

Labor & Employment Law/Immigration Law

The Faithless Servant Doctrine

One of the most draconian remedies in our jurisprudence arises in claims that employees violate their duty of loyalty to their employers by faithless misconduct. The faithless servant doctrine provides for the forfeiture of employee compensation during the period of disloyalty. "An employee forfeits his right to compensation for services rendered by him if he proves disloyal."¹

Because of the onerous remedies imposed for an employee's breach of the duty of loyalty, its application is limited to a few discrete categories of misconduct.² Courts applying New York law have imposed forfeiture of compensation when faithless employees engaged in conduct directly competitive with their employers and thereby diverted business opportunities from their employers.³ Forfeiture of compensation has also been ordered where employees embezzled funds or accepted kickbacks.⁴

More than Moonlighting

Some employees attempt to supplement their income with second jobs or by engaging in side businesses. Some moonlighting employees may use their primary employers' facilities and resources, including work time, email, or office equipment. Faithless servant claims against such employees are generally dismissed in the absence of allegations of competition, diversion of corporate opportunities, or theft.

In *Veritas Capital Management*, defendant was a high ranking employee of plaintiff investment firm whose employment contract required him to "devote all of his working time exclusively to the business of [plaintiff] and he

will not engage independently or with others in other investments or business ventures of any kind."⁵ Plaintiff employer alleged that defendant violated this covenant by engaging in investment activity with another investment firm, "devoting a substantial amount of time, effort and resources to these outside investment activities...and was using [plaintiff's] resources to work on his [outside] investment activities during business hours."⁶

The plaintiff in *Veritas* brought claims for breach of the duty of loyalty and breach of fiduciary duty. The court dismissed the claims because plaintiff failed to allege competitive conduct, diversion of any corporate opportunities, theft, or improper kickbacks.⁷ The First Department affirmed, holding that a breach of the duty of loyalty claim "is available only where the employee has acted directly against the employer's interests—as in embezzlement, improperly competing with the current employer, or usurping business opportunities."⁸

In *Grewal v. Cuneo*, an unsuccessful faithless servant claim was brought by a law firm against a moonlighting attorney who, among other things, surreptitiously and independently represented two clients.⁹ The court held these allegations, "unaccompanied by any facts that she benefitted from these cases *to the detriment of the firm* - [are] insufficient as a matter of law to state a claim for breach of fiduciary duty or the duty of loyalty."¹⁰

As demonstrated by *Grewal*, competitive conduct by itself is insufficient to establish a



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faithless servant claim. Diversion of business opportunities is also required. "Even assuming that plaintiff has established that defendants were disloyal in operating a competing business while employed by plaintiff, plaintiff has failed to establish that the defendants usurped any corporate opportunity, by showing that it was seeking any of defendants' allegedly competing projects, or that its survival was jeopardized by its failure to acquire any of those projects."¹¹

Side Work on Company Time Not Actionable

An employee's use of employer resources and time is also generally insufficient to establish a claim. In *Vanacore v. Expedite Video Conferencing Services, Inc.*, District Judge Seybert adopted the Report & Recommendation ("R&R") of Magistrate Judge Brown dismissing counterclaims for breach of the duty of loyalty.¹² The facts are set forth in Judge Brown's R&R:

Expedite discovered that since 2017, plaintiff performed information technology services for hire on behalf of [another] entity...as well as other persons or entities (collectively, "other clients")....

Defendants allege that plaintiff provided work for the other clients from his home office at Expedite's expense,

using the home office supplies paid for by Expedite.... In addition, defendants allege that [plaintiff] performed work for other clients while being paid by Expedite....

As a result, defendants seek various remedies, including offset, disgorgement, an accounting of hours and services paid by the other clients, and a money judgment as a result of damages incurred by Expedite.¹³

Judge Brown recommended the dismissal of the counterclaim for breach of the duty of loyalty because there was no evidence or allegation that plaintiff competed with defendants, and "misuse of the employer's resources to compete with the employer is generally required."¹⁴ District Judge Seybert agreed:

Allowing an employer to sue an employee for breach of fiduciary duty merely because the employee was not devoting enough time to his job is contrary to the current state of the law and would create unnecessary line-drawing problems. *Employers already have an adequate remedy for this kind of conduct--they can fire the employee.*¹⁵

Whether allegations are sufficient to establish diversion of a corporate opportunity is dependent upon the "tangible expectancy" of the employer. "The prevailing method for determining what constitutes a protected corporate opportunity asks whether the corporation had a 'tangible expectancy' in

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the opportunity—meaning something much less tenable than ownership, but more certain than a desire or a hope.”¹⁶

In *Veritas*, the side investment activities of the defendant employee did not deprive plaintiff employer of any business opportunity.¹⁷ The court explained why the plaintiff had no “tangible expectancy” in these investment activities: “[Plaintiff employer] focus[ed] on investments in middle market companies in aerospace, automotive components, branded consumer products and metals, [and] defense and aerospace. There is nothing in the complaint or in opposition that Campbell’s personal investment [activities] were in those industries.”¹⁸ The *Veritas* court also articulated a second alternative test for determining “whether a corporate opportunity has been diverted, [which] is whether the opportunity is the same as, necessary for, or essential to the line of plaintiff’s business.”¹⁹ The necessity of establishing a tangible expectation in an employee’s moonlighting activities was recently reaffirmed in *Bluebanana Group v. Sargent*.²⁰

