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Yet Another Employer Trap: Be Careful How You Hire At-Will Employees

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A. Introduction

Every business seeks productive and knowledgeable employees. Employers invest considerable amounts of time and expense in training employees. Employers provide employees access to their know-how, business contacts, pricing, growth strategies and trade secrets. Even so, employers are reluctant to provide employees, even highly valued employees, with written employment contracts, preferring instead to maintain an "at-will" status with these employees. The perception is, of course, that it is easier to terminate an "at-will" employee than it is to terminate an employee under contract. All too frequently an employer will learn, usually too late, that a valued at-will employee is leaving to go work for a competitor. Such a departure can be very costly for the employer, including loss of the employer's investment, potential disclosure of its trade secrets, recruiting fees and the cost of training of new employees.

The prior employer may feel constrained in taking any action against the new employer because of the "at-will" arrangement with the

former employee. The new employer may feel that it has no exposure for hiring someone else's "at-will" employee. An employee may believe that due to the "at-will" relationship, the prior employer may not have any rights against the employee or new employer.

Does the "at-will" status of the former employee immunize the new employer from claims by an aggrieved former employer or, restated, can the former employer make a claim against the new employer arising from the hiring of the former employer's at-will employee? This issue was presented front and square in the California Supreme Court's decision of *Reeves v. Hanlon* (2004) 33 Cal.4th 1140. In *Reeves*, the California Supreme Court had to determine whether "the tort of interference with contractual relations may be predicated upon interference with an at-will contract." Answering that question with "yes," the *Reeves* Court found that, historically speaking, the at-will relationship is between the employer and employee, and that the "contractual relationship is at the will of the parties, not at the will of outsiders." *Reeves*, while restating prior law that simply making

a job offer itself will not expose a potential new employer to liability, held that a former employer could in certain circumstances "recover for intentional interference with an at-will employment relation" when the employee's new employer engaged in "independently wrongful acts" in the recruiting process. The Court defined "independently wrongful acts" as "an act proscribed by constitutional, statutory, regulatory, common law, or other determinable legal standard." This ruling provides a note of caution for any new employer.

B. Review of Prior Law Under GAB Business Services.

Prior to *Reeves*, the general rule exonerating a new employer from any liability for interference claims raised by a former employer was stated in *GAB Business Services, Inc. v. Lindsey & Newsom Claim Services, Inc.* (2000) 83 Cal. App.4th 409. *GAB Business Services, Inc.* ("GAB"), an independent adjusting company, sued its former officer and employee, Neal, and his new employer, Lindsey, for their respective roles in soliciting 17 key GAB

employees to resign en masse in order to join the former officer and his new employment. GAB sued for breach of fiduciary duty, unfair competition, and interference with the at-will relationships with its former employees. The trial court, after a jury trial, entered a verdict in favor of Neal and Lindsey. Later, GAB prevailed, on appeal, regarding its claims for breach of fiduciary duty and unfair competition. Regarding the employment claims, GAB, in its appeal, argued the trial court erred in refusing to instruct the jury on its theory that Neal and Lindsey intentionally interfered with GAB's employment relationship with the 17 employees. Finding no case law supporting an employer's right to state such a claim, the trial court declined to "mak[e] new law." The GAB court concluded that the trial court "acted wisely."

The GAB court noted that it was well established that the at-will nature of a contract does not preclude a tortious interference claim relying upon *Pacific Gas & Electric Co. v. Bear Stearns & Co.* (1990) 50 Cal.3d 1118, where the California Supreme Court stated, "We have affirmed that interference with an at-will contract is actionable interference with the contractual relationship, on the theory that a contract 'at the will of the parties ... does not make it one at the will of others' [citations]." (*Id.* at p. 1127; *PMC, Inc. v. Saban Entertainment, Inc.* (1996) 45 Cal. App.4th 579, 599, *fn.* 15 ["In California, an at-will contract is an enforceable contract and thus it may be actionable to interfere with that contract"].) The GAB court also

