

**OVERVIEW OF**  
**POST-EMPLOYMENT RESTRAINTS**  
**AND CAUSES OF ACTION**

PENNSYLVANIA BAR INSTITUTE  
RESTRICTIVE COVENANTS AND TRADE SECRETS  
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## I. CONTRACTUAL PROTECTIONS: RESTRICTIVE COVENANTS

### A. Introduction

Restrictive covenants are an employer's most important tool in preventing or deterring an ex-employee from damaging the employer's business interests through competitive activity. Properly drafted restrictive covenants are material to an employer's ability to protect customer goodwill and trade secrets. *Compare Seligman and Latz of Pittsburgh, Inc. v. Vernillo*, 382 Pa. 161, 114 A.2d 672 (1955) (beauty salon's restrictive covenant enforced against ex-employees who memorized customers' names, and formed new salon) with *Renee Beauty Salons, Inc. v. Blose-Venable*, 438 Pa.Super. 601, 652 A.2d 1345 (1995), *appeal denied*, 541 Pa. 627, 661 A.2d 874 (1995) (salon without restrictive covenant unable to enjoin competition by ex-employees who memorized customer names).

Without a restrictive covenant, an at-will employee is free to leave employment at any time, and to compete with a former employer, so long as the employee does not misuse trade secrets or confidential information, engage in fraud, solicit customers while still employed, or otherwise engage in conduct directly damaging the employer during the period of employment. The employee may even take steps to prepare to compete before leaving, e.g., by incorporating, obtaining bank financing, signing leases, or scheduling appointments with (but not actually soliciting) customers. *See United Aircraft Corporation v. Boreen*, 284 F.Supp. 428 (E.D. Pa. 1968), *affirmed*, 413 F.2d 694 (3d Cir. 1969); *Spring Steels, Inc. v. Molloy*, 400 Pa. 354, 162 A.2d 370 (1960); *The New L&N Sales and Marketing, Inc. v. Menaged*, 1998 WL 575270, \*7 (E.D. Pa. 1998).

A cautionary note is necessary, however. Restrictive covenants are not favored in Pennsylvania and have been viewed as a trade restraint that prevents a former employee from earning a living. *Hess v. Gebhard & Co.*, 570 Pa. 148, 157, 808 A.2d 912, 917 (2002). Restrictive covenants are strictly construed against the employer, particularly if the employer drafts the covenant without input from the employee. *All-Pak, Inc. v. Johnston*, 694 A.2d 347, 351 (Pa.Super. 1997); *Doyle Consulting Group, Inc. v. Stoffel*, 2004 WL 362316 (Phila. Co. 2004), *affirmed w/o opinion*, 869 A.2d 18 (Pa. Super. 2004).

### B. Types of Restrictive Covenants

1. **Non-competition covenants**, or "non-competes", typically

prohibit an ex-employee from the following activity after employment:

- a. employment or affiliation with an entity that is similar to or competitive with the employer;
- b. engaging in business with a customer of the employer.

NOTE: These covenants are separate and distinct from each other. The covenant prohibiting competition *per se* is a *general* non-compete, and the prohibition against competition for customers is a *specific* non-compete. *Morgan's Home Equipment Corp. v. Martucci*, 390 Pa. 618, 136 A.2d 838 (1957). The covenant against engaging in business with customers is also separate and distinct from the non-solicitation covenant (discussed at I, B, 2 below).

In *Advanced Fox Antenna, Inc. v. Csaszar*, 1999 WL 54567 (E.D. Pa. 1999), the covenant restricted both affiliation with a competitor and calling on or endeavoring to sell to customers. The court treated the two restrictions separately, enjoining the customer contact but allowing the ex-employee's new employment. *See also Thermo-Guard, Inc. v. Cochran*, 408 Pa.Super. 54, 596 A.2d 188 (1991). Where a covenant prohibits competing with the employer but fails to prohibit employment by a customer, the courts will not prohibit such employment. *ZA Consulting, LLC v. Wittman*, 2002 WL 31898369 (Phila. Co. 2002).

A non-compete protecting an employee against an employer's competition is unusual; but in *Matthews v. Unisource Worldwide, Inc.*, 748 A.2d 219 (Pa.Super. 2000), an employee sued for breach of a restrictive covenant prohibiting the ex-employer from doing business with the employee's customer accounts after the employment ended.

NOTE: Employment contracts may also prohibit the employee from competing with the employer *during* employment. This prohibition is a deterrent but is not essential; the employee has a common-law fiduciary duty not to compete with the employer during employment. *See, e.g., SHV Coal, Inc. v. Continental Grain Co.*, 376 Pa.Super. 241, 545 A.2d 917 (1988), *reversed in part on other grounds*, 526 Pa. 489, 587 A.2d 702 (1991).

2. **Customer non-solicitation covenants** typically prohibit the ex-employee from soliciting (i.e., initiating any contact with) customers of the employer (see, e.g., *Bell Fuel Corp. v. Cattolico*, 375 Pa.Super. 238, 544 A.2d 450 (1988), *appeal denied*, 520 Pa. 612, 554 A.2d 505 (1989); *Merrill, Lynch, Pierce, Fenner and Smith, Inc. v. Napolitano*, 85 F.Supp.2d 491 (E.D. Pa. 2000)). Such agreements will not prohibit solicitation of former customers absent an explicit prohibition. *Doyle Consulting Group, Inc. v. Stoffel*, 2004 WL 362316 (Phila. Co. Feb. 13, 2004), *affirmed w/o opinion*, 869 A.2d 18 (Pa. Super. 2004).

- a. Non-solicitation covenants are limited by the reasonableness requirements that govern non-competes. *Bell Fuel Corp. v. Cattolico*, *supra*, 544 A.2d at 458. Therefore, courts may limit these covenants (e.g., to prohibit contact with only those customers with whom ex-employee did business at former employer). See *Robert Half of PA, Inc. v. Feight*, 48 Pa. D.&C.4<sup>th</sup> 129 (C.C.P. Philadelphia Co. 2000).
- b. A covenant that an ex-employee may not “solicit, divert, or take away” customers allows an ex-employee to accept customers who seek out the ex-employee. *Merrill, Lynch, Pierce, Fenner and Smith, Inc. v. Moose*, 365 Pa.Super. 40, 528 A.2d 1351 (1987), *appeal denied*, 518 Pa. 641, 542 A.2d 1370 (1988); *Harry Blackwood, Inc. v. Caputo*, 290 Pa.Super. 140, 434 A.2d 169 (1981).

3. **Employee non-solicitation covenants** or “anti-piracy” covenants prohibit employees from soliciting other employees to leave and join a new organization. See, e.g., *Unisys Corp. v. Entex Information Services, Inc.*, 45 Pa. D.&C.4<sup>th</sup> 405 (Montg. Co. 2000).

4. **Confidentiality/non-disclosure agreements** prohibit the employee from disclosing or using confidential, customer, or trade secret information or records or property that belong to the employer, other than for the employer’s benefit. These covenants may also require the employee to return all property to the employer upon termination. These

covenants often contain a broad definition of proprietary information.

- a. The law of trade secrets, unfair competition, or agency subjects the employee to these restrictions, even in the absence of a confidentiality agreement. The agreement provides evidence of the confidentiality of the information covered in the agreement. *See Bell Fuel Corp. v. Cattolico, supra*, 544 A.2d 450, 458; *Morgan's Home Equipment Corp. v. Martucci*, 390 Pa. 618, 136 A.2d 838 (1957).
- b. Confidentiality agreements are not limited by the reasonableness requirements that govern non-competes or non-solicitation agreements. *See Bell Fuel Corp. v. Cattolico, supra*.
- c. Confidentiality agreements are enforceable even where an accompanying non-compete covenant is not enforceable. *See, e.g., Morgan's Home Equipment Corp. v. Martucci, supra; Insulation Corp. of America v. Brobston*, 446 Pa.Super. 520, 667 A.2d 729 (1995).

