Garden Leave Provisions in Employment Agreements

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A Practice Note discussing garden leave provisions in employment agreements as an alternative or a companion to traditional employee non-compete agreements. This Note addresses the differences between garden leave and non-compete provisions, the benefits and drawbacks of garden leave, and drafting considerations for employers that want to use garden leave provisions. This Note applies to private employers and is jurisdiction neutral.

In recent years, traditional non-compete agreements have faced increasing judicial scrutiny, with courts focusing on issues such as the adequacy of consideration, the propriety of non-competes for lower level employees, and whether the restrictions of a non-compete are justified by a legitimate business interest or are merely a tool used to suppress competition.

Although the Trump Administration's view on non-competes is unknown, the Obama Administration took issue with them. Both the US Department of Treasury and the White House issued reports in 2016 that questioned the widespread use of non-competes and suggested that they hampered labor mobility and ultimately restrained economic growth (see US Department of the Treasury: Non-Compete Contracts: Economic Effects and Policy Implications (Mar. 2016) and White House: Non-Compete Agreements: Analysis of the Usage, Potential Issues, and State Responses (May 2016)). Some states have passed legislation essentially banning non-competes for certain categories of workers, such as low-wage workers in Illinois (820 ILCS 90/1) and technology sector workers in Hawaii (Haw. Rev. Stat. § 480-4(d)). In other states, such as California, almost all post-employment non-competes are unenforceable (Cal. Bus. & Prof. Code § 16600-16602.5).

Against this backdrop, employers are seeking alternatives to traditional non-competes to protect their proprietary information and customer relationships. One alternative gaining rapid favor is the use of garden leave provisions in employment agreements. These provisions extend the employment relationship for a period of time during which the employee continues to receive a salary (and sometimes benefits) but cannot go to work elsewhere. While garden leave provisions are not a panacea, they may serve as a helpful tool that employers can use to protect their legitimate business interests and prevent certain employees from immediately working for a competitor.

This Practice Note addresses:

- The history and general characteristics of garden leave in the US.
- Comparisons between traditional non-competes and garden leave provisions.
- Advantages and disadvantages of garden leave.
- Drafting considerations for employers that want to use garden leave provisions, including potential issues under:
  - Section 409A of the Internal Revenue Code (Code); and
  - the Consolidated Omnibus Budget Reconciliation Act (COBRA).

GARDEN LEAVE OVERVIEW

GARDEN LEAVE IN THE US

Garden leave is a relatively new concept in the US but well-established in the UK and elsewhere in Europe. In those jurisdictions, most employment relationships are governed by contract and can only be terminated by notice to the other party (and often only for cause by the employer). In contrast, because most US workers are at-will employees, the notice concept is relatively rare except for more senior executives and certain other unique personnel who are employed under an employment contract that restricts the parties' termination rights.

Garden leave is a variation of a notice provision. Instead of actively working during their notice period, employers place employees on garden leave (to "tend to their gardens"). The employees typically are relieved of their duties and responsibilities during that time, yet remain employed by the employer and therefore cannot go to work for a competitor.

Garden leave was first widely adopted in the US by the financial services industry in New York, presumably after these firms became familiar with the concept in London financial circles. In recent years, it has gained some traction as another way for employers to restrict competition by departing employees, either as an independent tool or combined with non-compete or non-solicitation provisions.

GARDEN LEAVE VERSUS TRADITIONAL NON-COMPETES

Garden leave and non-compete provisions are both tools employers can use when seeking to prevent a departing employee from working for a competitor for a period of time. Traditional non-compete agreements directly prohibit employees from working in certain capacities for the employer's competitors (or certain defined competitors) for a limited time after their employment relationship ends. Employees generally are not paid during the non-compete period. This leads to close judicial scrutiny and concerns about fairness to the employee and the adequacy of consideration for the agreement.

In contrast, under typical garden leave provisions, employees must give advance notice of their resignation, typically between 30 and 90 days' notice. During this garden leave period, the employees remain employees of the company and continue to receive their salary (and often benefits) but generally are relieved of some or all of their duties and responsibilities. In some cases, employers also pay a pro rata share of the employee's bonus, especially where the bonus constitutes a significant portion of the employee's total compensation. With garden leave provisions, the employer has a mirror image obligation not to terminate an employee without giving the same advance notice or pay in lieu of the notice.

During the garden leave period, the employer generally can:

- Remove employees from their active duties.
- Exclude employees from the workplace.
- Prevent employees from contacting and communicating with staff and customers or clients.
- Limit or cut off employees' access to the employer's computer systems, email, and other documents and information.

However, because employees on garden leave remain employed and draw a salary, they continue to owe a duty of loyalty (and for some employees, a fiduciary duty) to their employer and therefore cannot join or assist a competitor or any other employer during the garden leave period. The garden leave period therefore functions as a traditional non-compete period by keeping the employee out of the competitive market but may be perceived as less Draconian and more enforceable because:

- Garden leave periods are typically shorter in duration than traditional non-compete periods (six months or less).
- The employee continues to be paid during the garden leave period.

Although paid post-employment non-competes are sometimes also referred to as garden leave, that usage is inaccurate. While paid non-compete periods have some of the same characteristics of garden leave, and share some of the same advantages (see Advantages and Disadvantages of Garden Leave Provisions), there is an important distinction between the two. With a non-compete, the employment relationship has terminated, and employees have no continuing duty of loyalty during the non-compete period. Paid non-competes are therefore subject to the same judicial scrutiny as traditional non-competes and should not be confused with true garden leave provisions.

JUDICIAL TREATMENT OF GARDEN LEAVE PROVISIONS

In most states (with the exception of states such as California, North Dakota, and Oklahoma), non-competes are generally enforceable, though subject to rigorous judicial review. Some states regulate non-competes by statute. Other states evaluate them under common law contract principles. Although the specific iterations vary, most common law jurisdictions disfavor non-competes but enforce them to the extent reasonably necessary to protect legitimate business interests.

Case law regarding garden leave provisions is not as well developed. This is likely because:

- Garden leave provisions are relatively new in the US.
- Garden leave provisions are challenged less often than non-competes, generally because garden leave periods are:
  - shorter than most non-competes;
  - paid; and
  - increasingly common and accepted in the financial services industry where they are most used.
- Many employment disputes in the financial services industry, where garden leave provisions are most common, are subject to mandatory Financial Industry Regulatory Authority (FINRA) arbitration (see Practice Note, FINRA Industry Arbitration: A Step-by-Step Guide (w-000-4413)).

In the relatively few published decisions considering "pure" garden leave provisions, courts have reached conflicting conclusions about their enforceability. Courts have been particularly reluctant to specifically enforce these provisions, because doing so would require the court to order employees to continue an at-will employment relationship against their will (see Limitations on Specific Enforcement of Garden Leave Provisions).

For example, in *Bear Stearns & Co., Inc. v. McCarron*, Bear Stearns sought enforcement of a garden leave provision requiring 90 days' advance notice of resignation that was "buried" in various deferred compensation plans that the departing employees never signed. Bear Stearns agreed to pay the employees' salaries during the garden leave period but reserved the right to terminate their employment or not assign any work during that time. The court refused to enforce these "stealth" garden leave provisions. (2008 WL 2016897 (Mass. Super. Ct. Suffolk Co. Mar. 5, 2008).)

In *Bear, Stearns & Co., Inc. v. Sharon*, the resigning broker had signed a memorandum to all senior managing directors accepting a raise in base salary in exchange for agreeing to a 90-day garden leave provision. Bear Stearns agreed to pay the broker's salary during the garden leave period and reserved the right to decide what, if any, duties the broker would perform during that time. Although the court originally granted a temporary restraining order preventing the broker from going to work for a competing firm, the court refused to grant a preliminary injunction as against public policy (see Limitations on Specific Enforcement of Garden Leave Provisions). However, the court found that there was a likelihood that Bear Stearns would prevail on a breach of contract claim and could be compensated by monetary damages for that breach. (550 F. Supp. 2d 174, 178 (D. Mass. 2008).)

However, in *Bear Stearns & Co. v. Arnone*, a New York state court found that a garden leave clause protected a legitimate business interest and enforced the provision against a departing broker who contacted her clients during the garden leave period, informing them that she could be reached at her new employer following the garden leave period. The court prohibited her from any further communications with those clients. (Case No. 103187 (Sup. Ct. N.Y. Co. 2008).)

Similarly, in *Natsource LLC v. Paribello*, the court enforced a 30-day notice provision followed by a three-month paid non-compete and enjoined a commodities broker from working for a competitor for the combined four months. The court found it reasonable because the employer continued to pay the employee's full salary during this period. (151 F. Supp. 2d 465, 472 (S.D.N.Y. 2001).)

Many cases conflate their discussion of paid notice or garden leave provisions and paid non-competes and use these terms interchangeably. Courts generally find that reasonable notice or garden leave provisions and other restrictions are enforceable when supported by a legitimate business interest, such as protecting and cementing customer relationships, maintaining the confidentiality of proprietary information, or both. For example, courts have:

- Found reasonable a 60-day notice and two-year non-solicitation and non-service of clients provision (*Chernoff Diamond & Co. v. Fitzmaurice, Inc.*, 651 N.Y.S.2d 504, 505-06 (1st Dep't 1996)).
- Enforced a 60-day notice provision (*Alliance Bernstein, L.P. v. Clements*, 932 N.Y.S.2d 759 (Sup. Ct. N.Y. Co. 2011)).

When analyzing the reasonableness of a garden leave or a non-compete, courts generally find that an employer's willingness to pay an employee during the restricted period weighs in favor of enforcing the restriction (see, for example, *Maltby v. Harlow Meyer Savage Inc.*, 633 N.Y.S. 2d 926, 930 (Sup. Ct. N.Y. Co. 1995) (finding the restrictive covenant reasonable "on condition that plaintiffs continue to receive their salaries for six months while not employed by a competitor"); *Lumex Inc. v. Highsmith*, 919 F. Supp. 624, 629-36 (E.D.N.Y. 1996) (enforced a six-month non-compete where the employer agreed to pay the employee's salary and benefits if he could not find work because of the non-compete)). Courts have also enforced these provisions where employees only receive their base salary and no bonus, even if this results in a substantial reduction in pay for the period (see, for example, *Hekimian Labs., Inc. v. Domain Sys., Inc.*, 664 F. Supp. 493, 498 (S.D. Fla. 1987) (enforcing a non-compete where the employee received 50% of his salary during the restricted period)).

