No. 70 180 00648 02

RUSSELL GRIGSBY Claimant, V. PROTRADER GROUP MANAGE-MENT, L.L.C., PROTRADER GROUP LIMITED PARTNERSHIP, INSTINET GROUP, INC., DAVID R. BURCH, DAVID G. JAMAIL, ANDREW S. KERSHNER, JOHN A. McENTIRE, OVERUNDER, L.L.C., ZONE TRADING PARTNERS, L.L.C and ZONE EQUITY PARTNERS, L.P. Respondents.	§ § § § § § § § § § § § § § § § §	**AMERICAN** **ARBITRATION** **ASSOCIATION**

CLAIMANT'S OPPOSITION TO RESPONDENTS' MOTION FOR PARTIAL SUMMARY JUDGMENT THAT HIS CLAIMS FOR DURESS. OPPRESSION AND OTHER NON-CONTRACT BASED CLAIMS ARE BARRED BY HIS CONDUCT RATIFYING HIS BUY-OUT AND RELEASE

INTRODUCTION

Claimant Russell Grigsby respectfully files this Response to the Motion of all Respondents except Instinet Group, Inc. ("Instinet") for Partial Summary Judgment That Grigsby's Claims for Duress and Oppression and Other Non-Contract Based Claims are Barred by his Conduct Ratifying his Buy-Out and Release.

Respondents' motion is premised on the argument that Grigsby ratified and waived his claims for shareholder oppression and fraud by accepting the benefits of and performing under the Letter of Intent executed on April 30, 2000 ("LOI") and the Redemption and Termination Agreement executed on May 11, 2001 ("RTA"). The motion does not contest that Respondents owed Grigsby a fiduciary duty at all times, or that they breached that duty; it assumes these allegations to be true, as it must, and argues only that Grigsby ratified the breaches after the fact as a matter of law.

Respondents' motion is also filled with sermonizing and self-righteous rhetoric about the need to live with one's choices. See, e.g., Motion at 2-3, 19, 22, 27. At one point, Respondents announce ominously that Grigsby's "greed overcame his honor." See id. at 12. Discarding any vestige of subtlety, they attack Grigsby for daring to spend payments even they concede they owed him on personal items like stock (an odd complaint coming from day traders), his mortgage, and what they characterize as "luxury automobiles." Motion at 2.

More than just out of place, these ad *hominem* attacks are strikingly hypocritical. According to their own former compliance officials – people with no interest in this lawsuit whatever – Respondents are willful and serial violators of federal and state securities laws, one of whom reportedly declared that they could not make money without cheating. They are indisputably far wealthier than Grigsby, yet much of this wealth was garnered by lying to Grigsby about Instinet, forcing him out of the company he helped build, and helping themselves to remuneration Grigsby should have shared. They are in no position to preach.

More importantly, Respondents' legal arguments regarding ratification are without merit. Because ratification and waiver involve intent, they are particularly inappropriate for resolution on summary judgment, and Respondents have not demonstrated their entitlement to that relief. Relying almost entirely on cases that do not involve fiduciaries, Respondents overlook two rules governing ratification in that context which defeat their motion. First, when fiduciaries act in their own interests and at the expense of their beneficiaries, there can be no ratification. Because such a fiduciary breach is precisely what Grigsby alleges here, Respondents' motion must fail. Second, when fiduciaries breach their duties, beneficiaries are permitted to avoid or mitigate their losses without ratifying. In this case, much of Respondents' motion is founded on the claim that Grigsby's retention of payments, and his refusal to return them to Respondents constitutes ratification. This tendering back is simply not required of beneficiaries, however. Moreover, Respondents do not dispute that, whether he wins this suit or not, Grigsby is entitled to keep all of the payments he has retained. Regardless of the outcome of this case, these sums will never have to be repaid to Respondents. In these circumstances, holding that Grigsby must have offered to return the payments or be deemed to have ratified defies both logic and the law.

Respondents' motion should also be denied for reasons independent of Grigsby's status as a beneficiary. One of these is that ratification is not effective until the conditions giving rise to the oppression are removed, and Respondents have not done that here. On the contrary, they continue to freeze Grigsby out of his former company. Moreover, though all but two pages of their motion is devoted to Grigsby's oppression claim, Grigsby has not ratified Respondents' fraud either – because the statutory and securities fraud claims are immune from waiver, and because the facts do not establish a waiver of his common law fraud claims. Finally, even in the unlikely event that the Panel concludes Respondents' ratification defense has been established as a matter of law, that defense cannot preclude an award of legal damages – only the equitable remedy of rescission.

In sum, the Panel should deny Respondents' motion.

