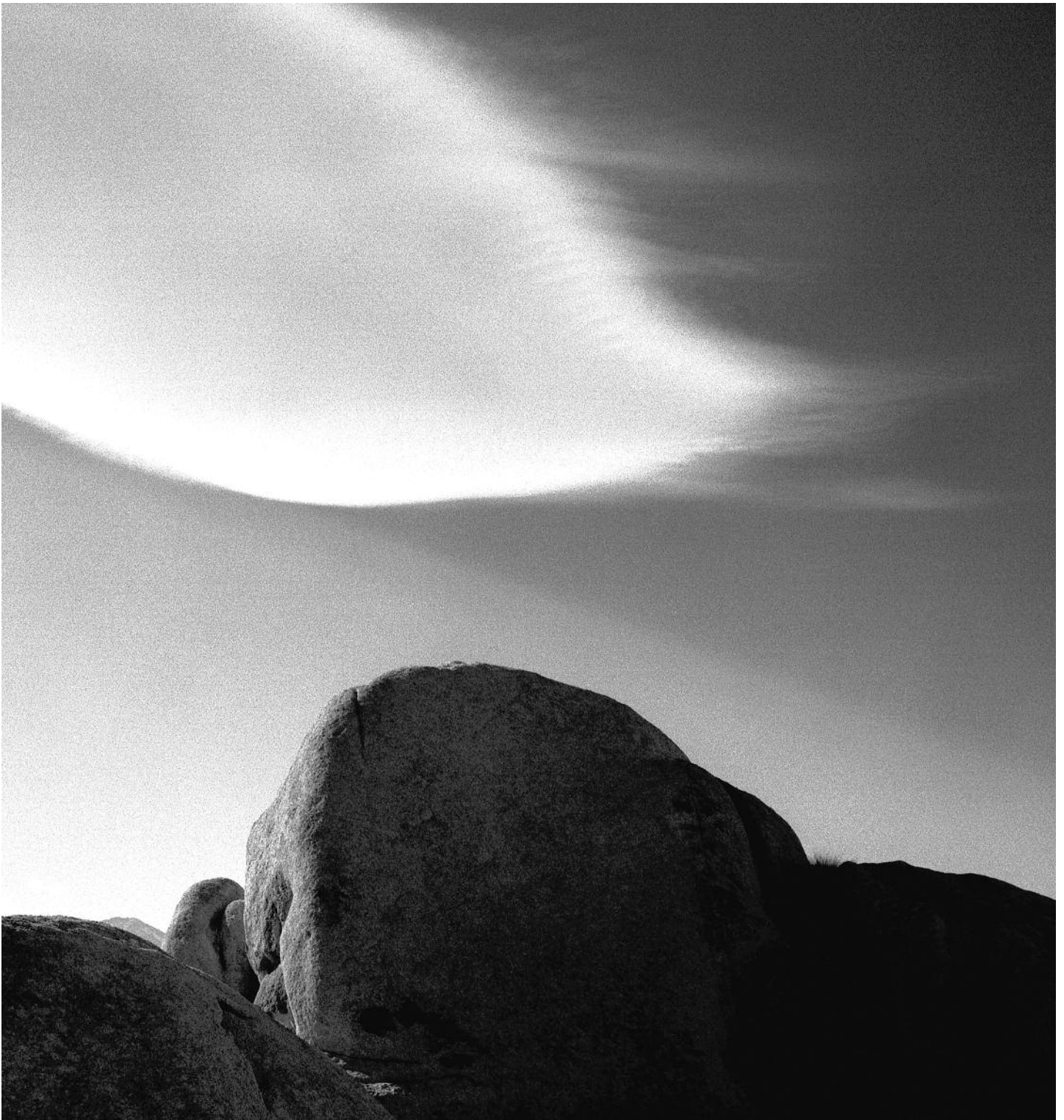

TEXAS BUSINESS LITIGATION JOURNAL



Business Torts and Delaware Fiduciary Duty Law

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COVER: "Lenticular Cloud," Photograph by Larry Gustafson, Dallas.

■ FROM THE SECTION CHAIR ■



Dear Section Members:

I would like to remind you about the Section's program at the upcoming 2009 State Bar Annual Meeting in Dallas at the Hilton Anatole Hotel. The program will occur on June 25, 2009, from 11:00 a.m. to noon. Two former United States Attorneys – Don J. De Gabrielle and Richard B. Roper – will be presenting *New Trends in Complex White Collar Crime Enforcement and Corporate Responsibility in a New Administration*. This is sure to be an interesting and informative program, and we hope that you will be able to join us.

The Section has now sponsored two CLE programs, one in December 2008 and the other in April 2009, that were conducted via teleconference and provided updates on a variety of business litigation topics, including some of those addressed in the *Journal*. We anticipate conducting these teleconferences on a regular basis, with the next one expected to occur in September 2009. If you are interested in participating as a speaker in one of these programs, please contact me at the email address or telephone number listed below to discuss your suggested topics. I'd appreciate hearing from you.

The *Journal* continues to provide Section members with valuable news and scholarship covering a wide variety of topics of interest to business litigators. Thanks to Todd Murray for his annual survey article on Delaware fiduciary duty law and to Leah Boyd for coauthoring the annual survey article on business torts. As always, thanks also to Larry Gustafson for his cover photograph. If you have an article in mind, please contact Mike Ferrill (amferrill@coxsmith.com) – we're always on the lookout for interesting articles touching on any aspect of business litigation.

In closing, I hope that you enjoy this issue of the *Journal* and that you will be able to join us in Dallas at the Annual Meeting.

Best regards,
Bill Katz
Section Chair
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his issue of the Journal features the annual survey articles on business torts and Delaware fiduciary duty law.

As always, we solicit written contributions to the Journal. We currently have commitments for annual survey articles on antitrust, securities, RICO, business torts, arbitration, class actions, D&O and expert witness developments. If you have an idea for a survey article in another area of business litigation, or an article focusing on a particular aspect of or development in the law (even if it falls within one of the broad survey categories), contact me at 112 E. Pecan, Suite 1800, San Antonio, Texas 78205 (210) 554-5282; (210) 226-8395 (fax), amferril@coxsmith.com.