However, even paid non-competes that extend for time periods that are too long or cover a geographic area that is too broad may be deemed unreasonable in scope or not necessary to protect an employer's legitimate business interests (see, for example, *Estee Lauder Co., Inc. v. Batra*, 430 F. Supp. 2d 158, 180-82 (S.D.N.Y. 2006) (reducing a 12-month paid non-compete period to five months); *Baxter Int'l, Inc. v. Morris*, 976 F.2d 1189, 1197 (8th Cir. 1992) (Illinois law) (refusing to enjoin a research scientist from working for a competitor during a one-year paid non-compete period, where the company's legitimate interests in protecting its trade secrets were already covered by an injunction against disclosing confidential information)).

Limitations on Specific Enforcement of Garden Leave Provisions

Courts have been reluctant to specifically enforce notice or garden leave provisions because doing so requires the court to order employees to continue an at-will employment relationship against their will (see, for example, *Smiths Grp., plc v. Frisbie*, 2013 WL 268988, at *3 (D. Minn. Jan. 24, 2013); *Sharon*, 550 F. Supp. 2d at 178). Courts are instead more likely to issue an injunction prohibiting competition during the garden leave period (see, for example, *Ayco Co., L.P. v. Feldman*, 2010 WL 4286154, at *10 (N.D.N.Y. Oct. 22, 2010) (issuing preliminary injunction enforcing a combined 90-day notice and non-compete period but acknowledging that the court would not issue an injunction forcing the employee to continue working for the employer); *Smiths Grp., plc*, 2013 WL 268988, at *5 (refusing to enforce a six-month notice provision but enforcing one-year non-compete)).

Another court refused to specifically enforce a 90-day notice of termination (garden leave) provision because it would be "fundamentally unfair" to the employee's private banking clients to deprive them of their choice of financial advisor, especially during the turbulent market times of 2008 (*McCarron*, 2008 WL 2016897).

STATUTORILY REQUIRED "GARDEN LEAVE"

In August 2018, Massachusetts enacted the Massachusetts Noncompetition Agreement Act (MNAA), which requires an employer to provide for "garden leave," or other mutually agreed on consideration, to support an enforceable non-compete provision. The MNAA applies to most non-compete (but not non-solicit or confidentiality) agreements with employees and independent contractors entered into on or after October 1, 2018. The MNAA defines garden leave as a provision by which the employer agrees to pay the employee during the restricted non-compete period, "provided that such provision shall become effective upon termination of employment unless the restriction upon post-employment activities [is] waived by the employer or ineffective" because the employee was terminated without cause or laid off.

Garden leave under the MNAA must:

- Provide for pay on a pro rata basis during the entire restricted period of at least 50% of the employee's highest annualized base salary paid by the employer within two years of the employment termination.
- Not allow the employer to unilaterally discontinue or fail to make the payments, unless the restricted period is extended because of the employee's breach or misappropriation of employer property.

(M.G.L. ch. 149, §§ 24L(a), (b)(vii).)

The MNAA contemplates that the payments continue after the termination of employment, and does not require that the employer extend the employment relationship throughout the so-called garden leave period. The statutory garden leave therefore functions more like a paid non-compete than traditional garden leave, which extends the employment period but relieves the employee of the obligation to perform active duties during that time.

Employers should continue to monitor statutory developments around the country because the MNAA may be a harbinger of legislation to come in other states.

For more information on the MNAA, see Legal Update, Massachusetts Legislature Finally Passes Non-Compete Law (w-016-1109) and Massachusetts 2018 Sessions Laws, Chapter 228, Section 21.

ADVANTAGES AND DISADVANTAGES OF GARDEN LEAVE PROVISIONS

Garden leave clauses have many advantages over traditional non-competes, including:

- Increased likelihood of enforcement. Although case law is limited, courts may be more receptive to garden leave clauses because:
  - the employee is paid during the garden leave period;
  - garden leave is typically much shorter in duration than a non-compete; and
  - employers use garden leave more selectively.
- Added protection for the employer. The employee's common law duty of loyalty (and in some cases, fiduciary duty) continues throughout the period because the employee remains an employee while on garden leave.
- A more orderly transition of client relationships and work responsibilities. When an employee leaves, the most crucial period for an employer is the immediate 30- to 90-day period after the resignation notice. That period is typically covered by garden leave and is longer than the amount of notice typically given when an employee resigns.
- Decreased likelihood of overuse when not necessary to protect legitimate business interests. Because of the cost of paying an employee while on garden leave, employers use garden leave provisions more selectively.
- Flexibility to release employees from their garden leave obligations if their departure poses no competitive threat (if the garden leave provision specifically allows for this).

Despite the benefits, garden leave is not without its drawbacks. The disadvantages of garden leave clauses include:

- The significant cost of paying an employee who does not perform any work during the garden leave period.
- The relatively short duration of a garden leave period (typically 30 to 90 days) compared with a typical non-compete period (six to 18 months). A garden leave provision therefore may provide less protection to an employer than a reasonable non-compete.
- Logistical issues regarding electronic access during the garden leave period if the employee is needed for transitional duties during that time, especially if the employee is prohibited from working or contacting clients or coworkers.
- The lack of case law regarding garden leave provisions, which creates greater uncertainty about enforceability.
- Difficulty in specifically enforcing garden leave provisions because doing so requires that employees remain employed against their will (especially if the employer can require the employee to perform services during that time).

DRAFTING GARDEN LEAVE PROVISIONS

Garden leave provisions may be included in various agreements between employers and employees, such as:

- Offer letters.
- Employment agreements.
- Stock option plans (see Practice Notes, Overview of Equity Compensation Awards (w-007-3131) and Stock Options Overview (w-008-0930)).
- Bonus plans or agreements.
- Equity award agreements.
- Long-term incentive plan (LTIP) agreements.
- Supplemental Executive Retirement Plan (SERP) agreements (see Practice Note, Supplemental Executive Retirement Plans (SERPs) (w-001-4933)).
- Stand-alone non-compete, non-solicit, or confidentiality agreements.
- Severance agreements.

Garden leave provisions can also be found in separation agreements. It is not uncommon for employers terminating employees, especially high level employees, to provide for a transitional period during which employees are not expected or permitted to work but continue to be paid their salaries and receive certain benefits. In these circumstances, the garden leave period is often negotiated, which provides an even stronger basis for its enforcement.

To maximize the employer's protections and increase the likelihood of enforcement, employers should consider several issues when drafting garden leave provisions.

REQUIRE SIGNED AGREEMENTS

Employers should ensure that employees subject to garden leave provisions sign the agreement or plan that contains the restriction. Employee should clearly acknowledge the garden leave provision. Failure to do so creates difficulty in enforcement. (See, for example, *McCarron*, 2008 WL 2016897 (refusing to enforce restrictive covenants "buried" in the terms and conditions of a deferred compensation plan, where the former employees did not sign the terms and conditions and may never have seen them).) In some cases, the signature may be electronic (see Standard Clause, General Contract Clauses: Electronic Signatures (0-529-7779)).

IDENTIFY COVERED EMPLOYEES

Employers must determine which employees will be subject to garden leave provisions. Since the garden leave period is paid, often with benefits and sometimes with bonuses, and requires a continuing relationship with the employer, employers generally restrict garden leave to those employees at its highest level, such as key executives and technical employees.

Garden leave provisions may also be useful for sales or other employees responsible for developing relationships with clients to provide a period in which the employer can work to transition their client relationships without direct competition. A garden leave period may also be useful for employees with substantial access to trade secrets and other confidential information. Garden leave provisions are generally not used for low-level employees.

DEFINE GARDEN LEAVE PERIOD

Employers must determine the appropriate length of the garden leave period. Periods of 90 days or less are the most common, though some garden leave periods can be up to six months. Garden leave periods for much longer than this run the risk of being challenged, especially in non-negotiated agreements, as a form of involuntary servitude because the employee must remain employed.

The single most important factor in determining the garden leave period is the protectable interests at stake. Employers should consider the nature of the employee's position as well as particular concerns associated with that position. For example, employers may have incrementally longer garden leave periods for persons with greater responsibility, such as:

- 30 days for a vice president.
- 60 days for a director.
- 90 days for a managing director.

DETERMINE EMPLOYEE COMPENSATION

Employers must decide what compensation to provide to employees during the garden leave period. At a minimum, employees should continue to receive their regular salary, usually with benefits, but may forfeit eligibility for bonuses or other incentive pay. This may be problematic for employees who receive a substantial portion of their compensation through bonuses because they may claim that they are not receiving adequate consideration and therefore the garden leave provision should not be enforced. Although not always stated in these terms, courts are reluctant to enforce non-competes and, by extension, garden leave provisions, that are perceived as fundamentally unfair to the employee. However, this argument may not be persuasive in jurisdictions where continued at-will employment is sufficient consideration for enforcing even an unpaid non-compete period.

More complicated situations arise when employees are paid solely on a commissioned basis. For these employees, employers may want to set a formula to compensate the employees (such as the average of commissions paid over the last several months) that complies with the parties' contract and applicable law but must be mindful that the law is not well-developed on these issues.

CONSIDER LEAVE ACCRUAL AND OTHER BENEFITS

Employers may choose to limit or decrease certain fringe benefits during the garden leave period, such as the accrual of paid time off. This and other similar reductions in benefits during the garden leave period will likely have a negligible effect on the potential enforceability of the garden leave provision. It may also be helpful for employers to add language to the garden leave provision stating that employees must use all unused accrued leave, such as paid time off or vacation, during the garden leave period.

RESERVE RIGHT TO EXCLUDE FROM WORK

Employer should expressly reserve the right to exclude employees from performing any work during the garden leave period. Employers may also want to restrict access to the employers':

- Workplace.
- Email and other electronic communication systems.
- Clients.
- Confidential or proprietary information.

Employers should also specify that during the garden leave period, the employee will not bind, attempt to bind, or otherwise obligate the employer to any third party and shall not incur business expenses unless preapproved in writing.

RESERVE DISCRETION TO WAIVE OR MODIFY GARDEN LEAVE RESTRICTIONS

Employers can decide whether to retain discretion to shorten or waive the garden leave restrictions and whether or not the employee receives pay in lieu of garden leave for any waived period. If employers want to retain these rights, the garden leave provision should explicitly state what discretion the employers have and how they must notify employees when exercising that discretion. For example, employers may include a section reserving their rights to shorten or waive the period and stating they shall notify the employee in writing of any modification or waiver.

A case in Illinois shows the risk of not having this provision in an agreement. In *Reed v. Getco, LLC*, an employer had to pay an employee $1 million in exchange for a six-month non-compete. Shortly after the employee resigned, the employer notified the employee it was waiving the six-month non-compete restriction and therefore not paying the $1 million. The employee nonetheless complied with his end of the bargain and refrained from competing with the employer for six months. Because the agreement provided that there could be no waiver of the agreement unless it was signed by both parties, the court held that the payment was due. (65 N.E.3d 904 (Ill. App. Ct. 2016) and Legal Update, Epstein Becker: Illinois Appellate Court Holds Employer's Waiver of Non-Compete Period to Avoid $1 Million Payment Was Ineffective (w-003-8876); see also *Tini v. AllianceBernstein L.P.*, 968 N.Y.S.2d 488, 489 (1st Dep't 2013) (finding that the employer had no right to unilaterally reduce the notice period).) Although these cases arose in the context of a non-compete, they nonetheless highlight the importance of planning for contingencies and reserving discretion to modify terms when drafting garden leave provisions.

