The Unanticipated Consequences of Employment At Will: Proving Damages in Restrictive Covenant Enforcement Cases

*By J. Gregory Grisham & Larry R. Wood, Jr.**

The employment at-will doctrine is a creature of the common law that has long protected the right of employers and employees to end the employment relationship "without breach of contract for good cause, bad cause or no cause at all."[1] The employment at-will doctrine recognizes and protects the freedom of employers to make judgments about employees and business decisions without judicial interference.[2] While the employment at-will rule is subject to statutory and judicial exceptions, the rule has retained its vitality.[3] Despite the presumption of employment at-will, employers ordinarily include disclaimers of contractual intent and statements of at-will employment in employment applications, employee handbooks and other company publications such as policy manuals.[4]

While employers find it important to embrace employment at-will and create a protective paper trail disclaiming contractual intent, many employers also have an interest in protecting themselves from the post-employment activities of former employees, particularly those with important customer/client relationships or proprietary information. Post-employment restrictive covenants contained in employment agreements typically limit competition, solicitation of customers, and the disclosure of confidential information. In general, courts will enforce restrictive covenants as long as such covenants are reasonable in geographic scope and time, where the employer demonstrates that it has a protectible interest, supported by valid consideration, and not contrary to the public interest.[5] Commonly recognized protectible interests include specialized training, access to trade secrets and customer relationships.[6] Employment Agreements that contain post-employment restrictive covenants often include a statement of at-will employment. In appropriate cases, employers seek to enforce restrictive covenants against former employees by seeking injunctive relief and damages.[7]

Two recent cases suggest that the otherwise beneficial employment at-will rule may be a double-edged sword for employers when they seek damages in post-employment restrictive covenant enforcement actions. The employment at-will doctrine likely will be particularly problematic where the employer tries to establish damages based solely on historical revenue numbers based on the former employee's efforts during employment.

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In *Saks Fifth Avenue, Inc. v. James Ltd.*,[8] the plaintiff, James Ltd., ("James") sued a former employee, Douglas Thompson ("Thompson"), and Thompson's subsequent employer, Saks Fifth Avenue ("Saks"), *inter alia*, for breach of fiduciary duty, intentional interference with contractual relations, intentional interference with prospective business and contractual relations, as well as a claim under a Virginia statute prohibiting conspiracies to injure another in business.[9] Thompson was also sued individually for breach of his restrictive covenant.[10] Thompson had worked with James, a "high-end men's clothing store," for seventeen years and was James' best salesperson working out of the Tysons Galleria Store.[11] In 1998, James issued a handbook to all employees which provided that all of James' employees were "at-will" employees, and also included a "memorandum of understanding on confidentiality" and a "covenant not to compete."[12] In May 1998, Thompson signed a document agreeing to all handbook provisions, including the confidentiality provisions and the restrictive covenant and acknowledged that employment was "at-will."[13]

Saks, a national retailer, operated a store in Tysons Galleria, but the store was less profitable than company projections.[14] Therefore, in 2003, Saks' management devised a plan to improve profits, which included a plan to "attract top salesmen to the men's department who would expand selection and sales."[15] Saks made contact with Thompson and another James' employee, Ray Ybarme, in the summer of 2003 to see if they could be persuaded to come to work for Saks.[16] Thompson and Ybarme both shared their concerns over their James' covenant not to compete, since the Saks store was within the geographic area where competition was prohibited.[17] The Saks' legal department reviewed the covenant not to compete and gave the opinion that it was not enforceable.[18] Thompson was given a letter by Saks' management that Saks would provide "any legal defense and costs necessary to accept and continue employment at Saks should [he] be challenged by James on the non-compete provision."[19] Thompson resigned his employment at James and went to work for Saks.[20] He took his customer listings and later notified his customers that he had moved to the Saks store in the Tyson Galleria.[21]

At trial, James presented Bruce G. Dubinsky, a certified public accountant, as an expert witness on damages.[22] Dubinsky relied on a "but-for" analysis which he also called a "lost volume method" calculating damages over an eleven year, three month period.[23] Dubinsky's damages analysis assumed that "every customer Thompson had served at James who did not purchase something at James after Thompson left was gone due to the actions of Mr. Thompson and Saks."[24] In sum, Dubinsky testified that "but for Thompson's departure to work at Saks, James would have had sales equal to the amount if Mr. Thompson had remained."[25] At the close of the plaintiff's case, the defendants moved to strike James' evidence on the proof

of damages as speculative and on the ground that Dubinsky's calculations "ignore[d] James' burden of proving causation," but the motion was denied by the trial court.[26] The trial court adopted Dubinsky's calculations and awarded three years of damages running from Thompson's October 2003 resignation date and the appeal followed.[27]

