

**CHANGE IN CONTROL PROVISIONS IN  
EXECUTIVE EMPLOYMENT CONTRACTS**

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**Pennsylvania Bar Institute  
Business Law Institute**

**November 2009**



## CHANGE IN CONTROL PROVISIONS

### I. What is a “Change in Control” (“CIC”) Provision and Why Adopt CIC Provisions?

A CIC provision typically provides generous severance pay and benefits upon separation from employment within a specified period after a change in control of the employer. CIC coverage may arise either under an individual agreement or a broader plan. One intent of CIC agreements or plans is to alleviate employee concerns over job security and the loss of benefits in the event of corporate changes and relocations. *See Lettrich v. J.C. Penney Company, Inc.*, 213 F.3d 765, 766 (3d Cir. 2000). By lessening these concerns, CIC provisions enable employers to retain the services of employees at and after the time of a CIC (*Televantos v. Lyondell Chemical Worldwide, Inc.*, 31 Fed. Appx. 63, 2002 WL 369804 (3d Cir. March 8, 2002)). These factors may lead to the inclusion of terms in CIC agreements that are more favorable to employees than typical employment agreements. *See, e.g., Gray v. Shoney’s, LLC*, 2006 WL 3093217 (Tenn.App. Oct. 31, 2006).

Ultimately, however, CIC provisions enable employers to reduce the number of employees after a merger or acquisition, while providing employees with a buffer against the economic effects of a reduction in force. The CIC severance process is more complex than the standard severance process in timing and procedure, and it is important to know when the circumstances allow an employee to exercise the CIC provisions in an agreement or plan, because the financial consequences of a mistaken CIC exercise can be enormous.

### II. Typical Components in the CIC/Severance Process

#### A. A CIC Event

1. Merger or consolidation (*Lettrich v. J.C. Penney Company, Inc.*, 213 F.3d 765, 766 (3d Cir. 2000)).
2. Transfer of ownership (whether by stock sale or change in voting control or other action) - *Televantos v. Lyondell Chemical Worldwide, Inc.*, 31 Fed. Appx. 63, 2002 WL 369804 (3d Cir. March 8, 2002); *Fair v. Giant of Maryland LLC*, 2006 WL 361338 (D. Md. Feb. 15, 2006).

#### B. Payment of Severance Pay and Benefits

1. Severance pay equal to the employee’s salary for an extended period, typically though not always paid in a lump sum (*Lettrich v. J.C. Penney Company, Inc.*, 213 F.3d 765, 766 (3d Cir. 2000)). *See, e.g., Foster v. E.I. DuPont de Nemours and Company*, 2001 WL 740122 (S.D. Ia. Jan. 3, 2001) (three years’ pay).
2. Medical and dental coverage (*See Lettrick v. J.C. Penney Company, Inc.*, *supra.*)

3. Term life insurance (*See Id.*)
4. Stock options (*See Id.*)
5. Pension coverage (*See Id.*)
6. Relocation expenses (*See Id.*)
7. Outplacement services (*See Congregation Beth Aaron v. Yang*, 2009 WL 1689707 (N.D. Cal. June 15, 2009)).
8. Enhanced pension benefits (*Wassil v. Advanced Technology Laboratories, Inc.*, 1996 WL 238688 (E.D. Pa. 1996)).

C. Triggering Events for Severance Pay/Benefits

1. Involuntary termination of employment without “cause” or “good cause” - *See Hooven v. Exxon Mobil Corporation*, 465 F.3d 566 (3d Cir. 2006).
  - (a) “Involuntary” - The Third Circuit will uphold language that limits the payment of severance pay to events of *involuntary* termination (e.g., termination for economic reasons, reduction in force, facility closing, reorganization or consolidation). *Mallon v. Trust Co. of New Jersey Severance Pay Plan*, 282 Fed. Appx. 991, 995, 2008 WL 2553027 (3d Cir. June 27, 2008). The plan in *Mallon* did not provide for severance pay upon constructive discharge and denied severance pay to an employee who refused employment that was comparable to the employee’s current position. *See Id.*
  - (b) “Good cause”- Typically, termination for “cause” that would preclude severance includes such circumstances as criminal misconduct, ethical misconduct, gross negligence, willful misconduct, or material breach of contractual duties. *See, e.g., Fair v. Giant of Maryland LLC*, 2006 WL 361338, \* 2 (D.Md. Feb. 15, 2006); *Peach v. Ultramar Diamond Shamrock*, 229 F. Supp. 2d 759 (E.D. Mich. 2002).
2. Resignation by Employee for “Good Reason”
  - (a) Failure/Refusal to Pay Compensation
  - (b) Reduction in Compensation (including benefits) - *See, e.g., Bublitz v. E.I. DuPont de Nemours and Company*, 171 F. Supp. 2d 906 (S.D. Ia. 2001).

