

**THE INVESTIGATION AND PROSECUTION OF  
DISLOYAL EMPLOYEES**

by

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## I. INTRODUCTION

Employees who wrongfully solicit and take customers when they leave their employer have been the bane of corporate America for decades. However, many employers, from the largest (Fortune 500) to the smallest (closely held family companies), have increasingly attempted to forestall this disloyal behavior by requiring their employees to sign non-compete, non-solicit and confidentiality agreements. This trend has now led to dramatically increased litigation, as employees attempt to evade the agreements they have signed and their employers attempt to enforce them.

Corporate officers and in-house attorneys must realize that the departure of a disloyal employee, who wrongfully attempts to take the company's customers, requires lightning reactions. Indeed, it is crucial that corporate attorneys and executives properly and thoroughly investigate the actions of their departing employees when they become aware of potential wrongdoing. As soon as enough evidence is available, the employer must seek a temporary restraining order and preliminary injunction. A company that waits too long to combat wrongful activity will find that many of its customers are irretrievably lost before the company even knew they were gone.

Given the importance of a lightning response, in-house executives and counsel must join with their outside law firms to determine what, if any, documents or electronic data have been taken, what customers are being solicited and what employees or ex-employees are involved.

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The writer wishes to acknowledge, with gratitude, the invaluable assistance of Pamela Wolff Cohen, an attorney at Gallagher Gosseen Faller & Crowley, who provided substantial contributions to the preparation of this paper.

## II. INTERVIEW AND DEBRIEF THE RIGHT PEOPLE

When outside counsel is contacted by a client, the first thing that counsel should do is determine who to speak with at the client company. Sales representatives are the employees who have the most contact with customers and, therefore, most of the litigation involving disloyal employees concerns sales representatives. Counsel should determine whether or not the sales representatives under investigation had support staff who worked with them on servicing customers. Support personnel often have extensive and helpful knowledge about the activities of the departed sales representative and they are often the first to notice a decrease in orders placed by customers serviced by the departed sales representative. Additionally, support personnel, as well as the departed employee's peers, frequently have knowledge regarding customer lists and electronically stored data which the sales representative either possessed or had access to. In the modern world of telecommuting, it is not uncommon for a sales representative to have his or her entire customer list, complete with contact names and phone numbers, stored on a notebook computer or Blackberry.

An inventory should be taken of these types of items and the client should determine which, if any, of the items were company owned or company provided. Care should be taken to request and obtain the immediate return of such items from departing sales representatives.

Information technology specialists should also be consulted and asked to aid by searching the departed employee's company computer to determine if there is any record of missing or downloaded customer data. The download of sales data is another topic that the departed sales representative's support staff may help with.

In addition to lists of customers, information regarding customer credit histories, buying habits, seasonal and cyclical buying needs and order requirements should be considered. What access did the departed employee have to this type of information? How could the departed employee have downloaded or taken such information prior to or at the time of departure? What record, if any, does the company have that such material was either possessed by the departing employee or improperly removed?

All of these questions should be answered at the first opportunity, as the answers will determine the scope and viability of the investigation and litigation.

## III. INTERVIEWS OF CUSTOMERS

One of the crucial questions an employer must ask, at the earliest juncture, is whether or not the company is willing to allow its own customers to be interviewed. Such customer interviews often lead to evidence that a departing employee spoke with some or all of the customers prior to the employee's departure and attempted to induce the customers to transfer their business to the employee's new sales company. Such activity is a breach of the employee's fiduciary obligations and may often be, without anything else, sufficient grounds for an injunction against the departing employee. Such interviews are thus extremely helpful to the

attorney attempting to investigate and prosecute a wrongful attack on the company's customers. However, business executives are often, understandably, reluctant to "drag their customers" into what may be perceived as an unseemly business dispute.

On the other hand, the best possible way to learn of wrongful behavior, particularly premature sales solicitation, is to interview the customers serviced by the departing employee. The client must understand that some customers may already be irretrievably lost, particularly those customers which have a close relationship with the departing sales representative. In those instances, the client should "bite the bullet" and find out, as early as possible, why the customer has left and whether there is evidence of breach of fiduciary duty on the part of the sales representative.