Faithless Servant Claims and Breach of Fiduciary Duty

Faithless servant claims are frequently joined with claims for breach of fiduciary duty against employees, predicated on identical allegations. Courts have rejected such repackaged breach of fiduciary duty claims when they are “bound up” with the primary faithless servant claim in the absence of allegations of competitive misconduct, usurpation of corporate opportunity, embezzlement, or kickbacks.²¹

In *Riom Corporation v. McLean*, the First Department applied the identical standards for faithless servant claims when affirming the dismissal of a breach of fiduciary duty claim against an employee: “The trial evidence did not establish that McLean acted in direct competition with plaintiff or diverted corporate assets so as to warrant forfeiture of his salary on a breach of fiduciary duty theory.”²²

Few causes of action carry the extraordinary disgorgement remedies of a faithless servant claim. It is a striking exception to the statutory rule prohibiting deductions or forfeiture of employee wages.²³ “In the absence of a special agreement, an employer may not recover back wages or equivalent drawings paid during a period of completed employment.”²⁴ Because of the harsh forfeiture pen-

alty, courts applying New York law continue to strictly limit faithless servant claims to employees who steal or divert employer funds or opportunities.

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1. *Visual Arts Foundation, Inc. v. Egnasko*, 91 A.D.3d 578, 579 (1st Dept. 2012), quoting *Lamdin v. Broadway Surface Advertising Corp.*, 272 N.Y. 133, 138 (1936).
2. *Veritas Capital Management LLC v. Campbell*, 82 A.D.3d 529, 530 (1st Dept. 2011), *lv dismissed*, 17 N.Y.3d 778 (2011).
3. *Soam Corporation v. Trane Company*, 202 A.D.2d 162 (1st Dept. 1994), *lv denied*, 83 N.Y.2d 758 (1994); *Bon Temps Agency Ltd. v. Greenfield*, 184 A.D.2d 280 (1st Dept. 1992), *lv dismissed* 81 N.Y.2d 759 (1992).
4. *CC Industries, Inc. v. Segal*, 286 A.D.2d 234 (1st Dept. 2001) (employee devised scheme whereby his employer paid over \$750,000 in fraudulent invoices to entities established by the employee); *William Floyd UFSD v. Wright*, 61 A.D.3d 856 (2d Dept. 2009) (employees criminally convicted of embezzlement from their employer school district).
5. The facts are taken from the lower court decision, *Veritas Capital Management LLC v. Campbell*, 22 Misc.3d 1107(A), 2008 WL 5491146, at *2 (Sup. Ct., N.Y. Co. Nov. 24, 2008) (“*Veritas I*”).
6. *Id.*
7. *Id.* at *11. The employee’s investment activities were in markets in which plaintiff employer was not engaged and therefore no corporate opportunities were implicated.
8. 82 A.D.3d at 530.
9. *Grewal v. Cuneo*, 2016 WL 308803, at *8 (S.D.N.Y. Jan. 25, 2016).
10. *Id.* (emphasis added).
11. *Epstein Engineering, P.C. v. Cataldo*, 150 A.D.3d 411, 411–12 (1st Dept. 2017).
12. 2016 WL 1171585 at *2 (E.D.N.Y. Mar. 23, 2016).
13. *Vanacore v. Expedite Video Conferencing Svcs.*, 2015 WL 10553221, at *2 (E.D.N.Y. Dec. 10, 2015).
14. *Id.* at *4.
15. *Vanacore*, 2016 WL 1171585 at *2 (emphasis added).
16. *Pawlowski v. Kitchen Expressions Inc.*, 2017 WL 10259773, at *3 (S.D.N.Y. Dec. 15, 2017) (quotations omitted) (denying motion to dismiss counterclaim for breach of the duty of loyalty brought against employee who installed kitchen fixtures for employer where employee installed kitchen fixtures on the side without the knowledge of his employer).
17. *Veritas I*, at *11.
18. *Id.*
19. *Id.*
20. 176 A.D.3d 408 (1st Dept. 2019) (“Plaintiffs have not alleged that they were in any of the same businesses as Sargent. Plaintiffs do not claim any tangible expectancy in Sargent’s alleged side business activity ...”).
21. *Vanacore*, 2016 WL 1171585, at *2; *Cerciello*, at 968 (dismissing breach of fiduciary duty claim premised on faithless servant allegations). After dismissing claims for breach of the duty of loyalty in *Veritas I*, *Grewal*, and *Bluebanana*, those courts also dismissed the companion breach of fiduciary duty claims on the same grounds. *Veritas I*, 2008 WL 5491146, at *11; *Grewal*, 2016 WL 308803, at *8; *Bluebanana*, 176 A.D.3d at 408.
22. 23 A.D.3d 298, 299 (1st Dept. 2005) (internal citation omitted).
23. Labor Law § 193.
24. *Cerciello v. Admiral Insurance Brokerage Corp.*, 90 A.D.3d 967, 969 (2d Dept. 2011) (quotations omitted).