



RESTATEMENT OF THE LAW THIRD EMPLOYMENT LAW

Preliminary Draft No. 7
(August 24, 2010)

SUBJECTS COVERED

- CHAPTER 3 Employment Contracts: Compensation and Benefits
(black letter and commentary) (revised)
- CHAPTER 5 Employer Liability for Harm to Employees: General Principles
(black letter and commentary) (revised)
- CHAPTER 6 Other Torts Affecting the Formation or Continuation of the
Employment Relationship (revised)
- CHAPTER 8 Employee Obligations and Restrictive Covenants (revised)

THE EXECUTIVE OFFICE
THE AMERICAN LAW INSTITUTE
4025 Chestnut Street
Philadelphia, PA 19104-3099
Telephone: (215) 243-1626 • Fax: (215) 243-1636
E-mail: ali@ali.org • Website: <http://www.ali.org>

©2010 BY THE AMERICAN LAW INSTITUTE
ALL RIGHTS RESERVED

This document is submitted to the Members Consultative Group for their meeting on September 11 (at 10:00 a.m.), 2010, and to the Advisers for their meeting on September 12 (at 9:00 a.m.), 2010, both meetings at ALI Headquarters, 4025 Chestnut Street, Philadelphia, Pennsylvania. As of the date it was printed, it had not been considered by the Council or membership of The American Law Institute, and therefore does not represent the position of the Institute on any of the issues with which it deals.

The American Law Institute

MICHAEL TRAYNOR, *Chair of the Council and President Emeritus*

ROBERTA COOPER RAMO, *President*

ALLEN D. BLACK, *1st Vice President*

DOUGLAS LAYCOCK, *2nd Vice President*

CAROLYN DINEEN KING, *Treasurer*

SUSAN FRELICH APPLETON, *Secretary*

LANCE LIEBMAN, *Director*

STEPHANIE A. MIDDLETON, *Deputy Director*

COUNCIL

KENNETH S. ABRAHAM, University of Virginia School of Law, Charlottesville, VA

SHIRLEY S. ABRAHAMSON, Supreme Court of Wisconsin, Madison, WI

SUSAN FRELICH APPLETON, Washington University School of Law, St. Louis, MO

KIM J. ASKEW, K&L Gates, Dallas, TX

JOSÉ I. ASTIGARRAGA, Astigarraga Davis, Miami, FL

JOHN H. BEISNER, Skadden, Arps, Slate, Meagher & Flom, Washington, DC

SHEILA L. BIRNBAUM, Skadden, Arps, Slate, Meagher & Flom, New York, NY

ALLEN D. BLACK, Fine, Kaplan & Black, Philadelphia, PA

AMELIA H. BOSS, Drexel University Earle Mack School of Law, Philadelphia, PA

WILLIAM M. BURKE, Shearman & Sterling (retired), Costa Mesa, CA

ELIZABETH J. CABRASER, Lieff Cabraser Heimann & Bernstein, San Francisco, CA

EDWARD H. COOPER, University of Michigan Law School, Ann Arbor, MI

N. LEE COOPER, Maynard, Cooper & Gale, Birmingham, AL

MARY B. CRANSTON, Pillsbury Winthrop Shaw Pittman, San Francisco, CA

GEORGE H. T. DUDLEY, Dudley, Topper and Feuerzeig, St. Thomas, U.S. VI

CHRISTINE M. DURHAM, Supreme Court of Utah, Salt Lake City, UT

KENNETH C. FRAZIER, Merck & Co., Inc., Whitehouse Station, NJ

PAUL L. FRIEDMAN, U.S. District Court, District of Columbia, Washington, DC

ANTON G. HAJJAR, O'Donnell, Schwartz & Anderson, Washington, DC

CONRAD K. HARPER, Simpson Thacher & Bartlett, New York, NY

GEOFFREY C. HAZARD, JR.*, University of California, Hastings College of the Law,

San Francisco, CA; University of Pennsylvania Law School, Philadelphia, PA

GAIL K. HILLEBRAND, Consumers Union of the United States, Inc., San Francisco, CA

D. BROCK HORNBY, U.S. District Court, District of Maine, Portland, ME

WILLIAM C. HUBBARD, Nelson Mullins Riley & Scarborough, Columbia, SC

MARY KAY KANE, University of California, Hastings College of the Law,

San Francisco, CA

HERMA HILL KAY, University of California at Berkeley School of Law, Berkeley, CA

CAROLYN DINEEN KING, U.S. Court of Appeals, Fifth Circuit, Houston, TX

CAROLYN B. LAMM, White & Case, Washington, DC

DEREK P. LANGHAUSER, Maine Community College System, South Portland, ME

DOUGLAS LAYCOCK, University of Virginia School of Law, Charlottesville, VA

DAVID F. LEVI, Duke University School of Law, Durham, NC

MARTIN LIPTON, Wachtell, Lipton, Rosen & Katz, New York, NY

GERARD E. LYNCH, U.S. Court of Appeals, Second Circuit, New York, NY

MYLES V. LYNK, Arizona State University, Sandra Day O'Connor College of Law,
Tempe, AZ

MARGARET H. MARSHALL, Supreme Judicial Court of Massachusetts, Boston, MA

**Director Emeritus*

M. MARGARET McKEOWN, U.S. Court of Appeals, Ninth Circuit, San Diego, CA
JOHN J. MCKETTA, III, Graves, Dougherty, Hearon & Moody, Austin, TX
DANIEL J. MELTZER, Harvard Law School, Cambridge, MA
JUDITH A. MILLER, Chevy Chase, MD
ROBERT H. MUNDHEIM, Shearman & Sterling, New York, NY
KATHRYN A. OBERLY, District of Columbia Court of Appeals, Washington, DC
HARVEY S. PERLMAN, University of Nebraska-Lincoln, Lincoln, NE
ELLEN ASH PETERS, Supreme Court of Connecticut (retired), Hartford, CT
ROBERTA COOPER RAMO, Modrall, Sperling, Roehl, Harris & Sisk, Albuquerque, NM
DAVID W. RIVKIN, Debevoise & Plimpton, New York, NY
YVONNE GONZALEZ ROGERS, Superior Court of California, County of Alameda,
Oakland, CA
LEE H. ROSENTHAL, U.S. District Court, Southern District of Texas, Houston, TX
MARY M. SCHROEDER, U.S. Court of Appeals, Ninth Circuit, Phoenix, AZ
MARSHA E. SIMMS, Weil, Gotshal & Manges, New York, NY
JANE STAPLETON, Australian National University College of Law, Canberra, Australia;
University of Texas School of Law, Austin, TX; University of Oxford, England
ROBERT A. STEIN, University of Minnesota Law School, Minneapolis, MN
LARRY S. STEWART, Stewart Tilghman Fox & Bianchi, Miami, FL
ELIZABETH S. STONG, U.S. Bankruptcy Court, Eastern District of New York, Brooklyn, NY
CATHERINE T. STRUVE, University of Pennsylvania Law School, Philadelphia, PA
DAVID K. Y. TANG, K&L Gates, Seattle, WA
MICHAEL TRAYNOR, Cobalt, Berkeley, CA
BILL WAGNER, Wagner, Vaughan & McLaughlin, Tampa, FL
DIANE P. WOOD, U.S. Court of Appeals, Seventh Circuit, Chicago, IL

COUNCIL EMERITI

PHILIP S. ANDERSON, Williams & Anderson, Little Rock, AR
BENNETT BOSKEY**, Washington, DC
MICHAEL BOUDIN, U.S. Court of Appeals, First Circuit, Boston, MA
HUGH CALKINS, Initiatives in Urban Education Foundation, Cleveland Heights, OH
GERHARD CASPER, Stanford University, Stanford, CA
WILLIAM T. COLEMAN, JR., O'Melveny & Myers, Washington, DC
ROGER C. CRAMTON, Cornell Law School, Ithaca, NY
GEORGE CLEMON FREEMAN, JR., Hunton & Williams, Richmond, VA
VESTER T. HUGHES, JR., K&L Gates, Dallas, TX
NICHOLAS DEB. KATZENBACH, Princeton, NJ
PIERRE N. LEVAL, U.S. Court of Appeals, Second Circuit, New York, NY
BETSY LEVIN, Washington, DC
HANS A. LINDE, Salem, OR
ROBERT MACCRATE, Sullivan & Cromwell, New York, NY
VINCENT L. MCKUSICK, Pierce Atwood, Portland, ME
ROSSELL B. PERKINS***, Debevoise & Plimpton, New York, NY
LOUIS H. POLLAK, U.S. District Court, Eastern District of Pennsylvania,
Philadelphia, PA
WM. REECE SMITH, JR., Carlton Fields, Tampa, FL
PATRICIA M. WALD, Washington, DC
LAWRENCE E. WALSH, Crowe & Dunlevy (retired), Oklahoma City, OK
WILLIAM H. WEBSTER, Milbank, Tweed, Hadley & McCloy, Washington, DC
GEORGE WHITTENBURG, Whittenburg Whittenburg Schachter & Harris, Amarillo, TX
HERBERT P. WILKINS, Boston College Law School, Newton, MA

***Treasurer Emeritus*

****President Emeritus and Chair of the Council Emeritus*

**Restatement of the Law Third
Employment Law
Preliminary Draft No. 7**

Comments and Suggestions Invited

We welcome written comments on this draft and ask that they be addressed to the Director and the Reporters; their contact information appears below. Unless expressed otherwise in the submission, by submitting written comments the author authorizes The American Law Institute to retain the submitted material in its files and archives, and to copy, distribute, publish, and otherwise make it available to others, with appropriate credit to the author.

Chief Reporter

Professor Samuel Estreicher
New York University School of
Law
40 Washington Sq. S.
New York, NY 10012-1005
Fax: (212) 995-4341
Email: samuel.estreicher@nyu.edu

Professor Andrew P. Morriss
University of Alabama School
of Law
101 Paul Bryant Drive East,
P.O. Box 870382
Tuscaloosa, AL 35487-0382
Fax: (205) 348-3917
Email: amorriss@law.ua.edu

Reporters

Professor Matthew T. Bodie
St. Louis University School of Law
3700 Lindell Blvd.
St. Louis, MO 63108-3412
Fax: (314) 977-3333
Email: mbodie@slu.edu

Dean Stewart J. Schwab
Cornell Law School
263 Myron Taylor Hall
Ithaca, NY 14853-4901
Fax: (607) 255-3876
Email: sjs15@cornell.edu

Professor Michael C. Harper
Boston University School of Law
765 Commonwealth Ave.
Boston, MA 02215-1401
Fax: (617) 353-3077
Email: mconradh@bu.edu

Director
Professor Lance Liebman
The Executive Office
THE AMERICAN LAW INSTITUTE
4025 Chestnut Street
Philadelphia, PA 19104-3099
Fax: (215) 243-1636
Email: director@ALI.org

**Restatement of the Law Third
Employment Law**

CHIEF REPORTER [from 2006]

SAMUEL ESTREICHER, New York University School of Law, New York, NY

REPORTERS

MATTHEW T. BODIE, Saint Louis University School of Law, St. Louis, MO [from 2008]

MICHAEL C. HARPER, Boston University School of Law, Boston, MA

ANDREW P. MORRIS, University of Alabama School of Law, Tuscaloosa, AL [from 2008]

STEWART J. SCHWAB, Cornell Law School, Ithaca, NY

ADVISERS

FRED W. ALVAREZ, Wilson Sonsini Goodrich & Rosati, Palo Alto, CA

ALICE W. BALLARD, Law Office of Alice W. Ballard, Philadelphia, PA

MARSHA S. BERZON, U.S. Court of Appeals, Ninth Circuit, San Francisco, CA

JOAN M. CANNY, Akerman Senterfitt, Miami, FL [from 2008]

DENNY CHIN, U.S. District Court, Southern District of New York, New York, NY

FRANK CUMMINGS, Washington, DC

KENNETH G. DAU-SCHMIDT, Indiana University Maurer School of Law, Bloomington, IN
[from 2009]

MIKE DELIKAT, Orrick, Herrington & Sutcliffe, New York, NY [from 2008]

DEBORAH A. DEMOTT, Duke University School of Law, Durham, NC [from 2004]

CHRISTINE M. DURHAM, Utah Supreme Court, Salt Lake City, UT

CYNTHIA L. ESTLUND, New York University School of Law, New York, NY [from 2004]

LAURENCE GOLD, Bredhoff & Kaiser, Washington, DC [from 2007]

WILLIS J. GOLDSMITH, Jones Day, New York, NY [from 2004]

MARVIN L. GRAY, JR., Davis Wright Tremaine, Seattle, WA

HOWARD C. HAY, Paul, Hastings, Janofsky & Walker, Costa Mesa, CA

JONATHAN P. HIATT, General Counsel, AFL-CIO, Washington, DC

WILLIAM F. HIGHBERGER, Superior Court of California, County of Los Angeles,
Los Angeles, CA [from 2008]

PAUL V. HOLTZMAN, Krokidas & Bluestein, Boston, MA

JERRY M. HUNTER, Bryan Cave, St. Louis, MO

RODERICK L. IRELAND, Massachusetts Supreme Judicial Court, Boston, MA

HERMA HILL KAY, University of California at Berkeley School of Law, Berkeley, CA

PAULINE T. KIM, Washington University School of Law, St. Louis, MO

GILLIAN L.L. LESTER, University of California at Berkeley School of Law, Berkeley, CA

PAUL W. MOLLICA, Meites, Mulder, Mollica & Glink, Chicago, IL [from 2008]

WAYNE N. OUTTEN, Outten & Golden, New York, NY

CLIFF PALEFSKY, McGuinn, Hillsman & Palefsky, San Francisco, CA

BETTINA B. PLEVAN, Proskauer Rose, New York, NY

DEBRA L. RASKIN, Vladeck, Waldman, Elias & Engelhard, New York, NY

LEE H. ROSENTHAL, U.S. District Court, Southern District of Texas, Houston, TX
[from 2009]

MARK A. ROTHSTEIN, University of Louisville, Louis D. Brandeis School of Law,
Louisville, KY

KAZUO SUGENO, Faculty of Law, University of Tokyo, Tokyo, Japan [from 2003]

KENNETH P. THOMPSON, Thompson Wigdor & Gilly, New York, NY [from 2008]

PAUL H. TOBIAS, Tobias, Torchia & Simon, Cincinnati, OH

JAY W. WAKS, Kaye Scholer, New York, NY [from 2004]

LIAISONS

For the American Bar Association

STEWART S. MANELA, Washington, DC

ARNOLD H. PEDOWITZ, New York, NY

For the American Association for Justice

NED MILTENBERG, Washington, DC

For the College of Labor and Employment Lawyers, Inc.

MICHAEL J. LEECH, Chicago, IL

For the National Employment Lawyers Association

JOSEPH D. GARRISON, New Haven, CT

MEMBERS CONSULTATIVE GROUP

Employment Law (as of July 29, 2010)

ROGER I. ABRAMS, Boston, MA
LINDA AUERBACH ALLDERDICE, Los Angeles, CA
JOSÉ F. ANDERSON, Baltimore, MD
BERNARD F. ASHE, Delmar, NY
KIM J. ASKEW, Dallas, TX
SCOTT L. BAENA, Miami, FL
WILLIAM SCOTT BALES, Arizona Supreme Court, Phoenix, AZ
HELEN I. BENDIX, Superior Court of California, County of Los Angeles, Los Angeles, CA
ROBERT O. BERGER, Boston, MA
CARTER G. BISHOP, Boston, MA
SUSAN BISOM-RAPP, San Diego, CA
SANFORD L. BOHRER, Miami, FL
AMELIA H. BOSS, Philadelphia, PA
MARGOT BOTSFORD, Massachusetts Supreme Judicial Court, Boston, MA
JEAN BRAUCHER, Tucson, AZ
SCOTT A. BRISTER, Austin, TX
HARVEY G. BROWN, Jr., Houston, TX
W. AMON BURTON, Jr., Austin, TX
J. WILLIAM CALLISON, Denver, CO
CHRISTOPHER RUIZ CAMERON, Los Angeles, CA
ELENA A. CAPPELLA, Philadelphia, PA
DALE A. CARPENTER, II, Minneapolis, MN
HENRY L. CHAMBERS, Jr., Richmond, VA
MIRIAM A. CHERRY, Sacramento, CA
PAT K. CHEW, Pittsburgh, PA
ANDREW A. CHIRLS, Philadelphia, PA
STEPHEN YEE CHOW, Boston, MA
LOVIDA H. COLEMAN, Jr., Washington, DC
GEORGE W. CONK, New York, NY
ROBERTO L. CORRADA, Denver, CO
LEONARD COURT, Oklahoma City, OK
BARBARA J. COX, San Diego, CA
JOHN G. CRABTREE, Key Biscayne, FL
DAVID M. CURTIS, Dallas, TX
BEVERLY WINSLOW CUTLER, Alaska Superior Court, Third Judicial District, Palmer, AK
ROSS E. DAVIES, Arlington, VA
HECTOR DE LEON, Austin, TX
ANTHONY M. DiLEO, New Orleans, LA
ANTHONY E. DiRESTA, Washington, DC
JAMES B. DOLAN, Jr., Boston, MA
CHRISTINE MICHELLE DUFFY, Parsippany, NJ
BYRON F. EGAN, Dallas, TX
BRYAN K. FAIR, Tuscaloosa, AL
CHAI R. FELDBLUM, Washington, DC
LOUIS G. FERRAND, Jr., Washington, DC
STEPHEN F. FINK, Dallas, TX
ROBERT G. FLANDERS, Jr., Providence, RI
JOSEPH Z. FLEMING, Miami, FL
JOAN FLYNN, Cleveland, OH
SIMONE R. D. FRANCIS, St. Thomas, U.S. VI
VERNON L. FRANCIS, Philadelphia, PA
PAUL E. FREEHLING, Chicago, IL
JOEL WM. FRIEDMAN, New Orleans, LA
MARVIN GARFINKEL, Philadelphia, PA
JOSEPH D. GARRISON, New Haven, CT
E. SUSAN GARSH, Trial Court of Massachusetts, Superior Court Department, Boston, MA
JAMES PAUL GEORGE, Fort Worth, TX
MARK P. GERGEN, Berkeley, CA
KRISTIN BOOTH GLEN, New York County Surrogate's Court, New York, NY
MICHAEL G. GOLDSTEIN, Newport Beach, CA
MICHAEL S. GOODRICH, Fort Worth, TX
SUSAN P. GRABER, U.S. Court of Appeals, Ninth Circuit, Portland, OR
GILSON B. GRAY, III, New York, NY
MICHAEL Z. GREEN, Fort Worth, TX
MICHAEL GREENWALD, Philadelphia, PA
JAY E. GRENIG, Milwaukee, WI
JOSEPH R. GRODIN, San Francisco, CA
BRIAN ALLEN GROSMAN, Toronto, ON, Canada
RICHARD E. GUTMAN, Dallas, TX
ANTON G. HAJJAR, Washington, DC
SUSAN MARIE HALLIDAY, McLean, VA

ROBERT E. HARRINGTON, Charlotte, NC
RICHARD E. V. HARRIS, Piedmont, CA
HARRIS L HARTZ, U.S. Court of Appeals,
Tenth Circuit, Albuquerque, NM
ED HENDRICKS, Sr., Phoenix, AZ
JOHN E. HIGGINS, Jr., Washington, DC
PAULINE E. HIGGINS, Houston, TX
BEVERLY J. HODGSON, New Haven, CT
MARK R. HORNAK, Pittsburgh, PA
STEPHEN K. HUBER, Houston, TX
EDWIN E. HUDDLESON,
Washington, DC
BRIAN J. HUNT, Chicago, IL
ALAN HYDE, Newark, NJ
KEITH N. HYLTON, Boston, MA
MARIA O'BRIEN HYLTON, Boston, MA
RALPH A. JACOBS, Philadelphia, PA
SCOTT L. KAFKER, Massachusetts
Appeals Court, Boston, MA
WALTER KAMIAT, Washington, DC
CEM KANER, Melbourne, FL
JOSHUA KARSH, Chicago, IL
MATTHEW I. KATZ, Vermont Superior
Court, Burlington, VT
MARK R. KILLENBECK, Fayetteville, AR
KENNETH F. KIRWIN, St. Paul, MN
DANIEL S. KLEINBERGER, St. Paul, MN
THOMAS C. KOHLER, Newton, MA
CANDACE SAARI KOVACIC-FLEISCHER,
Washington, DC
DANIEL M. KOWALSKI, Austin, TX
MICHAEL J. KRAMER, Noble Superior
Court, Albion, IN
MARK I. LABATON, Los Angeles, CA
DAVID LANDAU, New Jersey Superior
Court, Appellate Division,
Newark, NJ
HOWARD LANGER, Philadelphia, PA
ELIZABETH LANG-MIERS, Texas Court of
Appeals, Fifth District, Dallas, TX
STEVEN L. LEFELT, New Jersey Superior
Court, Appellate Division, New
Brunswick, NJ
LAWRENCE C. LEVINE, Sacramento, CA
HAROLD S. LEWIS, Jr., Macon, GA
JOHN B. LEWIS, Cleveland, OH
DON H. LIU, Stamford, CT
BARBARA M. G. LYNN, U.S. District
Court, Northern District of Texas,
Dallas, TX
W. CULLEN MAC DONALD,
New York, NY
HUGH G. E. MACMAHON, Falmouth, ME
MERYL C. MANEKER, San Diego, CA
DAVID CHARLES MASON, Missouri
Circuit Court, 22nd Judicial Circuit,
St. Louis, MO
MARGARET P. MASON, New Haven, CT
DAVID B. McCORMACK, Charleston, SC
COLLEEN McHUGH, Corpus Christi, TX
ANNE H. McNAMARA, Dallas, TX
M. ISABEL MEDINA, New Orleans, LA
ARTHUR D. MELENDRES,
Albuquerque, NM
CARRIE J. MENKEL-MEADOW,
Washington, DC
BRUCE P. MERENSTEIN, Philadelphia, PA
RICHARD MOBERLY, Lincoln, NE
SCOTT C. MORIEARTY, Boston, MA
FRED F. MURRAY, Washington, DC
ARNOLD K. MYTELKA, Springfield, NJ
BARBARA REEVES NEAL,
Los Angeles, CA
RICHARD L. NEUMEIER, Boston, MA
MARIA L. ONTIVEROS, San Francisco, CA
MARIAN P. OPALA, Supreme Court of
Oklahoma, Oklahoma City, OK
DAVID BENJAMIN OPPENHEIMER,
Berkeley, CA
PETER M. PANKEN, New York, NY
ROBERT S. PECK, Washington, DC
MARY MARGARET PENROSE,
Fort Worth, TX
JUAN F. PEREA, Gainesville, FL
JOSEPH M. PERILLO, Chelsea, NY
MARILYN E. PHELAN, Lubbock, TX
W. MICHEL PIERSON, Circuit Court for
Baltimore City, Eighth Judicial
Circuit, Baltimore, MD
DONALD J. POLDEN, Santa Clara, CA
ROBERT D. RACHLIN, Burlington, VT
BERNARD D. REAMS, JR.,
San Antonio, TX
JOHN M. REED, Boston, MA
E. LEE REICHERT III, Denver, CO
MARJORIE O. RENDELL, U.S. Court of
Appeals, Third Circuit,
Philadelphia, PA
JOHN H. RICH, III, U.S. District Court,
District of Maine, Portland, ME
DOUGLAS R. RICHMOND, Chicago, IL
SALLY M. RIDER, Tucson, AZ
CLIFFORD A. RIEDERS, Williamsport, PA

KENNETH F. RIPPLE, U.S. Court of Appeals, Seventh Circuit, South Bend, IN

A. JAMES ROBERTSON, II, Superior Court of California, City and County of San Francisco, San Francisco, CA

JAMES L. ROBERTSON, Jackson, MS

XAVIER RODRIGUEZ, U.S. District Court, Western District of Texas, San Antonio, TX

THEODORE O. ROGERS, JR., New York, NY

YVONNE GONZALEZ ROGERS, Superior Court of California, County of Alameda, Oakland, CA

MARK B. ROTENBERG, Minneapolis, MN

HOWARD RUDA, New York, NY

MARGARET M. RUSSELL, Santa Clara, CA

THOMAS E. RUTLEDGE, Louisville, KY

LYNN HECHT SCHAFRAN, New York, NY

ANDREW WILLIAM SCHILLING, New York, NY

LORRAINE A. SCHMALL, DeKalb, IL

SOL SCHREIBER, New York, NY

VICTOR E. SCHWARTZ, Washington, DC

MICHAEL SCHWARZ, Santa Fe, NM

PAUL M. SECUNDA, Milwaukee, WI

MARGARET B. SEYMOUR, U.S. District Court, District of South Carolina, Columbia, SC

GERALD K. SMITH, Phoenix, AZ

KAIGHN SMITH, JR., Portland, ME

BRIAN F. SPECTOR, Miami, FL

EMILY SPIELER, Boston, MA

ARTHUR B. SPITZER, Washington, DC

CHARLES W. SPRAGUE, Brookfield, WI

MICHAEL K. STEENSON, St. Paul, MN

LARRY S. STEWART, Miami, FL

H. MARK STICHEL, Baltimore, MD

ELIZABETH S. STONG, U.S. Bankruptcy Court, Eastern District of New York, Brooklyn, NY

GUY MILLER STRUVE, New York, NY

BARRY SULLIVAN, Chicago, IL

CHARLES A. SULLIVAN, Newark, NJ

PAUL K. SUN, JR., Cary, NC

PAUL W. SWEENEY, JR., Los Angeles, CA

JOHN M. TRUE, III, Superior Court of California, County of Alameda, Hayward, CA

BOWEN H. TUCKER, Chicago, IL

E. PETER URBANOWICZ, Sun Valley, ID

LEA S. VANDERVELDE, Iowa City, IA

DAVID C. VLADECK, Washington, DC

BILL WAGNER, Tampa, FL

PATRICIA H. WAGNER, Seattle, WA

HOWARD P. WALTHALL, Birmingham, AL

LELAND WARE, Newark, DE

DAVID G. WEBBERT, Augusta, ME

HARVEY WEINER, Boston, MA

KATHRYN MICKLE WERDEGAR, California Supreme Court, San Francisco, CA

ELLEN G. WIDESS, San Francisco, CA

MICHAEL A. WILLIAMS, Denver, CO

DAVID B. WILSON, Denver, CO

JAMES C. WILSON, JR., Birmingham, AL

MICHAEL J. WISHNIE, New Haven, CT

CAROLYN B. WITHERSPOON, Little Rock, AR

TOBIAS B. WOLFF, Philadelphia, PA

WILLIAM J. WOODWARD, JR., Philadelphia, PA

WILLIAM A. WORTHINGTON, Houston, TX

DAVID PAUL YAFFE, Superior Court of California, County of Los Angeles, Los Angeles, CA

MICHAEL J. ZIMMER, Evanston, IL

The bylaws of The American Law Institute provide that “Publication of any work as representing the Institute’s position requires approval by both the membership and the Council.” Each portion of an Institute project is submitted initially for review to the project’s Consultants or Advisers as a Memorandum, Preliminary Draft, or Advisory Group Draft. As revised, it is then submitted to the Council of the Institute in the form of a Council Draft. After review by the Council, it is submitted as a Tentative Draft, Discussion Draft, or Proposed Final Draft for consideration by the membership at the Institute’s Annual Meeting. At each stage of the reviewing process, a Draft may be referred back for revision and resubmission. The status of this Draft is indicated on the front cover and title page.

The Council approved the start of the project in 2000.

The first Tentative Draft, covering the existence of an employment relationship, contractual law dealing with the termination of the employment relationship, and the tort of wrongful retaliation in violation of public policy, was submitted to the membership at the 2008 Annual Meeting; however, due to lack of time, no final vote was taken on the draft. A revised Tentative Draft (Tentative Draft No. 2) was approved at the 2009 Annual Meeting.

In October 2009 the Council approved §§ 8.01 through 8.08 of Chapter 8, dealing with the employee’s duty of loyalty. There was insufficient time to discuss the Chapter’s last three Sections. Sections 8.01-8.04 and 8.06-8.08 were approved at the 2010 Annual Meeting. There was insufficient time to discuss §§ 8.05 and 8.09-8.11.

An earlier version of some of the black letter contained in Chapter 3 of this Draft and an earlier version of some of the black letter and commentary contained in Chapter 6 of this Draft can be found in Preliminary Draft No. 6 (2009). An earlier version of some of the black letter and commentary contained in Chapter 5 of this Draft can be found in Preliminary Draft No. 5 (2008). An earlier version of some of the material contained in Chapter 8 of this Draft can be found in Tentative Draft No. 3 (2010).

The project’s Reporters may have been involved in other engagements on issues within the scope of the project; all Reporters are asked to disclose any conflicts of interest, or their appearance, in accord with the Policy Statement and Procedures on Conflicts of Interest with Respect to Institute Projects; and copies of Reporters’ written disclosures are available from the Institute upon request; however, only disclosures provided after July 1, 2010, will be made available and, for confidentiality reasons, parts of the disclosures may be redacted or withheld.

8/16/10

REPORTERS' MEMORANDUM (September 11-12, 2010)

PRELIMINARY DRAFT NO. 7

**RESTATEMENT OF THE LAW THIRD
EMPLOYMENT LAW**

TABLE OF CONTENTS & CHAPTERS 3, 5-6, 8

Table of Contents

In addition to renumbering Chapters 4 and 5, we are considering deleting from this project proposed Chapter 10 (Alternative Dispute Resolution), Chapter 11 (Secondment of U.S. Workers Abroad), and Appendix (Inventory of Federal and State Employment Laws). Our reasons are, as follows: The question of arbitration, in particular, has become a largely statutory subject governed by the Federal Arbitration Act (FAA). Outside the FAA, which also broadly preempts state law except for defenses to contract enforcement (which perhaps is more usefully considered within Contracts), there is little common law as such. Proposed Chapter 11 will largely turn on conflict-of-law issues in the multinational context and is also best considered as part of Conflict of Laws. As for the proposed Appendix, this is a very large undertaking with limited payoff given the frequent amendment and addition (and less frequent, repeal) of statutory law. It would seem a more appropriate task for a publication that comes out more frequently than ALI work product.

Chapter 3

Employment Contracts: Compensation and Benefits (SE)

This Chapter applies principles developed in the previous Chapter to the topic of compensation and benefits. Whether or not an employment relationship is terminable only for cause or at will, employees have an enforceable right to receive compensation they have earned and employers have a corresponding duty to pay such compensation, unless there is a bona fide dispute as to whether claimed compensation has been earned. This general framework is set out in § 3.01, which covers both wages or salary and commissions. The next two address special issues that arise in the context of payment of bonuses and other incentive compensation (§ 3.02). As a general matter, whether employees have earned particular compensation, or are entitled to particular benefits, depends on the content of any agreement between the employer and employee or any binding promises (see § 2.02(b), Comment *c*) or policy statements of the employer (see §§ 2.02(c) and 2.05). Benefits are treated separately in (§ 3.03) because they are often

handled through unilateral employer policy statements rather than agreements with employees.

Modification or revocation of compensation and benefits, as a prospective matter, is taken up in § 3.04. It follows the general approach of § 2.06. The general rule is that the agreement between the parties controls whether compensation or benefits can be changed prospectively. Vested or accrued rights under such an agreement, including agreements based on a promise enforceable by promissory estoppel or a statement enforceable under § 2.05, cannot be revoked absent the consent of the affected employees.

Section 3.05 addresses the implied duty of good faith and fair dealing (§ 2.07), which operates to prevent employers from using any power to discharge or otherwise adversely affect employment to cause, or compel consent to, a forfeiture of earned compensation or benefits.

Chapter 5

Employer Liability for Harm to Employees: General Principles (MCH)

This Chapter treats the general principles governing employer responsibility for harm suffered by employees. Inasmuch as most employees in modern society are employed by business entities, such as corporations, rather than by individuals, most harm for which employers might be responsible is caused by the actions, or failures to act, of agents of the employers. Thus, the Chapter builds on the law of agency to articulate the principles defining an employer's possible direct or indirect liability for harm to its employees. In some cases, employers are not suable in court under these principles because the harms in question are covered by no-fault workers'-compensation statutes.

Section 5.01 addresses a principal's liability for the actions of its agents, applying with specific reference to the employment relationship the rules stated in §§ 7.03 through 7.08 of the Restatement Third of Agency. Section 5.01(3) states an additional principle of indirect liability reflecting the Supreme Court's formulation of employer liability for harassment by supervisors actionable under the antidiscrimination laws.

The latter Sections of this Chapter define an employer's duties to protect its employees from wrongdoers under its control and to provide a safe, or to warn of an unsafe, workplace. These duties are not delegable; a failure to discharge one of these duties is a wrong committed by the employer. The wrong consists of the failure of an employer or its agents to act reasonably.

The Chapter does not focus on the substantive definitions of wrongful conduct that may render an employer or other actors liable to employees. Employer torts are

considered in other Chapters in this Restatement, such as the tort of wrongful discipline in violation of public policy in Chapter 4, the torts of defamation and wrongful interference in Chapter 6, and invasions of employee privacy and autonomy in Chapter 7. Other employer torts, such as assault and battery, intentional infliction of emotional distress, false imprisonment, and negligence, do not involve special considerations for the employment relationship. Other actionable wrongs for which employers may be responsible are defined by statutory law, such as the federal and state antidiscrimination laws. Employee obligations to their employer are the subject of Chapter 8.

Chapter 6

Other Torts Affecting the Formation or Continuation of the Employment Relationship (MCH)

This Chapter covers several torts that may present special issues when applied in the context of employment. The torts—defamation, intentional interference with contractual or business relations, and fraudulent misrepresentation—all have potential relevance to actions that interfere with the formation or continuation of employment relationships. These torts are concerned with insuring that employees and prospective employees are treated fairly and without malice, rather than with the protection of employees against status discrimination, as is true of the federal and state antidiscrimination statutes, or the protection of socially valued activity, as is true for the law of wrongful termination in violation of public policy treated in Chapter 4.

The torts, however, are also qualified in the employment context to avoid discouragement of the efficient exchange of accurate information about employees between employers and to protect employers' managerial discretion to discharge employees for reasons not otherwise proscribed by law. Thus, while employment references and evaluations are appropriately regulated by the law of defamation, the law also recognizes a broad qualified privilege for internal and external managerial comments on current and former employees. Similarly, while the tort of intentional interference of contract may further discipline employers in providing references on current and former employees to other employers, it must be limited to avoid constraints on employers' discretion to discontinue or avoid their own contracts.

The treatment of these torts in this Chapter is limited to their application to the formation or continuation of employment relationships, and to the special issues that this application presents. The Chapter, for instance, does not specifically cover defamation of the reputation of an employee by another employee outside the latter's scope of employment. The Chapter specifically treats employee liability to other employees only to limit the reach of the intentional-interference-with-contractual-relations tort to protect underlying employers' managerial discretion.

Chapter 8

Employee Obligations and Restrictive Covenants (SJS)

At its Annual Meeting on May 18, 2010, the membership of the Institute approved §§ 8.01-8.04 and §§ 8.06-8.08 of this Chapter (Tentative Draft No. 3), subject to the caveat that the Reporters would revise the draft in light of the comments made at the Meeting.

The title of the Chapter has been changed back to “Employee Obligations and Restrictive Covenants” from the earlier title, “Employee Duty of Loyalty and Restrictive Covenants.”

Chapter 8 describes the legal duties employees owe to their employers. The first part of the Chapter describes the background obligations arising from the common-law duty of loyalty without a specific contractual clause on point. Section 8.01 describes the common-law duty of loyalty. Succeeding Sections focus on the most common applications of the common-law duty of loyalty—namely, the duty not to use or disclose confidential information (§§ 8.02 and 8.03), and the duty not to compete with the current employer (§ 8.04) but the right to compete with former employers (§ 8.05). Key issues in this first part include:

- The duty of loyalty applies to all employees (§ 8.01), although its scope varies with the nature of the employee’s responsibilities; a heightened duty applies to corporate executives and other employees in positions of trust or confidence. We have made changes in the text of this Section to more precisely delimit what is entailed by the common-law duty of loyalty (see § 8.01(b)). The Reporters’ Notes on this Section have been revised accordingly.
- The definition of confidential information (§ 8.02) is coextensive with the definitions of trade secrets or other protected information in the Uniform Trade Secrets Act, the Restatement Third, Unfair Competition § 39, and the Economic Espionage Act (18 U.S.C. § 1839).
- Confidential information is distinguished from the general experience and skills the employee acquires in the course of employment (§ 8.02(d)), which the employee is entitled to exploit for the employee’s own benefit certainly after the employment relationship has ended.
- Customer relationships are distinguished from customer lists and databases developed by employers (§ 8.02, Comment *f*), with information arising from relationships being less likely to be protected as proprietary information.
- Section 8.03 has been modified to make clear that the nondisclosure obligation does not apply where this is a “legal duty” to disclose or “legal protection” of disclosure. Comment *d* has been added to spell this out.

- Competition by current managerial or supervisory employees violates the duty of loyalty (§ 8.04), although the right to prepare to compete is recognized (§ 8.04, Comment *a*). The Section now makes clear that the privilege of nonmanagerial employees to compete does not apply if such activity conflicts with “time committed to the [first] employer.”
- Corporate executives and other employees in positions of trust or confidence may not usurp business opportunities for their individual gain (§ 8.04, Comment *c*).
- The right of ex-employees to compete with their former employer is recognized (§ 8.05). Although this has been a point of contention, the inevitable-disclosure doctrine is recognized but severely limited, so that courts may enjoin an ex-employee from taking a subsequent job absent a noncompetition covenant only in “exceptional circumstances” where the employee must inevitably disclose proprietary information to perform the functions of that subsequent job (§ 8.05, Comment *b*).

The next part of Chapter 8 analyzes the legal validity of express contractual restraints on actions an ex-employee can take. The wide variety of restrictive covenants—including no-compete clauses, confidentiality clauses, no-solicitation clauses, and financial-penalty clauses—are analyzed under a common framework. To be enforceable, the restrictive covenant must be reasonably tailored in time, geography, and scope to protect a legitimate employer interest (defined in § 8.07 to be the employer’s confidential information, customer relationships, or investment in the employee’s reputation or sale of the employee’s business).

Key issues include:

- Enforceable restrictive covenants can be entered into even after the employment relationship has begun (§ 8.06, Comment *e*).
- Restrictive covenants are generally enforceable against employees fired for cause, but not against employees fired without cause (§ 8.06(a), Comment *f*).
- A court can modify and enforce an overbroad restrictive covenant unless the employer entered into the covenant in bad faith or without a reasonable basis for believing the covenant was reasonably tailored to further a protectable interest (the so-called “blue pencil” rule—§ 8.08).

The last part of Chapter 8 deals with the division of intellectual property between employer and employee.

- Absent a special contract, employees generally have the right to patent inventions they make, even on company time and with company materials (§ 8.09).

- Employers have a nonexclusive, nonassignable “shop right” to use an invention made by an employee on company time or with company materials (§ 8.10).
- Reasonable agreements by an employee to assign the patent to the employer are enforceable (§ 8.11).

RESTATEMENT THIRD, EMPLOYMENT LAW

**TABLE OF CONTENTS
FOR PRELIMINARY DRAFT NO. 7**

Reporters' Memorandum xi
Projected Overall Table of Contents xix
Projected Overall Table of Contents (redline)xx

**Chapter 3
Employment Contracts: Compensation and Benefits**

<u>Section</u>	<u>Page</u>
Introductory Note	1
§ 3.01 Right to Earned Compensation	1
§ 3.02 Bonuses and Other Incentive Compensation	5
§ 3.03 Benefits.....	7
§ 3.04 Modification of Compensation or Benefits.....	8
§ 3.05 Implied Duty of Good Faith and Fair Dealing	9

**Chapter 5
Employer Liability for Harm to Employees:
General Principles**

§ 5.01 Employer's Liability to Employees for Acts of Its Agents	12
§ 5.02 Employer's Duty to Provide Safe Conditions or to Warn of Risk	21
§ 5.03 Employer's Duty to Exercise Care in Selecting and Supervising Agents.....	22
§ 5.04 Employer's Duty to Exercise Care in Preventing and Correcting Wrongful Conduct Subject to Employer's Control.....	22

Chapter 6
Other Torts Affecting the Formation or Continuation of the
Employment Relationship

<u>Section</u>	<u>Page</u>
§ 6.01 Employer’s Liability for Defamation of Employee.....	24
§ 6.02 Employer Privilege to Communicate With Its Own Agents and Other Employers.....	40
§ 6.03 Employer’s Wrongful Interference with an Employee’s Employment Relationship with Another Employer	51
§ 6.04 Employer Does Not Tortiously Interfere with Its Own Employment Relationship	61
§ 6.05 Employer’s Fraudulent Misrepresentation Inducing the Initiation, Maintenance or Cessation of an Employment Relationship	70
§ 6.06 Employer’s Negligent Provision of False Information to Employees	81

Chapter 8
Employee Obligations and Restrictive Covenants

§ 8.01. Employee Duty of Loyalty.....	90
§ 8.02. Definition of Employer’s Confidential Information	99
§ 8.03. Disclosures or Use by Employee or Former Employee of Employer’s Confidential Information	120
§ 8.04. Competition by Employee with Current Employer.....	123
§ 8.05. Competition by Former Employee with Former Employer	140
§ 8.06. Enforcement of Restrictive Covenant in Employment Agreement...151	
§ 8.07. Protectable Interests for Restrictive Covenants.....	178
§ 8.08. Modification of Unreasonable Restrictive Covenant.....	186
§ 8.09. Rights of Employee to Inventions.....	193
§ 8.10. Employer Shop Right to Employee Inventions	195
§ 8.11. Employee Agreements to Assign Patents.....	201

8/6/10

**RESTATEMENT THIRD, EMPLOYMENT LAW
PROJECTED OVERALL TABLE OF CONTENTS**

- Ch. 1 Existence of an Employment Relationship (MCH)
 - Ch. 2 Employment Contracts: Termination (SE)
 - Ch. 3 Employment Contracts: Compensation and Benefits (SE)
 - Ch. 4 Employer Liability for Harm to Employees: General Principles (MCH)
 - Ch. 5 Tort of Wrongful Discipline in Violation of Public Policy (SJS)
 - Ch. 6 Other Torts Affecting the Formation or Continuation of the Employment Relationship (MCH)
 - Ch. 7 Workplace Privacy and Autonomy (MTB)
 - Ch. 8 Employee Obligations and Restrictive Covenants (SJS)
 - Ch. 9 Remedies (AM)
 - Ch. 10 Alternative Dispute Resolution
 - Ch. 11 Secondment of U.S. Workers Abroad
- Possible Appendix: Inventory of Federal and State Employment Laws

8/6/10

**RESTATEMENT THIRD, EMPLOYMENT LAW
PROJECTED OVERALL TABLE OF CONTENTS**

Ch. 1 Existence of an Employment Relationship (MCH)

Ch. 2 Employment Contracts: Termination (SE)

Ch. 3 Employment Contracts: Compensation and Benefits (SE)

~~Ch. 4~~ Employer Liability for Harm to Employees: General Principles (MCH)

Ch. 5 Tort of Wrongful Discipline in Violation of Public Policy (SJS)

Ch. 6 Other Torts Affecting the Formation or Continuation of the Employment Relationship (MCH)

Ch. 7 Workplace Privacy and Autonomy (MTB)

Ch. 8 Employee Obligations and Restrictive Covenants (SJS)

Ch. 9 Remedies (AM)

Ch. 10 Alternative Dispute Resolution

Ch. 11 Secondment of U.S. Workers Abroad

Possible Appendix: Inventory of Federal and State Employment Laws

Deleted: Ch.4 . Tort of Wrongful Discipline in Violation of Public Policy (SJS)[¶]

Deleted: 5

Deleted: Other T

1
2
3 **Chapter 3**
4

5 **Employment Contracts: Compensation and Benefits (SE)**
6

7 **Introductory Note.** Remuneration is a principal ingredient of the employment
8 relationship; it is a major reason why employees work under the control of their
9 employer; moreover, from the employer’s standpoint, compensation is both a cost and
10 essential motivational mechanism. This Chapter applies the principles developed in
11 Chapter 2, as well as the framework provided by the Restatement Second of Contracts, to
12 the subject of compensation and benefits. The amount, kind and frequency of
13 compensation for services is principally determined by the agreement of the parties,
14 broadly construed to include express and implied contracts as well as unilateral promises
15 and policy statements by employers considered to have binding effect.

16 Many states have enacted laws spelling out the mode and frequency of payments
17 (often called “wage payment” laws). In addition, the Employment Retirement Income
18 Security Act of 1974 (“ERISA”) broadly preempts the area of employee pension and
19 welfare benefit plans. Despite these statutes, the common law remains important because
20 the legislation contains certain exclusions from coverage and, more importantly, does not
21 itself deal with the underlying contract issues but, rather, overlays its requirements on
22 relationships defined by state decisional law.
23
24

25 **§ 3.01 Right to Earned Compensation**
26

- 27 (a) **Whether the employment relationship is terminable at will or terminable**
28 **only for cause, employees have a right to be paid the compensation they have**
29 **earned.**
- 30 (b) **Whether compensation has been earned is determined by the agreement**
31 **between the employer and employee or any binding promises or policy**
32 **statements of the employer.**
- 33 (c) **Employers are under an obligation to pay the compensation employees have**
34 **earned, except to the extent there is a bona fide dispute as to whether the**
35 **compensation claimed has been earned.**

36
37 **Comment:**
38

39 *a. Scope.* The overarching principle of this Chapter is that employers have an
40 obligation to pay, and employees have a right receive, promised remuneration for their
41 earned services. This general principle is set out in § 3.01, which covers both wages,
42 salary and commissions, and applies whether employment is terminable at will or for
43 cause only. The next Section addresses special issues that arise in the context of payment
44 of bonuses and other incentive compensation (§ 3.02). As a general matter, whether
45 employees have earned particular compensation, or are entitled to particular benefits,
46 depends on the content of any agreement between the employer and employee and any

1 binding promises (see § 2.02(b) comment c) or policy statements of the employer (see §§
2 2.02(c) & 2.05). Benefits are treated separately in (§ 3.03) because they are often, but not
3 always, handled through unilateral employer policy statements rather than agreements
4 with employees.

5
6 Modification or revocation of compensation and benefits, as a prospective matter,
7 is taken up in § 3.04. It follows the approach of §2.06. The general rule is that the
8 agreement between the parties controls whether compensation or benefits can be changed
9 prospectively. Vested or accrued rights under such an agreement, including agreements
10 based on a promise enforceable by promissory estoppel or a statement enforceable under
11 § 2.05, cannot be revoked absent the consent of the affected employees.

12
13 Section 3.05 addresses the implied duty of good faith and fair dealing (§ 2.07)
14 which applies to constrain employers from using any power to discharge or otherwise
15 adversely affect employment to cause, or compel consent to, a forfeiture of earned
16 compensation or benefits.

17
18 At all times, applicable statutes would control application of common law
19 principles. The most common legislation are wage-payment laws, which often assume
20 that the parties have entered into an enforceable agreement with respect to the item of
21 compensation in question; where such an agreement is absent, typically the wage-
22 payment law does not apply.

23
24 Recovery for contractual losses typically requires mitigation of damages. See §
25 9.--.

26
27 *b. Relationship to wage-payment laws.* Many states have wage-payment laws that
28 determine the mode and frequency of payment of “wages”. Where these statutes apply,
29 of course they control. As a general matter, however, they do not preclude common law
30 development. The wage-payment laws typically are based on the background common
31 law principles of contract, and look to the common law to determine whether the
32 employer has an underlying binding obligation. Moreover, some statutes exclude certain
33 categories of employees (e.g., commissioned salesmen or high wage-earners) or certain
34 forms of compensation (e.g., incentive payments, future unearned payments), thus
35 requiring full application of contract law in those cases.

36
37 *c. At-will vs. for cause relationships.* Section 3.01(a) states the general principle:
38 Even if, under the principles stated in Chapter 2, the employment relationship is
39 terminable at the will of either party, the employer nevertheless is obligated to pay the
40 agreed-upon, earned compensation for services rendered by the employee.

41
42 **Illustrations:**

43
44 1. Employer X and employee E enter into an employment agreement providing
45 for a \$50,000 “annual salary”. E begins work on January 1. Three months into the
46 relationship, on March 1, X serves E with notice of termination of the agreement. Under

1 applicable law, the employment agreement is terminable at the will of either party, with
2 or without cause. X's payroll practice was pay its employees on the first of each month
3 for the prior month's services. X owes E one month's salary.
4

5 2. Same facts as Illustration 1, except that X terminates E's employment for cause
6 on March 1. X owes E one month's salary.
7

8 *d. Earned compensation.* The employer's obligation to pay compensation
9 depends on whether the employee has earned the compensation. In the case of a salary or
10 wage, the employee is typically being paid for a period of service, and the compensation
11 is earned with completion of that period, as in Illustrations 1-2. In the case of employee
12 compensation in the form of commissions, however, the employee is being paid for sales
13 made or other unit of output produced, and whether compensation is earned depends on
14 whether on the sale has been made and or other unit of output is produced in accordance
15 with the terms of the agreement between the parties.
16

17 **Illustrations:**
18

19 3. X, in the freight forwarding business, hired E as a commissioned sales person
20 in February 2010. The employment agreement states that E is "guaranteed compensation
21 on the basis of 50 percent of the profit generated by accounts you are instrumental in
22 obtaining freight business" for X. On April 15, 2010, E obtains a potentially significant
23 increase in freight business from Road Masters, a customer of X whose business
24 historically yielded \$300,000 average annual profit for X. For calendar year 2010, Road
25 Masters business accounted for \$500,000 in profit for X. If the agreement provides for
26 profits generated by preexisting, as well as entirely new, accounts (presumably a question
27 for the trier of fact), X is entitled to \$100,000 in commissions.
28

29 4. E sells newspaper subscriptions for X via telephone solicitations. Under the
30 Sales Agreement E signed, he is to receive a commission only on "commissionable
31 orders," defined as "a sale that is input into X's home delivery computer where the
32 §customer maintains the subscription for a minimum of 28 days without giving a specific
33 stop date." E is owed commissions only on subscriptions where customers do not transit
34 a stop date within the 28-day period.
35

36 5. Upon commencing employment for X on January 1, 2009, E, who sells wire
37 manufactured by third parties, signed a "Manufacturer's Representative Agreement,"
38 which provides for a one-year term and then successive periods of one year unless either
39 party gives 30 days' written notice of termination of the Agreement. The Agreement
40 further provides for commissions "payable with respect to orders accepted by X up to
41 and including the termination date and X shall have the right to appoint a new Sales
42 Representative for the Territory effective immediately upon such termination date."
43

44 E's employment is terminated on March 14, 2010 pursuant to the Agreement. E
45 sues for commissions with respect a substantial order from Y, a major purchaser of wire,
46 that E initiated but was not accepted by X until after the termination of his employment.

1 The jurisdiction in question would treat any implied covenant of good faith and fair
2 dealing (see §§ 2.07 & 3.05) as not available in view of the express provisions of the
3 Agreement governing termination of employment. E is not entitled to commissions on
4 the post-termination sale to Y.

5
6 *e. Agreement between the parties, or any binding promises or policy statements of*
7 *the employer.* As developed in Chapter 2, an agreement is based on consideration or
8 bargained-for exchange and thus enforceable under the general law of contracts (§ 2.03).
9 In addition, employers can be bound by promises that reasonably induce detrimental
10 reliance by employees (§2.02(b) & comment c) and by policy statements they promulgate
11 to govern workplace conditions (§2.05).

12
13 *f. Extensive course of dealing.* Past practices of the employer can in appropriate
14 cases inform the agreement of the parties.

15
16 **Illustration:**

17
18 6. X provides recruitment, marketing and staffing services for other companies.
19 X employed E from April 2002 to December 2009 as an vice-president of X responsible
20 for arranging media advertisements for clients. E's commissions were calculated on the
21 basis of the following formula. When a client agreed to a media buy, X would advance a
22 payment to the media company and the client would reimburse X and pay a fee for E's
23 services. When the client was billed, E would receive 20 percent of the amount minus
24 certain charges such as E's entertainment and travel expenses, finance charges for any
25 late payments by the client, and half of the salary of E's assistant. E was aware of these
26 charges and acquiesced in these charges during her employment. In December 2009, E
27 resigned her position with X and sues for reimbursement of these charges as a breach of
28 contract and under state wage-payment law. There is no written agreement between X
29 and Y.

30
31 The parties' extensive course of dealings for over seven years and regular written
32 compensation statements issued by X to E, and acquiesced in by E, support a finding that
33 there was implied contract between X and E under which the final computation of the
34 commissions owed to E depended on adjustments for late payment by clients, half of the
35 cost of E's assistant and other work-related charges. (Implied contract terms are
36 discussed in § 2.03, comment g).

37
38 *g. Payment of undisputed amount.* It is a corollary of § 3.01(a) that the employer
39 is obligated to pay that portion of the compensation that is undisputably owed. State wage
40 payments generally prohibit any deduction by employers from wages that are not
41 expressly authorized by the employee, but this prohibition is not found in the common
42 law.

1 **§ 3.02 Bonuses and Other Incentive Compensation**
2

- 3 **(a) If so provided in an agreement between the employer and the employee or**
4 **any binding promises or policy statements of the employer, bonuses and**
5 **other incentive compensation are a form of compensation which employees**
6 **have a right to be paid if they have earned such compensation. Absent such**
7 **an agreement or any binding promises or policy statements, bonuses and**
8 **incentive compensation are awards made in the employer’s discretion.**
9 **(b) Whether bonuses or other incentive compensation have been earned is**
10 **determined by the agreement between the employer and employee or any**
11 **binding promises or policy statements of the employer.**
12 **(c) Employers are under an obligation to pay employees the bonuses and other**
13 **incentive compensation they have earned, except to the extent there is a bona**
14 **fide dispute as to whether the compensation claimed has been earned.**
15

16 **Comment:**
17

18 *a. Compensation or discretionary award?* Employers award bonuses and other
19 types of incentive compensation as a means of motivating their employees. Whether
20 bonuses are a form of compensation that employees have a right to receive or, rather, are
21 merely awards that the employer makes solely in its own discretion depends on the
22 agreement between the employer and employees, including any binding promises or
23 policy statements of the employer. This is necessarily a fact-intensive inquiry. Important
24 factors include (1) whether the documents establishing the bonus expressly state that the
25 bonus is a discretionary award; (2) whether the bonus is an important part of the
26 employee’s overall compensation; (3) whether the criteria for receiving the bonus are
27 keyed to objective measures of employee performance or conduct (such as remaining
28 with the employer for a particular period of time) or firm performance rather than purely
29 subjective assessments of the employer; and (4) the course of dealing between the parties.
30

31 **Illustrations:**
32

33 1. In January 2008, X, an investment bank, hired E to help develop its fledgling
34 underwriting business. The parties entered into a contract guaranteeing E’s employment
35 in 2008 and 2009 under the following terms: E would receive a base salary of \$200,000
36 plus a bonus that would raise his “total compensation” to 33% of the first \$4.5 million of
37 gross revenues that X derived from deals on which E worked (the “Percentage Bonus”),
38 but that in no case would E receive less than \$1 million total compensation. In both
39 years, E could also receive an extra bonus “at X’s discretion.”
40

41 X discharged E in August 2009. E received a total of \$1.4 million for the two
42 years, but claims he was entitled \$2.97 million under the Percentage Bonus formula,
43 excluding any discretionary bonus. The Percentage Bonus for the 2008 and 2009 was
44 compensation earned by E.
45

1 2. E was hired in January 2007 as a commodities trader for the natural gas desk at
2 X, an investment bank. E received a formal offer letter which he signed, dated and
3 returned to X's personnel department. The letter stated that E's annual salary would be
4 \$150,000 and he would be eligible to participate in X's Investment Bank Incentive Plan.
5 It further stated:

6
7 The payment and amount of any incentive compensation award under the
8 Incentive Plan is in the complete discretion of the firm. Subject to your being
9 actively employed as of the date of the payout, you will be eligible under the
10 Incentive Plan to receive an annual incentive bonus which is intended to motivate
11 future performance and which may be based on individual achievement, business
12 unit and overall corporate results and awarded under the terms of the Plan and in
13 our sole discretion. ... If your employment terminates for any reason before the
14 award date, whether the termination is initiated by you or the firm you will not
15 earn or receive any award. ... No employee or officer of the firm is authorized to
16 make any oral promises to you about an incentive compensation award.
17

18 In January 2009, E quits his position to apply to law school. X's payout date for
19 2007-2008 period, under the Incentive Plan, is March 15, 2009. E is not entitled to a
20 bonus under the Plan.
21

22 *b. Bonuses to motivate continued service or other employee conduct.* Sometimes
23 employers provide bonuses not so much to incentivize employee performance as to
24 ensure that employees will continue working for the employer during some period of
25 corporate change. Such bonuses normally constitute earned compensation once the
26 conditions of the bonus are satisfied.
27

28 **Illustration:**

29
30 3. Concerned that key performers might leave for competitors because of rumors
31 of a corporate takeover, X, a major financial services company, promulgated an Incentive
32 Compensation Plan (ICP) for certain executives, including E. The plan provided eligible
33 employees with restricted company stock at substantially reduced prices in lieu of a
34 portion of the executive's compensation. Employees participating in this program,
35 including E, signed agreements stating that should they resign before their restricted
36 shares of stock vested, they would forfeit the stock and the portion of the compensation
37 they directed be paid in the form of restricted stock.
38

39 E quits his employment with X before any of his shares of restricted stock under
40 the ICP vest. E forfeits his shares of the stock and the portion of compensation he
41 directed be paid in the form of such stock.
42
43
44
45
46

1 § 3.03 Benefits

- 2
- 3 (a) If so provided in an agreement between the employer and the employee or
- 4 any binding promises or policy statements of the employer, benefits are a
- 5 form of compensation which employees have a right to receive, in accordance
- 6 with any applicable plan documents.
- 7 (b) Employers are under an obligation to provide employees, in accordance with
- 8 any applicable plan documents, the benefits the employers have agreed or
- 9 promised, as a matter of practice or policy statement, to provide, except to
- 10 the extent there is a bona fide dispute as to whether the requirements of
- 11 applicable plan documents have been satisfied.

12

13 **Comment:**

14

15 *a. ERISA preemption.* Federal legislation – namely, the Employment Retirement

16 Security Act of 1974 (ERISA) -- broadly preempts state regulation of employee pension

17 and welfare benefit plans. State contract law continues to play an important role because

18 ERISA does not cover benefit plans funded by government employers and does not cover

19 payroll practices and terms of individual employment agreements. In addition, respecting

20 employee welfare benefit plans – plans that do not provide retirement benefits -- ERISA

21 provides very little substantive law requiring the courts to develop an “ERISA common

22 law” which heavily depends on state contract (and trust) law.

23

24 *b. Benefit plans.* Employers provide employees with benefits not only as a

25 motivational mechanism but also because tax advantages and economies of scale allow

26 employers to provide benefits desired by employees at substantially lower costs than they

27 would incur on their own in the open market. In order to derive these economies of scale,

28 the employer establishes plans that cover a relatively number of employees and provide

29 common terms for covered employees.

30

31 *c. Employer unilateral policy statements.* In the benefits context, employers are

32 likely, though not invariably, to set the terms of benefit plans through unilateral policy

33 statements rather than agreements with employees. The statements are intended generally

34 to establish binding commitments while they are in effect.

35

36 **Illustration:**

37

38 1. Anticipating a significant reduction in force, X, a manufacturer, informs his

39 employees via the company email that salaried employees who are designated for this

40 round of layoffs (ending December 31, 2010) will receive three months of salary and

41 healthcare benefits continuation, in addition to one week of severance pay for each year

42 of service. Nonsalaried employees receive only the one week of severance pay for each

43 year of service (Reorganization Plan Benefits).

44

45 E, a salaried employee of X, is laid off on August 1, 2010. X is entitled to the

46 Reorganization Plan Benefits.

1 **§ 3.04 Modification of Compensation or Benefits**
2

- 3 **(a) An employer may prospectively modify or revoke any compensation or**
4 **benefits based on its past practices or policy statement by providing**
5 **reasonable notice of the modification or revocation to the affected**
6 **employees.**
7 **(b) Such modifications and revocations apply to all employees hired, and all**
8 **employees who continue working, after the effective date of the notice of**
9 **modification or revocation.**
10 **(c) Such modifications and revocations cannot, absent the consent of affected**
11 **employees, adversely affect rights under any agreement between the**
12 **employer and the employee or employees (§ 2.03) or adversely affect any**
13 **vested or accrued employee rights that may have been created by an**
14 **agreement (§ 2.03), employer statement (§2.04), or reasonable detrimental**
15 **reliance on an employer promise (§ 2.02, comment c).**
16

17 **Comment:**

- 18
19 *a.* This Section applies the principles developed in § 2.06.
20

21 **Illustration:**

22
23 1. Same facts as in § 3.03, Illustration 1, except that X announces that for the
24 second round of layoffs commencing January 1, 2011 and ending March 15, 2011, the
25 Reorganization Plan Benefits have been changed to provide only 2 months of salary and
26 healthcare benefit continuation plus severance pay; the severance pay component is not
27 changed (“Modified Reorganization Plan Benefits”).
28

29 F learns on January 2, 2011 that he is scheduled for layoff on February 15, 2010.
30 F will receive the Modified Reorganization Plan Benefits and has no claim to the earlier
31 plan benefits because they were limited to employees laid-off during the first round.
32

33 *b. The special case of vested or accrued employee rights.* As developed in § 2.06,
34 Comment *b*, an employer cannot by unilateral action modify or rescind enforceable
35 employee contractual rights. Such rights normally arise from express agreements
36 covered by §§ 2.02(a)-(b) & 2.03. In appropriate circumstances, unilateral employer
37 policy statements may also create vested or accrued employee rights that cannot be
38 unilaterally modified or rescinded; any adverse change would require an agreement by
39 the employee backed by consideration. Factors in determining whether an employer
40 policy statement creates a vested or accrued employee right include the statement’s
41 language, other policies of the employer, the employer’s course of conduct, and usages in
42 the particular industry or occupation.
43
44
45
46

Illustrations:

2. Upon commencing employment for X Corporation on January 1, 2000, E, an insurance salesperson, was told he would be paid under an “Accrued Commission Plan” in effect for all of X’s sales force. That plan provided a sales commission of 7% on the premiums of the policies sold or renewed. On January 1, 2004, X modified the compensation plan so that commissions would be based not on a percentage of premiums, but rather on a stated flat rate for each policy sold or renewed. E has challenged the application of the “flat rate” commission system to renewals of policies sold while the original plan was in effect. E’s claim against X should go to the trier of fact because the foregoing facts create a bona fide dispute as to whether the original plan set a fixed system for compensating X’s salespersons only for sales of policies made while that plan was in effect or whether it also governed all future renewals of those policies -- despite the announced change in the change in the compensation plan.

3. Seven tenured professors at a X State University were hired before 1990 and have been paid on a calendar year basis (envisioning 11 months of duties) rather than academic year levels, which were lower. These professors were therefore paid as if they were performing 11 months of duties when they worked only 9-month academic year schedules. All professors hired since 1990 have been paid on an academic year basis unless they in fact perform 11 months of duties. On January 1, 2010, the University informed the seven professors that beginning January 1, 2011, they would be paid only on an academic year basis. Unless these professors can show they have an agreement with X, express or implied, to be paid on a calendar year basis for the duration of their careers with the University, they are subject to the University’s changed policy effective January 1, 2011.

§ 3.05 Implied Duty of Good Faith and Fair Dealing

- (a) Both the employer and employee, whether or not the relationship is terminable for cause or at-will, owe a nonwaivable duty of good faith and fair dealing to each other, which includes an agreement by each not to hinder the other’s performance under, or to deprive the other of the benefit of, the employment relationship (§ 2.06).
- (b) The employer’s duty of good faith and fair dealing includes the duty not to terminate or seek to terminate the employment relationship or implement other adverse employment action, for the purpose of
- (1) preventing the vesting or accrual of an employee right or benefit,
 - or
 - (2) retaliating against the employee for refusing to consent to a change in earned compensation or benefits.

1
2 **Comment:**
3

4 *a. Opportunistic firings.* The implied duty of good faith and fair dealing not only
5 promotes basics notices of fairness but enables the parties to enter into certain
6 relationships where performance is not simultaneous – where, for example, the
7 employees renders services but the employer’s obligation to pay for those services does
8 not ripen until certain conditions subsequent have been satisfied. As with any implied
9 term, the express terms of the agreement between the parties controls.
10

11 **Illustration:**
12

13 1. Employer X assigns its sales people – all at-will employees – to specific
14 territories. X does not require its sales people to sign an employment agreement. As a
15 matter of practice, each sales employee is paid 75% of the applicable commission upon
16 executing a sales agreement with the customer, and the remaining 25% of the
17 commission after the equipment is delivered to the customer and 30 days have transpired
18 without a customer complaint. In addition, the 25% is paid only if the employee is still
19 on X’s payroll at that latter date. E, an at-will sales person employed by X, has procured
20 a substantial order for X’s equipment from a large customer, and has received 75% of the
21 applicable commission. On January 1, the equipment is delivered to the customer. On
22 January 15, E is fired without cause. E has an action against X for the remaining 25% of
23 the applicable commission (but not for reinstatement) if E was discharged in order to
24 prevent E’s obtaining the 25% commission.
25

26 2. Same facts as Illustration 1, except that each sales employee, including E,
27 signed an agreement upon being hired that states that the “the 25% component of the
28 commission is paid only if the employee is still on X’s payroll 30 days after the
29 equipment has been delivered without an employee complaint (“Customer Satisfaction
30 Date”). If the employee is not on the payroll as of the Customer Satisfaction Date, the
31 25% component is to be paid to the employee servicing the customer account on that
32 date.” E has no claim against X for the remaining 25% of the commission.
33

34 *b. Employer retaliation.* As stated in § 3.04(c), employers cannot by
35 unilateral action modify accrued or vested rights of employees. The implied duty of good
36 faith and fair dealing also prevents the employer from taking adverse action against
37 employees who refuse to agree to an adverse change in compensation or benefit which
38 they are owed. Employers can try to obtain the consent of employees to such changes but
39 they breach the implied covenant if they compel such consent as a condition of
40 employment or subject the employee to an adverse employment action for refusing to
41 consent to such changes.
42
43 .