A. Michael Ferrill
Editor

2008 –2009 Business Torts Update

By William M. Katz, Jr. and Leah M. Boyd¹



William M. Katz, Jr.



Leah M. Boyd

This survey examines significant business torts decisions by Texas courts for the period from April 2008 through February 2009. “Business torts” obviously covers a broad spectrum, and in narrowing the survey, we included cases that either decided new issues or examined issues of particular interest to business litigators. During the survey period, Texas courts addressed: (1) whether a property manager has a duty to protect mall patrons from unforeseeable third-party criminal acts; (2) single business enterprise liability; (3) whether the proportionate responsibility statute applies to claims for breach of implied warranty; and (4) whether summary judgment was appropriate for a former employee’s claims of intentional infliction of emotional distress, defamation, and retaliation.

I. No Duty to Protect from Unforeseeable Third-Party Criminal Acts

In *Trammell Crow Central Texas, Ltd. v. Gutierrez*,² the Texas Supreme Court held that a property manager did not have a duty to protect mall patrons from the unforeseeable criminal acts of third parties. Landowners generally do not have a duty to protect people or their property from criminal acts except in certain circumstances where the risk of crime is sufficiently unreasonable and foreseeable to justify imposing a duty on landowners to protect invitees.

On February 17, 2002, Luis Gutierrez and his wife left a shopping mall movie theater and were walking toward their car when two masked gunmen started shooting at Gutierrez. He was shot four times and later died of his wounds. The police classified the crime as a homicide, but charges were never filed. The mall shopping guard saw the two individuals just minutes before the shooting occurred but did not stop to investigate. Gutierrez’s widow filed suit against the mall property owner,

alleging negligent failure to provide adequate security. She claimed her that husband was killed in a botched robbery; the mall property manager claimed the attack was an act of retaliation for providing the police with information about a series of robberies. Gutierrez had been receiving threatening phone calls from members of a burglary ring and asked for police protection. The jury found in favor of Gutierrez’s estate, and the trial court awarded over \$5 million in damages. The court of appeals affirmed, holding that the mall property manager owed Gutierrez a duty as a matter of law and that sufficient evidence to support the proximate cause and breach questions existed.

The property manager claimed that the evidence of previous criminal activity at the shopping mall did not establish that Gutierrez’s death was foreseeable, so any failure on its part did not proximately cause Gutierrez’s death. The Supreme Court limited its review of the 227 crimes that occurred at the mall in the previous two years to the ten robberies that were classified as violent. To determine whether the risk of Gutierrez’s death was foreseeable, the court analyzed the recency, frequency, and similarity of these ten crimes with the details of Gutierrez’s death. Proximity and publicity, the other two relevant factors, were not in dispute. The court looked at crime rates and odds calculations to determine that an individual within San Antonio was much more likely to be the victim of a violent crime than an individual on the grounds of the shopping mall. In looking at the similarity of the prior crimes, the court noted that one crime had similar facts in that it occurred at the movie theater, but it was different because the criminals did not use a deadly weapon and did not seriously injure the victim. The court also looked at the nine other crimes and found several differences: (1) the other robberies involved the use of physical force or the threat of injury, but no weapons were ever fired; (2) no one was seriously

injured in any of the other robberies; (3) in six of the robberies, the perpetrator made a demand on the victim for property; and (4) three of the robberies were perpetrated on businesses rather than individuals.

Looking at all five of the factors, the Supreme Court determined that Gutierrez's murder was not foreseeable because the previous crimes were not sufficiently frequent and similar. Furthermore, the circumstances of the Gutierrez attack were extraordinary – opening fire from behind at long range and without making any prior demand on the victim. Nothing about the previous robberies put the property manager on notice that a patron would be murdered as part of a robbery on its premises. The court explained that the foreseeability requirement protects landowners from liability for crimes that are so random, extraordinary, or otherwise disconnected from them that they could not reasonably be expected to foresee or prevent the crimes. Because his death was not foreseeable, the property manager did not have a duty to prevent the attack, so the Supreme Court reversed the court of appeals.

II. No Single Business Enterprise Liability

In *SSP Partners v. Gladstrong Investments (USA) Corp.*,³ the Texas Supreme Court held that corporations cannot be held liable for each other's obligations merely because they are part of a single business enterprise. The court also held that the seller of a defective product is not entitled to indemnity from an upstream supplier other than the manufacturer unless the seller can show that the supplier was at fault.

A young boy was killed in a house fire allegedly started by a cigarette lighter with a defective child-resistant mechanism. His parents sued the lighter's seller and Gladstrong USA, the lighter's importer. The seller sought indemnity from one of its suppliers, who sought indemnity from Gladstrong. All of the parties settled their claims except the supplier's claim for indemnity from Gladstrong. The remaining parties disputed whether Gladstrong was the actual manufacturer, and the trial court granted Gladstrong's summary judgment motion. The appellate court concluded that Gladstrong was the "apparent manufacturer" of the lighter and could be liable for common law indemnity. The court also held that one entity cannot be liable as part of a single business enterprise if the other entities are not parties to the case.

The court first considered the statutory indemnity question. It determined that Gladstrong was not a manufacturer under the indemnity statute because it had nothing to do with making the lighters; it merely imported them from China.

Next, the court addressed the supplier's argument that the supplier was entitled to indemnity because the importer and the lighter manufacturer operated as a single business enterprise. The court noted that it had never approved of imposing joint liability on separate entities merely because they were part of a single business enterprise—an enterprise where separate entities integrated their

resources to achieve a common business purpose—because that liability theory does not require the level of agreement necessary for joint enterprise liability or the abuse required before the law disregards the corporate structure. The single business enterprise theory imposes liability based merely on coordinated business activities, activities that are not abstractly abusive or unjust. Absent such evidence, centralized control, mutual purposes, and shared finances are not sufficient to disregard the corporate entity. Moreover, creating a corporation to limit individual liability for corporate obligations is a foundational and legitimate purpose supporting corporate formation. Furthermore, the single business enterprise theory is not consistent with the state legislature's strict approach to disregarding the corporate structure as demonstrated in Texas Business Corporation Act Article 2.21. Therefore, liability cannot be imposed on an entity merely because it is part of a single business enterprise.

