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INFORMATION MEMO
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Dr. Dolittle and the Faithless Servant Doctrine in 2018 (So Far)

In his iconic book, *The Story of Doctor Dolittle*, children's author Hugh Lofting introduces the world to a mythic animal — the pushmi-pullyu — that has two heads on the opposing ends of its body, begging the questions: 1) how does it make up its mind?; and 2) didn't I once argue an appeal before a panel of them? As it were, in 2018 the inherent mind-bend of the pushmi-pullyu has seemingly entered into what has heretofore been the steady trajectory of the powerful faithless servant doctrine.

In prior blog articles, we have pointed out the incredible power of the faithless doctrine as a tool for clawing back compensation from disloyal employees while creating an in *terrorem* deterrent to would-be wrongdoers. We suggested, based on case law at the time, the doctrine could result not just in a full forfeiture of compensation but also an award of investigative costs. The doctrine could also be used, in our view, as a means of striking back at serial sexual harassers. In 2018, the courts have solidified the doctrine in one way but may have retracted it in another.

Multi-Million Dollar Forfeiture Upheld

In *Salus Capital Partners, LLC v. Moser* (2018) — after terminating the company's CEO without cause, the employer reviewed the former CEO's emails and uncovered evidence that he attempted to conceal unauthorized personal charges on the corporate credit card. The employer, in arbitration, asserted the faithless servant doctrine to obtain a forfeiture of compensation and recoup the fees it paid to its outside counsel for investigating the CEO's misconduct. The U.S. District Court for the Southern District of New York upheld the arbitrator's award, which found that the CEO had:

- Spent $90,000 in questionable credit card charges, including charges on patio furniture, watches, and family travel expenses;
- Falsified an audio visual vendor's invoices totaling $100,000 with the intent to deceive Salus as to the true nature of the expenses incurred — since the AV work was actually done for his personal home, not Salus; and
- Spent $35,000 in personal use of the company's NetJets account.

Adding insult to injury, the CEO used corporate funds to purchase Boston Bruins gear (had it been New England Patriots gear, capital punishment may have been on the table).

The Court ultimately upheld the arbitrator's award of $879,514 in compensation forfeiture and $748,155 in attorneys' fees for the investigation conducted after the CEO's employment ended. Despite the CEO's protestations that the award was overly punitive and did not consider his otherwise positive job performance, the Court upheld a complete compensation forfeiture, holding: "[the CEO's] purported exemplary performance of his duties when he was not stealing from plaintiff does not insulate him from the application of the faithless servant doctrine."

The investigative costs were recoverable pursuant to an indemnification clause in the applicable LLC agreements. The same misconduct that formed the basis for the compensation forfeiture triggered the indemnity. Such costs have been held recoverable under the faithless servant doctrine as well.

Given the cost of retaining a blue chip law firm to conduct an investigation and the Court's holding that a disloyal executive can be charged with that cost, the decision in *Salus Capital Partners, LLC* can serve as powerful anvil to obtain a pre-litigation settlement. The case further underscores the policy of deterring disloyal conduct that is at the very core of the faithless servant doctrine.

Sexual Harassment

The #MeToo movement has brought about the seemingly weekly undoing of high profile employees. Victims who may previously have felt frightened of coming forward for fear of being blackballed or disbelieved are finding a much more receptive climate in which to make their complaints known. A necessary corollary to this movement is that a company's image can be eviscerated when news of sexual harassment in its midst goes viral.

While the faithless servant doctrine has been around for more than a century, there is a dearth of cases involving sexual harassment as the underlying act of disloyalty.

In *Astra USA, Inc. v. Bildman* (2009), the Massachusetts Supreme Court, applying New York law, upheld a massive salary forfeiture under the faithless servant doctrine based on a CEO's fiscal improprieties and repeated acts of sexual harassment that resulted in paying off settlements and injuring Astra's reputation. With respect to the harassment, the Court noted that the CEO used Astra as "his sexual fiefdom" and caused Astra months of bad publicity.

In *Colliton v. Cravath, Swaine & Moore, LLC* (2008), the U.S. District Court for the Southern District of New York held that an attorney was subject to a forfeiture of his compensation because by committing statutory rape and patronizing a prostitute he was incapable of meeting the ethical standards of his profession constituting "a substantial breach of his duty of loyalty."

In 2018, however, one court held that sexual harassment by an executive does not constitute a breach of the duty of loyalty. In *Pozner v. Fox Broadcasting Co.* (2018), the Supreme Court, New York County, attempted to distinguish *Astra* by noting that in *Astra* the misconduct was not limited to sexual harassment, but "involved acts directly against the company's interests, including stealing company funds, destroying its property . . . ." The Court apparently did not consider that sexual harassment is also an act "directly against a company's interests" as it creates an untenable work environment, victimizes valued employees, and severely damages the company's reputation to its customers and potential customers, as well as its employees and potential employees.

The Court also distinguished *Colliton*, reasoning that the conduct at issue there rendered the disloyal employee unable to fulfill the terms of his contract and that his employment was the product of fraudulent concealment. It appears that the court in *Pozner* did not fully consider that hidden sexual harassment makes the perpetrator's continued employment the product of fraudulent concealment as well. Indeed, many victims of sexual harassment do not come forward because of threats made by the very perpetrators of the harassment, making the harasser's disloyalty doubly repugnant and deserving of the wrath of the faithless servant doctrine.

Prior to *Pozner*, New York courts strictly applied the faithless servant doctrine with a keen eye for its unique and salutary purpose. In *Diamond v. Oreamuno* (1969), the New York Court of Appeals held: "[T]he function [of a breach of fiduciary duty action], unlike an ordinary tort or contract case, is not merely to compensate the plaintiff for wrongs committed by the defendants but . . . to *prevent* them, by removing from agents and trustees all inducement to attempt dealing for their own benefit in matters which they have undertaken for others, or to which their agency or trust relates." The Court in *Astra* echoed this sentiment, holding: "For New York . . . the harshness of the remedy is precisely the point."

Pozner is a lower court decision, and it remains to be seen whether an appellate court, recognizing the deterrent goal of the faithless servant doctrine, will hold that using one's position of power in a corporation to sexually harass subordinates constitutes a breach of fiduciary duty or duty of loyalty. Until there is more appellate court authority on this issue, would-be harassers should not view *Pozner* as a proverbial "get out of jail free card" when it comes to the application of the faithless servant doctrine.

If you have any questions about this Information Memo, please contact Howard M. Miller, any of the attorneys in our Labor and Employment Law Practice, or the attorney in the firm with whom you are regularly in contact.

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