5. **Assignments of property rights** may include the following:

- a. Assignments of intellectual property rights, in which the employee assigns to the employer all rights to own, patent, trademark, or copyright any items developed by the employee during (and sometimes after) employment.
  - (1) Such an assignment is necessary to transfer patent rights to an employer, except where the employee is hired to invent an item or to solve a particular problem. *See University Patents, Inc. v. Kligman*, 762 F.Supp. 1212, 1219 (E.D. Pa. 1991). In *Brosso v. Devices for Vascular Intervention, Inc.*, 879 F.Supp. 473 (E.D. Pa. 1995) *aff'd*, 74 F.3d 1225 (3d Cir. 1995), the court held that an employee could not bring an action for wrongful

discharge after being fired for refusal to assign ownership of an invention to an employer.

(2) For copyrightable material, an assignment clause is advisable, although the employer will have the right to copyright materials developed by the employee during employment under the “work made for hire” doctrine. *Community for Creative Non-violence v. Reid*, 490 U.S. 730, 109 S.Ct. 2166 (1989).

b. Assignment of the right to “own” (i.e., to restrict the employee’s contact with) the employee’s customer contacts brought from a prior employer. *See, e.g., Merrill, Lynch, Pierce, Fenner and Smith, Inc. v. Napolitano*, 85 F.Supp.2d 491 (E.D. Pa. 2000).

## C. **Relationship of Restrictive Covenants to Employment Tenure**

### 1. **Employment at will rule**

a. The signature of a restrictive covenant at the outset of employment does not, by itself, provide consideration to override the employment at will presumption. *See Shriver v. Cichelli*, 1992 WL 350226 (E.D. Pa. 1992).

b. An at-will employee discharged for refusing to sign a non-compete or non-solicitation agreement has no claim for wrongful discharge in violation of a public policy under Pennsylvania law. *Oestereich v. Environmental Inks & Coatings Corp.*, 1990 WL 210599 (E.D. Pa. Dec. 17, 1990); *see also Brosso v. Devices for Vascular Intervention, Inc., supra*.

c. Similarly, a New Jersey employee discharged for refusing to sign a restrictive covenant has no claim for wrongful discharge in violation of New Jersey’s Conscientious Employee Protection Act. *Maw v. Advanced Clinical Communications, Inc.*, 179 N.J. 439, 846 A.2d 604 (2004).

- d. An employee forced to sign a restrictive covenant or lose a job may defend against enforcement of the restrictive covenant on the basis of lack of consideration or duress. *See In re Verdi*, 244 B.R. 314, 321 (Bankr. E.D. Pa. 2000).

2. **Discrimination claims** – Refusal to sign a restrictive covenant constitutes a legitimate, non-discriminatory reason for an employee’s discharge. *See O’Regan v. Arbitration Forums, Inc.*, 1999 WL 731775, \*4 (N.D. Ill. 1999), *affirmed*, 246 F.3d 975 (7<sup>th</sup> Cir. 2001).

3. **Unemployment compensation claims**

- a. An employee discharged for refusing to sign a confidentiality agreement was held to have left work voluntarily and to be ineligible for unemployment compensation in *Shrum v. Commonwealth, Unemployment Compensation Board of Review*, 690 A.2d 796 (Pa.Cmwlth. 1997), *appeal denied*, 548 Pa. 663, 698 A.2d 69 (1997).
- b. An employee discharged after failing to disclose that her employment violated a non-compete with a previous employer was not guilty of willful misconduct that would preclude unemployment compensation. *Zimmerman v. Commonwealth, Unemployment Compensation Board of Review*, 836 A.2d 1074 (Pa.Cmwlth. 2003).

D. **Basic Elements of a Non-Compete or Non-Solicitation Covenant**

1. **Description of circumstances of entry** – This provision should set forth the relationship between the parties and the consideration for entry into the covenant (e.g., commencement of a job, increase in compensation, etc.).

2. **Nature of restrictions** – The covenant will contain one of more of the restrictions discussed in Section I, B, above.

3. **Duration of restrictions** – The covenant will prohibit some or all the activities set forth in I, B for a period of time after the

employee leaves employment.

DRAFTING NOTE: The starting point for the durational restriction should be the end of employment, not the end of the contract, since an employment contract may expire before the end of actual employment. *See, e.g., Boyce v. Smith-Edwards-Dunlap Co.*, 398 Pa.Super. 345, 580 A.2d 1382 (1990), *appeal denied*, 527 Pa. 639, 650, 593 A.2d 413, 422 (1991); *Geisinger Clinic v. DiCuccio*, 414 Pa.Super. 85, 606 A.2d 509 (1992), *appeal denied*, 536 Pa. 625, 637 A.2d 285 (1993), *cert. denied*, 513 U.S. 1112, 115 S. Ct. 904 (1995). The covenant should also explicitly survive termination of the contract and the employee's employment.

4. **Geographic restrictions** typically prevent activities within a specified geographic area (e.g., within a 100-mile radius of Philadelphia, or within a 50-mile radius of any of the employer's offices). These are less typical in non-solicitation clauses than non-competes because non-solicitation clauses typically focus on customers and employees rather than a geographic area. As such, non-solicitation clauses contain implied geographic limitations. *Bell Fuel Corp. v. Cattolico*, 375 Pa.Super. 238, 544 A.2d 450, 458 (1988), *appeal denied*, 520 Pa. 612, 554 A.2d 505 (1989).

5. **Assignability provisions** – In *Hess v. Gebhard & Co., Inc.*, 570 Pa. 148, 808 A.2d 912 (2002), the Pennsylvania Supreme Court held that, in a sale of assets, a restrictive covenant is not assignable to a purchasing business in the absence of a specific assignability provision in the covenant. *Compare Siemens Medical Solutions Health Services Corp. v. Carmelengo*, 167 F.Supp.2d 752 (E.D. Pa. 2001) (New owner's purchase of 100% of employer's stock did not constitute change in "employer" that would discharge employee from non-solicitation covenant). The courts will disfavor assignments without an airtight assignment clause. *Allegheny Anesthesiology Associates, Inc. v. Allegheny General Hospital*, 826 A.2d 886 (Pa.Super. 2003), *appeal denied*, 577 Pa. 684, 844 A.2d 550 (2004). For complete assignability, the restrictive covenant should explicitly be assignable; should bind and benefit successors and assigns; and any subsequent purchase or sale agreement should explicitly assign the restrictive covenants. *See Villanova Health Corp. v. Hawrylak*, 1998 WL 961374 (E.D. Pa. 1998). In addition, the employer must follow the contractually required procedure for assignment, or risk losing the right to enforce restrictions against the assignee. *Savage, Sharkey, Reiser*

*& Szulborski Eye Care Consultants v. Tanner*, 848 A.2d 150 (Pa.Super. 2004) (failure to notify employee of assignment precluded enforcement of non-compete).

6. **Enforcement tools** – A restrictive covenant may contain many more provisions designed to facilitate the employer’s enforcement of the covenant, including the following:

- a. **Consent to injunctive relief** – *See, e.g., Merrill, Lynch, Pierce, Fenner and Smith, Inc. v. Napolitano*, 85 F.Supp.2d 491 (E.D. Pa. 2000).
- b. **Provision for partial relief** – *See Worldwide Auditing Services, Inc. v. Richter*, 402 Pa. Super. 584, 587 A.2d 772 (1991). Although such a provision may help a court to modify the covenant, Pennsylvania law allows a court to reduce the scope of a restrictive covenant even without such a clause. *See, e.g., Sidco Paper Co. v. Aaron*, 465 Pa. 586, 351 A.2d 250 (1976); *Bell Fuel Corp. v. Cattolico*, *supra*.
- c. **Tolling provision** – The covenant should contain a “tolling” provision extending the covenant’s prohibitions in the event of violations by the employee. A typical tolling provision will postpone commencement of any restrictions until either the employee ceases all violations or a court enforces the restrictions. *See, e.g., Worldwide Auditing Services, Inc. v. Richter*, 402 Pa.Super. 584, 587 A.2d 772, 775 (1991). A tolling provision protects the employer against expiration of the covenant during the pendency of litigation, an event that will preclude enforcement of even a valid restrictive covenant. *See, e.g., Hayes v. Altman*, 438 Pa. 451, 266 A.2d 269 (1970).
- d. **Choice-of-law clause** – *See, e.g., BABN Technologies Corp. v. Bruno*, 1998 WL 720171 (E.D. Pa. 1998), recognizing the effect of a choice-of-law clause on the court’s power to modify a restrictive covenant.

