STATE OF NORTH CAROLINA
COUNTY OF MECKLENBURG

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
03 CVS 17744

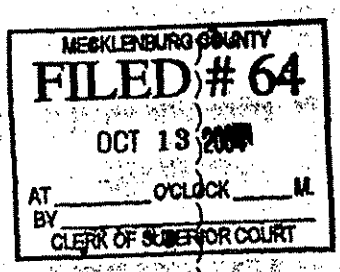
KOHLER COMPANY, INC.,

Plaintiff,

v.

THOMAS H. McIVOR,

Defendant.



ORDER

The Court heard this matter on August 16, 2004 on Defendant's Motion for Sanctions pursuant to N. C. R. Civ. P. 11(a) and to recover Attorney Fees pursuant to N.C.G.S. § 6-21.5. After considering the Court file, the written briefs and materials submitted by the parties, and the arguments of counsel, the Court **DENIES** the Motion. In support of its ruling, the Court enters the following

FINDINGS OF FACT

1. On October 14, 2003, Plaintiff Kohler Company, Inc. ("Kohler") filed a Verified Complaint alleging (among other things) that Defendant Thomas H. McIvor ("McIvor") had breached the terms of an employment agreement (the "Agreement") by resigning his employment and thereafter accepting a job in the same line of business with one of Kohler's largest competitors.

2. Plaintiff further alleged that McIvor violated the Agreement by improperly retaining certain confidential information and thereafter using that information both for Defendant's benefit and that of his new employer.

3. In a separate memorandum filed in support of its request for a temporary restraining order (the "Memorandum"), Plaintiff alleged that it had searched Defendant's company-issued laptop and determined that Defendant had improperly forwarded confidential and proprietary information from his laptop to his personal home computer.[1]

4. The Memorandum also alleged that North Carolina law applied as to the claims alleged in the Verified Complaint and Plaintiff's request for temporary injunctive relief.

[1] Plaintiff, however, attached the offending information to the Memorandum, without any effort to seal the documents or otherwise maintain their confidentiality.

5. Kohler is a global company with a diverse portfolio of businesses. Among other things, Kohler is the largest manufacturer and supplier of plumbing supplies in North America, with annual sales of over $3 billion and offices in every continent except Antarctica.

6. Sometime in October or November of 2000, McIvor offered McIvor employment in North Carolina as a Sales Executive with Kohler's Plumbing Division. In that capacity, Defendant was responsible for selling plumbing products for use in residential home construction.

7. Kohler's employment offer required McIvor to execute the Agreement, which contains the following relevant provisions:

> I understand that during the course of my employment, the Company will necessarily reveal to me confidential information which would cause damage to Kohler if known to competitors. Such information includes but is not limited to . . . marketing and advertising strategies, . . . product data, including names of customers, price strategies, costs, and quantities sold . . . [.]
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> 1. I will not disclose confidential information during my employment or thereafter, or use such confidential information for personal gain or in employment elsewhere, unless and until such confidential information shall become public knowledge without any contribution by me in causing such confidential information to become public knowledge. . . [.] I agree that upon the termination of my employment with Kohler, I will promptly return all information (whether or not considered confidential), materials, documents, computer programs and other property provided to me by the company in connection with my employment, and that I will not retain any copies thereof.
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> * * *
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> 4. For a period of one (1) year from the date of the termination of my employment (whether voluntary or involuntary), I agree not to render services directly or indirectly for my own account or to any person, partnership, or corporation in North America in a line of business which is competitive with the line(s) of Kohler's business in which I worked. It is understood, however, that I may accept employment with a diversified company, so long as my new employment pertains solely to that part of its business which is not in competition with any business of Kohler.

8. The Agreement further provided that, should Defendant be involuntarily terminated and thereafter be unable to secure employment except from a Kohler competitor, Plaintiff would have the right to either waive the non-competition clause or pay (for a stipulated time) Defendant's salary as of the date of his termination.