If it is legal in the jurisdiction where outside counsel practices, the practitioner should strongly consider taping the conversations between the customers and investigators. In New York, for instance, the taping of witnesses by law firms and investigators is legal. (*See, Mena v. Key Food*, 195 Misc.2d 402, 758 N.Y.S.2d 246, 2003 N.Y. Misc. LEXIS 231).<sup>2</sup> Further, the New York County Lawyer's Association has issued an ethics opinion which finds it perfectly ethical for a lawyer and staff to tape phone conversations with witnesses. *Professional Ethics Opinion* 696. *See, also ABA Formal Opinion* 422. However, ethics opinions from other bar organizations have held that such taping is unethical and many states bar the taping of a conversation unless both parties to the conversation consent. For this reason, one should consult local ethics opinions before taping such witnesses. Customers who have a relationship with a disloyal employee will frequently truthfully discuss the employee's activities during an informal discussion with an investigator and yet tell a much different tale when called to testify in court. Confronting such witnesses with prior inconsistent taped conversations is a wonderfully effective way to highlight their inconsistency and duplicity in front of the judge presiding over the injunction hearing.

Thought should be given to who should conduct interviews with the customers. Should a lawyer make the phone call? Should a paralegal call or an outside investigator? If the person conducting the interview hits pay dirt and learns that a disloyal employee contacted a customer while the employee was still working for the employer, the interviewer will most likely become a witness in a hearing to obtain an injunction. Therefore, the interviewer should be chosen with the assumption that the interviewer may be called to the witness stand at any future hearing.

#### IV. VISUAL SURVEILLANCE

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<sup>2</sup>Included among the other jurisdictions which permit taping under certain circumstances are Georgia (*see, Malone v. State*, 246 Ga. App. 882, 541 S.E.2d 431, 2000 Ga. App. LEXIS 1303 (2000)); Mississippi (*see, Attorney M. v. Mississippi Bar*, 621 So.2d 220, 1992 Miss. LEXIS 416 (Miss. 1992)); and, New Jersey (*see, D'Onofrio v. D' Onofrio*, 344 N.J. Super. 147, 780 A.D.2d 593, 2001 N.J. Super. LEXIS 365) (App. Div. 2001).

Another effective tool in investigations of disloyal employees is visual surveillance. There is no better way to prove that an employee is soliciting a company's customers than to follow the employee around, surreptitiously, for a few days. Such surveillance may unearth a lengthy list of customers that the employee is meeting with and soliciting, often in violation of a non-compete or non-solicitation agreement. Use of still cameras and video cameras to document these meetings is highly effective evidence when introduced in court. The investigators conducting the surveillance should be properly prepared and briefed on what to look for and what to photograph or videotape.

Some clients, particularly smaller businesses, may balk at the perceived expense of surveillance. However, anyone who has watched a videotape introduced in court which conclusively proves that an employee violated a non-compete agreement, by meeting with and soliciting customers, realizes that such expenditures, early in the case, are often worth their weight in gold during the injunction hearing.

## V. COMMENCEMENT OF LITIGATION

With diligence and effort, coupled with a little luck, a thorough and well-planned investigation should provide evidence of wrongful conduct on the part of the departed employee(s). Now counsel must move swiftly and decisively in court to safeguard the client's customers.

### A. Complaint

The Complaint is the blueprint for the case and the foundation for the injunction. Before filing the Complaint, one should consider what jurisdiction to file the case in. In many jurisdictions, Federal judges are more likely to take some risk and enjoin a disloyal employee.

Depending upon the facts of the case, consider the following causes of action:

#### 1. Unfair Competition

Unfair competition does not describe a single course of conduct or a tort with a specific number of elements. Instead, it describes a general category into which a number of torts may be placed when recognized by the courts. The category is open-ended and nameless forms of unfair competition may be recognized at any time for the protection of commercial values. Prosser and Keeton, *On Torts* (5<sup>th</sup> Ed., Chapter 24, Section 130, page 1015.)

The main Categories of Unfair Competition are as follows:

#### a. Trade Secrets

A trade secret is defined as any “formula, pattern, device or compilation of information that is used in one’s business and which gives the business an opportunity to obtain an advantage over competitors who do not know or use it. *Ashland Management, Inc. v. Janien*, 604 N.Y.S.2d 912 (1993); *Kewanee v. Bicron*, 41 6 U.S. 470, 1974 U.S. LEXIS 134; *Harvey Barnett, Inc. v. Shidler*, 338 F.3d 1125, 2003 U.S. App, LEXIS 16116 (10<sup>th</sup> Cir. 2003); *Business Men’s Assurance Co. v. Farm & Business Ins. Agency*, 1991 U.S. Dist. LEXIS 2750 (W.D. MI. 1951)

The factors to be considered in evaluating a trade secret claim include:

1. The extent to which the information is known outside the business;
2. The extent to which it is known by employees and others involved in the business;
3. The extent of measures taken by the business to guard the secrecy of the information;
4. The value of the information to the business and its competitors;
5. The amount of effort or money expended by the business in developing the information;
6. The ease or difficulty with which the information could be properly acquired or duplicated by others. (New York Pattern Jury Instructions, 3:58, page 398.)

