Supreme Judicial Court

FOR THE COMMONWEALTH OF MASSACHUSETTS

SJC-12112

ERIC N. BALLES,
Plaintiff-Appellee,

v.

BABCOCK POWER, INC.,
Defendant-Appellant.

ON DIRECT APPELLATE REVIEW OF A JUDGMENT OF
THE MIDDLESEX SUPERIOR COURT

BRIEF OF AMICUS CURIAE NEW ENGLAND LEGAL FOUNDATION IN SUPPORT OF THE DEFENDANT-APPELLANT

NEW ENGLAND LEGAL FOUNDATION,

By its attorneys,

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CORPORATE DISCLOSURE STATEMENT

Amicus curiae New England Legal Foundation ("NELF") states, pursuant to S.J.C. Rule 1:21, that it is a 26 U.S.C. § 501(c)(3) nonprofit, public interest law foundation, incorporated in Massachusetts in 1977, with its headquarters in Boston. NELF does not issue stock or any other form of securities and does not have any parent corporation. NELF is governed by a self-perpetuating Board of Directors, the members of which serve solely in their personal capacities.

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ISSUE PRESENTED

This case presents the following issue:

> When a stockholder agreement provides that a corporation's board of directors has the sole authority to decide whether a senior executive should be terminated for cause, should a reviewing court defer to the Board's good-faith employment decision, or should the court instead determine the issue for itself in a trial *de novo*?

INTEREST OF AMICUS CURIAE

NELF is a nonprofit, public interest law firm, incorporated in Massachusetts in 1977 and headquartered in Boston. NELF's membership consists of corporations, law firms, individuals, and others who believe in its mission of promoting balanced economic growth in New England, protecting the free enterprise system, and defending economic rights. NELF's members and supporters include a cross-section of large and small businesses and other organizations from all parts of the Commonwealth, New England, and the United States.

NELF is committed to the foundational principle of freedom of contract, which in this case means that an employer and a high-ranking employee should be allowed generally to structure their business relationship and its termination in any way they wish.

Accordingly, courts of the Commonwealth should enforce the parties' contractual arrangement by deferring to the employer's good-faith decision to terminate the employee under the terms of their agreement.

Amicus is also committed to the related and well-settled principle that the judiciary should defer to internal business decisions involving sensitive issues of corporate governance. Under the business judgment rule, courts should presume that a corporation's board of directors has acted in good faith and in the best interests of the corporation when it has terminated a high-level executive employee for cause, unless the employee can prove otherwise.

NELF has appeared regularly as amicus curiae before this Court in many other cases that have raised issues of general concern for businesses in Massachusetts.[1]

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[1] *See, e.g.*, *Gyulakian v. Lexus of Watertown,* 475 Mass. 290 (2016); *Verdrager v. Mintz, Levin, Cohn, Ferris, Glovsky & Popeo, P.C.*, 474 Mass. 382 (2016); *Vale v. Valchuis*, 471 Mass. 495 (2015); *Meshna v. Scrivanos*, 471 Mass. 169 (2015); *Glovsky v. Roche Bros. Supermarkets, Inc.,* 469 Mass. 752 (2014); *Martin v. Simmons Prop.s, LLC*, 467 Mass. 1 (2014); *McInnes v. LPL Fin., LLC*, 466 Mass. 256 (2013); *Flagg v. AliMed, Inc.*, 466 Mass. 23 (2013); *Machado v. System4 LLC*, 465 Mass. 508 (2013); *Feeney v. Dell Inc.*, 465 Mass. 470 (2013).

Accordingly, NELF believes that its brief could assist the Court in deciding the issue presented in this case.[2]

ARGUMENT

I. A COURT SHOULD UPHOLD AN EMPLOYER'S GOOD-FAITH TERMINATION OF A HIGH-RANKING EXECUTIVE EMPLOYEE FOR CAUSE, ESPECIALLY WHEN THE PARTIES HAD AGREED THAT THE EMPLOYER WOULD HAVE THE EXCLUSIVE AUTHORITY TO DECIDE THAT ISSUE.

This case raises the important issue of how a court should review an employer's decision to terminate a high-ranking executive employee for cause, when the parties had agreed in advance that the corporation's board of directors would have the sole authority to decide that issue. The agreement in dispute provides that "a determination of 'Cause' may *only be made* by the Board of Directors . . . ." Addendum to Defendant's Brief ("ADD")82 (emphasis added). The agreement also provides a definition of cause. ADD81-82.