1
2
3
4
5
6
7
8
9

CHAPTER 5

EMPLOYER LIABILITY FOR HARM TO EMPLOYEES:

GENERAL PRINCIPLES

10 This Chapter treats the general principles governing employer responsibility for
11 harm suffered by employees. Inasmuch as most employees in modern society are
12 employed by business entities, such as corporations, rather than by individuals, most
13 harm for which employers might be responsible is caused by the actions, or failures to
14 act, of agents of the employers. Thus, the Chapter builds on the law of agency to
15 articulate the principles defining an employer's possible direct or indirect liability for
16 harm to its employees. In some cases, employers are not suable in court under these
17 principles because the harms in question are covered by no-fault workers' compensation
18 statutes.

19

20 Section 5.01 addresses a principal's liability for the actions of its agents,
21 incorporating with specific reference to the employment relationship the rules stated in §§
22 7.03 through 7.08 of the Restatement Third of Agency. Section 5.01(3) recognizes an
23 additional principle of indirect liability reflecting the Supreme Court's formulation of
24 employer liability for harassment by supervisors actionable under the anti-discrimination
25 laws.

26

27 The latter sections of this Chapter define an employer's duties to protect its
28 employees from wrongdoers under its control and to provide a safe, or to warn of an
29 unsafe, workplace. A failure to discharge one of these duties is a wrong committed by
30 the employer. The wrong consists of the failure of an employer or its agents to act
31 reasonably.

32

33 This Chapter does not focus on the substantive definitions of wrongful conduct
34 that may render an employer or other actors liable to employees. Employer torts

1 considered elsewhere in this Restatement include the tort of wrongful discipline in
2 Chapter 4, the torts of defamation and wrongful interference in Chapter 6, and invasions
3 of employee privacy and autonomy in Chapter 7. Other employer torts, such as assault
4 and battery, intentional infliction of emotional distress, false imprisonment, and
5 negligence, do not involve special considerations for the employment relationship. Other
6 actionable wrongs for which employers may be responsible are defined by statutory law,
7 such as the federal and state anti-discrimination laws. Certain employee obligations to
8 their employer are defined in Chapter 8. If a subject matter is not covered in this Chapter
9 or Chapter 6, the reader should consult the Restatement Second of Torts and the
10 Restatement Third of Agency.

11 12 **§ 5.01 Employer's Liability to Employees for Acts of Its Agents**

13
14 **Except to the extent otherwise provided in a workers' compensation law, an**
15 **employer is subject to liability to an employee for harm to the employee caused by**

16
17 **(1) wrongful conduct of an agent of the employer if that conduct has been**
18 **authorized or ratified by the employer;**

19
20 **(2) wrongful conduct of another employee of the employer if that conduct has**
21 **been taken within the other employee's scope of employment; or**

22
23 **(3) a wrong intentionally committed by an agent of the employer to whom the**
24 **employer has delegated power to direct, reward, or discipline the employee, through**
25 **the explicit or implicit use or threatened use of such power, unless the employer can**
26 **demonstrate**

27 **(a) that it took all reasonable steps to prevent and promptly correct**
28 **any such wrong, and**

29 **(b) that the wrong could have been avoided had the employee not**
30 **unreasonably failed either to**

- 1 **(i) to take advantage of any preventive or corrective**
2 **opportunities provided by the employer, or**
3 **(ii) to avoid harm otherwise.**
4

5 **Comment:**
6

7 *a. Employer's liability for authorized acts of agents.* Under the general law of
8 agency, an employer as a principal is liable for harm caused by the wrongful acts of its
9 agent where the employer has authorized those acts, either by giving authority to the
10 agent to so act or by ratifying the acts after their commission. Such acts are treated as acts
11 of the employer for which it may be directly liable. An employer, whatever its
12 organizational form or size, gains benefit from the delegation of authority to agents and
13 can monitor the exercise of that authority. The employer therefore bears responsibility for
14 this exercise.

15 An employer's liability for authorized or ratified acts does not depend on the
16 employer authorizing or ratifying what makes the actions wrongful, including the agent's
17 wrongful motivation for the actions. Thus, an employer is liable for an authorized agent's
18 wrongful discriminatory or retaliatory discharge of an employee if the agent had authority
19 to impose the discharge, regardless of whether the employer had a formal policy against
20 and opposed discrimination or retaliation.

21
22 **Illustrations:**
23

24 1. P, a large incorporated retailer, delegates authority to the managers of
25 each of its stores to hire and fire sales clerks. M, a manager of one of P's stores,
26 discharges E, a sales clerk at the store, because E files a claim for workers'
27 compensation after being injured while moving merchandise. P's senior
28 management has directed all its store managers not to take any adverse actions
29 against employees because they have filed claims for workers' compensation.
30 Applicable law prohibits adverse employment action against employees because
31 they have filed workers' compensation claims.

1 P may be subject to liability to E. P has authorized M to terminate P's
2 employees who work in the store managed by M. M's wrongful motivations may
3 be imputed to P.
4

5 2. Same facts as Illustration 1 except that M discharges E because E
6 refuses M's demands that she engage in sexual acts with M. P has clear policies
7 against sexual discrimination and sexual harassment and no other managerial
8 agent of P is aware of M's demands on E or M's motivation for firing E.
9 Applicable law prohibits employment discrimination on the basis of sex and has
10 been interpreted to cover discrimination against employees who refuse a
11 supervisor's sexual demands.

12 P may be subject to liability under these anti-discrimination laws for M's
13 termination of E. Ms discriminatory motivation may be imputed to P because M
14 was using P's authority to discipline employees when M discharged E.
15

16 3. E is an Executive Vice President and special assistant to the
17 president of P, a paper company. E has worked as an executive at P for ten years
18 and in the industry as an executive for thirty years. After P hires M as P's new
19 president, M transfers E to a position as the manager of P's warehouse. The
20 transfer involves a substantial reduction of responsibilities and pay. M's
21 motivation for the transfer is to obtain a new, younger special assistant. M does
22 not discharge E because he fears a lawsuit. P has a longstanding policy against
23 age discrimination. Applicable law prohibits employment discrimination on
24 account of age.

25 P may be subject to liability to E. As President of P, M had authority to
26 reassign E and P is responsible for M's exercise of this authority irrespective of
27 any company policy against age discrimination. (*Wilson v. Monarch Paper Co.*,
28 939 F.2d 1138 (5th Cir. 1991).
29

30 *b. Employer liability for unauthorized acts of employees within scope of*
31 *employment.* Under the general law of agency, an employer may be liable for

1 unauthorized acts of its employee agents if those acts are taken as part of or incident to
2 work assigned by the employer or subject to the employer's control and are motivated at
3 least in part to serve the employer. Such acts are said to be within the scope of
4 employment. See § 7.07 of the Restatement Third of Agency.

5

6 **Illustrations:**

7

8 4. P employs E as an accountant in its corporate offices. M, P's Chief
9 Financial Officer and E's supervisor, has authority to terminate E's employment.
10 M discharges E because E has to take time off for a major operation during a
11 period that is inconvenient for P's operations. In response to questions from E's
12 coworkers, M states that he discharged E because E was conspiring with an
13 outside contractor to misappropriate company funds. M knows this to be untrue,
14 but M thinks his real reason for terminating E may be illegal and that it is in P's
15 interest, as well as his own, that this reason not be known.

16 P may be liable for F's defamation of E under applicable law. P did not
17 authorize M to publish intentionally defamatory statements about E. M, however,
18 published this defamation in the course of his employment as P's executive and
19 with the intent to serve the interests of P.

20

21 5. P employs S as a supervisor in a supply warehouse. S regularly yells
22 screams, and uses curse words when giving work-related directions to his
23 subordinates E, F, G, and H at the warehouse. S also regularly yells and curses
24 and uses vulgar insults when evaluating the work of these subordinates. To
25 express his displeasure with his subordinates' work, S charges at them with his
26 head down and his fists clenched, and threatens them with violence.

27 If S's behavior may be sufficiently extreme and outrageous to constitute
28 the intentional infliction of emotional distress under applicable law, P may be
29 liable to E, F, G, and H. P did not give S authority to yell, curse, insult, and
30 threaten his subordinates. P, however, did give S authority to supervise these
31 workers and S's behavior was within the scope of this employment and

1 undertaken in part to serve the interests of P in having the warehouse operations
2 supervised. (GTE Southwest, Inc. v. Bruce, 998 S.W.2d 605, 42 Tex. Sup. Ct. J.
3 907 (1999). See also King v. Brooks, 788 P.2d 707 (Alaska 1990).

4
5 6. E is employed as a sales clerk at P, a department store. F, another sales
6 clerk, thought he saw E take some jewelry merchandise from a case and put it in
7 E's purse. F informs the store manager, M, who calls E into M's office with the
8 store detective, D. While D stands against the door out of M's office, M tells E
9 that she will have to stay in his office until she signs a confession for stealing the
10 jewelry, although he cannot find any in her purse.

11
12 P may be subject to liability to E for the acts of M and N if they constitute
13 the tort of false imprisonment and arrest under applicable law. P did not authorize
14 M and N to hold E against her will in M's office. In restraining E's movement,
15 however, M and N were acting incident to their employment by P as store
16 manager and store detective. (E.g., Skelton v. W.T. Grant Co., 331 F.2d 593 (5th
17 Cir. 1964).

18
19 *c. Employer's liability for supervisors' misuse of supervisory power outside scope*
20 *of employment.* The rationale for imposing liability on employers for the wrongful acts
21 of their employees may extend in some cases to the misuse of supervisory power by
22 employee-agents for their own ends outside the scope of employment. Employers do not
23 benefit when employees to whom the employers have delegated power or discretion to
24 direct, reward and discipline other employees use that power for the employees' own
25 purposes rather than for the purpose of serving their employer. However, they do benefit
26 from the delegation of supervisory authority or discretion generally and can foresee that
27 such power can be misused in the interests of the supervisors rather than that of the
28 employers. The power of supervisors over employees is also enhanced by the employer's
29 delegation of authority or discretion. Employers also generally are in a better position
30 than are employees injured by supervisory abuses to minimize such harm by monitoring
31 and channeling the use of supervisory power.

1 If an employer, however, has taken reasonable steps to monitor, prevent, and
2 correct the possible wrongful misuse of delegated supervisory power, an employee victim
3 of the misuse may be in a better position than is the employer to minimize harm. If such
4 an employee fails to act reasonably in attempting to do so, the rationale for making the
5 employer liable for the supervisor’s wrongful misuse of power for the supervisor’s own
6 purposes is much weaker than for making the employer liable for the supervisor’s
7 wrongful misuse of power in service to the employer. Without warning or complaints,
8 employers cannot be expected to monitor their supervisors pursuing independent courses
9 of conduct for their own ends as closely as supervisors acting within the scope of their
10 employment.

11 The Supreme Court’s holding in *Burlington Industries, Inc. v. Ellerth*, 524 U.S.
12 742 (1998) and *Faragher v. City of Boca Raton*, 524 U.S. 775 (1998), reflects these
13 considerations by allowing liability under Title VII of the Civil Rights Act of 1964, 42
14 U.S.C. § 2000e-2(a)(1), to be imposed on employers for their supervisors’ discriminatory
15 sexual harassment of subordinate employees unless the employers can demonstrate: “(a)
16 that the employer exercised reasonable care to prevent and correct promptly any sexually
17 harassing behavior, and (b) that the plaintiff employee unreasonably failed to take
18 advantage of any preventive or corrective opportunities provided by the employer or to
19 avoid harm otherwise.” Subsection 5.01(3) recognizes this holding as a general common
20 law principle for the wrongful misuse of supervisory power whether or not outside the
21 scope of employment.

22 This subsection, like the holding of *Ellerth* and *Faragher*, does not extend to
23 wrongs committed outside the scope of employment by nonsupervisory employees on
24 other employees. Such wrongs do not involve the misuse of power that the employer has
25 delegated for its own benefit. An employer generally does not enhance an employee’s-
26 opportunities for wrongful action against a fellow employee when the first employee
27 lacks supervisory power over the fellow employee. As stated in § 5.03, employers have a
28 duty to protect their employees from co-employees by exercising care in hiring,
29 supervision, and retention; and as stated in §§ 5.02 and 5.04, employers also have duties
30 to provide their employees with a reasonably safe workplace. But these duties are not
31 breached by wrongful actions by a nonsupervisory employee that are outside the scope of

1 the wrongdoer's employment. Employees can be expected to take the first steps in
2 alerting employers to wrongs they have suffered at the hands of nonsupervisory
3 employees.

4 **Illustrations:**

5
6 7. P employs E as a salesperson. M directs and evaluates E's work. M
7 extends numerous sexual propositions to E and tells E that if she does not "loosen
8 up" and "play nice" with him, he will see that she is fired. E asks M to stop, but M
9 continues to make physical and coarse verbal advances. M also treats E rudely
10 and continues to threaten her with unfavorable evaluations. P has disseminated to
11 all employees a formal policy against sexual discrimination and harassment at the
12 workplace, but it does not offer its employees any way to report harassment
13 except by complaining to their supervisor. M's superiors never learn of M's
14 harassment of E before E resigns her position with P on account of M's
15 misconduct.

16
17 P may be subject to liability to E for M's sexual harassment of E. M did
18 not discharge or take any other action against E that was authorized or ratified by
19 P. M's harassment of E was outside his scope of employment as it was not
20 incident to his assigned duties and was not undertaken in service of P. M,
21 however, did use his authority as E's supervisor to subject E to verbal and
22 physical advances and to threaten E with adverse personnel action if E did not
23 submit to those advances. P did not have a reasonable policy to prevent E's
24 harassment because E had to report through her supervisor-harasser, M.

25
26 8. Same facts as Illustration 7 except that P designates a corporate officer
27 to hear complaints of supervisory harassment. P also conducts seminars at which
28 it explains both how it will protect from retaliation employees who report
29 supervisory harassment and also how it has prevented continuing supervisory
30 harassment in prior cases. E does not report M's harassment before resigning.

31

1 P may not be subject to liability for M's harassment of E. P took
2 reasonable steps to prevent the harassment and E failed to take advantage of P's
3 reasonable prevention scheme.

4
5 9. Same facts as Illustration 7 except that the harasser is F, not E's
6 supervisor, but only another salesperson in the same office as E. F makes coarse
7 verbal and physical advances toward E both inside and outside the office. Neither
8 F's supervisor or any other manager of P know of F's harassment of E.

9
10 P may not be subject to liability for F's harassment of E. F as a co-worker
11 did not have delegated power to direct, reward or discipline E. E could have
12 reported on F without fear that F would retaliate against her as her supervisor.

13
14 10. Same facts as Illustration 8 except M, E's supervisor, does not threaten
15 or verbally or physically assault E her at the office. Rather, M tells E that they
16 need to have a business meeting over dinner. At the dinner M makes sexual
17 propositions to E and on the way home assaults her.

18
19 P may be subject to liability for M's assault on E if so provided under
20 applicable law. The assault was not within the scope of M's employment with P.
21 However, M used his power as a supervisor to create the opportunity to subject E
22 to the assault. Moreover, the immediacy of the assault precluded any reasonable
23 opportunity for E to take advantage of P's reasonable preventive policy or to
24 avoid the harm of the assault otherwise.

25
26 *d. Wrongs covered.* The wrongs committed by its agents for which an employer
27 may be liable include those defined by statutory law, such as the federal and state anti-
28 discrimination laws. The wrongs also include the employment-related torts covered in
29 other Chapters of this Restatement. Other actionable wrongful conduct through which an
30 employer's agents may harm the employer's employees include intentional infliction of
31 emotional distress, assault and battery, false imprisonment, and negligence.

1 Whether an agent’s conduct is wrongful, and thus may be the basis for employer
2 liability, depends on the definition of the elements of the tort or statutory wrong with
3 which the agent is charged. The elements of some of the wrongs are specially defined for
4 the employment setting. The elements of other wrongs are defined in various statutes or
5 generally without special variance for the employment setting in the common law of
6 torts.

7 An example of the latter tort is the intentional infliction of emotional distress.
8 Thus, if the standard for employer liability stated in § 5.01 is satisfied, an employer may
9 be liable for an employee’s intentional infliction of emotional distress on another
10 employee only if the first employee’s conduct satisfies the tort’s elements as set forth in §
11 46 of the Restatement Second of Torts. These elements include being “extreme and
12 outrageous” and the intentional or reckless causation of “severe emotional distress.”

13

14 **Illustration:**

15

16 11. P employs M as a supervisor in a supply warehouse. M is always
17 highly critical of his subordinates E, F, G, and H at the warehouse. E, F, G, and H
18 claim this continual criticism causes them emotional distress. M’s supervision is
19 within the scope of his employment. Since this supervision is not extreme and
20 outrageous, however, P cannot be liable to E, F, G, and H for intentional infliction
21 of emotional distress.

22

23 *e. Exclusivity principle of workers’ compensation laws.* All states have a workers’
24 compensation statute that generally excludes alternative remedies for injuries covered by
25 the statute. Workers’ compensation statutes generally provide remedies for physical and
26 some mental injuries suffered by employees in the course of their employment. Such
27 statutes do not generally cover the economic or reputational harms resulting from
28 termination of employment or other adverse employment decision, including violations
29 of antidiscrimination laws. As a general matter, these laws do not affect employer
30 liability for the employment-related torts considered in Chapters 4 and 6 of this
31 Restatement.

1 Not all employees are covered by workers' compensation statutes. Some
2 jurisdictions may allow at least some employers to elect not to be covered. Some
3 jurisdictions do not cover small employers and some do not cover all agricultural and
4 domestic employees. Some jurisdictions allow employees to waive coverage.

5

6 **Illustration:**

7

8 12. Same facts as Illustration 11, except that M verbally and physically
9 assaults E, F, G, and H. P's operations, including the supply warehouse
10 supervised by S, is in a jurisdiction whose workers' compensation law does not
11 cover injuries caused by a course of conduct or by repetitive abuse rather than by
12 a particular traumatic event.

13 Because the jurisdiction's workers' compensation law does not cover the
14 emotional distress suffered by E, F, G, and H, the law does not bar recovery
15 against P for an intentional infliction of emotional distress claim that is available
16 under applicable law.

17

18 *f. Fellow servant doctrine does not bar recovery.* Where an employee's
19 cause of action is not barred by the exclusivity principle of a jurisdiction's workers'
20 compensation law, it should not be barred by the fellow servant doctrine. This doctrine,
21 which was originally formulated to protect businesses from liability for harm caused to
22 some employees for the negligence of others, has been abrogated or modified by judicial
23 decision or statute in most jurisdictions.

24

25 **§ 5.02 Employer's Duty to Provide Safe Conditions or to Warn of Risk**

26

27 **Except to the extent otherwise provided by a workers' compensation law, an**
28 **employer is subject to liability for harm to an employee caused by breach of its duty**

29

30 **(a) to provide working conditions that are reasonably safe, or**

31

32 **(b) to warn of the risk of unavoidably unsafe conditions.**

33

34 Summary Comment: This section is based on a similar provision, § 525, in the
35 Restatement Second of Agency. It is a principle of direct employer liability as it depends

1 on the employer's wrongful failure to act. The case law in support mostly predates
2 workers' compensation laws, as those laws generally provide the exclusive remedy for
3 the kind of physical injury that might be caused by a breach of this duty. However, there
4 are a few modern cases involving workers, such as those in agriculture, who are not
5 covered by workers' compensation laws. This doctrine remains as a backdrop to these
6 laws to cover any employees and employers who have opted out of coverage or who are
7 otherwise exempted from coverage.

10 **§ 5.03 Employer's Duty to Exercise Care in Selecting and Supervising Agents**

11
12 **Except to the extent otherwise provided by a workers' compensation law, an**
13 **employer is subject to liability for harm to an employee caused by breach of its duty**
14 **to exercise reasonable care in selecting, assigning, training, retaining, and**
15 **supervising its agents.**

16
17 Summary Comment: This section is well supported by case law in most jurisdictions. It
18 also builds on § 7.05 of the Restatement Third of Agency, which states that a principal is
19 subject to direct liability for harm "caused by the principal's negligence in selecting,
20 training, retaining, supervising, or otherwise controlling the agent." The black letter here
21 is expressed in terms of a duty of care because this Restatement of Employment purports
22 to express what obligations might be special in the employment relationship and because
23 the current Restatement Third of Torts expresses rules in terms of duties. See also § 317
24 of Restatement Second of Torts.

25
26 The case law confirms, however, that employees cannot recover under this tort for
27 injuries for which a workers' compensation law provides a remedy. An employee
28 covered by a workers' compensation law injured in the course of his or her employment
29 by the employer's negligence generally has only the remedy provided by that law. Thus,
30 a covered employee generally can recover for an employer breach of this duty only for
31 humiliation, indignity, discrimination, or some kind of nervous distress not compensable
32 under the statute. It would seem that employees injured outside the course of their
33 employment by an employer's negligent hiring or retention also should be able to recover
34 under this tort, as workers' compensation would not be available. There do not seem to
35 be cases confirming this, however, perhaps because it is difficult to prove an employer's
36 negligence was the actual and proximate cause of an employee's off work injuries.

41 **§ 5.04 Employer's Duty to Exercise Care in Preventing and Correcting Wrongful** 42 **Conduct Subject to Employer's Control**

43
44 **Except to the extent otherwise provided by a workers' compensation law, an**
45 **employer is subject to liability for harm to an employee caused by breach of its duty**
46 **to control wrongful conduct by another person**

1

2

(a) at a time and place that the wrongdoer was subject to the employer's control, and

3

4

5

(b) causing harm that the employer knew or reasonably should have known had occurred or would likely occur, where

6

7

8

(c) the harm could have been prevented had the employer responded with prompt and appropriate corrective action.

9

10

11

Summary Comment: This section confirms the employer's duty to control wrongful conduct directed at employees. It reflects the tort of negligent supervision and doctrine under the anti-discrimination laws making employers liable for harassment that the employers negligently allowed to continue. It is a more specific corollary of the employer's duty to provide a safe work place expressed in § 5.02. Section 5.04, unlike § 5.03, covers an employer's responsibility to exercise control that the employer might have over non-agent actors, such as customers or non-agent contractors. Section 5.03, like §§ 5.02 and 5.03, does not provide an additional remedy for injuries that have remedies under a workers' compensation law. Workers' compensation laws do not exclude remedies under anti-discrimination laws, however.

12

13

14

15

16

17

18

19

20

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28
29
30
31
32

Chapter 6
Other Torts Affecting the Formation or Continuation of the Employment Relationship

This Chapter covers employer liability for several torts relevant to the formation or continuation of the employment relationship. The Chapter applies general principles stated in Restatement Second of Torts to the employment setting. The focus is on employer liability and not on the liability of co-employees (except, in § 6.04(2)), to the extent necessary to delimit the scope of the tort of intentional interference with the employment relationship). The Chapter also does not cover employee liability to employers for any of the torts it addresses, including defamation. It also does not deal with employer liability for physical harm at the workplace, which is the subject of workers' compensation laws and will be covered to some extent in Chapter 5. Where a subject is not covered in this Chapter (or Chapter 5), the reader should consult the Restatement Second of Torts.

§ 6.01 Employer's Liability for Defamation of Employee

(1) If not protected by the privilege set forth in § 6.02, an employer may be subject to liability for intentionally or negligently publishing a false and defamatory statement concerning the employee or former employee.

(2) Publication occurs when an employer communicates a statement concerning an employee or former employee to any third party, including another employee of the same employer.

(3) Publication occurs when an employer communicates a statement to another employer by making the statement to the employee or former employee who is the subject of the statement if

(a) the employer also indicates to the employee or former employee that the employer would communicate the statement to another employer and

(b) the employee or former employee is later required to repeat the statement to another employer.

1 **(4) An employer publishes a statement concerning an employee or former employee**
2 **by conduct that is reasonably interpreted as intended to communicate a statement.**

3 **Comment on § 6.01**

4 a. *Overview.* As set forth in § 558 of the Restatement Second of Torts, the
5 elements of the tort of defamation include: “(a) a false and defamatory statement
6 concerning another; ((b) an unprivileged publication to a third party; (c) fault amounting
7 at least to negligence on the part of the publisher; and (d) either actionability of the
8 statement irrespective of special harm or the existence of special harm caused by the
9 publication.” Section 559 defines a communication as “defamatory if it tends so to harm
10 the reputation of another as to lower him in the estimation of the community or to deter
11 third persons from associating with him.”

12 The law of defamation thereby protects individuals from losses resulting
13 from unjustified reputational harms caused by other culpable actors. This law provides a
14 remedy to employees who suffer loss of employment opportunities because of the
15 intentionally or recklessly false and defamatory statements of their employers or former
16 employers. An employer’s communication to another employer of a defamatory
17 statement regarding an employee or former employee may result in the employee’s
18 failure to attain employment with the second employer. A defamatory communication
19 between two employees of an employer also may result in a third employee losing a
20 position with that employer or another employer.

21 There is also, however, a strong countervailing public interest in open and
22 candid communications between employers, and among employees of the same
23 employer, concerning the skills, capabilities, and character of employees and former
24 employees. This countervailing interest requires recognition of a qualified privilege, as
25 set forth in § 6.02, to avoid discouraging such communications. Only defamatory
26 employer publications regarding employees or former employees that are not made in the
27 reasonable course of business or that are made with the intent to deceive or with reckless
28 indifference to the truth are not protected by the privilege.

29 b. *Internal publication.* Publication of a false, defamatory statement can
30 occur entirely within the employer’s organization. This Restatement follows the view of
31 Restatement Second of Torts § 577 comment (i) and the majority of courts that

1 communications between employees can constitute a publication by the employer if the
2 statements are made within the publishing employee's scope of employment. In order to
3 encourage candid intra-organizational business-related discussions, however, § 6.02
4 recognizes a qualified privilege for reasonable employer communication of relevant facts
5 about employees, on a need-to-know basis. Furthermore, to be actionable, the publication
6 of a defamatory statement must be intentional or negligent. See § 577 (1) of the
7 Restatement Second of Torts. Thus, if a manager takes reasonable care to ensure that a
8 defamatory, but privileged evaluation of an employee is viewed only by those with
9 legitimate interests, the perusal of the evaluation by an unauthorized additional employee
10 would not constitute a publication.

11 **Illustrations:**

12 1. E, S and M are employees of P. S, E's supervisor, submits a report to
13 M, the head of personnel of P, that E has falsified his expense accounts. S's report
14 is shown only to M and other managers with responsibility for determining
15 whether E's employment should be terminated. S's report is a publication by S
16 and P.

17 2. Same facts as in Illustration 1 except that S is a not a supervisor and
18 has no responsibility for reviewing coworker expense accounts. S's report is a
19 publication by S but not by P if S was not acting in the scope of his employment.

20 *c . Publication to another employer.* An employer may publish a false and
21 defamatory statement regarding an employee or former employee to another employer in
22 the myriad ways that it can publish any statement. These include communications to the
23 community at large as well as written or oral statements submitted directly to a particular
24 other employer.

25 **Illustration:**

26 3. P, a health clinic, terminates E from her employment as an
27 administrative assistant. Upon E's request to P, P's manager, M, writes a letter
28 of reference for E that M agrees to send to any other prospective employer of E
29 who asks for substantiation of E's prior experience with P. M, who dislikes E,
30 includes in the letter a charge that E had breached the confidentiality of several of
31 P's patients. M knows this charge is false. M sends the letter to R, a hospital that

1 is considering hiring E and has requested a reference letter from P. After reading
2 the letter, R's managers decide not to hire E.

3 M and P have published a potentially defamatory statement by sending M's
4 letter to R, E's prospective employer.

5 d. *Publication to another employer through defamed employee.* Section
6 6.01(3) recognizes that in some circumstances an employer's statement regarding an
7 employee to that employee may constitute publication to another employer. An employer
8 that wishes to prevent an employee from securing other employment can do so by making
9 a defamatory statement to the employee that the employee will be compelled to repeat to
10 another employer considering hiring the employee. An employer, for instance, may
11 provide an employee a written letter of reference that the employer knows or should
12 know the employee will need to show to prospective employers who ask for a reference
13 from the prior employer.

14 An employer also can make oral statements to employees about the reasons
15 for the employees' termination from employment that the employer knows or should
16 know the employees will need to repeat when asked by a prospective employer about
17 their reasons for leaving their prior employer. An employer that intends to communicate
18 a defamatory statement to other employers by using the defamed employee as a medium
19 of communication should be treated as publishing the statement to other employers who
20 receive the communication. So should an employer that thereby communicates
21 defamatory matter to other employers by the creation of "an unreasonable risk" of such
22 communication. As stated in *comment k* to § 557 of the Restatement Second of Torts:
23 "There is an intent to publish defamatory matter when the actor does an act for the
24 purpose of communicating it to a third person or with knowledge that it is substantially
25 certain to be so communicated. ... If a reasonable person would recognize that an act
26 creates an unreasonable risk that the defamatory matter will be communicated to a third
27 person, the conduct becomes a negligent communication."

28 For an employer's communication to an employee or former employee to
29 constitute publication under this Subsection, however, an employer must indicate to the
30 employee that it would make the same statement to another employer. An employer
31 reasonably acts to avoid compelling the employee to repeat a defamatory statement to

1 other employers where, by contrast, the employer assures the employee that it will not
2 itself repeat the statement. An employer may assure the employee either when making
3 the communication, when asked by the employee, or through a general policy of
4 responding to queries from prospective employers with the employee's job title and term
5 of employment without conveying internal criticisms or reasons for terminations.

6 Furthermore for an employer's defamatory statement to the defamed
7 employee to constitute publication, the defamed employee must be required by another
8 employer to repeat the statement. If the employee is not required by the prospective
9 employer to give the reasons for termination of prior employment, the employee's
10 unsolicited provision of those reasons is a form of self-publication, rather than the
11 conveyance of the first employer's publication to the prospective employer. Moreover,
12 employees defamed by explanations of their terminations or by other criticisms of their
13 work, like the potential victims of other torts, have an obligation to avoid or mitigate, not
14 to augment, harm. Even where the past employer has not provided assurance of
15 confidentiality, the employee's unsolicited repetition of the first employer's statement is
16 not a potentially actionable publication of that statement to the prospective employer.

17 Section 6.01(3) does not adopt the broad doctrine of "compulsory self-
18 publication" that has been rejected by a majority of courts. In contrast to this doctrine,
19 this Subsection recognizes that where an employer indicates that it will not communicate
20 its criticisms of an employee to other employers, the employer is not responsible for the
21 employee's later repetition of those criticisms. Section 6.01(3), coupled with the qualified
22 privilege set forth in § 6.02, balances the encouragement of candid internal criticism of
23 employees with the protection of employee reputations from the risk of malicious
24 defamation by prior employers seeking to prevent employees from obtaining employment
25 with new employers.

26 **Illustrations:**

27 4. Same facts as Illustration 3 except that M, provides E with several
28 sealed copies of the reference letter, which is addressed to "whom it may
29 concern". If M's reference letter is forwarded by E in response to queries from
30 prospective employers, the letter may constitute a publication by M and P. M

1 knew that E wanted the letter to show to prospective employers in order to secure
2 new employment.

3 5. P's supervisor M terminates the employment of E, advising E that the
4 cause was her "dishonesty" in failing to return to work when E received her
5 medical clearance to return to work after a period of disability. M refuses to give
6 E an assurance that her "dishonesty" will not be reported to other employers and P
7 has no policy against giving such information in references. E applies for a
8 position with R. R asks E to explain why she left her employment with P. E states
9 that P accused her of dishonesty, but that the accusations were based on false
10 reports from a biased supervisor, M. M's accusation of dishonesty to E constitutes
11 a publication by P and M.

12 6. Same facts as Illustration 5 except that M assures E that in response to
13 inquiries from prospective employers, P will report only her dates of employment
14 and will not relay its concerns about E's "dishonesty." E nonetheless repeats M's
15 accusations of dishonesty to R when asked about her reasons for leaving P's
16 employ. M's accusation of dishonesty does not constitute a publication.

17 7. Same facts as Illustration 5, except that R does not ask E why she left
18 her employment with P. E nonetheless advises R of P's allegations against her.
19 M's accusation of dishonesty does not constitute a publication.

20 e. *Statement or underlying implication of statement must be false.* Falsity is a
21 necessary element of any actionable claim of defamation. True statements, however
22 damaging to reputation, are not actionable as defamation.

23 An opinion or prediction alone cannot be actionable. Neither is subject to
24 verification at the time that it is made. An employer's opinion, however, may be
25 actionable if it suggests a factual basis that is not disclosed. This is not the case if the
26 opinion seems based on facts that are known to those to whom the opinion is published.

27 It may be sufficient for the underlying implication of a statement of fact to be
28 false if that underlying implication is what is damaging to reputation. Thus, when an
29 employer publishes a statement that an employee has been terminated for engaging in
30 particular conduct, falsity may be demonstrated by proof that the employee did not
31 engage in that conduct, regardless of the truth of the assertion that this was the

1 employer's stated reason for the termination. See Restatement Second of Torts, § 581 A,
2 comment e (1977).

3 **Illustrations:**

4 8. P employs E as a sales representative. In a meeting of executives of P
5 called to review P's marketing efforts, M, E's manager, describes E as a "cancer
6 eating away at company sales figures." The executives all have been advised of
7 E's poor sales results over the past year. P terminates E soon after the meeting.

8 M's description of E as a "cancer" is not actionable defamation because it
9 was only a subjective characterization or opinion based on accurate facts known
10 to those to whom the opinion was conveyed. Given its context, the opinion did not
11 imply further facts.

12 9. P provides R with a requested reference letter concerning E, P's former
13 employee. The letter states that E had been a "dishonest" employee during her
14 tenure with P. The letter does not specify the nature of E's dishonesty. P's
15 reference letter may constitute actionable defamation if there was no factual basis
16 for the claim of dishonesty and if the statement was not privileged. The accusation
17 of dishonesty implied the commission of specific acts of dishonesty not disclosed
18 or known to R.

19 10. P employs E as a sales representative. M, an officer of P, discharges E
20 from this position, explaining to E that the discharge was due to E's "gross
21 insubordination" in refusing to file accurate expense accounts for a recent
22 business trip. E in fact filed accurate reports in accord with P's policy, but M
23 wanted him to accept less than full reimbursement to compensate for a mistake by
24 M. M advises E that E's insubordination will be reported to other employers
25 seeking references and E is compelled to explain to R, a prospective employer,
26 that he had been charged at the time of his discharge with "gross insubordination"
27 for refusing to file accurate expense accounts.

28 M and P may be subject to liability for defamation of E. The truth of E
29 being charged with "gross insubordination" by M at the time of his discharge is
30 not a defense to the claim that the charge of gross insubordination damaged E's

1 reputation by falsely portraying him as an uncooperative worker who refused to
2 file accurate expense accounts.

3 *f. Publication by conduct.* As stated in the Restatement Second of Torts, §
4 568, comment d, the “publication of defamatory matter may be made by conduct”, even
5 in the absence of written or spoken words. Humans often intend to make statements
6 through hand gestures and other actions that have no or little non-communicative
7 purpose. This is as true in the workplace as in other arenas of human conduct. Thus,
8 employers may defame employees by conduct as well as by words.

9 Conduct, however, most often has purposes other than communication. In
10 most circumstances, conduct cannot reasonably be interpreted as being intended to state
11 any particular fact, whether or not false and defamatory. Thus, conduct at the work place
12 can constitute defamation only when the conduct has been reasonably interpreted as
13 intended to communicate a defamatory statement about an employee rather than to serve
14 some non-communicative purpose. For example, employer actions to protect the security
15 of property, such as the guard-escorted removal of discharged employees or reasonable
16 searches to discover stolen goods, cannot be reasonably interpreted as communicative.

17 **Illustrations:**

18 11. P employs E as a nurse’s aide at P’s nursing home. E is often late to work
19 and also has been observed being unnecessarily rough with patients. A, P’s
20 administrator at the home, discharges E and asks the home’s security guard to
21 accompany E as E cleans out his locker and then proceeds out of the building. As
22 the guard does so, he and E are observed by other employees.

23 The guard’s conduct cannot be reasonably interpreted to be intended to
24 communicate any statement to other employees. The purpose of the escort was to
25 protect P’s property and operations and could only be so reasonably interpreted.

26 12. E works on the assembly line of an automobile manufacturing plant
27 owned by P. F, E’s supervisor, suspects that E has stolen goods hidden in the
28 large pockets of a baggy coat that E has not previously worn to work. F, deciding
29 to make an example of E, asks P’s security guards to demand that E take off his
30 coat and other clothing to be searched in front of other employees. The guards

1 hold E at the window of a glass-enclosed office to ensure that other employees
2 leaving the plant at the end of their shift can observe the search of E.

3 The conduct of the guards can be reasonably interpreted by the other
4 employees to be intended to communicate the message that E is a thief who has
5 been thwarted by P's security. Whether that communication is privileged is
6 determined under § 6.02.

7 *g. Employee defamation of the employer.* Although this Section does not
8 cover employee defamation of employers, an employee's intentional or negligent
9 publication of a false and defamatory statement concerning an employer may be
10 actionable under the general principles of defamation law.

11 ***Reporters' Notes***

12 *Comment a.* In order to be actionable, a defamatory statement must be false.
13 The common law rule, however, has been that the falsity of a defamatory statement could
14 be presumed and truth has to be proven as an affirmative defense. See Restatement
15 Second of Torts § 581A. In *Philadelphia Newspapers, Inc. v. Hepps*, 475 U.S. 767
16 (1986), the Supreme Court held that the first amendment requires falsity to be proven by
17 any plaintiff, even one who is not a public official or figure, who is seeking damages for
18 a defamatory publication on a matter of public concern, at least where the defendant is
19 part of the media.
20

21 The requirement of special harm being caused by the publication applies
22 only to defamation as slander through spoken words, rather than as libel through written
23 words, and does not apply if the publication, even if spoken, conveys certain kinds of
24 disparagements, including "matter incompatible with his business, trade, profession, or
25 office." See Torts §§ 569-576. The distinction between libel and slander is not important
26 to § 6.01 because this section treats when an employer may be liable for causing the loss
27 of an employment opportunity, which is a special harm.

28 The common law historically imposed liability regardless of whether the
29 defendant knew or should have known that a published statement was false and
30 defamatory. In *New York Times Co. v. Sullivan*, 376 U.S. 254, 279-80 (1964), however,
31 the Court held that a public official could not recover damages "for a defamatory

1 falsehood relating to his official conduct unless he proves that the statement was made
2 with ‘actual malice’ – that is, with knowledge that it was false or with reckless disregard
3 of whether it was false or not.” The Court extended this protection to a “public figure” in
4 *Curtis Publishing Co. v. Butts*, 388 U.S. 130, 162-65 (1967). Then, in *Gertz v. Robert*
5 *Welch, Inc.* 418 U.S. 323, 347-50 (1974), the Court pronounced that the first amendment
6 compels state law to require even private figures, who have not voluntarily placed
7 themselves in the public arena, to prove the defendant’s actual malice to recover
8 presumed or punitive damages, and to prove some level of fault to recover actual
9 damages. After *Gertz*, most common law jurisdictions required private-figure defamation
10 plaintiffs seeking any kind of damages to demonstrate that the defendant at least was
11 negligent. See Stuart M. Speiser, Charles F. Krause, & Alfred W. Gans, *The American*
12 *Law of Torts*, Vol. 8, § 29.29, with 2010 supplement, and cases collected there. In *Dun &*
13 *Bradstreet, Inc. v. Greenmoss Builders, Inc.* 472 U.S. 749 (1985), the Court held that the
14 *Gertz* rule requiring the proof of actual malice for presumed and punitive damages does
15 not apply when the speech defaming a private-figure plaintiff is of purely private
16 concern. *Id.* at 761 (plurality opinion of Powell, J.); *id.* at 764 (Burger, C.J., concurring in
17 judgment); *id.* at 774 (White, J., concurring in judgment). Although this holding seems to
18 suggest that the common law might now impose liability without fault for defamation
19 against private figures on matters of only private concern, there seems to be no trend to
20 depart from the general fault requirement set forth in the Restatement Second of Torts in
21 the wake of *Gertz*. See Speiser, Krause, & Gans, *supra*; Harper, James & Gray on Torts,
22 Vol 2, § 5.0, at n. 61,3^d. ed., (2006).

23 *Comment b.* Illustration 1 is based on *Torosyan v. Boehringer Ingelheim*
24 *Pharm., Inc.*, 234 Conn. 1, 41 (1995) (“Although intracorporate communications were
25 once considered by many courts not to constitute “publication” of a defamatory
26 statement, that view has been almost entirely abandoned and we reject it here.”). The
27 *Torosyan* court cited *comment i* to Torts § 577, which states that “communication within
28 the scope of his employment by one agent to another agent of the same principal is a
29 publication not only by the first agent but also by the principal and this is true whether
30 the principal is an individual, a partnership or a corporation.” See also *Gaudio v. Griffin*

1 Health Services Corp. 249 Conn. 523 (confirming *Torosyan* and the “doctrine of
2 intracorporate communication”).

3 The question of whether intracorporate or intraemployer communications are
4 publications for purposes of defamation law divided the jurisdictions for decades. See
5 William Prosser & W. Page Keeton Torts (5th Ed. 1984) § 113 p. 798 and cases cited in n.
6 15 (explaining decisions not recognizing publication as “confusing publication with
7 privilege”). The most recent decisions indicate that the emerging “contemporary”
8 majority rule is that such communications, though subject to a qualified privilege, do
9 constitute publication. See, e.g., *Dube v. Likins*, 216 Ariz. 406, 417-18 (2007) (citing
10 recent cases and finding more jurisdictions in favor of recognizing publication). As held
11 by the *Dube* court, recognizing publication, with the protection of a privilege, is certainly
12 the better approach, because it “protects the principal’s interest in free communication
13 while providing for recovery in case of abuse.” *Id.* at 418. See also Rodney Smolla, Law
14 of Defamation § 15.02 and cases cited therein.

15 *Comment c.*. Illustration 3 represents a variation on the facts of *Neighbors v.*
16 *Kirksville Coll. of Osteopathic Medicine*, 694 S.W.2d 822 (Mo. Ct. App. 1985). In
17 *Neighbors*, as in Illustration 4 in *comment d*, rather than sending the defamatory reference
18 letter directly to other employers, the employer gave the reference letter to the employee
19 to give to the other employers for whom the employee wished to work. In cases like
20 Illustration 3, where the employer’s publication of a harmful reference is not an issue and
21 there is adequate evidence of an abuse of any privilege or immunity, courts have
22 consistently allowed findings of actionable defamation. See, e.g., *Sigal Constr. Corp. v.*
23 *Stanbury*, 586 A.2d 1204 (D.C. 1991) (affirming damages for defamatory and false
24 reference made with malice); *Nowik v. Mazda Motors of Am. (East) Inc.*, 523 So.2d 769
25 (Fla. Dist. Ct. App.1988) (defamation action may proceed based on negative reference
26 that caused loss of prospective employment and was allegedly given with malice); *Geyer*
27 *v. Steinbronn*, 351 Pa. Super. 536 (1984) (upholding jury verdict for defamation based on
28 loss of employment opportunity caused by unprivileged negative job reference);
29 *Stuempges v. Parke, Davis & Co.*, 297 N.W.2d 252 (Minn.1980) (upholding jury verdict
30 for defamatory reference when evidence was adequate to show falsity and malice);
31 *Agarwal v. Johnson*, 25 Cal.3d 932 (1979) (affirming award of damages for defamation

1 from negative references where there was adequate evidence of actual malice). Whether
2 the defamed employee is an employee-at-will is not relevant to the defamation cause of
3 action; although an employer may discharge an employee-at-will for a bad reason, it may
4 not use intentionally false statements to deny the employee other employment
5 opportunities.

6 Courts do not allow defamation actions to proceed if there is not adequate
7 evidence that the employer abused its privilege to publish to other employers statements
8 regarding its former employees. In cases in which plaintiffs cannot produce adequate
9 evidence of abuse of the privilege, courts uniformly have dismissed defamation claims
10 based on harmful references. See, e.g., *Deutsch v. Chesapeake Ctr.* 27 F.Supp.2d 642
11 (D.Md. 1998) (applying Maryland law). The privilege is the subject of § 6.02.

12 An employer can publish defamatory statements to other employers both
13 directly by sending out letters or by answering oral solicitations from the other
14 employers, or indirectly. It may, for instance, publish the statements in newspapers or
15 magazines likely to be read by other employers. See, e.g., *Spivak v. J. Walter Thompson,*
16 *U.S.A., Inc.*, 685 N.Y.S, 2d 247 (N.Y. App. Div. 1999) (statements in advertising trade
17 publications).

18 *Comment d.* As indicated in Illustration 4, an employer may use the defamed
19 employee as a conduit for publication to other employers. This Illustration is based on
20 *Neighbors v. Kirksville College of Osteopathic Medicine*, 694 S.W.2d 822 (Mo. Ct. App.
21 1985), although it is not clear in that case whether the reference letter given to the
22 employee was sealed.

23 Illustration 5 demonstrates that an employer may use the employee as a
24 conduit for publication to other employers by making an oral or a written statement to the
25 employee. The Illustration is based on a defamatory statement to the defamed employee
26 that the Supreme Court of Colorado treated as a potentially actionable publication in
27 *Churchey v. Adolph Coors Co.*, 759 P.2d 1336 (Colo.1988). The *Churchey* court relied
28 on *comment k* to Torts, § 577 to find the statement to the defamed employee to be at least
29 a negligent publication to any employer to whom the employee would feel compelled to
30 repeat it. *Id.* at 1343-45. The analysis of the *Churchey* court thus was not based on a
31 theory of what has been termed “self-publication”, that a defamed employee’s repetition

1 of a defamatory statement is a publication of that statement for purposes of defamation
2 law. It was instead based on a theory of negligent publication by the employer to other
3 employers. It is not fully clear, therefore, that the *Chuchey* analysis was rejected by a
4 later Colorado statute, Colo. Rev. Stat. Ann. § 13-25-125.5, providing that “[s]elf
5 publication, either orally or in writing, of the defamatory statement to a third party by the
6 person making [the] allegation of [libel or slander] shall not give rise to a claim for libel
7 or slander ...”

8 Many other courts, in addition to the *Neighbors* and *Churchey* courts, have
9 held that an employer can be liable for defamatory statements conveyed to defamed
10 employees that the employer could expect would be later seen or heard as well by other
11 employers. *See, e.g.*, *Theisen v. Covenant Med. Ctr., Inc.*, 366 N.W.2d 74, 83 (Iowa
12 2001); *Lewis v. Equitable Life Assurance Soc’y of the U. S.*, 389 N.W.2d 876, 886-87
13 (Minn. 1986); *McKinney v. County of Santa Clara*, 11 Cal. App. 3d 787, 795-97 (1980);
14 *Munsell v. Ideal Food Stores*, 208 Kan. 909, 919-20 (1972); *Grist v. Upjohn Co.*, 16
15 Mich. App. 452, 484 (1969).

16 The trend of more recent decisions, however, is to reject the doctrine of
17 compulsory “self-publication.” *See, e.g.*, *Cwelinsky v. Mobil Chem. Co.*, 837 A.2d 759,
18 761-63 (Conn. 2004); *White v. Blue Cross & Blue Shield of Mass., Inc.* 442 Mass. 64
19 (2004); *Gonsalves v. Nissan Motor Corp. of Hawaii, Ltd.*, 100 Haw. 149 (2002); *Gore v.*
20 *Health-Tex, Inc.*, 567 So.2d 1307, 1308-09 (Ala. 1990); *Sullivan v. Baptist Memorial*
21 *Hosp.*, 995 S.W.2d 569, 570-75 (Tenn. 1999). These courts express concern “that
22 acceptance of the doctrine would have a chilling effect on communication in the
23 workplace, thereby contradicting society’s interest in the free flow of information.” *See,*
24 *e.g., Cweklinsky, supra*, at 219. The courts also worry that the doctrine discourages
25 employees from discharging their duty to mitigate damages and allows employees to
26 circumvent a state’s applicable statute of limitations by continuing to republish the
27 defamation in later job applications. *Id.* at 224.

28 Section 6.01(3) accommodates these concerns without ignoring that an
29 employer may wrongfully harm an employee’s reputation by compelling the employee to
30 repeat defamatory statements because of fear that the employer will itself do so. To rule
31 out the protections of the defamation tort entirely where such fear is reasonable is

1 unnecessary because legitimate employer concerns, as well as the public interest in
2 encouraging employers to give candid accounts for adverse personnel actions, can be
3 addressed in other ways. First, such publications are protected by the same qualified
4 privilege, recognized in § 6.02, that protects direct communications between employers
5 concerning employees. *See, e.g., Theisen, supra*, at 84-85 (qualified privilege applies to
6 publication through defamed employee). Second, because a statement to the defamed
7 employee is not a publication until it is heard by “one other than the person defamed,”
8 Torts, § 577(1), there can be no action if the employee never is compelled to repeat the
9 statement to third parties. *See, e.g., Downs v. Waremart, Inc.* 324 Or. 307 (1996). Third,
10 there is no publication, under this Section, when the employer making the statement
11 advises the defamed employee that the employer will not communicate the statement to
12 other employers and in fact does not do so. Employers can avoid publication of
13 defamatory statements to defamed employees by assuring the employees of
14 confidentiality. *Cf. Alstad v. Office Depot*, 1995 WL 84452 (N.D. Cal. Feb. 7, 1995)
15 (employer’s policy against giving references to prospective employers meant it could not
16 foresee repetition by employee); *Mathis v. Boeing Co.*, 684 F. Supp. 641, 645 (W.D.
17 Wash. 1987) (employer’s policy against revealing reasons for discharge insulates it from
18 liability for defamation through employee’s repetition to others).

19 Moreover, treating the employer’s statement to the defamed employee, rather
20 than the employee’s repetition to other employers, as the defamatory publication enables
21 the applicable statute of limitations to provide intended repose. An employee should not
22 be able to create a new cause of action and the renewal of the period for bringing an
23 action with every repetition of the employer’s statement to another employer. Because
24 the employer’s threatening statement to the defamed employee, not each later repetition,
25 is the wrongful act, the statute should begin to run no later than the first communication
26 of the statement to another employer. The employer’s statement can be treated as a
27 “single publication”, as is a single edition of a newspaper or a single electronic broadcast.
28 *See* § 577A of the Restatement Second of Torts.

29 The imposition of a duty on the defamed employee to mitigate rather than
30 augment the defamatory publication of the employer is fully consistent with imposing
31 liability on the employer for loss of employment opportunities with other employers

1 caused by malicious or otherwise unprivileged false and defamatory statements made
2 between employees of the first employer, including those made directly to the defamed
3 employee. Courts recognizing that defamatory statements to the defamed employee can
4 be the basis of liability have consistently stressed the employee's duty to avoid
5 unnecessary repetition and to challenge the truth of the employer's allegation. See, e.g.
6 *Lewis*, 380 N.W.2d at 888 (liability should be imposed only where "the defamed person
7 has no reasonable means of avoiding publication of the statement or avoiding the
8 resulting damages"); *Davis v. Consolidated*, 34 Cal. Rptr. 2d 438, 449 (Ct. App. 1994)
9 (no showing of compulsion because plaintiff did not claim any prospective employer
10 asked him about reason for discharge).

11 For comprehensive reviews of the cases and issues covered by this comment,
12 see Markita D. Cooper, *Between A Rock and A Hard Case: Time For A New Doctrine of*
13 *Compelled Self-Publication*, 72 *Notre Dame L. Rev.* 373 (1997); Deanna J. Mouser, *Self-*
14 *Publication Defamation and the Employment Relationship*, 13 *Indus. Rel. L. J.* 241
15 (1992).

16 *Comment e.* Under the old common law, pure opinions, rather than only the
17 facts which they implied or on which they were based, were sometimes sufficient for
18 actionable defamation. The treatment of opinions by the common law of defamation in
19 the United States changed, however, after the Supreme Court in dicta in *Gertz v. Robert*
20 *Welch, Inc.*, 418 U.S. 323, 339-40 (1974), pronounced: "Under the First Amendment
21 there is no such thing as a false idea. However pernicious an opinion may seem, we
22 depend for its correction not on the conscience of judges and juries but on the
23 competition of other ideas. But there is no constitutional value in false statements of
24 fact." The Restatement Second of Torts in 1977 responded by stating, in § 566, that: "A
25 defamatory communication may consist of a statement in the form of an opinion, but a
26 statement of this nature is actionable only if it implies the allegation of undisclosed
27 defamatory facts as the basis for the opinion." Since *Gertz*, the courts generally have
28 followed § 566. See 2 Harper, James, & Gray on Torts, § 5.8 (2006).

29 As § 566 makes clear, however, opinions still may be the basis for a
30 defamation action if they imply defamatory facts. The Supreme Court in *Milkovich v.*
31 *Lorain Journal Co.*, 497 U.S. 1 (1990), confirmed that the dicta in *Gertz* should not be

1 read broadly: “[W]e do not think this passage from *Gertz* was intended to create a
2 wholesale defamation exemption for anything that might be labeled ‘opinion’. . . . If a
3 speaker says, ‘In my opinion John Jones is a liar,’ he implies a knowledge of facts which
4 lead to the conclusion that Jones told an untruth. . . . Simply couching . . . statements in
5 terms of opinion does not dispel these implications; and the statement, ‘In my opinion
6 Jones is a liar,’ can cause as much damage to reputation as the statement, ‘Jones is a
7 liar.’” *Id.* at 18-19.

8 Illustration 8 is based on *Drury v. Sanofi-Synthelabo Inc.*, 292 F.Supp.2d
9 1068 (N.D. Ill. 2003). In the actual case, it was not clear to what the “vague” term
10 “cancer” referred. See also, e.g., *Lee v. Metropolitan Airport Comm’n*, 428 N.W.2d 815
11 (Minn. Ct. App. 1988) (“fluffy”, “bitch”, and “flirtatious” treated as subjective vague
12 characterizations).

13 Illustration 9 is based on *Weissman v. Sri Lanka Curry House*, 469 N.W.2d
14 471 (Minn. Ct. App. 1991). Not only an opinion, but also a statement of non-defamatory
15 facts may imply defamatory facts because of other facts already known by those to whom
16 it is published. See, e.g., *Baudoin v. Louisiana Power and Light Co.*, 540 So.2d 1283 (La.
17 Ct. App. 1989) (employer’s letter stating that certain employees were no longer permitted
18 on work site after search known to letter recipients to be an investigation of theft).

19 Illustration 10 is based on *Lewis v. Equitable Life Assurance Society of the*
20 *U. S.*, 389 N.W.2d 876, 888-89 (Minn. 1986). The *Lewis* court relied on *comment e* to
21 *Torts*, § 581A, which states: “When one person repeats a defamatory statement that he
22 attributes to some other person, it is not enough for the person who repeats it to show that
23 the statement was made by the other person. The truth of the defamatory charges . . . is
24 what is to be established.” In the actual case, the employer’s statement to the discharged
25 employees may have been privileged under the actual malice standard of § 6.02, and the
26 employees’ compulsion to repeat the allegation to other employers was not clear.

27 *Comment f.* Section 568(b) of the Restatement Second of *Torts* states that
28 “[s]lander consists of the publication of defamatory matter by spoken words, transitory
29 gestures or by any form of communication other than those” constituting libel. The
30 Illustrations to comment d to this section include examples of how defamatory statements

1 can be communicated by actions and gestures without the use of words. These examples
2 include the “shadowing” of a man in a public place.

3 For an excellent treatment of defamation by conduct in the workplace, see
4 *Phelan v. May Dept. Stores Co.*, 443 Mass. 52, 55-59 (2004). The opinion stresses that
5 the test to determine whether conduct, as well as words, communicated a defamatory
6 meaning must have an objective component. Thus, a plaintiff must show that an observer
7 of the conduct not only interpreted it to be intended to communicate a defamatory
8 statement, but also that such an interpretation was reasonable. *Id.* See also, e.g., *Bolton v.*
9 *Dept. of Human Servs.*, 540 N.W.2d 523, 525 (Minn. 1995) (simple escorting of
10 employee to exit door cannot be defamatory); *Dubrovin v. Marshall Field’s & Co.*
11 *Employee’s Credit Union*, 180 Ill.App.3d 992, 997 (1989) (conduct not actionable
12 because it could be construed as “innocent”); *Krochalis v. Ins. Co. of N.Am.*, 629 F.
13 *Supp.* 1360, 1369 (E.D. Pa. 1985) (“doubtful” that circulation of plaintiff’s photograph
14 among security personnel was “capable of defamatory meaning”); *Zechman v. Merrill*
15 *Lynch, Pierce, Fenner & Smith*, 742 F. *Supp.* 1359, 1370 (N.D. Ill. 1990) (escorting
16 discharged employee out of building may be standard employer policy, not capable of
17 communicating further statement about employee).

18 Illustration 11 is based on *Gay v. William Hill Manor, Inc.*, 74 Md.App. 51
19 (Md. Ct. Sp. App. 1988)). The court distinguishes the decision in *General Motors Corp.*
20 *v. Piskor*, 277 Md 165 (Md. Ct. Sp. App. Md. 1976), on which Illustration 12 is based.

21 22 **§ 6.02 Employer Privilege to Communicate With Its Own Agents and Other** 23 **Employers**

24 **An employer acting within the reasonable course of its business has a privilege to**
25 **publish job-related facts or opinions concerning an employee or former employee to**
26 **agents of the employer and to other employers. This privilege does not protect**
27 **publication made with knowledge of falsity or with reckless disregard of truth or**
28 **falsity.**

29 **Comment on § 6.02:**

30 *a. Overview; Employer-to-Employer Publication.* The common law generally
31 offers a conditional or qualified privilege for occasions in which the publication of

1 defamatory matter may be justified because of a sufficiently important interest of the
2 publisher, the recipient, or both. Employers have an important interest in receiving
3 information from other employers on the performance and character of prospective
4 employees. There is a strong public interest in encouraging such an exchange so that
5 employers can determine which prospective employees are best suited for efficient and
6 productive service and do not have a record of committing violent acts against or other
7 harm to coworkers, customers, or others.

8 The law therefore recognizes an employer's publication of facts or opinions about
9 current or former employees to other prospective employers of the employees as an
10 occasion for a qualified privilege.

11 An employer may invoke this privilege to communicate statements about the
12 employee or former employee to prospective employers only when the statements are
13 made at the request of either the employee or the prospective employer. Volunteering
14 adverse information about an employee or former employee to third parties is not within
15 the reasonable course of the employer's legitimate business.

16 The privilege recognized in this Section does not protect an employer from
17 liability for the publication of a defamatory statement about an employee or former
18 employer with knowledge of the falsity of the statement or with reckless disregard of its
19 truth. Nor does the privilege extend to an employer's publication to another employer of
20 defamatory information that is of no potential legitimate interest to the other employer,
21 even when such information has been solicited by the recipient employer. Such a
22 publication is not within the reasonable course of the employer's legitimate business and
23 does not serve the purpose of the privilege.

24 **Illustrations:**

25 1. P, a hospital, discharges E, its security manager, based on a
26 determination that he had recorded an obscene phone call to F, one of P's nurses,
27 on P's voice mail system. P's determination that E had made the recording was
28 based on the views of three people who knew E well, including F and S, the
29 hospital's chief executive. Upon the request for information about E from
30 prospective employers, P advises such employers that E had been discharged for

1 making an obscene call to a coworker. E sues P for defamation, basing his claim
2 on expert opinion that the recorded voice on the message was not that of E.

3 Even if the recorded voice was not E's, P had a privilege to make the
4 reports, and the privilege was not abused because the reports were not
5 intentionally false or made without regard for the truth.

6 2. P, a construction company, does not renew the contract of E, one of its
7 managers of large projects, because of a contraction in business and E's age and
8 experience relative to other managers. E applies for a construction manager's job
9 at R, another company. M, the Chief Operating Officer of R, asks N, a newly
10 hired vice president for personnel at P, why E no longer worked at P. N has
11 never met E and did not work for P while P employed E. N only once heard E
12 discussed at P, when a few lower level employees talked about E uncritically as
13 particularly focused on details. Wanting to seem informed and important, N
14 without further inquiry tells M that E was "detailed oriented to the point of losing
15 sight of the big picture" and the fact that he no longer worked at P should tell M
16 "enough of what he needs to know." R does not hire E based on N's report to M.

17 N's report to M may have been actionable defamation of E because it
18 implied a false reason for E's termination that N would have known was false had
19 he taken reasonable care in his investigations. N's report is not protected by a
20 privilege because he did not care whether or not it was accurate.

21 3. P, the owner of a retail store, calls R, P's friend and the owner of
22 another retail store in the same city, to advise R that R's new employee, E,
23 underwent a sex change operation while working for P. P's statement to R was
24 not privileged because R had not requested the information and P had no reason to
25 believe that such statement was relevant to the legitimate operation of R's
26 business.

27 *b. Privilege extends to intra-employer communications.* Employers have
28 important legitimate interests in having their employees reasonably share information
29 about subordinate and co-employees during normal business operations. Such sharing of
30 information may occur during the evaluations of employees as well as during internal
31 disciplinary proceedings. The privilege also extends to defamatory statements made to

1 give advice or information to defamed employees, as both employers and employees
2 benefit from the free expression of evaluations of employee performance and conduct.

3 **Illustrations:**

4 4. Same facts as Illustration 1 except that the obscene phone call is not
5 reported to anyone outside of P's employ. P's manager, M, discharges E based on
6 P's determination that E made the obscene phone call. This determination follows
7 an investigation that elicited accounts from F and S of what E had said. The
8 communications between M, F and S in the course of this investigation are
9 privileged.

10 5. Same facts as Illustration 4 except that M advises E in his exit interview
11 that E's obscene phone call was the reason for his termination. E then applies for
12 employment at R where he is asked the reason he left employment at P. M's
13 communication to E about the reason for his termination is privileged.

14 6. M, the manager of an oil refinery owned by P, asks S, the refinery's
15 director of security, to investigate reports that drugs are being sold in the employee
16 cafeteria. S interviews one employee, F, who says she thinks E has been selling drugs,
17 though F has never seen E do so. E denies involvement. S then searches E's truck but
18 finds no evidence of illegal drugs. S, wanting to look responsive, nevertheless reports that
19 his investigation identified E as a drug seller. P discharges E.

20 S's report to M was privileged, but the privilege may have been abused
21 because the report may have been made with reckless indifference to whether its
22 allegations against E were true or not.

23 *c. Abuse of privilege through excessive publication.* To warrant protection under
24 the privilege recognized in this Section, the communication must be made in the
25 reasonable course of business either to employees for whom knowledge of the content of
26 the communication might reasonably serve the legitimate interests of the publishing
27 employer, or to a prospective employer making an inquiry about a current or former
28 employee. The privilege does not extend to excessive or otherwise unreasonable
29 publication.

30 Employers generally have no legitimate business interest in having most
31 employees know adverse or embarrassing facts about a coworker that resulted in

1 suspension or termination of employment of that individual. In some cases, however,
2 employers may legitimately use the punishment of one employee for a particular
3 infraction of company rules as an example for other employees. In other cases employers
4 may have a legitimate interest in dispelling rumors or other bad publicity through the
5 broad publication of facts about current or former employees to other employees or other
6 interested parties. In such instances, the privilege does apply.

7 **Illustrations:**

8 7. Same facts as Illustration 4 except that S, P's chief executive, reports
9 E's discharge for sexual harassment to a group of professional employees of P at a
10 meeting to discuss hospital procedures. One of these employees, G, repeats the report
11 to a friend who is an executive at R, which then rejects E's application for employment.

12 Neither S's statements at the meeting nor G's statements to his friend are
13 privileged. Neither statement was made in the reasonable course of P's legitimate
14 business. P would not be liable for G's statement if made outside the scope of G's
15 employment.

16 8. P, a large manufacturer, discharges several of its management
17 employees because an investigation had suggested that these managers, without
18 authorization, negotiated special arrangements with some of P's suppliers. There
19 is widespread concern among P's employees that the discharged managers were
20 unfairly treated. P sends an email blast to its workforce explaining in general
21 terms the reason why the managers were discharged.

22 P's email communication is privileged. P had a legitimate interest in
23 responding to widespread concerns among its workforce.

24 *d. Privilege applies only to communications of facts and opinions, not to threats*
25 *or offers of financial inducement.* The privilege applies only to statements of facts or
26 opinions that could potentially subject the first employer to liability for defamation or for
27 intentional interference with an employment relationship. It does not apply to threats
28 against or offers of financial benefit to the second employer to induce it not to employ a
29 current or past employee of the first employer, regardless of whether the first employer
30 has some business interest in preventing this employment. Whether or not these threats or

1 offers are actionable in particular circumstances, they are not covered by the privilege
2 recognized in this Section, which is aimed at encouraging the sharing of information.

