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HOW WOULD YOU RULE?

From *The Wall Street Journal*, June 10 and August 19, 2005:

MASSMUTUAL BOARD FIRED CEO ON

FINDING WILLFUL MALFEASANCE!

The abrupt notice of termination given last week to the head of MassMutual Financial Group, one of the nation's largest financial companies, came after a board investigation concluded he had engaged in an improper pattern of self-dealing and abuse of power, according to people familiar with the probe.

The probe made several allegations against former Chairman and Chief Executive Robert J. O'Connell, among them that he inflated the value of a special retirement account by tens of millions of dollars, bought a company-owned condominium at a below-market price, misused company aircraft, had affairs with two female employees, and interfered in efforts to discipline his son and son-in-law, who worked at MassMutual.

In announcing its notice of termination to Mr. O'Connell, who had been CEO nearly seven years, the company said only that its action was related to his "conduct." In a statement, new Chairman James R. Birle, a director since 1992, declined to comment on the findings of the probe, but said the board "has a zero-tolerance policy for any acts ... that violate the letter and the spirit of the company's code of ethics. When we learned of possible wrongdoings and misdeeds by our Chief Executive Officer, we began a thorough and fair investigation" and later gave Mr. O'Connell a notice of intent to "terminate his employment, for cause," he said.

Starting in December 2004, the chief executives of two MassMutual subsidiaries and others began contacting members of MassMutual's board threatening to resign if O'Connell remained. The board members encouraged them to hold off in doing so. James Birle . . . contacted a lawyer, Dennis Block. He (Block) began conducting interviews of employees,

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although his firm . . . was not formally retained by the governance committee until later that year.

According to O'Connell's contract signed in 1998 when he joined MassMutual, he could be fired for criminal conviction, theft or embezzlement, as well as "for conduct that constitutes willful gross neglect or willful gross misconduct . . . resulting in material harm to the company." The board was obligated to give him 15 days notice if he was fired for cause. He was allowed to "cure" the reasons for his dismissal during that period, which ends June 23. If he failed to correct those issues, he remained ultimately entitled to arbitration.

On the morning of June 2, the board convened a meeting near Hartford, Conn. A subdued Mr. O'Connell defended his stewardship of the company but didn't address the various allegations against him, according to two people who attended the meeting. He spoke for less than half his allotted 30 minutes. When he left the room, some board members expressed anger he didn't respond to the allegations, these two people said. Board members debated how much to offer him to resign quietly, in hopes of avoiding a legal fight. In the end, Mr. O'Connell was given a choice: leave voluntarily with benefits valued at roughly \$7 million . . . or face termination with no money.

A spokesman for Mr. O'Connell declined to comment. One person familiar with the matter said Mr. O'Connell disputes the board findings and argues he did nothing wrong. The board's termination notice "is subject to contractual rights that I intend to exercise," Mr. O'Connell said in a statement last week. Mr. O'Connell, who claimed he stood to receive \$60 million under his contract . . . chose to fight in arbitration.

If you were an arbitrator, how would you rule? See page 5.

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TENANCY BY THE ENTIRETY PROTECTS THE MARITAL RESIDENCE

In 1990, the Illinois Legislature enacted a law which provides that a married couple may own jointly their marital residence "in the entirety." This provision is only available to a married couple, and terminates upon the dissolution of the marriage or upon the death of one of the spouses. It applies only to their marital residence. This mode of ownership should be carefully evaluated and used by persons who have a high risk of being sued personally as a result of professional or business issues.

Tenancy by the entirety is essentially joint tenancy with right of survivorship but with the added benefit of protection of the marital residence from the creditor of one spouse. Thus, for example, a judgment creditor of a husband, when the wife has no liability, may not levy upon the marital residence if it is held by such husband and his spouse as tenants by the entirety. By comparison, the typical joint tenancy situation would permit the creditor to levy upon the husband's interest, sever the joint tenancy and foreclose upon the real estate, forcing the wife to either redeem the husband's interest or find a new residence with her portion of the sale proceeds.

Please do not hesitate to telephone us if you desire more information about tenancies by the entirety.

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**WRITTEN PRICE ALLOCATION ESSENTIAL WHEN
STOCK PURCHASE INCLUDES COVENANT NOT TO COMPETE**

Buyers and sellers of businesses or business assets have divergent objectives in structuring purchase and sale transactions. Sellers want to allocate as much as possible to non-taxable return of capital or items to which capital gain, as opposed to ordinary income, tax rates apply. Buyers want to allocate as much as possible to items that provide a current deduction against income, as opposed to those that require costs to be depreciated or amortized over time or capitalized. The IRS generally will respect an allocation agreed upon by the parties. Trouble results when the parties fail to specify an allocation, as illustrated in the recent decision in *R. William Becker and Mary Ann Becker v. Commissioner of Internal Revenue*.