BACKGROUND

Respondents' motion assumes that Grigsby will prove they owed him fiduciary duties at all times, and that they committed shareholder oppression. They argue only that Grigsby ratified that oppression by his subsequent conduct. A brief review of the facts underlying Grigsby's shareholder oppression and fraud claims will be useful in understanding why Respondents' ratification arguments are baseless.

I. Respondents Oust Grigsby and Pressure Him to Sinn the Letter of Intent

In late 1999 and early 2000, two long-simmering sources of conflict between Grigsby and Respondents began to worsen. First, Respondents ignored Grigsby's repeated warnings and persisted in flagrantly violating the securities laws by intentionally short selling, disabling the software put in place to ensure compliance, and committing other related violations. See Deposition of Roseanne Daylong (attached hereto as Exhibit 1) at 103-09, 138 (generally describing violations). According to ProTrader's former Chief Technology Officer, whose compliance software Respondents deactivated in order to trade illegally, Respondents "knew they were breaking the rules and they were doing it anyway." Deposition of Kevin Nesmith (attached hereto as Exhibit 2) at 35-36 (willfulness), 39, 89-90, 180-84, 229-234 (disabled compliance software). This issue reached a boiling point in February 2000, during a contentious meeting when Grigsby and Chief Compliance Officer Roseanne Daylong demanded the violations stop once and for all. See Daylong Depo., Exh. 1 at 201-05. In this meeting, it became clear that Respondents would never obey the law – Kershner went so far as to declare that they could not make money "unless they "cheated"

– and that Grigsby's days at ProTrader were numbered. See *id.* ("shortly after that they fired Russell").

A second source of disagreement lay in Respondents' unwillingness to live up to their promise to Grigsby to pay retail commissions to ProTrader on their trading. See Deposition of Russell Grigsby (attached hereto as Exhibit 3) at 136-37. Their refusal to pay commissions deprived ProTrader and its other shareholders, including Grigsby, of considerable profits. On April 30, 2000, *the same day Respondents claim Grigsby happily agreed to sell out,* he e-mailed shareholders Shane Young and Currin Van Eman imploring them to join him in opposing Respondents' efforts to continue to trade without paying appropriate commissions. See Grigsby e-mail to Young and Van Eman, April 30, 2000 (attached hereto as Exhibit 4). The e-mail makes crystal clear that Grigsby was not on the verge of selling out on the afternoon of April 30. If he had been, the question of commissions would have had no importance to him or his future compensation under the LOI. Indeed, his comment in the e-mail that "[o]ur stock valuation will decline if you approve the discount," see *id.*, is hardly to be expected from someone about to sell all his stock. Moreover, the e-mail demonstrates the extent to which the issue had come to acrimoniously divide the parties. See *id.*

Unwilling to tolerate further interference from Grigsby on these issues, Respondents began their ouster of him by cutting off his salary – a fact Grigsby learned when the firm's controller called him while he was on a family vacation. See Grigsby Depo., Exh. 3 at 208-09. Then, shortly after Grigsby returned, Respondents called a shareholders meeting and replaced him as the director with

McEntire and two others who reported to McEntire. See Deposition of Jay McEntire (attached hereto as Exhibit 5) at 176-80. Where Grigsby had previously contemplated a gradual transition out of many of the day-to-day management responsibilities over the course of 2000, see Grigsby Depo., Exh. 3 at 200-04; Grigsby e-mail to Cornerstone partners dated December 7, 1999, Motion Exh. 2, Respondents wanted him out without delay.

Respondents' plan was all the more threatening because they could withhold the partnership distributions Grigsby -- unlike the other, far wealthier Respondents -- badly needed to pay taxes on the company's earnings. See Grigsby Depo., Exh. 3 at 308-18. Indeed, Respondents had withheld the distribution Grigsby needed to pay taxes in the last quarter of 1999, and it was only by unilaterally arranging the distribution himself that he avoided the same problem during early 2000. See id. Under these circumstances, Grigsby naturally felt "a tremendous amount of pressure . . . to leave and to sell to them at a low price," id. at 226, and therefore offered through counsel to sell his interests for $17.5 million: "I think these guys just thought they could do whatever they wanted to do to me, and I was just willing to go back and say, 'Look, I think what you're doing is illegal, and if you're going to force me out, at least pay something that's fair."' Id. at 226.

