

Additional Protections May Be Needed to Protect Employers from Departures of Key Employees

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Practice Area: Business and Corporate Law & Labor and Employment

A recent decision of the Wisconsin Court of Appeals has highlighted the risks associated with the loss of key non-officer employees. In *Modern Materials Inc. v. Advanced Tooling Specialists, Inc.*, the Court of Appeals held that a plant manager for a tool and die company did not breach any fiduciary duty to his employer when he and two other employees took steps to set up their own tooling company prior to the termination of their employment.

The plant manager in *Modern Materials* was a salaried employee, considered by the owner of the company to be "the number two" person in the organization. As plant manager, the employee shared responsibility for the company's Tooling Division with a design engineer. The plant manager had discussions with two other employees regarding the possibility of establishing their own tooling company, and the three retained an accountant to put together a business plan for their proposed company. Approximately one month later, the owner of Modern Materials learned that his employees were attempting to secure financing for a tool and die business, and terminated their employment. The three former employees proceeded to set up their own company, Advanced Tooling Specialists, Inc. Modern Materials then sued the three ex-employees and their new company.

The *Modern Materials* case demonstrates how the duty of an employee to his or her employer may vary depending upon the employee's position with the company. At a basic level, every employee owes to the employer the duty of undivided loyalty. Nevertheless, absent an agreement to the contrary, the employee is free to engage in competition with the employer after the employment relationship terminates and may plan and develop this competitive enterprise during the course of the employment, provided it is on the employee's own time.

An employee owes additional duties to the employer when that employee is an officer or director of the company. Corporate officers and directors owe "fiduciary" duties of loyalty, good faith and fair dealing which preclude them from exploiting their positions for personal gain when the benefit or gain would properly belong to the corporation. A non-officer/director also may owe fiduciary duties under certain circumstances. In *Modern Materials*, the Court of Appeals concluded that "the controlling question is whether an employee is vested with policy-making authority or has the ability to make decisions which bind the company."

The plant manager and his co-employees in *Modern Materials* fell short of that test. None of the employees was an officer or director of the company. The plant manager attended management meetings and had prepared a five-year business plan for the company at the request of the owner. The plant manager did not attend directors meetings, however, and had no input on whether the business plan would be adopted. The plant manager reported to the owner for decisions on day-to-day operations, hiring, quotes, ordering of materials and scheduling. As a result, the plant manager did not have the level of policy-making authority that would impose a fiduciary duty.

The activities of the employees in *Modern Materials* can be contrasted with other cases in which managerial employees have violated their duties to their employers. In *General Automotive Mfg. Co. v. Singer*, for example, a general manager had responsibility for procurement of machine shop work. While serving as a general manager for his employer, he was brokering the same type of work to another machine shop without his employer's knowledge. He pocketed profits of over \$64,000 from this sideline business. The court held that the general manager's brokering activities violated his duty to act solely for the benefit of his employer.

In another case, employees copied drawings and plans for a machine modification which had been developed by their employer, and which were unique to the company's manufacturing operation. The employees utilized those plans to develop the machinery necessary to set up a competing business. The court in *Standard Brands, Inc. v. The United States Partition & Packaging Corp.* held that the defendants violated their duties to their employer by appropriating their employer's secret and confidential information.

There are several lessons to be learned from these cases. First, employees may not engage in a competing business with a current employer or appropriate trade secrets in order to facilitate a competing business, regardless of whether or not they are officers or directors of the company. Second, while officers and directors may not take steps to compete with the company while they are still employed by that company, other employees may be free to plan and develop a competing business while they are still employed.

As a result, employers may be well advised to consider entering into noncompetition agreements with their key managerial employees. In the *Modern Materials* case, the plant manager had actually signed a noncompete agreement at one point, but that agreement had terminated. To be enforceable, noncompetition agreements must be supported by adequate consideration and must not be overreaching on terms such as the geographic scope or length of time of the restrictions. For new employees, the consideration may be the fact of employment itself; for existing employees, the employer may have to provide consideration in addition to the prospect of continuing employment. These agreements ultimately may protect an employer from the significant harm that can result from the loss of a key managerial employee.

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