

THOMAS W. RIECK
trieck@rieckcrotty.com
JEROME F. CROTTY
jcrotty@rieckcrotty.com
RONALD P. DUPLACK
rduplack@rieckcrotty.com
DOUGLAS C. CONOVER
dconover@rieckcrotty.com
KEVIN P. BROWN
kbrown@rieckcrotty.com
BERNARD A. HENRY
bhenry@rieckcrotty.com

RIECK AND CROTTY

ATTORNEYS AT LAW

A PROFESSIONAL CORPORATION

55 WEST MONROE STREET, SUITE 3390

CHICAGO, ILLINOIS 60603-5062

CHICAGO'S BUSINESS LAWYERS

TELEPHONE

(312) 726-4646

TELECOPIER

(312) 726-0647

FIRM WEB SITE:

<http://www.rieckcrotty.com>

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WHEN IS AN EMPLOYER RESPONSIBLE FOR AN AGENT'S BAD ACTS?

Errors or omissions by employers, their employees and agents often result in damage to others. An employer is always responsible for its own acts or omissions, and, under some circumstances, it may also be responsible for acts or omissions of its employees and agents. To determine an employer's liability, you may need to brush up on your Latin.

Respondeat superior is a Latin term that means "let the superior make answer." Legally, it refers to the concept that an employer should be liable for an employee or agent's wrongful acts or omissions committed within the scope of their employment or agency relationship. *In pari delicto* is a Latin term that means "in equal fault," which represents the concept that one who participates in a wrongful act should not be entitled to recover damages resulting from the wrongdoing. It is often asserted as a defense to a damage claim. The recent Illinois case of *Williams Electronics Games, Inc. v. Garrity* illustrates application of these principles.

Williams, the manufacturer of *Mortal Kombat* and other video games, brought fraud and related claims against two of its component suppliers, Arrow and Milgray, who allegedly bribed one of Williams' buyers, Greg Barry, to buy components from them. Williams also sued James Garrity, an Arrow salesman. Milgray countersued, claiming that Williams conspired with two of Milgray's employees, Gnat and Slupik, to defraud Milgray by purchasing components from Microcomp, a company that Gnat and Slupik created and operated in violation of their duties to Milgray.

Barry received over \$100,000 in cash bribes from Arrow and Milgray over a four-year period during which they sold approximately \$100 million in components to Williams. Williams fired Barry after discovering the bribes. Arrow and Milgray claimed Williams knew or should have known of Barry's actions, but turned a blind eye because of favorable pricing and service. Williams denied knowledge of Barry's wrongdoing. It said that all of its buyers, including Barry, were prohibited from accepting gifts. It admitted, however, that suppliers often made gifts ranging from \$25 to \$500 to Williams' employees at Christmas time and that employees were permitted to accept such gifts, provided that any gift of \$100 or more was subject to prior disclosure and approval by Williams.

The trial court instructed the jury that if Williams had known or should have known of the defendants' bribes to Barry, it should find that Williams had ratified the fraud and could not recover damages. It also instructed the jury that if Williams had been *in pari delicto* with the defendants, because it was aware of a general practice of bribery of its buyers by its suppliers, or because it knew or was recklessly indifferent to

Barry's acceptance of bribes, it could not recover. The jury concluded that Williams had been defrauded, but also concluded that recovery was barred because Williams had ratified Barry's acts or was *in pari delicto* with the defendants. On appeal, the Illinois Appellate Court considered the trial court's jury instructions erroneous.

If an employee or agent acts entirely on his own behalf, doing things that could not be interpreted as merely overzealous or ill-judged performance of his duties, he is acting outside the scope of his employment. In this hypothetical *respondeat superior* would not apply to impose fault on the employer. If the employer actually knows of the acts, it may be held to have ratified them and, therefore, may be accountable for damages or barred from recovery. Mere negligence in failing to uncover the wrongful acts of an employee or agent will not constitute a ratification. By instructing the jury that it should return a verdict for the defendants if it found that Williams "should have known" that Barry was taking bribes, the judge allowed the jury to exonerate the defendants on the basis of the carelessness of their victim in failing to discover that *it* was a victim.