3 **Illustration:**

4 9. C, the chief executive officer of a manufacturing company, P,
5 discharges E, P's chief financial officer, for failing to support C's business plan.
6 C, bearing a grudge against E, tells D, the president of a major parts supplier, R,
7 that E was a poor executive and that P will no longer purchase from R if R hires
8 E. C's communication to D of his opinion about E's competence was protected by
9 a privilege if not intentionally or recklessly false, but C's threat to D concerning E
10 was not privileged.

11 *e. Plaintiff must prove abuse of privilege.* Under the general law of defamation, as
12 stated in the Restatement Second of Torts, the court determines as a matter of law
13 whether the occasion of the publication gives rise to a privilege asserted by the defendant.
14 See § 619 (1). The question of abuse is typically a question for the trier of fact, however,
15 see § 619 (2); and the burden of proof on the question of abuse is to be carried by the
16 plaintiff, *see* § 613(1)(h).

17 *f. Statutory privileges for reference letters.* A growing majority of states has
18 codified some kind of qualified privilege for employers to communicate to other
19 employers information about an employee's job performance and other work-related
20 information. The terms of the statutes vary. Some jurisdictions supplement rather than
21 supplant the common law privilege. Others may retain the common law privilege only for
22 references that are not covered by the statutory privilege. Like the privilege set out in this
23 Section, these laws are intended to encourage employers to exchange information about
24 employees or former employees without the fear of undue litigation.

25 *g. Absolute privilege.* Certain employer communications also may be immunized
26 from actions for defamation by an absolute, unqualified privilege afforded by the
27 common law or a state statute. The common law generally immunizes communications
28 made by parties or witnesses in, or preliminary to, judicial, quasi-judicial, or legislative
29 proceedings. This absolute privilege has been codified in some states.

30

31

Reporters' Notes

1
2 *Comment a.* For treatment of conditional privileges arising as defenses to actions
3 for defamation, see §§ 593 – 605A of the Restatement Second of Torts. Section 602
4 restates the legal rule in all jurisdictions that employer communications about current or
5 former employees are conditionally privileged if not abused.

6 Section 602 sets forth a standard for abuse of privilege that is based on the
7 definition of “actual malice” provided for the constitutional protection of speech about
8 public officials in *New York Times v. Sullivan*, 376 U.S. 254 (1964). This standard
9 requires knowledge of a statement’s falsity or a reckless disregard of the statement’s truth
10 or falsity. The standard is not satisfied by negligence or even gross negligence. It has
11 been adopted for determining abuse of conditional privilege by an increasing number of
12 jurisdictions since the *Sullivan* decision. See, e.g., *McIntyre v. Jones*, 194 P.2d 519, 530
13 (Colo. App. 2008) (recklessness requires more than mere negligence; it means publisher
14 “willfully chose not to learn the truth”); *Denardo v. Bax*, 147 P.3d 672, 679 (Alaska
15 2006) (malice means “knowledge or reckless disregard as to the falsity of the defamatory
16 matter”); *Ball v. British Petroleum Oil*, 670 N.E.2d 289, 293, 295 (Ohio Ct. App. 1995)
17 (“knowledge that the statements are false or acting with reckless disregard as to their
18 truth”, meaning “high degree of awareness of the probable falsity”); *Hagler v. Proctor &*
19 *Gamble Mfg. Co.*, 884 S.W.2d 771, 771 (Tex. 1994) (“In the defamation context, actual
20 malice does not include ill will, spite, or evil motive.”); *Miller v. Servicemaster by Rees*,
21 851 P.2d 143, 146 (Ariz. Ct. App. 1992) (“Actual Malice is a question of fact for a jury
22 and it can be demonstrated by proving a defendant made a statement knowing it was false
23 or with reckless disregard of its truth.”) The *Sullivan* Court’s “actual malice” standard
24 was also adopted in § 600 of the Restatement Second of Torts.

25 A minority of jurisdictions continue to hold to the traditional common law
26 standard for malice, which requires “spite or ill will” toward the party who may be
27 harmed by the publication. See, e.g., *Butler v. Town of Argo*, 871 So.2d 1, 27 (Ala. 2003)
28 (“Actual malice can be shown by evidence of ‘previous ill-will, hostility, threats, rivalry,
29 ... or by the violence of the defendant’s language, the mode and extent of the publication,
30 and the like.”); *Murray v. Holnam, Inc.*, 344 S.C. 129 (S.C. Ct. App. 2001) (defendant
31 must be actuated by ill will, with the design to causelessly and wantonly injure the

1 plaintiff). Some courts have suggested that both standards of malicious abuse apply, so
2 that the privilege is lost either through knowledge or reckless disregard of truth or
3 through the publisher's ill will toward the plaintiff. See, e.g., *Albert v. Loksen*, 239 F.3d
4 256, 272 (2d Cir. 2001) (applying New York law); *Cole v. Handler* 752 A.2d 1189 (Me.
5 2000); *Lieberman v. Gelstein*, 80 N.Y.2d 429 (1992).

6 The actual malice standard has the virtue of eliminating protection of speech
7 made without any regard for the truth of what it conveys. Regardless of whether the
8 reason for an intentional or reckless falsehood was ill will or mere laziness, the purpose
9 of the privilege as applied to employment – encouragement of the exchange of accurate
10 information about employees -- does not extend to the falsehood's protection.
11 Furthermore, adopting the actual malice standard in place of the traditional common law
12 standard avoids difficult inquiries into a publisher's often uncertain and complicated
13 feelings toward a plaintiff. Ill will may be too difficult for a plaintiff to demonstrate in
14 some cases and too easy to demonstrate to a jury in other cases. An employer, for
15 instance, may have both bad feelings toward a former employee and also good reason to
16 respond to another employer's questions about the employee's past work performance.

17 Illustrations 1 and 2 demonstrate the difference between the negligent failure to
18 determine the truth of a defamatory statement or implication and the reckless indifference
19 to truth that constitutes an abuse of the conditional privilege. Illustration 1 is based on
20 *Theisen v. Covenant Med. Ctr.*, 636 N.W.2d 74 (Iowa 2001), although in the actual case
21 the defamatory publication was between employees of the defendant. Illustration 2 is
22 based on *Sigal Construction Corp. v. Stanbury*, 586 A.2d 1204 (D.C. 1991).

23 Section 603 of the Restatement Second of Torts states that a conditional privilege
24 also is abused by publications that are not made "for the purpose of protecting the
25 interest" which warrants the privilege. In the case of the privilege stated in § 6.02, the
26 interest to be protected is the interest of the recipient or publishing employer in learning
27 relevant information about current and prospective employees. This is the basis for the
28 privilege not applying in Illustration 3. Section 605 of the Restatement Second of Torts
29 states that the publication of unprivileged defamatory matter along with privileged matter
30 abuses a conditional privilege. Thus, if an employer advises a second employer of two

1 false and defamatory facts about an employee, only one of which may be relevant to the
2 second employer's business, there has been an abuse of the privilege.

3 *Comment b.* Although not all jurisdictions recognize intra-employer or intra-
4 corporate communications as publications for purposes of defamation law, see § 6.01
5 *comment b*, those jurisdictions that do so protect the communications with the same
6 qualified privilege that protects inter-employer communications. See, e.g., *Dube v.*
7 *Likins*, 216 Ariz. 406, 418 (Ariz. Ct. App. 2007); *Torosyan v. Boehringer Ingelheim*
8 *Pharm.*, 234 Conn. 1, 29 (1995); *Hanrahan v. Kelly*, 269 Md. 21, 27-28 (1973).

9 Illustrations 4 and 5, like Illustration 1, are based on *Theisen v. Covenant Medical*
10 *Center*, 636 N.W.2d 74 (Iowa 2001). The actual facts in the case were most like those of
11 Illustration 4 because the publication was internal to other employees.

12 *Comment c.* Section 604 of the Restatement Second of Torts states: "One who,
13 upon an occasion giving rise to a conditional privilege for the publication of defamatory
14 matter to a particular person or person, knowingly publishes the matter to a person to
15 whom its publication is not otherwise privileged, abuses the privilege unless he
16 reasonably believes that the publication is a proper means of communicating the
17 defamatory matter to the person to whom its publication is privileged."

18 Illustration 8 is based on *Straitwell v. National Steel Corp.*, 869 F.2d 248 (4th Cir.
19 1989) (applying West Virginia law). For other cases recognizing that employers may
20 have legitimate interests in publishing negative statements about their employees or
21 former employees to the employer's general workforce as well as to other constituencies,
22 see, e.g., *Merlo v. United Way of Am.*, 43 F.3d 96 (4th Cir. 1994) (because of nationally
23 publicized controversy in national media, United Way had a legitimate interest in
24 releasing a report to media of its discharge of chief financial officer); *Gallo v. Princeton*
25 *Univ.*, 281 N.J. Super. 134 (N.J. Super. Ct. App. Div. 1995) (university did not
26 excessively publish in student and alumni newspapers information concerning its
27 investigation of alleged improper use of university property).

28 *Comment e.* Section 613 (1)(h) of the Restatement Second of Torts provides that
29 "[i]n an action for defamation the plaintiff has the burden of proving, when the issue is

1 properly raised, the abuse of a conditional privilege.” Section 619 states: “(1) The court
2 determines whether the occasion upon which the defendant published the defamatory
3 matter gives rise to a privilege.” And: “(2) Subject to the control of the court whenever
4 the issue arises, the jury determines whether the defendant abused a conditional
5 privilege.”

6 These long-established principles state the common law of defamation’s general
7 allocation of the burdens on defamation privileges: the defendant must demonstrate to the
8 court that the occasion of the publication was one to which a privilege applies, while the
9 plaintiff must prove abuse as a question of fact. See Harper, James & Gray on Torts, Vol.
10 2, § 5.29, at n. 22-25, 3d ed. (2006); William Prosser & W. Page Keeton on Torts (5th ed.
11 1984) § 115, p. 835. These principles have been applied consistently to the employer’s
12 privilege to publish concerning its employees and former employees, as stated in § 6.02.
13 See, e.g., Delloma v. Consolidation Coal Co., 996 F.2d 168, 172 (7th Cir. 1993) (“[A]n
14 employer may invoke a conditional privilege to respond to direct inquiries by prospective
15 employers. Once a privilege is established, the plaintiff must prove that the defendant
16 acted with malice.”); Sigal Construction Co. v. Stanbury, 586 A.2d 1204, 1214 (D.C. Ct.
17 of App. 1991) (“Once the privilege applies, the plaintiff has the burden of proving the
18 defendant has abused, and thus lost it.”); Churchey v. Adolph Coors Co., 759 P.2d 1336,
19 1346 (Col. S. Ct. 1988) (“Once the court determines as a matter of law that a qualified
20 privilege applies to the defendant’s communication, the plaintiff has the burden of
21 showing that, as a matter of fact, the defendant” abused the privilege.)

22 *Comment f.* For a state statute that expressly supplements the common law
23 privilege, see, e.g., Utah Code Ann. § 34-42-1. For a state law that supplants the common
24 law privilege for references covered by the statutory immunity, see, e.g., Ohio Rev. Code
25 Ann. § 4113.71.

26 State statutes typically allow plaintiffs to defeat an employer’s immunity by
27 proving malice or a lack of good faith. State immunity statutes defining bad faith as
28 intentionally or recklessly false include Mich. Comp. Laws § 423.452 (2009); N.D. Cent.
29 Code § 34-02-18; Okla. Stat. tit. 40, § 61; Va. Code Ann. § 8.01-46.1. Statutes using a
30 negligence standard for bad faith include Colo. Rev. Stat. § 8-2-114 (2008) (immunity
31 does not apply where “employer knew or reasonably should have known that the

1 information was false”); N.C. Gen. Stat. § 1-539.12; 42 Pa. Cons. Stat. 42 § 8340.1.
2 Statutes allowing plaintiffs to defeat immunity through proof of either type of malice
3 include Alaska Stat. § 09.65.160; Ore. Rev. Stat. § 30.178; Wis. Stat. § 895.487; Wyo.
4 Stat. Ann. § 27-1-113. Maine requires proof of both malicious intent and a deliberate
5 intent to mislead. Me. Rev. Stat. Ann. tit. 26, § 598 (West Supp. 2001) (requiring “clear
6 and convincing evidence of ... knowing disclosure, with malicious intent, of false or
7 deliberately misleading information”).

8 For immunity laws that do not apply to references that violate anti-discrimination
9 or other laws, see, e.g. Fla. Stat. § 768.095 (declining immunity for statements violating
10 state’s civil rights statutes); Mich. Comp. Laws Ann. § 423.452 (preponderance of
11 evidence must show that employer knew information was false or misleading, had
12 reckless disregard of truth, or acted against a specific prohibition in state law).

13 Missouri requires the exchange of information between employers by mandating
14 that an employer provide upon the request of a past employee an accurate statement of
15 the “nature and character” and “duration” of the employee’s past service. See Mo. Rev.
16 Stat. § 290.140 (2009).

17 *Comment g.* Section 587 of the Restatement Second of Torts states that a “party
18 to a private litigation ... is absolutely privileged to publish defamatory matter concerning
19 another in communications preliminary to a proposed judicial proceeding, or in the
20 institution or during the course and as a part of, a judicial proceeding in which he
21 participates, if the matter has some relation to the proceeding.” Section 588 provides that
22 a “witness is absolutely privileged to publish defamatory matter concerning another in
23 communications preliminary to a proposed judicial proceeding or as a part of a judicial
24 proceeding in which he is testifying, if it has some relation to the proceeding.” Section
25 590A provides the same for witnesses in legislative proceedings.

26 Jurisdictions differ over what proceedings are to be treated as quasi-judicial and
27 thus protected by an absolute, rather than only qualified privilege. Many jurisdictions
28 now extend the absolute privilege to grievance and arbitration proceedings pursuant to
29 collective bargaining agreements. See, e.g., *Hasten v. Phillips Petroleum Co.*, 640 F.2d
30 274 (10th Cir. 1981); *Bushell v. Caterpillar, Inc.*, 291 Ill. App.3d 559 (1997). But see
31 *Ezekial v. Jones Motor Co.*, 374 Mass. 382 (1978). See also *Overall v. Univ. of Pa.*, 412

1 F.3d 492 (3d Cir. 2005) (Alito, J.) (university’s unilaterally promulgated arbitration
2 process not protected by absolute privilege because no government involvement).

3 Whether an employer makes a statement preliminary to a quasi-judicial
4 proceeding may also be at issue. *See, e.g., Rogozinski v. Airstream by Angell*, 152
5 N.J.Super. 133, 150 (N.J. Super. Ct. Law Div. 1977) (statements made by an employer to
6 an unemployment compensation commission are not protected by absolute privilege
7 because no quasi-judicial proceeding was pending). One court has extended the absolute
8 privilege to statements made to a private regulatory board serving a quasi-public function
9 even in the absence of a pending judicial-type proceeding. *See Rosenberg. v. MetLife,*
10 *Inc.*, 8 N.Y.3d 359, 367, 834 N.Y.S.2d 494 (2007) (employer’s statements on a National
11 Association of Securities Dealers’ (NASD) termination notice; “NASD routinely
12 investigates termination for cause to determine whether the representative violated any
13 securities rules”).

14 For examples of state statutes conferring absolute immunity to defamation
15 actions, see, e.g., Cal. Civ. Code § 47(2) (covering publication in “any (1) legislative or
16 (2) judicial proceeding, or (3) in any other official proceeding authorized by law”).

17

18 **§ 6.03 Employer’s Wrongful Interference with an Employee’s Employment**

19 **Relationship with Another Employer**

20 **(a) An employer wrongly interferes with an employee or former employee’s**
21 **employment relationship with another employer when the employer intentionally**
22 **and by improper means or without a legitimate business justification causes another**
23 **employer to discontinue or to not enter into an employment relationship with the**
24 **employee or former employee.**

25 **(b) An employer does not wrongly interfere with an employee or former employee’s**
26 **employment relationship with another employer by making or causing to be made a**
27 **communication concerning the employee or former employee that is privileged**
28 **under § 6.02.**

29 **Comment on 6.03:**

30 *a. Overview.* The torts of intentional interference with performance of contract
31 and of interference with prospective or expected contractual or business relations or

1 advantage (hereafter, “tort of wrongful interference”) are applicable to employment
2 relationships and prospective employment relationships. The elements of the two torts do
3 not clearly differ in most jurisdictions and in some jurisdictions the torts have been
4 combined into a single tort of interference with business relations. The torts are
5 recognized in the Restatement Second of Torts §§ 766 and 766B (1979).

6 The elements of the torts include the existence of a contractual or prospective
7 contractual or other business relationship between the plaintiff and a third party; the
8 defendant’s awareness of the existence of this relationship; the defendant acting with the
9 intent to cause an interference with the relationship or prospective relationship; the
10 defendant’s actions in fact causing such an interference; the interference resulting in
11 reasonably foreseeable damages to the plaintiff, and the defendant’s actions being
12 “improper”. “Improper” is defined in § 767 of the Restatement Second of Torts through a
13 multifactor test that includes consideration of the propriety of the defendant’s means and
14 purposes. Most decisions do not use the term “improper”, but instead ask whether the
15 interference is “justified” or “privileged”. Illegal or otherwise tortious conduct or
16 intentional misrepresentations that are not proper are not justified or privileged. Since
17 courts consider the propriety of both a defendant’s means and its purposes, § 6.03
18 combines these formulations by stating that an intentional interference may be actionable
19 because it lacks any legitimate business justification or involves use of improper means,
20 unless the privilege set forth in § 6.02 applies. Section 6.03 does not adopt the multifactor
21 balancing test suggested by the Restatement Second of Torts because that test has not
22 influenced most decisions in the employment setting.

23 The tort of wrongful interference may apply to one employer’s interference with
24 the employment or prospective employment of an employee by another employer. While
25 intent is a necessary element of the wrongful-interference tort, ill will is not; even in the
26 absence of ill will an intentional interference causing pecuniary loss may be tortious if it
27 lacks any legitimate business justification or if improper means are used. Demonstrating
28 a defendant’s ill will also is not sufficient; an employer that bears ill will toward an
29 employee is not liable for wrongfully interfering with the employee’s contract with
30 another employer if the employer acts through otherwise proper conduct and also has a
31 legitimate business justification for its conduct.

1 Improper means include those defined by common or statutory law as wrongful.
2 Misrepresentation, whether or not defamatory, is also an improper means.

3 Legitimate business justifications for otherwise proper conduct include the
4 protection of property and competition for profit. Such justifications encompass the
5 anticipation of reciprocal business benefits from other employers, as when multiple
6 employers exchange information on their employees. Legitimate business justifications,
7 however, do not include a desire to retaliate against an employee out of spite or
8 vindictiveness. An employer must have some reasonable expectation of gaining a
9 legitimate business benefit in order to justify intentionally interfering with the
10 employment relationship of an employee or former employee with another employer.

11 **Illustrations:**

12 1. E, who is employed by P as a sales representative, resigns to take a similar
13 position with P's competitor, R. P advises R that E is subject to a non-compete
14 agreement and that P will sue both R and E because of E's employment by R. As a
15 result, R terminates its at-will employment relationship with E. P knows that E never
16 agreed to a non-compete covenant and that it has no grounds to sue R for R's
17 employment of E.

18 P is subject to liability for tortious interference with E's employment
19 relationship with R. P intentionally caused the discontinuation of the
20 relationship by misrepresenting that E was subject to the no-compete covenant
21 and that it intended to sue R to enforce the covenant.

22 2. E resigns his position as supervisor with employer P to take a position as a
23 customer service supervisor with employer R. Dissatisfied after a few days with E's
24 performance as a supervisor, R's president and owner, Q, calls P without identifying
25 herself as E's new employer. Q asks several of P's employees if Q could speak with
26 E, P's "customer service supervisor". P's employees, without determining E's past
27 status or Q's identity, tell Q that E was never the customer service supervisor at P. R
28 discharges E.

29
30 P is not subject to liability for tortious interference with E's employment
31 relationship with R. Whether or not P's employees had a legitimate business
32 justification for telling Q that E had not been P's customer service supervisor, P's

1 employees could not have intended to interfere with E's employment relationship
2 with R because they did not even know they were communicating with E's new
3 employer.

4 *b. Privileged communications between employers are not a basis for liability.* The
5 tort of wrongful interference, like the tort of defamation, could discourage socially
6 beneficial communications between businesses, especially the accurate exchange of
7 information about the abilities and character of employees. Employers have legitimate
8 business justifications for such exchanges. The considerations that inform the qualified
9 privilege set out in § 6.02 apply to tortious interference claims as well as to defamation
10 claims. A plaintiff claiming that an employer's communication of facts or opinions
11 concerning the employee to another employer constitutes an actionable intentional
12 interference thus must demonstrate an abuse of the privilege.

13 **Illustration:**

14 3. P discharges E because E was discovered moving company tools out of
15 a company truck into E's vehicle. P does not accept E's claim that E had done so
16 to play a joke on a co-employee. E applies for a new job with employer R, and R
17 asks P for a report on E. M, P's manager, looks in E's personnel file and responds
18 in a letter stating that E was terminated for stealing company property.

19 M's letter to R is privileged. M's letter implied that E stole company
20 property, but regardless of its truth, this statement was not intentionally or
21 recklessly false. M and P thus cannot be subject to liability for defamation of E or
22 for tortious interference with E's employment relationship with R.

23 *c. Absence of § 6.02 privilege is not sufficient.* The privilege set forth in § 6.02
24 provides a safe harbor for communications between employers concerning employees,
25 former employees, and prospective employees. The privilege does not cover all
26 employer-to-employer communications that cause an interference with an employment
27 relationship. As explained in comment d to § 6.02, the privilege applies only to
28 communications of facts and opinion, not to threats or offers of financial inducements.
29 Employers, however, may have legitimate business justifications, such as the protection
30 of intellectual or other property, for certain threats or inducements that interfere with an
31 employee's or past employee's relationship with another employer. For instance, an

1 employer's threat to enforce, or actual enforcement of, a valid contract restricting an
2 employee's future employment is not tortious even though not covered by the § 6.02
3 privilege.

4 **Illustration:**

5 4. Same facts as Illustration 1 except that E did sign a valid non-compete
6 agreement with P. P is seriously considering bringing such an action against E if
7 E continues to work for R. P's threat to R to bring such litigation is not privileged
8 under § 6.02 because it is not a statement of fact or opinion. It is not a tortious
9 interference with E's employment relationship with R, however, as P has a
10 legitimate justification for the threat.

11 *d. Relation between wrongful interference and defamation torts.* An employer
12 may tortiously interfere in an employee's relationship or prospective relationship with
13 another employer without tortiously defaming the employee. While the tort of defamation
14 requires the publication of a false statement, an employer may tortiously interfere through
15 physical actions or threats or inducements that are not subject to the criterion of
16 falsification. Furthermore, an employer's publication of facts or opinions about an
17 employee to another employer, if not within the reasonable course of the publishing
18 employer's legitimate business, are not privileged under § 6.02 even if the facts or
19 opinions are not false and thus cannot constitute defamation. Unlike the tort of
20 defamation, the tort of wrongful interference with an employment relationship may be
21 based on intentionally harmful statements that are true if the publisher of the statements
22 also has no legitimate business justification for the publication.

23 In some cases statements from one employer to another about an employee may
24 be actionable defamation even though not actionable as intentional interference. An intent
25 to interfere is a necessary element of the tort of wrongful interference, while the intent to
26 defame is not a necessary element of the tort of defamation. The tort of defamation may
27 be based on the negligent publication of an unprivileged defamatory statement.

28 **Illustration:**

29 5. E resigns from his position as a computer programmer in the employ of
30 P. T, the state's department of transportation, then hires E. E's employment with T
31 violates the strict terms of his non-competition agreement with P. P is not affected by E's

1 employment with T and does not attempt to enforce the non-competition agreement
2 against E. P's chief officer, C, however, is angry at E for resigning and decides to
3 retaliate against him by informing his friend, D, a high official at T, that E had a non-
4 competition agreement with P and that the hiring of E may have been contrary to T's
5 normal proceedings. Based on a report of D, T terminates its relationship with E.

6 C and P may be liable for intentionally interfering with E's employment
7 relationship with T. C did not give false information to T. C, acting as an agent for P,
8 had no legitimate business justification for interfering with E's employment with T as P's
9 business was in no way affected by this employment. C acted only in retaliation for
10 E leaving P's employ.

11 *Reporters' Notes*

12
13 *Comment a.* Section 766 of the Restatement Second of Torts covers the
14 "Intentional Interference With Performance Of Contract By Third Person". Section 766B
15 covers the "Intentional Interference With Prospective Contractual Relation". Many
16 jurisdictions, using variant labels, combine the torts into one tort of intentional
17 interference. See, e.g., *Hensen v. Truman Med. Ctr., Inc.*, 62 S.W.3d 549, 552-53 (Mo.
18 Ct. App. 2001) ("interference with a contract or business expectancy"); *Daley v.*
19 *Wellpoint Health Networks, Inc.*, 146 F. Supp.2d 92, 104 (D. Mass. 2001) ("business
20 relations"); *Voorhess v. Guyan Mach. Co.*, 446 S.E.2d 672, 675 (W.Va. 1994)
21 ("contractual or business relationship expectancy"). Both sections condition liability on
22 the defendant both "intentionally" and also "improperly" interfering with a contract or
23 prospective contract.

24 Section 767 of the Restatement Second of Torts provides that in determining
25 whether an interference is improper "consideration is given to the following factors: (a)
26 the nature of the actor's conduct, (b) the actor's motive, (c) the interests of the other with
27 which the actor's conduct interferes, (d) the interests sought to be advanced by the actor,
28 (e) the social interests in protecting the freedom of the actor and the contractual interests
29 of the other, (f) the proximity or remoteness of the actor's conduct to the interference and
30 (g) the relations between the parties." This formulation suggests a weighing of the actor's
31 motives and conduct against the nature, and perhaps foreseeability, of the harm caused by

1 the conduct. See, for instance, the court’s attempt to balance in *Hayes v. Advanced*
2 *Towing Services, Inc.*, 73 Ark. App. 36 (2001).

3 The courts generally have not followed the multi-factor inquiry of § 787. Rather
4 than balancing many factors, most courts focus on whether the interference was
5 privileged or justified by a legitimate business motivation without use of improper
6 means. See, e.g., *Foxx v. Electromotive*, 2005 U.S. Dist. LEXIS 13859 (N.D. Ill. 2005)
7 (using justification terminology); *Delloma v. Consolidation Coal Co.*, 996 F.2d 168, 170-
8 71 (7th Cir. 1993) (applying Illinois law); *Tiernan v. Charleston Area Med. Ctr.*, 506 S.E.
9 2d 578, 592 (W. Va. 1998); *Chaves v. Johnson*, 335 S.E.2d 97, 102-104 (Va. 1985);
10 *Luketich v. Goedecke Wood & Co.*, 835 S.W.2d 504, 508 (Mo. Ct. App. 1992); *Stebbins*
11 *& Robbins*, 582 S.W.2d 266, 268 (Ark. 1979). Even for those decisions that cite § 767,
12 the multi-factor test does not do much analytical work; rather the courts ask whether the
13 interference is privileged and focus on the actor's justification and means. See, e.g.,
14 *Turner v. Halliburton Co.*, 240 Kan. 1, 27, 722 P.2d 1106, 1116 (1986) (using
15 justification or privilege terminology, but noting “in the area of interference with
16 prospective contractual relations the terminology of privilege, proper vs. improper, and
17 justification are used interchangeably with no overwhelming preference for any term”);
18 *Sorrells v. Garfinkel’s*, 565 A.2d 285, 290-92 (D.C. 1989). See generally Alex Long, *The*
19 *Disconnect Between At Will Employment and Tortious Interference with Business*
20 *Relations: Rethinking Tortious Interference Claims in the Employment Context*, 33 *Ariz.*
21 *St. L.J.* 91, 497-99 (2001).

22 Illustration 1 is based on *Collincini v. Honeywell, Inc.*, 411 Pa. Super. 166, (Pa.
23 Super. Ct. 1991). For another similar decision, see *Voorhees v. Guyan Machinery Co.*,
24 191 W. Va. 450, 446 S.E.2d 672 (1994). In *Voorhees*, the defendant employer did have a
25 non-competition agreement with the plaintiff, its former employee. The court, however,
26 reasoned that the defendant had no legitimate business interest in threatening to enforce it
27 against the plaintiff because there was only negligible competition between the defendant
28 and plaintiff’s new employer.

29 Illustration 2 is based on *Singer v. Beach Trading Co.*, 379 N.J. Super. 63 (2005).
30 In some cases, an employer’s privileged general or limited description of the work of a
31 past employee may harm that employee’s chances of securing new work without in itself

1 even suggesting any intent to interfere with the employee’s ability to secure a new
2 employment relationship. See, e.g., *Jacobs v. Continuum Health Products, Inc.*, 776
3 N.Y.S.2D 279 (2004) (defendant who told prospective employer that employee had been
4 an “average” employee not liable for tortious interference).

5 *Comment b.* No jurisdiction allows claims for intentional interference with an
6 employment relationship to be based on inter-employer communications that would be
7 treated as privileged in an action for defamation. Many courts have expressly recognized
8 that the same privilege applies, thus clarifying that the plaintiff bears the burden of
9 proving an abuse of the privilege. Illustration 3 is based on *Turner v. Halliburton*, 240
10 Kan. 1, 29-30 (1986). For other cases requiring plaintiffs pressing an intentional
11 interference action to prove abuse of a qualified defamation privilege, see, e.g., *Delloma*
12 *v. Consolidation Coal Co.*, 996 F.2d 168, 171-72 (7th Cir. 1993) (applying Illinois law);
13 *Koch v. American Telephone & Telegraph Co.*, 1989 U.S. Dist. LEXIS 3945, *7 (1993)
14 (applying Pennsylvania law); *Stelzer v. Carmelite Sisters of the Divine Heart of Jesus of*
15 *Missouri*, 619 S.W.2d 766, 768 (Mo. 1981).

16 *Comment c.* Illustration 4 is based on *Foxx v. Electromotive*, 2005 U.S. Dist.
17 LEXIS 13589 (N.D. Ill. 2005) (applying Illinois law). The defendant employer in this
18 case had a policy of requiring each of its buyers to agree not to be employed by one of
19 the employer’s suppliers for a period of two years following the end of employment with
20 the defendant employer. The defendant would not waive this policy in the plaintiff’s case
21 and the court found the defendant “justified in taking action to protect its financial
22 interests and foster competition among its suppliers.” *Id.* at *8.

23 In most cases an employer would have a legitimate business justification for
24 threatening to bring or actually bringing an objectively reasonable suit against an
25 employee for entering into an employment relationship with another employer. Although
26 difficult to prove, it is possible, however, that an employer would threaten or even bring
27 what appears to be a reasonable suit only for the purpose of hurting the other employer
28 for a personal reason, rather than to protect its business interests. See *Reichhold*
29 *Chemicals, Inc. v. Goel*, 146 N.C. App. 137, 148 (2001) (even if the employer’s suit “was
30 objectively reasonable”, the employer “could still be liable for tortious interference”).

1 *Comment d.* The tort of wrongful interference does not require a showing of
2 defamation. Interference, for instance, may be based on threats or improper economic
3 coercion without any misrepresentation of facts. See, e.g., *Childress v. Abeles*, 240 N.C.
4 667, 84 S.E.2d 176 (1954); *Sumwalt Ice & Coal Co. v. Knickerbocker Ice Co.*, 114 Md.
5 403, 80 A. 48 (1911) (both involving threats of a refusal to deal unless a contract was
6 broken). For an example of tortious interference with an employment relationship
7 through coercion without misrepresentation, see *Smith v. Ford Motor Co.*, 289 N.C. 71
8 (1976). In *Smith* the court held that Ford could be liable for requiring Smith’s employer, a
9 car dealership selling Ford vehicles, to terminate Smith’s employment-at-will if it “acted
10 with malice and for a reason not reasonably related to the protection of a legitimate
11 business interest.” *Id.* at 94.

12 Illustration 5 is based on *Pratt v. Prodata, Inc.*, 885 P.2d 786 (Utah 1994). The
13 court in this case rejected the argument of the defendants that “a judgment for intentional
14 interference with economic relations cannot be based on the transmission of truthful
15 information.” *Id.* at 790. The court found “substantial credible evidence in the record to
16 support the jury’s determination that defendants interfered with [plaintiff’s] economic
17 relations for an improper purpose . . . something akin to extortion” rather than any
18 legitimate interest in protecting the company’s business or property. *Id.* at 789.

19 For other cases finding an employer liable for interfering with a past employee’s
20 employment relationship with another employer by the publication of intentionally
21 harmful, though not false information, to the other employer, see, e.g., *Linafelt v. Beverly*
22 *Enterprises-Florida, Inc.*, 745 So. 2d 386, 389-90 (Fla. 1999) (defamation claim fails
23 because statement about plaintiff was not false, but sufficient evidence to find tortious
24 interference); *Hayes v. Advanced Towing Servs., Inc.* 73 Ark App. 36, 44 (2001) (“law
25 does not provide that knowledge about a particular fact concerning an individual carries
26 with it a corresponding right to reveal that fact under all circumstances without any
27 exposure to potential civil liability”). See also *Collincini v. Honeywell, Inc.*, 411 Pa.
28 Super. 166 (Pa. Super. Ct. 1991) (“Truth is an absolute defense to defamation; it is *not* a
29 defense to intentional interference with contractual relations.”).

30 Citing § 772(a) of the Restatement Second of Torts, many decisions do state that
31 “a person does not incur liability for interfering with a business relationship by giving

1 truthful information to another.” See *Recio v. Evers*, 278 Neb. 405, 421 (2009). See also,
2 e.g., *Tiernan v. Charleston Area Med. Ctr., Inc.*, 203 W. Va. 135 (1998); *Allen v.*
3 *Safeway Stores Inc.*, 699 P.2d 277 (Wyo. 1985); *Montorne v. Maxfield*, 122 N.H. 724
4 (1982); *Kutcher v. Zimmerman*, 87 Hawaii 394 (Hawaii Ct. App. 1998); *Soderlund Bros.,*
5 *Inc. v. Carrier Corp.*, 278 Ill App. 3d 606 (1995); *Savage v. Pacific Gas & Elec. Co.*, 21
6 Cal.App.4th 434 (1993). In these decisions, however, unlike in those decisions finding
7 truth not to be an absolute defense to a claim of intentional interference, the plaintiff did
8 not have credible proof of improper motivation and of the absence of a legitimate
9 business justification.

10 Section 772(a) does not state that truth is a defense to all claims of intentional
11 interference. It states only that “[o]ne . . . does not interfere improperly with the other’s
12 contractual relation, by giving the third person (a) truthful information” This does
13 not necessarily preclude liability based not on improper conduct, but rather on the
14 defendant’s motive, i.e. on the defendant’s intent to harm in the absence of any legitimate
15 business motivation. Indeed, making truth an absolute defense even in cases where the
16 defendant’s motivation is solely improper would be in tension with the direction in § 767
17 to consider “the actor’s motive” as well as the “nature of the actor’s conduct” in
18 determining whether the actor’s interference was “improper”. As stated in comment d to
19 § 767, if “a desire to interfere with the other’s contractual relations . . . was the sole
20 motive the interference is almost certain to be held improper. A motive to injure another
21 or to vent one’s ill will on him serves no socially useful purpose.” Thus, many courts that
22 rely on the Second Restatement of Torts to analyze intentional interference claims state
23 that truth is a defense to such claims in some, but not all cases. See, e.g., *C.N.C.*
24 *Chemical Corp., v. Pennwalt Corp.*, 690 F. Supp. 139, 143 (D.R.I. 1988); *Puente v.*
25 *Dillard’s Dep’t Stores*, 1998 Tex. App. LEXIS 7627, at * 17 (Tex. Ct. App. Dec. 10,
26 1998).

27
28
29
30

1 **6.04 Employer Does Not Tortiously Interfere with Its Own Employment**
2 **Relationship**

3 **(1) An employer is not subject to liability because of the interference by one of its**
4 **employees, or by any other party, with an employment relationship or prospective**
5 **employment relationship of that employer.**

6 **(2) (a) An employee (“first employee”) wrongly interferes with the employment**
7 **relationship of another employee or former employee (“other employee”) when the**
8 **first employee intentionally and by improper means or without a legitimate**
9 **justification causes the employer to discontinue or to refuse to enter into an**
10 **employment relationship with the other employee.**

11 **(b) An employee does not wrongly interfere with the employment relationship of**
12 **another employee or former employee if that employee is acting in part to serve the**
13 **interests of the employer.**

14 **Comment on § 6.04:**

15 *a. Overview; Employer Not Liable for Breaching Its Own Employment Contracts;*
16 *Employees Not Liable When Acting for Employer.* The torts of intentional interference
17 with performance of contract and of intentional interference with prospective business
18 relations do not impose liability on employers for terminating relationships with their
19 own employees; nor do they impose liability on employees for taking actions in behalf of
20 their employer that result in the disruption of the employment relationship of another
21 employee with the same employer. The purpose of these torts is to protect contracting
22 parties’ control over the terms and implementation of mutually advantageous economic
23 relationships, including employment relationships, from improper interference by third
24 parties. The purpose is not to insure the performance of contracts or commitments to
25 enter into contracts, as these are matters for the law of contracts.

26 Most employers are organizations, whether corporate or otherwise, that act
27 through human agents. Employers thus may be liable under a variety of laws for actions
28 of their agents within the course of the agents’ employment. An employer is not liable,
29 however, for an employee’s interference with the employer’s own employment contracts,
30 even if the employee’s interference takes the form of some action, such as a formal
31 employment decision like discharge, within the authorized scope of the employee’s own

1 employment with the employer and for which the employer normally would be liable.
2 The rule of non-liability for the employer for interference with its own contracts applies
3 whether or not the interfering employee is acting for his or her own interests or to serve
4 the interests of the employer.

5 In the latter situation, where the interfering employee attempts to serve the
6 employer, the employee also is not subject to liability for tortious interference with an
7 employment relationship. Subjecting the employee to such tort damages would impede,
8 rather than protect, the employer's control over the implementation of its relationships
9 with its other employees, and would discourage employees from carrying out duties
10 assigned them by their employer. It could also result in employers having to indemnify
11 managers and supervisors and thus effectively pay tort damages for contractual breaches.

12 Employees, however, who for reasons other than service to their employer,
13 intentionally and improperly or without legitimate justification interfere with a fellow
14 employee's employment relationship with the employee's mutual employer may be
15 subject to liability. Employers' interests in employment relationships may be advanced
16 rather than harmed by holding their employees liable for unjustifiably interfering with
17 those relationships for reasons other than service to their employer. This may be true
18 even when the impaired employment relationship is terminable at the will of either party.

19 **Illustrations:**

20 1. P, a large manufacturer, employs F to evaluate and coordinate the
21 purchase from various suppliers of containers used in its operations. P also
22 employs E as F's assistant. Because supplier S gives F a kickback, F directs
23 almost all purchases of containers to S. E writes a memorandum questioning the
24 quality of the containers supplied by S. In response F recommends that E be
25 discharged for poor performance. As a result, P discharges E.

26 F may be liable for intentional interference with E's employment
27 relationship with P. F recommended E's discharge to serve his own interests in
28 receiving bribes from S against the interests of F's employer P. P cannot be liable
29 for intentional interference with its own employment relationship with E.

30 2. Same facts as Illustration 1 except that F is not accepting bribes from S
31 and instead recommends the discharge of E because F has calculated that a

1 computer program could do E's job at a much lower cost for P. F makes this
2 calculation because he finds E's personality and political views annoying.

3 F is not liable for intentional interference with E's employment
4 relationship with P. Even if F acted in part out of ill will toward E, he also acted
5 to serve the interests of P and thus was not acting as an independent third party to
6 P's employment relationship with E.

7 3. Same facts as Illustration 1 except that F is not accepting bribes from S
8 and instead recommends that P discharge E because E has written a memorandum
9 to him suggesting that S's containers are unsafe to employees and may expose P
10 to health and safety law violations. P may be liable to E for the tort of wrongful
11 discipline in violation of public policy (see §§ 4.01 and 4.02), but P is not liable
12 for the tort of interference with P's own employment relationship with E. F also is
13 not liable for tortious interference with this relationship, as F acted, perhaps
14 mistakenly, with the intent of serving P.

15 *b. Third party co-employee interference.* Determining when an interference is
16 without legitimate justification may pose special issues where one employee is charged
17 with interfering with the employment of another employee of the same employer. In
18 some cases, an employee may justifiably interfere with the employment relationship of a
19 fellow employee in the service of interests other than those of the employer. An
20 employee, for instance, may have a legitimate purpose in reporting the wrongdoing of a
21 fellow employee to advance the interest of the general public, or may testify in support of
22 the allegations of one fellow employee against a third employee.

23 No employee, including a supervisor or manager, however, has an absolute
24 privilege to interfere in the employment relationship of co-employees. If an employee is
25 not acting in part to serve the interests of his or her employer, the employee may be liable
26 for interfering with an employee's employment relationship through an improper means
27 or without a legitimate justification. Personal ill will toward the employee is not a
28 legitimate justification.

29 **Illustrations:**

30 4. P employs E, F, and G in its sales office. F accuses G of sexual
31 harassment. During P's investigation of the charges, E provides good faith

1 corroboration of F's allegations. P discharges G based in part on E's testimony.
2 Regardless of whether E provided corroboration in service to P, E's testimony
3 was justifiable and he is not liable for interference with G's employment
4 relationship with P.

5 5. P, a supplier of linens and uniforms, employs E as a district manager
6 through a contract of indefinite duration without any promises or assurances of
7 job security. P also employs M as a regional manager with responsibility over E's
8 district. M dislikes E because E revealed at a meeting with senior company
9 officers that M had approved a servicing contract that the officers questioned.
10 Because of these feelings, M chooses to discharge E rather than other less senior
11 and less productive employees when M is required to consolidate his region's
12 operations.

13 M may be liable to E for interfering with E's employment relationship
14 with P. M's discharge of E was not in service of the interests of P and had no
15 other legitimate justification. P is not liable to E, however.

16 6. P, a hospital, employs F as the supervisor of its radiology department
17 and E as an assistant physicist in the department. E has criticized F for F's
18 observance of safety regulations and general management of the department.
19 Feeling threatened by these criticisms, F falsely reports to hospital management
20 that E has repeatedly threatened patient safety by not following departmental
21 regulations. As a result of these reports, P discharges E.

22 F may be liable to E for interfering with E's contractual relationship with
23 P because F's statements about E were not made to serve the interests of P or
24 other legitimate interests. F's statements also were intentionally false and thus
25 improper. P is not liable to E for intentional interference with P's own contract
26 with E.

27 *c. Interference with prospective employment relationships within the same*
28 *organization.* The wrongful-interference tort also covers an employee's interference with
29 another employee's promotion to another employment relationship with the same
30 employer and interference with another prospective employee being hired by the
31 employer. In order to avoid setting additional undefined and indirect limitations on

1 employer discretion to make promotions or hires, however, employees cannot be liable
2 for interfering with prospective employment relationships with their own employer unless
3 they are acting solely for their own or a third party's interest rather than in the interest of
4 the employer.

5 **Illustration:**

6 7. Same facts as Illustration 6, except that M makes his intentionally false
7 reports concerning E in order to block E's promotion to head physicist in the
8 department. M, though not P, may be liable to E for interfering with E's
9 prospective employment relationship with P.

10 *d. Other forms of interference; interference with another employee's performance*
11 *of contract.* The wrongful-interference tort is not limited to situations where the
12 interfering employee induces the discharge of a co-employee. An employee may interfere
13 with another employee being hired by the first employee's employer or may impede the
14 other employee's promotion to another employment relationship with the same employer.
15 An employee also may interfere with another employee's employment relationship by
16 impeding the other employee's performance of her obligations in that relationship. In
17 order for an employee to be liable for any form of interference, however, the first
18 employee must intentionally interfere through improper means or without legitimate
19 justification in order to advance personal or a third party's interests rather than those of
20 the employer.

21 **Illustration:**

22 8. P, a department store, employs E as a cosmetics salesman under the
23 supervision of F. F feels threatened by E's success in sales and worries that E
24 might replace her as the cosmetic sales supervisor. F reacts by restricting E's
25 phone privileges and moving her sales counter to an undesirable location. As a
26 result, E's sales drops and F convinces her managers to terminate E. F may be
27 liable for tortious interference with E's employment relationship with P. F acted
28 only to serve her own improper interests, not those of P.

29 9. E, F, G, and H work together in a manufacturing assembly team as
30 employees of P. F, G, and H are close friends and resent E because she was hired
31 to replace another close friend and because as a female she does not fit in well

1 with their group. F, G, and H would like to get rid of E and have her replaced with
2 another male worker. F, G, and H therefore conspire together to make E
3 uncomfortable at work and to make it more difficult for her to complete her
4 assembly duties as a member of their team.

5 F, G, and H may be liable for wrongfully interfering with E's employment
6 relationship with P. The three male coworkers have conspired against E in their
7 own improper interests rather than in the interest of P. If P allows the conspiracy
8 against E to continue, it may be liable under laws proscribing sex discrimination
9 in employment. P cannot be liable for interfering with the performance of its own
10 contract with E, however.

11 *Reporters' Notes*

12 *Comment a.* The proposition that an employee may not sue his or her employer
13 for intentional interference with their employment relationship is well established. See,
14 e.g., *Harrison v. NetCentric Corp.*, 433 Mass. 465, 744 N.E.2d 622, 632 (2001); *Albert v.*
15 *Loksen*, 239 F.3d 256, 274-75 (2d Cir. 2001) (applying New York law). Few decisions
16 have suggested otherwise. The court in *Yaindl v. Ingersoll-Rand Co.*, 281 Pa. Super. 560
17 (1980), held that a corporate employer could be vicariously liable for interference by a
18 corporate officer in the efforts of a discharged employee to find another job in another
19 division of the corporation. The court considered the interfering officer to be a third party
20 to the discharged employee's prospective employment relationship because that officer
21 acted in behalf of a corporate division separate from the one in which the plaintiff sought
22 a new position. *Id.* at 625. The court, in other words, treated the case under the principles
23 of § 6.03 as if there were two employers involved: "a manager's pursuit of a former
24 employee and interference with the employee's employment opportunities at another
25 company constitutes a far greater infringement upon the employee's right to make a
26 living than does the manager's discharge of the employee from the manager's own
27 company." *Id.* at 624.

28 The only decision that expressly accepts a theory of intentional interference as the
29 basis for employer liability for a discharge of one of its own employees is *Cappiello v.*
30 *Ragen Precision Industries, Inc.*, 192 N.J. Super. 523, 471 A.2d 432 (1984). Cf. also
31 *Bernstein v. Aetna Life & Cas.*, 843 F.2d 359, 367 (9th Cir. 1988) (ambiguous treatment

1 of Arizona law concerning the liability of corporate officers acting within the scope of
2 employment). In *Cappiello* the court first held that “since one cannot interfere with one’s
3 own contract”, the corporate employer could not be directly liable in tort for punitive
4 damages for the discharge of plaintiff by high company officials to appropriate
5 commissions due the plaintiffs. 471 A.2d at 436. The court, however, then ignored the
6 elements of the interference court in finding the corporation vicariously liable for the
7 punitive damages because one of the company officials was the company president. *Id.* at
8 437.

9 The analysis of *Cappiello* on vicarious liability has not been followed by any
10 other decision and is, in any case, both formally flawed and problematic as policy. For an
11 employer to be vicariously liable in tort for its officer’s discharge of another employee of
12 the employer, the officer must have been acting within the scope of the officer’s
13 employment by acting at least in part to serve the interests of the employer. See § § 7.03
14 and 7.07 of the Restatement Third of Agency. An officer-agent so acting is not a third
15 party to his or her employer-principal’s employment contract with another employee.
16 Furthermore, there is no strong policy argument for imposing punitive damages or other
17 tort liability for intentional interference on an employer in a contractual-breach, discharge
18 case like that of *Cappiello*, rather than in a case like *Yaindl* where corporate officers
19 interfere with other employment opportunities. See *Daniel Adams Assoc., Inc. v.*
20 *Rimbach Publishing, Inc.*, 360 Pa. Super. 72, 82 (1987) (refusing to apply *Yaindl* to a
21 discharge case like *Cappiello*).

22 While *Cappiello* is an aberrational decision, many courts have held that liability
23 may be imposed on corporate managers or supervisors for interfering with the
24 employment contracts of their employers with other employees. See, e.g., *Wagenseller v.*
25 *Scottsdale Mem’l Hosp.*, 710 P.2d 1025, 1043-44 (Ariz. 1985); *Trimble v. City and*
26 *County of Denver*, 697 P.2d 716, 726-27 (Colo. 1985); *Sorrells v. Garfinkel’s*, 565 A.2d
27 285, 286 (D.C. 1989); *Haupt v. International Harvester Co.*, 582 F.Supp. 545 (N.D. Ill.
28 1984).

29 Illustrations 1 and 2 are based on *Haupt*. The court denied summary judgment to
30 the supervisor because the supervisor’s motivation for causing his employer’s discharge
31 of the supervisor’s assistant was a material fact in dispute.

1 As indicated in Illustration 3, even when managers, supervisors or other co-
2 employees act against public policy or otherwise improperly, proper analysis must
3 include consideration of whether their actions were taken as agents of one of the parties
4 to the contract, their employer. In accord with the principle stated in § 7.07 of the
5 Restatement Third of Agency, this requires a determination of whether the manager or
6 supervisors acted “within an independent course of conduct not intended . . . to serve any
7 purpose of the employer.” See *McGanty v. Staudenraus*, 321 Ore. 532, 538 (1995)
8 (“when an employee is acting within the scope of the employee’s employment, and the
9 employer, as a result, breaches a contract with another party, that employee is not a third
10 party for the tort of intentional interference with economic relations”); *Hanson v. New*
11 *Tech., Inc.*, 594 So. 2d 96, 102 (Ala. 1992) (citing *Perlman v. Shurett*, 567 So. 2d 1296,
12 1297 (Ala. 1990) (for managerial personnel to be liable for interference in the contracts
13 of other employees they must have acted “outside the scope of their employment”);
14 *Fuller v. Chicago College of Osteopathic Medicine*, 719 F.2d 1326 (7th Cir. 1983)
15 (Wood, J.) (“Illinois law requires . . . that the officers induced the breach to further their
16 personal goals or to injure the other party to the contract, and acted contrary to the best
17 interest of the corporation.”); *Huff v. Swartz*, 258 Neb. 820, 831(2000) (“an at-will
18 employment relationship can be the subject of a tort action for intentional interference
19 with a business relationship or expectancy . . . against a co-employee who acts as a third
20 party to the relationship by taking actions for his or her own personal benefit, or for the
21 benefit of an entity other than the employer.”).

22 For helpful and supportive analysis, see Frank J. Cavico, *Tortious Interference*
23 *with Contract in the At-Will Employment Context*, 79 U. Det. Mercy L. Rev. 503 (2002);
24 Alex Long, *The Disconnect Between At-Will Employment and Tortious Interference*
25 *with Business Relations: Rethinking Tortious Interference Claims in the Employment*
26 *Context*, 33 Ariz. St. L. J. 491 (2001).

27 *Comment b.* As represented in Illustration 4, courts do not compromise the normal
28 elements of the interference tort for actions brought by one employee against a co-
29 employee. Thus, as set forth in § 6.03, an improper means or lack of legitimate
30 justification must be shown. Many courts state that co-employees, or at least supervisors
31 or managers, have a “privilege” to interfere unless they act solely out of personal interests

1 rather than to benefit the employer. See, e.g., *Los Angeles Airways, Inc. v. Davis*, 687
2 F.2d 321, 328 (9th Cir. 1982) (“where, as here, an advisor is motivated in part by a desire
3 to benefit his principal, his conduct in inducing a breach of contract should be
4 privileged”); *Salit v. Ruden, McClosky, Smith, Schuster & Russell, P.A.*, 742 So. 2d 381,
5 386 (Fla. Dist. Ct. App. 1999) (“The privilege is destroyed where an employee acts solely
6 with ulterior purposes, without an honest belief that his actions would benefit the
7 employer, and the employee’s conduct concerning the contract or business relationship is
8 not in the employer’s best interest.”). This recognition of a qualified privilege mirrors the
9 requirement that the co-employee act solely for independent reasons as a third party.

10 Although other judicial statements of the privilege suggest that employees may be found
11 liable for interfering with co-employees’ employment for malicious reasons even when
12 acting within the scope of employment, see, e.g., *Gram v. Liberty Mutual Ins. Co.*, 384
13 Mass. 659, 429 N.E.2d 21, 24 (1981); *Sorrells v. Garfinkel’s*, 565 A.2d 285, 286, 289-90
14 (D.C. 1989), a purely personal malicious motive, as those alleged in *Gram* and *Sorrells*,
15 is independent of the interests of the employer and thus establishes third party status. In
16 *Sorrells*, for instance, the court approved jury instructions stating that “[i]f the defendant
17 acted with the belief, in good faith and on reasonable grounds that her conduct was in
18 furtherance of Garfinkel’s business interests, then her conduct was not malicious”
19 *Id.* at 292.

20 Only a few courts have found the privilege of supervisors or co-employees to be
21 absolute. Illustration 5 is based on the facts in *Halvorsen v. Aramark Uniform Services,*
22 *Inc.*, 65 Cal. App. 4th 1383 (Cal. Ct. App. 1998), an unusual case finding an absolute
23 privilege for managers. For criticism and rejection of the *Halvorsen* decision, see *Graw v.*
24 *Los Angeles Metro Trans. Auth.*, 52 F. Supp. 2d 1152 (C.D. Cal. 1999).

25 Illustration 6 is based on *Albert v. Loksen*, 239 F.3d 256 (2d Cir. 2001) (applying
26 New York law). The court held that if the supervisor acted “purely out of self interest . . .
27 by defaming” the plaintiff, the supervisor could be liable for intentional interference. *Id.*
28 at 276.

29 *Comment d.* Illustration 8 is based on the facts of *Sorrells v. Garfinkel’s*, 565 A.2d
30 285 (D.C. 1989). The court held “that the jury could find . . . that [the defendant]

1 maliciously destroyed Sorrells' ability to generate sales and otherwise interfered with her
2 performance, with the object of causing her to be fired”

3 For another decision in which the court found a corporate officer's disparagement
4 and general harassment of a subordinate employee to constitute potentially actionable
5 interference, see *Zimmerman v. Direct Financial Credit Union*, 262 F.3d 70 (2001)
6 (applying Massachusetts law). In *Zimmerman* the plaintiff alleged that the chief executive
7 officer of her employer denied her significant assignments and turned other employees
8 against her through lies and humiliation in retaliation for her claim that he had
9 discriminated against her for becoming pregnant. *Id.* at 73-74. The plaintiff could have
10 sued the employer under laws prohibiting retaliation for making a claim of
11 discrimination, see, e.g., 42 U.S.C. § 2000e-3, but apparently wanted to sue the chief
12 executive officer for personally directing the retaliation.

13

14 **§ 6.05 Employer's Fraudulent Misrepresentation Inducing the Initiation,**
15 **Maintenance or Cessation of an Employment Relationship**
16 **An employer may be subject to liability for intentionally inducing an employee or**
17 **prospective employee, through fraudulent misrepresentation of fact, opinion,**
18 **current intention, or law, to enter into or to maintain or to refrain from entering**
19 **into or maintaining an employment relationship with the employer or with another**
20 **employer.**

21 **Comment on § 6.05:**

22 *a. Overview.* The fraudulent-misrepresentation tort recognized in this Section is
23 based on § 525 of the Restatement Second of Torts. The section does not impose
24 additional duties on employers beyond those imposed by § 525 generally on actors,
25 including employees in their relations with employers. The tort recognized here applies to
26 the fraudulent inducement to enter into, maintain, or to not enter into or maintain, any
27 employment relationship, including those that generally are terminable at-will. The
28 elements of the tort include false representation, knowledge of the misrepresentation,
29 intent to induce reliance through the falsity, justifiable reliance, and resulting foreseeable
30 damage.

1 The scienter requirements -- that the misrepresenting party both know of the
2 misrepresentation and also intend to use it to induce reliance -- ensure that the tort cannot
3 be used by an employee to obtain damages in tort for the breach of any good-faith
4 promise of an employer that induced the employee to enter into, maintain, or leave an
5 employment relationship. When an employer induces an employee to enter into,
6 maintain, or leave an employment relationship on the basis of promises that the employer
7 intended to keep when the promises were made, but ultimately does not, the employer
8 may be liable for breach of contract, see § 2.02(b), but the employer is not liable in tort
9 for fraudulent inducement. If an employer does not intend to keep a promise when the
10 promise is made, however, the promise may constitute an actionable fraudulent
11 inducement through intentional misrepresentation of current intent.

12 **Illustrations:**

13 1. E is employed by R as a manufacturing plant manager. P offers E a
14 higher salary to accept employment as P's manager of manufacturing at a plant in
15 another city. When E resists leaving her secure job with R, P tells E that P's sales
16 and operations have been growing and that P plans further hiring and an increase
17 in production at the plant. When making these statements, P knows that a decision
18 has been made to close the plant for which P has been recruited and to merge its
19 operations into another plant in another city. P wants to employ E for a short
20 period to help phase out the plant's operations. P successfully uses the false
21 description to induce E to resign from her job with R.

22 P may be liable to E for any losses suffered because of E's resignation
23 from her job with R. P intentionally induced E to resign from the position with R
24 by misrepresenting material facts about P's operations and about P's current
25 plans. E reasonably relied on P's misrepresentations in making her decision to
26 resign.

27 2. E is employed by P as an advertising account executive. E receives an
28 offer with a higher salary from R, another advertising firm. P tells E that if she
29 stays in her current position, she will be promoted in a few months with a much
30 higher salary than that offered by R. P does not intend to keep this promise, but

1 wants to induce E to stay a few more months while P can transfer her most
2 important account to a newly hired executive.

3 P may be liable to E for any losses suffered because of E's declension of
4 R's offer. P intentionally induced E to decline the offer and to maintain
5 employment with P by misrepresenting material facts about P's intentions. E
6 reasonably relied on P's misrepresentations.

7 3. P desires to recruit E as an executive in his new technology company. P
8 is optimistic about the company's product and marketing plans and believes the
9 company will have extraordinary growth over the next few years. P also believes
10 that he will be able to raise necessary capital from investors to fund that growth. P
11 confidently expresses these beliefs to E to induce him to accept employment. E
12 accepts the position with P, but P's optimism was not realistic and the company
13 fails.

14 P is not liable to E for fraudulent inducement. P did not induce E to accept
15 employment with P with opinions or statements of intention that P knew to be
16 false. P provided only opinions held in good faith, even if not reasonably.

17 *b. Employer can make fraudulent misrepresentations through incomplete*
18 *statements.* An employer does not have a general duty to disclose information about its
19 business to prospective or current employees, even if that information might be material
20 to the employees' decisions about employment with the employer. An employer,
21 however, may be subject to liability for fraudulent misrepresentation by intending to
22 induce employees through incomplete statements that are intended to mislead. As
23 provided in § 529 of the Restatement of Torts Second, the tort of fraudulent
24 misrepresentation covers representations that are intentionally misleading because they
25 are incomplete.

26 **Illustration:**

27 4. P, a subsidiary company providing computer services, hires a new
28 president, M, to try to reverse the decline in the company's business and the company's
29 increasing financial losses. M is told that if he is not successful in six months, the
30 company will be liquidated. M recruits E from another employer to become P's new sales
31 manager. Before accepting employment with P, E asks M about P's financial status and

1 prospects. M truthfully tells E that P's *parent* company is in great financial condition and
2 that he believes E will have a long career at P. M does not tell E what he knows about P's
3 actual loss of business or poor financial statements. M also does not tell E that if P's
4 business does not improve in six months, it will be liquidated. P's business does not
5 improve and M and E both lose their jobs.

6 M and P may be liable for fraudulent misrepresentation. M's incomplete
7 responses to E's question were intended to mislead her about the prospects of P and to
8 induce her to accept employment with P.

9 *c. Unkept promises are not sufficient to establish fraud.* An employer does not
10 fraudulently induce an employee to enter into, maintain or leave an employment
11 relationship by making promises of future intent that are not kept, unless the employer
12 intends not to fulfill the promises at the time they are made. Thus, an employer that
13 breaches a promise of future benefits or job security is not liable for fraudulent
14 inducement unless it knew at the time the promise was made that it would not be kept.

15 **Illustration:**

16 5. P tells E, P's employee, that E will be promoted to vice president in a
17 short period if she declines another job offer and moves her residence from her
18 home town to the city of P's company headquarters. P intends to keep this
19 promise when made. E declines the other offer and moves. Soon after E suffers a
20 serious injury from a fall while on company business. E files a claim for worker's
21 compensation. P reacts to this claim by demoting E to her old position, requiring
22 her to return to her home town.

23 Although P may be liable to E under the state worker's compensation law,
24 for the tort of wrongful discipline (§ 4.02(c)) and perhaps for breach of contract
25 (see § 2.02(b)), P is not liable to E for fraudulent inducement. P intended to keep
26 his promises when they were made to E.

27 *d. Employee must reasonably rely on misrepresentation.* The elements of the tort
28 of fraudulent misrepresentation include the requirement that the defrauded party must
29 reasonably rely on the misrepresentation. Thus, employees claiming under this tort must
30 demonstrate that they both actually and also reasonably relied on the employer's
31 misrepresentations. If the misrepresentations did not in fact cause the employment

1 decisions that resulted in harm to the employees, the misrepresenting employer is not
2 liable to the employees for the harm. If the misrepresentations, even if intentional, were
3 too ambiguous or amorphous to be reasonably relied on by the employees, the
4 misrepresenting employer also is not liable to the employees for the harm. An employee,
5 however, may have reasonably relied on an employer's intentionally false opinion if the
6 employee reasonably considered the opinion to be based on information known by the
7 employer and not the employee.

8 **Illustrations:**

9 6. Hoping to increase her income, E decides to leave her position as an
10 accountant to accept a job with P as a financial sales broker with pay based on
11 commissions. A short time after E starts work at P, F, P's regional office manager,
12 intentionally exaggerates the amount of income of several brokers in the office. F
13 does so to provide E with extra motivation to sell. A few months later, E learns of
14 these exaggerations from another broker, G, but continues employment with P.

15 When E does not increase her own income after two years in the job, she resigns
16 and claims that F's exaggerations constituted actionable fraud.

17 F and P are not liable to E for fraudulent misrepresentation as E did not
18 rely on F's misrepresentations of the income of other brokers in accepting or
19 continuing her employment with P.

20 7. Same facts as Illustration 5 except that F tells E before E accepts
21 employment with P that E will be very successful as a financial sales broker and will
22 be able to earn "big bucks" doing so. F in fact is not convinced that E will be successful,
23 but wants to induce her to try.

24 F and P are not liable to E for fraudulent misrepresentation. F may have
25 intentionally misrepresented his actual opinion, but E could not reasonably rely on F's
26 general opinion in deciding to accept P's offer of employment.

27 8. Same facts as Illustration 4 except that M responds to E's question
28 about the financial health of P by stating that in his opinion P's finances are very strong
29 and the prospects for the company are very good. M actually knows that P's finances and
30 future prospects are precarious and that there is a good chance the company will be
31 liquidated within a year.

1 M and P may be liable for fraudulent misrepresentation. E reasonably
2 relied on M's intentionally misleading opinion about P's finances and prospects
3 as M was in a position to base this opinion on his special knowledge about P.

4 *e. Fraudulent inducement to leave employment relationship.* An employer's
5 fraudulent inducement of an employee to leave an employment relationship with the
6 employer may be tortious, even though the employer would have been subject to no more
7 than a contract action had it discharged the employee directly. An employer may want to
8 induce an employee to resign rather than to discharge her because the employee may be
9 protected from discharge by her employment contract or by external law. By inducing a
10 resignation the employer may attempt to minimize the chances that the employee will
11 assert any legal right against the employer. A fraudulently induced resignation may be
12 treated as a constructive discharge subject to challenge under any right of the employee
13 against wrongful discharge, but a fraudulently induced resignation may prevent the
14 former employee from learning that she may have a right of action to challenge a
15 discharge. A fraudulent inducement of a resignation thus may be tantamount to the
16 fraudulent inducement of a waiver of a right of action. The remedy for the fraudulent
17 inducement of a resignation therefore may include not only the revival of any
18 independent cause of action for constructive discharge, but appropriate tort remedies for
19 any pecuniary loss from the delay in commencing the action.

20 Where employees induced to resign are in at-will employment relationship and
21 would have no cause of action had they been discharged, however, it can be presumed, in
22 the absence of special proof, that the employees would have been discharged had they not
23 been induced to resign. In such cases, the employees have not been injured by any
24 misrepresentation and no remedy is appropriate.

25 **Illustrations:**

26 9. P employs E as a welding supervisor. P has disseminated to all its
27 employees a personnel handbook that provides that no employee will be
28 terminated except for "good cause". M, P's head of operations, believes that E is
29 getting too old to be effective. M tells E that her position is going to be eliminated
30 and that she should resign to insure that she will achieve her pension benefits. M
31 knows that both of these assertions are false, but wants to induce E to resign

1 because M fears that discharging her may result in a lawsuit claiming a
2 contractual breach based on the assurances in the handbook and also an action
3 alleging age discrimination. E resigns. She later learns that her position was not
4 eliminated.