noted that cases which have applied tortious interference claims in the specific context of at-will employment relationships involved claims asserted by the employee. (*Savage v. Pacific Gas & Electric Co.* (1993) 21 Cal.App.4th 434, 448 [the tort of interference with contractual relations may be based on at-will employment contract]; *Kozlowsky v. Westminster Nat. Bank* (1970) 6 Cal.App.3d 593, 598 ["the fact that the Bank was privileged to discharge plaintiff at any time does not necessarily privilege a third party unjustifiably to induce the termination"]; *Truax v. Raich* (1915) 239 U.S. 33, 38 [unjustified interference of third persons in the employment relationship "is actionable although the employment is at will"].) The GAB court also relied upon a leading commentator's explanation that the principle underlying such claims was as follows: "[I]nterference with employment ... contracts terminable at will is actionable, since until it is terminated the contract is a subsisting relation, of value to the plaintiff, and presumably to continue in effect." (*Prosser & Keeton, Torts* (5th ed. 1984) § 129, pp. 995-996, *fn. omitted.*) (*Ibid.* at 426.)

GAB's difficulty, however, was that no case at the time specifically allowed an employer to bring such an interference claim. The GAB court found three key reasons not to provide employers the right to bring an interference claim. First, the GAB court believed that recognizing an employer's right to sue for intentional interference with its employment relationships would open the floodgates to new litigation – a new employer would be continuously subject to exposure upon the

hiring of a competitor's at-will employee(s). Second, California has a strong public policy supporting the mobility of employees. (See *Metro Traffic Control, Inc. v. Shadow Traffic Network* (1994) 22 Cal.App.4th 853, 859), *Diodes, Inc. v. Franzen* (1968) 260 Cal.App.2d 244, 255 ["The interests of the employee in his own mobility and betterment are deemed paramount to the competitive business interests of the employers ..."].) and, thus, facilitating employer claims may chill employment opportunities, and hence discourage employee mobility, i.e. the prospect of a lawsuit (given its costs and usurpation of management time) may discourage employment as hiring a competitor's employee could be much more trouble than it's worth. Third, the GAB court stated that there "seems to be something inherently suspect about a tort that, at bottom, concerns an employee's voluntary departure from employment." (*Ibid.* at 427.) While the GAB court did not want to condone unfair or unlawful conduct among employers competing for talented employees, the court felt that the tort of unfair competition, could adequately address the problem. The GAB court was "unconvinced" of the need for an additional avenue of recovery in tort and declined to recognize an employer's right to sue for intentional interference with the employment relationship.

C. Reeves Case Facts.

GAB is no longer good law in light of Reeves. The case facts in Reeves requires

examination. In *Reeves*, the plaintiff law firm, focused on immigration law, employed Hanlon as an attorney in 1995. In 1997 the firm employed Greene as an associate attorney. In 1998 Hanlon became a partner and the law firm changed its name to *Reeves & Hanlon*. Around June 30, 1999, both Hanlon and Greene resigned without notice or warning. The court determined that, for more than five months prior to their departure, Hanlon and Greene had accessed plaintiffs' password-protected computer database to print out confidential name, address, and phone number information on 2,200 clients and had fomented dissatisfaction among plaintiffs' personnel. (*Ibid.* at 1146.) Although Greene had been chair of plaintiffs' litigation department and Hanlon had been responsible for over 500 client matters when they abruptly resigned without notice, they left no status reports or list of matters or deadlines on which they had been working. Nor did they attempt to cooperate with plaintiffs on a notice to clients. Shortly before resigning, Greene erased extensive computer files in plaintiffs' computer server containing client documents and form files used by plaintiffs. The evening of their resignations, defendants personally solicited plaintiffs' key employees.

As a result, plaintiffs lost nine employees over the next 60 days, six of them joining defendants' new firm. Defendants also began a campaign to solicit plaintiffs' clients, contacting at least 40 clients by telephone without offering them a choice of counsel. All of this had been "intentionally done ... to disrupt [plaintiffs'] ongoing business."

Although historically, plaintiffs typically lost only one or two clients a month, plaintiffs lost 144 clients to defendants over the next 12 months. (*Ibid.*)

The trial court found that defendants' conduct caused damage to plaintiffs in the total amount of \$182,180.18, as follows: (1) 144 of plaintiffs' clients who transferred to Hanlon and Greene did not pay \$62,540.50 in fees that they owed to plaintiffs; (2) plaintiffs suffered \$36,000 in lost future business revenue; (3) plaintiffs incurred \$61,639.68 in expenses to mitigate damages, including \$41,630.49 for informing clients that the firm was still in business and \$20,009.19 for recruiting replacement employees; and (4) defendants were unjustly enriched in the amount of \$22,000 due to the misappropriation of confidential client information.

