The Employee's Duty of Loyalty in New Jersey

"No man can serve two masters for either he will hate the one, and love the other; or else he will hold to the one, and despise the other." Gospel of Matthew 6:24. Under English Common Law, every servant owes a duty of loyalty to his or her master. The Restatement (Third) of Agency states, at §8.01 that,

> An agent has a fiduciary duty to act loyally for the principal's benefit in all matters connected with the agency relationship. Unless otherwise agreed, an agent is subject to a duty to his principal not to act on behalf of an adverse party in a transaction connected to his agency without the principal's knowledge. Further, an agent is subject to a duty not to act or to agree to act during the period of his agency for persons whose interests conflict with those of the principal in matters in which the agent is employed.

If your Agent has breached the duty of loyalty, can you seek the return of one hundred percent (100%) of his earnings?

Simulations Systems says yes.

In Simulation Systems Technologies, Inc. v. Oldham, the New Jersey Appellate Division held that a disobedient employee, "would not be entitled to *any salary compensation* for any month during which he engaged in acts breaching his duty of loyalty nor would he be entitled to *any bonus payments* for any quarter during which he engaged in acts breaching his duty of loyalty." Simulation Systems, 269 N.J. Super 107 at 113 (1993) (emphasis added).

Simulation Systems (Systems) was a computer programming and Information Technology Systems Analysis Company. Systems hired Oldham as a computer engineer. In what will become a familiar pattern, Oldham formed a new company, East Coast, to compete with Systems. Prior to leaving Systems, he advertised in the Yellow Pages and secured customers, some of whom had been customers of Systems. Not until a customer of East Coast mistakenly contacted Systems did Mr. Oldham's scheme come to light. Systems sought all of Mr. Oldham's wages and all of his profits. The Court awarded all of his profits. In allowing Oldham to keep his wages, the Court relied on Oldham's lowly position and his lack of critical duties. The Court stated that it was content to wait until presented with a case of pervasive and reprehensible conduct before deciding that forfeiture of wages would be the correct penalty.

In Cameco, Inc. v. Gedicke, the New Jersey Supreme Court stated that,

> If the employee directly competes with the employer, aids the employer's direct competitors or those with interests adverse to the employer's interests, participates in a plan to destroy the employer's business, or secretly deprives the employer of an economic opportunity, the employee may forfeit the right to Compensation. Cameco, 157 N.J. 504 (1999), citing Orkin v. Rathje, 72 F.3d 206 (1st Cir 1995).

Cameco involved the traffic manager for a food distribution business, one Mr. Gedicke. Gedicke's salaried position required him to arrange for the transportation of Cameco's food products from rented warehouses to retail stores by the use of common carrier trucking companies. Gedicke coordinated shipping from the third party warehouses, negotiated trucking rates and supervised the loading of the trucks. Because of his position, Gedicke learned the identities and locations of Cameco's

suppliers, customers and competitors. Gedicke also knew the delivery routes and the trucking rates.

By now, you have guessed what Gedicke did. He and a friend formed Newton Transportation Service. On behalf of Cameco, Gedicke hired Newton to arrange for transportation. Because Newton would hire an entire truck, space was available for other goods. Newton took advantage of Gedicke's knowledge to ship competitor's goods to the same stores which were on Newton's route. All of this profited Gedicke, but Gedicke claimed that Cameco also benefited (I did it for you, Ma!). It should be noted that Gedicke was not an officer or director of Cameco and he did not sign a covenant not to compete. However, he ran Newton in secret during business hours. The Supreme Court, after holding for Cameco, remanded the case to better develop the facts.

In Chernow v. Reyes, the Appellate Division stated that, “soliciting and performance of competitive work during his employment constituted a breach by defendant Reyes of the implied covenant of loyalty and good faith owed to plaintiff, his employer.” And further, that Reyes, “may not solicit his employer's customers for his own benefit before he has terminated his employment.” Lastly, the Court found that Reyes must remit *all profits* earned in his business while he was employed, citing Restatement (Second) of Agency §403 Chernow, 239 N.J. Super. 201 at 202, 05 (1990) (emphasis added) (petition for cert. Denied, 122 N.J. 184).