Employers should be aware that there is a potential risk in expressly retaining unilateral discretion to waive or modify the garden leave period without agreeing to pay in lieu of notice. For example, if the threat of enforcing the garden leave provision limits an employee's job mobility, the employer's ability to waive the garden leave period with no notice may still limit the employee's ability to immediately obtain new employment (without the employer obligating itself to do or pay the employee anything in return). A court may find that the employer's promise in this situation is illusory and therefore refuse to enforce the garden leave provision for lack of consideration.

CONSIDER PAIRING GARDEN LEAVE WITH NON-COMPETE AND NON-SOLICITATION PROVISIONS

Another option employers can consider is pairing garden leave provisions with non-competes or non-solicitation provisions. Some courts may be reluctant to specifically enforce garden leave provisions because they compel an employee to remain employed against their will and therefore specific enforcement would violate public policy.

To increase the likelihood of specific enforcement, employers may want to contract for a non-compete or non-solicitation period (or both) that runs concurrently with the employee's garden leave period. The non-compete period can be paid or unpaid, though if paid, a court may be more likely to enforce it. The employer will then have another avenue for enforcement if the employee starts working for a competitor and the employer cannot enforce the garden leave provision, at least in those jurisdictions that allow post-employment non-competes.

OTHER DRAFTING ISSUES

Employers should consider including the following provisions when drafting garden leave provisions:

- Choice of law and forum selection provisions (see Standard Document, Employee Non-Compete Agreement: Choice of Law and Forum Selection (7-502-1225) and Practice Note, Choice of Law and Choice of Forum: Key Issues (7-509-6876)). As with non-competes, the jurisdiction and applicable law may be outcome dispositive.
- Jury waiver provisions (see Standard Clause, General Contract Clauses: Waiver of Jury Trial (9-523-4508)).
- Severability and blue pencil provisions (see Standard Document, Employee Non-Compete Agreement: Severability (7-502-1225) and Standard Clause, General Contract Clauses: Severability (2-519-1319)). However, as with non-competes, the court's ability to blue pencil (or modify) a garden leave provision may depend on applicable state law (see Non-Compete Laws: State Q&A Tool: Question 6).

BENEFIT AND GROUP HEALTH PLANS

If employees subject to garden leave provisions participate in any pension, severance, or other benefit plans, employers should ensure that the plan documents clearly define whether the employees vest in their benefits based on a notice of termination (that is, by placing employees on garden leave) or on the final employment termination (the end of the garden leave period). If this is ambiguous, terminated employees may have a claim for interference with their rights to these benefits under the Employee Retirement Income Security Act (ERISA) (see, for example, *Kirby v. Frontier Medex, Inc.*, 2013 WL 5883811, at *10 (D. Md. Oct. 30, 2013)).

TAX ISSUES SECTION 409A ISSUES

Although a detailed discussion of this issue is beyond the scope of this Note, when contemplating garden leave, employers also must consider potential issues arising under Section 409A of the Internal Revenue Code. Section 409A creates a complex and comprehensive set of rules regarding nonqualified deferred compensation. Section 409A defines deferred compensation broadly as any form of compensation that is or may be paid in a year following the year in which the legal right to the payment arises, unless an exception applies. Incentive compensation and severance payments and benefits often fall within its reach. While there are often ways to structure payments to comply with an exception from Section 409A, it is important to consider the issue before entering into any garden leave arrangement because the rules are complicated and do not specifically contemplate garden leave. Employers should consult with counsel because even a minor violation of Section 409A can result in significant adverse tax consequences.

For an overview of Section 409A, see Practice Note, Section 409A: Deferred Compensation Tax Rules: Overview (6-501-2009). For additional Section 409A resources, see Section 409A Toolkit (1-500-6652).

COBRA Issues

Although a full discussion of this issue is beyond the scope of this Note, employers that sponsor group health plans also must consider whether placing employees on garden leave triggers any rights or obligations under the Consolidated Omnibus Budget Reconciliation Act (COBRA). COBRA requires most employer-sponsored group health plans to offer covered employees and dependents (known as qualified beneficiaries) the opportunity to continue their health coverage in situations where the coverage would otherwise end because of certain life events (known as qualifying events). Among other compliance obligations, plans must provide COBRA-qualified beneficiaries an election notice when certain COBRA qualifying events occur (see Standard Document, COBRA Election Notice (7-580-9578)).

Placing an employee on garden leave with a reduction in, or total elimination of, work hours may:

- Constitute a qualifying event under COBRA.
- Result in a loss of coverage under a plan, depending on the plan terms (including governing eligibility provisions).

Failure to comply with COBRA's specified notice obligations may result in claims by the employee for:

- Claims by employees for damages resulting from the loss of coverage.
- Penalties and fines.

Employers that place employees on garden leave should:

- Consult the governing plan terms and, if applicable, the plan's insurer or stop-loss carrier.
- Address how COBRA will be handled under the garden leave provision (including whether the garden leave constitutes a COBRA qualifying event), so that the commencement and duration of any COBRA coverage period is clear.
- Coordinate with any third-party COBRA administrators to ensure that required COBRA notices are timely provided and premium payments are handled properly.

For more information on COBRA generally, see Practice Note, COBRA Overview (3-519-8589) and COBRA Toolkit (w-001-8389).

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Hiring from a Competitor: Practical Tips to Minimize Litigation Risk

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A Practice Note describing the steps an employer can take to minimize litigation risk when hiring from a competitor. This Note discusses potential statutory and common law claims when hiring from a competitor, the need to identify any existing contractual restrictions a potential new hire may have, how to avoid potential issues during the recruitment process, ensuring the new hire is a "good leaver" during the resignation process, responding to cease and desist letters, and potential pre-litigation settlement concepts. The Note is jurisdiction neutral. For information on state-specific hiring or non-compete issues, see State Q&As: Hiring Requirements and Non-Compete Laws.

In most industries, competition is not limited to battles over customers and clients, but also includes efforts to recruit, employ, and retain the most productive and talented workforce. In fact, many employers consider their employees to be their most valuable asset and vigorously work to prevent competitors from taking that asset. For that reason, litigation between competitors arising out of the recruitment of employees has become increasingly common. When a hiring employer becomes embroiled in such a dispute, the time and expense necessary to defend itself can easily outweigh the benefits of hiring the employee.

Fortunately, there are a number of steps a hiring employer can take to minimize the risk of litigation when recruiting employees from a competitor. This Note provides a number of practical suggestions for recruiting individuals from a competitor and significantly lowering the litigation risk for various associated claims.

CONSIDER POTENTIAL CLAIMS AGAINST A HIRING EMPLOYER WHEN HIRING FROM A COMPETITOR

The most common claims arising out of hiring from a competitor are described below.

TORTIOUS INTERFERENCE WITH CONTRACT

If a new employee's employment violates an enforceable agreement with his prior employer, such as a post-employment restrictive covenant (most commonly a non-compete or non-solicitation agreement) or confidentiality agreement, the prior employer will often assert a tortious interference claim against the hiring employer by alleging the hiring employer wrongly induced, encouraged, or assisted the employee's breach of the agreement. The damages for this type of claim are typically measured by the losses caused by the employee's underlying breach. Tortious interference claims are tort claims, so a plaintiff could seek punitive damages in addition to compensatory damages.

AIDING AND ABETTING BREACH OF FIDUCIARY DUTY OR DUTY OF LOYALTY

Even when a new employee is not subject to a valid post-employment contractual restriction, the hiring employer may still face a risk of litigation if the new employee engaged in misconduct rising to the level of a breach of his fiduciary duty or duty of loyalty to the former employer. For example, if an employee solicits clients or employees on behalf of a new employer while still working for the prior employer, the employee may be violating a common law duty requiring all employees to act in the best interests of their current employer.

When an employee violates that duty, the employer can, and often does, accuse the new employer of encouraging that violation by "aiding and abetting" or "inducing" the new employee's breach. Even if the new employer had no idea that the new employee was violating a duty of loyalty, the new employer can easily become embroiled in a dispute involving the new employee's conduct.

MISAPPROPRIATION OF TRADE SECRETS

As with an aiding and abetting theory, if a departing employee misappropriates a former employer's trade secrets or confidential or proprietary information, the hiring employer faces a significant risk that it will be accused of participating in that misappropriation. For that reason, when a former employer asserts a misappropriation claim, it is not uncommon for the former employer to add a claim against the new employer by alleging that the new employer acted in concert with the employee. Once again, an employer can be dragged into a dispute regarding a new employee's misconduct, even if it played no active role in that misconduct.

For trade secret misappropriation that occurs on or after May 11, 2016, the former employer also may assert a claim under the federal Defend Trade Secrets Act (DTSA), which creates a private cause of action for civil trade secret misappropriation under federal law (18 U.S.C. § 1836(b)). The new law supplements but does not preempt or eliminate existing state law remedies for trade secret misappropriation.

Remedies available under the DTSA include:

- An injunction to preserve evidence and prevent trade secret disclosure, provided that it does not:
  - prevent a person from entering into an employment relationship, and that any conditions placed on the employment relationship are based on evidence of threatened misappropriation and not merely on the information the person knows; or
  - otherwise conflict with an applicable state law prohibiting restraints on the practice of a lawful profession, trade, or business.
- Compensatory damages;
- Exemplary damages up to two times the amount of the damages for willful and malicious misappropriation.
- Reasonable attorneys' fees for the prevailing party for certain bad faith conduct.

(18 U.S.C. § 1836(b)(3).)

The DTSA also permits the court to issue an *ex parte* seizure order, but only under extraordinary circumstances (18 U.S.C. § 1836(b)(2)). For more information on the civil seizure of property under the DTSA, see:

- Defend Trade Secrets Act (DTSA) Issues and Remedies Checklist (w-003-6953).
- Article, Expert Q&A on the Defend Trade Secrets Act and Its Impact on Employers: What Remedies Are Available to Employers? (w-002-2128).
- Article, The DTSA Turns One, But What Has It Done? (w-007-9652).