The Virginia Supreme Court, in considering the appeal, set forth the law on damages noting that "James had the burden of proving with reasonable certainty the amount of damages and the cause from which they resulted; speculation and conjecture cannot form the basis of the recovery."[28] The court further noted that "James bore the burden of proving that its damages were 'proximately caused by wrongful conduct."[29] The court disagreed with the trial court, concluding that "by relying solely on Dubinsky's opinion evidence as to damages, James failed to carry its burden of proving that the wrongful conduct of Saks and Thompson proximately caused those damages."[30] The court, in finding the plaintiff's proof inadequate to establish causation, noted Thompson's status as an at-will employee and the lack of proof showing a loss of profits related to Thompson's employment at Saks:

> Dubinsky failed to connect the lost profits he claimed James incurred after Thompson's departure to anything other than the mere fact that Thompson was no longer working at James. This fact alone cannot be a basis for recovering damages, however, because Thompson was an at-will employee who was free to stop working at James at any time.

Rather than being connected to Thompson's employment at Saks, solicitation of James' customers, or removal of James' confidential information, Dubinsky's calculation of damages focuses solely on a "but-for" model of what James' profits would have been had Thompson remained employed there. Under Dubinsky's analysis, James' damages were the same regardless of whether Thompson left to work at the Saks store in the same shopping mall or simply retired. Having neglected to show that its lost profits corresponded to the defendants' wrongful conduct, James failed to show that its lost profits corresponded to the defendants' wrongful conduct, James failed to show the necessary factor of proximate causation and thus did not carry its necessary burden of proof as to damages.[31]

The court also rejected the plaintiff's reliance on cases where the defendant's failure to fulfill a contractual obligation to remain employed over the period in which damages were calculated might show proximate cause.[32] The court again noted that Thompson was an "at-will" employee; therefore, reliance on this line of cases was not appropriate.[33] The court reversed the trial court's judgment finding the defendants jointly and severally liable in damages for breach of fiduciary duty and violation of Code §§18.2-499 and -500 and entered judgment in favor of the defendants.[34]

In *Blasé Industries Corporation d/b/a Wilson Solutions v. Anorad Corporation*,[35] a Texas case involving the hiring of an at-will employee in violation of a limited restrictive covenant, the Fifth Circuit Court of Appeals affirmed summary judgment in favor of the defendant, upholding the district court's finding that the plaintiff had failed to prove damages.[36] The plaintiff, Wilson Solutions ("Wilson"), a computer software consulting company, hired Jason Schwartzman in April 1997 to work as a consultant.[37] A year later, Wilson entered into an agreement with defendant Anorad, a manufacturer, to provide consulting services.[38] The agreement contained a "no-hire" provision in which both parties agreed, during the term of the agreement and for a period of one year thereafter, not to "solicit, employ or hire any person who is or who has been an employee of either party unless otherwise consented to in writing."[39] Schwartzman was placed with Anorad by Wilson as a consultant, but was not aware of the "no-hire" provision and did not consent to it.[40] A year later, Schwartzman resigned his employment with Wilson.[41] Anorad approached Wilson and asked for permission to hire Schwartzman, but permission was denied.[42] Despite that, Anorad offered Schwartzman employment as the company's director of information systems, which Schwartzman accepted.[43] Wilson sued seeking lost profit damages for the first year that Schwartzman worked at Anorad, namely, the amount of fees generated by Schwartzman at Wilson the year before he became employed by Anorad, minus his salary and overhead expenses.[44]

The district court granted summary judgment in favor of Anorad finding that the "no-hire" agreement was unreasonable and, therefore, unenforceable.[45] The court of appeals affirmed the district court's decision on another basis, specifically, that Wilson failed to prove its lost profits damages. Recognizing the legal standard, the court of appeals stated: "In Texas, lost profit damages must be established with 'reasonable certainty' [and] [l]ost profit damages may not be based on evidence that is speculative, uncertain, contingent, or hypothetical."[46] The court of appeals found that Wilson could not meet its burden to show, to a reasonable certainty, that it was damaged by Anorad's breach of the no-hire provision.[47] The aourt of appeals concluded that Schwartzman's status as an at-will employee was fatal to Wilson's claim for damages, explaining that "an at-will employee can be terminated at any time for any lawful reason."[48] Therefore, since an at-will employee has no guarantee of future employment, there is no way to prove an entitlement to future earnings.[49] The court of appeals opined that, since Schwartzman was an at-will employee, "any consulting fees Schwartzman would have potentially received are too uncertain to serve as the basis for Wilson Solution's request for damages."[50]