At the same time Respondents were forcing Grigsby out, they were secretly negotiating with Instinet to sell ProTrader. On April 14, 2000, Instinet officials came to Austin to "kick the tires" for a sale, as Respondent McEntire described it. See McEntire Depo., Exh. 5 at 124-25. As Respondents themselves characterized the Instinet negotiations during this period: "There were numerous discussions and communications with Instinet . . . [D]iscussions relating to a potential sale progressed in the Spring 2000 [sic] such that on April 14, 2000, Instinet and ProTrader entered into a confidentiality agreement to govern the sharing of any information incident to discussions relating to a potential acquisition or strategic partnership." Individual Respondents' Response to Claimant's Interrogatory 8 and ProTrader Respondents' Response to Interrogatory No. 9 (attached hereto as Exhibit 6). Respondents concealed these negotiations and the confidentiality agreement from Grigsby, who would learn nothing at all about Instinet's negotiations to acquire ProTrader until a full year later. See Grigsby Depo., Exh. 3 at 432.

Respondents' oppression reached fruition on Sunday night, April 30. Contrary to Respondents' claim, there were no intense negotiations of the terms of the LO1 that weekend. See id. at 279-81. Rather, McEntire called Grigsby at approximately 10:30 p.m. on April 30 and demanded to come to Grigsby's house. When he arrived, Grigsby protested vigorously, but to no avail:

Q: What happened? What was the discussion?

A: Well, Mr. McEntire told me that he was there with a final proposal then to buy my interest, he needed it to be signed that night and that I had to sign all the reorg. documents that night as well. He told me that this was not negotiable, "This is our last offer. You have to take it or leave it. There's no other" – "no other buyers. This [sic] is the only people that are ever going to buy you out, and it has to be done tonight or the deal is off."

Q: And if the deal were off, what did you understand that to mean?

A: That these guys have fired me from my job; they've taken over the board; they can now do whatever they want to with this company and I cannot stop them. I cannot stop them

> from illegal trading. I cannot stop – or make them distribute money for taxes. I cannot control them from absolutely destroying my business that I built. . .
>
> I told him it was outrageous that he shows up at my house after 10:00 at night and gets me out of bed, that this is a ridiculous way to negotiate this deal, and that I thought they should give me the time that I need to have this reviewed, that this, you know, cramming it down my throat at night saying "You've got an hour to sign or die," basically, I just thought that was just — it was insane, and it was not the way I felt I should be treated by these guys.

Id. at 285436. As Grigsby reiterated, "I was very upset at the way I was being treated, and I protested. I don't believe it was heated, but I made the way I was feeling very clear." *Id.* at 302. "Q: Did you express your frustration on that point – A: yes. Q: to Mr. McEntire? What did he say. A: 'Got to do it tonight."' *Id.* at 306. Given the late hour and McEntire's ultimatum, it was the most Grigsby could do to skim the many voluminous documents given to him to sign. See *id.* at 287-92. Nor could Grigsby even consult with his attorney; he had no idea how to reach her outside of the office. See ***id.*** at 298.

II. Respondents' Ongoing; Fraud and Oppression after April 30, 2000

Grigsby signed the LO1 on the night of April 30, 2000, but Respondents' oppression and fraud did not end that evening. On the contrary, Grigsby and Respondents continued dealing with each other over the next several months, hashing through the many issues left outstanding by the LO1 and negotiating to complete the RTA required to actually effect the sale of Grigsby's interests. Respondents claim that Grigsby never complained about their shareholder oppression during this period, see Motion at 8, 16, but Grigsby *did* voice his complaints about the oppression he continued to suffer after April 30 to Jamail and McEntire. See Grigsby Depo., Exh. 3 at 351.[1] Moreover, on August 14, 2000, Grigsby's lawyer sent Respondents' lawyer a letter making clear that Grigsby demanded to continue to be treated as a director of ProTrader, and to be kept fully informed about the companies:

> I would like to call to your attention the fact that the Binding Letter of Intent contemplates that Mr. Grigsby will continue as a director of the company until the final Redemption Agreement is signed. I trust that there have not been any directors' meetings since April 30, 2000 and that he will be given notice of all directors' meetings that take place prior to the execution of the Redemption Agreement. He is also entitled to financial statements for April, May, June and July for all entities as well as to be informed of all significant transaction involving ProTrader.

Letter from Kathryn Lindauer to Vince Maurer and Jay Hebert dated August 14, 2000 (attached hereto as Exhibit 7) at 2. Of course, Respondents simply ignored this letter and went ahead with their freeze-out of Grigsby by failing to treat him as a director, notify him of board meetings, or keep him informed about the entities.

