CLIENT ALERT

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Employment & Labor

New York Ruling Strengthens an Employer's Breach of Duty of Loyalty Claim

The New York Supreme Court Appellate Division, Second Department, recently issued a decision that helps protect companies from departing employees who divert corporate opportunities in breach of their duty of loyalty. In Gomez v. Bicknell, the Court held that even an employee's brief discussion with a prospective client that does not lead to a deal until after the employee resigns can subject him or her to liability. The Court also clarified the method for calculating damages for breach of duty of loyalty claims, which is likely to result in larger recoveries for prevailing employers.

Gomez's Diversion Of His Employer's Corporate Opportunity

Plaintiff Christian Gomez was an employee of defendant Bicknell Advisory Services, Inc. ("Bicknell"), a merger and acquisition advisory services firm. Gomez and Bicknell entered into a non-compete agreement that prohibited Gomez from competing with Bicknell for two years following the termination of his employment.

Gomez and Bicknell also entered into a profit-sharing agreement that, according to Gomez, was subsequently modified orally. Gomez and Bicknell were increasingly at odds over the compensation to which Gomez was entitled under that agreement.

Meanwhile, the president of Sigma Marketing Group, Inc. ("Sigma"), one of Bicknell's clients, offered to give Gomez information about a prospective merger and acquisition transaction. The president told Gomez that he would disclose the information after an unrelated pending deal closed.

Gomez informed Bicknell that the president had offered to disclose this prospective corporate opportunity, but when the president subsequently disclosed the name of the prospective client, Gordon Bailey & Associates ("GBA"), Gomez did not share it with Bicknell. Instead, Gomez called GBA from his home and said that he could not talk at that time, but would call again in a few weeks. The telephone call lasted nine minutes.

Five days later, Gomez resigned from Bicknell, purportedly because Bicknell was not complying with the profit-sharing agreement as orally modified. After resigning, Gomez started a competing firm.

Several weeks after Gomez's resignation, GBA retained Gomez's new firm to handle its merger. GBA paid Gomez $353,000, which amounted to a $260,000 profit for him.

The Claims

Subsequently, Gomez filed a lawsuit against Bicknell that included a claim that Bicknell breached the profit-sharing agreement. Bicknell filed counterclaims including that Gomez breached his duty of loyalty to Bicknell

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by diverting the GBA business and that he breached his non-compete agreement.

Rulings on Counterclaims

At the close of the defense's case, the trial court granted Gomez's motion to dismiss Bicknell's claim for breach of the non-compete agreement, on the ground that there was no evidence that Bicknell had lost profits or incurred other damages as a result of Gomez's alleged breach.

The court, however, denied Gomez's motion to dismiss the breach of duty of loyalty claim. In so doing, the court rejected Gomez's argument that he could not be liable because GBA did not retain him until after he resigned from Bicknell.

Damages Instructions and Verdict

The trial court instructed the jury that, if it found that Gomez had breached his duty of loyalty to Bicknell, then it could consider the profits that Gomez earned in calculating damages. Bicknell objected to this instruction, arguing that the jury should have been instructed that, upon finding that Gomez had breached his duty of loyalty, the jury was required – not merely permitted – to consider Gomez's profits in calculating damages.

The jury found in favor of Gomez on his claim that Bicknell had breached the profit-sharing agreement as orally modified, and awarded him $601,189.91. The jury found in favor of Bicknell on its breach of the duty of loyalty claim, but awarded it only $5,000.

The Appeal

On appeal, Gomez argued that the evidence was insufficient to support the verdict against him for breaching his duty of loyalty to Bicknell by diverting its corporate opportunity. He asserted that he was not disloyal during the period of his employment, but only secured the business of GBA after he left.

The Appellate Division disagreed, explaining that such an argument "would license any faithless employee to steal a corporate opportunity but conceal the theft until he or she has departed from employment." The Court held that the evidence was sufficient to support the breach of the duty of loyalty claim.

Regarding the calculation of damages for the breach of duty of loyalty, the Appellate Division held that the trial court's instructions to the jury were erroneous. The Appellate Division explained that for a breach of a non-compete agreement, a plaintiff is only entitled to recover its lost profits. For a breach of the duty of loyalty, however, a plaintiff has the option of recovering either the former employee's profit or the profit that the plaintiff would have earned had the plaintiff been given the diverted opportunity. Accordingly, the Appellate Division held that the jury's $5,000 award to Bicknell was against the weight of the evidence, and remitted for retrial Bicknell's claim for damages.

The Appellate Division affirmed the trial court's dismissal of Bicknell's breach of the non-compete agreement claim because, as the trial court had reasoned, there was no evidence that Bicknell suffered lost profits as a result of the breach.

Finally, the Appellate Division held that there was insufficient evidence to support the jury's verdict that Bicknell had breached its profit-sharing agreement with Gomez as orally modified because, among other things, the evidence revealed that there had never been a meeting of the minds as to the modification.

Conclusion

The Gomez v. Bicknell decision highlights the fact that, even in the absence of enforceable restrictive covenants, claims for breach of the duty of loyalty may be useful in thwarting unfair competition by a former employee. The case also makes it easier to prevail against an employee who diverts a corporate opportunity – even if he or she is savvy enough to delay consummation of the deal until after his or her departure.

Finally, the Appellate Division's approach to calculating damages in breach of duty of loyalty cases should result in higher recoveries for employers, and further deter employees from diverting corporate opportunities in New York.

We send these Alerts to our clients and friends to provide information on recent developments in the law. The Alerts, however, should not be relied on for legal advice in any particular matter. If you would like additional information, please contact David W. Garland or Lester Aron, Co-Chairs of the Firm's Employment and Labor Department.

SILLS CUMMIS RADIN TISCHMAN EPSTEIN & GROSS
ONE RIVERFRONT PLAZA
NEWARK, NJ 07102-5400
973.643.7000 ~ FAX: 973.643.6500
WWW.SILLSCUMMIS.COM
NEW JERSEY • NEW YORK • SAN FRANCISCO