9. Finally, the Agreement contained signature lines for the Defendant and a Kohler Vice-President.

10. McIvor was living in Virginia when he received Plaintiff's offer of employment. Although he listed the North Carolina address of his girlfriend in the Agreement[2], Defendant signed the document in Virginia on November 5, 2000.

11. Sometime thereafter, Defendant returned the Agreement to Kohler's corporate offices in Wisconsin. A Kohler Vice-President signed the Agreement on January 31, 2002, nearly 14 months after McIvor signed it.

12. McIvor began work for Kohler sometime in November 2000, operating out of his girlfriend's home in Concord, North Carolina. McIvor's initial sales territory included Charlotte and its surrounding suburbs, Western North Carolina, Augusta, Georgia, and South Carolina.

13. Following an internal realignment in January 2003, McIvor was re-assigned as a Sales Executive in Kohler's Construction Division.

14. In this new role, McIvor was the primary contact for local plumbing contractors in Charlotte and its surrounding suburbs, as well as South Carolina. Additionally, McIvor was the sales contact for certain local divisions of national builders doing business in this same geographic region.

15. McIvor was also given access to proprietary information, including Kohler's customer lists and contact information, prospective leads in the construction industry, outstanding quotes, pricing information, new marketing strategies, new product distribution strategies, client-specific rebate tables and price points for new product rollouts.

16. McIvor resigned his employment with Kohler on September 18, 2003. At that time, he advised Kohler representatives that he would be moving to California to take a position in the same line of business with TOTO USA ("TOTO"), one of Kohler's largest plumbing products competitors in North America.

17. When reminded of the terms of the Agreement, McIvor responded that the Agreement was (in his view) unenforceable and that he would "welcome any lawsuit attempting to stop him from competing." McIvor also declined to certify that he had returned all proprietary information.

18. On October 14, 2003, the Court entered a temporary restraining order ("TRO") against the Defendant and set Plaintiff's Motion for Preliminary Injunction for hearing on October 21, 2003. The Court also granted Plaintiff's Motion for Expedited Discovery.

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[2] Defendant did so at the behest of Plaintiff so as to not confuse its Human Resources Department, who understood that Plaintiff would be working for Kohler in North Carolina.

19. Three days after Kohler obtained the TRO, a former Kohler Vice-President reported seeing Defendant manning a booth for TOTO at a trade show for builders at the Anaheim Convention Center in Anaheim, California. During a conversation with this former officer, McIvor boasted of his intent to compete on behalf of TOTO for Kohler's preexisting builder accounts.

20. On October 21, 2003, the Court granted Plaintiff's Motion for Preliminary Injunction. Defendant received notice of the October 21 hearing, but he did not appear.

21. On October 28, 2003, Defendant moved to set the aside the preliminary injunction pursuant to N. C. R. Civ. P. 60. In support of his motion, Defendant filed an affidavit wherein he denied being privy to, or having possession of, any confidential information related to his employment with Kohler—in effect making the type of certification that he declined to make a month earlier.

22. On November 14, 2003, the Court denied Defendant's motion to set aside the preliminary injunction.

23. On November 19, 2003, Defendant gave Notice of Appeal to the Court of Appeals, seeking relief from the preliminary injunction.

24. Although this Court denied Defendant's motion for a stay, the Court of Appeals granted relief pending that court's consideration of Defendant's appeal.

25. On December 17, 2003, Defendant filed his Answer to the Verified Complaint, along with various counterclaims, including a claim for attorneys' fees pursuant to N.C.G.S. § 6-21.5.

26. On December 22, 2003, McIvor resigned his employment with TOTO.

27. On March 22, 2004, Plaintiff dismissed its claims against McIvor with prejudice. Defendant's counterclaims are scheduled for trial during the week of December 13, 2004.

28. On July 6, 2004, Defendant filed the motion now before the Court.

Based on the above findings of fact, the Court enters the following

CONCLUSIONS OF LAW

1. N. C. R. Civ. P. 11(a) provides, in relevant part:

> The signature of an attorney or party constitutes a certificate by him that he has read the pleading, motion, or other paper; that to the best of his knowledge, information, and belief formed after reasonable

> inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose . . . .

