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Defending Your Business From Ex-Employees:

An Employer's Guide

by James L. Komie

It is one of the biggest challenges facing business owners today. You hire an employee with little or no experience. You devote significant time and money to training him. You introduce him to your customers and give him resources to develop new customers for your company. Slowly but surely, the employee starts to become profitable.

That's when it happens. Late Friday afternoon, your new superstar hands you a letter of resignation. He is joining your main competitor. You soon learn that he is contacting the customers he got to know while working for you. Customers begin to follow him to his new employer, including some of your best and oldest customers.

What do you do? Well, that may depend on what preparations you have made for this scenario. Did you have the employee sign a non-compete agreement? Have you treated the customer information as confidential? Have you taken adequate steps to protect the confidentiality of the information?

This article will set forth the basics on non-competes and give real-world tips about how to prevent an employee's departure from turning into a disaster. This article will also discuss some easy steps that every business can take right now to position itself better in the event of an employee's departure.

NON-COMPETES – THE BASICS

A non-compete is a contract provision that restricts the post-employment activity of an employee by limiting his/her ability to compete with the employer. Some provisions actually prohibit the employee from working in a similar line of business for a period of time within a specified geographic region. Other provisions prohibit the employee from soliciting the employer's customers or employees for a period of time. The most basic provisions simply prohibit the employee from disclosing or using the employer's confidential business information, such as customer lists.

Many business owners assume that courts treat non-competes like regular contracts and will enforce them to the letter. Other business owners have heard the opposite – namely, a horror story of an employer who filed suit against an ex-employee only to learn (after thousands of dollars in attorneys' fees) that its non-compete was not enforceable.

The truth lies somewhere in the middle. Most courts will not prevent an ex-employee from contacting customers or working for a competitor simply because his employment contract says that he cannot do so. Standing alone, the contract is not enough. Courts also typically require that the employer have a "protectable interest" in the information or customers that are covered by the non-compete.

Non-disclosure of confidential information clauses are the easiest to enforce. Courts almost always find that an employer has the right to protect its confidential business information. Covenants barring the employee from working in the industry for a period of time are the most difficult to enforce. Courts dislike such covenants because of their significant effect on free competition. Provisions that prohibit the employee from soliciting clients or employees fall somewhere in between.

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WHAT YOU CAN DO NOW TO PROTECT YOUR COMPANY

An ounce of prevention is worth a pound of cure. There are a variety of things you can do today to improve your business's readiness to defend its competitive position in such a situation.

Implement Or Update Your Non-competes. If you have not had your employees sign non-competes, you should consider doing so immediately. Even if you have had your employees sign non-competes, you may want to have the agreement reviewed to determine its enforceability. You may learn that your agreement is outdated or that it is so broad and overreaching that a court may refuse to enforce it.

Having your employees sign new or updated non-compete agreements can have a variety of benefits. It should give your business a powerful weapon in the event an employee leaves and begins competing against you unfairly. Also, having your employees sign new or updated non-competes can have a significant deterrent effect. An employee who has just signed a non-compete may think twice about taking a customer list.

Record-keeping. You should keep all non-compete agreements in an easily accessible place. An employee's personnel file is as good a place as any. It is also a good idea to have multiple copies of each employee's non-compete agreement and keep them in different places. In some extreme cases, employees have pulled their personnel files and destroyed the copy of their contract.

You should also do a quick review of your files to confirm that you in fact have a signed non-compete agreement from each employee. It is not uncommon for employees to slip through the cracks. For example, some employees say they want to review the agreement and then fail to return a signed copy. There is nothing worse than finding out after an employee has left that he never returned a signed copy of his non-compete agreement.

Tighten Security. One factor that courts look at in evaluating whether to enforce a restriction on an ex-employee's use of customer information is the steps that the employer has taken to protect the confidentiality of its customer information.

You should therefore consider implementing certain measures to tighten the security of your customer information. You may want to require that customer information be kept under lock and key when not being used. Confidential information should be labeled as such. You may want to permit employees to have access to customer information only on an "as needed" basis. Any such measures should include a device (such as a password) to restrict access to any customer information maintained on your computer system.

