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A POTPOURRI

NEW BUSINESS RULE LIMITS DAMAGE AWARDS

Parties to an agreement may have a variety of remedies available to them in the event of a breach. These include specific performance, through which a party may be required to perform the agreement; injunctive relief, through which a party may be required to take or cease certain actions; and damages, through which a party may recover the lost value of the agreement. The recent decision in the *TAS Distributing Company* case illustrates the conditions to be satisfied if damages are sought, and the particular problems faced when a new business or product is involved.

TAS Distributing Company, Inc. ("TAS") granted Cummins Engine Company, Inc. ("Cummins") a co-exclusive license to use its idle-control technology for heavy-duty truck engines. Cummins was required by the license agreement to "make all reasonable efforts to market and sell" the licensed products in an effort to maximize royalties payable to TAS. Believing that Cummins was not making "all reasonable efforts," TAS sued Cummins, asserting, among other things, claims for breach of contract and damages in the form of lost profits. The district court held that TAS could not prove damages, and TAS appealed.

The Appellate Court ruled against TAS. It noted that "to plead a cause of action for breach of contract, a plaintiff must allege: (1) the existence of a valid and enforceable contract; (2) substantial performance by the plaintiff; (3) a breach by the defendant; and (4) resultant damages." The plaintiff bears the burden of proving that he or she sustained damages. Merely showing that a contract has been breached is not enough.

Damages for lost profits are prospective, inherently uncertain and incapable of precise calculation. As a result, courts do not require proof with absolute certainty and expert opinions are not necessarily required. However, there must be "a reasonable basis for the computation of damages which, with a reasonable degree of certainty, can be traced to defendant's wrongful conduct." When a new business or product is involved, claims generally are considered too uncertain, speculative and remote to permit recovery under the "new business rule." This rule may be avoided where damages can be established by reference to comparable past profits in an established business or product line. Unfortunately for TAS, it was unable to present evidence to the courts' satisfaction.

TAS attempted to establish damages in two ways. First, it presented evidence of past sales of its products by Cummins' chief competitor, Detroit Diesel Company ("Detroit Diesel"). Second, it argued that Cummins should have achieved the level of sales projected by Cummins during negotiations with TAS.

Reference to Detroit Diesel sales was rejected by the Appellate Court. It noted that courts have sometimes recognized damages based on comparable businesses operated by the same or another party from comparable locations during comparable time periods, but such cases are exceptional. The new business rule has, however, barred comparison of different products offered by established businesses, or an established product or products offered by different parties in the same or different markets because past successes with similar products or businesses do not provide a reasonable basis upon which to calculate lost profits for a new product, a new business, or a new market. Moreover, the mix of facts often is too distinguishable to permit reliance upon another's experience. Such was the case here, where the court acknowledged operational and circumstantial differences between Detroit Diesel and Cummins too significant to warrant reliance upon Detroit Diesel's experience as a basis to establish TAS' claimed losses with reasonable certainty. Merely stating that Cummins *should have* sold as many engines incorporating the TAS technology as did Detroit Diesel, without more, did not warrant reversal of the lower court's judgment.

Similarly, the Appellate Court rejected TAS's argument that Cummins should be bound by the sales projections it forwarded during negotiations. The projections were not incorporated in the parties' agreement. In fact, an integration clause in the agreement specifically precluded reliance upon any documentation or agreements between the parties to the extent not contained in the agreement. Therefore, Cummins' pre-contractual sales projections introduced during negotiations could not be considered a basis upon which to establish damages with reasonable certainty.

Claimants should be aware of the elements to be proven in order to recover for a lost profits claim, as well as those needed to prove damages with reasonable certainty. Careful evaluation is required before filing a lawsuit and, indeed, during the negotiation and preparation of the underlying agreement. Otherwise, a breach may simply be a breach, providing no basis for recovery.

