

A Third Party in New Jersey May be Unable to Avoid Fee Awards Under an Exception to the American Rule

As a cautionary tale, in *Accounteks.Net, Inc. v. CKR Law, LLP, and Christian Montes*, the New Jersey Appellate Court ruled on May 9, 2023, that, under an exception to the American Rule, a third party can be liable for attorneys' fees in situations where litigation is initiated against a tortfeasor and a third party simultaneously. Not only does this serve as a warning to parties sued simultaneously with other parties, but this decision has specific implications for companies intent on hiring an individual with employment restrictions due to a restrictive covenant agreement.

The plaintiff, an information technology contractor (IT contractor), hired an employee and required him to sign a restrictive covenant agreement in which he agreed, among other provisions, that he would not leave the company to work for any of the company's clients for two years. After some training and obtaining experience in his position, the employee acted as the primary technical support for one of the IT contractor's clients, a law firm.

The employee worked for the IT contractor for just under a year when he then resigned and went to work for another IT firm. Shortly thereafter, upon learning that the employee left employment with the IT contractor, the law firm contacted the employee and offered him employment with the law firm. The law firm notified the IT contractor it intended to hire the employee. In response, the IT contractor informed the law firm that it did not consent to this hiring, nor would it waive the terms of the employee's restrictive covenant agreement. The law firm moved ahead with hiring the employee. As a result, the IT contractor filed a lawsuit in New Jersey state court seeking enforcement of the non-compete agreement and alleging that the employee and the law firm misappropriated confidential information.

After a bench trial, the trial court held:

1. the non-compete agreement is enforceable, and the employee is liable for breach of contract;
2. the law firm is liable for tortious interference;
3. the employee and law firm are jointly liable for breach of the implied covenant of good faith and fair dealing; and
4. the IT contractor proved its breach of contract, account stated, and unjust enrichment claims.

The trial court then awarded the IT contractor damages against the law firm. At a separate hearing, the trial court also awarded the IT contractor attorneys' fees.

One of the issues raised for the New Jersey Appellate Court's review was whether an award of attorneys' fees is proper against a third party where a plaintiff files litigation against different parties simultaneously. The Appellate Court noted the courts generally adhere to the American Rule, where each party is responsible for its own attorneys' fees unless fee shifting is permissible by law or agreement. While the restrictive covenant agreement at issue included an express fee-shifting provision, the law firm was not a party to that agreement. The trial court nonetheless determined that the attorneys' fees should be assessed to the law firm because the costs constituted additional damages flowing from the law firm's tortious interference. The Appellate Court upheld the determination, recognizing it as an exception to the American Rule. It then agreed with a view expressed by the Colorado Court of Appeals that "form should not prevail over substance." It held that in circumstances such as in this case, where it was warranted for the company to bring two simultaneous actions in one suit – the breach of the non-compete against the employee and the tortious interference claim against the law firm – the company should not have to file two separate lawsuits just to recover attorneys' fee awards for seeking to enforce a restrictive covenant. Moreover, there were two distinct tortfeasors – the law firm and the employee. Accordingly, the Appellate Court upheld the fee award, holding the fees fell into an exception to the



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American Rule.

There are a number of takeaways from this decision. First, in any type of litigation, a party should be mindful that it could be on the hook for attorneys' fees under this exception to the American Rule, even if the litigation is brought simultaneously against other parties. Second, on a positive note, given the recent decisions and proposed federal action severely limiting the use of restrictive covenants, this decision could constitute a win for employers in the non-compete arena, particularly those businesses trying to avoid the poaching of their employees in an employment landscape with a labor shortage. Finally, this decision further serves as a reminder to any company considering hiring an employee with an existing restrictive covenant that it should take any such obligation seriously and make efforts to resolve any disputes with a former employer when hiring a new employee.
