

Rumbles in the “C-Suite”

Representing Texas Executives in Employment Disputes

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Today's Topics

1. Breach of contract lawsuits over “Just Cause”
2. Other common contract litigation
3. “Change of Control” litigation – both ERISA and non-ERISA situations
4. Fiduciary Duty rules and litigation – both ordinary employees and corporate officers
5. June 24, 2011 – Texas Supreme Court decision regarding non-competition agreements
6. Practice Pointers for representing executives in employment disputes

Breach of Contract Suits Over “Just Cause”

- Often, severance benefits are tied to whether the company has “just cause” to terminate the executive.
- Texas law defines “cause” as “...the employee’s failure to perform the duties in the scope of employment that a person of ordinary prudence would have done under the same or similar circumstances. An employee’s act constitutes good cause for discharge if it is inconsistent with the continued existence of the employer-employee relationship.”
- *Lee-Wring, Inc. v. Hall*, 840 S.W.2d 572, 580 (Tex. App.—Houston [1st Dist.] 1992, no writ); accord *Dixie Glass Co. v. Pollak*, 341 S.W.2D 530, 542-43 (Tex. App.—Houston, 1960 writ ref’d n.r.e.).

Breach of Contract Suits Over “Just Cause”



- Whether just cause existed to justify termination is ordinarily a fact question for the jury to decide.
- *Dixie Glass Co.*, 341 S.W.2d at 542-43 (whether plaintiff’s alleged mishandling of two of his employer’s clients constituted “cause” to terminate his employment was for the jury to decide);
- *Hernandez v. Exxon Corp.*, 943 F. Supp. 740, 751 (S.D. Tex. 1996) (whether plaintiff’s alleged conflict of interest, which he denied, constituted “cause” to terminate his employment, could not be resolved on summary judgment, but, rather, was for the jury to decide).

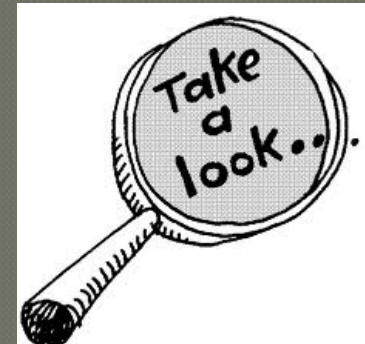
Breach of Contract Suits Over “Just Cause”



- The only Texas cases finding that this issue could be resolved on summary judgment are cases where employees admitted engaging in fairly serious wrongdoing.
- *Watts v. St. Mary's Hall, Inc.*, 662 S.W.2d 55, 58 (Tex. App.—San Antonio 1983, writ ref'd n.r.e.) (employee of private school who admittedly slapped (drunken) student was terminated for “cause” as a matter of law).
- *Tave v. Alanis*, 109 S.W.3d 890 (Tex. App.—Dallas 2003, no pet.) (teacher who admittedly disseminated confidential reprimands of other teachers was terminated for “cause”).

Breach of Contract Suits Over “Just Cause” – Practice Pointers

1. Review specific definition in contract – often, the exact language demands a higher standard than the company can satisfy
2. Gather statements from favorable witnesses before filing suit or arbitration claim
3. Do discovery on prior situations involving the same or similar conduct and how the employer responded
4. Focus on actual or potential harm, or lack thereof, to the company resulting from the executive’s conduct
5. Focus on lack of supporting documentation (which is often the case when it comes to executive level terminations) and annual performance reviews



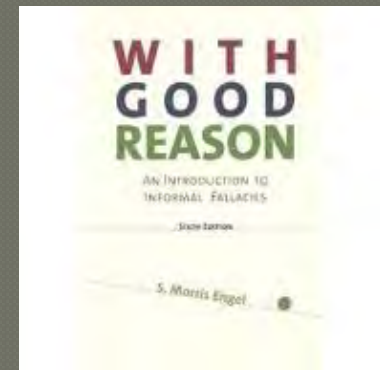
Other Common Contract Litigation Issues

- Notice and cure provisions
- *Hanson v. Capital Dist. Sports*, 218 A.D.2d 909, 630 N.Y.S.2d 429 (N.Y. App. 1995) (employee's discharge violated terms of employment contract, even if there was cause for discharge, where contract required employer to give employee written notice of cause for discharge and seven days to cure or commence to cure such cause, and employer failed to give employee such notice)