5 M and P may be liable to E for the tort of fraudulent inducement. E should
6 be able to recover for the pecuniary losses due to the delay in or sacrifice of any
7 causes of action that would have been available had she been discharged.

8 *f. Employer liable for losses caused by reliance on inducement, not for loss of*
9 *employee's expectations.* Establishing the elements of fraudulent misrepresentation is not
10 sufficient to establish the existence of a contractual commitment. An employer who is
11 liable to an employee for an inducement through fraudulent misrepresentation is liable for
12 pecuniary losses incurred by the employee in reliance on the misrepresentation, but not
13 for fulfilling any promise contained in the misrepresentation. Thus, an employer is liable
14 for the loss of opportunities or benefits that it fraudulently induces an employee to
15 sacrifice, but not for fulfilling the fraudulent promises used to induce that sacrifice.

16 **Illustration:**

17 10. P, by promising a secure “long and lucrative career” in P’s “thriving”
18 business, induces E to leave her secure position in her family’s business in New
19 York and move to California. P tells E that if she performs well, she will be
20 promoted to a top executive position in a short period. P does not intend to fulfill
21 these promises, but instead intends to shut down the part of the business for which
22 he recruited E for a short transitional period and to then discharge E. After this
23 short period, P does discharge E after shutting down the business on which E
24 briefly worked.

25 P is liable to E for the costs of moving her family across the country and
26 for other loss occasioned by her relinquishing her former position in New York. P
27 is not liable to E for the value of the promised “long and lucrative career” in
28 California.

29 ***Reporters’ Notes***

30 *Comment a.* Section 525 of the Restatement Second of Torts provides “One who
31 fraudulently makes a misrepresentation of fact, opinion, intention or law for the purpose

1 of inducing another to act or to refrain from action in reliance upon it, is subject to
2 liability to the other in deceit for pecuniary loss cause to him by his justifiable reliance
3 upon the misrepresentation.” Subsequent sections elaborate the elements of the tort.

4 Illustration 1 is derived from *Meade v. Cedarapids, Inc.*, 164 F.3d 1218 (9th Cir.
5 1999) (applying Oregon law). In *Meade* the agents of the employer who recruited new
6 employees without disclosing the plan to shut down the plant did not actually know of the
7 plan. The court held, however, that the employer as the principal of the recruiting agents
8 was responsible if it intentionally withheld the information from the agents so that the
9 agents would misrepresent the facts. *Id.* at 1222.

10 Other similar decisions include: *Lazar v. Superior Court of Los Angeles County*,
11 12 Cal. 4th 631, (1996) (employer liable for fraud if it used intentionally false
12 representations of its financial health and business and compensation plans to induce
13 executive to give up secure job and business network in New York to move to California
14 to work for employer); *Interstate Freeway Services, Inc. v. Houser*, 310 Ark. 302 (1992)
15 (restaurant manager induced to accept job by intentionally false representation of
16 continuing independence from supervision when employer only wanted manager to do
17 initial hard work of opening restaurant and intended to replace him soon after); *Palmer v.*
18 *Beverly Enterprises*, 823 F.2d 1105 (7th Cir. 1987) (applying Illinois law) (employer
19 liable for fraudulent inducement if it did not intend to purchase plaintiff’s house in
20 Illinois when it promised to do so to induce him to move to California to accept
21 employment there).

22 Courts have found the tort of fraudulent misrepresentation or inducement to be as
23 applicable to employer misrepresentations made to induce employees to remain in the
24 employer’s employment as to misrepresentations made to induce employees to
25 commence new employment relationships. Illustration 2, for instance, is based on *Cole v.*
26 *Kobs & Draft Advertising, Inc.*, 921 F.Supp. 220 (S.D. N.Y. 1996) (applying New York
27 law). Other decisions finding actionable an employer’s fraudulent inducement of current
28 employees not to resign include: *Spoljaric v. Percival Tours, Inc.*, 708 S.W.2d 432 (Tex.
29 S. Ct. 1986) (actionable fraudulent misrepresentation if executive employee was induced
30 not to resign at same time as other executive by intentional misrepresentation of current
31 intent to pay executives a bonus if company became profitable); *LaFont v. Taylor*, 902

1 S.W.2d 375 (Mo. Ct. of App. 1995) (employee stated cause of action for fraud by
2 alleging that employer induced him to forgo other more lucrative employment by falsely
3 promising he would give employee opportunity to purchase the business from employer).

4 Decisions finding that employers may be liable for fraudulently inducing
5 employees to commence or maintain employment do not make exceptions for an
6 employee in an at-will relationship who has been terminated. See, e.g., *Agosta v. Astor*,
7 120 Cal. App. 4th 596, 15 Cal. Rptr. 3d 565 (2004); *Clement-Rowe v. Michigan Health*
8 *Care Corp.*, 212 Mich. App. 503 (1995). Employees are allowed to recover damages for
9 being induced to commence or continue employment, even though they may not be able
10 to claim damages for being terminated. The court in *Cole, supra*, for instance, explained
11 that the fact that the plaintiff was an employee-at-will was not relevant to her claim that
12 she suffered damages to her career from her employer inducing her to decline another
13 offer and remain in the employer's employ until she was later discharged. She could
14 recover damages only for harms caused by the fraudulent inducement not to resign to
15 take another position, not for harms caused by her termination. *Id.* at 224-26. In *Lazar*,
16 *supra*, the court stressed that the damages alleged by the plaintiff derived not from his
17 termination, but from the earlier fraudulent misrepresentations "which allegedly came to
18 light only at the time of termination", and which allegedly caused him to accept
19 employment with the defendant. 12 Cal. 4th at 643.

20 Illustration 3 derives from *Maroun v. Wyreless Systems, Inc.*, 141 Idaho 604, 615
21 (2005). The court concluded that the defendant only made predictions, rather than "a
22 statement or a representation of past or existing fact."

23 *Comment b.* Section 529 of the Restatement of Torts Second provides: "A
24 representation stating the truth so far as it goes but which the maker knows or believes to
25 be materially misleading because of his failure to state additional or qualifying matter is a
26 fraudulent misrepresentation." Section 551(b) of the Restatement Second of Torts also
27 states that a party to a business transaction is under a duty to disclose "matters known to
28 him that he knows to be necessary to prevent his partial or ambiguous statement of the
29 facts from being misleading."

30 Illustration 4 is based on *Berger v. Security Pacific Information Systems, Inc.*,
31 795 P.2d 1380 (Col. Ct. of App. 1990). See also, e.g., *Miller v. Fairchild Industries, Inc.*,

1 885 F.2d 498, 509 (9th Cir. 1989) (applying California law) (suppression of material facts,
2 such as impending layoffs, may constitute fraud where employer intends to mislead);
3 Harlan v. Intergy, 721 F. Supp. 148, 150 (N.D. Ohio 1989) (“Ohio law imposes a duty to
4 make full disclosure of facts where it is necessary to dispel misleading impressions ...
5 created by a defendant’s partial revelation of facts”; misleading to claim company was
6 “profitable” because it had made money for several weeks after losing money for more
7 than two years).

8 *Comment c.* Courts do not allow employees to claim that an employer’s failure to
9 keep promises of acts to be performed in the future is actionable fraud without proof that
10 the employer when the promise was made did not intend to perform the acts. This is true
11 even for appealing cases, like that in Illustration 5, where the employer’s breach of a
12 promise is not justified. Illustration 5 is based on National Security Insurance Co. v.
13 Donaldson, 664 So.2d 871, 876-77 (Ala. S. Ct. 1995) (“there was no evidence submitted
14 from which the jury could infer that, at the time the alleged misrepresentation was made,
15 [the defendant] intended to deceive [the plaintiff] and intended not to make him vice
16 president”). See also, e.g., *Maroun*, supra, at 615, 985 (“promise or statement that an act
17 will be undertaken, however, is actionable, if it is proven that the speaker made the
18 promise without intending to keep it.”(quoting *Magic Lantern Prods., Inc v. Dolsot*, 126
19 Idaho 805, 807 (1995).)

20 *Comment d.* Illustration 6 is based on *Kary v. Prudential Insurance Co.*, 541
21 N.W.2d 703 (N.D. Sup. Ct. 1996). See also, e.g., *State Farm Mutual Automobile Ins. Co.*
22 *v. Novotny*, 657 So. 2d 1210 (Fla. Dist. Ct. 1995) (claims representative dismissed after
23 confessing to accepting free paint job on her car from body shop did not rely on
24 supervisor’s intentionally untrue statements before confession).

25 Despite the coverage of “opinion” by § 525 of the Restatement Second of Torts,
26 courts often rule that statements of opinions cannot be the basis for fraudulent
27 misrepresentation because they are not statements of fact and therefore cannot be
28 reasonably relied upon. See, e.g., *LaScola v. US Sprint Communications*, 946 F.2d 559,
29 568 (7th Cir. 1991) (applying Ohio law) (employer described itself as an “excellent
30 company comprised of “a bunch of straight shooters”” and described its formal
31 compensation plan as “lucrative”); *Hayes v. Computer Associates Int’l*, 2003 WL

1 21478930 (ND. Ohio 2003) (employer expressed perhaps somewhat inflated opinions of
2 its products and sales opportunities). These decisions, like Illustration 7, however,
3 involve opinions that do not imply a basis in facts specially known by the one expressing
4 the opinion. In a case like Illustration 8, where the employer expresses an opinion
5 apparently based on special knowledge of material facts, reliance may be reasonable and
6 an opinion intended to mislead may be actionable.

7 *Comment e.* Section 6.05, as elaborated by comment e, adopts the view of the
8 dissenting opinion in *Hunter v. Up-Right, Inc.*, 6 Cal.4th 1174, 1186 (1993) (Mosk, J.).
9 Judge Mosk states: “although plaintiff’s damages are presumably the same for being
10 tricked into resigning as they would be if he had been simply wrongfully discharged
11 outright, the former behavior involves a fraud for which the law of tort provides special
12 disincentives. The purpose of the fraud in this case, as the jury fairly inferred, was to
13 dupe plaintiff into forfeiting his contractual and employment rights by deceiving him into
14 resigning. The corporation sought through this artful deception to extricate itself from its
15 contractual obligations, rather than to straightforwardly discharge him and risk potential
16 liability for breach of contract. The law of fraud is designed to deter the use of such
17 stratagems.” *Id.* at 1191, at 98.

18 *Comment f.* Illustration 10 is based on *Lazar v. Superior Court of Los Angeles*
19 *County*, 12 Cal. 4th 631 (1996). See also, e.g., *Smith v. Texas Children’s Hospital*, 84
20 F.3d 152 (11th Cir. 1996) (applying Texas law) (employee may sue employer for loss of
21 benefits owed by a former employer and which she sacrificed because defendant
22 employer intentionally misrepresented the benefits it offered in order to induce her to
23 change employers).

24 Section 549 (2) of the Restatement Second of Agency states that the “recipient of
25 a fraudulent misrepresentation in a business transaction is also entitled to recover
26 additional damages sufficient to give him the benefit of his contract with the maker, if
27 these damages are proved with reasonable certainty.” Many courts apply this “benefit-of-
28 the-bargain” rule as a measure of damages for fraudulent misrepresentations in cases
29 involving a contract for a sale of property. It has not been adopted in the context of
30 employment where the existence of a contractual bargain may be at issue.

31 .

1 **§ 6.06 Employer’s Negligent Provision of False Information to Employees**

2 **(1) An employer has a duty to an employee or prospective employee to exercise**
3 **reasonable care not to provide false information on a topic about which it has**
4 **special knowledge and which it knows is material to the employee’s or prospective**
5 **employee’s decision whether to enter into or to maintain an employment**
6 **relationship with the employer.**

7 **(2) An employer may be subject to liability for reasonably foreseeable pecuniary**
8 **loss suffered by an employee or prospective employee if the employer by breaching**
9 **the above-stated duty intentionally induced the employee or prospective employee to**
10 **enter into or to maintain or refrain from entering into or maintaining an**
11 **employment relationship with the employer or with another employer.**

12 **Comment on § 6.06:**

13 *a. Overview.* An employer may be liable to an employee for pecuniary loss caused
14 by the employer’s intentionally inducing an employment decision through the negligent
15 as well as the intentional provision of false information. Such liability derives from the
16 employer’s duty to exercise reasonable care to not provide false information that it knows
17 may be material to the employee’s decision concerning an employment relationship. This
18 duty applies when the information provided by the employer concerns a topic about
19 which the employer, but not the employee, has special knowledge.

20 This section is based on § 552 of the Restatement Second of Torts, which defines
21 the tort of negligent misrepresentation. Section 552 imposes a duty of care and
22 competence on one “who, in the course of his business, profession or employment, or in
23 any other transaction in which he has a pecuniary interest, supplies false information for
24 the guidance of others in their business transactions.” This definition applies to
25 employers who supply false information to influence employees or prospective
26 employees to enter into or maintain an employment relationship with the employer, a
27 relationship in which employers have a pecuniary interest.

28 The elements of the tort of negligent misrepresentation include an intent to guide
29 or influence a business transaction, the provision of false information, a breach of a duty
30 of care in determining the accuracy of the information, reasonable reliance on the false
31 information, and the causation of reasonably foreseeable loss. In the employment context

1 covered by § 6.06 an employer does not have a duty to exercise care in the provision of
2 information on a topic about which it has no special knowledge beyond that readily
3 available to the employee. An employee, in any event, does not reasonably rely on
4 information supplied by an employer if information on the same topic is otherwise
5 readily available to the employee.

6 The tort of negligent misrepresentation, like the tort of fraudulent
7 misrepresentation, may cover inducements to enter into at-will employment relationships.
8 An employer may discharge without cause an employee it negligently or fraudulently
9 induced to enter into an at-will employment relationship, but the employer may be liable
10 for pecuniary losses it caused the employee by inducing the employee to enter into the
11 relationship.

12 **Illustrations:**

13 1. M, the newly hired Chief Executive Officer (CEO) of hospital P, desires
14 to hire E to be the manager of physical therapy at the hospital. E tells M that he
15 does not want to resign from his attractive position at hospital R without knowing
16 how much he will earn at P and that the offer from P is definite. M tells E what E's
17 salary will be and that as the CEO of P, M has authority to offer E the position,
18 albeit as an at-will employee. M makes this statement without confirming that he
19 does have the authority to make this hiring decision and set E's salary. E resigns
20 from hospital R. E later learns that M did not have final authority to offer E the
21 position with P without the approval of another executive, N. N then vetoes E's
22 hiring because E lacked a formal degree in physical therapy.

23 M and P may be liable to E for the reasonably foreseeable pecuniary
24 losses caused by E's resignation from his position at R. M negligently
25 misrepresented his authority to hire, knowing that this authority was material to E's
26 decision to resign from R and to accept M's offer of employment with P. E could
27 reasonably rely on the statements of M as the CEO of P about the hiring authority at
28 P, even though E could not assume he would have long-term job security at P.

29 2. M, the manager of a bakery, P, tells P's employees in a speech to boost
30 morale on the plant floor that the purchase of P by a larger company, R, will not
31 affect employment at P because P continues to be profitable. In fact, had M

1 carefully read R's financial analysis of P's operations, he would have realized that P
2 did not satisfy R's targeted return on equity and was under consideration for being
3 contracted. As a result of a subsequent contraction, many employees are laid off.

4 M, P, and R are not liable to the employees for negligent
5 misrepresentation. M delivered his speech to the employees only to boost general
6 morale, not for the purpose of offering them advice about any particular
7 employment decisions to influence them to remain as employees of P.

8 *b. Employer does not negligently misrepresent its own opinion or intention.*

9 Unlike the tort of fraudulent misrepresentation covered by § 6.05, the tort of negligent
10 misrepresentation does not cover the misrepresentation of opinion or current intention,
11 only the misrepresentation of information. Employers, like others attempting to influence
12 business decisions, know their own opinions and intent. Any misrepresentation of either
13 therefore must derive from an intention to deceive, rather than from a failure to exercise
14 care in determining or communicating some factual information.

15 An employer, however, may negligently convey false information by stating an
16 opinion that conveys false information. If such information is so conveyed with the intent
17 to induce an employee to make a particular employment decision in which the employer
18 has an interest, the statement may be actionable. Furthermore, an employer, or its agent,
19 may negligently, as well intentionally, misstate information about the opinion or current
20 intent of another. Such a negligent statement also may be actionable if the other elements
21 of the tort of negligent misrepresentation are demonstrated.

22 The tort of negligent misrepresentation, like the tort of fraudulent
23 misrepresentation can never be based on predictions or promises of future intent that are
24 not ultimately realized. It does not encompass promises of future intent or performance.

25 **Illustrations:**

26 3. A large private school, P, employs E as a language teacher on a one
27 year contract. In March, E asks M, P's principal, whether E should seek another
28 teaching job because E might not be offered a contract for the following year. P
29 knows E has been a successful teacher and tells E that E's work warrants a
30 contract for the following year. When making this statement, P fails to consider
31 the worsening state of the local economy and the decline in applications for

1 enrollment. In May, when P plans the next school year, she realizes that P cannot
2 offer E another contract because of declining enrollments. In the period between
3 March and May, E has forfeited opportunities to secure alternative employment.

4 M and P are not liable to E for negligent misrepresentation. M only
5 conveyed her actual opinion and future intent; she did not convey false
6 information or misrepresent her opinion or intent.

7 4. Same facts as Illustration 3 except that in response to E's question
8 about seeking another position, M tells E that despite the economy, enrollment
9 looks good and there should be a position for E in the next school year. M makes
10 her false statement about the enrollment figures not because she intends to
11 mislead E, but because she has not taken the time to look at the actual applications
12 for the following year. M intends to influence E not to secure alternative
13 employment.

14 M and P may be liable to E for negligent misrepresentation. M conveyed
15 to E more than her opinion or intent. M negligently stated false information as the
16 basis of her opinion.

17 *c. Requirement of employer's special knowledge.* The employer's duty of care is
18 dependent upon the employer having special knowledge about the information by which
19 it intends to influence an employee's or prospective employee's decision whether to enter
20 into or to maintain an employment relationship. This is most often true for information
21 about the state of the employer's own business or the terms of work available to the
22 employee or prospective employee. It may also be true for information, as in Illustration
23 1, concerning the identity of those with authority to initiate or terminate the employee's
24 employment. It generally is not true for representations about the business or employment
25 conditions of other employers. Individuals making business decisions, like whether to
26 enter into or maintain an employment relationship, do not reasonably rely on information
27 supplied by an interested party, like an employer, without special knowledge.

28 *d. Employer has duty not to mislead, but no general duty to disclose.* An employer
29 has no general duty to disclose information to employees or prospective employees, even
30 if the employer knows the information might be material to their employment decisions.
31 An employer may refuse to respond to employee requests for such information. An

1 employer, however, does have a duty to disclose information of which it has special
2 knowledge if that disclosure is necessary to prevent the employer's partial or ambiguous
3 statement of material facts from being misleading. An employer may be liable for
4 intending to influence employee decisions concerning the initiation or maintenance of an
5 employment relationship by statements that the employer should know are materially
6 misleading because incomplete. This employer duty not to mislead is based on §
7 551(2)(b) of the Restatement Second of Torts.

8 **Illustrations:**

9 5. E, who is employed by R, in response to an advertisement, applies for a
10 higher paying position with P. E tells M, P's personnel manager, that he does not
11 want to resign his position with R without knowing that he has a definite offer of
12 secure employment with P. M tells E that E does have such an offer and that
13 while his new position would not have a definite term, it would provide E "job
14 security and an opportunity to grow with the company." M knows or should know
15 that P's executives have been seriously considering a reorganization that would
16 eliminate the position for which E is being hired. E resigns his position at R and
17 begins employment with P. Six days later M tells E that his position has been
18 eliminated for business reasons and that there are no other positions available for
19 him at P.

20 M and P may be liable to E for negligent misrepresentation. M intended
21 to induce E to resign his position with R in order to accept employment with P.
22 Whether or not M intended to mislead E, M negligently did so by stating the
23 position offered security, without also advising E about the reorganization under
24 consideration at P.

25 6. Same facts as Illustration 5 except that M tells E only that E has a
26 definite offer of at-will employment with P, without suggesting anything about
27 job security or an opportunity for growth with the company. M and P are not
28 liable to E for negligent misrepresentation. M and P had no duty to provide
29 information in response to E's question about job security with P.

30 *e. Employer liable for losses caused by reliance on inducement, not for loss of*
31 *employee's expectations.* Employer liability for negligent, as for intentional,

1 misrepresentation is limited to pecuniary losses incurred by the employee in reliance on
2 the misrepresentation. Costs incurred by an employee in reliance on an employer's
3 misrepresentation may include the loss of opportunities or benefits that the employer
4 induces an employee to sacrifice. An employer, however, is not liable for fulfilling any
5 promises used to induce the employee's decision. Establishing the elements of negligent
6 misrepresentation is not sufficient to establish the existence of a contractual commitment.

7 **Illustration:**

8 7. Same facts as Illustration 1. M and P may be liable to E for the loss of
9 income or benefits E incurred from resigning his position at R and for any out-of-pocket
10 costs incurred by E in moving to take the position at P. M and P are not liable to E for the
11 salary and benefits he would have gained from working at P.

12 ***Reporters' Notes***

13 *Comment a.* Courts in many jurisdictions have found the tort of negligent
14 misrepresentation applicable to employers who give advice to employees or prospective
15 employees on a matter, such as whether to commence or continue employment with the
16 employer, in which the employer has a pecuniary interest. See, e.g., *Griesi v. Atlantic*
17 *General Hosp. Corp.*, 360 Md. 1 (2000) (discussed below); *Gayer v. Bath Iron Works*,
18 687 A.2d 617, 621 (Me. 1996) (rejecting summary judgment for employer who allegedly
19 misrepresented availability of positions); *Levens v. Campbell*, 733 So.2d 753, 762 (Miss.
20 1999) (recognizing cause of action, though finding no misrepresentation in case); *Branch*
21 *v. Homefed Bank*, 6 Cal. App. 4th 793 (Cal. App. 4th Dist. 1992) (jury could find
22 employer induced employee to move across country by negligent misrepresentation);
23 *D'Ulisse-Cupo v. Board of Directors of Notre Dame High School*, 202 Conn. 206 (Conn.
24 1987) (discussed below); *Pearson v. Simmonds Precision Prod., Inc.*, 160 Vt. 168 (Vt.
25 1993) (employer could be liable for negligent misrepresentations to induce hiring of at-
26 will employee); *Miksch v. Exxon Corp.*, 979 S.W.2d 700, 706 (Tex. App. 1993)
27 (recognizing cause of action, but finding employer made no misrepresentation of current
28 fact); *Eby v. York Division Borg-Warner*, 455 N.E.2d 623, 628-29 (Ind. Ct. App. 1983)
29 (employer could be liable for negligent misrepresentations in inducing employee to move
30 to Florida); *Williams v. Bd. of Regents of Univ. of Minn.*, 763 N.W.2d 646 (Minn. App.
31 2009) (court could consider coach's claim against employer for negligent

1 misrepresentation); *Burland v. ManorCare Health Services, Inc.* 1999 U.S. Dist. LEXIS
2 725 (E.D. Pa. 1999) (applying Pennsylvania law) (discussed below). Courts have rejected
3 applying the tort to cases in which plaintiffs have sought damages for termination of an
4 at-will employment relationship, rather than for costs incurred in reliance on the
5 employer's inducement to initiate or continue the relationship. See, e.g., *Fry v. Mount*,
6 554 N.W.2d 263, 264 (Iowa S. Ct. 1996) (alleged misrepresentations were not about
7 information within the special knowledge of employer, but about predictions of success
8 in the job).

9 Illustration 1 is based on *Griesi v. Atlantic General Hospital Corp.*, 360 Md. 1
10 (2000). The court rejected the defendant's argument that the negligent misrepresentation
11 tort in employment only applies to high-level executives or to fixed term employment
12 contracts. *Id.* at 17. The court characterized the plaintiff's claim as whether the employer
13 "failed to exercise reasonable care in communicating information to [the plaintiff] that
14 was material to his business decision whether to accept the offer for the in-house,
15 managerial physical therapist position, that he relied on those misrepresentations, and
16 suffered injury as a result of that reliance." *Id.* at 19. For a similar case involving an
17 apparent misrepresentation of authority to hire, see *Eby v. York-Division, Borg-Warner*,
18 455 N.E.2d 623 (Ct. of App. Ind. 1983). *Petitte v. DSL.NET, Inc.*, 102 Conn. App. 363,
19 925 A.2d 457 (2007) is a contrasting case in which an accepted offer for at-will
20 employment was withdrawn after the prospective employee's references were checked,
21 but there was no misrepresentation of the authority of the hiring agent to make a final
22 decision or no other intentionally or negligently misleading inducement.

23 Illustration 2 is based on *Jordan v. The Earthgrains Cos., Inc.*, 155 N.C. App. 576,
24 S.E.2d 336 (N.C. App. 2003). The court stressed that the plaintiff employees failed to
25 offer evidence demonstrating that the speech was given to offer the employees advice in a
26 transaction in which the employer had some pecuniary interest. *Id.* at 767, at 340. As
27 Illustration 2 indicates, in accord with § 552 of the Restatement Second of Torts, an
28 employer may be liable for negligent misrepresentation only if it intends to influence the
29 employee's employment or business decision through the provision of the information.
30 No court has held an employer liable for negligent misrepresentations absent this intent.

1 *Comment b.* Illustrations 3 and 4 are derived from *D’Ullisse-Cupo v. Board of*
2 Directors of Notre Dame High School, 202 Conn. 206, 520 A.2d 217 (1987), in which the
3 Supreme Court of Connecticut applied the negligent misrepresentation tort to employer
4 negligent misrepresentations intended to influence employees. The facts of *D’Ullisse-*
5 *Cupo* are closer to those of Illustration 4, as the principal told the plaintiff that
6 “everything looked fine for rehire the next year”, thus implying, though not expressly
7 stating, that there was no problem with enrollments. *Id* at 208.

8 For decisions holding that the tort of negligent misrepresentation does not cover
9 promises of future conduct, see, e.g., *Wilkinson v. Shoney’s, Inc.*, 269 Kan. 194, 221
10 (2000) (vague statement that Shoney’s “treated people well”); *Manon v. Solis*, 142
11 S.W.2d 380, 388 (Tex. Ct. of App. 2004) (promises about future working conditions).

12 *Comment d.* Section 551(2)(b) of the Restatement Second of Torts provides that
13 “One party to a business transaction is under a duty to exercise reasonable care to
14 disclose to the other before the transaction is consummated . . . (b) matters known to him
15 that he knows to be necessary to prevent his partial or ambiguous statement of the facts
16 from being misleading.”

17 Illustration 5 is based on *Burland v. Manorcare Health Services, Inc.*, 1999 U.S.
18 Dist. LEXIS 725 (E.D. Pa. 1999) (applying Pennsylvania law). The court concluded that
19 the defendant “may have committed actionable omissions regarding the continued
20 viability of the position or the length of time he might remain employed at that post.” *Id.*
21 at *7-*8. See also, e.g., *Pearson v. Simmonds Precision Products, Inc.*, 160 Vt. 168, 171
22 (1993) (jury could find in favor of plaintiff for employer’s negligent misrepresentation
23 and failure to disclose his position depended on the success of a specific project after
24 telling him that there was other work available in other projects).

25 *Comment e.* The reasons for adoption of an out-of-pocket rather than a benefit-of-
26 the-bargain measure of damages rule for negligent misrepresentation in the employment
27 context are even stronger than for the adoption of an out-of-pocket rule for fraudulent
28 misrepresentation in the employment context.

29 Section 552B (1) of the Restatement Second of Torts states that the “damages
30 recoverable for a negligent misrepresentation are those necessary to compensate the
31 plaintiff for the pecuniary loss to him of which the misrepresentation is a legal cause.”

1 Section 552B (2) states “the damages recoverable for a negligent misrepresentation do
2 not include the benefit of the plaintiff’s contract with the defendant.” Comment b to this
3 sections states that the “considerations of policy that have led the courts to compensate
4 the plaintiff for the loss of his bargain in order to make the deception of a deliberate
5 defrauder unprofitable to him, do not apply when the defendant has had honest intentions
6 but has merely failed to exercise reasonable care in what he says or does.” See also, e.g.,
7 *Trytko v. Hubbell, Inc.*, 28 F.3d 715, 722 (7th Cir. 1994) (citing decisions adopting the
8 out-of-pocket rule for negligent misrepresentation and adopting the rule in an
9 employment case under Indiana law).

10 Courts do not allow the recovery of damages for non-pecuniary losses for
11 negligent misrepresentation in employment. See, e.g., *Pearson v. Simmonds Precision*
12 *Products*, 160 Vt. 168, 174 (1993) (no recovery for associated emotional distress).

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27

CHAPTER 8

EMPLOYEE OBLIGATIONS AND RESTRICTIVE COVENANTS

§ 8.01. Employee Duty of Loyalty

(a) Employees owe a duty of loyalty to their employer in matters related to the employment relationship.

(b) Employees breach the duty of loyalty by

(i) disclosing or using the employer’s confidential information to serve an interest other than the employer’s interest (including after termination of the employment relationship),

(ii) competing with the employer while employed by the employer (§ 8.04), or

(iii) appropriating the property of the employer or engaging in self-dealing through use of the employer’s property.

Comment:

a. Scope. All employees are subject to a duty of loyalty, the obligations of which vary according to the employer’s legitimate interest and the nature of the employee’s position, including whether the employee exercises managerial responsibilities for the employer. Some courts refer to a “fiduciary” duty of loyalty when dealing with managerial employees, including corporate officers and others in positions of trust and confidence, but not when dealing with nonmanagerial employees (see § 8.04 below). In that usage, the “fiduciary” label describes an aspect of the duty of loyalty, rather than a separate duty.

1 This Chapter deals primarily with two aspects of the employee’s duty of loyalty to
2 the employer that have figured most prominently in employment litigation: the obligation
3 not to compete with the employer while remaining an employee, and the obligation not to
4 disclose or use confidential information belonging to the employer for any reason other
5 than the employer’s interest. The obligation not to disclose or use confidential
6 information outlasts the term of employment and endures as long as the information
7 remains confidential according to the requirements of § 8.02. See § 8.03.

8 A third, somewhat less often invoked, aspect of the duty of loyalty is the
9 obligation not to appropriate the property of one’s employer or engage in self-dealing
10 through use of the employer’s property. While similar to the corporate opportunity
11 doctrine—which applies only to traditional corporate fiduciaries and others in position of
12 trust and confidence—this aspect of the duty of loyalty is broader and applies to all
13 employees.

14 The duty of loyalty is separate and distinct from the duty of performance “to act
15 in accordance with the express and implied terms of any contract” with the employer and
16 is also distinct from the duty “to act with the care, competence, and diligence normally
17 exercised by agents in similar circumstances.” Restatement Third, Agency §§ 8.07, 8.08.
18 These duties are normally enforced by the employer through legitimate workplace
19 discipline, including termination of employment. A breach of these duties typically gives
20 rise to tort or judicial contract remedies only when the employee’s breach causes property
21 damage, injury to third parties for which the employer may be held liable, or when the
22 employee is a professional or otherwise owes a special duty of care.

1 engaging in self-dealing through use of the employer’s property. The overwhelming
2 number of reported decisions recognizing the employee’s duty of loyalty fall into one or
3 more of these fact patterns.
4

5 *i. Obligation not to compete with employer while employed.* Subject to the
6 circumstances described in § 8.04 of this Restatement, an employee may not compete
7 with his employer while employed. See *Illumination Station, Inc. v. Cook*, Civil No. 07-
8 3007, 2007 WL 1624458 (W.D. Ark. June 4, 2007) (applying Arkansas law) (refusing to
9 dismiss a breach-of-loyalty claim against a sales representative who, while employed,
10 diverted customer orders to a rival company); *Bancroft-Whitney Co. v. Glen*, 411 P.2d
11 921, 939 (Cal. 1966) (en banc) (holding that a corporation’s president breached his
12 fiduciary duty of loyalty by recruiting subordinates for a competitor prior to his departure
13 and failing to disclose conflicts that would harm the original employer); *Charles Schwab
14 & Co., Inc. v. McMurry*, No. 2:08-cv-534-FtM-29SPC, 2008 WL 5381922, at *1 (M.D.
15 Fla. Dec. 23, 2008) (applying Florida law) (holding that “[i]t is well-established under
16 Florida law that an employee owes a fiduciary duty and a duty of loyalty to his or her
17 employer” and granting injunction against financial consultant-employee who removed
18 confidential data and solicited clients after joining rival firm, in violation of
19 confidentiality, non-solicitation, and assignment agreement); *Eckard Brandes, Inc. v.
20 Riley*, 338 F.3d 1082, 1085 (9th Cir. 2003) (applying Hawaii law) (upholding summary
21 judgment against supervisor and laborer in counterclaim for disgorgement of profits from
22 running a competing pipe-repair business establishes while still employed with their
23 employer); *LCOR Inc. v. Murray*, No. 97 C 1302, 1997 WL 136278, at *9 (N.D. Ill. Mar.
24 20, 1997) (applying Illinois and Pennsylvania law) (granting a preliminary injunction to
25 prevent former employee from competing with LCOR for the purchase of a piece of
26 property within the state and holding that defendant, as the principal representative
27 entrusted with LCOR’s pursuit of the property, breached his fiduciary duty in failing to
28 use his best efforts to obtain such property, and in fact competed with LCOR while he
29 was an agent acting on LCOR’s behalf); *Condon Auto Sales & Service, Inc. v. Crick*, 604
30 N.W.2d 587, 599 (Iowa 1995) (stating that “[t]he duty of loyalty is not precisely defined,
31 but has been applied on several occasions in the context of employee competition and
32 self-dealing” but finding it “unnecessary . . . to determine . . . whether a separate cause of
33 action exists for breach of loyalty” independent of breach of fiduciary duty as an agent,
34 due to lack of evidence that the employer, an automobile dealership, was damaged by
35 unfair competition by former used car sales manager, the employee’s self-dealing, and his
36 enticement of employees to leave the dealership) (internal citations omitted); *Maryland
37 Metals, Inc. v. Metzner*, 382 A. 2d 564, 568 (Md. 1985) (reiterating that “a corporate
38 officer or other high-echelon employee is barred from actively competing with his
39 employer during the tenure of his employment” and holding that failure to disclose in
40 detail preliminary arrangements to enter into competition with employer was not a breach
41 of employees’ fiduciary duties); *Eaton Corp. v. Giere*, 971 F.2d 136, 141 (8th Cir. 1992)
42 (applying Minnesota law) (declaring that “an employee owes his employer a duty of
43 loyalty which prohibits him from soliciting other employer’s customers for himself, or
44 from otherwise competing with his employer, while he is still employed” and affirming
45 judgment against a mechanical engineer who formed a competing corporation for
46 purpose of selling a device he developed while still working for the employer and

1 solicited the employer’s customers for himself); *Las Luminarias of N.M. Council of the*
2 *Blind v. Isengard*, 587 P.2d 444, 449 (N.M. Ct. App. 1978) (finding a breach of duty of
3 loyalty by employees who, while employed by plaintiff employer, formed a separate
4 organization that competed for grants against the employer, and declaring that “he who
5 undertakes to act for another in any matter of trust or confidence shall not in the same
6 matter act for himself against the interest of the one relying upon his integrity.”); *Futch v.*
7 *McAllister Towing of Georgetown, Inc.*, 518 S.E.2d 591, 595 (S.C. 1999) (noting that
8 solicitation of an employer’s customers breaches the duty of loyalty but concluding that
9 the eighty-eight year old former employee, a tugboat captain and local manager of
10 operations who began making plans with a co-worker to start their own tugboat business,
11 did not violate such duty because new business was started only after the employer
12 informed him that his job would terminate and was considering closing operations in the
13 area); *Prince, Yeates & Geldzahler v. Young*, 94 P.3d 179, 184 (Utah 2004) (holding that
14 the attorney defendant, as a member of the bar, owed a fiduciary duty to his employer
15 that encompassed obligation not to compete with the employer without the employer’s
16 prior knowledge and agreement). See also *Ballew v. W.D. Larson Cos. Ltd., Inc.*, No.
17 1:08cv490, 2009 WL 4724264, at *8 (S.D. Ohio Dec. 1, 2009) (refusing to grant
18 summary judgment to a former employee on her former employer’s counterclaim for a
19 breach of the duty of loyalty where there was an issue of material fact as to whether the
20 other company that the former employee worked for while still employed by her former
21 employer was indeed a competitor); *Pathfinder, LLC v. Luck*, No. Civ.A. 04-1475, 2005
22 WL 1206848, at *9 (D.N.J. May 20, 2005) (applying New Jersey law) (denying former
23 executive vice-president’s summary judgment motion because he was contractually
24 limited from being employed by active clients for one year after his termination and his
25 contract of employment “expressly imposed a duty of loyalty on him.”).

26
27 *ii. Obligation not to reveal or use employer’s confidential information for*
28 *personal business or third parties.* As detailed in § 8.03 of this Restatement, an
29 employee must not use or reveal confidential information obtained during the course of
30 employment for any purpose adverse to the employer. Doing so is a violation of the duty
31 of loyalty. See generally 19 *Williston on Contracts* § 54:31 (4th ed. 2009) (noting that “it
32 is now clearly established that the nature of the employment relationship imposes an
33 implied duty on agents and employees to protect the employer’s trade secrets and other
34 confidential information.”). See also *Hanger Prosthetics & Orthotics, Inc. v. Capstone*
35 *Orthopedic, Inc.*, 556 F. Supp. 2d 1122 (E.D. Cal. 2008) (applying California law)
36 (refusing to dismiss a breach-of-loyalty claim against Hanger’s former employees,
37 including former practice manager, branch manager, and office administrator/soft goods
38 fitter, who acquired confidential information while employed by Hanger and held back
39 business for a month in anticipation of their departure for a competing company); *Allen*
40 *Mfg. Co. v. Loika*, 144 A.2d 306, 309 (Conn. 1958) (noting that “[t]he law is well settled
41 that knowledge acquired by an employee during his employment cannot be used for his
42 own advantage to the injury of the employer during the employment; and after the
43 employment has ceased the employee remains subject to a duty not to use trade secrets,
44 or other confidential information which he has acquired in the course of his employment,
45 for his own benefit or that of a competitor to the detriment of his former
46 employer.”); *American Bldgs. Co. v. Pascoe Bldg. Sys., Inc.*, 392 S.E.2d 860, 864 (Ga.

1 1990) (noting an implied term exists in every employment contract “that an employee
2 will not divulge a trade secret learned by virtue of his employment to a competitor of his
3 former employer.”); *Cherne Indus., Inc. v. Grounds & Assocs., Inc.*, 278 N.W.2d 81, 91
4 (Minn. 1979) (noting that two employees acquired “knowledge from [their employer] by
5 way of their confidential relationship and in so doing they incurred a duty not to use it to
6 [their employer’s] detriment.”); *A.B. Chance Co. v. Schmidt*, 719 S.W.2d 854, 859 (Mo.
7 Ct. App. 1986) (noting that there is an “independent duty . . . not to disclose confidential
8 information or trade secrets” for employees in a fiduciary relationship with an employer);
9 *Cameco, Inc. v. Gedicke*, 724 A.2d 783, 786, 791 (N.J. 1999) (applying New Jersey law)
10 (finding a possible breach of duty of loyalty where former employee, a salaried traffic
11 manager, used the employer’s shipping information and arranged transportation of goods
12 for various companies, including the employer’s competitors); *Nutronics Imaging v.*
13 *Danan*, No. CV 96-2950, 1998 WL 426570, at *4 (E.D.N.Y. June 10, 1998) (applying
14 New York law) (sustaining claim stated by employer seeking an accounting from a
15 former employee technician/mechanic who solicited employer’s customers “during the
16 course of . . . employment and afterwards”; accounting needed to determine “with of
17 [plaintiff’s] former customers left because of Danan’s on-the-job solicitation”); *Burbank*
18 *Grease Servs., LLC v. Sokolowski*, 717 N.W.2d 781, 796 (Wis. 2006) (holding that a
19 manager who allegedly obtained a computer-generated report containing valuable and
20 confidential information about the business relationships his employer had with its
21 customers from the employer’s computer system and who then used such information to
22 divert substantial customer relationships away from his employer breached his duty of
23 loyalty to his employer and observing that claims for breach of duty of loyalty may lie
24 against employees if they are deemed to be “key” employees).

25
26 *iii. Obligation not to appropriate employer’s property or engage in self-dealing*
27 *through use of such property.* An employee must not appropriate the employer’s
28 property or engage in self-dealing therewith. See *Stout v. Laws*, 37 Haw. 382, 392 (Haw.
29 1946) (ruling that employer had common law right to exclusive use of trademark that was
30 not impaired by relative employee’s use of same trademark name while employed, which
31 was both “presumptively fraudulent” and a breach of the duty of loyalty); *FryeTech, Inc.*
32 *v. Harris*, 46 F. Supp. 2d 1144, 1152 (D. Kan. 1999) (applying Kansas law) (holding that
33 employees breached duty of good faith and loyalty owed to employer when they secretly
34 bought equipment they were instructed to dismantle and scrap through sham arrangement
35 with salvage company for their own competitive printing endeavor); *Bessman v.*
36 *Bessman*, 520 P.2d 1210, 1217 (Kan. 1974) (discussing the faithless servant doctrine and
37 holding that a defendant who was employed as a manager at the plaintiff’s hotel was
38 “prohibited from acting in any manner inconsistent with his agency or trust and [was] at
39 all times bound to exercise the utmost good faith and loyalty in the performance of his
40 duties” and thereby finding a breach of such duty where the employee embarked on a
41 course of dealing with various parties with the objective of putting cash in his own
42 pocket); *Chemfab Corp. v. Integrated Liner Techs. Inc.*, 693 N.Y.S.2d 752, 754 (N.Y.
43 App. Div. 1999) (refusing to grant summary judgment for an employee on a duty of
44 loyalty claim where evidence was presented that he used his employer’s time and
45 resources to aid a competitor). Cf. *Otsuka v. Polo Ralph Lauren Corp.*, No. C 07-02780
46 SI, 2007 WL 3342721, at *3 (N.D. Cal. Nov. 9, 2007) (applying California Law)

1 (counterclaim stated breach of duty of loyalty as even “a lower-level employee, such as a
2 sales clerk or a laborer, owes a duty of loyalty to his employer” and employee “had on
3 more than one occasion entered fictitious customer names when selling products to a
4 [former employee] who was improperly using merchandise credits for her purchases,”
5 thus violating company policy against use of employee discount for a nonemployee).
6 The closely-related corporate opportunity doctrine requires that a corporate officer or
7 other high-level employee in a position of trust and confidence not take a business
8 opportunity in which his employer has an interest or tangible expectancy, and which his
9 employer is financially able to undertake. *Guth v. Loft, Inc.*, 5 A.2d 503, 511 (Del.
10 1939). This doctrine is often understood as imposing a duty on the employee to disclose
11 a business opportunity to the employer before taking it as his own. See *Today Homes,*
12 *Inc. v. Williams*, 634 S.E.2d 737, 744 (Va. 2006). Moreover, the obligations of imposed
13 by the corporate opportunity doctrine are typically seen as stemming from the duty of
14 loyalty. See e.g. *Davis v. Dorsey*, 495 F. Supp. 2d 1162, 1173 (M.D. Ala. 2007)
15 (applying Alabama law) (stating that “[w]here the director or officer uses the resources of
16 the corporation to obtain and take advantage of an opportunity for himself, he has
17 breached his duty of loyalty under the corporate-opportunity doctrine.”); *Demoulas v.*
18 *Demoulas Super Mkts, Inc.*, 677 N.E.2d 159, 180 (Mass. 1997) (noting that “[t]he
19 corporate opportunity doctrine is rooted in the principle that corporate directors and
20 officers are bound by their duty of loyalty to subordinate their self-interests to the well
21 being of the corporation.”).

22
23 Some courts, appearing reluctant to endorse a robust fiduciary duty on all
24 employees, assert that not all employees owe a duty of loyalty. See *Lucht’s Concrete*
25 *Pumping, Inc. v. Horner*, 224 P.3d 355, 360 (Colo. Ct. App. 2009) (holding that “[w]hether an
26 employee owes an employer a duty of loyalty is typically a question of fact,” turning on
27 whether the employee has sufficient authority to create a principal-agent relationship, but
28 acknowledging the Colorado Supreme Court has not ruled whether all employees owe a
29 duty of loyalty and has suggested the duty may not apply in some circumstances);
30 *Gardner v. Construct Corps, LLC*, No. 8:09-cv-1743-T-23TBM, 2010 WL 427742 at *2
31 n.2 (M.D. Fla. Feb. 1, 2010) (applying Florida law) (noting that “[a] mere employee of a
32 corporation ordinarily does not occupy a position of trust unless he also serves as its
33 agent.”) (internal citations omitted); *Physician Specialists in Anesthesia, P.C. v.*
34 *Wildmon*, 521 S.E.2d 358, 362 n.3 (Ga. Ct. App. 1999) (declaring that former
35 nonphysician administrators had no fiduciary duty to medical-practice group because
36 they had no confidential relationship with the group and noting that a cause of action for
37 breach of an employee’s duty of loyalty must be based upon a fiduciary duty.”);
38 *TalentBurst, Inc. v. Collabera, Inc.*, 567 F. Supp. 2d 261, 266 n.4 (D. Mass. 2008)
39 (applying Massachusetts law) (concluding “that the duty of loyalty does not extend to
40 ‘rank-and-file’ employees under Massachusetts law, absent special circumstances
41 indicating they held a position of ‘trust and confidence,’” but noting that “a lower-level
42 employee easily could be considered to occupy a position of “trust and confidence” if
43 they are provided with access to confidential information.”); *Block Corp. v. Nunez*, No.
44 1:08-CV-53, 2008 WL 1884012, at *3 (N.D. Miss. April 25, 2008) (applying Mississippi
45 law) (“declaring that “[n]o Mississippi court has created a fiduciary relationship or
46 allowed a claim for breach of a fiduciary duty based [merely on] on a relationship

1 between an employer and employee,” but allowing a claim against a purchasing manager
2 of a clothing manufacturer for refusing to release inventory owned by the employer);
3 *Pony Computer, Inc. v. Equus Computer Sys. of Mo., Inc.*, 162 F.3d 991, 997–98 (8th
4 Cir. 1998) (applying Missouri law) (finding no confidential relationship on which to base
5 a claim of breach of fiduciary duty against clerical worker who had access to limited
6 computer files with a password but otherwise did not know information divulged to
7 competitor was confidential, former employee could not have breached a duty of loyalty
8 because the employee had no fiduciary duty arising from a confidential relationship);
9 *White v. Ransmeier & Spellman*, 950 F. Supp. 39, 43 (D.N.H. 1996) (applying New
10 Hampshire law) (dismissing duty-of-loyalty counterclaim against legal secretary suing
11 for discriminatory termination who had allegedly made death threats to coworkers,
12 holding that such actions by an at-will, nonmanagerial employee were “beyond the scope
13 of any cause of action for breach of the duty of loyalty recognized by the New Hampshire
14 Supreme Court.”); *Dalton v. Camp*, 548 S.E.2d 704, 708–09 (N.C. 2001) (rejecting
15 employer’s claim of unfair competition by former production manager of publisher,
16 declaring that “absent a finding that the employer . . . was somehow subjugated to the
17 improper influences or domination of his employee . . . [the court] cannot conclude that a
18 fiduciary relationship existed between the two” and holding that there is “no basis for
19 recognizing an independent tort claim for breach of duty of loyalty” in the absence of a
20 fiduciary relationship); *Modern Materials, Inc. v. Advanced Tolling*, 557 N.W.2d 835,
21 838 (Wis. 1996) (noting that “[i]n order to show that an individual breached a fiduciary
22 duty, the first element which must be established is that the defendant is an officer and
23 therefore a fiduciary duty is owed.”).

24
25 Nevertheless, many courts reject a formalistic distinction between traditional
26 fiduciaries and non-fiduciaries, and either apply a functional analysis of the duty of
27 loyalty, or simply apply that duty to all employees. See *Zep, Inc. v. Brody Chem. Co.,*
28 *Inc.*, No. CV-09-0505-PHX-NVW, 2010 WL 1381896 (D. Ariz. April 6, 2010) (noting
29 that “the common law fiduciary duty of loyalty [is] imposed on all employees.”); *Hanger*
30 *Prosthetics & Orthotics, Inc. v. Capstone Orthopedic, Inc.*, 556 F. Supp. 2d 1122, 1142
31 (E.D. Cal. 2008) (applying California law) (noting that “all employees owe a duty of
32 loyalty to their employers.”); *Jet Courier Serv. v. Mulei*, 771 P.2d 486 (Colo. 1989)
33 (“[W]e choose to describe the duty at issue here simply as a “duty of loyalty” arising out
34 of the employer-employee relationship.”); *Ins. Field Servs., Inc. v. White & White*
35 *Inspection*, 384 So. 2d 303, 308 (Fla. Dist. Ct. App. 1980) (noting the general common-
36 law duty to refrain from disloyal acts); *Beltran v. Brentwood North Healthcare.*, 426 F.
37 *Supp. 2d 827, 831* (N.D. Ill. 2006) (applying Illinois law) (noting that “[u]nder Illinois
38 law, employees as well as officers and directors owe a duty of loyalty to their
39 employer.”); *In re Sullivan*, 305 B.R. 809, 819 (Bankr. W.D. Mich. 2004) (applying
40 Michigan law) (stating that the “common law imposes a fiduciary duty of loyalty on all
41 employees of a corporation.”); *Griep v. Yamaha Motor Co. USA, Inc.*, 120 F. Supp. 2d
42 1196, 1199 (D. Minn. 2000) (applying Minnesota law) (stating that “[a]ll employees owe
43 a duty of loyalty to their employers.”); *Global Transp. Logistics, Inc. v. Dov Transp.*, No.
44 *BER-C-79-05*, 2005 WL 1017602, at *4 (N.J. Super. Ct. Apr. 5, 2005) (noting that “all
45 employees owe a duty of loyalty to the employer.”); *Camp Summit of Summitville, Inc.*
46 *v. Visinski*, No. 06-CV-4994 (CM)(GAY), 2007 WL 1152894, at *13 (S.D.N.Y. Apr. 16,

1 2007) (applying New York law) (noting that “[i]t is well-settled under New York law that
2 all employees owe a duty of loyalty to their employers, regardless of whether the
3 employee has a formal employment contract.”) (internal citations omitted); *Lydian
4 Wealth Mgmt Co., LLC v. Jacob*, No. CV 06-1796-PK, 2007 WL 4964427, at *14 (D.
5 Ore. Oct. 11, 2007) (applying Oregon law) (stating that “[u]nder Oregon law, every
6 employee owes her employee duties of loyalty and faithfulness.”); *Setliff v. Akins*, 616
7 N.W.2d 878, 886 (S.D. 2000) (noting that “[p]ursuant to South Dakota law, all
8 employees have a statutory duty of loyalty.”); *Williams v. Dominion Tech. Partners,
9 L.L.C.*, 576 S.E.2d 752, 757 (Va. 2003) (stating that “under the common law an
10 employee, including an employee-at-will, owes a fiduciary duty of loyalty to his
11 employer during his employment.”); *Burbank Grease Servs., LLC v. Sokolowski*, 717
12 N.W.2d 781, 796 (Wis. 2006) (applying a “key employee” test to determine which
13 employees are subject to a fiduciary duty of loyalty).

14
15 The definition of the duty of loyalty outlined here parallels the definition
16 articulated in the Restatement Third of Agency. See Restatement (Third) of Agency
17 § 8.04 (2006) (“Throughout the duration of an agency relationship, an agent has a duty to
18 refrain from competing with the principal and from taking action on behalf of or
19 otherwise assisting the principal’s competitors. During that time, an agent may take
20 action, not otherwise wrongful, to prepare for competition following termination of the
21 agency relationship.”); *Id.* § 8.05 (“An agent has a duty (1) not to use property of the
22 principal for the agent’s own purposes or those of a third party; and (2) not to use or
23 communicate confidential information of the principal for the agent’s own purposes or
24 those of a third party.”)

25
26 Poor job performance is not a violation of the duty of loyalty, but may
27 nonetheless furnish adequate grounds for terminating an employment relationship where
28 the contract calls for cause for termination. See *In re Petersen*, 296 B.R. 766, 779 (Bankr.
29 C.D. Ill. 2003) (applying Illinois and federal law) (holding that, in the absence of gross
30 misconduct, office manager’s “poor job performance is not tantamount to a breach of a
31 duty of loyalty” (citing *Boock v. Napier*, 120 N.E.2d 244, 248 (Ill. App. Ct. 1954) (noting
32 that employee’s conduct must rise to gross misconduct in order to constitute a breach of
33 the duty of loyalty and that such a breach may result in forfeiture of compensation)); *In re
34 Leal*, 360 B.R. 231, 239 (Bankr. S.D. Tex. 2007) (applying Texas law) (holding that,
35 absent a showing of misconduct, partner’s “poor management performance is not
36 actionable” on a theory of breach of fiduciary duty). If, however, the employee damages
37 the employer’s property, many courts allow the employer to sue the employee in tort. See
38 *Withhart v. Otto Candies, LLC*, 431 F.3d 840, 845 (5th Cir. 2005) (applying federal
39 maritime law) (holding that a shipping employer was allowed to assert a negligence claim
40 against an employee for allegedly causing property damage); *Nordgren v. Burlington N.
41 R.R.*, 101 F.3d 1246, 1247 (8th Cir. 1996) (discussing Minnesota law) (holding that the
42 Federal Employee Liability Act did not preempt railroad’s state-law counterclaims
43 against employees for property damage); *Stack v. Chi., Milwaukee, St. Paul & Pac. R.R.*,
44 615 P.2d 457, 459 (Wash. 1980) (after a railroad collision killing the train’s head
45 engineer, and the engineer’s family sued the employer railroad company, the court found
46 that the employer had a common-law right to sue employees for property damages).

1
2 *b. Protected labor activities and the duty of loyalty.* Protected organizing and
3 collective bargaining activities generally do not violate the duty of loyalty. Activities that
4 go beyond legal protections, however, may violate that duty, even if done under union
5 auspices. See *NLRB v. Local 1229, IBEW*, 346 U.S. 464 (1953).

6
7 **§ 8.02. Definition of Employer’s Confidential Information**

8
9 **An employer’s confidential information is commercially valuable**
10 **information that**

11
12
13 **(a) the employer has taken reasonable measures to keep confidential;**

14
15 **(b) is not generally known to the public or in the employer’s industry;**

16
17 **(c) is not readily obtainable by others through proper means; and**

18
19 **(d) is not part of the general experience, knowledge, and skills that its**
20 **employees acquire in the ordinary course of their employment.**

21
22
23 **Comment:**

24 *a. Scope.* The definition of “confidential information” in this Section is
25 coextensive with the definitions of trade secrets or other protected information used in the
26 Uniform Trade Secrets Act, the Restatement (Third) of Unfair Competition § 39 (2006),
27 and the Economic Espionage Act, 18 U.S.C. § 1839 (2006). The term reaches all types
28 of information, including financial, business, scientific, technical, economic, and
29 engineering information. The term also covers all forms of information, including
30 patterns, plans, compilations, program devices, formulas, designs, prototypes, methods,
31 techniques, processes, procedures, and codes. Finally, the term includes all manner of
32 information, irrespective of how it is recorded, compiled, or memorialized, whether
33 tangible or intangible, including by physical, electronic, graphic, and photographic
34 methods.

1 Information regarding an employer's illegal activities is not confidential
2 information within the meaning of this Section, nor is such information protectable by
3 means of restrictive covenant under §§ 8.06 and 8.07. So-called "whistleblowers" who
4 reveal such information are protected in accordance with Chapter 4 of this Restatement.
5 Employee personnel files that meet the requirements of this Section are also confidential
6 information, and may be protected by a restrictive covenant valid under §§ 8.06 and 8.07.

7 This Section addresses only the common law duty not to use or disclose an
8 employer's confidential information. It does not address other potential sources of
9 nondisclosure requirements, such as court orders, statutory and administrative
10 regulations, and principles of professional responsibility. The common law duty also
11 does not protect customer relationships, investment in an employee's reputation in the
12 market, or investment in the purchase of an employee's business. An employer seeking
13 to protect these interests must do so contractually, in accordance with §§ 8.06 and 8.07.

14

15 **Illustrations:**

16 1. Employer X spends 30 years and a large amount of money developing a
17 process for manufacturing coated steel. X's process is information that may, if
18 the other requirements of the Section are met, be protected as confidential.

19 2. X's employee-engineers design drill replacement parts for X's drills.
20 The design drawings are embodied only in electronic form. The drawings
21 constitute information that may, if the other requirements of this Section are met,
22 be protected as confidential.

23

1 *b. Commercially valuable information.* Information that an employer seeks to
2 protect as confidential information must have economic or commercial value. The phrase
3 “commercially valuable” is derived from the Prefatory Note to the Uniform Trade Secrets
4 Act (1985), and as noted in Comment *a*, the definitions of this Section are intended to be
5 coextensive with therewith. Information may have economic or commercial value even
6 if the employer seeking to protect such information is a not-for-profit or governmental
7 organization.

8 Information protected under this Section ordinarily enhances the value of the
9 employer’s enterprise and, if not kept confidential, might help a competitor and hurt the
10 employer. Such information, however, could also have negative or “dead end” value, in
11 the sense that disclosure would not directly harm the employer, but could be of advantage
12 to a competitor, who could use it to avoid missteps in research. The information in
13 Illustrations 1 and 2 are examples of the former. Illustration 3 gives an example of the
14 latter.

15

16 **Illustration:**

17 3. X is a company involved in the design and manufacture of writing
18 instruments and other office products. E worked for X as director of product
19 development and engineering for three years, and during that time discovered
20 many “dead ends” of unfruitful research. X took substantial measures to keep this
21 information secret. E later quit and accepted a position in a nearly identical
22 capacity with Z, a competitor of X. The information regarding research “dead

1 ends” is of commercial value because it would assist Z in developing new
2 products with greater speed, and is protectable under this Section.

3

4 *c. Confidentiality.* For information to come within the scope of § 8.02, the
5 employer must take reasonable measures to keep that information confidential. Courts
6 consider several factors in assessing whether an employer took reasonable measures to
7 prevent disclosure beyond reasonable business needs. These include whether the
8 employer has allowed the information to be shared with employees, customers, or
9 vendors without business justification, as well as whether the employer has actively
10 reminded employees or other authorized recipients to keep the information secret during
11 and after their employment or engagement or obtained an agreement from them to that
12 effect. An express confidentiality agreement is often part of a series of reasonable
13 employer measures to prevent disclosure, but idiosyncratic definitions of confidentiality
14 in such an agreement cannot make something confidential that is not confidential within
15 the meaning of this Restatement.

16

17 **Illustrations:**

18 4. Employer X creates a list itemizing the particular needs of a large group
19 of customers for products and services X might deliver. X shares the list with
20 employee E in the ordinary course of business. X does not mark the list as secret,
21 provides all of its employees free access to the list, and allows its employees to
22 take copies of the list home. X’s list is not confidential information because X did
23 not take reasonable measures to keep the list confidential.

1 5. Employer X keeps the details of its manufacturing process in a locked
2 room to which only a few select employees have access. X tells those employees
3 that the process must be kept confidential but does not require them to sign any
4 confidentiality agreement. X permits select nonemployees to enter the room, but
5 only after those nonemployees sign a confidentiality agreement. X's
6 manufacturing process is confidential information because X took reasonable
7 measures to keep it confidential.

8 6. Employer X has made its computerized client profiles accessible by
9 passwords known only by employees. Only branch managers can make printouts
10 of the client files and only branch managers have Internet and e-mail availability.
11 X has taken reasonable measures to reduce the possibility of electronic
12 distribution of its confidential client information.

13
14 *d. Information known generally, known within the industry, or readily obtainable*
15 *through proper means.* If information is known generally to the public or widely in the
16 employer's industry, or is readily obtainable by others through proper means, it is not
17 confidential under this Section. Information is not readily obtainable if it requires
18 significant expense, unusual expertise, or substantial difficulty to develop or obtain.
19 Proper means for these purposes do not include such methods as theft, espionage, or
20 knowing or reckless receipt from one who is breaching a fiduciary obligation or a binding
21 agreement to keep the information confidential. Nonetheless, proper means may include
22 taking publicly available information and breaking it down into its constituent elements
23 (a process sometimes called "reverse engineering"), observing a product or process on

1 public display, or discerning the information by reading trade journals or other publicly
2 available materials.

3

4 **Illustrations:**

5 7. Employee E is given access to employer X's profit-margin information
6 during the course of E's employment with X. X's costs for supplies and labor and
7 the prices it charges customers for final products are contained within X's
8 publicly available corporate publications. From that public information, one can
9 readily discern X's profit margin. Thus, X's profit-margin information is not
10 confidential.

11 8. X is a manufacturer of through-wall air conditioners. X manufactures
12 the air conditioners from component parts purchased from mail-order catalogues.
13 X's manufacturing process is a standard process used throughout the industry. E,
14 a former employee of X, begins manufacturing air conditioners in competition
15 with X. The manufacturing process employed by X does not constitute
16 confidential information, as the product design of the air conditioners is known
17 within the industry.

18 9. X hires a high-level executive employee to develop an innovative
19 business plan. X requires the executive to keep all details about the business plan
20 secret. X's business plan is confidential information.

21

22 *e. Employee knowledge and skills.* An employee's general knowledge and skills,
23 including any increase in knowledge and skills the employee obtains in the ordinary

1 course of employment, are not employer confidential information within the meaning of
2 this Section. Such nonconfidential information, which normally includes knowledge
3 about the habits and preferences of particular customers or other persons, may be used by
4 a former employee as part of legitimate competition with a former employer. However,
5 the content of an employer's training programs or specially developed sales pitch
6 materials, including knowledge of the employer's special processes, may qualify as
7 confidential information in appropriate circumstances.

8

9 **Illustrations:**

10 10. E, a radio traffic reporter, gains considerable experience working for
11 X, a radio station. E gets feedback from X's listeners that improves E's reporting
12 skills. The improvement in E's general skills as a reporter is not X's confidential
13 information.

14 11. E, a scientist, is employed by X, a developer of spacesuit technology,
15 to research how to improve the manufacture of space suits. The methods and
16 materials used for X's particular space suits that E learns about during E's work
17 may, if the other requirements of this Section are met, be X's confidential
18 information.

19 12. X, a company that operates an airport, teaches E, an air-traffic
20 controller, how to operate state-of-the-art air-traffic-control equipment, which few
21 airports currently have but which are gaining use. What E learns in the training
22 program is not X's confidential information.

23

1 *f. Customer lists or databases.* An employer's information about its customers is
2 generally developed in two ways: as a by-product of ongoing customer relationships, and
3 by consciously developing formal customer lists or databases. The former is rarely
4 protected as confidential information; the latter may meet this Section's definition of
5 confidential information.

6 Employees who work closely with particular customers often learn the habits and
7 preferences of those customers, including such information as preferred telephone
8 numbers, how they interact with support staff, and best time of day to call; that is,
9 employees gain valuable customer information simply by doing their job. Such
10 information about particular customers is a type of general knowledge that the employee
11 with a working relationship with those customers acquires by ordinary experience. It is
12 not confidential information within the meaning of this Section.

13 Employers wishing to prevent former employees from exploiting customer
14 relationships must do so contractually, rather than by relying on the general protections of
15 confidential information under §§ 8.02 and 8.03 available to protect customers lists, as
16 discussed below. Contractual restrictions that protect customer relationships are
17 considered in §§ 8.06 and 8.07.

18 Customer lists or databases are conceptually distinct from general information
19 about customers that employees acquire during the normal course of their work
20 relationship with those customers. Customer lists or databases that are the product of a
21 conscious employer effort to compile economically useful information are often protected
22 as confidential information. Factors that determine whether information contained in a
23 customer list or database is confidential information include whether the employer made

1 reasonable efforts to keep the information confidential, whether the information is
2 difficult to develop by proper means, and whether the information derives economic
3 value from not being generally known.

4

5 **Illustrations:**

6 13. X, a mortgage repurchase broker, maintains a database of its several
7 hundred customer off-dates, which indicates when its customers are ready for new
8 business. X spent significant time and resources to build the information in its
9 customer database, and such information is not readily obtainable by others. X
10 keeps the database secret except for use by its employees in the course of their
11 employment. X's database is confidential information.

12 14. E, an insurance agent, was an employee of X for several years, during
13 which time E developed relationships with specific customers of X. E came to
14 know their needs and preferences, including such things as whether they preferred
15 receiving phone calls in the morning and afternoon. Even though X reduced the
16 information to a customer list, E's knowledge of these customers' needs and
17 preferences is not confidential information, because it arose from E's experience
18 working with the customers rather than from working with the list created by X.

19

20 *g. Discredited "memory rule."* Whether information is confidential does not
21 directly turn on whether the information is in tangible form or retained in an employee's
22 memory. Most courts no longer apply a "memory rule," under which former employees
23 were free to use confidential customer information committed to memory so long as there

1 was no physical (or perhaps electronic) appropriation of a list or database. Under the
2 modern approach, if a customer list or database otherwise meets the criteria for
3 confidential information under this Section, it does not lose its confidential character if an
4 employee purposefully memorizes the information rather than takes a tangible or digital
5 copy. This modern approach is reflected in the Uniform Trade Secrets Act (1985), as
6 well as the Restatement (Third) of Agency § 8.05 (2006) and the Restatement (Third) of
7 Unfair Competition § 42 (1995).

