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Case Comments 0. Master And Servant Raybuck V. Usx, Inc

first brought in state court. The suit in *Farrell*, however, was by retired employees against their former employer, a claim over which the federal and state courts shared concurrent jurisdiction.[573] Because the state court had not been clearly without jurisdiction, tolling was appropriate.

Shofer's ERISA-specific holding appears consistent with the more general accord of the circuits: some subject matter jurisdiction must have existed in the state court of filing, or at least the plaintiff must have relied on a reasonable legal theory supporting state jurisdiction before the courts will consider equitable tolling in a subsequent federal suit.[574] Where, as in *Shofer*, a claim involves subject matter that is plainly of exclusive federal jurisdiction, such tolling is unavailable.

O. Master and Servant

Raybuck v. USX, Inc.

961 F.2d 484 (4th Cir. 1992)

The granting of stock options to management employees, in an effort to promote the long-term financial interests of the issuing corporation, to motivate key employees, and to identify the interests of those employees with the interests of the stockholders of the corporation, has become a common part of the benefit and compensation packages offered by many corporations. These stock option plans frequently include provisions which allow the corporation issuing the options to revoke these stock options in the best interests of the corporation.

In *Raybuck v. USX, Inc.*[575] the United States Court of Appeals for the Fourth Circuit considered the right of a retired management employee to exercise a series of outstanding stock options after he accepted employment with a direct competitor of the issuing corporation. In addition to considering the employee's right to the stock options, the Fourth Circuit also examined whether the law of the place of incorporation, or the law of the place where the last act which made the contract binding, controlled.[576]

The facts in *Raybuck* were essentially undisputed. Robert W. Raybuck was a retired management employee of the defendant, USX, Inc. Raybuck began working for USX in 1955. In 1976 USX established a Management Incentive Plan granting options to purchase USX stock to chosen management employees. These options were granted to Raybuck annually from 1978 to 1985. In 1986 Raybuck elected to apply for an early retirement

573. Farrell v. Automobile Club, 870 F.2d 1129, 1134 (6th Cir. 1989) (citing 29 U.S.C. § 1132(a)(1)(B) (1988)).

574. Fox v. Eaton Corp., 615 F.2d 716, 719-20 (6th Cir. 1980); *see supra* note 561 (listing similar holdings among circuits).

575. 961 F.2d 484 (4th Cir. 1992).

576. Raybuck v. USX, Inc., 961 F.2d 484, 487 (4th Cir. 1992).

program offered by USX. USX accepted Raybuck's application effective August 31, 1986.

In October of 1986, Raybuck accepted a position as a consultant to Bethlehem Steel, a major competitor of USX. On January 1, 1987, Raybuck became the full time plant manager of Bethlehem Steel's Sparrows Point plant. On December 30, 1986, USX cancelled Raybuck's stock options after learning of his employment with Bethlehem Steel and informed Raybuck of the cancellation by letter dated January 8, 1987. Raybuck then submitted his options for payment, which USX refused. Raybuck subsequently brought suit in the United State District Court for the District of Maryland.[577]

Raybuck's basic claim was for breach of contract. Raybuck also raised a conflict of laws issue as to whether the law of Pennsylvania or Delaware applied. Additionally, Raybuck raised claims for breach of implied contract, breach of fiduciary duty of good faith and fair dealing, intentional interference with property, fraud, constructive fraud, and negligent misrepresentation, which the trial court found to be unsupported.

The district court treated *Raybuck* as a question of contract interpretation. This interpretation centered upon two passages in the Management Incentive Plan and a passage in the stock options themselves. Section 4 of the Management Incentive Plan stated that:

> The options shall contain such conditions and restrictions as to the purchase and delivery of shares, and such provisions as to the rights of the Corporation in the event of a breach of the agreement to continue as an employee, as may be deemed advisable for the protection of the Corporation.[578]

Section 11 of the Plan declared that "If a participant retires prior to termination of his option without having fully executed his option, he shall have the right to exercise or surrender the option during its term within such period as may be provided in the option, not to exceed three years after retirement."[579] Finally, paragraph 3 of the stock options contained a provision granting the Compensation Committee the right to cancel the options ". . . after the Optionee retires at any age when the Committee deems such cancellation to be in the best interests of the Corporation."[580]

As a preliminary matter, the court decided which state law applied. Raybuck argued for the application of Delaware law, the state of incorporation for USX. The district court disagreed, and instead applied the law of the place of contract. In making this determination the district court relied upon *Stout v. Home Life Insurance Co.*[581] *Stout* addressed the question

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577. Raybuck v. USX, Inc., No. CIV.JFM-89-2260, 1990 WL 3528200 (D. Md. June 18, 1990). The district court decision in *Raybuck v. USX, Inc.* was a memorandum decision not reported in the Federal Supplement. *Id.*

578. *Id.* at *3.

579. *Id.* at *2.

580. *Id.*

581. 651 F. Supp. 28 (D. Md. 1986), *aff'd*, 818 F.2d 29 (4th Cir. 1987).

of where a series of life insurance policies had become binding. Under Maryland conflict of law rules, the *Stout* court applied the laws of the state in which the last act making the agreement a binding contract was performed.[582] In *Raybuck*, Pennsylvania is where USX administered the plan and where Raybuck would have redeemed the options. The district court therefore applied the law of Pennsylvania.