Inevitable Disclosure Theory

Even if there is no actual misconduct, a hiring employer can be sued for misappropriation of trade secrets under a theory of inevitable disclosure, meaning that despite the hiring employer's best efforts, the new hire will inevitably disclose trade secrets. The inevitable disclosure of trade secrets theory is often used where an individual had access to an employer's trade secrets, joins a competitor in a similar position to the one held with the former employer, and the circumstances suggest a lack of trustworthiness of the individual. However, the inevitable disclosure doctrine is not recognized in all states. For more on inevitable disclosure, see Practice Note, Non-Compete Agreements with Employees: Protection in the Absence of Non-Competes: Inevitable Disclosure (7-501-3409).

For more information about misappropriation of trade secrets generally, see Practice Notes, Protection of Employers' Trade Secrets and Confidential Information (5-501-1473) and Trade Secrets Litigation (5-523-8283). For information on state-specific inevitable disclosure doctrines, see Non-Compete Laws: State Q&A Tool: Question 17 and Trade Secret Laws: State Q&A Tool: Question 17.

UNFAIR COMPETITION

Unfair competition is often asserted as a catch-all claim in an action against a hiring employer. In most cases, an unfair competition claim is derivative of other claims alleging wrongful conduct, such as tortious interference or aiding and abetting a breach of fiduciary duty.

IDENTIFY ANY EXISTING CONTRACTUAL RESTRICTIONS

One of the first things a hiring employer should determine when recruiting from or even considering an application of an employee of a competitor is whether the candidate is subject to any post-employment restrictions, such as non-competition and non-solicitation provisions. Since the existence of an enforceable restriction may impact a decision about whether the individual is a viable candidate and whether his anticipated duties would violate a restriction, a prospective employer should:

- Ask the candidate about any restrictions as early as possible during the recruitment process.
- Examine all nooks and crannies where restrictions may be found. When discussing the restriction concerns with a candidate, specifically ask if there are any relevant agreements. The prospective employer should remind the candidate that although post-employment restrictions are typically found in employment agreements, they can also be found in a variety of other agreements, such as:
  - stock option agreements;
  - deferred compensation agreements;
  - bonus plans; and
  - purchase and sale agreements.
- Have any applicable post-employment restrictions reviewed by a legal expert. The scope of enforceability of restrictive covenants varies broadly, depending on the:
  - state in which the restrictions would be enforced. An agreement that is likely to be enforceable in New York is just as likely to be unenforceable in California (for more information on state-specific non-compete enforceability issues, see Non-Compete Laws: State Q&A Tool);
  - scope of the restrictions, and;
  - nature of the employee's responsibilities and background.
- If the restriction likely is enforceable, consider whether the candidate would violate the restriction by working in the position at issue. Potential employers should compare the contractual restriction with any written job description, and discuss the requirements of the position with the candidate's prospective manager.

ASSESS THE LIKELIHOOD OF LITIGATION

When assessing the likelihood that a particular hiring decision will result in litigation, the hiring entity should put itself in the prior employer's shoes and consider:

- What are the circumstances of the employee's departure?
- What are the similarities between the new and old positions?
- How competitive are the two businesses?
- Has the hiring entity hired any other employees from the prior employer?
- Have the hiring entity and the prior employer been involved in any past litigation?
- What is the likelihood of customer or co-worker flight?
- What is the value of the trade secrets or proprietary information to which the employee had access?
- How sensitive is the position held by the employee?
- Do the circumstances justify the cost of litigation? For example, might there be a need for the former employer to send a message to the new employer or to other employees?

Similarly, when assessing the likelihood of litigation, it is helpful to gather intelligence about the prior employer's history of enforcing its restrictive covenants. Some employers are quite aggressive and will file a lawsuit to enforce restrictive covenants of even relatively low level employees. Others only litigate in rare circumstances. Knowing a particular employer's enforcement history helps employers weigh the litigation risks and can inform decisions about potential protective steps.

SEEK LEGAL ADVICE AND CONSIDER INDEMNIFYING THE CANDIDATE

Because of the potential consequences to the candidate, potential employers should encourage the candidate to seek independent legal counsel regarding the enforceability of any restrictive covenant. However, provided that the candidate and the potential new employer have a common interest and there are no non-waivable conflicts, they can jointly seek advice from an attorney regarding enforceability issues.

In appropriate circumstances, a new employer can also agree to indemnify the candidate against any potential litigation. Any such decision should involve an assessment of various factors, including:

- The likelihood of litigation.
- Its potential outcome (both positive and negative).
- Its likely outcome.
- Potential attorneys' fees and costs.
- Whether the candidate is willing to accept the position without indemnification.
- Whether the fact of the indemnification agreement may be used against the hiring employer in any resulting litigation, such as to support a claim for interference with contract or inducing breach of contract.
- Whether indemnification is consistent with other corporate policies and procedures.

Any agreement to indemnify (or not to indemnify) a candidate should be clear and should exclude indemnification for intentionally dishonest or fraudulent conduct. It should also allow the employer to modify or terminate the agreement in appropriate circumstances (for example, if the employer later learns that the candidate was not honest).

CONSIDER POSSIBLE PROTECTIVE STEPS IF THE CANDIDATE HAS AN ENFORCEABLE RESTRICTIVE COVENANT

If a candidate is subject to an enforceable restrictive covenant, and if the position for which the candidate is being considered would require the candidate to violate the terms of that restrictive covenant, there are steps the hiring employer can take to minimize the litigation risk associated with the hire. For example, the hiring employer may:

- Restructure the position so that its duties and responsibilities do not run afoul of any contractual restrictions (for example, restricting a salesperson or manager from soliciting or servicing certain customers for a period of time).
- Place the candidate "on the bench" (for example, pay them a salary, but do not require them to perform any duties) or place them in a temporary position for the duration of any contractual restriction.
- Ask the candidate to request a waiver of any contractual restrictions from his former employer. Depending on the circumstances (for example, if the candidate was laid off or the former employer is planning to leave the competitive line of business), the former employer may be willing to waive the contractual restriction. Given the potential consequences of such a request, however, this needs to be the candidate's decision, and the candidate should be the one to make any such request.

MINIMIZE RISK DURING THE RECRUITMENT PROCESS

Once a hiring employer has decided to proceed with an offer, it should make sure its recruitment of that employee does not give rise to any potential claims against itself or the incoming employee. To help minimize the risk of legal claims, the hiring employer should instruct the candidate to:

- **Not use current employer's facilities to communicate with the hiring employer or discuss employment opportunities at the hiring employer with anyone else at the current employer**. The use of an employer's facilities (such as email, computer system, letterhead, or phone lines) to pursue competitive employment is arguably inconsistent with the employee's duty of loyalty to the current employer. In addition, in the event of litigation, any evidence that the employee used the former employer's resources for any purpose other than the performance of his normal duties (particularly in connection with the pursuit of employment with a competitor) can undermine a legal defense.
- **Not disclose or volunteer competitive information.** When recruiting from a competitor, the hiring employer should not ask for or accept any information regarding the competitor's business, clients, strategies, or finances. It instead should focus on the candidate's qualifications and suitability for the position, not the current employer's operations. If the candidate offers to share any information about the current employer, the hiring employer should politely decline and remind the candidate not to disclose any of the employer's confidential or proprietary business information.
- **Not disparage the current employer.** Not only are disparaging remarks unprofessional, they can lead to defamation claims. Litigation in this area is frequently driven by emotions such as anger and fear, and the hiring employer should avoid any conduct

that might inflame these emotions. For more information, see Practice Note, Defamation Basics (w-001-0437).

- **Not recruit other employees.** Before the effective date of resignation, the employee should not encourage any other employees to resign for any reason. This could be construed as improper solicitation and may be actionable even in the absence of any contractual restrictions against solicitation of the former employer's employees. In most jurisdictions, employees have a common law duty of loyalty (and often a fiduciary duty) to act in the best interest of their current employer, even after tendering a notice of resignation. Violation of this duty of loyalty can result in substantial damages against the employee, including, among other things, forfeiture of the wages paid to the employee during the period of disloyalty. To the extent a subsequent employer assists the employee in breaching his duty of loyalty, the new employer may be liable for aiding and abetting the employee's breach.
- **Not discuss resignation with coworkers.** The hiring employer should instruct the candidate to avoid even discussing his new employment with coworkers before submitting a formal resignation letter. This reduces the risk of breach of duty of loyalty claims regarding the improper solicitation of employees. Once the employee has resigned, if he believes it is important to inform certain co-workers that he is leaving, the employee should limit the discussion as much as possible to informing co-workers of his departure date, and sharing information necessary for a smooth and orderly transition of his duties and responsibilities.
- **Not solicit or appear to solicit clients.**The new employer should instruct the candidate that, before the effective date of resignation, he should avoid any communications with clients that could even arguably be construed as a solicitation for the new employer or any other company. If a prior employer can prove that an employee solicited a client while still employed by the prior employer, the employee (and the new employer) could be liable for substantial monetary damages for breach of the duty of loyalty in addition to any contractual restrictions against soliciting clients. As stated above, those damages can even include the return of any salary or bonuses paid to the employee during the period of alleged disloyalty.
- **Attest to the disclosure of all employment agreements and restrictions.** In any offer letters or employment agreements provided to the candidate, employers should include a representation to be signed by the candidate that he has disclosed to the new employer all agreements or other post-employment restrictions that may apply. The representation should also include a statement that the candidate has reviewed the duties and responsibilities of the new position and is not subject to any contractual restriction that would prevent him from performing them. The offer letter or agreement can also instruct the new hire not to bring, distribute, or use any confidential information, trade secrets, or property of a prior employer, and it should require the new hire to confirm he can perform the duties and responsibilities of the new position without using or disclosing a former employer's confidential or proprietary material. For a sample offer letter containing this language, see Standard Document, Offer Letter/Employment Agreement for a Non-Executive (Short-Form): Continuing Obligations (0-501-1654). Offer letters frequently become litigation exhibits. Accordingly, employers should write them with a judicial audience in mind (for example, the tone should be professional and respectful of the legal rights of others).
- **Review relevant handbook policies.** Employers should include a provision in any employee handbook prohibiting the unauthorized use or distribution of confidential information or trade secrets of a third party. This provision can be further evidence of the hiring employer's good faith. For sample language, see Standard Document, IT Resources and Communications Systems Policy (8-500-5003).

ENSURE THE EMPLOYEE IS A "GOOD LEAVER" DURING THE RESIGNATION PROCESS

Once an employer has extended an offer to an employee working for a competitor, the hiring employer can further reduce its risk of legal exposure by doing its best to ensure the employee behaves appropriately throughout the resignation process, also known as being a "good leaver." As a good leaver, the employee not only reduces his own risk of exposure, but also reduces the risk of a claim against the hiring employer.

