community. *Kumho Tire Co. v. Carmichael*.

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The Courts Struggle With Conflicting Policies

Courts deciding cases in this area have struggled with the strong competing desires of protecting a business' trade secrets, yet permitting individuals to earn a living in their chosen field or specialty. In *FMC Corp. v. Cyprus Foote Mineral Co.*, decided shortly after *PepsiCo*, the United States District Court for the Western District of North Carolina showed concern that broad application of the Doctrine of Inevitability would prevent employees from exercising "the privilege every citizen has of accepting employment in the field for which he is trained." Since the employee in *FMC* had "general skill and knowledge," and no knowledge of specific techniques or processes, he was "free to sell those skills in the marketplace."

In *E.I. DuPont de Nemours & Co. v. American Potash & Chemical Corp.*, the Court of Chancery in Delaware cogently summarized the dilemma:

The court fully recognizes that this is a case of great social and industrial significance both on the question of the right to relief and, if established, the scope thereof. Among the substantial and conflicting policies at

play in this situation are the protection of employers' rights in their trade secrets on the one hand, versus the right of the individual to exploit his talents, use matters of general knowledge, and pursue his calling without undue hindrance from a prior employer.

The Delaware court, in denying the former employer's motion for summary judgment, recognized the fact-intensive and complex nature of the issue: "[t]he 'interests' involved are as easy to state as they are difficult to protect, particularly in the face of the ever-increasing complexity of present day technology. What accommodation, if any, is to be made must await the decision after trial."

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Attorney-Client Privilege Does Not Shield Conversation With Investment Banker

The IRS was entitled to enforce a subpoena against an investment banker who had explained a proposed investment to the lawyer for the company being audited, the U.S. Court of Appeals for the Second Circuit held. The court noted that the attorney-client privilege would not shield the investment banker's conversations with the lawyer as the investment banker did not play a "translator" role analogous to that of an accountant in previous cases upholding the privilege. *United States v. Ackert*.

Former Executive May Have To Repay Stock Option Profits

A former IBM executive who left the company to join a rival may be forced to repay to IBM the profits he received by exercising company-granted stock options as the options were not "wages." The U.S. District Court for the Southern District of New York noted that the executive could keep the profits if he could demonstrate that he was constructively discharged. *International Business Machines v. Martson*.

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Conclusion: What's A Company To Do?

Prospective employers must understand and carefully consider the potential restrictions in hiring, especially mid-level and upper management employees, whether or not those employees have signed non-competition and confidentiality agreements. The failure of a company to have written non-compete and confidentiality/non-disclosure agreements itself may be evidence that the company is not truly facing imminent injury, but simply is retaliating against a “disloyal” employee or is seeking to hamper or frustrate the ability of the new prospective employer to effectively compete.

Companies wishing to prevent departing employees from competing and to protect against disclosure of trade secrets should keep the following guidelines in mind:

- Insist upon written non-competition and confidentiality agreements that can withstand judicial scrutiny;
- Provide reasonable restrictions as to time, geography and scope; and

- Provide adequate consideration for those restrictions.
- Clearly define the parameters of and carefully protect its trade secrets, making certain to alert employees as to what is considered proprietary information.

New employees should:

- Carefully check all contracts signed by the employee with his/her former employer for restrictive covenant language.
- Ascertain the existence of any issues regarding employee honesty/misconduct.
- Avoid any unscrupulous behavior in hiring the new employee.
- Place the new employee in a position where he/she will not need to “inevitably” use protected confidential or trade secret information.

These preventive measures and careful preparatory work may avoid costly litigation, the issuance of disruptive injunctions and/or embarrassment to a company.



Janet Hensch not pictured

Steven Cooper and **Janet Hensch** are with the New York office of Anderson Kill & Olick, P.C., and have represented companies and employees in the types of matters discussed in this article.

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notable decisions

New York Forum Suits Brooks Brothers: In a case originally filed against Brooks Brothers in state court in Dallas, Texas, AKO removed the case to federal court, and succeeded in having it transferred to the Southern District of New York. The Texas court found it significant that all of Brooks Brothers' relevant executives and documents were located in New York, as well as the crucial third-party witnesses identified in Brooks Brothers' transfer papers.

Victory for Real Estate Developer Sued For Commissions: AKO successfully defended real estate developer Yassky Properties in an action by a real estate brokerage firm. The brokerage firm claimed commissions were due since it had introduced the developer to a purchaser who was ready, willing and able, and the purchaser and developer had signed a Letter of Intent. The court granted Yassky's motion to dismiss, stating that the language of a draft purchase and sale agreement and similar language in the Letter of Intent stated that a commission would be due only upon an actual closing.