Vanderbilt Law Review

Volume 52
Issue 1 *Issue 1 - January 1999*

Article 12

1-1999

Free Competition or Corporate Theft?: The Need for Courts to Consider the Employment Relationship in Preliminary Steps Disputes

Scott W. Fielding

Free Competition or Corporate Theft?: The Need for Courts to Consider the Employment Relationship in Preliminary Steps Disputes

I. INTRODUCTION

The scenario occurs daily in many different businesses. A disgruntled employee decides to use her talents, skills, and knowledge of the industry to start a rival enterprise. She plans to do things differently—offer lower prices, a different sales approach, a more service-oriented style. To minimize the risk involved, the employee decides to investigate potential markets, possible locations for the business, and financing. She would also like to discuss first-hand with current clients or fellow employees the possibility that they would follow her into the new business. Concerned with breaching fiduciary obligations, the employee contacts her attorney and asks for advice—specifically, what steps may she take while still employed?

The above hypothetical currently perplexes corporate attorneys because of uncertainty in the law on this mattor. The law is clear that absent a covenant-not-to-compete, a high-level employee may resign and set up a new company directly competing with the former employer.[1] In so doing, the employee may use the skills and knowledge acquired from the employer, and the employee may solicit the employer's customers and employees.[2] Promotion of free competition and entrepreneurial behavior justifies the rule; the right to start a new business based on an innovative idea, product, or approach is intogral to our capitalist system.[3] As studies have shown, small- and

1. *See* RESTATEMENT (SECOND) OF AGENCY § 396 (1958) ("Unless otherwise agreed, after the termination of the agency, the agent ... has no duty not to competo with the principal ...."); PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 5.06 cmt. f (1994) [hereinafter PRINCIPLES OF CORPORATE GOVERNANCE] (stating that in the absence of a covenant, a senior executive is free te compete after resigning).

2. *See* RESTATEMENT (SECOND) OF AGENCY § 396 cmt.h (1958) ("[A]lthough an agent cannot properly subsequently use copies of written memoranda concerning customers ... he is normally privileged to use, in competition with the principal, the names of customers retained in his memory as the result of his work for the principal and also methods of doing husiness and processes which are but skillful variations of general processes known to the particular trade.").

3. *See* Pat K. Chew, *Competing Interests in the Corporate Opportunity Doctrine*, 67 N.C. L. REV. 435, 452 (1989) [hereinafter *Competing Interests*] (argning that the corporate opportunity doctrine, which limits the competitive actions an employee can take against her employer, will actually decrease the number of opportunities exploited).

medium-size firms have employed the most people over the last two decades, serving as the largest source of economic growth.[4]

Most businesspeople, however, plan carefully before starting a new enterprise. Before beginning operations, the entrepreneur considers financing, location, the product, customers, and other items.[5] Only through careful consideration of these factors can the entrepreneur make an informed decision about the new venture's likelihood for success.[6] For the employee desiring to form her new business within the same industry that she currently works, such planning creates tensions with opposing policy interests—the duty of loyalty protecting the company from employee self-interest[7] and free competition requiring that the employee have some freedom to make necessary preparations to compete.

Courts apply the "preliminary steps doctrine" in an attempt to resolve the tension. The doctrine allows an employee to pursue investment, seek legal advice, research the market, and take other

---

4. *See* DAVID L. BIRCH, JOB CREATION IN AMERICA: HOW OUR SMALLEST COMPANIES PUT THE MOST PEOPLE TO WORK 6-16 (1987) (arguing that small firms provide the most innovation and that most American workers are employed by small enterprises).

5. Numerous books and articles support this point. Many of these sources indicate the importance of direct customer contact in researching the market. *See generally* SCOTT A. CLARK, BEATING THE ODDS: 10 SMART STEPS TO SMALL-BUSINESS SUCCESS 38-44 (1991) (explaining that in-person interviews with potential key custemers are the best method for testing product ideas); Ernest R. Cadotte & Robort B. Woodruff, *Analyzing Market Opportunities for New Ventures, in* MARKETING AND ENTREPRENEURSHIP: RESEARCH IDEAS AND OPPORTUNITIES 115-29 (Gerald E. Hills ed., 1994) (suggesting that a market opportunity analysis—a general study of the industry typically conducted bofore starting a new entorprise—should include customer and competition profiles, with customer profiles detailing customer needs and wants, activities, opinions and attitudes, purchase procedures, and satisfaction with past purchases, among other items); Antonio S. Lauglaug, *Technical-Market Research—Get Customers to Collaborate in Developing New Products, in* MARKETING STRATEGIES: NEW APPROACHES, NEW TECHNIQUES 23-25 (Malcolm McDonald ed., 1995) [hereinafter MARKETING STRATEGIES] (showing that companies frequently collaborate closely with customers in developing new products through an approach that allows customers to "see [the product] and experience it" before it is developed to determine if a need for the product actually exists).

6. *See generally* Robert G. Cooper & Elko J. Kleinschmidt, *Screening New Products for Potential Winners, in* MARKETING STRATEGIES, *supra* note 5, at 2-6 (explaining that the key to the success of new products, besides being unique or superior, is extensive pre-development homework including a detailed market study and constant customer contact and input).

7. Loyalty is currently a significant problem for businesses. Occupational fraud and abuse cost United States businesses more than four billion dollars annually, with the "average organization los[ing] about 6 percent of its total annual revenue to fraud and abuse committed by its own employees." Harvey Gelb, *Employee Disloyalty, Costs and Remedies*, 32 LAND & WATER L. REV. 891, 893 (1997) (analyzing statistical data from National Report of Certified Fraud Examiners). Asset misappropriation accounts for more than 80 percent of employee fraud offenses covered in the report. *See id.* Bribery and corruption, including conflict of interest transactious, account for about 10 percent. *See id.* Thus, problems associated with broaches of loyalty cost businesses millions of dollars each year, with most of the damages caused by high-level officers, owners, and executives. *See id.* at 894.

reasonable preparatory steps before resigning from employment.[8] The employee, however, may not actually compete with the employer prior to resignation.[9]

The preliminary steps doctrine, however, has failed to be a workable standard. Courts struggle to explain which preliminary activities are competitive. The lines drawn between what constitutes mere preparation and actual competition have been arbitrary, often based on differing conceptions of competition.[10] The vague line has prevented attorneys from providing adequate counsel. Attorneys typically advise employees to resign before taking any action, or to proceed carefully and cautiously, "keeping in mind that there are many gray areas where a reasonable fact-finder could find in favor of either party."[11]

In efforts to end the confusion, one commentator has argned to eliminate the doctrine altogether,[12] and at least one jurisdiction has done so.[13] Other jurisdictions purport te apply the same preliminary steps standard but reach inconsistent results on whether pre-termination negotiations with the employer's customers or employees rise

---

8. *See, e.g.*, Harllee & Atec Assocs. v. Professional Serv. Indus., 619 So. 2d 298, 300 (Fla. Dist. Ct. App. 1992) (stating that an employee can essentially form her own business and outfit it while still employed so long as she does not commence business prior to resigning); Adams v. Lockformer Co., 520 N.E.2d 1177, 1183 (Ill. App. Ct. 1988) ("[E]ven though an employee of Lockformer, Adams could go so far as form a rival corporation and outfit it for business as long as he did not commence business while still employed."); Lawter Int'l, Inc. v. Carroll, 451 N.E.2d 1338, 1349 (Ill. App. Ct. 1983) (defining preliminary activities to include obtaining financing, designing a production plant, and purcbasing equipment and supplies); Meyers v. Roger J. Sullivan Co., 131 N.W. 521, 522 (Mich. 1911) (allowing departing employee to organize business and make plans for a new store).

9. *See* RESTATEMENT (SECOND) OF AGENCY § 393 (1958).

10. *See* Cudahy Co. v. American Lab., Inc., 313 F. Supp. 1339, 1346 (D. Neb. 1970) (stating that "[b]ecause of the competing intorests the actionable wrong is a matter of degree"); Bancroft-Whitney Co. v. Glen, 411 P.2d 921, 935 (Cal. 1966) ("No ironclad rules as to the type of conduct which is permissible can be stated, since the spectrum of activities in this regard is as broad as the ingenuity of man itself.").

11. David J. Gass, *Departing Directors, Officers and Employees and the Limits of Their Fiduciary Duties*, 72 MICH. B.J. 650, 654 (1993) (pointing out that there are few Michigan cases showing where the line between preparation and competition is drawn and suggesting that cases in otber jurisdictions offer ouly broad principles).

12. *See* William Lynch Schaller, *Disloyalty and Distrust: The Eroding Fiduciary Duties of Illinois Employees*, 3 DEPAUL BUS. L.J. 1, 73-75 (1990-91) (labeling the preliminary steps doctrine a "siren's song" for employee disloyalty and concluding that eliminating the preliminary steps doctrine "would simply require employees to suffer the same risks and costs other persons face in starting a business, thereby preventing employees from obtaining an unfair headstart").

13. *See* Steelvest, Inc. v. Scansteel Serv. Ctr., 807 S.W.2d 476, 483 (Ky. 1991) (holding that directors and officers should terminate their pesition when they first make arrangements or begin preparations to compete).

to the level of wrongful competitive behavior.[14] While the various results are explainable in part by the heavy factual inquiry involved, this Note shows that very similar cases lead to conflicting judgments. This Note advocates an approach that considers the expectations of the parties to the employment relationship. In particular, it contends that a relaxed duty of loyalty should be required of an at-will employee, because the right to make extensive preparations is implicit within an employment relationship that can be terminated at any time with or without cause. This relaxed duty of loyalty should allow at-will employees the right to contact customers and clients before ending the employment relationship—an approach that corresponds with current employee and employer expectations in the business world. A different duty of loyalty, however, should be expected of a fixed-term employee. The security of a fixed-term relationship justifies the imposition of stricter loyalty requirements that forbid all pre-termination contact. Corporato law duty of loyalty principles such as the corporate opportunity doctrine support this approach. As this Note explains, distingmishing between fixed-term and at-will employees will allow courts to consider the reasonable expectations of the parties and the corporate and individual interests at issue.

