Originally published in <u>Maryland State Bar Association Section of Labor and Employment Law Newsletter</u>, Vol. 10, No. 6, Winter 2005.

THE FIDUCIARY DUTY OF LOYALTY AND THE DEPARTING EMPLOYEE

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What exactly ***is*** the fiduciary duty of loyalty, and what does it mean to the employee who's leaving to work for a competitor or start a competing business? According to Maryland case law, the fiduciary duty of loyalty requires the employee to "act solely for the benefit of his employer in all matters within the scope of his employment, avoiding all conflicts between his duty to the employer and his own self-interest." *Maryland Metals, Inc. v. Metzner*, 282 Md. 31, 38 (1978). On the surface, this standard sounds simple enough. You would be correct in assuming that this fiduciary duty prohibits a sales representative from using his position to divert sales opportunities from his employer to himself. You'd also be correct in concluding that the duty of loyalty protects an employer from the corrupt corporate officer who receives secret kickbacks from its vendors or misappropriates its trade secrets.

But things get murkier in the case of an employee who is simply preparing to move on to the next professional opportunity – assuming, of course, that he or she is not bound by a non-compete agreement. Indeed, isn't an employee who interviews with her employer's arch-competitor really putting her own self-interest above the interests of her employer? And what about the worker who wants to start his own competing business? Must he wait until he's unemployed before he can even look into financing, talk to potential partners, or search for office space?

The good news for employees is that the "duty of loyalty" doctrine has limits, as the courts recognize that the need to prevent employees from abusing their employers' trust and confidence should be balanced by the employees' legitimate interest in career advancement.

First, it should be noted that the employee's duty of loyalty, like his or her other fiduciary duties, exists only for the duration of the employment. That is, the duty expires when the job does. Second, an employer may recover for breach of the duty of loyalty only where it has actually suffered injury. Third, in most circumstances, an employee may begin ***preparing*** to compete even before the employment's termination. He may, without breaching the duty of loyalty,

> search for another job prior to leaving his current position. A group of employees may agree to leave together, such as when a partner at a law firm leaves with his associates . . . . [A]n employee may discuss job offers with his circle of friends and the group may debate whether to leave together. Such discussions are a normal part of workplace intercourse . . . The employee may also advise current customers that he is leaving. . . . Departing employees may purchase a rival business or equipment, secure land options, and obtain financing for a prospective new business.

(Citations omitted). *Quality Systems Inc. v. Warman*, 132 F.Supp.2d 349, 354 (D.Md. 2001).

Even the "preparation" exception has limits, however. Generally, preparations to compete will breach the duty of loyalty to the extent that they involve "fraudulent," "unfair," or otherwise "wrongful" acts. For example, the "preparation" privilege does not extend to an employee's misappropriation of the employer's valuable trade secrets for use in his new business. Further, although an employee may discuss job offers with her "circle of friends" and leave the company with them, she may not, with the purpose of destroying a key part of the employer's business, use her position to actively solicit employees outside of that circle. In addition, although the soon-departing employee may inform customers that she is leaving, she usually must wait until after her official termination date to solicit their business in competition with the employer.

The limits to the "preparation" privilege are illustrated in *C-E-I-R, Inc. v. Computer Dynamics Corp.*, 229 Md. 357 (1962), *cited in* *Insurance Co. of N. Am. v. Miller*, 362 Md. 361 (2001), in which an employer successfully sued a group of former employees who had surreptitiously used their positions in the company to divert a lucrative business opportunity to

their new start-up company. C-E-I-R was a provider of consulting services related to complex data processing systems, and the defendant employees, collectively, had been responsible for negotiating government contracts, managing the company's commercial systems department, and performing the actual services. Those individuals, each of whom had an agreement preventing the publication or disclosure of data or information to his employment, played important roles with regard to a short-term consulting contract between C-E-I-R and its governmental client, the Bureau of Old Age and Survivors Insurance. C-E-I-R and the individual defendants all understood that this short-term contract might lead to a long-term relationship between C-E-I-R and the Bureau. They also understood that, although the Bureau would let future contracts out on competitive bids, C-E-I-R's experience with the Bureau could put it in a favored position over other bidders.

What C-E-I-R did not know, however, was that these employees were secretly preparing to start Computer Dynamics Corporation, a new company that would compete with C-E-I-R's commercial services department. Indeed, exploiting their relationship with the Bureau and their thorough familiarity with its needs, they secretly told a Bureau representative that they were forming a new company and would like to be considered for future business. Moreover, in order to increase their chances of obtaining this important client for their new business, the individual employees secretly recruited other C-E-I-R employees who had directly worked on the Bureau project. They ultimately succeeded in obtaining an invitation from the Bureau to submit bids.

The Maryland Court of Appeals, reversing the Circuit Court's denial of injunctive relief and consequential damages to C-E-I-R, held that the individual defendants had engaged in the subject activity while still employed by C-E-I-R – meaning they were bound by a duty of loyalty at the time – and that the activities amounted to improper "solicitation" of customers in breach of the duty. In so doing, the Court stated as follows:

> There would appear no precise line between acts by an employee which constitute mere preparation and those which amount to solicitation. However indefinite that line may be, we feel that the [defendants] crossed over the line into the area of solicitation forbidden to the loyal employee.

Id. at 367. This conclusion was based not on the communications alone, but on the totality of the circumstances, including the secrecy in which the individual defendants operated, the solicitation of C-E-I-R's employees, and the fact that the defendants used C-E-I-R's confidential information after agreeing in writing not to do so. The Court determined that these factors, taken in sum, were wrongful and gave the former employees an unfair competitive advantage over C-E-I-R.

Given the lack of a clear "bright line" with regard to the "preparation" exception to the duty of loyalty, an employee who plans to leave his or her employer should proceed with caution until the employment relationship is officially terminated. Although an employee is entitled to and often needs to engage in a certain degree of preparatory activity, he or she should refrain from taking actions that would compromise the employer's trust or confidence. Once the employment relationship has ended, however, the employee may engage in lawful competition without fear of breaching this fiduciary duty.