Restatement of Employment Law § 8.01 (2015)

Restatement of the Law - Employment Law | March 2023 Update

Restatement of Employment Law

Chapter 8. Employee Obligations and Restrictive Covenants

§ 8.01 Employee Duty of Loyalty to the Employer

Comment:
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Case Citations - by Jurisdiction

(a) Employees in a position of trust and confidence with their employer owe a fiduciary duty of loyalty to the employer in matters related to their employment. Other employees who come into possession of the employer's trade secrets owe a limited fiduciary duty of loyalty with regard to those trade secrets. In addition, employees may, depending on the nature of the employment position, owe an implied contractual duty of loyalty to the employer in matters related to their employment.

(b) Employees breach their duty of loyalty to the employer by:

(1) disclosing or using the employer's trade secrets (as defined in § 8.02) for any purpose adverse to the employer's interest, including after termination of the employment relationship (§ 8.03);

(2) competing with the employer while employed by the employer (§ 8.04); or

(3) misappropriating the employer's property, whether tangible or intangible, or otherwise engaging in self-dealing through the 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 with any right or privilege provided by law to cooperate with regulatory authorities.

Comment:

a. Scope and cross-references. Employees who are in an ongoing relationship of trust and confidence with their employer owe a fiduciary duty of loyalty to the employer and are subject to special remedies for breach of that fiduciary duty (see §§ 9.09-9.10). Other employees who come into possession of their employer's trade secrets are in a limited relationship of trust and confidence with their employer and owe a fiduciary duty of loyalty to the employer with regard to those trade secrets and are likewise subject to special remedies for breach of that fiduciary duty. In addition, depending on the nature or circumstances of their employment, other employees may owe an implied contractual duty of loyalty to their employer and are subject only to contract remedies for breach of that contractual duty (see §§ 9.07- 9.08).

As a general matter, the duty of loyalty stated in this Section has little practical application to the employer's "rank-and-file" employees, i.e., employees who are subject to the employer's close oversight or supervision, or who are not granted substantial discretion in carrying out their work responsibilities. The employees who do owe a fiduciary duty of loyalty to their employer are (1) employees who exercise substantial discretion and are not subject to close supervision in carrying out their managerial, supervisory, professional, or similar highly skilled work responsibilities; and (2) the employees who are entrusted with, and the employees who come into possession of, the employer's trade secrets. Employees falling outside either category do not owe a fiduciary duty of loyalty to their employer but may nevertheless owe an implied contractual duty of loyalty if, for example, their position gives them the opportunity to misappropriate the employer's property or otherwise engage in self-dealing.

b. *Duty of loyalty and agency principles.* Courts often point to the agency relationship between the employer and employee as the source of the duty of loyalty. But as the decisions make clear, labels from agency law or elsewhere are no substitute for a fact-sensitive analysis of whether the employee in question either occupies a position of trust and confidence sufficient to trigger the fiduciary duty of loyalty, assumes a limited fiduciary duty when coming into possession of the employer's trade secrets, or is subject only to an implied contractual duty of loyalty arising from the nature or circumstances of the employment.

This Chapter deals with the three principal aspects of the employee's duty of loyalty to the employer: (1) the obligation not to disclose or use trade secrets belonging to the employer for any purpose adverse to the employer's interest; (2) the obligation not to compete with the employer while remaining an employee; and (3) the obligation not to misappropriate the employer's property or engage in self-dealing through the use of the employee's position with the employer. Officers and other key executives also owe an obligation, usually grounded in corporation law, not to seize for their own benefit a business opportunity related to the employer's business. As set forth in § 8.03, the obligation not to disclose or use trade secrets outlasts the term of employment and endures as long as the information remains protectable under § 8.02.

Employees may owe other obligations to their employer, including obligations set forth in contract or arising from the employee's commission of independent torts such as assault and battery or defamation. In addition, the Restatement Third, Agency, should be consulted for specific direction on issues not treated in this Chapter.