Part II of the Note explains that the preliminary steps doctrine developed to balance the policy interests of fairness to the company and free competition. Part III presents the difficulties in distinguishing mere preparation from actual competition and suggests that the contradictory results by courts stem from the application of a narrow standard. Part IV contends that the current standard fails to protect the corporate and individual interests at stake. Part V concludes by presenting a framework that considers the employment relationship. This Part suggests that courts should relax the loyalty required of at-will employees.

---

14. The following states have expressly accepted the preliminary steps standard: California, Delaware, Florida, Georgia, Indiana, Iowa, Louisiana, Maryland, Massachusetts, Michigan, Minnesota, Missouri, New Jersey, New Mexico, New York, Ohio, Pennsylvania, South Dakota, Tennessee, Utah, Washington, West Virginia, and Wyoming. *See generally* ABA SECTION OF LABOR AND EMPLOYMENT LAW, EMPLOYEE DUTY OF LOYALTY: A STATE-BY-STATE SURVEY (Stewart S. Manela & Arnold H. Pedowitz eds., 1995) [hereinafter EMPLOYEE DUTY OF LOYALTY].

II. DEVELOPMENT OF THE PRELIMINARY STEPS DOCTRINE

A. *Overview of the Fiduciary Duty of Loyalty*

The duty of loyalty demands that the fiduciary place corporate interest above self-interest. Based on a recognition of human characteristics and motivations, the duty of loyalty attempts te prevent the exploitation of the corporation for personal gain.[15] Courts most often find a breach of the duty of loyalty when fiduciaries stand on both sides of a transaction,[16] appropriate a corporate opportunity,[17] or form an enterprise that directly competes with their employer.[18] By enforcing rules requiring the utmost fidelity from high-level employees, the

15. *See* Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939) (noting that the duty of loyalty attempts to deter fiduciaries from betraying the corporation by demanding the most "scrupulous observance" of fiduciary obligations to protect the company).

16. Corporate law considers this a conflict-of-interest transaction. *See* DEL. CODE ANN. tit. 8, § 144(a) (1997); *see, e.g.*, State *ex rel.* Hayes Oyster Co. v. Keypoint Oyster Co., 391 P.2d 979, 984 (Wash. 1964) (holding that the fiduciary obligation of undivided loyalty is not autematically breached if the fiduciary has an interest in the transaction, but the fiduciary must show fairness to the company and that full disclosure has occurred).

17. Courts use various tests te determine if the opportunity appropriated belonged to the corporation. The line-of-business test is probably the most common. Under this approach, an opportunity is a corporate opportunity if closely related to the corporation's existing or prospective activities. Courts usually consider several factors in determining whether the opportunity is within the line of business: the existence of a contractual right; the relationship of the opportunity to the corporation's business and current activities; and whether the opportunity is essential, necessary, or merely desirable. There is a good deal of overlap and confusion among courts over the difference between the line-of-business test and the duty not te compete. *See, e.g.*, *Guth*, 5 A.2d at 510-11; Ellzey v. Fyr-Pruf, Inc., 376 So. 2d 1328, 1333 (Miss. 1979); Jodi L. Popofsky, Note, *Corporate Opportunity and Corporate Competition: A Double-Barreled Theory of Fiduciary Liability*, 10 HOFSTRA L. REV. 1193, 1216-25 (1982) (discussing cases wbere courts impose liability for competition).

Some jurisdictions, however, adopt a more narrow interest or expectancy test. These states differ on whether a narrow or broad definition of expectancy is used. *Compare* United Seal & Rubber Co. v. Bunting, 285 S.E.2d 721, 722-23 (Ga. 1982) (defining interest or expectancy as a contractual right te the opportunity), *with* Comedy Cottage, Inc. v. Berk, 495 N.E.2d 1006, 1011 (Ill. App. Ct. 1986) (providing a broader view of interest and expectancy). Other jurisdictions use a fairness test that asks whether the fiduciary violated some legal or moral duty to the company in taking the opportunity. *See* Daloisio v. Peninsula Land Co., 43 N.J. Super. 79, 93 (N.J. Super. Ct. App. Div. 1956). Still others combine two different approaches. *See, e.g.*, Miller v. Miller, 222 N.W.2d 71, 81 (Minn. 1974) (combining the line-of-business and fairness test into a two-step balancing test).

18. What behavior constitutes competition under the corporate competition doctrine is not entirely clear, as the preliminary steps cases demonstrate. Delaware law provides a starting point for many courts. Under Delaware law, a corporate officer or director may engage in a competitive enterprise, even if adversely affecting the principal, so long as the fiduciary violates no legal or moral duty to the corporation. While the meaning of legal or moral duty is nnclear, most courts tend to supplement this general standard with specific prohibitions against unfair exploitation. *See* Popofsky, *supra* note 17, at 1216-25 (discussing liability for competition).

corporation is relieved of the nearly impossible task of monitoring employee behavior.[19]

At one time, only officers and directors with access to confidential information were considered fiduciaries. Changes in the economy and workplace, however, have significantly increased those subject to fiduciary duties.[20] Currently courts consider fiduciaries to be anyone with significant corporate trust or responsibility. Individuals commonly considered fiduciaries are officers and directors (including the president, vice-president, secretary and treasurer), as well as employees with access to confidential information and with significant authority.[21] Moreover, under agency law, all employees are considered agents who owe a duty of loyalty to act entirely for the employer in all matters relating to the employment relationship.[22] Thus, the obligations of loyalty under agency and corporate law extend to employees in non-traditional fiduciary positions. Evidence indicates that many of these employees do not realize the restraints on economic mobility that come with their employment status.[23] While arguably a less stringent standard of loyalty should apply to these lower-level employees, courts have yet to explain the relevance of employee status in loyalty disputes.[24]

---

19. *See Competing Interests, supra* note 3, at 442.

20. *See id.* at 450-51.

21. *See* PAT K. CHEW, DIRECTORS' AND OFFICERS' LIABILITY 94-95 (1995) [hereinafter DIRECTORS'].

22. The RESTATEMENT (SECOND) OF AGENCY § 1 (1958) defines an agent as anyone who has manifested consent to act in a fiduciary relation on behalf of another and subject te his control. Comment d to section 2.2 indicates that a servant is an agent, and under most statutes, "servant" translatos as an employee. For instance, section 220.1 of the RESTATEMENT (SECOND) OF AGENCY defines servant as "a person employed to perform services in the affairs of another and who with respect to the physical conduct in the performance of the services is subject to the other's control or right to control."

23. Corporato law in some ways distinguishes between the ordinary employee and the traditional fiduciary by imposing the corporato opportunity doctrine only on high-level employees with access to confidential information. Still, the lines between fiduciary and non-fiduciary are blurred, and under agency law all employees are subject te a duty not to competo with the employer until the agency is terminated. *See* RESTATEMENT (SECOND) OF AGENCY § 393 cmt. e (1958).

24. Some cases can be read to suggest that at-will employees are subject to a more lenient standard. *See, e.g.*, Headquarters Buick-Nissan, Inc. v. Michael Oldsmobile, 539 N.Y.S.2d 355, 356 (Sup. Ct. App. Div. 1989) (stating that under certain conditions an at-will employee may be free to establish a business in competition with his employer while still employed). One commentator, however, has suggested that employment status will not make much difference in preliminary steps cases as a practical matter. Only officers, directors, and key employees are involved in these disputos because they have the talents and contacts to attract future customers. Thus, they are the only ones whose disloyalty will actually harm the employer. *See* Schaller, *supra* note 12, at 72-73.

B. Balancing Fairness to the Company and Free Competition

Despite the duty of loyalty's requirement of self-denying behavior, common law has long recognized an employee's right to plan for future work. The practical need to protect oneself from the possibility of a layoff[25] and the belief in fundamental notions of individual liberty and free competition[26] provided the impetus for a rule that allowed an employee to make certain preparations to start a competitive enterprise while still employed. The Restatement of Agency codified the preliminary steps doctrine in Comment e to Section 393. Almost all jurisdictions accepting the doctrine follow the Restatement's formulation.[27]

Comment e states that an employee can make preliminary arrangements to compete with her employer, so long as the employee does not use confidential information pertaining to the employer's business.[28] Preliminary arrangements include the purchase of a rival business and presumably any step necessary to purchase or establish the rival business.[29] The duty of loyalty prohibits the agent from actually competing with the employer, however, until after termination of the agency.[30] The Restatement, however, fails to define solicitation or provide guidance on what behavior would be deemed competitive.

Restrictions on the departing agent's conduct towards fellow employees also are not well defined. While the Restatement prohibits an agent from enticing fellow employees to breach contracts with employers or from convincing fellow employees to leave simultaneously, some liberty for agents to agree among themselves to start a new venture is allowed.[31]

---

25. *See* Meyers v. Roger J. Sullivan Co., 131 N.W. 521, 522-23 (Mich. 1911) ("One is entitled to seek other employment before he is on the street.").

26. One court explained that employees owe a "duty to give loyal and conscientious service while [employer] employed them," but the employee's "individual liberty includes the right to advise customers of the fact that he is going to quit, and that thereafter he will be working for a competitor." Baker v. Battershell, Madison Equity No.5, 1986 WL 7602, at *3 (Tenn. Ct. App. 1986).

27. For states recognizing the preliminary steps doctrine, see EMPLOYEE DUTY OF LOYALTY, *supra* note 14. Kentucky is the only state that appears to forbid any preliminary arrangements. *See id.* at 260; Steelvest Inc. v. Scansteel Serv. Ctr., 807 S.W.2d 476, 483 (Ky. 1991) (holding that directors and officers should first terminate their positions before making arrangements or preparing to compete). *Scansteel* is slightly ambiguous, however, with some language in the decision suggesting that preparation is allowed.

28. RESTATEMENT (SECOND) OF AGENCY § 393 cmt.e (1958).

29. *See id.*

30. *See id.* Competition includes solicitation of customers.

31. *See id.*

In providing an exception to the duty of loyalty, the preliminary steps doctrine embodied in the Restatement caused a tension to emerge between the competing policies of fairness to the corporation and the individual interest in economic mobility. *Maryland Metals Inc. v. Metzner* recognized and first explained these conflicting policies.[32] In *Maryland Metals*, the vice-president of a scrap metal business discovered a new machine that he found to be more efficient than other equipment at separating metal from non-metal. He made several recommendations to the board of directors to acquire the machine, but all were deferred for various reasons.[33] After failing to persuade the president to provide him with equity in the company, the defendant made preparations prior to resignation, including the formation of a new company that would use the machine.[34] The employer brought an action for breach of fiduciary obligations on grounds that the defendant failed to disclose these competitive plans.