8 REPORTERS' NOTES

9
10 *a. Scope.* The Uniform Trade Secrets Act defines a trade secret as “information,
11 including a formula, pattern, compilation, program, device, method, technique, or
12 process, that: (i) derives independent economic value, actual or potential, from not being
13 generally known to, and not being readily ascertainable by proper means by, other
14 persons who can obtain economic value from its disclosure or use, and (ii) is the subject
15 of efforts that are reasonable under the circumstances to maintain its secrecy.” Uniform
16 Trade Secrets Act § 1(4) (1985). The Restatement (Third) of Unfair Competition defines
17 a trade secret as “any information that can be used in the operation of a business or other
18 enterprise and that is sufficiently valuable and secret to afford an actual or potential
19 economic advantage over others.” Restatement (Third) of Unfair Competition § 39
20 (1995). The Economic Espionage Act defines trade secret as “all forms and types of
21 financial, business, scientific, technical, economic, or engineering information, including
22 patterns, plans, compilations, program devices, formulas, designs, prototypes, methods,
23 techniques, processes, procedures, programs, or codes, whether tangible or intangible,
24 and whether or how stored, compiled, or memorialized physically, electronically,
25 graphically, photographically, or in writing if—(A) the owner thereof has taken
26 reasonable measures to keep such information secret; and (B) the information derives
27 independent economic value, actual or potential, from not being generally known to, and
28 not being readily ascertainable through proper means by, the public.” Economic
29 Espionage Act, 18 U.S.C. § 1839(3) (2006). This Section corresponds to these three
30 definitions but explicitly adds the key point that employee knowledge gained from
31 general training is not a trade secret.

32
33 Facts relating to actual, alleged or potential violations of the law are generally not
34 confidential information within the meaning of this Section. An agreement not to
35 disclose such information is, in most situations, unenforceable as against public policy.
36 See *Chambers v. Capital Cities/ABC*, 159 F.R.D. 441, 444 (S.D.N.Y. 1995). See also
37 *EEOC v. U.S. Steel Corp.*, 671 F. Supp. 351, 358 (W.D. Pa. 1987), *rev'd on other*
38 *grounds*, 921 F.2d 489 (3d Cir. 1989) (holding that an agreement not to “counsel or
39 assist” in any age discrimination suits to be unenforceable, both as a matter of statutory

1 interpretation and as a matter of public policy); *EEOC v. Astra, Inc.*, 94 F.3d 738 (1st Cir.
2 1996) (similar holding).

3
4 Employee personnel files that meet the requirements of this Section are
5 confidential information. As with any other form of confidential information, a former
6 employee—whether or not he has signed a non-disclosure agreement—may not use such
7 files to benefit his current employer to the detriment of his former employer. A former
8 employer may enjoin both the former employee and that employee’s current employer
9 from using such personnel files, and may also sue either for damages. See *Labor Ready,*
10 *Inc. v. Williams Staffing, LLC*, 149 F. Supp. 2d 398, 412 (N.D. Ill. 2001).

11
12 An in-house lawyer is at once a lawyer for and employee of his employer.
13 Attorney-client confidentiality rules apply to the in-house lawyer and may give rise to
14 confidential information beyond what is described in this Chapter. See Restatement
15 (Third) of the Law Governing Lawyers § 1.09 cmt. d (2000).

16
17 Illustration 1 is based on *BIEC Int’l, Inc. v. Global Steel Servs., Ltd.*, 791 F.
18 Supp. 489, 542 (E.D. Pa. 1992) (applying Pennsylvania law) (holding that “technology,
19 operating, marketing, and equipment manuals [describing a steel-making process] qualify
20 as legally protected trade secrets.”).

21
22 Illustration 2 is based loosely on *Drill Parts & Serv. Co. v. Joy Mfg. Co.*, 439 So.
23 2d 43 (Ala. 1983), *superseded by statute*, Alabama Trade Secrets Act, Ala. Code § 8-27-1
24 (1987), *as recognized in* *Allied Supply Co., Inc. v. Brown*, 585 So. 2d 33, 36 (Ala. 1991).
25 That case involved an employer’s product design, which, along with manufacturing
26 processes, is one of the most common types of confidential information. See also *Hayes-*
27 *Albion v. Kuberski*, 364 N.W.2d 609, 614 (Mich. 1984) (protecting manufacturing
28 process of silicone rubber formula and hot-stamp decorating technique); *Inflight*
29 *Newspapers, Inc. v. Magazines In-Flight, LLC*, 990 F. Supp. 119, 131 (E.D.N.Y. 1997)
30 (applying New York law) (protecting a magazine binding process); *Flexible Techs., Inc.*
31 *v. World Tubing Corp.*, 910 F. Supp. 109, 114 (E.D.N.Y. 1996) (applying New York
32 law) (protecting the design for a vacuum-hose manufacturing machine); *Monovis, Inc. v.*
33 *Aquino*, 905 F. Supp. 1205, 1224 (W.D.N.Y. 1994) (applying New York law) (protecting
34 design and manufacturing process of a single-screw compressor); *J.W.S. Delavau Co. v.*
35 *Lederman*, No. 4495, 1991 WL 1011102, at *382 (Pa. Com. Pl. Sept. 16, 1991)
36 (protecting tablet formula and granulation process); *SI Handling Sys., Inc. v. Heisley*,
37 753 F.2d 1244, 1256–1261 (3d Cir. 1985) (applying Pennsylvania law) (protecting
38 manufacturing process and formula book); *ForScan Corp. v. Dresser Indus., Inc.*, 789
39 S.W.2d 389, 395 (Tex. Ct. App. 1990) (protecting design of nuclear well-logging tools).

40
41 *b. Commercially valuable information.* Information must be commercially
42 valuable to qualify as confidential information within the meaning of this Section. See
43 Uniform Trade Secrets Act § 1(4)(i) (1985). See also *United Technologies Corp. v.*
44 *United States Department of Defense*, 601 F.3d 557, 563 (D.C. Cir. 2010) (stating the
45 requirement that confidential information must be “commercially valuable.”).
46 Nonetheless, the mere fact that a piece of information has commercial value is not

1 sufficient to establish that it is a trade secret. See *IDX Systems Corp. v. Epic Systems*
2 *Corp.*, 285 F.3d 581, 583 (7th Cir. 2002) (stating that “[t]rade secrets are a subset of all
3 commercially valuable information.”) For example, retail price information may be
4 commercially valuable, but it is not of itself a trade secret, while the formula by which
5 that retail price is developed may be confidential information. See *Applied Industrial*
6 *Materials Corp. v. Brantjes*, 891 F. Supp. 432, 437–38 (N.D. Ill. 1994). See also *The*
7 *Foot Locker Inc., v. Finish Line, Inc.*, No. 1:04CV877RLYWTL, 2006 WL 146633 (S.D.
8 Ind. Jan. 18, 2006) (refusing to give confidential status to a document that provided only
9 highly general information that was, of itself, not useful to a competitor).

10
11 Not-for-profit employers and their employees are subject to the provisions of this
12 Chapter on the same footing as for-profit employers. An employee charged with
13 disclosure of confidential information may not defend on the grounds that his employer
14 or former employer is a not-for-profit organization. See, e.g., Brian M. Malsberger,
15 *Employee Duty of Loyalty: A State By State Survey* 846, 1030, 1757, 1794, 1904, 2206
16 (2005). On the ability of not-for-profit organizations to protect, and be injured by the
17 disclosure of, trade secrets, see *Planned Parenthood L.A. v. Gonzales*, No. B190490,
18 2007 WL 1087292, at *7–10 (Cal. Ct. App. Apr. 12, 2007) (holding that a former
19 employee’s disclosure of a not-for-profit organization’s business processes, accounting,
20 and pricing information were sufficient for a prima facie showing of a breach of the
21 former employee’s duty of confidentiality); *White Gates Skeet Club v. Lightfine*, 658
22 N.E.2d 864, 866 (Ill. App. Ct. 1995) (holding that members of a nonprofit skeet-shooting
23 corporation usurped a corporate opportunity by purchasing real estate that the corporation
24 sought to purchase for new shooting location); *American Baptist Churches of Metro.*
25 *N.Y. v. Galloway*, 710 N.Y.S.2d 12 (N.Y. App. Div. 2000) (reasoning that “it would be
26 unfair and counterproductive for a charitable organization to have no recourse against a
27 dishonest fiduciary who thwarts the organization’s endeavors. . .”).

28
29 Illustration 3 is based on *Avery Dennison Corp. v. Finkle*, No. CV010757706,
30 2002 WL 241284 (Conn. Super. Ct. Feb. 1, 2002). That case involved a high ranking
31 developer/designer with knowledge of research dead ends that would be useful to a
32 competitor. See also *Morton v. Rank Am., Inc.*, 812 F. Supp. 1062, 1073–74 (C.D. Cal.
33 1993) (applying California and New York law) (holding that asserting trade secret status
34 over information about business practices to be avoided because they were unsuccessful
35 were sufficient to overcome a motion for summary judgment); *Int’l Bus. Machs. Corp. v.*
36 *Seagate Tech., Inc.*, No. Civ. 3-91-630, 1991 WL 757821 (D. Minn. Dec. 31, 1991)
37 (applying Minnesota law) (holding that “the benefits of negative knowledge (i.e. the
38 knowledge of what has not worked)” are protectable as confidential information). The
39 Uniform Trade Secrets Act also acknowledges that “the definition [of a trade secret]
40 includes information that has commercial value from a negative viewpoint, for example
41 the results of lengthy and expensive research which proves that a certain process
42 will *not* work could be of great value to a competitor.” Uniform Trade Secrets Act § 1
43 cmt. (1985). The Restatement (Third) of Unfair Competition similarly rejects any “use”
44 requirement for trade secret protection because such a requirement places “unjustified
45 limitations on the scope of trade secrets protection” in part by “plac[ing] in doubt

1 protection for so-called ‘negative’ information that teaches conduct to be avoided.”
2 Restatement (Third) of Unfair Competition, § 29 cmt. e (1995).

3
4 Merely complaining about one’s employer or employment conditions, without
5 more, does not constitute improper use of negative value information. Indeed, where a
6 collective bargaining agreement is in place that establishes a process for filing a
7 grievance, exercising one’s rights under that process are protected under the National
8 Labor Relations Act (“NLRA”). See *NLRB. v. City Disposal Sys., Inc.*, 465 U.S. 822,
9 835 (1984).

10
11 Information revealed by employees during the course of a government
12 investigation is often of potentially negative value. In cases under the NLRA, an
13 employer may not prohibit an employee from revealing negative value information to
14 authorized government investigators, nor may it require that the employee be authorized
15 beforehand to reveal such information or otherwise to co-operate with a government
16 investigation. See *Jack in the Box Distribution Center*, 339 N.L.R.B. 40, 54–55 (2003).

17
18 *c. Confidentiality.* Illustration 4 is based on *Allied Supply Co. v. Brown*, 585 So.
19 2d 33 (Ala. 1991). After noting that the employer had not marked its customer lists as
20 confidential and had not prohibited employees from removing the lists from the premises,
21 the court concluded that the employer did not satisfy its burden of proving that it had
22 taken reasonable measures to preserve the confidentiality of the lists. *Id.* at 36. See also
23 *Alagold Corp. v. Freeman*, 20 F. Supp. 2d 1305, 1315–16 (M.D. Ala. 1998) (applying
24 Alabama law) (refusing to protect information about manufacturing processes, computer
25 software, deployment of sales personnel, and business strategies because employer did
26 not take sufficient steps to keep the statement confidential, and emphasizing that
27 “employees who need to know secret information have free access to it, and none of the
28 filing cabinets containing such information are locked. There is no evidence that
29 Alagold’s proprietary information was marked ‘confidential’ or that Alagold
30 communicated to its employees that such proprietary information was to be kept
31 confidential,” and that the employee was not required “to execute a confidentiality or
32 non-compete agreement limiting the use of information [he] learned during his
33 employment”); *The Foot Locker Inc., v. Finish Line, Inc.*, No. 1:04CV877RLYWTL,
34 2006 WL 146633 (S.D. Ind. Jan. 18, 2006) (applying Indiana law) (refusing to protect as
35 confidential information a document shared with a third party on a non-confidential
36 basis); *Alder Food Distribs., Inc. v. Keating*, No. 0000748, 2000 WL 33170823, at *7
37 (Mass. Super. Ct. June 6, 2000) (refusing to protect business strategy, supplier, customer,
38 and pricing information because employer failed to keep the information secret); *Geritrex*
39 *Corp. v. Dermarite Indus.*, 910 F. Supp. 955, 961–62 (S.D.N.Y. 1996) (applying New
40 York law) (refusing to protect manufacturing processes and product formulas that the
41 employer failed to keep secret); *Ashland Mgmt. Inc. v. Janien*, 624 N.E.2d 1007, 1013
42 (N.Y. 1993) (stating that “a trade secret must first of all be secret.”).

43
44 Illustration 5 is based on *Dulisse v. Park Int’l Corp.*, 45 U.S.P.Q.2d (BNA) 1688,
45 1690–91 (N.D. Ill. 1998) (applying Illinois law). The court determined that “unique
46 product designs, manufacturing processes, customer lists, customer requirements,

1 information about future sales opportunities, special account pricing, employee
2 compensation rates, pricing calculations, and special computer software modifications
3 [is] proprietary information [that] holds economic value by virtue of its secrecy,” and that
4 the employer “made reasonable efforts to maintain the confidentiality of this information
5 by keeping it in a segregated locked room for which only six employees had keys,
6 requiring all employees . . . to acknowledge a written confidentiality policy, requiring
7 plant visitors to sign a confidentiality agreement, and reminding [the departing employee]
8 of his confidentiality obligations when it learned that he was employed by [a
9 competitor].” *Id.* Thus, the information was a trade secret.

10
11 Illustration 6 is based on *The Agency, Inc. v. Grove*, 839 N.E.2d 606, 617 (Ill.
12 App. Ct. 2005), where the court determined that the employer had taken sufficient
13 measures to guard its computerized client profiles. See also *U.S. v. Lange*, 312 F.3d 263,
14 264–65 (7th Cir. 2002). In that case—decided under the Economic Espionage Act of
15 1996—the employee stole computer data from his former employer and attempted to sell
16 the data to a competitor. The court found that the employer took “reasonable measures to
17 keep [the] information secret” by storing all of its drawings and manufacturing data in a
18 computer-assisted room “protected by a special lock, an alarm system and a motion
19 detector.” *Id.* at 266. The employer also ensured that copies of sensitive information
20 were kept to a minimum, that surplus copies were shredded, and that every employee
21 received a notice that he was working with confidential information. The employer
22 further divided the work among its subcontractors—no single vendor had full copies of
23 the schematics of its product so that none could replicate the exact product. See *id.*

24
25 *d. Information readily obtainable by others through proper means.* Illustration 7
26 is an example of readily available information, which is not protected by this Section. It
27 is based loosely on *Ivy Mar Co. v. C.R. Seasons, Ltd.*, No. 95-CV-0508, 1998 WL
28 704112, at *8 (E.D.N.Y. Oct. 7, 1998) (applying New York law) (holding that publicly
29 available information is not eligible for confidential-information protection). See also
30 *Cosmopolitan Imps. LLC v. Pac. Funds LLC*, 145 Wash. App. 1047 (Wash. Ct. App.
31 2008) (holding that a business plan containing easily obtainable public real estate listings
32 is not protectable as confidential information).

33
34 Illustration 8 is based on *Atmospherics, Ltd. v. Hansen*, 702 N.Y.S.2d 385, 386
35 (N.Y. App. Div. 2000) (holding that where a manufacturing process or product design is
36 readily ascertainable—in this case, from public sources—it will not be afforded
37 protection).

38
39 Illustration 9, an example of business management information, is taken from
40 *Byrd’s Lawn & Landscaping, Inc. v. Smith*, 542 S.E.2d 689, 693–94 (N.C. Ct. App.
41 2001) (upholding jury finding that confidential cost-history records were trade secrets).
42 See also *MAI Sys. Corp. v. Peak Computer, Inc.*, 991 F.2d 511, 521 (9th Cir. 1993)
43 (applying California law) (protecting a customer database); *Laro Maintenance Corp. v.*
44 *Culkin*, 700 N.Y.S.2d 490, 491–492 (N.Y. App. Div. 1999) (protecting pricing
45 information); *Inflight Newspapers, Inc. v. Magazines In-Flight, LLC*, 990 F. Supp. 119,
46 134 (E.D.N.Y. 1997) (applying New York law) (protecting binding-process information);

1 Merck & Co. v. Lyon, 941 F. Supp. 1443, 1465 (M.D.N.C. 1996) (applying North
2 Carolina law) (protecting marketing plans and plans to release a new dosage product
3 line); SI Handling Sys., Inc. v. Heisley, 753 F.2d 1244, 1256–61 (3d Cir. 1985) (applying
4 Pennsylvania law) (protecting cost and pricing information); Patient Transfer Sys., Inc. v.
5 Patient Handling Solutions, Inc., No. 97-1568, 2001 WL 936641, at *10–18 (E.D. Pa.
6 Aug. 16, 2001) (applying Pennsylvania law) (protecting product part numbers and price
7 list); J.W.S. Delavau Co. v. Lederman, No. 4495, 1991 WL 1011102, at *382 (Pa. C.P.
8 Sept. 16, 1991) (protecting pricing and financial information).

9
10 Confidential information does not lose protection merely because it has been
11 misappropriated by an employee or prior employee. Courts will protect such information
12 with an injunction whose length depends on the amount of time necessary to
13 independently produce such information. See Winston Research Corp. v. Minn. Mining
14 & Mfg. Co., 350 F.2d 134, 142 (9th Cir. 1965) (applying California law).

15
16 *e. General knowledge and skills acquired in the course of employment.*
17 Illustration 10 is drawn from Metro Traffic Control, Inc. v. Shadow Traffic Network, 27
18 Cal. Rptr. 2d 573, 579 (Cal. Ct. App. 1994) (holding that “a stable of trained and talented
19 at-will employees does not constitute an employer’s trade secret.”). See also AutoInfo,
20 Inc. v. Hollander Publ’g Co. Inc., No. 90 Civ. 6994 (JSM), 1991 WL 64190, at *2–3
21 (S.D.N.Y. Apr. 17, 1991) (applying New York law) (holding that an employer could not
22 prevent its former employee from using basic programming skills and commercially
23 available software).

24
25 Illustration 11 is based on B.F. Goodrich Co. v. Wohlgemuth, 192 N.E.2d 99,
26 103–05 (Ohio Ct. App. 1963), which held that the employer’s special-process
27 information obtained by the employee in the course of his employment was protected
28 confidential information of the employer on both equitable and contractual grounds.

29
30 *f. Customer lists or databases.* Employers are considerably less likely to succeed
31 in protecting information contained in customer lists and databases when the amount of
32 customer information contained in the list is not substantial or likely to yield any
33 economic advantage over competitors, the employer did not make reasonable efforts to
34 keep the information secret, the information is readily ascertainable by proper means, and
35 the employer expended few resources to obtain or compile the list. See Public Sys., Inc.
36 v. Towry, 587 So. 2d 969, 973 (Ala. 1991) (refusing to protect a customer list that the
37 employer distributed to its prospective customers); Cinebase Software, Inc. v. Media
38 Guar. Trust, Inc., No. C98-1100 FMS, 1998 WL 661465, at *9 (N.D. Cal. Sept. 21, 1998)
39 (applying California law) (refusing to protect customer information that was publicly
40 available); Cambridge Filter v. Int’l Filter Co., 548 F. Supp. 1301, 1306 (D. Nev. 1982)
41 (applying California law) (holding that a customer list was not a trade secret where the
42 list can be easily reproduced by any reasonably prudent competitor by consulting widely
43 available directories or catalogues); Mathews Paint Co. v. Seaside Paint & Lacquer Co.,
44 306 P.2d 113, 117 (Cal. Ct. App. 1957) (holding that former employees breach no duty of
45 loyalty by appropriating customer information where the same information could be
46 revealed through “the exercise of just ordinary perspicacity” (quoting Avocado Sales Co.

1 v. Wyse, 10 P.2d 485, 488 (Cal. Ct. App. 1932)); Clinipad Corp. v. Aplicare, Inc., No.
2 235252, 1991 WL 27899, at *7 (Conn. Super. Ct. Jan. 10, 1991) (refusing to protect a
3 customer list where the information could be readily ascertained through trade shows,
4 industry brochures, government records, and professional publications); Holiday Food
5 Co. v. Munroe, 426 A.2d 814, 818 (Conn. Super. Ct. 1981) (refusing to protect a
6 customer list where the employee removed the list with “the full knowledge of and
7 without objection from” the former employer, the former employer did not make
8 reasonable efforts to keep the list confidential, and the information of customers could be
9 ascertained without great expense or “energetic spying” simply by observing a plainly
10 marked truck as it makes deliveries); Barberio-Powell v. Bernstein Leibstone Assocs.,
11 Inc., 624 So. 2d 383, 384 (Fla. Dist. Ct. App. 1993) (refusing to protect a customer list
12 where the information was easily obtainable in the industry and from published sources);
13 Fleming Sales Co. v. Bailey, 611 F. Supp. 507, 513 (N.D. Ill. 1985) (applying Indiana
14 law) (holding that a list containing customer information such as names of contact
15 persons, purchasing history, and product and service requirements does not constitute a
16 trade secret if the information is readily available, even if the employer makes some
17 effort to keep it confidential); Millet v. Crump, 687 So. 2d 132, 136 (La. Ct. App. 1996)
18 (refusing to protect a customer list where the employer did not treat it as though it was
19 confidential and the information was easily acquired through proper means); Cruises of
20 Distinction v. Northstar Cruises, Inc., No. 97-CV-74152-DT, 1999 U.S. Dist. LEXIS
21 8743, at *17–20 (E.D. Mich. 1999) (applying Michigan law) (holding that a customer list
22 of a few hundred clients was readily available and that the employer made no attempt to
23 prevent employees from taking the information); Lasermaster Corp. v. Sentinel Imaging,
24 931 F. Supp. 628, 637–38 (D. Minn. 1996) (applying Minnesota law) (refusing to protect
25 a customer list where the competitor was able to compile the list through publicly
26 available information); Subcarrier Commc’ns, Inc. v. Day, 691 A.2d 876, 881 (N.J.
27 Super. Ct. App. Div. 1997) (refusing to grant injunctive relief to protect a
28 communications company’s customer list where the list of potential customers could be
29 duplicated merely by identifying tall buildings and other places to locate antennas);
30 Inflight Newspapers, Inc. v. Magazines In-Flight, LLC, 990 F. Supp. 119, 129–30
31 (E.D.N.Y. 1997) (refusing, under New York law, to protect a customer list where the
32 information was readily ascertainable through public means such as trade directories, the
33 telephone book, the Internet, trade shows, and publicly available magazines); Amana
34 Express Int’l, Inc. v. Pier-Air Int’l, Ltd., 621 N.Y.S.2d 108, 109 (N.Y. App. Div. 1995)
35 (refusing to protect a customer list because the information was publicly available in
36 trade directories); Cox v. Dine-A-Mate, Inc., 501 S.E.2d 353, 356 (N.C. Ct. App. 1998)
37 (refusing to protect a customer list because it was readily ascertainable); W. Med.
38 Consultants, Inc. v. Johnson, 80 F.3d 1331, 1337–1338 (9th Cir. 1996) (applying Oregon
39 law) (refusing to protect a customer list where the information was readily ascertainable
40 to anyone interested in starting a business in the state through the yellow pages, industry
41 publications, or an inquiry at a relevant state agency); Venture Express, Inc. v. Zilly, 973
42 S.W.2d 602, 606 (Tenn. Ct. App. 1998) (articulating “some factors to be considered in
43 determining whether certain information constitutes a business’s trade secret: (1) the
44 extent to which the information is known outside of [the] business; (2) the extent to
45 which it is known by employees and others involved in [the] business; (3) the extent of
46 measures taken by [the business] to guard the secrecy of the information; (4) the value of

1 the information to [the business] and to [its] competitors; (5) the amount of money or
2 effort expended by [the business] in developing the information; and (6) the ease or
3 difficulty with which the information could be properly acquired or duplicated by
4 others.”); *ADCO Indus. v. Metro Label Corp.*, No. 05-99-01128-CV, 2000 WL 1196337,
5 at *4 (Tex. App. Aug. 23, 2000) (refusing to protect a customer list that was readily
6 ascertainable by independent investigation); *MacPherson’s Inc. v. Windermere Real*
7 *Estate Servs. Co.*, No. 03-35107, 2004 WL 1202131, at *2 (9th Cir. May 25, 2004)
8 (applying Washington law) (refusing to protect a customer list that was sufficiently easy
9 for a competitor to duplicate through proper means). But cf. *N. Atl. Instruments, Inc. v.*
10 *Haber*, 188 F.3d 38, 45 (2d Cir. 1999) (applying New York law) (refusing to protect
11 customer identities because they were readily ascertainable but protecting the specific
12 contact names at those companies because such information was not readily available to
13 others in the same industry and the employer took reasonable efforts to keep that
14 information secret).

15
16 On the other hand, courts are likely to protect customer lists if the employer made
17 reasonable efforts to keep the information secret, the information derives independent
18 economic value from not being generally known, and the amount of customer
19 information contained in the list is extensive. See *Morlife, Inc. v. Perry*, 66 Cal. Rptr. 2d
20 731, 735–737 (Cal. Ct. App. 1997) (protecting a roof repair company’s customer list
21 where the company provided unusual roofing service, the information was not generally
22 known, and the company made reasonable efforts to protect the list); *MAI Sys. Corp. v.*
23 *Peak Computer, Inc.*, 991 F.2d 511, 521 (9th Cir. 1993) (applying California law)
24 (protecting a computer company’s customer database and Field Information Bulletins,
25 which contained customer repair and servicing information, on the grounds they were of
26 economic value and the employer took reasonable steps to keep them secret); *ABBA*
27 *Rubber Co. v. Seaquist*, 286 Cal. Rptr. 518, 528 (Cal. Ct. App. 1991) (protecting a
28 customer list where it was the result of employer’s “winnowing down from a generalized
29 list of companies which [might] utilize rubber rollers. . . .”); *Courtesy Temp. Serv., Inc.*
30 *v. Camacho*, 272 Cal. Rptr. 352, 357 (Cal. Ct. App. 1990) (protecting customer
31 information of a temporary employment agency because the information derived an
32 independent economic value by not being generally known and the employer made
33 reasonable efforts to maintain its secrecy); *Unistar Corp. v. Child*, 415 So. 2d 733, 734
34 (Fla. Dist. Ct. App. 1982) (protecting a customer list derived by the employer from a
35 larger list of financial planners with considerable effort, knowledge, and time, and where
36 the employer made reasonable efforts to keep it confidential); *Erik Elec. Co. v. Elliot*,
37 375 So. 2d 1136, 1137–38 (Fla. Dist. Ct. App. 1979) (protecting a list compiled at
38 significant cost by an employer who purchased a large listing of companies, categorized
39 those companies by industry, sent out mailings to potential customers in those industries,
40 and recorded the information of those customers that returned inquiry cards); *Kozuch v.*
41 *CRA-MAR Video*, 478 N.E.2d 110, 113 (Ind. Ct. App. 1985) (holding that a customer
42 list was a trade secret where the list derived independent economic value by not being
43 generally known or ascertainable by competitors, and the employer made reasonable
44 efforts to keep the list secret by locking up computer disks containing the list); *White*
45 *Pigeon Agency, Inc. v. Madden*, No. 00-1189, 2001 WL 855366, at *7 (Iowa Ct. App.
46 July 31, 2001) (holding that a customer list can be protected as a trade secret if the

1 employer makes reasonable efforts to keep it confidential and it provides economic
2 advantage over competitors); *AYR Composition, Inc. v. Rosenberg*, 619 A.2d 592, 597
3 (N.J. Super. Ct. App. Div. 1993) (protecting a service company’s customer list that was
4 economically valuable and not easily discernible by competitors but noting that it would
5 not likely protect a similar list in the manufacturing or wholesaling industry because
6 customers in those industries are more readily ascertainable (citing *Haut v. Rossbach*, 15
7 A.2d 227 (N.J. Ch. 1940))); *Platinum Mgmt., Inc. v. Dahms*, 666 A.2d 1028, 1038 (N.J.
8 Super. Ct. Law Div. 1995) (protecting a list of customer names, reasoning that even
9 though those names may be publicly listed in trade directories, the fact that they are
10 customers of the former employer is not); *Alexander & Alexander Benefits Servs., Inc. v.*
11 *Benefit Brokers & Consultants*, 756 F. Supp. 1408, 1414 (D. Or. 1991) (applying Oregon
12 law) (holding that former employees misappropriated customer lists where the employer
13 made reasonable efforts to keep them secret); *Mettler-Toledo, Inc. v. Acker*, 908 F. Supp.
14 240, 247 (M.D. Pa. 1995) (applying Pennsylvania law) (holding that a customer list may
15 be protected even if information claimed confidential is available to the general public “if
16 the value of the information stems from its compilation or collection in a single place or
17 in a particular form which is of value.” (citing *Nat’l Risk Mgmt., Inc. v. Bramwell*, 819
18 F. Supp. 417, 432 (E.D. Pa. 1993) (noting that under Pennsylvania law information
19 publicly available can constitute a trade secret where the combination of information
20 reflected market research performed by the employer and decisions to include and
21 exclude certain elements from a larger pool of data.)); *Jeter v. Associated Rack Corp.*,
22 607 S.W.2d 272, 276 (Tex. App. 1980) (noting that “[t]he fact that [the] information
23 [used by the former employer] might have been available on the open market is not
24 determinative.”). Some courts will not protect a customer list even if the employer
25 compiled it at substantial cost if it does not otherwise satisfy the criteria of confidential
26 information. See *Reed, Roberts Assocs., Inc. v. Strauman*, 353 N.E.2d 590, 594 (N.Y.
27 1976) (refusing to protect a customer list when the information was readily ascertainable
28 from public sources, regardless of whether the employer expended substantial funds to
29 compile its customer list); *Ace-Tex Corp. v. Rosenberg*, No. 88-CV-1300A, 1992 U.S.
30 Dist. LEXIS 20584, at *20–21 (W.D.N.Y. Oct. 6, 1992) (applying New York law)
31 (same).

32
33 Illustration 13 is based on *Garvin GuyButler Corp. v. Cowen & Co.*, 588
34 N.Y.S.2d 56, 59–60 (N.Y. Sup. Ct. 1992), which held that trade secret protection will be
35 afforded where substantial effort has been made to compile extensive information
36 relevant to servicing the needs of one’s customers. See also *N. Atl. Instruments, Inc. v.*
37 *Haber*, 188 F.3d 38, 44 (2d Cir. 1999) (applying New York law) (holding that customer
38 lists might be confidential information but that it is “generally a question of fact” that
39 requires consideration of the employer’s measures to protect the information as well as
40 “the ease or difficulty with which the information could properly be obtained from other
41 sources”); *A.M. Skier Agency, Inc. v. Gold*, 747 A.2d 936, 940–41 (Pa. Super. Ct. 2000)
42 (protecting an employer’s customer database that an employee appropriated and
43 explaining that “whether such information is protected depends upon the circumstances
44 of its creation”); *J.W.S. Delavau Co. v. Lederman*, No. 4495, 1991 WL 1011102, at
45 *367–68 (Pa. C.P. Sept. 16, 1991) (protecting a customer list that was not readily
46 ascertainable and kept secret).

1
2 Illustration 14 is based on *Arnold K. Davis & Co. v. Ludemann*, 559 N.Y.S.2d
3 240 (N.Y. App. Div. 1990). In that case, the former employer sued to enjoin an insurance
4 salesperson who had contacted forty-four clients he had serviced over fifteen years,
5 telling the clients he had moved to a new employer. *Id.* at 241. The court refused the
6 injunction, emphasizing that the salesperson knew the identities and requirements of
7 these customers based on working with them over many years rather than using or
8 memorizing a physical customer list, emphasizing that the information used by the
9 employee “could be obtained by any insurance agent reviewing the accounts in issue.”
10 *Id.*

11
12 *g. Memory rule.* An employee breaches the duty of loyalty to an employer by
13 improperly using or disclosing the employer’s confidential information, regardless of
14 whether the employee merely discloses the information from memory rather than from
15 some tangible document. See *Allen v. Johar, Inc.*, 823 S.W.2d 824, 827 (Ark. 1992)
16 (noting that “whether the customer information used was written down or memorized is
17 immaterial . . . [T]he proper issue is whether the information is protectable as a trade
18 secret.”); *Schulenburg v. Signatrol Inc.*, 212 N.E.2d 865, 869 (Ill. 1965) (“It should,
19 moreover, make no difference whether the information contained in the blueprints, if it
20 qualified as a trade secret (which in our judgment it does), has been pilfered by tracing
21 the blueprints themselves, . . . or has been memorized by someone with a photographic
22 memory, or has been committed to memory by constant exposure to the prints while in
23 the employ of the plaintiffs.”); *Sweetzel, Inc. v. Hawk Hill Cookies, Inc.*, 1995 WL
24 550585, at *13 (E.D. Pa. Sept. 14, 1995) (applying Pennsylvania law) (holding that
25 “whether [the] information was embodied in written lists or committed to memory is . . .
26 of no significance” (quoting *Morgan’s Home Equipment Corp. v. Martucci*, 136
27 A.2d 838, 843 (Pa. 1957))); *Ed Nowogroski Ins., Inc. v. Rucker*, 971 P.2d 936, 945
28 (Wash. 1999) (holding that confidential customer information does not lose status as a
29 trade secret because the employee remembers it rather than taking it in tangible form).

30
31 Previously, courts more readily applied a memory rule under which an employee
32 was free to use customer information that the employee remembered after leaving an
33 employer. For example, one court said that where a former employee merely used “in his
34 new employment the knowledge that he had acquired in the old,” his actions were “not
35 unlawful; for equity has no power to compel a man who changes employers to wipe clean
36 the slate of his memory.” *Peerless Pattern Co. v. Pictoral Review Co.*, 132 N.Y.S. 37, 40
37 (N.Y. App. Div. 1911). The modern trend, however, enjoins former employees from
38 using customer information they recall from the confidential customer lists of former
39 employers and departs from the older rule that in effect allows employees to take
40 customer lists by memorization. See 2 *Louis Altman, Callmann on Unfair Competition,*
41 *Trademarks and Monopolies* § 14:25 (4th ed. 2007) (“[T]he Uniform Trade Secrets Act
42 has abrogated the common law rule which permitted misappropriation of customer lists
43 by memorization.”) (citations omitted). See also Restatement (Third) of Agency § 8.05
44 cmt. c (2006) (noting that recent decisions generally do not follow the memory rule and
45 stating that “[a]n agent is not free to use or disclose a principal’s trade secrets or other
46 confidential information whether the agent retains a physical record of them or retains

1 them in the agent’s memory. If information is otherwise a trade secret or confidential, the
2 means by which an agent appropriates it for later use or disclosure should be irrelevant.”).
3 Cf. Restatement (Third) of Unfair Competition § 42 cmt. d (1995) (noting that, “although
4 information that is retained in the employee’s memory may be less likely to be regarded
5 as a trade secret absent evidence of intentional memorization, the inference is not
6 conclusive.”).

7
8 Most states that have adopted the Uniform Trade Secrets Act (“UTSA”) now hold
9 that it does not distinguish between confidential information obtained by an employee
10 that is tangible or that which has been memorized. See, e.g., *Morlife, Inc. v. Perry*, 66
11 Cal. Rptr. 2d 731, 738 (Cal. Ct. App. 1997) (construing the Uniform Trade Secrets Act to
12 hold that customer lists may qualify as protected trade secrets whether the employee
13 misappropriates a written version or commits the information to memory). Indeed, as
14 one court has noted, more than forty states have adopted the UTSA in a substantially
15 similar form and the majority position is that memorized information can be the basis for
16 a trade-secret claim. See *Al Minor & Assocs., Inc. v. Martin*, 881 N.E.2d 850, 853–54
17 (Ohio 2008) (citing *Allen v. Johar, Inc.*, 823 S.W.2d 824 (Ark. 1992). See also
18 *Schulenburg v. Signatrol, Inc.*, 212 N.E.2d 865 (Ill. 1965); *Jet Spray Cooler, Inc. v.*
19 *Crampton*, 282 N.E.2d 921 (Mass. 1972); *Cent. Plastics Co. v. Goodson*, 537 P.2d 330
20 (Okla. 1975); *Van Prods. Co. v. Gen. Welding & Fabricating Co.*, 213 A.2d 769 (Pa.
21 1965); *Rego Displays, Inc. v. Fournier*, 379 A.2d 1098 (R.I. 1977)); *M.N. Dannenbaum,*
22 *Inc. v. Brummerhop*, 840 S.W.2d 624 (Tex. App. 1992).

23
24 While the rule distinguishing between memorized and tangible customer lists has
25 properly been discredited, many courts ostensibly applying the memory rule
26 appropriately refuse to enjoin the employee’s use of the information. That is because the
27 underlying information that is “memorized” was not otherwise confidential information
28 under this Section, usually because it arose as a by-product of the employee’s
29 relationships with customers. See *Fleming Sales Co. v. Bailey*, 611 F. Supp. 507, 513
30 (N.D. Ill. 1985) (applying Indiana law) (holding that a former employee who competed
31 with his former employer by using his unwritten knowledge about certain customers
32 acquired in the course of performing his duties for the former employer did not breach
33 the duty of loyalty to his employer because that information was readily ascertainable by
34 proper means); *Arnold K. Davis & Co. v. Ludemann*, 559 N.Y.S.2d 240, 242 (N.Y. App.
35 Div. 1990) (holding that an employee did not misappropriate customer information where
36 “[he] relied upon his knowledge and experience” to contact his former employer’s
37 customers and the names and addresses were readily discoverable through public
38 sources); *Zurich Depository Corp. v. Gilenson*, 503 N.Y.S.2d 415, 416–17 (N.Y. App.
39 Div. 1986) (finding no cause of action for misappropriation of trade secret where the
40 information contained in the list was readily ascertainable in a trade directory and where
41 no extraordinary efforts were expended in creating the list); *Cont’l Dynamics Corp. v.*
42 *Kanter*, 408 N.Y.S.2d 801, 802 (N.Y. App. Div. 1978) (holding that because the names of
43 potential customers on the employer’s customer lists were readily ascertainable through
44 proper means, there is no cause of action where the defendant solicits the plaintiff’s
45 customers from casual memory); *Ace-Tex Corp. v. Rosenberg*, No. 88-CV-1300A, 1992
46 U.S. Dist. LEXIS 20584, at *21 (W.D.N.Y. Oct. 6, 1992) (applying New York law)

1 (holding that employee was free to use customer information that he remembered because
2 the information was readily discoverable from public sources such as industrial guides,
3 chamber of commerce directories, and telephone books); *Albert B. Cord Co. v. S & P*
4 *Mgmt. Servs., Inc.*, 207 N.E.2d 247, 248 (Ohio Ct. App. 1965) (holding that a former
5 employee did not misappropriate a confidential customer list of his former employer by
6 using information about the former employer’s customers where no such customer list
7 was ever created by the former employer); *Patient Transfer Sys., Inc. v. Patient Handling*
8 *Solutions, Inc.*, No. 97-1568, 2001 WL 936641, at *10–18 (E.D. Pa. Aug. 16, 2001)
9 (applying Pennsylvania law) (refusing to protect vendor list or customer contact list
10 where the employer took few if any measures to keep the information contained in the
11 customer list secret and the list was readily ascertainable through proper means but
12 protecting information on the list referring to part numbers and prices, which the
13 employee could not possibly remember and only became aware after joining as an
14 employee and which information was of considerable value to the employer); *ADCO*
15 *Indus. v. Metro Label Corp.*, No. 05-99-01128-CV, 2000 WL 1196337, at *4 (Tex. App.
16 Aug. 23, 2000) (holding that information that an employee remembered was not
17 confidential because it could be easily discerned from public sources).

18
19 Courts appropriately hesitate to prohibit an employee from using contacts,
20 friendships, and relationships in new employment, even if the rule protecting anything in
21 the employee’s memory was an inadequate articulation of the interests at stake. This is
22 so because there is a strong public interest in protecting employee mobility. See *AMP*
23 *Inc. v. Fleischhacker*, 823 F.2d 1199, 1202 (7th Cir. 1987) (applying Illinois law) (stating
24 that “[o]ur society is extremely mobile and our free economy is based upon competition.
25 One who has worked in a particular field cannot be compelled to erase from his mind all
26 of the general skills, knowledge and expertise acquired through his experience. These
27 skills are valuable to such an employee in the market place for his services.” (quoting
28 *ILG Indus., Inc. v. Scott*, 273 N.E.2d 393, 396 (Ill. 1971))), *superseded by statute*, Illinois
29 Trade Secrets Act, 765 Ill. Comp. Stat. Ann. 1065/1 (West 2009), *as recognized in*
30 *PepsiCo, Inc. v. Redmond*, 54 F.3d 1262, 1269 (7th Cir. 1995) (applying Illinois law).
31 Seen in this light, the memory rule appears to be a tool used to ensure that employers are
32 not protecting customer relationships under the guise of protecting customer lists.
33 Reinforcing this point is the fact that even those states that do not explicitly follow the
34 memory rule are much more likely to protect a customer list when the employee
35 physically takes information from the employer, as opposed to merely remembering
36 customer information. See, e.g., *Hayes-Albion v. Kuberski*, 364 N.W.2d 609, 615 (Mich.
37 1985) (refusing to protect customer contact information where the employee “did not
38 ‘steal’ a list of customers that [employer] had kept secret” and stating that “there is
39 nothing improper in an employee establishing his own business and communicating with
40 customers for whom he had formerly done work in his previous employment”); *Cruises*
41 *of Distinction v. Northstar Cruises, Inc.*, No. 97-CV-74152-DT, 1999 U.S. Dist. LEXIS
42 8743, at *19–20 (E.D. Mich. May 20, 1999) (applying Michigan law) (refusing to protect
43 customer information that the employee remembered); *Orbach v. Merrill Lynch*, No. 93-
44 CV-75349-DT, 1994 WL 900431, at *6–8 (E.D. Mich. Jan. 11, 1994) (applying
45 Michigan law) (protecting a customer list that the employee photocopied and gave to his
46 next employer). See also Restatement (Third) of Unfair Competition § 42 cmt. f (1995)

1 (stating that “[t]he fact that an employee has appropriated a written list or has made an
2 attempt to memorize customer information prior to terminating the employment may
3 justify an inference that the information is valuable and not readily ascertainable by
4 proper means.”).

5
6 Georgia is one jurisdiction that still strictly applies a “memory rule,” under which
7 employees not bound by an enforceable covenant not to compete are free to disclose
8 information obtained during previous employment, including trade secrets, that is
9 retained in their memory. As such, an employer must prove that an employee physically
10 appropriated some tangible form of customer information in order for that information to
11 be eligible for protection. See *Avnet, Inc. v. Wyle Lab., Inc.*, 437 S.E.2d 302, 305 (Ga.
12 1993) (affirming a trial court’s limitation of injunctive relief to the protection of tangible
13 handwritten, typed, or printed customer information but not with respect to that
14 information retained in a former employee’s memory); *AmeriGas Propane, L.P. v. T-Bo*
15 *Propane, Inc.*, 972 F. Supp. 685, 698 (S.D. Ga. 1997) (applying Georgia law) (stating that
16 “a former employee’s personal knowledge of the information on [customer] lists . . . can
17 only be curtailed from use through restrictive covenants.”).

18
19
20 **§ 8.03. Disclosure or Use by Employee or Former Employee of Employer’s**
21 **Confidential Information**

22 **An employee or former employee breaches the duty of loyalty owed to the**
23 **employer if, without a legal duty, legal protection, or the employer’s consent, the**
24 **employee discloses to a third party or uses for the employee’s own benefit or a third**
25 **party’s benefit the employer’s confidential information, as that term is defined in**
26 **§ 8.02. The employee’s obligation with respect to the employer’s confidential**
27 **information lasts as long as the information remains confidential under § 8.02, and**
28 **continues beyond termination of the employment relationship regardless of the**
29 **reason for that termination.**

30 **Comment:**

31 *a. Scope.* This Section states the background rule that allows employers to share
32 confidential information with their employees without undue fear of competitive harm.
33 Absent such a rule, employers might incur substantial costs to limit the confidential

1 information its employees learn on the job so that employees would not to be able to
2 capitalize on the employer's confidential information should they leave to go into
3 business for themselves or with a new employer. Some employers might even refuse to
4 share confidential information with employees at all. Accordingly, this rule encourages
5 employers to develop socially useful and commercially valuable information and
6 maximize employee productivity by allowing employers to share that confidential
7 information with employees without fear of unfair competition. Remedies for the
8 wrongful disclosure or use of confidential information are treated in Chapter 9 of this
9 Restatement.

10 *b. Duration of the duty.* The employee's duty not to disclose the employer's
11 confidential information survives the termination of the employment relationship.
12 Indeed, the duty exists so long as the information remains confidential in accordance with
13 § 8.02. Where an injunction is otherwise appropriate under § 8.06, a court may enjoin the
14 employee and competing employers for the time that would be necessary for them to
15 independently duplicate the information. An injunction of this duration will ensure that
16 they are not unjustly enriched by the misappropriation.

17 *c. Employer's consent.* The employer's consent to disclosure under § 8.03 or to
18 employee competition under § 8.04 may be express or reasonably implied from the
19 employer's knowledge of the employee's activities and acquiescence to them.

1 See, e.g., *Trump's Castle Assocs. v. Tallone*, 645 A.2d 1207, 1207–08 (N.J. Super. Ct.
2 1994).

3
4 Under *Nat'l Parks & Conservation Ass'n v. Morton*, 498 F.2d 765, 770 (D.C. Cir.
5 1974) and *Critical Mass Energy Project v. Nuclear Regulatory Commission*, 975 F.2d
6 871, 871 (D.C. Cir. 1992), confidential information provided to a government agency in
7 compliance with a legal requirement, such as a reporting or approval obligation, remains
8 protected and is typically exempt from Freedom of Information Act and related state law
9 requests.

10 11 **§ 8.04. Competition by Employee with Current Employer**

12 **(a) An employee breaches the duty of loyalty to the employer if, without the**
13 **employer's consent, the employee, while employed by the employer,**
14 **competes with the employer.**

15 **(b) Competition under subsection (a) includes solicitation of business from**
16 **the employer's customers or impermissible recruitment of other**
17 **employees to leave the employer to work for a potential competitor; it**
18 **does not include reasonable preparation to compete.**

19 **(c) An employee who does not exercise managerial or supervisory authority**
20 **for the employer may also work for a competitor of the employer without**
21 **breaching the duty of loyalty so long as the work is not done during time**
22 **committed to the employer and does not involve the use or disclosure of**
23 **that employer's confidential information.**

24 **Comment:**

25 *a. Managerial and nonmanagerial employees.* As stated in § 8.01, the duty of
26 loyalty applies to all employees, but varies in scope according to the nature of
27 employment. Because an employee with managerial or supervisory authority can often
28 bind the employer by the discretionary exercise of that authority, the scope of that

1 employee's duty of loyalty is broader than that of an employee who does not exercise
2 such authority. As subsection (c) indicates, the duty of loyalty to which a low-level
3 employee is subject does not, in the typical case, include a duty not to compete. An
4 employer wishing to restrict "moonlighting" or other competition by a low-level
5 employee must, in the typical case, obtain an enforceable agreement.

6 Both the National Labor Relations Act and the Fair Labor Standards Act
7 distinguish between classes of employees. These distinctions are merely persuasive and
8 not determinative of nonmanagerial status under this Section.

9

10 *b. Preparing to compete.* Although employees may not compete with a current
11 employer, they may take reasonable preparatory steps to be in a position to compete upon
12 terminating the employment relationship. Such preparation could include, for example,
13 setting up offices or production facilities and obtaining financing for a competing
14 venture, so long as the preparation is not done on company time or by using company
15 resources. Such preparation may also include announcing the employee's impending
16 departure to the employer, to customers, and to coworkers. While employed, however,
17 the employee may not solicit business or promises of future business from the employer's
18 customers. In addition, although employees can jointly agree to seek new employment or
19 business opportunities, the employee may not recruit fellow employees to leave the
20 employer to join a competing venture. After leaving his employer, however, a former
21 employee may solicit customers of that employer, provided that he is not subject to an
22 enforceable non-solicitation agreement and does not use confidential information in the
23 process.

1 **Illustration:**

2 1. E, X's vice president and general manager, decides to leave X, an air
3 courier company, and start a competing company. Prior to leaving, E tells X's
4 customers about this employment change, but does not ask them to switch their
5 business to the new company. E's actions constitute reasonable preparation to
6 compete and thus are permissible.

7
8 *c. "Moonlighting"*. Absent an agreement otherwise, a nonmanagerial
9 employee—that is, an employee who does not make policy for an employer, implement
10 policy with substantial independent discretion, or supervise other personnel— does not
11 breach the common-law duty of loyalty simply by holding a second job (often known as
12 “moonlighting”) for a competitor of the employer so long as the work does not occur
13 during time dedicated to the employer and does not involve use or disclosure of that
14 employer's confidential information under § 8.03.

15
16 **Illustration:**

17
18 2. E, a nonmanagerial employee tasked with scheduling the transportation
19 of products for employer X, takes a second job during his off hours, performing a
20 similar task for employer Z, a competitor of X. E does not disclose or use any
21 confidential information that belongs to X. E does not breach the duty of loyalty
22 owed to X simply by also working for Z.

23

1 *d. Recruitment of coworkers.* An employee who actively recruits coworkers to
2 work for a competitor to his employer breaches the duty of loyalty. On the other hand, an
3 employee may inform coworkers that he is preparing to start or join a competing
4 business. In addition, a group of employees may agree among themselves to start or join
5 a competing business so long as this does not involve urging the departure of employees
6 who are not part of the group. Such a group may naturally form from an employee's or
7 group of employees' social circle within the workplace; it may also be stimulated by an
8 outside organizer.

9 The line between permissible preparation and impermissible recruitment is
10 necessarily fact-sensitive. Relevant factors include whether the recruiter is a high-
11 ranking employee with managerial responsibilities or discretionary authority to affect
12 business operations; whether the recruitment causes the departure of key employees or a
13 sufficient portion of the employer's workforce that the employer's business is materially
14 damaged or threatened; whether formal offers of employment were made to coworkers as
15 a result of the recruiter's conduct; and whether departing employees had independent
16 reasons for leaving the employer unrelated to the conduct of the recruiter.

17

18 **Illustrations:**

19

20 3. E, X's vice president and general manager, decides to leave X, a food-
21 distribution company, and start a competing food-distribution company. Prior to
22 leaving, E extends offers of employment to several of X's key employees and to
23 most of the staff in E's department. Within a week after E's resignation, most of
24 the solicited employees accept E's offers of employment and leave X to work for
25 E's competing business. Their departure seriously threatens X's business. E's
26 actions breach the duty of loyalty.

27

28 4. E, an executive of X, plans to leave X and start a competing business. E
29 reveals that plan to several of X's employees prior to resigning. Following E's
resignation, several of the employees who were privy to E's plan leave X to work

1 for E. However, while still employed by X, E did not urge any coworkers to
2 leave X or make any offers of employment to any of X's employees. E's actions
3 do not breach the duty of loyalty.

4 5. E, an executive of X, and several other employees of X agree to leave X and
5 start a competing company for which they will be officers. The group has been
6 social friends since graduating from the same school. They all resign from X and
7 subsequently begin competing with X as a rival business. E's actions do not
8 breach the duty of loyalty.

9 6. Several executives and key employees of X agree to leave X and form a rival
10 business. The group successfully recruits a number of X's employees to leave
11 X's employ and come to work for the new business. X's business is seriously
12 threatened because of the loss of so many employees stemming from the
13 recruitment. Each member of the group breaches a duty of loyalty to X.
14

15 7. E, an employee of X, a food importer, is given substantial autonomy
16 and discretion over all purchasing in a certain regional market. While still an
17 employee of X, E negotiates with one of X's customers to establish a competing
18 food importer. E breaches a duty of loyalty to X.
19

20 *e. Corporate executives and other high-level managerial employees in positions*
21 *of trust and confidence.* Because of their special position with the employer, the duty of
22 loyalty imposes greater requirements on corporate executives and other employees in
23 positions of trust and confidence. Such employees breach the duty of loyalty owed to
24 their employer by seizing for their own benefit or that of a third party a business
25 opportunity related to the business in which the employer is engaged or would be
26 reasonably expected to engage. Corporate officers and other employees in positions of
27 trust and confidence must disclose the opportunity to the employer and may pursue the
28 opportunity only upon its rejection by the employer and only so long as it does not result
29 in competition with the employer in violation of § 8.04.

1
2 **Illustrations:**
3

4 8. E is president of X, a country club operating a golf course. E discovers
5 that adjoining real estate will soon become available for purchase and knows X
6 would be financially able and likely to want to purchase it. E does not inform X's
7 board of the opportunity, but instead purchases the real estate on E's own account.
8 The real estate was sufficiently related to X's business to constitute a corporate
9 opportunity, and so E's actions violate the duty of loyalty.

10 9. E is a corporate officer in a joint venture of X and Y formed for the
11 limited purpose of purchasing and developing a particular plot of land. E
12 becomes aware of an opportunity to purchase other land in the same town at a
13 very favorable price. Without first bringing the opportunity to X's or Y's
14 attention, E purchases the land on E's own account. Because the other land is not
15 within the joint venture's defined line of business—namely, to develop a
16 particular plot of land—E has not breached the duty of loyalty owed to X or Y by
17 pursuing the opportunity for E's own benefit.

18
19 **REPORTERS' NOTES**

20 *a. Managerial and nonmanagerial employees.* The distinction between
21 employees with supervisory or managerial responsibilities and those without such
22 responsibilities occurs frequently in U.S. labor and employment law. See, e.g., 29 U.S.C.
23 § 152(11) (2006) (supervisory employees lack collective bargaining rights under the
24 National Labor Relations Act ("NLRA")); *NLRB v. Bell Aerospace Co.*, 416 U.S. 267,
25 267 (1974) (managerial employees lack collective bargaining rights under the NLRA); 29
26 U.S.C. § 213(a)(1) (2006) (overtime protections of Fair Labor Standards Act ("FLSA")
27 do not apply to "any employee employed in a bona fide executive, administrative, or
28 professional capacity"). These distinctions are helpful in determining an employee's
29 nonmanagerial status, but they are not determinative of that status under this Section.

30

1 *b. Preparing to compete.* Courts generally recognize “a privilege in favor of
2 employees which enables them to prepare or make arrangements to compete with their
3 employers prior to leaving the employ of their prospective rivals without fear of incurring
4 liability for breach of their fiduciary duty of loyalty.” *Md, Metals, Inc. v. Metzner*, 382
5 A.2d 564, 569–71 (Md. 1978) (holding that actions by former employees were
6 “manifestly preparatory in nature” where those employees purchased equipment and
7 land, and made arrangements for a loan for their new business while still employees of
8 employer but did not open a competing business until nine months after their departure
9 from their employer). What constitutes mere preparation is a fact-sensitive inquiry. See
10 *Bacon v. Volvo Serv. Ctr., Inc.*, 597 S.E.2d 440, 444 (Ga. 2004) (holding that employees
11 did not compete with their employer because the employees did not solicit the employer’s
12 customers before their employment ended); *Fletcher, Barnhardt & White, Inc. v.*
13 *Matthews*, 397 S.E.2d 81, 84 (N.C. 1990) (holding that employee did not breach the duty
14 of loyalty by merely “making plans to compete with his employer before he left the
15 company” even where these plans included the formation of a competing business entity).
16

17 While an employee may make reasonable preparations to compete with his
18 employer, he may not solicit his employer’s customers while still employed with his
19 employer. See *Bancroft-Whitney Co. v. Glen*, 411 P.2d 921, 935 (Cal. 1966). However,
20 as in the context of solicitation of one’s coworkers, an employee may notify customers
21 that he is changing his employer, as long as he does not go beyond mere notification. See
22 *MAI Sys. Corp. v. Peak Computer, Inc.* 991 F.2d 511, 521 (applying California law)
23 (notification sent to customers of change of employers not solicitation); *Warwick Group,*
24 *Inc. v. Cipolla*, No. C.A. NO.86-2259, 1986 WL 714207, at *3 (R.I. Super. Ct. Sep. 12,
25 1986) (noting that notification to employer’s customers of a change in employers is a
26 professional courtesy and not solicitation). As in the context of determining what
27 constitutes mere preparation, determining what constitutes going beyond mere
28 announcement is, however, a fact intensive inquiry. See, e.g., *Merrill, Lynch, Pierce,*
29 *Fenner, & Smith Inc. v. Chung*, No. CV 01-00659 CBM RCX, 2001 WL 283083 (C.D.
30 Cal. Feb. 2, 2001). Furthermore, in the absence of a nonsolicitation agreement
31 enforceable under § 8.07, a former employee may contact and solicit business from his
32 former employer’s customers, so long as he does not use confidential information in
33 doing so. See *Veco Corp. v. Babcock*, 611 N.E.2d 1054, 1059 (Ill. App. Ct. 1993) (“In
34 the absence of a contractual restrictive covenant. . . former employees may compete with
35 their former employer and solicit former customers so long as there was no demonstrable
36 business activity by the former employee before the termination of employment.”).
37

38 Illustration 1 is based on *Jet Courier Serv. v. Mulei*, 771 P.2d 486 (Colo. 1989).
39 In that case, the employee signed a noncompetition agreement as part of his employment
40 agreement. *Id.* at 489. During the employee’s tenure at Jet Courier, he began to
41 investigate the possibility of setting up a competing company, talking to Jet customers
42 and employees during the process. *Id.* at 489–90. The court remanded to determine
43 whether the employee’s actions constituted solicitation of customers for a rival business,
44 in which case he would have breached his duty of loyalty to his employer. *Id.* at 493–94.
45
46

1 c. “*Moonlighting*”. While all employees are subject to a duty not to compete with
2 their employers, nonmanagerial employees generally may work for another employer,
3 even a competitor, during their off hours, as long as there is no agreement otherwise and
4 the situation does not involve the risk of misappropriation of confidential information.
5 See *Sabin v. Yellow Transp., Inc.*, No. 04 C 193, 2006 WL 2192007, at *8–10 (N.D. Ill.
6 July 31, 2006) (applying Illinois law) (holding that the evidence presented at trial did not
7 support a claim for breach of duty of loyalty where a truck driver performed similar tasks
8 for a competitor on his personal days and there was no provision in the employment
9 agreement prohibiting such “moonlighting”); *Food Lion, Inc. v. Capital Cities/ABC, Inc.*,
10 194 F.3d 505, 516 (4th Cir. 1999) (applying North and South Carolina law) (declaring
11 that “[a]n employee does not commit a tort simply by holding two jobs or by performing
12 a second job inadequately. For example, a second employer has no tort action for breach
13 of the duty of loyalty when its employee fails to devote adequate attention or effort to her
14 second (night shift) job because she is tired. That is because the inadequate performance
15 is simply an incident of trying to work two jobs. There is no intent to act adversely to the
16 second employer for the benefit of the first,” while holding that ABC undercover
17 reporters who took jobs as meat cutters to expose unsanitary practices at grocery store
18 breached fiduciary duty to grocery store). However, the employee should inform his
19 employer if it is likely that such moonlighting would conflict with his duties to the
20 employer. See *Cameco, Inc. v. Gedicke*, 724 A.2d 783, 789 (N.J. 1999) (noting that
21 “[t]he greater the possibility that another occupation will conflict with the employee’s
22 duties to the employer, the greater the need for the employee to alert the employer to that
23 possibility.”) Despite this background rule, however, a collective bargaining agreement
24 may contain additional restrictions on moonlighting, usually including employee
25 reporting and employer approval before an employee can work a second job. Such
26 restrictions are generally enforceable. See, e.g., *Columbia Gas of Ohio, Inc. v. Util.*
27 *Workers Union of Am.*, 329 F. App’x 1, 1 (6th Cir. 2009). When an employee
28 successfully works two jobs and is wrongfully fired from one, however, the back pay
29 award due that employee may not be reduced by the income he earns from the second job
30 in the interim period. See *People ex rel. Bourne v. Johnson*, 199 N.E.2d 68, 72 (Ill. App.
31 Ct. 1964).

32
33 Illustration 2 is based loosely on *Cameco, Inc. v. Gedicke*, 724 A.2d 783 (N.J.
34 1999). In that case, a traffic manager tasked with arranging for the transportation of the
35 employer’s food products formed a venture that arranged for the transportation of various
36 other goods for other companies, including the employer’s competitors. See *id.* at 786.
37 The court held that, absent any explicit agreement prohibiting this activity, the traffic
38 manager was free to supplement his income by establishing a business that did not
39 compete directly with the employer, even if it assisted the employer’s competitors in
40 some minor way. Such “moonlighting,” the court reasoned, is a “reality of contemporary
41 life” for those employees earning low or modest incomes. *Id.* at 789.

42
43 d. *Recruitment of coworkers*. Generally, an employee’s duty of loyalty prohibits
44 an employee, prior to termination of employment, from soliciting coworkers to start or
45 join a competing venture. See *Vigoro Indus., Inc. v. Crisp*, 82 F.3d 785, 788 (8th Cir.
46 1996) (applying Arkansas law) (noting that an employee has a duty of loyalty that

1 “precludes him from soliciting other employees” prior to the termination of the
2 employee’s employment); *McCallister Co. v. Kastella*, 825 P.2d 980, 984 (Ariz. Ct. App.
3 1992) (noting that an employee breaches the duty of loyalty to an employer by soliciting
4 coemployees prior to termination of the employee’s employment agreement); *Thomas*
5 *Weisel Partners LLC v. BNP Paribas*, No. C 07-6198 MHP, 2010 WL 1267744, at *10
6 (N.D. Cal. Apr. 1, 2010) (applying California law) (finding that a manager who
7 orchestrated the en masse exodus of key employees to a competitor breached the duty of
8 loyalty to his then-current employer); *Jet Courier Serv. Inc. v. Mulei*, 771 P.2d 486, 494
9 (Colo. 1989) (noting that, in general, an employee breaches a duty of loyalty to the
10 employer if, prior to the termination of employment, the employee solicits coemployees
11 to join a competing enterprise); *News Am. Mktg. In-Store, Inc. v. Marquis*, 862 A.2d
12 837, 843 (Conn. App. Ct. 2004) (holding that an employee breached his duty of loyalty to
13 his employer by soliciting, prior to his resignation, a coemployee for employment at a
14 competitor but finding no cause of action where the employer could not demonstrate
15 monetary harm); *Johnson Controls, Inc. v. Rumore*, No. 8:07-cv-1808-T-17TBM, 2008
16 WL 203575, at *10–11 (M.D. Fla. Jan. 23, 2008) (applying Florida law) (holding that a
17 defendant breached the duty of loyalty to his employer by soliciting six coemployees to
18 compete with the employer but finding a codefendant did not breach his duty of loyalty
19 by merely contacting a coemployee and answering that employee’s questions about the
20 competitor corporation); *Fish v. Adams*, 401 So. 2d 843, 845 (Fla. Dist. Ct. App. 1981)
21 (“[An] employee may not engage in disloyal acts in anticipation of his future
22 competition, such as . . . soliciting customers and other employees prior to the end of his
23 employment.”); *R Homes Corp. v. Herr*, 123 P.3d 720, 724 (Idaho Ct. App. 2005) (noting
24 that reported Idaho decisions have not yet addressed claims of breach of duty of loyalty
25 by soliciting coemployees, but stating that employees have a duty before the end of their
26 employment “not to cause employees to break their contracts with the employer.”
27 (quoting Restatement (Second) of Agency § 393 (1958))); *Riad v. 520 South Mich. Ave.*
28 *Assocs. Ltd.*, 78 F. Supp. 2d 748, 763 (N.D. Ill. 1999) (applying Illinois law) (noting that
29 an employee who owes a fiduciary duty of loyalty to an employer “breaches the trust if
30 he . . . entices co-workers away from his employer.”); *Md. Metals, Inc. v. Metzner*, 382
31 A.2d 564, 568 (Md. 1978) (noting that, prior to resignation, an employee who owes a
32 duty of loyalty to an employer “must refrain from actively competing with his employer
33 for customers and employees. . . .”); *Augat, Inc. v. Aegis, Inc.*, 565 N.E.2d 415, 421
34 (Mass. 1991) (holding that “a general manager, who while still employed, secretly
35 solicits key managerial employees to leave their employment to join the general manager
36 in a competitive enterprise” breaches a duty of loyalty); *Guidant Sales Corp. v. George*,
37 No. 05-2890 (PAM/JSM), 2006 WL 3307633, at *4 (D. Minn. Nov. 14, 2006) (applying
38 Minnesota law) (holding that a nonofficer employee unfairly competed by soliciting
39 coworkers, prior to termination of his employment agreement, to terminate their
40 employment and join the employee at a direct competitor); *Cudahy Co. v. Am. Lab., Inc.*,
41 313 F. Supp. 1339, 1347 (D. Neb. 1970) (applying Nebraska law) (noting that Nebraska’s
42 highest court has not passed directly on claims of breach of duty of loyalty premised on
43 solicitation of coworkers but indicating that an employee’s pretermination solicitation of
44 coworkers constitutes a breach of duty of loyalty if the solicitation evinces a scheme to
45 hamper the employer’s ability to function); *Liberty Mut. Ins. Co. v. Ward*, No. C-93-610-
46 L, 1994 WL 369540, at *4 (D.N.H. July 11, 1994) (applying New Hampshire law)

1 (denying a motion to dismiss a claim for breach of the duty of loyalty where the
2 employee solicited clients and other coworkers prior to resigning); *Las Luminarias of*
3 *N.M. Council of the Blind v. Isengard*, 587 P.2d 444, 449 (N.M. Ct. App. 1978) (“[A]n
4 employee may not solicit customers before the end of his employment or do other similar
5 acts in direct competition with the employer’s business.”); *Eagle Sys., Inc. v. Black, Nos.*
6 *01-35634, 01-35770*, 2003 WL 683860, at *1 (9th Cir. Feb. 25, 2003) (applying Oregon
7 law) (affirming a district- court ruling that an employee breached the duty of loyalty to
8 her employer by soliciting the drivers of the employer to switch to her future employer);
9 *Am. Republic Ins. Co. v. Union Fid. Life Ins. Co.*, 470 F.2d 820, 824 (9th Cir. 1972)
10 (applying Oregon law) (holding that an employee’s hiring of fellow employees during his
11 employment agreement constituted unfair competition); *B&L Corp. v. Thomas &*
12 *Thorngren, Inc.*, 162 S.W.3d 189, 204 (Tenn. Ct. App. 2004) (holding that former
13 employees breached their duty of loyalty to their employer by soliciting coemployees
14 while still employees of the plaintiff); *Williams v. Dominion Tech. Partners, LLC*, 576
15 S.E.2d 752 (Va. 2003) (noting that employees breach the duty of loyalty owed to their
16 employer by soliciting employees prior to the termination of their employment); *Standard*
17 *Brands Inc. v. U.S. Partition & Packaging Corp.*, 199 F. Supp. 161, 173 (E.D. Wis. 1961)
18 (applying Wisconsin law) (holding that managerial employees breached their fiduciary
19 duty of loyalty by soliciting coemployees, prior to terminating their employment, to leave
20 the employer and join a competing venture).