Finally, the court considered the issue of common law indemnity. The supplier argued that an upstream seller owes the same obligations to innocent downstream sellers that a manufacturer owes to downstream sellers. Imposing liability on an innocent party (upstream or downstream), however, would oppose the fundamental principle underlying indemnity law – an active wrongdoer must indemnify those innocent parties who are subject to liability for his or her wrong. Although it did not agree with all of the court of appeals' reasoning, the Supreme Court affirmed the appellate court's summary judgment on the statutory indemnity question and its remand of the common law indemnity question because of outstanding fact issues.

III. Proportionate Responsibility Scheme Applies to Claims for Breach of Implied Warranty

In *JCW Electronics, Inc. v. Garza*,⁴ the Texas Supreme Court held that a party who seeks damages for death or personal injury pursuant to a breach of implied warranty claim under Article 2 of the Uniform Commercial Code seeks damages in tort and is subject to the proportionate responsibility statute.

In 1999, Rolando Montez was arrested and jailed on charges of public intoxication. He called his mother, Pearl Garza, from a phone in his jail cell that was installed by JCW Electronics ("JCW"). On the day he was to be released, however, Montez was found dead in his cell, hanging from the phone cord. Garza sued the city and JCW for negligence, misrepresentation, and breach of implied warranty of fitness. The jury attributed 60% of the fault to Montez, 25% to the city, and 15% to JCW. The trial court granted judgment against JCW for breach of contract and fraud. The court of appeals reversed, concluding that the contract claim was not pled and that the proportionate responsibility statute (Chapter 33 of the Texas Civil Practice & Remedies Code), barred the fraud claim. The court of appeals affirmed the judgment, however, based on the jury's finding of breach of implied warranty and held that Chapter 33 does not apply to a claim for breach of implied warranty.

After determining that the 1995 version of Chapter 33 applied to Garza's claims, the Supreme Court noted that the 1987 version expressly provided for proportionate responsibility in breach of implied warranty claims but the 1995 version did not; the 1995 version merely stated that it should apply "to any cause of action based on tort." Although the 1995 version no longer identifies specific liability theories, it is clear from the statute as a whole that the Legislature intended for Chapter 33 to continue covering claims such as negligence, products liability, and breach of implied warranty. If Chapter 33 applies to products liability claims, which it does, then it also applies to implied warranties because a claim for implied warranty is one basis for a products liability action. Additionally, the statute's definition of "toxic tort" included a cause of action for breach of implied warranty, so the legislature did not intend to exclude these claims from Chapter 33.

The court responded to Garza's argument that breach of implied warranty is not a tort-based cause of action by explaining that the precise nature of a claim for breach of implied warranty is determined by looking at the damages alleged: when the damages are purely economic, the claim sounds in contract; when the claim alleges damages for death or personal injury, however, the claim sounds in tort. Garza claimed damages from her son's death, so her claim sounded in tort and Chapter 33 applied.

Garza also argued that applying Chapter 33 to claims under Article 2 of the UCC would disrupt the UCC's nature and purpose. The court had refused to apply Chapter 33 to an Article 3 conversion claim in a previous case because Article 3 had a unique loss allocation scheme. Unlike UCC Article 3, however, Article 2 does not undertake a comprehensive fault scheme. Therefore, the court has historically included breach of implied warranty claims when comparing fault in tort-based litigation. Because Chapter 33 applies to implied warranty claims and Garza was seeking damages for a tort-based claim, the court concluded that her son's contributory negligence, as found by the jury, barred her recovery in this case and reversed the court of appeals.

IV. Summary Judgment Was Appropriate for Former Employee's Intentional Infliction of Emotional Distress, Defamation, and Retaliation Claims

In *Louis v. Mobil Chemical Co.*,⁵ the Beaumont Court of Appeals held that a former employee's allegations of supervisors' profane and inflammatory language and threats to ruin the employee's career could not form the grounds for a claim of intentional infliction of emotional distress. The court also held that alleged threats to ruin a career were insufficient to establish a claim for intentional infliction of emotional distress. Moreover, the employer was not liable for defamation because the statements were substantially true, and the employee failed to establish his workers' compensation retaliation claim.

Thomas Louis claimed that his supervisors, Roy and Bowser, told him to falsify safety reports, which he did because they threatened to fire him if he refused. At the end of 2003, when Louis believed that his

job was in jeopardy because of these actions, he started experiencing chest pains and went to see the company nurse. Louis claimed that the nurse discouraged him from filing a workers' compensation claim because the company would not like that, so he never filed a claim. He immediately went on medical leave and remained at home until he was fired. Louis also claimed that his supervisors frequently used racist, obscene, and profane language when talking to him. A company employee investigated the falsified reports and formally accused Louis of intentionally falsifying equipment safety reports in May 2004. Louis was terminated on July 29, 2004 for violating the company's ethics policy.

Louis sued his former employer and supervisors for intentional infliction of emotional distress, defamation, and retaliation. The defendants moved for summary judgment. They claimed that the supervisors' language and instructions to Louis, and the subsequent investigation and termination, were not extreme and outrageous as a matter of law. They also claimed that statements about Louis's falsification of the records were true and could not be defamatory as a matter of law. Regarding Louis's retaliation claim, the defendants claimed that seven months passed between his visit to the company nurse and his termination, and there was no causal connection between his workers' compensation inquiry and his termination. The trial court granted the defendants' motion for summary judgment on all claims.

First, the court of appeals explained that intentional infliction of emotional distress is a gap-filler tort that is unavailable where the gravamen of the complaint is really another tort. To the extent Louis's supervisors used racist language, racial discrimination was actionable through employment discrimination statutes. The use of profane and inflammatory language also fell within statutory causes of action for discrimination or harassment. The supervisors' actions that fell outside the scope of racial discrimination—threats to terminate an employee—did not rise to the level of extreme and outrageous conduct because employers can generally terminate an employee at will. Moreover, the gravamen of Louis's complaint about these threats was actually a claim for retaliatory discharge for the refusal to perform an illegal act (a "*Sabine Pilot*" claim), which made intentional infliction of emotional distress unavailable to him. The fact that Louis could not succeed on a *Sabine Pilot* claim, because he actually performed the illegal act, did not change the nature of his underlying claim. Therefore, summary judgment on the intentional infliction of emotional distress claim was appropriate.