Illustrations:

1. Employee E is a line worker for sprocket manufacturer X. E's day-to-day tasks are highly routinized and E has no access to X's trade secrets. E generally knows that X's sales are increasing, having noticed that he and his colleagues have worked a good deal of overtime in recent months. Independent of his position with X, E also learns that a parcel of land next to X's factory is for sale—the only adjacent property available to X for future expansion. E acquires an option to purchase the property. Subsequently, X approaches the seller about purchasing the parcel and learns that E has acquired the option. X sues E for breach of the duty of loyalty. X's action should be dismissed because E did not owe a fiduciary or implied contractual duty to refrain from purchasing the parcel.

2. Same facts as Illustration 1, except that E first learns of X's intention to expand the factory when he finds a copy of the company's business plans, labeled "Trade Secret: Do Not Circulate," on his supervisor's desk. The plans state that X will arrange to purchase in the near future the adjacent parcel of land. E does not disclose to anyone that he has read these plans and acquired an option to purchase the parcel of land. Provided that X has taken reasonable measures to maintain the secrecy of its business plans and the plans would otherwise qualify for trade-secret protection under § 8.02, E is liable for breach of the fiduciary duty of loyalty because he became a fiduciary responsible for maintaining the secrecy of X's trade secret and not using the information for a purpose adverse to X when E came into possession of the information knowing that it was X's trade secret.

3. Employee E works as an entry-level sales clerk for clothing retailer X. E allows friends and relatives to use E's employee discount to purchase items in return for favors from the nonemployees. It violates X's policy to use one's employee discount to benefit nonemployees. E is not in a position of trust and confidence

subject to fiduciary duties because E exercises no managerial authority, has not been entrusted with access to X's trade secrets, and does not have substantial discretion in carrying out his tasks. However, because E is able to exercise some discretion over the use of discounts, E is subject to an implied contractual duty to not use the employee discount to enrich himself through misappropriation of X's property.

c. *The Uniform Trade Secrets Act.* Most states have adopted a version of the Uniform Trade Secrets Act (UTSA), which codifies the basic principles of common-law trade-secret protection and in many cases preempts common-law tort causes of action arising from the appropriation of trade secrets and other confidential employer information. Because the UTSA essentially codifies common-law protections, outcomes will be substantially similar in statutory actions as in common-law actions, although the statutory remedies may differ.

d. *Limits on the duty of loyalty.* The employee's duty of loyalty is not absolute. As recognized in subsection (c) and developed in Chapter 5, the duty of loyalty must be read in a manner consistent with the rights, privileges, and obligations employees have as members of a profession and as members of the general public, including the right under Chapter 5 to be shielded from employer discharge when making appropriate disclosure of certain employer wrongdoing both within the firm and to public authorities.

e. *Remedies.* Employers typically enforce the duty of loyalty through legitimate workplace discipline, including termination of employment. As developed further in Chapter 9 of this Restatement, when an employee breaches a fiduciary duty of loyalty causing economic injury to the employer, appropriate tort and fiduciary remedies may be available. Employees who owe an implied contractual duty of loyalty are subject only to contract remedies for breach (unless, of course, they commit an independent tort). When the employee's breach of the duty of loyalty involves solely the disclosure or use of the employer's trade secrets, the employer must, in many jurisdictions, seek a remedy under the Trade Secrets Act of the particular jurisdiction. Statutory remedies include injunctive relief and compensatory damages, in addition to exemplary damages where appropriate.

