

Lessons from a \$10.5 Million Settlement

One of the best ways employers can protect themselves from facing competition from a former employee is through covenants not to compete. A recent settlement shows that even without such a covenant, employers may be able to protect themselves from particularly egregious acts by former employees.

The story of the settlement began in June 2002 when SouthBanc Mortgage hired Theresa L. Ritter as a vice president of production. SouthBanc insisted that Ritter sign an employment contract, but she refused. On June 29, 2003, after a year of being unable to get Ritter to sign such a contract, SouthBanc fired her.

Ritter promptly formed Summit Financial, LLC, as a direct competitor of SouthBanc, and over the next three months lured away over 30 SouthBanc employees to join Summit. Ritter also knew SouthBanc's proprietary method of sending out roughly 1.7 million letters a month to targeted homeowners, offering to refinance mortgages or providing second deeds of trust to consolidate loans, and duplicated that method at Summit. It was alleged that as many as 80 percent of the homeowners who applied for loans from Summit had also received SouthBanc solicitations.

After learning of Summit's efforts to steal SouthBanc's employees and customers, SouthBanc issued cease-and-desist letters and ultimately sued Ritter, Summit, and others alleging various business torts.

Although Ritter had not signed an employment contract with SouthBanc, SouthBanc relied on the common law fiduciary duties that every employee owes his or her employer as the basis for their claims against her, and that Ritter was aware of the employer's policy to not disclose proprietary information, even after termination of employment. SouthBanc was also aided by the defendants' obstruction during the lawsuit—the defendants destroyed evidence after being sent a preservation letter, and gave a steady stream of "I don't recall" answers during depositions. As a result, Ritter and the other defendants opted to settle the case for a whopping \$10.5 million.

The lesson of this case is twofold. First, even without an employment contract or a covenant not to compete, employers have significant remedies available to them when a former employee steals proprietary information and client lists, such as through the Virginia Trade Secrets Act. Second, covenants not to compete can offer an additional layer of protection by allowing an employer to seek injunctive relief—something SouthBanc could not do—to stop the unlawful activity immediately.

But what if an employee refuses to sign a covenant not to compete, like Ritter? One option is to simply not hire that person. Obviously, someone who refuses to honor a reasonable non-competition deal with you is more likely to become your next competitor anyway, like Ritter. But if you think the employee is too valuable to give up, then make sure that the employee is aware of your company policies concerning proprietary and confidential information, either through your handbook or other written communication.

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