

## Employment Litigation

# Keeping the Faith...less Servant Doctrine Alive

### The Bottom Line

- The faithless servant doctrine has potentially huge advantages for employers, including alleviating the need to prove damages – a requirement for any claim for breach of contract.
- Disgorgement of past wages allows for monetary relief in circumstances where proving damages may be difficult, if not impossible.
- When a faithless servant claim resembles an allegation of fraud, employers must be sure that they can meet the heightened pleading standard for fraud, or they may lose this powerful weapon.

New York employees have a (legal) duty of loyalty to their employers – under the state’s faithless servant doctrine, a court may require an employee to return compensation received from their employer during any period when the employee was disloyal.

A recent decision by the federal court in Manhattan reaffirmed the viability of New York’s faithless servant doctrine, but held that an employer pursuing such a claim may need to allege the basis of the claim in detail to avoid dismissal of their complaint.

### New York Cases Prove Faith in the Faithless Servant Doctrine

In New York, the faithless servant doctrine has proven to be a powerful device for employers to recover potentially large sums.

In *Matter of Mahn v. Major, Lindsey, & Africa, LLC*, a New York state appellate court confirmed an arbitration award requiring an employee to return \$2 million in compensation, which constituted the employee’s full salary and commissions during the four year period of his disloyalty.

A recent decision of the Southern District of New York, however, held that faithless servant claims based on allegations similar to *fraud* must meet a heightened pleading standard in order to survive a motion to dismiss the claim.

In *Rubio v. BSDB Mgmt (Rubio)*, the employer asserted a faithless servant claim based on an employee's alleged over-reporting of the hours that he and his subordinates had worked. The employer alleged that this over-reporting caused an overpayment of wages. The court found that the faithless servant claim "mirror[ed] the very elements of a cause of action for fraud – that is 'a material misrepresentation of a fact, knowledge of its falsity, an intent to induce reliance, justifiable reliance by the plaintiff and damages.'"

As the federal rules require fraud allegations to be plead with specificity, the Court found that the employer's faithless servant claim needed to be plead with specificity. Stating that the employer failed to allege facts describing "when, where, or in relation to whom the reports were made", the court dismissed the employer's faithless servant claim.

In light of *Rubio*, employers should be aware that when they assert a faithless servant claim that alleges fraudulent conduct, the employer should plead the basis of their claim with detail. In contrast, faithless servant claims that are based on allegations of negligence, for example, do not trigger heightened pleading requirements.

### The Faithless Servant Doctrine

The faithless servant doctrine provides that "an agent is obliged to be loyal to his employer and is prohibited from acting in any 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."

Conduct that can give rise to a cause of action under the faithless servant doctrine includes:

- Wrongfully diverting a corporate opportunity
- Destroying company files
- Stealing confidential business documents
- Causing negative rumors while forming a competing business

Should an employee fail to maintain loyalty, the doctrine may entitle the employer a refund of **all wages** paid to the employee after the first disloyal act. This includes wages for periods where the employee committed both loyal and disloyal acts (e.g., where the employee spent most of the day as a loyal employee and acted disloyally for a small portion of the day, week, month, etc.).

A court may require the disloyal employee to return their compensation regardless of whether the employer suffered any actual damages. Moreover, an employer may assert a faithless servant claim in addition to any breach of contract claims.

In assessing the sufficiency of faithless servant claims, New York courts apply one of two standards to determine whether an employee's conduct warrants disgorgement of wages.

1. The first requires that the misconduct substantially violate a contractual agreement with the employer.
2. The second requires that the employee act adversely to the employer or omit to disclose a conflict of interest.

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### **For More Information**

Please contact the attorneys listed below or the Davis+Gilbert attorney with whom you have regular contact.

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