

**Employment Non-Competition and Trade Secrets 2009:  
"Lift-Outs"; "Garden Leave," Bad-Faith Actions, and  
"White Hats"**

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## EMPLOYEE "LIFT-OUTS"

### Overview

The terms "employee raiding" and "employee lift-outs" refer to the practice of one business hiring away a group of a competitor's employees. Business experts recognize lift-outs as both an efficient method of beefing up personnel and as a formidable weapon on the corporate battlefield.<sup>1</sup> Consider the following examples of the damage inflicted by lift-outs:

When Conseco Capital Management lost its chief equity investment officer and multiple members of his department to one competitor, and 16 or so associates in the fixed-income management group to another, the company also lost a significant number of clients. Another company, the investment bank HSBC, was left with only a graduate trainee to take charge of analyzing media equities after its entire team of media analysts decamped for ABN AMRO.

*Id.*

Yet with the efficacy of lift-outs comes concomitant risk. As with many of the rugged tactics employed by corporate strategists, lift-outs entail a significant likelihood of litigation. When lift-outs involve employees under contract, the employer losing employees often possesses a cognizable claim for tortious interference with contract. In contrast, courts typically deem employee lift-outs involving at-will employees to be lawful. Under certain circumstances, however, an employer victimized by a lift-out of its at-will employees may possess a cause of action against its raiding competitor.

Generally, an employer may assert a cause of action against a competitor for hiring away its at-will employees, but only if the competitor engaged in improper means to solicit the employees or solicited the employees for an improper purpose. Depending on the jurisdiction, potential theories of recovery for the lift-out of both contract and at-will employees include predatory hiring, unfair competition, tortious interference with contract, and tortious interference with a business relationship. With respect to at-will employees, these theories require a common element when applied to an employee lift-out: that the competitor acted in an unlawful manner.

In *Diodes, Inc. v. Gustav H.D. Franzen*, the California court of appeals summarized the general approach of courts to this type of action:

Even though the relationship between an employer and his employee is an advantageous one, no actionable wrong is committed by a competitor who solicits his competitor's employees

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<sup>1</sup> See, e.g., Groyberg & Abrahams, *Lift Outs: How to Acquire a High Functioning Team*, Harvard Bus. Rev. (Dec. 1, 2006).

or who hires away one or more of his competitor's employees who are not under contract, *so long as the inducement to leave is not accompanied by unlawful action . . . .*

260 Cal. App. 2d 244, 255 (Cal. Ct. App. 1968) (emphasis added).

### **Unfair Competition and "Corporate Raiding"**

In *Boyce v. Smith-Edwards-Dunlap Co.*, a Pennsylvania appellate court confronted a claim of unfair competition where a competitor "systematically induced [employer's] employees to leave [employer] and come to work for [competitor]." 580 A.2d 1382, 1390 (Pa. Super. Ct. 1990). The *Boyce* court noted that offering employment to another company's at-will employee is not actionable in and of itself. *Id.*

However, systematically inducing employees to leave their present employment is actionable when the purpose of such enticement is to cripple and destroy an integral part of a competitive business organization rather than to obtain the services of particularly gifted or skilled employees.

*Id.*

More recently, a federal trial court concluded that Minnesota law lacks a cause of action for "corporate raiding," which the plaintiffs defined as "'a systematic and massive program of hiring another company's employees.'" *Storage Tech. Corp. v. Cisco Systems, Inc.*, No. Civ. 00-2253, 2003 WL 22231544 at \*3 (D. Minn. Sept. 25, 2003), *aff'd* 395 F.3d 921 (8th Cir. 2005). The *Storage Tech* court reasoned that Minnesota's unfavorable view of non-compete clauses and other restrictive covenants in employment contracts indicates that the Minnesota Supreme Court would not approve of a cause of action for corporate raiding. *Id.* The court also noted that the plaintiff possessed alternate claims for tortious interference and breach of contract. *Id.* Notably, while the language with which plaintiff framed its cause of action bore a striking similarity to language employed in *Boyce*, the *Storage Tech* court opted not to reach the issue of whether the defendant's attempt to hire the plaintiff's employees constituted wrongful conduct.

