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The *Restatement's* Supersized Duty of Loyalty Provision

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THE *RESTATEMENT'S* SUPERSIZED DUTY OF LOYALTY PROVISION

BY
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I. INTRODUCTION

The beauty of the employment at-will relationship, it is often said, is its reciprocity: neither employees nor employers are bound to continue the relationship. Employees are free to quit at any time, and this freedom is often invoked to explain why employees prefer at-will employment. This supposed preference obviously ignores the imbalance of power that governs the non-union employment setting, which typically leaves little room for employee preferences, but putting aside this issue of preference, employees increasingly find themselves with less freedom to move to a new employer than they might have expected. Over the last decade or so, within the at-will relationship, employers have begun to impose a number of restrictions on employees' ability to move to new employers. One means of accomplishing this is through non-compete agreements, which have found their way into a vast number of employment relations even for employees at lower levels of the company hierarchy.[1] Not so long ago, there was a general judicial hostility to

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1. *See, e.g.*, Viva R. Moffatt, *The Wrong Tool for the Job: The IP Problem Within Noncompetition Agreements*, 52 WM. & MARY L. REV. 873, 878 (2010) (noting the sharp increase in the use of non-compete agreements); Charles A. Sullivan, *The Puzzling Persistence of Unenforceable Contract Terms*, 70 OHIO ST. L.J. 1127, 1149 (2009) ("In the past, only the most valuable employees, often those under individual contracts, were subject to noncompetition clauses. Today, however, many at-will employees are also subject to such

non-competes because they were seen as a restraint on competition, but that hostility has faded in all but a few jurisdictions, and today most non-competes that are drafted with a limited time and purpose tend to be upheld.[2]

There has also been a related and parallel trend in trade secrets litigation, which has also increased substantially over the last decade and can likewise impose a significant restriction on an employee's ability to move to a new employer.[3] Unlike a non-compete, which is contractually based, trade secrets litigation is now primarily statutory in nature and is typically dependent on swift enforcement to protect the purported secrets.[4] If a court finds that an employer's trade secret is threatened by an employee's move to a competitor, that employee will typically be restrained from moving for some defined period of time, although the competitor may ultimately lose interest in that employee if the time delay is too great, thus preventing her from moving at all.

Together these twin doctrines have created what can be substantial limitations on an employee's mobility; and there is a third doctrine that can serve a similar function, though to date it has played the role of a lonely cousin who sits on the sidelines while the older kids play. This third doctrine is the duty of loyalty, which is a tort claim that carries with it the full panoply of tort remedies. Compared to the litigation over either trade secrets or non-compete agreements, the duty of loyalty tort has generated only a modest amount of either

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restrictions . . . .").

2. It should be noted that there is considerable variance among jurisdictions with some jurisdictions subjecting the agreements to more strict scrutiny than others. *See* Michael J. Garrison & John T. Wendt, *The Evolving Law of Employee Noncompete Agreements: Recent Trends and an Alternative Policy Approach*, 45 AM. BUS. L.J. 107 (2008) (discussing the different approaches courts take).

3. The increased litigation regarding trade secrets has recently been documented. *See* David S. Almeling et al., *A Statistical Analysis of Trade Secret Litigation in Federal Courts*, 45 GONZ. L. REV. 291, 293 (2009/2010) ("Trade secrets litigation is growing exponentially. The data show that trade secret cases doubled in the seven years from 1988 to 1995, and doubled again in the nine years from 1995 to 2004.").

4. The need for injunctive relief is captured in the judicial aphorism, "[a] trade secret once lost is, of course, lost forever." FMC Corp. v. Taiwan Tainan Giant Indus. Co., 730 F.2d 61, 63 (2d Cir. 1984). This is reflected in the controversial doctrine of "inevitable disclosure," where an employer seeks to enjoin an employee based on the inevitability of disclosing trade secrets. *See* PepsiCo, Inc. v. Redmond, 54 F.3d 1262 (7th Cir. 1995). But the need for injunctive relief also arises to prevent continued use of a trade secret. *See* Litig. Mgmt., Inc. v. Bourgeois, 32 Individual Emp. Rts. Cas. (BNA) 677 (Ohio App. 2011) ("Without an injunction, it is plain that [the] trade secrets would continue to be used in the future . . . .") Damages can also be available. *See* Siemens Water Tech. Corp. v. Revo Water Sys. LLC, 74 So.3d 824, 828 (La. App. 2011) (permitting damages based on "profits derived from the misappropriation").

litigation or interest, and most commonly, it is a tag-on claim to one of the other causes of action.[5] Another distinguishing feature is that the duty of loyalty is a creature of agency law, based on the premise that an agent owes a duty of loyalty to her principal, and many, though not all, courts have seen fit to treat the employment relationship as a principal-agent relationship.[6] Even among courts that have found such a relationship, the duty of loyalty has been successfully invoked primarily in two situations. The most common claim involves an employee who leaves to start a competing business, and the question that arises is whether the employee in preparing to set up a competing business did anything that might have hurt the employer, or principal – did he or she divert business, solicit employees, sabotage performance, or anything else that might have been in conflict with his or her duties as an agent?[7] The law in this area is well defined, and that law is that employees can prepare to compete with their current employer, but they must not solicit business and, in some circumstances, employees prior to leaving their employment.[8] But most employees do not leave to start a competing business; more commonly, an employee might leave to work for a competitor. To date, the duty of loyalty tort has had very little to say about that circumstance. Absent a non-compete or the

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5. *See, e.g.*, Omega Optical, Inc. v. Chroma Tech. Corp., 800 A.2d 1064 (Vt. 2002), discussed further *infra* text accompanying notes 25-27.

