

NEW YORK COURT OF APPEALS ROUNDUP

COURT OF APPEALS CONSIDERS SCOPE OF EMPLOYER'S DUTY OF SUPERVISION OVER EMPLOYEE

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In *Moore Charitable Foundation v. PJT Partners*, the Court of Appeals considered the scope of an employer's duty of supervision over its employee and whether a complaint sufficiently alleged that an employer was on notice of its employee's propensity to commit fraud before the employee caused injury to the plaintiff. In a majority decision written by Judge Anthony Cannataro and joined by Chief Judge Wilson and Judges Rivera, Troutman and Nancy E. Smith of the Fourth Department (sitting by designation), the court reversed the Appellate Division, First Department and held that the parties to whom employers owe a duty of supervision include more than just the employer's actual customers and that the plaintiffs adequately alleged a cause of action for negligent supervision and retention where the plaintiff was defrauded by an employee of the defendants while using his work email address and documents obtained in connection with his employment.

According to the complaint, the defendant investment bank and one of its divisions hired an employee to represent private equity fund managers interested in offering liquidity to their investors. The employee was initially successful and brought in a substantial amount of work for the defendants, but over time he allegedly engaged in "dangerous and destructive behaviors" while at work, including excessive high-risk trading from personal accounts, obsessively monitoring the performance of his investments, and "drinking to excess." In 2014, the employee closed a deal earning the defendants a deal fee of \$8.1 million. The employee allegedly intercepted the payment and diverted it to his own personal funds, which he later lost in connection with personal investments. When the defendants inquired about the missing payment, the employee lied and claimed that no payment would be received until after a "stub closing" was complete. The complaint asserts that the employee's explanation was implausible and transparently false for a variety of reasons but that the defendants failed to challenge the employee's explanation about the delayed payment at that time.

To secure new funds to replace the stolen funds, the employee allegedly devised a scheme whereby he contacted the plaintiffs using his company email address and convinced them to invest in a security with a purportedly risk-free 15% rate of return. The employee also used information from the defendants' data room to substantiate the proposed investment. The plaintiffs agreed to provide the employee with \$25 million in connection with his financing proposal. The payment instructions were sent on the defendants' letterhead and from the employee's company email address. Upon receipt of the payment, the employee transferred the missing \$8.1 million to the defendants and the rest to his own personal account. In 2016, the plaintiffs discovered the fraud and the employee pleaded guilty in federal court to securities and mail fraud charges later that year. He was sentenced to four-years imprisonment and required to pay restitution to the plaintiffs, but no payment has been made.

The plaintiffs commenced this action to recover their losses from the defendants, asserting causes of action for negligent supervision and retention, conversion, and fraud. The Supreme Court, New York County allowed the conversion and fraud causes of action to proceed, but dismissed the negligent supervision and retention cause of action because the plaintiffs failed to adequately plead that the defendants were on notice of the employee's propensity for fraud and had not considered whether the

defendants' duty ran only to actual customers. No. 654584/17, 2018 N.Y. Misc. LEXIS 3489 at *26-27 (N.Y. Sup. Ct., Aug. 13, 2018). On the parties' cross appeals, the First Department dismissed the complaint in its entirety. 178 A.D.3d 433, 434 (1st Dep't 2019). The Appellate Division agreed with the Supreme Court that the complaint did not adequately allege that the defendants were aware of the circumstances that, the plaintiffs contend, would have put the defendants on notice of the employee's criminal propensity. Moreover, the complaint failed to allege that the plaintiffs were customers of the defendants, which the Appellate Division held was fatal to a cause of action for negligent supervision. The Court of Appeals granted the plaintiffs' motion for leave to appeal.

The majority began its analysis with the standard for an employer's knowledge in a negligent supervision and retention cause of action. According to the majority, "when an employer has notice of its employee's propensity to engage in tortious conduct, yet retains and fails to reasonably supervise such employee, the employer may become liable for injuries thereafter proximately caused by its negligent supervision and retention ... A defendant is on notice of an employee's propensity to engage in tortious conduct when it knows or should know of the employee's tendency to engage in such conduct." Defendants argued that the standard requires actual knowledge of multiple acts by the employee similar to those alleged in the complaint. According to the majority, however, "an employer 'should know' of an employee's dangerous propensity if it has reason to know of the facts or events evidencing that propensity, and may be liable if it nonetheless 'places the employee in a position to cause foreseeable harm.'" The majority further explained that "the notice element is satisfied if a reasonably prudent employer, exercising ordinary care under the circumstances, would have been aware of the employee's propensity to engage in the injury-causing conduct."

The plaintiffs' allegations concerning the employee's excessive drinking and obsessive personal stock trading during work hours, and the "transparently false" response the employee gave regarding the missing deal fee payment were enough for the majority to hold that the plaintiff adequately pleaded a cause of action for negligent supervision and retention. However, the majority agreed with the defendants that allegations of excessive drinking and obsessive stock trading alone would not be sufficient to justify an inference that the defendants should have known of the employee's propensity to commit fraud. "For prior conduct to provide notice of an employee's propensity to commit a tort, that conduct must be 'similar to the injury-causing act'" and there is too great of a disconnect between excessive drinking and obsessive personal stock trading and the fraud perpetuated against the plaintiffs. Accordingly, it was the plaintiffs' allegations that the defendants did not uncover the employee's "transparent" lie about the missing deal fee payment and at least one other similar diversion-and-cover-up scheme that were critical to the majority's decision.

The majority next turned to the Appellate Division's holding that the plaintiffs needed to allege that they were customers of the defendants. The majority rejected the argument that a special relationship or privity between the plaintiff and an employer is a required element of a negligent supervision cause of action. Even though the plaintiffs were not customers of the defendants, they allege that they were prospective customers who were solicited by the employee to participate in a financing arrangement supported by the defendants' documentation to which the employee had access as a result of his employment. These allegations were sufficient for the majority to find the existence of a duty on the part of the defendants to supervise the employee in a non-negligent manner for the plaintiffs' benefit. Judge Madeline Singas, joined by Judge Garcia (Judge Halligan took no part in the decision), wrote a lengthy dissent arguing that the majority's opinion would expose law firms, banks, hedge funds, and countless other financial institutions to limitless liability for the criminal actions of rogue employees. The dissent focused on the fact that the plaintiffs had no connection to the defendants and were targeted by a criminal actor who convinced them to invest in his scheme that involved a transaction that was not part of his job description.

According to the dissent, "permitting all potential customers to sue employers for an employee's fraud unrelated to the employment but perpetrated via company email or phone would result in unmitigated proliferation of claims and virtually unlimited liability, well beyond the traditional concepts of respondeat

superior and apparent authority.” The dissent expressed concern with the effect that this would have on financial and other commercial institutions’ desire to continue conducting business in New York.

Time will tell how lower courts will apply such guidance to future cases and whether the dissent’s predictions and fears will be realized.

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