Reporters' Notes

Comments a-b. The precise contours of an employee's duty of loyalty vary according to the scope of the employee's responsibilities and other circumstances of the employment. Although all employees may in some sense owe a duty of loyalty to their employer, "[t]he specific implications vary with the position the employee occupies, the nature of the employer's assets to which the employee has access, and the degree of discretion that the employee's work requires." Restatement Third, Agency § 1.01, Comment *g*. See, e.g., Lawlor v. N. Am. Corp. of Ill., 983 N.E.2d 414, 433 (Ill. 2012) (declaring that "[e]mployees as well as officers and directors owe a duty of loyalty to their employer," but affirming intermediate court's reversal of jury verdict in favor of employer on duty-of-loyalty claim, because there was no evidence that the employee-salesperson in charge of generating business attempted to divert any of the employer's business to competitor); Cenla Physical Therapy & Rehab. Agency, Inc. v. Lavergne, 657 So. 2d 175, 177 (La. Ct. App. 1995) (reversing summary judgment in favor of employees, holding that the two physical therapists owed a fiduciary duty to their employer which they violated by misappropriating confidential information; the appellate court rejected the trial court's conclusion that the employees were "merely minor-role-playing employees and not officers or directors which owe a fiduciary duty to their employer"); Cameco, Inc. v. Gedicke, 724 A.2d 783, 789 (N.J. 1999) (explaining that the "scope of the duty of loyalty that an employee owes to an employer may vary with the nature of their relationship. Employees occupying a position of trust and confidence, for example, owe a higher duty than those performing low-level tasks."); Berry v. Goodyear Tire & Rubber Co., 242 S.E.2d 551, 552-553 (S.C. 1978) (noting that "[i]t is implicit in any contract for employment that the employee shall remain faithful to the employer's interest throughout the term of employment," and concluding that commercial salesman breached his duty of loyalty to his employer when he spent time working for a competitor while on fully compensated sick leave).

Most courts find that the following obligations arise from the employee's duty of loyalty: (i) the obligation not to disclose or use trade secrets obtained during employment for any purpose adverse to the employer's interest; (ii) the obligation to refrain

from competing with one's employer while employed; and (iii) the obligation not to misappropriate the employer's property or engage in self-dealing through the use of one's position with the employer. In addition, officers and key executives owe a duty not to seize for their own benefit a business opportunity related to the employer's business. See, e.g., White v. Ransmeier & Spellman, 950 F. Supp. 39, 43 (D.N.H. 1996) (applying New Hampshire law; finding employees in a position of trust and confidence owe a duty of loyalty to their employer, which they breach by "misappropriating a business opportunity of their employer, us[ing] confidential information, or soliciting clients of the company for the employee's competing business").

For a similar formulation, see Restatement Third, Agency § 8.04 ("Throughout the duration of an agency relationship, an agent has a duty to refrain from competing with the principal and from taking action on behalf of or otherwise assisting the principal's competitors. During that time, an agent may take action, not otherwise wrongful, to prepare for competition following termination of the agency relationship."); id. § 8.05 ("An agent has a duty (1) not to use property of the principal for the agent's own purposes or those of a third party; and (2) not to use or communicate confidential information of the principal for the agent's own purposes or those of a third party.").

*(1) Obligation not to disclose or use employer's trade secrets.*As detailed in § 8.03, an employee must not disclose or use trade secrets obtained during the course of employment for any purpose adverse to the employer. Doing so is a violation of the duty of loyalty. See generally 19 Williston on Contracts § 54:31 (4th ed. 2009) (noting that "it is now clearly established that the nature of the employment relationship imposes an implied duty on agents and employees to protect the employer's trade secrets and other confidential information"). See Hanger Prosthetics & Orthotics, Inc. v. Capstone Orthopedic, Inc., 556 F. Supp. 2d 1122, 1142 (E.D. Cal. 2008) (applying California law; refusing to dismiss a breach-of-loyalty claim against Hanger's former employees, including former practice manager, branch manager, and office administrator/soft-goods fitter, who acquired trade secrets while employed by Hanger and held back business for a month in anticipation of their departure for a competing company); Cherne Indus., Inc. v. Grounds & Assocs., Inc., 278 N.W.2d 81, 91 (Minn. 1979) (noting that two employees acquired "knowledge from [their employer] by way of their confidential relationship and in so doing they incurred a duty not to use it to [their employer's] detriment"); A.B. Chance Co. v. Schmidt, 719 S.W.2d 854, 859 (Mo. Ct. App. 1986) (noting that there is an "independent duty … not to disclose confidential information or trade secrets" for employees in a fiduciary relationship with an employer); Nutronics Imaging, Inc. v. Danan, No. CV 96-2950, 1998 WL 426570, at *2 (E.D.N.Y. June 10, 1998) (applying New York law; sustaining claim by employer seeking an accounting from a former employee—a technician/mechanic—who solicited the employer's customers "during the course of … employment and afterwards"); Burbank Grease Servs., LLC v. Sokolowski, 717 N.W.2d 781, 796 (Wis. 2006) (holding that a manager who obtained valuable and confidential information from the employer's computer system about business relationships with customers, then used the information to divert customer relationships away from his employer, breached his duty of loyalty; observing that claims for breach of duty of loyalty may lie against "key" employees).