In finding no liability, the court recognized the importance of the duty of loyalty in protecting the company from unfairness and commercial immorality in the business world. It acknowledged that obligations of loyalty were necessary to protect the employer from abuse and exploitation by high-level employees.[35] Nevertheless, the court explained that the duty of loyalty must be balanced with the policy favoring the promotion of free competition and the consideration of individual interests such as economic mobility. Because of these policy considerations, the court held that preparation should be allowed, even though the employee's competition may eventually harm the employer.[36] The court explained that liability would be found only if the preparation was in bad faith.[37]

---

32. Maryland Metals, Inc. v. Metzner, 382 A.2d 564, 568 (Md. 1978). Prior to the *Maryland Metals* decision, some courts required full disclosure of the employee's preparations. *See, e.g.*, C-E-I-R, Inc. v. Computer Dynamics Corp., 183 A.2d 374, 379-80 (Md. 1962).

33. *See Maryland Metals*, 382 A.2d at 566.

34. *See id.* at 567.

35. *See id.* at 568.

36. *See id.* at 569.

37. By bad faith the court meant some "fraudulent, unfair or wrongful act" such as the misappropriation of trade secrets, the misuse of confidential information, the usurpation of an employer's business opportunity, or a conspiracy to bring about mass resignation of the employer's key employees. In this case, appellants produced no evidence of fraudulent or wrongful conduct. At trial the evidence revealed that defendant had continued to put forth his best efforts for the employer until the end of his employement. *See id.* at 569-72.

III. THE UNCERTAINTY IN THE PRELIMINARY STEPS DOCTRINE

Although the court in *Maryland Metals* concisely explained the competing policies at issue, it failed to provide practical guidance in balancing these interests.[38] Since *Maryland Metals*, courts attempting to balance the competing policy interests have produced contradictory results from similar fact patterns.[39] In particular, courts have been unable to determine when an employee's actions in notifying employees or customers of her plans goes beyond mere preparation.[40] The inconsistent decisions stem in part from the differing conceptions of competitive behavior among the courts. Some courts narrowly interpret competition to mean receiving guarantees of future contracts, while others apply a broader interpretation, viewing almost all notification as solicitation.

A. Jurisdictions Inconsistently Determine Whether Client Contact Violates the Duty Not to Compete

1. Some Courts Adopt a Lenient Approach to Preparation

Determining a breach of the fiduciary duty of loyalty in preliminary steps disputes requires a close analysis of the facts and circumstances of each case, with particular attention on the nature of the preparations.[41] Under this standard, however, some courts suggest preparation includes actions by employees that are inherently competitive with their employer. In *Dwyer, Costello & Knox, P.C. v. Diak*, for example, the defendant, an officer of the plaintiff's accounting firm, informed his employer of his plans to leave, but agreed to stay a few months to complete work in progress.[42] During this period, the defendant sent letters to his employer's clients,

38. *Maryland Metals* presented a series of factors that courts should look at to determine bad faith. These factors included soliciting clients and employees, stealing trade secrets or confidential information, and usurping a corporate opportunity. *See id.*

39. This unpredictability caused attorneys to struggle in representing clients on these matters. *See* Gass, *supra* note 11, at 654 (stating that the outcome of litigation involving departed employees is difficult to predict); Schaller, *supra* note 12, at 4 (blaming legal confusion in part for the extensive amount of litigation).

40. As one judge stated, "[t]here would appear to be no precise line between acts by an employee which constitute mere preparation and those which amount to solicitation." C-E-I-R, Inc. v. Computer Dynamics Corp., 183 A.2d 374, 379 (Md. 1962).

41. *See* Bancroft-Whitney Co. v. Glen, 411 P.2d 921, 935 (Cal. 1966) (stating that the mere fact that an employee makes preliminary steps to competo is not sufficient to find a breach of fiduciary duty).

42. Dwyer, Costello & Knox, P.C. v. Diak, 846 S.W.2d 742, 744-45 (Mo. Ct. App. 1993).

informing them of his new partnership and indicating his willingness to provide them future services.[43] Several of the employer's clients transferred their business to the defendant's new partnership.[44] Because the defendant did not seek business opportunities for his competitive enterprise prior to informing his employer of his departure, the court found the activity proper.[45]

Other decisions provide a similarly lenient interpretation of mere preparation, finding no breach of the duty of loyalty if the preparation fails to guarantee future work. The employee's contact with clients, therefore, may go beyond notification to include subtle attempts to persuade customers to conduct business with the new venture.[46] In *Ellis & Marshall Associates v. Marshall*, the court found that the defendant's preliminary discussions with clients constituted "statements as to the defendant's future plans," and therefore did not constitute a breach of the duty of loyalty.[47] The defendant in *Marshall*, a long-time owner and partner of the plaintiff, decided to start his own enterprise when he and the plaintiff failed to reconcile their differences.[48] He approached clients of their partnership and informed them that he wanted to represent them, also stating that he could wait for an answer.[49] He also informed several employees of his intentions.[50] The court considered these activities to be mere arrangements to compete, because the plaintiff did not ask plaintiff's

43. Other facts in the case reveal the extent of the employee's actual competition with the employer. At the time these letters were sent to the clients, the defendant had already rented office space, moved files, and convinced other employees of the employer to join his new company. *See id.*

44. *See id.*

45. The court reasoned that free competition and economic mobility—particularly concerning at-will employees—in part justified the result. The employer could have protected itself from the loss of major clients if it had obtained a covenant-not-to-compete. *See id.* at 748. Other cases directly contradict this result, holding that entering into transactions with potential corporate customers while still working for the employer constitutes a breach of the fiduciary duty of loyalty. *See, e.g.*, E.J. McKernan Co. v. Gregory, 623 N.E.2d 981, 993-94 (Ill. App. Ct. 1993) (holding that resignation will not sever liability for transactions completed after resignation, if the transactions began during the existence of the relationship or were based on information gained during the relationship).

46. *See, e.g., In re* Golden Distrib., Ltd. v. Auburn Merchandising Distributorship, Inc., 134 B.R. 750, 756 (Bankr. S.D.N.Y. 1991) (finding no violation of duty of loyalty when employees notified customers of their departure to join new employer and implied that customers should submit orders to the new employer).

47. Ellis & Marshall Assocs. v. Marshall, 306 N.E.2d 712, 715-16 (Ill. App. Ct. 1973).

48. *Id.* at 714.

49. *See id.* at 715. The plaintiff and defendant disagreed over when the defendant notified the plaintiff of his intentions to resign. Under either's facts, however, some of the defendant's notification and solicitation of clients occured before his disclosure.

50. The employees later joined the plaintiff. *See id.* at 714-15.

clients to approve of the plan and did not attempt to persuade them to employ him in his new capacity.[51]

In *McCallister Co. v. Kastella*, a high-level employee provided a thirty-day notice of her resignation, stating an intontion to form a competitive enterprise.[52] She also contacted clients through personal letters which explained that she "appreciated [the client's] kindness and support."[53] The letter specifically denied that it was a solicitation of the client's business.[54] Nevertheless, four of the employer's six or seven commercial clients called promptly after receiving the letter and verbally informed the defendant that they would hire the new enterprise. Several fellow employees also approached the defendant about the possibility of work. She told them that they could join the business once the company started operations.[55] Six of nine employees joined the new business.[56]

The *McCallister* court required more direct evidence of persuasive pre-termination activity before it would find a breach of the duty of loyalty.[57] The letter te the clients and verbal confirmations prior to the end of the employee's employment did not establish a breach.[58] Using language similar to that in *Ellis & Marshall Associates*, the *McCallister* court indicated that the employer must show that the departing employee actively sought guarantoes of future work. Accepting verbal confirmations over the phone did not constitute such solicitation.[59]

2. Some Courts Find a Breach of the Duty of Loyalty for Almost Any Pre-termination Client Contact

Some courts interpret competitive behavior more broadly. These courts significantly limit the amount of preparation allowed, suggesting that subtle attempts to "feel out" clients constitute disloyal competition. In *Veco Corp. v. Babcock*, the employees' preliminary arrangements included approaching several key employees of the National Exchange Benefit Trust ("NEBT"), their employer's major

---

51. *See id.* at 716-17.
52. McCallister Co. v. Kastella, 825 P.2d 980, 981 (Ariz. Ct. App. 1992).
53. *Id.* at 981.
54. *See id.*
55. *See id.* at 983.
56. *See id.*
57. *Id.* at 984-85; *see also* Jet Courier Serv. v. Mulei, 771 P.2d 486, 491-98 (Colo. 1986) (providing another interesting example of the extensive amount of preparation that a court has allowed).
58. *See McCallister*, 825 P.2d at 984-85.
59. *See id.* at 984.

client, to "see what their feelings were" as to whether they would be willing to transfer work to a new enterprise.[60] They also made it known that the client's employer would be losing all key personnel who worked on and understood the client's accounts. A day after the employees were fired and began full-time at their competing business, opened earlier in the month, several clients transferred their accounts to the new company.[61]

In contrast to *Ellis & Marshall Associates*, the court in *Veco* found that the defendant's pre-termination acts constituted solicitation even though none of the clients had verbally or otherwise guaranteed any business.[62] The court found significant the number of clients that transferred their business so quickly despite the typical practice of carefully examining the insurance carrier.[63] This coincidence suggested to the court that pre-termination solicitation must have occurred.[64] Rather than looking for firm guarantoes as a sigu of competitive behavior, the *Veco* court indicated a willingness to infer competitive behavior from the surrounding evidence.