6. *See, e.g.*, Taser Int'l v. Ward, 231 P.3d 921, 925-26 (Ariz. App. 2010) (citing agency principles as informing duty of loyalty); Lucht's Concrete Pumping, Inc. v. Horner & Everist Materials, LLC, 224 P.3d 355, 360 (Colo. App. 2009), *rev'd on other grounds*, 255 P.3d 1058 (Colo. 2011); ERI Consulting Eng'rs, Inc. v. Swinnea, 318 S.W.3d 867, 874 (Tex. 2010). For a good and succinct discussion of the agency principles, see Deborah A. DeMott, *Disloyal Agents*, 58 ALA. L. REV. 1049 (2007).

7. One statement of this principle is: "It is an agent's duty to act, in all circumstances, with due regard for the interests of his principal, and to act with the utmost good faith and loyalty." Allied Supply Co. v. Brown, 585 So.2d 33, 37 (Ala. 1991).

8. It would be easy to cite any number of cases for this proposition, which is well accepted, but one case that has found its way into the casebooks is *Augat, Inc. v. Aegis, Inc.*, 565 N.E.2d 415 (Mass. 1991), where the court stated,

> An at-will employee may properly plan to go into competition with his employer and may take active steps to do so while still employed. Such an employee has no general duty to disclose his plans to his employer, and generally he may secretly join other employees in the endeavor without violating any duty to his employer. . . . There, are, however, certain limitations on the conduct of an employee who plans to compete with his employer. He may not appropriate his employer's trade secrets. He may not solicit his employer's customers while still working for his employer, and he may not carry certain information, such as the lists of customers. Of course, such a person may not act for his future interests at the expense of his employer by using the employer's funds or employees for personal gain or by a course of conduct designed to hurt the employer.

Id. at 419-20.

misappropriation of trade secrets, an employee is free to move to the highest bidder.

The other situation is equally limited in that it only applies to high-ranking company officials who typically owe their employer a higher duty of loyalty, one that is generally defined as a fiduciary duty, and are also in a position to cause more harm to their employer than would be true of a low-level employee.[9] Yet, even in this realm, the duty of loyalty tort is rarely invoked, in part because executive employees commonly have a contract that governs their employment relationship.[10] All of this is to suggest that to date, the duty of loyalty has been a minor character in the many ways in which employers might seek to restrain an employee's mobility, and it has never been used in lieu of either a formal non-compete agreement or trade secrets protection. At least until now.

The *Restatement (Third) of Employment Law* could change all of that, as the duty of loyalty claim is presented as a catch-all provision that could displace the need for either a non-compete agreement or statutory trade secrets protection. According to the *Restatement*, an employee has a duty not to divulge confidential information, including trade secrets, and no formal agreement is necessary to protect confidential information, which is defined in a manner that is much broader than trade secrets.[11] If the *Restatement* view were to be adopted by courts, the duty of loyalty would go from being a stepchild of the mobility limitations to the family patriarch, and this expansion of the duty of loyalty could create substantial barriers to employee mobility without any obvious or added benefit to employees. This, by itself, would be distressing for those concerned about the interests of employees, but even more problematic is the way in which this expansive approach is justified, which is in an entirely unconvincing manner. As is common in a *Restatement*, much of the justification comes through the citation of cases to document trends in the law, but the case citation in this section is deeply off base and one might even say misleading. Indeed, the vast majority of the cases that are cited to

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9. *See, e.g.*, Aon Risk Servs., Inc. v. Liebenstein, 710 N.W.2d 175, 191 (Wisc. App. 2005) ("In order to show that an individual breached a fiduciary duty, the first element which must be established is that the defendant is an officer and therefore a fiduciary duty is owed . . . .").

10. *See* Stewart J. Schwab & Randall S. Thomas, *An Empirical Analysis of CEO Employment Contracts: What Do Top Executives Bargain for?* 63 WASH. & LEE L. REV. 231 (2006).