In accordance with the LO1 Respondents compelled him to sign, Grigsby retained and did not recontribute $1.25 million in dividends to the new ProTrader entities following the May 1, 2000 reorganization. He also received monthly payments pursuant to the LO1 that were wired directly into his account beginning in July 2000. Respondents' motion is based largely on this retention of payments. But Respondents left Grigsby with no choice other than to try to alleviate the loss they inflicted as best he could. And they certainly made no effort of any kind to end their oppression by, e.g., welcoming him back to the company he helped build, treating him as a director as provided for in the LOI,

[1] Similarly, Grigsby did not "declare[] his happiness with the deal in a press release." Motion at 7. In fact, Grigsby was never shown the press release Respondents quote. See Grigsby Depo., Exh. 3, at 398-99.

offering to pay a fair price for his shares, keeping him fully informed about events at the company, or otherwise fulfilling their legal duty to treat him as a beneficiary of their fiduciary obligations.[2]

Indeed, far from treating Grigsby like a beneficiary, Respondents continued negotiating with Instinet for the sale of the company and hiding those negotiations from Grigsby. For example, on July 6, 2000, Instinet's Chief of Staff informed Instinet's CEO and other members of the executive committee that ProTrader was "anxious" to sell to Instinet and would take unregistered Instinet stock as consideration. See e-mail from David Good dated July 6, 2000 and attached memoranda (attached hereto as Exhibit 8).

By early 2001, the Instinet deal was close to completion – yet Grigsby had not been bought out of the ProTrader entities because Respondents had refused to negotiate in good faith and complete the RTA, and were trying to renegotiate several aspects of what had been memorialized in the LOI. See Grigsby Depo., Exh. 3 at 405-19; Grigsby letter to McEntire dated July 25, 2000, Motion, Exh. 10. Then, in an obvious turnabout in late April and early May 2001, Respondents suddenly pressed Grigsby to complete it. On May 10, 2001, Grigsby and Respondents finally executed the RTA, and Respondents acquired Grigsby's interests. See Redemption and Termination Agreement, Respondents' Motion, Exh. 16. *The very next* day, on May 11, 2001, Instinet and Respondents announced that Instinet had agreed to buy the ProTrader entities.

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[2] Respondents also mention that Grigsby took payments pursuant to a consulting agreement entered into after April 30, 2000, and referred to in the LOI. See Motion at 7. However, Grigsby's acceptance of consulting fees under the consulting agreement, which was an entirely separate and distinct contract from the LO1 or RTA, in no way ratifies these other purported agreements. At most, performance of, and acceptance of benefits under, the consulting agreement might ratify the consulting agreement, which Grigsby does not challenge or seek to rescind.

Grigsby learned of the potential Instinet acquisition the day it was publicly announced, on May 11, 2001. See Grigsby Depo., Exh. 3 at 432. At that point, Grigsby had no way of knowing how long negotiations with Instinet had been taking place, and how long he had been kept in the dark. Nor, as Respondents acknowledge, was the ProTrader-Instinet sale final. See Motion at 9 (referring to deal as "non-binding"). Five days later, on May 16, when the next check was wired into his account, Grigsby was in the process of asking his attorney about his rights and trying to learn more about the proposed Instinet acquisition by, e.g., seeking information from ProTrader counsel Vince Mourer. See Grigsby Depo., Exh. 3 at 431-38. A few weeks later, by the time the next payment was wired into Grigsby's account in June 2001, Grigsby e-mailed Mourer and made clear that his acceptance was conditional: "I conditionally accept the wire without prejudice to my claims that I may be entitled to far greater compensation or consideration due to recently discovered material information not disclosed to me prior to execution of the settlement for which there was a fiduciary duty to disclose." Grigsby e-mail to Mourer dated June 22, 2001 (attached hereto as Exhibit 9). Grigsby did the same with the wired payment received in August. See Grigsby e-mail to Mourer dated August 25, 2001 (attached hereto as Exhibit 10).

On September 14, 2001, ProTrader changed tacks, stopped wiring payments into Grigsby's account, and sent him the August payment under cover of a letter from its counsel addressed to Grigsby's counsel. The letter warned Grigsby that, in ProTrader's view, acceptance of the check would amount to ratification of the RTA:

> The enclosed check is being delivered to you pursuant to, and for the purpose of performing, the RTA, and for no other purpose. The deposit, cashing, or other negotiation of the enclosed check will constitute your client's acknowledgement and affirmance of the RTA and a waiver of any assertion by Mr. Grigsby that the RTA is for any reason void and unenforceable.

Letter from Gary Ewe11 to Lawrence Waks, dated September 14, 2001 (attached hereto as Exhibit 11). This letter represents the first time ProTrader expressly took the position that cashing a monthly payment would constitute some kind of ratification or waiver. In response, Grigsby returned the check to ProTrader with a letter from his counsel making clear that, in light of ProTrader's unreasonable view of the effect of the payment, he had no intention of ratifying the RTA or anything else:

> Please enclosed find the ProTrader check made payable to Mr. Grigsby in the amount of $149,644.65. Given the conditions in your letter attaching to Mr. Grigsby's negotiation of this check, he is of course returning it to you, and to your client.