Some courts that do not recognize a duty of loyalty independent from a fiduciary duty binding corporate officers and other high-level employees nonetheless recognize an implied duty of all employees not to misappropriate their employer's trade secrets. See, e.g., Allen Mfg. Co. v. Loika, 144 A.2d 306, 309 (Conn. 1958) (noting that "[t]he law is well settled that knowledge acquired by an employee during his employment cannot be used for his own advantage to the injury of the employer during the employment; and after the employment has ceased the employee remains subject to a duty not to use trade secrets, or other confidential information which he has acquired in the course of his employment, for his own benefit or that of a competitor to the detriment of his former employer"); Am. Bldgs. Co. v. Pascoe Bldg. Sys., Inc., 392 S.E.2d 860, 864 (Ga. 1990) (noting an implied term exists in every employment contract "that an employee will not divulge a trade secret learned by virtue of his employment to a competitor of his former employer").

Similarly, the Restatement Third, Unfair Competition, in particular § 42, recognizes that employees are bound by a duty to refrain from using trade secrets acquired in the course of employment in any manner that is detrimental to their employer.

*(2) Obligation not to compete with employer while employed.*Subject to the circumstances described in § 8.04(c) below, employees may not compete with their employer while employed. See Illumination Station, Inc. v. Cook, No. 07-3007, 2007 WL 1624458, at *4 (W.D. Ark. Nov. 20, 2007) (applying Arkansas law; refusing to dismiss a breach-of-loyalty claim against a sales representative who, while employed, diverted customer orders to a rival company); Bancroft-Whitney Co. v. Glen, 411 P.2d 921, 939 (Cal. 1966) (en banc) (holding that a corporation's president breached his fiduciary duty of loyalty by recruiting subordinates for a competitor prior to his departure and failing to disclose conflicts that would harm the original employer);

