The Duty of Loyalty Lives on in New Jersey

Barbara E. Hoey

October 8, 2015

In an interesting decision affirming the 'old-but-not-forgotten' principle that an employee owes his first duty of loyalty to her employer, the New Jersey Supreme Court recently affirmed a decision allowing an employer to recover the salary it had paid to a disloyal employee, who coincidentally was also an attorney. In ***Bruce Kaye v. Alan P. Rosefielde***, the defendant employee was both the COO and General Counsel – earning a very respectable salary of $500,000 per year. It seems that was not enough, as while the employer was looking the other way, defendant did a number of "underhanded" things, such as forging signatures on real estate documents, creating a corporate entity without the employers consent and giving himself a 20% interest in it, and charging a $4,000 trip to Las Vegas on the corporate account. Once this came to light, he was fired. The employer then took the bold step of suing the GC for fraud, malpractice and breach of the duty of loyalty.

After a lengthy trial, the employer won – and was awarded the $4,000 expenses for the Las Vegas trip and over $800,000 in counsel fees. However, the trial court declined to order disgorgement of the employee's salary.

On appeal, the Supreme Court reviewed and reversed the disgorgement finding, holding that a Court may order disgorgement of salary, even when the employer could not show that it had suffered an economic loss. The court made clear that "An agent is entitled to no compensation for conduct which is disobedient or which is a breach of his duty of loyalty, if such conduct constitutes a willful and deliberate breach of his contract of service, he is not entitled to compensation even for properly performed services for which no compensation is apportioned." The court also noted that the possibility of disgorgement could have a "valuable deterrent effect, because its availability signal agents that some adverse consequences will follow a breach of fiduciary duty." The court held that, in deciding whether to order disgorgement, a court should consider a number of factors, including "the egregiousness of the misconduct that leads to the claim." The court said that it could also consider factors such as the amount of compensation, the extent to which the misconduct placed the business in jeopardy and could set an amount that was proportionate to the misconduct.

It is still not clear what attorney Rosefielde will owe, as that decision was remanded back to the trial court. However, given the enumerated factors the court was directed to consider, his prospects don’t look good.

This is a heartening decision for employers, both in New Jersey and in other states that recognize the concept of the “faithless servant”. Not only did the Kaye court uphold the right of the employer to terminate a disloyal employee, but it makes it clear that an employer may also seek to recover back from that disloyal employee the salary which it has paid – even if the employer cannot show direct economic damage due to the bad conduct. This could be a powerful weapon to utilize against an individual who has been terminated, and has ‘lawyered- up’ and is threatening litigation. If the employer has clear evidence of the disloyal conduct, such evidence could be a powerful weapon to dissuade litigation. As the employee now has to worry about paying out damages, they will likely think twice about a lawsuit.