11. This issue will be taken up in the next section. For a good discussion of the important difference between confidential information and trade secrets see *Wolfe Electric, Inc. v. Duckworth*, 266 P.3d 516, 523-25 (Kan. 2011).

support a broad approach to the duty of loyalty claim are, in fact, cases that involve statutory trade secrets claims, formal non-compete agreements, or other related doctrines.[12] Throughout the commentary and sections, it is never clear why the Reporters deem it advisable to merge the various doctrines in the least known, but potentially most potent, cause of action.[13]

At this juncture, I should be clear that whether one approves of the direction the *Restatement* takes may depend on the purpose one sees behind the *Restatement* project. To the extent the *Restatement* is designed to provide a consensus regarding existing case law, this *Restatement* falls dramatically short. There is no jurisdiction that has developed case law as extensive as provided in the *Restatement*, though one can certainly find sporadic cases in a field of thousands to support each proposition contained in chapter 8. If the *Restatement* is designed to provide the best reading of existing case law, then one would have to determine what best reading might mean. If the best reading is one that favors employers, then this chapter certainly succeeds; if it is one that serves social and political interests consistent with the broad parameters of employment law, that seems to again be a substantial miss, and certainly one that has not been justified in the course of chapter 8.

This short paper will proceed in two parts. The first will provide a quick survey of existing case law and highlight where the duty of loyalty claim fits in. The second part will explore the vision conveyed in the *Restatement* and will critique that vision and in particular its justification. A quick word on methodology – it is a challenge to critique a *Restatement* short of writing one's own. Within employment law, or any field, it is relatively easy to find a case to support virtually any proposition, within some limits, and as I mentioned above, the *Restatement* succeeds in finding some cases to support the broad propositions (it also offers a large array of misleading citations). I will instead seek to provide the general consensus on the duty of loyalty – and there is a clear consensus that sees the duty serving a distinct but limited function relating to employees who leave for a competitor or to start a competing business.

12. *See infra* section III.
13. This issue is discussed in section III.

II. THE STATE OF EXISTING LAW

The duty of loyalty is primarily a creature of agency law. In its broadest outline, an agent owes a duty to its principal. Employees can also be seen as agents, and the duty of loyalty generally requires that employees not harm their employer.[14] But in the employment context, the harms employees might cause are generally subsumed in other causes of action. An employee, for example, might move to a competitor, taking with her trade secrets, customer lists, or similar valuable information. In the way the law has developed, an employer would typically seek to restrain the employee either by invoking a preexisting non-compete agreement or by suing to prevent the disclosure of trade secrets, through what is now a statutory cause of action. An employee might also steal equipment or something of value, but there are criminal laws to remedy those violations. There are literally hundreds of cases in these areas, and in fact, litigation involving trade secrets and non-competes has grown rapidly over the last decade.[15]

These two primary causes of action have left relatively little room for claims arising under the duty of loyalty, particularly when it comes to non-management level employees. Traditionally the claim, which permits broader damage remedies than are generally available for trade secrets violations, has been reserved for the situation when employees depart their employ to begin a competing business.[16] In this context, the law has developed in a relatively uniform manner with an aphoristic quality to it. Courts have generally held that an employee is permitted to "prepare to compete" while still employed but may not solicit clients, and occasionally other employees, until after they have left their employment, in which case they may also be limited to announcing their new enterprise rather than soliciting clients directly. This is a scenario likely familiar when attorneys leave law firms, or any personal service provider such as a hairdresser leaves his or her workplace, as the law seeks to protect against unfair

14. For the comparable provisions see RESTATEMENT (THIRD) OF AGENCY, §§ 8.01-.05 (2006).

15. *See supra* note 3.

16. There are many such cases. For a partial sampling of recent cases, see Sitton v. Print Direction, Inc., 718 S.E.2d 532 (Ga. App. 2011); Hanson Staple Co. v. Eckelberry, 677 S.E.2d 321 (Ga. App. 2009) (preparing to compete); Wesco Autobody Supply, Inc. v. Ernest, 243 P.3d 1069 (Idaho 2010); Coates v. Heat Wagons, Inc., 942 N.E.2d 905 (Ind. App. 2011) (diverted business and competed with employer); Weichert Co. of Maryland, Inc. v. Faust, 19 A.3d 393 (Md. 2010) (leaving for competitor).

competition but does not want to deprive the public of superior services and greater competition.

As should be apparent, there is considerable overlap between the various causes of action. Through a valid non-compete agreement, an employer can restrain an employee from moving to a competitor, and it could also, depending on how it is framed, restrain the employee from starting a competing business.[17] There are two significant differences between these approaches. A non-compete provides notice to the employee of the scope of her restrictions, and, at least theoretically, the employee should be compensated for that restriction on her future mobility. Under basic economic principles, an employer should be required to pay (either monetarily or in the form of greater access to information or other benefits) for imposing a restraint on the employee's ability to move to a new employer, and the requirement that the non-compete be in writing is designed to ensure notice if not active negotiation over the terms.[18] As a practical matter, outside of those for higher level employees, most non-competes are imposed on a take-it-or-leave-it basis, but there are still the advantages that attend to all contracts, namely notice and clarity regarding the terms.