Interestingly, the trial court, declined to award punitive damages, finding that defendants did not act with malice, oppression or fraud, but instead acted out of "immaturity" and "an apparent get-rich-quick mentality at the expense of [plaintiffs]." The court reduced the damages award to \$150,000 pursuant to the parties' stipulation, and thereafter awarded plaintiffs \$47,427.63 in costs. (*Ibid.* at 1147.)

As noted above, in *Reeves*, the primary issue presented was whether a defendant may be held liable under an intentional interference theory for having induced an at-will employee to quit working for the plaintiff. Because an interference as such is primarily an interference

with the future relationship between the plaintiff and the at-will employee, the *Reeves* court held that inducing the termination of an at-will employment relation may be actionable under the standard applicable to claims for intentional interference with prospective economic advantage. To recover for a defendant's interference with an at-will employment relationship, a former employer must plead and prove that the new employer engaged in an independently wrongful act, that is an act "proscribed by some constitutional, statutory, regulatory, common law, or other determinable legal standard" (*Korea Supply Co. v. Lockheed Martin Corp.* (2003) 29 Cal.4th 1134, 1159) that induced the at-will employee to leave the former employer. *Reeves* found that adopting this standard of recovery in the context of at-will employment relations was particularly appropriate. The *Reeves* court reasoned that not only will it guard against unlawful methods of competition in the job market, but it will promote the public policies supporting the right of at-will employees to pursue opportunities for economic betterment and the right of employers to compete for talented workers. The *Reeves* court emphasized that based on the standard articulated, that a new employer commits no actionable wrong by merely soliciting or hiring the at-will employee of another.

D. Legal Underpinnings Of *Reeves*.

Reeves builds on existing case law that in essence makes a person who is not a party to a contract liable, under certain circumstances,

for interfering in a contractual relationship. This body of case law does not preclude healthy competition – it is designed to prevent improper interference. In California, the law is settled that “a stranger to a contract may be liable in tort for intentionally interfering with the performance of the contract.” (*Pacific Gas & Electric Co. v. Bear Stearns & Co.* (1990) 50 Cal.3d 1118, 1126) To prevail on a cause of action for intentional interference with contractual relations, a plaintiff must plead and prove (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. (*Ibid.*) To establish the claim, the plaintiff need not prove that a defendant acted with the primary purpose of disrupting the contract, but must show the defendant’s knowledge that the interference was certain or substantially certain to occur as a result of his or her action. (*Quelimane Co. v. Stewart Title Guaranty Co.* (1998) 19 Cal.4th 26, 56.)

Under this analysis, the Reeves court surmised, an interference with an at-will contract properly is viewed as an interference with a prospective economic advantage, a tort that similarly compensates for the loss of an advantageous economic relationship but does not require the existence of a legally binding contract. These torts protect the public interest in stable economic relationships and both share the same intent requirement. (*Korea Supply,*

supra, 29 Cal.4th at p. 1157, [defendant must know that interference was certain or substantially certain to occur as a result of its action].)

On a parallel track, the Reeves court noted that it has long been the public policy of California that “[a] former employee has the right to engage in a competitive business for himself and to enter into competition with his former employer, even for the business of ... his former employer, provided such competition is fairly and legally conducted.” (*Continental Car-Na-Var Corp. v. Moseley* (1944) 24 Cal.2d 104, 110; *Bus. & Prof. Code*, § 16600 [generally recognizing as void any agreement “by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind”].) Consistent with this policy favoring competition, decisions involving parties in competition readily indicate that certain competitive conduct is non actionable when it interferes with the at-will contract relations of another. In *Buxbom v. Smith* (1944) 23 Cal.2d 535, for example, the court explained that “where the means of interference involve no more than recognized trade practices such as advertising or price-cutting, the plaintiff’s loss as a result of the competitive strife is deemed *damnum absque injuria*.” (*Ibid.* at 546) *Buxbom* observed that “it is not ordinarily a tort to hire the employees of another for use in the hirer’s business.” (*Ibid.* at 547.) As *Buxbom* explained, however, this general rule is subject to one significant limitation: “This immunity against liability is not retained ... if unfair methods are used in interfering in such advantageous relations.”