Regarding Louis's defamation claim, the court clarified that his supervisors could not be held liable for statements they did not make. Mobil, however, could be held liable if the employee's statement was false, was made within the scope of the employee's general authority in furtherance of Mobil's business, and for the accomplishment of the object for which the employee was hired. Because Louis admitted that he falsified the reports, the only aspect of the investigator's statements that could possibly be defamatory were those statements implying that it was Louis's idea to falsify the reports. Literally true

■ DEVELOPMENTS ■

statements, however, are not slanderous merely because others might infer dishonesty. Although the investigator did not make it clear that Louis's supervisor pressured him to falsify the reports, that omitted fact went to the supervisor's culpability, not Louis's. The act that would tend to expose Louis to public scorn was the falsification of the reports, which Louis admitted was true. Therefore, summary judgment on the defamation claim was appropriate.

In considering Louis's retaliation claim, the court first considered whether there was any evidence of a causal link between Louis's termination and his filing of a workers' compensation claim. Although there was evidence he inquired about workers' compensation, there was no evidence that he actually filed a claim. Moreover, there was no evidence that anyone involved in the decision to terminate Louis knew about his workers' compensation inquiry with the company nurse. Because there was no connection between the nurse's comment and Louis's termination and there was no evidence that the company did not have a legitimate, non-discriminatory reason to terminate his employment, summary judgment on the retaliation claim was appropriate.

ENDNOTES

- 1 Mr. Katz is a partner and Ms. Boyd is an associate in the Dallas office of Thompson & Knight LLP.
- 2 267 S.W.3d 9 (Tex. 2008).
- 3 — S.W.3d —, No. 05-0721, 2008 WL 4891733 (Tex. Nov. 14, 2008).
- 4 257 S.W.3d 701 (Tex. 2008).
- 5 254 S.W.3d 602 (Tex. App.—Beaumont 2008, pet. denied).



2008 Update Of Delaware Fiduciary Duty Law

By Todd A. Murray¹

The Delaware courts issued a number of opinions dealing with fiduciary duty during 2008. However, it is with extreme interest that practitioners in this area look toward the events of 2009 and 2010. With the federal government investing in companies, and forcing replacement of officers and directors of major companies, we may see dynamic changes in the law of corporate governance. Only time will tell.

Ryan v. Gifford²

This case of first impression addressed a number of fundamental issues related to stock option backdating. Arising in the context of a motion to dismiss, Chancellor Chandler's opinion took a fairly strong stance on the impropriety of backdated stock option grants, holding that allegations of such actions are sufficient to excuse demand under *Aronson*, rebut the business judgment rule, and satisfy the doctrine of fraudulent concealment so as to toll the statute of limitations. The opinion also found that the plaintiff lacked standing to assert claims prior to his becoming a shareholder, denied the defendants' motion to stay the action in favor of an earlier filed federal court case, and held that the CEO's failure to exercise backdated grants did not undermine an unjust enrichment claim.³

A March 18, 2006 article in *The Wall Street Journal* indicated that statistical analysis revealed that numerous companies had apparently issued backdated stock option grants to their officers. Among the companies identified was Maxim Integrated Products, Inc. Maxim's shareholder-approved stock option plans indicated that the exercise price of stock option grants would be no less than the fair market value of the company's common stock on the date of the grant.⁴ The plaintiff filed suit alleging that the defendant officers of Maxim approved and accepted backdated stock options in violation of the plans and thereby had breached their fiduciary duties to the company.⁵ The defendant officers moved to stay the action or dismiss it on its merits.⁶

The defendants argued that the plaintiff failed to make demand or prove demand futility before filing suit. The normal inquiry into whether demand is excused, as stated in *Aronson v. Lewis*, is whether the plaintiff raised a reasonable doubt (i) that a majority of the board

is disinterested or independent, or (ii) that the challenged acts were the product of the board's exercise of its business judgment.⁷ However, in cases where the decision being challenged is not one of the board in place when the complaint was filed, the normal rule does not apply. Instead the plaintiff must create a doubt that the board could exercise independent and disinterested judgment in responding to the demand as established in *Rales v. Blasband*.⁸

According to the court, *Rales* did not apply because one half of the current board approved the challenged transactions – “Where [as here] half or more of the board has already approved a corporate action, even acting through a committee, there is no need for a shareholder to give the entire board a second bite at the apple.”⁹ The court, therefore, reviewed the plaintiff's allegations of demand futility under the *Aronson* test and, under the second prong, held that demand was excused because the plaintiff sufficiently pled a knowing and intentional violation of the stock option plan – which required the exercise price of granted options be 100% of the fair market value – which could not be a valid exercise of business judgment.¹⁰ In a footnote, the opinion addressed the defendants' argument that the plaintiff's allegations were based on statistical abstractions by choosing to infer that the numerous examples of stock grants when the stock prices were lowest was the product of “knowing manipulation of option grants,” and not “improbable good fortune.”¹¹

The court did not stop with its futility analysis under *Aronson*, but went further and stated that even if *Rales* applied, demand would have been futile because the complaint sufficiently alleged a reason to doubt that a majority of the directors were independent or disinterested enough to consider the demand.¹² As the court saw it, when directors' potential for liability is substantially likely, they have a disabling interest with regard to pre-suit demand.¹³

The defendants next asserted that the plaintiff failed to rebut the business judgment rule and the complaint therefore failed to state a claim for breach of fiduciary duty.¹⁴ The plaintiff countered by arguing that the directors' violation of the stock option plan which established demand futility also rebutted the business judgment rule.¹⁵ The court agreed, holding that facts sufficient to show demand futility under *Aronson* are “*a fortiori*” sufficient to rebut the business

judgment rule and survive a Rule 12(b)(6) motion to dismiss.¹⁶ Moreover, as the court continued, a complaint alleges a breach of the duty of loyalty sufficient to rebut the business judgment rule when it shows that the board acted intentionally, in bad faith, or for personal gain. Here, according to Chancellor Chandler, the intentional violation of a stock option plan and fraudulent disclosures regarding compliance with that plan “constitute conduct that is disloyal to the corporation and is therefore an act in bad faith.”¹⁷