In contrast, in *The Finish Line, Inc. v. Foot Locker, Inc.*, No. 1:04CV877RLYWTL, 2006 WL 146633 at \*9 (S.D. Ind. Jan. 18, 2006), a federal trial court in Indiana applied the familiar "lawfulness" analysis to a claim of unfair competition—also referred to by the court as "employee raiding"—brought by one large athletic shoe retailer against a competitor that targeted the plaintiff's best employees. In rejecting the plaintiff's claim, the court concluded that defendant's statements that its plan to hire the plaintiff's employees would "hit the competition where it hurts" and possibly "destroy" the plaintiff's business proved insufficient to demonstrate that the defendant's hiring plan qualified as unlawful. *Id.* After the court noted the at-will status of the employees targeted, and the fact that the plaintiff possessed no restrictive covenants concerning their employment, it opined that the defendant's statements qualified as "offhand remarks, made in the heat of competition." *Id.* (citing *Nat'l Parcel Services, Inc. v. J.B. Logistics, Inc.*, 150 F.3d 970, 971 (8th Cir. 1998)).

## **Tortious Interference with a Business Relationship**

In *Reeves v. Hanlon*, 95 P.2d 513, 21 IER Cases (BNA) 1244 (Cal. 2004), the California Supreme Court squarely addressed the question of whether a defendant may incur liability under an intentional interference with a prospective business relationship theory for hiring away the at-will employees of a competitor. The defendant attorneys, a partner and associate, left the plaintiff law firm and formed a new firm, taking six of the plaintiff's employees with them. The evidence demonstrated that the defendants "engaged in unlawful and unethical conduct in mounting a campaign to deliberately disrupt plaintiff's business." *Id.* at 1251. This unlawful "campaign" included the destruction of computer files containing client documents and forms, the misappropriation of client information, the solicitation of the plaintiff's clients, and the cultivation of dissent among the plaintiff's employees. *Id.*

The *Reeves* court first noted that under California law, to prevail on a claim of intentional interference with a contractual relationship, a plaintiff must establish the following elements: "(1) the existence of a valid contract between the plaintiff and a third party; (2) the defendant's knowledge of that contract; (3) the defendant's intentional acts designed to induce a breach or disruption of the contractual relationship; (4) actual breach or disruption of the contractual relationship; and (5) resulting damage." *Id.* at 1247. The court then asserted that the cause of action could be premised upon interference with an at-will contract. *Id.* After a lengthy analysis, the court held that "to recover for a defendant's interference with an at-will employment relation, a plaintiff must plead and prove that the defendant engaged in an independently wrongful act—i.e., an act 'proscribed by some constitutional, statutory, regulatory, common law, or other determinable legal standard.'" *Id.* (citation omitted). Applying this standard, the court affirmed the trial court's award of damages attributable to the defendant's unlawful acts. *Id.* at 1251.

Likewise, in *Carroll Anesthesia Associates v. Anesthacare, Inc.*, 507 S.E.2d 829, 832-33 (Ga. Ct. App. 1998), the Georgia Court of Appeals denied defendant's motion for summary judgment on a tortious interference with a business relationship claim involving the hiring away of at-will employees. Under Georgia law, a claim of tortious interference with a business relationship requires a showing that the defendant (1) acted improperly and without privilege; (2) acted purposely and maliciously with the intent to injure; (3) induced a third party not to enter into or to continue a business relationship with the plaintiff; and (4) caused the plaintiff some financial injury. *Id.* at 832.

The *Carroll* court discussed the privilege of fair competition, which protects a competitor who solicits another employer's at-will employee in accordance with the standard articulated by the Restatement of Torts 2d § 768<sup>2</sup>. "The privilege is not applicable where a competitor destroys

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<sup>2</sup> The Restatement, Torts 2d § 768(1) provides:

One who intentionally causes a third person not to enter into a prospective contractual relation with another who is his competitor or not to continue an existing contract terminable at will does not interfere improperly with the other's relation if (a) the relation concerns a matter involved in the competition between the actor and the other; (b) the actor does not employ wrongful means; (c) his action does not create or continue an unlawful restraint of trade; and (d) his purpose is at least in part to advance his interest in competing with the other.

or inflicts substantial injury by means of attracting away all or a large percentage of personnel upon whom the employer must depend to function, especially if other circumstances are present." *Id.* at 833. Ultimately, the *Carroll* court denied the competitor's motion for summary judgment because plaintiff demonstrated an issue of fact as to whether defendant engaged in a plan or scheme designed to impair the plaintiff's financial position. *Id.*

On the other hand, in *Avtec Industries, Inc. v. Sony Corp.*, 500 A.2d 712, 714 (N.J. Super. Ct. 1985), a New Jersey appellate court rejected plaintiff's tortious interference claim. The plaintiff alleged that Sony intentionally interfered with the employer-employee relationship between the employee and the plaintiff, a fact which the court deemed as beyond question. Sony was aware of the employee's relationship with the plaintiff and induced the employee to leave by offering him better terms. The court noted that the at-will nature of the relationship between the plaintiff and the employee stood as irrelevant because the employee's right to leave did not furnish Sony with a right to interfere. *Id.* The ultimate issue at bar concerned whether the interference qualified as improper. *Id.* The court's two-pronged analysis asked (1) whether Sony acted with an unlawful or improper purpose, and (2) whether Sony used improper means.