There is another significant difference between the two that is more real than theoretical, and that has to do with the available remedies. Non-competes are typically enforced through injunctive relief, and to the extent damages would ever be awarded, those damages would be contractual in nature, thus excluding the possibility of punitive and compensatory damages.[19] In contrast, breach of the duty of loyalty sounds in tort with the full range of damage remedies available. Indeed, in rare cases, a court might go so far as to award the plaintiff the defendant's business as a remedy for the breach of the duty of loyalty,[20] a remedy that would be very difficult, though perhaps not impossible, to recover under a contractual claim. With

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17. For one example of a non-compete see Hopper v. All Pet Animal Clinic, Inc., 861 P.2d 531 (Wyo. 1993). The latter – keeping someone from opening a competing business – often arises in the context of a sale of a business, and is not directly related to employment law.

18. For an economic analysis of the various issues see Gillian Lester, *Restrictive Covenants, Employee Training and the Limits of Transaction Cost Analysis*, 76 IND. L.J. 49 (2001).

19. Punitive and compensatory damages are not available to remedy a breach of contract. As a general matter, a breach of a non-compete starts with a presumption of irreparable injury. *See* Envtl. Servs., Inc. v. Carter, 9 So.3d 1258, 1262 (Fla. App. 2009).

20. *See* Design Strategies v. Davis, 384 F. Supp. 2d 649, 668-69 (S.D.N.Y. 2005) (discussing forfeiture of business as possible remedy); Jet Courier Serv. v. Mulei, 771 P.2d 486 (Colo. 1989) (en banc) (same).

this in mind, the duty of loyalty could be a more potent weapon, but, to date, the law has preferred the more certain contours of the non-compete claim.

There is also significant overlap between a claim for misappropriation of trade secrets and breach of the duty of loyalty claim, but the trade secrets cause of action is, again, more certain and less far reaching. Trade secrets law is now primarily codified, and as is true with the non-compete agreements, misappropriation of trade secrets is typically enforced through injunctive relief. Damages are rare and punitive or compensatory damages even more so, and the litigation often involves either a question of what constitutes a trade secret or whether the employer has taken sufficient steps to protect the information.[21] One reason damages play a limited role is that, contrary to the images conjured up by the name of the claim, trade secrets litigation rarely involves issues of spying, espionage, or outright theft. No one claims a right to share the formula for Coca-Cola with Pepsi, for example, but rather the cases turn on what information an employee can rightfully carry away with her and rely on in her new employment, and more often than not, the information at issue is a customer list.[22] As a result, the trade secrets cases typically do not involve a dispute about theft or misappropriation, and this, too, makes them distinctive from the duty of loyalty cause of action.

By its nature, a breach of the duty of loyalty implies active wrongdoing, a desire to conceal information from the employer in a way that the party expects or intends to harm her current employer. That is one reason why it should be reserved for limited and occasional use, particularly in the case of an at-will employee since there is no reciprocal duty on the employer's part.[23] This latter point has led some, though not many, courts to hold that at-will employees owe no duty to their employer, while many other courts impose only a limited duty on at-will employees, for to do otherwise would go beyond what the parties presumably bargained for, to the extent one

21. For one such case see Dicks v. Jensen, 768 A.2d 1279 (Vt. 2001) (finding that the employer failed to take adequate steps to keep the customer information secret).

22. In an electronic search, literally hundreds of cases come up in the last five years regarding customer lists as trade secrets. Here are a few of them including some earlier cases that set the parameters: Morlife, Inc. v. Perry, 66 Cal. Rptr. 2d 731 (App. 1997); Charter Oak Lending Group, LLC v. August, 14 A.3d 449 (Conn. 2011); Multiut Corp v. Draiman, 834 N.E.2d 43 (Ill. App. 2005); Al Minor & Assocs., Inc. v. Martin, 881 N.E.2d 850, 855 (Ohio 2008); Dicks v. Jensen, 768 A.2d 1279 (Vt. 2001).

23. On this latter point see Ken Matheny & Marion Crain, *Disloyal Workers and the "Un-American" Labor Law*, 82 N.C. L. REV. 1705, 1740-48 (2004).

sees the relationship as some form of bargained for exchange.[24] Indeed, this short summary provides an accurate characterization of the state of the law when it comes to the duty of loyalty tort claim – it is reserved for limited circumstances when the employee actively engages in competition with her current employer or effectively sabotages an employer to provide an advantage for a competitor. The duty has been narrowly circumscribed, and courts have not expanded the tort claim into the established domain of either non-compete agreements or the trade secrets regime. To do so would impose a significant threat to employees who would face a potentially expensive lawsuit simply by virtue of moving to a competitor.