- e. **Forum selection clause** – Courts will uphold a clause establishing Pennsylvania as a forum unless it is clearly unjust, or a product of fraud or coercion. *See Behavioral Health Industry News, Inc. v. Lutz*, 24 F.Supp.2d 401 (M.D. Pa. 1998); *compare Dentsply International, Inc. v. Benton*, 965 F.Supp. 574 (M.D. Pa. 1997) (invalidating forum selection clause).
- f. **Consent to (or waiver of objection to) personal jurisdiction** – *Behavioral Health Industry News, Inc. v. Lutz, supra*.

NOTE: This clause is important for the same reason that the forum selection clause is important. It is advisable to include a consent both to jurisdiction in specified courts and to a specified manner of service of process.

- g. **Consent to expedited discovery**
- h. **Arbitration clause** – In industries such as the securities industry, it is the practice to arbitrate all claims arising from employment, even the violation of restrictive agreements. Standard employment agreements in such industries include an arbitration clause. *See, e.g., Merrill, Lynch, Pierce, Fenner and Smith, Inc. v. Poore*, 2003 WL 21294995 (E.D. Pa. Feb. 20, 2003); *Merrill, Lynch, Pierce, Fenner and Smith, Inc. v. Rodger*, 75 F.Supp.2d 375 (M.D. Pa. 1999).
- i. **Consent to injunction as a carve-out from arbitration** – It is advisable, but not necessary in Pennsylvania, to allow the employer to bring a proceeding for an injunction against an ex-employee in addition to commencing arbitration. However, Pennsylvania courts will grant preliminary injunctive relief restraining violations of restrictive covenants pending arbitration, even without a contractual provision for injunctive relief. *Merrill, Lynch, Pierce, Fenner and Smith, Inc. v. Rodger*, 75 F.Supp.2d 375 (M.D. Pa. 1999); *Merrill, Lynch,*

*Pierce, Fenner and Smith, Inc. v. Moose*, 365 Pa.Super. 40, 528 A.2d 1351 (1987), *appeal denied*, 518 Pa. 641, 542 A.2d 1370 (1988).

- j. **Provision for payment of salary while restrictive covenant is effective** – See e.g., *Visual Software Solutions v. Managed Healthcare Associates*, 2001 WL 1159741 (E.D. Pa. Aug. 10, 2001).
- k. **Forfeiture clauses**, which may include the following:
  - (1) forfeiture of deferred compensation (*Fraser v. Nationwide Insurance Co., Inc.*, 334 F.Supp.2d 755 (E.D. Pa. 2004) (upholding forfeiture)); and
  - (2) forfeiture of stock appreciation (*Capozzi v. Latsha & Capozzi, P.C.*, 797 A.2d 314 (2002), *appeal denied*, 573 Pa. 670, 821 A.2d 586 (2003) (invalidating such a clause in a law firm agreement)).
- l. **Damages provisions**, which may include:
  - (1) provisions for an accounting of profits (*See DeMuth v. Miller*, 438 Pa.Super. 437, 652 A.2d 891 (1995), *appeal denied*, 542 Pa. 634, 665 A.2d 469 (1995), *cert. denied*, 516 U.S. 1114, 116 S.Ct. 916 (1996)); or
  - (2) a provision for liquidated damages (*Geisinger Clinic v. DiCuccio*, 414 Pa.Super. 85, 606 A.2d 509 (1992), *appeal denied*, 536 Pa. 625, 637 A.2d 285 (1993), *cert. denied*, 513 U.S. 1112, 115 S.Ct. 904 (1995)).
  - (3) NOTE: A provision for the award of damages is not inconsistent with the entry of an injunction (*See Bettinger v. Carl Berke Association, Inc.*, 455 Pa. 100, 314 A.2d 296 (1974); *Surya Systems, Inc. v. Sunku*,

2005 WL 1514225, \*2 (E.D. Pa. June 24, 2005); and *Judge Technical Services, Inc. v. Clancy*, 813 A.2d 879 (Pa. Super. 2002) (upholding damage award of over \$2 million)), although a plaintiff may elect to pursue only liquidated damages relief (*See Geisinger Clinic v. DiCuccio, supra*).

- m. **Provision for attorney's fees** – *See Judge Technical Services, Inc. v. Clancy, supra*.
- n. **Non-waiver clauses**, authorizing the employer to enforce restrictions even if the employer has earlier declined to do so.

## II. TRADE SECRET PROTECTION

### A. The Pennsylvania Uniform Trade Secrets Act

The new Pennsylvania Uniform Trade Secrets Act, 12 Pa.C.S. § 5301 *et seq.* (“PUTSA”), took effect on April 19, 2004. Pennsylvania became the 43<sup>rd</sup> state to adopt the Uniform Trade Secrets Act. PUTSA expands the definition of trade secrets and the available remedies for misappropriation of trade secrets in Pennsylvania.

#### 1. Uniform Trade Secrets Act Definitions of “Trade Secret”

- a.. A “trade secret” is defined as “information, including a formula, drawing, pattern, compilation including a customer list, program, device, method, technique or process that (1) derives independent economic value, actual or potential, from not being generally known to and not being readily ascertainable by proper means by other persons who can obtain economic value from disclosing or using the information and (2) is the subject of reasonable efforts under the circumstances to protect its secrecy. 12 Pa.C.S. § 5302.
- b. PUTSA’s definition of “trade secret” expands upon common law by including *customer lists* as a trade secret. Pennsylvania courts had not been uniformly

willing to recognize customer lists as trade secrets. Because the definition of “trade secret” requires that the information be “not generally known” and “not readily ascertainable by proper means”, customer lists that are a matter of general knowledge or that can readily be generated will still not be protected as trade secrets.

- c. Although PUTSA defines trade secrets more broadly than the Restatement and displaces conflicting common law regarding trade secrets (but not contractual remedies), Pennsylvania common law will provide guidance as cases are decided under the new Act. See “Practitioners’ Guide to the New Pennsylvania Trade Secret Law – Can You Keep a Secret? –The Pennsylvania Uniform Trade Secrets Act”, Saunders, Pennsylvania Bar Association Quarterly, October 2004.

## 2. **New Features of Trade Secret Protection Under PUTSA**

### a. **Substantive**

- (1) protection of “customer lists” – § 5302.
- (2) protection of items of “potential value” – § 5302. *Compare* definition under Restatement § 757, which required that the trade secret be “used in one’s business.”

### b. **Procedural**

- (1) injunctive relief – § 5303
  - (a) available against “actual or threatened misappropriation” (§ 5303(a)). This provision would appear to allow injunctive relief on the basis of “inevitable disclosure.”
  - (b) availability of both affirmative (§ 5303(c)) and prohibitive (§ 5303(a)) injunctive relief.

- (c) continuation of injunctive relief until the trade secret has ceased to exist (§ 5303(a)).
  - (d) ability to require payment of a royalty for continued use of the protected information (§ 5303(b)).
- (2) damages (§§ 5304-5305)
  - (a) recovery of both lost profits and unjust enrichment (§ 5304(a)).
  - (b) availability of punitive damages for willful and malicious misappropriation (§ 5304(b)).
  - (c) recoverability of attorney's fees for willful and malicious misappropriation or for certain bad faith conduct in litigation (§ 5305).
- (3) other procedural changes
  - (a) availability of secret proceedings including protective and nondisclosure orders, in camera hearings, and sealed records (§ 5306).
  - (b) three-year statute of limitations, running from the date of discovery or the date on which reasonable diligence would have led to discovery (§ 5307). NOTE: Although this three-year statute apparently replaces the two-year statute for injury to personal property under 42 Pa.C.S. § 5524(7), the need to act immediately to enjoin misappropriation of trade secrets makes a statute of limitations largely academic.