The court concluded that Sony's actions failed to qualify as improper. Sony's hiring of the employee in question lacked intent to injure the plaintiff. Instead, Sony's purpose in hiring the employee arose from its own interest in hiring competent employees. *Id.* The court then addressed whether Sony acted with improper means. The court listed the following examples of conduct that qualified as "improper": fraud, misrepresentation, intimidation, obstruction, and molestation. *Id.* at 715. In past cases, courts found interference where a defendant directed egregious conduct toward the destruction of the competitor's business, which was not present in the instant case. *Id.*

### **Additional Examples of "Improper Conduct"**

The following are further examples of conduct which courts have found to be improper where a competitor hired employees away from an employer.

- *Reading Radio, Inc. v. Fink*, 833 A.2d 199, 212 (Pa. Super. Ct. 2003)—Sufficient evidence supported radio station's unfair competition claim against a competitor that hired away two of plaintiff's top sales representatives. The evidence demonstrated that after beginning employment with the defendant, the sales representatives solicited the former employer plaintiff's sales clients and employees with the knowledge and permission of the new employer defendant, and with knowledge of existing non-compete agreements.
- *Medtronic Inc. v. Eli Lilly & Co.*, 15 U.S.P.Q.2d (BNA) 1465, 1467 (D. Minn. 1990) – Employer's claim against competitor of unfair competition based upon employee solicitation survived dismissal where the employer alleged that the competitor offered employees salaries designed not as reasonable compensation, but intended to destroy the employer's sales organization.

- *E.D. Lacey Mills, Inc. v. Keith*, 359 S.E.2d 148 (Ga. Ct. App. 1987) – Triable issue of fact remained as to whether competitor used wrongful means to solicit employer's employees and sales representatives where the competitor hired 17 of the employer's 21 sales representatives and 18 other employees. The employees stood as particularly crucial to the employer's manufacturing process. The competitor, which included former employees of the employer, left the employer and then immediately issued a telegram announcing the formation of the new company and sent the telegram to sales representatives affiliated with other competitors. Additionally, the competitor told certain sales representatives he believed a sufficient amount of the employer's business would be lost to the competitor/new company, and as a result the former employer might suffer financial difficulties and possibly would not survive.

### **Tortious Interference with Contract**

*Amigo Broadcasting v. Spanish Broadcasting Sys.*, 521 F.3d 472, 27 IER Cases (BNA) 758 (5th Cir. 2008), involved the tortious interference with contract claim of a broadcasting company brought against a competitor that hired away two of the plaintiff's popular radio personalities. Applying Texas law, the Fifth Circuit panel focused on the question of whether the defendant committed "willful and intentional acts of interference." *Id.* at 770. The Court held that the record demonstrated sufficient evidence that the defendant knew of the existence of the contractual relationship between the plaintiff and its former employees. Despite this knowledge, the defendant "continued to communicate with and negotiate with [the employees] . . . in an attempt to lure them away from [the plaintiff]." Consistent with the general approach to tortious interference with *contract* cases, the Court's analysis failed to include the issue of lawfulness.

### **"GARDEN LEAVE" CLAUSES**

The concept of the "Garden Leave" clause derives from British employment law. The term refers to a clause in an employment contract under which an employer pays a former employee to stay at home for a certain period of time after separating from employment. During the restricted period, the employee may not work for competitors. Recently, American employers and counsel have begun looking to Garden Leave clauses as a potential alternative to traditional covenants-not-to compete. As a relatively new concept in the American legal world, the enforceability of a Garden Leave clause remains an open question. Moreover, one recent case involving a Garden Leave clause highlights a potential pitfall.

