Breach of Fiduciary Duty by Employees

As early as 1925, Indiana jurisprudence recognized that the employment relationship gives rise to an implied obligation on the part of the employee to "honestly and in good faith" perform his duties so as to "carry out the work to the best interest of the employer." *H.C. Bay Co. v. Kroner*, 83 Ind.App. 541, 544 (1925). Sixty years later, in what is perhaps the seminal case on the subject in Indiana, *Potts v. Review Bd. of Indiana Employment Security Division*, the Indiana Court of Appeals elaborated on this implied obligation and affirmatively declared that an employee owes a "fiduciary duty of loyalty" to his employer. 475 N.E.2d 708, 713 (Ind. Ct. App. 1985). To define the general contours of this duty, *Potts* borrowed general principles of agency law: "an agent is subject to a duty to his principal to act solely for the benefit of the principal," and an "agent may not place himself in a position wherein his own interests are potentially antagonistic to those of his principal." *Id.* at 711.

An employee my dream, aspire and even plan but may not actually compete against his or her employer. A key element of an employee's fiduciary duty of loyalty is, as *Potts* noted, the obligation to avoid "actively and directly competing" with his employer during the employment relationship. *Id.* at 712. This rule however, like many others, is not absolute. Indeed, in order to promote healthy competition, case law has carved out a slight exception to the duty not to compete, *i.e.*, employees "may lay plans and take *limited* steps to begin competing with their employers." *Setliff v. Akins*, 616 N.W.2d 878, 886 (S.D. 2000) (emphasis added). This thin privilege permits an employee to make general preparations and arrangements for post-termination competition, including "investments or the purchase of a rival corporation or equipment." *Potts*, 475 N.E.2d at 712. Employees, however, must continue to exert their best effort while making such preliminary preparations. *See id.* Importantly, employees must refrain from using company time or resources to make such preliminary preparations. In *Long v. Vertical Techs, Inc.*, 113 N.C.App. 598, 604 (1994) the Court found the duty of loyalty was breached when current employees used their employer's "employees, facilities, computers and computer software" to establish a competing business which they "worked for and promoted" during business hours. Likewise, *E.D. Lacey Mills, Inc. v. Keith*, 183 Ga.App. 357, 363 (1987), the Court determined that a genuine dispute existed as to whether two full-time employees breached their fiduciary duty of loyalty in light of the evidence that they conducted "numerous meetings and telephone calls" in furtherance of plans to compete, were "frequently absent from work," and had "broached the subject of their plans" to other employees. In *Cf. Food Lion v. Capital Cities/ABC*, 194 F.3d 505, 516 (4th Cir. 1999), The Court recognized that an employee who holds two jobs does not automatically violate the duty of loyalty by performing one job inadequately as a result of being tired from working at the other; as there is "no intent to act adversely to the second employer for the benefit of the first."

However, courts make it abundantly clear that when employees "go too far" in making their preparations, they risk violating their duty of loyalty. *Setliff*, 616 N.W.2d at 886; As the Court in *Maryland Metals v. Metzner*, 282 Md. 31, 40 (1978) noted, "The right to make arrangements to compete is by no means absolute and the exercise of the privilege

may, in appropriate circumstances, rise to the level of a breach of an employee's fiduciary duty of loyalty." Indeed, when general preparations cross into the realm of impermissible competition, the fiduciary duty is breached. *Jet Courier v. Mulei*, 771 P.2d 486, 493 (Colo. 1989).

The line separating the two can, however, be hard to draw. *Id.* In any event, the focus of the inquiry is the "nature of the employee's preparations." *Id. Potts* recognized that an employee breaches his fiduciary duty of loyalty by, prior to his termination, competing with his employer for customers or employees. 475 N.E.2d at 712. This holding provides a bright-light that: "soliciting" co-workers or customers for the employee's new competing venture is impermissible. *Davis v. Eagle Prods. Inc*., 501 N.E. 2d 1099, 1104 (Ind. Ct. App. 1987). To date, it appears Indiana courts have not established any specific criteria for determining whether pre-departure communications amount to improper "solicitation." Outside Indiana, at least one state Supreme Court has looked to the definition of "solicit" in Black Law's dictionary for guidance on the issue. *Aetna Bldg. Main. Co. v. West* 246 P.2d 11, 14 (Cal. 1952) (defining solicit as "to ask for with earnestness, to make petition to, to endeavor to obtain, to awake or excite to action, to appeal to, or to invite," *citing* Black's Law Dictionary, 3d ed., p. 1639). Rather than attempt to define solicitation, the Colorado Supreme Court in *Jet Courier* set forth several "factors" that help determine whether solicitation has occurred. According to *Jet Courier*, under an employee's privilege to make preparations for post-termination competition, an employee may "advise" fellow employees and customers "he will be leaving his current employment." *Jet Courier*, 771 P.2d at 494. Communications that go beyond this limited announcement, however, may rise to the level of solicitation.