To be a good leaver, the employee should:

- **Not bring any materials from the former employer to the new employer.** On departure, the employee should not take anything with him unless it is unquestionably a personal item (for example, personal photographs, artwork, or shoes). The employee should not take any business-related items, including, among other things, reports and other materials prepared solely by the employee regardless of where the material is physically located. Any non-personal material should not be removed from the former employer's premises and all copies should be returned to the former employer. Even if the material technically belongs to the client rather than the former employer, it still may represent work product of the former employer and may even be subject to copyright protection. If the employee needs this material for a subsequent engagement with a new employer, the employee should ask the client and former employer to voluntarily provide a copy. Former employers will often comply with a client's request for relevant material to maintain goodwill with that client.
- **Find a monitor.** Ask the employer to designate someone to monitor the employee's departure and approve the removal of any non-personal items, such as appointment calendars and contact lists, whether stored in hard copy or electronically. Employers often allow departing employees to take a copy of their personal contacts even if stored on the employer's computer system. Using a monitor avoids claims that the employee:
  - did not have the right to take these items; or
  - improperly downloaded, copied, or forwarded any of the employer's confidential business information.
- **Return materials to the former employer.** All work-related material maintained by the employee both inside and outside the office (including computer files contained on a home PC, laptop, or smartphone, equipment belonging to the employer, and any hardcopy files) should be returned to the employer. An employee's retention of any proprietary or confidential information or material following resignation is one of the single most damaging pieces of evidence in restrictive covenant and unfair competition cases. Should litigation ensue, if the former employer can articulate

a legitimate basis for believing that a former employee's personal computer contains the former employer's proprietary and confidential information, a court may permit a forensic examination of the former employee's personal computer to determine if proprietary and confidential information was retained by the employee after resignation.

- **Determine ownership of social media accounts.** The employee should determine whether the former employer or the employee owns any social media accounts that the employee used while working for the former employer. Many employers define the ownership of social media and related data in their employment policies or agreements with their employees (see, for example, Standard Clauses, Employer Ownership of Social Media Accounts Clauses (3-531-8025)).
- **Tender a written letter of resignation.** The resignation letter should not contain any disparaging or critical comments. Instead, the letter should be brief and courteous. It may also include an offer to remain with the current employer for a reasonable period of time (for example, one or two weeks) to finish pending projects or help transition his duties, but this will depend on the circumstances of the resignation, the existence of any enforceable notice provisions in the employee's agreement, and the business needs of the current employer. In practice, employers often require resigning employees to leave the premises immediately.

RESPOND TO ANY "CEASE AND DESIST" LETTERS

Even when a hiring employer does everything possible to ensure its recruitment efforts are proper, it still can find itself the recipient of a letter from the competitor, or the competitor's counsel, complaining about the circumstances of the employee's departure or threatening legal action. In most circumstances, the hiring employer should respond to any "cease and desist" letter that it receives. For sample cease and desist letters, see Standard Documents, Restrictive Covenant Cease and Desist Letter to Former Employee (w-002-5174) and Restrictive Covenant Cease and Desist Letter to New Employer (w-002-5171).

There are steps a hiring employer can take to defuse a possible litigation even when it receives a particularly hostile letter. Hiring employers should:

- **Use an appropriate tone.** Using a reassuring or sympathetic tone when responding to a cease and desist letter (for example, a tone suggesting the new employer takes the concerns of the prior employer seriously, but believes there is no basis for concern). Resist the temptation to respond in an adversarial manner even where the former employer's allegations are completely unfounded.
- **Provide assurances.** If the former employer alleges that the employee misused or misappropriated confidential information, for example, the new employer can assure the prior employer that it has no interest in this information and that it has investigated the allegation and found it meritless. However, if it turns out that the employee does possess this information, the new employer can offer to return or destroy it.
- **Avoid legal debates.** Do not include in the letter legal debates over the enforceability of restrictive covenants. In most cases, it is useless to try and persuade an employer that its restrictive covenants are overbroad or otherwise unenforceable. If the former employer claims it has an enforceable restriction that the hiring employer believes to be unenforceable, it should focus instead on its commitment to free and fair competition.
- **Maintain an open dialogue.** Keep the door open for further discussion. Any response letter should state that if it has not addressed all concerns of the former employer, or if the former employer has additional information that it would like to share about its concerns, the hiring employer is open to discussing the matter further.
- **Find a similarly situated author.** To avoid escalating the dispute, if possible, the response should come from someone in a position similar to the sender of the cease and desist letter. For example, if the cease and desist letter came from the prior employer's in-house attorney, the response should come from an in-house attorney. If the cease and desist letter came from outside counsel, the response should come from outside counsel.
- **Write for a judicial audience.** Cease and desist letters and any responses are frequently used as exhibits in any resulting litigation. Accordingly, authors should draft these letters with a potential judicial audience in mind.
- **Not respond to reminder letters.** Unlike true cease and desist letters, reminder letters do not allege misconduct; therefore a response is generally not required. For sample reminder letters to departing employees and hiring employers, see Standard Documents, Continuing Obligations Letter to New Employer (9-520-5638) and Continuing Obligations Letter to Departing Employee (5-520-0096).

AVOID SUBSEQUENT EVIDENCE SPOLIATION CLAIMS

Cease and desist letters frequently trigger a duty to preserve pertinent evidence. Where litigation is reasonably foreseeable, the duty may be triggered even before the receipt of such a letter. For example, if an employer independently discovers that a new employee may have improperly taken a prior employer's proprietary information and concludes that there is a reasonable likelihood of litigation over that conduct, the new employer and the employee may have a duty to preserve potentially relevant information even before the prior employer sends a cease and desist letter or even becomes aware of the potential misappropriation.

After receiving a cease and desist letter, employers should issue a document preservation notice to all individuals who may have relevant documents or information, as well as to the appropriate information technology (IT) personnel to make certain that relevant emails and other electronic communications are preserved. For a sample letter to employees, see Standard Document, Litigation Hold Notice (0-501-1545). For a hold notice to opposing or third parties and other relevant litigation hold resources, see Litigation Hold Toolkit (0-501-1545).

Where litigation is reasonably foreseeable, and where certain employee hard drives are likely to contain evidence that would be relevant to the litigation, it may also be prudent to take a forensic image of those hard drives. In such circumstances, the cost of creating such a forensic image should be weighed against the possibility of evidence spoliation in the absence of such an image.

CONSIDER PRE-LITIGATION SETTLEMENT OPTIONS

Resolution of disputes involving the movement of employees between competitors may require more than a mere exchange of letters. Potential settlement options may include the following:

- The return or destruction of documents or other information improperly taken.
- Representations and warranties from the hiring employer to the prior involving topics including:
  - the employee's duties and responsibilities;
  - the hiring employer's lack of knowledge regarding any inappropriate activity by the employee; and
  - the hiring employer's pledge to return any documents or information that it subsequently learns was inappropriately taken.
- A hiring protocol governing how the employee should respond to employment inquiries from former colleagues.
- An agreement that for a limited period of time, the employee will not solicit certain designated customers or employees. Such an agreement can be a reaffirmation of existing non-solicitation contractual obligations, or it could be a means of remedying an alleged theft of trade secrets or confidential information.

AVOID BLANKET NO HIRE AGREEMENTS

As an alternative to litigating individual restrictive covenant disputes, employers sometimes enter into "no hire" or "no poaching" agreements, where for a limited time, the new employer agrees not to hire certain specific employees from the former employer. However, these agreements may violate federal antitrust laws. On October 20, 2016, the Department of Justice (DOJ) and the Federal Trade Commission (FTC) issued its Antitrust Guidance for Human Resources (HR) Professionals Employers indicating their intent to focus on antitrust violations in the employment context. Employers that enter into blanket no hire or no poaching agreements therefore may risk serious civil and criminal penalties.

For more information on the Guidance, see Legal Update, FTC and DOJ Issue Antitrust Compliance Guidelines for HR Professionals (w-004-1019) and Article, Expert Q&A on the DOJ and FTC Antitrust Guidance for HR Professionals and Its Impact on Employers (w-004-8025).

04-18

Trade Secrets Litigation

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A Practice Note discussing trade secrets litigation for employers whose employees have misappropriated trade secrets. This Note describes pre-litigation investigations, sending cease and desist letters, and contacting law enforcement. It also addresses filing a legal action, including forum selection and choice of law, deciding whether to include the employee's new employer and third parties, common causes of action (including misappropriation under the Defend Trade Secrets Act of 2016 (DTSA)), discovery, injunctive relief, damages, and attorneys' fees. It includes best practices for preparing to counter potential defenses and counterclaims and maintaining confidentiality during litigation. This Note applies to private employers and is jurisdiction-neutral. For more information on state-specific laws, see Trade Secret Laws: State Q&A Tool.

Trade secrets are often an employer's most valuable assets. When an employee or former employee misappropriates an employer's trade secrets, the employer frequently initiates litigation with several goals in mind, including:

- Preventing further unauthorized use or disclosure of its trade secrets.
- Recovering the trade secrets.
- Obtaining damages.

This Practice Note discusses trade secrets litigation. In particular, it addresses:

- Preliminary steps to consider, such as sending a cease and desist letter and contacting law enforcement.
- Filing a legal action.
- Common causes of action.
- Discovery, including expedited discovery.
- Injunctive relief, damages, and attorneys' fees.
- Best practices for preparing to counter potential defenses and counterclaims.
- Maintaining confidentiality during trade secrets litigation.

For more information on what constitutes a trade secret and how to protect trade secrets from unauthorized use or disclosure, see Practice Note, Protection of Employers' Trade Secrets and Confidential Information (5-501-1473).

PRELIMINARY STEPS

INVESTIGATING THE SUSPECTED MISAPPROPRIATION

A prompt and thorough investigation can be critical to successful trade secrets litigation. One of the first steps in an investigation is an analysis of which information of the employer is truly secret and valuable because it is secret. Next, the employer must investigate what, if any, trade secret information the employee actually misappropriated. This investigation often consists of an in-depth forensic analysis of the employee's:

- Email.
- Desktop and laptop computers.
- Handheld electronic devices.
- Office files.
- Calendar.
- Computer and telephone logs.
- Records of office access.
- Travel and expense records.

The investigation should be performed by an experienced electronic forensic analyst who not only can perform the investigation, but can later act as electronic forensic expert in support of the employer's claims.

An investigation's revelation that the employee misappropriated trade secret information is often sufficient to obtain a court order directing the employee to cease all use and disclosure of that information and return it to the employer. This result rests on the evidence or presumption that:

- As a former employee, the defendant has no authorized or legitimate purpose for using or disclosing the employer's trade secret information.
- The employer will be competitively injured by the employee's or the new employer's use or disclosure of this information.

An employer's investigation into suspected trade secrets misappropriation also typically includes gathering information about the employee's new employer and business. For more on gathering this information, see Practice Note, Preparing for Non-Compete Litigation: Best Practices for Gathering Evidence (3-516-9469).