A helpful case regarding trade secrets and confidential customer lists is *InFlight Newspapers, Inc. v. Magazines In-Flight*, 990 F.Supp. 119, 1997 U.S. Dist. LEXIS 21147 (E.D.N.Y. 1997). The court found that the defendants were aware of every facet of their employer’s contracts with every customer and that this information included pricing, billing, delivery and product selection. Although the names of the customers might have been available through directories and other public sources, the knowledge derived while employed at InFlight was not commonly available, hence, the precise terms of InFlight’s proposals and contracts with its customers were trade secrets. *See also, Area Landscaping, L.L.C. v. Glaxo-Wellcome, Inc.*, 160 N.C. App. 520, 525 S.E.2d 507,511, 2003 N.C. App. LEXIS 1825 at 9 (2003) (“information regarding customer lists, customer lists, pricing formulas and bidding formulas can qualify as a trade secret...”); *Hydraulic Exchange and Repair, Inc. v. KM Specialty Pumps, Inc.*, 690 N.E.2d 782, 1998 Ind. App. LEXIS 34 (Ind. Ct. App. 1998)(although customer lists in itself is not protected trade secret under Indiana statute, the customer and pricing information at issue included profits, sales and special suppliers that are specific to each customer and thus, were protected as trade secrets).

b. Misappropriation

Another form of unfair competition which is distinct and separate from the use of trade secrets, is misappropriation. Essentially, one may not misappropriate the results of the skill, expenditures and labors of a competitor or, stated another way, a business is not entitled “to reap where it has not sown.” *International News Service v. Associated Press*, 248 U.S.215, (1918).

2 Tortious Interference with Prospective Business Advantage

The elements of interference with prospective advantage are as follows:

1. The defendant knows of a proposed contract between the plaintiff and the third party;
2. The defendant intentionally interferes with this proposed contract;
3. The proposed contract would have been entered into but for the defendant’s interference;
4. The defendant’s interference was by wrongful means; and
5. The plaintiff has been damaged.

(New York Pattern Jury Instructions, NYPJI 3:57.)<sup>3</sup>

A defendant who intentionally and knowingly and by wrongful means, prevents another from entering into a contract that would have been entered into, absent this interference, is liable for the damages sustained. Wrongful means includes fraud, misrepresentation or undue economic pressure. This undue economic pressure includes violation of a duty owed by a confidential relationship. *Pepitone v. Sofia*, 203 A.D.2d 981, 611 N.Y.S.2d 375, 1994 N.Y. App. Div. LEXIS 4399 (4<sup>th</sup> Dept. 1994). *See also, Albert V. Loksen*, 239 F.3d 256, 2001 U.S. App. LEXIS 1502 (2d Cir. 2001)(at will employee asserting tortious interference claim may show that means used to effectuate termination violated a duty owed by defendant to plaintiff.

Damages for interference with prospective advantage include loss of profit, such as the difference between the value of the plaintiff’s business without the lost accounts and its value with the lost accounts. Courts take into consideration testimony on volume, commission and net profits and the fact that the lost contracts were subject to cancellation. *Duane Jones Company v. Burke*, 306 N.Y. 172, 1954 N.Y. LEXIS 1049 (1954). *See also, Sole Engery Company v. Petrominerals Corp.*, 128 Cal. App. 4<sup>th</sup> 212, 2005 Cal. App. LEXIS 535 (2005)(a proper plaintiff

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<sup>3</sup>See, *San Francisco Design Center v. Portman*, 41 Cal. App. 4<sup>th</sup> 29, 1995 Cal. App. LEXIS 1525 1<sup>st</sup> App. Dist. 1995.

may recover lost profits); *Exotex Corp. v. Rinehart*, 3 P.3d 826, 2000 Wyo. LEXIS 82 (2000) (damages for intentional interference with prospective advantage include lost profits).

### 3. Breach of Employment Contract

With increasing frequency, businesses require their employees to sign non-compete, non-solicitation or confidentiality agreements, as a prerequisite of employment.

