

INVESTMENT FUNDS ALERT

HEDGE FUND KEY EMPLOYEES NOT REQUIRED TO GIVE NOTICE OF TERMINATION



Recently, the Delaware Court of Chancery ruled in *Lazard Debt Recovery Group GP, LLC v. Michael A. Weinstock* that the failure of two key hedge fund managers to provide their employer with advance notice of their intent to terminate employment did not constitute a breach of contract or fiduciary duty, despite the fact that the departure of the managers led to the windup of the fund.¹

Lazard Freres & Co. (Lazard) started a hedge fund focusing on distressed debt investing (the Fund). The Fund's investment manager hired two Lazard partners to manage the Fund (the Managers). The investment manager employed the Managers without first entering into written contracts setting forth the terms of their employment.

Less than two years after the formation of the Fund, the Managers decided to leave the Fund and seek employment with another firm, although prior to such departure, the Managers had generally indicated to investors that they were happy with Lazard. On the same day that the Managers informed Lazard of their intent to resign and form a distressed debt fund at another firm, they terminated their employment with the investment manager.

As a result of the immediate resignations, Lazard determined that it had to wind down the Fund, rather than have the Managers "lift out" the Fund to the other firm.

Lazard claimed that the Managers' failure to provide advance notice of termination was a breach of contract and a breach of fiduciary duty. The court ruled that the Managers did not breach any contract in failing to provide Lazard with advance notice of their termination. In addition, the court ruled that they did not have a fiduciary duty to remain employed. The court reasoned that Lazard should have realized the importance of contractual arrangements to ensure the Managers' retention. The court admonished Lazard by stating that without a contract, the departure of the Managers without notice was a foreseeable business reality. In short, the court

¹ Such managers were still required not to misuse confidential information.

refused to create “ill-defined judge-imposed fiduciary duties” on employees which would shift the “economic risk from [employers] that bore it to employees who exercised the economic freedom left to them by their employers” who failed to adequately protect themselves through contract.

In light of this ruling, employers must recognize the legal and business significance of entering into written contractual arrangements with key employees that address issues relating to termination and post-employment activities. A properly drafted written employment agreement should afford employers the protection of advance notice of termination of key individuals. In addition, employers may want to consider reasonable non-competition or non-solicitation agreements that protect employers from unfair competition by departing key employees.

CONTACT INFORMATION

If you have any questions concerning this Alert or would like further information on employment arrangements or other related matters, please contact:

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