SENDING A CEASE AND DESIST LETTER

Depending on the circumstances, a cease and desist letter can be a valuable preliminary step to litigation or a less expensive alternative. Cease and desist letters typically:

- Remind former employees of their contractual and other obligations to the employer.
- Advise them to cease and desist from conduct that violates their obligations.
- Where appropriate, demand the return of:
  - information;
  - documents; or
  - data.

Depending on the facts of a particular situation, an employer may decide to send a copy of the cease and desist letter or a similar letter to the employee's new employer. For sample letters, see Standard Documents, Restrictive Covenant Cease and Desist Letter to Former Employee (W-002-5174) and Restrictive Covenant Cease and Desist Letter to New Employer (W-002-5171).

The employer should investigate and be able to substantiate its allegations of trade secret misappropriation before sending any cease and desist letter, as its failure to do so can expose the employer to a tortious interference claim by the employee or the employee's new employer (see Preparing for Potential Counterclaims).

CONTACTING LAW ENFORCEMENT

When an employer suspects criminal conduct, it may decide to contact law enforcement to investigate and prosecute trade secret theft, in addition to or instead of sending one or more cease and desist letters. Misappropriating trade secrets is a crime under various federal laws. For example, it is illegal to:

- Misappropriate trade secrets or knowingly receive misappropriated trade secrets with the intent to benefit a foreign government or a foreign agent (18 U.S.C. § 1831).
- Transport in interstate or foreign commerce stolen property worth $5,000 or more (18 U.S.C. § 2314).
- Use the mail or a wire transmission to misappropriate trade secrets as part of a scheme to defraud (18 U.S.C. §§ 1341, 1343, and 1346).

Contacting law enforcement regarding suspected trade secrets misappropriation has three main advantages:

- The mere threat of criminal prosecution and penalties may encourage employees to explain what happened.
- Prosecutions are public, and publicity may deter other employees who are contemplating similar acts.
- If an employee has misappropriated trade secrets and left the country, law enforcement can obtain evidence abroad and possibly hold foreign conspirators accountable for their involvement.

The main drawback of contacting law enforcement is the potential for disclosure of the employer's trade secrets in connection with the prosecutorial proceedings. Law enforcement officials and judges typically try to avoid disclosing sensitive, confidential, or trade secret information unnecessarily. However, the risk exists that the employer's trade secrets may be disclosed, purposefully or inadvertently, if it helps in the prosecution of the case.

FILING A LEGAL ACTION

FORUM SELECTION AND CHOICE OF LAW

Unless the employee and employer have signed an agreement with an enforceable and exclusive forum selection provision, the employer decides where to initiate litigation. Depending on the facts of a particular situation, an employer may have the option of filing a complaint in federal or state court. For claims arising on or after May 11, 2016, if an employer has evidence that an employee misappropriated trade secrets, it may opt to bring a claim under the Defend Trade Secrets Act (DTSA) in federal court and join state law claims in the federal action under the court's supplemental jurisdiction. Typically, the circumstances of the case help an employer determine the more advantageous option.

Note that employers with businesses or employees in California are limited in their ability to impose forum selection clauses that require the parties to litigate outside of California or apply a law other than the law of that state. For all contracts entered into, modified, or extended on or after January 1, 2017, involving any person who primarily resides or works in California, choice of law and choice of venue contract provisions are prohibited if they apply another state's law or require adjudication in another state as a condition of employment (Cal. Lab. Code § 925). For more information, see Legal Update, California to Prohibit Choice of Law and Venue Provisions in Employment Contracts (W-003-9491). The Massachusetts Noncompetition Agreement Act (MNAA) also limits an employer's ability to impose the law of a jurisdiction other than Massachusetts against individuals who live or work in the state (M.G.L. ch. 149, § 24K(e)).

In the absence of a choice of law provision, the court decides which state's trade secrets law should be applied if the employer and employee are located in different states. Depending on the states and the case law involved, an employer may argue that the employee violated the trade secrets law of the state or states where:

- The employer electronically stored its trade secrets.
- The employee accessed the employer's trade secrets to misappropriate them.
- The employee used the employer's trade secrets to harm the employer.

For more information on determining where to file, see Practice Notes, Preparing for Non-Compete Litigation: Where to File the Lawsuit (3-516-9469) and Choice of Law and Choice of Forum: Key Issues (7-509-6876).

DECIDING WHETHER TO INCLUDE THE EMPLOYEE'S NEW EMPLOYER IN THE ACTION

Before initiating litigation, employers must decide which parties to name in the complaint. In certain instances, an employer may be inclined to include the employee's new employer. For example, employers should consider naming the new employer if there is evidence that:

- The former employee was acting under the new employer's direction when the employee misappropriated the former employer's trade secret information.
- The new employer has agreed to indemnify the former employee for any liability arising out of the employee's move to the new employer or breach of contract with the former employer.

For more information, see Practice Note, Preparing for Non-Compete Litigation: Deciding Whether to Include the Employee's New Employer in the Action (3-516-9469).

DECIDING WHETHER TO INCLUDE THIRD PARTIES IN THE ACTION

In addition to naming former employees and their new employers, employers should consider naming any third parties who:

- Procured or assisted in the misappropriation of the trade secrets.
- Received those trade secrets.

Naming third-party defendants in the lawsuit can help ensure the return of all copies or derivatives of the trade secrets. Employers may also be able to obtain discovery more easily than using the third-party subpoena discovery process.

COMMON CAUSES OF ACTION

MISAPPROPRIATION OF TRADE SECRETS

The most common claim against former employees who use or disclose an employers' confidential, proprietary information is a claim of trade secret misappropriation. Until the DTSA was enacted in May 2016, trade secrets had been protected primarily by state law (see Defend Trade Secrets Act). As of October 1, 2018, all states (except New York) and the District of Columbia have enacted a version of the model Uniform Trade Secrets Act (UTSA), and the requirements for stating a claim of misappropriation under the laws of those states are often similar. Typically, to state a claim under state law, employers must allege that:

- The information at issue is the employer's trade secret.
- The employee misappropriated the trade secret.
- The employee used or intended to use the trade secret in the employee's or the new employer's business.
- The employer suffered or will suffer damages.

For more information on demonstrating trade secrets misappropriation under state law, see Trade Secret Laws: State Q&A Tool: Question 9.

INEVITABLE DISCLOSURE OF TRADE SECRETS

An employer that fails to discover evidence of an employee's actual or intended misappropriation, use, or disclosure of trade secret information should consider an inevitable disclosure claim. This claim may apply where it is impossible for the former employee to perform the new job without relying on the employee's knowledge of the former employer's trade secrets, disclosing them to the employee's new employer, or both. Employers alleging this type of claim argue that it is inevitable that the former employee will:

- Use or disclose those trade secrets in the employee's new position.
- Cause injury to the former employer as a result.

Not every state recognizes claims for inevitable disclosure of trade secrets. In the jurisdictions that recognize this cause of action, employers should emphasize in their pleadings that:

- The companies are engaged in fierce competition in a niche market.
- The former employee was a high level executive privy to strategic plans or information.
- It would be impossible for the former employee to perform the new job without using or disclosing the plans or information.
- Circumstances support or highlight the employer's concern, such as the employee being dishonest or misleading about his departure from the former employer.

In *PepsiCo, Inc. v. Redmond*, the seminal case on inevitable disclosure, Pepsi introduced evidence that:

- Quaker was one of its principal competitors.
- They were engaged in a fierce competition in the new age drink niche market.
- One of Pepsi's high-level executives had been privy to its strategic plans for the next steps in its efforts to gain market share.
- A high-level executive had resigned to work for Quaker in that same niche market.
- It would have been impossible for the former employee to perform his job at Quaker in that same niche market without bearing Pepsi's strategic plans in mind.
- Its concern was well-founded because the former executive had been dishonest about the scope of his new position at Quaker when he left Pepsi.

(54 F.3d 1262 (7th Cir. 1995).)

As a practical matter, however, courts are relatively reluctant to recognize inevitable disclosure claims because:

- The claims may effectively prevent an employee from accepting a new job even where the employee is not violating any contractual or other obligation.
- There is no evidence that the employee misappropriated anything or did anything wrong.

To convince a court to apply the inevitable disclosure doctrine, the former employer should be able to demonstrate, as in *PepsiCo*, that it is in a position where its star player has left to join the rival team right before the big game with the former employer's playbook in hand.

Although some have argued that the DTSA does not allow for inevitable disclosure claims, the DTSA is clear that it does not preempt state law, and therefore has no impact on the ability to bring inevitable disclosure claims in those jurisdictions that recognize the doctrine.

For more on inevitable disclosure, see Trade Secret Laws: State Q&A Tool: Question 17 and Practice Note, Non-Compete Agreements with Employees: Protection in the Absence of Non-Competes: Inevitable Disclosure (7-501-3409).

DEFEND TRADE SECRETS ACT

Private Cause of Action

The DTSA creates a private cause of action for civil trade secret misappropriation under federal law (18 U.S.C. § 1836(b)). The new law supplements but does not preempt or eliminate the existing patchwork of state law remedies for trade secret misappropriation (see Article, Expert Q&A on the Defend Trade Secrets Act and Its Impact on Employers: How Does the DTSA Affect Existing State Non-Compete Laws? (W-002-2128)). The DTSA applies to misappropriation that occurs on or after the law's May 11, 2016 effective date.

The DTSA uses the definition of trade secret already contained in the Economic Espionage Act (18 U.S.C. § 1836(e)). Under that definition, a trade secret is business or scientific information that:

- Derives independent economic value from not being generally known to or readily accessible by the public through proper means.
- The owner has taken reasonable measures to keep secret.

(18 U.S.C. § 1839(3).)

Under the DTSA, misappropriation occurs when a person:

- Acquires a trade secret that the person knows or has reason to know was acquired through improper means.
- Discloses or uses a trade secret of another without express or implied consent and:
  - used improper means to acquire knowledge of the trade secret; or
  - knew or had reason to know that knowledge of the trade secret was derived through improper means or under circumstances giving rise to a duty to maintain its secrecy.
- Before a material change in position of the person:
  - knows or has reason to know that the information was a trade secret; and
  - acquires knowledge of the trade secret by accident or mistake.

(18 U.S.C. § 1839(b)(5).)

Improper means includes:

- Theft.
- Bribery.
- Misrepresentation.
- Breach or inducement of a breach of duty to maintain secrecy.
- Espionage through electronic or other means.

The DTSA expressly states that improper means do not include:

- Reverse engineering.
- Independent derivation.
- Any other lawful means of acquisition.

(18 U.S.C. § 1839(b)(6).)