With this key contractual language, the defendant, Babcock Power, Inc., retained its employer's prerogative to decide whether sufficient

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[2] Neither the defendant nor its counsel, nor any individual or entity aside from amicus, has authored this brief in whole or in part, or has made any monetary contribution to its preparation or submission. *See Aspinall v. Philip Morris Co.s*, 442 Mass. 381, 385 n.8 (2004) (discussing Mass. R. App. P. 17).

cause existed to discharge the plaintiff, Dr. Eric Balles, a high-ranking executive employee. Contrary to the Superior Court's trial *de novo* in this case, a court should not usurp the Board's exclusive decisionmaking authority, under the plain terms of the parties' agreement, by deciding for itself whether cause existed to terminate Dr. Balles:

> [W]here the employment contract provides the employer with sole discretion to determine whether cause exists justifying the employee's termination, then courts may not review the employer's determination that cause existed. . . . [I]t is a fundamental proposition that parties to an employment contract are free to bind themselves to whatever termination provisions they wish.

Taylor v. Spectrum Health Primary Care Partners, 2015 WL 8539499, at *3 (Mich. Ct. App. Dec. 10, 2015) (affirming summary discharge of licensed medical professional under agreement authorizing healthcare facility's board of directors to take such action upon finding serious, intentional violation of standards of patient care or unethical behavior) (citation and internal quotation marks omitted).

Indeed, the parties' agreement codifies the foundational principle that an employer, not a court, is in the best position to decide whether a high-

ranking employee with substantial managerial responsibilities has harmed the corporation's interests sufficiently to warrant termination for cause. Such an employee's utmost loyalty is essential to the corporation's welfare. Accordingly, "[a]n employer must have wide latitude in making independent, good faith judgments about high-ranking employees without the threat of a jury [or court] second-guessing its business judgment." *Cotran v. Rollins Hudig Hall Int'l, Inc.*, 948 P.2d 412, 417 (Cal. 1998) (citation and internal punctuation marks omitted) (emphasis added). *See also Percival v. General Motors Corp.*, 539 F.2d 1126, 1130 (8th Cir. 1976) (Employer "must be accorded wide latitude in determining whom it will employ and retain in high and sensitive managerial positions . . . .") (applying Michigan law).

Stated otherwise, Babcock's exclusive decisionmaking authority to terminate Dr. Balles for cause under the terms of the agreement is an exercise of business judgment warranting judicial deference. *See Harhen v. Brown*, 431 Mass. 838, 845 (2000) ("The business judgment rule affords protection to the business decisions of directors . . . because

directors are *presumed* to act in the best interests of the corporation.") (emphasis added). Accordingly, a court should presume that the Board acted in good faith, and in the best interests of the corporation, when it decided that Dr. Balles' misconduct as a high-ranking employee warranted his termination for cause. *Cf*. *Harhen*, 431 Mass. at 845 ("[A] plaintiff must allege facts that challenge the board's good faith or the reasonableness of the board's investigation of the plaintiff's [litigation] demand.").

Judicial review should therefore be limited to whether the Board performed its contractual decisionmaking responsibilities in good faith. *See Uno Restaurants, Inc. v. Boston Kenmore Realty Corp.*, 441 Mass. 376, 385 (2004) ("The covenant of good faith and fair dealing is implied in every contract . . . [and] concerns *the manner of performance*. . . . [T]he purpose of the covenant is to guarantee that the parties remain faithful to the intended and agreed expectations of the parties *in their performance*.") (emphasis added).

The Board's decision should therefore be upheld, unless Dr. Balles can show that the Board terminated him in bad faith. And deference should apply to each

stage of the Board's decisionmaking process--i.e., to its factfinding efforts, to its interpretation of the contractual definition of cause, and to its application of that interpretation to the facts that it found. *See Black v. Fox Hills North Comty. Ass'n., Inc.*, 599 A.2d 1228, 1231 (Md. 1992) (deferring, under business judgment rule, to property owners association's interpretation of contract as allowing property owner to build fence: "The 'business judgment' rule, therefore, precludes judicial review of a legitimate business decision of an organization, absent fraud or bad faith. . . . Whether [the association's] decision [in interpreting the contract] was *right or wrong*, the decision fell within the legitimate range of the association's discretion.") (emphasis added); *Gottlieb v. Schenck*, 82 N.Y.S.2d 719, 721-22 (N.Y. Sup. Ct. 1942) (in shareholder derivative suit against movie distributor for corporate waste, "[t]he interpretation of the contracts and the accounting practices thereunder were primarily for the *business judgment* of the corporate agents and the Board of directors in the absence of fraud or its equivalent . . . . The resolution of such questions is *peculiarly for the corporate management*,

and the court must hesitate to substitute its judgment for that of directors . . . .") (emphasis added).

