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Managing Within the Law II

reference materials

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Your Rights as a Manager
and Employee Responsibilities

With all that's been said about employees' rights, we sometimes forget that employees have responsibilities, too.

Although they receive less media attention than employees' rights, these duties have been cited successfully by employers to win wrongful termination cases. Employees cannot win their lawsuits if they violate their common law duties.

The Employment Relationship

In the chapter on wrongful termination, we talked about how the law of employment originally developed from the law of master and servant. The law of master and servant is part of agency law.

Not every agent is an employee. Not every employee is an agent for the purpose of representing the employer. But every employee is bound by agency principles when dealing with the employer.

Employees' most basic duty is to show up for work.

Employees can be dismissed for excessive absenteeism. If employees are unable to perform their jobs, even if due to physical or mental disability, their employment can be terminated. Sometimes, we forget that.

Not everything that is unfair is illegal.

Employees' Fiduciary Duty

An agent is a *fiduciary*. A fiduciary is like a trustee. That means employees must treat the company's interests better than their own. They should treat the company's business, equipment and money as if holding them in trust.

Employees must tell the employer about all important information they learn concerning the employer's business.

Under the law of some states, the "faithless servant" doctrine requires an employee who breaches the duties of loyalty and good faith to forfeit his compensation, including commissions and salary. This doctrine was applied in a 2003 federal appeals case to compel an investment banker to disgorge more than $4 million in stock profits that rightfully belonged to his employer.

Agents and employees must use reasonable care, diligence and skill while working. They must use the care and skill that are standard for that kind of work. If employees say they have special knowledge or expertise, they must have it and use it.

The duty of care doesn't mean employees have to be perfect. But if they don't use reasonable care, and as a result the employer is injured, they are liable to the company for the damage.

In one case, Mr. Wilcox was hired to build, manage and maintain a low-income housing development. As the project manager, he was responsible for the smooth running of the operation. But after seven years of employment, he left a "chronicle of failures."

Among other things, his hands-off management style resulted in thefts by high-ranking employees, illegal accounting practices, violations of government regulations, failure to collect rent, vandalism, and poor construction resulting in leaking roofs, backed-up sewers and no electric or water service.

Mr. Wilcox was fired for mismanagement. He sued for the management fees still owed him. The court refused to require his former employer to pay. The court said Wilcox had failed to meet the standards of reasonable skill or care. Mr. Wilcox brought disrepute upon his employer because of his shoddy management.

You have the right to expect employees and applicants to be honest about their job qualifications and experience. You don't have to hire people with resumes claiming degrees that were never earned, fudging dates of employment to cover gaps, or listing credentials that have lapsed. In fact, in Illinois it is unlawful to use a false academic degree to obtain employment.

Imagine you are a dean at a college and are hiring a professor to teach Business Law and Business Ethics. You receive a resume from an applicant who says that he headed his own company for 12 years before selling it and retiring. He says he has extensive experience in business law and a "particular interest" in business ethics.

Delighted with his background, you hire him. But a short time later, you find out that for the last four years he had been spending his "retirement" in federal prison, serving time for bank fraud, and has been ordered to pay $12 million in restitution. Shocked and disgusted, you fire him. He then sues for wrongful termination.

Vermont State College faced this predicament. It had to take the case all the way to the Vermont Supreme Court.

The Court held that the employer could not be sued for wrongful termination. It was reasonable for the college to fire the employee because of his material misrepresentations about his criminal record, and that dishonesty and fraud are good cause for firing (especially when hiring a professor to teach ethics!)

What this means to you: First, always be sure to check references. If someone sounds too good to be true, maybe he is! Second, if you do discover an employee lied to get the job, that may be grounds for termination.

Employee's Duty of Loyalty

Employees' must give their undivided loyalty to the employer during their employment.

They must give a good day's work for a good day's pay.

Employees can't allow their personal lives to affect their jobs.

