Bridging the Gap When There Are No More Non-Competes

By Paul F. Millus, Esq.

Non-compete and non-solicitation agreements are under attack. While Governor Hochul recently vetoed proposed legislation which would have essentially abolished non-competition agreements in N.Y., there should be no doubt that the issue will reappear. The bill will likely come back in a modified form and become law. Notwithstanding such an event, the Federal Trade Commission is expected to issue its final formal rule as early as April 20, 2024, which many believe will likely be a full ban on non-compete agreements regardless of salary level, and only possibly with an exception as it applies to the sale of the business. So, what is an employer to do to protect the goodwill and its confidential information from being used by ex-employees to feather their nest at the expense of their former employer?

While non-competes are in a category of their own as creatures of contract, a business is not without some measure of protection under common law. Those protections come from the duty of loyalty owed by an employee to his employer- also known as the "faithless servant doctrine" which dates to 1886.[1] Moreover, in connection with an employee's fiduciary duties, they can extend past his or her prior employment. These protections are especially available if the employee was an owner or officer in a closely-held corporation.[2]

The duty of loyalty, while not a complete replacement for the protections afforded by a non-compete, can provide the former business/employer some solace. Employees are bound by a duty of loyalty, and, for some, they have a fiduciary obligation as well to their employer even post-employment.

For example, the Second Circuit has held that a former officer, director or shareholder of a closely-held corporation who left the company to start a competing business, while not bound by any non-compete, continued to owe a fiduciary duty after the termination of employment and prohibited the use of business opportunities in which the former employer had a "tangible expectancy."[3] The court stated that the corporate opportunity doctrine prohibits a corporate employee from utilizing information obtained in a fiduciary capacity to appropriate a business opportunity belonging to the former employer.

In the end, there is no question that an employee owes a duty of loyalty to his employer. As an "agent", an employee is obligated to be loyal to his employer and is prohibited from acting in a matter inconsistent with that agency, such that the employee is— at all times—bound to exercise "utmost good faith and loyalty in the performance of his duties."[4] This duty of loyalty is not dependent upon any express contractual relationship and even exists when an employment relationship is at will.[5] Accordingly, when an employee uses an employer's proprietary information to establish a competing business, the employee breaches his or fiduciary duty to the employer. The damages can be significant as the employer may choose to either seek (1) profit disgorgement from the disloyal employee after an accounting, or (2) damages based on what the employer would have made had the employee not breached his duty.[6] Penalties for diversion of business under the corporate opportunity doctrine apply to employees even after their employment has been terminated.[7]

There is abundant authority supporting a complete forfeiture of the employee's compensation during the period of the employee's disloyalty while still employed. Likewise, there is also case law which provides employers a measure of protection against those disloyal employees before and after they leave their employ. Accordingly, if the time comes when non-compete agreements are forbidden, businesses are not without recourse against their former employees.

Paul F. Millus, Esq.

Paul F. Millus is a Litigation Partner at Meyer, Suozzi, English & Klein, P.C. He can be reached at pmillus@msek.com

[1] *Murray v. Bear,* 102 N.Y. 505 (1886).
[2] *Global Minerals and Metals Corp v. Holme,* 35 A.D.3d 93, 824 N.Y.S.2d 210 (1st Dep't 2006).
[3] *American Federal Group Ltd. v. Rothenberg,* 136 F.3d 897 (2d Cir. 1998).
[4] *Pure Power Boot Camp v. Warrior Fitness Boot Camp,* 813 F. Supp. 2d 489 (S.D.N.Y. 2011).
[5] *DDS Partners, LLC v. Celenza,* 16 A.D.3d 114, 794 N.Y.S.2d 1 (1st Dep't 2005).
[6] *Gomez v. Bicknell,* 302 A.D.2d 107, 756 N.Y.S.2d 209 (2nd Dep't 2002).
[7] *Securitas Electronic Security, Inc. v. DeBon,* 2021 WL 965382 (S.D.N.Y. 2021).