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Expert Analysis

# Options When a Competitor Raids the Company

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Imagine you are the general counsel or other senior officer of a company sitting in your office on a Friday afternoon, and your phone rings. One of your firm's largest revenue producers is leaving the company for a competitor. Disappointed, you realize the business will have to move forward without him. Minutes later, you receive a barrage of additional phone calls, emails and facsimiles announcing that swarms of employees are resigning or intend to leave the company at the end of their contract terms. You soon learn they are all leaving to work for the same competitor. Your firm is under attack. It is the target of an employee raid.

Courts recognize an employee's freedom to make his or her own employment decisions, and generally, one or two employees departing for a competitor does not cause a stir. However, the lift-out of an entire team (or teams) of employees may be indicative of unfair or improper conduct. Such conduct not only threatens the target company's business, but often violates the law. This article outlines the legal remedies that may be available to companies in the face of an employee raid.

## Legal Remedies

• **Should the Company Seek Emergency Relief?** The specific circumstances involved and the law applied in your case can make a world of difference when it comes to provisional relief. For example, in one instance, the Supreme Court, New York County, refused to enjoin a team of 18 interdealer brokers from joining a competitor prior to the expiration of the post-termination restriction periods contained in their employment agreements, because the harm caused by the brokers' departures could be measured in money damages and therefore was not irreparable.[1]

> The lift-out of an entire team of employees may be indicative of unfair or improper conduct. Such conduct not only threatens the target company's business, but often violates the law.

In another instance, the same court applying California law entered a temporary restraining order, and later a preliminary injunction, against a company that hired 75 employees away from a rival allegedly in violation of an agreement between the companies.[2] You will need to assess how courts in your jurisdiction treat employee moves in your industry and whether you can demonstrate that an unlawful move could cause irreparable harm.

• **What Causes of Action Should the Target Company Assert?** Employee raiding gives rise to numerous causes of action, both against the competitor and against current and/or former employees who participated in the raid (by, for example, helping the competitor recruit employees).

**Raiding.** Raiding is a novel, yet broad, cause of action. Generally, to demonstrate an unlawful raid, a party must show that a competitor: (1) hired away a significant number of employees and (2) used deceptive or improper means, such as encouraging senior managers to solicit other employees; misappropriating confidential information; disparaging the target company; and coordinating simultaneous mass departures.[3] There is no uniform standard for how many (or what percentage of employees) must be hired away to constitute a raid. Participants in the securities industry have reported that they consider hiring to be a raid if a competitor poaches at least 30-40 percent of a business unit's employees, revenues, or other production metric.[4]

A claim for raiding can be asserted against the competing firm, as well as any current and/or former employees who participated in the raid. Raiding claims are commonly brought in FINRA arbitration among financial services firms and registered persons. However, the common law of most states does not recognize raiding as an independent cause of action and, because the claim is not clear in all jurisdictions, it is always best to plead raiding along with other, related causes of action.

**Breach of Contract.** Breach of contract claims are typically no-brainers when it comes to employees who quit and begin working for a competitor prior to the termination of their employment contracts., However, your company should be mindful

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to abide by its own performance of employee contracts during the fallout of a raid. A perceived (or concocted) breach of an employee's contract by your company can arm a departing employee with a defense to your breach of contract claim.

**Breach of Fiduciary Duty and Duty of Loyalty.** To effectuate a raid, a competitor will often rely on an insider from the target company to assist. The insider may be a manager or senior employee who can convince those who report to him to join the competing firm. The target company will likely have strong claims against the insider for breaches of his duties of fidelity and loyalty, especially if the insider serves in a management or executive function.[5]

**Aiding and Abetting Breaches of Contract and Common Law Duties.** The victim of a raid may also have claims against the competing firm for aiding and abetting breaches of contract and common law duties.[6] A company should assert such claims where the circumstances suggest that the competing firm paid or promised bonuses or other compensation to your company's employees (while they were still working for your company) in exchange for the disclosure of confidential information, solicitation of other employees or other assistance. Further, if the competing firm indemnified the poached employees for claims arising out of their employment, resignation or departure, such indemnifications can serve as evidence that the competing firm aided and abetted their contractual and/or common law breaches.