The defendants also moved to dismiss on other grounds. First, they argued that the plaintiff lacked standing. Specifically, seven of the plaintiff’s nine claims were based on transactions that occurred before the plaintiff owned stock. Based on longstanding Delaware law that requires ownership of stock at the time of the injury and through completion of litigation, the court agreed with the defendants.¹⁸

Additionally, the defendants argued that none of the transactions at issue occurred within the three years preceding filing of the lawsuit, and were therefore barred by the statute of limitations. The plaintiff argued that the defendants fraudulently concealed the transactions, thus tolling the statute of limitations. The defendants countered that all of the stock option grants were disclosed to the public as demonstrated by the fact that the same information that formed the basis of *The Wall Street Journal* article was available to the plaintiff. The court, however, disagreed with the defendants, noting that the reasonable diligence a shareholder can be expected to exercise does not require the “shareholder to conduct complicated statistical analysis in order to uncover alleged malfeasance.”¹⁹

Finally, the defendants argued that the plaintiff’s unjust enrichment claim against Maxim’s founder, chairman, and CEO should be dismissed because the CEO had not exercised any of the backdated options. Therefore, the CEO had not obtained any benefit to the detriment of the shareholders. The court disagreed, holding that the CEO retained something of value – the backdated options – at the expense of the shareholders and the corporation.²⁰

In re Tyson Foods, Inc.²¹

In this opinion, the Court of Chancery expanded on, and helped to clarify, a statement in its earlier February 6, 2007 opinion in the same case, that in some circumstances, spring-loading stock options could constitute a breach of a director’s fiduciary duties.

The plaintiffs’ fiduciary duty claim challenged three stock option grants awarded by the compensation committee of Tyson’s Board.²² The defendants moved for judgment on the pleadings. The court began its analysis by noting that it could consider the documents incorporated into the consolidated complaint and Tyson’s public filings.²³ Tyson’s shareholder – approved stock incentive plan allows for two types of stock option grants – incentive or qualified grants, and non-qualified grants. The compensation committee, pursuant to the plan, could distribute options at a fixed price or at a discretionary strike price.²⁴ The options about which the plaintiffs com-

plained were expressly described as non-qualifying incentive options. Although the complaint alleged that the stock incentive plan required stock option grants be at a price no lower than the fair market value of the stock on the day of the grant, the plan itself contradicted this argument.

According to the court, the director defendants suspected that Tyson’s stock price would climb. With that information in mind, the compensation committee issued non-qualified options to employees.²⁵ The director defendants did not disclose this fact, but instead simply stated that the grants complied with the plan. The court found this “bare formalism concealed by a poverty of communication” insufficient.²⁶

According to the defendants, the fact that the grants complied with the letter of the stockholder-approved plan meant that the decision to make the grants were consistent with their duty of loyalty.²⁷ The court disagreed, pointing out that if the incentive plan had never been put to a shareholder vote, the spring-loading of the options would be material information that the directors would be duty-bound to disclose. By merely voting to adopt the plan, the shareholders did not “forfeit their right to the same degree of candor from their fiduciaries.”²⁸ The court found that the grants were “inherently unfair to shareholders,” and that the “long-term nature of the deceit” indicated the scheme was outside the realm of a reasonable business judgment.²⁹ As the Chancellor saw it, the court can conclude that grants violate the directors’ fiduciary duty of loyalty when the directors conceal the true nature of the grants.

The opinion went on to distinguish the holding in *Desimone v. Barrows*. According to the court, *Desimone* rested on assumptions that the directors had revealed their strategies to the shareholders with complete candor.³⁰ *Desimone* found that a board may insulate itself from fiduciary liability for misleading investors or regulatory authorities by candid disclosure. At the pleading stage, however, failing to disclose the reasons motivating spring-loaded or backdated grants suggests purposeful subterfuge. Thus, the court denied the defendants’ motion for judgment on the pleadings.³¹

In re County of York Employees Retirement Plan v. Merrill Lynch & Co., Inc.³²

In this case, the County of York Employees Retirement Plan brought a class action lawsuit to challenge the stock-for-stock merger of Merrill Lynch & Co., Inc. with Bank of America Corporation (“BAC”), asserting that Merrill’s directors breached their fiduciary duties in reaching the merger agreement. The plaintiff alleged that the directors negotiated too quickly and without sufficient due diligence, allowing BAC to include unfair provisions such as a “force-the-vote” provision, under which the directors had to submit the merger to a shareholder vote even if a superior offer emerged.

BAC argued that the court should stay or dismiss the action in favor of a federal derivative action, filed a year earlier, which included breach of fiduciary claims regarding Merrill’s underwriting and

investing in debt secured by under-collateralized sub-prime mortgages. Three days before the merger action was filed, amendments were made to the federal derivative action complaint taking the merger into account.

Under the Delaware Supreme Court's decision in *McWayne*, a court may stay an action "when there is a prior action pending elsewhere, in a court capable of doing prompt and complete justice, involving the same parties and the same issues." *McWane Cast Iron Pipe Corp. v. McDowell-Wellman Eng'g Co.*, 263 A.2d 281, 284 (Del. 1970). The court concluded that the two actions lacked substantial similarity because the core issues in the federal derivative action dealt with responsibility for risk management, a "separate and distinct" question from whether the merger process was appropriate.³³ Applying a *forum non conveniens* analysis, the court concluded that Delaware was a better venue than New York, and denied Merrill's motion to stay or dismiss.

The court then proceeded to address the plaintiff's motion for expedited discovery. In order to receive expedited discovery in Delaware, plaintiffs must show that their claims are sufficiently colorable and that there is a sufficient possibility of a threatened irreparable injury.³⁴ The court found that the plaintiff's fiduciary duty claims were colorable despite Merrill's claim that the business judgment rule justified their decisions.³⁵ "To hold otherwise," said the court, "would notice as fact the very essence of Defendants' factual argument, and would allow inference and conjecture to serve as factual record. This the court should not do, even though such inference and conjecture might be viewed as reasonable."³⁶

Although noting that the plaintiff pled irreparable harm "only in the most cursory fashion," the court nonetheless found a sufficient possibility of irreparable harm to justify expedited discovery.³⁷ As the court explained, when damages that may be available are "difficult to calculate and other uncertainties, such as collectibility exist, a sufficient showing of irreparable harm has been made to warrant expedition."³⁸ Therefore, the court granted the plaintiff's motion for expedited discovery.

