

STERNS & WEINROTH, P.C.

E M P L O Y M E N T L A W

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## Confidentiality, Loyalty and Business Ethics

LaMorte Burns & Co. is in the business of investigating and adjusting claims for liability insurers. LaMorte's Clark, New Jersey office handled marine liability claims. Two of LaMorte's employees worked in Clark. Michael Walters, an attorney, managed the office, and Nancy Nixon worked for him.

Walters had significant responsibilities. LaMorte introduced Walters to its existing clients and expected that he would develop additional business. When he arrived in the Clark office in 1990, Nixon was already well established there. Shortly after his arrival, Walters signed a contract containing confidentiality and post-employment non-competition covenants.

In the spring of 1996, LaMorte's president told Walters that the company planned to deemphasize the investigation and investment business line in which Walters specialized. As a result, Walters began planning to start a competing business and, in July 1996, along with Nixon, incorporated The Walters Nixon Group. Thereafter, Walters and Nixon added each new LaMorte file they worked on to a target solicitation list which contained all

## Effective Arbitration Provisions

In 1996, David Garfinkel, M.D., with the assistance of legal counsel, negotiated an employment agreement with the Morristown Obstetrics & Gynecology Associates, P.A. ("MOGA"). The agreement set forth all of the terms and conditions of Dr. Garfinkel's employment, including work obligations, salary, stock ownership, termination and restrictions on subsequent employment. Dr. Garfinkel and MOGA also agreed to include an arbitration provision in the agreement to cover the resolution of disputes between them. Not unlike many arbitration provisions included in employment agreements, the one included in Dr. Garfinkel's employment agreement read:

[A]ny controversy or claim arising out of, or relating to this Agreement or the breach thereof, shall be settled by arbitration..., in accordance with the rules then obtaining of the American Arbitration Association....

In 1998, Dr. Garfinkel's employment was terminated, and at the time, the doctor was

vital information about the file. Walters transferred the data to his home computer.

After leasing office space for his new business, purchasing office equipment, and arranging for phone and fax lines, Walters called in sick on December 18 and 19, 1997. He used the time to set up the new office. On December 20, a Saturday, Walters and Nixon phoned the Clark office. Receiving no answer, they drove there, removed their personal property and, later that day, faxed letters of resignation to LaMorte's headquarters in Connecticut.

The next day, December 21, 1997, Walters and Nixon faxed solicitation letters and transfer authorization forms to all but one of the LaMorte's claims clients they had serviced, promising a fee structure more favorable than LaMorte's. By the first week of January, 1998, all of the clients solicited signed the authorization forms.

In a suit entitled *LaMorte Burns & Co. v. Walters*, decided on May 14, 2001, the Supreme Court of New Jersey answered the follow-

ing questions: 1) was the client claim information Walters and Nixon took—names, addresses and phone and fax numbers, claimant names, accident dates and details, and file numbers — legally protectable; 2) does an employee who starts a competing business while employed by another violate the duty of loyalty owed to his or her employer; and 3) did Walters and Nixon act aggressively but appropriately, or did they violate our notions of free and fair competition and business ethics?

Although the information Walters and Nixon took may not have been a "trade secret," it was LaMorte's property and, given Walters' and Nixon's relationship to LaMorte, it was information LaMorte had given them in confidence. The Supreme Court had no difficulty concluding that, irrespective of whether these employees had signed confidentiality agreements, they could not take advantage of their position to use customer information for their own benefit and to harm their employer.

What information is confidential? Any data which common sense tells us provides a person with a competitive edge one outside the company would not have.

The loyalty an employee owes the employer is also a matter of common sense. While employed, one cannot act contrary to the employer's interest. The employee can make preparations for forming a rival business, but cannot compete with the employer or use confidential information acquired during employment for his or her own benefit prior to termination.

By these standards, Walters and Nixon evidently breached the duty of loyalty they owed LaMorte while employed there. The duty goes beyond actual solicitation of customers. It extends to any affirmative steps which have the effect of injuring the employer's business or are in conflict with the employer's interests.

Finally, the secretive actions Walters and Nixon took on the weekend of their resignation were immoral and unethical, and actionable on that basis. While there are no hard and fast rules governing such conduct, persons will be liable whenever their conduct "oversteps" the line and maliciously harms a rival business.

We have described the facts of this case in great detail for a good reason. To understand them is to understand the nature of Walters' and Nixon's actions, which the Supreme Court described as a "weekend coup." Each case will, of course, rise and fall on its own facts. We do not need a course on employment law to know what Walters and Nixon did was wrong. If an employee's actions seem wrong and immoral, they most likely are.