Finally, it is important to note that courts from other jurisdictions have deferred to an employer's good-faith termination of an employee for cause even when the agreement is altogether *silent* on the issue of who should make that decision. Those courts conclude that the decision inherently belongs to the employer. "[A]bsent substantial evidence of an express or implied agreement *contracting away its fact-finding prerogatives* to some other arbiter, the employer is the ultimate finder of facts constituting good cause for termination." *Sw. Gas Corp. v. Vargas*, 901 P.2d 693, 700 (Nev. 1995) (emphasis added). *See also Towson Univ. v. Conte*, 862 A.2d 941, 950 (Md. 2004) (on judicial review of university's termination for cause of director of research institute, where contract lacked directive on who should decide issue, court "may not review whether the factual bases for termination actually occurred or whether they were proved by a preponderance of the evidence . . . . Instead, the proper role of the [court] is to review . . . *whether the employer acted in objective good faith* and in accordance with a reasonable employer

under similar circumstances when he decided there was just cause to terminate the employee.") (emphasis added).

Notwithstanding the plain terms of the parties' agreement and these well-settled principles of corporate governance, the Superior Court conducted a trial *de novo.* ADD102-216. In so doing, the lower court usurped the Board's exclusive authority to decide whether a high-ranking employee's misconduct was sufficiently egregious to warrant termination for cause. In effect, the lower court acted as an unauthorized super-board of directors, second-guessing and rejecting several of the Board's factual findings that underlay its decision, four years earlier, to terminate Dr. Balles for cause. ADD102-185. The court also set aside the Board's interpretation of the definition of cause under the stockholders' agreement and its application of that interpretation to the facts that the Board had found. ADD185-216.

For these reasons, the Superior Court overstepped its authority in this case. Accordingly, the lower court's judgment should be reversed and the case remanded for the appropriate deferential review of the Board's decision.

II. TO WARRANT DEFERENTIAL REVIEW FOR ITS EMPLOYMENT DECISIONS, AN EMPLOYER NEED NOT EXPRESSLY RECITE IN ITS AGREEMENTS THAT ITS EXCLUSIVE DECISIONMAKING AUTHORITY IS FINAL.

In the course of the proceedings below, the Superior Court effectively announced a new and unsupportable rule of contract construction that should be rejected by this Court. In particular, the lower court observed that, while the parties' agreement gave the Board the exclusive authority to decide the issue of cause, the agreement did not recite that the Board's decision would be final. ADD56. From this the lower court concluded that a trial *de novo* was permissible. ADD56-58.

And so the trial court effectively announced a new rule of contract construction: to warrant deferential, "closed-record" review of a decision to terminate an employee for cause, a Massachusetts employer must include express language in its agreement stating that its exclusive decisionmaking authority is final.

The lower court erred. To preclude *de novo* review, an agreement should not have to recite that the Board's exclusive determination of cause is final. This is because the parties' agreement *already* means

that the Board's decision is final: "[A] determination of 'Cause' may *only be made* by the Board of Directors . . . ." ADD82 (emphasis added).

This contractual language authorizes the Board, and the Board alone, to exercise primary jurisdiction over the issue of how to characterize Dr. Balles' termination, subject to limited judicial review of the Board's decisionmaking process, as discussed above. Simply put, the Board's decision is final by virtue of its exclusive decisionmaking authority. "[W]here the employment contract provides the employer with sole discretion to determine whether cause exists justifying the employee's termination, then *courts may not review the employer's determination that cause existed*." *Taylor*, 2015 WL 8539499, at *3 (emphasis added). *Cf*. *Fernandes v. Attleboro Hous. Auth.*, 470 Mass. 117, 121 (2014) ("Where an agency has statutorily been granted *exclusive* authority over a particular issue, the doctrine of primary jurisdiction requires that a court refer the issue to the agency for adjudication in the first instance") (emphasis in original).

Indeed, courts from other jurisdictions have held that an entity's contractual power to decide a

disputed issue is *inherently* final and, therefore, does not require express finality language in the agreement to warrant judicial deference. *See Black*, 599 A.2d at 1231 (deferring to property owners association's interpretation of contract, where contract did not recite that association's decision was final: "As a general rule, . . . courts will not interfere in the internal affairs of a corporation. . . . When the tribunals of an organization . . . have power to decide a disputed question[,] *their jurisdiction is exclusive, whether there is a by-law stating such decision to be final or not*. . . . Courts will not second-guess the actions of directors unless it appears that they are the result of fraud, dishonesty or incompetence. . . ."") (emphasis added) (citations and internal punctuation marks omitted).