Other Common Contract Litigation Issues

- Resigning for “Good Reason”
- *Orbit One Communications, Inc. v. Numerex Corp.*, 692 F. Supp.2d 373 (S.D.N.Y. 2010) (fact issues precluded summary judgment for employer as to whether executive had “good reason” to resign, given that employer may not have given executive the necessary resources to perform his duties as president)



Other Common Contract Litigation Issues

- Fee shifting provisions – executive wins

- *Creel v. Houston Industries, Inc.*, 124 S.W.3d 742 (Tex.App.--Houston [1st Dist.] 2003, no pet.) (fee shifting provision required employer to pay three executive' fees for bringing suit against employer under contract even though employer won the lawsuit)

- Fee shifting provisions – executive loses

- *Ludwig v. Encore Medical, L.P.*, 191 S.W.3d 285 (Tex. App.--Austin] 2006, pet. denied) (fee shifting provision did not require employer to pay executive's fees for bringing suit against employer under contract where employer won)

Other Common Contract Litigation Issues

- Letter Agreements
- Retention and transition agreements and their interplay with existing employment contracts



Other Common Contract Litigation Issues

- **Discretionary bonuses.** *See, e.g., Lewis v. Vitol, S.A.*, 2006 WL 1767138 (Tex.App. – Houston [1st Dist.] 2006, no writ) (where contractual bonus was in management’s sole discretion, the plaintiff had no claim for any bonus).
- **Nondiscretionary bonuses.** *See, e.g., Vanegas v. American Energy Servs.*, 302 S.W.3d 299 (Tex. 2009) (promise to pay specific bonus if company was ever sold was enforceable)



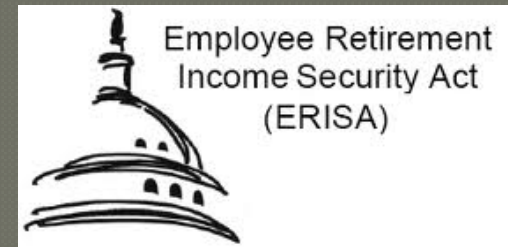
Change of Control Litigation



- Governed by ERISA if an ongoing administrative program / plan is required to meet the employer's obligation.
- *See Crowell v. Shell Oil Co.*, 541 F.3d 295, 302-07 (5th Cir. 2008) (letters of agreement which provided some retirees, in the event of a change of control of the company, benefits above and beyond those described in employer-sponsored retirement plan, constituted "plan" subject to ERISA).

Change of Control Litigation

- Not governed by ERISA if an ongoing administrative program / plan is not required to meet the employer's obligation – *e.g.*, a one time payment based on an objective formula
- *Fontenot v. NL Industries, Inc.*, 953 F.2d 960, 961 (5th Cir. 1992) (“golden parachute” cash severance payment issued upon a change of control not governed by ERISA)



Change of Control Litigation

- **When governed by ERISA, the standard of review is deferential and pro-plan administrator / Defendant**
- *Stone v. UNOCAL Termination Allowance Plan*, 570 F.3d 252 (5th Cir. 2009) (applying abuse of discretion standard of review, and upholding plan administrator's denial of benefits based on the finding that the plaintiff was not constructively discharged after change of control, and thus was not entitled to severance benefits)
- *Threadgill v. Prudential Secs. Group, Inc.*, 145 F.3d 286 (5th Cir. 1998) (upholding plan administrator's conclusion that a merger agreement between the plaintiffs' employer and acquiring corporation did not constitute a change of control as defined by an ERISA plan provision requiring severance payments to plaintiffs in the event of a change of control)



Change of Control Litigation



- **When governed by ERISA, the standard of review is deferential and pro-plan administrator / Defendant**
- *Harms v. Cavenham Forest Indus., Inc.*, 984 F.2d 686 (5th Cir. 1993) (upholding plan administrator’s determination that employee who were beneficiaries under successor employer’s separate severance pay plan were not also entitled to benefits under their predecessor’s severance plan, and stating that “[w]hat the beneficiaries seek, as they forthrightly conceded at oral argument, is merely a double-recovery windfall – a result abhorred by ERISA.”) (citation omitted)

Change of Control Litigation

- **When not governed by ERISA, it is just a straight breach of contract case. Plaintiffs tend to do better in that situation.**
- *Shaffer v. Regions Financial Corp.*, 29 So.3d 872 (Ala. 2009) (genuine issues of material fact as to whether management employee's responsibilities changed after merger, whether changes were materially adverse, and whether employee left employment for good reason, precluded summary judgment on whether change of control agreement obligated employer to pay plaintiff aggregate of accrued compensation plus severance pay and legal expenses)



