AN EMPLOYEE'S DUTY OF LOYALTY:

The Supreme Court Attempts to Clarify in *Lamorte Burns & Co. v. Walters*

By

Michael L. Rich
February 2002

Employers should take considerable comfort from the New Jersey Supreme Court's recent decision in *Lamorte Burns & Co. v. Walters*, 167 N.J. 285 (2001), in which the Court attempted to clarify the sometimes murky area of an employee's common law duty of loyalty owed to his or her employer. At a minimum, *Lamorte* makes clear that it is impermissible for an employee to secretly gather confidential and proprietary information during his or her employment for later use in a competing business. *Lamorte* also is likely to be read as an expansion of the types of activities in which an employee planning to leave to pursue a competitive venture may not engage.

Before *Lamorte*, numerous lower court decisions generally discussed an employee's common law duty of loyalty. Few New Jersey reported decisions, however, have cited specific examples of what constitutes actionable disloyalty, as distinguished from permissible steps an employee may take to plan and prepare for future employment elsewhere.

New Jersey law has long held that an employee owes his or her employer a duty of undivided loyalty and must not, while employed, act contrary to the employer's interest.[1] An equally long-standing tenet of New Jersey law, however, is that a former employee generally may, in the absence of fraud or an enforceable restrictive covenant, compete with a former employer by thereafter accepting employment with a rival or personally undertaking a competing business.[2] In its 1999 decision in *Cameco, Inc. v. Gedicke*, 157 N.J. 504 (1999), the Supreme Court delved into the fine line between permissible preparation to compete and actionable disloyalty. The Court's decision in *Lamorte* further expounded on this topic.

The Facts in *Lamorte*

Since 1938, plaintiff Lamorte, a Connecticut-based company, had been in the business of investigating and adjusting claims for liability insurers, their associations and owners. Defendants Walters and Nixon met in Lamorte's New Jersey office, where both worked on protection and indemnity (P & I) claims. Walters had been recruited by Lamorte's president to manage the New Jersey office, handle P & I claims and supervise other employees, including Nixon.

Shortly after joining the company, Walters (but not Nixon) signed an employment agreement containing a provision requiring that he maintain in confidence all proprietary and confidential information obtained or developed in the course of his employment. It also provided that he would not accept any claim, case or dispute being handled by the company for twelve months after leaving the company. Although Walters signed the contract, he testified that he never believed it was enforceable against him. He reasoned that the restrictive covenant lacked consideration because he was an at-will employee.

About six years after joining Lamorte, Walters formulated the idea of commencing a competing business. Approximately seventeen months prior to departing Lamorte, Walters incorporated a new business. He also enlisted Nixon to assist in his plan for a competing enterprise.

Walters and Nixon then surreptitiously proceeded to take from their employer's files important information, including client names, addresses, telephone and facsimile numbers, file numbers, claim contact information and incident dates, and the names of injured persons. Each time they worked on a Lamorte P & I claim file, they added to a solicitation list that they were compiling using such information from the employer's files.

At some point, Lamorte's president confronted the defendants about rumors that they were planning to leave to start a competing business. The defendants denied the rumors, fearing that they would be fired if the truth were known.

Prior to leaving Lamorte, Walters signed a lease for office space, purchased office equipment, leased computers and secured telephone and fax lines for his new business. Defendants agreed on a late December date for resigning from Lamorte so they could first collect a Christmas bonus from the company.

In the several days before resigning, Walters called in sick. In fact, he used the time to install computers, arrange furniture and prepare to commence business operations. Defendants faxed their resignation letters to the Connecticut headquarters on a Saturday afternoon, and thereupon began faxing solicitation letters and transfer authorization forms to all but one of Lamorte's P & I clients. Each solicitation letter was accompanied by a transfer request form that included "a list of open files *we* have been handling for you," the names of the client and the injured person, and the accident date. Within approximately two weeks, all thirty-three of Lamorte's P & I clients requested transfer of their active claim files to defendants' new business. Lamorte then instituted suit.

The *Lamorte* Ruling

The trial court granted summary judgment in favor of the company, finding among other things that defendants had breached their duty of loyalty. The Appellate Division reversed, concluding that there were material facts in dispute which required a trial of the issues. It reasoned that there exists a fact-sensitive nature to evaluating whether an employee's conduct in planning and preparing for future employment constitutes a breach of the duty of loyalty and whether the information taken from Lamorte was confidential and proprietary.

The Supreme Court reversed the Appellate Division and reinstated the trial court's grant of summary judgment for the former employer. While the Court could have ruled on narrower grounds based on the misappropriation of Lamorte's client files, it chose instead to enunciate broader standards for the conduct of an employee planning to compete against his employer.

> The Court pronounced[3]:
>
> Loyalty from an employee to an employer consists of certain very basic and common sense obligations. An employee must not while employed act contrary to the employer's interest.
>
> . . . .
>
> Before the end of his employment, [the employee] can properly purchase a rival business and upon termination of employment immediately compete. He is not, however, entitled to solicit customers for such rival business before the end of his employment nor can he properly do other similar acts in direct competition with the employer's business.

The Court found that the Appellate Division incorrectly concluded that a trial is needed to determine whether the information secretly gathered by the defendants was legally protected. It concluded that although Lamorte's information would be entitled to trade secret protection, such was not essential to a decision. Rather, the Court held that the specific information provided to defendants by Lamorte, in the course of employment for the sole purpose of servicing its customers, is legally protectable as confidential and proprietary information. The Court noted that defendants would not have been aware of the information but for their employment, and indeed Walters had acknowledged that he would not have given such information to a competitor.

The Court thus held that the defendants purloined protected information while still employed, solely to effect an advantage in competing with Lamorte immediately on their resignation and commencement of their business. The Court further found that defendants intentionally began a process of subverting Lamorte's business while still employed.[4] Their actions were held to be contrary to Lamorte's interest, and therefore a breach of their common law duty of loyalty.

Prior to Lamorte, the activities engaged in by the defendants – with the exception perhaps of the systematic culling out of information from the employer's files – would not necessarily have been found actionable. While these actions may not be regarded as altogether honest, they would not likely have been found legally prohibited, absent a restrictive covenant.

Lamorte signals to the trial courts that if an employee's conduct in preparing to compete with his or her employer offends very basic, practical and common-sense notions of fair play, a finding that the employee breached the common law duty of loyalty will be upheld by the state's highest court. It can reasonably be anticipated that the conduct in *Lamorte* will serve as something of a guidepost on activities a departing employee can and cannot undertake before leaving the employer.

For further information and assistance with regard to this recent decision or other related areas of employment law, please do not hesitate to contact the author.

---

[1] *Chernow v. Reyes*, 239 N.J. Super. 201, 204 (App. Div. 1990), cert. denied, 122 N.J. 184 (1990).
[2] *Auxton Computer Enterprises, Inc. v. Parker*, 174 N.J. Super 418, 423 (App. Div. 1980); *Abalene Exterminating Co. v. Elges*, 137 N.J. Eq. 1 (Chan. 1945).
[3] 167 N.J. at 302.
[4] 167 N.J. at 305.