In *Bannister v. Bemis Co.*, 556 F.3d 882 (8th Cir. 2009), an Eighth Circuit panel, applying Arkansas law, reviewed a trial court's decision in favor of an employee who brought an action to enforce his rights under a confidentiality and non-compete agreement (the "NCA"). The NCA contained a "Garden Leave"<sup>3</sup> clause under which the employer promised to pay the employee his salary for up to the eighteen-month term of the NCA if the terms of the NCA prevented the employee from obtaining employment "consistent with his abilities and education." *Id.* at 883. To trigger the employer's obligation under the "Garden Leave" clause,

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<sup>3</sup> The parties and court did not specifically refer to this provision as a "Garden Leave" clause, but its substance appears consistent with the Garden Leave concept.

the NCA required the employee to provide the employer with documentation of his efforts to obtain appropriate employment.

The employee initially provided the required documentation. The employer responded by refusing to pay the employee, and releasing him from the NCA *except* as to its main competitor, for whom the employee hoped to work. *Id.* at 886. The employer argued that its partial release of the employee's restrictions under the NCA reduced the employee's potential recovery under the Garden Leave provision to one month's salary at most because, after his "release," the employee failed to continue providing documentation of his job search. The court rejected this contention, noting that the employee's obligation to provide documentation ceased once the employer refused to pay him in accordance with the Garden Leave provision. Thus, the court held the employee entitled to his salary for the full nine-month period of his unemployment.

As *Bannister* demonstrates, the Garden Leave clause entails a significant downside risk. Employers who utilize Garden Leave provisions should prepare to meet the attendant financial obligation. Even a Garden Leave clause containing a requirement to mitigate—as was the case in *Bannister*—leaves an employer open to months or even years of salary continuation, particularly where the employee in question possesses such a high level of skill, ability, or education that finding comparable employment will likely prove an arduous process.

#### **FLIR SYSTEMS, INC. V. PARRISH: THE CAUTIONARY TALE OF A BAD FAITH TRADE SECRETS ACTION**

A recent case out of California's Second District Court of Appeal puts in sharp relief the dangers of bringing a trade secret action of questionable merit. In *FLIR Systems, Inc. v. Parrish*, 2009 WL 1653103 (Cal. App. 2d Dist 2009), the court upheld an award to defendants of a whopping \$1,641,216.78 in attorneys' fees and costs for a trade secret action gone wrong. The court of appeal upheld the trial court's finding that the plaintiff filed and maintained the action in bad faith within the meaning of Section 3426.4 of the California Uniform Trade Secrets Act. *See* Cal. Civ. Code § 3426.4.

Section 3426.4 states, in pertinent part, as follows:

If a claim of misappropriation is made in *bad faith*, a motion to terminate an injunction is made or resisted in bad faith, or willful and malicious misappropriation exists, the court may award reasonable attorney's fees and costs to the prevailing party. Recoverable costs hereunder shall include a reasonable sum to cover the services of expert witnesses, who are not regular employees of any party, actually incurred and reasonably necessary in either, or both, preparation for trial or arbitration, or during trial or arbitration, of the case by the prevailing party.

*Id.* (emphasis added).

The defendants, Parish and Fitzgibbons, stood as officers and shareholders of Indigo, which manufactured and sold microbolometers, a device used in connection with infrared technology. Plaintiff FLIR manufactured and sold devices that utilize microbolometers: infrared cameras, night vision, and thermal imaging systems. In 2004, FLIR purchased Indigo. The defendants stayed on with Indigo until 2006, when they informed FLIR that they intended to leave Indigo and start a new company to mass produce bolometers. Fitzgibbons developed the business plan for the new company (to be called "Thermicon") years before FLIR purchased Indigo. The defendants offered FLIR an opportunity to take an ownership stake in Thermicon, contingent upon the defendants acquiring the necessary intellectual property and technology licenses, but FLIR rejected the defendants' offer. *Id.* at \* 1.

The defendants left Indigo and proceeded with their plan to form Thermicon. They entered into negotiations with Raytheon Corp. to acquire the necessary licensing, technology, and manufacturing facilities. The defendants provided Raytheon with assurances that they would not misappropriate Indigo's trade secrets. *Id.*

After learning of the negotiations between the defendants and Raytheon, FLIR sued the defendants for injunctive relief and damages. FLIR proceeded on a theory of "inevitable disclosure," asserting that the defendants' mass production of low-cost bolometers necessarily entailed the defendants' misappropriation of FLIR's trade secrets. *Id.* at \*1, \*3 n. 3. FLIR's lawsuit proved fatal to the defendant's plans for Thermicon, as a spooked Raytheon informed the defendants that it would not go forward with negotiations. In turn, the defendants informed FLIR that they had abandoned their new business. FLIR nevertheless proceeded to bring its action for a permanent injunction to trial. *Id.* at \* 1.

