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Supreme Court of Texas.
Eri Consulting Engineers, Inc. and Larry G. Snodgrass, Petitioners,
v.
J. Mark Swinnea, Brady Environmental, Inc., and Malmeba Company, Ltd.,
Respondents.
No. 07-1042.
December 17, 2009.

Oral Argument

Appearances:Sarah B. Duncan, Locke Lord Bissell & Liddell LLP, Austin, TX, for petitioners.

Greg Smith, Ramey & Flock P.C., Tyler, TX, for respondents.

Before:

Chief Justice Wallace B. Jefferson, Justice Nathan L. Hecht, Justice Harriet O'Neill, Justice Dale Wainwright, Justice David M. Medina, Justice Paul W. Green, Justice Phil Johnson, Justice Don R. Willett, Justice Eva Guzman.

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CHIEF JUSTICE WALLACE B. JEFFERSON: The Court is now ready to hear argument in 07-1042, ERI Con-sulting vs. Mark Swinnea and others.

MARSHALL: May it please the Court, Ms. Duncan will present argument for the Petitioners. The Petitioners have reserved five minutes for rebuttal.

ORAL ARGUMENT OF SARAH B. DUNCAN ON BEHALF OF THE PETITIONER

ATTORNEY SARAH B. DUNCAN: May it please the Court, following Socrates' example, I'd like to spend the first minute of my argument talking about what this case is not about, because that's where I think the court of appeals' errors begin and where they end. And then we can move on to talk in a more positive way about the three issues we brought forward. What this case is not about is an arm's length transaction between relative strangers. It's about two men who were partners for

years, who agreed that one would be bought out of their mutual financial relationship. It's about two fiduciaries, who owed one another what this Court has held is the highest duty known at law, the utmost honesty and good faith. It's not about actual damages for the most part. The lost profits award was actual damages, but for the most part, the trial court's judgment is about the equitable remedy of disgorgement. It's not, and I think this is where the court of appeals starts getting off the right foot, it's not just about a sale of stock, it's about the dissolution of a financial arrangement. I think that point is most easily seen if the Court would look at the first page behind Tab 2 of the appendix to our brief on the merits. That's the first page of Exhibit 7. That page is titled “Buyout of Mark Swinnea.” It then lists ten documents that are part of that buyout from the stock redemption agreement all the way down to the stock certificates being canceled. But in the middle is the lease agreement. So if you then look at the court of appeals' opinion, it equates the first agreement, the Stock Redemption Agreement with the Buyout Agreement, and that's just wrong. Both parties testified the Buyout Agreement is all of this. And the court of appeals also misun-derstood-- I'm sure the Court has seen the extensive findings of fact made by Judge Kent, which were the last document in our appendix. This case is not about just fraudulently inducing the Buyout Agreement. The trial court expressly found that the fraud, the breaches of fiduciary duty, the misrepresentations and the false promises began before the buyout, continued during the buyout and after the buyout. There has never been on appeal a challenge to the trial court's liability findings, and those liability findings establish fraud, breach of fiduciary duty, conspiracy, false promises, promises that Mr. Swinnea never intended to perform. He had a plan and the plan was to get his partner to sell him... to buy his stock, and then he gets half a million in cash and an income stream, and then he's going to run the company into the ground and buy it back for pennies on the dollar. What this case is about is whether Larry Snodgrass and his company, ERI, have any remedy for that fraud, those breaches of fiduciary duty, the conspiracy, the false promises. The court of appeals said no, but I think they said no because they got all tangled up in what this case isn't about, actual damages, just a sale of stock.

JUSTICE NATHAN L. HECHT: Let me ask you about the lost profits. Of course, disgorgement, the idea is that the agent shouldn't profit from his wrongdoing even if by fortuity the principal wasn't harmed. But lost profits sounds more like damages than forfeiture.

ATTORNEY SARAH B. DUNCAN: I agree.

JUSTICE NATHAN L. HECHT: Why isn't that the case?

ATTORNEY SARAH B. DUNCAN: I agree. I think the lost profits aspect of the trial court's judgment is an award of an attempt to arrive at actual damages to the company.

JUSTICE NATHAN L. HECHT: And so how is that sustainable under a forfeiture rule?

ATTORNEY SARAH B. DUNCAN: Well, I don't think it is under a rule of forfeiture. I think it's sustainable --

JUSTICE NATHAN L. HECHT: Do you think that's --

ATTORNEY SARAH B. DUNCAN: -- because there is legally sufficient evidence of the lost profits.