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PAY ATTENTION TO PAID-IN CAPITAL

Under the Illinois Business Corporation Act (the "Act"), every corporation has "paid-in capital," and is required to report its paid-in capital each year, along with all changes to the paid-in capital, to the Illinois Secretary of State. The primary reason for determining paid-in capital under the Act is that the amount of each corporation's annual franchise tax is based on the amount of its paid-in capital. The Act's method for determining paid-in capital is not same as the calculation of paid-in capital under generally accepted accounting principles or federal income tax concepts. As a result, paid-in capital on the corporation's balance sheet is not necessarily the same as the paid-in capital on the records of the Secretary of State.

The Act defines "paid-in capital" as the sum of (1) cash and other consideration received, less expenses, including commissions paid or incurred by the corporation in connection with the issuance of its shares; plus (2) cash and other consideration contributed to the corporation by or on behalf of its shareholders;

plus (3) amounts transferred to paid-in capital by action of the board of directors or shareholders pursuant to a share dividend, share split, or otherwise; and minus (4) reductions in paid-in capital as provided elsewhere in the Act.

Paid-in capital is generally determined by adding the corporation's capital account and its paid-in surplus accounts set forth in the equity section of a corporation's balance sheet. For example, if a newly formed domestic corporation issues 100 common shares having a par value of \$1 per share for a consideration of \$1,000, the corporation's paid-in capital account would be \$1,000, consisting of the sum of the corporation's capital account of \$100 (100 shares × \$1 par value) *plus* the corporation's paid-in surplus account of \$900 (the consideration received for the shares upon issuance less the par value of such shares). Increases in paid-in capital can result from the issuance of additional shares or the contribution of additional capital to the corporation without the issuance of shares or as a result of amounts added to paid-in capital by action of a corporation's board of directors or shareholders pursuant to a share dividend or share split.

A corporation may reduce its paid-in capital in a number of ways. The board of directors may reduce paid-in capital by: (1) acquiring and cancelling shares to the extent of the cost of the reacquired and cancelled shares or such lesser amount as may be elected by the corporation; (2) the amount of dividends paid on preferred shares; or (3) the amount of any liquidating dividends. Paid-in capital can also be reduced pursuant to a bankruptcy reorganization plan. However, paid-in capital can never be reduced to an amount that is less than the aggregate par value of all issued shares having a par value.

A reduction in paid-in capital may also occur as a result of a merger between a parent and subsidiary corporation. In the case of such a "vertical" merger, the paid-in capital of a subsidiary may be eliminated if either (1) it was created, totally funded, or wholly owned by the parent corporation; or (2) the amount of the parent's investment in the subsidiary was equal to or exceeded the subsidiary's paid-in capital. Finally, a corporation may reduce its paid-in capital by reacquiring its own shares. Reacquired shares, however, constitute treasury shares until cancelled on the records of the Secretary of State.

All increases and reductions to paid-in capital are required to be reported to the Illinois Secretary of State, and are not effective until reported, regardless of when the increase or reduction occurred.

Why bother keeping track of paid-in capital at all? There can be penalties for failure to timely report increases to the Secretary of State. Assume that the board of directors of a corporation decides it must obtain an audited financial statement, whether because its lender requires an audit or because the corporation will be sold. During the audit, the auditors note that the paid-in capital as reported to the Illinois Secretary of State is not the same as the paid-in capital on the corporation's balance sheet. The auditor advises the board that in this particular case the two paid-in capital amounts should be the same. As a result, the corporation is required to report the increase in paid-in capital, but because the increases took place several years prior, substantial penalties are due by the corporation for failure to report increases in a timely manner.

Please do not hesitate to contact us if you have any questions regarding your corporation's calculation or reporting of its paid-in capital.