21
22 Whether an employee’s pretermination conduct constitutes solicitation of
23 coemployees is usually a fact-sensitive issue. See *Bancroft-Whitney Co. v. Glen*, 411
24 P.2d 921, 935 (Cal. 1966) (noting that “[n]o ironclad rules as to the type of conduct
25 which is permissible can be stated.”); *Jet Courier Serv., Inc. v. Mulei*, 771 P.2d 486, 496
26 (Colo. 1989) (stating that “[a] court should consider the nature of the employment
27 relationship, the impact or potential impact of the employee’s actions on the employer’s
28 operations, and the extent of any benefits promised or inducements made to co-workers
29 to obtain their services for the new competing enterprise. No single factor is dispositive;
30 instead, a court must examine the nature of an employee’s preparations to compete to
31 determine if they amount to impermissible solicitation.”); *Cent. States Indus. Supply, Inc.*
32 *v. McCullough*, 279 F. Supp. 2d 1005, 1046 (N.D. Iowa 2003) (applying Iowa law)
33 (concluding that “the better course is to consider, as a question of fact, whether
34 solicitation of an at-will employee, based on the circumstances of the case . . . constituted
35 solicitation that inflicted sufficient damage to constitute a violation of the defendant’s
36 fiduciary duty of loyalty.”); *Rehab. Specialists, Inc. v. Koering*, 404 N.W.2d 301, 305
37 (Minn. Ct. App. 1987) (stating that “[t]here is no precise line between acts by an
38 employee which constitute prohibited ‘solicitation’ and acts which constitute permissible
39 ‘preparation.’”); *Setliff v. Akins*, 616 N.W.2d 878, 887 (S.D. 2000) (stating that “whether
40 [an employee] went too far in preparing to compete with [the employer] and whether he
41 solicited [fellow] employees . . . are questions of fact.”). See also *Cameco, Inc. v.*
42 *Gedicke*, 724 A.2d 783, 789 (N.J. 1999) (noting that “[t]he contexts giving rise to claims
43 of employee disloyalty are so varied that they preclude the mechanical application of
44 abstract rules of law.”).

45

1 After departure or other termination, a former employee may, in the absence of an
2 enforceable restrictive covenant, solicit his former coworkers freely. See *Diodes, Inc. v.*
3 *Franzen*, 67 Cal. Rptr. 19, 26 (Cal. Ct. App. 1968) (finding that “no actionable wrong”
4 was committed by a former employee who formed a competitive venture and solicited his
5 former coworkers who were not under contract “so long as the inducement to leave is not
6 accompanied by unlawful action.”); *Electronic Assocs., Inc. v. Automatic Equip. Dev.*
7 *Corp.*, 440 A.2d 249, 252 (Conn. 1981) (noting that once an executive left his employer,
8 “no fiduciary duty restrained him from using ordinary methods to encourage his former
9 coworkers or subordinates to follow him to its competitor.”); *Boyce v. Smith*, 580 A.2d
10 1382, 1390 (Pa. Super. Ct. 1990) (a former employee who formed a competing venture
11 was allowed to solicit his former coworkers because “[o]ffering employment to another
12 company’s at-will employee is not actionable in and of itself.”). In general, a former
13 employee not bound by a non-solicitation agreement or other restrictive covenant is on
14 the same legal footing as any other competitor to his former employer in soliciting his
15 former coworkers. See *Republic Sys. & Programming, Inc. v. Computer Assistance, Inc.*,
16 322 F.Supp. 619, 626 (D. Conn. 1970) (applying Connecticut law) (noting that, absent a
17 non-solicitation agreement, a former employee may solicit his former coworkers to work
18 for a competitor according to “the applicable legal principles . . . relating to the
19 solicitation of employees not under contract by those without fiduciary obligations to the
20 employer.”).

21
22 The actions of corporate executives are likely to receive particular scrutiny. See
23 *Condon Auto Sales & Serv., Inc. v. Crick*, 604 N.W.2d 587, 599–600 (Iowa 1999)
24 (noting that a fiduciary duty of loyalty is not ascribed to all employees because “an
25 employee is not always an agent for the employer” and that only “employees who assume
26 the same type of responsibility [as agents] can become bound by a fiduciary duty”); *PFS*
27 *Distrib. Co. v. Raduechel*, 332 F. Supp. 2d 1236, 1244 (S.D. Iowa 2004) (applying Iowa
28 law) (noting that “[t]he extent of any duty [of loyalty] owed by an employee varies,
29 depending on the nature of the employee’s position within the company, and the degree
30 of confidence entrusted to him or her.”). For example, some courts ascribe a heightened
31 duty of loyalty to corporate officers. See *Vigoro Indus., Inc. v. Crisp*, 82 F.3d 785, 788
32 (8th Cir. 1996) (applying Arkansas law) (noting that a corporate officer has “fiduciary
33 duties to the corporation beyond those of less essential employees”); *Veco Corp. v.*
34 *Babcock*, 611 N.E.2d 1054 (Ill. App. Ct. 1993) (stating that “[c]orporate officers . . .
35 stand on a different footing; they owe a fiduciary duty of loyalty to their corporate
36 employer not to (1) actively exploit their positions within the corporation for their own
37 personal benefit, or (2) hinder the ability of a corporation to continue the business for
38 which it was developed.”). But cf. *Fish v. Adams*, 401 So. 2d 843, 845 (Fla. Dist. Ct.
39 App. 1981) (noting that an employee need not have to be managerial to have a duty of
40 loyalty); *Feddeman & Co., C.P.A., P.C. v. Langan Assocs., P.C.*, 530 S.E.2d 668, 673
41 (Va. 2000) (noting that both “employees and directors of a corporation” owe a duty of
42 loyalty to their employer).

43
44 Courts often emphasize the harm done to the former employer, looking at the
45 number and the position of departing employees as an important factor. See *Vigoro*
46 *Indus., Inc. v. Crisp*, 82 F.3d 785, 788–89 (8th Cir. 1996) (applying Arkansas law)

1 (holding that an employee cannot solicit all of the employee’s coworkers to terminate
2 their employment agreements and work for a competitor); *Veco Corp. v. Babcock*, 611
3 N.E.2d 1054, 1061 (Ill. App. Ct. 1993) (holding that “[c]orporate officers are liable for
4 breaching their fiduciary duties where, while still affiliated with the company, they . . .
5 orchestrate a mass exodus of employees to follow shortly the officer’s resignation from
6 the company”); *ABC Trans Nat’l Transp., Inc. v. Aeronautics Forwarders, Inc.*, 413
7 N.E.2d 1299, 1303–07 (Ill. App. Ct. 1980) (holding that former officers breached their
8 duty of loyalty by recruiting over thirty former employees, amounting to forty percent of
9 the workforce, causing a multistate walkout); *Augat, Inc. v. Aegis, Inc.*, 565 N.E.2d 415,
10 420 (Mass. 1991) (holding that a corporate officer who recruited coworkers had a duty to
11 maintain “at least adequate managerial personnel” at the former employer, thus
12 prohibiting the officer from seeking to solicit key managers away to a competitor); *Duane*
13 *Jones Co. v. Burke*, 117 N.E.2d 237, 245 (N.Y. 1954) (holding that several officers and
14 key employees breached their duty of loyalty by successfully conspiring to induce a mass
15 resignation of 50 percent of the employer’s work force prior to terminating their
16 employment relationship); *Sunbelt Rentals, Inc. v. Head & Engquist Equip., LLC*, 620
17 S.E.2d 222, 230 (N.C. Ct. App. 2005) (holding that corporate officers are liable for
18 breach of their fiduciary duties of loyalty if, prior to terminating their employment
19 relationship, they solicit key employees to join a competing business with the result of
20 crippling the employer’s business and noting that key employees were “solicited to work
21 for [the corporate officers] *en masse*”); *Feddeman & Co., C.P.A., P.C. v. Langan Assocs.,*
22 *P.C.*, 530 S.E.2d 668, 673 (Va. 2000) (holding that officers breached their duty of loyalty
23 by orchestrating the resignation of 25 out of 31 coemployees prior to terminating their
24 employment relationship). But cf. *Unichem Corp. v. Gurtler*, 498 N.E.2d 724, 728 (Ill.
25 App. Ct. 1986) (holding that the improper solicitation of a single employee, in the context
26 of additional acts contrary to the former employer, established a breach of the duty of
27 loyalty); *Cent. States Indus. Supply, Inc. v. McCullough*, 279 F. Supp. 2d 1005, 1045
28 (N.D. Iowa 2003) (applying Iowa law) (noting that an employee who encourages a mass
29 departure of fellow employees as a sort of “pied piper” is not the only circumstance in
30 which an employer may bring a “solicitation of employees” claim for breach of fiduciary
31 duty).

32
33 Whether an employee’s pretermination conduct constitutes solicitation of
34 coworkers may depend on the extent to which an employee’s conduct induced the
35 departure of coworkers. For example, many courts hold that an employee’s
36 pretermination interaction with coworkers does not breach a duty of loyalty if the
37 departing employees had personal reasons, independent of the employee’s conduct, for
38 leaving the employer. See *Metal Lubricants, Co. v. Engineered Lubricants Co.*, 411 F.2d
39 426, 429 (8th Cir. 1969) (applying Missouri law) (noting that an employee cannot be held
40 liable for solicitation of coworkers if “evidence show[s] that the employees who left
41 plaintiff company terminated their relationship for personal reasons.”); *Cudahy Co. v.*
42 *Am. Lab., Inc.*, 313 F. Supp. 1339, 1347 (D. Neb. 1970) (applying Nebraska law)
43 (holding that an employee cannot be held liable for the solicitation of coworkers if the
44 coworkers who left testify that they terminated their employment relationship because
45 they would not advance any further at the employer’s company); *Headquarters Buick-*
46 *Nissan, Inc. v. Michael Oldsmobile*, 539 N.Y.S.2d 355, 357 (N.Y. App. Div. 1989)

1 (holding that a director of leasing did not breach his duty of loyalty by soliciting
2 coworkers to leave the employer because “[a]ll [of the employees who left] had personal
3 reasons for joining [the competing company], which do not suggest any motive to harm
4 the plaintiff corporation”); *Miller Bros. Excavating, Inc. v. Stone Excavating, Inc.* No.
5 97-CA-69, 1998 WL 12646, at *11 (Ohio Ct. App. Jan. 16, 1998) (holding that a vice
6 president did not breach his duty of loyalty by soliciting a coworker to join his competing
7 business because the coworker had decided to seek alternative employment prior to the
8 solicitation due to preexisting grievances against the company).

9
10 An employee’s solicitation of coworkers after termination of the employee’s
11 employment generally does not constitute a breach of the duty of loyalty. See *Elec.*
12 *Assocs., Inc. v. Automatic Equip. Dev. Corp.*, 440 A.2d 249 (Conn. 1981) (holding that
13 in the absence of fraud, misrepresentation, intimidation, or malicious acts a former
14 subcontractor of the plaintiff could not be held liable for soliciting plaintiff’s employees
15 and did not owe any fiduciary duties to the plaintiff company); *TAD, Inc. v. Siebert*, 380
16 N.E.2d 963, 967 (Ill. App. Ct. 1978) (finding that two former employees were free to
17 solicit employees of their former employer after leaving that employer); *CNC/Access,*
18 *Inc. v. Scruggs*, No. 04 CVS 1490, 2006 WL 3350854, at *4 (N.C. Super. Nov. 15, 2006)
19 (holding that an employee did not breach his duty of loyalty by soliciting coworkers
20 where there was no evidence indicating the former employee solicited employees while
21 still employed).

22
23 An employee’s pretermination notification to coworkers of a plan to start or join a
24 competing business also does not constitute a breach of duty of loyalty. See *McCallister*
25 *Co. v. Kastella*, 825 P.2d 980, 983–84 (Ariz. Ct. App. 1992) (holding that a vice
26 president did not breach her duty of loyalty by notifying coemployees of her plan to start
27 a competing firm because she did not make any formal offers of employment to
28 coemployees prior to terminating her employment); *Ellis & Marshall Assocs., Inc. v.*
29 *Marshall*, 306 N.E.2d 712, 715 (Ill. App. Ct. 1973) (holding that an officer’s
30 “conversations [with coworkers] were aptly characterized by the trial judge as statements
31 as to the defendant’s future plans” and therefore did not breach his duty of loyalty);
32 *Kopka, Landau & Pinkus v. Hansen*, 874 N.E.2d 1065, 1071–72 (Ind. Ct. App. 2007)
33 (holding that a law-firm associate did not breach his duty of loyalty by questioning
34 coworkers regarding their desire to quit and work for another firm on the grounds that he
35 made no formal offers of employment); *Setliff v. Akins*, 616 N.W.2d 878, 887 (S.D.
36 2000) (holding that a physician at the employer’s clinic did not breach his duty of loyalty
37 by communicating to a coworker that “he could not legally offer her a job, but that he
38 was leaving an opening in his practice” for her); *Feddeman & Co., C.P.A., P.C. v.*
39 *Langan Assocs., P.C.*, 530 S.E.2d 668, 673 (Va. 2000) (holding that corporate officers
40 can inform coworkers of their intent to leave, but they cannot solicit coworkers to start or
41 join a competing venture); *Appleton v. Bondurant & Appleton, P.C.*, No. 04-1106, 2005
42 WL 3579087, at *19 (Va. Cir. Ct. July 5, 2005) (holding that a former employee did not
43 breach his duty of loyalty to his employer by discussing the possibility of starting a new
44 law firm with coworkers where those discussions took place after office hours and away
45 from the employer’s offices).

46

1 Indeed, a group of employees may agree to compete with their employer upon
2 termination of their employment. See *Quality Sys. v. Warman*, 132 F. Supp. 2d 349, 354
3 (D. Md. 2001) (applying Maryland law) (stating that “an employee may discuss job
4 offers with [the employee’s] circle of friends and the group may debate whether to leave
5 together . . . A breach of loyalty may occur, however, when an about-to-leave employee
6 targets employees outside his normal circle and uses his position to induce them to
7 defect.”); *Metal Lubricants, Co. v. Engineered Lubricants Co.*, 411 F.2d 426, 429 (8th
8 Cir. 1969) (applying Missouri law) (noting that the law recognizes that coworkers may
9 agree among themselves to compete with their employer upon termination of their
10 employment contracts (citing Restatement (Second) of Agency § 393 cmt. e (1958) (“[I]t
11 is normally permissible for employees of a firm, or for some of its partners, to agree
12 among themselves, while still employed, that they will engage in competition with the
13 firm at the end of the period specified in their employment contracts. However, a court
14 may find that it is a breach of duty for a number of the key officers or employees to agree
15 to leave their employment simultaneously and without giving the employer an
16 opportunity to hire and train replacements.”))).

17
18 Some decisions focus on the crippling impact of group departure initiated by a
19 corporate officer. See *Veco Corp. v. Babcock*, 611 N.E.2d 1054, 1061–62 (Ill. App. Ct.
20 1993) (holding that officers breached their duty of loyalty by successfully conspiring to
21 solicit three key employees to join their competing business, where the recruitment of
22 those employees left the employer unable to service a key customer); *Quality Sys. v.*
23 *Warman*, 132 F. Supp. 2d 349, 354 (D. Md. 2001) (applying Maryland law) (holding that
24 “an employee may discuss job offers with his circle of friends [even if they are managers]
25 and the group may debate whether to leave together. Such discussions are a normal part
26 of workplace intercourse,” but noting that “[a] breach of loyalty may occur, however,
27 when an about-to-leave employee targets employees outside his normal circle and uses
28 his position to induce them to defect”); *Duane Jones Co. v. Burke*, 117 N.E.2d 237, 245–
29 46 (N.Y. 1954) (holding that several officers and key employees breached their duty of
30 loyalty by agreeing to take over the business of the plaintiff corporation by either
31 purchasing a controlling interest or by resigning *en masse* and forming a competitor
32 agency).

33
34 Moreover, some courts hold that corporate officers or high-ranking employees
35 breach their duty of loyalty by merely agreeing among themselves to compete with their
36 employer. See *Foodcomm Int’l v. Barry*, 328 F.3d 300, 304 (7th Cir. 2003) (applying
37 Illinois law) (holding that two officers breached their duty of loyalty by conspiring to
38 establish a competing corporation); *B & L Corp. v. Thomas & Thorngren, Inc.*, 162
39 S.W.3d 189, 207 (Tenn. Ct. App. 2004) (holding that two high-ranking employees
40 breached their fiduciary duties of loyalty by failing to disclose each other’s intentions and
41 preparatory actions of establishing a competing business).

42
43 Illustration 3 is based loosely on *PFS Distrib. Co. v. Raduechel*, 332 F. Supp. 2d
44 1236, 1244 (S.D. Iowa 2004) (applying Iowa law). In that case, the defendants, an at-will
45 general manager and a key salesperson of a food-distribution center, agreed to start a
46 competing business. *Id.* at 1240. Prior to their resignation, they made formal offers of

1 employment to all but two office employees at the employer’s food-distribution center.
2 See *id.* at 1241. The departure of the defendants and the solicited employees caused a
3 significant drop in the food-distribution center’s business, and the plaintiff-employer
4 testified that the food- distribution center would have to close if it continued to operate at
5 a loss. See *id.* at 1243. The court held that a jury would likely find that the defendants
6 breached their common-law duties of loyalty by soliciting coworkers to leave the
7 employer and join their business. See *id.* at 1244–47.

8
9 Illustration 4 is based on *McCallister Co. v. Kastella*, 825 P.2d 980, 983 (Ariz. Ct.
10 App. 1992). In that case, the defendant, an at-will vice president of a real estate agency,
11 notified coworkers that she intended to start her own commercial property management
12 firm; however, she did not make any formal offers of employment to any of the
13 coworkers prior to her resignation. See *id.* The court held that the defendant did not
14 breach her duty of loyalty by merely advising coworkers of her plan to start a competing
15 business. *Id.* at 984–85.

16
17 Illustration 5 is based on *Quality Sys. v. Warman*, 132 F. Supp. 2d 349, 354 (D.
18 Md. 2001) (applying Maryland law). In that case, the defendant, an at-will manager of an
19 employment agency, agreed with six other managers to leave the employer and join a
20 competitor’s business. *Id.* Within six weeks of the defendant’s resignation, the six
21 managers left the employer to work for the competitor that the defendant had joined. See
22 *id.* at 352. The court noted that “a group of employees may agree to leave together
23 An employee may not, however, systematically induce other employees to leave their
24 jobs if his purpose of enticement is to destroy an integral part of his employer’s
25 business.” *Id.* at 354 (internal citations omitted). The court did not find evidence of a
26 scheme to destroy the plaintiff-employer’s business, and it therefore held that the
27 defendant did not breach his duty of loyalty by agreeing with several coworkers to leave
28 the plaintiff-employer. *Id.* at 354.

29
30 Illustration 6 is loosely based on *Feddeman & Co., C.P.A., P.C. v. Langan*
31 *Assocs., P.C.*, 530 S.E.2d 668, 673 (Va. 2000). In that case, the defendants, three
32 directors and three employees, conspired to seize the plaintiff-employer’s law firm by
33 purchasing a controlling interest in the firm and then merging the firm with a competitor.
34 See *id.* at 670. The defendants threatened the plaintiff-employer with a mass walkout if
35 the employer did not comply with the terms of their buyout offer. See *id.* at 670–71.
36 Upon failing to reach a favorable agreement for the buyout, the defendants followed
37 through and orchestrated a mass resignation of the firm’s employees. See *id.* at 671.
38 They successfully solicited the departure of twenty-five out of thirty-one coworkers and
39 fifty percent of the firm’s clients. *Id.* The court held that the defendants breached their
40 duty of loyalty by soliciting coworkers and clients. *Id.* at 672–73.

41
42 Illustration 7 is based on *Foodcomm Int’l v. Barry*, 328 F.3d 300, 304 (7th Cir.
43 2003) (applying Illinois law). In that case, the employees breached their duty of loyalty
44 by arranging to provide services to a dissatisfied current customer through a new
45 company while informing the employer that they were instead simply “smoothing things
46 over” with that customer on behalf of the employer. See *id.* Although the defendants

1 were not corporate officers, the courts treated them as employees owing the fiduciary
2 duties of corporate officers because of their high salaries, responsibilities in the firm, and
3 their exclusive control in performing those responsibilities. See *id.*

4
5 *e. Corporate executives and other high-level employees in positions of trust and*
6 *confidence.* Courts generally hold that corporate executives and other high-level
7 managerial employees in positions of trust and confidence owe their employers a greater
8 duty of loyalty by virtue of their fiduciary relationship to the employer and its
9 shareholders. See *Shepard of the Valley Lutheran Church v. Hope Lutheran Church*, 626
10 N.W.2d 436, 442 (Minn. Ct. App. 2001) (holding that corporate officers owe a duty “to
11 act in good faith, with honesty in fact, with loyalty, in the best interests of the
12 corporation.”); *Cameco, Inc. v. Gedicke*, 724 A.2d 783, 791 (N.J. 1999) (noting that “[a]n
13 officer, director, or key executive, . . . has a higher duty than an employee working on a
14 production line.”). As discussed below, this heightened duty includes an obligation not to
15 divert for their material benefit business opportunities that their employer could have
16 exploited. In some jurisdictions, the heightened duty also includes an obligation of
17 corporate officers to inform their employer of intention to compete upon termination of
18 the employment agreement. See 1 Principles of Corporate Governance § 5.06 (1992).

19
20 Corporate officers breach their duty of loyalty where they divert a “corporate
21 opportunity,” i.e., an opportunity that the employer corporation could otherwise have
22 exploited and would be reasonably expected to exploit. See *Hollinger Int’l, Inc. v. Black*,
23 844 A.2d 1022, 1060–62 (Del. Ch. 2004) (holding that a corporate officer violated his
24 duty of loyalty by actively denying the board of directors the right to consider a corporate
25 opportunity and then diverting that opportunity to himself); *Foodcomm Int’l v. Barry*,
26 328 F.3d 300, 303–04 (7th Cir. 2003) (applying Illinois law) (holding that corporate
27 officers breached their duty of loyalty and actively exploited their positions within the
28 corporation by arranging to provide services to a dissatisfied customer through a new
29 company while informing the current employer that they were instead simply “smoothing
30 things over” with that customer); *Delta Env’tl. Prods., Inc. v. McGrew*, 56 F. Supp. 28
31 716, 718–19 (S.D. Miss. 1999) (applying Mississippi law) (holding that the corporate-
32 opportunity doctrine does not apply to an exclusive sales representative employee with
33 neither executive nor administrative authority); *In re Insulfoams, Inc.*, 184 B.R. 694, 707
34 (Bankr. W.D. Pa. 1995) (holding that corporate officers may not pursue for personal gain
35 a business opportunity that is within the line of the employer’s activities unless the
36 employer is incapable of exploiting the opportunity).

37
38 There is some disagreement as to whether corporate officers breach their duty of
39 loyalty by availing themselves of a corporate opportunity that the employer could not
40 otherwise exploit. Some courts hold that the employer’s financial inability is no defense
41 to an officer’s usurpation of a corporate opportunity. Compare *Graham v. Mimms*, 444
42 N.E.2d 549, 558–59 (Ill. App. Ct. 1982) (holding that a corporate officer who uses
43 corporate assets to develop a business opportunity is estopped from denying that the
44 resulting opportunity belongs to the corporation whose assets were misappropriated, even
45 if it was not reasonable for the corporation to pursue the opportunity or the corporation
46 had no expectancy in the project), and *Prodan v. Hemeyer*, 610 N.E.2d 600, 606–07

1 (Ohio Ct. App. 1992) (holding that a corporate officer usurps a corporate opportunity
2 when that officer obtains information about a financial opportunity because of his
3 position as corporate officer), with *Design Strategies, Inc. v. Davis*, 384 F. Supp. 2d 649,
4 672 (S.D.N.Y. 2005) (applying New York law) (explaining that one corporate
5 opportunity doctrine asks test that asks whether the consequences of the misappropriation
6 of the opportunity are so severe as to threaten the viability of the corporation), *aff'd*, 469
7 F.3d 284 (2d Cir. 2006). See also *Jenkins v. Jenkins*, 64 P.3d 953, 958 (Idaho 2003)
8 (finding there was no corporate opportunity to usurp where the corporation did not have
9 the financial ability to take advantage of the opportunity and where “common sense”
10 suggested that any attempt to expand the corporation at that time would not have been
11 practical because of “acrimony among the few shareholders.”). Some courts hold that the
12 employer’s financial inability is a defense if the officer first shares the opportunity with
13 the shareholders and obtains their consent. See *Lussier v. Mau-Van Dev., Inc.*, 667 P.2d
14 804, 813 (Haw. Ct. App. 1983) (holding that there is no corporate opportunity if the
15 corporation is financially incapable of undertaking it and, “before a corporate officer
16 seizes the opportunity for himself, he discloses [it] to the shareholders and obtains their
17 consent to the acquisition of the opportunity and such action is not detrimental to the
18 corporate creditors.” (citing *Hill v. Hill*, 420 A.2d 1078, 1082 (Pa. 1980))).
19

20 A not-for-profit organization may also bring a claim that a former employee
21 diverted a corporate opportunity. See *White Gates Skeet Club, Inc. v. Lightfine*, 658
22 N.E.2d 864, 866 (Ill. App. Ct. 1995) (holding that members of a nonprofit skeet-shooting
23 corporation usurped a corporate opportunity by purchasing real estate which the
24 corporation sought to purchase for new shooting location); *Valle v. N. Jersey Auto. Club*,
25 359 A.2d 504, 507–09 (N.J. Super. Ct. App. Div. 1976) (holding that members of a
26 nonprofit automobile club usurped a corporate opportunity by acquiring an insurance
27 agency for their own benefit without first revealing it to other members); *Lutherland, Inc.*
28 *v. Dahlen*, 53 A.2d 143, 149–50 (Pa. 1947) (holding that a not-for-profit organization’s
29 board member improperly diverted an opportunity where the opportunity was not
30 revealed to shareholders). Cf. *Am. Baptist Churches of Metro. N.Y. v. Galloway*, 710
31 N.Y.S.2d 12, 15 (N.Y. App. Div. 2000) (reasoning that “it would be unfair and
32 counterproductive for a charitable organization to have no recourse against a dishonest
33 fiduciary who thwarts the organization’s endeavors. . . .”).
34

35 Illustration 8 is based on *Ne. Harbor Golf Club, Inc. v. Harris*, 725 A.2d 1018,
36 1021–22 (Me. 1999). In that case, the president of a country club purchased and
37 developed properties adjoining the club without first bringing the opportunity to the
38 club’s board. *Id.* at 1020. The court held that the opportunity to purchase the land, even
39 if discovered in the president’s individual capacity, constituted a corporate opportunity.
40 *Id.* at 1021–22.
41

42 Illustration 9 is based on *Dremco, Inc. v. S. Chapel Hill Gardens, Inc.*, 654 N.E.2d
43 501, 506 (Ill. App. Ct. 1995). In that case, a party to a joint-venture agreement expressly
44 limited to a particular parcel of land purchased adjacent land without bringing it to the
45 attention of the joint venture. The court found no usurpation of corporate opportunity or

1 breach of a duty of loyalty because the opportunity was outside the line of business of the
2 joint venture. *Id.*

3

4 **§ 8.05. Competition by Former Employee with Former Employer**

5 **A former employee may compete with, or work for a competitor of, the**
6 **former employer, including by soliciting customers or recruiting employees, unless**

7 **(a) the former employee is bound by an agreement not to compete**

8 **enforceable under § 8.06; or**

9 **(b) in doing so the former employee discloses or uses, or given exceptional**

10 **circumstances must inevitably disclose or use, the former employer's**

11 **confidential information in violation of § 8.03.**

12 **Comment:**

13 *a. Scope.* Section 8.05 reflects the public interest in competition and in employee
14 mobility by recognizing that when employees go to work for new employers they may
15 take advantage of their general skills and training they obtained during the course of their
16 former employment. However, the rule favoring competition and mobility is a default
17 rule, and thus can be modified by an enforceable agreement not to compete under § 8.06.
18 It is also subject to other applicable laws; for example, tort law provides that outsiders,
19 including former employees, may not tortiously interfere with the former employer's
20 contractual relations with its employees. See Restatement (Second) of Torts §§ 766, 767
21 (1977). The rule of § 8.06 also incorporates the rule of § 8.03: a former employee may
22 not use or disclose the former employer's confidential information in violation of § 8.03.

23

1 *b. “Inevitable disclosure” doctrine.* The general rule stated by this Section is that
2 an enforceable agreement not to compete is necessary to limit a former employee’s right
3 to compete with the former employer. Courts are generally averse to implying non-
4 compete agreements. However, even absent such an agreement, the former employee’s
5 right to compete is limited in the very unusual situation in which the former employer can
6 demonstrate that its confidential information would inevitably be used or disclosed in
7 violation of § 8.03. Only in truly exceptional circumstances would the inevitable-
8 disclosure doctrine be available to prohibit a former employee from competing with a
9 former employer. Courts finding that application of this extraordinary doctrine is
10 warranted typically require that: (1) the former and current employers be direct
11 competitors; (2) the new position be sufficiently similar to the old position so that (3) the
12 employee could not fulfill the new responsibilities without using information obtained
13 from his former employer that is confidential (as that term is defined in § 8.02 of this
14 Restatement). Furthermore, courts are more likely to find the inevitable-disclosure
15 doctrine applicable when the employee’s conduct demonstrates a pattern of deceit or
16 misappropriation of confidential information indicating that ethical constraints and a
17 court injunction barring the disclosure or use of confidential information would, standing
18 alone, be inadequate to protect the former employer’s legitimate interests.

19 Where such factors are present, in addition to restraining the disclosure or use of
20 confidential information, the court may also enjoin the former employee from competing
21 with the former employer for a limited time period no longer than necessary to prevent an
22 unfair trade advantage against the former employer, and may require the former employer
23 to take reasonable protective steps as well. In addition, courts may consider measures

1 falling short of a non-compete injunction to protect the legitimate interests of the former
2 employer. Courts are understandably reluctant to employ the inevitable-disclosure
3 doctrine for concern that the doctrine effectively creates an implied covenant not to
4 compete where the parties did not bargain for one. Thus, the burden is on the former
5 employer to show that use or disclosure is inevitable, rather than merely possible or
6 likely.

7 While the inevitable-disclosure doctrine is one of very limited application when
8 invoked to prevent competition by a former employee who has not signed an enforceable
9 non-competition agreement, many courts will invoke reasoning similar to the doctrine to
10 enforce a reasonable non-competition agreement.

11

12 **Illustrations:**

13 1. E is a Vice President of sales at X, a company that produces and sells
14 commercial or “low-slope” roofing materials. As a condition of employment, E
15 signs an enforceable confidentiality agreement with X. During the course of his
16 employment, E has access to sensitive financial data that X has taken pains to
17 keep secret. After working for X for 7 years, E leaves X to work for company Y
18 as vice president of national accounts. Company Y produces and sells both a
19 competing line of low-slope roofing products and a line of residential or “high-
20 slope” roofing products that does not compete with X’s products. E informs Y of
21 the confidentiality agreement he has with X, and Y limits E’s responsibilities to
22 the high-slope product line. Because low-slope and high-slope product markets
23 are significantly different, E can perform his job at Y without using or disclosing

1 X's confidential information; therefore, E may not be enjoined from working for
2 Y.

3 2. Employee E worked for X, a national food products company, as a plant
4 manager for its coffee and tea division. He never signed a non-competition
5 agreement with X. During the course of his employment with X, E oversaw
6 research and development of new coffee and tea products, and received reports
7 detailing technical methods and advances in their creation. Z, a regional
8 competitor to X, has hired E to work as a production manager in one of its plants.
9 Z does not engage in any new product development, making E's responsibilities
10 with Z significantly different than those he had with X; furthermore, E has not
11 threatened to disclose or use E's confidential information while working for Z.
12 Even if the research and development information E acquired from X might be
13 helpful to Z, any disclosure of that information to Z by E would be a conscious
14 and deliberate act, rather than an inevitable consequence of E's employment with
15 Z. E may not be enjoined from working for Z on grounds of inevitable disclosure.

16 3. Employee E worked as the regional head of marketing for soft-drink
17 producer X, where E helped develop X's near-term strategic plan to gain market
18 share in a specialty line of sports-oriented soft drinks. Upon joining X's
19 workforce, E signed an enforceable confidentiality agreement with X requiring E
20 to maintain the confidentiality of such strategic plans. Keen to capitalize on E's
21 experience, Y, a primary competitor of X, offers to hire E to help develop a
22 strategic plan for its soft-drink product, which competes directly with X's product
23 in many markets. E continues to work for X for three months after deciding to

1 take Y's offer. In response to a direct question from X's CEO, E states that he
2 has no intention of leaving X and continues to participate in planning meetings
3 during those three months. E then leaves X and goes to work for Y. Despite E's
4 not having signed a covenant not to compete with X, a court may enjoin E from
5 working for Y if X is able to prove that E would inevitably use or disclose X's
6 trade secrets in developing a strategic marketing plan for Y's product. The
7 injunction must be limited to the time necessary to negate Y's unfair competitive
8 advantage against X gained from having access to X's near-term strategic plans
9 for the competing product line on which E worked.

10 4. E is an employee of X, a manufacturer of oilfield equipment, and has
11 signed an enforceable non-disclosure agreement. X spent tens of millions of
12 dollars on research and development, in which E was deeply involved at a high
13 level; this included the creation of P, a highly successful product. Y, a direct
14 competitor to X, normally copies X's products by a process of trial and error.
15 However, Y could not devise a method to produce copies of P. Y hired E for a
16 similar position to E's position with X, in order to bolster its efforts to attempt to
17 copy P. Y and E assert that they will not use X's trade secrets, but also assert that
18 they are unsure of what parts of E's knowledge of P are X's confidential
19 information. A court may not only enjoin E from disclosing X's confidential
20 information, but may also enjoin E from working for Y for as long as necessary to
21 negate any unfair trade advantage Y would gain from X's confidential
22 information.

23

REPORTERS' NOTES

1
2
3 *a. Scope.* Numerous cases emphasize the public interest in competition by former
4 employees, and that the duty of loyalty does not prevent employees from competing with
5 former employers. See Prof'l Baseball Instruction, Inc. v. Lamitola, No. BER-C-58-08,
6 2008 WL 2090774 (N.J. Super. Ct. Ch. Div. Mar. 18, 2008) (noting that the public has an
7 "interest in fostering competition, creativity and ingenuity"); Edwards v. Athena Capital
8 Advisors, Inc., No. 072418E, 2007 WL 2840360, at *3 (Mass Super. Ct. Aug. 9, 2007)
9 (noting that "an employee's right to use his or her 'general knowledge, experience,
10 memory, and skill' promotes the public interest in labor mobility and the employee's
11 freedom to practice his or her profession, as well as limiting what would otherwise be a
12 restraint of legitimate competition." (quoting J.T. Healy & Son v. James A. Murphy &
13 Son, 260 N.E.2d 723, 740 (Mass. 1970))).
14

15 *b. "Inevitable-disclosure" doctrine.* Recognition and application of the inevitable-
16 disclosure doctrine varies by state, and generally falls into four categories. Some states
17 fall into more than one of these categories.
18

19 The first category includes those states that are generally willing to apply the
20 inevitable-disclosure doctrine even in the absence of a non-competition agreement if the
21 balance of the relevant factors favors application over non-application. Although there is
22 no uniform set of factors sufficient to apply the inevitable-disclosure doctrine, several
23 conditions would seem necessary. First, the new employer should be a direct competitor
24 to the former employer. See, e.g., Essex Group, Inc. v. Southwire Co., 501 S.E.2d 501,
25 504 (Ga. 1998). Second, the position with the new employer should be substantially
26 similar to the position with the former employer. See, e.g., Dexas Digital Storage, Inc.
27 v. Haenszel, 832 N.E.2d 62, 68 (Ohio Ct. App. 2005). Third, the nature of the new
28 position should be such that the use of confidential information obtained from the old
29 employer is inevitable and "more than a mere suspicion," such that damages after the fact
30 would be an inadequate remedy. See, e.g., Nat'l Starch & Chem. Corp. v. Parker Chem.
31 Corp., 530 A.2d 31, 33 (N.J. Super. Ct. App. Div 1987) (internal quotations omitted).
32 Fourth, some courts appear more willing to enjoin competition where the employee has
33 engaged in deceitful behavior, or where the new employer has a reputation for
34 misappropriating confidential information from competing businesses. See, e.g., Novell
35 Inc. v. Timpanogos Research Group, Inc., 46 U.S.P.Q.2d (BNA) 1197, 1204 (Utah Dist.
36 Ct. Jan. 30, 1998) (issuing an injunction where defendants pirated former employer's
37 software). This fourth factor, however, is not always required. See, e.g., FMC Corp. v.
38 Varco Int'l, Inc., 677 F.2d 500, 504 (5th Cir. 1980) (stating that an injunction against
39 competition would issue "[e]ven assuming the best of good faith" on the part of a former
40 employee).
41

42 Twelve states fall into this first category generally supportive of the doctrine. See
43 Cardinal Freight Carriers, Inc. v. J.B. Hunt, Inc., 987 S.W.2d 642, 647 (Ark. 1999)
44 (holding that a non-disclosure agreement unaccompanied by a non-competition
45 agreement is sufficient to support an injunction preventing an employee from working for
46 a competitor where that competitor "had no compunction about using or disclosing

1 information covered under [the employee’s] confidential agreement to gain an unfair
2 competitive advantage.”); *Sonoco Prods. Co. v. Johnson*, No. 98CV4833, 1998 WL
3 35166425 (D. Col. Sept. 25, 1998) (applying Colorado law) (order granting a preliminary
4 injunction against an employee who took confidential information with him and
5 consequently “ha[d] the ability to misappropriate in the future” while working for a direct
6 competitor in a highly similar position); *E. I. duPont de Nemours & Co. v. Am. Potash &
7 Chem. Corp.*, 200 A.2d 428, 435 (Del. Ch. 1965) (leaving in place a temporary
8 restraining order preventing a former employee from working for his former employer’s
9 direct competitor in a highly similar position, despite that employee’s clearly expressed
10 intent not to use his former employer’s confidential information, on the theory that
11 “plaintiff’s trade secrets [with which the employee dealt are not] susceptible of
12 consciously being so isolated” from unprotected information, and that their use in
13 violation of a non-disclosure agreement would thus “inevitably or probably” occur);
14 *Fountain v. Hudson Cush-N-Foam Corp.*, 122 So.2d 232, 232 (Fla. Dist. Ct. App. 1960)
15 (despite the absence of a non-competition agreement, upholding a temporary restraining
16 order preventing an employee from working for a competitor of his former employer in a
17 highly similar position because the employee’s “knowledge of the trade secrets would be
18 so entwined with his employment as to render ineffective an injunction directed only
19 toward a prevention of disclosure.”), cf. *Hatfield v. AutoNation, Inc.*, 939 So. 2d 155,
20 156–157 (Fla. Dist. Ct. App. 2006) (despite lack of non-competition clause, upholding
21 injunction barring competition by a car dealership general manager who had improperly
22 downloaded 26 computer files containing “everything necessary to start up a dealership,”
23 while declaring that injunction “does not rely on inevitable disclosure, which [the court]
24 deem[s] inapplicable here.”); *Essex Group, Inc. v. Southwire Co.*, 501 S.E.2d 501, 504–
25 06 (Ga. 1998) (upholding a permanent injunction preventing an employee who headed
26 the two year, \$2 million development project of a confidential logistics system from
27 working for a direct competitor to his former employer on grounds that the injunction
28 was narrow and necessary to protect the former employer’s confidential information);
29 *Pepsico, Inc. v. Redmond*, 54 F.3d 1262, 1269 (7th Cir. 1995) (applying Illinois law)
30 (holding that “a plaintiff may prove a claim of trade secret misappropriation by
31 demonstrating that defendant’s new employment will inevitably lead him to rely on the
32 plaintiff’s trade secrets.”); *Allis-Chalmers Mfg. Co. v. Continental Aviation &
33 Engineering Corp.*, 255 F. Supp. 645 (E.D. Mich. 1966) (applying Michigan law) (issuing
34 an injunction preventing a former employee from doing competing work because “a
35 simple injunction against disclosure and use of this information inadequate.”); *Nat’l
36 Starch & Chem. Corp. v. Parker Chem. Corp.*, 530 A.2d 31, 33 (N.J. Super. Ct. App. Div
37 1987) (upholding an injunction against a former employee preventing him from
38 competing with his former employer where it was difficult or impossible to tailor a non-
39 disclosure agreement with sufficient specificity before trial to protect the former
40 employer’s interests, and where damages would not be an adequate remedy for
41 disclosure); *Dexxon Digital Storage, Inc. v. Haenszel*, 832 N.E.2d 62, 69–71 (Ohio Ct.
42 App. 2005) (reversing the denial of an injunction preventing former employees from
43 working for a competitor, even though their former employer failed to obtain or renew
44 non-competition agreements), but see *Hydrofarm, Inc. v. Orendorff*, 905 N.E.2d 658, 663
45 (Ohio Ct. App. 2008) (stating that “[n]either this court nor the Supreme Court of Ohio
46 has applied the inevitable-disclosure doctrine in a case that did not involve an enforceable

1 noncompetition agreement.”); *Novell Inc. v. Timpanogos Research Group, Inc.*, 46
2 U.S.P.Q.2d (BNA) 1197, 1217 (Utah Dist. Ct. Jan. 30, 1998) (enjoining a group of
3 software engineers who formed a competing entity from working on projects that would
4 compete with their former employer’s products—even though they had not signed non-
5 competition agreements—after noting that they had pirated software from their former
6 employer and “essentially admitted” that they would use trade secrets if not enjoined
7 from so doing); *Soultec Corp, Inc. v. Agnew*, No. 16105-6-III, 1997 WL 794496, at *9
8 (Wash. Ct. App. Dec. 30, 1997) (in the absence of a non-competition agreement,
9 upholding a broad injunction preventing two former employees from competing because
10 a narrower injunction preventing only disclosure would be “extremely difficult to
11 police.”). Pennsylvania applies the inevitable-disclosure doctrine, but appears to limit it
12 to highly technical or otherwise specialized fields. See *Fishkin v. Susquehanna Partners,*
13 *Inc.*, 340 F. App’x 110, 120 (3d Cir. 2010) (applying Pennsylvania law); *Quadratec, Inc.*
14 *v. Dongen*, No. 03-09010, 2004 WL 5149357 (Pa. C.P. Chester Mar. 2, 2002) (holding
15 that the inevitable-disclosure doctrine is not applied where the employee “obtained no
16 specialized knowledge or information from [his former employer].”)
17

18 Texas may be an additional jurisdiction in support of the inevitable-disclosure
19 doctrine. In *FMC Corp. v. Varco Int’l, Inc.*, 677 F.2d 500, 505 (5th Cir. 1980), the Fifth
20 Circuit, purportedly applying Texas law, appeared to use the logic of the inevitable-
21 disclosure doctrine to prevent the “inherent threat” of disclosure posed by a former
22 employee. However, since that case, the state court of appeals has on several occasions
23 stated that Texas does not expressly adopt the inevitable-disclosure doctrine. See, e.g.,
24 *Cardinal Health Staffing Network, Inc. v. Bowen*, 106 S.W.3d 230, 242 (Tex. App. 2003)
25 (observing that there is “no Texas case expressly adopting the inevitable disclosure
26 doctrine, and it is unclear to what extent Texas courts might adopt it or might view it as
27 relieving an injunction applicant of showing irreparable injury.”). In spite of this, the
28 Texas Court of Appeals has cited the Fifth Circuit’s opinion approvingly on several
29 occasions and adopted its logic. See *IAC, Ltd. v. Bell Helicopter Textron, Inc.*, 160
30 S.W.2d 191, 200 (Tex. App. 2005) (citing the *Varco* decision for the proposition that
31 inherently threatened disclosure is grounds for a preliminary injunction against
32 competition); *Williams v. Compressor Engineering Corp.*, 704 S.W.2d 469, 471 (Tex.
33 App. 1986) (same). It appears, then, that Texas does indeed apply the inevitable-
34 disclosure doctrine, without expressly calling it by that name.
35

36 Ten states comprise a second category – jurisdictions that acknowledge the
37 inevitable-disclosure doctrine, but tend not to apply it, whether or not the employee has
38 signed to a non-competition agreement. One frequently offered reason for such
39 reluctance is that the former employee has clearly stated that he will uphold the former
40 employer’s confidentiality and has not acted inconsistently with that pledge. See *Aetna,*
41 *Inc. v. Fluegel*, No. CV074033345S, 2008 WL 544504, at *7 (Conn. Super. Ct. Feb. 7,
42 2008) (refusing to enjoin competition when former employee who had not signed a non-
43 competition agreement “credibly stated, in no uncertain terms, that he [would] uphold the
44 confidentiality of [the former employer’s] trade secrets.”); *Standard Brands, Inc. v.*
45 *Zumpe*, 264 F. Supp. 254, 270 (E.D. La. 1967) (applying Louisiana law) (refusing to
46 grant an anti-competition injunction against a former employee who was an “honest and

1 honorable man” because disclosure was not “imminent or eventually inevitable.”). See
2 also *Northwest Bec-Corp v. Home Living Service*, 41 P.3d 263, 268 (Idaho 2002)
3 (refusing to overturn summary judgment in favor former employee bound only by a non-
4 disclosure agreement where the former employer’s response to that motion rested largely
5 implausible assertion of inevitable disclosure). Cf. *EarthWeb, Inc. v. Schlack*, 71 F.
6 Supp. 2d 299, 310 (S.D.N.Y. 1999) (“Absent evidence of actual misappropriation by an
7 employee, the doctrine should be applied in only the rarest of cases.”).
8

9 Unlike the first category, many states in this second category use the absence of
10 factors present in the typical inevitable-disclosure analysis as grounds for denying an
11 injunction even when there is a non-competition agreement in place. See *Meritage*
12 *Homes Corp v. Hancock*, 522 F. Supp. 2d 1203, 1220 (D. Ariz. 2007) (applying Arizona
13 law) (holding that a “conclusory statement that misappropriation of trade secrets was
14 inevitable is insufficient” to issue an injunction enforcing a non-competition agreement);
15 *Bridgestone/Firestone, Inc. v. Lockhart*, 5 F. Supp. 2d 667, 681 (S.D. Ind. 1998)
16 (applying Indiana law) (refusing to enjoin a former executive who signed a non-
17 competition agreement because he did not remember time-sensitive trade secrets in detail,
18 did not take any documents with him upon departure, and worked with his current
19 employer to avoid using the former employer’s trade secrets, thus making the non-
20 competition agreement overbroad, and stating that “the broad injunctive relief granted in
21 *Ackerman* remains the exception rather than the rule” in inevitable disclosure cases);
22 *United Products Corp. of Am., Inc. v. Cederstrom*, 2006 WL 1529478, at *5 (Minn. Ct.
23 App. 2006) (upholding a lower court’s refusal to enforce an overbroad non-competition
24 covenant, in part because the former employer did not demonstrate the “a high degree of
25 probability of inevitable disclosure” necessary to obtain such an injunction); *Tank Tech,*
26 *Inc. v. Neal*, 2007 WL 2137817, at *7 (E.D. Mo. 2007) (applying Missouri law) (where
27 an employee signed a non-competition agreement, refusing to issue a preliminary
28 injunction preventing an employee from competing with his former employer or
29 disclosing its information because there was no “real apprehension that future acts are not
30 just threatened but in all probability will be committed” and because the former employer
31 did not show that its information qualified for trade secret protection); *Marietta Corp. v.*
32 *Fairhurst*, 754 N.Y.S.2d 62, 65 (N.Y. App. Div. 2003) (stating that “the doctrine of
33 inevitable disclosure is disfavored . . . ‘[a]bsent evidence of actual misappropriation by an
34 employee,’” (quoting *EarthWeb, Inc. v. Schlack*, 71 F.Supp.2d 299, 310 (S.D.N.Y.
35 1999))); *Merck & Co. v. Lyon*, 941 F. Supp. 1443 (M.D.N.C. 1996) (applying North
36 Carolina law) (issuing an injunction against disclosure only, and explaining that “[w]here
37 alleged trade secrets were only broadly defined, plaintiffs must rely on their
38 confidentiality agreement with [the former employee]. The Court cannot add to that
39 agreement a covenant not to compete.”); *Drayton Enters., LLC v. Dunker*, No. A3-00-
40 159, 2001 WL 629617, at *3 (D.N.D. Jan. 9, 2001) (applying North Dakota and
41 Minnesota law) (in the absence of a non-competition agreement, refusing to enjoin a
42 former employee from working for a direct competitor when the products that would be
43 protected by such an injunction were available and likely obtained from a third-party
44 competitor, thus making it “unclear the extent to which disclosure is inevitable.”).
45

1 Six states will, on appropriate facts, issue an injunction to enforce the terms of a
2 non-competition agreement, or even exceed the terms of that agreement when necessary.
3 It is unclear, however, whether these states would also issue an injunction based on the
4 inevitable-disclosure doctrine absent such an agreement. See *Branson Ultrasonics Corp.*
5 *v. Stratman*, 921 F. Supp. 909, 913–14 (D. Conn. 1996) (applying Connecticut law)
6 (preventing a former lead engineer who signed a non-competition agreement from
7 working for a competitor because there was “a high degree of similarity between [the]
8 employee's former and current employment [that made] it likely that the former
9 employer's trade secrets and other confidential information [would] be used and disclosed
10 by the employee in the course of his new work.”); *Ackerman v. Kimball Int’l, Inc.*, 652
11 N.E.2d 507, 510 (Ind. 1995) (upholding an injunction broader than the terms of a non-
12 competition agreement against a former manager—who had also obtained customer and
13 supplier lists a day before quitting—in order to protect trade secrets of his former
14 employer from disclosure that would occur if he worked for a competitor); *Uncle B’s*
15 *Bakery, Inc. v. O’Rourke*, 920 F. Supp. 1405, 1437 (N.D. Iowa 1996) (applying Iowa
16 law) (issuing an injunction against competition to enforce a non-competition agreement
17 where the defendant had confidential information covering “every aspect” of the
18 operation of his former employer’s business); *Marcam Corp. v. Orchard*, 885 F. Supp.
19 294, 297 (D. Mass. 1995) (applying Massachusetts law) (where an employee signed a
20 valid non-competition agreement, issuing an injunction of indefinite length preventing
21 him from working for a direct competitor of his former employer because “harm to the
22 plaintiff cannot be avoided simply by the former employee's intention not to disclose
23 confidential information, or even by his scrupulous efforts to avoid disclosure.”);
24 *Superior Consultant Co. v. Bailey*, No. 00-CV-73439, 2000 WL 1279161, at *12 (E.D.
25 Mich. Aug. 22, 2000) (applying Michigan law) (issuing an injunction preventing
26 competition based on “threatened” disclosure for a term co-extensive with the non-
27 competition agreement, and stating that it would be possible to issue an even longer
28 injunction had the employee “flouted the terms” of that agreement.”); *CBM*
29 *Geosolutions, Inc. v. Gas Sensing Tech. Corp.*, 215 P.3d 1054, 1060 (Wyo. 2009) (while
30 not mentioning inevitable-disclosure doctrine by name, upholding a preliminary
31 injunction against former employees who signed non-competition agreements, preventing
32 them from working for a newly-formed competitor to their former employer).

33
34 Finally, three jurisdictions reject the inevitable-disclosure doctrine entirely. See
35 *Whyte v. Schlage Lock Co.*, 125 Cal. Rptr. 2d 277, 292 (Cal. Ct. App. 2002) (rejecting
36 the inevitable-disclosure doctrine by holding it contrary to California public policy
37 because it results in a de facto covenant not to compete rather than serving as an
38 injunction prohibiting the disclosure of trade secrets); *LeJeune v. Coin Acceptors, Inc.*,
39 849 A.2d 451, 471 (Md. 2004) (rejecting the inevitable-disclosure doctrine because it
40 improperly serves as an ex post facto covenant not to compete even though the former
41 employer chose not to negotiate a restrictive covenant with the employee); *Gov’t Tech.*
42 *Servs., Inc. v. IntelliSys Tech. Corp.*, 51 Va. Cir. 55 (1999) (stating, without further
43 explanation, that “Virginia does not recognize the inevitable disclosure doctrine.”)

44
45 Illustration 1 is based on the facts of *Bridgestone/Firestone Inc. v. Lockhart*, 5 F.
46 Supp. 2d 667 (S. Ind. 1998) (applying Indiana law). In that case, the court denied an

1 injunction because the new employer took precautions to prevent disclosure and because
2 there was no evidence of actual or threatened misappropriation. *Id.* at 682.

3
4 Illustration 2 is based loosely on the facts of *Standard Brands, Inc. v. Zumpe*, 264
5 F. Supp. 254 (E.D. La. 1967) (applying Louisiana law). In that case, the court found that
6 disclosure was not inevitable and thus refused to issue an injunction preventing work for
7 a competitor. However, the court stated in dicta that an injunction against disclosure
8 might issue if the employee in question threatened or intended to use confidential
9 information belonging to his former employer. *Id.* at 267–71.

10
11 Illustration 3 is based on *PepsiCo, Inc. v. Redmond*, 54 F.3d 1262, 1269–71 (7th
12 Cir. 1995), where the court, applying Illinois law, affirmed the injunctive relief granted to
13 PepsiCo, barring a former executive from working at Quaker’s Gatorade division, despite
14 not having signed a noncompetition agreement with PepsiCo. See *id.* But see *LeJeune v.*
15 *Coin Acceptors, Inc.*, 849 A.2d 451, 470–471 (Md. 2004) (discussing cases in which
16 inevitable disclosure has been raised and declining to adopt the theory).

17
18 Illustration 4 is based on *FMC Corp. v. Varco International, Inc.*, 677 F.2d 500
19 (5th Cir. 1980) (applying Texas law), where the court, applying Texas law, enjoined an
20 engineer who had signed only a non-disclosure agreement from working for a direct
21 competitor of his former employer. The competitor operated primarily as a copier of the
22 former employer’s products, but could not manage to copy a highly profitable product
23 developed at great expense. *Id.* at 501. The competitor then hired the former engineer
24 for his “precise competitive background.” *Id.* The former engineer was to supervise the
25 creation of a competing product, but was enjoined from engaging in such work because
26 of the “inherent threat” that he would disclose trade secrets in doing so, despite any
27 conscious efforts to avoid disclosure. *Id.* at 505.

28
29 Courts also vary in their willingness to use “inevitable discovery” reasoning as a
30 basis for issuing an injunction to enforce an otherwise reasonable non-competition
31 covenant. Decisions granting an injunction include *Strata Mktg. Inc. v. Murphy*, 740
32 N.E.2d 1166, 1178 (Ill. App. Ct. 2000) (recognizing the inevitable-disclosure doctrine
33 under Illinois law); *Uncle B’s Bakery, Inc. v. O’Rourke*, 920 F. Supp. 1405, 1433 n.17
34 (N.D. Iowa 1996) (applying Iowa law) (“The court recognizes that . . . courts will enjoin
35 employment with a competitor in order to protect a former employer from disclosure of
36 trade secrets where disclosure appears inevitable from the nature of the former
37 employee’s employment with the competitor.”); *IBM Corp. v. Papermaster*, No. 08-CV-
38 9078 (KMK), 2008 WL 4974508, at *7, 10 (S.D.N.Y. Nov. 21, 2008) (applying New
39 York law) (enjoining former IBM executive from heading the iPod/iPhone division at
40 Apple, even though there was no evidence that the employee had actually
41 misappropriated any confidential information, or that he had “intentionally acted
42 dishonorably,” because there was nonetheless a high likelihood of an “inadvertent
43 disclosure” of trade secrets.); *Merck & Co. v. Lyon*, 941 F. Supp. 1443, 1459–60
44 (M.D.N.C. 1996) (applying North Carolina law) (citing factors that North Carolina courts
45 look for in applying their own version of inevitable disclosure but recognizing that
46 employment by a competitor, without more, is insufficient for an injunction); *FMC Corp.*

1 v. Varco Int'l, 677 F.2d 500, 505 (5th Cir. 1982) (applying Texas law) (injunction against
2 working for a competitor issued to prevent the new employer from “placing or
3 maintaining him in a position that posed inherent threat of disclosure or use of company’s
4 trade secrets.”).

5
6 Other courts have been more cautious and have found that the policy of employee
7 mobility outweighs the need to protect trade secrets. See *Whyte v. Schlage Lock Co.*,
8 125 Cal. Rptr. 2d 277, 292 (Cal. Ct. App. 2002) (applying California law) (rejecting the
9 theory because it results in “an injunction restricting employment”); *Bayer Corp. v.*
10 *Roche Molecular Sys., Inc.*, 72 F. Supp. 2d 1111, 1112 (N.D. Cal. 1999) (applying
11 California law) (stressing California’s policy of employee mobility); *EarthWeb, Inc. v.*
12 *Schlack*, 71 F. Supp. 2d 299, 310 (S.D.N.Y. 1999) (applying New York law) (“Absent
13 evidence of actual misappropriation by an employee, the doctrine should be applied in
14 only the rarest of cases.”).

15 16 17 **§ 8.06. Enforcement of Restrictive Covenant in Employment Agreement**

18
19 **Except to the extent other law or applicable professional rules provide**
20 **otherwise, a covenant in an agreement between the employer and the former**
21 **employee restricting a former employee’s activities is enforceable if it is reasonably**
22 **tailored in scope, geography, and time to further a protectable interest of the**
23 **employer, as defined in § 8.07, unless:**

24 **(a) the employer discharges the employee on a basis other than cause that**
25 **makes enforcement of the covenant inequitable;**

26 **(b) the employer acted in bad faith in requiring or invoking the covenant;**

27
28 **(c) the employer materially breached the underlying employment agreement;**

29
30 **or**

31
32 **(d) in the geographic region covered by the restriction a great public need for**
33 **the special skills and services of the former employee outweighs any**
34 **legitimate interest of the employer in enforcing the covenant.**

35 **Comment:**

1 *a. Purpose.* Contractual restrictions on former employees’ working activities
2 (often termed “restrictive covenants”) involve several competing interests. On the one
3 hand, these provisions enable employers to protect customer relationships, investments in
4 employee reputation, and other legitimate interests under § 8.07. On the other hand, they
5 inhibit the freedom of employees to leave their employer and move to other employment
6 where they may be more productive; and they frustrate the public interest in promoting
7 competition. Courts balance these competing interests by enforcing restrictive covenants
8 only to the extent necessary to protect the legitimate employer interests identified in §
9 8.07. Some states prohibit by statute the enforcement of non-compete clauses in most
10 employment contexts not related to the sale of a business, but these states generally will
11 enforce restrictive covenants more limited than non-competition clauses that are
12 reasonably tailored to protect a legitimate interest of the employer.

13

14 *b. Types of restrictive covenants.* The rule of this Section applies to many
15 different types of postemployment restraints. So long as a restrictive covenant has the
16 effect of substantially discouraging employees from competing with their former
17 employer, whether completely or in only a specific manner, the agreement must meet the
18 requirements of this Section to be enforceable. In addition to covenants not to compete,
19 this Section also covers covenants that, rather than forbidding competition entirely,
20 provide that certain competitive activity will require specified payments or other
21 consequences.

22 This Section also applies to covenants that prohibit an employee or former
23 employee from soliciting customers or coworkers with whom the employee came in

1 contact while employed. It also reaches clauses preventing employees from using or
2 disclosing confidential information.

3 Different types of restrictive covenants may be necessary to protect different
4 types of employer interest, and courts should examine the asserted business justification
5 for each specific limitation. The same general inquiry, however, applies to all restrictive
6 covenants—namely, a court should looking into whether the employer has a protectable
7 interest, and whether the restrictive covenant is reasonably tailored to furthering that
8 interest.

9

10 **Illustrations:**

11 1. Salesperson E interacts with the customers of employer X and has
12 developed good relationships with them, sometimes using the expense budget
13 provided by X for this purpose. E agrees that, for one year after leaving X's
14 employ, E will not solicit those customers of X with whom E dealt while working
15 for X. E quits and immediately begins soliciting those customers for a
16 competitor. X has a legitimate interest in enforcing the agreement for a
17 reasonable period of time in order to protect its customer relationships.

18 2. Employee E agrees to pay employer X a sum of money if E competes
19 with X after leaving X's employ. E quits and begins competing with X. In the
20 new position, E does not use X's confidential information, customer lists, or X's
21 investment in E's reputation. X has no protectable interest (as that term is defined
22 in § 8.07) in preventing E from competing. Thus, even though X does not want a

1 good employee like E competing against it, E's agreement to pay X is
2 unenforceable.

3
4 *c. Reasonably tailored.* A court will enforce a restrictive covenant only if it is
5 reasonably tailored to the protection of a legitimate interest of the employer as set forth in
6 § 8.07. The covenant should be no more restrictive in duration, scope of activities, or
7 geography than necessary to protect the legitimate interest at stake. Whether limitations
8 are reasonable will vary depending on the circumstances of the case, including industry
9 practices and the nature of the interest justifying the restrictive covenant. When
10 confronted with a contractual restriction on all competition—even if the restriction
11 otherwise is of reasonable duration, scope, and geographical extent—courts will inquire
12 whether the employer's legitimate interest could not be equally well served by a narrower
13 restriction. For example, could the employer's interest in protecting customer
14 relationships be satisfied by a reasonable no-solicitation clause? In some circumstances,
15 however, such as where it would be very difficult for an employer to determine whether a
16 former employee is soliciting its customers, a nonsolicitation clause may not adequately
17 protect the employer's legitimate interests. Regardless of the nature of an employer's
18 interest, the employer may not restrict employees from working in any market in which
19 the employer does not do business.

20 The inquiry into the reasonableness of geographic, temporal, and scope-of-
21 business limitations in restrictive covenants is context-sensitive and depends heavily on
22 the nature of the legitimate interests at stake. Identical limitations will be reasonable to
23 protect some interests but not others. The provision of compensation to the former

1 employee during the term of the restrictive covenant (sometimes called “garden leave”)
2 may be a factor in favor of finding it reasonable.

3

4 **Illustrations:**

5 3. Same facts as in Illustration 1, except that E also agrees to refrain from
6 all competition with X for the one-year period. E solicits no business from
7 customers with whom E had contact while employed by X, but otherwise
8 competes against X. Because a nonsolicitation covenant would have been
9 sufficient to address X’s legitimate interests, the noncompetition covenant is
10 unenforceable.

11 4. Employee E agrees not to compete with employer X, a website-
12 developing business, for one year after the termination of their employment
13 relationship. Within a year of quitting, E goes to work for a competitor of X.
14 Because of the nature of the website industry, X’s confidential strategic business
15 plans, which E knows, are obsolete within six months. The covenant is not
16 reasonably tailored to protect X’s strategic business plan and thus is not
17 enforceable for a full year.

18 5. Salesperson E agrees not to solicit or do business with any customer of
19 employer X until 30 days after X has stopped serving that customer. This
20 agreement is not reasonably tailored to protect X’s customer relationships because
21 it effectively prevents E from soliciting customers for an indefinite period. A
22 reasonable covenant would prevent E from soliciting or doing business with X’s

1 customers for only so long as needed to enable X to attempt to establish
2 relationships with the customers with whom E dealt.