Letter from Lawrence Waks to Gary Ewell, dated September 21, 2001 (attached hereto as Exhibit 12). Since September 2001, ProTrader has continued to tender monthly payments to Grigsby -- and he has continued to return them.

On October 1, 2001, ProTrader provided a letter of credit to Grigsby. Respondents assert that Grigsby accepted the letter of credit "without condition," Motion at 10, but, in fact, Grigsby's counsel fully communicated Grigsby's position regarding the letter of credit: that *drawing* on *it* might arguably represent waiver, but simply holding it could not. See Letter from Lawrence Waks to Gary Ewe11 dated January 4, 2002, Motion, Exh. 29 (" . . . should Mr. Grigsby draw on it, he would, in effect, arguably be liquidating and settling his claims"). At no time did Grigsby leave the impression through silence or otherwise that merely holding the letter of credit constituted a ratification.

On October 3, 2001, Grigsby sued Respondents in Texas state court alleging, among other claims, that they had tortiously ousted him from the ProTrader entities and defrauded him by concealing the Instinet sale negotiations. See Plaintiff's Original Petition (attached hereto as Exhibit 13).

ARGUMENT

I. The Summary Judgment Standard in Cases of Ratification and Waiver

"When reviewing a traditional motion for summary judgment . . . every reasonable inference must be indulged in favor of the non-movant and any doubts resolved in its favor." *McStay v. Heady Financial Corp.*, __ S.W.2d __, 2003 WL 21710534 at * 1 (Tex. App.-Eastland, Jul 24, 2003). More specifically, the existence of ratification and/ or waiver is ordinarily a question of fact. See *Cathey v. Meyer*, __ S.W.2d __, 2003 WL 21877786 at * 7 (Tex. App. – Waco, Aug 4, 2003) (citing *Caldwell v. Callender Lake Prop. Owners*, 888 S.W.2d 903, 910 (Tex. App. – Texarkana 1994, no writ) (quoting *Jordan v. City of Beaumont*, 337 S.W.2d 115,118 (Tex. App. – Beaumont 1960, writ ref'd n.r.e.))). Because ratification and waiver turn on whether the party at issue intended to relinquish a known right, "ratification and waiver are largely a matter of intent." *Avary v. Bank of America*, 72 S.W.3d 779, 788 (Tex. App. – Dallas 2002, rev. denied). And it has long been held that where a party's intent is at issue, the case is unsuited for summary judgment: "Summary judgment should not be granted when the issues are inherently those for a jury, as in cases involving intent." *RRR Farms, Ltd. v. American Horse Ass'n*, Inc., 957 S.W.2d 121, 132 (Tex. App. – Houston [14th Dist.] 1997, rev. denied); *accord Grotjohn Precise Connexiones Intern., S.A. v. JEM Financial, Inc.*, 12 S.W.3d 859, 865 (Tex. App. – Texarkana *2000); Frias v. Atlantic*

Richfield Co., 999 S.W.2d 97, 106 (Tex. App. – Houston [14 Dist.] 1999, rev. denied).

Thus, because Respondents aim to convince the Panel that Grigsby's intent – and therefore their ratification and waiver defenses – can be found as a matter of law, they face a particularly heavy burden. As the court observed in *Meyer Farms,* Inc. *v.* Texaco *Producing,* Inc., 1999 WL 125725 (Tex. App. – Amarillo 1999, rev. denied): "when a party moves for summary judgment on the affirmative defense of ratification, the burden is particularly onerous since ratification hinges on a question of intent." *Id.* at * 5 (citing *The Atrium v. Kenwin Shops of Crockett,* Inc., 666 S.W.2d 315,318 (Tex. App. – Houston [14th Dist.] 1984, writ ref'd n.r.e.) (citing *Sawyer v. Pierce,* 580 S.W.2d 117, 123 (Tex. Civ. App. – Corpus Christi 1979, writ ref'd n.r.e.))).

II. <u>The Panel Should Deny Respondents' Motion as to Grigsby's Shareholder Oppression Claim</u>

The vast majority of Respondents' motion is devoted to attempting to convince the Panel that Grigsby's shareholder oppression claim is barred by ratification and waiver or release. Grigsby's shareholder oppression claim represents only one facet of only one of his claims: the claim for breach of fiduciary duties. See Grigsby' Third Amended Statement of Claims, Cause of Action E, ¶¶ 66, 68-70. At the end of their motion, as an afterthought, Respondents allot two pages to the claim that Grigsby has also somehow ratified or waived his far more numerous fraud claims based on state and federal securities laws, Section 27.01 of the Texas Business and Commerce Code, and common law fraud. See Motion at 28-29. Therefore, Grigsby will also address Respondents' arguments as to oppression and fraud separately.