(4) pre-emption

Section 5308 of 12 Pa.C.S.A. provides for limited pre-emption of related tort claims that contain the same elements as misappropriation of a trade secret. Section 5308(a) provides, “except as provided in subsection (b), this chapter displaces conflicting tort, restitutionary and other law of this Commonwealth, providing civil remedies for misappropriation of a trade secret.” Section 5308(b) saves the following remedies from pre-emption: (1) contractual remedies, whether or not based on misappropriation of a trade secret; (2) other civil remedies that are not based upon misappropriation of a trade secret; or (3) criminal remedies, whether or not based upon misappropriation of a trade secret.

The practical effect of § 5308 will be to preclude certain ancillary tort claims (e.g., conversion) that mirror the claim for misappropriation of trade secrets).

**B. Common Law of Trade Secrets**

**1. Restatement definitions of trade secret**

a. Restatement of Torts, § 757, Comment b:

A trade secret may consist of any formula, pattern, device or compilation of information which is used in one’s business, and which “gives . . . an opportunity to obtain an advantage over competitors who do not know or use it. It may be a formula for a chemical compound, a process of manufacturing, treating or preserving materials, a pattern for a machine or other device, or a list of customers.”

b. Restatement of Unfair Competition, § 39, Comment d:

A trade secret can consist of a formula, pattern, compilation of data, computer program, device, method, technique, process, or other form of embodiment of economically valuable information. A trade secret can relate to technical matters such as the composition or design of a product, a method of manufacture, or the know-how necessary to perform a particular operation or service. A trade secret can also relate to other aspects of business operations such as pricing and marketing techniques or the identity and requirements of customers. (*See* Restatement of Unfair Competition § 42, Comment f). Although rights and trade secrets are normally asserted by businesses and other commercial enterprises, nonprofit entities such as charitable, educational, governmental, fraternal, and religious organizations can also claim trade secret protection for economically valuable information such as lists of prospective members or donors.

2. **Factors determining trade secret status** – The factors determining trade secret status tend to interlock. The courts have recognized the five following factors:

- a. the extent to which the information is known outside of the owner's business (*see, e.g.*, cases on customer lists, Section II, B, 4).
- b. the extent to which the information is known by employees and others involved in the employer's business. Secrecy need not be absolute; information may be disclosed on a need-to-know basis without losing trade secret status. *Greenberg v. Croydon Plastics Co.*, 378 F.Supp. 806 (E. D. Pa. 1974). There must be, at a minimum, an implied restriction on the trade secret's use. *Highland Tank & Mfg. Co. v. PS International, Inc.*, \_\_\_\_ F.Supp.2d \_\_\_\_, 2005 WL 2125977, \*4 (W.D. Pa. Aug. 30, 2005).
- c. the extent of measures taken by the owner to guard the secrecy of the information. *See Greenberg v. Croydon Plastics Co.*, *supra*.

- d. the value of the information to the owner and to competitors.
- e. the amount of effort or money expended by the owner in developing the information. *See, e.g. Christopher M's Hand Poured Fudge, Inc. v. Hennon*, 699 A.2d 1272 (Pa.Super. 1997) (\$140,000 to develop the fudge recipe).
- f. the ease or difficulty with which the information could be properly acquired by others.

*See Christopher M's Hand Poured Fudge, Inc., supra; O.D. Anderson, Inc. v. Cricks*, 815 A.2d 1063 (Pa.Super. 2003).

### 3. Sources of trade secret protection

- a. An employee's duty not to disclose trade secrets may arise from either a confidential relationship between the employer and employee or an express agreement. *Felmler v. Lockett*, 466 Pa. 1, 351 A.2d 273 (1976); *Morgan's Home Equipment Corp. v. Martucci*, 390 Pa. 618, 136 A.2d 838 (1957).
- b. An attorney-client relationship can provide the necessary confidentiality to establish trade secret protection, even for items within the public's knowledge. *The Hyman Companies, Inc. v. Brozost*, 964 F.Supp. 168 (E.D. Pa. 1997).
- c. An express contract can provide added trade secret protection, and will also document the confidentiality of certain information. *See, e.g., Bell Fuel Corp. v. Cattolico*, 375 Pa.Super. 238, 544 A.2d 450 (1988), *appeal denied*, 520 Pa. 612, 554 A.2d 505 (1989); *Merrill, Lynch, Pierce, Fenner and Smith, Inc. v. Napolitano*, 85 F.Supp.2d 491 (E.D. Pa. 2000) (agreement to give trade secret status to customer information); *Air Products and Chemicals, Inc. v. Inter-Chemical, Ltd.*, 2003 WL 22917491, \*9 (E.D. Pa. Dec. 2, 2003). A confidentiality agreement does not by itself establish

trade secret status. *Iron Age Corp. v. Dvorak*, \_\_\_\_\_ A.2d \_\_\_\_\_, 2005 WL 1744664 (Pa.Super. July 26, 2005).

- d. Matters of public knowledge or general knowledge of the trade do not constitute trade secrets. *See Macbeth-Evans Glass Co. v. Schnellbach*, 239 Pa. 76, 86 A. 688 (1913). The information must be the employer's actual trade secret and not a mere general trade practice. *Felmler v. Lockett*, 466 Pa. 1, 351 A.2d 273 (1976). However, a trade secret need not be more than a slight mechanical advance over common knowledge and practice in the art. *Greenberg v. Croydon Plastics Co.*, 378 F.Supp. 806 (E.D. Pa. 1974).

NOTE: Otherwise secret information is not placed in the public domain when it is placed in the trash; therefore an action for theft of trade secrets from the trash is possible. *CDI International, Inc. v. Marck*, 2005 WL 146890 (E.D. Pa. Jan. 21, 2005).

- e. An employee's aptitude, know-how, manual and mental ability, people skills, experience, general knowledge, memory, and knowledge acquired during tenure in a particular field do not constitute trade secrets. *Mettler Toledo, Inc. v. Acker*, 908 F.Supp. 240 (M.D. Pa. 1995); *Diversey Lever, Inc. v. Hammond*, 1997 WL 28711 (E.D. Pa. 1997), *aff'd*, 116 F.3d 467 (3d Cir. 1997); *Coventry First, LLC v. Ingrassia*, 2005 WL 1625042, \*10 (E.D. Pa. July 11, 2005). Nor do an employee's personal business contacts, even those made during service to an employer. *National Risk Management, Inc. v. Bramwell*, 819 F.Supp. 417, 431 (E.D. Pa. 1993).

#### 4. **Subjects of trade secret protection**

##### a. **Customer information**

- (1) Confidential customer lists or information are protectible trade secrets; the employer must show that the information is not

publicly available or obtainable through legitimate means, and that the employer invested a material amount of time and money in developing the information.

Courts have applied these principles to protect the following customer information:

- (a) route salesman/collector's customer information, even if used by memory with new employer (*Morgan's Home Equipment Corp. v. Martucci*, 390 Pa. 618, 136 A.2d 838 (1957)).
- (b) security alarm firm's information about customers' businesses (*Robinson Electric Supervisory Co. v. Johnson*, 397 Pa. 268, 154 A.2d 494 (1959)).
- (c) A medical practice's referral base was held to be a trade secret that would support the enforcement of a non-compete but only in the geographic area in which actual competition existed. (*Wellspan Health v. Bayliss*, 869 A.2d 990 (Pa.Super. 2005)).
- (d) a dental firm's patient list (*In re Phoenix Dental Systems, Inc.*, 144 B.R. 22 (Bankr. W.D. Pa. 1992). The Court held that the patients' names were not ascertainable from an outside service; were the firm's most valuable asset; and were developed through efforts of the firm at the firm's place of business and with the firm's equipment. The court allowed the dentist to retain personal friends and relatives as patients but prevented the dentist from access to any other patients (even those

generated by his own contacts and efforts) because the patients came to the dentist as a result of the firm's facilities and services.

