Consider . . . 16.4

Benjamin Chavez served as executive director of the National Association for the Advancement of Colored People (NAACP). Mary Stansee, a former employee of the NAACP executive offices, charged Mr. Chavez with sexual harassment, and he settled the claim for $332,400. The NAACP was financially troubled at the time of the settlement, with a deficit of $2.7 million, and Mr. Chavez did not disclose the settlement to the board until after it was completed.

Did Mr. Chavez have implied authority to make the settlement? Did he have apparent authority?

16-3 The Principal–Agent Relationship

To this point, the focus of the discussion has been on the relationship between the agent and the principal on the one hand and third parties on the other. However, it is important to realize that a contractual relationship exists between the agent and the principal, so that each has certain obligations and rights. This section of the chapter covers that relationship.

16-3a The Agent's Rights and Responsibilities

Principals and agents have a fiduciary relationship, which is characterized by loyalty, trust, care, and obedience. An agent in the role of fiduciary must act in the principal's best interests.

Duty of Loyalty: General

An agent is required to act only for the benefit of the principal, and an agent cannot represent both parties in a transaction unless each knows about and consents to the agent's representation of the other. Further, an agent cannot use the information gained or the offers available to or by the principal to profit personally. For example, an agent hired to find a buyer for a new invention cannot interfere with the principal's possible sale by demonstrating his own product. Neither can an agent hired to find a piece of property buy the property and then sell it (secretly of course) to the principal. *Lucini Italia Co. v Grappolini* (Case 16.2) involves an issue of an agent's fiduciary duty in a sale transaction.

CASE 16.2

Lucini Italia Co. v Grappolini
2003 WL 1989605 (N.D. Ill. 2003)[3]

A Slick Deal by the Olive Oil Agent

© iStockPhoto.com/Ancika

FACTS

Lucini Italia imports and sells premium extra-virgin olive oil of Italy. Lucini was formed by Arthur Frigo, a Chicago entrepreneur and adjunct professor of management and strategy at Northwestern University's Kellogg Graduate School of Management. Giuseppe Grappolini, from Loro Ciuffenna, Italy, served as a consultant to Lucini. Under the terms of his consulting contract, Mr. Grappolini was to develop Lucini Premium Select extra-virgin olive oil as well as other flavored olive oil products. Mr. Frigo had discovered a market niche in the United States for high-end olive oil ($10 to $12 per bottle).

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Mr. Grappolini is also the sole owner of the Grappolini Company, an Italian limited liability company. The Grappolini Company distributes small volumes of extra-virgin olive oil in Chicago and other markets throughout the United States, but it has much larger sales volume in Europe. Between December 1997 (the date of the Grappolini consulting contract with Lucini) and June 2000, the Grappolini Company was Lucini's supplier of extra-virgin olive oil. The two companies had signed a supply agreement for this arrangement also in December 1997.

Mr. Frigo instructed Mr. Grappolini to try to negotiate an exclusive supply contract for Lucini with Vegetal, an Italian company with a unique olive oil that Mr. Frigo needed to develop another premium brand of olive oil that would have flavors such as lemon and garlic added (called the LEO project). Vegetal was the only company that could supply the type of olive oil Mr. Frigo needed for the blending process with the extra flavors. Mr. Grappolini led Mr. Frigo along with promises of a deal with the Vegetal company for nearly a year, through reports of meetings as well as with faxes and memos appearing to detail terms, conditions, and dates for delivery. At the same time, Mr. Grappolini was meeting with Mr. Frigo almost daily as they discussed the plans for the new Lucini olive oil. In the meetings, Mr. Frigo discussed the formulas, the marketing, consumer profiles, and marketing strategies for the LEO project. Apparently, Mr. Grappolini was impressed by the plans and entered into his own exclusive supply contract with Vegetal. Mr. Grappolini did not tell Mr. Frigo of the contract and continued to work as a consultant. Mr. Grappolini also assured Mr. Frigo that Lucini had a supply contract with Vegetal.

Mr. Frigo proceeded with all the contracts, ads, and plans for the LEO product launch based on assurances from Mr. Grappolini that it had the supply contract with Vegetal. However, when pressed, Mr. Grappolini could not deliver the paperwork. When Mr. Frigo requested a meeting with the CEO of Vegetal, Mr. Grappolini arranged for the meeting but cautioned Mr. Frigo not to mention the supply arrangement because such a discussion in a first-time meeting would be considered rude in the Italian culture.

With the LEO product launch approaching, and no copy of the alleged Vegetal supply contract available, Mr. Frigo had Lucini's lawyer in Italy contact Vegetal directly for a copy. The lawyer learned that Vegetal had a supply contract but that the contract was with Mr. Grappolini's company and that it was not transferable to Lucini. Mr. Frigo then confronted the officers of Vegetal, and they acknowledged that they had negotiated with Mr. Grappolini for his company, not for Lucini, and were not aware of Lucini's needs or Mr. Grappolini's representation of Lucini. The officers at Vegetal said that Grappolini had been a "bad boy" in negotiating the contract for himself. Vegetal agreed to supply Lucini with olive oil in the future but could not deliver it in time for the launch of Lucini's new line. The soonest it could deliver would be after the next harvest, a time that meant the marketing and sales plans of Lucini for its new product had been wasted.