Love affairs and divorces often disrupt job performance. As discussed in the chapter on safety, you should reasonably accommodate an employee's stress, no matter what the source. But if it's not job-related, after a reasonable amount of time the employee must be counseled, warned and ultimately terminated if performance standards aren't met.

Employees can't hold second jobs or run their own businesses if they interfere with job performance. Many companies have conflict of interest policies to remind employees of this responsibility.

You can’t assume all second jobs will interfere with employees' performance. You must be able to prove it -- the employee falls asleep at work, receives phone calls from the other job or is not available during working hours (including normal overtime and on-call).

Employees must put the company's interest ahead of their own, even at their own expense.

Employee Duty of Good Conduct

Depending upon their positions, employees must not do anything in their private lives that brings disrepute upon the employer.

As discussed in the chapter on privacy, an employer shouldn't pry into the personal lives of employees. But where the employee's private life becomes public, either voluntarily or involuntarily, the employer can protect its own reputation.

The book *Cyberpunk* has an example of a termination under this rule. It's the story of Kevin Mitnick, a notorious hacker who broke into computer systems during the 1980's.

At the same time he was breaking into other computer systems, Kevin was hired by Security Pacific Bank to work as a computer security consultant in its electronic funds transfer section. As soon as the bank learned of his past illegal activities, it terminated his employment.

The bank was allowed to fire him to protect its funds. But what if he never went after the bank's money? He had been covered by the media as a result of his arrests. If the public had the perception he was dishonest, he still could be terminated because his employment would bring discredit to the bank's reputation for financial integrity.

Work Well With Others

The duty of good conduct also requires employees to work well with others, especially you, the manager.

As one statement of the law puts it, the employee "need not render cheerful obedience, but he must not be insubordinate" in speech or otherwise. If an employee addresses you in highly abusive language, that is grounds for discharge for breach of the duty of good conduct.

Some employees say, "You can't fire me as long as I do a good job." They think they can be obnoxious, withdrawn or mean to their co-workers. Wrong! It's hard enough to run a productive organization when everyone gets along. If employees are so anti-social they disrupt the workplace, they can be counseled, warned and ultimately terminated. And rudeness can lead to violent retaliation.

Employees' Duty of Confidence

Agents and employees have the duty not to disclose information given to them in confidence by the employer. This duty goes beyond protecting trade secrets. As long as the information is not generally known and would injure the employer if known, the employee can't reveal it.

This duty applies both to employees and former employees.

The reason for the rule is simple. The relation of employer and employee requires freedom of communication and trust. If employees could tell competitors, potential investors and customers what they learned at work, employers would be reluctant to reveal any information. Work would slow to a standstill.

The duty applies not only to information labeled confidential but also to any information which the employee *should know* is confidential.

Employees may reveal information to people, like family members, who won't use it to injure the employer. The duty is to protect the company from unfair competition, not to prevent all disclosures. But don't forget: "loose lips sink ships."

Employees of the company and spouses are the safest people to tell confidential information. If you do, ask them not to tell others. Imagine how damaging this information would be to the company if it got out to investors or competitors.

But if other people don't have a need to know, don't tell them. If you can't keep your duty of confidence, how can others -- who have no duty -- be expected to keep it quiet?

Employees' Duty Not to Reveal Trade Secrets

The Uniform Trade Secrets Act has been adopted in 42 states and the District of Columbia. Most of the states that have not adopted the uniform Act still apply the common law, on which the Act is based.

Although it is not identical in every state, the law generally prohibits any person, including employees and former employees, from obtaining trade secrets through improper means.

A "trade secret" is information, including a formula, pattern, compilation, program, device, method, technique or process that has value because it is not generally known to competitors.

Examples of trade secrets are:

--salary information
--product specifications
--inventions
--customer lists
--vendor lists
--unpublished works
--software
--sales and marketing plans
--pricing information

A trade secret does not have to be novel in order to be protected. Even "know-how" trade secrets are protected. These are procedures, methods and expertise that do not rise to the level of a patent. Know-how secrets include new applications of known skills or processes.

