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IN THE SUPREME COURT OF TEXAS
AUSTIN, TEXAS

Lee C. Ritchie, as director of Rupe Investment Corporation and as Trustee for the Dallas Gordon Rupe Trust, Paula Rupe Dennard, as director of Rupe Investment Corporation and as Trustee for the Dallas Gordon Rupe Trust and as Trustee for the Paula Dennard Management Trust, Dennis Lutes, as director of Rupe Investment Corporation and as Trustee for the Paula Dennard Management Trust, and Rupe Investment Corporation,

Petitioners,

v.

Ann Caldwell Rupe, as Trustee for the Dallas Gordon Rupe, III 1995 Family Trust,

Respondent

AMICUS CURIAE BRIEF OF JOHN R. FAHY, WAYNE WHITAKER AND REX WHITAKER IN SUPPORT OF PETITION FOR REVIEW

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TO THE HONORABLE SUPREME COURT OF TEXAS:

JOHN R. FAHY and WAYNE WHITAKER respectfully submit this brief in support of the Petition for Review filed by Petitioners.

IDENTITY OF AMICUS CURIAE AND SOURCE OF FEE

The following disclosures are made pursuant to Rule 11 of the Texas Rules of Appellate Procedure. Amici are members of the Business Law Section (the "Section") of the State Bar of Texas. Specifically, the Amici are:

1) John R. Fahy, Vice-Chair, Securities Law Committee, Business Law Section, State Bar of Texas;
2) Wayne Whitaker, member Securities Law Committee, Business Law Section, State Bar of Texas; and
3) Wayne Whitaker, member Securities Law Committee, Business Law Section, State Bar of Texas.

The views expressed in this amicus brief represent the views of the Amici only and do not represent the views of our colleagues, clients or law firms, the Section or the official position of the State Bar of Texas. None of the Amici are being compensated, directly or indirectly, for our work on this amicus brief or have any beneficial interest in the matter before the Court.

STATEMENT OF INTEREST OF AMICUS CURIAE

The Amici are business law attorneys in Texas who frequently advise clients on compliance with securities laws and business entity governance. We are concerned about the impact of the Fifth Court of Appeals's holding in *Ritchie v. Rupe*, _____ S.W.3d _____, 2011 WL 1107214 (Tex. App. – Dallas 2011) that securities issuers and their management who choose not to make statements relating to securities transactions in which they will receive no benefit

may be held liable for shareholder oppression solely for so choosing. We are concerned that this holding forces issuers with minority shareholders and their management to make a "Sophie's Choice" of being at risk for securities law liability for meeting with prospective purchasers of minority shareholder interests or being at risk of shareholder oppression liability for not meeting with the prospective purchasers. We are also concerned that the Fifth Court of Appeal's holding interferes with the cost/benefit analysis that is the province of a business entity's governing authority under the business judgment rule. Finally, we are concerned with competitive disadvantages that Texas business entities may incur if they are subject to judge-made governance regimes that materially differ from other states. These public policy concerns provide our interests in this matter.

ARGUMENT

I. The Court of Appeals Holding that Equitable Remedies for Shareholder Oppression Can Be Imposed Due To Company Management Not Meeting With Prospective Purchasers of Minority Interests Is Not Equitable.

As business attorneys we seek to bring to the Supreme Court's attention relevant consideration of securities laws that exist when a securities issuer considers whether to meet with a prospective purchaser of securities from a minority shareholder. The Court should consider that the issuer and its management realize no benefit from such meetings. The purchase price will go to a shareholder instead of capitalizing the issuer. But, answers given by issuer management to the prospective purchaser could be deemed to be **statements** made in connection with a securities transaction. Thus, meeting participants and the issuer could incur the risk of securities liability for a transaction in which they realize no benefit.