- (c) Change in Bonus Opportunities
  - i. An addition of thresholds for incentive pay eligibility can constitute a reduction in maximum bonus opportunities, providing good reason for departure. *Frick v. U.S. Bancorp*, 98 F. Supp. 2d 1202, 1210 (W.D. Wash. 2000) (employer’s motion for summary judgment denied); *Mavel v. Scan-Optics, Inc.*, 509 F. Supp. 2d. 183, 187 (D. Conn. 2007).
  - ii. Elimination of matching contributions for 401(k) accounts. *Mavel v. Scan-Optics, Inc., supra*.
- (d) Demotion or reduction in duties or authority- *See generally Robertson v. Rubbermaid Incorporated*, 2000 WL 33309371, \* 5 (S.D. Ind. March 31, 2000); *Minahan v. Lesco Inc.*, 2008 WL 4186924 (N.D. Ohio Sept. 5, 2008).
  - i. New Directors’ assertion of control over areas previously handled by the executive employee, leading to “serious reduction” in the employee’s power, status, authority and responsibility. *Mavel v. Scan-Optics, Inc.*, 509 F. Supp. 2d. 183, 187 (D. Conn. 2007).
  - ii. Changes in authority, discretion, and reporting relationships. *Gray v. Shoney’s, LLC*, 2006 WL 3093217 (Tenn. App. Oct. 31, 2006) (affirming summary judgment for *plaintiff-employee* on the evidence of reduced authority).
- (e) Relocation - *See Televantos v. Lyondell Chemical Worldwide, Inc.*, 31 Fed. Appx. 63, 2002 WL 369804 (3d Cir. March 8, 2002). Relocation can be interpreted to be the actual movement of the place of work to a new location. *See Id.* Travel to another location on temporary assignment was held not to be relocation in *Peach v. Ultramar Diamond Shamrock*, 229 F. Supp. 2d 759 (E.D. Mich. 2002); therefore an employee who resigned rather than travel to the new location was properly denied severance benefits under a CIC severance plan.
- (f) Employee’s good faith determination of “good reason” may be determinative. *Minahan v. Lesco, Inc.*, 2008 WL 4186924, \* 3 (N.D. Ohio Sept. 5, 2008).

- (g) “Good reason” may exclude certain events, e.g., outsourcing of a department. *Fair v. Giant of Maryland LLC*, 2006 WL 361338, \* 2 (D. Md. Feb. 15, 2006).
- (h) In *Vry v. Martin Marietta Materials, Inc.*, 2003 WL 297309 (D. Minn. Feb. 7, 2003), the employer offered a two tiered Plan with higher benefits when an employee resigned for “good reason” and lower benefits when an employee resigned for “no reason” after a CIC.

D. Examples of Prescribed Intervals Between CIC and Triggering Event

1. One year - *Peach v. Ultramar Diamond Shamrock*, 229 F. Supp. 2d 759, 762 (E.D. Mich. 2002).
2. 2 years - *Hooven v. Exxon Mobil Corporation*, 465 F.3d 566 (3d Cir. 2006).
3. 3 years - *Wassil v. Advanced Technology Laboratories, Inc.*, 1996 WL 238688 (E.D. Pa. 1996).
4. 6 months preceding CIC if connected with anticipated CIC. *Fair v. Giant of Maryland LLC*, 2006 WL 361338, \* 1 (D. Md. Feb. 15, 2006).