Before moving to the *Restatement*, let me provide a description of how these cases today typically proceed. Because it seems quite exemplary, I will rely on a Vermont case, but it would be possible to choose a case almost at random and end up with a similar fact pattern. In *Omega Optical, Inc. v. Chroma Technology Corp.*,[25] a number of Omega employees left their employment to go into business together as Chroma Technology. Chroma began making an optical filter similar to what Omega produced, and Omega brought suit against Chroma and the ten employees who had started the company. Most of the case involved the plaintiff's trade secrets claim, which ultimately failed. Significant, and in contrast to the *Restatement*, the court firmly rejected the plaintiff's claim that the former employees owed "a duty of confidentiality to the employer merely by virtue of their status as employees," adding that "[t]his argument is simply at odds with the case law, which requires something more than the mere employer-employee relationship to establish a duty of confidentiality."[26] Both of these arguments failed because the employer had failed to take adequate steps to protect the secrecy of the information. The court also found it significant that no non-compete or confidentiality agreement was in existence. Only then did the court move to the duty of loyalty claim, which it discussed in the traditional manner, noting a right to plan to compete and noting that there is some overlap between trade secrets misappropriation and the duty of loyalty, but suggesting that the

24. A leading case along these lines, and one that is acknowledged in the *Restatement* is *Dalton v. Camp*, 548 S.E.2d 704 (2001) (limiting the duty of loyalty claim to those who have fiduciary status).

25. 800 A.2d 1064 (Vt. 2002).

26. *Id.* at 1067.

latter claim was fully subsumed in the former.[27] And this is how these cases generally work – without a restrictive covenant, the only independent issue on a duty of loyalty claim is whether the employees began to compete while they were still employed. Issues of confidentiality and trade secrets are just not pursued, at least as a general matter, under the tort principles.

III. THE THIRD *RESTATEMENT'S* VISION

The *Restatement* takes a different approach, one that could lead to an expansive definition of the duty of loyalty, and one that is contrary to existing case law. On the surface, the definition of the duty of loyalty could displace the need for written non-compete agreements and could likely transform statutory trade secrets claims into tort claims for the breach of the duty of loyalty. The primary section reads:

> § 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 (as defined in § 8.02) for any purpose adverse to the employer's interest including after termination of the employment relationship) (§8.03);
>
> (ii) competing with the employer while employed by the employer (as defined in §8.04), or
>
> (iii) appropriating property of the employer or engaging in self-dealing through use of the employee's position with the employer.
>
> (c) The employee's duty of loyalty must be interpreted in a manner consistent with the employee's rights and responsibilities as set forth in Chapter 5 and under employment and other law, as well as any privilege or obligation to cooperate with professional or governmental authorities.[28]

Sections (b)(ii) and (iii) articulate the traditional scope of the duty while section (i) would greatly expand the purpose of the duty of loyalty, at least potentially. Section 8.02 defines "confidential information" with the traditional definition of a trade secret:

> §8.02. Definition of Employer's Confidential Information
>
> (a) An employer's information is confidential information

27. *Id.* at 1070.

28. RESTATEMENT (THIRD) OF EMPLOYMENT LAW § 8.01 (Tentative Draft No. 4, 2011).

> under this Chapter if it has economic value and the employer has taken reasonable measures to keep it secret.
>
> (b) An employer's information is not confidential information if it is
>
> (i) generally known to the public or in the employer's industry;
>
> (ii) readily obtainable by others through proper means; or
>
> (iii) acquired by employees in increasing their general experience, knowledge, and skills during the ordinary course of employment.[29]

Here one sees the conflation of the three causes of action – section 8.02(a) simply provides the traditional definition of a trade secret, which is amplified in section (b) by also distinguishing general skills and knowledge, which is an area that is often tied to restrictive covenants. One of the classic restrictive covenant cases from the 1970s emphasizes that an employer cannot impose a non-compete agreement as a way of retaining high quality employees, and an employer's interests must go beyond the general skills or knowledge workers acquire in the workplace.[30] Similarly, a non-compete agreement is often used to protect the future use of confidential information that falls below the threshold of a trade secret, and here certainly one interpretation of these two provisions is that an employer could rely on the common law tort claim in lieu of a written non-compete agreement. This is particularly true in light of section 8.03 which states that the duty of loyalty with respect to confidential information survives the end of the employment relationship and lasts as long as the information remains confidential.[31] This is also a potential stretching of the concept as typically employees do not owe any duty of loyalty to a former employer,[32] and the way to protect such information is through either a formal confidentiality agreement or a non-compete agreement. As an Illinois court recently stated, "[The plaintiff] has not cited, and our research has not disclosed, any

29. *Id.* § 8.02.

30. Rem Metals Corp. v. Logan, 565 P.2d 1080 (Or. 1977).

31. RESTATEMENT (THIRD) OF EMPLOYMENT LAW § 8.03 (Tentative Draft No. 4, 2011).

32. *See* Norman B. Bishara & Michelle Westerman-Behaylo, *The Law & Ethics of Restrictions on an Employee's Post-Employment Mobility*, 49 AM. BUS. L.J. 1, 15 (2012) (noting that "employee's duty of loyalty . . . appl[ies] only during the employment relationship not after"). This makes sense because, to the extent the duty arises from agency principles, any duty should cease when the relationship ends. To be sure, there is some support for a continuing duty, but most such cases involve trade secrets rather than the duty of loyalty. Obviously, one can misappropriate trade secrets only while employed, but the harm comes later in the use of those misappropriated trade secrets.