Richard E. Becker and his family conducted Florida citrus operations since at least the 1950s. In 1983, he formed Becker Holding Corporation (“BHC”) for estate planning purposes and to ensure continuation of the family business. He served as BHC’s chairman of the board and his son, William, served as CEO. Family disputes resulted in William’s termination and the redemption of his shares in BHC. The redemption was made pursuant to an agreement that provided for a \$5 million down payment and installments totaling \$18,953,934, payable pursuant to a note. The agreement contained a covenant not to compete and the note provided for offsets against the purchase price if William violated the covenant. The redemption agreement did not contain a provision allocating the price between the shares and the covenant not to compete.

Following closing, William’s accountant told him that BHC missed a tax advantage by not allocating a portion of the price to the covenant not to compete and suggested that William negotiate an allocation of a portion of the price to the covenant in exchange for additional consideration or a shorter non-compete period. Negotiations concluded without agreement.

On his tax returns, William reported amounts received as payments for shares taxable as capital gains and subject to non-deductible capitalization by BHC. On its tax returns, BHC claimed all amounts paid were subject to the covenant not to compete and deductible as an amortized expense. The IRS issued a protective deficiency against both parties. Ultimately, William’s treatment prevailed.

The Tax Court noted that the parties’ intent determines price allocations in the absence of mistake, fraud, undue influence or duress. A clear expression of intent in an agreement will be respected by the courts and IRS and will be binding upon the parties. Although the redemption documents included a covenant not to compete and a provision for payment offsets for any breach of the covenant, thereby establishing the parties’ recognition of economic value in the covenant, the Court noted there was no mutual assignment of value in the absence of an agreed upon allocation. On the other hand, the documents clearly stated that the price was being paid in redemption of the shares. Consequently, all amounts received by William were properly reportable as capital gain for the redemption, and none were allowable deductions as amortization of the covenant by BHC, resulting in deficiency assessments for BHC of approximately \$1,900,000.

BHC could have avoided this liability by negotiating an allocation to covenant not to compete during the redemption negotiation process. Please call us if you would like to discuss tax issues when planning a purchase, sale or other business transaction.

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COMPANIES CAN SERVE COMPETITIVE CUSTOMERS

ABSENT A FIDUCIARY RELATIONSHIP

Autotech Technology Limited Partnership (“Autotech”) and Automationdirect.com (“ADC”) are two companies involved in the touch screen industry. Autotech manufactures computer equipment, while ADC is a direct marketer that sells automation control products through e-commerce and catalogs. On September 8, 1999, ADC and Autotech entered into a contract for the joint development and sale of a product that would later be known as the “EZTouch touch screen.” They also signed a document entitled, “This Marriage and Signing of a \$100 Million Contract.” Non-lawyer employees at ADC and Autotech drafted both documents without the assistance of lawyers. In the court’s own words: “This usually sets the stage for a lovely lawsuit.”

By terms of the contract, Autotech agreed to manufacture and ship products to ADC, and ADC agreed to market them. Each party contributed \$150,000 to a joint investment account as the initial co-investment. The parties were to “mutually agree upon the dispersion of funds.” Both parties agreed that this was not a “simple legal relationship.” Instead, the contract was to “more strongly define a deeper sense of commitment to the longterm success of all partners in the relationship.”

Peppered throughout the contract was language describing the parties as “partners.” However, the contract also provided that neither party had the right or responsibility “to assume or to create any obligations or responsibilities expressed or implied on behalf of or in the name of the other or to bind the other party in any manner whatsoever.” Also, neither party was prohibited from developing competing products. The contract had an initial term of five and a half years and was automatically renewed for successive one-year terms unless notice was given.

Without informing Autotech, ADC began to develop a new product known as “C-More” with a different manufacturer, Koyo Electronics, Industries Company, Limited. ADC planned to introduce the new product after the contract with Autotech expired in January 2005. In June 2004, ADC gave timely notice of nonrenewal to Autotech.

On September 15, 2005, Autotech sued ADC, asserting claims for, among others, breach of fiduciary duty. Autotech contended that C-More was a clone of EZTouch that ADC developed based on proprietary information that ADC obtained from Autotech. Autotech pointed to the similarity of the display of the computer icons on C-More when compared to EZTouch.