Customer Lists

When employees leave your company, they may want to take your customers with them. Can the company prohibit that by claiming the customer list is a trade secret?

A customer list is protected to some extent in a few instances. The names of customers usually aren't protected, unless those names would not be known or accessible to any competitor in the market. To determine that, courts ask these questions:

-- is the information available from public sources?
-- was the list easy to compile?
-- did the employee have personal relationships with customers?
-- do the customers purchase from more than one supplier?

If the answer to any of these questions is yes, the names of customers probably will not be protected.

If a customer list contains specialized information like the names of contacts, expiration dates of contracts, previous price quotations or product preferences, it may be protectable.

Even if a customer list is a trade secret, it still may be used by a former employee to announce a new business. But your former employee can't use it to solicit your customers for a new business. What's the difference between announcing and soliciting? Announcing is advertising, which is basic to everyone's right to engage in fair competition. Soliciting is personally asking a particular customer for business.

In a 2008 decision from the Ohio Supreme Court, an employee memorized confidential customer information, then left and solicited 15 clients of his former firm. The court rejected his argument that the employer "should not have the right to control the use of his memory" and found that the list was a protectable trade secret. The ex-employee was ordered to disgorge all the fees paid by those clients and pay them to his former employer.

Protecting Against Competitors

Trade secrets are protected from disclosure only by improper means, such as using physical force, lying to induce someone to disclose them and spying on competitors. Reverse engineering alone is not considered improper means.

A competitor can't induce your employees or former employees to breach their duty to maintain secrecy. In fact, you should enlist the aid of competitors to ensure your former employees don't reveal trade secrets. If they do, they can be forced to pay you the profits they made or some other form of damages, including punitive damages.

When key employees leave, work with the Legal Department to write letters to their new employers. Your letter should inform the company of the general nature of the trade secrets known by the employee, and request the company to confirm in writing that the employee will not be allowed to use any of the secret information.

If your competitor refuses to cooperate, you may be able to get an injunction. That's what IBM did in January, 1992. The company got a court order prohibiting a former employee from using or disclosing IBM technology to his new employer. The injunction also prohibited him from working on his new employer's version of the same technology.

Theft of trade secrets can lead to criminal charges, as well. In 1995, Cadence Design Systems, Inc., filed a civil trade secrets and copyright infringement lawsuit claiming that some of its former employees had stolen its source code to start their new business, Avant. Securities fraud class actions were filed by shareholders, and a criminal action also was brought. In addition to other evidence, experts found that error messages in Avant's code matched error messages in Cadence's. Avant settled the class actions for $47 million and on May 22, 2001, pled no contest to charges of stealing trade secrets. As a result of the plea agreement, the company will pay $27 million, plus restitution. The individuals will pay $8 million in fines and serve time in jail ranging from one to six years.

What started as “a pen-pal relationship between a lonely Maine lab technician and a reclusive California scientist,” in the words of the United States Court of Appeals for the First Circuit, grew into a criminal conspiracy to steal trade secrets (a violation of the Economic Espionage Act of 1996) and transport stolen goods across state lines. The chemist, who passed along her employer’s software, test kits and other proprietary information, including sales and marketing materials, R&D data, memos and e-mails on prices, strategic plans and product problems, agreed to testify against her scientist pen-pal as part of a plea bargain. The scientist’s federal convictions for wire fraud, mail fraud, conspiracy to trade secrets, and conspiracy to transport stolen property in interstate commerce were upheld on appeal in 2000.

Written Confidentiality Agreements

Written confidentiality agreements don't necessarily give you any more protection than common law. But experts recommend you have them anyway.

They are evidence that you treat trade secrets with the appropriate secrecy, and that employees know of their duty to maintain confidentiality. Employees can't later claim ownership of trade secrets specifically mentioned in the agreement. And just by signing an agreement, employees may take their responsibility more seriously.

Employee's Duty Not to Compete

While employed, an employee cannot compete with the employer, either by starting a competing business or working for a competitor.

Your employees can't solicit customers for a rival business while employed by you.