#### a. Non-Compete Agreements

Non-compete agreements generally require an employee to refrain from competing in the same or similar business as his or her employer, upon completion of employment. Courts across the nation are loathe to enforce such agreements unless they are geographically and temporally limited. Non-compete agreements with terms of a year or two are often upheld. Agreements not to compete within an area of ten to thirty miles of the company's office are also frequently enforced. However, if a sales or marketing territory is larger than a twenty or thirty mile radius and the sales representative regularly services customers in this larger territory, then a non-compete agreement which requires a sales representative to refrain from competing in the wider territory may be upheld. *Madison Bank v. First National Bank*, 276 Ark. 405, 635 S.W.2d 268, 1982 Ark. LEXIS 1441; *Styles v. Lyon*, 87 Conn. 23, 86 A. 564, 1913 Conn. LEXIS 77; *Tillinghast v. Boothby*, 20 R.I. 59, 37 A. 344; *Freiberger v. J-U-B Engineers, Inc.*, 2005 Ida. LEXIS 53; *Saxton v. Coastal Dialysis*, 220 Ga. App. 805, 470 S.E.2d 252, 1996 Ga. App. LEXIS 244; *Raymundo v. Hammond Clinic*, 449 N.E.2d 276, 1983 Ind. LEXIS 846.

#### b. Non-Solicitation Agreement

A non-solicitation agreement bars an employee from *soliciting* his or her former employer's customers. Courts generally interpret the term solicitation to mean that the ex-employee cannot reach out and contact customers, either by phone, mail or in person. However, if customers call the ex-employee or travel to the ex-employee's store, without any solicitation on the part of the ex-employee, then courts generally allow the sales representative's new company to sell to these customers.

#### c. Confidentiality Agreements

A confidentiality agreement requires the employee to acknowledge that certain company information, including but not limited to customer lists, sales pricing information, customer contact information, customer sales histories and customer credit

information, are all deemed confidential. The employee is then prohibited from making use of any such confidential information upon the employee's termination with the employer.

#### 4. Breach of Fiduciary Duty

An employee who, while still employed by his or her employer, establishes a new company or performs duties for another company in direct competition with the employer, is acting in a manner inconsistent with employment and is failing to exercise the utmost good faith and loyalty in the performance of these duties. *Bon Temps Agency v. Greenfield*, 184 A.D.2d 280, 584 N.Y.S.2d 824, 1992 N.Y. App. Div. LEXIS 7885 (1<sup>st</sup> Dept. 1992). See *Lamdin v. Broadway*, 272 N.Y. 133, 1936 NY LEXIS 880 (1936); *Duane Jones v. Burke*, 306 N.Y. 172, 1954 NY LEXIS 1049 (1953); *Opus Investment Management, Inc. v. Donohue*, 18 Mass. L. Rep. 51; 2004 Mass. Super. LEXIS 242 (2004); *Custard Insurance Adjusters v. Nardi*, 2000 Conn. Super. LEXIS 1003.

Often, the practitioner is faced with a situation in which a disloyal employee has left the practitioner's client and joined a competitor. The practitioner may have evidence that the employee acted against his or her fiduciary duty by telling customers to hold their sales orders until the employee switched employers or engaged in similar disloyal activities. Under these circumstances, a cause of action arises against the new employer for inducing the employee to breach his or her fiduciary duty. This cause of action is particularly helpful, as it brings the disloyal employee's employer into the litigation and renders the competitor amenable to the powers of the court, should an injunction be granted.

#### 5. An Accounting

A cause of action for an accounting is highly useful because, if granted by the court, it allows the employer to audit the books of the defendants, which may include not only the disloyal employee but the disloyal employee's new employer.

#### 6. Waste of Corporate Assets

If the departing employee is a corporate officer, a cause of action for a waste of corporate assets may lie, assuming the evidence shows that the officer breached a fiduciary duty prior to leaving the corporation.

#### 7. Conversion

The elements of conversion are as follows:

1. Intent;

2. Interference with an owner's property rights to the exclusion of those rights (NYPJI 3:10).

A person who, without authority, intentionally exercises control over the property of another, thereby interferes with the rights of possession and commits conversion and is liable for the value of the property. It is not conversion when damages are merely sought for breach of contract. Punitive damages are possible in a conversion cause of action if the defendant's conduct is gross, wanton or deliberate and demonstrates a high degree of moral culpability.

8. Unjust Enrichment

The elements of unjust enrichment are:

- a. The defendant received money or property belonging to the plaintiff;
- b. The defendant benefitted from the receipt of the money or property; and
- c. Under principles of equity and good conscience, the defendant should not be permitted to keep the money or property. (NYPJI 4:2).

9. Fraud

The elements of fraud are as follows:

- a. Misrepresentation of a material fact;
- b. With knowledge that it is false;
- c. Detrimental reliance by the deceived party. (NYPJI 3:20).

10. Preliminary Injunction

A cause of action requesting a preliminary injunction is the most important cause of action in the entire complaint.

