Losing the Battle, Winning the War?

Author : Charles A. Sullivan

Date : October 30, 2013

Catherine Fisk & Adam Barry, *Contingent Loyalty and Restrictive Exit: Commentary on the Restatement of Employment Law,* 16 **Empl. Rts. & Employ. Pol'y J.** 413 (2012), available at SSRN.

As the Restatement of Employment Law (REL) wends its way towards final approval, most likely next May, the debates about it—both within and without the American Law Institute (ALI)—may seem like yesterday's news. But the promulgation of a new Restatement, unlike the passage of a statute, is not the last word on a legal subject but rather the beginning of a struggle for court imprimatur. In this regard, the scholarship that analyzes REL as it grinds through the laborious ALI mill may prove to have greater influence in judicial venues than it does before the Institute. At least in the case of *Contingent Loyalty and Restrictive Exit: Commentary on the Restatement of Employment Law* by Catherine Fisk and Adam Barry, that's a good thing.

At the 30,000 foot level, the authors view the REL as having "two inconsistent visions about the employment relationship and about employee mobility." Chapter 2, dealing with termination of employment, "envisions employment as a commodity market in which employers and employees contract for the sale of labor and expertise and are free to terminate the relationship when they deem it in their interest to pursue more lucrative opportunities with other contracting partners." In contrast, Chapter 8, governing employee obligations, "shackles employees with continuing obligations at and after the termination of employment." Fisk & Barry summarize:

> [These obligations] are quite asymmetrical. The employer owes no duty of loyalty to the employee and is free to pursue its self-interest by firing him to hire another for a lower wage or for better skills. Yet the employee's ability to pursue her own self-interest by seeking better opportunities is limited. The employer can cast him or her onto the labor market whenever it is in the employer's interest to do so, yet the employee is burdened with an expansive duty of loyalty [while employed] and can be contractually burdened with a non-compete agreement, making it hard for the employee to find alternate employment when he or she is back in the labor market.

While the article's discussion of noncompetes is well worth reading in its own right, the Restatement is poised to break new ground in imposing a "duty of loyalty" on all employees, and here the article should trigger "not so fast" thoughts when the REL is cited to the courts.

A little background. While the duty of loyalty certainly did not originate with the Restatement, its common law reach and parameters are far from clear. Which employees have such a duty, and what that duty comprises varies radically from jurisdiction to jurisdiction and often from court to court. For example, all agree that employees cannot steal from their employers, but this is more often treated as simple conversion than disloyalty, and it's not clear that the REL's folding of "don't steal" in with other commandments adds anything. Perhaps more critically, higher level employees often have "fiduciary" duties, which might be what is meant by a duty of loyalty[1], but, if so, the REL expands this set of obligations to all employees, an expansion that the two authors think makes little sense. A separate question is the scope of the duty not to compete with one's employer while still employed, which the REL also treats as a loyalty question, albeit one with more nuance than the "duty" framing might suggest.

Contingent Loyalty argues that the REL uses "loyalty" as a one-size-fits-all category that ignores historical origins and may eclipse important distinctions. While the final version of the Restatement might avoid some of the difficulties (for

example, Chapter 8 acknowledges, somewhat vaguely, a higher level duty for higher level employees[2], and the final Remedies chapter may further clarify the question), the current version is problematic.

For instance, Fisk & Barry write that the confusion in the courts as to competition by current employees might well justify a restatement, but conclude that "even in this core area, the duty of loyalty has no content apart from other laws—trade secrets, the corporate opportunity doctrine, and tort claims for interference with contract—that define the circumstances in which employee competition with a current employer is wrongful." Further, "unifying" these disparate theories under the loyalty umbrella risks obscuring the requirements of each regime and inappropriately restricting employee endeavors: "In a capitalist economy committed to free markets, employee competition that is not a misappropriation of trade secrets, a violation of the corporate opportunity doctrine, or interference with contract or with prospective business advantage should not be illegal."

Focusing on a question where the REL could have made a real contribution—what activity during employment constitutes impermissible competition—*Contingent Loyalty* notes that neither the blackletter nor the comments shed much light on the dividing line. In fairness to the Reporters, the case law is similarly incoherent, but a Restatement should improve things, and the authors stress the failure of section 8.04(b) to clarify the distinction, with important consequences for potential entrepreneurs:

> The comment vaguely says that permissible preparation "may . . . include announcing the employee's impending departure" and that "employees can jointly agree to seek new employment or business opportunities," but condemns efforts to "recruit other employees," at least where the departures leave "the employer . . . crippled or materially damaged." From this it appears that tort liability may turn on how effusive an employee was in explaining to coworkers the new job she proposes to take and the reasons she proposes to take it, or on whether the employee or the coworker was the first to suggest that the coworker might like to go too, or how it is that employees came to "jointly agree to seek new employment."

My own critique of the REL in this regard was that it seemed to bar recruiting other employees to leave with you, but created what I call the BFF principle: you can take your best friends—so long as it doesn't cripple the company.[3] While this opens the door somewhat to employee competition, the concept is ultimately incapable of principled application, especially at the front end when an employee is considering going out on his own—with or without colleagues.

Especially where the law is incoherent, the ALI has the opportunity to bring to bear considerations beyond case-counting. In this vein, the authors argue that focusing on damage to the employer's business by several employees jumping ship together "is simply wrongheaded" since, in a market-based economy, tort liability should not protect businesses that fail to recruit and retain talent. Indeed, this seems just the other side of the at-will coin: the employer has failed to either sufficiently compensate employees or enter into long term contracts with key workers, and should not be bailed out by the law. The authors make similar arguments about the REL's blessing of covenants not to compete.

There is much more in *Contingent Loy*alty worth reading, and, as I suggested, the REL's final version may take into account some of its concerns. But the more interesting possibility is that, as the Restatement is trotted out, the policy debates that have played out in the law journals and on the floor of the Institute will be revisited in courtrooms across the country, and perhaps even in state legislatures. In those venues, Fisk & Barry deserve a fair hearing.

1. §9.09, cmt. A of Tentative Draft No. 6 describes the duty of loyalty as "a prime example of employee's fiduciary duty owed to an employer." [?]
2. §8.08, cmt. A of Tentative Draft No. 4 says "the obligations of [the duty of loyalty] vary according to the employer's legitimate interest and the nature of the employee's position, including whether the employee exercises managerial responsibilities . . . ." In tension with §9.09, it goes on to say that "[s]ome courts refer to a "fiduciary" duty of loyalty when dealing with managerial employees . . . but not when dealing with

nonmanagerial employees." [?]

3. §8.04 cmt. D bars "actively recruiting" co-workers, but not informing them of plans to compete. "In addition, a group of employees may agree among themselves to start or join a competing business" as long as so many are urged to depart that the employer's business is "immediately crippled." Ill. 5 identifies a group of "social friends since graduating from the same school." [?]

Cite as: Charles A. Sullivan, *Losing the Battle, Winning the War?*, JOTWELL (October 30, 2013) (reviewing Catherine Fisk & Adam Barry, *Contingent Loyalty and Restrictive Exit: Commentary on the Restatement of Employment Law,* 16 **Empl. Rts. & Employ. Pol'y J.** 413 (2012), available at SSRN), http://worklaw.jotwell.com/losing-the-battle-winning-the-war/.