Generally, employees are allowed to agree among themselves to leave and go into competition. But they can't actively solicit their co-workers to leave and work for them or another rival.

Employees don't have to inform you about their plans for competing, unless not revealing those plans would harm your company. While employed, they can take steps preliminary to starting business such as writing announcements, leasing office space and forming a corporation.

Your employees may be hired away by your competitors as long as no deceptive or unfair methods are used. For example, a competitor cannot hire away all your employees with the intent to shut down your company.

In addition to this common law prohibition on employees competing, a company can have written non-compete agreements that are more extensive.

Some employers have agreements that cover not only current employees, but also members of their households. They prohibit a spouse, for example, from working for a competitor. Such agreements have been upheld.

Non-Compete Contracts With Former Employees

Generally speaking, former employees can't be prohibited from working in a competing business after leaving employment. That is a restraint of trade and unfair competition. However, if an applicant for employment has such a non-compete clause with their current or former employer, do not hire them without calling in a legal expert.

But if necessary to protect the company’s investment in customer relationships and confidential business information, reasonable restrictions can be placed on former employees if the restrictions don't cause them undue hardship. The liberty of employees to work where they want must be balanced against both the business interests of the employer and the public's interest in a competitive market.

There is no federal law in the United States concerning restrictive covenants, also known as non-competition agreements. In most states, there is no statutory law on the subject, but only common law precedent. In states that permit such agreements, courts will enforce a covenant not to compete if the covenant is found to be "reasonable," that is, the length of time, geographic scope, and type of activities restricted are necessary to protect the former employer's legitimate business interests.

In determining the covenant's reasonableness, courts will ask two questions: (1) Does the employer have a protectable interest? and (2) Is the restrictive covenant reasonably related to protecting that interest or is overbroad and unduly restrictive of the ex-employee's right to earn o a living in his/her chosen field? Over the years, courts have increasingly looked upon non-compete agreements with disfavor as restraints of trade, and they have been carefully scrutinized and construed narrowly, in favor of employees. However, these restrictions don't apply to non-compete agreements between the former owners of a business and its buyers. For example, when Ross Perot sold EDS to General Motors, he agreed not to compete nationally for three years. That was bargained for as part of the purchase price.

And, some states – including California and Colorado – ban non-compete restrictions on employees. But even in those states, employees can be barred from using their former employer's trade secrets, or other confidential and proprietary information.

Interference with Contract

Under some circumstances, it is illegal for any person, including a former employee, to try to take away your business with another company or person. When the relationship currently exists, this is called interference with contract. If the contract is anticipated for the future, the same principle applies and it is called interference with prospective economic advantage.

Interference with contract is unfair competition -- intentionally using improper means to take away business from a competitor.

The cases turn on the interferer's motive or purpose, and whether improper means were used to accomplish it. "Improper means" include fraud, violence, intimidation, defamation, blackmail, extortion and other crimes.

For example, Mr. Carlson was a Certified Public Accountant who worked for Ernst & Ernst. He was fired because he disagreed with some legitimate, if aggressive, tax advice given by the firm to one of its clients, Cubic Corporation.

After he was fired, Mr. Carlson applied for a job with Cubic. When he wasn't hired, he bought 100 shares of stock and began a campaign to force it to amend its tax returns. He called the corporation's attorneys and threatened to bring a shareholder's suit. He wrote letters to the corporate officers. He brought it up at a stockholders' meeting in front of the press. He reported it to the SEC and the IRS.

Ernst & Ernst sued for an injunction to stop him. The court granted it, holding that he had interfered with the contract between Ernst & Ernst and Cubic Corporation, by attempting to destroy the client's confidence in its accountants.

Mr. Carlson did more than interfere with the contract. He also breached his duty as an employee by revealing confidential information about Ernst & Ernst. And he violated his duty of confidence as an accountant to his client, Cubic Corporation.

Manager's Rights

Like employee responsibilities, manager's rights are derived from the common law of agency and master-servant.