E. Conditions on Eligibility for Severance Pay

Remaining with employer to complete all transitional assignments. *See Televantos v. Lyondell Chemical Worldwide, Inc.*, 31 Fed. Appx. 63, 2002 WL 369804 (3d Cir. March 8, 2002) (employee forfeited rights to CIC benefits by failing to remain with employer after notice of relocation 10 months in future). *See also Minahan v. Lesco, Inc.*, 2008 WL 4186924, \*19-20 (N.D. Ohio Sept. 5, 2008), in which the employer accused the departing corporate counsel of violating a fiduciary duty by failing to assist in the transition of legal matters.

F. Limitation on Activity During Severance Period

1. Restrictions on competition during all or part of the severance period. *Robertson v. Rubbermaid Incorporated*, 2000 WL 33309371, \* 5 (S.D. Ind. March 31, 2000).
2. Prohibition on retention and use of confidential information. *Minahan v. Lesco, Inc.*, 2008 WL 4186924, \*16 (N.D. Ohio Sept. 5, 2008).
3. Prohibition on inducing other employees to resign. *Minahan v. Lesco, Inc.*, 2008 WL 4186924, \*17 (N.D. Ohio Sept. 5, 2008).

- G. Successor Liability for CIC Payments - *Fair v. Giant of Maryland LLC*, 2006 WL 361338, \* 2 (D.Md. Feb. 15, 2006). A successor's failure to honor a CIC provision can itself constitute a triggering event. *Peach v. Ultramar Diamond Shamrock*, 229 F.Supp.2d 759, 762 (E.D. Mich. 2002).

### III. What Laws Apply to CIC Payment Obligations?

#### A. Contract Law

#### B. State Wage Payment and Collection Laws

1. Cases in which courts have upheld CIC bonus claims under the Pennsylvania WPCL include *Riseman v. Advanta Corp.*, 39 Fed. Appx. 761, 2002 WL 1480773 (3d Cir. July 8, 2002).
2. By contract the Southern District of New York denied a claim for CIC payments under the New York Labor Law because (a) CIC payments did not lie within the definition of "wages" under the law; and (b) executives' claims were not covered under the law. *Jacobs v. Claire's Stores, Inc.*, 2009 WL 2474108 (S.D. N.Y. Aug. 12, 2009).

#### C. ERISA

1. A post-CIC severance pay plan is an employee welfare benefit plan and subject to ERISA if the plan requires the establishment and maintenance of a separate and ongoing administrative scheme. *Fort Halifax Packing Co. v. Coyne*, 482 U.S. 1, 11 (1987).
  - (a) The determination of "good reason" may or may not require an ongoing administrative scheme. For example, salary reduction or relocation typically would not require an administrative scheme; an alteration in duties would require some administrative discretion, by contrast. *Sutton v. Brandywine Realty Trust*, 2007 WL 2288118 (N.D. Cal. Aug. 7, 2007).
  - (b) A "lump sum" payment does not typically require an ongoing administrative scheme. *See e.g., Citarella v. Goldleaf Financial Solutions, Inc.*, 2009 WL 3029760 (N.D. Ga. Sept. 21, 2009); *Donovan v. Branch Banking and Trust Company*, 220 F. Supp. 2d 560 (no ongoing administrative scheme).
  - (c) However, an ongoing administrative scheme may exist even with a lump sum payment that cannot be determined by simple arithmetical calculations, or where other aspects of the plan require ongoing administration or individualized determinations. *See, e.g.,*

*Cvelbar v. CBI Illinois, Inc.*, 106 F.3d 1368 (7<sup>th</sup> Cir. 1997), *cert. denied*, 522 U.S. 812 (1997) (ongoing administrative scheme).  
*Compare*