Under Illinois law, to establish a claim for breach of fiduciary duty, Autotech must prove the existence of a fiduciary duty, breach of that duty, and damages proximately resulting from that breach. A fiduciary duty arises either as a matter of law or by special circumstances. Autotech asserted that ADC owed it fiduciary duties based on the existence of a partnership or joint venture relationship or special circumstances.

Fiduciary duties exist as a matter of law in certain relationships including partnerships and joint ventures. The burden of proving the existence of a partnership or joint venture is on the person who claims such a relationship exists. A partnership is an association of two or more persons to carry on, as co-owners, a business for profit. A joint venture is similar but relates to a single enterprise. To establish a partnership, the plaintiff must show that the parties (1) joined together to carry on a trade or venture, (2) for their common

benefit, (3) with each contributing property or services to the enterprise, and (4) having a community of interest in the profits. To establish a joint venture, the plaintiff must prove (1) an express or implied agreement to carry on some enterprise, (2) a manifestation of intent by the parties to be associated as joint ventures, (3) a joint interest as shown by the contribution of property, financial resources, effort, skill or knowledge, (4) a degree of joint proprietorship or mutual right to the exercise of control over the enterprise, and (5) a provision for joint sharing of profits and losses.

Other than the text of the contracts referring to “marriage” and “partners,” Autotech failed to offer any evidence showing a partnership or joint venture. In fact, the evidence indicated the opposite: the contract expressly prohibited joint control; there was no provision for profit sharing and loss; the parties did not file joint tax returns; and there was no evidence of intent to be associated as a partnership or joint venture. On this basis, the court determined that there was no partnership or joint venture to support a fiduciary relationship because the parties had no right or ability to create joint liabilities with third persons.

The court also examined whether there were any special circumstances that could give rise to a fiduciary duty. To determine if special circumstances exist, courts consider the degree of kinship between the parties; the disparity in age, health, mental condition, education, and business experience between the parties; and the extent to which the servient party entrusted his business affairs to the dominant party and placed trust and confidence in it. Autotech asserted that a confidential relationship existed between it and ADC because ADC had exclusive control over customer relationships. The court found that this fact alone was insufficient to establish special circumstances where fiduciary duties are owed.

This case stands for at least two propositions: manufacturers and service providers can serve competitive companies provided no fiduciary relationship exists with either of the customer companies; and parties should be represented by counsel when they enter into a business relationship.

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HOW WOULD YOU RULE?

From the October 20, 2006 *MarketWatch*:

**ARBITRATION PANEL FINDS . . . O’CONNELL WAS UNJUSTLY
TERMINATED. UNANIMOUS VOTE AWARDS MR. O’CONNELL
APPROXIMATELY \$50 MILLION IN SALARY AND BENEFITS
AND TO PAY ALL MR. O’CONNELL’S LEGAL FEES.**

A three member panel of arbitrators has ruled that MassMutual unjustly terminated former chairman, president and CEO Robert J. O’Connell for cause and awarded him all the benefits he was entitled in his employment agreement. The distinguished three member panel which was assigned by the American Arbitration Association (consisting of Massachusetts’ secretary of state, attorney general and insurance commissioner) ruled that MassMutual violated its employment agreement with Mr. O’Connell and it therefore concluded the company’s efforts to terminate him for cause was ineffective. The panel also ruled that MassMutual did not respect the process his contract requires and called the board’s procedures a “sham” and their

conduct “Draconian.” “Block’s investigation was unauthorized by the full board of directors and based on stale evidence,” the arbitration panel said in its findings. Furthermore, the investigation . . . “presented to the board of directors the selective, biased statements of O’Connell’s chief detractors and unfairly prejudiced the process to remove O’Connell, the panel concluded.

The arbitration panel said that O’Connell in fact had affairs with two female employees, made millions in profit in a special retirement account by improper transactions, and perhaps stepped over the line in the use of company aircraft. But none of these acts constituted “willful gross misconduct” on his part or resulted in “material harm” to the company, the arbitration panel ruled.

In their decision, the arbitrators ordered MassMutual to pay Mr. O’Connell a lump-sum payment equal to three times the sum of Mr. O’Connell’s base salary and short-term incentive award; a pro-rated payment for Mr. O’Connell’s short-term incentive award; payout of all long-term incentive plan cycles in progress as of June 23, 2005; three years of continued benefits and three years of additional deemed service for the purpose of determining benefits under the company’s defined benefit plans. MassMutual must also pay all legal fees that were incurred . . . and all arbitration expenses.