Hexion Specialty Chemicals, Inc. v. Huntsman Corp.³⁹

In this opinion, the court found that a buyer who attempted to back out of a cash acquisition breached several provisions in the merger agreement, and did not suffer a material adverse effect that would justify its behavior. In May 2007, Huntsman Corp. began soliciting bids. Hexion Specialty Chemicals, Inc. (the controlling majority of which was owned by Apollo Global Management, an asset manager focusing on private equity) and Basell ended up as the most significant potential buyers. After a bidding war between Hexion and Basell that rose from \$25.25 per share to \$28 per share, Huntsman signed an all cash deal for \$28 per share with Hexion on July 12, 2007.

Within a year, the initial excitement over the merger had died down and Apollo concluded that, based on Huntsman's most recent

numbers, the merger would not prove as profitable as expected. As the court characterized it, at this point Apollo began instigating a strategy to get out of the merger agreement. Apollo engaged outside counsel (Wachtell, Lipton, Rosen & Katz), obtained an insolvency opinion (from Duff & Phelps, LLC), and then published that opinion in order to frustrate financing so that Hexion could claim that it did not knowingly and intentionally breach its contractual obligations to close (because of the impossibility of getting financing without a solvency certificate). Hexion then brought a declaratory judgment action against Huntsman seeking declarations that Hexion was not obligated to close the transaction.

The court first examined whether, under the merger agreement, a material adverse effect had happened in the business of Huntsman that would justify waving Hexion's obligations. As the court explained:

A buyer faces a heavy burden when it attempts to invoke a material adverse effect clause in order to avoid its obligation to close. Many commentators have noted that Delaware courts have never found a material adverse effect to have occurred in the context of a merger agreement. This is not a coincidence.⁴⁰

The court concluded that the parties allocated the risk to Hexion that Huntsman might underperform, and that Hexion could have negotiated for warranties regarding performance forecasts. The court therefore held that Huntsman did not suffer a material adverse effect.

The court then looked to Huntsman's contention that Hexion knowingly and intentionally breached the merger agreement and agreed, ordering that Hexion specifically perform its obligations. The court defined a "knowing and intentional" breach as "the taking of a deliberate act, which act constitutes in and of itself a breach of the merger agreement, even if breaching was not the conscious object of the act."⁴¹ Hexion's avoidance of consummating the merger, its failure to notify Huntsman of its beliefs regarding solvency problems, and its propagation of financing problems by way of the insolvency opinion all demonstrate that Hexion knowingly and intentionally breached the merger agreement.⁴²

In re Lorai Space and Communications, Inc.⁴³

In this opinion, the court reformed an unfair transaction in which a dominant shareholder influenced a corporation to accept capital in exchange for a controlling equity stake. When satellite company Lorai Space and Communications, Inc., emerged from bankruptcy in November 2005, defendant MHR Fund Management LLC, a large stockholder in MHR, influenced Lorai into accepting one of MHR's advisors, defendant Michael B. Targoff, as CEO for Lorai. Under Targoff's pressure, the Lorai board of directors and special committee approved a deal with MHR for \$300 million in exchange for preferred stock that gave MHR the potential to acquire 63% of Lorai's equity, 39.99% class voting rights and a unilateral veto over any Lorai initiative.

The court concluded that although Loral ostensibly had a check on unfair transactions through the special committee, the special committee was effectively strong-armed into considering only the deal with MHR, failing to perform a market check or seeking better terms with MHR. The special committee itself was comprised of an advisor of MHR and another member who, according to the court, was inexperienced and lazy.⁴⁴ The court applied the entire fairness standard because MHR had effective control over the board (direct control over three of eight directors and indirect control over another two).⁴⁵

The entire fairness standard looks to whether an interested transaction includes fair dealing and fair price.⁴⁶ A court should not bifurcate the analysis, but rather look at the transaction as a whole.⁴⁷ With regard to fair dealing, the court looked at whether the special committee functioned as a guarantee of arms-length bargaining, concluding that it did not because of its failure to conduct a market check or to attempt to negotiate a better deal.⁴⁸ With regard to fair price, again, the lack of a market check prevented the special committee from potentially finding a better deal, and the court felt that MHR's deal did not adequately reflect Loral's value.⁴⁹

The appropriate remedy, as the court concluded, was to reform the transaction to convert MHR's convertible preferred stock into non-voting common stock.⁵⁰ MHR contended that this remedy was beyond the powers of the court, but the court disagreed, noting that Chancery Courts have broad remedial powers of equity with regard to addressing breaches of the duty of loyalty, which the court concluded happened in this case.⁵¹

In re Countrywide Corporation Shareholders Litigation⁵²

In this opinion the court ordered limited discovery regarding whether Countrywide undertook proper valuation of the derivative claims against its directors for breaches of fiduciary duty before Countrywide was acquired by Bank of America. The parties in the derivative litigation had reached a proposed settlement agreement when five former shareholders (who also were plaintiffs in the derivative litigation) objected to the settlement out of concern that the value of the derivative claims was not properly considered by Countrywide's board before the merger or by the plaintiffs' counsel in reaching settlement.

The court explained that in the context of objecting to a settlement agreement, the objectors do not get "full-blown discovery."⁵³ Objectors to a settlement do not have to "win the case on the merits;" instead, they merely have to challenge whether the settlement is "fair, reasonable, and in the best interests of the shareholder class."⁵⁴ The burden of proof regarding the appropriateness of the settlement is on the proponents of the settlement, not the objectors.⁵⁵

As a result, objectors usually only need a limited right to discovery, and the court found no cause to expand the scope of discovery in this case.⁵⁶ The court ordered lead counsel for the plaintiffs to disclose to the objectors whether they made effort to preserve the derivative

claims and their projections for the derivative claims' valuation.⁵⁷ The court ordered Countrywide to inform the objectors whether the derivative claims were valued before the merger.⁵⁸

In re Lear Corp. Shareholder Litigation⁵⁹

In this opinion, the court dismissed a complaint alleging breach of fiduciary duty with regard to approving a merger agreement. Stockholder plaintiffs brought an action against Lear Corp. after the shareholders voted against a buyout proposal from Carl Icahn's fund, AREP. Lear's board had originally negotiated a merger agreement under which AREP would buy Lear for \$36 per share, well above the \$16-\$17 range that Lear shares traded at before Icahn first expressed interest in acquiring Lear.

