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RE: Faw, Casson & Co., L.L.P. v. Halpen
C.A. No. 00C-01-015

Dear Counsel:

This dispute is between an accounting firm and a former employee for business lost to the employee's new firm.

On Monday, July 30th, the parties presented testimony and argument at a bench trial. The complaint seeks damages under an employment agreement signed in 1987 (sometimes referred to as the "agreement"). The following findings of fact and conclusions of law are made:

## FINDINGS OF FACT

1. Albert Halpen (hereafter "Halpen" or "defendant") is a public accountant and signed an agreement with Faw Casson & Co. (hereafter "Faw Casson" or "plaintiff") on June 29, 1987.

2. Faw Casson is a certified public accounting firm, providing accounting services in Delaware and Maryland.

3. The agreement provided that Halpen perform senior accounting services for clients of Faw Casson.

4. The defendant read the agreement before signing it and understood its terms, conditions, and restrictions.

5. Without signing the agreement, the defendant could not continue working for plaintiff. Although free to leave, defendant signed the agreement, remained with Faw Casson, and accepted a salary increase in July of 1987.

6. This increase would not have been provided without signing the agreement and was part of the understanding between the parties.

7. Defendant enjoyed continued employment until terminated on July 31, 1998.

8. Halpen was thereafter employed by Ballard, Thompson & Associates, P.A. (hereafter "Ballard"), another certified public accounting firm providing services to the public, in November of 1998.

9. Halpen worked in a Delaware office of Ballard as a public accountant.

10. Halpen was contacted by Georgetown Fire Company and by Milford Grain Company to see if Ballard would be interested in doing accounting work for them.

11. Georgetown Fire Company and Milford Grain Company were clients of Faw Casson and defendant worked on these accounts while employed by plaintiff before his termination.

12. Ballard accepted work from Georgetown Fire Company and Milford Grain Company within three (3) years of defendant's termination.

13. The Georgetown Fire Company used the public bidding process to solicit proposals for its work. The award was given to Ballard.

14. Aside from Ballard, plaintiff and other accounting firms submitted bids to the fire company, but were unsuccessful.

15. Defendant did not participate in the preparation of Ballard's bidding package. Defendant did not use proprietary information from his prior employment to give Ballard an advantage in the bidding process.

16. As a result of defendant's contact with Milford Grain, Milford Grain became a client of Ballard, and defendant facilitated the loss of this client.

17. Faw Casson learned Ballard was doing work for Georgetown Fire Company and Milford Grain. Thereafter, under paragraph 9 of the agreement, Faw Casson demanded payment from Halpen of $5,275.00 for billings of Milford Grain Company and $5,675.00 for billings of Georgetown Fire Company for the year preceding Mr. Halpen's termination.

18. The foregoing amounts were billed to Milford Grain Company and Georgetown Fire Company by Faw Casson in the year before Halpen's termination.

19. Defendant refused to pay the demanded amounts.

## CONCLUSIONS OF LAW

(A) Paragraph 9 of the agreement provides for the protection of Faw Casson's good will, confidential information and client relationships. In recognition of these interests where firm clients follow the employee, it provides:

> 1. Employee agrees as follows: (a) To pay an amount or amounts equal to one hundred percent (100%) of the gross fees billed by the company to a particular client over the twelve month period immediately preceding such termination, which was a client of the Company within such period, and which client is served (with the type of services set forth above) by Employee, or any corporation, partnership, firm or other business entity with which Employee is associated as set forth above within three (3) years from such termination of employment.

This is a restrictive employment covenant and a liquidated damages clause.[1]

(B) As a liquidated damages clause, the amount based on past billings is a reasonable forecast of harm and not a penalty. The harm resulting from lost clients is not capable of accurate estimation and the damages are uncertain.[2] In the accounting field, liquidated damages are structured on a percentage billings basis, and this clause was based on standard valuation methods consistent with this professional practice.[3] There is no distinction between accepting or soliciting clients in terms of harm to Faw Casson.[4]

(C) The agreement is supported by consideration - being the benefit conferred of a salary raise and continued employment.[5]

(D) Employment restrictions are governed by a rule of reason.[6] The criteria used to determine whether reasonableness exists is described in Restatement (Second), *Contracts* § 188:

> Ancillary Restraints on Competition
>
> (1) A promise to refrain from competition that imposes a restraint that is ancillary to an otherwise valid transaction or relationship is unreasonably in restraint of trade if
>
> (a) the restraint is greater than is needed to protect the promisee's legitimate interest, or
>
> (b) the promisee's need is outweighed by the hardship to the promisor and the likely injury to the public.

> (2) Promises imposing restraints that are ancillary to a valid transaction or relationship include the following:
>
> * * * * * * *
>
> (b) a promise by an employee or other agent not to compete with his employer or other principal.

(E) In the Milford Grain Company circumstance, defendant precipitated the loss of the client. Faw Casson suffered harm. No countervailing public policy weighs against enforcement. The restraint is reasonable in all respects.