3 6. Salesperson E agrees not to compete with employer X in any state in
4 which X services its customers. X services customers in 36 states, but E dealt
5 with customers in only three states while working for X. The noncompetition
6 agreement is not reasonably tailored to protect X from losing customer
7 relationships E developed with X's assistance because a narrower agreement—
8 e.g., one only prohibiting E from soliciting the customers whom E had serviced
9 while working for X—would be adequate to protect X's interest.

10 7. E, a vice president of computer-data-storage company X, agrees not to
11 compete with X anywhere in the world for six months. Both X and its
12 competitors serve customers worldwide, and E has had extensive access to X's
13 confidential information that applies worldwide. Because E's confidential
14 information has worldwide utility, the worldwide restriction is reasonably tailored
15 to further a protectable interest of X.

16

17 *d. Relation to § 8.03.* The scope of agreements enforceable under this Section is
18 significantly broader than the default rule stated in § 8.03, which prohibits the use or
19 disclosure of confidential information. The range of protectable interests that might
20 support a reasonable restrictive covenant (as set forth in § 8.07) is not limited to the
21 employer's confidential information, but also includes its customer relationships and
22 employee-specific goodwill. Further, a restrictive covenant can do more than prohibit the

1 use or disclosure of confidential information; it can, in appropriate cases, proscribe all
2 competition.

3

4 **Illustrations:**

5 8. X employs insurance broker E to manage a substantial number of
6 accounts for X. X does not obtain a noncompetition agreement from E. E
7 subsequently quits to work for a competitor of X, and then begins soliciting X's
8 customers. X has no claim against E under § 8.03; X also has no claim under §
9 8.06 because X did not obtain a restrictive covenant.

10 9. Same facts as in Illustration 8, except that, upon hire, E agreed to a non-
11 compete covenant reasonably tailored to protect X's customer relationships. The
12 agreement is enforceable under § 8.06.

13 10. In the course of employment, stockbroker E learned confidential
14 information of X, his employer. E quits working for X and begins working for Y,
15 a competitor of X.

16 (a) E and X have no restrictive covenants. Under § 8.03, E may not use or
17 disclose X's confidential information; under § 8.05, E may work for Y in
18 competition with X.

19 (b) E agreed to a restrictive covenant with X, promising not to compete
20 against X for six months after leaving X's employ. Assuming this to be a
21 reasonable length of time, not only may E not use or disclose X's
22 confidential information, but E also may not work for Y for six months.

23

1 *e. Restrictive covenants agreed to after the start of the employment relationship.*

2 Continuing employment of an at-will employee is sufficient consideration to support the
3 enforcement of an otherwise valid restrictive covenant. Thus, parties may enter into
4 enforceable restrictive covenants after the beginning of an employment relationship.

5

6 **Illustrations:**

7 11. E, an at-will employee of X, begins working for X with no restrictive
8 covenant. Two years later, X requires E to enter into a reasonable non-
9 competition agreement, after which X shares competitively sensitive confidential
10 information with E. The agreement is enforceable.

11

12 *f. Terminated employees.* Reasonable restrictive covenants are generally
13 enforceable against employees who have been discharged for cause. An opposite rule
14 would have the perverse consequence for employers of providing an incentive for an
15 employee who wants relief from the restrictions of a reasonable covenant to perform
16 badly and thus trigger a for-cause termination.

17 In contrast, restrictive covenants (beyond the obligation inhering in the duty of
18 loyalty) are generally unenforceable against employees who are terminated without cause
19 or who quit employment for cause attributable to the employer. (Within this Section,
20 “cause” is defined in the same way as cause for termination of fixed-term agreements in §
21 2.04(a) of this Restatement (Tentative Draft No. 2, 2009).) An opposite rule would have
22 the perverse consequence for employees of providing an incentive to an employer to
23 advance its business interests by choosing to terminate rather than retain an employee
24 who is performing satisfactorily and by then restrict the discharged employee’s ability to

1 secure new employment. By the same consideration, a restrictive covenant should not be
2 enforced where the employer acts in bad faith, such as by securing the employee's
3 execution of the covenant despite having planned to discharge the employee soon after
4 obtaining the employee's signature.

5

6 **Illustrations:**

7 12. X employs E as a chiropractor. E who has access to X's patient files
8 and other confidential business information, signs a reasonable restrictive
9 covenant as part of an employment agreement with X. The employment
10 agreement provides that E can be terminated without notice if the termination is
11 for cause. E is persistently late to work, despite counseling, and his lateness has a
12 substantial negative impact on patients and clinic operations. X fires E for cause
13 based on E's persistent lateness. X may enforce the restrictive covenant against E.

14 13. X's employee E, who has access to X's confidential information, signs
15 a reasonable restrictive covenant as part of an employment agreement with X.
16 The covenant states that E will forfeit special severance benefits if E competes
17 with X within one year of leaving X's employ. X fires E without cause, and E
18 then begins working for a competitor. X may not enforce the covenant against E.

19 14. Same facts as Illustration 13, except that E quits because X, without
20 cause, has demoted E and deprived E of all customary staff assistance. Because E
21 quit for reasons attributable to the employer, X may not enforce the covenant
22 against E.

23

1 *g. Employer's material breach of employment agreement.* If the employer
2 materially breaches the employment agreement, it cannot enforce an otherwise valid
3 restrictive covenant contained in the agreement.

4

5 **Illustration:**

6 15. Employee E signs a restrictive covenant as part of a two-year
7 employment agreement with employer X. The covenant states that E will not
8 compete with X for one year after the termination of E's employment. X
9 materially breaches the employment agreement by failing to pay E for several
10 weeks. X may not enforce the restrictive covenant against E. (This result would
11 still obtain even if E quit in these circumstances because quitting would be in
12 response to X's material breach of the employment agreement. See Illustration
13 14.)

14

15 *h. Professionals.* Laws and regulations governing various professions may limit
16 the enforceability of some restrictive covenants. For example, a covenant not to compete
17 is generally not enforceable against an attorney because the rules governing the legal
18 profession provide that the right of clients to have an attorney of their choice outweighs
19 the protectable interests of employers under § 8.07. Enforcement of reasonable
20 restrictive covenants against doctors, accountants, lawyers, or other professionals may
21 vary by jurisdiction not only because the rules regulating those professions may vary in
22 different jurisdictions but because the availability of such professionals to serve public
23 needs may also vary by area. (See Comment *i*.)

1 and training an employee who has served an employer for a period of less than two years;
2 (d) Executive and management personnel and officers and employees who constitute
3 professional staff to executive and management personnel.”).

4 *b. Types of restrictive covenants subject to § 8.06.* This Section applies to all
5 types of restrictive covenants ancillary to an employment contract. Thus, a covenant that
6 specifies forfeiture of some financial benefit as a consequence of competition is subject
7 to the requirements listed in this Section. See *Anniston Urologic Assocs., PC v. Kline*,
8 689 So. 2d 54, 57–58 (Ala. 1997) (invalidating a covenant that devalued an employee’s
9 stock if he competed after employment); *Pierce v. Hand, Arendall, Bedsole, Greaves &*
10 *Johnston*, 678 So. 2d 765, 769–70 (Ala. 1996) (same); *Cray v. Nationwide Mut. Ins. Co.*,
11 136 F. Supp. 2d 171, 179–80 (W.D.N.Y. 2001) (applying New York law) (evaluating a
12 contract that specified the forfeiture of deferred compensation in the event of
13 competition); *Pettingell v. Morrison, Mahoney & Miller*, 687 N.E.2d 1237, 1239 (Mass.
14 1997) (noting that the “strong majority rule in this country is that a court will not give
15 effect to an agreement that greatly penalizes a lawyer for competing with a former law
16 firm, at least where the benefits that would be forfeited accrued before the lawyer left the
17 firm.”). A covenant that mandates the payment of a monetary penalty in the event of
18 competition must meet the requirements of this Section as well. See *Cherry, Bekaert &*
19 *Holland v. Brown*, 582 So. 2d 502, 505–06 (Ala. 1991) (invalidating a covenant that
20 specified the payment of 150 percent of the employee’s past year’s billings in the event
21 of competition); *BDO Seidman v. Hirshberg*, 712 N.E.2d 1220, 1222 (N.Y. 1999)
22 (evaluating agreement that requires the departing employee “to pay ‘for the loss and
23 damages’ sustained by [the former employer] in losing any of its clients to [the
24 employee] within 18 months after his departure, an amount equivalent to 1½ times the
25 last annual billing for any such client who became [his] client”); *Leon M. Reimer &*
26 *Co. v. Cipolla*, 929 F. Supp. 154, 159–60 (S.D.N.Y. 1996) (applying New York law)
27 (invalidating a covenant that specified the payment of 150 percent of the employee’s past
28 year’s billings in the event of competition). See also *Falmouth Ob-Gyn Assocs. v.*
29 *Abisla*, 629 N.E.2d 291, 292–93 (Mass. 1994) (invalidating a covenant that contemplated
30 employee payment of \$250,000 to employer in the event of competition); *MetroWest*
31 *Med. Group, Inc. v. Mount Auburn Hosp.*, No. 94-4767, 1994 WL 902895, at *4 (Mass.
32 Super. Ct. Dec. 14, 1994) (invalidating a covenant that required a group of employees to
33 assume \$2,500,000 in debt if they competed); *Philip H. Hunke, D.D.S., M.S.D., Inc. v.*
34 *Wilcox*, 815 S.W.2d 855, 856 (Tex. App. 1991) (invalidating a covenant that required an
35 employee to pay his former employer \$75,000 if he subsequently competed).

36
37 Moreover, § 8.06 also applies to more limited restrictive covenants such as those
38 forbidding solicitation of specific customers or those forbidding disclosure of an
39 employer’s information. See *Picker Int’l, Inc. v. Parten*, 935 F.2d 257, 261–64 (11th Cir.
40 1991) (applying Alabama law) (upholding a nonsolicitation clause on the basis of
41 customer relationships but invalidating a nondisclosure clause because the employee was
42 not privy to any valuable information); *McFarland v. Schneider*, No. Civ.A. 96-7097,
43 1998 WL 136133, at *40–48 (Mass. Super. Ct. Feb. 17, 1998) (upholding nonsolicitation
44 agreement and a covenant not to compete); *Rehmann, Robson & Co. v. McMahan*, 466
45 N.W.2d 325, 327–28 (Mich. Ct. App. 1991) (evaluating the reasonableness of
46 nonsolicitation provision that prohibited former employee from contacting, soliciting, or

1 offering to perform services for clients of the former employer for a period of two years
2 following termination); *Empire Farm Credit ACA v. Bailey*, 657 N.Y.S.2d 211, 212
3 (N.Y. App. Div. 1997) (invalidating a nonsolicitation agreement because the employer
4 had no legitimate interest in protecting its readily ascertainable customer list).

5
6 Illustrations 1 and 3 both are drawn from *McFarland v. Schneider*, No. Civ.A. 96-
7 7097, 1998 WL 136133, at *41–42 (Mass. Super. Ct. Feb. 17 1998). In that case, the
8 employee agreed to both a covenant not to compete and a covenant not to solicit clients
9 with whom he had fostered a relationship at his employer’s expense. See *id.* The court
10 upheld the nonsolicitation covenant but invalidated the covenant not to compete, finding
11 it unreasonable insofar as the employer had a legitimate interest only in protecting its
12 customer relationships. See *id.* See also *Fortune Personnel Consultants, Inc. v.*
13 *Hagopian*, No. Civ. A. 97-24440-A, 1997 WL 796494, at *3 (Mass. Super. Ct. Dec. 30,
14 1997) (granting limited injunction and finding that “the portion of the covenant not to
15 compete which prevents [the employee] from contacting any client or candidate whose
16 account she handled, . . . is reasonable in scope and is reasonably drafted to protect the
17 [former employer’s] goodwill.”); *DataType Int’l, Inc. v. Puzia*, 797 F. Supp. 274, 285
18 (S.D.N.Y. 1992) (applying New York law) (finding that former employer had a
19 protectable interest in the personal relationships the employee had developed with
20 particular customers on its behalf and prohibiting the employee from soliciting those
21 specific individuals for a period of two years). Similarly, in *Zep Mfg. Co. v. Harthcock*,
22 824 S.W.2d 654, 660–63 (Tex. App. 1992), the court upheld a nondisclosure covenant
23 but invalidated a covenant not to compete because it contained no geographical
24 limitations.

25
26 Illustration 2 is based loosely on *Leon M. Reimer & Co., P.C. v. Cipolla*, 929 F.
27 Supp. 154, 158–60 (S.D.N.Y. 1996) (applying New York law). That case gives an
28 example a compensation-for-competition clause subject to requirements of this Section
29 that overprotects the former employer’s interests and unreasonably restricts client choice
30 in professional services. See also *Falmouth Ob-Gyn Assoc. v. Abisla*, 629 N.E.2d 291,
31 294 (Mass. 1994) (citing cases from Arkansas, Iowa, Maryland, and Georgia and
32 concluding that compensation-for-competition agreements should be analyzed the same
33 as competition restriction covenants).

34
35 Courts often claim to evaluate whether a restrictive covenant is an undue burden
36 on the employee who agreed to it. However, courts seldom, if ever, invalidate covenants
37 solely on this ground. See, e.g., *Marcam Corp. v. Orchard*, 885 F. Supp. 294, 297 (D.
38 Mass. 1995) (applying Massachusetts law) (holding that a covenant not to compete in the
39 entire United States did not work an undue burden on the employee because he could
40 move to London or work in the United States for a noncompetitor). Generally, courts
41 find that a restrictive covenant is an undue burden only when it fails to meet the
42 requirements articulated in this Section. See, e.g., *Chavers v. Copy Prods., Inc.*, 519 So.
43 2d 942, 945 (Ala. 1988) (holding that a covenant unnecessary to protect any legitimate
44 interest also worked an “undue hardship”). At most, it seems that the undue-burden
45 requirement is a tack-on rationale courts use only when a restrictive covenant is
46 otherwise invalid.

1
2 *c. Reasonably tailored.* The inquiry into the reasonableness of geographic and
3 temporal limitations on restrictive covenants is context-sensitive and depends heavily on
4 the nature of the legitimate interest at stake. Identical temporal and geographic restraints
5 will be reasonable to protect some interests but not others.
6

7 Illustration 4 is derived from *EarthWeb, Inc. v. Schlack*, 71 F. Supp. 2d 299, 313
8 (S.D.N.Y. 1999) (applying New York law), and shows how even relatively short
9 restrictions might be invalidated depending on an employer's industry and the nature of
10 its legitimate interest. In that case, the employer's "strategic content planning" was soon
11 obsolete and thus did not justify restraining the employee for even a single year. *Id.*
12

13 Illustration 5 is based on *Gen. Devices, Inc. v. Bacon*, 888 S.W.2d 497, 504 (Tex.
14 App. 1994), and is an example of a covenant that is temporally unreasonable. The
15 covenant in that case was designed to last indefinitely; as long as the employer continued
16 servicing its clients, the employee could not compete with it. See *id.* at 503–04. See also
17 *Cost Mgmt. Incentives, Inc. v. London-Osborne*, No. CV020463081, 2002 WL
18 31886860, at *6 (Conn. Super. Ct. Dec. 5, 2002) (holding a two-year nonsolicitation
19 agreement in the biotechnology employee placement industry to be unreasonably long);
20 *Delli-Gatti v. Mansfield*, 477 S.E.2d 134, 137 (Ga. Ct. App. 1996) (holding that a
21 noncompete agreement in a doctor's employment contract limited to one county and a
22 length of twelve months was reasonable).
23

24 Illustration 6 comes from *Hartman v. W.H. Odell and Assocs., Inc.*, 450 S.E.2d
25 912, 918–20 (N.C. Ct. App. 1994). The covenant at issue in *Hartman* was clearly
26 unnecessary to protect the employer's legitimate interests in the customer relationships its
27 employee had developed while employed. *Hartman* nicely illustrates how the only
28 customer relationships that an employer may legitimately protect by contract are those
29 specific to the employee it seeks to restrain. See *id.* at 917–18. When it attempts to
30 protect its other customer relationships, the employer risks having its covenant
31 invalidated. See also *DataType Int'l, Inc. v. Puzia*, 797 F. Supp. 274, 285–86 (S.D.N.Y.
32 1992) (applying New York law) (upholding a nonsolicitation clause but declining to
33 enforce a covenant not to compete, protecting only an employer's interest in those
34 customer relationships it had fostered in its employee); *Fortune Personnel Consultants,*
35 *Inc. v. Hagopian*, No. Civ. A. 97-24440-A, 1997 WL 796494, at *3 (Mass. Super. Ct.
36 Dec. 30, 1997) (same); *Farr Assocs. v. Baskin*, 530 S.E.2d 878, 882 (N.C. Ct. App. 2000)
37 (invalidating a clause covering all worldwide clients and declaring a reasonable clause
38 would cover only those clients with whom the employee actually dealt).
39

40 Illustration 7, based on the facts of *EMC Corp. v. Allen*, No. 975972B, 1997 WL
41 1366836, at *1 (Mass. Super. Ct. Dec. 15, 1997). That case is an example of a covenant
42 of unlimited geographic scope that is reasonably necessary to protect an employer's
43 legitimate interests. See also *Learn2.com, Inc. v. Bell*, 2000 U.S. Dist. LEXIS 14283, at
44 *29–31 (N.D. Tex. July 20, 2000) (applying Texas Law) (holding a geographically
45 unlimited covenant not to compete valid because the employee's physical location does
46 not matter for competition in the software industry); *Superior Consulting Co. v. Walling*,

1 851 F. Supp. 839, 847 (E.D. Mich. 1994) (applying Michigan law) (holding a
2 noncompetition agreement that was unlimited in geographic scope not to be unreasonable
3 where the former employer had worldwide business interests); *Sigma Chem. Co. v.*
4 *Harris*, 586 F. Supp. 704, 710 (E.D. Mo. 1984) (applying Missouri law) (finding
5 worldwide application of restrictive covenant reasonable where the employer operated on
6 a worldwide basis).

7
8 Provision of a “garden leave” is not required, but helpful in obtaining
9 enforcement of an otherwise reasonable restrictive covenant. See, e.g., *Pontone v. York*
10 *Group, Inc.*, No. 08 Civ. 6314(WHP), 2008 WL 4539488, at *4 (S.D.N.Y. Oct. 8, 2008)
11 (applying New York law) (stating that “[a] factor weighing in favor of reasonableness is
12 whether the individual received compensation during the time he was restrained from
13 competing.”) See also *Bradford v. New York Times Co.*, 501 F.2d 51, 58 (noting that
14 payments during the restricted period support the reasonableness of a non-competition
15 agreement).

16
17 *d. Relation to §§ 8.03 and 8.04.* Even absent a contractual clause, an employee
18 cannot disclose or use confidential information (§ 8.03) and cannot compete while an
19 employee (§ 8.04). This Section (§ 8.06) recognizes that, with an appropriate contractual
20 clause, the employer can protect interests other than confidential information and can
21 restrict competition by the employee after the employment relationship ends.

22
23 Compare Illustration 8, taken from *Arnold K. Davis & Co. v. Ludemann*, 559
24 N.Y.S.2d 240, 241 (N.Y. App. Div. 1990), with Illustration 9, derived from *Stiepleman*
25 *Coverage Corp. v. Raifman*, 685 N.Y.S.2d 283, 284 (N.Y. App. Div. 1999). The facts of
26 the two cases these Illustrations were drawn from are nearly identical, with the exception
27 of the restrictive covenant signed in Stiepleman. See 685 N.Y.S.2d at 284. Taken
28 together, they nicely illustrate how employers can contractually protect customer
29 relationships irrespective of whether information about those relationships is confidential
30 information within the meaning of § 8.02. See also *Booth v. WPMI Television Co.*, 533
31 So. 2d 209, 210–211 (Ala. 1988) (holding that customer relationships are legitimate
32 interests of employers capable of supporting restrictive covenants); *James S. Kemper &*
33 *Co. Southeast, Inc. v. Cox & Assocs., Inc.*, 434 So. 2d 1380, 1384 (Ala. 1983) (same);
34 *Bowne of Boston, Inc. v. Levine*, No. Civ.A. 97-5789A, 1997 WL 781444, at *4–5
35 (Mass. Super. Ct. Nov. 25, 1997) (upholding a restrictive covenant protecting customer
36 relationships); *Lowry Computer Prods., Inc. v. Head*, 984 F. Supp. 1111, 1116–17 (E.D.
37 Mich. 1997) (applying Michigan law) (same); *BDO Seidman v. Hirshberg*, 712 N.E.2d
38 1220, 1226 (N.Y. 1999) (upholding restrictive covenant but limiting scope to those
39 clients with whom the former employee had developed relationships through his
40 performance of services); *Contempo Commc’ns, Inc. v. MJM Creative Servs., Inc.*, 582
41 N.Y.S.2d 667, 669 (N.Y. App. Div. 1992) (holding explicitly that customer relationships
42 are protectable interests sufficient to support a restrictive covenant but are not trade
43 secrets entitled to common-law protection); *Car Wash Sys., Inc. v. Brigance*, 856 S.W.2d
44 853, 858 (Tex. App. 1993) (holding that customer relations will support a restrictive
45 covenant). This difference in scope recognizes the unique role that employees play in
46 fostering customer relationships and goodwill and allows the parties contractually to

1 divide the value that the joint efforts of the employer and employee create. Because it is
2 often difficult for an employer to monitor an employee's efforts to develop goodwill, the
3 parties might choose to allocate such goodwill to the employee in order to properly
4 incentivize employee investment in the creation of goodwill and customer relationships.
5 See Gillian L.L. Lester & Eric L. Talley, Trade Secrets and Mutual Investments
6 (Georgetown Law and Economics Research, Paper No. 246406, 2000), available at
7 <http://ssrn.com/abstract=246406> (arguing that an optimal trade-secret law “would (1)
8 expressly consider the parties' relative skills at making value-enhancing investments
9 rather than the mere existence of a valuable informational asset; (2) tend to favor ‘weak’
10 entitlements (such as fractional property rights and/or liability rules) rather than
11 undivided property rules; and (3) frequently have a dynamic structure that progressively
12 favors employees during the lifetime of the disputed asset.”). The default rule in § 8.03
13 presumes that the optimal incentives arise when employees are allowed to keep customer
14 relationships and goodwill after the termination of an employment arrangement but that
15 the opposite is true for other forms of valuable information created by the employer.
16

17 Illustrations 10 and 11 show the broader remedial scope available under this
18 Section as compared with § 8.03. Illustration 10 is drawn from *Garvin GuyButler Corp.*
19 *v. Cowen & Co.*, 588 N.Y.S.2d 56, 59–60 (N.Y. Sup. Ct. 1992), and Illustration 11 is
20 loosely based on *Maltby v. Harlow Meyer Savage, Inc.*, 633 N.Y.S.2d 926, 930 (N.Y.
21 Sup. Ct. 1995). In *Garvin*, a stockbroker took his employer's compilation of customer
22 “off dates”—i.e., when customer repurchase or rollover was due—as well as a history of
23 customer buying patterns and contact information. *Garvin*, 588 N.Y.S.2d at 59–60.
24 When he used the information to compete with his former employer, the court enjoined
25 him from using the valuable information but, importantly, did not prevent him from
26 competing. See *id.* In contrast, the court in *Maltby* enjoined the stockbroker, who was
27 subject to a restrictive covenant, from working for a competitor of his former employer
28 regardless of whether the stockbroker was making use of the employer's valuable
29 information or customer relationships. See 633 N.Y.S.2d at 930. See also *Cent.*
30 *Bancshares, Inc. v. Puckett*, 584 So. 2d 829, 831 (Ala. 1991) (enjoining bank executives
31 subject to a restrictive covenant from working in the banking industry in the state of
32 Alabama for two years); *U.S. Reinsurance Corp. v. Humphreys*, 618 N.Y.S.2d 270, 272–
33 73 (N.Y. App. Div. 1994) (enjoining an employee from using or disclosing a valuable
34 reinsurance scheme created by his employer but not from competing); *DoubleClick Inc.*
35 *v. Henderson*, No. 11614/97, 1997 WL 731413, at *8 (N.Y. Sup. Ct. Nov. 7, 1997)
36 (enjoining employees from making use of or disclosing valuable information but
37 explicitly permitting employees to work for competitors).
38

39 *e. Restrictive covenants agreed to after the start of the employment relationship.*
40 In most states, a promise of continued indefinite employment is sufficient consideration
41 for a restrictive covenant that the employee signed after the inception of the employment
42 arrangement. See *Clark v. Liberty Nat'l Life Ins. Co.*, 592 So. 2d 564, 567 (Ala. 1992)
43 (enforcing noncompetition clause signed four years after initial employment and holding
44 that the “sufficient and valid consideration” was the employee's “continued employment .
45 . . beyond [the signing date]”); *Olin Water Servs. v. Midland Research Labs., Inc.*, 596 F.
46 Supp. 412, 415 (E.D. Ark. 1984) (applying Arkansas and Kansas law) (finding that the

1 agreements in question could be upheld under both Arkansas or Kansas law and that “the
2 continued employment of [the employees] was sufficient consideration to support the
3 agreements not to compete signed by them” but not indicating whether the employees
4 signed at the time of or after initial employment); *Veliz v. Cintas Corp.*, No. C 03-1180
5 SBA, 2004 WL 2452851, at *11 (N.D. Cal. Apr. 5, 2004) (stating that “[w]here a party is
6 offered employment or chooses to remain employed, there is legal consideration.”);
7 *Research & Trading Corp. v. Powell*, 468 A.2d 1301, 1303, 1305 (Del. Ch. 1983)
8 (holding “there was sufficient consideration at the time of the signing of the covenant to
9 support an enforceable restrictive covenant” when at-will employee signed the restrictive
10 covenant at least one month after he accepted promotion and was told he would lose the
11 position if he did not sign); *Coastal Unilube v. Smith*, 598 So. 2d 200, 201 (Fla. Dist. Ct.
12 App. 1992) (upholding enforceability of noncompetition clause signed one week after
13 initial employment, where employee had moved his family to take the job and the
14 noncompetition clause had not been discussed earlier, declaring that ““where employment
15 was a continuing contract terminable at the will of either [the] employer or employee, the
16 Florida Courts have held continued employment constitutes adequate consideration to
17 support a contract.”” (quoting *Wright & Seaton, Inc. v. Prescott*, 420 So. 2d 623, 628
18 (Fla. Dist. Ct. App. 1982))); *Ins. Assocs. Corp. v. Hansen*, 723 P.2d 190, 191 (Idaho Ct.
19 App. 1986) (enforcing noncompetition covenant signed two years after employment
20 began and eight months before the employee was fired, rejecting employee’s argument
21 that he “did not receive anything he did not already have before the agreement was
22 entered into” and instead holding “there was consideration for the agreement” in that “if
23 [the employee] had not signed the agreement, his employment would have been
24 terminated” and “that, upon executing the agreement, [the employee] did keep his job
25 ‘for an additional eight or nine months.’”); *Ackerman v. Kimball Int’l, Inc.*, 652 N.E.2d
26 507, 509 (Ind. 1995) (enforcing restrictive covenant signed by at-will employee in 1974,
27 nine years after initial hire and nineteen years before termination, holding that “the 1974
28 employment agreement was not unenforceable due to lack of consideration, both because
29 [the employee] received [the employer’s] promise to continue at-will employment and
30 because [the employee] ratified the 1974 employment agreement by executing the
31 termination agreement.”); *Moore Bus. Forms, Inc. v. Wilson*, 953 F. Supp. 1056, 1064
32 (N.D. Iowa 1996) (applying Iowa law) (enforcing noncompetition agreements repeatedly
33 signed after initial employment, holding that “[w]ith respect to the later-signed
34 employment agreements, the [employees’] continued employment after entering into the
35 agreements is sufficient consideration to support formation of the covenants not to
36 compete”); *Puritan-Bennett Corp. v. Richter*, 657 P.2d 589, 592 (Kan. Ct. App. 1983)
37 (upholding noncompetition clause signed on first day of work, which was a month after
38 the initial confirmed employment offer and after the employee sold his house and moved
39 from Wisconsin to Kansas, holding “that continued employment should not as a matter of
40 law be disregarded as consideration sufficient to uphold a covenant not to compete” and
41 noting that the employee “was given consistent promotions, increased responsibilities and
42 greater importance in company operations after signing the covenant not to compete” and
43 that “he had been advised that his continued employment was conditioned upon
44 execution of the hiring agreement when he signed it.”); *Cellular One v. Boyd*, 653 So. 2d
45 30, 34 (La. Ct. App. 1995) (“reject[ing employees’] argument that the noncompetition
46 agreement is unenforceable because of a lack of mutuality or insufficient cause” where

1 agreement was signed after the initial date of employment as a condition of continued
2 employment); *Wausau Mosinee Paper Corp. v. Magda*, 366 F. Supp. 2d 212, 220 (D. Me.
3 2005) (applying Maine law) (holding “that the execution of a written non-compete
4 agreement by a preexisting, at-will employee constitutes a unilateral promise that will
5 give rise to an enforceable contract where the employer continues to employ the at-will
6 employee for a period in excess of one year from the date of execution of the non-
7 compete agreement,” even when the employee moved from New Jersey to Maine and
8 began work without knowing about the required noncompetition clause); *Robert Half
9 Int’l, Inc. v. Van Steenis*, 784 F. Supp. 1263, 1273 (E.D. Mich. 1991) (applying Michigan
10 law) (stating that “continued employment constitutes sufficient consideration for the
11 [employee’s] execution of the restrictive covenants in the Employment Agreement
12 where, as here, the [employee’s] employment is otherwise ‘at will.’”); *Computer Sales
13 Int’l, Inc. v. Collins*, 723 S.W.2d 450, 452 (Mo. Ct. App. 1986) (“‘A continuance by
14 employee in the employment of employer where he is under no obligation to remain and
15 that continuance by the employer of the employment where continuance is not required
16 supplies adequate consideration for a secondary contract.’” (quoting *Reed, Roberts
17 Assocs., Inc. v. Bailenson*, 537 S.W.2d 238, 241 (Mo. Ct. App. 1976))); *Sec. Acceptance
18 Corp. v. Brown*, 106 N.W.2d 456, 462–63 (Neb. 1960), *aff’d on reh’g*, 107 N.W.2d 540
19 (Neb. 1961) (holding that an employee is estopped from challenging the sufficiency of
20 consideration supporting a postemployment noncompetition agreement where the
21 employee stayed with the employer for seven years after signing the covenant); *Camco,
22 Inc. v. Baker*, 936 P.2d 829, 832 (Nev. 1997) (declaring that “[t]oday we adopt the
23 majority rule which states that an at-will employee’s continued employment is sufficient
24 consideration for enforcing a non-competition agreement.”); *Smith, Batchelder & Rugg
25 v. Foster*, 406 A.2d 1310, 1312 (N.H. 1979) (stating that “[c]ontinued employment after
26 signing an employment contract constitutes consideration for a covenant not to compete
27 contained therein.”); *MAI Basic Four, Inc. v. Basis, Inc.*, 880 F.2d 286, 288 (10th Cir.
28 1989) (applying New Mexico law) (holding that continued employment is enough
29 consideration to support a restrictive covenant entered into after employment began);
30 *Campbell Soup Co. v. Desatnick*, 58 F. Supp. 2d 477, 492 (D.N.J. 1999) (applying New
31 Jersey law) (stating that “the continued employment of an at-will employee upon his
32 execution of an agreement not to compete may constitute sufficient consideration to
33 support the validity and enforceability of the restrictive covenant under New Jersey
34 law.”); *Lake Land Employment Group, LLC v. Columber*, 804 N.E.2d 27, 32 (Ohio
35 2004) (holding that “consideration exists to support a noncompetition agreement when, in
36 exchange for the assent of an at-will employee to a proffered noncompetition agreement,
37 the employer continues an at-will employment relationship that could legally be
38 terminated without cause.”); *Nestle Food Co. v. Miller*, 836 F. Supp. 69, 77 (D.R.I. 1993)
39 (applying Rhode Island law) (holding that continued employment and employment
40 benefits are sufficient consideration for a restrictive covenant entered into while
41 employed); *Cent. Monitoring Serv., Inc. v. Zakinski*, 553 N.W.2d 513, 517–518 (S.D.
42 1996) (holding that continued employment is adequate consideration for an at-will
43 employee signing a noncompetition agreement six months after initial employment); *Sys.
44 Concepts v. Dixon*, 669 P.2d 421, 429 (Utah 1983) (holding that an at-will employee’s
45 continued employment is sufficient consideration to support a post-employment covenant
46 not to compete); *Summits 7, Inc. v. Kelly*, 886 A.2d 365, 372–73 (Vt. 2005) (citing

1 Restatement (Third) of Employment Law § 6.05 cmt. d (Preliminary Draft No. 2, May
2 17, 2004) (“Continuing employment of an at-will employee is enough consideration to
3 support an otherwise valid restrictive covenant. This means that parties may agree to
4 enforceable restrictive covenants after the beginning of an employment relationship.”)
5 and holding that “[r]egardless of what point during the employment relationship the
6 parties agree to a covenant not to compete, legitimate consideration for the covenant
7 exists as long as the employer does not act in bad faith by terminating the employee
8 shortly after the employee signs the covenant”); *NBZ, Inc. v. Pilarski*, 520 N.W.2d 93,
9 105 (Wis. Ct. App. 1994) (implying that continued employment may be sufficient
10 consideration for a restrictive covenant, if it is made explicitly dependent on signing the
11 covenant).

12
13 Illustration 12, based on *Campbell Soup Co. v. Desatnick*, 58 F. Supp. 2d 477,
14 490–92 (D.N.J. 1999) (applying New Jersey law), is an example of when an employer’s
15 promise of continued employment is sufficient consideration for a restrictive covenant
16 that the employee agreed to after the start of the employment relationship.

17
18 In a few states, courts recognize the promise of continued employment as
19 sufficient consideration, but only where the employer actually retains the employee for a
20 substantial period of time after covenant formation. See *Curtis 1000, Inc. v. Suess*, 24
21 F.3d 941, 945–47 (7th Cir. 1994) (applying Illinois law) (enforcing a covenant not to
22 compete entered into after the employee’s start date because it was supported by adequate
23 consideration of continued employment and employee retained job for eight years after
24 signing); *Brown and Brown, Inc. v. Mudron*, 887 N.E.2d 437 (Ill. App. Ct. 2008)
25 (refusing to enforce covenant not to compete against employee who resigned seven
26 months after signing covenant, when covenant was entered when the company was sold
27 five years after employee began work); *Raines v. Bottrell Ins. Agency, Inc.*, 992 So. 2d
28 642, 646 (Miss. Ct. App. 2008) (holding that a covenant not to compete entered into by
29 an employer and an employee was enforceable because it “specifically mention[ed] [the
30 employee’s] continued employment as consideration supporting the agreement. . . .”);
31 *Simko, Inc. v. Graymar Co.*, 464 A.2d 1104, 1107 (Md. Ct. Spec. App. 1983) (“[T]he
32 continuation of employment for a substantial period beyond the threat of discharge is
33 sufficient consideration for a restrictive covenant.”); *Int’l Paper Co. v. Suwyn*, 951 F.
34 Supp. 445, 448 (S.D.N.Y. 1997) (applying New York law) (“Where any employment
35 relationship continues for a substantial period after the covenant is given, the forbearance
36 necessary to constitute consideration is ‘real, not illusory and the consideration given for
37 the promise is validated.’” (quoting *Zellner v. Stephen D. Conrad*, 589 N.Y.S.2d 903, 907
38 (N.Y. App. Div. 1992))); *McCombs v. McClelland*, 354 P.2d 311, 315 (Ore. 1960)
39 (holding that “where one already employed is induced to enter into a subsequent
40 agreement containing a restrictive covenant as to other employment, such agreement to
41 be enforceable must be supported by a promise of continued employment, express or
42 implied, or some other good consideration.”); *Cent. Adjustment Bureau, Inc. v. Ingram*,
43 678 S.W.2d 28, 35 (Tenn. 1984) (“Whether performance is sufficient to support a
44 covenant not to compete depends upon the facts and circumstances of each case.”). See
45 also *Mattison v. Johnston*, 730 P.2d 286, 290 (Ariz. Ct. App. 1986) (holding that
46 continued employment was sufficient consideration for the employee’s promise not to

1 compete where the employee voluntarily elected to terminate employment shortly after
2 signing the covenant not to compete). These courts, although often reaching the correct
3 result, appear confused as to the appropriate rationale. The length of time between the
4 execution of the covenant and the end of the employment relationship may be relevant to
5 whether the employer was acting in good faith in securing the covenant, see § 8.06,
6 Comment *f*, but is inconsistent with the general contracts rule that courts do not measure
7 the adequacy of consideration.

8
9 In a significant minority of states, the courts hold that in order to be valid and
10 enforceable, a covenant not to compete executed after the commencement of employment
11 must be supported by new consideration. See *Lucht's Concrete Pumping, Inc. v. Horner*,
12 224 P.3d 355, 358 (Colo. Ct. App. 2009) (holding “that when an employee continues his
13 or her job without receiving additional pay or benefits when a noncompete agreement is
14 signed, the agreement lacks consideration.”); *Timenterial, Inc. v. Dagata*, 277 A.2d 512,
15 515 (Conn. Super. Ct. 1971) (refusing to enforce a restrictive covenant because it lacked
16 consideration when the employee signed it five days after beginning employment);
17 *Freeman v. Duluth Clinic, Ltd.*, 334 N.W.2d 626, 630 (Minn. 1983) (requiring that
18 employees receive “real advantages” other than continued employment as consideration
19 for a restrictive covenant); *Access Organics, Inc. v. Hernandez*, 175 P.3d 899, 904 (Mont.
20 2008) (holding that “in the context of non-compete agreements, we require clear evidence
21 that the employee received good consideration in exchange for bargaining away some of
22 his post-employment freedom to practice the profession or trade of his choice” while also
23 “declin[ing] to broadly hold that continued employment may never serve as sufficient
24 consideration.”); *Forrest Paschal Mach. Co. v. Milholen*, 220 S.E.2d 190, 196 (N.C. Ct.
25 App. 1975) (holding that “when the relationship of [the] employer and employee is
26 already established without a restrictive covenant, any agreement thereafter not to
27 compete must be in the nature of a new contract based upon new consideration.”);
28 *Admiral Servs., Inc. v. Drebit*, No. CIV. A. 95-1086, 1995 WL 134812, at *4 (E.D. Pa.
29 Mar. 28, 1995) (applying Pennsylvania law) (stating that “[a]n employee’s continued
30 employment is not sufficient consideration for a covenant not to compete which the
31 employee signed after the inception of his employment, where the employer makes no
32 promise of continued employment for a definite term.”); *Poole v. Incentives Unlimited,*
33 *Inc.*, 548 S.E.2d 207, 209 (S.C. 2001) (holding that “when a covenant is entered into after
34 the inception of employment, separate consideration, in addition to continued at-will
35 employment, is necessary in order for the covenant to be enforceable.”); *Mona Elec.*
36 *Group, Inc. v. Truland Serv. Corp.*, 193 F. Supp. 2d 874, 876 (E.D. Va. 2002) (applying
37 Virginia law) (predicting that Virginia Supreme Court would not follow majority rule and
38 holding that continued employment, standing alone without threat of termination or other
39 employment action, does not provide consideration for a restrictive covenant executed
40 after the commencement of employment); *Labriola v. Pollard Group, Inc.*, 100 P.3d 791,
41 796 (Wash. 2004) (stating that “independent consideration is required at the time
42 promises are made for a non-compete agreement when employment has already
43 commenced.”); *Environmental Products Co., Inc. v. Duncan*, 285 S.E.2d 889, 890 (W.
44 Va. 1981) (stating that “[i]f a covenant not to compete is contracted after employment has
45 been commenced without restriction, there must be new consideration to support it.”);
46 *Hopper v. All Pet Animal Clinic, Inc.*, 861 P.2d 531, 541 (Wyo. 1993) (declaring that the

1 “better view, even in the at-will relationship, is to require additional consideration to
2 support a restrictive covenant entered into during the term of the employment” and that
3 “[t]his view recognizes the increasing criticism of the at-will relationship, the usually
4 unequal bargaining power of the parties, and the reality that the employee rarely
5 ‘bargains for’ continued employment in exchange for a potentially onerous restraint on
6 the ability to earn a living” but holding that a pay raise provided adequate additional
7 consideration in this case (quoting Howard A. Specter & Matthew W. Finkin, *Individual*
8 *Employment Law and Litigation* § 8.02 (1989)).
9

10 Massachusetts may be reconsidering its earlier view in *Sherman v. Pfefferkorn*,
11 135 N.E. 568, 569 (Mass. 1922), that a promise of indefinite employment is sufficient.
12 See *Zabota Cmty. Ctr., Inc. v. Frolova*, No. 061909BLS1, 2006 WL 2089828, at *2–3
13 (Mass. Super. Ct. May 18, 2006) (refusing to issue injunction enforcing a noncompete
14 covenant signed by a recent Russian immigrant with limited command of English after
15 working for the employer for about a year and told she would be fired the next day if she
16 did not sign); *IKON Office Solutions, Inc., v. Belanger*, 59 F. Supp. 2d 125, 131 (1999)
17 (applying Massachusetts law) (while recognizing that older Massachusetts decisions hold
18 that continuing employment is sufficient consideration, refusing to issue preliminary
19 injunction in part because “later decisions demonstrate that, in order for a restrictive
20 covenant to withstand scrutiny, some additional consideration ought pass to an employee
21 upon the execution of a post-employment agreement. While those later cases do not
22 specifically abrogate the prior holdings, they do reflect . . . that some additional
23 consideration was in fact given the employees upon acceptance of the post-employment
24 covenants. Moreover, these decisions require some evidence that the terms of the
25 underlying employment contract had been negotiated.”).
26

27 Texas has taken a particularly complex legal path on the question of the
28 enforceability of restrictive covenants signed after initial employment, but the trend is
29 toward enforceability. A 1989 statute declared that “if the covenant not to compete is
30 executed on a date other than the date on which the underlying agreement is executed,
31 such covenant must be supported by independent valuable consideration.” 1989 Tex.
32 Gen. Laws, ch 1193, p. 4852. Responding to judicial decisions invalidating some
33 restrictive covenants, the legislature in 1993 removed the “independent valuable
34 consideration” requirement, 1993 Tex. Gen. Laws, so that the current statute reads: “a
35 covenant not to compete is enforceable if it is ancillary to or part of an otherwise
36 enforceable agreement at the time the agreement is made to the extent that it contains
37 limitations as to time, geographical area, and scope of activity to be restrained that are
38 reasonable and do not impose a greater restraint than is necessary to protect the goodwill
39 or other business interest of the promisee.” Tex. Bus. & Com. Code Ann. § 15.50(a)
40 (Vernon 2009). There has been considerable litigation over the words “otherwise
41 enforceable agreement at the time the agreement is made.” In *Mann Frankfort Stein &*
42 *Lipp Inc. v. Fielding*, 289 S.W.3d 844 (Tex. 2009), an employee, upon being rehired,
43 agreed to a confidentiality clause and also a client purchase agreement, whereby he
44 would pay the employer a set price if he did business for the employer’s clients after
45 quitting. See *id.* at 846. The Texas Supreme Court enforced the restrictive covenant,
46 finding that the nature of the job meant that the employer impliedly promised to provide

1 the employee confidential information, and that this implied promise satisfied the
2 statutory “otherwise enforceable agreement” requirement. *Id.* at 850. See also *Alex*
3 *Sheshunoff Mgmt. Servs., L.P. v. Johnson*, 209 S.W.3d 644, 657 (Tex. 2006) (enforcing
4 do-not-compete clause signed three months after at-will employee was promoted).

5
6 *f. Terminated employees.* The case law specifically addressing the enforceability
7 of reasonable restrictive covenants against discharged employees is quite variable.
8 Relatively few jurisdictions have squarely ruled that such covenants are enforceable
9 regardless of the circumstances surrounding the termination of employment. See *Twenty*
10 *Four Collection v. Keller*, 389 So. 2d 1062, 1062–63 (Fla. Dist. Ct. App. 1980)
11 (enforcing a noncompetition covenant triggered by a “termination, voluntarily or
12 involuntarily,” declaring that “[t]he only authority the court possesses over the terms of a
13 non-competitive agreement is to determine, as the statute provides, the reasonableness of
14 its time and area limitations.”); cf. *Ins. Assocs. Corp. v. Hansen*, 723 P.2d 190, 190–91
15 (Idaho Ct. App. 1986) (enforcing a restrictive covenant against an employee terminated
16 without cause without analyzing how the circumstances of termination affect the
17 enforceability of a restrictive covenant); *Weber v. Tillman*, 913 P.2d 84, 91–93 (Kan.
18 1996) (upholding restrictive covenant against physician without addressing the effect of
19 physician being terminated without cause); *Cellular One, Inc. v. Boyd*, 653 So. 2d 30,
20 31–34 (La. Ct. App. 1995) (enforcing, based on its interpretation of a Louisiana statute, a
21 restrictive covenant against two employees, one who was fired and the other who left
22 voluntarily, with no differences in analysis); *Hogan v. Bergen Brunswick Corp.*, 378 A.2d
23 1164, 1166–67 (N.J. Super. Ct. App. Div. 1977) (not addressing whether dismissal was
24 with or without cause in upholding restrictive covenant even though trial court noted the
25 dismissal was without cause).

26
27 Courts generally consider the circumstances surrounding the employee’s
28 termination to be an important, if not decisive, factor in determining whether the
29 restrictive covenant should be enforced. See *Gomez v. Chua Medical Corp.*, 510 N.E.2d
30 191, 194 (Ind. Ct. App. 1987) (“There appear to be four basic alternatives: (1) the
31 employee voluntarily leaves the employment; (2) the employee is discharged for good
32 cause; (3) the employee is discharged in bad faith; and (4) the employee is terminated,
33 but neither good cause nor bad faith appear to exist.”). Most courts will not enforce an
34 otherwise reasonable restrictive covenant is not enforceable against an employee who has
35 been discharged without cause, who quits for cause attributable to the employer (a form
36 of “constructive discharge”), or who is let go because of a downturn in business. See
37 *Bailey v. King*, 398 S.W.2d 906, 908 (Ark. 1966) (reasoning in dicta that “[o]f course, if
38 an employer obtained an agreement of this nature from an employee, and then, without
39 reasonable cause, fired him, the agreement would not be binding.”); *Bishop v. Lakeland*
40 *Animal Hosp., PC*, 644 N.E.2d 33, 36 (Ill. App. Ct. 1994) (“We agree with the [S]eventh
41 [C]ircuit’s reasoning and find that the implied promise of good faith inherent in every
42 contract precludes the enforcement of a noncompetition clause when the employee is
43 dismissed without cause.”); *Ma & Pa, Inc. v. Kelly*, 342 N.W.2d 500, 502 (Iowa 1984)
44 (“[D]ischarge by the employer is a factor opposing the grant of an injunction, to be
45 placed in the scales in reaching the decision as to whether the employee should be
46 enjoined.”); *Orion Broad., Inc. v. Forsythe*, 477 F. Supp. 198, 201 (W.D. Ky. 1979)

1 (applying Kentucky law) (“[H]ad [the employee] voluntarily severed her relationship
2 with plaintiff, the Court has no doubt that the non-competition covenant would have been
3 enforceable against her. To hold that [the employee], at the whim of [her former
4 employer], could be deprived of her livelihood in a highly competitive market, seems to
5 the Court to be an example of industrial peonage which has no place in today’s society.”);
6 *MacIntosh v. Brunswick Corp.*, 215 A.2d 222, 225–26 (Md. 1965) (holding that
7 restrictive covenant imposed “undue hardship” on employee in part because employee
8 was fired “through no fault of his own”); *Post v. Merrill Lynch, Pierce, Fenner & Smith,*
9 *Inc.*, 397 N.E.2d 358, 360–61 (N.Y. 1979) (refusing to enforce a restrictive covenant
10 because employee was terminated without cause and explaining that “[w]here the
11 employer terminates the employment relationship without cause, . . . his action
12 necessarily destroys the mutuality of obligation on which the covenant rests”); *In re UFG*
13 *Int’l, Inc.*, 225 B.R. 51, 56 (Bankr. S.D.N.Y. 1998) (applying New York law)
14 (“Regardless of the scope of the restrictive covenant, an employer cannot hobble his
15 employee by terminating him without cause and then enforcing a restriction that
16 diminishes his ability to find comparable employment.”); *Insulation Corp. of Am. v.*
17 *Brobston*, 667 A.2d 729, 735 (Pa. Super. Ct. 1995) (“The employer who fires an
18 employee for failing to perform in a manner that promotes the employer’s business
19 interests deems the employee worthless. Once such a determination is made by the
20 employer, the need to protect itself from the former employee is diminished by the fact
21 that the employee’s worth to the corporation is presumably insignificant. Under such
22 circumstances, we conclude that it is unreasonable as a matter of law to permit the
23 employer to retain unfettered control over that which it has effectively discarded as
24 worthless to its legitimate business interests.”); *Cent. Adjustment Bureau, Inc. v. Ingram*,
25 678 S.W.2d 28, 35 (Tenn. 1984) (noting in dicta that “[a]nother factor affecting
26 reasonableness is the circumstances under which an employee leaves” and “[a]lthough an
27 at-will employee can be discharged for any reason without breach of the contract, a
28 discharge which is arbitrary, capricious or in bad faith clearly has a bearing on whether a
29 court of equity should enforce a non-competition covenant”); *Sec. Servs., Inc. v. Priest*,
30 507 S.W.2d 592, 595 (Tex. App. 1974) (refusing to enforce restrictive covenant against
31 employee discharged without cause, finding “[the trial judge] could have inferred that
32 [the employer] had employed [the employee] chiefly for the purpose of attracting the
33 customers of [his former company] and that as soon as [the employer] had obtained
34 maximum benefit from [the employee’s] contacts with those customers, it discharged him
35 without reasonable cause”).

36
37 In addition, a number of courts have expressly distinguished the enforceability of
38 restrictive covenants when the employee was fired for cause from the enforceability of
39 the covenant against an employee discharged without cause. See *Bishop v. Lakeland*
40 *Animal Hosp., P.C.*, 644 N.E.2d 33, 36 (Ill. App. Ct. 1994) (refusing to enforce a
41 noncompetition agreement against an employee who was fired without cause because it
42 would breach the implied covenant of good faith inherent in every contract even though
43 the employment contract authorized termination by either party “with or without cause”);
44 *Prop. Tax Representatives, Inc. v. Chatam*, 891 S.W.2d 153, 157–58 (Mo. Ct. App. 1995)
45 (while noting that restrictive covenants are enforceable after termination with cause or
46 voluntary departure, upholding lower court’s decision that restrictive covenant was

1 unenforceable as a matter of equity when employee was terminated without cause); Cent.
2 Monitoring Sev., Inc. v. Zakinski, 553 N.W.2d 513, 521 (S.D. 1996) (applying balancing
3 test for deciding whether to enforce a restrictive covenant and considering additional
4 factors for a restrictive covenant against an employee who was terminated without cause
5 as compared to employees who left voluntarily or were terminated with cause); Clinch
6 Valley Physicians, Inc. v. Garcia, 414 S.E.2d 599, 601 (Va. 1992) (because employment
7 contract lapsed, construing noncompetition covenant narrowly so as to apply only to
8 terminations for cause).

9
10 Many courts have refused, or stated in dicta that they would refuse, to enforce a
11 restrictive covenant against a discharged employee when the employer has acted in bad
12 faith. See *Robinson v. Computer Servicenters, Inc.*, 346 So. 2d 940, 943 (Ala. 1977)
13 (refusing to enforce a restrictive covenant against an employee when the employer had
14 intended to discharge the employee at the time the covenant was executed); *Am. Credit*
15 *Bureau, Inc. v. Carter*, 462 P.2d 838, 841 (Ariz. Ct. App. 1969) (upholding lower court’s
16 decision that restrictive covenant could not be enforced because employer’s practice of
17 only telling employee about restrictive covenant after inducing employee to quit previous
18 job indicated employer had unclean hands); *Kupscznk v. Blasters, Inc.*, 647 So. 2d 888,
19 891 (Fla. Dist. Ct. App. 1994) (noting in dicta that “in rare circumstances equitable
20 considerations could possibly render a noncompetition agreement void. For instance, had
21 [the employer] hired [the employee] under the same terms and then terminated him
22 without cause after a very short time, even though the termination would not be wrongful
23 under the Florida at-will employment doctrine, [the employer’s] conduct might be
24 deemed unconscionable and a court of equity would not permit its perpetuation by entry
25 of an injunction.”); *Rao v. Rao*, 718 F.2d 219, 222–24 (7th Cir. 1983) (applying Illinois
26 law) (noting that when an employer terminates an employee to prevent him from
27 exercising his rights under the agreed upon stock-option plan, the court will refuse to
28 enforce a covenant not to compete because the employer wrongfully terminated the
29 employee and acted in bad faith); *Edin v. Jostens, Inc.*, 343 N.W.2d 691, 694 (Minn. Ct.
30 App. 1984) (holding that to enforce the restrictive covenant would be inequitable where
31 “management induced [the employee] into allowing his current contract to expire without
32 signing the new contract, then terminated him for failing to timely sign the new
33 contract”); *Empiregas, Inc. of Kosciusko v. Bain*, 599 So. 2d 971, 975–76 (Miss. 1992)
34 (refusing to enforce restrictive covenant in part because, considering that evidence
35 indicated that employee had acted in employer’s best interest, termination was in bad
36 faith); *Cent. Adjustment Bureau, Inc. v. Ingram*, 678 S.W.2d 28, 35 (Tenn. 1984)
37 (upholding covenant where employees left voluntarily and there was no evidence that the
38 employer “acted in bad faith or with unclean hands”); *Allen v. Rose Park Pharmacy*, 237
39 P.2d 823, 825–26 (Utah 1951) (enforcing restrictive covenant even though termination
40 was without cause but suggesting an exception for covenants imposed in bad faith, “with
41 intent on the part of the employer that the employment would be only long enough to
42 bind the employee to the covenant, and with a view only of preventing him from working
43 elsewhere”); *Hopper v. All Pet Animal Clinic, Inc.*, 861 P.2d 531, 541 (Wyo. 1993)
44 (noting, in dicta, that “if an employer hired an employee at will, obtained a covenant not
45 to compete, and then terminated the employee, without cause, to arbitrarily restrict
46 competition, we believe such conduct would constitute bad faith. Simple justice requires

1 that a termination by the employer of an at will employee be in good faith if a covenant
2 not to compete is to be enforced”). See also *Colonial Life & Accident Ins. Co. v. Sisco*,
3 No. CA 98-751, 1999 Ark. App. LEXIS 373, at *18–19 (Ark. Ct. App. May 19, 1999)
4 (finding that restrictive covenant could not be enforced against employee because
5 employer’s termination without cause of employee breached employment agreement);
6 *Research & Trading Corp. v. Pfuhl*, No. Civ. A. 12527, 1992 WL 345465, at *28–30
7 (Del. Ch. Nov. 18, 1992) (after noting that circumstances of termination are relevant to
8 the enforcement of a restrictive covenant, enforcing a restrictive covenant because the
9 deterioration of the employment relationship indicated no improper purpose in
10 termination); *C.G. Caster Co. v. Regan*, 410 N.E.2d 422, 426–27 (Ill. Ct. App. 1980)
11 (holding that employee was excused from complying with restrictive covenant after
12 employer’s failure to pay contractually required termination benefits); *Francorp, Inc. v.*
13 *Siebert*, 126 F. Supp. 2d 543, 547 (N.D. Ill. 2000) (applying Illinois law) (holding that
14 employer “materially breached its employment relationship with [former employees] . . .
15 by failing to pay them for a substantial period prior to their departure from the
16 company”); *Dunning v. Chem. Waste Mgmt., Inc.*, No. 91 C 2502, 1997 WL 222891, at
17 *11 (N.D. Ill. Apr. 22, 1997) (applying Illinois and South Carolina law) (holding that an
18 employer cannot materially breach the employment agreement “and then expect to
19 uphold the restrictive covenant as well”); *Gomez v. Chua Med. Corp.*, 510 N.E.2d 191,
20 195 (Ind. Ct. App. 1987) (noting in dicta that a court will preclude enforcement if
21 evidence indicates employer terminated employee in bad faith because employer is
22 asking the court for equitable relief with unclean hands, but also holding that an employer
23 need not establish a valid reason for discharge in order to enforce restrictive covenant);
24 *Lantech.com, LLC v. Yarbrough*, 2006 WL 3323222, at *3 (W.D. Ky. Nov. 14, 2006)
25 (applying Kentucky law) (refusing to enforce restrictive covenant when employer’s
26 termination without cause “violate[d] its significant representations to [the employee] and
27 its own corporate human resources policy.”); *Kroeger v. Stop & Shop Cos.*, 432 N.E.2d
28 566, 572–74 (Mass. App. Ct. 1982) (holding that executive’s restrictive covenant is valid
29 even though the executive was not fired for misconduct but refusing to enforce the
30 covenant’s remedy of forfeiture of retirement benefits out of concern that doing so would
31 be unfair to employee).

32
33 Illustration 12 is based on *Medical Wellness Associates, P.C. v. Heithaus*, No.
34 6500 of 2000, 2001 WL 1112991 (Feb. 13, 2001 Pa. Com. Pl. 2001). In that case, a
35 chiropractor employed by a corporate practice signed an employment agreement that
36 included nondisclosure and noncompetition clauses. The noncompetition clause
37 prohibited the chiropractor from opening a practice within a forty five mile radius of his
38 employer’s clinic, and from soliciting clients for a two year period. *Id.* at *7–8. The
39 chiropractor was fired for cause based on his persistent tardiness, which disrupted clinic
40 operations, and failing to maintain a clean work area. *Id.* at *28. The chiropractor was
41 fired for cause, and before leaving, made copies of sensitive business information,
42 including patient lists and contact information and “highly confidential” patient
43 development and advertising plans for use in setting up a competing practice, which he
44 did within the two year period at an unacceptably close distance. *Id.* at *20. The
45 chiropractor was enjoined from competing with his former employer according to the

1 terms of the employment agreement, and was required to return all confidential
2 information he removed from the office. *Id.* at *32.

3
4 Illustrations 13 and 14 are based on *Post v. Merrill Lynch, Pierce, Fenner &*
5 *Smith, Inc.*, 397 N.E.2d 358 (N.Y. 1979). In *Merrill Lynch*, employees were informed
6 that they had forfeited their pension benefits by accepting employment with a competitor
7 after Merrill Lynch terminated their employment. See *id.* at 360. In its analysis of the
8 forfeiture provision at issue in the case, the New York Court of Appeals drew a
9 distinction between voluntary and involuntary termination. See *id.* The court found that
10 in all prior cases, the termination had been voluntary and after the employee went to work
11 for a competitor, “effect has been given to the forfeiture-for-competition provision”
12 Guided by a “powerfully articulated congressional policy” against forfeiture of employee
13 benefits and a lack of “decisions which command a contrary result,” the court determined
14 that an employer may not enforce a forfeiture provision where the employee was
15 terminated without cause. *Id.*

16
17 *g. Employer’s material breach of employment agreement.* Illustration 15 is based
18 loosely on the facts of *Francorp, Inc. v. Siebert*, 126 F. Supp. 2d 543, 547 (N.D. Ill. 2000)
19 (applying Illinois law), which held that an employer cannot enforce a covenant not to
20 compete after materially breaching an employment agreement by failing to pay an
21 employee. Most courts agree with this approach, as it stems from the longstanding
22 contract principle that material breach by one party generally excuses the nonbreaching
23 party from having to perform their contractual obligations. See *Laconia Clinic v. Cullen*,
24 408 A.2d 412, 414 (N.H. 1979) (holding that a clinic’s mismanagement of its financial
25 affairs constituted a material breach of an employment agreement, thus releasing a
26 physician from his covenant not to compete); cf. *Wichita Clinic v. Louis*, 185 P.3d 946
27 (Kan. Ct. App. 2008) (holding that an employer’s breach of employment agreement did
28 not relieve an employee of specific performance under a covenant not to compete where
29 the employee was estopped from raising issue of employer’s breach because the
30 employee accepted prior breaches by the employer).

31
32 *h. Professionals.* Absolute restrictions on competition are generally
33 unenforceable against attorneys. See *Dwyer v. Jung*, 336 A.2d 498, 500 (N.J. Super. Ct.
34 Ch. Div. 1975), *aff’d*, 348 A.2d 208 (N.J. Super. Ct. App. Div. 1975); *Denburg v. Parker*
35 *Chapin Flattau & Klimpl*, 624 N.E.2d 995, 998 (N.Y. 1993). A few states will enforce
36 forfeiture-for-competition and compensation-for-competition clauses among law-firm
37 partners. See, e.g., *Howard v. Babcock*, 863 P.2d 150, 156–57 (Cal. 1993) (holding that
38 an agreement imposing a reasonable economic consequence does not constitute a
39 restriction on an attorney’s ability to practice law). Most states will not enforce even
40 these “indirect” restraints on competition. See *Cnty. Hosp. Group, Inc. v. More*, 869
41 A.2d 884, 893–96 (N.J. 2005) (contrasting judicial treatment of restrictive covenants
42 against physicians and attorneys and noting that a per se rule prohibits such restrictions
43 against attorneys while restrictions against physicians are subject to a reasonableness
44 test); *Jacob v. Norris, McLaughlin & Marcus*, 607 A.2d 142, 151 (N.J. 1992) (noting that
45 “[t]he more lenient test used to determine the enforceability of a restrictive covenant in a
46 commercial setting, . . . is not appropriate in the legal context”) (internal citations

1 omitted); *Whiteside v. Griffis & Griffis, P.C.*, 902 S.W.2d 739, 743 (Tex. App. 1995)
2 (declaring that “cases from other jurisdictions almost universally hold that financial
3 disincentives . . . are void and unenforceable restrictions on the practice of law.”). In a
4 few states, some law firm employees owe a fiduciary duty of loyalty to their firm that
5 imposes certain obligations with respect to competition. See *Graubard Mollen Dannett &*
6 *Horowitz v. Moskovitz*, 653 N.E.2d 1179, 1183–84 (N.Y. 1995) (noting that “secretly
7 attempting to lure firm clients (even those the partner has brought into the firm and
8 personally represented) to the new association, lying to clients about their rights with
9 respect to the choice of counsel, lying to partners about plans to leave, and abandoning
10 the firm on short notice (taking clients and files) would not be consistent with a [law
11 firm] partner’s fiduciary duties.”); *Johnson v. Brewer & Pritchard, PC*, 73 S.W.3d 193,
12 202 (Tex. 2002) (holding that “an associate owes a fiduciary duty not to accept a fee or
13 other compensation for referring a matter to a lawyer or law firm other than the
14 associate’s employer without the employer’s consent”); *Prince, Yeates & Geldzahler v.*
15 *Young*, 94 P.3d 179, 185 (Utah 2004) (“Because of the privilege granted to engage in the
16 practice of law, we impose upon members of our bar a fiduciary duty that encompasses
17 the obligation to not compete with their employer, which [the court] define[s] as any law
18 firm or legal services provider who may employ them in a legal capacity, without the
19 employer’s prior knowledge and agreement.”).
20

21 In most states, restrictive covenants are enforceable against professionals other
22 than lawyers to the same extent as any other employee. See, e.g., *Mohanty v. St. John*
23 *Heart Clinic*, 866 N.E.2d 85, 93–95 (Ill. 2006) (restrictive covenant in physician
24 employment contracts held not void against public policy). A few states will not enforce
25 restrictive covenants against other classes of professionals. See *Anniston Urologic*
26 *Assocs., P.C. v. Kline*, 689 So. 2d 54, 56 (Ala. 1997) (refusing to enforce a covenant
27 imposing a \$75,000 penalty on a doctor competing for one year within 25 miles of his
28 former firm). In New York, doctors and accountants are considered to have “unique” or
29 “extraordinary” skills justifying a reasonable non-compete covenant, but this is a matter
30 of proof dependent on the particular market for the professional services. See *BDO*
31 *Seidman v. Hirshberg*, 712 N.E.2d 1220, 1224 (N.Y. 1999) (recognizing that courts give
32 “wider latitude to covenants between members of a learned profession because their
33 services are unique or extraordinary” but refusing to uphold a covenant where the
34 relevant market consisted of “the entirety of a major metropolitan area” and the
35 employee’s “status in the firm was not based upon the uniqueness or extraordinary nature
36 of the accounting services he generally performed on behalf of the firm, but . . . on his
37 ability to attract a corporate clientele.”).
38

39 *i. Public interest.* Most decisions addressing a residual “public interest” factor
40 deal with a shortage of healthcare professionals in particular area. See, e.g., *Cmty. Hosp.*
41 *Group, Inc. v. More*, 869 A.2d 884, 900 (N.J. 2005) (finding that a restrictive covenant
42 among physicians was reasonable except in its geographical limitations, and “blue
43 penciling” the agreement accordingly on grounds of public policy so as not to adversely
44 affect access to specialists); *Odess v. Taylor*, 211 So. 2d 805, 810–12 (Ala. 1968)
45 (pointing out a shortage of doctors in Alabama and adopting a blanket prohibition of
46 restrictive covenants among medical professionals as a matter of statutory interpretation).

1 Some courts will subject restrictive covenants affecting public access to health care
2 professionals to a higher degree of scrutiny based on public policy. See, e.g., AGA, LLC
3 v. Rubin, 533 S.E.2d 804, 806 (Ga. Ct. App. 2000) (holding that the geographical scope
4 contained in a restrictive covenant must be predictable beforehand to be reasonable). See
5 also Sammarco v. Anthem Ins. Cos., Inc., 723 N.E.2d 128, 132 (Ohio Ct. App. 1998),
6 *overruled on other grounds*, 839 N.E.2d 49, 54 (Ohio Ct. App. 2005).