- (e) a dermatology practice's patient list. The court upheld the list's trade secret status on the ground that the medical records were confidential. *Pollack v. Skinsmart Dermatology & Aesthetic Center*, 68 Pa. D.&C.4<sup>th</sup> 417 (Phila. Co. 2004). The court upheld the list's trade secret status on the ground that the medical records were confidential.
  - (f) a tour bus operator's customer lists (*O.D. Anderson, Inc. v. Cricks*, 815 A.2d 1063 (Pa. Super. 2003)).
  - (g) an insurance agency's information on policy renewals (*Alexander & Alexander, Inc. v. Drayton*, 378 F.Supp. 824 (E.D. Pa. 1974), *aff'd*, 505 F.2d 729 (3d Cir. 1974)).
  - (h) an insurance firm's customer directory including customer data, charges, and renewal dates (*A. M. Skier Agency, Inc. v. Gold*, 747 A.2d 936 (Pa. Super. 2000)).
  - (i) a chemical manufacturer's password protected list of customers (*Air Products and Chemicals, Inc. v. Inter-Chemical, Ltd.*, 2003 WL 22917491, \*10 (E.D. Pa. Dec. 2, 2003)).
- (2) Customer lists or information are not protectible trade secrets if the information is widely known or readily ascertainable from an independent source, or from the

employee's own efforts. Therefore, courts have refused to protect the following customer information:

- (a) a customer list that is posted on a business' website (*American Hearing Aid Associates, Inc. v. GN Resound North America*, 309 F.Supp.2d 694 (E. D. Pa. 2004)).
  - (b) route listings in the dairy business (*Carl A. Colteryahn Dairy, Inc. v. Schneider Dairy*, 415 Pa. 276, 203 A.2d 469 (1964)).
  - (c) names and styling preferences memorized by hairdresser (*Renee Beauty Salons v. Blose-Venable*, 438 Pa.Super. 601, 652 A.2d 1345 (1995)).
  - (d) a list of agricultural customers of trucking firms, widely known throughout the industry (*Agra Enterprises, Inc. v. Brunozzi*, 302 Pa.Super. 166, 448 A.2d 579 (1982)).
  - (e) list compiled on salesman's own, largely through trade journals and telephone directories (*Spring Steels, Inc. v. Molloy*, 400 Pa. 354, 162 A.2d 370 (1960)).
  - (f) a list of hiring contacts at law firms, which could be compiled simply by calling the firms. (*Robert Half of PA, Inc. v. Feight*, 48 Pa.D.&C.4<sup>th</sup> 129, 155 (C.C.P. Philadelphia Co. 2000)).
- (3) An employee who brings customers to a business from a firm that the employee

owned may have the freedom to later leave the business with those same customers. *See, e.g., Fidelity Fund, Inc. v. DiSanto*, 347 Pa.Super. 112, 500 A.2d 431 (1985) and *Keystone Dedicated Logistics Co. v. Bartmess*, 133 Fed. Appx. 817, 2005 WL 1122648 (3d Cir. May 12, 2005); *but see Merrill, Lynch, Pierce, Fenner and Smith, Inc. v. Napolitano*, 85 F.Supp.2d 491 (E.D. Pa. 2000) (employee may contractually “give up” customers); and *A. M. Skier Agency, Inc. v. Gold*, 747 A.2d 936 (Pa.Super. 2000) (employee cannot be viewed to have brought new customers to business where the employee was a staff employee subject to non-compete in earlier firm).

**b. Strategic, financial, or price information**

- (1) Information about a software company’s successful business strategy and methodology is protectible (*Omicron Systems, Inc. v. Weiner*, 860 A.2d 554 (Pa. Super. 2004)).
- (2) Information on a potential acquisition is protectible, particularly under the terms of a confidentiality agreement (*Den-Tal-EZ, Inc. v. Siemens Capital Corp.*, 389 Pa.Super. 219, 566 A.2d 1214 (1989)).
- (3) By contrast, a publicly available price list is not protectible (*Tyson Metal Products, Inc. v. McCann*, 376 Pa.Super. 461, 546 A.2d 119 (1988)), nor is price information that *could* be obtained readily from customers (*Olympic Paper Co. v. Dubin Paper Co.*, 60 Pa. D.&C.4<sup>th</sup> 102 (Phila. Co. 2000)).
- (4) A corporate counsel’s information on store leases, renewals, profitability, and plans for expansion were protected in *The Hyman Companies, Inc. v. Brozost*, 964 F.Supp. 168

(E.D. Pa. 1997) and 119 F.Supp.2d 499  
(E.D. Pa. 2000).

c. **Manufacturing processes / product preparation information** – Courts have protected the following items:

- (1) manufacturing processes for a specialized chemical (*Air Products and Chemicals, Inc. v. Inter-Chemical, Ltd.*, 2003 WL 22917491, \*11 (E.D. Pa. 2003));
- (2) recipes (*Christopher M's Hand Poured Fudge, Inc. v. Hennon*, 699 A.2d 1272 (Pa.Super. 1997); *Sweetzel, Inc. v. Hawk Hill Cookies, Inc.*, 1995 WL 550585 (E.D. Pa. Sept. 14, 1995));
- (3) packaging methods (*Uncle B's Bakery, Inc. v. O'Rourke*, 920 F.Supp. 1405 (N.D. Ia. 1996));
- (4) machine adjustments for producing chicken parts (*West Mountain Poultry Co. v. Gress*, 309 Pa.Super. 361, 365, 455 A.2d 651, 652-53 (1982)).

d. **Technical information** – Courts have protected the following information:

- (1) product or system design (*Ogontz Controls Co. v. Pirkle*, 346 Pa.Super. 253, 499 A.2d 593 (1985); *SI Handling Systems, Inc. v. Heisley*, 753 F.2d 1244 (3d Cir. 1985), *on remand*, 658 F.Supp. 362 (E.D. Pa. 1986)). A design of a structure or product item that is in public view and subject to reverse engineering is not entitled to trade secret status. *United Products Corp. v. Transtech Manufacturing, Inc.*, 2000 WL 33711051 (Phila. Co. Nov. 9, 2000).
- (2) computer programs (*Computer Print*

*Systems, Inc. v. Lewis*, 281 Pa.Super. 240, 422 A.2d 148 (1980)).

- (3) broad technical and marketing knowledge (*Air Products and Chemicals, Inc. v. Johnson*, 296 Pa.Super. 405, 442 A.2d 1114 (1982)).

## C. **Misappropriation**

### 1. **Generally**

The elements of a misappropriation claim are as follows:

- a. The information taken constitutes a trade secret.
- b. The information is of value to the employer and important in the conduct of the employer's business.
- c. By reason of discovery or ownership, the employer had the right to the use and enjoyment of the secret.
- d. The secret was communicated to the employee while employed in a position of trust and confidence under such circumstances as to make it inequitable and unjust for the employee to disclose it to others, or to make use of it to the prejudice of the employer (*O.D. Anderson, Inc. v. Cricks*, 815 A.2d 1063, 1072 (Pa.Super. 2003); *Sweetzel, Inc. v. Hawk Hill Cookies, Inc.*, 1995 WL 550585 (E.D. Pa. Sept. 14, 1995); *A.M. Skier, Inc. v. Gold*, 747 A.2d 936, 940 (Pa. Super. 2000)). *Compare In re Allegheny Health, Education and Research Foundation*, 1999 WL 1051211, \*8 (Bankr. E. D. Pa. Feb. 1, 2000) (no protectible interest where employer knew of patient list and failed to protect list).
- e. The trade secret has been misappropriated by being used or disclosed in breach of a confidence, with knowledge of the breach of confidence, and to the detriment of the employer (*Rohm and Haas Co. v. Adco Chemical Co.*, 689 F.2d 424 (3d. Cir. 1982); *see also College Watercolor Group, Inc. v. William*

*H. Newbauer, Inc.*, 468 Pa. 103, 360 A.2d 200 (1976) (use of misrepresentation to gain access to competitor's plant)).

## 2. Inevitable disclosure

The doctrine of “inevitable disclosure” may prohibit an ex-employee from working in a broad class of duties with a new employer if the ex-employee would inevitably disclose trade secrets of the former employer.