Illinois decision where an at-will employee was held liable for breaching the duty of loyalty for disclosing information unless the information was used to compete against the employer prior to termination."[33]

In defense of the *Restatement's* expansive approach, one might be tempted to argue that the sections simply capture activity that is already prohibited. No employee, one might suggest, has a right to use confidential information. While this statement may sound correct, it misunderstands the nature of the employment relationship and the requirements the law currently imposes. Although an employee may have no right to trade on confidential information, the real issue in any such dispute is whether the information is, in fact, confidential. As noted above, a common definition of confidential information is information that is important to the employer but does not rise to the level of a trade secret, and it is often difficult to know what falls within that category. That is why many employers require their employees to sign confidentiality agreements, which can then be enforced under standard contract law. Allowing employers to protect confidential information via the duty of loyalty not only abandons the formalities of a contract, with the presumed employer payment to secure that contract, but also dramatically shifts the damage remedies from the limited realm of contracts to the more far reaching expanse of tort. Surely, this kind of expansion should be fully justified, but this is another area on which the *Restatement* fails, and in terms of case law support, fails rather dramatically.

There are, for example, no cases imposing a duty of loyalty after the employment relationship has ended; there are no cases relying on the duty of loyalty tort to protect either confidential information or trade secrets. I should be clear that when I say there are no cases, I do not mean to suggest I have read or even searched all of the possible cases. Rather, I mean to suggest a more limited, though equally revealing, set of cases – cases cited in the *Restatement* notes, where one would expect illustrations; cases included in the casebooks designed for an employment law class in a law school, and cases I or my research assistants have sought to locate with a particular emphasis on recent cases. Indeed, within this set of cases, one finds only the far more limited concept of the duty of loyalty described earlier, one that primarily involves employees who go off to begin their own competing company, often taking employees and clients

33. Lawlor v. N. Am. Corp., 949 N.E.2d 155, 180 (Ill. App. 2011).

with them.

Given the expansive approach adopted by the *Restatement*, one might expect clear and strong justification, or at least clear support in the cited case law. But perhaps the most distressing aspect of the *Restatement* is that the case law support is virtually non-existent, and the commentary often misstates holdings or takes those holdings out of context. Indeed, and this may sound too strong but I believe it is accurate, there is nothing in the cases cited that would support anything other than the traditional notion of the duty of loyalty, one where employees are prohibited from competing with their employer only while still employed.

I want to be fair in my criticism, but at the same time, I am not going to parse every case that is listed in the commentary. Instead, I will focus on the few cases that are cited for the more expansive approach. Before doing so, it is worth noting that even a cursory glance at the cases reveals that the Reporters freely interchange a variety of distinct concepts. This is probably most apparent in the many cited cases involving an employee's duty to preserve confidential information, a duty the *Restatement* asserts outlasts the employment relationship. As noted previously, this duty is typically enforced via trade secrets law, and true to form, the vast majority of cases the Reporters cite involve trade secrets litigation, typically under statute, and some of the cases fail to even mention the duty of loyalty, for example, all of the cases listed in the reporter's notes following section 8.01 that define an employee's "[o]bligation not to reveal or use employer's confidential information for personal business or third parties" are trade secrets cases.[34] Although the quoted holdings are generally accurate, only one of the eight cases actually turned on the duty of loyalty claim,[35] and what this section

34. *See* RESTATEMENT (THIRD) OF EMPLOYMENT LAW § 8.01 reporters' note a(ii) (Tentative Draft No. 4, 2011). The case of *Hanger Prosthetics & Orthotics, Inc. v. Capstone Orthopedic, Inc.*, 556 F. Supp. 2d 1122 (E.D. Cal. 2008), is illustrative. The case primarily involved allegations that employees took confidential information from their former employer to a competitor. There were ten separate causes of action, with the duty of loyalty claim coming last and discussed in two paragraphs, noting that the claim was available in a situation where the theft of confidential information was alleged. *Id.* at 1141-42.