We are concerned that the Fifth Court of Appeals's mandate that issuer management be required to meet with prospective purchasers of minority interests under pain of shareholder

oppression liability misaligns the costs and benefits of corporate decision-making through judicial fiat. In a *Ritchie*-type meeting, the issuer and its management incur all the securities law liability while the minority shareholder reaps all the benefit. Even so, the Fifth Court of Appeals gave no deference to the issuer management's evaluation of these costs and benefits under the business judgment rule. *See Gearhart Industries, Inc. v. Smith International, Inc.*, 741 F. 2d 707, 721 (5th Cir. 1984). The Court of Appeals held that the business judgment rule was irrelevant because the corporate governance claim about not having a meeting with directors was not against the directors, but against the corporation. *Ritchie* at **12-13. But:

> The minority shareholder's reasonable expectations must be balanced against the corporation's need to exercise its business judgment and run its business efficiently. . . . Therefore, despite the existence of the minority-majority fiduciary duty, a corporation's officers and directors are still afforded a rather broad latitude in conducting corporate affairs.

Willis v. Bydalek, 997 S.W.2d 798, 801 (Tex. App. – Houston [1st Dist] 1999, pet. denied) (citations omitted).

The *Ritchie* case involves equitable remedies for shareholder oppression. *Ritchie* at *5. But, it would be inequitable to require a meeting where the issuer and its management incur all the potential liability and the minority shareholder accrues all the benefit. Thus, the equities are not in balance and not having such a meeting should not be the basis for equitable relief.

The First Court of Appeals held in fiduciary litigation that: "A court cannot substitute its discretion for that of a trustee, and can interfere with the exercise of discretionary powers only in cases of fraud, misconduct, or clear abuse of discretion." *Di Portanova v. Monroe*, 229 S.W.2d 324, 330 (Tex. App. – Houston [1st Dist.], 2006, pet. denied) (citations omitted). The Fifth Court of Appeals in *Ritchie* overruled the issuer management's discretion in determining whether to hold a meeting, but made no findings of fraud, misconduct, abuse of discretion or other

breaches of fiduciary duty. Instead, the Court only found a thwarting of the Plaintiff's non-contractual "reasonable expectations" to justify the imposition of equitable remedies. But:

> A court of equity has no right to interfere with and control, in any case, the exercise of a discretionary power, no matter in whom it may be vested; a corporate body or individuals, the aldermen of a city, the directors of a bank, a trustee, executor or guardian; and I add, that meaning and principle of the rule, and the limitations to which it is subject, are in all the cases to which it applies, exactly the same. The meaning and principle of the rule are, that the court will not substitute its own judgment for that of the party in whom the discretion is vested, and thus assume to itself a power which the law had given to another[.]
>
> *Di Portanova* at 331 (citations omitted).

Moroever, in our experience as business attorneys the equitable imbalance of a *Ritchie*-type meeting can be mitigated. For example, the minority shareholder receiving the benefit of the *Ritchie*-type meeting could have offered to indemnify the issuer or its management for any liability resulting from the meeting. Alternatively, a prospective purchaser who demands a *Ritchie*-type meeting could be required to execute a waiver of reliance on the information and statements derived from the meeting. Either approach would more equitably align costs and benefits. But, the *Ritchie* opinion cited no facts showing any indemnification offer or other attempt to mitigate risk. Consequently the costs and benefits of the proposed *Ritchie*-type meeting in this case were inequitable and the Court of Appeals should not have awarded equitable remedies based on the defendants not agreeing to have an inequitable meeting.

Further, we question whether a minority shareholder should reasonably expect issuer management to meet with a prospective purchaser of its interest when it has not offered to indemnify the issuer or its management or otherwise mitigate the risk of such a meeting.

II. Requiring Corporate Management to Meet with Prospective Purchasers of Minority Shareholder Interests May Expose the Company and its Management to the Risk of Securities Liability under the Texas Securities Act and the Securities Exchange Act of 1934

As stated above, having a meeting with a prospective purchaser of securities is problematic from a securities liability perspective because answering the purchaser's questions could be deemed to be making a **<u>statement</u>** in a connection with a securities transaction. Making a **<u>statement</u>** is an element in proving violations of the anti-fraud provisions of the Texas Securities Act and the Securities Exchange Act of 1934.

The Texas Securities Act imposes liability on:

> A person who offers or sells a security . . . by means of an untrue **<u>statement</u>** of a material fact or an omission to state a material fact necessary in order to make the **<u>statements</u>** made, in the light of the circumstances under which they are made, not misleading.
>
> TEX.REV.CIV.STAT. art. 581-33(A) (Emphasis supplied).

