



FORENSIC PERSPECTIVE



Courts Rule on Company Data Violations by Departing Employees

In this recessionary period, more non-compete and violation of trade secret actions are finding their way into the court system. Increasing numbers of employees with intimate knowledge of company trade secrets, customer lists and other proprietary data are losing their jobs as a result of downsizing. Some of the employees are using the information to start their own businesses or to benefit their new employers.

A recent study¹ by Ponemon Institute of almost 1,000 adult-aged participants in the US who had been laid-off, fired or had changed jobs in the previous 12 months had some ominous revelations:

- 59% of respondents had stolen company data.
- 79% of these admitted that their former employer did not permit them to leave with company data.
- 67% of the respondents admitted that they used their former company's confidential, sensitive or proprietary information to leverage a new job.
- 68% planned to use such stolen information.

Cases that have recently gone through the court process have yielded interesting decisions. *Medical Staffing Network Inc. v. Thomas Dean Ridgway and Trinity Health Care Staffing Group*² was a case involving two medical staffing companies that ended up before the North Carolina Court of Appeals. In 2005, Trinity sought and hired Mr. Ridgway who had been working as a manager for their competitor, Medical Staffing, for about 5 years.

Mr. Ridgway had signed an "Agreement Regarding Confidential Information, Non Competition, and Non-Solicitation" on commencement of his employment. The Agreement addressed, among others, non disclosure of Medical Staffing's information, non solicitation of its employees and non competition with its business. Shortly before leaving Medical Staffing, Mr. Ridgway accessed a number of confidential documents he had only occasionally accessed in the past. After joining Trinity, Mr. Ridgway also attempted to recruit several employees from Medical Staffing (10 nurses had joined Trinity at the time of trial) and attempted to solicit its clients.

59% of respondents admitted to stealing company data, 67% said that they used the stolen data to leverage a new job.

While the lower court had generally ruled in favor of Medical Staffing, the North Carolina Court of Appeals reversed the trial court's decision ruling that the non-compete agreement was unenforceable because the scope of prohibited conduct was overbroad. However, the appeals court upheld the trial court's ruling that on hiring Mr. Ridgway, Trinity acquired and used Medical Staffing's confidential information thereby causing harm to the Plaintiff. The Court noted that there was a substantial turnaround in Trinity's business and a concurrent substantial decrease in Medical Staffing's business in the period subsequent to Mr. Ridgway's hiring.

As it related to damages, the higher court ruled that the use of total revenues as a basis for calculating lost profits was too speculative and concluded that a more reasonable measure of economic loss would include:

- The profit Trinity gained from the ten nurses they acquired from Medical Staffing.
- Profits that could be attributed to market share changes resulting from Trinity's acquisition of Medical Staffing's marketing strategy information and other confidential data.

Closer home, the Ohio Supreme Court, in *Al Minor & Associates, Inc., v. Martin*,³ ruled that information stolen from a previous employer could be transmitted via the employee's memory and did not have to be written or in a physical format.

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Courts Rule on Company Data Violations by Departing Employees (cont'd)

Mr. Martin had worked as a pension analyst for AI Minor for about five years when he organized his own company. He later resigned from AI Minor and while he did not take any confidential documents from his employer, he successfully solicited 15 clients from AI Minor. AI Minor sued him for violation of Ohio's Trade Secrets Act. Mr. Martin argued that a memorized client list did not satisfy the definition of a trade secret as ruled by the trial court and upheld by the Franklin County Court of Appeals.

The Supreme Court affirmed the judgment of the court of appeals concluding that it is the information that is protected, regardless of the manner, mode, or form in which it was stored. The Court also affirmed a \$25,973 verdict in favor of AI Minor for lost fees from clients that Mr. Martin had successfully solicited using the memorized confidential information.

In *Charles Schwab v. Karpiak*,⁴ it was alleged that Karpiak had signed several versions of Charles Schwab's non-compete agreements during his eight years of employment. The agreements prohibited him from soliciting the clients he was servicing at Schwab for eighteen months subsequent to termination of his employment. Within two weeks of his resignation, however, several of his clients contacted Schwab seeking to transfer their assets to his new employer, RBC Dain.

Karpiak testified that he did not directly solicit clients from Schwab and that he only called his clients to inform them that he was no longer with Schwab and to thank them for working with him. He said that he did not volunteer information on his new employer unless the client specifically asked him. The judge who first heard the case ordered a temporary injunction stopping Karpiak from soliciting Schwab's clients. The judge found that Karpiak had, at RBC Dain's request, prepared a 90 page spreadsheets with detailed information on his Schwab clients including their names, addresses, account titles and the type services they would need. Karpiak had then used these spreadsheets to prepare letters to the clients along with transfer forms specific to each client's needs. Karpiak also testified that he intended to continue calling his former clients at Schwab.

In proceedings, a Financial Industry Regulatory Authority (FINRA) arbitration panel made the injunction permanent and ordered Karpiak and RBC Dain to destroy and purge all of Schwab's proprietary information. In addition, the panel awarded Schwab \$957,061 in liquidated damages. Before his resignation, Karpiak had been servicing more than 125 clients with approximately \$178 million in assets. The panel heard that Karpiak had transferred about \$24 million in assets from Charles Schwab. To determine the damage amount, the panel enforced a clause in the non-compete agreement providing that damages be calculated as a percentage of the transferred clients' assets.

Defendant had prepared detailed spreadsheets on his former clients including their names, account titles and types of service.

¹ *Data Risks During Downsizing – As Employees Exit so Does the Corporate Data*, Dr. Larry Ponemon, Ponemon Institute, February 23, 2009.

² *North Carolina Court of Appeals, No. COA07-1486. Decision filed January 6, 2009*

³ *AI Minor & Assoc., Inc. v. Martin*, 117 -Ohio St.3d 58, 2008-Ohio-292

⁴ *No. 06-4010, 2006 U.S. Dist. LEXIS92763, at *2-18 (E.D.Pa. Dec. 6, 2006)*

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Mortgage Fraud

Fraud Corner

In today's economy, the number of reported mortgage fraud incidents has reached an all-time high despite the fact that the number of home loan originations has declined. Experts agree there is a direct correlation between fraud and distressed markets. The FBI reports that **cases of mortgage fraud increased 36%** from 2007 to 2008, and they are expected to increase again in 2009.¹

WHAT CONSTITUTES MORTGAGE FRAUD?

According to the FBI, which investigates reports of mortgage fraud, "any material misstatement, misrepresentation, or omission relied upon by an underwriter or lender to fund, purchase, or insure a loan" constitutes mortgage fraud. Some common forms include:

- 1) Falsifying income and concealing debt on a mortgage application
- 2) Gross misrepresentations concerning appraisals and loan documents
- 3) Buyers receiving money from a seller for repairs when the lender has not been informed
- 4) Not informing the lender that the down payment was made with a gift that will be repaid

MORTGAGE FRAUD IN OHIO

- In 2008, Ohio was ranked in the top five for number of pending investigations of mortgage fraud
- Between 2007 and 2008, the number of reported cases of mortgage fraud in Ohio increased by over 6%
- Based on 2008 loan applications, Ohio is ranked third in the top ten states for possible fraudulent activity

The FBI projects that new programs implemented with the Economic Stimulus Package may provide new targets for mortgage fraud as perpetrators prey on the billions of dollars from the programs.

If a borrower or real estate professional is suspected of mortgage fraud, they may face a criminal investigation by the FBI, six figure fines or even jail time.

¹ *2008 Mortgage Fraud Report "Year in Review"*, Federal Bureau of Investigations

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