As one blogger stated: Under the terms of the contract, “mere” incompetence, uncooperativeness, or awful judgment are not enough to justify termination. A “mere” breach of fiduciary duty isn’t either. Same with sexual harassment. Indeed, “willful gross misconduct” isn’t enough unless the firm can prove resulting “material harm” to the company. Sure, the firm could still fire such an incompetent, uncooperative, duty-breaching, harassing, or wrongdoing CEO, but, in a context such as this one, only with a \$40-50 million payout.

MassMutual executives declared the panel’s findings “incomprehensible” and inconsistent with good corporate governance. On Friday, the company filed suit in a Massachusetts court to appeal the panel’s findings.

From *The Wall Street Journal*, January 4, 2007:

MASSMUTUAL ORDERED TO PAY EX-CEO

Boston – A judge here upheld an arbitration finding that MassMutual Financial Group fired Chief Executive Officer Robert O’Connell without cause and owes him about \$50 million in salary and benefits . . . Suffolk Superior Court Judge Allan van Gestel dismissed MassMutual’s lawsuit to overturn the October arbitration ruling, saying he found no grounds to vacate the award.

The bottom line: Employment contracts must be precisely prepared and enforced according to their terms. We track employment law decisions and issues nationally. Please do not hesitate to contact us if you have any questions about entering into or enforcing the provisions of an employment contract.

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**AN AMBIGUITY IN A WRITTEN CONTRACT WILL BE
CONSTRUED AGAINST THE DRAFTER**

Often when parties are involved in litigation regarding an alleged breach of contract, the outcome of the litigation hinges on the court's interpretation a written agreement. While the courts seek to strictly adhere to the contract language and enforce its provisions and the intent of the parties, it is sometimes difficult to determine exactly what the parties intended when they entered into the agreement. In other words, the contract language is ambiguous.

In *Guerrant v. Roth*, a law firm brought suit against a former client, asserting it was due additional fees under its legal fee agreement. The parties disagreed as to which expenses were recoverable by the firm. Specifically, the parties disagreed as to the interpretation of a provision in the contract which stated, "these expenses include court reporting services, expert witness fees, reasonable travel expenses, if any, fees paid to trial witnesses and the cost to create demonstrative trial exhibits." The firm argued the items following the word "include" were merely illustrations, and not limitations as to which costs were recoverable. Its former client, on the other hand, argued that any item not specifically enumerated in this list was not included in the contract, and, therefore, not recoverable.

In evaluating the terms of the contract, the court noted that it will find a contract ambiguous if it is subject to more than one interpretation. In this case, the court decided the legal fee agreement was subject to different interpretations and, therefore, the agreement was ambiguous. Following a long line of established Illinois case law, the court construed the agreement against the drafter. The court stated the reasoning behind this rule: the party preparing the agreement is deemed to be more knowledgeable as to the expressed intent of the parties.

In those few instances when the intent of the parties cannot be clearly expressed, possibly because of a highly complex or technical subject matter, or as a result of an omitted comma or misplaced modifier, the preparer of a contract can prevent a later determination of ambiguity from being construed against it by insertion of the following provision: *the parties to this contract jointly participated in the preparation of this contract. Hence, ambiguities should not be attributed to either party.*

If you have questions regarding the interpretation of a contract or are considering becoming a party to a contract, please contact a member of the firm.

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BAUCUS AMENDMENT TO ESTATE TAX PASSES U.S. SENATE

In late March 2007, the U.S. Senate passed (97-1) the Baucus Amendment, a proposal to "freeze" from 2009 until 2012 the estate tax exemption at \$3,500,000 per person and the tax rate of 45%. The exemption is \$2,000,000 per person in 2007 and 2008, and increases to \$3,500,000 in 2009. The Baucus Amendment was part of the Senate's approved budget resolution. The U.S. House of Representatives visits this issue next.

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From *The Lawyer Joke Book*:

Warning Signs that You Need a New Lawyer:

You met him in prison.

All his law books are by Time-Life.

During your initial consultation, he tries to sell you Amway.

He tells you that his last good case was Budweiser.

When the prosecutors see who your lawyer is, they high-five each other.

He picked the jury by playing Duck, Duck, Goose.

During the trial, you catch him playing with his Gameboy.

He asks a hostile witness to “pull my finger.”

A prison guard is shaving your head.

Litigant, n. A person about to give up his skin for the hope of retaining his bones.

A guy who sets out to make a name for himself as a lawyer usually gets to hear plenty of other names directed at him along the way.

What do you call an automobile accident between two lawyers?

A Saab story.

It ain't no sin if you crack a few laws now and then, just so long as you don't break any.

- Mae West

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