WHAT YOU SHOULD DO WHEN AN EMPLOYEE LEAVES

When an employee hands you his letter of resignation, there are several things you should keep in mind to enhance your company's ability to protect itself from improper competition from the employee.

Exit Interview. You should try to conduct an exit interview. While an employee has no legal obligation to answer any questions, many employees feel guilty about what they are doing. It is precisely at that time that they are most likely to provide you with information that you need to know.

You should also take advantage of the exit interview to remind the employee that he signed a non-compete. If it is handy, you should provide him with a copy of the agreement he signed. If it is not readily accessible, you should send a copy of the agreement to his home address.

Act Quickly. It is crucial to act quickly. If you want a court to issue an injunction against the employee enforcing his non-compete, you must show the court that your company will be "irreparably injured" if the court does not issue an injunction immediately. If you sit on your hands for several weeks before acting, a court is less likely to believe that the matter is urgent and may not issue an injunction.

Preventing Counterclaims. A common strategy used by an ex-employee in defending against a non-compete lawsuit is to file a counterclaim against his former employer. It is important to protect your company against such counterclaims.

It is therefore critical not to give the ex-employee any grounds for complaint after his departure. The ex-employee should not be bad-mouthed to the customers. Nor should he be accused of taking property from your company unless you have solid evidence that he did so.

Employees joining competitors is a reality in today's business environment. It is never a good thing when an employee jumps ship; however, if properly managed, an employee's departure should not be anything more than a speed bump for your business.

JIM KOMIE *is a Shareholder at Schuyler, Roche & Zwirner, P.C. He has a wide variety of experience in commercial litigation, with an emphasis on employment litigation and counseling. During his tenure at Schuyler, Roche & Zwirner, Jim has worked closely with the law department of a major U.S. securities brokerage firm on a variety of matters, including planning and implementing its nationwide strategy with regard to restrictive covenant and trade secret litigation. He is a Contributing Legal Editor of the Securities Litigation Commentator.*

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What is the State of Your Real Estate Title?

by Douglas A. Hanson

CAVEAT EMPTOR: LET THE BUYER BEWARE... OF REAL ESTATE TITLE DEFECTS

Since the Middle Ages, a maxim of all real estate purchases has been caveat emptor – let the buyer beware. Simply put, all real estate purchasers must examine, test and judge the condition of real estate because sellers were not historically required to disclose real estate defects. While this caveat emptor concept has been eroded by case law and statutes requiring certain disclosures about the physical condition of the property to be purchased, it still applies to real estate title defects. Real estate title defects negatively affect how you can use property which you purchase. Based on this, all purchasers of real estate must review the state of real estate title to protect his or her intended use of the property and, indeed, his or her investment. In order to protect against these title defects, real estate purchasers customarily require the seller to provide a title insurance commitment so these defects can be reviewed and approved; however, this may no longer be enough to protect the purchaser from caveat emptor.

TITLE INSURANCE POLICIES CANNOT BE RELIED UPON TO DISCLOSE TITLE DEFECTS

After the Illinois Supreme Court unanimously decided *First Midwest Bank v. Stewart Title Guaranty Company*, you may need to purchase an abstract of title to verify the state of your real estate title–a title insurance commitment may not be enough. An abstract of title is a listing of all documents affecting the chain of title (e.g., all deeds, easements, unpaid mortgages) since the property was acquired by the U.S. government and is more cumbersome and expensive than title insurance.

TITLE INSURANCE HAS BEEN THE NORM IN ILLINOIS

Traditionally, in Illinois, real estate purchasers would cause the seller to order a commitment from an Illinois-licensed title insurance company to provide a title insurance policy on the property being purchased. Such a title insurance commitment lists the exceptions to title which affect the purchaser's use and enjoyment of the property. The commitment is scrutinized by the purchaser's attorney to determine whether the purchaser can accept the property subject to these exceptions. The seller, the purchaser, their respective attorneys and the entire real estate bar have customarily relied upon this commitment as conclusive evidence of the state of real estate title.