JUSTICE NATHAN L. HECHT: And which then, which of the four amounts, the upfront cash payment, the rent, the half-value of Malmeba or the lost profits, which of those were covered by the forfeiture?

ATTORNEY SARAH B. DUNCAN: The first three. Only the lost profits is an actual damage award.

JUSTICE NATHAN L. HECHT: So we should look at the lost profits just as we would any actual damage award?

ATTORNEY SARAH B. DUNCAN: Separate and apart. I think it's easiest to understand how the court of appeals got off track by looking at the lease payments, as Judge Hecht just brought up. The court of appeals said, “Well, yeah, both parties testified that the lease payments for the building in which ERI conducted its operation, were supposed to be additional consideration for the buyout.” But if you look at the Stock Redemption Agreement it only talks about the upfront, almost half a million dollars in cash, the building, the Malmeba Building, and the equipment, end of story. Therefore, the parties' testimony that these lease payments were intended to be additional consideration for the buyout is parol evidence, inadmissible, incompetent. But again, the lease agreement is part of the buyout, it can't, it's not a separate agreement. The parties weren't testifying about a wholly separate agreement that conflicted with the buyout. The lease agreement was part of the buyout and it can't be incompetent parol testimony.

JUSTICE GUZMAN: Does the fact that all of these documents are listed, I guess, in the Buyout Agreement make them all an integral part of the agreement, the buyout?

ATTORNEY SARAH B. DUNCAN: That's what the parties testified to, and if you go through the evidence, Judge Guzman, and look at what was the value of this company, the building, the people, the little bit of equipment, the value of the company was the people, and what Swinnea was getting bought out of was the whole thing, was the income stream he would get as a result of his stock in the company. So he gets the $3600 a month in lease payments, paid by ERI, guaranteed by Mr. Snodgrass, and he gets his $60,000 in salary to not compete with the company when he knows he's already created a company to siphon, to cause a terrible problem with Merico, one of ERI's biggest customers. He knows he's not going to continue to work the way he used to work, he knows he's not going to perform these promises. That's why Judge Kent made the award she made. This was part of a plan --

JUSTICE PAUL W. GREEN: Let me ask you about that, though. I mean in terms of disgorgement and damages or a remedy, you've got a situation where Snodgrass knew that Swinnea was doing this, didn't he? I mean working with AQA and all of that, didn't know about that?

ATTORNEY SARAH B. DUNCAN: No, he didn't know any of that until after the buyout agreement, after when he was having lunch with Merico's, one of Merico's employees, one of their management people, and the first

time Merico said, “Who is this AQA, and why are they competing with us on these air monitoring projects?”

JUSTICE PAUL W. GREEN: Okay.

ATTORNEY SARAH B. DUNCAN: And Snodgrass said, “I have no idea.” It wasn't until after the buyout that he found out that before the buyout Swinnea had formed that company, put his wife in charge, who had no experience with asbestos abatement, and then basically lied about it, and that's when Mr. Snodgrass got so upset. There's a part of the record where one of his employees, Power, comes in and says, “You know, I want to apologize for not telling you about this,” because Power was also involved, and Mr. Snodgrass says, “I just can't talk about that right now.” I mean this was the majority of his work life as an adult.

JUSTICE PAUL W. GREEN: So it's not a situation where he recognized there was some problem and allowed it to continue.

ATTORNEY SARAH B. DUNCAN: He did afterwards. After, after he found out that Swinnea and his wife and Mr. Power and his wife had formed Air Quality Associates, AQA, then and Merico gave him a choice and said, “Look, it's either AQA or us. You're going to lose one of us as a client.” Then yes, Mr. Snodgrass knew he was making a choice, but again who put him to the choice?

JUSTICE HARRIET O'NEILL: Well, but by continuing to do business with AQA, does that not impact the lost profits award?

ATTORNEY SARAH B. DUNCAN: It could have if Mr. Swinnea had wanted to present evidence of the profits ERI made from its business relationship with AQA as an offset. Yes, it could have reduced ERI's number that ERI claimed as its lost profits, but he didn't do that.

JUSTICE PAUL W. GREEN: But the --

ATTORNEY SARAH B. DUNCAN: He didn't raise it, he didn't prove evidence of it, and it's not our burden to present evidence to show his offset.

JUSTICE PAUL W. GREEN: What about the disgorgement of damages, would it have an effect on that?

ATTORNEY SARAH B. DUNCAN: I don't believe so. And I don't believe the disgorgement is not any part of lost -- it's not, no part of that is lost profits.

