

## TO DITCH OR NOT TO DITCH

### General Information

*In an initial interview session, Dale Doran conveyed the following information to his/her prospective attorney:*

Dale Doran is a top salesperson at Design Display, Inc. a small company that designs and constructs museums and trade exhibition displays. When he was hired, Dale signed a non-compete agreement prohibiting him from soliciting Design Display customers or competing for new business within a 100 mile radius for two years after leaving voluntarily or termination for cause. Design Display has been financially troubled since the recession. Commissions have dropped dramatically. Dale believes the company is unlikely to survive. Dale began talking with a friend, the Sales VP at Upscale Display, a similar company catering only to the "high end." They have been meeting for breakfast brainstorming about the challenges of more expensive installations. Dale confided with the Upscale VP regarding Design Display's financial troubles. Last week, Upscale offered Dale a job at 40% commission (Design Display pays 30%).

Dale wants to go now, while the Upscale job is open. He thinks it would be unfair to enforce the non-compete. Dale never trusted the way his bonuses were awarded (when they had profits and bonuses). Also, when Design Display's CEO (also the founder and majority shareholder) gets leads on potential clients, he diverts them all to his designer daughter. Dale gets the "long shots." Dale attributes the business's financial troubles to the CEO's waste and poor judgment.

*After the Initial Interview*

Dale decided to retain the attorney, signed an engagement letter, and provided the documentation the attorney requested. This included a copy of his employment agreement containing the non-compete provision, and reference to an award of 5% of the stock in the company, after 5 years of employment. The non-compete provision applies only if Dale voluntarily terminates his employment, NOT if he is terminated by the company, unless the termination is for fraud or a criminal act. The agreement states that it will be automatically renewed from year to year, unless terminated in writing by either party. It specifically states that the non-competition obligation continues for the full two years after contract termination. The first paragraphs of the agreement state that Dale is to be employed as a commission salesperson, earning 30% of the gross sales generated, after deduction of his direct expenses. Dale is to be paid a semi-monthly advance on commissions, based upon a calculation of 80% of his previous year's totals, allocated over 26 pay periods. The difference between his advance and the commissions earned is to be paid quarterly, with final adjustments after the end of the calendar year. It states that Dale is to use his best efforts to sell the company's product and services and that the company is to provide administrative and business support for sales efforts.

In a subsequent meeting with the attorney, Dale confirmed that he received 5% of the company stock, but he knows it has little value. He has never known the company to have a shareholder's

meeting. No profits have been distributed for the past 5 years. He suspects that the CEO and his daughter sometimes use company funds for themselves. When the company's parking lot was paved, Dale believes the paving company moved on to the CEO's and daughter's home driveways, on the company tab. Dale does not know if more of this sort of thing has gone on.

Dale told his attorney that during the recession, the company decided to reduce the salary draws to 60% instead of 80% of the previous year's totals, anticipating lower revenues. He also detailed several instances in which he had identified a business lead, but the company's president steered the customer to his daughter. Within the past year, the company's president decided that Dale should split his commissions on two significant accounts with another sales person who claimed that she had helped to originate and service the accounts. Since then, they've started nickel and diming him on expenses, seeking to deduct certain administrative costs from his gross - costs they have covered in the past.

Dale has explained that while he wants to leave Design Display, he has to be able to work. He believes that Design Display has not lived up to its end of the bargain. At this point, he services more than 50 loyal customer accounts, many of them for a decade. While perhaps half of the accounts are within the 100 mile radius, others are all over the country. He feels responsible to his customers and believes they are entitled to quality service and product. He is confident that many of his customers would follow him to Upscale Display, if that were possible. Dale is angry and frustrated with the people at Design Display.

Dale's spouse is a marketing manager at a pharmaceutical company and earns 110,000 per year. Dale's earnings were \$200,000 per year at peak, but have been in the \$100,000 - \$125,000 range since the recession. They have three children, between the ages of 8 and 15. While they could manage on the spouse's salary, money would be tight. They would be fine if Dale could earn \$90,000 - \$100,000 or close to that. They carry a substantial mortgage; the three children are in private school. Dale is 48 years old.