Charles Schwab & Co., Inc. v. McMurry, No. 2:08-cv-534-FtM-29SPC, 2008 WL 5381922, at *1 (M.D. Fla. Dec. 23, 2008) (holding that "[i]t is well-established under Florida law that an employee owes a fiduciary duty and a duty of loyalty to his or her employer," and granting an injunction against financial consultant-employee who removed confidential data and solicited clients after joining rival firm, in violation of confidentiality, nonsolicitation, and assignment agreement); Eckard Brandes, Inc. v. Riley, 338 F.3d 1082, 1085 (9th Cir. 2003) (applying Hawaii law; upholding summary judgment against supervisor and laborer counterclaimed for disgorgement of profits from running a competing pipe-repair business establishment while still employed by their employer); LCOR Inc. v. Murray, No. 97 C 1302, 1997 WL 136278, at *9 (N.D. Ill. Mar. 20, 1997) (applying Illinois and Pennsylvania law; granting a preliminary injunction to prevent former employee from competing with LCOR for the purchase of a piece of property within the state and holding that defendant, as the principal representative entrusted with LCOR's pursuit of the property, breached his fiduciary duty in failing to use his best efforts to obtain the property and in fact competed with LCOR while he was an agent acting on LCOR's behalf); Condon Auto Sales & Serv., Inc. v. Crick, 604 N.W.2d 587, 599-600 (Iowa 1995) (recognizing "the existence of a common law duty of loyalty which is implied in employment relationships … [and which] has been applied on several occasions in the context of employee competition and self-dealing," but not reaching the question of whether a separate cause of action exists for breach of the duty of loyalty due to lack of evidence that the employer, an automobile dealership, was damaged by former sales manager's self-dealing and enticement of employees to leave the dealership) (internal citations omitted); Md. Metals, Inc. v. Metzner, 382 A.2d 564, 568 (Md. 1985) (reiterating that "a corporate officer or other high-echelon employee is barred from actively competing with his employer *during* the tenure of his employment," and holding that failure to disclose in detail preliminary arrangements to enter into competition with employer was not a breach of employee's fiduciary duties); Eaton Corp. v. Giere, 971 F.2d 136, 141 (8th Cir. 1992) (applying Minnesota law; declaring that "an employee owes his employer a duty of loyalty which prohibits him from soliciting the employer's customers for himself, or from otherwise competing with his employer, while he is still employed," and affirming judgment against a mechanical engineer who formed a competing corporation for the purpose of selling a device he developed while still working for the employer and solicited the employer's customers for himself); Las Luminarias of N.M. Council of the Blind v. Isengard, 587 P.2d 444, 449 (N.M. Ct. App. 1978) (finding a breach of duty of loyalty by employees who, while employed by plaintiff employer, formed a separate organization that competed for grants against the employer, and declaring that "he who undertakes to act for another in any matter of trust or confidence shall not in the same matter act for himself against the interest of the one relying upon his integrity"); Futch v. McAllister Towing of Georgetown, Inc., 518 S.E.2d 591, 595 (S.C. 1999) (noting that solicitation of an employer's customers breaches the duty of loyalty but concluding that the former employee —a tugboat captain and local manager of operations—who began making plans with a coworker to start their own tugboat business, did not violate such duty because the new business was started only after the employer informed defendant that his job would terminate and that employer was considering closing operations in the area); Prince, Yeates & Geldzahler v. Young, 94 P.3d 179, 185 (Utah 2004) (rejecting, in dicta, the contention that, as a matter of law, "mere employees" cannot owe a fiduciary duty of noncompetition, and holding that the attorney defendant, as a member of the bar, owed a fiduciary duty to his employer that encompassed an obligation not to compete with the employer without the employer's prior knowledge and agreement). See also Ballew v. W.D. Larson Cos. Ltd., Inc., No. 1:08cv490, 2009 WL 4724264, at *8 (S.D. Ohio Dec. 1, 2009) (refusing to grant summary judgment to a former employee on her former employer's counterclaim for a breach of the duty of loyalty where there was an issue of material fact as to whether the former employee was indeed working for a competitor while still employed by her former employer); cf. Pathfinder, LLC v. Luck, No. Civ.A. 04-1475, 2005 WL 1206848, at *10 (D.N.J. May 20, 2005) (applying New Jersey law; denying former executive vice-president's summary-judgment motion because he was contractually limited from being employed by active clients for one year after his termination and his contract of employment "expressly imposed a duty of loyalty on him").

*(3) Obligation not to misappropriate the employer's property or engage in self-dealing.*The employee's obligation not to misappropriate the employer's property extends beyond trade secrets. See, e.g., FryeTech, Inc. v. Harris, 46 F. Supp. 2d 1144, 1152 (D. Kan. 1999) (applying Kansas law; holding that employees breached duty of loyalty when they secretly bought equipment they had been instructed to dismantle and scrap through sham arrangement with salvage company for their own competitive printing endeavor).

In addition, employees may not exploit their position with their employer in order to further their own, adverse (often pecuniary) interests. See Otsuka v. Polo Ralph Lauren Corp., No. C 07-02780 SI, 2007 WL 3342721, at *3 (N.D. Cal. Nov. 9, 2007) (applying California law; counterclaim stated breach of the duty of loyalty as even "a lower-level employee, such as a sales clerk or a laborer, owes a duty of loyalty to his employer" and employee "had on more than one occasion entered fictitious customer names when selling products to a [former employee] who was improperly using merchandise credits for her purchases," thus

violating company policy against use of employee discount for a nonemployee); Stout v. Laws, 37 Haw. 382, 392 (Haw. 1946) (ruling that employer had common-law right to exclusive use of trade name and that employee, acting manager of his employer's business, breached his duty of loyalty by registering the same name, even though it was the employee's last name as well as the employer's last name); Bessman v. Bessman, 520 P.2d 1210, 1217 (Kan. 1974) (finding a breach of such duty where the employee embarked on a course of dealing with various parties with the objective of putting cash in his own pocket); Cameco, Inc. v. Gedicke, 724 A.2d 783, 791 (N.J. 1999) (noting, in dicta, that employees may not "take advantage of their employers by engaging in secret self-serving activities, such as accepting kickbacks from suppliers"); Chemfab Corp. v. Integrated Liner Techs. Inc., 693 N.Y.S.2d 752, 754 (N.Y. App. Div. 3d Dept. 1999) (refusing to grant summary judgment for an employee on a duty-of-loyalty claim where evidence was presented that he used his employer's time and resources to aid a competitor).