(F) In the Georgetown Fire Company circumstance, the public bidding process by such a quasi-public, charitable and community service organization is a significant interest. This interest outweighs Faw Casson's private expectations. Defendant played no role in the bid award. Like others, Faw Casson is subject to loss of business through open bidding. The process is neutral, and other CPA firms were disappointed as well. The restraint in these aspects is not reasonable.

Should the clause be applied indiscriminately, then it would have an unlawful *in terrorem* purpose and effect.[7]

## CONCLUSION

Considering the foregoing, judgment is entered in favor of plaintiff and against the defendant in the amount of $5,275.00, plus prejudgment and postjudgment

interest at the legal rate and costs. Judgment is entered for Faw Casson on Halpen's counterclaim. Faw Casson did not tortiously interfere in defendant's employment with Ballard.

Plaintiff is entitled to attorney's fees and expenses under paragraph 9(f) of the agreement. If the parties cannot agree on a figure, then the Court will determine a reasonable amount. The Court should be informed within seven (7) business days if a hearing is necessary.

**IT IS SO ORDERED.**

_____
Richard F. Stokes, Judge

cc: Prothonotary

## ENDNOTES

1. The defendant promised to pay a sum of money when plaintiff's clients followed him. Without the covenant, defendant would be able to service clients elsewhere without an adverse economic impact (assuming duties of fairness were not implicated - an employee cannot exploit trade secrets, for example, see *Meyer Ventures, Inc. v. Barnak*, Del. Ch., C.A. No. 11502, Allen, C. (Nov. 2, 1990) (Mem. Op.) (citing *Wilmington Trust Co. v. Consistent Asset Management*, Del. Ch., C.A. No. 8867, Allen, C. (Mar. 25, 1987)). This is a restraint that has a noncompetitive effect. As the amount is fixed, it imposes liquidated damages. "Many noncompetition agreements contain liquidated damages provisions. As a general rule, a liquidated damages provision must represent a reasonable estimate of the monetary loss likely to be suffered, yet relate to an injury incapable of accurate estimation. As a general rule, the underlying noncompetition agreement must also pass the test of reasonableness for the liquidated damages provision to be enforceable." Donald J. Aspelund & Clarence E. Erikson, *Employee Noncompetition Law* § 10.04[6] (Release #8, 7/95).

2. "Two factors are relevant to a determination of whether the amount fixed as liquidated damages is reasonable. The first factor is the anticipated loss . . . . The second factor is the difficulty in calculating that loss; the greater the difficulty, the easier it is to show the amount fixed was reasonable." *Brazen v. Bell Atlantic Corp.,* Del. Supr., 695 A.2d 43, 48 (1997). Both factors are satisfied here. It is difficult to know what a lost profit claim might entail in personal service work. No doubt harm is suffered by a professional employer like plaintiff, where clients may employ former employees elsewhere for an indeterminate period of time.

3. In accounting employment contracts, liquidated damages have been upheld based upon average fees. Aspelund, *supra* note 1, § 10.04[6] (Release #8, 7/95). *Francis v. Schlotfeld*, Kan. App., 704 P.2d 381, 382-85 (1985) (upholding a provision in accounting partnership agreement which allowed parties to leave partnership and take clients, but required withdrawing partner to compensate the partnership by paying the higher of 50 percent of the previous thirty-six months' billing (for those clients) or 150 percent of the previous twelve months' billing or 150 percent of the annualized fee of a new client not serviced for a complete year). The Faw Casson partner provided unrebutted testimony that the gross billings formula was standard fare in the field. The defendant's status as an employee, but not a partner, does not make a difference in this legal context.

4. As then Chancellor Marvel wrote: "However, I find such distinction to be without merit, one of the purposes of such a covenant being to protect the employer from loss of business arising out of an employee's profitable association with the former employer's clientele. Damages of this type occur as well whether an employer's clients are solicited or merely accepted by a former employee." *Faw Casson & Co. v. Cranston*, Del. Ch., 375 A.2d 463, 467 (1977).

5. *Id.* at 466-467; *Research & Trading Corp. v. Powell*, Del. Ch., 468 A.2d 1301, 1305 (1983).

6. *McCann* at 3-4; *Research & Trading Corporation v. Pfuhl, et. al*., Del. Ch., C.A. No. 12527, Allen, C. (Nov. 19, 1992), citing *Restatement (Second) of Contracts* § 188 (1981) (Illustration 11).

7. This analysis appears in equity cases that consider injunctive relief. Without considering other interests and connecting defendant's conduct in some fashion with a resulting business loss, this liquidated damages claim would be improper. *See*, *Humana Medical Plan, Inc. v. Jacobson*, Fla. App. 3 Dist., 614 So.2d 520, 523 (1992). In support of this conclusion, Chief Justice Veasey observed that the traditional goal of the law of contracts has not been compulsion of the promisor to perform but compensation of the promisee for the loss resulting from a breach. *DuPont Co. v. Pressman*, Del. Supr., 679 A.2d 436, 445 (1996). "The law generally frowns on agreements that restrict competition, so noncompetition agreements are construed narrowly. Generally, such an agreement is valid only if it protects a legitimate business interest, and if it is reasonably restricted so as to not unduly burden the employer or the public interest." Aspelund*, supra* note 1, § 1.01 (Release #10, 6/97).