Change of Control Litigation

- **When not governed by ERISA, it is just a straight breach of contract case. Plaintiffs tend to do better in that situation.**
- *Nalty v. D.H. Holmes Co., Ltd.*, 882 So.2d 1 (La.App. 4th Cir. 2004, writ denied) (rejecting plan administrator's conclusion in non-ERISA cases, and finding that former directors of the defendant company did not voluntarily terminate their employment, and thus, the directors were entitled to retirement benefits under plan provisions for involuntary termination due to change in control, where directors refused to sign voluntary resignation letters after company merger)



Change of Control Litigation – Practice Pointers

1. Tread into ERISA territory very carefully, if at all
2. If ERISA, be sure to include all relevant and helpful information into the administrative record. Although there are some exceptions, generally speaking a court will not allow the plaintiff to supplement the administrative record after-the-fact
3. Build a consistent, compelling record before proceeding with suit
4. Don't be (or appear to be) greedy



Fiduciary Duty Rules and Litigation

Ordinary Employees

- An at-will employee breaches their fiduciary duty to their employer if, during their employment, they: (1) misappropriate the company's trade secrets; (2) solicits the employer's customers while still working for their employer; (3) solicits the departure of other employees while still working for the employer; or (4) carries away confidential information.
- *Johnson v. Brewer & Pritchard, P.C.*, 73 S.W.3d 193, 202 (Tex. 2002).



Fiduciary Duty Rules and Litigation

Ordinary Employees

- Aside from those limitations, taking preparatory steps to compete with an employer while still working for that employer is not actionable
- *Navigant Consulting, Inc. v. Wilkinson*, 508 F. 3d 277, 284 (5th Cir. 2007) (under Texas law, an at-will employee may properly plan to go into competition with his employer and may take active steps to do so while still employed)



Fiduciary Duty Rules and Litigation

Ordinary Employees



- The employee has no general duty to disclose his plans and may secretly join with other employees in the endeavor without violating any duty to the employer.
- Further, an employee may use his general knowledge, skill, and experience acquired in the former employment to compete. *Abetter Trucking Co.*, 113 S.W.3d at 512.

Fiduciary Duty Rules and Litigation

- **Ordinary Employees**
- But, there are fact specific exceptions to the “no duty to disclose rule” when fairness demands it.
- *See Navigant Consulting, Inc.* (failure to disclose plans to form competitive business while simultaneously signing long term lease for employer in order to put employer in ongoing vulnerable financial position was a breach of fiduciary duty).
- *See PAS, Inc. v. Engel*, ___ S.W.3d ___, 2011 WL 2535733, at *11 (Tex.App.–Houston [14th Dist.] June 28, 2011) (depending on facts, it could be a breach of fiduciary duty for vice president not to disclose that he had already created a competing business to compete against his employer in a way that would have violated his original non-compete agreement as he was negotiating a narrower non-compete restriction with his employer).

Fiduciary Duty Rules and Litigation

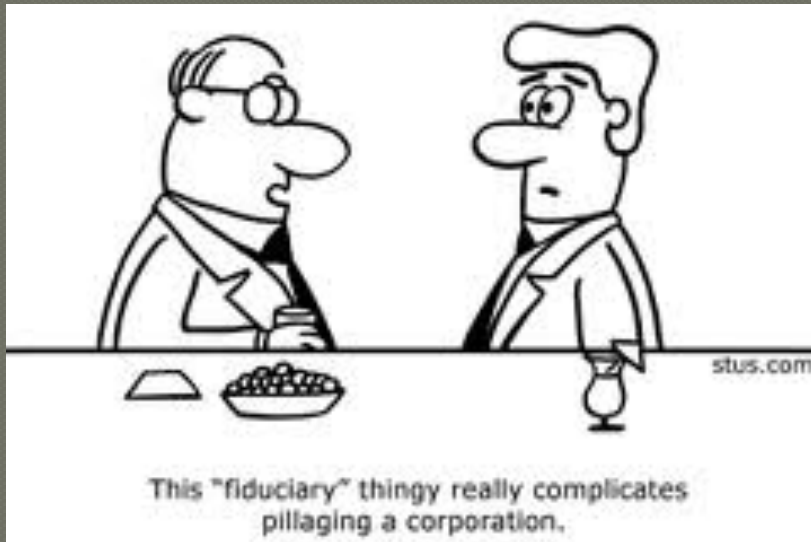
Ordinary Employees

- On May 17, 2010, the Fifth Circuit U.S. Court of Appeals affirmed a \$1.43 million award against a company's two former employees and the new company they formed to compete against their ex-employer
- *Meaux Surface Protection, Inc. v. Fogleman*, 607 F.3d 161 (5th Cir. 2010)
- They had solicited many of their coworkers to leave and join their competitive venture before they resigned from plaintiff's employment.