Thus, Rule 11 imposes on an attorney or party a duty of reasonable inquiry, both as to the facts and the law set out in the paper, and a separate obligation not to file papers for an improper purpose. A breach of the certification as to any one of these three prongs is a violation of the Rule. *Bryson v. Sullivan*, 330 N.C. 644, 655, 412 S.E.2d 327, 332 (1992).

2. Because Rule 11, however, should "not have the effect of chilling creative advocacy, courts should [avoid hindsight] and resolve all doubts in favor of the signer." *Cross & Cross Properties, Ltd. v. Everett Allied Co.*, 886 F.2d 497, 504 (2d Cir. 1989).

3. In assessing whether an attorney has made a "reasonable inquiry" into the facts and applicable law, the Court examines an attorney's conduct according to a standard of objective reasonableness. Thus, the applicable test is "whether a reasonable attorney in like circumstances would believe his actions to be factually and legally justified." *Cabell v. Petty*, 810 F.2d 463, 466 (4th Cir. 1987). *See also Turner v. Duke University*, 325 N.C. 152, 164, 381 S.E.2d 706, 713 (1989)("The standard is one of reasonableness under the circumstances.").

4. For purposes of Rule 11, "[a] legal contention is unjustified when a reasonable attorney would recognize [it] as frivolous." *Forrest Creek Assocs. Ltd. v. McLean Sav. & Loan Ass'n*, 831 F.2d 1238, 1245 (4th Cir. 1987). Put differently, a legal position violates Rule 11 if it "has '**absolutely no chance of success** under the existing precedent.'" *Brubaker v. City of Richmond*, 943 F.2d 1363, 1373 (4th Cir. 1991) (*quoting Cleveland Demolition Co. v. Azcon Scrap Corp.*, 827 F.2d 984, 988 (4th Cir. 1987))(emphasis added).

5. "A Rule 11 violation occurs, if at all, when one signs and files a 'pleading, motion or other paper' in violation of the rule." *Brooks v. Giesey*, 334 N.C. 303, 314, 432 S.E.2d 339, 345 (1993). Accordingly, although Defendant criticizes Plaintiff's attorneys for certain alleged oral misrepresentations made during the TRO and preliminary injunction hearings and for Plaintiff's alleged failure to obtain a certificate of authority to transact business in North Carolina[3], the Court will instead focus on the papers of

[3] While perhaps not counsel's finest hour, the Court concludes that the alleged oral misrepresentations did not impact the Court's decision to grant injunctive relief. And contrary to Defendant's view, Rule 11 does not authorize sanctions simply because a corporation brings an action before obtaining a certificate to do business in North Carolina, or paying any past due fees and taxes associated with such failure. N.C.G.S. § 55-15-02 makes clear that any deficiencies in this area must be raised by motion and determined by the trial judge prior to trial. Absent such a motion, the issue is waived. In any event, Kohler made no false representations in its **papers** regarding its authority to transact business.

record in the Court file, specifically the Plaintiff's Verified Complaint, Affidavits, and Memorandum.[4]

6. Plaintiff's Verified Complaint and supporting Affidavits satisfy the certification requirements of Rule 11. On their face, these papers set out facts alleging that Plaintiff (a) accepted employment with one of Plaintiff's direct competitors in violation of the non-compete provision of the Agreement; and (b) improperly retained a variety of confidential information that should have been returned to Kohler, in violation of the Agreement and North Carolina statutory law.

7. Defendant does not seriously contest the basic facts with respect to the non-compete portion of the Agreement. In fact, Defendant's statement to Plaintiff's representatives virtually inviting a lawsuit on this issue reflects a clear understanding of the possible consequences of his actions.

8. Instead, Defendant's argument focuses on counsel's alleged misrepresentation to the Court regarding the applicability of North Carolina law to the facts. In other words, Defendant asserts that Plaintiff's counsel failed to undertake a reasonable inquiry into the law. The Court disagrees.

