

My Little Ditty About *Corporate Jack & Diane!* ^{TM©2006}

YOU'RE FIRED! WITHOUT PAY! ^{TM©2006}
FIRED FROM MY OWN COMPANY?

Federal Bankruptcy Laws Are A Two-Edged-Sword For The Small Business Person!

[CPAs, Attorneys, Small Business Owners, Directors, Executives, CEO's, CFO's, Auditors]

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All too often the client wants to save legal fees by self-forming, or paying for a bare-bones entity formation, without an appropriate employment and buy-out agreement. The client fails to appreciate that not-all-entity-formations are created equally. **Sometimes you get exactly, and only, what you pay for!**

The client consults an attorney about forming an entity to start up a new business. The client barks at the price and decides to do it himself, or instructs the attorney (or CPA) to form a bare-bones entity. Maybe the client either decided not to pay for certain key operating agreements or the attorney simply failed to advise the client of this option, and the risks concomitant in his decision.

In any event, the client gets his new entity, no-frills. He starts operating his business, and despite the odds, he starts to succeed, succeed, and succeed. After a few years, he now has gross revenues in the mid-tens of millions of dollars.

Being a self made man, he hires the minimum qualified personnel to run his executive offices, as he is not one to give away his hard earned money. As a result the company runs afoul of certain tax requirements, license or agency arrangements, but manages to continue growing exponentially. Then some event occurs which changes the direction of this growth plan. Let's assume, that he buys his partner out and fails to adequately plan the cash flow requirements of such a deal, or his licensor, or agency principal, decide to make an end-run around this client's rapid success-train and take back this successful going concern, either based on *'the bigger corporate greed doctrine'*, or because this client has violated terms of his arrangements (that they say simply cannot be cured).

Well, let's not forget, that 'the bigger corporate greed doctrine' comes with *'bigger corporate lawyers'*, and a much *bigger war-chest*. Maybe just maybe, they have experience getting around *their* nuevo-riche. They have probably done it before, many times. Well, the big-guy usually has.

Consider, if the client, made certain financial decisions that jeopardized, even potentially, the ability of this entity to pay its bills as they became due. The creditors, licensors, and agency principals might have some rights. Right? Yes, the state corporate and civil codes have laws that protect the creditors, but the Federal Bankruptcy Laws are even more potent. Federal Bankruptcy Laws interpreting State Property or Employment Rights can be a two-edged-sword for the unwary!

If this client's situation is put into the jurisdiction of the Federal Bankruptcy Court ("BK Court"), watch out, the freight-train is-a-coming. The BK Court has its mandates. It must look out for the creditors – not the owners, necessarily. Let's image that the 'bigger corporate lawyers' (or the BK version of them) get the BK Court to replace the client as the person-in-charge (or Responsible Officer or Person ("RP")), by in part, accusing the client of wrongdoing. Yes, stealing money, falsifying invoices and like, yes even before any due process or investigation. Well, the judge might have to put an RP in charge of the client's entity (business). When the client gets to work the next day, the new RP, hands him his Pink-Slip – and says your services are no longer needed; and by the way, there will be no further compensation as well. YOU'RE FIRED - WITHOUT PAY! Please get off the property.

Now you say, that can't happen! He's the founder, the owner, the President, the Director and the controlling Shareholder of his (own) company. Wrong, it can happen, and it does! The client sits back and reflects his thoughts for the moment, scratches his head and does his best James Dean. He says, Diane we oughta run off to the city, Diane says, baby you're missin' something. Jackie, say-a,

How could this happen?

Here's two ways.

1st. Failure to have a written or provable employment agreement requiring "cause" for termination can come back to ruin your client!

If the new RP wants to fire the client, he/she should first review any employment agreements with the client and his company. What's that! There are none? Or are there? Well then, the law in many states, certainly California, allows a person without an employment agreement to the contrary, to be fired for any reason, without cause. This is a matter of State Law determination. The client in California would be considered an at-will employee, and as such could be terminated at any time.¹ The RP here, found no written employment or buy sell agreement. Hence, the RP had every right to say YOU'RE FIRED - WITHOUT PAY! *Or did he?*

Employment for an indefinite term is presumed to be at-will. [Cal. Lab. Code 2922; Foley v. Interactive Data Corp., 47 Cal 3d 654, 677] This presumption may be rebutted by a contract, express or implied, that limits the employer's right to terminate. Id. "The board's removal of a person from office has no effect on whatever rights that person may have under contract of employment with the corporation... [Corps C Section 312 (b) creates "at-will" presumption which can be overcome by terms of express or implied contract]² {emphasis added}