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**SUPERVISOR'S COMMENTS RESULT IN
PREGNANCY DISCRIMINATION VERDICT**

The consequences of the failure to properly train supervisors regarding a company's responsibilities to employees who become pregnant can be seen in the case of *Arismendez v. Nightingale Home Health Care, Inc.*

Mariluz Arismendez ("Arismendez") was a customer service representative for Nightingale Home Health Care, Inc. ("Nightingale"). Shortly after starting her employment, Arismendez discovered she was pregnant with her third child. Approximately five months into her pregnancy, Arismendez began experiencing abdominal pain related to her pregnancy. Arismendez's doctor ordered bed rest. Thereafter, Arismendez's doctor extended her period of bed rest several times, setting a new work release date after each extension.

While attempting to deliver notice of her doctor's most recent extension of her period of bed rest to her supervisor, Arismendez was told she had been terminated several weeks prior for "excessive sick leave/job abandonment." Arismendez's supervisor also stated that although it was illegal to fire an employee because the employee was pregnant, the supervisor had a business to run and "could not take having a pregnant woman in the office." Thereafter, Arismendez filed suit alleging pregnancy discrimination.

At trial, the jury found in favor of Arismendez and awarded her damages of \$26,150 in back pay, \$10,000 in compensatory damages and \$1,000,000 in punitive damages, later reduced by the trial court to \$200,000 because of a statutory damage cap. Upon a post-trial motion, the trial court rejected the jury's verdict and dismissed Arismendez's case holding she had not presented sufficient evidence of pregnancy discrimination.

On appeal, Arismendez argued the supervisor's statements were sufficient evidence to establish pregnancy discrimination. Nightingale responded that the supervisor's comments could not establish liability because the supervisor did not make the decision to terminate Arismendez. The court agreed with Arismendez, holding that her case involved a question of credibility, which the jury could answer in her favor based on the supervisor's statements. Moreover, the fact that the supervisor did not make the decision to terminate Arismendez did not shield Nightingale from liability because it was the supervisor's recommendation to the decisionmaker which led to Arismendez's termination. Accordingly, the jury verdict was reinstated.

The *Arismendez* case demonstrates the importance of training supervisory personnel about pregnancy discrimination. If the Nightingale supervisor had been trained not to make decisions based upon, nor comments about, an employee's pregnancy, the judgment against Nightingale may have been avoided.

If you have a question about pregnancy discrimination, please telephone a member of the firm.

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IRREVOCABLE DOES NOT NECESSARILY MEAN INFLEXIBLE

Irrevocable trusts, whether their purpose is to own life insurance, for asset protection, or for gift planning, can provide significant benefits. However, many clients have difficulty with a threshold issue: in order to obtain the desired estate tax or other planning benefits, the trust must be irrevocable. The “irrevocability” of such trusts causes concern among clients who want to maintain control of the assets, the income, the beneficiaries, or the ultimate distribution of the principal. Clients are sometimes reluctant to take advantage of irrevocable trusts, equating *irrevocability* with *inflexibility*. However, with proper planning, an irrevocable trust can be structured with a fair amount of flexibility.

It is possible to draft an irrevocable trust to plan in advance for a number of changes, building flexibility into the trust document at the time of its creation. Some of the concepts which could be considered include:

- The trustee may have the power to make secured loans to any person, including the grantor.
- A trustee may have the power to distribute the property to beneficiaries based upon their “best interests,” provided that the trustee is not a beneficiary.
- The trustee may be given the power to change certain provisions of the trust to account for changes in state or federal tax laws or otherwise.
- The grantor may retain the right to remove a trustee and appoint a successor independent trustee. This right may also be granted to the beneficiaries.
- The trust may provide that the grantor’s spouse will cease to be a beneficiary in the event of divorce.
- A trustee may be given the right to amend or terminate the trust in certain controlled circumstances, provided the trust assets do not revert to or for the benefit of the grantor, and the trustee is not a beneficiary of the trust.