9. North Carolina law on this issue is simple enough: "In deciding which law should govern interpretation of a contract, North Carolina follows the principle of *lex loci contractus*, which provides that the law of the state where the last act occurred to form a binding contract should apply." *NAS Surety Group v. Precision Wood Products*, 271 F. Supp. 776, 780 (M.D.N.C. 2003).[5] *Accord Walden v. Vaughn*, 157 N.C. App. 507, 510, 579 S.E.2d 475, 477 (2003). Applying it to the muddled facts of this case, however, would test the most seasoned of choice of law practitioners, given that three jurisdictions (Virginia, North Carolina, and Wisconsin) arguably fit the bill.

10. Defendant signed the Agreement in Virginia, thus lending support for the application of Virginia law. Defendant, however, listed a North Carolina address in the Agreement, leading Kohler and its attorneys to believe that he signed it in North Carolina, and thus, this state's law should apply. Finally, Defendant delivered the signed Agreement to Plaintiff's corporate headquarters in Wisconsin, where it apparently sat for over a year before Plaintiff's representative signed it on January 31, 2002. As a result, Defendant contends that Wisconsin law applies, which, Defendant asserts, would not approve the employment restrictions imposed by the Agreement.

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[4] Although Defendant attaches several of Plaintiff's discovery responses to his motion, these "responses are not properly the subject of sanctions under Rule 11." *Brooks v. Giesey*, 334 N.C. 303, 318-19, 432 S.E.2d 339, 347-48 (1993)(holding that Rule 26(g) is the proper avenue for sanctioning improper conduct related to discovery responses).

[5] Plaintiff also asserts that North Carolina law applies because it is the state with the most significant relationship to the transaction and the parties. The Court disagrees, as this unique exception to the *lex loci contractus* rule is limited to the interpretation of insurance contracts under the North Carolina insurance statutes. *See e.g., Collins & Aikman Corp. v. Hartford Accident & Indemnity Co.*, 335 N.C. 91, 436 S.E.2d 243 (1993).

11. While the Court is tempted to tackle this bar exam puzzler, the critical question, for purposes of Rule 11, is whether Plaintiff and its counsel made a "reasonable inquiry" before settling on their choice of North Carolina law. The Court concludes that they did. In particular, on the date Plaintiff filed its Verified Complaint, Kohler and its counsel had adequate grounds for believing, based on the documents available to them, that McIvor had accepted Plaintiff's offer of employment in North Carolina on November 6, 2000, and that this acceptance was the last act necessary to make the Agreement binding.[6]

12. Defendant complains that he included the North Carolina address of his girlfriend (now wife) at Plaintiff's behest so as not to confuse Plaintiff's Human Resources Department, presumably because Defendant was being hired to work in North Carolina. Nevertheless, there is no evidence that Plaintiff knowingly kept this information from its attorneys, or that it even maintained records from which it could cull this obscure fact almost three years later.

13. In short, neither a reasonable client nor its attorneys would be expected to discern the choice of law machinations resulting from the bizarre execution of an employment agreement by a mid-level sales executive and a multinational conglomerate, which occurred nearly three years before the filing of the Verified Complaint. As a result, Kohler's decision to advocate for the application of North Carolina law was reasonable.

14. Defendant also argues that Plaintiff's interpretation of North Carolina law (as set forth in Plaintiff's Memorandum) is patently unreasonable and therefore warrants Rule 11 sanctions. As to the legal sufficiency of a paper under Rule 11, the relevant inquiry is not the relative merits of the parties' positions, but instead (1) whether the paper is facially plausible, and, if not (2) whether the alleged offender undertook a reasonable inquiry into the law and thereafter formed a reasonable belief that the paper was warranted by existing law, judged as of the time the paper was signed. *Mack v. Moore*, 107 N.C. App. 87, 91, 418 S.E.2d 685, 688 (1992).