Mr. Frigo and Lucini filed suit against Mr. Grappolini and his company (defendants) for breach of fiduciary duty.

JUDICIAL OPINION

DENLOW, Magistrate

As agents, Defendants owed Lucini general duties of good faith, loyalty, and trust. In addition, Defendants owed Lucini "full disclosure of all relevant facts relating to the transaction or affecting the subject matter of the agency."

Defendants were Lucini's agents and owed Lucini a fiduciary duty to advance Lucini's interests, not their own. When Defendants obtained an exclusive supply agreement with Vegetal for the Grappolini Company instead of for Lucini, they were disloyal and breached their fiduciary duties. Lucini suffered substantial damages as a result of this breach.

Punitive damages are appropriate where the defendant has intentionally breached a fiduciary duty. Defendants' breach of their fiduciary duties was flagrant and intentional. Defendants deliberately usurped a corporate opportunity sought by Lucini, which Lucini had entrusted Defendants to secure on Lucini's behalf. Although Defendants explicitly accepted this trust and ensured [sic] Lucini that Mr. Grappolini and his company would do as Lucini requested, Defendants failed to do so and hid this fact from Lucini.

Defendants misappropriated Lucini's valuable trade secrets. Defendants acquired Lucini's trade secrets under circumstances giving rise to a duty to maintain their secrecy. Defendants' assistant Marco Milandri testified that he understood that Lucini's Premium Select and LEO product formulations were company secrets. Likewise, Grappolini testified that he understood the secrecy of trade secret information communicated to him. Indeed, his various contracts specified that he would maintain the confidentiality of Lucini's research conclusions. After Defendants had secretly secured their own exclusive supply contract with Vegetal, they hid this fact from Lucini in order to induce Lucini to continue sharing its trade secret research, strategies, and plans with Grappolini.

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Lucini's decision to focus its LEO project around essential oils from Vegetal Progress was a closely guarded trade secret. When Mr. Grappolini used this information on behalf of the Grappolini Company to allow it unfettered access to negotiate its own exclusive arrangement with Vegetal, it is necessary to conclude that the Grappolini Company "acquired" the information with full knowledge that: (i) Lucini had not consented to the use of the information by a competitor, and (ii) Mr. Grappolini had no right to transmit or use the information for his own purposes or on behalf of the Grappolini Company.

As a proximate result of Defendants' breach of their fiduciary duties, Lucini suffered lost profits damages of at least $4.17 million from selling its grocery line of LEO products from 2000 through 2003. The Court will award Lucini its lost profits of $4,170,000, together with its $800,000 of development costs for LEO project. Defendants engaged in willful and malicious misappropriation as evidenced by their use of the information for directly competitive purposes and their efforts to hide the misappropriation and, accordingly, the Court will award $1,000,000 in exemplary damages. Such an award is necessary to discourage Defendants from engaging in such conduct in the future.

CASE QUESTIONS

1. Explain how Mr. Grappolini breached his fiduciary duty.
2. What lessons can you learn about contracts, suppliers, and product launches from the case?
3. Evaluate the ethics of Mr. Grappolini's conduct. Why did Vegetal's officers refer to Mr. Grappolini as a "bad boy"?

Duty of Loyalty: Postemployment and Noncompete Agreements

Many companies have their employees sign contracts that include covenants not to compete or covenants not to disclose information about their former employers should the employees leave their jobs or be terminated from their employment.

Downsizings in the high-tech industry have brought back the issue of noncompete and confidentiality agreements. When employees are recruited by upstart firms and lured with stock options, it is often difficult for them to imagine a time when the company would need to downsize or would no longer exist. As a result, most of them signed fairly restrictive covenants not to compete.

In dealing with these covenants, courts are striking a balance between the employees' right to work and an employer's right to protect the trade secrets, training, and so forth that the former employee has and then transfers to another company or to himself or herself for purposes of starting a business.

Requirements for Noncompete Agreements

1. **The Need for Protection**

   The laws on noncompete agreements vary from state to state, with California and a handful of states being the most protective of employees. However, across all states, courts are clear in their positions that there must first be an underlying need or reason for the noncompete agreement—that is, the employee must have had access to trade secrets or be starting his or her own business in competition with the principal/employer.

2. **Reasonableness in Scope**

   The covenant must also be reasonable in geographic scope and time. These factors depend on the economic base and the nature of the business. For example, a noncompete in a high-tech employee's contract could be geographically global but must be shorter in duration because technology changes so rapidly. A noncompete for a collection agency could not be global but might be longer in duration because the nature of that business is one of relationships.

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