2. Other factors that may determine whether a plan is an “employee welfare benefit plan” include the following:
  - (a) The amount of discretion involved in disbursing benefits;
  - (b) Whether the benefits are disbursed on an ongoing or 1-time basis;
  - (c) Whether the obligation to pay benefits is triggered by a single event; and
  - (d) Whether the employer assumes a long-term obligation to review claims and make payments. *See Citarella v. Goldleaf Financial Solutions, Inc.*, 2009 WL 3029760 (N.D. Ga. Sept. 21, 2009); *Nadworny v. Shaw’s Supermarkets, Inc.*, 405 F. Supp. 2d 124, 131 (D. Mass. 2005).
3. ERISA requirements for welfare plans
  - (a) In contrast to pension plans, there is no automatic vesting requirement for welfare plans. *Lettrich v. J.C. Penney Company, Inc.*, 213 F.3d 765, 769 (3d Cir. 2000).
  - (b) Since there is no substantive entitlement to employee welfare benefits, employers are free, for any reason and at any time, to adopt, modify, or terminate welfare plans. *Curtiss-Wright Corp. v. Schoonejongen*, 514 U.S. 73, 78, 115 S.Ct. 1223 (1995).
  - (c) Any change or modification to welfare plans must be in writing with a plain English summary and such plans must have an amendment procedure. *See Id.*; 29 U.S.C. § 1022 (a), 1102(a)(1) and 1102(b)(3).
4. ERISA will pre-empt state actions to enforce CIC obligations to the extent that the plan in question is an ERISA plan. *Fair v. Giant of Maryland LLC*, 2006 WL 361338, \* 11 (D. Md. Feb. 15, 2006).
5. Federal Common Law- Congress has authorized the courts to create a body of federal common law under ERISA. *Hooven v. Exxon Mobil Corporation*, 465 F.3d 566, 573 n.5 (3d Cir. 2006). However, federal courts may not lightly create additional rights under the rubric of federal common law. *See Id.*, citing *Van Orman v. American Insurance Co.*, 680

F.2d 301, 312 (3d Cir. 1982). Traditional rules of contract construction govern review of an employment benefit plan under ERISA. *Televantos v. Lyondell Chemical Worldwide, Inc.*, 31 Fed. Appx. 63, 2002 WL 369804 (3d Cir. March 8, 2002).

6. Scope of review of decision of the Plan Administrator

- (a) Whether the Administrator's interpretation was consistent with the goals of the Plan;
- (b) Whether the interpretation renders any language in the Plan meaningless or internally inconsistent;
- (c) Whether the interpretation conflicts with the substantive or procedural requirements of the ERISA statute;
- (d) Whether relevant decision makers have interpreted the provision consistently; and
- (e) Whether the interpretation is contrary to the language of the Plan.

*Moench v. Robertson*, 62 F.3d 553, 566 (3d Cir. 1995); *Smith v. United Television, Inc. Special Severance Plan*, 474 F.3d 1033 (8<sup>th</sup> Cir. 2007); *Mallon v. Trust Co. of New Jersey Severance Pay Plan*, 282 Fed. Appx. 991, 995, 2008 WL 2553027 (3d Cir. June 27, 2008). NOTE: Common law rules of contract construction are used to interpret Plan language.

7. Problems Presented by ERISA Pre-emption

- (a) Lack of right to jury trial under ERISA - *See, e.g., Nadwordny v. Shaw's Supermarkets, Inc.*, 405 F.Supp.2d 124 (D. Mass. 2005).
- (b) Deference to Plan Administrator determination - *See Id.* and Section V(B), *intra*.
- (c) "Catch-22" Situation where Federal ERISA claim is dismissed because of deference to Administrator while state claim is dismissed in Federal Court for lack of subject matter jurisdiction. *See, e.g., Berg v. BCS Financial Corporation*, 372 F. Supp. 2d 1080 (N.D. Ill. 2005).

D. Section 409

E. Section 280(G)

IV. Key Issues in CIC Agreement Litigation

A. Existence of a CIC Agreement – *Shaffer v. Regions Financial Corp.*, \_\_\_\_ So. 3d \_\_\_\_, 2009 WL 2723334 (Ala. Aug. 28, 2009).

B. Applicability of CIC Provisions

A closing of a failing bank by the government is not a CIC giving rise to a right to severance pay when a CIC is limited to shareholder-approved events such as a “sale, lease, or transfer” of assets or a planned liquidation. *McCarron v. Federal Deposit Insurance Corporation*, 111 F.3d 1089, 1095 (3d Cir. 1997). (NOTE: The FDIC can repudiate severance agreements by statutory authority. *See Id.*)

C. Existence of a Termination or Resignation

There may be confusion on whether a departure from employment is a termination without good cause or a resignation. In *Boone v. Platinum Technology, Inc.*, 2000 WL 33119415 (E.D. Pa. Dec. 21, 2000), the employee argued that he was fired without good cause for refusing to sign a new, less favorable employment agreement. The employer asserted that the employee had resigned.