Chernow was in the business of auditing telephone bills to ensure that the New York Telephone Company charged appropriate tariff rates on local, in state and long distance calls. Chernow received a commission of fifty percent of all refunds received by its customers after audit. Reyes was employed by Chernow under an oral contract. Reyes had never before audited telephone bills and acquired all of his skills in that field under Chernow's employ.

What happened next is scarcely surprising. Dissatisfied with his rate of pay, Reyes opened a separate corporation, copied Chernow's business methods and plans, and entered into secret competition with his employer for the large available pool of customers. Mr. Reyes asserted that he never solicited one of Chernow's existing customers, but both parties were both clearly fishing in the same pond. Mr. Reyes further asserted that his competing efforts were conducted at night and on weekends and did not detract from his employment with Chernow.

Mr. Reye's protestations fell on deaf ears. The Restatement (Third) of Agency is clear that the Agent's duty of loyalty requires him to bring new business to the Principal's attention, not just for information, but as a business opportunity rightly belonging to his employer. Reye's secret business violated his duty to his employer and his profits (prior to leaving Chernow's employ) belonged to his employer.

In Kaye v. Rosefielde the New Jersey Supreme Court got the chance which had eluded the Appellate Division in Simulation Systems. Rosefielde was a practicing attorney who served as outside Counsel and then became an employee of Kaye's various real estate enterprises. The Trial Court found Rosefielde engaged in, “egregious conduct constituting a breach of his duty of loyalty, breach of his fiduciary duty, legal malpractice, and civil fraud.”

Mr. Rosefielde created several companies whose sole function was to syphon Kaye's profits to the Rosefielde family. If that weren't enough, he forged legal documents and swore false affidavits. He sexually harassed two female employees and used Company funds to entertain “adult film stars.”

The Supreme Court approved forfeiture/disgorgement of all or part of Rosefielde's salary as an available remedy, subject to the trial court weighing the following factors:

1. the employee's degree of responsibility and level of compensation;
2. the number of acts of disloyalty;
3. the extent to which those acts placed the employer's business in jeopardy;
4. the existence of a written employment agreement;
5. whether the employer knew of or agreed to the conduct; and
6. the degree of planning by the employee.

Mr. Rosefielde ticked all of these boxes, and forfeiture was certain.

Under New York law, it is firmly established that an employee is prohibited from acting in a manner inconsistent with his agency or trust and is at all times bound to exercise the utmost good faith and loyalty in the performance of his duties. Not only must an employee account to his principal for secret profits but he also forfeits his right to compensation if he proves disloyal. Lamdin v. Broadway Surface Adv. Corp., 272 N.Y. 133 (1936).

In Maritime Fish Products v. Christensen 474 N.Y.S. 2d 281 (1984) the New York Appellate Division considered the case of Mr. Christensen, a cousin of Maritime's owner. Maritime purchased frozen fish parts from Canadian packers for wholesale and retail distribution in the United States and the Caribbean, including the Dominican Republic (DR). DR is the largest commercial market in the Caribbean. Christensen, as you by now expect, formed a secret company to compete with Maritime. Teaming with Maritime's buyer, he formed a separate company to buy frozen fish parts from a Canadian supplier. Having copied every aspect of Maritime's business model and packaging (including the color scheme) he proceeded to operate through the two companies to sell frozen fish parts to a buyer in the DR. Christensen was not an officer of Maritime and had not signed a restrictive covenant not to compete. Christensen was in business for himself, while drawing a salary from a trusting employer. Not only did he cheat his employer out of a business opportunity, but he corrupted another employee in the process. Citing Lamdin, the Court held that Christensen must return *all* compensation earned during his “period of disloyalty,” as well as *any profits* diverted by his disloyal acts.

Any employee not subject to direct daily supervision is capable of scheming. The author has handled cases where a salaried salesman considered himself a manufacturer's representative, and sold complementary or competing products during sales visits paid for by his employer. If you believe that you have a disloyal employee, please contact Buttermore and Foltz or your Parlex advisor.