

Management Alert



Getting Your Money Back: New Jersey Employers Can Disgorge A Disloyal Employee's Salary

By Christopher Lowe, Robert T. Szyba, and Samuel Sverdlov

In a recent ruling, the New Jersey Supreme Court gave employers a great recourse for dealing with former employees who breach their duty of loyalty. In *Bruce Kaye v. Alan P. Rosefielde*, the Court allowed an employer to recover compensation paid to a disloyal, recently terminated, employee, even where the employer sustained no economic hardship from the employee's acts of disloyalty.

Background

In *Kaye*, the employee, an attorney, who was only licensed to practice in New York, was hired as Chief Operating Officer ("COO") and General Counsel for plaintiff's business selling and managing timeshares in Atlantic County, New Jersey. Interestingly, although the defendant's contract refers to his salary as a retainer for his services, and it appeared that both parties intended defendant to be an independent contractor, both parties agreed that defendant performed the services of an employee rather than an independent contractor.

While employed in the hybrid COO/General Counsel role -- earning a salary of \$500,000 per year -- the Court found that the employee committed a number of "egregious" acts that ultimately resulted in the termination of his employment, including: (1) expensing a \$4,000 personal trip to Las Vegas, the cost of which included a hotel suite with three "adult film stars"; (2) fraudulently applying for health insurance; (3) forging signatures on false quitclaim deeds of defaulting timeshare owners; (4) carved out a greater-than-agreed-upon personal interest in one of his employer's corporate entities; (5) creating an entity under his employer's name, without his employer's consent, taking a 20% interest in that entity for himself (the employee); and (6) making numerous sexual advances towards other employees. When the employer learned what was going on, he fired the employee and sued him for breach of fiduciary duty, fraud, legal malpractice, unlicensed practice of law, and breach of duty of loyalty.

The Trial and Appellate Courts

After a 26-day bench trial, the trial court found that the former employee breached his duty of loyalty to the employer, and committed legal malpractice and fraud. The employer was awarded \$4,000 for the Las Vegas trip, over \$800,000 in counsel fees and costs, and rescission of all of the employee's ill-gotten interests in the employer's other companies. But despite it being "difficult to imagine more egregious conduct by a corporate officer," the trial court declined to order equitable disgorgement for the former employee's compensation during the period of disloyalty. The trial court interpreted a prior Supreme Court decision, *Cameco, Inc. v. Gedicke*, as holding that "in order to compel disgorgement of a disloyal employee's compensation, a court must first find that 'the employee's breach proximately caused the requested damages.'" The Appellate Division agreed with the trial court on that point and affirmed that the employer could not disgorge the compensation paid to the disloyal former employee because it could prove no actual harm.

The New Jersey Supreme Court granted certification only to address the specific question of “whether a court may remedy disgorgement of a disloyal employee’s salary to an employer that has sustained no economic damages.”

The Court reversed the courts below, holding that disgorgement is an equitable remedy within the trial court’s authority, including where a disloyal former employee’s misconduct is not tied to an economic loss suffered by the employer on account of the employee’s disloyalty. The Court directed lower courts to consider four factors to determine whether an employee breaches his/her duty of loyalty:

- (1) the existence of contractual provisions relevant to the employee’s actions;
- (2) the employer’s knowledge of, or agreement to, the employee’s actions;
- (3) the status of the employee and his/her relationship to the employer (for example, corporate officer or director versus production line worker); and
- (4) the nature of the employee’s conduct and its effect on the employer.

In effect, courts are directed to consider “the parties’ expectations of the services that the employee will perform in return for his or her compensation, as well as the ‘egregiousness’ of the misconduct that leads to the claim.”

The Court further clarified that once the employee is found to have breached the duty of loyalty, courts should decide whether disgorgement is a proper remedy by considering: “[t]he employee’s degree of responsibility and level of compensation, the number of acts of disloyalty, the extent to which those acts placed the employer’s business in jeopardy,” “the degree of planning to undermine the employer that is undertaken by the employee,” as well as “other factors” that may be relevant. And once disgorgement is found to be appropriate, the court suggested apportionment commensurate to misconduct at issue, as opposed to “wholesale disgorgement.”

Outlook for Employers

New Jersey employers scored a significant win and a meaningful tool to deter and redress a breach of an employee’s duty of loyalty. The *Kaye* Court addressed the circumstance of a disloyal employee who’s employment was terminated, however the analysis is certainly instructive in addressing situations with current employees. The ability to recoup some or all of a disloyal employee’s salary/compensation is certainly a powerful tool in the right circumstances, and certainly something to consider when faced with a breach of the duty of loyalty.

[Christopher Lowe](#) is a partner in Seyfarth Shaw’s New York office, [Robert Szyba](#) is an associate in the firm’s New York office, and Samuel Sverdlov is a senior fellow in the firm’s New York office. If you would like further information, please contact any member of Seyfarth Shaw’s New Jersey Practice Group, or your Seyfarth Shaw LLP attorney, Christopher Lowe at clowe@seyfarth.com, Robert Szyba at rszyba@seyfarth.com, or Samuel Sverdlov at ssverdlov@seyfarth.com.

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