15. Plaintiff's legal argument was facially plausible. Specifically, while Defendant's arguments to the contrary are compelling, North Carolina law lends some support for the enforcement of a one-year non-compete provision throughout North America, where (a) the former employer is itself engaged in business throughout the world; (b) the former employee takes a position in the same line of business with a company that is one of the former employer's principal competitors; and (c) the former employee makes clear his intent to solicit business from the former employer's customers. *See e.g.*

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[6] This is not, however, the only reasonable conclusion that can be drawn from these facts. As the drafter of the Agreement, any ambiguity in its interpretation must be resolved against Kohler. *See Silvers v. Horace Mann Ins. Co.*, 324 N.C. 289, 295, 378 S.E.2d 21, 25 (1989). Since the Agreement specifically requires written acceptance by Kohler's representative, a Court could conclude that the last act necessary to bind the parties did not occur until January 31, 2002, when Kohler's representative signed the Agreement in Wisconsin. *See e.g., Equifax Services Inc. v. Hitz*, 1992 U.S. App. LEXIS 16557, slip op. at 12 (10th Cir, 1992)(last act necessary for formation of employment contract was signature of employer's president at its home office, following signature by employee). That there exists another reasonable view of the law, however, does not mean that Plaintiff's analysis was unreasonable and therefore sanctionable.

Harwell Enterprises, Inc. v. Heim, 276 N.C. 475, 173 S.E.2d 316 (1970)(enforcing a two-year restrictive covenant prohibiting employee from competing anywhere in the United States, where former employer specifically alleged that its business activities extended throughout the United States and former employee was engaged in active solicitation of former employer's customers); *Market America, Inc. v. Christman-Orth*, 135 N.C. App. 143, 520 S.E.2d 570 (1999)(approving six-month non-competition agreement containing no link to actual customer base and no territorial restriction, where court assumed covenant was intended to reach the entire U.S.)

16. Defendant spends much time disputing Plaintiff's recitation of Defendant's duties and geographic areas of responsibilities while a Kohler and TOTO employee. Since Plaintiff's claims were not resolved on the merits, however, the Court is left with dueling affidavits and deposition testimony on these and many other factual issues. Rule 11, however, is not an end-around the crucible of a trial to conclusively determine the facts, nor does it authorize the award of sanctions where the evidence is in conflict.

17. In any event, the precise scope of Defendant's job responsibilities, while clearly relevant on the issue of enforceability of the Agreement[7], is not dispositive. The broader issue is whether the restraint "affords only a fair protection to the employer's interest, and is not so broad as to impose undue hardship on the employee, due regard being given the interests of the public." *See Harwell Enterprises, Inc.*, 276 N.C. at 478, 173 S.E.2d at 318.

18. On this question of law, reasonable judges have differed depending on the facts. *Cf. Triangle Leasing Co. v. McMahon*, 327 N.C. 224, 393 S.E.2d 854 (1990)(affirming two-year non-solicitation agreement applicable in North Carolina or any other state or territory where Plaintiff conducts business); *A.E.P. Industries, Inc., v. McClure*, 308 N.C. 393, 302 S.E.2d 754 (1983)(applying New Jersey law, which the Court determined was similar to North Carolina law, and approving 18-month non-competition agreement applicable throughout U.S.); *Harwell Enterprises, Inc., supra; Dunbar Ins. Agency, Inc. v. Barber*, 147 N.C. App. 463, 556 S.E.2d 331 (2001)(approving two-year agreement prohibiting employee from soliciting any customers, irrespective of prior contact); *Farr Assocs., Inc. v. Baskin*, 138 N.C. App. 276, 530 S.E.2d 878 (2000)(rejecting five-year agreement where prohibition extended to all clients in most of the U.S. and four countries, regardless of client location or employee's prior contact with them); *Market America, Inc., supra; Hartman*, 117 N.C. App. at 313-17, 450 S.E.2d at 917-20 (rejecting five-year non-competition agreement that extended beyond Defendant's business operations and was not tied to Defendant's customers); *Electrical South, Inc. v. Lewis*, 96 N.C. App. 160, 385 S.E.2d 352 (1989), *rev. denied*, 326 N.C. 595, 393 S.E.2d 876 (1990)(rejecting two-year world wide non-competition restriction because it