Therefore, this Court should reject the Superior Court's requirement of express finality in the disputed agreement to warrant deferential review of the Board's decision.

III. A REVIEWING COURT SHOULD DEFER TO THE EMPLOYER'S FACTFINDING PREROGATIVE BY CONSIDERING THE FACTS AS THE EMPLOYER FOUND THEM AT THE TIME OF ITS DECISION.

In reviewing an employer's decision to terminate an employee for cause, a court should consider the facts as the employer found them at the time of its decision, especially when, as here, the employer expressly retained its factfinding prerogative in the parties' agreement. ADD82. Contrary to the lower court's approach here, a court should not second-guess or reconsider the factual bases for the employer's decision, in a formal trial taking place many years after the events in question.

After all, an employer's decision is based on facts that are "typically gathered under the *exigencies of the workaday world* and without benefit of the slow-moving machinery of a contested trial." *Towson Univ.*, 862 A.2d at 952 (emphasis added). *See also Waters v. Churchill*, 511 U.S. 661, 677 (1994) (in public employee's First Amendment challenge to termination, rejecting *de novo* determination of facts in court, and deferring to employer's informal factual findings made at time of decision, even if employer relied on information that may have been incomplete or

inadmissible in court). Such deference gives legal effect to the practical realities of the workplace and to the Board's unique insider's position to exercise its organizational judgment and evaluate the employee's misconduct in light of the corporation's best interests.

Contrary to the lower court's approach in this case, then, an employer should not be expected to function as a court and conduct a formal, trial-type hearing. Such impractical and costly demands on the employer would defeat the employer's legitimate "interest in efficient employment decisionmaking." *Waters*, 511 U.S. at 676. After all,

> [e]mployers . . . often do rely on hearsay, on past similar conduct, on their personal knowledge of people's credibility, and on other factors that the judicial process ignores. *Such reliance may sometimes be the most effective way for the employer to avoid future recurrences of improper and disruptive conduct.* What works best in a judicial proceeding may not be appropriate in the employment context.

Id. (emphasis added).

If the lower court's decision were allowed to stand, a reviewing court would not only displace the employer's factfinding role, but it would also function as a "fact-finding board *unconnected* to the

challenged employer, . . . *unattuned to the practical aspects* of employee suitability over which it would exercise consummate power, and *unexposed to the entrepreneurial risks* that form a significant basis of every state's economy . . . ." *Sw. Gas Corp.*, 901 P.2d at 699 (emphasis added). *See also Towson Univ.*, 862 A.2d at 952-53 (discussing "the jury's relative remoteness from the everyday reality of the workplace." "The decision to terminate an employee for misconduct is one that not uncommonly implicates *organizational judgment* and may turn on intractable factual uncertainties, even where the grounds for dismissal are fact specific.") (emphasis added). And, as this case illustrates, a reviewing court "would be empowered to impose substantial monetary consequences on employers whose employee termination decisions are found wanting." *Sw. Gas*, 901 P.2d at 699.

Simply put, a reviewing court should limit itself to determining whether the employer performed its exclusive factfinding role in good faith. In so limiting its review, a court would give legal effect not only to the parties' agreement but also to the exigencies of the workplace, along with the employer's unique vantage point in understanding first-hand the

nature of an executive employee's misconduct and its harmful effects on the employer.

CONCLUSION

For the foregoing reasons, NELF respectfully requests that the judgment of the Superior Court be reversed and the case remanded.

Respectfully submitted,

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By its counsel

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Dated: October 21, 2016

CERTIFICATE OF COMPLIANCE

Pursuant to Mass. R. App. P. 16(k), I hereby certify that this brief complies with the rules of court pertaining to the filing of an amicus brief, including, but not limited to, Mass. R. App. P. 17.

/s/ Ben Robbins

Ben Robbins

CERTIFICATE OF SERVICE

I, Ben Robbins, hereby certify that on this 21st day of October, 2016, I served the within brief by causing two copies to be delivered by priority mail to counsel for the Plaintiff: Jody L. Newman, Collora LLP, 100 High Street, Boston, MA 02110; and David J. Burgess, 81 Middle Street, Concord, MA 01742-2429; and to counsel for the Defendant: Mark C. Fleming, Wilmer, Cutler, Pickering, Hale and Dorr LLP, 60 State Street, Boston, MA 02109; and Kristy Avino, McCarter & English, LLP, 265 Franklin Street, Boston, MA 02110.

Signed under penalties of perjury.

/s/ Ben Robbins

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