- a. Pennsylvania courts dealt with the issue of “inevitable disclosure” in *Air Products and Chemicals Company, Inc. v. Johnson*, 296 Pa.Super. 405, 442 A.2d 1114 (1982) in which the courts prohibited an ex-Air Products employee from using broad-based knowledge of the marketing and technical aspects of on-site delivery of industrial gases.
- b. In *Doebler's Pennsylvania Hybrids, Inc. v. Doebler Seeds, LLC.*, 88 Fed. Appx. 520 (3d Cir. 2004), the Third Circuit predicted that Pennsylvania courts would adopt the “inevitable disclosure” doctrine. The Third Circuit applied the doctrine and issued an injunction because the new employer included so many ex-employees of the entity seeking trade secret protection. *Doebler, supra*, 88 Fed. Appx. at 522.
- c. In *Pepsico, Inc. v. Redmond*, 54 F.3d 1262 (7<sup>th</sup> Cir. 1995), the 7<sup>th</sup> Circuit used the doctrine of inevitable disclosure to enjoin a former Pepsico executive from working on matters related to the marketing, pricing, and distribution of beverages with his new employer.
- d. By contrast, in *Oberg Industries, Inc. v. Finney*, 382 Pa.Super. 525, 555 A.2d 1324, 1326 (1989), the Pennsylvania Superior Court refused to impose the “inevitable disclosure” rule on a non-technical employee.
- e. Application to the internet industry – In *Earthweb*,

*Inc. v. Schlack*, 71 F.Supp.2d 299 (S.D. N.Y. 1999), the United States District Court refused to apply the doctrine of inevitable disclosure to prevent an employee from new employment with an internet company.

**D. Enforcement and Remedies**

**1. General criteria for preliminary injunction**

- a. **State court** – A preliminary injunction may be granted if:
- (1) that the activity that the plaintiff seeks to restrain is actionable, and the rights of the plaintiff are clear (i.e., plaintiff has a strong likelihood of success on the merits);
  - (2) an injunction is necessary to prevent irreparable harm which cannot be compensated by damages;
  - (3) greater injury would result by refusing the injunction than by granting it;
  - (4) the preliminary injunction properly restores the parties to the status that existed immediately prior to the alleged wrongful conduct;
  - (5) the injunction is reasonably suited to abate the offending activity; and
  - (6) that a preliminary injunction will not adversely affect the public interest. *Iron Age Corp. v. Dvorak*, \_\_\_\_\_ A.2d \_\_\_\_\_, 2005 WL 1744664 (Pa.Super. July 26, 2005) (denying injunction).

NOTE: Pennsylvania courts treat a special or preliminary injunction as a drastic remedy, tantamount to a judgment and execution before trial; therefore, courts will grant injunctions sparingly, and

only in the strongest cases. *See Herman v. Dixon*, 393 Pa. 33, 36, 141 A.2d 576, 577 (1958).

b. **Federal court** – Under F.R.C.P. 65, the showings required for a preliminary injunction and for a temporary restraining order are essentially identical. The moving party must demonstrate:

- (1) a likelihood of success on the merits;
- (2) the probability of irreparable harm if the relief is not granted;
- (3) granting the relief will not result in greater harm to another party; and
- (4) granting the relief is consistent with the public interest (*Air Products and Chemicals, Inc. v. Inter-Chemical, Ltd.*, 2003 WL 22917491, \*8 (E.D. Pa. Dec. 2, 2003); *Merrill, Lynch, Pierce, Fenner and Smith, Inc. v. Napolitano*, 85 F.Supp.2d 491 (E.D. Pa.) (public interest served by enforcing contracts)).

## 2. **Defenses**

- a. The trade secret does not exist (e.g., it originated from public sources or is generally known in the business).
- b. The ex-employer does not have the right to the secrets.
- c. The trade secret was not communicated or kept in confidence (*see, e.g., In re Allegheny Health, Education and Research Foundation*, 1999 WL 1051211, \*8 (Bankr. E. D. Pa. Feb. 1, 2000)).
- d. The defendant independently developed the information or is merely using its own general knowledge, not specific confidential information. *See Moore v. Kulicke & Soffa Industries, Inc.*, 318

F.3d 561 (3d Cir. 2002) (once defendant raises independent development, even in a denial of plaintiff's allegations, plaintiff must prove that no independent development took place).

- e. unclean hands.
- f. Any equitable defenses regarding harm.

3. **Compensatory damages** – Under Pennsylvania law, compensatory damages need to be computed with reasonable certainty (*Scobell, Inc. v. Schade*, 455 Pa.Super. 414, 688 A.2d 715, 718-19 (1997)). In restrictive covenant cases, damages are often difficult to ascertain (*Judge Technical Services, Inc. v. Clancy*, 813 A.2d 879 (Pa. Super. 2002); *Records Center, Inc. v. Comprehensive Management, Inc.*, 363 Pa.Super. 79, 525 A.2d 433 (1987)).

Among the elements recognized as possible damages in restrictive covenant, trade secret, and unfair competition cases are the following:

- a. lost profits (*Scobell, Inc. v. Schade, supra*; *Certified Laboratories of Texas, Inc. v. Rubinson*, 303 F.Supp. 1014 (E.D. Pa. 1969); *Medical Broadcasting, Inc. v. Flaiz*, 2003 WL 22838094 (E.D. Pa. Nov. 25, 2003) (recognizing right to accounting for lost profits); *Sweetzel, Inc. v. Hawk Hill Cookies, Inc.*, 1996 WL 434012 (E.D. Pa. July 30, 1996));
- b. lost orders (*Certified Laboratories of Texas, Inc. v. Rubinson, supra* (holding damages obtainable but proof deficient));
- c. lost goodwill (*Certified Laboratories of Texas, Inc. v. Rubinson, supra* (holding damages obtainable but proof deficient));
- d. lost client revenues (*Joseph D. Shein, P.C. v. Myers*, 394 Pa.Super. 549, 576 A.2d 985 (1990), *appeal denied*, 533 Pa. 600, 617 A.2d 1274 (1991));

- e. development costs for trade secrets (*Computer Print Systems, Inc. v. Lewis*, 281 Pa.Super. 240, 422 A.2d 148 (1980));
- f. loss of property converted (*Sweetzel, Inc. v. Hawk Hill Cookies, Inc.*, 1996 WL 434012 (E.D. Pa. July 30, 1996)).

4. **Attorneys fees** are recoverable in accordance with the terms in any contract. See *Profit Wize, Inc. v. Wiest*, 812 A.2d 1270 (Pa. Super. 2002) (no recovery of attorneys fees available to “prevailing” party if case is settled).

5. **Punitive damages** – See generally, *Joseph D. Shein, P.C. v. Myers, supra*; *Certified Laboratories of Texas, Inc. v. Rubinson, supra*; *Sweetzel, Inc. v. Hawk Hill Cookies, Inc., supra*.

6. **Contempt sanctions** may be imposed where (1) a valid court order exists; (2) the party using trade secrets had knowledge of the order; and (3) this party violated the order. *Air Products and Chemicals, Inc. v. Inter-Chemical, Ltd.*, 2005 WL 196543 (E.D. Pa. Jan. 27, 2005); *Mrozek v. James*, 780 A.2d 670 (Pa. Super. 2001).

### III. DUTY OF LOYALTY

#### A. The Law of Agency

Under Pennsylvania law, employees and many independent contractors are agents of the hiring entity. An agent owes a duty of loyalty to the principal (the employer or hiring entity) to act solely for the benefit of the principal in all matters connected with the agency. An agent is subject to a duty not to compete with the principal concerning the subject matter of the Agency. Restatement (Second), Agency § 393.

1. In furtherance of this duty, the agent must disclose all actual or potential business opportunities to the principal during the term of the agency, and may not take personal advantage of such business opportunities. See Restatement (Second), Agency § 393 *et seq.*; *SHV Coal, Inc. v. Continental Grain Co.*, 376 Pa.Super. 241, 545 A.2d 917 (1988), *reversed in part on other grounds*, 526 Pa. 489, 587 A.2d 702 (1991).

2. After the termination of the agency, an agent has a duty to the principal not to take advantage of a still subsisting confidential relation created during the prior agency. *See Adler, Barish, Daniels, Levin & Creskoff v. Epstein*, 482 Pa. 416, 393 A.2d 1175 (1978).

3. An agent who is employed at will does not violate a fiduciary duty by preparing to compete while still employed. *United Aircraft Corporation v. Boreen*, 413 F. 2d 694, 700 (3d Cir. 1969).