## FAMILY LEAVE ACT REMINDER

One of the most troublesome issues under the Family and Medical Leave Act ("FMLA") is the question: when is an eligible employee entitled to an unpaid leave? The answer: when the employer learns that an absence is for an FMLA purpose — even if there is no mention made of the FMLA or even if the employee has no idea of her rights under the FMLA. A call from an employee advising that she will be hospitalized due to a serious medical condition and unable to return to work for some time by itself triggers the leave provisions of the FMLA. Under the Department of Labor's regulations, the employee simply needs "to state a qualifying reason for the needed leave." 29 C.F.R. §825.208(a)(2).

An employer may even learn of such a "qualifying reason" after the employee's return to work. In that case, the employer may designate the leave as an FMLA, but must do so within two business days of the return to work. 29 U.S.C. §825.208(c)(1). The rules for paid leave are different.

allegedly informed that the reason for his termination was that he "did not attract patients well because he was a male." Dr. Garfinkel then filed a lawsuit in the New Jersey Superior Court alleging breach of the employment agreement, violation of the duty of good faith and fair dealing, defamation and violation of the New Jersey Law Against Discrimination (*N.J.S.A. 10:5-1 et seq.* ("LAD")).

MOGA asked the court to dismiss the complaint on the grounds that Dr. Garfinkel had agreed to arbitrate any disputes he had with them and not to sue. The trial court agreed that the arbitration provision was binding, and dismissed the doctor's complaint. The New Jersey Appellate Division affirmed that decision. However, on further appeal, the New Jersey Supreme Court reversed the lower courts.

In an important decision that calls into question the effectiveness of standard arbitration provisions included in many employment agreements, the Supreme Court decided that Dr. Garfinkel was not required to arbitrate his discrimination claim under LAD even though he negotiated the arbitration provision in his employment agreement. The Court said it was not clear from the language of the arbitration clause that Dr. Garfinkel intended to waive his statutory rights under LAD — particularly his right to trial by jury. The Court said that in order to be effective, an arbitration provision "should at least provide that the employee agrees to arbitrate all statutory claims arising out of the employment relationship or its termination..." and "should also reflect the employee's general understand-

ing of the type of claims included in the waiver, e.g., workplace discrimination claims." Because the arbitration provision did not include such language and because Dr. Garfinkel did not specifically waive his right to trial by jury for his discrimination claim, the Court ruled that the doctor would not be required to arbitrate and would be permitted to proceed with his lawsuit.

The Court also ruled that the trial would not be limited to the statutory LAD claim, but that in the interest of judicial economy, all claims, including the common law claims raised by the doctor that would otherwise be subject to arbitration, would be resolved by trial. In so doing, the Court effectively invalidated the entire arbitration agreement.

From this decision, employers should be aware that an employee who signs an agreement to arbitrate will nonetheless, not be required to arbitrate any claim raised under any statute — federal or state — unless the employee specifically agrees to arbitrate statutory claims and to waive the right to trial.

Therefore, in order to be enforceable, an arbitration agreement should clearly state that the employee intends to be bound to it — regardless of the nature of the claims asserted. The agreement should include language:

[R]eflecting that the employee, in fact, knows that other options such as federal and state administrative remedies and judicial remedies exist; that the employee also knows by signing the contract, those

remedies are forever precluded; and that, regardless of the nature of the employee's complaint, he or she knows that it can only be resolved by arbitration.<sup>1</sup>

An employer should not assume that it is protected from litigation in the event of a dispute with an employee because the employee has agreed to arbitrate. The employer must ensure that the agreement to arbitrate is an agreement to arbitrate all claims, and that in reaching that agreement, the employee knowingly waives all statutorily rights, including the right to administrative proceeding and the right to trial by jury.

<sup>1</sup> Quoting *Alamo Rent A Car, Inc. v. Galarza*, 306 N.J. Super. 384, 394 (App. Div. 1997).

## EMPLOYMENT ALERT

Without a court order or court approved consent decree, a plaintiff who settles a federal civil rights action will not be considered a prevailing party and will not be eligible for an award of attorneys' fees (usually available under the fee shifting statutes), even if the lawsuit was a substantial factor in bringing about the result sought and obtained by the plaintiff.

*Buckhannon Board & Care Home, Inc., et al. v. West Virginia Dept. of Health and Human Resources*, United States Supreme Court, May 29, 2001.

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