The deal included a 45-day shopping period, which yielded no higher bidders. Nevertheless, when three proxy voting advisory services (ISS, Glass Lewis & Co., and Proxy Governance) and a large public pension fund recommended that shareholders vote against the merger, the Lear board renegotiated with Icahn and AREP to try and get a better deal. AREP ultimately agreed to increase the bid to \$37.25 per share in exchange for a \$25 million "No-Vote Termination Fee," to which Lear's board agreed. ISS continued to recommend voting against the merger, and indeed, the shareholders did not approve the merger.

The plaintiffs alleged, among other things, that the Lear board breached its fiduciary duties by granting the No-Vote Termination Fee in exchange for the bid increase. Because it was a derivative action and the plaintiffs failed to make a demand on the board, the plaintiffs had to plead demand futility under *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984). The plaintiffs chose only to pursue the second plank of the *Aronson* demand futility test, which requires that plaintiffs allege particular facts creating a reasonable doubt that the transaction was the product of a valid exercise of business judgment.

The court concluded that the plaintiffs did not even come close: "[p]ut bluntly, the complaint would not state a claim for lack of due care even if simple negligence were the applicable standard."⁶⁰ The court noted that the Lear board received outside advice from reputable financial institutions that the merger was fair to the shareholders, the board knew that Lear had been freely shopped and no bidder had come up with a better offer, and Lear's trading price had been far lower before Icahn entered the scene.⁶¹ Addressing the plaintiffs' theory that the Lear board breached its fiduciary duty of loyalty, the court explained that the plaintiffs could not show the bad faith required to sustain their claim where the board had "employed a special committee that met frequently, hired reputable advisors, and met frequently itself."⁶² The court therefore dismissed all of the plaintiffs' claims.

Brinckerhoff v. Texas Eastern Products Pipeline Company, LLC⁶³

In this opinion, the court denied the defendant directors' motion to dismiss the plaintiff unitholder's breach of fiduciary

claims, but granted the directors' motion to dismiss the unitholder's inadequate disclosure claims. This litigation arose out of Dan Duncan's acquisition of Texas Eastern Products Pipeline Company, LLC ("TEPPCO"). As the plaintiff alleged, Duncan influenced the directors of TEPPCO to allow overlapping directors with other Duncan-owned entities and to engage in several conflicted transactions, after reducing the percentage of units required to approve conflicted transactions from 66% to 50%.

The court found that it was reasonable to infer that the directors who made up TEPPCO's board at the time of the allegedly conflicted transactions participated in approving the transactions.⁶⁴ As a consequence, the court held that the plaintiff's breach of fiduciary claims were pled sufficiently to avoid Rule 12(b)(6) dismissal because the transactions may have been a breach of the directors' fiduciary duties.⁶⁵

The court then looked at the plaintiff's disclosure claims, which alleged that the directors' proxy materials contained materially misleading information and omitted material information. Contrary to the plaintiff's averments, the court found that the proxy materials honestly characterized the conflicted transactions as unfair to TEPPCO, and the complaint failed to properly plead facts supporting the existence of misstatements in the proxy materials.⁶⁶ Granting the defendants' motion to dismiss the failure to disclose claims, the court held that the proxy materials were included in the total mix of information available to unitholders, and that fact remedied any problems that the plaintiff alleged in other materials that would not have been relied on in isolation.⁶⁷

Ryan v. Lyondell Chem. Co.⁶⁸

In this opinion, the court refused to certify an interlocutory appeal of its decision to deny summary judgment for the defendants regarding whether potential breaches of fiduciary duty were covered by the exculpatory provision in the defendant directors' company charter. The defendants were directors of Lyondell Chemical Company that, in June 2007, approved the sale of Lyondell to Basel AF for \$13 billion.

As the court explained, the defendants moved for summary judgment quickly, and as such, there was only a limited summary judgment record. From the record, the court determined that the directors knew, based on the filing of a Schedule 13D with the SEC in May 2007, that Lyondell was in play, and that the directors did little or nothing to search for a better deal in accord with the principles of *Revlon*.⁶⁹

Reviewing the standard of bad faith set out by the Delaware Supreme Court in *In re Walt Disney Company Derivative Litigation*, 906 A.2d 27, 64 (Del. 2006), the court explained the spectrum between non-exculpable malicious bad faith on the one hand and exculpable gross negligence on the other hand.⁷⁰ "[D]irector conduct amounting *only* to a violation of the duty of care, but otherwise taken in good faith, is exculpable under 8 Del. C. § 102(b)(7) or

indemnifiable under 8 Del. C. § 145."⁷¹ The court noted that behavior which exhibits a "conscious disregard" for the fiduciary duty to act in good faith falls somewhere between bad faith and gross negligence, and is also non-exculpable and non-indemnifiable.⁷²

The plaintiffs, according to the court, did not need to show exactly where on the spectrum the defendants' behavior lies in order to survive summary judgment:

In the context of a motion for summary judgment, it is not necessary (or prudent) for the Court to determine precisely where, on these facts, the line falls between exculpable, "bad faith" conduct (i.e. gross negligence amounting only to a violation of the duty of care) and a non-exculpable, knowing disregard of the directors' known fiduciary obligations in a sale scenario. It suffices that, on this limited record, there exists apparent and unexplained director inaction despite their knowing that the Company was "in play" and their knowing that *Revlon* and its progeny mandated certain conduct or impeccable knowledge of the market in pursuit of the best transaction reasonably available to the stockholders in a sale scenario.⁷³

As a result, the court denied the defendants' motion for summary judgment and also denied the defendants' request for a certification for an interlocutory appeal on the basis that the court's opinion did not preclude the defendants from prevailing on their defensive theories later at trial.⁷⁴

Crescent/Mach I Partners L.P. v. Dr. Pepper Bottling Co. of Texas⁷⁵

In this opinion, the Delaware Supreme Court held that the Court of Chancery had exceeded its power by addressing a dispute that had become moot by operation of a settlement.