*(4) Obligation of corporate officers and other key employees not to seize for the employee's own benefit a business opportunity related to the employer's business.*Officers and other key executives owe a fiduciary duty not to seize for their own benefit a business opportunity related to the employer's business. Courts often refer to the "corporate opportunity" doctrine when discussing this obligation not to take as one's own a business opportunity in which the employer has an interest or tangible expectancy and which the employer is financially able to undertake. See Guth v. Loft, Inc., 5 A.2d 503, 511 (Del. 1939) ("[I]f there is presented to a corporate officer or director a business opportunity which the corporation is financially able to undertake, [which] is … in the line of the corporation's business and is of practical advantage to it, [and which] is one in which the corporation has an interest or reasonable expectancy, … the law will not permit him to seize the opportunity for himself."). This doctrine is often understood as imposing a duty on the corporate officer or key employee to disclose a business opportunity to the employer before taking it as the employee's own. See Today Homes, Inc. v. Williams, 634 S.E.2d 737, 743-744 (Va. 2006) (stating that "an officer's desire to take an opportunity as his own, puts him on notice of his fiduciary duty to disclose the opportunity to the corporation before acting upon it for his personal benefit," and remanding the case for a determination of whether the vice-president of a real-estate development company breached that duty by not disclosing a potentially attractive investment to his employer). Courts often refer to the obligations imposed by the corporate-opportunity doctrine as stemming from the fiduciary duty of loyalty. See, e.g., Davis v. Dorsey, 495 F. Supp. 2d 1162, 1173 (M.D. Ala. 2007) (applying Alabama law; stating that "[w]here the director or officer uses the resources of the corporation to obtain and take advantage of an opportunity for himself, he has breached his duty of loyalty under the corporate-opportunity doctrine"); Demoulas v. Demoulas Super Mkts., Inc., 677 N.E.2d 159, 180 (Mass. 1997) (noting that "[t]he corporate opportunity doctrine is rooted in the principle that corporate directors and officers are bound by their duty of loyalty to subordinate their self-interests to the well being of the corporation").

Poor job performance is not generally a violation of the duty of loyalty, but may nonetheless furnish adequate grounds for terminating an employment relationship. See In re Petersen, 296 B.R. 766, 779 (Bankr. C.D. Ill. 2003) (applying Illinois and federal law; holding that, in the absence of gross misconduct, office manager's "poor job performance is not tantamount to a breach of a duty of loyalty" (citing Boock v. Napier, 120 N.E.2d 244, 248 (Ill. Ct. App. 1954) (noting that employee's conduct must rise to gross misconduct in order to constitute a breach of the duty of loyalty and that such a breach may result in forfeiture of compensation))); In re Leal, 360 B.R. 231, 239 (Bankr. S.D. Tex. 2007) (applying Texas law; holding that, absent a showing of misconduct, partner's "poor management performance is not actionable" on a theory of breach of fiduciary duty).

If the employee damages the employer's property, many courts allow the employer to sue the employee in tort. See Withhart v. Otto Candies, LLC, 431 F.3d 840, 845 (5th Cir. 2005) (applying federal maritime law; holding that a shipping employer was allowed to assert a negligence claim against an employee for allegedly causing property damage); Nordgren v. Burlington N. R.R., 101 F.3d 1246, 1253 (8th Cir. 1996) (holding that the Federal Employers Liability Act, 45 U.S.C. § 51 et seq., did not preempt railroad's Missouri-law counterclaims against employees for property damage); Stack v. Chi., Milwaukee, St. Paul & Pac. R.R., 615 P.2d 457, 459 (Wash. 1980) (after a railroad collision killing the train's head engineer, and the engineer's family sued the employer railroad company, the court found that the employer had a common-law right to sue employees for property damages).