An owner of a trade secret that is misappropriated may bring a civil action under the DTSA if the trade secret is related to a product that is used in or intended for use in interstate or foreign commerce (18 U.S.C. § 1836(b)(1)). The DTSA claim can be combined with any applicable state law claims under statutes or common law (including for misappropriation of trade secrets, breach of a confidentiality or non-competition agreement, or unfair competition). A civil action under the DTSA may be brought in US district court (18 U.S.C. § 1836(c)). A DTSA action must be brought no later than three years after the date the misappropriation either:

- Was discovered.
- Should have been discovered with reasonable diligence.

(18 U.SC. § 1836(d).)

The remedies under the DTSA are similar to those under the UTSA (see Remedies Under the DTSA).

The DTSA has no impact on existing state law inevitable disclosure theories, except to the extent that the standard for obtaining injunctive relief may be different in federal than in state court.

For more on the DTSA, see:

- Defend Trade Secrets Act (DTSA) Issues and Remedies Checklist (W-003-6953).
- Article, Expert Q&A on the Defend Trade Secrets Act and Its Impact on Employers (W-002-2128).
- Article, The DTSA Turns One, But What Has It Done? (W-007-9652).

Whistleblower Protections

The DTSA includes protections for whistleblowers who disclose trade secrets under certain circumstances by providing criminal and civil immunity under any federal or state trade secret law for the disclosure of a trade secret that either is made:

- In confidence solely for the purpose of reporting or investigating a suspected violation of law to:
  - a federal, state, or local government official; or
  - an attorney.
- In a complaint or other document filed under seal in a lawsuit or other proceeding (see Practice Note, Filing Documents Under Seal in Federal Court (5-562-9328)).

(18 U.S.C. § 1833(b).)

Employers must give employees, contractors, and consultants notice of this potential immunity in any contract or agreement entered into or amended after the effective date of the DTSA that governs the use of a trade secret or other confidential information. An employer may comply with this requirement by cross-referencing a policy document that contains the employer's reporting policy for a suspected violation of law. (18 U.S.C. § 1833(b)(3)(A) and (B).)

For a sample notice provision, see Standard Clause, Notice of Immunity Under the Defend Trade Secrets Act (DTSA) Provision (W-003-5261).

An employer that does not provide the required notice is precluded from recovering exemplary damages or attorneys' fees under the DTSA in an action against an employee to whom notice was not provided (18 U.S.C. § 1833(b)(3)(C)) (see Remedies Under the DTSA).

ADDITIONAL CLAIMS

Employers investigating suspected trade secret misappropriation or the potential inevitable disclosure of trade secrets should consider whether alternative causes of action also apply. The employer may be able to obtain compensation for damages it has suffered by using alternative legal claims such as:

- Breach of contract.
- Common law torts.
- Violation of the Computer Fraud and Abuse Act (CFAA).

Because the burden of proof and available relief are not the same under each claim, employers should consider each claim to maximize their chances of recovery. Although beyond the scope of this Note, additional claims may be available if an employer involves law enforcement to pursue claims of, for example:

- Conspiracy.
- Criminal trade secret theft under the Economic Espionage Act of 1996.
- Mail or wire fraud.

(See Contacting Law Enforcement).

Breach of Contract

Breach of contract claims can be based on:

- A non-compete agreement if the former employee is working for a competitor in violation of the agreement (see Standard Document, Employee Non-Compete Agreement (7-502-1225)).
- A non-solicitation agreement if the former employee is soliciting customers or employees in violation of the agreement (see Standard Clause, Non-Solicitation Clause (4-589-5271)).
- A nondisclosure or confidentiality agreement if the former employee disclosed confidential or trade secret information to the employee's new employer or another party (see Standard Document, Employee Confidentiality and Proprietary Rights Agreement (6-501-1547)).

(See Practice Notes, Protection of Employers' Trade Secrets and Confidential Information: Breach of Contract (5-501-1473) and Preparing for Non-Compete Litigation (3-516-9469)).

Tortious Interference with Contract

An employer should consider a tortious interference with contract claim against an employee's new employer. This claim may apply if the new employer was aware that the former employee was a party to a non-compete, non-solicitation, or nondisclosure agreement, and the new employer hired the employee in a capacity where the employee would violate the agreement with the old employer. (See Practice Note, Protection of Employers' Trade Secrets and Confidential Information: Tortious Interference with Contract (5-501-1473)).

Often an employer sends a cease and desist letter to the new employer before initiating legal action against it. For a sample letter, and drafting notes about the factors employers should weigh before sending a cease and desist letter, see Standard Document, Restrictive Covenant Cease and Desist Letter to New Employer (W-002-5171).

Breach of Duty of Loyalty or Fiduciary Duty

Under the laws of most states, employees owe a duty of loyalty to their employers. Employers that discover a former employee acted contrary to their interests while still employed may also have a claim for breach of the duty. (See Practice Note, Protection of Employers' Trade Secrets and Confidential Information: Breach of Duty of Loyalty or Fiduciary Duty (5-501-1473)).

For information on state common law duties prohibiting employees from disclosing employer information, see Trade Secret Laws: State Q&A Tool: Question 16.

Defamation

Employers may consider a defamation claim if a former employee or the new employer made defamatory statements to:

- The former employer's customers in an effort to encourage them to transfer their business to the new employer.
- Former coworkers in an attempt to recruit them.

For information about defamation claims, see Practice Note, Defamation Basics (W-001-0437) and Defamation Basics State Laws Chart: Overview (3-619-6023).

Unfair Competition or Tortious Interference with Business

Employers may have a claim for tortious interference if a former employee or the new employer, or both, took an unprivileged action in an effort to interfere with the former employer's business relationships. This claim is also known as tortious interference with:

- Business relations.
- Prospective economic advantage.
- Expectancy.

Violation of the CFAA

The CFAA provides a civil cause of action against employees who access a protected computer without authorization or exceed their authorized access (18 U.S.C. § 1030). In some jurisdictions, employers may have a claim under the CFAA against a former employee who accessed the employer's computer system and obtained the employer's information for an illegitimate purpose, even if the individual was still an employee at the time of access (see, for example, *Int'l Airport Ctrs, L.L.C. v. Citrin*, 440 F.3d 418 (7th Cir. 2005)). In other jurisdictions, courts have held that an employee's access was not without authorization and did not exceed the employee's authorized access under similar circumstances (see, for example, *WEC Carolina Energy Solutions LLC v. Miller*, 687 F.3d 199, 205 (4th Cir. 2012) and *Teva pharm. USA, Inc. v. Sandhu*, 291 F. Supp. 3d 659, 668-71 (E.D. Pa. 2018) (summarizing circuit split)). The US Supreme Court has not yet weighed in on this circuit split.

DISCOVERY

Interrogatories and written document requests in trade secret misappropriation cases typically seek information about:

- The employee's skill set and duties.
- The employee's access to confidential and trade secret information, including the nature and extent of the employee's access to confidential computer databases and files.
- Any agreements between the employer and employee, including any restrictive covenants.
- The employee's acknowledgment of and agreement to the employer's policies.
- The employee's wrongful acts of appropriation, including the information and materials misappropriated.
- Collaborative or conspiratorial conduct by the employee and other employees or third parties.
- The employee's contacts and communications with the new employer.
- The employee's contacts and communications with any corporate recruiter involved in the employee's hire by the new employer.
- The policies and practices and any relevant acts of the new employer.
- Records of the new employer's knowledge or use of the former employer's trade secrets, including existing and deleted computer files.

EXPEDITED DISCOVERY

Employers requesting injunctive relief (see Injunctive Relief) should consider requesting that the court permit discovery on an expedited schedule in advance of the hearing. Employers should:

- Narrowly tailor discovery requests to the issues that are essential to the hearing on injunctive relief.
- Emphasize the potential harm the employer is attempting to prevent.
- Demonstrate the reasonableness of the requested information by attaching the proposed discovery requests to the employer's motion for injunctive relief.

OBTAINING RELIEF FOR TRADE SECRET MISAPPROPRIATION

Depending on the facts of the case, the jurisdiction, and the claims alleged, an employer should consider drafting its complaint to include a prayer for relief seeking:

- Temporary, preliminary, or permanent injunctive relief.
- A seizure order under the DTSA (see Remedies Under the DTSA).
- Monetary damages, comprised of any combination of:
  - lost profits;
  - the wrongdoer's unjust enrichment caused by the misappropriation;
  - a reasonable royalty, where damages are difficult to calculate; and
  - exemplary damages under the DTSA or applicable state law.
- Costs.
- Attorneys' fees.
- Pre- and post-judgment interest.

INJUNCTIVE RELIEF

Typically the goal in filing a misappropriation of trade secrets lawsuit is not simply to recover damages, but first and foremost to recover the trade secrets and prevent the misappropriation from inflicting any additional (and often difficult to quantify) harm on the employer. This means that in most cases, employers request that a court issue an injunction in addition to damages.

In a trade secrets case, a temporary restraining order (TRO) may:

- Direct the return of purported trade secret information.
- Prohibit the use or disclosure of trade secret information.
- Prohibit a party from violating a restrictive covenant such as a non-compete or non-solicitation agreement.

(See Practice Note, Preparing for Non-Compete Litigation: Requesting Injunctive Relief (3-516-9469)).

Federal courts traditionally consider four factors when evaluating a motion for a preliminary injunction or TRO:

- The moving party's likelihood of success on the merits.
- The likelihood that the moving party will suffer irreparable harm absent preliminary injunctive relief.
- The balance of harms between the moving party and the non-moving party.
- The effect of the injunction on the public interest.

The federal circuits vary in how they weigh these factors. Some circuits apply a balancing test, allowing a weaker showing in one factor to be offset by a stronger showing in another. Other circuits apply the traditional factors sequentially, requiring sufficient demonstration of all four before granting preliminary injunctive relief. For more on the standards for relief in federal court, see Standard for Preliminary Injunctive Relief by Circuit Chart (8-524-0128).

MONETARY DAMAGES

In addition to injunctive relief, several types of damages are typically available for trade secret misappropriation.

Employers typically request compensatory damages that result from the misappropriation of trade secrets. Under Section 3 of the UTSA, damages can include both:

- The actual loss to the employer caused by misappropriation.
- To the extent the former employee or the new employer, or both, used misappropriated trade secrets, the unjust enrichment caused by misappropriation that is not taken into account in computing the employer's actual loss.

(Unif. Trade Secrets Act § 3.)

At times, damages in trade secret misappropriation cases depend on future events or sales and therefore are difficult to quantify. In those cases, the damages caused by misappropriation may be measured by the imposition of liability for a reasonable royalty for the employee's unauthorized disclosure or use of a trade secret.

If willful and malicious misappropriation exists, the court may award exemplary damages. Nearly all state laws follow the UTSA and permit exemplary damages limited to double the underlying award (for example, see 765 Ill. Comp. Stat. § 1065/4(b)).

