

Recent Case Law: Concerns Involving the Departure of Key Employees and Agents from a Brokerage Firm

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Recent lawsuits highlight the risks related to the departure of key employees and agents from brokerage firms. In two recent cases, Douglas Elliman of Westchester, LLC v. Theiss (No. 58059/2015, 2017 WL 3159223 (N.Y. Sup. Ct., Westchester Cty., June 20, 2017)) and Douglas Elliman, LLC v. Steinberg (2017 Slip Op 31047 (N.Y. Sup. Ct., New York Cty., May 16, 2017)), several important issues are addressed of which all brokerage firms, as well as managers and licensed salespersons, should be aware. Both cases involved former employees and agents of a brokerage firm being sued for soliciting and/or recruiting other employees and agents to leave the former firms and to join their new firms. Each of these cases also involved allegations that these former agents and employees misappropriated confidential and proprietary information belonging to their prior firms.

The Cases: The Facts and Circumstances Surrounding the Departure

In Douglas Elliman of Westchester, LLC v. Theiss, the jury awarded the plaintiff brokerage firm \$4.75 million in damages. In this case, the manager of the firm allegedly solicited salespeople and encouraged them to leave Douglas Elliman and move to the competitor firm, William Raveis Real Estate. As reported by the National Association of REALTORS® (“NAR”) in a press release, the competitor attempted to recruit sales agents from the firm previously and “[a]llegedly, the Competitor asked the Manager to remain with the Employer for a period before moving to the Competitor so that she could recruit salespeople and also bring listings to the Competitor.” The Manager eventually moved to the competitor firm and eleven sales agents also moved to the new firm. It was additionally alleged that the manager copied and misappropriated confidential information belonging to the prior firm.

The plaintiff in Theiss also sued the manager for breach of fiduciary duty. NAR reported that the plaintiff alleged that the “...Manager had a fiduciary duty to the Employer to recruit/maintain the firm’s relationship with its salespeople and she breached that duty when she recruited the salespeople to work for the Competitor.” The breach of fiduciary duty included allegedly stealing confidential information. The defendants indicated that they would be filing an appeal.

In Douglas Elliman, LLC v. Steinberg, two agents, affiliated with Douglas Elliman, LLC as independent contractors, left the firm to work for a new start-up real estate brokerage firm, Urban Compass, Inc. After the two agents left the firm, they entered into a “Commission Confirmation Agreement” which confirmed the commission arrangement on transactions that were still in process and had not yet closed. In October 2016, Douglas Elliman commenced an action against the two agents and their new firm.

Similarly, as in the Theiss case, this plaintiff also alleged that the agents, with the assistance of the defendant brokerage firm, improperly solicited and “induced” other agents to

leave the prior firm. The Commission Confirmation Agreement included non-solicitation provisions which were negotiated and agreed upon by the parties. The non-solicitation provisions were upheld by the Court.

Douglas Elliman also sued Compass for “tortious interference with a contract.” First, the plaintiff alleged that Compass induced the agents to breach the Commission Confirmation Agreement by hiring a “...recruiter to work in connection with the [defendant agents] to contract every agent...” at Douglas Elliman’s office in New York City. In addition, the plaintiff also alleged that the defendants induced property owners to breach exclusive listing agreements they had with the plaintiff brokerage firm. If proven, an action for tortious interference with a contract can result in punitive damages being awarded to the plaintiff which can be significant.

A Basis for Tortious Interference with a Contract

In Steinberg, the Court explains that in order for a party to prove tortious interference with a contract, a plaintiff must establish and prove the following:

1. There must be a valid contract between the plaintiff and a third party;
2. The defendant must have knowledge of the existence of the contract;
3. The defendant must have intentionally induced and procured the third-party's breach of the contract without justification;
4. That there is an actual breach of the contract; and
5. The plaintiff has to suffer actual damages resulting from the interference.

The Court in Steinberg granted the defendant’s motion to dismiss based on plaintiff’s first claim of tortious interference because the plaintiff failed to adequately plea that Compass intentionally procured the agents to breach the Commission Confirmation Agreement. The Court further held that simply because Compass hired a third party recruiter to recruit agents from the plaintiff’s firm did not establish sufficient grounds to survive a motion to dismiss. The Court also pointed out that Compass had the legal right to hire a recruiter and that the recruiter was not subject to the restrictive covenant contained in the Commission Confirmation Agreement and was not a party to that agreement.