Unsurprisingly, the trial court ruled in favor of the defendants, finding no misappropriation or threatened misappropriation of trade secrets. The fact that the defendants failed to bring Thermicon to fruition proved critical to the court's analysis. As the court of appeals noted,

It was uncontroverted that respondents received no funding for Thermicon, did not start a new business, had no employees or customers, did not lease a facility or develop technology, and did not design, produce, sell, or offer to sell infrared products.

*Id.* at \*2.

In other words, Thermicon never developed into a full-fledged business. Yet FLIR proceeded with its action even after the defendants apprised FLIR of their intention to toss Thermicon on the scrap heap. Moreover, FLIR based its injunction on the theory of "inevitable disclosure," which, the trial court noted, California courts reject as a contravention of "a strong public policy of employee mobility that permits ex-employees to start new entrepreneurial endeavors." *Id.* at \*2 (citation omitted).

In reviewing the trial court's award of \$1,352,000 in attorneys' fees and \$289,216.78 in costs, the court of appeal employed the two-part judicial gloss that California courts utilize in determining whether a claim of misappropriation meets the definition of bad faith under Section

3426.4 of the California Uniform Trade Secrets Act. First, the court considered the "objective speciousness of the claim." Second, the court looked at the plaintiff's "subjective bad faith in bringing or maintaining the action, i.e., [whether the plaintiff brought it] for an improper purpose." *Id.* at \*2.

As to the question of "objective speciousness", the court upheld the trial court's finding that the plaintiff's action qualified as such in that the plaintiff "suffered no economic harm and there was no misappropriation or threatened misappropriation of trade secrets." *Id.* at \*2. Notably, the court found support for "objective speciousness" in the testimony of FLIR's CEO, who testified that "'we can't tolerate a direct competitive threat by Bill [Parrish] and Tim [Fitzgibbons].'" The court appeared strongly influenced by what it termed "a preemptive strike . . . for an anticompetitive purpose." *Id.* at \*3. The court then noted the plaintiff's reliance on the "inevitable disclosure" theory, which lacked support in California law. Finally, the court pointed to a most damning piece of testimony: the admission, by the president of one of FLIR's divisions, that he lacked an explanation as to why the lawsuit remained ongoing. *Id.* at \*3.

Turning to the second prong, the court marshaled a parade of evidence indicating the plaintiff's objective bad faith. First, the court noted the plaintiff's reliance on a faulty piece of evidence that Parrish had "threatened" a misappropriation—his download of company data onto a hard drive. However, the plaintiff learned of the download *after* seeking the injunction and the data contained on it was inaccessible. *Id.* at \*4-5. Second, the court debunked the plaintiff's contention that Parrish's objection to certain patent applications submitted by the plaintiff indicated that he would misappropriate trade secrets. Next, the court pointed to baseless and non-scientific expert testimony presented by the plaintiff. Finally, the court detailed the plaintiff's bad-faith settlement tactics, which included proposing certain settlement terms for "anticompetitive" purposes. *Id.* at \* 6-7.

In reaching its affirmation of the trial court's award of attorneys' fees and costs, the *FLIR* court appeared particularly moved by the admissions of plaintiff's own CEO concerning FLIR's anti-competitive motivations. In this respect, the FLIR decision provides an expensive object lesson on when *not* to bring, or maintain, a trade secret (or non-compete) action. At least in California, courts conceive of actions to protect trade secrets as strictly defensive measures, not a hammer to hold over the heads of competitors. FLIR compounded the issue by pursuing its anti-competitive purpose even after any real threat of injury evaporated.

### **WEARING THE "WHITE HAT"**

Case law continues to suggest no substitute exists for "wearing the white hat." One recent example offering support for this time-honored maxim: *Glenn v. Dow Agrosociences, LLC*, 861 N.E.2d 1 (Ind. Ct. App. 2007). Here, the non-compete language appeared subject to a reasonable and enforceable interpretation. Yet, the facts revealed a defendant employee who repeatedly sought guidance from his current employer as to what he could and could not do, and who openly revealed his future employment plans in advance and appeared to have employer imprimatur on his plans. On such facts, the court appeared to go out of its way to find the restriction overbroad and unenforceable when the former employer unexpectedly sued. Unfortunately, the Indiana Supreme Court accepted transfer and then the case settled, so it possesses no value as precedent. Nonetheless, never fail to try and wear the white hat!