Fiduciary Duty Rules and Litigation

Corporate Officers

- Corporate officers owe fiduciary duties to the corporations they serve. *Pride Intern., Inc. v. Bragg*, 259 S.W.3d 839, 849 n.3 (Tex.App.--Hous. [1 Dist.] 2008, no pet.).
- This includes a duty to act only in the corporation's best interests. *See Hughes v. Houston Northwest Medical Center, Inc.*, 680 S.W.2d 838, 843 (Tex.App.-Houston [1st Dist.] 1984, writ ref'd n.r.e.) (corporate officers and directors owe corporation and shareholders duty to act only in their best interest).



Fiduciary Duty Rules and Litigation

Corporate Officers

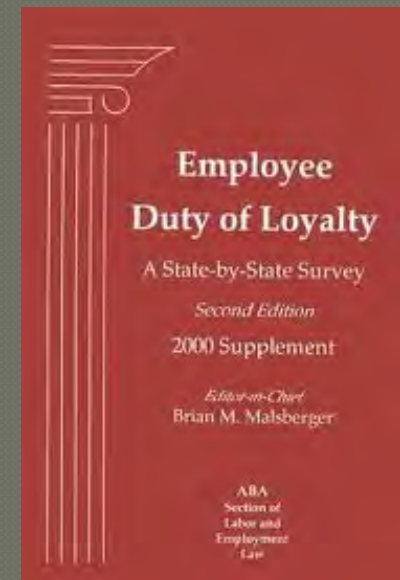
- The Texas Supreme Court in *International Bankers Life Insurance Company v. Holloway*, 368 S.W.2d 567 (Tex. 1963), noted that corporate officers and directors owe a strict fiduciary obligation to their corporation.
- Three broad duties stem from the fiduciary status of corporate officers and directors. **Namely, the duties of: (1) obedience; (2) loyalty; and (3) due care.** *Gearhart Industries, Inc. v. Smith International, Inc.*, 741 F.2d 707, 719 (5th Cir. 1984)(addressing Texas law); see *General Dynamics v. Torres*, 915 S.W.2d 45, 49 (Tex.App.-El Paso 1995, writ den'd).



Fiduciary Duty Rules and Litigation

Corporate Officers

- The duty of loyalty dictates that a corporate officer or director must act in good faith and must not allow his or her personal interest to prevail over the interest of the corporation.
- The duty of loyalty requires an extreme measure of candor, unselfishness, and good faith on the part of the officer or director. *International Bankers Life Insurance Company v. Holloway, supra* at 577.



Fiduciary Duty Rules and Litigation

Corporate Officers



- **Corporate opportunity doctrine:** To establish a breach of fiduciary duty by usurping a corporate opportunity, the corporation must prove that an officer or director misappropriated a business opportunity that properly belongs to the corporation. *International Bankers Life Ins. Co. v. Holloway*, *supra* at 576-78; *Icom Sys., Inc. v. Davies*, 990 S.W.2d 408, 410 (Tex. App. – Texarkana 1999, no writ).

Fiduciary Duty Rules and Litigation

Corporate Officers

- **Corporate opportunity doctrine:** The business opportunity arises where a corporation has a legitimate interest or expectancy in and the financial resources to take advantage of a particular business opportunity. *Icom Systems, Inc. v. Davies, supra* at 410.
- A corporation's financial inability to take advantage of a corporate opportunity is one of the defenses which may be asserted in a suit involving an alleged appropriation of a corporate opportunity. *Canion v. Texas Cycle Supply, Inc.*, 537 S.W.2d 510, 513 (Tex. Civ. App.--Austin 1976, writ ref'd n.r.e.).
- A corporation's abandonment of a business opportunity is another defense to a suit alleging usurpation of a corporate opportunity. *Huffington v. Upchurch*, 532 S.W.2d 576 (Tex.1976).

Fiduciary Duty Rules and Litigation

Corporate Officers



- **Corporate opportunity doctrine:**
- Case law example is *In re Advanced Modular Power Systems, Inc.*, 413 B.R. 643, 665-68 (Bkrtcy. S.D. Tex. 2009).
- Officer of company breached fiduciary duty to corporation by usurping and diverting business opportunities to a new corporation he had set up in the event the company went bankrupt.