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[7] *See e.g., Hartman v. W.H. Odell and Associates, Inc.*, 117 N.C. App. 307, 312, 450 S.E.2d 912, 917 (1994)(setting out six factor test relevant to determining whether geographic scope of covenant not to compete is reasonable: (1) area or scope of the restriction; (2) area assigned to employee; (3) area where employee actually worked or was subject to work; (4) area in which employer operated; (5) nature of the business involved; (6) nature of employee's duty and his knowledge of employer's business operation). What the cases demonstrate, however, is that the geographic scope of the agreement must be considered in tandem with its length. *Id.*, at 311-12, 450 S.E.2d at 916.

failed to focus on legitimate goal of preventing employee's competition for employer's customers in a relevant territory; and *Manpower of Guilford County, Inc., v. Hedgecock*, 42 N.C. App. 515, 257 S.E.2d 109 (1979)(rejecting one-year non-competition agreement; length of restriction was reasonable but restrictions included geographic areas where plaintiff's business did not extend).

19. Given its breadth and scope, the Court finds that the Agreement toes the line of facial plausibility under North Carolina law. Nevertheless, three prior judges of this Court preliminarily determined that the Agreement was enforceable. North Carolina cases provide facially plausible support for this view, just as other cases compellingly support the contrary conclusion. Such a reasonable difference of opinion, however, necessarily defeats Defendant's claim for Rule 11 sanctions. Simply put, Defendant has not shown that Plaintiff's legal argument had "absolutely no chance of success under the existing precedent." *Brubaker*, 943 F.2d at 1373.

20. Plaintiff also did not violate Rule 11 by pursuing its statutory trade secrets and unfair and deceptive trade practices claims.

21. Admittedly, Plaintiff's curious decision to disclose to public view the very information its insists was proprietary, and its later concession that it had discovered no other evidence in support of its claims makes this a somewhat closer question. Nevertheless, the Court is satisfied that Plaintiff's initial factual investigation, which uncovered Defendant's transfer of a discrete subset of pricing, rebate, and other product related information to his home computer, coupled with Defendant's refusal to certify that he had not retained any proprietary information following his resignation, and his boast that he intended to ignore the terms of the Agreement, raised a reasonable concern that Defendant had misappropriated other such information and intended to use it to Plaintiff's detriment. Thus, Plaintiff had sufficient cause to pursue its claims.

22. Nor did Plaintiff violate the "improper purpose" prong of Rule 11. While Plaintiff is perhaps guilty of using the legal equivalent of a sledgehammer to swat a fly, Plaintiff instituted this suit for a proper purpose—to vindicate its rights under the Agreement. The Court also concludes that Plaintiff acted in good faith by dismissing its claims within a reasonable period after Defendant resigned his employment with TOTO (in effect providing Plaintiff the primary relief sought in this litigation).

23. As for Defendant's claim that he incurred significant expense in responding to the Verified Complaint, the Court finds this wound to be partially self-inflicted—the logical consequence of Defendant's decision to bait a Plaintiff with substantial resources by boldly pronouncing his intent to ignore the Agreement and compete for Plaintiff's customers. The wisdom of Sun Tzu in *The Art of War* seems particularly apt here: "He who wishes to fight must first count the cost."

24. Accordingly, the Court **DENIES** Defendant's Motion for Rule 11 sanctions.

25. Finally, the Court finds no basis at this stage for awarding attorney fees under N.C.G.S. § 6-21.5. Nevertheless, because the pending trial may be relevant to a final determination of this issue, the Court **DENIES** the Motion without prejudice to Defendant's right to renew it following the trial of his counterclaims.

This the 13th day of October, 2004.

Albert Diaz
Special Superior Court Judge