

New Jersey Law Journal

VOL. CXCI—NO.11 — INDEX 889

MARCH 17, 2008

ESTABLISHED 1878

EMPLOYMENT & IMMIGRATION LAW

Court Limits Damages in Restrictive Covenant Cases

Decision establishes new factors in assessing breaches of nonsolicitation agreements

By **Thomas B. Lewis** and
Michael Brittan

In *Totaro, Duffy, Cannova and Company, L.L.C. v. Lane, Middleton & Company*, the New Jersey Supreme Court limited the damages for breach of a nonsolicitation provision to reasonable, expected losses over a period of one year, taking into consideration the relationship of the departing employee with the clients, even though the nonsolicitation provision contained a four-year restriction on solicitation. *Totaro, Duffy, Cannova and Company, L.L.C. v. Lane, Middleton & Company, L.L.C.*, 191 N.J. 1 (N.J. 2007). Traditionally, damages recoverable for a breach had to be foreseeable as a probable consequence of the breach. *Restatement (Second) of Contracts*. The *Totaro Duffy* Court opined that monetary damages for breach of a nonsolicitation agreement is not necessarily a mathematical computation of the loss of business multiplied by the length of the nonsolicit term. Rather, the material issue of analysis hinged on the relationship between the departing

Lewis is a certified civil trial attorney and chair of and Brittan is an associate of the employment litigation group of Stark & Stark in Lawrenceville.

employee and the client, and whether the client would remain with the company. The *Totaro Duffy* decision forces courts to reassess the appropriate measure of damages awarded in nonsolicitation cases.

The defendant in *Totaro Duffy*, Merritt Lane, began working as an accountant in 1978. In 1997, as part of his decision to stop performing compliance accounting work, he helped form, along with David Middleton, the firm of Lane, Middleton & Company, L.L.C. In 2000, the owner of the Lane Middleton, David Middleton, decided to sell the practice, and eventually made arrangements to sell the business to Totaro, Duffy, Connova and Company, L.L.C. As part of the sale to Totaro Duffy, Lane agreed to a nonsolicitation provision contained in the sales agreement. The nonsolicitation provision stated that Lane would not, for a period of four years after the date of his termination, provide compliance accounting services to any of the Lane Middleton clients he was servicing at the time of the sale.

In 2001, Lane terminated his employment with Totaro Duffy, and took with him a list of more than 150 Totaro Duffy clients. Using that list, Lane sent out solicitation packages containing a letter announcing his departure and a

form disengagement letter for the clients to return to Totaro Duffy. By the time the case went to trial, Lane was providing compliance accounting services to 140 of those clients. The trial court found that Lane, by sending the solicitation packages to Totaro Duffy's clients, had breached the nonsolicitation provision of the sales agreement.

The primary issue, both at trial and on appeal, was the proper measurement of damages for Lane's breach. The trial court took a multi-pronged approach, first determining which clients of Totaro Duffy had transferred their business to Lane after receiving his solicitation package, next calculating losses from those transfers, and then reducing that figure by the 35 percent to 40 percent expected client attrition rate that could be associated with Totaro Duffy's purchase of Lane Middleton. Finally, using that figure, the trial court was able to determine the lost net profits during one year. Then, after determining that Lane had three years remaining on his nonsolicitation agreement, the trial court multiplied the lost net profits figure by the three remaining years on the nonsolicit to arrive at Totaro Duffy's final damages.

On appeal to the Supreme Court, Lane did not contest his breach, only the appropriate measure of damages. Before

the Supreme Court, Lane argued that, because the clients who transferred their business to him after receiving the solicitation package would have transferred their business regardless of the solicitation package, his breach yielded no damages. The Court held, however, that “the issue is not whether the clients would have left eventually, but whether they would have left when he did.”

The issue then, according to the Court, was one of causation, and it ultimately held that, while Lane’s breach caused Totaro Duffy’s damages, the breach did not cause damages to the extent awarded by the trial court.

The Court noted that, after leaving Totaro Duffy, Lane performed compliance accounting work for those clients who transferred to him from Totaro Duffy, but Lane did not provide those same clients with compliance accounting services when he was employed by Totaro Duffy. Therefore, because Lane was not providing compliance accounting services to those clients before his termination, the Court reasoned that they would not have been immediately aware of his departure from Totaro Duffy and would not have immediately transferred their business had they not received his solicitation package. According to the Court, “[t]he breach ... was the impetus for that business to be lost when it was, an event that occurred

earlier than it otherwise would have, had defendant been forced to wait until the clients discovered that he had departed and undertook to find him.”

As to the extent of damages caused by Lane’s breach, however, the Court held that “the fact that the clients would have ultimately left ... bears on the calculation of damages. The trial court’s analysis accounts for the fact that clients would have left when they learned of defendant’s departure by reducing the first year’s calculated loss in accordance with plaintiff’s evidence about expected attrition rates. The undisputed evidence however, also demonstrated the loss attributed to defendant’s breach would not have extended for the full three years remaining on the life of defendant’s nonsolicitation agreement.” In fact, the Court concluded that the evidence presented at trial showed that “all of the clients would have left plaintiff and retained defendant to perform their compliance work once they learned of defendant’s departure ...” Therefore, because the evidence proved that those clients who transferred to Lane would have left Totaro Duffy regardless of the solicitation package and only left *sooner* because of the package, the Court held that Totaro Duffy’s damages should be limited to one year.

The *Totaro Duffy* Court establishes that the Trial Court must look at a vari-

ety of factors for damages in a breach of a nonsolicitation agreement. A mathematical calculation of loss of profits multiplied by the length of nonsolicitation terms will not suffice. Rather, *Totaro Duffy* instructed the court to look to the relationship that the breaching party had with his clients. This ruling will be important in the sales/service industry where personal relationships develop and permeate the business relationship. These personal relationships often continue after the departure of the employee. By recognizing that these personal relationships continue after an employee ends his relationship with an employer, the Court enabled a former employee who is sued for breach of a nonsolicitation agreement to reduce any potential judgment against him if he can prove that the clients he solicited would have followed him regardless of the solicitation. Therefore, *Totaro Duffy* is instructive because it requires courts to look at the totality of the circumstances and to analyze the relationship between the departing employee and the clients he serviced when awarding damages for violation of a nonsolicitation agreement. After the Court’s decision, traditional theories of reasonably foreseeable damages multiplied by the time remaining on the nonsolicitation agreement will not suffice. ■