JUSTICE PAUL W. GREEN: The fact that he knew, at some point he began to know that there was this competition that violated the agreement that they had and he allowed it to continue before taking any action?

ATTORNEY SARAH B. DUNCAN: He did, and --

JUSTICE PAUL W. GREEN: I mean I just wonder if disgorgement is an equitable remedy and he knew about this, I mean does the equity weight against --

ATTORNEY SARAH B. DUNCAN: And Judge Green, if you were the trial judge, you could have also taken that into account in fashioning the

remedy. That's why we give trial judges and triers of fact to some extent, discretion to weigh the evidence that they hear and fashion the equitable remedy, because cases like this are not, not necessarily cut and dry. It's not like you take your partner of ten years and find out that they're competing with one of your clients, is what Mr. Snodgrass first found out --

JUSTICE PAUL W. GREEN: And it wouldn't necessarily --

ATTORNEY SARAH B. DUNCAN: -- and you go fire them, right?

JUSTICE PAUL W. GREEN: But it certainly wouldn't --

ATTORNEY SARAH B. DUNCAN: That's not what Snodgrass did.

JUSTICE PAUL W. GREEN: It certainly wouldn't take the damage of the award down to zero.

ATTORNEY SARAH B. DUNCAN: It wouldn't take it down to zero, and I don't think that's how we want business people to behave. What Mr. Snodgrass found out at first was just that the Swinneas and the Powers had formed this small asbestos abatement company that competed with one of ERI's clients. That's the extent of what Mr. Snodgrass knew at that point. What he learned in the ensuing year was that Mr. Swinnea wasn't going to work really the way he had promised to work. He had formed another company, that's Brady, after he sold his interest in AQA to Power. He formed another company and then he started telling ERI's existing clients, like the Tyler ISD, “That job that, you know, that ERI is going to do that requires a consultant, it requires an asbestos consultant, you can do that by a method known as RFCI, and then you can cut out the consultant, and my little company, Brady, can do that for you.” That's the kind of evidence the trial court was hearing, and that's why I say the breaches of fiduciary duty, the disloyal conduct continued after the buyout agreement.

JUSTICE NATHAN L. HECHT: Burrow kind of -- well, Burrow leaves it up to the trial court to fashion an equitable remedy, but --

ATTORNEY SARAH B. DUNCAN: Okay, ultimate decision.

JUSTICE NATHAN L. HECHT: -- but what limits are there? I mean how can we tell if it's inequitable? We clearly thought in Burrow that you shouldn't forfeit everything in every case, or nothing in every case, so what-but we didn't announce standards, what standards should we use?

ATTORNEY SARAH B. DUNCAN: Well, what the Court did was remand it to the trial court to make the ultimate decision.

JUSTICE NATHAN L. HECHT: Well, but --

ATTORNEY SARAH B. DUNCAN: It never came back up for this Court to announce standards.

JUSTICE NATHAN L. HECHT: So how can we tell if this is too much?

ATTORNEY SARAH B. DUNCAN: Well --

JUSTICE NATHAN L. HECHT: The forfeiture in this case.

ATTORNEY SARAH B. DUNCAN: I'm not sure that that would be the Court's prerogative as long as it's within reasonable, understandable boundaries that are linked to the evidence, and certainly in this case they are. The trial judge just can't -- did not require Mr. Swinnea to forfeit everything. He was allowed to keep his $60,000 initial investment in ERI, he kept the $60,000 salary he made while he was pursing his plan to run ERI into the ground and buy it back for pennies on the dollar. So I think, Judge Hecht, the answer to your question is as long as there is evidence that links what is being required to be disgorged to the breaches of fiduciary duty, I don't know that the Court can go much further than that in examining the trial court's exercise of discretion.

CHIEF JUSTICE WALLACE B. JEFFERSON: Any further questions? Thank you, Ms. Duncan. The Court is now ready to hear argument from the Respondents.

MARSHALL: May it please the Court, Mr. Smith will present argument for the Respondents.