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### Instructions for the Attorney

You have assessed Dale's legal claims and considered various options as follows:

(1) Dale leaves voluntarily and fights a legal battle over the non-compete.

If Dale leaves the company voluntarily and begins to work for the competition (or sets up a competitive business on his own), and if Design Display seeks to enforce it through a motion for preliminary injunction, the non-compete provision in his employment agreement will likely be enforced, at least to some degree. A judge might reduce the time period from two years to 18 months or one year, and somewhat shrink the geographic area.

The court, sitting in equity on a motion for preliminary injunction, might possibly reject the preliminary injunction motion, if you (and Dale) can establish the company's "unclean hands" by its alleged breaches of Dale's employment agreement or violation of his shareholder rights. That would be great, but you wouldn't bank on it. Dale seems to have gone along with some of these changes because of the financial circumstances. The company will no doubt provide colorable explanations on the other issues. Thus, you see only a slim chance of proving the company's "hands" to be sufficiently "unclean" to void the non-compete. *This legal work is likely to cost \$25,000.* A hearing on a temporary restraining order (\$10,000) would occur within a few weeks. The preliminary injunction hearing would take place within a few months thereafter (\$15,000).

(2) Dale continues at Design Display, but brings legal action as a shareholder

While working at Design Display, Dale could threaten or bring a shareholder derivative action, or breach of fiduciary duty to a minority shareholder, asserting that the company is squandering funds. You have no idea what such an action would yield, but Dale clearly has a right to attend shareholders' meetings and to see the corporate books and records. It would not yield significant money for Dale because any recovery goes to the corporation (and he only has 5%).

This option might give Dale some leverage for settlement. It might make him a sufficient thorn in the side of the company that they would release him from some or all of the non-compete in exchange for return of his 5%. *This legal work is likely to cost \$5000 for filing suit, \$15,000 for discovery, and an additional \$25,000 if it ever went to trial. The cost of negotiating a settlement after filing suit would likely be \$5,000. Trial would not take place for 2 years.*

(3) Dale leaves Design Display and files a breach of contract action

Dale could leave Design Display and file suit for breach of his employment contract, based on the reduced salary, reduction of commission percentages and "diversion" of customers. He could file a summary judgment motion, seeking a declaration that the contract was no longer in force. The

problem, of course, is that the company could “cure” the alleged breaches. *Legal work to trial would be approx. \$35,000, perhaps \$20,000 through summary judgment. Summary judgment might be heard in six months, but it would not get to trial for 18 months or two years.*

- (4) Dale continues to work at Design Display, while attempting to negotiate terms of departure and work at Upscale.

Dale could remain at Design Display while seeking to negotiate terms under which he could leave AND take the Upscale Design job. As leverage, he could assert his right to hold the company to the letter of the employment contract. If this is not successful, Dale would still retain the options listed above.

You don't know what terms, if any, Design Display would agree to. One possible term to propose is that the non-compete be reduced to a “non-solicit.” Dale would be permitted to go to Upscale Design and compete in the marketplace for new customers. But for a certain period of time (a year or two), Dale would not approach his old customers or those of others at Design Display.

Dale could attempt to negotiate himself (with your advice, in the background) or you could become directly involved, and negotiate with Design Display or, most likely, its attorney. On the one hand, you are a lawyer and you would be less emotional in the negotiations. On the other hand, when businesses learn that an employee has counsel, they often become anxious, defensive and adversarial to the employee.

If Dale's offer at Upscale Design becomes known, you are concerned that Design Display would contact Upscale Design and threaten litigation, which might cause Upscale to withdraw the offer.

*Legal work to advise regarding negotiations and write up an agreement would be approximately \$3,000. If you were directly involved, the bill might run as high as \$5,000.*

- (5) Dale could simply continue to work at Design Display. Pass on the Upscale Design opportunity. Perhaps line up another commission sales job in a business that does not compete.

Discuss these options with Dale. Invite him to think of other options. Assist Dale in deciding which option to select.