If you are considering an irrevocable trust, you may also want to consider authorizing another person to designate the recipient of trust benefits by means of a special power of appointment, which allows a third party to direct the distribution of interests in the trust property to specified groups or classes of beneficiaries. By way of example, the holder of a special power of appointment might permit someone to override the typical trust distribution rules and redirect trust assets to particular parties in the event of changed circumstances. This technique can be useful because it allows the deferral of decision-making until the most appropriate time.

In the next issue of *A Potpourri*, we will discuss the issue of amendment of existing irrevocable trusts. If you care to discuss the manner in which flexibility can be designed into otherwise irrevocable trusts, please do not hesitate to contact us.

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DISABILITY PREVENTS DISCHARGE FOR VIOLATION OF EMPLOYER'S RULES

In the recent case of *Gambini v. Total Rental Care, Inc. d/b/a Da Vita, Inc.*, the court relied upon the Americans with Disabilities Act (“ADA”) in holding that the State of Washington’s statute prohibiting disability discrimination required conduct arising from a disability to be considered a part of the disability and thus prevented such conduct from being considered as separate grounds for a termination.

In the *Gambini* case, Stephanie Gambini (“Gambini”) worked for Da Vita, Inc. (“Da Vita”). Gambini suffered from bipolar disorder, which caused her to experience depression, anxiety, and on one occasion caused her to suffer an emotional breakdown while at work. Gambini advised Da Vita of her condition and that she was seeking treatment from her doctor. The treatment was not successful and when her symptoms worsened, her job performance suffered.

As a result of her deteriorating performance, Da Vita presented Gambini with a performance improvement plan. During the meeting in which the plan was presented, Gambini cried and threw the performance improvement plan across the desk at her supervisors, to whom she also directed numerous profanities. When she returned to her desk, Gambini called her therapist and admitted that she was suffering from suicidal thoughts. Concerned about her condition, Gambini’s therapist had her admitted to the hospital.

Upon Gambini’s admission, Da Vita placed Gambini on leave as provided by the Family Medical Leave Act (the “Act”). Da Vita also began an investigation of Gambini’s conduct in the workplace. Upon discovering additional emotional outbursts by Gambini, Da Vita concluded her conduct violated Da Vita’s workplace conduct rules and terminated Gambini. Gambini filed suit alleging a violation of the State of Washington’s statute prohibiting disability discrimination and the Act. The jury ruled in favor of Da Vita.

On appeal, Gambini argued that the jury failed to connect the conduct resulting from Gambini’s disability, her emotional outbursts, to the disability itself. The Ninth Circuit Court of Appeals agreed. The Court found that under the ADA, “conduct resulting from a disability is considered part of the disability, rather than a separate basis for termination.” Washington’s state statute also required the jury to make such a connection because the state statute’s prohibition against disability discrimination was the same as the ADA’s. Accordingly, Gambini was entitled to a new trial because the jury had not been properly instructed to make such a connection.

In so much as the Illinois Human Rights Act contains a similar prohibition against disability discrimination as the Washington statute, considering the Court’s comments regarding the prohibitions of the ADA, Illinois employers with 15 or more employees must proceed with caution when deciding whether to discipline or discharge an employee for misconduct which may arise as a result of a disability. If the employer concludes the disability or its treatment caused the misconduct, the employer may not discipline or terminate the employee until the employer complies with the ADA’s reasonable accommodation requirements.

If you have a question about whether misconduct is related to a disability, please telephone a member of the firm.

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ACCOMMODATION DISCRIMINATION IS PERMISSIBLE

ABSENT EQUITABLE ESTOPPEL

This issue comes up frequently in the workplace: absent statutory or contractual obligations, can employers discriminate in the benefits they offer or give to their employees? In their treatment of employees?

Sylvia Thomas (“Thomas”) was employed by Elmwood Cemetery (“Elmwood”). Elmwood consistently employed fewer than twenty people during that time period. Thomas had health insurance coverage provided by Elmwood while she was employed there. During Thomas’s employment, notwithstanding that Elmwood employed fewer than twenty people, Elmwood offered COBRA benefits to another employee, John Winn (“Winn”). Thomas became aware of Elmwood’s provision of those benefits to Winn from conversations overheard within the small office in which she formerly worked.