ORAL ARGUMENT OF GREG SMITH ON BEHALF OF THE RESPONDENT

ATTORNEY GREG SMITH: In our conversation, let's begin if we could with what the trial court's analysis actually was, compare it to ERI's analysis in this Court, and then talk about Burrow and talk about disgorgement. Those are my aims here. Now the trial court's analysis, the way the trial court came about its decision was this, the trial court said -- its remedial decision, and I'll tell that there are many, many findings of fact on liability in this case, counsel drafted findings, I would suggest to the Court that really where you determine what the trial court was thinking, you look at its remedies because those were crafted by the trial court. Now what did the trial court do? It said, “I am finding that all but $60,000 of the cash consideration should be refunded.” And here was the trial court's analysis, how it got to that. It said, “I'm finding there's no good will to this business, and I'm finding that you determine value of these shares by one simple calculation. What is the accounts receivable as of the date of the sale and what was the debt owed as of the date of the sale?” And the Court found that the accounts receivable was $200,000, that's not in dispute. The Court found that the debt owed was $80,000. That actually was wrong, the evidence was that as of the date of the sale, according to plaintiff's accountant, the amount owed was about $40,000, and then bills paid in September following the sale accrued another 40,000, but the accountant didn't take account of the additional income that came in in that month, or those things. But the Court said, “Therefore, $200,000 minus $80,000 equals $120,000,” the correct math. “Half of that is $60,000; I am finding that this stock is worth $60,000.” That's absolutely positively indefensible in this case before this Court, because this is a company that at the time of the sale had $1.8 million in revenues, Mr. Snodgrass himself said it had 25 percent profit margin, which would equate to $450,000 of profits that year. Three years later it had almost $4 million in revenues and $800,000 in profit. It had numerous clients, absolutely undisputed. It had three branch offices in Tyler, Houston and Fort Worth, and only one client, only one in this entire record is affected by anything that ERI put on

evidence about, and that was Merico, that one client. It's absolutely impossible to reasonably and rationally say that the way that you determine that there was an imbalance in consideration is to take accounts receivable less debt on the date of sale. So the trial court's analysis is indefensible, and indeed that's proven because ERI never owns up to the trial court's analysis, never tries to defend the trial court's analysis. Instead what ERI does is this. ERI says, “trial court invoked disgorgement principles.” Then the key to ERI's position though, is to take not just what we will say disgorgement principles, but to say fee forfeiture is where this Court should look, and the two cases that ERI rides are Henspoct [Ph.] and Burrow. Now fee forfeiture, you can do it as a specie of disgorgement perhaps, a specialized specie of disgorgement where because it's relationship driven, because it's service driven, it's a self-limiting kind of thing. If you will think about fee forfeiture in the attorney -- certainly we don't contend it's only limited to attorney's contracts, it's all fees for services, but let's just look at attorney contracts such as in the Burrow case. In that case the Court did not say, “Lawyers, since you breached a fiduciary duty, you have to give up all the fees you have ever accrued in the last year or all the fees you have every accrued in your practice.” The Court didn't say that, the Court said, “We're going to remand to consider how much of the fee in this particular matter you need to disgorge, so there's a self limit there.” But when it comes to a sale such as this, you don't have that kind of limit. Just think about this.

JUSTICE NATHAN L. HECHT: Why don't you have the same limit? I mean it's just limited to whatever the culprit received during the transaction.

ATTORNEY GREG SMITH: Well, but the culprit gave a value. This case, I'd like to talk about this case in par-ticular.

JUSTICE NATHAN L. HECHT: So did the lawyer, he presented the client.

ATTORNEY GREG SMITH: He certainly did, but if you will assume with me -- well, the lawyer -- well, lawyers don't represent just one client, and even in Burrow, even though there were multiple clients involved, those lawyers represented thousands of other clients over the years. They weren't being asked, based on one breach, to be financially destitute for the rest of their --

JUSTICE NATHAN L. HECHT: But it had to do with the fee that they stood to receive in that case, for that representation.

ATTORNEY GREG SMITH: Yes, Your Honor.

JUSTICE NATHAN L. HECHT: But it was limited by that. They gave services and they got a fee, but if they got it by violating the rules, even if the client wasn't hurt, they shouldn't get to keep the fee otherwise that would encourage violating the rules.

ATTORNEY GREG SMITH: We have no problem with the principles behind that whatsoever, Your Honor.

JUSTICE NATHAN L. HECHT: Why isn't it limited here to whatever Mr. Swinnea received in the transaction?

ATTORNEY GREG SMITH: Here, what Swinnea gave up -- let's talk about what he gave up because we think there's inequality there in what he gave up and what he received. What he gave up was stock that he had built up through sweat equity over ten years of his life. This was not the equivalent of a lawyer's fee in one particular case; this was this man's entire livelihood if you will. And just look at -- after the stock sale he agreed to work for ERI for $60,000 a year. He now faces a judgment of two and a half million dollars including interest, that's going to be -- well, excuse me, he doesn't now after the court of appeals decision, but under the trial court opinion two and a half million dollar absolutely undischargeable in bankruptcy debt. Now what did he do to deserve that in the transaction? He didn't disclose that he and another man, who today is the executive vice president of the plaintiff, of EIR, that they had gone in together and formed a new business, not to compete with ERI, a new business that would be a contractor not a consultant, and true, should have disclosed it perhaps, didn't disclose it, but that --

JUSTICE NATHAN L. HECHT: Well, I mean you can see a breach of fiduciary duty involved.