However, with regard to the second tortious interference claim relating to the defendants’ alleged actions in inducing property owners to breach their exclusive listing agreement and list with the defendants, the Court held that the plaintiff sufficiently established that Compass was aware of the exclusive listing agreements and that it induced many property owners to breach their agreements.

The Validity of Non-Solicitation Agreements and Restrictive Covenants

The defendants in Steinberg argued, as most defendants do in similar instances, that the non-solicitation provision and restrictive covenant is unreasonable and unenforceable. However, the Court held that the non-solicitation clause in the Commission Confirmation Agreement was reasonable. The Court explained that in New York, a restrictive covenant such as this non-

solicitation clause (or even a non-compete provision), is reasonable and enforceable provided the following:

1. The restraint is not greater than is necessary to protect the legitimate interest of the employer;
2. The restriction does not impose an undue hardship; and
3. The restraint does not injure the public.

The Court explained that the non-solicitation provision in this instance was “narrowly tailored” and promoted a legitimate interest of the plaintiff. The Court pointed out the Commission Confirmation Agreement allowed the agents to work for Compass and even allowed them to hire agents of the plaintiff if these agents approached the defendants on their own.

The Court further held that the length of the non-solicitation period of eighteen (18) months was reasonable. Challenges to restrictive covenants, such as non-compete and non-solicitation provisions, can be successful if a defendant is able to establish that the restricted periods or radius restrictions are too long or overbroad. The Court in Steinberg further pointed out that even when a “restrictive covenant” is found to be unenforceable, “...where an employee voluntarily resigns and the ‘employer conditions receipt of post-employment benefits upon compliance with a restrictive covenant’ the restriction will be enforced ‘without regard to reasonableness.’” In this case, the defendants agreed to accept ongoing payments of commission for pending transactions that had not yet closed.

Unfair Competition and Breach of Fiduciary Duty Claims

In both Steinberg and Theiss, the plaintiffs alleged that the manager and/or agents misappropriated proprietary and confidential information and used it to compete against them. The Court in Steinberg explained that, in New York, in order to establish a claim for unfair competition, the “...plaintiff must demonstrate that it had compiled information used in its business that provided an opportunity to obtain a competitive advantage and that a competitor misappropriated it.” In Steinberg, the defendant allegedly misappropriated a report and presented it to its clients as its own.

In Theiss, which involved the manager of the firm, who was an employee, the plaintiffs alleged that the manager had a fiduciary duty to it to maintain the brokerage firm’s relationship with its salespeople and she breached that duty by recruiting agents for the competitor firm. In addition, she allegedly breached her duty to her employer by stealing confidential information. Theiss also allegedly breached her duty by encouraging the salespeople to delay the execution of listing agreements so that the listings could be transferred to the defendant firm.

How Can Brokers and Agents Guard Against Issues Arising from a Break Up?

It is clear from these cases, that regardless of who is right and who is wrong, the consequences could be severe. It is very important for all parties (i.e., whether brokers, agents or employees) to have agreements in place that address many of these issues at the time a person is hired as an employee or engaged as a salesperson (i.e., independent contractor). Regardless of

whether it is an employment agreement or an independent contractor agreement, the parties should enter into a formal agreement that clearly delineates the rights of the parties and provides for what happens if an agent, manager or employee leaves a firm and the restrictions placed upon that person. As is evident in Steinberg, even when the parties enter into an agreement, post-break-up, there still could be issues.

It is important to note that the Courts do uphold non-solicitation, non-disclosure and non-compete provisions and therefore, it is a good idea for a principal broker to include these provisions in any agreement with a prospective independent contractor or employee, especially a key employee such as a manager. In addition, it is a very good idea to include specific provisions dealing with the payment of commission upon a break-up or split. Agents, especially, should want to include provisions dealing with commission payments particularly when a broker would not be required to pay a commission to an agent who leaves the firm. While it is critical to have agreements in place before something happens, it is even more crucial to have the forms of employment or independent contractor agreements reviewed by an attorney before implementing them in your business.

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