**Misappropriation of Confidential Information or Trade Secrets.** Most states have adopted the Uniform Trade Secrets Act (UTSA),[7] which can be used to assert claims of misappropriation against the competing firm and former employees. The UTSA defines misappropriation both as the "acquisition of a trade secret of another with knowledge or reason to know that the trade secret was acquired by improper means" and the "disclosure or use of a trade secret of another without express or implied consent[.]"[8] The UTSA defines a trade secret as "information, including a formula, pattern, compilation, device, method, technique, or process" that derives economic value for its owner from not being known or available to competitors and that is kept secret through reasonable efforts.[9]

In some jurisdictions, misappropriation claims can be based on protected confidential information that does not rise to the level of a trade secret. For example, in New York (a state that has not adopted the UTSA), an individual or entity that uses protected confidential information "in breach of an agreement, a confidential relationship, or duty, or as a result of discovery by improper means" can be found culpable.[10]

**Unfair Competition.** A claim for unfair competition should be a part of any employee raid lawsuit. Unfair competition is a broad business tort, encompassing an array of conduct that includes some element of unfairness or bad faith. To support an unfair competition claim, plaintiffs generally must demonstrate that: (1) plaintiff and defendant are competitors; (2) defendant unfairly competed in bad faith; and (3) plaintiff suffered damages as a result.[11] For instance, the bad faith misappropriation of another's commercial advantage (including skills, labor or customer relationships) through the exploitation of confidential or proprietary information can amount to unfair competition.

Payments made by the competitor to induce employees to breach their contracts or common law duties may be recoverable by the raided firm, either from the competitor or from the employees who received them.

**Tortious Interference.** There are several different types of "interference" torts that may be available. Perhaps one of the most useful aspects of tortious interference claims is their malleability. For example, tortious interference with contract can refer to any contract, including employment contracts of the departing employees, non-competition and non-solicitation agreements, confidentiality agreements, as well as contracts with customers, vendors or suppliers.[12] The target company may also have a claim for tortious interference with prospective economic relationships.[13]

## Seeking Damages

**Lost Profits.** The typical measure of damages in raiding cases is the lost profits that would have been generated by the departed employees had they remained at the target company.[14] Lost profits attributable to the alleged raiding conduct are calculated by subtracting the employment and related variable costs from lost revenue.[15] Lost profits calculations can vary greatly because two of the inputs into the calculation are highly variable: the average revenues generated by the poached employees and the amount of time those employees likely would have remained with the company.

**Compensation Paid to Disloyal Employees.** A raided company may also be able to claw-back compensation from disloyal former employees who breached duties of loyalty or fidelity. Typically, the compensation subject to claw-back (including salary, bonuses, and potentially even benefits) will include payments to the employee on the date of his first disloyal act through the employee's termination date.[16]

**Bribes and/or Payments Made to Targeted Employees.** Payments made by the competitor to induce employees to breach their contracts or common law duties may be recoverable by the raided firm, either from the competitor or from the employees who received them.[17] Different theories support such awards. For example, the payments made (or offered) by the competing firm can serve as a representative value of what the competing firm might have offered the target company to acquire the business of those employees lawfully and therefore constitute a reliable floor of damages.[18] Such payments may also be recovered by the victimized firm from its disloyal employees upon a theory that they constitute bribes and/or the misappropriation of corporate opportunities by the disloyal employees.[19]

**Retention Payments and/or Increased Compensation.** Raided firms must deter-

mine what they should spend to mitigate the harm caused by a raid, likely including costs associated with hiring replacement employees. Your company may also need to pay existing employees retention payments and increased salaries to ensure they do not leave. Those costs, so long as they can be shown to be a natural, probable and/or direct consequence of a competitor's raid, may be recoverable damages.