The court in *Veco* may have been more willing to infer solicitation because evidence suggested that the defendants had deliberately sought to steal NEBT's business from the employer.[65] More importantly, however, the court was influenced by the defendants' positions as corporato officers—traditional fiduciaries—rather than typical employees. The court explained that corporate fiduciaries stood on a "different footing" from typical employees, and that the law governing the right of former employees to competo was separate and distinct

60. Veco Corp. v. Babcock, 611 N.E.2d 1054, 1058 (Ill. App. Ct. 1993).

61. *See id.*

62. *Compare id.* at 1059-60, *with* Ellis & Marshall Assocs. v. Marshall, 306 N.E.2d 712, 717 (Ill. App. Ct. 1973) ("The defendant here did not ask the plaintiff's clients to approve his plan or even attempt at that time to persuade them to employ him in his new capacity.").

63. *See Veco*, 611 N.E.2d at 1060 (noting that shortly after defendant's departure from Veco, six Veco group clients transferred their business).

64. *See id.* The court was most likely influenced by other acts suggesting disloyal behavior, including the employees' knowledge that their departure would leave the employer unable to service NEBT, and specific evidence suggesting that the departing employees planned and actively sought to steal the employer's business. Indeed, a "smoking gun" report existed detailing how the departing employees planned to steal Veco Company's group accounts. *See id.* at 1056-61. Nevertheless, the holding suggests that even absent these actions, a breach of fiduciary obligations would have existed because pre-termination solicitation must have occurred based on the number of clients that transferred their business so quickly. *See also* Alexander & Alexander Benefits Serv. Inc. v. Benefit Brokers & Consultants, Inc., 756 F. Supp. 1408, 1412-13 (D. Or. 1991) (finding that employees breached fiduciary duty of loyalty because sending letters notifying clients of the new business, its services, budget, and address constituted wrongful solicitation).

65. *Veco*, 611 N.E.2d at 1059-60.

from a breach of fiduciary duty by an officer.[66] Thus the court seemed more willing to scrutinize the pre-termination behavior of fiduciaries more closely than that of the typical employee.

Vigoro Industries, Inc. v. Cleveland Chemical Co. also considered the employment status of the defendant in determining whether a breach of loyalty had occurred.[67] The court was more willing, however, to apply a strict view of the duty of loyalty despite the defendant's status as an at-will employee. In this case, a highly respected and talented supervisor became disgruntled with his employer.[68] He entered into a number of discussions with a competitor over a period of several years and finally decided to operate a facility for the competitor.[69] In preparing to start the competitive venture, the defendant informed fellow employees of his departure and told them that there would be work for them at the new location if the employees wanted to join him.[70] He also sent a letter to customers after resigning but before termination. Although the letter was addressed to "our valued customers," like the letter in *McCallister*, it simply stated a wish to serve the customers' needs in the future.[71] The court found the letter crossed the line from mere notification into solicitation, however, even though it included no price information and did not lead to any guarantees of future work.[72]

The *Vigoro* court stated a reluctance to place restrictions on at-will employees that would prevent them from earning a living, especially in today's free-wheeling, high-turnover job environment.[73] The court did not consider the defendant's employment status in determining whether a breach of loyalty had occurred. Instead, the court simply applied the duty not to compete irrespective of employee status, finding a breach of loyalty even though the pre-termination activity could have been construed as either notification or solicitation.[74] The court's decision not to consider the employee's

---

66. *Id.* at 1059.

67. Vigoro Indus., Inc. v. Cleveland Chem. Co., 866 F. Supp. 1150, 1160 (E.D. Ark. 1994).

68. *See id.* at 1156-57. The employee believed that his employer was not providing equipment necessary to meet the challenges of the competitive market. *See id.* at 1157.

69. *See id.*

70. *See id.* at 1158. Although many of the employees left with the defendant, the court did not consider this a factor in finding a breach of the duty of loyalty, because it was convinced the employees would have departed whether or not the defendant had solicited them. *See id.* at 1169.

71. *Id.* at 1164.

72. *See id.* at 1165.

73. *See id.* at 1160.

74. *See id.* at 1165. Comparing the letters and actions of the employee in *Vigoro* with the employer's actions in *McCallister* and *Ellis & Marshall* supports this point. See *McCallister Co. v. Kastella*, 825 P.2d 980, 982 (Ariz. Ct. App. 1992), and *Ellis & Marshall Associates v. Marshall,*

status comports with other decisions which have allowed at-will employees to make arrangements to compete as long as no solicitation has occurred. These courts hold that solicitation violates the at-will employee's duty of undivided loyalty.[75]

3. The Cases are Factually Similar yet Yield Different Results

Since the preparations in *Veco* and *Vigoro* resembled those in *McCallister* and *Ellis & Marshall Associates*, and both courts purported to apply the same standard, the courts should have reached the same results. Like the defendants in *McCallister* and *Ellis & Marshall*, the *Veco* defendant's preparation included investigating the possibility that clients would transfer business to the new enterprise.[76] Yet the courts reached different results on whether inquiries into the clients' willingness to change employers constituted a breach of the duty of loyalty. Moreover, there is little factual difference between the letters sent by the defendants in *McCallister* and *Vigoro*. Indeed, stating a wish to serve customers in the future and expressing appreciation for the clients' support are both calculated attempts at solicitation. The quick response by the clients in *McCallister* underscores this point, perhaps suggesting that the defendant in that case engaged in more competitive behavior than the defendant in *Vigoro*. Other decisions support this point.[77] Nevertheless, the court found the defendant's actions in *McCallister* to constitute mere preparation, while in *Vigoro* the court found similar behavior to constitute actual competition.

---

306 N.E.2d 712, 714 (Ill. App. Ct. 1973), both of which suggest that solicitation occurs when employees or customers guarantee that they will switch to the new venture.

75. *See, e.g.*, Space Aero Prods. Co. v. R.E. Darling Co., 208 A.2d 74, 85 (Md. 1965) (finding a duty of fidelity to the employer while employed); Eaves v. Hillard Co., Appeal No. 88-37-II, 1988 WL 49959, at *3 (Tenn. Ct. App. 1988) (stating that an employee may not solicit his employer's customers while still employed). Nevertheless, at least one jurisdiction has suggested a public policy not to inhibit an at-will employee's decision to compete. *See In re* Golden Distrib., Ltd. v. Auburn Merchandising Distributorship, Inc., 134 B.R. 750, 756 (Bankr. S.D.N.Y. 1991). In a close case, equity suggests the court should err on the side of an at-will employee. As this Note suggests, employer and employee expectations in an at-will relationship indicate that both employees and employers expect preparation for future employment is allowed.

76. Veco Corp. v. Babcock, 611 N.E.2d 1054, 1058 (Ill. App. Ct. 1993).

77. *See, e.g.*, Community Counselling Serv., Inc. v. Reilly, 317 F.2d 239, 244 (4th Cir. 1963):

> If prospective customers undertake the opening of negotiations which the employee could not initiate, he must decline to participate in them. Above all, he should be candid with his employer and should withhold no information which would be useful to the employer in the protection and promotion of its interests.

4. *Steelvest Inc. v. Scansteel Service Center Inc.*

Steelvest Inc. v. Scansteel Service Center Inc. further illustrates the limitations of the current preliminary steps doctrine. In *Steelvest*, the defendant, a long-time figure in the Kentucky steel industry, retained a high position in Steelvest after it bought out his employer.[78] After several months with Steelvest, the defendant began preparations to actively compete. He sought advice of counsel, contacted potential investors, and obtained financing prior to resigning.[79] Two of the investors included long-time friends of the defendant and high-ranking employees of Steelvest clients.[80] Steelvest brought suit claiming the defendant breached the duty of loyalty.[81]

The court found the evidence sufficient to conclude issues of material fact existed on the question.[82] In so doing, it promulgated a rule that found all preliminary arrangements to be by definition a breach of the duty of loyalty.[83] The stringent rule—draconian compared to other jurisdications—may have resulted from the court's struggle to justify finding the pre-termination contact with investors a breach of the duty of loyalty. Pre-termination contact with investors is an essential step in preparing to compete—that is, entrepreneurs must be able to obtain financing for their new enterprise before any business activity can occur. From a broader duty of loyalty perspective, however, pre-termination contact violates basic duty of loyalty concepts that require the employee to consider the employer's interests before her own. *Steelvest* can be viewed as yet another demonstration of a court struggling to define competition and to find the proper balance between the policy interests of fairness to the company and the promotion of free competition.

B. Pre-termination Employee Contact Leads to Various Results in Similar Fact Patterns

The application of the mere preparation doctrine to the solicitation of employees is also confusing. Some courts prohibit all at-

78. Steelvest, Inc. v. Scansteel Serv. Ctr., 807 S.W.2d 476, 478-79 (Ky. 1991).
79. *See id.*
80. *See id.* at 479-80.
81. *See id.* at 484.
82. *See id.*
83. In addressing the issue of whether the defendant's preparations went too far, the court explained that "directers and officers of a corporation may not set up, or attempt to set up, an enterprise which is competitive with the business in which the corporation is engaged . . . . [The directors and officers] should terminate their position/status . . . when they first make arrangements . . . to compete . . . ." *Id.* at 483.

tempts to persuade key employees to join competing ventures. In one example, the Supreme Court of Massachusetts held that an employee's solicitation of key managers breached the fiduciary duty of loyalty because it left the employer with inadequate personnel.[84] Other courts, however, indicate that extensive notification of fellow employees does not violate fiduciary obligations. In *McCallister,* the defendant responded to inquiries by fellow employees about possible employment by stating that they could join the company once it "got up and running."[85] The court found no breach of the duty of loyalty.[86] *Ellis & Marshall Associates* and *Dwyer* both held that a departing fiduciary can make an offer to an at-will employee.[87] In *Ellis & Marshall,* the court found no breach of the duty of loyalty even though the evidence revealed that the defendant had approached at least two fellow employees prior to the tormination of employment.[88]

These conflicting decisions are explainable in part on the basis of the particular employee being solicited and the relevant harm to the company. Courts have been willing to allow solicitation of at-will employees if such solicitation presents little harm to the employer.[89]

---

84. *See* Augat, Inc. v. Aegis, Inc., 565 N.E.2d 415, 420 (Mass. 1991). While still general manager, the defendant in this case convinced the vice-president for marketing, the new product design manager, the employer's most experienced engineer in technology, the manufacturing manager, and the engineering manager te leave the employer. *See id.* at 419; *see also* American Republic Ins. Co. v. Union Fidelity Life Ins. Co., 470 F.2d 820, 824 (9th Cir. 1972) (holding that hiring other employees of defendant's employer while still employed constituted unfair competition); E.D. Lacey Mills, Inc. v. Keitb, 359 S.E.2d 148, 155 (Ga. App. 1987) (finding that broaching tbe subject of plans to forın rival entorprise to employer's sales representatives raised an issue of matorial fact as to breach of fiduciary duty of loyalty); Radiac Abrasives, Inc. v. Diamond Tech., Inc., 532 N.E.2d 428, 431 (Ill. App. Ct. 1988) (finding breach of duty of loyalty by employee in contracting with fellow employees of employer while still employed); Unichem Corp. v. Gurtler, 498 N.E.2d 724, 728 (Ill. App. Ct. 1986) (finding breach of officer's duty of loyalty to solicit an employee to leave the employer and join a rival business in which the officer planned te join in near future).