#### **B. Elements of a Claim for Breach of Fiduciary Duty**

The elements a plaintiff must prove for a claim of breach of fiduciary duty are (1) that the defendant negligently or intentionally failed to act in good faith and solely for the benefit of plaintiff in all matters for which he or she was employed; (2) that the plaintiff suffered injury; and (3) that the agent's failure to act solely for the plaintiff's benefit was a real factor in bringing about plaintiff's injuries. *First American Marketing Corp. v. Canella*, 2004 WL 250537,\*8 (E.D. Pa. Jan. 26, 2004).

#### **C. Examples of Fiduciary Duty Violations**

A violation of an agent's fiduciary duty typically occurs right before an agent leaves an employment or contractual engagement, when the agent diverts business from a client or customer of the old principal to benefit the new principal. Specific examples include the following:

1. Diversion of a customer contract. *See SHV Coal, Inc. v. Continental Grain Co.*, *supra*.
2. Solicitation of a firm's clients. *See Adler, Barish, Daniels, Levin & Creskoff v. Epstein*, 482 Pa. 416, 393 A.2d 1175 (1978).
3. Solicitation of other employees in violation of a directive not to do so (*see CGB Occupational Therapy, Inc. v. REA Health Services, Inc.*, 357 F.3d 375 (3d Cir. 2004)) or in a conspiracy to divert business (*see, e.g., Reading Radio, Inc. v. Fink*, 833 A.2d 199, 211 (Pa.Super. 2003), *appeal denied*, 577 Pa. 723, 847 A.2d 1287 (2004); *Frederick Chusid & Co. v. Marshall Leeman & Co.*, 279 F.Supp. 913 (S.D. N.Y. 1968)).
4. Refusal to enforce non-compete covenants against departing

employees. *Reading Radio, Inc. v. Fink, supra.*

5. Deliberate provision of inferior products or service while working for an employer, resulting in a weakening of the employer's competitive position. *The New L&N Sales and Marketing, Inc. v. Menaged*, 1998 WL 575270, \*7 (E.D. Pa. 1998).

6. Diversion of principal's funds and inventory and use of principal's employees to benefit agent's own business ventures. *McDermott v. Party City Corp.*, 11 F.Supp.2d 612 (E.D. Pa. 1998).

7. Obtaining hidden commissions on business provided to employer's competitors, rather than to employer. *Katz v. Food Sciences Corp.*, 2000 WL 1022986 (E. D. Pa. 2000).

#### D. Remedies

An agent's breach of fiduciary duty will enable the principal to obtain the following compensation:

1. An accounting of the agent's profits from the breach.
2. Compensatory damages.
3. Punitive damages.
4. Repayment of compensation paid to the disloyal agent beginning on the date of the agent's breach.

*See SHV Coal, Inc. v. Continental Grain Co.*, 376 Pa.Super. 241, 545 A.2d 917, 924 (1988), *reversed in part*, 526 Pa. 489, 587 A.2d 702 (1991).

## IV. TORT LIABILITY

### A. Limitations on Tort Relief – The “Gist of the Action Doctrine”

The “gist of the action doctrine” prohibits an independent tort action that

arises solely from the violation of a contract, even a contract to protect trade secrets. *See Bohler-Uddeholm America, Inc. v. Ellwood Group, Inc.*, 247 F.3d 79 (3d. Cir. 2001), *cert. denied*, 534 U.S. 1162, 122 S.Ct. 1173 (2002). The “gist of the action” rule will not preclude a tort action where the defendant’s conduct violates some additional duty that is distinct from the obligations the defendant accepted by entering into the contract. *See Koresko v. Bleiweis*, 2004 WL 3048760 (E.D. Pa. Dec. 30, 2004); *Flynn v. Health Advocate, Inc.*, 2004 WL 51929 (E.D. Pa. Jan. 13, 2004). Such additional breaches may include a breach of the duty of good faith and fair dealing (*see Koresko, supra* at \*3).

**B. Intentional Interference With Existing or Prospective Contractual Relations**

**1. Elements of cause of action**

a. The elements of an intentional interference claim are:

- (1) the existence of an actual or prospective contract;
- (2) the defendants’ purpose or intent to harm the plaintiff by preventing completion of the contract;
- (3) improper conduct (i.e., absence of privilege) on the part of defendants; and
- (4) harm resulting from the defendants’ actions.

*Reading Radio, Inc. v. Fink*, 833 A.2d 199, 211 (Pa. Super. 2003), *appeal denied*, 577 Pa. 723, 847 A.2d 1287 (2004).

b. One who, without a privilege to do so, induces or purposely causes a third party (not the party’s employer) not to (a) perform a contract with another or (b) enter into or continue a business relation with another, is liable to the other for the harm caused thereby. Restatement (Second) of Torts (1979), § 766; *Adler, Barish, Daniels, Levin & Creskoff v. Epstein*, 482 Pa. 416, 393 A.2d 1175, 1182 (1978).

- c. The tort of intentional interference can arise where a new employer or key employee encourages employees or customers to leave a business. *See, e.g., National Risk Management, Inc. v. Bramwell*, 819 F.Supp. 417, 433 (E.D. Pa. 1993); *Morgan's Home Equipment Corp. v. Martucci*, 390 Pa. 618, 633, 634, 136 A.2d 838, 847 (1957) .
- d. Absence of privilege (i.e., an improper purpose) may be inferred from an employee's breach of a duty of loyalty to an employer. *See Adler, Barish, Daniels, Levin & Creskoff v. Epstein, supra*, 393 A.2d at 1184-1185.

## 2. **Intentional interference issues in inducing employees to leave employer**

- a. Offering employment to another employer's at-will employee is not actionable by itself (*Morgan's Home Equipment Corp. v. Martucci*, 390 Pa. 618, 136 A.2d 838 (1957)).
- b. The systematic inducement of employees to leave their present employment and work with another is unlawful when the purpose is to cripple and destroy an integral part of a competitive business or organization, rather than to obtain the services of particularly gifted or skilled employees (*Morgan's Home Equipment Corp. v. Martucci*, 390 Pa. at 633-634, 136 A.2d at 847).
- c. It is actionable to induce employees to commit wrongs, such as disclosing a former employer's trade secrets or enticing away a former employer's customers (*Morgan's Home Equipment Corp. v. Martucci, supra*; *Albee Homes, Inc. v. Caddie Homes, Inc.*, 417 Pa. 177, 207 A.2d 768 (1965)).

## 3. **Remedies**

An employer may obtain both compensatory and punitive damages and equitable relief in an action for

tortious interference with contractual relations. *Reading Radio, Inc. v. Fink*, 833 A.2d 199 (Pa. Super. 2003), *appeal denied*, 577 Pa. 723, 847 A.2d 1287 (2004); *Joseph D. Shein, P.C. v. Myers*, 394 Pa. Super. 549, 576 A.2d 985, 988 (1990), *appeal denied*, 533 Pa. 600, 617 A.2d 1274 (1991).

C. **Conversion**, under Pennsylvania law, is the deprivation of another's right to property, or use or possession of property, or other interference with property without the owner's consent, and without legal justification. In *Prudential Insurance Co. of America v. Stella*, 994 F.Supp. 308, 323 (E.D. Pa. 1998), the court held that a departing employee's removal of, and failure to return, client files and documents and computer equipment constituted conversion. Theft of trade secrets may give rise to a conversion claim. *Homenexus, Inc. v. Directweb, Inc.*, 1999 WL 959823, \*3 (E.D. Pa. Oct. 14, 1999).

D. **Unfair competition** claims arise in restrictive covenant/ trade secret contexts under both state common law and Section 43(a) of the Lanham Act, 15 U.S.C. § 1125, as follows:

1. A claim for unfair competition arises under the Federal Lanham Act, when an ex-employee passes off goods and services as those of the ex-employer by virtue of substantial similarity, leading to confusion on the part of potential customers. *See Prudential Insurance Co. of America v. Stella*, 994 F.Supp. 308, 322 (E.D. Pa. 1998).

2. More broadly, ex-employers sometimes sue for unfair competition for employee piracy, or to backstop other claims for appropriation of customers or trade secrets. (*See Air Products and Chemicals, Inc. v. Inter-Chemical, Ltd.*, 2003 WL 22917491, \*11-13 (E.D. Pa. Dec. 2, 2003)).