You have the right to have employees obey you. Employees must follow all reasonable directions from management.

The duty to obey is the essence of the employment relationship. By definition, an employee is someone who agrees to work under the control of the employer. Once the employee withholds the agreement to be under your control, the relationship is ended.

If employees were told when hired that they would not be required to do something, you can order them to do it. They must follow your instructions. Of course, you can't ask them to do anything illegal or unethical.

If an employee refuses an order, no matter how trivial, that is insubordination. Insubordination is a deliberate and willful disregard for authority. According to the common law authorities, insubordination always is grounds for immediate termination, because the employee is rejecting the employment relationship itself. (Some enlightened companies, however, set a higher standard and do not fire immediately for insubordination. Check with the experts at your company for guidance.)

A 1981 case illustrates this principle. Carl Bracale was the general manager of an Anchorage television station. The Board of Directors, his bosses, ordered him to fire one of his salesmen for excessive drinking.

Bracale admitted the salesman drank heavily. But he refused to terminate the salesman because he said the drinking didn't interfere with his work.

After several warnings, the Board terminated Bracale for insubordination. He sued for wrongful termination. He said he couldn't be fired because the order he violated was trivial.

The Alaska Supreme Court disagreed and he lost. The Court said it doesn't matter if the order is trivial. What's important is the relationship. If the employee refuses to recognize authority, he or she can be terminated.

If you decide not to terminate an employee for a terminable offense like insubordination, you can't come back later and terminate for the same offense, unless new facts have come to light. But if the employee later commits an offense that itself does not justify termination, the previous misconduct can be used so that the two incidents, taken together, may justify termination.

Your Right to Require Excellence

You have the right to set standards and expectations. You may have different expectations than your employees' previous managers. As long as you tell them in advance and give them reasonable opportunities to achieve, you can appraise their performance against new standards.

A 2003 case from the New Jersey Supreme Court strongly supports your right to require excellence. A small computer software company hired a Director of Support Services, whose employment contract contained a clause that gave the company the right to terminate his employment for "failure or refusal to faithfully, diligently, or completely perform his duties hereunder to the satisfaction of the Company"

Six months into his tenure, clients and resellers began to complain to the president about their disappointment with the performance and attitude of the support services staff generally, and several complaints targeted the director specifically. The president informed the director of those criticisms. The complaints continued to come in, and over the next several months the president sent e-mail to the director expressing his concerns and frustration. The president and the director had a one-on-one talk about his performance, and two weeks later, the director was terminated.

The director sued for breach of contract, and lost. The court upheld the president's right to use his "good faith, unilateral judgment." The court recognized that "application of another's notion of satisfactory performance would undermine recognized and accepted notions of business judgment and individualized competitive strategy, as well as principles of freedom of contract... The employer, not some hypothetical reasonable person, is best suited to determine if the employee's performance is satisfactory."

How did the employer act in good faith? The president told his subordinate about the customer complaints, gave him time to correct the deficiencies, followed up and documented his concerns in e-mail and then met with the employee face to face in a final effort to solve the problems. If the president had not followed these principles of legal and effective management, the result might have been quite different.

You can change the job duties of subordinates for legitimate business reasons. In most cases, you don't have to change the formal job description.

Have you ever heard employees say, "You can't make me do that -- it's not in my job description?" The correct answer is, "It is now. Are you refusing a direct order from your superior?" If they are, that's insubordination.

You have the right to require excellence. Your right to require excellence may be the most important right of all. It's one right that all employers have, including supervisors of unionized and government employees. It's a right that managers in many other countries *don't* have. For example, in Japan, companies that employ for life and promote based strictly on seniority keep nonproductive employees filling seats. In Germany, employees can be hired and fired only at certain times of the year.

The right of employers to require excellence gives U.S.-based companies a competitive edge. We all know the competitive costs of our legal system. But there are some benefits, too, and this is one.

If you consistently apply your standard of excellence to everyone, including yourself, you will be fulfilling your highest duty of loyalty to the company.