D. Existence of “Good Cause”

1. Differences may arise on whether the employee has good cause to resign because of a diminution in duties. A difference in rank and duties does not necessarily constitute a diminution in duties. *Tinkler v. Level 3 Communications, LLC*, 2008 WL 199901, \* 6 (N.D. Okla. Jan.22, 2008) (“It would rarely be the case that an affected employee’s position would remain exactly the same, especially if the new company is much larger”; remanding to plan administrator because of inadequate evidence to support denial of benefits). Structural differences between larger and smaller employers may lead to unavoidable changes in administrative functions without rising to the level of material alteration of employment status. *Vry v. Martin Marietta Materials, Inc.*, 2003 WL 297309 (D. Minn. Feb. 7, 2003).
2. For a discussion of the difference between “travel”, which did not constitute “good cause” for resignation, and “relocation”, which did constitute “good cause”, *see Peach v. Ultramar Diamond Shamrock*, 229 F. Supp. 2d 759, 762 (E.D. Mich. 2002).

E. Timing of “Good Cause” Event after CIC

F. Current Status of CIC Agreement or Plan (expiration/amendment)

V. What Standards Apply in Determining Eligibility for Benefits Under CIC Agreements?

A. Contract law

1. Contract interpretation is typically a matter of law to be decided by a court. *Gray v. Shoney's, LLC*, 2006 WL 3093217 (Tenn. App. Oct. 31, 2006) (affirming summary judgment for *plaintiff-employee* on the evidence of reduced authority).
2. Good faith - Erroneous advice to departing employees on the time limit for exercising stock options, is not a breach of the duty of good faith. *Dinger v. Allfirst Financial, Inc.*, 2003 WL 22466228 (3d Cir. Oct. 30, 2003); no evidence of intent to deceive employees although advice was simply wrong.

B. ERISA-

1. "De novo" standard applies to denial of benefits if the plan does not give the administrator discretionary authority to determine eligibility for benefits or construe the terms of the plan.
2. Basic "Abuse of Discretion" standard applies if plan documents give administrator the discretion to determine eligibility for benefits or interpret the terms of the plan. This standard applies to denial of benefits or to declaratory judgment of future entitlement to benefits. *Firestone v. Bruch*, 489 U.S. 101, 115, 109 S.Ct. 948, 956-57 (1989). Under the "abuse of discretion" standard, the Plan Administrator's decision can be overturned if the decision is "arbitrary and capricious". *See Id.*
3. An apparent conflict of interest arises when all members of the committee reviewing benefit applications are employees of the employer sponsoring the plan, i.e., when the employer both determines eligibility for benefits and pays benefits disbursed from its own funds. *Bader v. RHI Refractories America, Inc.*, 111 Fed. Appx. 117, 2004 WL 2278687 (3d Cir. 2004); *Frick v. U.S. Bancorp*, 98 F.Supp. 2d 1202 (W.D. Wash. 2000).
4. Heightened scrutiny is required when a conflict of interest exists. *Frick v. U.S. Bancorp*, 98 F.Supp. 2d 1202 (W.D. Wash. 2000).
5. Even under the heightened scrutiny standard, the administrator's interpretation is entitled to deference and may be disturbed if it is without reason, unsupported by substantial evidence or erroneous as a matter of law. *Communication Workers of America, AFL-CIO v. Comcast Cable Communications, Inc.*, 2008 WL 696925, \* 10 (W.D. Pa. March 12, 2008), *citing Courson v. Bert Bell NFL Player Retirement Plan*, 214 F.3d 136,

142 (3d Cir. 2000); *Woodbury v. American Home Products Corp.*, 285 F. Supp. 2d 544, 548 (D. N.J. 2003).

6. A denial of benefits was found to be arbitrary and capricious on two separate grounds in *Woodbury v. American Home Products Corp.*, *supra*. First, the Court found the Administrator's decision to be not rationally related to a valid plan purpose. The original purpose of the Plan had been to reassure the employees that their job status would not be affected after a merger; in this context, the decision that a drastic reduction in benefits did not provide "good reason" to resign was arbitrary and capricious. *Woodbury v. American Home Products Corp.*, *supra* at 548-549. Second, The Court found that the Administrator's interpretation was contrary to the language of the Plans. *Woodbury v. American Home Products Corp.*, *supra* at 550.