(*Ibid.*) In *Buxbom*, the record established that the defendant gained an unfair advantage over the plaintiff through “deceptive dealings” and “false promises” made in connection with a distribution contract between the parties that the defendant had no intention of performing. (*Ibid.* at 548.) He “deliberately induced the plaintiff to buildup his distributing organization” to perform the contract and in a matter of weeks became the plaintiff’s sole customer. (*Ibid.* at 547.) Once the defendant acquired this strategic position, he breached the distribution contract “to cut off the work required to sustain plaintiff’s organization” and “to prevent plaintiff from competing effectively for the retention of [his] employees.” (*Ibid.* at 548.)

Reeves reinforces the holding in *Buxbom* that the same considerations support similar limitations for actions alleging interference with an at-will employment relation. Where no unlawful methods are used, public policy generally supports a competitor’s right to offer more pay or better terms to another’s employee, so long as the employee is free to leave. A contrary result “would be intolerable, both to such employers as could use the employe[e] more effectively and to such employe[e]s as might receive added pay. It would put an end to any kind of competition.” (*Triangle Film Corp. v. Artcraft Pictures Corp.* (2d Cir. 1918) 250 F. 981, 982.) Or as *Diodes* put it: “The interests of the employee in his own mobility and betterment are deemed paramount to the competitive business interests of the employers, where neither the employee nor his new employer has committed any illegal

act accompanying the employment change.” (*Diodes, supra*, 260 Cal.App.2d at p. 255.)

Reeves held that a plaintiff may recover damages for intentional interference with an at-will employment relation under the same California standard applicable to claims for intentional interference with prospective economic advantage. That is, 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” (*Korea Supply, supra*, 29 Cal.4th at p. 1159.)--that induced an at-will employee to leave the plaintiff. Under this standard, a defendant is not subject to liability for intentional interference if the interference consists merely of extending a job offer that induces an employee to terminate his or her at-will employment. In *Reeves*, the court found that consistent with the holding in *Korea Supply*, defendants had unlawfully interfered with the former employer’s at-will employment relationships. The *Reeves* court noted that at the time the former employer’s at-will employees were being enticed away, Hanlon and Greene also mounted “a campaign to deliberately disrupt plaintiff’s business” that included persuading employees to resign without notice; failing to provide status reports for pending matters or deadlines; deleting and destroying certain computer files and forms; improperly soliciting plaintiff’s clients and misappropriating confidential information.

E. Lessons From Reeves

The main lesson from *Reeves* is that if employers engage in improper tactics while hiring away at-will employees, they could become subject to liability for interfering with another employer’s at-will relationships. What qualifies as legitimate conduct, as opposed to wrongful conduct, is unclear but commonsense dictates that actions such as destruction of equipment, theft of trade secrets, destruction of business and the like will in all likelihood create liability. By overruling *GAB*, the *Reeves* decision has given former employers who have lost a significant at-will employee support to initiate a claim against the new employer. Claims brought under *Reeves* will typically be augmented by claims under the Uniform Trade Secrets Act, unfair competition, common law misappropriation, breach of fiduciary duty, trade libel or conversion. There are some prophylactic steps a new employer should consider:

1. Existing employers should consider written agreements for key employees.
2. Existing employers should have formal policies and confidentiality agreements with their employees, or at the very least, an employee handbook.
3. Existing employers must take adequate steps to protect their trade secrets.
4. Early in the employment process (for example in an offer letter) new employees should be informed that they are not to take

any actions that may be viewed as improper, including usurping trade secrets or trying to disrupt a competitor’s business.

5. New employer due diligence should include reviewing with potential new employees any confidentiality agreements, non-solicitation agreements, non-compete agreements and new employers should enquire if there are any writings that could limit or restrict the new employees ability to perform the new job.

6. New employer should refrain from discussing any activities with the potential employee about business disruption of the operations of the prior employer.

7. New employers should state, in writing, that a new employee is not to use any of the former employer’s confidential information or a trade secret.

8. Employers should review their existing employee nonsolicitation provisions.

9. Employers and the new employee should recognize that the law limits solicitations of customers of the former employer, but the law does not ordinarily create any liability for sending send an announcement.

Reeves has changed the landscape. The decision seeks to encourage lawful competitive activities and discourages unlawful or unethical business practices arising from the hiring of an at-will employee.

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