The defense of *in pari delicto* applies where the victim participates in the misconduct giving rise to his claim. Actual knowledge of the wrongful acts or omissions of the employee or agent must be shown to establish the defense. Williams' recovery could not be barred by an assertion that it should have known or was recklessly indifferent to the fact that Barry was accepting bribes or that Milgray was harmed by Barry's purchases placed through Microcomp in violation of Gnat and Slupik's duties to Milgray. Barry doubtlessly harmed Milgray by buying through Microcomp, and Milgray could have sued him for that harm; however, the fact that Barry was bribed not only by Milgray, to Milgray's benefit, but also by two of Milgray's employees, to Milgray's detriment, does not establish fault on the part of Williams. An agent's knowledge is not imputed to his principal when the agent is acting adversely to the principal, as Barry was. Williams could be liable to Milgray under one theory or another, but it was not a participant in the fraud against Milgray, especially when Williams lost, and Milgray on balance benefitted, from Barry's wrongful conduct.

To summarize, an employer may be liable for a wrongful act or omission of an employee or agent that occurs within the scope of the employment or agency relationship (*respondeat superior*), or where the employer knows and participates in the wrongful act or omission (*in pari delicto*). It may also be liable for any negligence resulting in damage to another. However, if an act or omission is outside the scope of employment, application of a negligence standard (*i.e.*, the employer "should have known") will not establish liability. In such cases, proof of actual knowledge will be necessary to establish a ratification claim.

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"GREASING PALMS" TO FACILITATE INTERNATIONAL BUSINESS

Generally, the Foreign Corrupt Practices Act ("FCPA") prohibits payments to foreign officials to facilitate business in the official's jurisdiction; however, the FCPA allows payments to foreign government officials for "routine government action" which the official is "required" to provide, where no discretion, other than the timing of the performance, is involved. Please call us if you have any questions about the application of the FCPA to your international business transactions.

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CONTRACTS MAY BE TERMINATED ONLY FOR MATERIAL BREACHES

Those of our readers who are college basketball fans may remember the newspaper reports about Jim O'Brien ("O'Brien"), the former basketball coach at The Ohio State University (the "University"). The University terminated O'Brien's employment in 2004 after he advised the University that in 1998 he made a \$6,000 loan to the family of a player from Europe who was never eligible to play college basketball. The University considered the loan an egregious violation of the National Collegiate Athletic Association ("NCAA") rules and, thus, a material breach of O'Brien's employment contract. The University terminated O'Brien and he filed suit, alleging a breach of his contract which still had three years to run.

At trial, the University did not dispute that O'Brien made the loan for humanitarian reasons, that O'Brien was not motivated by a desire to gain any recruiting advantage in basketball, and that the loan recipient was not eligible to participate in intercollegiate athletics at the time of the loan because the recipient previously signed a contract with a pro team in Europe. The trial court also found that the loan and O'Brien's failure to disclose the same were the only reasons for O'Brien's termination.

O'Brien's employment contract provided it could be terminated for cause. "Cause" was defined as a material breach of the contract by O'Brien or a violation by O'Brien of an applicable law, policy or regulation of the NCAA or the Big Ten Conference which results in the University being sanctioned. Based on the evidence presented at trial, the court held that O'Brien had not been terminated for cause. It awarded O'Brien damages in the amount of \$2,494,972.83, pursuant to a contract provision that required the University to pay O'Brien his unpaid salary and benefits if he was not terminated for cause as defined in the contract. The University appealed the judgment.

In upholding the trial court's decision, the Ohio Appellate Court noted that a "material breach" of contract is a party's failure to perform an element of the contract that is "so fundamental to the contract" that the single failure to perform "defeats the essential purpose of the contract or makes it impossible for the other party to perform." The Court then reviewed the factual findings of the trial court and determined that O'Brien had performed his responsibilities under his contract. It concluded that the loan was not a material breach thereof because it was not intended to obtain a recruiting advantage and did not substantially harm the University, since the player was not eligible to play college basketball.

