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The Virginia Supreme Court on Damages, Equity Valuation, and the Significance of Delaware Corporations Law in the Termination and Removal of a Chairman and CEO

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The Virginia Supreme Court has spoken again on the calculation of damages in a complex employment contract case. In *Online Resources Corp. v. Lawlor*, No. 120208 (Va. Jan. 10, 2013), the court addressed the expert qualifications required for the valuation of equity following the termination of the chairman and chief executive officer (CEO) ("executive") of a publicly-traded company, as well as the applicability of Delaware Corporations Law to related change in control (CIC) provisions.

Background

The executive founded Online Resources Corporation (ORC) in 1989, and it went public 10 years later. He remained the CEO, and served as chairman of the board of directors (the "Board"). In 2006, Tennenbaum Capital Partners (TCP) invested $75 million in ORC and became its largest voting shareholder, with the right to designate one director to the Board. The executive and TCP's Board designee ("Designee") had a contentious relationship and TCP ran three of its own Board nominees in 2009, each of whom was elected (the "TCP Directors"). The Designee told the TCP Directors that the executive "doesn't fully appreciate that he is no longer in control … [and] is one election away from losing his job." In December 2009, the Board, in closed session, voted to remove the executive as CEO but retain him as chairman and as an employee until February 2010.

The executive resigned from the Board in January 2010, as did another director. The executive maintained that he resigned under duress after having reported insider trading by TCP. He also maintained, among other claims, that he was denied payments under a 1999 stock option plan, a 2005 stock option plan, and a 2009 change in control severance agreement that was entered into in May 2009, around the time the TCP Directors were elected (collectively, the "Agreements"). The severance agreement provided certain payments in the event of a CIC, and defined the "Incumbent Board" as the individuals who constituted the Board on the date the severance agreement was executed, and an "Incumbent Director" as a person who was a director on the date the severance agreement was executed or who was elected after that date by at least three-quarters of the Incumbent Board.

The Board is comprised of 10 seats. Upon the executive's resignation and the resignation of the other director, the Board was comprised of four Incumbent Directors, the TCP Directors, the Designee, and two empty seats.

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What Constitutes a CIC

CIC is defined in each of the Agreements. Though the definition varies in each, one element of the CIC definition that was common was that a CIC was considered to have occurred when the Incumbent Board members "cease to have a majority." The Agreements also had a choice of law provision that designated Delaware law as each agreement's governing law.

The threshold question under the Agreements' common CIC definition was whether the term "Board" meant: (1) only the directors then sitting; or (2) the total number of seats regardless of whether the seat is then filled. The executive argued either that it was the latter or that it was a contract ambiguity to be resolved by the jury after hearing evidence concerning the parties' intent that was not expressly included within the Agreements. ORC argued that under Delaware Corporations Law the term "majority of the Board" had a "default" meaning that excluded vacant seats.

Notwithstanding the Delaware choice of law provision, the supreme court rejected ORC's position that the Delaware default definition should apply. Rather, it held that that the issue was one of simple contract interpretation. As such, the jury as the finder of fact properly considered evidence of the parties' intent as to whether the "Board" was intended to include only those sitting or was intended to include the total number of seats.

The jury heard evidence as to the parties' intent (as well as other related issues), and agreed with the executive's interpretation that a CIC had in fact occurred. The supreme court upheld that finding, as it could not say that the jury verdict was "plainly wrong."

Damages

The executive's expert calculated the low range of the CIC-related severance to be $4,935,619. He arrived at this number using a stock price of $7.01 per share, which was the highest market price per share between the date of the executive's termination and the date of trial. The expert noted that the severance damages could be even higher if the value of the stock were to increase, and calculated the high range of the CIC-related severance to be $6,686,992. He arrived at this number using a stock price of $10.53 per share, which was a projection put forward in a Raymond James Investment Report for the period 2010 and 2011.

ORC objected to the expert's testimony on the basis that he was not an expert in stock valuation and that he did not conduct his own independent stock valuation. The executive argued that the expert was qualified as an expert in executive compensation with a particular expertise in advising companies on how much to pay executives including salary, bonus, long-term incentives, severance requirements, and extra benefits.

In upholding the trial court's decision to permit the expert's testimony, the supreme court noted that he was not offered as an expert in stock valuation, but rather as an expert in executive compensation. Relying on its earlier opinions, the court noted he did not make the mistake of testifying on an issue for which he was not qualified (*e.g.*, the value of the stock). Rather, the expert took reliable stock valuations that he did not calculate to create the specific calculations that he was well qualified to compute. The court reaffirmed that the use of calculations by others goes to the weight of an expert's testimony, not to his or her qualifications as an expert witness.

What this Means for Employers

Delaware contract choice of law provisions are favored in transactions, and in high-level executive agreements that can implicate complex issues of corporate law. It is critical that the drafting of these executive agreements (and any related transaction documents) be precise and that the agreements adequately consider and capture the business objectives. A declaration of Delaware law will not save or resolve vague or ambiguous contract language. It can be critical, therefore, to take the care to ensure consistency and clarity in and among related documents. As to projections and valuations, recognize that they can be used for many purposes. This can include, as is the case here, the use of such materials to support a claim against the company. Valuations that represent high-end projections that are aspirational, or that are otherwise dependent on the fruition of key events, can be problematic when used for other purposes, so care should be taken to ensure that any such materials appropriately identify the underlying assumptions so as to avoid unintended use of such valuations.

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