35. It is probably inaccurate to say "turned on" because the case involved an appeal from a dismissal of the case, and the question was whether an employee could breach his duty of loyalty by assisting a competitor while employed. *See* Cameco, Inc. v. Gedicke, 724 A.2d 783 (N.J. 1999). Notably, the court did not hold that the employee had breached his duty of loyalty, only that assisting a competitor, rather than directly competing, can constitute a breach depending on the factual circumstances. The court also noted that the duty of loyalty varies by "the nature of the relationship," with higher employees having a greater duty to their employer. *Id.* at 789. One other case could arguably be described as a duty of loyalty case, though

effectively accomplishes is to import other concepts, such as trade secrets protections, into the vast cavern of the duty of loyalty. Indeed, two of the cases do not even mention the duty of loyalty but instead involve a claim for tortious interference with contractual relations and trade secrets violations, both of which failed.[36]

This is not just an aberrant section that was the product of sloppy research. Virtually all of the cases cited in the commentary suffer from similar flaws. Twelve cases are cited in the commentary, and all of those cases involve trade secrets or restrictive covenants.[37] The case that is cited as the inspiration for illustration 4 in section 8.02 is about trade secrets with a brief discussion of the duty of loyalty tort that does little more than reaffirm the traditional scope.[38]

Not only is the commentary misleading, but the Reporters' own work is inconsistent with the expansive view of the duty of loyalty presented by the *Restatement*. Three of the Reporters, and the head of the ALI, are co-authors on employment law casebooks or treatises, and in each of those works, to the extent the duty of loyalty is covered, it is presented in its traditional form, one that is limited to the circumstance where an employee seeks to compete with his

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"arguably" seems apt. In *Burbank Grease Services, LLC v. Sokolowski*, 717 N.W.2d 781 (Wis. 2006), the case was primarily about whether the trade secrets state statute precluded common law claims involving confidential information that did not qualify as a trade secret. After a lengthy statutory discussion, the court concluded that common law claims, including based on the duty of loyalty, were permissible and that such claims should not have been dismissed. The discussion of the duty of loyalty is limited to a single paragraph that does not even list the elements but does note that key employees might have higher "fiduciary duties." *Id.* at 796.

36. *See* Am. Bldgs. Co. v. Pascoe Bldg. Sys., Inc., 392 S.E.2d 860 (Ga. 1990). In the case, a competitor opened an office near Pascoe, and several former employees of Pascoe went to work for American. Seven employees of Pascoe went to work for American (seventeen applied), and American was sued for tortious interference with contractual relations and what amounted to an inevitable disclosure claim under trade secrets law. It is worth noting that there was no allegation that a former employee had a continuing duty of loyalty to his or her former employer. *A.B. Chance Co. v. Schmidt*, 719 S.W.2d 854 (Mo. Ct. App. 1986), involved the enforcement of a restrictive covenant to prevent the disclosure of trade secrets, and most of the case involved a discussion of whether the information at issue constituted a trade secret. Another one of the cited cases mentioned the duty of loyalty only implicitly through reference to the *Restement of Agency*. *See* Cherne Indus., Inc. v. Grounds & Assocs., Inc., 278 N.W.2d 81, 92 (Minn. 1979) (noting that "trade secrets and confidential information are both subject to the same duty not to disclose," citing RESTATEMENT (SECOND) OF AGENCY §396 (1958)). Substantively, the case involved written employment contracts. *See id.* at 88-90 (discussing covenant not to compete).

37. *See* RESTATEMENT (THIRD) OF EMPLOYMENT LAW § 8.02 reporters' note f (Tentative Draft No. 4, 2011).

38. *See* Allied Supply Co. v. Brown, 585 So.2d 33. 35 (Ala. 1991) ("[I]t is not a violation of an employee's fiduciary duty to prepare to enter into competition with his employer without providing prior notice.") (citations omitted). The court went on to find a potential claim in the solicitation of customers and employees, *id.* at 37, again consistent with the traditional scope of the tort.

employer.[39] One of the books barely mentions the duty of loyalty,[40] and in each, the tort claim is afforded the shortest treatment among the trio of mobility claims.[41] And the casebook co-authored by Lance Liebman, the head of the ALI, specifically contradicts the notion that the duty of loyalty extends to all employees when it notes that "most courts have declined to find any fiduciary duty for ordinary employees."[42] None of the books mentions a duty that applies to former employees, and none of the books mentions the duty in reference to protecting confidential information.

What is left unexplained is why the Reporters thought it appropriate or important to so greatly expand the scope of the duty of loyalty claim. While we are left to speculate, there are several possibilities. One that has been asserted, and for which there is some support within the document, is that the Reporters wanted to align the duty of loyalty claim in the employment *Restatement* with the *Restatement (Third) of Agency*. There is undeniably a certain amount of logic to this position, but it begs several questions, most importantly why it is that the new *Restatement of Employment* is so much more expansive than existing case law, which originated primarily out of agency principles. If all the Reporters sought to do was ensure congruency between the two provisions then there would be no basis for expanding the doctrine; instead the *Restatement of Employment* would simply capture existing doctrine. But as I have

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39. *See* MARK A. ROTHSTEIN & LANCE LIEBMAN, EMPLOYMENT LAW: CASES AND MATERIALS 966 (7th ed. 2011) (primary case is *Mercer Mgmt. Consulting, Inc. v. Wilde*, 920 F. Supp. 219 (D.D.C. 1996), involving officers and directors); STEVEN L. WILLBORN ET AL., EMPLOYMENT LAW: CASES AND MATERIALS 334 (5th ed. 2012) (only case is *Jet Courier v. Mulei*, 771 P.2d 486 (Colo. 1989) (en banc), involving departing employees).