Additionally, the Court held the loan did not violate an applicable law, policy or regulation of the NCAA or the Big Ten Conference, at least in part because, when the University reported O'Brien's alleged 1998 violations in 2004, the four year statute of limitations instituted by the NCAA for such violation had expired. Thus, neither the NCAA nor Big Ten Conference ever imposed any sanctions on the University as required by O'Brien's employment contract to constitute a material breach by O'Brien.

Contracts may not be cancelled with impunity for merely technical or immaterial violations. If you question whether a breach of a contract is material or wish to discuss your rights under a contract, either as an employer or employee, please telephone a member of the firm.

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WHAT WILL BE THE LEGAL FEES TO SELL MY BUSINESS?

We are frequently asked this question at the outset of an engagement to sell a business. Our response is almost always the same: It is impossible to estimate the legal fees with a high degree of precision. The reason is a result of a combination of multiple factors that affect the sale process. Answers to the following questions, among others, will affect the fees for legal services required in a sale transaction:

- How complicated is the transaction? Is it an asset or stock purchase transaction? Are there any tax issues? Are the financial statements of the business audited, compiled or reviewed? Does the business have locations in other states, thereby requiring the hiring of counsel in those states?
- How much corporate housekeeping is necessary? Generally, a sale of stock requires an update of corporate minutes, and review of existing contracts, tax returns and financial statements, as buyers of stock customarily ask for more representations than in a strict asset sale. What agreements must be modified, or what corporate procedures must be adopted, after an asset sale for the continuing corporate entity?
- How many sellers of stock are there, or, in the case of sale of assets, how many shareholders must consent? Have the appropriate legal consents been prepared and obtained from the other shareholders, credit holders, and other parties, if necessary?
- Will the deal include employment agreements, covenants not to compete or other ancillary agreements? For both selling shareholders and key personnel?
- Will a letter of intent precede a formal purchase agreement? Will there be other ancillary agreements as a part of the transaction?
- Is real estate a part of the transaction? If so, will the real estate be sold by the selling shareholders and not the company? If the real estate will be retained but leased to the buyer, must a new lease be prepared? Is the existing lease assignable? Are negotiations with the landlord required in order to assign the lease?
- Must lenders, customers, or unions be contacted for their approval to assign their contracts to the prospective purchaser?
- Is an “earnout” a part of the deal? How broad is any indemnification expected to be? How extensive are the representations and warranties requested?
- Are there any pending or prospective lawsuits that must be addressed? Escrowed for? Settled?
- What is the competency and experience level of the counsel for the buyer? How many professionals – investment bankers, accountants and lawyers – are participating in the transaction? In the negotiations? How much due diligence is the buyer demanding?

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**FAMILY MEMBERS MAY ASSERT A CLAIM FOR SERVICES
AGAINST THE ESTATE OF A DECEASED RELATIVE**

The Illinois Probate Act permits persons who cared for a deceased person to be paid the reasonable value of the services they provided to the decedent. However, Illinois law distinguishes between services provided by relatives and those who are not relatives. The distinction is illustrated by a recent case involving claims filed by two women against the estate of their deceased aunt.

Carol Coffey and Christine Graves provided care for their aunt, Zoe Templeton, during the few years prior to Zoe's death. Zoe lived with Christine. Christine provided Zoe shelter and three meals daily, did Zoe's laundry, helped Zoe move around, checked her blood-pressure, and provided other care. Christine sat with Zoe for an estimated 24 hours per week because Zoe did not care to be alone. Carol also stayed with Zoe approximately 24 hours per week; she often helped Zoe with her contact lenses, which often bothered Zoe, by removing and reinserting them after they were rinsed or replaced, and she drove Zoe on errands.

Carol and Christine did not establish fees for their services to Zoe or invoice her while she was alive. Zoe never paid Carol or Christine for services, but there was evidence that Zoe expected Christine and Carol would be paid for the services they provided to her.