7
8
9 **§ 8.07. Protectable Interests for Restrictive Covenants**

10 (a) A restrictive covenant is enforceable only if the employer can
11 demonstrate that the covenant furthers one or more of the legitimate interests listed
12 in subsection (b).

13 (b) An employer has a legitimate interest in protecting, by means of a
14 reasonably tailored restrictive covenant with its employee, the employer's

15 (i) confidential information, as defined in § 8.02,

16 (ii) customer relationships,

17 (iii) investment in the employee's reputation in the market, or

18 (iv) investment in the purchase of a business belonging to the
19 employee.

20 **Comment:**

21 *a. Confidential information.* An employer's interest in protecting its confidential
22 information can justify a restrictive covenant.

23
24 **Illustration:**

25 1. Executive E at technology company X has access to X's strategic
26 business plans, pricing, and product information, all of which constitute
27 confidential information under § 8.02. Upon commencing employment with X, E

1 was required to enter into an otherwise reasonable noncompetition agreement. X
2 has a protectable interest in taking reasonable measures to protect its confidential
3 information, including a reasonable restrictive covenant to prevent E from
4 competing with X.

5
6 *b. Customer relationships.* An employer often makes large investments to foster
7 relationships between its customers and its sales force and other employees. An
8 employer has a legitimate interest in taking reasonable measures to protect that
9 investment by barring employees from appropriating customer relationships that the
10 employer paid to create. Because a covenant prohibiting former employees from
11 soliciting customers with whom they dealt while employed will ordinarily fully protect
12 this legitimate interest, a broader restriction barring all competition by former employees
13 ordinarily is not enforceable. The length of time that employees worked for their
14 employer is often relevant in determining the appropriate scope of a restriction claimed to
15 be necessary to preserve the former employer's customer relationships. Thus, for
16 example, employees who work for an employer for too short a time to have made use of
17 or benefited from the type of customer relationships that the employer would have a
18 legitimate interest in protecting should not be bound by a broad restrictive covenant. See
19 § 8.08 on modification of restrictive covenants.

20

21 **Illustrations:**

22 2. E works as an accountant for X, an accounting firm. E routinely deals
23 with some of X's repeat customers. As such, X has a legitimate interest in

1 preventing E from soliciting, for a reasonable time, any customers with whom E
2 worked while employed by X.

3 3. E, an investment manager working for X, manages investments for
4 several of X's clients. E agrees both not to compete with X and not to solicit
5 clients whose portfolios E managed while employed by X. X has a legitimate
6 interest in preventing E, after leaving X's employ, from soliciting for a reasonable
7 time any customers whose portfolios E managed at X; however, absent other
8 factors, X does not have a legitimate interest in preventing E from all competition
9 with X.

10 4. E is a broadcast ad salesperson working for X, a local television station.
11 E has signed a restrictive covenant that prevents E from working for a competitor
12 for a period of six months after leaving work with X. Two months after E begins
13 working for X, E accepts an offer with Z, a larger, regional competitor of X, also
14 as a broadcast ad salesman. Because E could not master and exploit X's customer
15 relationships in so short a period, the restrictive covenant is not enforceable
16 against E, and E may work for Z without a waiting period.

17
18 *c. Investments in an employee's reputation.* In some industries an employer
19 expends resources to enhance the reputation of particular employees with the public
20 generally, as distinct from specific customers with whom the employee builds a
21 relationship. Often this is done by advertising the quality and standing of the particular
22 employee. In these situations, the employer is in effect sharing its customer goodwill
23 with the employee. Unlike a former employee's interaction with particular customers, it

1 is impossible to monitor a former employee’s “misuse” of the former employer’s
2 goodwill because the very act of competition involves an appropriation of that goodwill.
3 Hence, in these unique situations, the employer can have a legitimate interest in
4 prohibiting the particular employee from all competition for a reasonably limited period
5 of time.

6

7 **Illustration:**

8 5. E is employed as a television news anchor by X, a television station. X
9 expends significant resources advertising E as its anchor to build its audience,
10 thus enhancing E’s reputation in the area. X has a legitimate interest in protecting
11 its investment in E’s reputation for a limited period of time to enable X to groom
12 a replacement when E leaves. Thus, E’s agreement to refrain from working as a
13 news broadcaster for a competing station in the same media market for six months
14 after leaving X’s employ is enforceable.

15

16 *d. Sale of business.* When selling a business, the owner commonly agrees not to
17 compete with the purchaser of the business for a period of time, and often becomes an
18 employee of the purchaser as well. While the basic enforceability test of § 8.07 applies to
19 these restrictive covenants as well (namely, that it be reasonably tailored in scope,
20 geography, and time to further a protectable interest of the employer), the tailoring can
21 have a more generous fit because the policy concerns counseling narrow tailoring are less
22 compelling. First, the employee/business-seller usually has considerable ability to
23 negotiate appropriate terms, compared to most employees. Second, a promise not to

1 compete is typically necessary to adequately protect the employer/buyer's interest
2 because the employee/business-seller/owner is at such a high level in and so integral to
3 the business that a lesser promise such as one not to solicit customers or reveal
4 confidential information will not adequately protect the buyer/employer's investment. In
5 fact, the sale of a business's goodwill is difficult to accomplish effectively unless the
6 seller agrees not to compete with the buyer. Finally, the seller is compensated for his
7 restricted employment with proceeds from the sale, which presumably are higher with the
8 noncompetition agreement.

9 *e. Insufficient employer interests.* An employer may have many economic
10 reasons to attempt to restrict what its employees can do after termination of their
11 employment. Some of these reasons, however, will not support an otherwise reasonable
12 restrictive covenant because they are not sufficiently weighty to justify the social and
13 individual costs inherent in restrictions on competition. For example, an interest in
14 recouping investments in the training of employees may justify repayment obligations, as
15 set forth in § 8.08, but would not justify a restriction on competition. Similarly, the
16 desire of an employer to retain its talented, trained, or experienced employees is not an
17 interest that can legitimately support a restrictive covenant. Finally, an employer's
18 understandable wish to prevent competition by former employees is not, by itself, a
19 protectable interest under this Section.

20 **REPORTERS' NOTES**

21
22 *a. Scope.* Some jurisdictions restrict the range of protectable interests that may be
23 served by otherwise reasonable non-compete clauses by limiting enforcement to
24 employees who provide "unique services" where misuse of confidential information or
25 solicitation of customers is not involved. See, e.g., *Becker v. Bailey*, 299 A.2d 835, 838
26 (Md. 1973). The concern of these courts is to prevent employers from enforcing clauses
27 against unskilled or semi-skilled employees. The approach of this Section is to address

1 the same sort of concerns through a functional assessment of the employer’s legitimate
2 interests rather than a test based on the skill level of the particular employees.

3
4 Illustration 1 is drawn from *EMC Corp. v. Allen*, No. 975972B, 1997 WL
5 1366836, at *4 (Mass. Super. Ct. Dec. 15, 1997). See also *Uniroyal Goodrich Tire Co. v.*
6 *Hudson*, 873 F. Supp. 1037, 1044 (E.D. Mich. 1994) (applying Michigan law) (upholding
7 a confidentiality agreement necessary to protect an employer’s trade-secret tire-
8 manufacturing specifications); *Inflight Newspapers, Inc. v. Magazines In-Flight, LLC*,
9 990 F. Supp. 119, 121–124, 126–128 (E.D.N.Y. 1997) (applying New York law)
10 (upholding a covenant not to compete on the basis of an employer’s trade-secret
11 magazine-binding process and bidding information); *Static Control Components, Inc. v.*
12 *Darkprint Imaging, Inc.*, 135 F. Supp. 2d 722, 728 (M.D.N.C. 2001) (applying North
13 Carolina law) (holding that an employer’s secret toner manufacturing process could
14 support a restrictive employment covenant); *Simplified Telesys, Inc. v. Live Oak*
15 *Telecom*, 68 S.W.3d 688, 695–696 (Tex. App. 2000) (upholding a confidentiality
16 contract necessary to protect an employer’s secret computer software program);
17 *Learn2.com, Inc. v. Bell*, Civil Action No. 3:00-CV-812-R, 2000 U.S. Dist. LEXIS
18 14283 (N.D. Tex. July 20, 2000) (applying Texas law) (upholding a covenant not to
19 compete protecting an employer’s trade-secret animation software).

20
21 Like for-profit employers, a not-for-profit organization may also protect its
22 legitimate interests from unfair competition by requiring its employees to sign
23 noncompete agreements. See, e.g., *Healthcare Servs. of the Ozarks, Inc. v. Copeland,*
24 *Inc.*, 198 S.W.3d 604, 614 (Mo. 2006) (“The simple fact that a corporation is organized
25 for benevolent purposes does not indicate that such corporation does not have protectable
26 business interests.”); *NYSARC, Inc. v. Syed*, 747 N.Y.S.2d 327, 328–329 (N.Y. Sup. Ct.
27 2002) (noting that “a medical practice’s interest in maintaining its patients is a legitimate
28 interest worthy of protection by a covenant not to compete” and accepting the nonprofit
29 organization’s argument that if it “loses patients who have insurance or can otherwise
30 afford to pay for services, it will be unable to continue serving those patients who cannot
31 afford to pay for services”).

32
33 *b. Customer relationships.* Illustration 2 is based on the facts of *HBD Inc. v.*
34 *Ryan*, 642 N.Y.S.2d 913 (N.Y. App. Div. 1996).

35
36 Illustration 3 is drawn from *McFarland v. Schneider*, No. Civ. A. 96-7097, 1998
37 WL 136133, at *41–42 (Mass. Super. Ct. Feb. 17, 1998).

38
39 Illustration 4 is based on *Birmingham Television Corp. v. DeRamus*, 502 So. 2d
40 761 (Ala. Civ. App. 1986). In that case, a former employee was a twenty-five year old
41 recently married ad salesman. *Id.* at 764. Based both on statutory interpretation and the
42 common law’s disfavor of contracts restraining employment, the court held that the
43 former employer did not have a protectable interest in its customer relationship as against
44 the former employee, because the latter could not have exploited them in his two-month
45 stint with the former employer. *Id.*

46

1 While extremely short employment periods will likely not give rise to a former
2 employer's protectable interest in customer relationships enforceable against a former
3 employee, longer periods will. See *Corson v. Universal Door Sys., Inc.*, 596 So. 2d 565
4 (Ala. 1992) (upholding a nonsolicitation clause to protect customer relationships that an
5 employee fostered at his employer's expense where the employee worked five years);
6 *Booth v. WPMI Television Co.*, 533 So. 2d 209 (Ala. 1988) (upholding a covenant
7 prohibiting an employee from selling television advertising in the territory in which he
8 had developed customer relationships at his employer's expense); *Preferred Meal Sys. v.*
9 *Guse*, 557 N.E.2d 506, 512 (Ill. Ct. App. 1990) (holding that an employer has a
10 protectable interest in customers obtained through a bidding process when "the amount of
11 money involved in developing a clientele, the difficulty involved in the process of
12 developing the clientele, the extent of client contact necessary for obtaining and retaining
13 a client, the storehouse of intimate knowledge one must accumulate to acquire and
14 maintain a client, and the continuity of the relationship with the client" are all
15 substantial); *Mintel Int'l Group, Ltd. v. Neergheen*, No. 08-cv-3939, 2010 WL 145786
16 (N.D. Ill. Jan. 12, 2010) (enjoining an employee who worked for ten years from soliciting
17 customers where that employee had signed both non-competition and non-solicitation
18 agreements, and was in violation of the former); *Bowne of Boston, Inc. v. Levine*, No.
19 *Civ. A. 97-5789A*, 1997 WL 781444 (Mass. Super. Nov. 25, 1997) (upholding a
20 nonsolicitation clause to protect customer relationships that an employee fostered at his
21 employer's expense where the employee worked fourteen years); *Fortune Pers.*
22 *Consultants, Inc. v. Hagopian*, No. *Civ. A. 97-24440-A*, 1997 WL 796494 (Mass. Super.
23 Dec. 30, 1997) (same, except the employee worked one year); *Rehmann, Robson & Co.*
24 *v. McMahan*, 187 Mich. App. 36 (1991) (same, except one employee worked ten years,
25 and another worked eight years); *BDO Seidman v. Hirshberg*, 93 N.Y.2d 382 (1999)
26 (partially upholding a compensation-for-competition clause to protect against a former
27 employee's competitive use of customer relationships that the employee acquired during
28 the course of his employment through the direct performance of his accounting services
29 for the firm, but refusing to enforce the restrictive covenant to the extent it applied to the
30 former employee's personal clients and those clients he had not served during his
31 employment agreement); *DataType Int'l, Inc. v. Puzia*, 797 F. Supp. 274 (S.D.N.Y. 1992)
32 (applying New York law) (upholding a nonsolicitation clause to protect customer
33 relationships where the employee worked 10 years, but declining to uphold a covenant
34 not to compete); *Peat Marwick Main & Co. v. Haass*, 818 S.W.2d 381 (Tex. 1991)
35 (holding the protectable business interest includes the client base acquired by a merger,
36 but that an agreement to pay damages for furnishing services to clients acquired after the
37 employee left the firm and those with whom the employee never had contact was an
38 overbroad restraint of trade). But see *Empire Farm Credit ACA v. Bailey*, 239 A.D.2d
39 855 (N.Y. App. Div. 1997) (invalidating a nonsolicitation clause ostensibly justified by
40 customer relationships because the relationships were not trade secrets).

41
42 *c. Investments in an employee's reputation in the market.* Illustration 5 is based
43 on *Post-Newsweek Station v. Brooks*, No. CV 94 704854, 1994 WL 110040 (Conn. Sup.
44 Ct. March 11, 1994). In that case, anchor Brooks agreed not to compete for six months
45 after the end of his employment with the station within certain broadcast areas serviced
46 by the station. The employment contract declared that the reason for the restriction was

1 that the station did not want to develop Brooks's reputation and allow Brooks to take it
2 wholesale to a competitor after the expense of that development. The station sued
3 Brooks, seeking a preliminary injunction preventing Brooks from working for a
4 competitor. The court found that "neither the geographical nor temporal restraints
5 imposed by the Covenant are unreasonable." *Id.* at *8 However, it refused to issue an
6 injunction against Brooks, for two reasons: first, the contract language was modified,
7 such that it was unclear whether the noncompetition covenant was applicable after the
8 right of first refusal was declined; second, E's contract with a competing broadcaster
9 would not have him on the air until after the restrictive period ended. See also *Daniel v.*
10 *Trade Winds Travel, Inc.*, 532 So. 2d 653 (Ala. 1988) (enforcing a covenant not to
11 compete against a travel agent to protect her employer's investment in goodwill). But see
12 *Lunt v. Campbell*, No. 07-3845-BLS2, 2007 WL 2935864, at *3 (Mass. Super. Sept. 24,
13 2007) (holding that a covenant not to compete signed by an employee-hairdresser did not
14 reasonably serve any legitimate business interest of the employer-hairdresser because the
15 "objective of a reasonable noncompetition clause is to protect the employer's good will,
16 not to appropriate the good will of the employee.") (internal citations omitted). See also
17 *Cent. Bank of the S. v. Beasley*, 439 So. 2d 70 (Ala. 1983) (upholding a covenant not to
18 compete supported by goodwill); *Browne v. Merkert Enterprise, Inc.*, No. Civ. A. 98-386,
19 1998 WL 151253 (Mass. Super. Ct. March 31, 1998) (same); *Marcam Corp. v. Orchard*,
20 885 F. Supp. 294 (D. Mass. 1995) (applying Massachusetts law) (upholding a covenant
21 not to compete in the entire United States on the basis of employee goodwill and
22 employer valuable information); *Bollengier v. Gulati*, 233 A.D.2d 721 (N.Y. App. Div.
23 1996) (upholding a covenant not to compete supported by goodwill); *Giller v. Harcourt*
24 *Brace & Co.*, 634 N.Y.S.2d 646 (N.Y. Sup. Ct. 1995) (upholding a covenant prohibiting a
25 bar-review-course student sales representative from competing on the Syracuse
26 University Law School campus). But cf. *Nobelpharma USA, Inc. v. Straumann Co.*, No.
27 933668F, 1993 WL 818813 (Mass. Super. Ct. July 15, 1993) (refusing to enforce a
28 covenant not to compete supported by goodwill when evidence showed that the employee
29 turned down business from customers of his former employer in attempt to comply with
30 the covenant).

31
32 A restrictive covenant based on Subsection c protects only an employer's
33 investments in reputation and good will. Massachusetts law holds that good will that
34 springs solely from an employee's personal qualities is good will that belongs to the
35 employee and not a valid basis for a restrictive covenant. See *First E. Mortgage Corp. v.*
36 *Gallagher*, No. 94372F, 1994 WL 879546 (Mass. Super. July 21, 1994) (holding that an
37 employer had no legitimate interest in protecting goodwill that sprung from the
38 employee's enthusiasm and personality). See also *Liberty Mut. Ins. Co. v. Batchelor*, 26
39 *Mass. L. Rptr.* 446, 447 (Mass. Super. Ct. 2009) (noting that as a preliminary matter a
40 court must decide "whether the good will in issue belongs to the employer or the
41 employee.").

42
43 *d. Insufficient employer interests.* Employers cannot enforce restrictive covenants
44 simply because the departing employee will compete vigorously with the employer. See
45 *Chavers v. Copy Prods., Inc.*, 519 So. 2d 942 (Ala. 1988) (holding that an employer's
46 interest in keeping its most skilled copy repairman was insufficient to justify a covenant

1 not to compete); *Danieli v. Braverman*, No. 9306532, 1994 WL 879855, at *4 (Mass.
2 Super. Jan. 20, 1994) (stating that “[a] nondisclosure agreement which seeks to restrict a
3 former employee’s right to use an alleged trade secret which is not such . . . is
4 unenforceable . . .”).

5
6 *e. Sale of business.* Covenants not to compete ancillary to the sale of a
7 business are treated more favorably by courts than traditional postemployment restrictive
8 covenants and do not require the same strict inquiry. See *Dominic Wenzell, D.M.D.*
9 *P.C., v. Ingram*, 228 P.3d 103, 112 (Alaska 2010) (stating that “[a high] level of scrutiny
10 is not applied to covenants ancillary to the sale of a business because the contracting
11 parties are more likely to be of equal bargaining power.”); *Bryceland v. Northey*, 772
12 P.2d 36, 39 (Ariz. Ct. App. 1989) (noting that with “a covenant given in the sale of a
13 business . . . courts are more lenient because of the need to see that good will is
14 effectively transferred.”); *McAndless v. Carpenter*, 848 P.2d 444, 449 (Idaho App. 1993)
15 (contrasting the rules applied to covenants that are incident to employment contracts and
16 covenants ancillary to sale of business); *Boulanger v. Dunkin’ Donuts, Inc.*, 815 N.E.2d
17 572 (Mass. 2004) (noting that courts are less concerned about unequal bargaining power
18 in the context of a sale); *Alexander & Alexander, Inc. v. Danahy*, 488 N.E.2d 22, 28
19 (Mass. App. Ct. 1986) (noting that “noncompetition covenants arising out of the sale of a
20 business [are] enforced more liberally than such covenants arising out of an employer-
21 employee relationship.”); *Insulation Corp. of America v. Brobston*, 667 A.2d 729 (Pa.
22 Super. 1995) (noting that much closer scrutiny is warranted by the unequal bargaining
23 power between employers and employees than sellers and buyers); *Hospital Consultants,*
24 *Inc. v. Potyka*, 531 S.W.2d 657 (Tex. Civ. App. 1975) (explaining that such restraints are
25 necessary to insure that the buyer receives the full value of what he is purchasing);
26 *Weaver v. Ritchie*, 478 S.E.2d 363, 369 (W.Va. 1996) (noting that “post-employment
27 restraint deprives society of the valuable economic services offered by the labor of one of
28 its members . . . the post-sale restraint does not disturb the status quo because the
29 transferred business continues to operate albeit under new ownership”).

30 § 8.08. Modification of Unreasonable Restrictive Covenant

32 **A court may delete or modify provisions in an overbroad restrictive covenant**
33 **in an employment agreement and then enforce the covenant as modified unless the**
34 **agreement itself bars modification or the employer lacked a reasonable good-faith**
35 **basis for believing the covenant was enforceable. Lack of a reasonable good faith**
36 **basis for believing a covenant was enforceable may be manifested by the**
37 **overbreadth alone, if sufficiently egregious, or by the overbreadth in connection**

1 **with other evidence showing that the employer was not seeking to protect its**
2 **legitimate interests.**

3 **Comment:**

4
5 *a. Rationale.* Although unreasonable restrictive covenants should never be
6 enforced as written, a court may modify an overly broad restrictive covenant into one that
7 is reasonably tailored to the employer's protectable interest under § 8.07, and as thus
8 modified may enforce the covenant. Such modification, sometimes called "blue
9 penciling," lies within the sound discretion of the court and should be exercised with
10 circumspection so as not to create an incentive for employers to draft overbroad
11 restrictive covenants that in some instances will be taken by employees at face value. On
12 the other hand, a rule that forbids judicial modification and leaves courts with only a
13 binary enforce-reject choice can also lead over time to overly broad covenants. For
14 example, a court faced with a seven-month restriction when it thinks a six-month
15 restriction is reasonable might uphold the greater restriction rather than strike it down
16 completely. This would create a precedent that seven months is reasonable to which
17 future employers might gravitate. The best approach in navigating these competing
18 concerns is for courts to refuse to modify an overly broad restrictive covenant when the
19 employer lacked a reasonable good-faith belief that the covenant was enforceable. In
20 some cases, lack of good faith can be shown by the covenant itself being so clearly
21 overbroad that no reasonable employer would have believed it was reasonably tailored to
22 protect the employer's legitimate interests. Other cases might require additional evidence
23 of bad faith. Once overbreadth has been shown, the employer has the burden of
24 demonstrating good faith in order to justify a modification.

1 *b. Overbreadth.* To be enforceable, a restrictive covenant must be based on a
2 protectable interest (as defined in § 8.07 of this Restatement) and be reasonable in scope
3 at the time of contracting and the time of enforcement. With regards to the time of
4 contracting, a restrictive covenant that is either obtained in bad faith or that is objectively
5 unreasonable is unenforceable. With regards to the time of enforcement, a change in
6 circumstances between the time a restrictive covenant was signed and when an employer
7 seeks to enforce it may so erode the employer's protectable interest so as to render the
8 covenant unenforceable.

9

10 **Illustrations:**

11 1. Salesperson E agrees with employer X that E will refrain from
12 contacting former customers for two years after E's employment ends. A
13 reasonable restraint in this industry could have prevented E from contacting
14 former customers for up to one year. Thus, the two-year restriction is overbroad
15 and unreasonable. A court may modify the restriction to one year and then enforce
16 it unless the court finds (i) that X did not have a good-faith belief that two years
17 was a reasonable restraint and thus acted in bad faith in requiring E to agree to it;
18 or (ii) that regardless of X's subjective belief, the restriction in the particular
19 market or industry is so clearly overbroad as to be objectively unreasonable.

20 2. Employee E agrees with employer X, a petroleum manufacturer, that E
21 will not be associated with or take an interest in any petroleum company that does
22 business in any country in which X or any of its affiliates does business. The court
23 should not narrow this clearly unreasonable covenant because its breadth alone

1 warrants the inference that X could not have acted in reasonable good faith in
2 crafting the restrictive covenant.

3 REPORTERS' NOTES

4 *a. "Blue penciling."* Section 8.08 describes the rule in the majority of U.S.
5 jurisdictions. This approach is sometimes characterized as the "liberal" blue-pencil
6 doctrine. See Mich. Comp. Laws. Ann. § 445.774a (West 1989) ("To the extent any such
7 agreement or covenant is found to be unreasonable in any respect, a court may limit the
8 agreement to render it reasonable in light of the circumstances in which it was made and
9 specifically enforce the agreement as limited."); Fla. Stat. § 542.335(1)(c) (1996) ("If a
10 contractually specified restraint is overbroad, overlong or otherwise not reasonably
11 necessary to protect the legitimate business interest or interests, a court shall modify the
12 restraint and grant only the relief reasonably necessary to protect such interest or
13 interests."). See also *Mason Corp. v. Kennedy*, 244 So. 2d 585 (Ala. 1971) (holding that
14 a court has the power to enforce a restrictive covenant although the territory or time may
15 be unreasonable by granting an injunction that contains reasonable time and area
16 restrictions); *Data Mgmt., Inc. v. Greene*, 757 P.2d 62, 64–65 (Alaska 1988); *National*
17 *Graphics Co. v. Dilley*, 681 P.2d 546, 547 (Colo. Ct. App. 1984) (recognizing that
18 Colorado courts, although possessing the power to partially enforce an overbroad
19 restrictive covenant, can exercise discretion in modifying the covenant); *Knowles-*
20 *Zeswitz, Inc. v. Cara*, 260 A.2d 171, 175 (Del. Ch. 1969); *Ellis v. James V. Hurson*
21 *Assoc.*, 565 A.2d 615, 617–18 (D.C. Ct. App. 1989); *Insurance Center v. Taylor*, 49 P.2d
22 1252, 1255 (Idaho 1972) (recognizing that Idaho courts employ equitable principles in
23 modifying the content of an unreasonable covenant not to compete); ; *N. Am. Paper Co.*
24 *v. Unterberger*, 526 N.E.2d 621, 625 (Ill. Ct. App. 1988) (recognizing that Illinois courts
25 are empowered to employ principles of equity in modifying overbroad covenants not to
26 compete if considerations of fairness weigh in favor of modification); *Kempner Mobile*
27 *Elecs. v. Sw. Bell Mobile Sys.*, 2003 WL 1057929, at *22–24 (N.D. Ill. March 10, 2003)
28 (applying Illinois law) (finding that the language of a noncompetition agreement,
29 although arguably too broad, was susceptible to an interpretation that would protect
30 legitimate interests of the employer and thus not entirely void) *Phone Connection v.*
31 *Harbst*, 494 N.W.2d 445, 449–50 (Iowa Ct. App. 1992) (recognizing that courts have the
32 power to modify the content of an overly broad covenant not to compete so long as the
33 modified terms are in agreement with past Iowa case law); *Am. Fid. Assurance Corp. v.*
34 *Leonard*, 81 F. Supp. 2d 1115, 1120–21 (D. Kan. 2000) (applying Kansas law) (holding
35 that Kansas courts have the power to modify the content of covenants not to compete so
36 as to bring the contents in line with acceptable restrictions); *Hammons v. Big Sandy*
37 *Claims Serv.*, 567 S.W.2d 313, 315 (Ky. Ct. App. 1978); *Moores Pump & Supply, Inc. v.*
38 *Laneaux*, 727 So. 2d 695, 698 (La. Ct. App. 1999) (recognizing that Louisiana state law
39 requires courts to reform overbroad provisions of covenants not to compete); *Lord v.*
40 *Lord*, 454 A.2d 830, 834 (Me. 1983) (recognizing that the content of covenants not to
41 compete can be modified so as to be made reasonable); *Wrentham Co. v Cann*, 345 Mass.
42 737, 742–43 (Mass. 1963); *Dean Van Horn Consulting Assocs., Inc. v. Wold*, 395
43 N.W.2d 405, 409 (Minn. Ct. App. 1986) (holding that the blue-pencil doctrine permits

1 the court to selectively enforce provisions of a covenant not to compete); *Taylor v.*
2 *Cordis Corp.*, 634 F. Supp. 1242, 1246–1247 (S.D. Miss. 1986) (applying Mississippi
3 law) (recognizing that Mississippi courts, although possessing the power to modify the
4 contents of an unreasonable covenant not to compete, are not obligated, especially if the
5 provision is exceedingly unreasonable, to modify the content of the covenant); *Superior*
6 *Gearbox Corp. v. Edwards*, 869 S.W.2d 239 (Mo. Ct. App. 1993) (holding that Missouri
7 courts have the power to modify the content of restrictive covenants to the extent
8 necessary to make the restrictions of the covenant reasonable); *Solari Indus., Inc. v.*
9 *Malady*, 264 A.2d 53, 57 (N.J. 1970) (noting that the modification of the contents of a
10 covenant not to compete does not depend on any mechanical divisibility with respect to
11 the drafting of the contract).

12
13 Some courts will refuse to modify noncompetition agreements if the provisions
14 are excessively broad or unreasonable in order to give employers an incentive to seek
15 narrowly defined noncompetition agreements. See *Eichmann v. Nat'l Hosp. & Health*
16 *Care Servs.*, 719 N.E.2d 1141, 1149 (Ill. App. Ct. 1999) (declining to modify a
17 noncompetition agreement because the agreement, in both the activities proscribed and
18 geographic scope, was so unreasonable that any modification to make the agreement
19 reasonable would have been tantamount to the court fashioning a new agreement because
20 the modification would have had to have been so drastic); *Trailer Leasing Co. v.*
21 *Associates*, 1996 WL 392135, at *6 (N.D. Ill. July 10, 1996) (applying Illinois law).

22
23 Illustration 1 is drawn from *Robert Half Int'l, Inc. v. Van Steenis*, 784 F. Supp.
24 1263 (W.D. Mich. 1991) (applying Michigan law), and demonstrates the general rule
25 described in § 8.06(b) of this Restatement that a court will not modify a restrictive
26 covenant obtained in bad faith. See *Ferrofluidics Corp. v. Advanced Vacuum*
27 *Components, Inc.*, 968 F.2d 1463, 1470 (1st Cir. 1992) (applying Massachusetts and New
28 Hampshire law) (indicating that “deliberately unreasonable and oppressive” restrictive
29 covenants are unenforceable); *Durapin, Inc. v. Am. Prods., Inc.*, 559 A.2d 1051, 1059
30 (R.I. 1989) (stating that “unreasonable restraints [will not] be modified and enforced [if]
31 the circumstances indicate bad faith or deliberate overreaching on the part of the
32 promise.”); *Cent. Adjustment Bureau, Inc. v. Ingram*, 678 S.W.2d 28, 37 (Tenn. 1984)
33 (stating that a court will not modify or partially enforce an unreasonable restrictive
34 covenant if “the circumstances indicate bad faith on the part of the employer.”).

35
36 Courts will also assess the reasonableness of a restrictive covenant when an
37 employer seeks to enforce it, and will modify a restrictive covenant that was reasonable
38 when signed, but unreasonable due to changed circumstances. See *Hilb, Rogal &*
39 *Hamilton Co. of Ariz. v. McKinney*, 946 P.2d 464, 468 (Ariz. 1997) (refusing to enforce
40 a restrictive covenant prohibiting solicitation of a particular client that was originally
41 supported by the employer’s legitimate protectable interest because that protectable
42 interest disappeared when the employer lost the client before the employee left for
43 reasons unrelated to the employee); *Hamer Holding Group, Inc. v. Elmore*, 613 N.E.2d
44 1190, 1200 (Ill. App. Ct. 1993) (stating that it was “the eminently appropriate view” to
45 hold that “the full extent of [a restrictive covenant] was no longer necessary to protect
46 value of [the employer’s] good will, and thus, [the restrictive covenant] was no longer

1 reasonable as a matter of law.”); *Alexander & Alexander v. Drayton*, 378 F.Supp. 824,
2 831 (E.D. Pa. 1974) (applying Pennsylvania law), *aff’d* 505 F.2d 729 (3d Cir. 1974)
3 (modifying to two years a restrictive covenant with a ten year term that was reasonable
4 when signed, but which had become unreasonable because it would now prevent the
5 former employee from competing until near retirement); *Last v. N.Y. Inst. of Tech.*, 631
6 N.Y.S.2d 397, 399 (N.Y. App. Div. 1995) (refusing to enforce a geographic restriction
7 against a physician-employee because the former employer no longer operated a clinic
8 within the protected area). Furthermore, courts will not enforce a restrictive covenant
9 that is invoked in bad faith. See *Luketich v. Godecke, Wood & Co., Inc.* 835 S.W. 2d
10 504, 509 (Mo. Ct. App. 1992) (stating that bad faith or the use of “improper means” in an
11 attempt to enforce a restrictive covenant would render it unenforceable, but finding
12 neither present on the facts before the court).

13
14 A minority of states articulate a “strict” version of the blue-pencil doctrine.
15 Under this approach, a court may modify a restrictive covenant only by eliminating
16 grammatically severable portions of the text. Courts cannot revise, rearrange, or add
17 language to the agreement between the employer and employee. See *Valley Medical*
18 *Specialists v. Farber*, 982 P.2d 1277, 1286 (Ariz. 1999) (noting that the courts possess the
19 ability to modify unreasonable covenants not to compete only if the unreasonable
20 provisions are grammatically severable from the larger agreement); *Gartner Group Inc. v.*
21 *Mewes*, No. CV910118332, 1992 WL 4766, at *5 (Conn. Super. Jan. 3, 1992) (holding
22 that a court may modify a restrictive covenant only by removing an unreasonable portion
23 that is grammatically severable, as the formulation of the contract in distinct and
24 severable parts demonstrates the parties’ desire not to have the entire agreement declared
25 void); *Hahn v. Dress, Perugini & Co.*, 581 N.E.2d 457, 462 (Ind. Ct. App. 1991) (holding
26 that a court may modify a restrictive covenant by redacting unreasonable terms but not by
27 adding additional terms); *Halloway v. Faw, Casson & Co.*, 552 A.2d 1311, 1324 (Md. Ct.
28 Spec. App. 1989) (reaffirming that, although Maryland courts will not redraft the content
29 of a noncompetition agreement, they may enforce reasonable terms of the agreement that
30 are severable from the unreasonable terms); *Hartman v. W.H. Odell & Assocs., Inc.*, 450
31 S.E.2d 912, 920 (N.C. Ct. App. 1994) (noting that North Carolina’s blue- pencil doctrine
32 “severely limits what the court may do to alter the covenant,” specifically, that the court
33 may only modify to the extent that the unreasonable provisions of the covenant are
34 distinctly separate from the reasonable provisions of the covenant); *Dial Media v. Schiff*,
35 612 F. Supp. 1483, 1490 (D.R.I. 1985) (applying Rhode Island law) (same); *Café Assocs.*
36 *v. Gerngross*, 406 S.E.2d 162, 164–65 (S.C. 1991); *Ward v. Midcom, Inc.*, 575 N.W.2d
37 233, 238 (S.D. 1998) (holding that South Dakota courts are permitted in making “partial”
38 modifications, consisting of the elimination of invalid provisions, to covenants not to
39 compete so as to bring the covenant in accord with the case law of South Dakota).

40
41 A few states refuse to reform unreasonable covenants in any way. See Wis. Stat.
42 Ann. § 103.465 (West 1988) (“[A]ny covenant, described in this subsection, imposing an
43 unreasonable restraint is illegal, void and unenforceable even as to any part of the
44 covenant or performance that would be a reasonable restraint.”). See also *Bendinger v.*
45 *Marshalltown Trowell Co.*, 994 S.W.2d 468, 472–73 (Ark. 1999) (declaring that “the
46 contract must be valid as written, and the court will not apportion or enforce a contract to

1 the extent that it might be considered reasonable”); *Harville v. Gunter*, 495 S.E.2d 862,
2 864 (Ga. 1998) (refusing to narrow an unreasonably broad provision regardless of
3 whether the contract contained a severability agreement); *Pitchford v. Oakwood Mobile*
4 *Homes*, 124 F. Supp. 2d 958, 965 (W.D. Va. 2000) (applying Virginia law) (reiterating
5 that Virginia courts refuse to employ any version of the blue-pencil doctrine as Virginia
6 courts wish to avoid rewriting the contract on behalf of the parties); *Roto-Die, Inc. v.*
7 *Lesser*, 899 F. Supp. 1515, 1523 (W.D. Va. 1995) (applying Virginia law) (refusing to
8 adopt blue-pencil rule and modify noncompetition agreement, but agreeing to enforce
9 severable confidentiality and nonsolicitation agreements). Cf. *Roy’s Orthopedic v.*
10 *Lavigne*, 487 A.2d 173, 175 (Vt. 1985) (refusing to extend three-year period of
11 noncompetition called for in contract, even though litigation delay through no fault of
12 employer meant the period had run before an injunction could issue, holding that “courts
13 must enforce contracts as they are written”). Nebraska has steadfastly declined to use the
14 blue-pencil doctrine, but has implied it might do so in an appropriately argued case. See
15 *Griffin Toronjo Pivateau, Putting The Blue Pencil Down: An Argument for Specificity in*
16 *Noncompete Agreements*, 86 Neb. L. Rev. 672, 682 n.35 (2008) (noting that “Nebraska
17 courts have not applied the blue pencil doctrine, but one cannot count it among the no-
18 modification states, as the Nebraska Supreme Court has reserved the right to use the
19 doctrine.” (citing *Polly v. Ray D. Hilderman & Co.*, 407 N.W.2d 751, 756–57 (Neb.
20 1987)).

21
22 Although the no-modification approach might appear to be throwing the
23 proverbial baby out with the bathwater, some scholars suggest that such an approach is
24 justified given that unenforceable provisions impose heavy burdens on individuals—
25 harming not only employees but also increasing inefficiencies and introducing confusion
26 into court proceedings—the blue-pencil doctrine often encourages employers to include
27 unenforceable provisions in covenants not to compete. See *Griffin Toronjo Pivateau,*
28 *Putting the Blue Pencil Down: An Argument for Specificity in Noncompete Agreements,*
29 86 Neb. L. Rev. 672, 689–92 (2008); Charles Sullivan, *The Puzzling Persistence of*
30 *Unenforceable Contract Terms*, 77 Ohio St. L.J. 1127 (2009). Outlining some of the
31 problems associated with unenforceable provisions, Charles Sullivan commented that,
32 “[w]hile it [unenforceable provision] will not be enforceable per se, the other party may
33 honor it for reasons ranging from a personal moral commitment to a misunderstanding of
34 its legality to unwillingness to risk the resources necessary to establish its
35 unenforceability.” *Id.* at 1162.

36
37 Illustration 2 is drawn from *Crippen v. United Petroleum Feedstocks, Inc.*, 245
38 A.D.2d 152 (N.Y. App. Div. 1997). See also *Leon M. Reimer & Co. PC v. Cipolla*, 929
39 F. Supp. 154 (S.D.N.Y. 1996) (applying New York law) (refusing to reform an overbroad
40 covenant), *Lee/O’Keefe Ins. Agency, Inc. v. Ferega*, 516 N.E.2d 1313, 1329 (Ill. Ct. App.
41 1987) (“A modification of the contract under the circumstances here would have involved
42 more than a temporal or geographical modification and would have been tantamount to
43 drafting a new contract. Moreover, it could have the potential effect of discouraging the
44 narrow and precise draftsmanship which should be reflected in written agreements.”).

45
46 *b. Overbroad restrictive covenants and actions at law.* The blue pencil doctrine is
47 an equitable one. Some courts appear receptive to the claim that breach of an

1 unreasonable restrictive covenant—one that would be blue-penciled in a suit seeking an
2 injunction or temporary restraining order—may be a defense to an action by an employee
3 seeking damages. See *Krauss v. M.L. Clusters & Sons, Inc.*, 254 A.2d 1,3 (Pa. 1969)
4 (refusing to overturn a judgment for the appellee who succeeded at trial on a breach of
5 contract defense where appellant complained that the restrictive covenant he breached
6 was overbroad and thus unenforceable); *Boyce v. Smith*, 580 A.2d 1382, 1389 (Pa.
7 Super. Ct. 1990) (limiting the breach of contract defense by remanding it to the trial court
8 for determination of proximate cause and amount of damages).

9
10 **§ 8.09. Rights of Employee to Inventions**

11 **(a) Unless an employee has been hired for inventive work, the employee has the**
12 **right to patent an invention the employee creates, even if the invention is created**
13 **during working hours or with the use of the employer’s resources.**

14 **(b) An employee hired or assigned to do inventive work is deemed to have agreed**
15 **to assign patents to the resulting inventions to the employer.**

16
17 **Comment:**

18 *a. Presumption of employee ownership if hired for noninventive work.* Federal
19 patent law and state laws generally assign ownership rights in inventions to the individual
20 creating the invention, thus encouraging the pursuit of creative activities. Unless the
21 employee is hired to perform inventive work, the law assumes the employee is the
22 rightful owner of any inventions the employee creates. An employee hired to perform
23 inventive work, by contrast, presumptively must assign the patent rights to any resulting
24 invention to the employer. Employer “shop rights” to inventions created by noninventive
25 employees during working hours or using the employer’s equipment are described in §
26 8.10.

27

1 Illustrations:

2 1. Employee E was hired to unload trucks and carry supplies at a pecan-
3 processing plant X. Nothing in E’s employment agreement touched on
4 inventions. After watching other workers struggle with separating worms from
5 the shelled pecans, E developed a process of soaking the pecans in a weak
6 solution of yellow food coloring, which helped distinguish the worms from the
7 pecans. Because E was not hired to invent and signed no agreement expressly
8 assigning inventions to X, E retains the exclusive right to patent the invention.

9 2. Employee E is hired by X to perform chemistry research in X’s research
10 and development laboratory. Because E was hired specifically to invent, X can
11 enforce the assignment of the rights to a chemical compound developed by E
12 while employed by X.

13 REPORTERS’ NOTES

14
15 *a. Presumption of employee ownership if hired for noninventive work.* The
16 general rule is that an employee owns the patent rights to any invention he or she creates.
17 See *United States v. Dubilier Condenser Corp.*, 289 U.S. 178, 187 (1933) (holding that
18 “if the employment be general, albeit it covers a field of labor and effort in the
19 performance of which the employee conceived the invention for which he obtained a
20 patent, the [employment] contract is not so broadly construed as to require an assignment
21 of the patent”); *Banks v. Unisys Corp.*, 228 F.3d 1357, 1359 (Fed. Cir. 2000)
22 (recognizing that employees are generally entitled to the patent rights of any inventions
23 they create absent an agreement that the employee was hired to invent; in this case, an
24 employee hired to invent refused to sign a contract transferring invention rights to the
25 employer and the court reversed summary judgment for the employer, remanding for a
26 factual determination of whether an implied-in-fact contract assigning rights existed);
27 *City of Cocoa v. Leffler*, 803 So. 2d 869, 873 (Fla. Dist. Ct. App. 2002) (holding that
28 absent employment agreement that employee was hired to invent, an employee retained
29 patent rights to any invention he created); *Pedersen v. Akona, LLC*, 429 F. Supp. 2d
30 1130, 1142 (D. Minn. 2006) (applying Minnesota law) (recognizing the presumption that
31 an employee-inventor retains the rights to his inventive work, but finding as a matter of
32 law that employee was “required to assign those rights to [the employer] based on an
33 implied-in-fact contract [by which the employee was hired] for the sole purpose of
34 developing a commercially viable floor-sweeping compound”); *Cahill v. Regan*, 157

1 N.E.2d 505, 509 (N.Y. 1959) (holding that employee hired to manage and supervise can
2 company and told to work with the company’s equipment and materials on the idea of a
3 new can, “which he had already conceived,” with no express agreement to assign any
4 resulting patents, did not have to assign patent to employer, because in determining
5 whether an employee was directed to invent one must distinguish between the birth of an
6 idea and the embodiment of the idea). The determination of whether an employee was
7 hired to invent is a question of fact to be gleaned from all of the circumstances
8 surrounding the relationship between the employee and employer. See *Teets v.*
9 *Chronalloy*, 83 F.3d 403, 407–08 (Fed. Cir. 1996) (applying Florida law).

10
11 Although an employee might have been hired for general purposes, and thus
12 would normally be entitled to the patent rights of any invention created, if the employee’s
13 responsibilities or job description change in such a way that the employee is being
14 employed to invent something, then the right to any subsequent invention lies with the
15 employer. See *Forberg v. Servel, Inc.*, 88 F. Supp. 503, 509 (S.D.N.Y. 1949) (holding
16 that where an employee is reassigned to invent a solution for a particular problem, the
17 rights to any subsequent invention belong to the employer because after the reassignment,
18 the employee was being employed to invent); *Houghton v. United States.*, 23 F.2d 386,
19 390 (4th Cir. 1928) (noting that, in determining whether an employee was being
20 employed to invent, “it matters not in what capacity the employee may originally have
21 been hired . . .” but rather the responsibilities of the employee at the time of the
22 invention).

23
24 Illustration 1 is based on *Wommack v. Durham Pecan Co.*, 715 F.2d 962 (5th Cir.
25 1983), in which the employer conceded the employee had the right to the patent but
26 successfully argued that the employer had a shop right to use the invention even after the
27 employee was fired, because the employee had consented to the employer’s use and the
28 employer had assisted in developing the invention for commercial use.

29
30 Illustration 2 is based on *Misani v. Ortho Pharmaceutical Corp.*, 210 A.2d 609
31 (N.J. 1965), which held that an agreement signed by an employee hired solely for
32 research purposes assigning to her employer the rights to any ideas and inventions
33 developed during her employment was valid and enforceable.

34 35 **§ 8.10. Employer Shop Right to Employee Inventions**

36 **In situations where an employee retains the patent, the employer has a**
37 **nonexclusive, nonassignable privilege to use, without payment of royalty, any**
38 **invention that an employee creates during working hours or with the use of the**
39 **employer’s resources.**

40 **Comment:**

1 *a. Relation to § 8.01.* While employed with an employer that hold's a shop right
2 to her invention, an employee may violate the duty of loyalty if she grants a license to use
3 that invention to a competitor of her employer.

4 *b. Relation to § 8.09.* The “shop right” rule is an important corollary to the rule in
5 § 8.09. If an employee were able to extract royalties from the employer for inventions
6 created in the course of employment, the employer would restrict its employees' use of
7 resources for creative endeavors. This would tend to undermine the creative enterprise.
8 The rules in §§ 8.09 and 8.10 create a dual incentive structure. They encourage the
9 creation of socially useful inventions both by providing incentives for employees to
10 invent, and by providing incentives for employers to let them do so. Inventions created
11 on the employee's personal time and without the use of the employer's resources do not
12 trigger an employer shop right.

13 *c. Nonalienability.* The shop right granted to the employer constitutes a
14 nonexclusive, nonassignable license to use the employee's patented invention which
15 remains the employee's property. Like the personal easement in property law, there is a
16 right of use but not the other incidents of ownership.

17 *d. Timing of creation.* An invention is not patentable until it is capable of being
18 put to practical use by developing, perfecting, or devising the product. An idea alone is
19 not sufficient to deem an invention “created.” Thus, a shop right is not created simply
20 when an employee comes up with an idea, even using company time and company
21 resources, if the embodiment of the idea in a useable form does not occur until after the
22 employee leaves the employer.

23

1 **Illustrations:**

2 1. Employee E conceives a new drug while working for biotech firm X. E
3 does not develop the idea into a patentable form or practical use until eight
4 months after employment with X has terminated. Absent an express agreement to
5 the contrary, X does not have a shop right in E's invention; X's rights here, if any,
6 depend on whether there has been an assignment under § 8.11.

7 2. Employee E conceives an idea to produce a product before beginning to
8 work for employer X. While employed by X, E reduces the idea to a practical
9 form using X's resources. X has a shop right in E's invention.

10 3. Employee E conceives an idea for a new product while working for
11 manufacturer X. With the assistance of X's laboratories, E reduces the idea to
12 practice. Not until after E's employment with X is terminated, however, does E
13 complete developing the model in a form that can be commercially exploited.
14 Nonetheless, during the term of E's employment, the invention was sufficiently
15 created for X to acquire a shop right in its use.

16
17 *e. Use of employer's resources.* An employee's use of the employer's resources
18 includes use of the employer's facilities, appliances, or materials, as well as the
19 employer's intellectual property such as computer programs and the working time of
20 fellow employees.

21

22

23

1 **Illustrations:**

2 4. Employee conceptualizes an idea while employed by employer X. E
3 was hired for noninventive work and did not agree to assign any inventions to X.
4 While employed, E reduces the idea to practice and uses X's tools to assemble the
5 product. E's idea is E's property but X is entitled to a shop right in this invention.

6 5. Employee E conceptualizes an idea while working for employer X. E
7 was hired for noninventive work and did not agree to assign any inventions to X.
8 E reduces the idea to practice at home, and works on the project entirely on E's
9 own time and without using any of X's resources. X does not have a shop right in
10 E's invention.

11

12 *f. Costs borne by the employer.* Even if an employee makes an invention outside
13 of working hours and uses neither the employer's resources nor the services of its
14 employees in conceiving, developing, or perfecting the invention, the employer acquires
15 a shop right if, acting at the employee's behest, it bears the cost of preparing the patents
16 and working drawings of the invention or the cost of construction to put the invention
17 into practical use.

18

19 **Illustration:**

20 6. E, an employee of casting manufacturer X, conceptualizes an idea for a
21 new steel casting. E reduces the idea to practice without using X's resources.
22 Two months later, X assists E with the costs of creating patterns, working
23 drawings, and working machines in anticipation of filing a patent application. E

1 was not hired to invent and did not agree to assign any inventions to X. X is
2 entitled to a shop right in E’s invention.

3

4 *g. Duration.* When an employee invention yields a patent with shop rights for the
5 employer, that shop right lasts for the life of the patent and is not limited to the duration
6 of employment. The duration of an employer’s shop right or similar license, however,
7 may be limited by agreement between employer and employee.

8

REPORTERS’ NOTES

9 *a. Relation to § 8.01.* While an employee is the sole owner of an invention or
10 patent subject to a shop right, she may still violate the duty of loyalty by granting, while
11 still employed with the shop right holder, a license to use that invention or patent to a
12 competitor of the shop right holder. See *Avtec Sys. Inc. v. Pfeiffer*, 805 F.Supp. 1312,
13 1317 (E.D. Va. 1992) (holding that an employee violated the duty of loyalty by
14 “attempting to serve two masters” when he contracted with employer’s competitor for
15 exclusive marketing and sale of a stand-alone version of a computer program subject to
16 the employer’s shop right while still employed with that employer) *vacated in part on*
17 *other grounds*, 21 F.3d 568 (4th Cir. 1994).

18

19 *b. Relation to § 8.09.* The shop-right doctrine is a common-law principle, and
20 most courts consider many factors and apply the principle flexibly as a question of
21 fairness. See *McElmurry v. Ark. Power & Light Co.*, 995 F.2d 1576, 1581–82 (Fed. Cir.
22 1993) (applying Arkansas law) (explaining that “the proper methodology for determining
23 whether an employer has acquired a ‘shop right’ in a patented invention is to look to the
24 totality of the circumstances on a case by case basis and determine whether the facts of a
25 particular case demand, under principles of equity and fairness, a finding that a ‘shop
26 right’ exists. In such an analysis, one should look to such factors as the circumstances
27 surrounding the development of the patented invention and the inventor’s activities
28 respecting that invention, once developed, to determine whether equity and fairness
29 demand that the employer be allowed to use that invention in his business.”).

30

31 *c. Nonalienability.* A shop right will pass to a successor corporation or receiver,
32 since they are considered to be a continuing entity. See *Spellman v. Ruhde*, 137 N.W.2d
33 425, 430 (Wis. 1965) (noting in dicta that “although shop rights are not assignable, they
34 nevertheless do pass to a successor corporation.”) This is true even where the successor
35 company does not continue to run the business in the same manner as the prior
36 corporation. See *Cal. E. Labs, Inc. v. Gould*, 896 F.2d 400 (Cal. 1990) (holding that
37 employer’s shop right passed to corporation that purchased employer’s business, even
38 though the purchasing corporation distributed the employer’s assets to various
39 subsidiaries.) However, if the corporation liquidates, the shop rights will terminate

1 commensurate with the termination of the original corporation. See *Hapgood v. Hewitt*,
2 119 U.S. 226 (1886) (holding that patent rights did not pass to newly formed company
3 where preexisting company which held the right had dissolved).
4

5 *d. Timing of creation.* Illustration 1 is based loosely on *Jamesbury Corp. v.*
6 *Worcester Valve Co.*, 318 F. Supp. 1, 7 (D. Mass. 1970) (applying Massachusetts law)
7 (holding that an invention is not created until it is represented by some type of
8 reproducible experiment or physical form).
9

10 Illustration 2 is based on *Logus Mfg. Corp. v. Nelson*, 195 U.S.P.Q. (BNA) 566,
11 569 (E.D.N.Y. 1977) (applying New York law) (holding that an employer who assisted
12 an employee with an invention is entitled to a shop right, even if the employee
13 conceptualized the idea prior to employment.)
14

15 Illustration 3 is based loosely on *Andreaggi v. Relis*, 408 A.2d 455, 464 (N.J.
16 Super. Ct. 1979) (finding that in order for an employer to acquire rights in an invention
17 created by an employee, the invention need only be reduced to practice, and need not be
18 reduced to a salable model).
19

20 *e. Use of employer's property.* Illustration 4 is loosely based on *United States v.*
21 *Dubilier Condenser Corp.*, 289 U.S. 178, 191 (1933) (holding that both government and
22 private employers are entitled to nonexclusive shop rights when an employee creates an
23 invention with the use of the employer's resources).
24

25 Illustration 5 is based on *Heywood-Wakefield Co. v. Small*, 87 F.2d 716, 721 (1st
26 Cir. 1937) (holding that an employer does not have a shop right in an employee's
27 invention, if such invention was created on employee's own time without using any of
28 employer's resources).
29

30 *f. Costs borne by the employer.* Illustration 6 is based on *Gill v. United States*,
31 160 U.S. 426, 436–37 (1896) (holding that an employer who assists an employee in
32 preparing the working drawings and models of an invention, even after it has been
33 reduced to practice, is entitled to a shop right). See also *Wommack v. Durham Pecan*
34 *Co.*, 715 F.2d 962, 966 (5th Cir. 1983) (“An employee may reduce his idea to practice on
35 his own time before showing his invention to his employer, and nevertheless subsequent
36 employer-employee cooperation on the invention may be sufficient to confer a shop right
37 upon the employer.”); *McElmurry v. Ark. Power & Light Co.*, 995 F.2d 1576 (Fed. Cir.
38 1993) (manufacturing costs borne by employer); 6 Donald S. Chisum, *Patents* § 22.03[3],
39 at 22–40 (1993) (discussing shop rights); Evelyn D. Pisegna-Cook, *Ownership Rights of*
40 *Employee Inventions: The Role of Preinvention Assignment Agreements and State*
41 *Statutes*, 2 U. Balt. Intell. Prop. L.J. 163, 167 (1994) (review of shop rights).
42
43
44
45
46

1 **§ 8.11. Employee Agreements to Assign Patents**

2 **A reasonable agreement by an employee to assign patents to the employer to**
3 **inventions created during an employment relationship or for a reasonable time**
4 **thereafter is enforceable. To be reasonable, an agreement may require the**
5 **employee to assign patents only to inventions that were created during work time or**
6 **using the employer’s resources, or that relate to the employer’s line of business or**
7 **research.**

8

9 **Comment:**

10 *a. Agreements must be reasonable in scope.* As a condition of employment,
11 employers often require employees to expressly agree to assign all inventions created by
12 an employee to the employer. Regardless of whether the employee was hired or retained
13 to invent, the agreement must be reasonable in scope to be enforceable. Generally, the
14 agreement cannot require the employee to assign inventions unrelated to the employer’s
15 line of business or research or not created with the employer’s resources or as a result of
16 work carried out on behalf of the employer.

17

18 **Illustrations:**

19 1. Employer X requires employee E to agree to assign any and all
20 inventions he creates which relate to any business in which X may at some point
21 engage. The assignment contract is not reasonable in scope and therefore is not
22 enforceable.

1 2. Defense contractor X requires employee E to agree to assign all
2 inventions created during the term of employment to X, if such invention is
3 related to X's line of business or resulted from work performed on behalf of X. E
4 invents a warfare simulator that is related to X's business, but does so after work
5 using E's own resources. The assignment is enforceable with regards to the
6 warfare simulator.

7
8 *b. Assignment as default rule.* The law generally recognizes that employees hired
9 to do inventive work implicitly agree to assign patents to their employers. Similarly, an
10 employee who is not specifically hired to do inventive work but is later assigned to do a
11 specific piece of inventive work implicitly agrees to assign the patent to any resulting
12 inventions. This rule is a sensible default, as employers would not hire employees to do
13 inventive work if they were not able to reap the benefits of their investments.

14

15 **Illustrations:**

16 3. Employee E is hired by manufacturer X to create new machinery. X
17 has not asked for an agreement from E specifically promising to assign to X the
18 patent rights of inventions E creates. Even without an express agreement, X has
19 exclusive rights to the patents of any inventions created by E in the course of his
20 employment.

21 4. Employee E is hired by manufacturer X to assist in administrative and
22 secretarial duties. E does not explicitly agree to assign any inventions to X, and

1 further is not asked by X to engage in any inventive work. E has not agreed to
2 assign inventions to X.

3

4 *c. Inventions by inventive employees created shortly after termination of*
5 *employment.* Absent an agreement to the contrary, an employee has the right to patent
6 inventions that the employee creates after the termination of an employment relationship,
7 even when the employee had agreed to assign inventions created during the term of
8 employment to the employer. It is normally a question of fact whether an employee
9 indeed created an invention during or after termination of employment. The
10 circumstances surrounding the end of the employment relationship and the creation of the
11 invention, including the asserted time between the two, are considered when determining
12 when an employee actually created an invention.

13

14 **Illustration:**

15 5. Employee E was hired by Company X for inventive work. During the
16 term of E's employment, E created numerous inventions which were patented,
17 and those patents were subsequently assigned to X. Eight months after E leaves
18 X's employ, E conceives of and reduces an idea for a new liquid display to
19 practice. E had not done any work on the liquid display, or used X's resources,
20 while employed by X. E retains the exclusive rights to patent the invention.

21

22 *d. Holdover assignment agreements.* Agreements by employees to assign the
23 patents to inventions created a reasonable time after the termination of an employment

1 agreement—often called “holdover assignment agreements” or “trailer clauses”—are
2 generally enforceable. Such agreements allow employers to limit the ability of inventive
3 employees to quit immediately after creating a valuable invention and falsely claim to
4 have created the invention after the end of the relationship. Such clauses must be
5 reasonably limited in duration and scope to allow research-and-development employees
6 to remain mobile.

7

8 **Illustrations:**

9 6. Employee E is hired for inventive work by company X. For the term of
10 the employment, E agrees to assign to X all inventions E creates that fall within
11 the scope of E’s employment. E also agrees for a period of six months following
12 the termination of employment to assign all inventions E creates that are invented
13 with the use of X’s proprietary information. The agreement is enforceable.

14 7. Same facts as in Illustration 6, except the agreement requires E to assign
15 all inventions E creates during the term of employment and for a period of ten
16 years following the termination of employment. The agreement is not
17 enforceable.

18

19

20 **REPORTERS’ NOTES**

21

22 *a. Agreements must be reasonable in scope.* Agreements to assign patent rights to
23 the employer are enforceable even if the employee was not hired to invent. See *Cubic*
24 *Corp. v. Marty*, 229 Cal. Rptr. 828, 833–34 (Cal. Ct. App. 1986). A number of states
25 have enacted statutes to deal with assignment agreements. See Cal. Lab. Code Ann. §
26 2870 (West 2003) (“(a) Any provision in an employment agreement which provides that
27 an employee shall assign, or offer to assign, any of his or her rights in an invention to his
28 or her employer shall not apply to an invention that the employee developed entirely on
29 his or her own time without using the employer’s equipment, supplies, facilities, or trade
secret information except for those inventions that either: (1) Relate at the time of

1 conception or reduction to practice of the invention to the employer’s business, or actual
2 or demonstrably anticipated research or development of the employer; or (2) Result from
3 any work performed by the employee for the employer.”). See also Del. Code Ann. tit.
4 19, section 805 (1993) (“Any provision in an employment agreement which provides that
5 the employee shall assign or offer to assign any of the employee’s rights in an invention
6 to the employee’s employer shall not apply to an invention that the employee developed
7 entirely on the employee’s own time without using the employer’s equipment, supplies,
8 facility or trade secret information, except for those inventions that; (i) relate to the
9 employer’s business or actual or demonstrably anticipated research or development, or
10 (ii) result from any work performed by the employee for the employer. To the extent a
11 provision in an employment agreement purports to apply to the type of invention
12 described, it is against the public policy of this State and is unenforceable. An employer
13 may not require a provision of an employment agreement made unenforceable under this
14 section as a condition of employment or continued employment.”); Kan. Stat. Ann.
15 section 44-130 (1993); Minn. Stat. Ann. § 181.78 (West 1994); N.C. Gen. Stat. §§ 66-
16 57.1–2 (1994); Wash. Rev. Code §§ 49.44.140–150 (1994).

17
18 Agreements to assign patent rights to an employer hinder an employee’s mobility
19 in the labor market and are thus restrictive contracts. As such, one would expect to find
20 the “blue pencil” doctrine of § 8.08 applied so as to limit enforcement of these
21 agreements to reasonable terms. Indeed, this is the case in at least two states. See
22 *Saccomanno v. Honeywell Int’l., Inc.*, No. BER-C-73-07, 2008 WL 2880700 (N.J. Super.
23 Ct. Ch. Div July 2, 2008) (adding a term to an invention assignment agreement);
24 *Universal Winding Co. v. Clarke*, 108 F. Supp. 329, 338 (D. Conn. 1952) (applying
25 Rhode Island law) (reading a restriction into the language of an invention assignment
26 agreement not present on the face thereof). There is no reason to believe that other courts
27 squarely presented with the issue would rule otherwise.

28
29 Illustration 1 is based on *Guth v. Minn. Mining & Mfg. Co.*, 72 F.2d 385, 388–89
30 (7th Cir. 1934) (holding that preinvention contracts that are unreasonable in scope and
31 duration are unenforceable as they constitute an unreasonable restraint on employee
32 mobility).

33
34 Illustration 2 is based on *Cubic Corp. v. Marty*, 185 Cal. App. 3d 438 (Cal. Ct.
35 App. 1986) (finding an assignment clause enforceable because a warfare simulator is
36 related to a defense contractor’s business).

37
38 *b. Implied agreements to assign.* Illustration 3 is based on *Standard Parts Co. v.*
39 *Peck*, 264 U.S. 52 (1924) (holding that an employee who is hired to invent, implicitly
40 assigns inventions made within the scope of his employment to his employer).

41
42 While the scope of this Restatement does not include independent contractors, it
43 should be noted that there is no presumption that independent contractors impliedly
44 assign their inventions to their employer. See 17 U.S.C. § 201(b) (2006) (“In the case of
45 a work made for hire, the employer or other person for whom the work was prepared is
46 considered the author for purposes of this title, and, unless the parties have expressly

1 agreed otherwise in a written instrument signed by them, owns all of the rights comprised
2 in the copyright.”); *Cmty for Creative Non-Violence v. Reid*, 490 U.S. 730 (1989)
3 (holding that sculptor retained copyright to his work because he was an independent
4 contractor and therefore not subject to the work-for-hire doctrine applicable to
5 employees).

6
7 Illustration 4 is based on the holding of *United States v. Dubilier Condenser*
8 *Corp.*, 289 U.S. 178 (1933), which held that, absent an explicit agreement to assign
9 patents, a Bureau of Standards employee not specifically directed to invent retained the
10 right to his inventions, even when created on work time with work materials.

11
12 *c. Inventions by inventive employees created shortly after termination of*
13 *employment.* Illustration 5 is also based on the holding of *United States v. Dubilier*
14 *Condenser Corp.*, 289 U.S. 178 (1933), which found that absent an explicit or implicit
15 agreement, an employee retains exclusive title to her inventions.

16
17 *d. Holdover assignment agreements.* As with restrictive covenants generally,
18 agreements to assign inventions created for a period after employment are generally
19 enforceable if they are reasonable in scope and time. See *Murray v. A.F. Holden*, 12
20 Conn. Supp. 419, 420 (Conn. Super. Ct. 1944). Such agreements are presumptively
21 unreasonable if they are limitless in scope and time. See *Guth v. Minnesota Mining &*
22 *Manufacturing Co.*, 72 F.2d 385, 388 (7th Cir. 1934).

23
24 Illustration 6 is based on *Gen. Signal Corp. v. Primary Flow Signal, Inc.*, Civ. A.
25 Nos. 85-0471B, 1987 WL 147798 (D.R.I. July 27, 1987). In that case, an employee
26 claimed to have developed a complex product a mere five days after the end of a six
27 month holdover agreement. The court, finding that the complex nature of the invention
28 conclusively showed that it had been developed during the holdover period, enforced the
29 agreement.

30
31 Illustration 7 is based on *United Shoe Mach. Co. v. La Chapelle*, 99 N.E.2d 289
32 (Mass. 1912). In that case, the court refused to uphold a holdover assignment agreement,
33 stating that a ten year holdover period “savor[ed] of restraint of trade” and “would choke
34 the inventive capacity of the defendant for a period so long after his employment ceased
35 that his usefulness to himself or to any competitor would be extinguished in most
36 instances.” *Id.*

37
38 As the Illustrations indicate, the reasonableness of a holdover assignment
39 agreement is fact dependent, and there is no single holdover period length that is
40 presumptively unreasonable. See *Murray v. A.F. Holden*, 12 Conn. Supp. 419, 422 (two
41 year holdover period reasonable and enforceable); *Universal Winding Co. v. Clarke*, 108
42 F. Supp. 329, 338 (D. Conn. 1952) (one year holdover period reasonable and
43 enforceable).

44
45
46