After her termination, Thomas developed serious cardiac and respiratory problems. Due to those maladies, Thomas incurred substantial medical expenses, portions of which were outstanding or were paid using borrowed funds at the time she filed suit against Elmwood.

Thomas alleged that Elmwood had a duty under COBRA to notify her “of her right to continue in force without interruption the health insurance that she had been provided as a prerequisite of her employment.” Thomas alleged that Elmwood failed to meet that duty. As a consequence, she requested relief in the form of continued health coverage during the litigation, notification of her rights under COBRA, \$100 per day as a penalty for failure to comply with the COBRA statute, and other appropriate remedies. She also sought attorney’s fees and costs.

Elmwood argued that COBRA did not apply to Elmwood because, at all times relevant to the litigation, Elmwood employed fewer than twenty people. COBRA applies only to employers with twenty or more employees.

Thomas conceded that Elmwood did not employ twenty or more people. Nevertheless, she claimed that Elmwood offered COBRA benefits to Winn after he left Elmwood and that she relied upon COBRA being available to her, should she ever leave Elmwood’s employ, because she knew that Winn got COBRA when he left. Thomas said Elmwood was equitably estopped from denying her the same COBRA benefits that Elmwood provided to Winn.

Under Illinois law, in order for a party to employ equitable estoppel against another party, the following elements must be satisfied. First, the party to be estopped must have used “conduct or language amounting to a representation of material fact.” Second, that party must have been aware of the true facts. Third, that party must have had an intention that the representation be acted on, or have conducted himself in such a way toward the party asserting estoppel that the latter had a right to believe that the former’s conduct was so intended. Fourth, the party asserting estoppel must have been unaware of the true facts. Finally, the party asserting estoppel must have detrimentally and justifiably relied on the representation. All of these elements must be present before a court may order estoppel.

The court stated that, because Thomas could satisfy neither the first nor the third element, she

could not prevail on her estoppel claim. With respect to the first element, Thomas would only be able to prevail if she could argue that Elmwood represented to her that she would have COBRA benefits. Elmwood never made such a representation to her. Thomas claimed that others near her in the office talked among themselves about Winn's receipt of benefits, and that she then inferred from hearing those conversations that she too would receive COBRA benefits. Without more, inferences drawn by a party from overheard conversations about another employee do not amount to representations to or about the overhearing party.

Thomas was also unable to satisfy the third element of an equitable estoppel. Since Thomas only *overheard* conversations among others about another employee, she was unable to present any evidence that Elmwood intended her to rely, in conducting her own affairs, on those conversations or on Elmwood's provision of COBRA to Winn.

Please do not hesitate to call us if you have any questions about the legality of an employer's different treatment of similarly-situated employees.

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From *The Lawyer Joke Book*:

A lawyer died and was being given a tour through hell by an associate devil.

"Step lively, sir," he directed. "Please observe everything you see carefully as we go, because after you have seen all of hell, you will have to choose the room in which you want to spend eternity."

The first room was pitch-black, and blood-curdling screams issued from inside. Then came the hideous sound of cracking bones and snapping tendons. The man shuddered and cried, "Not this room!"

The second room they came to was well lit, and the man peered inside. Strapped to a table was an emaciated man licking his lips and begging for water. "Certainly not this room," said the lawyer, quivering.

The next room was pleasantly lit, and inside they saw people standing knee-deep in manure, drinking cups of coffee and tea.

"Well, compared to the others, this room doesn't seem too unbearable. I guess I'll take this one."

With that, the demon shoved him into the room and locked the door behind him. The lawyer stood still for a moment, getting used to the squishy, stinking manure underneath him and looking around distastefully.

Just then another associate devil came into the room and announced, "All right, everyone, coffee break's over. Back on your heads."

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