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WHO TO SUE?

Strategy looms large in non-compete arena

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In an area of law where things move fast, end unpredictably, and there are multiple definitions of victory, one of the most difficult and critical decisions lawyers must make is deciding who to sue.

Though it's arguably the first decision in any lawsuit, when it comes to suing to enforce restrictive covenants such as non-competition agreements, the choice is a particularly tactical one.

A decision on whether a business should sue its former employee, its former employee's new employer, or both, doesn't rest solely on determining which parties a plaintiff can make good-faith claims against. There are benefits and pitfalls to each approach, and lawyers disagree on which course usually is the best.

And as if all that doesn't make the decision hard enough, it also has to be made in a hurry.

"There's a lot of discussion that goes on in these cases before you do anything, but you have to act quickly," said John R. Bauer of Birnbaum & Godkin in Boston. "It's kind of a fire drill. In order to obtain a preliminary injunction, the former employer has to show that they are being irreparably harmed. If the former employer delays in seeking injunctive relief, the court will infer that the harm is not so irreparable."

Divide and conquer

Few non-compete suits proceed beyond the injunction stage, with cases being either dropped or settled depending on who prevails there. But obtaining an injunction is not the only way a plaintiff business can "win" a case against a former employee.

Pressuring an employee to quit his new job with a competitor — or the competitor to fire him — can achieve the same practical effect of protecting trade secrets and customer relationships.

Lawyers say leaving the new employer out of the lawsuit is often the best, and cheapest, way to reach such a resolution.

Kevin J. O'Connor
Hinckley Allen

"If you bring in a new employer, you've brought in a deep pocket," said Michele Whitham, a partner at Foley Hoag in Boston. "And, depending on your sense of the facts in the case, you may wish to isolate the employee and hope the employer steps back. They may decide to back off a little bit or part ways before investing too much in the new employee. You can force a business decision to be made in your favor."

The strategy is particularly effective if the new employer is not aware of the restrictive covenants an employee has previously signed or the bad behavior he allegedly has engaged in — such as stealing proprietary materials from the former employer on the way out the door.

"If we can get the new employer to say that the employee misled the new employer as to the nature of his activities, we might not sue that new employer, but bring it to the court's attention that the former employee is lying to everyone," said Kevin J. O'Connor of Hinckley Allen in Boston.

One of the most active local players in the non-compete arena is Hopkinton-based EMC Corp. When the technology company sues to enforce its restrictive covenants, it usually names only its defecting employees as defendants, as it did last month when it sued several former, highly paid salespeople after losing 30 employees to California-based competitor Pure Storage Inc.

Pure Storage, however, did not back down or play into the divide-and-conquer strategy. The company has publicly vowed to defend its new employees and denies all allegations of a campaign to steal employees, customers and confidential information.

On Nov. 4, EMC amended its complaint to add Pure Storage itself as a defendant.

EMC General Counsel Paul T. Dacier declined a request to be interviewed for this story.

'Prospective relief swells'

Other lawyers said that a new employer's response, or lack thereof, to a lawsuit or pre-lawsuit demand letter can provide clues about whether a plaintiff business is dealing simply with an unethical, rogue employee, or if the new employer itself is encouraging the employee to violate his restrictive covenants and/or compete unfairly with his previous employer.

If the new employer does not respond to a demand letter or lawsuit against the employee by cutting ties or reaching out to the former employer to find a resolution, that silence may speak volumes and suggest that it is knowingly

benefiting from the employee's knowledge of his former employer's business practices and customer relationships.

"If the employee has been gone for a while and already disclosed confidential information, you're going to need to enjoin the employer from using those secrets," Bauer said. "That's a situation where you would [sue the new employer as well] right off the bat. Clearly, sometimes the former employer can't get all the relief it needs just by suing the employee."

In the case *Corporate Technologies Inc. v. Harnett, et al.*, O'Connor won an injunction for the plaintiff, upheld by the 1st U.S. Circuit Court of Appeals, that not only enforced a non-solicitation clause against CTI's former employee, but also forced his new employer to withdraw all bids it made to customers with which the employee had any prior involvement.

"That's a classic example of why you would want to get the employer," O'Connor said. "Also, when you have an injunction against a company, you have the benefit of a legal department paying careful attention and trying hard to comply."

C. Max Perlman of Hirsch, Roberts, Weinstein in Boston said the case illustrates that "your prospective relief swells if you include the employer."

