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The Duty Of Loyalty For Employers And Employees

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Many people are familiar with non-compete and non-solicit agreements between employers and employees. In contrast, the duty of loyalty that an employee owes an employer is less well-known. Yet this duty, which applies even in the absence of a written agreement, has substantial implications for employers and employees not unlike non-compete and non-solicit agreements.

For employers, the duty offers some measure of protection to guard their interests and help ensure that their employees remain loyal even, in some instances, once they leave their position. For employees, knowing the existence and reach of this duty can help them conduct themselves lawfully during the term of their employment and when they contemplate moving to another position.

The following discussion should prove useful to employers, by alerting them to their rights under Illinois law regarding the duty of loyalty, and to employees, by providing them with a list of problematic conduct which could give rise to substantial liability.

Under Illinois law, the duty of loyalty requires that an employee act solely for the benefit of the employer in all matters connected with his or her employment. What this concept means has been the subject of numerous lawsuits. As a starting point, through what has come to be known as the “preliminary stages” doctrine, courts agree that the duty of loyalty does not prevent an employee from taking certain preliminary steps which may be seen as competing with such employee’s employer.

This duty does not prohibit an employee from planning, forming, and outfitting a competing corporation while still working for the employer, or even informing a client of the employee’s intention to leave the employer, so long as the employee does not engage in competition with the employer. For example, a court has allowed an employee who served as the vice-president of manufacturing at his employer’s manufacturing company to obtain financing, design a production plant, and purchase equipment and supplies, all while still employed.

In contrast, when an employee’s activities extend beyond what courts deem “preliminary” competitive activities and “commence business as a rival concern while still in his employer’s service”, such as in the case of active solicitation of clients or employees, a court may find a violation of the duty of loyalty.

Beyond the “preliminary stages” doctrine, the reach of the duty of loyalty depends on whether the employee at issue is an officer or non-officer employee. This is because the duty of loyalty imposes more restrictions on officers than non-officer employees. Before discussing the prohibited and permissible actions of each type of employee, it is important to note how Illinois courts distinguish an officer from a non-officer employee. Rather than focusing on an employee’s title, Illinois courts analyze an employee’s everyday activities. An officer as an employee who performs “significant managerial and supervisory responsibilities for the operation of the ...office”, or otherwise has significant autonomy and discretion in the performance of her duties for the employer.

A. Officers

Corporate officers, as agents of their employer, are held to a higher duty of loyalty standard than regular employees. The duty of loyalty specifically prohibits corporate officers from (1) actively exploiting their positions within the corporation for their own personal benefit or (2) hindering the ability of a corporation to continue the business for which it was developed.

Further, for corporate officers, the duty of loyalty imposes affirmative obligations upon them to disclose information which falls within the scope of the fiduciary relationship and to refrain from profiting, without permission from the one who is owed the fiduciary duty, from property or information which is considered as belonging to the beneficiary.

Conduct which is likely to trigger liability for corporate officers under the duty of loyalty includes:

- 1) using corporate assets without compensating the corporation to develop a new entity;
- 2) appropriating the office space of the corporation to help another corporation or business in which the officer has an interest;
- 3) taking advantage of a corporate opportunity without first disclosing it and tendering the opportunity to the corporate employer;
- 4) taking advantage of a corporate opportunity where officer’s private interest would conflict with that of the corporation;
- 5) using corporate assets to usurp corporate opportunity for employee’s own venture;
- 6) pretermination solicitation of one or more customer of the employer;
- 7) soliciting or contracting with fellow employees of employer prior to terminating employment relationship;
- 8) voting for and accepting bonuses without disclosure that officer is leaving the company or firm; and

9) using firm's confidential information such as credit, billing or other financial information of the company or company's records for the benefit of employee's new venture.

It is also important to note that resigning does not automatically relieve a former officer of a corporation from her duty of loyalty to that former corporation where transactions which were initiated during the tenure of the officer's employment relationship are concerned. For those transactions which commenced during the officer's employment with her former employer or which were based upon information obtained during that relationship, the corporate officer, even after she resigns or is terminated, cannot utilize essential information from those transactions or contact the parties involved without subjecting herself to liability under the duty of loyalty doctrine.

B. Non-officer Employees

The duty of loyalty does not impose as many restrictions on employees who are not officers of a corporation. Under the more lenient standard for non-officer employees, Illinois law holds that once an employee leaves his position with an employer, he ceases to owe that employer a fiduciary duty. Further, where there is no fraud, no contractual restrictive covenant, and there has been no improper taking of a customer list, former employees may, without fear of breaching the duty of loyalty, compete with their former employers and solicit former customers provided there is no evidence of this kind of business activity prior to the employee's termination of his employment.

In general, the duty of loyalty prohibits non-officer employees from:

- 1) competing with the employer while still in the employ of that employer;
- 2) taking employer's customer list or soliciting customers away from employer while still in the employ of that employer; and
- 3) appropriating the employer's personal property.

C. Employer's Remedies for Employee's Breach of Duty of Loyalty

An employer has a wide array of remedies that it may seek in charging an (former) employee with a breach of the duty of loyalty. These remedies include:

- 1) recovery of an employee's total compensation paid during the time that the employee was breaching the fiduciary duty owed to his employer;
- 2) the imposition of a constructive trust to collect the profits reaped by the employee as a result of his breach of his fiduciary duty;
- 3) recovery of bonuses paid during the same period in which the employee breached his fiduciary duty;

- 4) the imposition of punitive damages if the breach was intentional and without just cause; and
- 5) injunctive relief.

* Conclusion *

By identifying prohibited and permitted conduct, the foregoing discussion is intended to make both employers and employees aware of their rights and obligations under the doctrine of the duty of loyalty, and to apprise them of some of the more serious implications of violating that duty.

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