85. McCallister Co. v. Kastella, 825 P.2d 980, 983 (Ariz. Ct. App. 1992).

86. *See id.* at 985.

87. Ellis & Marshall Assocs. v. Marshall, 306 N.E.2d 712, 714-15 (Ill. App. Ct. 1973) (finding no breach of duty of loyalty when fellow employees of defendant joined competing enterprise); Dwyer, Costello & Knox, P.C. v. Diak, 846 S.W.2d 742, 747 (Mo. Ct. App. 1993) (same).

88. *Ellis & Marshall,* 306 N.E.2d at 714-15. Although a factual dispute existed over the exact date at which the defendant terminated his employment, even under the defendant's testimony these employees were approached prior to resigning.

89. *See, e.g.,* Buick-Nissan v. Michael Oldsmobile, 539 N.Y.S.2d 355, 357-58 (Sup. Ct. App. Div. 1989) (holding that defendant had not breached fiduciary duties by inducing an at-will employee to join a competitive enterprise because no evidence indicated an intention to cause serious harm to the employer by raiding its employees). The justification for this rule comes from language in Comment e to the Restatement of Agency, which finds liability if an employee "causes fellow employees to break their contracts with the employer." RESTATEMENT (SECOND) OF AGENCY § 393 cmt.e. (1958). *But see* Jet Courier Serv. Inc. v. Mulei, 771 P.2d 486 (Colo. 1989). In *Jet Courier,* the court held that the employment relationship is only one factor for

Moreover, the Restatement allows employees to depart together and join a competing business, unless key employees agree to leave together, thus hindering the employer's ability to continue operations.[90] Decisions based on an *ex post* analysis of whether the activity harmed the employer, however, provide little guidance for the employee planning to establish his or her own business, for in most cases it will be difficult to predict the impact of taking a few employees. Such a rule also fails to comport with notions of competition. As some decisions recognize, the mere attempt to persuade another employee to join a new enterprise effectively places the departing employee in direct competition with the employer.[91]

IV. THE PRELIMINARY STEPS DOCTRINE CANNOT PROTECT CORPORATE AND INDIVIDUAL INTERESTS

Besides the inability of the current preliminary steps standard to render consistent results, the doctrine also has failed to balance competing policy interests of fairness to the company and the promotion of free competition. The fine line between notification and solicitation applied by courts adopting a narrow view of competitive behavior has allowed employees to steal customers and fellow employees. Meanwhile, the absence of a clear rule and the tendency of some courts to find almost all preliminary steps wrongful has limited the amount of preparation allowed and stifled the policy goal of promoting free competition.

A. The Corporate Interest

The extensive preparation allowed by some courts enables employees to circumvent fiduciary obligations that protect the employer from exploitative behavior.[92] As *McCallister* and *Ellis &*

---

courts to consider when determining if the fiduciary's attempts to solicit fellow at-will employees constituted a breach of the duty of loyalty. *Id.* at 496. The court explained that the employee's duty of loyalty was not limited to the duty to refrain from tortious interference with contractual relations between the employer and employees, and that the court should consider other factors such as the impact or potential impact of the employee's actions on the employer's operations and the extent of any promises or inducements made to the employees. *See id.* at 496-97.

90. *See* RESTATEMENT (SECOND) OF AGENCY § 393 cmt.e (1958).

91. *See, e.g.*, E.D. Lacey Mills, Inc. v. Keith, 359 S.E.2d 148, 155 (Ga. App. 1987); Maryland Metals, Inc. v. Metzner, 382 A.2d 564, 568 (Md. 1978).

92. See the duty of loyalty discussion *supra* notes 15-24 and accompanying text. *See also* Schaller, *supra* note 12, at 71-74 (discussing courts' different justifications for the preliminary steps doctrine).

Marshall Associates demonstrate, fiduciaries may secretly contact clients and fellow employees and suggest they transfer their business to the new firm. With the aid of an attorney, departing employees can tailor their actions to keep them within the boundaries of mere preparation. Thus, in the event they are discovered, they can argue that their pre-termination activity was only preliminary.[93] Moreover, under this rule employers have a high evidentiary burden. To prove liability, employers will have te incur extensive discovery expenses to show that significant efforts of persuasion were used by the departing employee.[94] Given the number of duty of loyalty suits filed each year, businesses must incur very high costs in proving liability.[95]

Courts adopting a narrow interpretation of competitive behavior fail te recognize the vulnerability of the corporation. Employees have personal contact with the customers, and the customers associate the product with the employee who serves them, especially in service industries.[96] Thus, when the employee starts her own business, the client will often transfer her account in order to prevent any disruption in services. The corporation is frequently left in economic turmoil.[97] The relationship between employees poses similar prob-

---

93. Many cases reveal the extensive secretive activity that fiduciaries can claim is mere preparation under the current standard. *See, e.g.*, McCallister Co. v. Kastella, 825 P.2d 980, 981, 985 (Ariz. Ct. App. 1992) (holding that letter sent by departing employee was mere notification, because the letter so stated). *Mercer Management Consulting, Inc. v. Wilde*, 920 F. Supp. 219, 235 (D.D.C. 1996), provides a good example of how departing employees can tailor their competitive, had-faith behavior as mere preparation. In *Mercer*, high-level management consultants were able te notify key clients of their plans to form their consulting business and send diskettes with all the clients' work on it, thus increasing the likelihood that the clients would switch businesses. *Id.* Sending the diskettes eliminated the clients' fear that past work would be lost. Conveniently sending these diskettes, when coupled with the notification, certainly suggests solicitive behavior.

94. *See* Schaller, *supra* note 12, at 71 (explaining that the preliminary steps rule tempts employees to engage in "carefully conceived and precisely executed schemes" that employers can catch only with time-consuming and costly investigation).

95. Over 70 reported cases have resolved duty of loyalty disputes in the last two years, but the prevalence of breaches of duty of loyalty is prebably much higher. The discovery expenses in an intensely factual situation probably deter many corporations from bringing claims at all. In fact, most litigated cases involve situatious in which a significant number of clients or employees switched to tbe new enterprise. The cases discussed in Part III provide a sampling of this preblem. *See* Gelb, *supra* note 7, at 893 (discussing the high costs of employee disloyalty and fraud to businesses each year).

96. *See* Walter E. Zemitsch, Inc. v. Harrison, 712 S.W.2d 418, 421-22 (Mo. Ct. App. 1986) (stating that "in the sales industry the goodwill of a customer frequently attaches to the employer's sales representative porsonally; the employer's product becomes associated in the customer's mind with that representative") (*quoting* Continental Research Corp. v. Scholz, 595 S.W.2d 396, 401 (Mo. Ct. App. 1980)).

97. *See, e.g.*, *McCallister*, 825 P.2d at 983 (finding that four of the employer's six or seven clients left and contracted with the defendant's new business). For instance, in *Fish v. Adams*, 401 So. 2d 843, 844-45 (Fla. Dist. Ct. App. 1981), an employee opened up a beauty shop down

lems. The strong personal ties that develop put departing employees in a position to influence the decisions of co-workers.[98] Often, a key employee notifies fellow workers of her plans, causing several to follow to the new enterprise.[99] Again, the company is left in dire economic straits.

The consequences of extensive preliminary stops can be devastating for the company and the economy as a whole. As courts become less inclined to use fiduciary obligations to protect the company, employees are more likely to act in their own self-interest. Businesses will have to spend even more time monitoring employee behavior, or will have te contract with key employees te protect themselves.[100] Regardless of the path chosen, business expenses will increase, causing profits to decline.

B. The Individual Interest

Despite the confusion of the preliminary steps doctrine and its inability to protect the corporation, some preparation must be allowed.[101] As *Maryland Metals* has pointed out, free competition is an essential component of our economy.[102] Without allowing some preparation, the restraint placed on fiduciaries by duty of loyalty principles may actually decrease the number of opportunities that are tapped, for competitive enterprises are frequently built on corporate opportunities.[103] As one commentater has argued, individual fiduciaries have a better chance to exploit the opportunity than the corporation in some instances,[104] especially if the opportunity deals with a product or market innovation. Bringing an innovation from the market stage to

---

the street from the employer. All five of the beauticians began working for the new shop as soon as it opened, and many clients also switched. The employer was out of business in four months *See id.*

98. *See* Terry A. O'Neill, *Employees' Duty of Loyalty and the Corporate Constituency Debate*, 25 CONN. L. REV. 681, 701 (1993) ("Employees often develop strong personal relationships with each other . . . and they are therefore in a pesition to influence the decisions of those co-workers and customers.").

99. *See, e.g.*, Vigoro Indus. v. Cleveland Chem. Co., 866 F. Supp. 1150, 1169 (E.D. Ark. 1994) (stating that the plaintiff's employees left with the departing defendant-employee because of their trust and loyalty to him).

100. *See, e.g.*, O'Neill, *supra* note 98, at 699 (explaining how restrictive covenants provide employers with greater protection than employees' common-law fiduciary duties).

101. *But see* Schaller, *supra* note 12, at 71-75 (arguing for the elimination of the preliminary steps doctrine).

102. Maryland Metals, Inc. v. Metzner, 382 A.2d 564, 568-69 (Md. 1978).

103. Fiduciaries are usually the highly talented and well-paid employees who have the client contact and finances to begin the new venture. *See Competing Interests*, *supra* note 3, at 452-55 (discussing the successful development of opportunities by fiduciaries).