"The injunction they got in that case, which is spectacular, wouldn't have been possible without suing the employer," Perlman said. "If you don't sue the employer, … the court is not likely to enjoin bids in process."

Suing an employer also allows plaintiffs to bring Chapter 93A claims that can't be alleged against an individual, which is important if the plaintiff hopes to recover damages, Bauer said, "because 93A comes with treble damages and attorneys' fees."

But adding an employer to the lawsuit also presents some substantial risks and higher costs.

"It's considerably more expensive because you now have two defendants to sue," Bauer said. "You have more depositions to take, more discovery to respond to."

And there are other issues to consider in suing the new employer, he said. If the allegation is that the new employer has the plaintiff's trade secrets, the plaintiff will have to disclose those trade secrets in the course of discovery.

"[I]n order for a company to defend itself against a claim that it misappropriated trade secrets, it's going to have to know what the trade secrets are. There will be protective orders and other measures taken, but there's a risk," Bauer said.

O'Connor also warned that "you may, for business reasons, not want to sue a competitor because you might be on the other end of a retaliatory strike down the road."

In a similar vein, Perlman said plaintiff businesses have to think about how suing a competitor will play within the industry and in the press. Companies have to consider whether they're going to look like the "good guy or the bad guy" and whether the lawsuit could harm efforts to recruit future employees.

"If you're not considering that, you're making a mistake. The cases don't happen in a vacuum," Perlman said. "You have to think 360 degrees on that decision."

Claims against new employers also are harder to prove since they are not parties to the restrictive covenants themselves and most often are sued for tortious interference with contractual relations, which requires proof of intent.

"Simply hiring a new employee is not a tortious act," Bauer said. "Hiring a person to steal trade secrets is a tortious act, but good luck proving it."

Nonetheless, even with a weak claim, plaintiff businesses will sometimes choose to include the employer in a lawsuit, and sometimes even the employer alone, without the employee himself as a co-defendant.

That's what Milton solo Sally A. Adams did in the federal lawsuit *TalentBurst v. Collabera Inc.* The decision had some lawyers scratching their heads when U.S. District Court Judge William G. Young dismissed the case in 2008 for failure to state a claim.

Lee T. Gesmer of Gesmer & Updegrove in Boston blogged at the time that "what the plaintiff/Former Employer had in mind when it sued the New Employer but not its Former Employee (against whom it appears it had the stronger claim) continues to elude me, but the strategy clearly back-fired in a major way."

Adams later was able to amend and beef up the complaint, however, and the parties ultimately reached a settlement the following year. (She was not available prior to deadline.)

Bauer said the decision to sue the new employer — and maybe leave out the employee against whom a business would have an easier claim — is sometimes made to send a larger message or reach a broader understanding with competitors that goes beyond the specific circumstances of one employee's defection.

"One reason is to send a message to the new employer to not hire my old employees because if you do, I'll sue you every time," Bauer said. "Some employers do that, knowing they'll lose, to send a message. Sometimes non-compete cases get settled because the old and new employer reach some accommodation, but you have to sue the new employer to reach that accommodation."

Rules of thumb

While Bauer believes suing the new employer is sometimes the best way to bring it to the negotiating table, Perlman warned that once the new employer is put on the defensive and hires lawyers, it may feel compelled to see the fight to the end.

"If you sue the employer, they get more invested in the employee's side of things," Perlman said. "You make it harder for them to wash their hands of the situation."

That's one reason Perlman said he usually errs on the side of leaving the new employer out of the lawsuit. He also prefers to stick with the usually stronger claims against the employee, if he can.

The tortious interference with contractual relations tort is a tough one and could prove to be a stumbling block, Perlman said.

"You might turn an easy injunction case against the employee into a hard one against the employer."

O'Connor, however, said his general preference is "to be as aggressive and inclusive as possible."

"If there's a way I can get to the new employer in good faith, I take advantage of that," he said. "You want the injunction to be as tight as possible and as broad as possible."

Bauer, meanwhile, advises sending demand letters in advance of a lawsuit to the employee and new employer.

"Sometimes those demand letters lead to a resolution before the lawsuit even gets filed," Bauer said. "And if there's no response from either the employee or the employer, that's significant."

The big risk is the letter's recipient might sue for a declaratory judgment first and lock the plaintiff into a jurisdiction it would prefer to avoid.

In general, though, it's worth sending the demand letter, Bauer said. "It can save a lot of money and it's pretty routine." MLW