ATTORNEY GREG SMITH: I don't concede that, in this Court at this stage I think I must because there's a finding of fact, there's evidence on both sides.

CHIEF JUSTICE WALLACE B. JEFFERSON: Okay, but not that wouldn't compete with ERI, but it would make it irrelevant, right?

ATTORNEY GREG SMITH: Your Honor, I just didn't hear.

CHIEF JUSTICE WALLACE B. JEFFERSON: But the business would make ERI irrelevant? Isn't that how it worked? You said that there's no competition between the new business formed and ERI.

ATTORNEY GREG SMITH: Yes, Your Honor.

CHIEF JUSTICE WALLACE B. JEFFERSON: And I didn't understand that.

ATTORNEY GREG SMITH: ERI was a consultant, ERI would oversee and would bid out an asbestos project, would oversee the contractor. Then AQA and this Merico, they were both contractors. So Merico and AQA competed with each other, but the plaintiff here, ERI, didn't. You could look at it kind of like maybe an architect and a building contractor, architects to building...

JUSTICE HARRIET O'NEILL: But I think the Chief's -- the import of his question was, they may not have competed with each other, but the product that AQA was selling and promoting cut out ERI as a consultant, it elim-inated them as a necessary party.

ATTORNEY GREG SMITH: No, Your Honor that's not true. If you're talking about the RFCI, this substitute. The evidence with respect -- now recall, there's kind of two or three balls in the air, there's the company that was set at the time, actually shortly before the buy out, that's AQA. AQA did do a limited amount of this RFCI work, very small projects. We're talking about 1,000 square foot rooms or 1000 square

foot projects or less. Everyone on both sides of the docket in this case agrees that ERI doesn't do those kinds of, those size projects and that that didn't compete. Various ERI employees did some of this RFCI on the side, it was known, no problem with it. Where in this record you get the issue about whether RFCI competed or not, and there is an issue there, but that's with this company, Brady, that was formed with ERI's knowledge. Now, Brady was formed with ERI's knowledge. Brady did do some RFCI, but let's see what the record really says about that. The record says that Brady's RFCI was largely the small stuff, just like AQA's. There was one project that was admitted that was a large scale project for the Lindale School District that Brady did. No attempt by ERI whatsoever to show that that project would have been garnered to ERI as opposed to someone else.

JUSTICE PAUL W. GREEN: But Swinnea was on the payroll of ERI at the time?

ATTORNEY GREG SMITH: I actually believe it's not clear. Mr. Swinnea left the payroll on June 7th, 2004; the testimony is that this Lindale project was spring or early summer of 2004, so just about exactly that time. We don't really know whether it was or not.

JUSTICE PAUL W. GREEN: But at least they were leading into that project while he was still on the payroll.

ATTORNEY GREG SMITH: Yes, Your Honor, but they were --

JUSTICE PAUL W. GREEN: Wouldn't that be a breach of fiduciary right there?

ATTORNEY GREG SMITH: It perhaps would if while he was on the payroll he recommended RFCI, but there's no testimony that he did that with respect to this Lindale project. And in fact --

JUSTICE EVA GUZMAN: But do you have to have direct testimony that the project would have been acquired or just the fact that he didn't disclose it and that he took on to engage in a project that directly competed with --

ATTORNEY GREG SMITH: Well, he wasn't working for Brady at the time. There is no evidence, Your Honor, that Mr. Swinnea had any communication at all with the Lindale School District about that project before it was taken on. Now there is in this record undisputed testimony from the two Tyler School District employees and from another school district's employee who say, “We new about this RFCI stuff, we had found out about it on our own at conferences. We knew it was a lot cheaper than the traditional method. Mr. Swinnea had come to us on ERI's behalf about projects he had told us he couldn't ask us, he couldn't promote RFCI. He convinced us” -- at least one of these school districts said -- “he convinced us to get three bids on traditional method. We wanted to do RFCI; we only got the traditional bids because he convinced us to try to do the traditional method. When the bids came back, RFCI was so much cheaper, we couldn't refuse. It was our decision, Mr. Swinnea never promoted it, in fact he tried to dissuade us from doing RFCI.” That was the evidence.