40. *See* SAMUEL ESTREICHER & MICHAEL C. HARPER, CASES AND MATERIALS ON EMPLOYMENT LAW (3d ed. 2008). The book does not mention the fiduciary duty as applied to employees within the section relating to non-competes and trade secrets, and only mentions the duty of loyalty in passing in a note in the non-compete section. *See id.* at 333-34 (citing *Jet Courier Serv.*, 771 P.2d at 486).

41. For example, in the book co-authored by Stewart Schwab, the duty of loyalty and trade secrets are lumped together in a single section, and only one older case is presented that involves the duty of loyalty, one that involves employees leaving to set up a competing business. *See* WILLBORN ET AL., *supra* note 39, at 333-53. The case included in the materials is *Jet Courier Serv.*, 771 P.2d at 486, one of the better known duty of loyalty cases. Though no Reporter is affiliated with the text, the primary treatise in the area includes the duty of loyalty in three pages at the very end of a chapter. *See* MARK A. ROTHSTEIN ET AL., EMPLOYMENT LAW 742-45 (3d ed. 2005). Oddly, the most extensive and best treatment is in one of the books in which none of the authors is directly related to the *Restatement*. *See* TIMOTHY P. GLYNN ET AL., EMPLOYMENT LAW: PRIVATE ORDERING AND ITS LIMITATIONS 398 (2007). This book describes the common fact patterns applicable to the duty of loyalty tort, and they are all consistent with what I have described above. *Id.*

42. ROTHSTEIN & LIEBMAN, *supra* note 39, at 990.

noted above, the current *Restatement* provisions are far broader than existing law, and so this justification is off the mark.[43]

Another possibility is that the Reporters sought to consolidate the disparate doctrines into a central cause of action. Under this interpretation, the misappropriation of trade secrets, although traditionally pursued as a statutory trade secrets claim, also falls within the established parameters of the duty of loyalty – as noted previously, it surely violates an agent's duty to misappropriate anything, including trade secrets. Yet, there is something missing here, given that the definition of a trade secret will turn on existing case law involving trade secrets and little would be gained by moving the claim into the duty of loyalty tort. In other words, to determine whether someone violated the duty of loyalty by misappropriating trade secrets, a court would have to determine whether the information qualified for trade secret protection, and that issue would turn on the law applicable to trade secrets. It might be that employers would have something to gain by moving from the statutory trade secrets realm to the duty of loyalty tort because the remedies might be broader under the duty of loyalty claim, although this need not be the case as the remedies available for the breach of one's duty of loyalty vary by the particular circumstances.[44] Even so, no similar explanation could justify relying on the duty of loyalty in lieu of a contractual non-compete agreement as the current provision does. Moreover, if this was the intent of the Reporters, one might expect that they would have offered such an explanation in the commentary as this would seem, if true, a perfectly legitimate effort to tie up a series of disparate doctrines. But no explanation is provided; rather the commentary proceeds as if the *Restatement* explicates, rather than modifies, existing law. However, with respect to confidential information, a continuing duty that exists after the employment relationship ends, and even with respect to a duty imposed on all employees, this is simply not true.

That leaves a perhaps unsavory explanation as the most plausible. The Reporters may have seen an expansive duty of loyalty provision as affording employers greater power – greater than exists under current law – to protect their property. This has been an

43. Seeking to make the two provisions congruent also begs the question of why there is a need for two separate provisions. The *Restatement of Employment* could have referenced the *Restatement of Agency* and perhaps provided a few key illustrations.

44. The *Restatement* has deferred attention of remedies to a later, as yet undrafted, chapter on remedies.

underlying concern of many who have opposed the development of a *Restatement of Employment*,[45] namely that the effort might be tinged with a desire to enhance employer interests. For most of the *Restatement*, this fear has been unfounded. The provisions on restrictive covenants, for example, have been fair and not overly protective of employer interests, and the same seems true of many other important provisions, including in the area of trade secrets where the inevitable disclosure doctrine has mostly been disclaimed. One would hope this was not the rationale behind the broad approach to the duty of loyalty, and one can also hope that this broad section is simply ignored by the courts as the current law seems to fill a limited role and do so just fine.

IV. CONCLUSION

Despite their officious tone, and the publication by the august American Law Institute, the various *Restatements* have been of varying influence, and my sense is that the *Restatement of Employment Law* is likely to be of modest influence, if for no other reason than that at this point in time, employment law is fairly mature and there is little need for guidance in many areas. Equally important, the *Restatement's* clear preference to protect the interests of employers is likely to appear to many courts to be too one-sided to be called a *Restatement*, and I think that will be particularly true when it comes to the duty of loyalty claim.

45. *See, e.g.*, Matthew W. Finkin, *A Consumer Warning for the Restatement of Employment Law: READ CAREFULLY BEFORE APPLYING*, 70 LA. L. REV. 193 (2009).