TITLE INSURANCE IS NOT CONCLUSIVE EVIDENCE OF STATE OF YOUR TITLE

Based on the information contained in the title commitment, the purchasers in the *First Midwest* case completed the closing of their new home. During their due diligence, their attorney searched the commitment for title exceptions which could negatively affect the purchaser's ability to build an office in their new garage. No such restrictive covenant was disclosed in the commitment. After construction commenced on the new garage/office, the purchasers discovered the existence of a restrictive covenant precluding any business use of the property. Shortly thereafter, the purchasers were forced into defaulting on their mortgage loan and their lender, First Midwest, sued the title company for negligently misrepresenting the state of real estate title because its damages far exceeded the policy limits on its lender's title insurance policy and there was a question as to whether the Stewart Title insurance policy was still in force. In order to prevail on this claim, First Midwest had to prove that Stewart Title was in the business of selling information. Stewart Title argued that the information supplied in the title commitment and policy was ancillary to the sale of the product itself, title insurance.

The Illinois Supreme Court agreed that Stewart Title (and, therefore, all other Illinois-licensed title insurance companies) is in the business of selling title insurance, not in the business of selling information. Consequently, the information contained in the title commitment, which has been relied upon by sellers, purchasers, and the real estate bar since title insurance became the norm for determining state of real estate title, is merely ancillary to the provision of title insurance. This opinion confirms to the title insurance industry that liability for a mistake in issuing a title insurance commitment or policy is limited to the face amount of the insurance provided and not the insured's actual damages if those damages are in excess of the limits of the insurance policy. The effect on real estate purchasers is that a title commitment or title policy cannot be relied upon to disclose the state of title of the property being purchased.

TITLE INSURANCE REMAINS NECESSARY, BUT CHANGE OF USE REQUIRES MORE

In light of the Court's ruling, do we abandon title insurance and return to abstracts of title? No, not in most cases. Most real estate purchases can be handled with title insurance because most purchases do not include a change of use of the property. Also, for minor title defects it is desirable to be able to file a claim against (and recover from) a title insurance policy. However, in the event you intend to change the use of property to be purchased, a two-tier process would be most prudent. First, require the seller to provide a title insurance policy to cover your purchase price. Second, order an abstract of title. Purchasing an abstract is the purchase of information. If there is a mistake made in the production of the abstract, you may sue for actual damages and most importantly, you will know the state of your real estate title.

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SRZ Highlights

SRZ ATTORNEYS NAMED AMONG TOP FIVE PERCENT IN STATE

Peer review can be unforgiving—tough, honest, no holds barred. For these reasons, peer review is among the most reliable means by which to select an attorney.

This year SRZ is pleased to announce that a record number of our attorneys have earned peer recognition from two of our industry's most credible organizations involved in professional evaluation: the Leading Lawyers Network and Law & Politics. Seventeen of SRZ's attorneys were recently named Leading Lawyers, and 17 now enjoy Super Lawyers status. Even more impressive, 13 of our attorneys enjoy dual distinction.

This honor is enjoyed by less than 5% of Illinois attorneys. For a complete list of SRZ Super Lawyers and Leading Lawyers, please visit www.srzlaw.com.

FORUM ON RESOLVING CUSTOMER CLAIMS

On May 25, 2006, Michael Roche led a panel on Defending Alleged Broker Misconduct in Suitability, Misrepresentation, and Unauthorized Trading Claims at the 3rd Annual Broker/Dealer Forum on Resolving Customer Claims. Mr. Roche's fellow panelists were Thomas Hommel, Managing Director and Co-Head, Litigation of Lehman Brothers, Inc. and David A. Travin, Vice President of Deutsche Bank.

KEEPING IT UNDER LOCK AND KEY

July 21, 2006 – SRZ will host a complimentary seminar titled "Keeping It Under Lock and Key - Restrictive Covenants, Trade Secrets and Employee Duty of Loyalty"

The Plaza Club
One Prudential Plaza
130 E. Randolph St., 40th Floor
8:30 a.m. – 11:30 a.m. (*Breakfast served*)
R.S.V.P. by July 14th to (312) 565-8311 or bayala@srzlaw.com

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