The Indiana case of *Wenzel v. Hopper & Galliher*, 779 N.E. 2d 30 (Ind. App. 2002) is illustrative. There, Mark Wenzel, a lawyer, announced to his firm that he would be leaving. Prior to his departure, Wenzel, also a shareholder in the firm, met with a fellow shareholder and attorney, George Hopper, and together they formulated an announcement Wenzel was to use in informing clients of his departure. *Id*. at 47. However, in a facsimile to one of the firm's largest clients, National City Bank ("NCB"), Wenzel deviated from the agreed upon announcement and wrote the following message: "As I indicated [in a previous conversation with the client,] [my new firm] has agreed that I can continue to provide legal services to NCB at my current rates and under the same terms. Once you have had a chance to review this information, please feel free to call if you have any questions or comments." *Id.* at 48 (brackets in original). In his defense, Wenzel asserted that he sent this correspondence at NCB's request. *Id.* Nevertheless, based on this facsimile, the Indiana Court of Appeals upheld the trial court's finding that Wenzel breached his fiduciary duty of loyalty by engaging in "secret solicitation."

A critical factor in analyzing whether employees have breached their duty of loyalty is the length of time that they continued to work for the employer while planning to eventually compete. As an employee may not "place himself in a position where his own interests are potentially antagonistic to the employer," working for a long period of time while planning to compete places the employee in a position of irreconcilable conflict. *Potts*, 475 N.E.2d 708.

Obviously, when employees continue to perform vital functions for an employer while simultaneously planning to eventually compete against the employer, they are presented with a tempting opportunity to undermine the current employer. Thus, evidence that before resigning, the employee delayed or otherwise compromised projects, made negative comments to other employees or customers of the employer, or generally performed poorly is powerful proof of a breach of fiduciary duty.

Another way in which preparation turns into a breach of duty is when the departing employee compiles the employer's trade secrets or confidential information for use in competing with his employer. *Potts*, 475 N.E.2d at 712. Of course, such conduct can also give rise to separate claims for misappropriation of trade secrets and conversion.

For example, in *Northern Electric Co. Inc., v. Torma*, 819 N.E.2d 417 (Ind. App. 2004), a supervisor at Northern Electric Company, Inc. ("Northern Electric") resigned and took with him a compilation of data that he and his subordinates had generated from over 650 "servo motor" repair jobs. The data compilation, which Torma refused to return, helped Torma, and his staff, quickly diagnose problems with and fix servo motors. *Id.* at 420, 424. After Torma left Northern Electric, he worked for a competing servo motor repair company that he had founded before he resigned from Northern Electric. *Id.* at 420-21. Northern Electric sought an injunction against Torma and his new company, and filed suit, alleging claims for misappropriation of trade secrets, conversion, and breach of fiduciary duty. The trial court found that Torma, not Northern Electric, owned the data compilation, and, accordingly ruled in favor of Torma and his competing business. On appeal, the Court of Appeals reversed finding that Northern Electric owned the data compilation and that Torma had committed misappropriation of a trade secret and conversion, and had breached his fiduciary duty of loyalty. With respect to the fiduciary duty claim, the court reasoned: "Relying on our holding in Potts [that an employee owes a fiduciary duty of loyalty to his employer] and the Restatement [(Second) of Agency], we find that by appropriating Northern Electric's servo motor data for his own by refusing to return it at the end of his employment and subsequently using it to compete with the company afterwards, Torma violated his fiduciary duty of loyalty." *Id.* at 430.