A. **Respondents Have Not Shown Grigsby's Ratification In Light of the Law Governing Ratification and Breach of Fiduciary Duty**

Respondents' motion is crucially deficient in its failure to account for the differences in how the principle of ratification is applied in cases of fiduciary breach. The cases they cite do not involve breaches of fiduciary duties, but rather ordinary contractors, at-will employees, and arms-length litigants who signed settlement agreements containing releases.[3] However, two principles of ratification in the special context of fiduciary duties – that a beneficiary cannot ratify a fiduciary's breach committed against the beneficiary's interests, and that the beneficiary is permitted to act to avoid loss – preclude granting Respondents' motion.

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3 *See Old Republic* Ins. Co., Inc. *v. Fuller, 919* S.W.2d 726 (Tex. App. – Texarkana 1996, writ denied) (settlement agreement of worker's compensation claim); Furnace *v.* Furnace, 783 S.W.2d 682 (Tex. App. – Houston [14th Dist.] 1989, writ dism'd w.o.j.) (contract for stock sale); *First Texas Sav. Ass'n of Dallas v. Dicker Center, Inc., 631* S.W.2d 179 (Tex. App. – Tyler 1982, no writ) (release and indemnity agreement); *Pack v. City of Fort Worth,* 552 S.W.2d 895 (Tex. Civ. App. – Fort Worth 1977, writ ref'd n.r.e.) (employee suit to rescind retirement agreement); *Shaddock v. Grapeffe Co., 259* S.W.2d 231 (Tex. Civ. App. – Waco 1953, no writ) (arms-length buyer and seller); *Hall v. Odiorne,* 14 S.W.2d 870 (Tex. Civ. App. – Austin 1929, writ dism'd) (ordinary contract); *Gibson v. Lancaster, 39* S.W. 1078 (Tex. 1897) (sales contract); *Uhreck v.* Houston *Light & Power Co., 997* F. Supp. 789, 795 (S.D. Tex. 1998) (release agreement); *United States v. McBride,* 571 F. Supp. 596, 613-14 (S.D. Tex. 1983), *aff'd,* 915 F.2d 1569 (5th Cir. 1990) (criminal case); *Ware v. Cooper* Cameron Iron Works, 2002 WL 1274793 (W.D. La. April 24, 2002) (employee claim).

Respondents do cite four decisions from other jurisdictions involving shareholder oppression. See Motion at 18. But, since none applies Texas law, they provide little guidance about Grigsby's breach of fiduciary claims under Texas common law. Moreover, they do not discuss the rules, relied on by Grigsby herein, that ratification is ineffective when fiduciaries act at the expense of beneficiaries, or when beneficiaries mitigate their losses. Indeed, the two more recent of these four cases do not discuss ratification at all. See *Ingle v, Glamore Motor Sales Inc., 538* N.Y.S.2d 771, 774 (NY 1989) (majority shareholders permitted to fire minority shareholder and thereby acquire his stock because of at-will employment agreement; no discussion of ratification); Jackson v. St. Regis Apartments, 565 S.W.2d 178, 183 (Mo. Ct. App. 1978) (no discussion of ratification or fiduciary duties); *Murtland Holding Co. v. Egg Harbor Commercial Bank,* 196 A. 230, 234 (NJ Ct. Chanc. 1938) (no discussion of fiduciary duties); *Trounsfine v. Remington Rand,* 194 A. 95 (discussing acquiescence and speculative delay).

Respondents' motion does not challenge Grigsby's position that Respondents owed him fiduciary duties at all times and at least until May **11,** 2001, when the RTA was executed. See, e.g., *Hollis v. Hill*, *232* F.3d 460 (5th Cir.2000) (duty between controlling and minority shareholders in close corporations same as that between partners); *DeBord v.* Circle Y **of** Yoakum, **Inc.,** 951 S.W.2d 127,133 (Tex. App. – Corpus Christi 1997), *rev'd* on other *grounds,* 967 S.W.2d 352 (Tex. 1998) ("Majority shareholders are sometimes said to stand in a fiduciary relationship both with the corporation which they control and with the minority shareholders. *Pepper v. Litton,* 308 U.S. 295, 306-07 (1939). This is especially true when the corporation is closely held by a small number of shareholders who operate more as partners than in strict compliance with the corporate form").