There is no question that, absent a liquidated damages provision, employers often face a difficult and uphill battle in proving damages in restrictive covenant enforcement cases.[51] Courts have struggled to provide a framework for determining when an employer has established a reasonable causative link between damages it has suffered and the defendant's (typically, the former employee's) conduct. The measure of damages recoverable under this situation varies from jurisdiction to jurisdiction. However, the general rule is that the defendant is responsible for all consequences stemming from the wrongful act.[52]

Courts typically apply a two-part test for evaluating causation issues: (1) causation in fact and (2) proximate cause. The first element is analyzed under the "but-for" test which asks whether the injury claimed would have occurred if the defendant had not engaged in the conduct at issue.[53]

The plaintiff has the burden of proving by a preponderance of the evidence the causal link between the plaintiff's injuries and the defendant's conduct. This evidence should show that more probable than not the defendant's conduct caused the plaintiff's harm. It is important to remember that causation need not be established by mathematical proof or beyond all doubt.[54]

In *Blasé*, the court noted that, "[w]hile some uncertainty as to the amount of damages is permissible, uncertainty as to the fact of damages will defeat recovery."[55] While damages can not be based on mere speculation, sufficient proof likely will exist where "a reasonable basis for computation and the best evidence which is obtainable under the circumstances of the case" is offered by the plaintiff to enable the trier of fact to arrive at a fair approximate estimate of loss.[56]

The lesson from *Saks* and *Blasé* is that a causation model based on continued employment assumptions about a former at-will employee will be deemed too speculative by courts to support a claim for damages in a restrictive covenant enforcement/tortious interference case. Rather, plaintiffs who seek to recover damages in addition to, or in lieu of, injunctive relief, must develop proof to connect their purported damages to the unfairly competitive actions of the former employee such as diversion of business, solicitation of customers or use of confidential information taken from the plaintiff.[57] As noted above, appropriate liquidated damages clauses in restrictive covenants may be an ideal way for employers to avoid the anticipated difficulty in proving damages based on such a breach.[58]

Footnotes

[1] Clanton v. Cain-Sloan Company, 677 S.W. 2d 441, 443 (Tenn. 1984) (citing Payne v. Railroad Company, 81 Tenn. 507 (1884).

[2] The Tennessee Court of Appeals in *Whittaker v. Care-More, Inc*., 621 S.W.2d 395, 396 (Tenn. Ct. App. 1981), noted the importance of the employment at-will doctrine to employers and to the free enterprise system: "It is not the province of this court to change the law as plaintiffs assert. That prerogative lies with the supreme court or the legislature. However, based upon our review of this area of the law we are compelled to note that any substantial change in the "employee-at-will" rule should first be microscopically analyzed regarding its effect on the commerce of this state. There must be protection from substantial impairment of the very legitimate interests of an employer in hiring and retaining the most qualified personnel available or the very foundation of the free enterprise system could be jeopardized."

[3] *See, e.g*., Dore v. Arnold Worldwide, Inc., 39 Cal. 4th 384, 2006 Cal. LEXIS 9288 (August 3, 2006).

[4] *See. e.g.*, Rose v. Tipton County Public Works Dept., 953 S.W. 2d 690, 695 (Tenn. Ct. App. 1997)("employee handbook provided that its policies were "subject to change by the Tipton County Public Works Department Committee without notice."); Claiborne v. Frito-Lay, Inc., 718 F. Supp. 1319, 1321 (E.D. Tenn. 1989) (handbook reserved to employer "the right to make changes to the material contained in this guide from time-to-time to meet changing conditions and business needs"); *see, e.g.,* Smith v. Morris, 778 S.W.2d 857, 858 (Tenn. App. 1988) (handbook's language clearly showed "that modifications were anticipated"); Bringle v. Methodist Hosp., 701 S.W.2d 622, 624 (Tenn. App. 1985) (handbook reserved to employer "right to change and abolish policies, procedures, rules and regulations"); *see also* Gregory v. Hunt, 24 F.3d 781, 786 (6th Cir. 1994) (handbook provided that policies were "subject to change by management, unilaterally and without notice"); Davis v. Connecticut Gen. Life Ins. Co., 743 F. Supp. 1273, 1279 (M.D. Tenn. 1990) (handbook reserved to employer "the right to change any or all such policies, practices and procedures in whole or in part at any time, with or without notice to you").