As to the meaning of the contract, Raybuck argued that the terms of the Management Incentive Plan gave him an absolute vested right to exercise his options at any time within three years of his retirement, and that any conflicting language in the options was void. Section 11 of the defendant's Management Incentive Plan allowed a retired participant in the plan to exercise their options, or surrender them, during the term provided in the option, for up to three years after the individual's retirement. Raybuck argued that this section was dispositive of his right to exercise his options. USX, however, pointed to the fact that paragraph 3 of each of the options signed by Raybuck granted USX's Compensation Committee the power to cancel an employees options at any time, so long as it was in the corporation's best interest. Raybuck had full knowledge that the options which he accepted contained this cancellation clause.

The district court agreed with USX, finding that paragraph 11 of the Management Incentive Plan did not guarantee Raybuck a three-year period in which to exercise his options. The court found that paragraph 11 provided that the option period shall not exceed three years, but did not preclude an earlier cancellation date. The District Court concluded that paragraph 4 of the management incentive plan gave USX the right to cancel the options of a former employee now working for a direct competitor, when USX reasonably concluded that cancellation was in the best interests of the corporation. The district court therefore applied the law of Pennsylvania and granted summary judgment for the defendant on all counts, holding that USX's Compensation Committee cancelled Raybuck's stock options under power vested in it by its Board of Directors under the terms of the Management Incentive Plan and the terms of the options themselves.

Raybuck appealed to the United States Court of Appeals for the Fourth Circuit. As to the conflict of law issue, Raybuck argued that because the case involved the internal affairs of USX the laws of the place of incorporation should apply. Raybuck cited *Beard v. Elster*[583] and *Ellis v. Emhart Manufacturing Co.*[584] as support for this proposition. *Beard* was a shareholders' derivative suit examining whether or not a series of stock options granted to American Airlines employees was valid. The *Beard* court held that the issuance of a stock option plan by a Delaware corporation involved the internal affairs of the corporation, and that therefore the laws of

582. Stout v. Home Life Ins. Co., 651 F. Supp. 28, 32 (D. Md. 1986), *aff'd*, 818 F.2d 29 (4th Cir. 1987).

583. 160 A.2d 731 (Del. Ch. 1960).

584. 191 A.2d 546 (Conn. 1963).

Delaware controlled.[585] In *Ellis*, the executor of the estate of Joseph Adam sought to exercise a series of stock options granted to the decedent by Emhart Manufacturing Company.[586] After Adam's death, the Board of Directors interpreted the terms of the stock option plan in a manner that limited the right of the plaintiff, as Adam's executor, to exercise the options. The principal issue before the *Ellis* court was whether an attempt by the Board of Directors to interpret the plan so as to limit rights already granted the decedent would be binding on the decedent's executor. Citing *Beard v. Elster*, the *Ellis* court held that the issuance of a stock option plan involved the internal affairs of the corporation, and should be governed by the laws of the state of incorporation.[587]

The Fourth Circuit disagreed with Raybuck's application of precedent, distinguishing *Beard* and *Ellis* from *Raybuck*. The Fourth Circuit reasoned that *Beard* and *Ellis* involved stockholders' suits challenging the power of a corporation to grant stock options under the law of the state of incorporation, whereas *Raybuck* was essentially a contract dispute. Because Raybuck had not challenged the power of the defendant to grant the options, the Fourth Circuit found the rationale cited for the application of Delaware law unpersuasive. The Fourth Circuit therefore affirmed the district court's rationale and concluded that Pennsylvania law applied.

The Fourth Circuit also affirmed the district court's interpretation of the contract. The Fourth Circuit stated that:

> the clarity of the cancellation clause in the stock option negates any credible assertion by Raybuck that he was unaware that his options were subject to cancellation in what USX deemed to be its best interests, and when he became employed by Bethlehem Steel before exercising his options, he was acting at his own risk.[588]

The Fourth Circuit concluded that Raybuck read too much into paragraph 11 of the Management Incentive plan, and that the "retirement exception" to the automatic termination of the stock options upon an individual's ceasing employment with the defendant did not in any way alter the other conditions and restrictions imposed upon the options by USX.

The Fourth Circuit's decision in *Raybuck* adds to a small but growing body of law dealing with the rights of former employees to claim unexercised stock options after the voluntary or involuntary termination of their employment with the corporation issuing the options. *Raybuck* is the first decision in the Fourth Circuit to examine the right of a corporation to terminate the stock options of a former employee who accepts employment with a direct competitor. For the Fourth Circuit, the mere fact that a claim involves a decision by a board of directors does not mean that the claim

585. Beard v. Elster, 160 A.2d 731, 735 (Del. Ch. 1960).
586. Ellis v. Emhart Mfg. Co., 191 A.2d 546, 547 (Conn. 1963).
587. *Id.* at 550.
588. Raybuck v. USX, Inc., 961 F.2d 484, 489 n.2 (4th Cir. 1991).