New Texas Supreme Court Case

- ***Marsh USA Inc. v. Cook*, ___ S.W.3d ___, No. 09-0558, 2011 WL 2517019 (Tex. Jun 24, 2011)**
 - Marsh involved a former managing director of Marsh USA Inc., a risk management and insurance business.
 - During the director's employment, Marsh offered him options to purchase 500 shares of stock in Marsh's parent company.
 - The options vested in increments and fully vested after four years.
 - Upon exercise of the options, the director was required to sign a non-solicitation agreement in which he promised that if he left the company within three years after exercising the options, he would not solicit certain company clients or certain employees for a period of two years.

New Texas Supreme Court Case

- ***Marsh USA Inc. v. Cook*, ___ S.W.3d ___, No. 09-0558, 2011 WL 2517019 (Tex. Jun 24, 2011)**
 - The director quit and went to work for a competitor, and violated the non-compete agreement.
 - The Dallas Court of Appeals held that stock options and similar financial incentives were not sufficient consideration to support a noncompetition agreement because, unlike confidential information or specialized training, mere financial consideration does not “give rise to the employer’s interest in restraining the employee from competing.”
 - The Supreme Court held that this was the wrong test to apply, and thus overruled a portion of its prior decision in *Light v. Centel Cellular Co. of Texas* setting out this test.

New Texas Supreme Court Case

- ***Marsh USA Inc. v. Cook*, ___ S.W.3d ___, No. 09-0558, 2011 WL 2517019 (Tex. Jun 24, 2011)**
 - Instead, the *Marsh* Court held, the proper test is whether the consideration merely gives rise to, or is “reasonably related to,” an “interest worthy of protection.”
 - Under this test, the Court found, stock options were sufficient consideration because they made the employee an “owner” of the company and linked his interests with the company’s long-term business interests, including the development of solid, long-term customer and employee relationships.
 - Thus, the stock options furthered the company’s goodwill, which is expressly an “interest worthy of protection” expressly identified in the Texas Covenants Not to Compete Act, Tex. Bus. & Comm. Code § 15.50

New Texas Supreme Court Case

- ***Marsh USA Inc. v. Cook*, ___ S.W.3d ___, No. 09-0558, 2011 WL 2517019 (Tex. Jun 24, 2011)**
 - *Marsh* leaves open a lot of questions for future litigation.
 - But, it is consistent with a pro-enforcement trend in noncompetition agreements in Texas starting in 2006 in *Alex Sheshunoff Mgmt. Servs., L.P. v. Johnson*, 209 S.W.3d 644 (Tex. 2006) and continued in 2009 in *Mann Frankfort Stein & Lipp Advisors, Inc. v. Fielding*, 289 S.W.3d 844 (Tex. 2009).
 - It is also consistent with the fact that courts often do not like to let highly paid employees escape their contractual agreements. This tends to work against executives. *See, e.g., M-I LLC v. Stelly*, 733 F. Supp. 2d 759, 798-800 (S.D. Tex. 2010) (enforcing non-compete more broadly than normal largely because of the ex-employees high ranking and sensitive position in the company); *See also Curtis v. Ziff Energy Group, Ltd.*, 12 S.W.3d 114, 118 (Tex. App.--Houston [14th Dist.] 1999, no pet.) (enforcing noncompetition agreement against Vice President of Pipelines and Energy Marketing that prohibited him from engaging in competitive business in Canada or the United States for six months).

New Texas Supreme Court Case

- **Lessons:**

- Advise executives to be careful what you sign. Executives often have the power to say no.



- Negotiate up front, but don't be too slick for your own good. *See PAS, Inc. v. Engel*, __ S.W.3d __, 2011 WL 2535733, at *11 (Tex. App.--Houston [14th Dist.] June 28, 2011) (depending on facts, it could be a breach of fiduciary duty for vice president not to disclose that he had already created a competing business to compete against his employer in a way that would have violated his original non-compete agreement as he was negotiating a narrower non-compete restriction with his employer).

Practice Pointers For Executive Representation

1. The First Meeting
2. Maintaining A Strong Working Attorney-Client Relationship
3. Communicating with the Defendant
4. Counteracting and Overcoming Bias Against High Earners
5. Managing Expectations

Practice Pointers For Executive Representation

1. Releases (Mutual)
2. Non-disparagement clauses
3. Cooperation clauses, especially regarding ongoing company litigation

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