Respondents' fiduciary duties included at least the basic obligations to: (i) disclose all material information to Grigsby, (ii) refrain from freezing him out of the companies by firing him and threatening to withhold salary and dividends, and (iii) pay a fair price for his shares and partnership interests. See, e.g., *Hollis,* 232 F.3d at 512-15 (discussing freeze outs); In *re Bennett, 989* F.2d 779, 787 (5th Cir. 1993) ("the specific duties imposed by the Texas courts on managing partners pursuant to this line of cases are the same as those imposed on trustees. They include the duty of loyalty, and the duty to 'deal with one another with the utmost good faith and most scrupulous honesty"'); *Johnson v. Peckham,* 120 S.W.2d 786, 787 (1938) (discussing duties owed by partners when buying each other out: good faith, full disclosure, and payment of fair consideration).

Two principles applicable to ratification in the context of fiduciary duties require denial of Respondents' motion. The first of these dictates that a fiduciary cannot claim ratification of actions taken to benefit himself, and which injure the beneficiary. For example, in *Herider* Farms - *El* Paso, Inc. v. *Criswell,* 519 S.W.2d 473, 477-8 (Tex. Civ. App. – El Paso 1975, writ ref'd n.r.e.), where the Court of Appeals reversed a summary judgment based on ratification, plaintiff's general manager conspired to take over his employer's business by arranging to lease the premises himself and secretly inducing employees to go to work for him instead of plaintiff. See *id.* at 475-76. Faced with this coup, plaintiff agreed to sell the business to his manager for less than its true worth. See id. Once sued, the manager made exactly the arguments Respondents urge here: that the plaintiff knew all of the facts surrounding the squeeze-out but elected to take the benefits of the sales contract instead, barring a subsequent suit. The Court of Appeals disagreed:

> [R]atification can only be effectual between the parties involved when the agent's act is done openly and admittedly for the principal, and not when done for the agent's expressed benefit or for some third party . . . Certainly any tort committed by Criswell was not for the benefit of Herider. Thus, the defense of ratification has not been established as a matter of law.

Id. at 477-78.

Like Herider, Grigsby was coerced through Respondents' breaches of their fiduciary duties into selling out for an unfair price. Both Herider and Grigsby knew the facts surrounding their oppression claims when they began accepting payment for their interests. Nonetheless, because the acts giving rise to suit were so blatantly taken in the interests of the fiduciaries, and at the expense of the beneficiaries, the defense of ratification is unavailable.

Spangler *v. Jones*, 861 S.W.2d 392, 396 (Tex. App. – Dallas 1993, writ denied), is to the same effect. In Spangler, a minority shareholder in a closely held corporation alleged that a fellow shareholder breached fiduciary duties to him by negotiating an unfairly priced sale of their business and presenting it him as a deal that "can't be changed" – an allegation strikingly similar to McEntire's insistence to Grigsby on the night of April 30 that the buy-out was "take it or leave it" and that there were no other buyers. *See id.* at *394; see also Spangler v. Jones,* 797 S.W.2d 125, 127-29 (Tex. App. – Dallas 1990, writ denied) (detailing facts). Plaintiff knew of the coercion as it happened; consented to the sale, though he protested in the form of a letter he asked his fellow shareholders to sign; took its benefits; and later sued for breach of fiduciary duties. See *id.* The jury even found Spangler ratified. See 861 S.W.2d at 394.

On appeal, however, the *Spangler* Court reversed and made clear that any ratification was ineffective because the defendant's acts were in his own interests and at the expense of the fiduciary's: "Under the reasoning of *Herider Farms* and *Vessels* [*v. Anschutz* Corp., 823 S.W.2d 762 (Tex. App. – Texarkana 1992)], Spangler's signing the sale agreement and accepting its benefits did not bar him from bringing his tort claims against Jones." *Id.* at 395. Speaking of constructive fraud, a species of breach of fiduciary duty, the Court observed: "Thus, when the jury found that Jones breached his fiduciary duty to Spangler, it necessarily found that Jones committed constructive fraud against him, which, as noted in *Herider Farms*, ***is incapable of being ratified."*** *Id.* at 396 (emphasis added); *accord General Dynamics v. Torres,* 915 S.W.2d 45, 50 (Tex. App. – El Paso 1995, writ denied) (no ratification of that not done for fiduciary's benefit; "the rule in Texas

[is] that ratification is not available to condone a corporate officer or director's disloyalty or fraud"). Here too, Grigsby protested at the time of sale by strenuously objecting to McEntire. He protested after April 30, 2000 to Jamail and McEntire. And here too, Respondents acted in their own interests and at the expense of Grigsby's. Thus, any claimed ratification is inoperative.[4]