After Zoe's death, Christine and Carol filed separate claims in the amounts of \$71,000 and \$30,000, respectively, against Zoe's estate for services they provided to Zoe during her life. The executor of Zoe's estate denied the claims. The probate judge conducted a bench trial, also denying Carol and Christine's claims for the reason that the evidence presented by Christine and Carol did not establish they had an express agreement with Zoe or that there was an expectation that they would be paid for their services. Carol and Christine appealed the denial of their claims.

The Appellate Court reviewed the disparate standards that apply to the presumption of whether services were rendered gratuitously. Under Illinois law, services provided by someone who is *not* a relative of the decedent are presumed to have been rendered with an expectation of payment. When rendered by a relative, those same services are presumed to have been given gratuitously. The presumption in either case may be rebutted by evidence presented to the court. The amount of evidence sufficient to rebut the presumption that services were to be gratuitous depends on the facts of each case, and the presumption diminishes proportionately with the remoteness of the degree of kinship, the character of the relationship, and the nature of the services.

The Court reversed the probate court's decision, finding there was sufficient evidence to rebut the presumption that Christine and Carol's services were gratuitous. In addition to the fact that the services rendered were substantial and provided over an extended period of time, the court placed value on Zoe's statements (to other relatives) that she expected Christine and Carol to be compensated for their services as caregivers and that she expected Carol and Christine to file a claim in Zoe's estate.

The expense and delay the parties experienced in this case was avoidable with one or more very simple written agreements or modifications to the decedent's estate plan.

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WHAT DUTIES DOES AN INSURANCE BROKER OWE ITS CLIENTS IN PROCURING A NEW POLICY?

The duty an insurance broker owes to its client is to faithfully negotiate and procure an insurance policy according to the wishes and requirements of the client. An insurance broker, however, has no duty to advise its clients of the meaning of provisions of the procured insurance policies. Such was the holding of a recent Appellate Court case, *IEC v. Glenview Insurance*.

IEC, an industrial box manufacturer, sought insurance for its manufacturing facility. IEC retained Glenview Insurance (“Glenview”) as its insurance broker; Glenview had previously procured policies for IEC. When the time for the renewal of the policy came, Glenview produced premium quotation comparisons from three insurance companies. IEC accepted a premium quotation from the Maryland Insurance Group/Northern Insurance Company (“Maryland”), which was less than their other premium quotation for renewing its expiring policy.

The Maryland policy did not insure against flood damage, but did contain a provision covering damage caused by water backup and sewer overflow. Shortly after the policy became effective, the Aurora area experienced severe rainfall and flooding. IEC’s facility was flooded by several feet of standing water, causing damage to the building and equipment. IEC then filed a claim with Maryland.

Maryland denied IEC’s claim because it determined the damage to be caused by general flooding from surface water. IEC claimed the loss was caused by water backup and overflow from the sewer and, therefore, covered under its policy. IEC filed suit for \$2.3 million in damages against Maryland.

At trial, IEC recovered \$1.1 million from Maryland. IEC then filed suit against Glenview for breach of contract and negligence to collect the balance of its damages. IEC argued that Glenview had a duty to inform IEC that Maryland might determine that flooding caused by surface water would or could nullify the sewerage overflow coverage. Thus, Glenview’s failure to do the same was negligent. The court ruled that no such duty existed because IEC requested only water backup and sewer overflow coverage and not general flood insurance. Thus, Glenview had no duty to advise IEC that an exception from general flood coverage could nullify coverage under the water backup and sewer overflow provision. The burden to know the meaning of the terms of insurance contracts is on the insured and not the broker.

The court then noted that an insurance broker need only exercise reasonable skill and diligence when the agent negotiates and procures an insurance policy. In this case, because IEC only asked for sewerage backup insurance and not general flood or surface water insurance and Glenview produced a policy that met those requirements, Glenview neither breached its contract nor was it negligent in the procurement of the policy.