**Loss of Value and/or Goodwill.** It may be possible to recover damages based upon the company's loss of value, as measured by a write-down in goodwill or a drop in the company's stock price. For instance, if your firm acquired another business and the employees who joined your company as part of the acquisition were poached by a competitor during an employee raid, the company's write-down of goodwill pertaining to that transaction could serve as a measure of damages. Or, where news of a raid and its potential financial impact reaches the public and negatively impacts a company's stock price, the stock price decline may serve as a measure of damage caused to your company by the raid.[20] Causation for this category of damage is often the most difficult to prove, as a defendant will point to anything other than its unlawful conduct as the possible cause of loss to the target company's value.

## Other Considerations

Your company may want to terminate employees who have given notice but have not yet left. After all, that employee may be one of the "insiders" helping the competitor raid your company. It is a frightening thought that by keeping those employees on the payroll, the company may actually be helping fund a competitor's raid. Companies need to make those decisions carefully. It is possible that employees' terminations provide them with a basis to escape post-termination agreements, such as covenants not to compete or solicit. You may want to consider placing an employee on paid leave, sometimes referred to as "garden leave," through the remainder of his or her contract term. A company should also seek advice on its ability to restrict or monitor employees' access to business-sensitive information.

Conversely, companies may be inclined to try to retain those employees. While a company is generally permitted to negotiate employment terms with its own employees, an employee raid presents unique circumstances to keep in mind. Targeted employees may already have signed contracts with the competitor, i.e., "forward start" agreements to start working for the competitor sometime in the future. While such contracts may be unenforceable (e.g., as the product of unlawful recruiting methods), your company's attempt to retain an employee who has signed a forward-start contract may be recast as an attempt to induce that employee to breach his or her forward-start agreement or to tortiously interfere with the relationship between the employee and the competitor. It could provide the competitor with an "unclean hands" defense.

Employees may also claim that your firm's retention efforts were unbearable and result in their leaving immediately under the guise of constructive termination. Invitations to discuss retention should be documented and voluntary, and if an employee is represented by counsel, all retention-related communications should be routed through counsel.

Hasty decisions made during the often stressful and chaotic wake of a raid can jeopardize your firm's claims and expose your company to legal liability. Decisions need to be made carefully and should be discussed with counsel.

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1. *GFI Sec. LLC v. Tradition Asiel Sec.*, 21 Misc.3d 1111(A), 2008 N.Y. Slip. Op. 52041 (U), at *6-7 (N.Y. Sup. Ct. July 28, 2008).

2. *Aon Corp. v. Alliant Ins. Services*, No. 650700/2014 (N.Y. Sup. Ct., March 5, 2014) (TRO); *Aon Corp. v. Alliant Ins. Services*, No. 650700/2014, 2014 N.Y. Slip. Op. 31735(U), 2014 WL 2990393 (N.Y. Sup. Ct., June 26, 2014) (preliminary injunction).

3. See, e.g., Saul Ewing LLP, Raiding in the Securities Industry: The Search for Consensus, Conference Report, at 4-5, Sept. 25, 2003.

4. Id. at 7-8.

5. See, e.g., *FTI Consulting, Inc. v. Graves*, No. 05 Civ. 6719 (NRB), 2007 WL 2192200, at *10 (S.D.N.Y. July 31, 2007) (an employee's solicitation of other employees from his or her current employer violates the duty of loyalty); *30 FPS Productions v. Livolsi*, 68 A.D.3d 1101, 1102 (2d Dept. 2009) (employer established prima facie breach of fiduciary duty cause of action against former employee where employer alleged that employee "utilized the plaintiff's time and facilities to organize competing businesses while still in its employ"); see also *Louis Capital Mkts. v. REFCO Grp.*, 9 Misc.3d 283, 289-90 (Sup. Ct. N.Y. Cnty. June 6, 2005) (employer stated claims for breach of fiduciary duty against former employees who allegedly secretly acted as "moles" to gather information and resources for competing company).