In order to obtain an injunction, the movant must demonstrate:

- a. Irreparable harm; and
- b. Likelihood of success on the merits. *Cablevision v. Town of East Hampton*, 862 F.Supp. 875, 1994 U.S. Dist. LEXIS 13133 (E.D.N.Y.

1994); *affirmed*, 57 F.3d 1062, 1995 U.S. App. LEXIS 15419 (2<sup>nd</sup> Cir. 1995); *Group Concepts v. Barberino*, 2004 Conn. Super. LEXIS 1036.

The irreparable harm must be something that money cannot compensate, it must not be remote or speculative, rather it must be actual and imminent.

Injunctions will be issued to enforce non-compete agreements or if an ex-employee (even in the absence of a non-compete agreement) has obtained customer information by wrongful means. *Ivy Mar Company v. C. R. Season*, 907 F.Supp. 547, 1995 U.S. Dist. LEXIS 20228 (E.D.N.Y. 1995); *see Hay Group v. Nadel*, 170 A.D.2d 398, 566 N.Y.S.2d 616, 1991 N.Y. App. Div. LEXIS 2414 (1<sup>st</sup> Dept. 1991) (use of injunction to enforce non-compete agreement).

Irreparable harm is presumed where a trade secret has been misappropriated, because a trade secret, once lost, is lost forever and as a result, such a loss cannot be measured in monetary damages. *FMC Corporation v. TaiWan Tainan Giant Industrial Company, Ltd.*, 730 F.2d 61 (2<sup>nd</sup> Cir. 1984).

## VI. OBTAINING A PRELIMINARY INJUNCTION

Unlike most litigation, which starts off slow and gradually develops momentum until it reaches the crucial trial stage, litigation involving disloyal employees is generally won or lost in the first month or two of the case. The battle over the requested preliminary injunction generally determines the winners and losers while the litigation is in its infancy. A company that obtains an injunction against a competitor generally finds that the competitor has few realistic options, other than coming to the negotiating table and hammering out a negotiated settlement. Conversely, a company that fails to obtain a preliminary injunction, at the outset, will often find that, by the time discovery is complete and a trial begins, most, if not all, of the customers who have departed are irrevocably gone and no amount of cajoling, not to mention no amount of legal opinions, will bring them back.

Therefore, the common practice is to move, by Order to Show Cause, for a Preliminary Injunction, immediately upon filing the Complaint. Depending upon the jurisdiction, some judges will hold hearings, at which witnesses must be called and examined, before deciding on the injunction. In other jurisdictions, the courts will decide on the injunction based solely on the papers submitted. Either way, the practitioner must carefully construct the motion for a preliminary injunction with thorough and detailed affidavits providing real and detailed evidence, not mere conclusions or speculation. The practice, common with some, of hiding one's best arguments until the time of trial, goes right out the window when one is seeking a preliminary injunction. Instead, the attorney representing the aggrieved company must "come out swinging" with everything the attorney has, at the first instance, in order to achieve the desired result. It is at this point that all of the investigation, interviews, surveillance, assembly of documents and selection of witnesses comes to fruition.

## VII. TEMPORARY RESTRAINING ORDER

In busy jurisdictions, in which the courts are flooded with cases, it may take weeks, if not months, for a judicial decision on the request for a preliminary injunction. It is therefore prudent to request a temporary restraining order when filing the Order to Show Cause seeking a preliminary injunction. If the supporting affidavits show, by convincing evidence, that the client is likely to suffer irreparable harm and there is a substantial likelihood of success on the merits, a temporary restraining order will often be granted. This is hugely important for the attorney prosecuting a disloyal employee case. The temporary restraining order should seek to enjoin the ex-employee from soliciting or selling goods and services to the ex-employer's customers. The TRO should also seek to enjoin the disloyal employee's new employer from selling anything to customers previously serviced by the ex-employee. It is also useful to request that the court enjoin the disloyal employee and competitor from soliciting or hiring any of the ex-employer's other employees. If granted, this provision will stop a hemorrhage of employees from the ex-employer to the new competitor.

Once a temporary restraining order is entered the status quo now benefits the ex-employer, as the plaintiff. The defendant or defendants are now unable to sell to customers they had targeted, which often severely hampers their cash flow. Their cash flow problems will be even further affected by the cost of protracted litigation. For these reasons, the imposition of a TRO, by itself, often leads to the negotiated settlement of a disloyal employee case.

## VIII. CONCLUSION

A company which is suddenly faced with a disloyal employee intent on wrongfully taking many, if not most, of the company's customers often finds itself teetering on the brink of catastrophe. Quick and efficient work on the part of its counsel can avert the crisis and prevent the unlawful solicitation of customers.