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**ON THE SOKOL / BERKSHIRE / LUBRIZOL
FACTS: WOULD YOU PAY SEVERANCE ?**

The Facts. The business news in the first week of April was full of public allegations against Berkshire Hathaway executive David Sokol. Mr. Sokol publicly admitted, while resigning from positions with Berkshire Hathaway, that he had purchased Lubrizol stock shortly before that company was purchased by Berkshire Hathaway. Mr. Sokol admits that soon after buying Lubrizol shares he suggested the acquisition of the Lubrizol company to Berkshire chairman Warren Buffet. It is reported that he made a \$3MM gain on his \$10MM purchase of Lubrizol shares, largely because Berkshire Hathaway acquired Lubrizol after his stock purchase and recommendation to Mr. Buffet. Mr. Sokol denies wrongdoing.

The Reaction. The *Wall Street Journal* reported that the Securities and Exchange Commission is investigating the events surrounding Mr. Sokol's Lubrizol stock purchases. Pundits, bloggers and others disagree as to whether Mr. Sokol's admitted actions were "insider trading" or other securities law violations. Questions are being voiced about whether Mr. Sokol's stock purchases and subsequent conduct violated Berkshire Hathaway's internal policies. Reasonable commentators are airing differences of opinion about whether Mr. Sokol's judgment was bad, or his behavior unethical.

The Lessons? For corporate leaders, what are the lessons? Most board members and CEOs won't need a fine legal analysis or ethical navel-gazing to have a gut reaction. They'll either think "it stinks, legal or not," or they'll think it's really not so bad. We can draw two early conclusions. First, if as a board member or CEO you don't like Mr. Sokol's behavior, then you'll want to know whether your company



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policies would permit or forbid this conduct. Second, you'll want to know whether dismissal of the executive would trigger severance payment obligations.

What is a "For Cause" termination? Typically, executive severance arrangements provide payments and option accelerations, sometimes very rich, when an executive is let go for reasons other than "for cause." In other words, the obligation to pay this package hinges on whether a firing is "for cause" or not.

Sokol Agreement's Definition of "Cause." For example, the *Wall Street Journal's Deal Journal* blog of March 31 links to Mr. Sokol's 2008 employment agreement with MidAmerican Energy Holdings Company (a Berkshire Hathaway company). To paraphrase, Mr. Sokol's agreement defines "cause" as any one of (a) willful, continued failure to perform services, after a written notice of nonperformance, (b) willful engaging in gross misconduct which is materially and demonstrably injurious to the company, or (c) gross negligence in performing services that is materially and demonstrably injurious to the Company. Even if a company policy has been violated, that is a tough standard for a company to prove. On the published facts, there would be serious doubt as to whether Mr. Sokol's admitted conduct violated the standard. Maybe, maybe not. Different language in the employment agreement would make a big difference here. And the stakes are high. For a dismissal without "cause" as defined in the agreement, Mr. Sokol would receive \$2.25 MM (three times his annual \$750K salary), plus an annual bonus amount, vesting of all performance based options, three years of time-based option vesting, and three years continuance of insurance and other employee benefits.

Conclusions. Mr. Sokol appears to have resigned voluntarily. I've read nothing to indicate that he will seek severance payments. Regardless, the conclusion here is that if you would fire an executive who had done what has been reported, then consider whether your company's policies and executive agreements would support your decision, or make it very expensive.

For more information, on this and other matters, please contact:

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