6. See, e.g., *S&K Sales Co. v. Nike*, 816 F.2d 843, 849-50 (2d Cir. 1987) (discussing elements of aiding and abetting breach of fiduciary duty claim; upholding jury verdict against defendant company); *Louis Capital Mkts*., 9 Misc.3d at 286-7 (Sup. Ct. N.Y. Cnty. June 6, 2005) (plaintiff employer stated claim for aiding and abetting breaches of its employees' fiduciary duties.)

7. Congress is considering two bills that would make misappropriation of trade secrets a violation of federal statute. H.R. 5233, 113th Congress (2013-14) (proposed Trade Secrets Protection Act); S. 2267, 113th Congress, 2013-14 (proposed Defend Trade Secrets Act).

8. See UTSA §§1.2(i)-(ii).

9. Id. §1.4.

10. See, e.g., *Hudson Hotels Corp. v. Choice Hotels Int'l*, 995 F.2d 1173, 1176 (2d Cir. 1993) (abrogated on other grounds).

11. See, e.g., *Barbagallo v. Marcum LLP*, No. 11-CV-1358, 2012 WL 1664238 at *8 (E.D.N.Y. May 11, 2012) (stating that "[c]ommon law unfair competition is a broad and flexible doctrine" that is "adaptable and capacious"); see also *Levine v. Landy*, 832 F.Supp.2d 176, 191 (N.D.N.Y. 2011); *A & G Research, Inc. v. GC Metrics*, 19 Misc.3d 1136(A) (Table), 2008 WL 2150110, at *23 (Sup. Ct. N.Y. Cnty. May 21, 2008).

12. See *Ullmannglass v. Oneida*, 86 A.D.3d 827, 828-29 (3d Dept. 2011) (plaintiff stated claim against competitor for tortious interference with contract for inducing the plaintiff's employee to breach his contract with plaintiff); see also *Aon Risk Services v. Cusack*, 34 Misc.3d 1205(A), 2011 WL 6955890, at *19-20 (Sup. Ct. N.Y. Cnty. Dec. 20, 2011) (tortious interference with contracts containing restrictive covenants); *Lama Holding Co. v. Smith Barney*, 88 N.Y.2d 413, 424 (1996) (discussing elements of tortious interference claims).

13. See, e.g., *Front v. Khalil*, 103 A.D.3d 481, 483 (1st Dept. 2013) (employer stated claim against competitor for tortious interference with the employer's business relationship with its former employee).

14. See John D. Finnerty, et al., "Calculating Damages in Broker Raiding Cases," 11 STAN. J.L. BUS. & FIN. 260, 261-62 (Spring 2006).

15. Id. at 266.

16. *In re Blumenthal*, 32 A.D.3d 767 (1st Dept. 2006); see also *Carco Grp. v. Maconachy*, 383 F. App'x 73, 76 (2d Cir. 2010) ("A person who is found to be faithless in his performance of services is generally liable for all compensation from the date of the breach."); *Lamdin v. Broadway Surface Adver. Corp.*, 272 N.Y. 133, 138 (1936) (an employee "forfeits his right to compensation for services rendered by him if he proves disloyal").

17. See *Byrne v. Tullett Liberty Brokerage*, Cons. FINRA Arb. No. 09-04807, Award at 28, 46, 52-53 (July 9, 2014) (the authors of this article represented Tullett Liberty Brokerage Inc. and related entities in this arbitration).

18. Id.

19. *Hadden v. Consol. Edison Co. of N.Y.*, 45 N.Y.2d 466, 469-70 (1978) (employee's acceptance of bribes and gifts constituted misappropriation of corporate opportunity); see also *In re Greenberg*, 206 A.D.2d 963, 964 (4th Dept. 1994) (defendant misappropriated corporate opportunities when he "unilaterally seized the tangible and intangible assets of [his employer], transferred them to his new corporation… and used that entity as a vehicle for usurping the corporate opportunities of [his former employer]").

20. See, e.g., *Tullett Prebon v. BGC Partners*, No. HUD-L-3796-11 (Velasquez, J.), at *8-9 (N.J. Superior Ct. Law Div., Nov. 9, 2011) (denying motion to dismiss certain claims in employee raiding case for damages measured by a drop in company's stock price).

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