Illustration 1 is drawn from Delta Envtl. Prods., Inc. v. McGrew, 56 F. Supp. 2d 716, 718-719 (S.D. Miss. 1999) (applying Mississippi law; rejecting employer's claim that former employees, an exclusive sales representative and a consultant, were "officers" and therefore subject to the corporate-opportunity doctrine).

The outcome in Illustration 2 is generally consistent with outcomes under the Restatement Third, Unfair Competition § 40, which imposes liability for misappropriation of an employer's trade secrets if the employee uses or discloses a trade secret without the employer's consent and if, at the time of use or disclosure, the employee "knows or has reason to know that the information is a trade secret that the [employee has] acquired through an accident or mistake, unless the acquisition was the result of the [employer's] failure to take reasonable precautions to maintain the secrecy of the information."

Illustration 3 is based on Otsuka v. Polo Ralph Lauren Corp., No. C 07-02780 Sl, 2007 WL 3342721 (N.D. Cal. Nov. 9, 2007) (applying California law).

Comment c. Most states (and the District of Columbia) have adopted legislation based on the Uniform Trade Secrets Act (UTSA), which expressly displaces conflicting tort, restitutionary, and other state law providing civil remedies for misappropriation of a trade secret. The UTSA has been interpreted by some courts as displacing, under certain circumstances, all common-law causes of action based on a breach of the employee duty of loyalty. See, e.g., Thola v. Henschell, 164 P.3d 524, 530 (Wash. Ct. App. 2007). In *Thola*, the court adopted and applied a three-step, fact-based analysis to determine whether a common-law claim of breach of the duty of loyalty was precluded by the state's Trade Secrets Act. Under this approach, the court (1) assesses the facts that support the plaintiff's civil claim, (2) asks whether those facts are the same as those that support the plaintiff's UTSA claim, and (3) holds as preempted by the UTSA any common-law claims that are not factually independent from the UTSA claim. A number of courts have also found that the UTSA preempts common-law tort claims based on the misuse of confidential information that does not meet the statutory definition of a trade secret. See, e.g., Mortgage Specialists, Inc. v. Davey, 904 A.2d 652, 664 (N.H. 2006) (concluding that the New Hampshire Trade Secrets Act "preempts [tort] claims that are based upon the unauthorized use of information, regardless of whether that information meets the statutory definition of trade secret"); Ethypharm S.A. France v. Bentley Pharmaceuticals, Inc., 388 F. Supp. 2d 426, 433 (D. Del. 2005) (applying Delaware law); Diamond Power Int'l, Inc. v. Davidson, 540 F. Supp. 2d 1322, 1345 (N.D. Ga. 2007) (applying Georgia law); BlueEarth Biofuels, LLC v. Hawaiian Elec. Co., 235 P.3d 310, 323 (Haw. 2010); Composite Marine Propellers, Inc. v. Van Der Woude, 962 F.2d 1263, 1265 (7th Cir. 1992) (applying Illinois law); Auto Channel, Inc. v. Speedvision Network, LLC, 144 F. Supp. 2d 784, 789 (W.D. Ky. 2001) (applying Kentucky law); Bliss Clearing Niagara, Inc. v. Midwest Brake Bond Co., 270 F. Supp. 2d 943, 949 (W.D. Mich. 2003) (applying Michigan law); Allied Erecting & Dismantling Co. v. Genesis Equip. & Mfg., Inc., 649 F. Supp. 2d 702, 722-723 (N.D. Ohio 2009) (applying Ohio law); Weins v. Sporleder, 605 N.W.2d 488, 491-492 (S.D. 2000). See also Powell Products, Inc. v. Marks, 948 F. Supp. 1469, 1474-1475 (D. Colo. 1996) (applying Colorado law; "[i]f the design of the plaintiff's machine is not a trade secret, plaintiff has no property right in its design, and it therefore would have no claim. Alternatively, if the design is a trade secret, plaintiff's claim is preempted by the UTSA"; holding that the plaintiff's claim was not fully preempted because it also sought the recovery of physical items stolen).