JUSTICE NATHAN L. HECHT: Let me see if I can boil down the dispute here, as I understand it. You no longer challenge in this Court the findings of fraud and breach of fiduciary duty?

ATTORNEY GREG SMITH: In this Court only. Were there a remand, certainly that would not hold.

JUSTICE NATHAN L. HECHT: Right. And you agree that disgorgement applies in this situation? It is an available remedy?

ATTORNEY GREG SMITH: Disgorgement of the illicit profit, illicit gain. Where we dispute is is that all the consideration or is that only the part of the consideration that was enhanced by the fraud or breach of fiduciary duty? There is no authority, if you will, Your Honor, that it's all the consideration. That's why Burrow is invoked.

JUSTICE NATHAN L. HECHT: All right. And you also agree, I take it, that it doesn't depend on proof of damages?

ATTORNEY GREG SMITH: Well, it may not depend on -- it depends on proof either of harm, damage, or of illicit benefit gain, so one or the other.

JUSTICE NATHAN L. HECHT: But in the Burrow case, there was no, we didn't require that the client prove that he'd been hurt in order to obtain disgorgement.

ATTORNEY GREG SMITH: That's right, Your Honor. And that really -- don't let me cut the Court off. But again it's very important to know why we consider Burrow to be in a different basket from where we are.

JUSTICE NATHAN L. HECHT: Yes.

ATTORNEY GREG SMITH: And that is the fee-for-service basket, this is the basket of any sale of any property. Let's take one illustration. Michael Del, let's say Michael Del tomorrow works out a deal to sell all his interest in Del Computer and whatever other companies he may own, and part of the deal is that he will stay on as a consultant and he'll work as an employee for Del Computer, and whatever it is, let's assume that in the process of that consulting arrangement or in the process of the handoff of the stock, that there later comes to rise an allegation that Michael Del committed some breach of fiduciary duty that actually induced the sale of the stock. Surely, surely this Court can't say that a trial court could order a remedy in that case that would say, “Whoever bought the stock, gets to keep the stock, and Mr. Del gets all the consideration or substantially all the consideration back.”

JUSTICE NATHAN L. HECHT: But Burrow doesn't say that.

ATTORNEY GREG SMITH: Well, Burrow says that depending on what the trial court says, the lawyer can be forced to give all of his fee back.

JUSTICE NATHAN L. HECHT: If it's bad enough.

ATTORNEY GREG SMITH: If it's bad enough, that's correct, Your Honor.

JUSTICE NATHAN L. HECHT: But if it's not bad enough, then there might not be any forfeiture required or it might be something in the middle.

ATTORNEY GREG SMITH: That's correct, Your Honor.

JUSTICE NATHAN L. HECHT: But I don't see how you distinguish that from this situation. It just seems to me whether it's a transaction like this or a service transaction, the principle is the same. You might have to give part of it back, you might not. It just depends on how bad the fraud and the breach of fiduciary duty was.

ATTORNEY GREG SMITH: Well, but in the fee for service, again it's limited to this distinct service the person performed in that one distinct transaction. Here in contrast, it could easily be that the stock that was involved was worth multiple times what the net worth of my client was because of leverage. That's a typical event. And the point I'm simply trying to drive home is there's not kind of limit if you impose an anything-goes-forfeiture outside the context of fee for service. What you need --

JUSTICE NATHAN L. HECHT: Well, I don't think Burrow stands for that, but anyway --

ATTORNEY GREG SMITH: Yes, it does, Your Honor.

JUSTICE NATHAN L. HECHT: If we get to -- if the remedy applies and there's a liability basis for it to apply in this case, we're down to talking about whether the disgorgement was fair, and whether there's evidence to support the lost profit award.

ATTORNEY GREG SMITH: Well, again, without replowing the same ground too much, we believe there was no evidence of an illicit gain in this case.

JUSTICE NATHAN L. HECHT: Well, isn't that whether it was fair or not? I mean whether it's part of an equitable remedy. I mean clearly the trial court could not order a forfeiture that exceeded all measure of the wrong that was done in the case.

ATTORNEY GREG SMITH: That's clear, but we believe it goes --

JUSTICE NATHAN L. HECHT: A very technical wrong and nobody was hurt, then, you know, maybe a small thing or maybe no forfeiture at all.