Please do not hesitate to contact us if you have any questions about the obligation of any professional who may serve your interests.

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HOW A VALUABLE EMPLOYEE HANDBOOK CAN BECOME WORTHLESS

It is not unusual for an employer to invest a significant amount of time and money in generating an employee handbook intended to protect the employer from baseless claims by employees. Such an investment, however, is worthless if the employer fails to distribute the handbook, require employees to acknowledge their receipt of and agreement to the terms set forth in the handbook, or train employees regarding its terms and enforce the provisions of the handbook, as the recent case of *Plebani v. Bucks County Rescue Emergency Medical Services* demonstrates.

In *Plebani*, Lisa Plebani (“Lisa”) and her father, Michael Plebani (collectively, the “Plebanis”), were employed by Bucks County Rescue Emergency Medical Services (“Bucks”). As a result of certain conduct which occurred during her employment, Lisa filed a sexual harassment claim against Bucks. Thereafter, when the Plebanis were terminated, they also filed retaliation claims against Bucks. Bucks sought to dismiss the Plebanis’ claims pursuant to the provisions of Bucks’ Employee Handbook (“Employee Handbook”) which required employees to submit all claims against Bucks to arbitration.

In reviewing the enforceability of the arbitration provision in the Employee Handbook, the court noted it must evaluate the provision under state contract law. Thus, to determine whether the arbitration provision constituted a valid contract, the court must decide: “(1) whether both parties manifested an intention to be bound by the agreement; (2) whether the terms of the agreement are sufficiently definite to be enforced; and (3) whether there was consideration.” Moreover, “in determining whether parties have agreed to arbitrate, courts should apply the rules of contractual construction, adopting an interpretation that gives paramount importance to the intent of the parties and ascribes the most reasonable, probable, and natural conduct to the parties.”

Applying the above rules, the court held that an enforceable arbitration agreement did not exist between Bucks and the Plebanis. In so ruling, the court stated that no person at Bucks gave the Plebanis an employee orientation regarding the Employee Handbook nor were the Plebanis asked to sign the forms acknowledging receipt of the Employee Handbook and agreeing to its arbitration policy. Moreover, the Employee Handbook did not indicate that it constituted an offer to enter into a unilateral contract and merely stated that it contained “guidelines” subject to change without notice. Thus, the Plebanis’ continued employment after the issuance of the handbook did not actually constitute acceptance of the offer since there was no “meeting of the minds” consisting of “an offer on one side and an unconditional acceptance on the other.” Finally, it appeared that the policies stated in the Employee Handbook were abandoned and were never enforced while the Plebanis worked for Bucks.

As the *Plebani* case makes clear, in order for an employee handbook to be enforceable, an employer must distribute the handbook to its employees, require the employees to acknowledge its receipt and their agreement to its terms, train the employer regarding its provisions, and regularly enforce the handbook’s provisions.

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**TOP TEN MAJOR ERRORS IN PLANNING FOR RETIREMENT BENEFITS –
AND HOW TO AVOID THEM ***

- Error #1 Not maximizing contributions
- Error #2 Not converting to a Roth IRA
- Error #3 Not keeping the assets in the retirement plan or IRA as long as possible
- Error #4 Not coordinating the beneficiary designation with the estate plan
- Error #5 Not leaving the retirement benefits to the spouse where appropriate
- Error #6 Not coordinating with the credit shelter disposition
- Error #7 Leaving the retirement benefits to children or grandchildren outright instead of in a discretionary trust
- Error #8 Collecting the benefits upon death and destroying the stretchout
- Error #9 Collecting the benefits before considering a disclaimer
- Error #10 Not considering a spousal rollover even if the spouse is not the named beneficiary.

* From Steve Leimberg's Employee Benefits and Retirement Planning Newsletter dated February 20, 2008

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From *The Lawyer Joke Book*:

“It’s better to enter the mouth of a tiger than a court of law”

-- Chinese proverb

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“Your Honor,” said the jury foreman solemnly, “we find that the man who stole the \$20,000 is not guilty.”

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