The action arose out of an October 1999 acquisition of Dr. Pepper Bottling Holdings, Inc. ("Holdings") by a wholly-owned subsidiary of Dr. Pepper/Seven-Up Bottling Group, Inc. ("Dr. Pepper"). The merger consideration was \$25 per share. Before the merger closed, Crescent/Mach I Partners and other minority shareholders of Holdings dissented from the merger and brought a statutory appraisal action against Holdings.⁷⁶

In the appraisal action, the Court of Chancery awarded \$32.31 per Holdings share, together with pre-and post-judgment interest. On June 1, 2007, Dr. Pepper entered into a settlement agreement to resolve both actions, agreeing to pay approximately \$47 million plus interest.⁷⁷

Three months after the settlement was executed, a disinterested financial analyst discovered analytical errors in the court's appraisal, and alerted Dr. Pepper. Taking these errors into account, Holdings was worth \$30.04 per share, not the \$32.31 per share the Court of Chancery had initially determined. Dr. Pepper sought relief under

Rule 60(a). The Court of Chancery found the settlement did not bar it from correcting the record and its opinion.⁷⁸

The Supreme Court found Rule 60(a) inapplicable. The parties' settlement fully and finally resolved the dispute over the appraised value. Upon execution of the settlement, the appraisal opinion ceased to govern the relationship between the litigating parties. In voluntarily settling their dispute, the parties "assumed the risk that there might be errors in the Court of Chancery's appraisal opinion."⁷⁹

ENDNOTES

1 Todd A. Murray is a partner at Carrington, Coleman, Sloman & Blumenthal L.L.P. in Dallas Texas. He is on the Council for the Texas State Bar's Antitrust and Business Litigation Section, is a Co-Chair of the Class Actions Subcommittee of the ABA Section of Litigation Securities Committee, and is the immediate past-Chair of the Dallas Bar Association's Securities Section.

2 918 A.2d 341 (Del. Ch. February 6, 2007).

3 *Id.*

4 *Id.* at 346.

5 *Id.* at 346.

6 *Id.* at 346.

7 *Id.* at 352 (citing *Aronson v. Lewis*, 473 a.2d 805, 812 (Del. 1984)).

8 *Id.* at 352-53 (citing *Rales v. Blasband*, 634 A.2d 927 (Del. 1993)).

9 *Id.* at 353 and n.29.

10 *Id.* at 354.

11 *Id.* at 355 n.34.

12 *Id.* at 355.

13 *Id.* at 355-56 (brackets in original).

14 *Id.* at 356.

15 *Id.* at 356.

16 *Id.* at 357.

17 *Id.* at 358.

18 *Id.* at 358-59.

19 *Id.* at 360.

20 *Id.* at 361.

21 2007 WL 2351071 (Del. Ch. Aug. 15, 2007).

22 *Id.* at *1.

23 *Id.*

24 *Id.* at *2.

25 *Id.* at *3.

26 *Id.* at *4.

27 *Id.*

28 *Id.*

29 *Id.*

30 *Id.* at *5 (citing *Desimone v. Barrows*, 924 A.2d 908, 936-47 (Del. Ch., June 7, 2007)).

31 *Id.* at *6.

32 C.A. No. 4066-VCN, 2008 WL 4824053 (Del. Ch. Oct. 28, 2008).

33 *Id.* at *3.

34 *Id.* at *5 (citing *Giammargo v. Snapple Beverage Corp.*, 1994 WL 672698, at *2 (Del. Ch. Nov. 15, 1994)).

35 *Id.* at *7.

36 *Id.*

37 *Id.* at *7.

38 *Id.* at *8.

39 C.A. No. 3841-VCL, 2008 WL 5704768 (Del. Ch. Nov. 19, 2008).

40 *Id.* at *17.

41 *Id.* at *22.

42 *Id.* at *23-26.

43 C.A. Nos. 2808-VCS, 3022-VCS, 2008 WL 4293781 (Del. Ch. Sept. 19, 2008).

44 *Id.* at *9.

45 *Id.* at *20.

46 *Id.* at *22 (citing *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983)).

47 *Id.* (citing *Weinberger*, 457 A.2d at 711).

48 *Id.* at *22.

49 *Id.* at *28-3.

50 *Id.* at *31-32.

51 *Id.* at *33 (citing *McGovern v. Gen. Holding, Inc.*, 2006 WL 1468850, at *24 (Del. Ch. June 2, 2006); *Int'l Telecharge, Inc. v. Bomarko, Inc.*, 766 A.2d 437, 439 (Del 2000); *Weinberger*, 457 A.2d at 715)).

52 C.A. No. 3464-VCN, 2008 WL 4173839 (Del. Ch. Sept.10, 2008).

53 *Id.* at *2.

54 *Id.*

55 *Id.*

56 *Id.*

57 *Id.* at *3.

58 *Id.*

59 C.A. No. 2728-VCS, 2008 WL 5704774 (Del. Ch. Sept. 2, 2008).

60 *Id.* at *7.

61 *Id.* at *8.

62 *Id.* at *11.

63 C.A. No. 2427-VCL, 2008 WL 4991281 (Del. Ch. Nov. 25, 2008).

64 *Id.* at *4.

65 *Id.* at *3-4.

66 *Id.* at *5.

67 *Id.* at *6.

68 C.A. No. 3176-VCN, 2008 WL 4174038 (Del. Ch. Aug. 29, 2008).

69 *Id.* at *2.

70 *Id.* at *3.

71 *Id.*

72 *Id.*

73 *Id.* at *4.

74 *Id.* at *6.

75 C.A. No. 330,2008, 962 A.2d 205 (Del. 2008).

76 *Id.* at 206.

77 *Id.* at 207.

78 *Id.* at 208.

79 *Id.* at 209.

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