There is contrary authority on UTSA preemption, usually turning on whether the information in question was a trade secret under the statute. See Burbank Grease Serv. v. Sokolowski, 2006 WI 103, 294 Wis.2d 274, 717 N.W.2d 181 (rejecting UTSA preemption because misappropriation of employer confidential information did not involve a statutory trade secret); see Combined Metals of Chicago Ltd. P'ship v. Airtek, Inc., 985 F. Supp. 827, 830 (N.D. Ill. 1997) (applying Illinois law; permitting defendant's breach-of-fiduciary-duty claim to proceed because misappropriated employer information did not rise to the level of trade secret under the Illinois Trade Secrets Act); Stone Castle Fin., Inc. v. Friedman, Billings, Ramsey & Co., 191 F. Supp. 2d 652, 658-659 (E.D. Va. 2002) (applying Virginia law; permitting a breach-of-fiduciary-duty claim against a competitor accused of misappropriating confidential business information to proceed because it was not yet determined whether a statutory trade secret was involved).

This Chapter follows the majority view of state courts and acknowledges that most employer claims for breach of the employee duty of loyalty that are based solely on the misappropriation of the employer's trade secrets are brought as actions under the relevant jurisdiction's Trade Secrets Act, if there is one. However, in those jurisdictions that allow for recovery under a tort theory, or where the claim includes allegations extending beyond the misappropriation of trade secrets, as where a current employee has set up a competing business and solicited customers of his or her employer, then the employer can assert a common-law duty-of-loyalty claim along with any applicable statutory claim.

Case Citations - by Jurisdiction

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C.A.7
D.Colo.
Iowa,

C.A.7

C.A.7, 2021. Cit. in ftn. Start-up company and its founder filed a claim for legal malpractice against company's former attorney after attorney obtained an arbitration award against them for years of unpaid wages, alleging that they would not have been liable for the award if he had not advised them to enter into an illegal agreement with him to defer his compensation. The district court granted attorney's motion to dismiss. This court affirmed the district court's determination that company and founder failed to show proximate cause by plausibly pleading that they would have taken a different course of action that would have avoided their liability to attorney if attorney had not recommended the agreement. In making its decision, the court cited Restatement of Employment Law § 8.01 in noting that it was rare but not completely unprecedented for an employer to sue its own employee for negligent acts taken within the scope of his or her employment. UFT Commercial Finance, LLC v. Fisher, 991 F.3d 854, 856.

D.Colo.

D.Colo.2019. Subsec. (a) quot. in sup. Staffing firm brought a claim for breach of the duty of loyalty against, among others, former employee, alleging that defendant solicited customers for a competitor while employed as plaintiff's human-resources specialist by sending plaintiff's onboarding paperwork with the competitor's letterhead to plaintiff's customers. This court granted defendant's motion to dismiss, holding that plaintiff failed to state a claim for breach of the duty of loyalty. The court explained that the factors set forth by Restatement Second of Agency § 393 and Restatement of Employment Law § 8.01(a) weighed heavily towards the finding that defendant did not act as plaintiff's agent, because the fact that she was plaintiff's employee did not determine that she was plaintiff's agent, and her duties primarily consisted of forwarding onboarding documents and taking orders from higher-ranked officers, which did not give her the level of discretion and independent authority necessary to find that she was an agent. DTC Energy Group, Inc. v. Hirschfeld, 420 F.Supp.3d 1163, 1175.

Iowa,

Iowa, 2019. Subsec. (b)(3) quot. in diss. op. After the initiation of disciplinary proceedings against attorney for his self-reported theft of client fees from his law firm, state disciplinary board appealed the grievance commission's report recommending a four-month suspension of attorney's license. This court indefinitely suspended attorney's license for not less than four months, holding, inter alia, that attorney violated professional-conduct rules reflecting adversely on his honesty and trustworthiness and professional-conduct rules governing fraudulent conduct. The dissent argued that the majority should have revoked attorney's license, because defendant breached his fiduciary duty as an employee under Restatement Third of Agency § 8.05(1) and Restatement of Employment Law § 8.01(b)(3) by misappropriating funds from his law firm, and caselaw indicated that revocation of a license was the proper remedy for such dishonest acts. Iowa Supreme Court Attorney Disciplinary Board v. Den Beste, 933 N.W.2d 251, 259.

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