104. *See id.*

successful commercialization is a long and risky process, and evidence indicates that smaller, more flexible operations can manage the process more effectively than a structured company.[105]

Prohibiting preliminary arrangements also raises fairness concerns because the rule places employees trying to start their own business at a competitive disadvantage. Most entrepreneurs have the ability to contact key players and even attempt to solicit their business before investing substantial funds inte the venture. These entrepreneurs already have some idea of how successful their product may be. But an employee considering a new venture that competes with her employer cannot effectively research the market until after resigning. Studies show that successful ventures require extensive background research, which includes contact with key customers in the industry.[106]

Furthermore, employers will have the upper hand in retaining their clients. Since employees usually must provide notice of resignation and an explanation for leaving, corporations will have several weeks to prepare for the competition. While the departing employee's hands remain tied, the employer can negotiate with clients te ensure they remain with the employer. Thus, eliminating all pre-termination negotiations increases the difficulty for the departing employee to achieve success in his or her new venture. Given the inherent risks in starting an enterprise, this additional burden will likely deter some employees from starting their own venture.

A strict duty of loyalty that prohibits all competitive planning, moreover, does not comport with the intentions of the contracting parties. In the absence of a covenant-not-to-compete, fiduciaries believe they retain the privilege to compete with the company in the future and te prepare te compete while still with the corporation.[107] Prohibiting all preparation and requiring a rigid standard of undivided loyalty does not comport with employee beliefs in freedom of economic mobility.[108] Officers and directors are not expected to put

---

105. Pat Chew has pointed out, following many of the ideas of Peter Drucker, that new innovations disrupt the corporate bureaucracy and its procedure and policies. *See id.* at 453. The extra cost, which will be incurred by the corporation should it pursue the innovation, often prevents it from so doing. In other words, pursuing the new product is not financially prudent. *See id.*

106. *See supra* notes 5-6 and accompanying text.

107. *See Competing Interests*, *supra* note 3, at 448-49 (discussing the positions of corporations and fiduciaries).

108. *See, e.g.*, Baker v. Battershell, Madison Equity No. 5, 1986 WL 7602, at *4 (Tenn. Ct. App. 1986) (suggesting employees' freedom of mobility should be considered); Crane Co. v.

forth all of their time, energies, efforts, and cumulative talents into the company; they are expected to perform all the job functions for which they contracted.[109] Furthermore, as a practical matter, fiduciaries often discuss ideas with employees, customers, friends, and colleagues. Getting some feedback from such individuals before a career-changing step is made is both smart and natural. Thus, interpreting competitive behavior to preclude virtually any pre-termination negotiations does not conform with either employee expectations or the realities of the business world.

Even more troubling, a stringent duty of loyalty does not consider variations in the employment relationship. As some courts have pointed out, expectations of loyalty differ greatly depending upon the employee's status as an inside or outside director, mid-level manager, corporate executive, or typical employee.[110] The vulnerability of the employee also differs, particularly between at-will and fixed-term employees. Since courts developed the preliminary steps doctrine in part to help employees prepare for the vagaries of the job market, the doctrine should not restrain employee mobility without considering employee vulnerability.[111] By not considering the employee's status in determining the amount of preparation allowed, courts do not consider the employee's interests.

The main problem with the current standard is the inability of courts to provide a consistent, predictable rule. Fiduciaries seeking to start their own enterprise are unable to determine what steps they may take, and attorneys are often unable to provide proper advice.[112] In many preliminary stops cases, the fiduciary found in breach had acted after consulting with an attorney.[113] The practical effect of this

---

Dahle, 576 P.2d 870, 872-73 (Utah 1978) ("[I]ndividual liberty includes the right to advise customers of the fact that he is going to quit.").

109. *See, e.g.*, Miller v. Miller, 222 N.W.2d 71, 77 (Minn. 1974) (indicating that best efforts does not require employees to "devoto their time exclusively to the corporation"); Durwood v. Dubinsky, 361 S.W.2d 779, 789-90 (Mo. 1962) ("Of course, the requirement to devote one's entire time is subject te a reasonable construction . . . .").

110. *See, e.g.*, Vigoro Indus. v. Cleveland Chem. Co., 866 F. Supp. 1150, 1160 (E.D. Ark. 1994) (stating a reluctance to put any restraint on at-will employees); Veco Corp. v. Babcock, 611 N.E.2d 1054, 1059 (Ill. App. Ct. 1993) (stating that corporate officers stand on different footing than typical employees due to fiduciary obligations).

111. *See* Meyers v. Roger J. Sullivan Co., 131 N.W. 521, 523 (Mich. 1911) ("One is entitled te seek other employment before he is on the street.").

112. *See supra* notes 10-11 and accompanying text.

113. *See, e.g.*, Radiac Abrasives, Inc. v. Diamond Tech. Inc., 532 N.E.2d 428, 429 (Ill. App. Ct. 1988) (stating that individual defendants admitted at deposition that they decided to begin preliminary steps only after discussing their proposed conduct with corporate counsel); Steelvest, Inc. v. Scansteel Serv. Ctr., 807 S.W.2d 476, 479 (Ky. 1991) (stating that defendant received advice of counsel while formulating a plan to start his own business during his employment with the plaintiff).

confusing standard is to deter some fiduciaries planning to compete from making any preparation. Under the present rule, only risk-takers will put forth any preparation before resigning.

V. SOLUTION—CONSIDERING EMPLOYEE STATUS AND EXPECTATIONS

Courts can satisfy the various policy interests and achieve more predictability by recognizing that the employer-employee relationship is essentially contractual, and that loyalty can be viewed as an implied contractual term that varies based on the employment relationship. From this standpoint, the restraint loyalty places on the employee's right to prepare to compete should differ significantly between fixed-term and at-will employees. Since no security exists in the at-will relationship, these employees both need and expect the right te make extensive preparations. Empirical evidence from the business world supports this point and suggests that even employers believe at-will employees have the right to prepare for the future.[114] Conversely, the security of a fixed-term relationship justifies a more stringent standard, perhaps prohibiting any preparation.

A. The Duty of Loyalty as an Implied Contractual Term

1. The Corporate Opportunity Doctrine Reflects a Contractual View of Loyalty

Although scholars continue to debate the issue, corporate law fiduciary duties perhaps can be best understood from a contractual, hypothetical-bargain viewpoint.[115] Assuming this premise, the fiduci-

---

114. *See infra* Part V.B.

115. The debate focuses on whether fiduciary duties should be understood in contract or in trust. Fischel and Easterbrook are the main proponents of the contract viewpoint. They argue that fiduciary duty is a response te the impossibility of writing contracts that completely cover all the parties' obligations, and, therefore, duties of loyalty should be determined based on the torms for which the parties would have bargained assuming low transaction costs. *See* Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425 (1993); *see also Competing Interests*, *supra* note 3, at 439 (suggesting that officers and directors should make explicit contracts with the corporation prior to employment, but in the absence of such agreements courts should examine the reasonable expectations of the parties to the agreement); Richard Epstein, *Contract and Trust in Corporate Law: The Case of Corporate Opportunity*, 21 DEL. J. CORP. L. 5, 24 (1996) (arguing that the corporate opportunity doctrine is not based on non-waivable trust principles but should be viewed *ex ante*).

Victor Brudney and Deborah DeMott, among others, oppose the contract view. *See* Victor Brudney, *Contract and Fiduciary Duty in Corporate Law*, 38 B.C. L. REV. 595, 601-07 (1997);

ary duty of loyalty could be viewed as a gap-filler to an indefinite contract, a material term that the court could interpret based on its belief of what reasonable parties would have agreed to had they considered the issue prior to employment.[116] Applying this approach to preliminary steps issues suggests that the restraint loyalty places on the right to make preparations should be determined by what the employer and employee would have agreed upon if they had discussed the issue. This "hypothetical bargain" view receives support from a few duty of loyalty cases, defenses in the corporate opportunity doctrine, and changes in the business world.

Some corporate opportunity cases explicitly consider the reasonable expectations of the parties when determining whether the taking of the opportunity breached the duty of loyalty. The well-known case of *Burg v. Horn* illustrates this tendency.[117] In *Burg*, the defendants wholly owned a few ventures that bought and sold real estate. Because of their success, they decided to convince the plaintiffs, who were close friends of the defendants, to join them in forming the Darand corporation.[118] The plaintiffs agreed, and over a period of several years the defendants acquired nine properties individually or through wholly-owned corporations. The defendants never offered the business opportunities to the Darand company, and the plaintiffs brought suit claiming the defendants had breached fiduciary obligations by taking corporate opportunities in the line of business of the Darand company.[119] The court found for the defendants, holding that the Darand Company did not have an interest or expectancy in the properties.[120]

The court reasoned that in determining a breach it must in each case consider the relationship between the fiduciary and the corporation. From this relationship, the court should then determine whether a duty to offer the opportunity should be implied.[121] In short, it suggested that whether loyalty constrained the directors from pur-

---

Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 DUKE L.J. 879, 882. They argue that fiduciary duties are grounded in trust and agency. These obligations require self-denying behavior by the fiduciary that go beyond fairness and honesty. The fiduciary must place the corporation first, a premise that a contractual viewpoint cannot account for.

116. *See* Easterbrook & Fischel, *supra* note 115, at 427 (suggesting that duty of loyalty should be seen as an implied term based on what parties would have agreed upon); *See generally* JOHN D. CALAMARI & JOSEPH M. PERILLO, THE LAW OF CONTRACTS 53-55, 62-64 (4th ed. 1998) (providing background information on implied, material terms).

117. Burg v. Horn, 380 F.2d 897 (2d Cir. 1967).

118. *See id.* at 898.

119. *See id.* at 899.

120. *See id.* at 900.