Similar damages are available under the DTSA (see Remedies Under the DTSA).

Courts have several tools at their disposal to ensure that damages are calculated accurately under the circumstances, such as the ability to:

- Appoint a special master.
- Award pre-judgment interest.
- Order an equitable accounting.

ATTORNEYS' FEES

In addition to damages, successful employers can sometimes recover the attorneys' fees they incur in bringing a trade secret misappropriation case if the misappropriation is willful and malicious. Under Section 4 of the UTSA, attorneys' fees can also be awarded to a defendant if:

- A claim of misappropriation is made in bad faith.
- A motion to terminate an injunction is made or resisted in bad faith.

(Unif. Trade Secrets Act § 4.)

The DTSA also allows for the recovery of attorneys' fees if the employer complied with the notice of immunity requirement, if applicable (see Remedies Under the DTSA).

REMEDIES UNDER THE DTSA

The remedies under the DTSA are similar to those under the UTSA. Available remedies include:

- An injunction to preserve evidence and prevent trade secret disclosure, provided that it does not:
  - prevent a person from entering into an employment relationship, and that any conditions placed on the employment relationship are based on evidence of threatened misappropriation and not merely on the information the person knows; or
  - otherwise conflict with an applicable state law prohibiting restraints on the practice of a lawful profession, trade, or business.
- Compensatory damages measured by:
  - actual loss and unjust enrichment, to the extent not accounted for in the actual loss calculation; or
  - a reasonable royalty for the unauthorized disclosure or use of the trade secret.
- Exemplary damages up to two times the amount of the damages for willful and malicious misappropriation.
- Reasonable attorneys' fees for the prevailing party if:
  - a misappropriation claim is made in bad faith;
  - a motion to terminate an injunction is made or opposed in bad faith; or
  - a trade secret was willfully and maliciously misappropriated.

(18 U.S.C. § 1836(b)(3); see also Defend Trade Secrets Act (DTSA) Issues and Remedies Checklist (W-003-6953)).

Unlike the UTSA, the DTSA also permits the court to issue an ex parte seizure order (18 U.S.C. § 1836(b)(2)). The DTSA includes protections designed to prevent abuse of this powerful remedy and only allows an ex parte seizure order under extraordinary circumstances. A party seeking an ex parte seizure order must demonstrate as a threshold matter that an order granting injunctive relief under FRCP 65 would be futile. The courts have set a high bar for making this showing.

For more information on the civil seizure of property under the DTSA, see Articles, Expert Q&A on the Defend Trade Secrets Act and Its Impact on Employers: What Remedies Are Available to Employers? (W-002-2128) and The DTSA Turns One, But What Has It Done?: Seizure Orders (W-007-9652) and Available Relief Under FRCP 65 (W-007-9652).

PREPARING FOR POTENTIAL DEFENSES AND COUNTERCLAIMS

Although a defendant's defenses may vary by claim and circumstance, employers can make their complaint less susceptible to attack by anticipating several common defenses.

THE INFORMATION IS NOT A TRADE SECRET

Former employees' and new employers' first line of defense often is claiming that the information at issue is not a trade secret. Employers should take the following steps in anticipation of that argument.

Do Not Overreach on What Is Claimed as a Trade Secret

Typically, defendants scrutinize a complaint for categories of information that are purportedly trade secrets but are actually publicly available. For example, if an employer claims that its pricing (rather than the methodology by which it sets its pricing) is a trade secret, the employee or new employer may argue that pricing is disclosed to third-party customers and potential customers and, as a result, is not secret. Employers should only claim that information is a trade secret if they have evidence to support the claim and if that information is pertinent to the facts of the case.

Consider What Information Is Common Industry Knowledge

Defendants also frequently try to undermine the claim that information is secret by arguing that the information is commonly known in the industry. To fuel that argument, defendants look to their peers at other companies that compete with the employer to obtain testimony that the other companies' employees know this information, as well. For example, if an employer claims that its manufacturing process is a trade secret, the defendant may try to obtain testimony from the employer's competitor that it knows the details of the employer's manufacturing process. Employers should consider what information may be known by the employer's competitors when deciding what information the employer should claim is a trade secret.

Explain How You Protect Your Trade Secrets

After attacking the secrecy of the information, defendants often argue that the employer did not take appropriate steps to protect the secrecy (or purported secrecy) of the information. For example, defendants may argue that:

- The employer did not have a policy defining and protecting its confidential information.
- The employer did not train its employees on its confidentiality policy.
- The employer did not follow its confidentiality policy.
- The employer permitted employees unfettered access to files, computer systems, and information.
- Employees shared this information with clients and competitors.

Employers should describe all efforts they take to protect the secrecy of their trade secrets in their complaints. All policies, training, access restrictions, and restrictive covenants that are used to protect that information should be identified. For a sample confidentiality policy, see Standard Document, Confidential Information Policy (W-005-2678).

For information on what efforts to maintain secrecy have been deemed reasonable or sufficient for trade secret protection under state law, see Trade Secret Laws: State Q&A Tool: Question 8.

THE INFORMATION WAS NOT MISAPPROPRIATED

Defendants often argue that they did not misappropriate any information. Without surveillance footage of a former employee leaving the office with files or the hard drive from the copy machine showing mass copying of sensitive files, it can be difficult to establish otherwise. An employer's initial investigation is often the key to demonstrating the information was misappropriated. Employers, therefore, should be sure their initial investigation includes reviewing any records concerning access to the physical work environment, as well as electronically stored information.

Typically, the best evidence of a former employee's misconduct is contained in the employee's computer and email. Creating a forensic image of the hard drive from the former employee's work computer and examining that forensic image and emails for any evidence of inappropriate activities can help an employer successfully demonstrate that information was misappropriated.

For more on preserving electronically stored information, see Practice Note, Preparing for Non-Compete Litigation: Preserving Electronic Evidence (3-516-9469).

For more on the defenses available under state law, see Trade Secret Laws: State Q&A Tool: Question 11.

THE MISAPPROPRIATION OR USE OCCURRED BEFORE THE DTSA'S EFFECTIVE DATE

One of the most litigated issues under the DTSA has involved questions about whether the statute applies to the alleged misappropriation. The DTSA applies only to misappropriation that occurred on or after May 11, 2016, and does not apply retroactively. Prohibited conduct under the DTSA can involve one or more of the following:

- The unlawful acquisition of a trade secret.
- The improper disclosure of a trade secret.
- The unauthorized use of a trade secret.

(18 U.S.C. § 1839(b)(5).)

The DTSA applies to "any misappropriation" that occurs on or after the effective date, even though for statute of limitations purposes any continuing misappropriation is treated as one act (*Adams Arms, LLC v. Unified Weapon Sys., Inc.*, 2016 WL 5391394, at *5-7 (M.D. Fla. Sept. 27, 2016)).

Some disputes involve trade secrets acquired before the statute's effective date, coupled with post-enactment use or disclosure. Other cases involve pre-statutory use and disclosure, with subsequent disclosures occurring after the effective date. The cases have generally concluded that the DTSA may cover pre-enactment misappropriation if the misappropriation continues post-enactment (see, for example, *Syntel Sterling Best Shores Mauritius Ltd. v. Trizetto Grp., Inc.*, 2016 WL 5338550 (S.D.N.Y. Sept. 23, 2016); *Brand Energy & Infrastructure Servs., Inc. v. Irex Contracting Grp.*, 2017 WL 1105648, at *8 (E.D. Pa. Mar. 24, 2017); *Roselein & Assoc., Inc. v. Elgin*, 2018 WL 1138465, at *9 (E.D. Mo. Mar. 2, 2018).

However, some cases have rejected DTSA claims where the trade secrets were used and disclosed pre-enactment (see *Avago Techs. U.S. Inc. v. Nanoprecision Prods., Inc.*, 2017 WL 412524, at *3-4, 8 (N.D. Cal. Jan. 31, 2017) (rejecting a DTSA claim where trade secret was initially disclosed pre-enactment); see also *Dazzle Software II, LLC v. Kinney*, 2016 WL 6248906 (E.D. Mich. Aug 22, 2016) (dismissing DTSA where plaintiff failed to plead with specificity conduct post-dating the DTSA's effective date)).

Though this issue will diminish in relevance over time, litigants faced with ambiguous coverage under the DTSA should consider whether the benefits of proceeding in federal court outweigh the costs and delay of pleading stage motion practice challenging the court's jurisdiction.

PREPARING FOR POTENTIAL COUNTERCLAIMS

When considering initiating litigation, employers should consider the possibility that their former employee and the employee's new employer may file counterclaims. The universe of potential counterclaims is limited only by the imagination of former employees and their new employers. However, counterclaims can often include claims of:

- Unpaid wages or commissions.
- Discrimination.
- Retaliation.
- Damage caused by wrongful seizure under the DTSA (18 U.S.C. § 1836(b)(2)(G)).

Recently, there has been an increase in tortious interference claims arising from cease and desist letters. To minimize the risk of a tortious interference claim, employers should avoid sending a cease and desist letter if the allegations of trade secret misappropriation may be found to be baseless. (See Standard Document, Restrictive Covenant Cease and Desist Letter to New Employer: Drafting Note: Potential Risks of Sending a Cease and Desist Letter (W-002-5171)).

MAINTAINING CONFIDENTIALITY DURING LITIGATION

Employers that file a lawsuit concerning trade secrets should take appropriate steps to prevent their trade secrets from being publicly exposed. The UTSA and many states' trade secrets laws specifically authorize courts to take appropriate steps to protect alleged trade secrets. This may include:

- Granting a protective order in connection with discovery proceedings.
- Holding in-camera hearings.
- Sealing the records of the action.
- Ordering persons involved in the litigation not to disclose an alleged trade secret without prior court approval.

(Unif. Trade Secrets Act § 5.)

Typically employers protect their trade secrets by requesting that the court enter a protective order. In general, courts are familiar with and typically willing to enter protective orders in trade secrets cases. Because they simply provide procedural protections and do not substantively affect the facts in dispute, protective orders are commonly submitted with the agreement of all parties. Many courts, however, have local rules that govern the drafting of protective orders. Therefore, counsel should review the local rules before requesting that the court enter a protective order.

The DTSA codifies the obligation to seal trade secrets in court proceedings, a benefit which may not be as readily available in state court (18 U.S.C. § 1835). Where the court orders the civil seizure of property under the DTSA, the court may take appropriate action to protect the:

- Seized property from disclosure (18 U.S.C. § 1836(b)(2)(B)(iii)).
- Person against whom seizure is ordered from publicity (18 U.S.C. § 1836(b)(2)(C)).
- Confidentiality of seized materials unrelated to the trade secret information that was ordered seized (18 U.S.C. § 1836(b)(2)(D)(iii)).

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