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"In a recent . . . case, the former president of a company was denied SERP benefits by reason of his 'disloyalty.'"

DISLOYALTY CAUSES LOSS OF SERP BENEFITS

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You hear a lot of talk these days about clawbacks. One question, though, is how to describe the circumstances warranting the return of compensation. That is, what should trigger a clawback? In a recent unpublished case, the former president of a company was denied SERP benefits by reason of his "disloyalty." Benefits were never paid to the executive in the first place, so strictly speaking there was no clawback. Nevertheless, the case is interesting in its application of the rather general (and undefined) term "disloyalty" to an executive's entitlement to deferred compensation benefits. The case is *Whitescarver v. Sabin Robbins Paper Co.,* 2008 U.S. App. LEXIS 22944 (6th Cir. 2008) (unpublished).

The case arose because the former president of a paper company asserted that he had been wrongly denied approximately $300,000 in plan benefits when the company terminated his employment, ostensibly "for cause." Under the plan, which was a SERP, benefits were payable only if the executive were involuntarily terminated without cause, and not if he quit or was discharged for cause.

Prior to his termination, the executive had been removed as president but his employment had not been terminated. Instead, he was assigned special responsibilities. It was his actions relating to those responsibilities that resulted in his loss of benefits.

The dispute began when the executive was asked at a meeting of the board of directors' executive committee to resign as president. When the executive refused, the board of directors voted to remove him in that capacity. His compensation was, however, not immediately affected. In fact, although he was excluded from the company's facilities, the executive remained the company's most highly compensated employee.

Upon his removal as president, the executive was assigned the responsibility of assisting with a failing business deal between the company and an investor group, relating to a papermill recently refurbished by the investment group. The company had agreed to purchase a large amount of paper produced by the mill, and the company and the executive were in agreement that the executive was uniquely positioned to take on the assigned task. Shortly after the assignment (and the executive's removal as president), the executive changed the billing on his company-issued cell phone, so bills and call details were mailed to his home instead of to the company's offices. When the executive submitted one of his subsequent cell phone bills to the company for reimbursement, some at the company apparently became suspicious that the executive was making prohibited contact with the company's employees, vendors, and customers, and

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therefore asked for billing detail. The executive refused to provide the relevant cell phone records.

The company terminated the executive about two and one half months after he had been removed as president, informing him that he had been terminated for cause, which meant he would not be eligible for SERP benefits. Importantly, the SERP defined "cause" as including "disloyalty . . . as such actions relate to the [company]." The Sixth Circuit decided that the company had reasonably concluded that the executive acted in his own best interests at the expense of the company's interests, and had been discharged for disloyalty. In explaining its conclusion, the court noted that after the executive was removed as president, his employment focused almost entirely on the investor group agreement relating to the papermill, and the company had, in that regard, asked the executive multiple times in the following couple of months to provide a detailed marketing and sales plan for the project. The court concluded that the executive stated at least twice that he would withhold assistance on the project until the company met his severance demands, and gave the impression that he was withholding helpful information on the agreement. In addition, the executive made several statements indicating that he viewed the company as an adversary. The court concluded that the executive was discharged for disloyalty in that he refused to provide the requested marketing plan, extorted the company, and concealed company cell phone records, effectively holding the company hostage by demanding that it first agree to satisfy the executive's own "personal and onerous" demands before he would help solve the papermill problem.

Lesson. One generally prefers precision in deferred compensation agreements. But, for provisions intended to protect a company in the event an executive acts improperly, the flexibility afforded by using the term "disloyalty" to describe an event resulting in a loss of entitlement to further compensation (or the need to return compensation already paid) may be useful.

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