Thus, making a statement is an integral element of the claim. Further, the Texas Securities Act defines "sell" as to:

> include every disposition, or attempt to dispose of a security for value. The term "sale" means and includes contracts and agreements whereby securities are sold, traded or exchanged for money, property or other things of value, or any transfer or agreement to transfer, in trust or otherwise. . . . ***The term "sell" means any act by which a sale is made*** . . . . ***Nothing herein shall limit or diminish the full meaning of the terms "sale," "sell" or "offer for sale" as used by or accepted in courts of law or equity.***
>
> TEX.REV.CIV.STAT. art. 581-4(E), (Emphasis supplied). *See generally*, *State of Texas v. Public Utility Commission of Texas*, _____ S.W.3d_______, *5 FN 56, 54 Tex. Sup. Ct. J. 690 (Tex. 2011) (2011 WL 923949)

Given this definition of "sale," company management could reasonably perceive that meeting with a prospective securities purchaser might possibly drag them within the definition of "sale," thus creating the risk of liability for any "statements" made. Moreover, even if such a meeting

was not within the definition of "sale," company management could still face exposure for such a meeting under the secondary liability provisions of the Texas Securities Act. (TEX.REV.CIV.STAT. art. 581-33(F)) as an issuer control person or "aider." See *Sterling Trust Company v. Adderly* 168 S.W.3d 835 (Tex. 2005)

Liability under the Securities Exchange Act of 1934's anti-fraud provisions is similarly tied to making **statements**. SEC Rule 10b-5 (17 CFR § 240.10b-5) provides liability for:

> any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange . . . to make any untrue **statement** of a material fact or to omit to state a material fact necessary in order to make the **statements** made, in the light of the circumstances under which they were made, not misleading . . . in connection with the purchase or sale of any security.

(Emphasis supplied)

On June 13, 2011, the U.S. Supreme Court held that Rule 10b-5 liability requires the defendant to have made the complained of statement. *Janus Capital Group, Inc., et al., v. First Deriviative Traders*, _____ S.Ct.______ (2011) (2011 WL 2297762). *Janus* focused on who made the complained of statement. The U.S. Supreme Court determined that it is the party with control over the statement. Thus, an investment adviser that advises a mutual fund does not "make" the statements in the mutual fund prospectus because the adviser and the mutual fund were legally separate and unaffiliated at the board of directors' level.

Similarly in *SEC v. Tambone*, 597 F.3d 436, 442-447 (1st Cir., *en banc*, 2010), the court held that a broker for an affiliated mutual fund distributor who sells a mutual fund did not make the statements in the mutual fund prospectus and did not adopt such statements by using the prospectus in the sales process. The court held that Rule 10b-5 says "make a statement" and a broker's use of an issuer's statement does not rise to making a statement.

Thus recent federal court decisions have focused on tying Rule 10b-5 liability to the persons or parties that actually make the actionable statements. Under such decisions the reasonable path for an issuer or management to pursue is to just not make statements in connection with securities transactions in which they will receive no benefit unless the securities liability risk is mitigated through indemnification or otherwise

III. The *Ritchie* Opinion Hurts the Texas Business Environment Through Its *Ad Hoc* Approach to Corporate Governance

In recent years the Texas Business Law Foundation and members of the Business Law Section of the State Bar of Texas have worked to help modernize Texas corporate law and diminish substantive advantages to incorporating in other states such as Delaware or Nevada. In 2003 the 78th Legislature adopted the Texas Business Organizations Code which recodified Texas corporate law in an effort to bring predictability to interpretations of corporate law. One reason why corporate entities flock to Delaware is greater certainty as to what to expect from courts' review of corporate business decisions. But, in *Ritchie* the Fifth Court of Appeals imposed its own singular corporate governance standards by requiring management meetings with prospective purchasers of securities from minority shareholders – something not mandated in the Texas Business Organizations Code. Unexpected decisions such as *Ritchie* which place corporate management in the position of picking their poison – risking securities or shareholder oppression liability – cast a pall over the viability of Texas as a jurisdiction of choice for corporate governance.

Respectfully submitted

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I certify that on July 14, 2011, a true and correct copy of the foregoing Amicus Brief was forwarded to the following counsel of record for Petitioner and Respondents by First Class United States Mail, Return Receipt Requested.

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