ATTORNEY GREG SMITH: Right. We believe in this case though, the Court should go further, and in fact the cases do go further and say, outside of the fee for service context, again the disgorgement has to be in the measure of either a harm to one party or an illicit improper gain to the other. And that's what's missing in this case. No harm to that side, no illicit gain to this side. And that one further distinction, Your Honor, and that would be that in a fee for service context, the lawyer case versus ours, there's no rescission remedy. You can't after you've worked the service and after you've committed that, whatever the breach was, you can't go back and really put them back in place. Here you had a clear rescission option, and it was just as clearly rejected both in fact at the time of the events, it was within a month to six weeks after the buyout when Mr. Snodgrass learned of all the facts with

respect to AQA. He embraced AQA when he had a choice. The Merico folks had come to him and said, “As long as you won't let AQA bid against us on the asbestos work, we'll work with you.” And he said, “I'm going to ride the AQA horse, not the Merico horse.” He chose that. Then later when it came time to sue, he didn't sue for rescission, he's not asking, in fact he doesn't want to give up that stock, it's worth much more today. To put it in context here, as we sit here today if the trial court's judgment were put back in place on the day before anything happened, you had Mr. Swinnea and Mr. Snodgrass equal partners, equal ownership in a thriving business that according to the calculations at trial I would say would be worth about $1.3 million, and that's the $500,000 roughly in cash consideration, plus the $150,000 value of half Malmeba, and then you would double that. A thriving business. Now after the trial court's judgment what do you have? You have Mr. Swinnea in the hole to the tune of almost $2 million even after you credit him with he still has the Malmeba Building and he still has a little bit of cash. You have Mr. Snodgrass owning all of ERI, and he has, which is valued at about three and a half million dollars today, I would suggest based on the doubling in revenues and doubling in profits, and he has a two and a half million dollar judgment. So if you do the math, Mr. Snodgrass under the trial court's judgment is in the plus column to the tune of $4 to $5 million, Mr. Swinnea is in the negative column to the tune of $1.7 million. Now that brings us to now why is that not fair? That's the Court's question and it's a fair question. It's not fair here because all that happened in connection with the buy out was that Mr. Swinnea failed to disclose that a business that doesn't compete with ERI had been formed and later it turns out, later it turns out that Mr. Snodgrass embraces that business, that business helps ERI prosper indisputably more than it would have with Merico because the business with Merico was declining.

JUSTICE PAUL W. GREEN: Counsel, it's kind of hard for the breaching party to be complaining about fairness though in this situation.

ATTORNEY GREG SMITH: Well, it's equity, equity in the remedy, Your Honor.

JUSTICE PAUL W. GREEN: But I mean it seems to me if you have two partners, they're in a business and they're selling widgets together, and one of the partners starts his own little business selling widgets without telling his partner and makes a bunch of money doing that, it seems to me when that comes to light and the suit for breach of fiduciary duty and disgorgement, all of the earnings that he made on that side business go back to the partnership.

ATTORNEY GREG SMITH: I would agree with that. That goes to the question --

JUSTICE PAUL W. GREEN: So the person that, and of course by that time the partnership is long gone, but the person that's suing gets the benefit, and the person who gets sued and has to disgorge those profits ends up at the short end of the stick, as you say.

ATTORNEY GREG SMITH: That's our position precisely. The difference in that analogy and our case --

JUSTICE PAUL W. GREEN: Why isn't that fair?

ATTORNEY GREG SMITH: The difference in that, we didn't gain any profit from this, Your Honor. Mr. Swinnea was only a party to AQA -- well, he was never a party, but his wife was a party for about six months, then got out of it for essentially what she brought into it. And AQA prospered, ERI prospered, nobody was hurt. Our client, Mr. Swinnea didn't make any money out of it. There wasn't any of that. In the hypothetical the Court poses, there's a transfer from the good partner if you will, to the bad partner. The bad partner diverts business and makes money from that business. That's what's missing here, Your Honor. There's none of that. Instead it's just an open-ended freewheeling whatever was got in that transaction, Mr. Snodgrass gets to keep it and Mr. Swinnea has to move it all back. There is no analysis other than the fee forfeiture cases that condones that. But again, this Court has never applied the fee forfeiture cases outside of fee for service. That is our position, that should be this Court's position, Your Honors.

CHIEF JUSTICE WALLACE B. JEFFERSON: Any further questions?

JUSTICE PHIL JOHNSON: If I could?

CHIEF JUSTICE WALLACE B. JEFFERSON: Justice Johnson.

JUSTICE PHIL JOHNSON: Just to make sure I understand your position. You want us to apply only disgorgement and fee forfeiture so we don't even have to get to the question of what standard of review we have on the remedy the trial court fashioned?