121. *See id.*

suing the opportunities individually depended upon the expectations of the parties. The court found no interest or expectancy requiring the defendants te offer the opportunity to the Darand company because the parties could have reasonably expected the opportunities to belong to the defendants' other businesses, since the defendants spent most of their time with those enterprises.[122] The court noted that the situation might be different if the defendants had been full-time employees of the Darand company.[123]

Common defenses to breach of loyalty claims further support a contractual view of loyalty in corporate opportunity cases. For instance, the fiduciary can defend a claim of usurpation of an opportumity by showing that the opportunity was offered to the fiduciary in a private, rather than a corporate, capacity. If so, the taking of the opportunity by the fiduciary does not breach the duty of loyalty even though the opportunity was in the same line of business as the corporation.[124] The results in these cases effectuate an *ex ante* view of what the parties would have agreed to had they bargained over the opportunity prior to the signing of the employment agreement. A reasonable outside director, for example, would not give up all interests upon agreeing to work for the company, nor would the company expect the director to do so. Many outside directors have significant interests in the same industry.[125] Indeed, the company employs them on the basis of this expertise. By assuming positious as fiduciaries, moreover, officers and directors have not relinquished all rights to pursue personal opportunities made available to them. Such a rule would amount to corporate slavery, considerably increasing the salaries corporatious would have to pay fiduciaries to work for the company.[126]

---

122. *See id.*

123. *See id.*

124. *See* PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 1, § 5.05(b)(1)(A) (stating that the opportunity must come te the officer or senior executive in a corporate capacity). *Science Accessories Corp. v. Summagraphics Corp.*, 425 A.2d 957, 964 (Del. 1980), provides an example of unwillingness by courts to find liability for opportunities offered to employees in a private capacity. The defendants in *Summagraphics* helpod develop and market a new product that was designed primarily by a friend, in direct competition with the employer. *Id.* at 960. The employer brought an action against the defendants claiming the new product represented a business opportunity which defendants were obligated to offer to their employer. *See id.* at 961. The court found the product was an outside opportunity not available to the employer, so defendants had no obligation to disclose the concept to their employer and receive approval before acquiring it for porsonal gain. *See id.* at 964.

125. Outside directors are often accountants, attorneys, educators, consultants, or officers in other corporations. *See* DIRECTORS', *supra* note 21, at 16.

125. Easterbrook and Fischel argne that a trust view of the duty of loyalty would increase the costs of contracting for these agents. *See* Easterbrook & Fischel, *supra* note 115, at 427. As

Officers and directors can also take business opportunities if, after full disclosure, the board of directors of the corporation consents.[127] This consent can be viewed as an agreement to relax the duty of loyalty with respect to that particular economic opportunity, since without consent the taking of the opportunity by the fiduciary would constituto a breach of the duty of loyalty. This exception further demonstrates the contractual foundation of the doctrine, suggesting that the duty of loyalty can be relaxed if the parties agree to do so. Recent corporate opportunity cases have taken this defense further, holding that fiduciaries can defeat a breach of loyalty claim by proving that the corporation would have rejectod the opportunity if it was offered.[128] Although these cases do not use the term "reasonable expectations," implicitly they view loyalty as an implied term by allowing the defendant to show the taking of the opportunity was fair and not harmful te the corporation.[129] This more flexible approach to the corporate opportunity doctrine suggests that the duty of loyalty requires something less than utmost loyalty.[130]

2. Current Business Realities Support the Premise that Loyalty is Best Understood as an Implied Contractual Term

At a practical level, changes in the economy and workplace support the assumption that loyalty can, and perhaps should, be viewed from a contractual perspective. With officers and directors increasingly switching jobs and frequently engaging in many different enterprises simultaneously, it is unrealistic to maintain a trust view of loyalty.[131] Because of the threat of layoffs, employees cannot give

---

they put it, "[a]cting on moral belief that agents *ought* to be selfless will not make principals better off; it will instead lead to fewer agents, or higher costs of hiring agents." *Id.*

127. *See* DOUGLAS M. BRANSON, CORPORATE GOVERNANCE § 8.31, at 481-85 (1993) (defining disclosure as a defense to a charge of usurpation of a business opportunity).

128. *See, e.g.*, Ostrowski v. Avery, 703 A.2d 117, 127-28 (Conn. 1997) (stating that even in the absence of disclosure, the fiduciary may prevail if able to show that the taking of the opportunity did not harm the corporation because the corporation would not have pursued the opportunity if it was offered); Broz v. Cellular Info. Sys. Inc., 673 A.2d 148, 156-57 (Del. 1996) (holding that the director did not have to offer the opportunity to the corporation when the corporation lacked capacity or interest in the opportunity); Epstein, *supra* noto 115, at 21-25 (analyzing *Broz* and stating that if the employer is not in the specific business in which the employee pursues an opportunity, there should be no breach of the duty of loyalty).

129. *See Ostrowski*, 703 A.2d at 127-28.

130. The approach is more flexible in comparison to ALI's *Principles of Corporate Governance*, which makes disclosure mandatory before an opportunity can be taken by a fiduciary. *See* PRINCIPLES OF CORPORATE GOVERNANCE, *supra* noto 1, § 5.05(a)(1).

131. *See generally* John Burgess, *Managers Forge New Employee Relations; Fear of Layoffs, Pressures of '80s Alter Concept of Loyalty to Firms*, WASH. POST, Sept. 4, 1988, at H1 ("American

their utmost loyalty to any one corporation. More importantly, however, a contractual vision of loyalty allows the courts to vary the obligation based on employee status. Holding a high-level officer with high compensation and access to significant confidential information to a duty of utmost loyalty is very different from holding a typical employee to the same standard. The perspectives of the high-level and low-level employees are significantly different.[132] Analyzing the employment relationship from an *ex ante* contractual viewpoint allows the court the flexibility to make these distinctions.

B. Courts Should Distinguish Between At-Will and Fixed-Term Employees

The reasonable expectations of an employee or employer concerning the right to make extensive preparations will depend on whether the employment is at will or for a fixed term. Studies have shown that the employee's expectation of loyalty directly relates to job security.[133] The increased security associated with a fixed-term employment agreement, therefore, suggests that greater employee loyalty should be expected. Indeed, from an *ex ante* position, the employer would provide guarantees of employment—that is, guarantees to fire only for cause—only in exchange for limitations on employee freedom.[134] A reasonable employer presumably would not

---

companies in the 1980s have become more willing to throw employees overboard on short notice . . . [and] ever-bigger paychecks are making employees more willing to jump on their own when a better offer comes along."). One commentator quoted a young manager who stated:

> I want to feel that the company is loyal to me and I do, to some degree, but I also know intellectually that they will only remain loyal for as long as they need me. When it comes time for them to make a choice, if there is someone better, I'm out and they are in.

CHARLES HECKSCHER, WHITE COLLAR BLUES: MANAGEMENT LOYALTIES IN AN AGE OF CORPORATE RESTRUCTURING 35 (1995).

132. Some courts have recognized the need for a more stringent duty of loyalty when a traditional fiduciary (e.g., officer, director, or high-level employee) is involved. *See supra* notes 65-73 and accompanying text.

133. *See, e.g.*, Denise M. Rousseau, *New Hire Perceptions of Their Own and Their Employer's Obligations: A Study of Psychological Contracts*, 11 J. ORGANIZATIONAL BEHAV. 389, 395 (1990) (noting that study of graduating business students entering their first full-time job indicated a strong relationship between loyalty and job security); James Traub, *Loyalty: A Spasm of Layoffs and Downsizing in the 1980s Obliterated What Was Left of Corporate Loyalty*, BUS. MONTH, Oct. 1, 1990, at 85-87 (noting that employees realize that jobs and employment relationships are not as assured or stable as they used to be).

134. As one commentator has suggested, "[f]irms benefit from fewer obligations to employees because it frees them to respond more nimbly to market changes." Paul M. Krawzak, *Trends Suggest Days of Lifelong Job Over: More Temporary Jobs, Training Cuts and Downsizing Among Changes in the Workplace*, PEORIA J. STAR, March 24, 1997, at A1; *see generally* PETER CAPPELLI ET AL., CHANGE AT WORK (Oxford University Press 1997) (arguing

limit his or her freedom to lay off employees without protecting the company from exploitation by departing employees. Similarly, the employee would only accept a fixed-term agreement if he or she had no better prospective employment interests. Thus, in the fixed-term relationship, imposing a more stringent loyalty requirement comports with the agreement the parties would have arrived at if they had bargained over the terms.

Similar reasoning suggests that the at-will employee should be subject to a relaxed duty of loyalty in the making of preparations to compete. Implicit within the at-will agreement is the right of either party to terminate the relationship any time with or without cause. The employer has no obligation to provide job security, and the employee has no responsibility to stay with the employer should a better job arise.[135] The employment at-will relationship has been characterized by some courts and commentators as a day-to-day agreement with the employee providing labor in exchange for wages, and with neither party having a view toward a future commitment to the other.[136] This relationship leaves little room for a restraint on mobility. Without job security, the at-will employee must constantly seek other job opportunities, both to maximize wages earned and to protect from layoff. Preparation and contact with outside parties, therefore, is of extreme importance to the at-will employee, especially considering the importance of client contact to the establishment of business ventures.[137] From an *ex ante* position, an at-will employee

---

that there is no longer an unspoken understanding that companies provide job security, training, and career development in exchange for hard work and loyalty).

135. The at-will relationship exists whenever the employee fails to receive assurances of termination only for cause, either verbally or in the employment contract or employee manual. Courts have provided a limited number of exceptions to the at-will relationship. These include the implied contract exception where statements or conduct by the employer imply some form of job security, and the public policy exception (which has been narrowly construed by the courts). Under the public policy exception, the discharge must implicate a strong, usually statute-based, public interest. A few courts have implied a covenant of good faith and fair dealing. For an overview of the legal implications of employment at-will, see DOUGLAS L. LESLIE, CASES AND MATERIALS ON LABOR LAW: PROCESS AND POLICY, 50-105 (3d ed. 1992); Peter Stone Partee, Note, *Reversing the Presumption of Employment At Will*, 44 VAND. L. REV. 689 (1991).

136. As one commentator has explained, the traditional view of the indefinite labor relationship is that the employer makes a unilateral offer of wages in exchange for the employee's labor, but with either party being able to withdraw from the relationship at any time. Thus on this basis, each day is a new contract on these terms, with no view for the future established. *See* Howard C. Ellis, *Employment-At-Will and Contract Principles: The Paradigm of Pennsylvania*, 96 DICK. L. REV. 595, 613 (1992).