E. **Unjust enrichment** – Unjust enrichment claims are generally an alternate means of stating a trade secret, fiduciary duty, or conversion claim. *Homenexus, Inc. v. Directweb, Inc.*, 1999 WL 959823 (E.D. Pa. 1999). In Pennsylvania, to sustain a claim for unjust enrichment, a plaintiff must show:

1. a benefit conferred upon one party by another;
2. appreciation of the benefit by the recipient; and

3. retention of the benefit under circumstances that would be unjust. The remedy for unjust enrichment is the imposition of a constructive trust on the benefit to the defendant.

F. **Conspiracy** – A claim for conspiracy is an ancillary tort claim when a departing employee acts improperly. Under Pennsylvania law, a “conspiracy” is a combination of two or more persons acting with a common purpose to do an unlawful act or to do an otherwise lawful act by unlawful means for an unlawful purpose, an overt act done in pursuant of the common purpose, and actual legal damage. *Reading Radio, Inc. v. Fink*, 833 A.2d 199, 212-213 (Pa.Super. 2003), *appeal denied*, 577 Pa. 723, 847 A.2d 1287 (2004).

1. Proof of malice is an essential part of a cause of action for conspiracy. *The New L&N Sales and Marketing, Inc. v. Menaged*, 1998 WL 575270, \*6 (E.D. Pa. 1998).

2. Lawful competition does not constitute a conspiracy. *See Agra Enterprises, Inc. v. Brunozzi*, 302 Pa.Super. 166, 448 A.2d 579 (1982).

3. A corporate entity cannot conspire with its own agents. *Reading Radio, Inc. v. Fink, supra; Patient Transfer Systems, Inc. v. Patient Handling Solutions, Inc.*, 1999 WL 54568 (E.D. Pa. 1999).

G. **Misuse of Confidential Business Information** – Even in the absence of a trade secret claim, an entity that suffers a wrongful loss of confidential information to a competitor may bring an action for misuse of confidential information. *See Pestco, Inc. v. Associated Products, Inc.*, \_\_\_ A.2d \_\_\_, 2005 WL 1792194 (Pa. Super. Jul. 29, 2005). In *Pestco*, a business obtained its competitor’s bills of lading through improper means from the trucking company that both competitors shared. The court refused to protect the information as trade secrets but held that the customer identities and classification of the goods being shipped on the bills of lading was confidential business information. *See Pestco, supra*, at \*6. Under Restatement of Torts, § 759, liability exists for the harm caused by a business’ procuring information about another’s business by improper means.

H. **Fraud** – Misrepresentations to an employer concerning an employee’s purposes in obtaining confidential or trade secret information

may constitute fraud. *See Flynn v. Health Advocate, Inc.*, 2004 WL 51929, \*9 (E.D. Pa. Jan. 13, 2004). The elements of fraud or misrepresentation claim include: (a) misrepresentation of a material fact, (b) under circumstances in which the misrepresenter ought to have known its falsity, (c) with the intent to induce another to act on it, (d) justifiable reliance by the other party, (e) damages to the victim. In *Firsttrust Bank v. Didio*, 2005 WL 2001105 (Phila. Co. 2005), the court refused to dismiss a fraud claim by a bank on the basis of disclosure statements filed by bank employees concerning conflicting interests, which concealed their establishment of a competing business.

I. **Defamation** – The elements of a claim for defamation are: (1) the defamatory character of a communication, (2) publication by the defendant, (3) its application to the plaintiff, (4) understanding by the recipient of its defamatory meaning, (5) the understanding by the recipient of it as intended to be applied to the plaintiff, (6) special harm resulting to the plaintiff from its publication, (7) abuse of a conditionally privileged occasion.

Defamation claims arise in the context of violation of post-employment restraints when an ex-employee (or new employer) makes statements about the character or financial status of the ex-employer. For example, in *Pennfield Precision, Inc. v. EF Precision, Inc.*, 2000 WL 1201381 (E.D. Pa. Aug. 15, 2000), the court held that a cause of action for defamation existed where a competitor told a customer that another competitor was “going out of business.”

J. **Business Disparagement** – A claim for business disparagement arises from an attack on the nature, extent, or quality of services rendered by a competitor, rather than the competitor’s character or reputation. *See Sweetzel, Inc. v. Hawk Hill Cookies, Inc.*, 1995 WL 550585 (E.D. Pa. Sept. 14, 1995).

## V. “RAIDING” OR GROUP HIRES

“Raiding” or “group hiring” is a species of unfair business competition that has attracted increased attention recently, particularly with the increase of “body shops” or staffing agencies that employ whole groups of individuals who serve clients. “Raiding” is not a separate tort, but rather actionable conduct that can give rise to multiple contract and tort claims, including: (1) breach of a restrictive covenant; (2) intentional interference with contractual relations; (3) breach of fiduciary duty; (4) unfair competition and (5) civil conspiracy. The long-standing standard for what is and is not

legitimate in “raiding” cases is set forth in *Reading Radio, Inc. v. Fink*, 833 A.2d 199, 211-212 (Pa.Super. 2003), as follows:

Offering employment to another company’s at-will employees is not actionable in and of itself. *Albee Homes, Inc. v. Caddie Homes, Inc.*, 417 Pa. 177, 182, 207 A.2d 768, 771 (1965). However, systematically inducing employees to leave their present employment is actionable “when the purpose of such enticement is to cripple and destroy an integral part of a competitive business organization rather than to obtain the services of a particularly gifted or skilled employees.” *Albee Homes, Inc., supra*, at 182, 207 A.2d at 771 (quoting *Morgan’s Home Equipment Corp. v. Martucci*, 390 Pa. 618, 63-634, 136 A.2d 838, 847 (1957)). Further, when the inducement is made for the purpose of having the employees commit wrongs, such as disclosing their former employer’s trade secrets or enticing away his customers, the injured employer is entitled to protection. *Albee Homes, Inc., supra*.

In recent years, courts have upheld claims for “raiding” in *CGB Occupational Therapy, Inc. v. REA Health Services, Inc.*, 357 F.3d 375 (3d Cir. 2004), in which a managing agent of nursing home facilities diverted employees of a provider of rehabilitation therapy services to another provider, in violation of specific instructions not to do so; *Nutrition Management Services Co. v. Harborside Health Care Corp.*, 2005 WL 1176048 (E.D. Pa. 2005), in which an owner/operator of long term care facilities hired ex-employees of a food service provider despite non-compete agreements in the employees’ contract, and in which the court upheld an award of \$2.5 million in damages; *Reading Radio v. Fink, supra*, in which the court upheld an award of over \$1 million in damages against a radio station that systematically raided its competitor by hiring an individual who continued to work at the competitor, who then facilitated the departure of several employees of the competitor to the defendant radio station, in violation of the employees’ non-competes; and *Unisys Corp. v. Entex Information Services*, 45 D.&C.4<sup>th</sup> 405 (Montg. Co. 2000), following a broad based solicitation and hiring of Unisys employees by a competitor in violation of a restrictive covenant.

A different result occurred in *Allegheny Anesthesiology Associates, Inc. v. Allegheny General Hospital*, 826 A.2d 886 (Pa.Super. 2003), *appeal denied*, 577 Pa. 684, 844 A.2d 550 (2004), in which an anesthesiology

practice tried to enjoin a local hospital from directly employing a group of nurse anesthetists whom the agency had provided to the hospital under a staffing contract. After failing to renew its contract with the hospital, the anesthesiology practice sought to force the nurse anesthetists to either work for a new hospital or pay the employer two years' salary to buy out the 24-month non-compete in the nurse anesthetists' contract. The hospital that had had the contract with the staffing agency wished to hire the nurse anesthetists as employees. The nurse anesthetists intervened in the litigation on the side of this hospital, and obtained an injunction against enforcement of the non-compete covenants, on the ground that there were no reasonable grounds for enforcement of the restrictive covenant because of the absence of an assignment clause and because of the harm to the nurses and the public if the nurses were prevented from continuing to work at the hospital.