ATTORNEY GREG SMITH: No, Your Honor, and I apologize.

JUSTICE PHIL JOHNSON: And what I'm troubled with is we're talking here about whether it's fair or not, and I don't understand what standard we can apply to that other than the trial court determines that, and I'm having a hard time understanding exactly what it is you're asking us to do.

ATTORNEY GREG SMITH: Yes, Your Honor. Our position is that the maximum limit, the trial court had no discretion to go further in this case because this isn't fee forfeiture. The trial court had no discretion to go further than making Mr. Swinnea disgorge whatever illicit profit he was shown to have accrued. There was no showing of an illicit profit accrued to Mr. Swinnea.

JUSTICE PHIL JOHNSON: Okay, so your standard is, if there is legally sufficient evidence to show some profit, then we defer to the trial court's discretion?

ATTORNEY GREG SMITH: Yes, Your Honor, but let me put it, maybe out of sight of the word “profit.” Let's say that the evidence showed the company was worth --

JUSTICE PHIL JOHNSON: But I just want to know the standard, if there's legally sufficient evidence in your mind.

ATTORNEY GREG SMITH: Well, legally sufficient evidence is the standard as we stand here.

JUSTICE PHIL JOHNSON: And we defer to the trial court's discretion?

ATTORNEY GREG SMITH: Only to the extent that the trial court has not gone beyond, the trial court is deter-mining that there was some illicit gain to Mr. Swinnea, and that's what the trial court hasn't found.

JUSTICE PHIL JOHNSON: Thank you.

CHIEF JUSTICE WALLACE B. JEFFERSON: Any further questions?

CHIEF JUSTICE WALLACE B. JEFFERSON: Thank you. Ms. Duncan.

REBUTTAL ARGUMENT OF SARAH B. DUNCAN ON BEHALF OF PETITIONER

ATTORNEY SARAH B. DUNCAN: Mr. Smith asked what did Mr. Swinnea do? All he did was form this little bitty company that didn't really actively compete with ERI. As Mr. Snodgrass testified, as long as that was all Mr. Swinnea did, he kept him on the payroll. That's not all Mr. Swinnea did. He basically started destroying the morale of all of ERI's employees. He would stand outside their offices, his Brady phone would ring, and when it rang he'd go outside the office and he'd start handling Brady's business. The rest of the employees in the office were like, you know, he's not going to work, he's not going to work and he's getting $60,000 a year. Why should I work? And we've all seen it happen from the time we took our first part time job in the summer. Once there's a feeling amongst employees that one employee cannot work and still get paid and the rest of them can't, that's a bad deal, and employee morale does go down. As Mr. Snodgrass testified, as long as Mr. Swinnea's efforts to undermine ERI were merely passive, he let him stay. It was when he began actively diverting business from ERI to Brady by convincing the prospective client that it could be done by the RFCI method. I believe Mr. Smith represented to the Court that counsel drafted the findings of fact while the trial court drafted the remedies and as far as I know that doesn't matter. They are trial court's findings and the trial court's remedies, no matter who actually writes them or punches keys on a computer. He also talked about how the trial court went through some analysis that the stock was worth $60,000, and I think if the Court reads the record, that's not the basis of the trial court's remedy. On page 19, footnote 3 of our brief of the merits we explain how the trial court evaluated the value of ERI. But what the trial court's remedy is, is that, “Mr. Swinnea, you fraudulently induced this entire buyout, and you're going to have to forfeit what you got from it.” And for the court of appeals to say and Mr. Smith to say there was no illicit gain is to me among the most shocking things that's been said today. I would consider half a million dollars that I got by fraud to be an illicit gain, and I would be embarrassed to say that it wasn't. Anything acquired as a result of fraud and fraudulent inducement is fraudulent. He also has, gets up here and says, “Well, we didn't go forward with the remedy of rescission.” I don't know about you, but once my partner has defrauded me and given me false promises that he knew he wasn't going to perform, I sure don't want him as a partner again. We ask the Court to reverse the court of appeals judgment and remand it to that court to consider only the unaddressed errors in that court.

CHIEF JUSTICE JEFFERSON: Any questions? Thank you, Ms. Duncan. That cause is submitted, and the Court will take another brief recess.

[End of proceedings.]

Eri Consulting Engineers, Inc. and Larry G. Snodgrass, Petitioners, v. J. Mark Swinnea, Brady Environmental, Inc., and Malmeba Company, Ltd., Respondents.
2009 WL 5113425 (Tex.) (Oral Argument)

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