¹ California statutory law provides generally that an employment relationship having no specified term may be terminated at the will of either party on notice to the other. Cal. Lab. Code §2922. These exceptions include (i) public policy; (ii) state and federal statutes (e.g., the California Fair Employment and Housing Act prohibits termination based on race, sex, etc.); (iii) implied contract ...to create an implied contract that employee can only be terminated for good cause; Foley v. Interactive Data Corp., 47 Cal.3d 654 (1988); and Pugh v. See's Candies, Inc., 116 Cal. App. 3d 311 (1981); and (iv) the covenant of good faith and fair dealing (one cannot terminate an employee in bad faith in order to deny the employee some benefit of the employment bargain). For the many exceptions to the at-will rule, see 4 Wilcox, California Employment Law, §60.02 (2000). In the absence of any termination clause, termination would be subject nominally to Labor Code section 2922 (termination "at will") if the Agreement provides for an indefinite term or to section 2924 ("willful breach of duty, . . . habitual neglect, . . . or continued incapacity to perform") if the Agreement is for a specified term. Either standard may be varied contractually. Employment nominally "at will" can also be altered by implied contract.

² [Corps C Section 312 (b) creates "at-will" presumption which can be overcome by terms of express or implied contract] 6:267 TRG CORPORATIONS *Current through Stats 2005, ch. 728* § 312. (b) Except as otherwise provided by the articles or bylaws, officers shall be chosen by the board and serve at the pleasure of the board, subject to the rights, if any, of an officer under any contract of employment. Any officer may resign at any time upon written notice to the corporation without prejudice to the rights, if any, of the corporation under any contract to which the officer is a party. [emphasis added]

The Evidence.

Why didn't the client have a "provable" 'for cause' employment agreement again? That's right, he didn't want to pay for it. A simple but, on point, 'for cause' employment agreement would have saved the day.³ Or did the client tell his counsel he had no contract, express or implied, or did his counsel fail to offer evidence of the client's implied contract for-cause? Had the client had the minimum written evidence of a for-cause employment agreement, the client would still be in the driver's seat, of his own company, as opposed to out in the cold!

2nd. Failure to have a written or provable buy-out agreement requiring a substantial buy out valuation in the event your client is fired or terminated from employment, or enjoined from working in his/her own company, can leave your client penniless!

Well even if your client failed to have a provable or written for cause employment agreement, the new RP who did exercise his option to terminate your client, would have to satisfy the client's **written buy-out agreement, in major part, by paying the client a substantial amount of money!**

Small business owners need to not only have buy-sell agreements that supply the mandate of buy-out, and valuation of same, whether it be *book value, fair market value, some fixed minimum, or some other valuation method*, but small business founders and owners, need to plant a poison-pill in their buy out agreements, coordinated with their employment agreement. ***A poison-pill could be a steep price to pay for the 'intruder'! That's right, beware of the contingency of an intruder of a private company!*** A poison pill is the very thing the big boys use at the public company level. Why shouldn't the small business person take heed. Maybe its time for the small business CPA and Attorney to undertake this protection of the client. When termination or *enjoindre* comes, retribution or redress for same should be awaiting – with teeth.

³ ASSUME IT ALL OR REJECT IT! If Jack had an employment or buyout contract 'for cause', he had a duty to offer such evidence to the court for a determination of whether to the estate would 'assume or reject' the contract in BK. If the court allowed it to be 'assumed', the court is required to assume all the terms and conditions of the contract (for cause) not just certain terms, conditions or provisions. *Raima UK Ltd. v. Centura Software Corp.* (In re Centura Software C..., 281 B.R. 660. "Section 365 provides for the assumption or rejection of executory contracts or leases in existence at the commencement of a bankruptcy case. Lawrence P. King et al., *Collier on Bankruptcy* P365.01 pp. 365-17 (15th ed. Rev. 2002). If the trustee or debtor-in-possession assumes a contract, it is not interrupted and the contracting parties' rights are undisturbed. *Id.* Assumption of executory contract under [11 USCS § 365](#) **requires debtor to accept its burdens as well as permitting debtor to profit from its benefits.** [In re University Medical Center \(1992, CA3 Pa\) 973 F2d 1065](#); "Bankruptcy law provides a federal machinery for enforcing creditors' rights but the rights themselves are created by state law."; [In re Christensen, 95 Bankr. 886, 890 \(Bankr.D.N.J.1988\)](#); [In re Skelly, 38 Bankr. 1000, 1001 \(D.Del.1984\)](#) ("The nature of a creditor's property rights in bankruptcy is **defined by state law**, not federal law.") (citation omitted)."

The Story Ends As It Begins.

Well then, of course, Diane then leaves Jack; and the Asset Protection analysis comes out.

Is this just a little ditty about Jack and Diane, two American kids done the best they can, or could they have done better (with our help)?

Remember; don't let your client, unwittingly, be penny wise and pound foolish! You may have a *duty to warn your client's* to review their entity structure for Legal Risk & Litigation Analysis, including Contingency Analysis, Asset Protection, etc.

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