[5] Mark R. Filipp, Covenants Not to Compete, § 2.01 (3d ed. 2005).

[6] *Id*. at § 3.01; *see also* Vantage Tech., LLC v. Cross, 17 S.W. 3d 637, 644-47 (Tenn. Ct. App. 1999).

[7] Filipp, *supra* note 5, § 11.02-.03.

[8] 272 Va. 177, 630 S.E.2d 304 (2006).

[9] 272 Va. at 182, 630 S.E. 2d at 307-08.

[10] *Id*.

[11] 272 Va. at 180, 630 S.E. 2d at 306.

[12] *Id*.

[13] 272 Va. at 181, 630 S.E. 2d at 307.

[14] *Id*.

[15] *Id*.

[16] *Id*.

[17] *Id*.

[18] *Id*.

[19] 272 Va. at 182, 630 S.E. 2d at 307.

[20] *Id*.

[21] *Id*.

[22] 272 Va. at 182, 630 S.E. 2d at 308.

[23] *Id*.

[24] 272 Va. at 183, 630 S.E. 2d at 308.

[25] *Id*.

[26] 272 Va. at 184, 630 S.E. 2d at 309.

[27] 272 Va. at 185, 630 S.E. 2d at 309. The trial court also found that Thompson breached his restrictive covenant with James and enjoined Thompson from working at Saks' Tysons Galleria store for a 3-year period.

[28] 272 Va. at 188, 630 S.E. 2d at 311 (quoting Shepherd v. Davis, 265 Va. 108, 125, 574 S.E.2d 514, 524 (2003); (Carr v. Citizens Bank & Trust Co., 228 Va. 644, 652, 325 S.E.2d 86, 90 (1985)).

[29] 272 Va. at 189, 630 S.E. 2d at 311.

[30] 272 Va. at 189, 630 S.E. 2d at 312.

[31] 272 Va. at 188, 630 S.E. 2d at 311.

[32] 272 Va. at 190, 630 S.E. 2d at 312.

[33] *Id*.

[34] 272 Va. at 191, 630 S.E. 2d at 313.

[35] 442 F. 3d 235 (5th Cir. 2006).

[36] *Id*. at 240.

[37] *Id*. at 237.

[38] *Id*.

[39] *Id*.

[40] *Id*.

[41] *Id*.

[42] *Id*.

[43] *Id*.

[44] *Id*.

[45] *Id*.

[46] *Id*. at 238 (citing Tex. Instruments Incorp. v. Teletron Energy Mgmt., 877 S.W.2d 276, 281, 37 Tex. Sup. Ct. J. 676 (Tex. 1994); Carter v. Steverson & Co., 106 S.W.3d 161, 165-66 (Tex. App. Houston [1st Dist.] 2003, pet. denied).

[47] 442 F. 3d at 238.

[48] *Id*. at 239.

[49] *Id*.

[50] *Id*. The Court of Appeals noted that liquidated damages provisions are often included in restrictive covenants because of the difficulty of calculating damages in these cases. *Id*. at 38. The Court of Appeals further noted that no-hire agreement in the case before it did not have such a provision. *Id*. *See also* Filipp, *supra* note 5, §11.02[B].

[51] Filipp, *supra* note 5, § 11.02[A].

[52] International Minerals and Resources, S.A. v. Pappas, 96 F.3d 586, 1997 A.M.C. 1214 (2d Cir. 1996).

[53] W. Page Keeton Symposium on Tort Law, *The Common Sense of Cause in Fact*, 75 Tex. L. Rev. 1765 (1997) (suggests the five steps for approaching but-for questions are (a)identify the injuries in suit; (b) identify the wrongful conduct; (c) mentally correct the wrongful conduct to the extent necessary to make it lawful; (d) ask whether the injuries would still have occurred had the defendant been acting correctly in that sense; and (e) answer the question).

[54] *Id.*

[55] 422 F. 3d at 239 (citing Davis v. Small Bus. Inv. Co., 535 S.W. 2d 740, 743 (Tex. Civ. App.-Texarkana 1976).

[56] Par Industries, Inc. v. Target Container Co., 708 So. 2d 44, 50 (Miss. 1998).

[57] *Saks*, 272 Va. at 189, 630 S.E. 2d at 312. *See also* R. Dunn, *Recovery of Damages for Lost Profits*, §§2.25, 3.9 (1981).

[58] Filipp, *supra* note 5, § 11.02[B].