

# Unfair Competition Trade Secrets

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A recent million dollar plus judgment highlights the importance of hiring people for their skills and not for their confidential business information especially when hiring employees working for direct competitors.

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## How *Not* To Hire Employees From A Competitor

By Paul Kennedy

A major retailer recently learned the hard way how not to hire a strong-performing employee from a competitor. In a recent decision from a Virginia Circuit Court, *James, Ltd. v. Saks Fifth Avenue, Inc., et al.*, Saks was hit with a \$1.6 million judgment for its actions when it hired a sales employee directly from a competitor, disregarding the employee's non-compete obligation.

The case illustrates the pitfalls of attempting to leapfrog the relationship-building process to obtain a competitive advantage.

### Factual Background

Saks sought to boost its high-end sales of men's clothing which had lagged behind sales of women's clothing. To achieve its goal, Saks looked to hire two high-powered salesmen from an exclusive men's clothing store that was located in the same shopping mall. One of the targeted salesmen had generated upward of \$1 million in annual sales of mostly custom-made men's clothing. The other salesman had typically generated just shy of \$1 million. Both maintained lists of clients that included information such as size measurements and fabric preferences developed over years of selling experience. Both had been long-time employees of James, with one salesman having worked there for more than 15 years.

Mindful of the investment in its client goodwill and relationships, James implemented an employee handbook containing a non-compete provision that precluded for three years employment with any competitor within a one-mile radius of the store location. Each employee who signed an acknowledgement of the handbook agreeing to its terms received additional consideration such as a cash bonus and a clothing allowance.

During Saks' courtship of the two James salesmen, one of them raised a concern about the non-compete obligation and provided the

handbook to Saks for review. After Saks' in-house counsel opined that the restriction was not enforceable, the road was cleared for earnest recruitment and hiring of the salesmen. To ease concern about any post-employment restraints, and to induce them to defect, Saks agreed to indemnify them — in writing — in any ensuing litigation. Further, Saks was aware of the manner and timing of the salesmen's resignations from James.

Significantly, during the recruiting phase, the salesmen provided Saks with James' confidential information such as the employee handbook that James had expressly labeled as confidential. Further, while still employed with James, both salesmen physically removed written records regarding their customers from James' premises for the purpose of soliciting the customers when the salesmen became employed with Saks. Saks had knowledge of these actions and looked the other way.

When the time came to announce their departures, one salesman — the million dollar producer — resigned, but James was able to convince the second salesman to stay. Upon commencing his employment with Saks, the million dollar producer began soliciting business from the clientele he developed at James — with considerable success as Saks had hoped.

Two months after his departure and following declining sales, James sued Saks and its former salesman. It brought claims for the breach of the restrictive covenant, breach of the duty of loyalty, tortious interference, conversion and violation of Virginia's business conspiracy statute.

After a bench trial, the court found in James' favor. Concluding that the restrictive covenant was reasonable and enforceable, the court ordered that the salesman be enjoined from working at Saks' location in the same mall as James for a period of three years following the Court's Order. In its decision, the court rejected Saks' argument that the employee

handbook — armed with disclaimer language — was not a binding contract insofar as the restrictive covenant was concerned.

Further, the court determined that the former salesman had breached his fiduciary duty to James by disclosing confidential company information to Saks. Since Saks encouraged and supported the salesman's actions, the court held Saks jointly and severally liable for the salesman's breach of his duty.

In addition, the court found that Saks and the salesman willfully and maliciously conspired to injure James' business. Among the evidence considered, the court found persuasive several emails illustrating Saks' desire to hire the salesman to obtain James' clients, as well as the possibility that the loss of these two salesmen might cause James to go out of business given the substantial revenue they represented for James. In the end, the court awarded \$548,611 in compensatory damages, an amount that was trebled to \$1,654,833 based on Virginia's conspiracy law. The court also intended to award attorneys' fees to James.

Even if Saks mounts a successful appeal, the decision underscores for all employers the importance of exercising care in hiring an employee from a competitor. Learning from Saks' mistakes, here are some steps employers can take:

- **Solicit and hire skills and abilities but not client information and relationships** Saks saw these high-powered salesmen (and more importantly their client lists) as a means to effect its strategy to enhance sales of high-end men's clothing. The evidence showed that Saks simply wanted the salesmen to transplant their customers. Employers are well advised in the face of post-employment restrictions to hire based on skills and abilities to generate revenue, and not as a shorthand way to capture a competitor's customers.
- **Get advice from independent counsel** Saks' in-house counsel's legal opinion about the validity of the non-compete provision was in full display — uncloaked from any privilege — because it was provided to the salesmen before they joined Saks outside of any attorney-client relationship. Not only did the court disagree with counsel's conclusion, but the opinion showed that Saks had willfully disregarded James' legitimate business interests on the assumption that the non-compete was unenforceable.
- **Set up entry barriers to competitors' trade secrets** To diffuse claims that a hiring decision was made to siphon a former employer's confidential information, companies should caution new employees to refrain from using their former employer's

information and not bring any such information with them. Employers should consider adopting policies that the company does not condone or participate in compromising third parties' legitimate business interests or misappropriating anyone's trade secrets. Employers should ensure that such a policy is set forth in an employee handbook and mention it in offer letters to new employees, who should then provide written acknowledgement of their understanding and agreement to the policy. Further protection is gained from periodically reiterating the policy. It is important for a company to create a culture built on respect for the proprietary information of itself and others.

- **Avoid upfront indemnity agreements** Evidence of Saks' pre-employment agreement to indemnify the departing employee showed its anticipation of, and willingness to deal with, litigation as well as its desire to induce the salesmen to accept the job offer without any financial risk stemming from James' attempt to enforce the non-compete obligation. Entering into such pre-employment indemnity agreements limited Saks' ability to separate itself from responsibility for condoning the salesmen's misappropriation of James' proprietary information and client relationships. Thus, pre-employment indemnity agreements create substantial risks both as evidence and as a financial obligation.
- **Document limitations on new employees with restrictive covenants** Assuming the invalidity of the non-compete provision, Saks took no steps to limit the former James' salesman's activities. Instead of cautioning him not to capitalize on client relationships developed at James' expense, Saks condoned and even encouraged the salesman to do so. It gambled and lost in a big way. A better approach is to limit a new employee's activities in soliciting former customers and build a data trail of new leads for him or her to get started in establishing new relationships. In this way, a new salesperson's success is best attributable to hard work and ability rather than theft.
- **Avoid the resignation process** Saks had knowledge of the departing employees' coordination and timing of their resignation from James. It did so on the heels of the salesmen's representations to Saks that they had taken customer information from James while still employed. The impact of this evidence was to show that Saks was more interested in the transition of client relationships than the salesmen's skills. Accordingly, while a company can certainly work with arriving employees to accommodate their start dates, any deeper

involvement in the timing and manner of resignation — particularly with more than one employee going to the same new employer — may smack of conspiracy.

While the *Saks v. James* case demonstrates a worst case scenario, employers are well advised to consider these issues during the hiring and entry phase of any relationship with a new employee coming from a competitor. The consequences of not doing so, as Saks learned, can be expensive.

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