137. Many business and marketing studies have shown the importance of extensive background research before the new venture is formed. Background research generally entails contact and negotiations with key customers in the industry. *See generally* CLARK, *supra* note 5, at 37-44 (discussing several methods of market research to complete a market analysis); Cadotte & Woodruff, *supra* note 5, at 115-29 (describing the research process to evaluate a market

would only sacrifice the right to make preliminary arrangements if promised job security at a desired wage.[138] The employer should likewise expect less loyalty from the at-will employee given the employer's ability to terminato the relationship at any time.

Empirical evidence from the business world supports the view that at-will employees expect and need the right to prepare.[139] Changes in the economy and workplace have significantly altered the employment relationship. The prevalence of at-will status in almost all employment positions, one that employers make clearly known to employees to avoid wrongful discharge suits,[140] and the numerous layoffs and downsizing that occurred in the late 1980s and early 1990s have forever destroyed traditional notions of loyalty.[141] The days of employer paternalism and utmost employee loyalty are gone. The employer no longer provides job security and the employee no longer expects it. A new professional employee outlook has developed, one with a commitment to career rather than to an organization. One scholar has dubbed this the emergence of the "protean manager," the

---

opportunity); Cooper & Kleinschmidt, *supra* note 6, at 1-14 (discussing factors, particularly pre-development activities, in the success of new products); Lauglaug, *supra* note 5, at 15-23 (discussing a new approach to the "collection, analysis and translation of customer needs, wants, and expectations").

138. This view is based on Rousseau's argument that loyalty and security are reciprocal obligations in the minds of most employees. *See* Rousseau, *supra* note 133, at 389-400.

139. *See id.*

140. Most companies include prominently displayed at-will employment policy statements, and employers usually reiterate the at-will relationship and have employees sign acknowledgments of their status. As one attorney has pointed out, in employment handbooks and company policies towards employees "[t]he parties both know in advance that [the employee] can be dismissed at any time, and that [the employee's] obligations are essentially to perform a generally understood task but with no specific future goals." *See* 213 PERSONNEL MANAGEMENT 5013-18 (BNA Policy and Practice Series 1997) (quoting Stanley H. Lieborstein, WHO OWNS WHAT IS IN YOUR HEAD? (1979)).

141. Since 1987, over seven million Americans have lost their jobs. *See* Denise M. Rousseau, *Organizational Behavior in the New Organizational Era*, 48 ANN. REV. PSYCHOL. 515, 518 (1997) (discussing mobility due te job loss and varied employment relationships across industries and firms). Numerous articles and books have boen written on the decline in loyalty in the modern workplace. *See generally* HECKSCHER, *supra* note 131, at 6-9, 35 (suggesting that corporations are no longer "offering protection and security in exchange for undivided loyalty"); Jeff Anderson, *How Do Companies Foster Employee Loyalty?*, CAP. DISTRICT BUS. REV., June 17, 1996, at *1-2 ("The organizational landscape is changing as we speak, and the notion of cradle-te-grave employment is no longer true. Employers are now saying: 'You could be a great performer but if we don't need your skills any more, we can't afford to keep you around.'") (quoting Professor Richard Leifer); John Burgess, *supra* note 131, at H1 (describing the changed outlook of employees and companies toward loyalty and security); Linda K. Stroh & Anne H. Reilly, *Loyalty in the Age of Downsizing*, 38 SLOAN MGMT. REV., Summer 1997, at 83 (indicating that the loyalty in both employers and employees is declining—making money is number one for the employer, and employees show less loyalty after the numerous changes in company structure).

self-directed manager who is willing to change to fulfill personal goals.[142]

The changes in the employment relationship and the differing expectations of employees suggest that the law should relax the duty of loyalty for at-will employees in preliminary steps situations. This relaxed duty of loyalty should allow the at-will employee significant leeway to make preparations, including client and employee contact.[143] Courts have stated a reluctance to inhibit the mobility of at-will employees as opposed to traditional fiduciaries.[144] Courts should act on this inclination by considering the fundamental differences between at-will and fixed-term employees when determining whether an employee's activities were disloyal.

C. Distinguishing Between At-Will and Fixed-Term Employees Will Provide Consistent Results and Protect Policy Interests

Relaxing the duty of loyalty for at-will employees yields consistont results while protecting the policy interests behind the preliminary steps doctrine. Individual interests are protected because at-will employees are provided leeway to make extensive preparations, including negotiating with clients and employees about employment possibilities. The ability to make extensive preparations eliminates the at-will employee's vulnerability. The departing employee can fully ascertain the risks and possibilities of opportunities before incurring a significant financial investment. The ability to plan thoroughly will increase the likelihood that the employee will be willing to start a new venture based on an innovative idea, furthering society's interest in free competition. Finally, this approach gives employees the means to maintain the freedom of mobility. Employees can retain the right to pursue future opportunities by refusing to sign fixed-term agreements.

---

142. DOUGLAS T. HALL ET AL., CAREER DEVELOPMENT IN ORGANIZATIONS (1986), *quoted in* Stroh & Reilly, *supra* note 141, at 84.

143. This Note advocates a relaxed duty of loyalty from a right-te-prepare vantage point only. By no means does this Note advocate a relaxed duty of loyalty in regards te the stealing of trade secrets or confidential information. Again, from a hypothetical bargain approach, employers would demand loyalty in this regard whether the employment relationship is fixed-term or at-will.

144. *See, e.g.*, Vigero Indus. v. Cleveland Chem. Co., 866 F. Supp. 1150, 1160 (E.D. Ark. 1994); *In re* Golden Distrib., Ltd. v. Auburn Merchandising Distributorship, Inc., 134 B.R. 750, 756 (Bankr. S.D.N.Y. 1991).

Consideration of the employment relationship also allows courts to impose tighter restraints on key employees while providing more leeway for typical employees. Most employees are at-will, and those with fixed-torm agreements or any kind of job security are usually the highly talented directors and officers who are best able to bargain for this security.[145] These high-level officers and directors have access to the most confidential information and the greatest influence on key customers. Thus, their disloyalty poses the greatest threat to their employers. Imposing a more stringent duty of loyalty on these employees is a logical approach.

Employers could likewise protect themselves under this rule. First, the employer would be on notice that at-will employees would be subject to relaxed fiduciary obligations. The employer, therefore, could buy additional protection by bargaining for a fixed-term contract. The employer could also bargain for a covenant-not-te-compete to further protect itself from employees stealing clients. The increased use of these covenants suggests that this is a viable option, and employers should be required to pay for it rather than simply relying on the duty of loyalty to stifle competition.[146] The covenant or fixed-torm approach would be particularly useful in protecting the closely-held corporation, where virtually all employees are vital to the business and have significant client contact.[147] This approach would also allow courts to apply a more stringent duty of loyalty when preparation is made by a fixed-term employee.

The distinction between at-will and fixed-term employees, moreover, would eliminato the confusion in preliminary steps cases. It would allow the at-will employee extensive preparation, including contact with customers and fellow employees, while still prohibiting the taking of trade secrets or other confidential information. High-

145. The employer will retain the right to fire at will unless the employee has enough talent and skill to bargain for more security. Those able to do so will only be high-level employees. Interview with Donald Langevoort, Professor, Vanderbilt Law School, in Nashville, Tenn. (Feb. 1, 1998).

146. A covenant-not-to-compete provides only limited protection, however, given the increasing willingness of the courts to find them in violation of public policy. It is also limited in geographic scope and therefore would not satisfy all disloyalty concerns.

147. Most preliminary steps problems occur in the closely-held corporation setting. This makes sense for a number of reasons: in closely-held corporations virtually all employees are key employees with confidential information and client access; smaller enterprises are more vulnerable to the loss of key clients and therefore have greater incentive to bring suit if clients or employees are stelen; finally, clients are more willing to leave in the closely-held corporation setting, probably because in this setting clients tend to associate products with the employees who provide services rather than with the corporation as a whole. *See generally* Schaller, *supra* note 12 (summarizing disloyalty cases in Illinois).

ranking officers, meanwhile, would be subject to a corporato opportunity analysis which would effectively eliminate pre-termination contact or solicitation with clients or fellow employees. An intensive factual inquiry would still be necessary, but instoad of using a vague competition standard to determine whether the employee's behavior breached the duty of loyalty, courts would simply consider the employment relationship and either relax the restraint of loyalty or apply the more stringent corporate opportunity doctrine. This consistent and clear rule would deter litigation, because attorneys would be able to provide proper advice and employers would have a better notion of when a valid claim exists.

VI. CONCLUSION

The preliminary steps doctrine poses significant problems for attorneys advising clients and for judges deciding cases. While most jurisdictions have accepted the preliminary steps rule, courts have inconsistontly applied the standard to cases involving pre-termination negotiations with customers and employees. Some courts have adopted a narrow view of competitive behavior, allowing employees extensive pre-termination contact. These courts suggest that preparation becomes actual competition only when customers guarantee future contracts. Other courts have provided a much broader view, finding that almost any pre-termination negotiations with clients constitutos wrongful solicitation. At least one jurisdiction appears to have prohibitod any preparation. Courts also struggle to consistently define what contact with employees is allowed within the right to prepare. A few courts allow some leeway when dealing with at-will employees and when little harm to the company occurs. Other courts deny any right to such negotiations.

Jurisdictions that provide significant leeway for preparation iguore the vulnerability of the corporation. Courts that prohibit almost all client contact, on the other hand, overlook both the importance of pre-termination negotiations for employees planning a new venture and the vulnerability of the at-will employee.

An approach that varies the duty of loyalty based on the employment relationship can satisfy many of the current dilemmas in the preliminary steps doctrine. Both scholars and courts have characterized the duty of loyalty as an implied term based on the reasonable expectations of the parties to the agreement. Courts should follow this conception of the duty of loyalty and realize that expectations

differ significantly between fixed-term and at-will employees. By providing more leeway for at-will employees, but applying the duty of loyalty stringently to fixed-term employees, courts can balance the needs of free competition and fairness to the company while establishing a more consistent rule.

Scott W. Fielding[*]

* Special thanks to Jeffery Mayfield, whose numerous dinner conversations on this topic will not be forgotten, and to Professor Donald Langevoort, Lawrence Fielding, and Jeff Sauer for their keen insight. Finally, I am grateful to Greg Kondritz, James Zimmerman, and Ann Bjerke for their significant and insightful contributions.