A second principle unique to ratification in the context of fiduciaries that defeats Respondents' motion is the right of beneficiaries to mitigate their losses when confronted with their former partners' breaches. According to the Restatement (Third) of Agency, § 4.02 (T.D. No. 2, 2001), "ratification is not effective . . . in favor of an agent against a principal when the principal ratifies to avoid a loss." Texas cases have reached similar conclusions. In *Vanasek v. Underkofler*, 50 S.W.3d 1 (Tex. App. – Dallas 1999), *aff'd in part, rev'd in part on other* grounds, 53 S.W.3d 343 (Tex. 2001), a client sued his lawyer for breaching his duties by arranging a disadvantageous settlement. The lawyer asserted the affirmative defenses of, *inter alia*, waiver, estoppel, ratification, compromise and settlement and election of remedies on the ground that the client "made a knowing choice to settle the case instead of try it to completion." Id. at 14-15. The Court of Appeals rejected all of these defenses and reversed a summary

[4] A similar principle, also applicable here, is that one with unclean hands cannot call upon equitable defenses such as estoppel and ratification. See, *e.g., Greater Ft. Worth and Tarrant County Community Action Agency v. Mims, 627 S.W.* 2d 149, 151 (Tex. 1982) (ratification an equitable defense); *Hughes* v. *Aycock*, 598 S.W.2d 370, 375 (Tex. Civ. App. – Houston [14th [Dist.] 1980, writ ref'd n.r.e.) (those with unclean hands may not take advantage of equitable defenses like estoppel); *Fidelity Management & Research Co. v. Ostrander,* 662 N.E.2d 699,704 (Mass. App. 1996) (ratification defense unavailable to defendant with unclean hands). By proving Respondents' fiduciary breaches at trial, Grigsby will establish their unclean hands and their disentitlement to reliance on a defense of ratification.

judgment because the client "maintain[ed] that [the lawyer's] acts and omissions forced him into the subsequent settlement in mitigation of his damages caused by [the lawyer's] malpractice." Id. at 15.

Similarly, in *Herider* Farms, the Court noted, as part of its discussion rejecting ratification, that it could not "conclude as a matter of law that one who has within a period of three or four days lost his lease, lost his general manager and all employees and is probably about to lose all of his customers consents to the conduct which brought about such losses merely because he concludes that it is economically feasible to make the best deal possible." 519 S.W.2d at 477-78.

This principle has also been applied outside of the context of fiduciary breaches. In *Landrum v. Davenport,* 616 S.W.2d 359 (Tex. App. – Texarkana 1981), the Court of Appeals reversed a directed verdict granted on the basis of ratification, where a buyer paid more for a car than he believed he was required to under a previously negotiated sales contract:

> If Landrum did not intend to make a new agreement [to pay the higher price], but only out of necessity in order to avoid a loss of his bargain paid the higher price under protest and while insisting upon his rights, his act would not amount to a ratification or waiver. ***Intention to ratify or waive cannot be inferred from acts where, under the exigencies of the case, the party had no satisfacto y alternative.***

Id. at 363 (emphasis added) (citing Tex. Bus. & Corn. Code Ann. § 1.201; Jon-T *Farms,* Inc. *v. Goodpasture,* Inc. 554 S.W.2d 743 (Tex. Civ. App. – Amarillo 1977, writ ref'd n.r.e.); *Mayhew & Isbell Lumber Co. v. Valley Wells Truck Growers Ass'n,* 216 S.W. 225 (Tex. Civ. App.-San Antonio 1919, no writ); 13 Tex. Jur. 2d Contracts § 330 at 594-95; 17 Am. Jur.2d Contracts § 395 at 840-41)). And in

Andrews v. Powell, 242 S.W.2d 656,661 (Tex. Civ. App. – Texarkana 1951, no writ), appellant failed to convince the court that appellee, after learning of the fraud, ratified a contract to rent and an option to purchase real property by selling an option to purchase the property to a third party:

> Efforts by appellee to sell the property to outside parties should be considered in the light of the situation existing at that time. If he could do this and satisfy appellant on his price and terms, he might thereby settle a controversy and mitigate appellant's damages, both of which are favored by the law. It would be a harsh rule, indeed, to hold that appellee, after being placed in a worsened condition through appellant's deception, could not even attempt to rescue himself and his property without at the same time abandoning all claim for his loss. It would be a severe penalty inflicted upon one who, after trusting the defrauding party, finds himself enmeshed in a situation from which he dare not even attempt to extricate himself. Appellee did nothing that placed appellant in any worse position.

Id. at 661.

Cases from other jurisdictions also follow this mitigation of loss rule. In *Delano v. Kitch, 663* F.2d 990 (10th Cir. 1981), *cert. denied 450* U.S. 946 (1982), plaintiffs were minority stockholders in a closely held corporation complaining of the broker's fee the company's lawyer took in arranging a sale of the company. The Court invoked the Restatement to reject the defendant's ratification defense:

> Kitch argues no violation because the plaintiffs in effect ratified his actions: if he owed a duty to plaintiffs, they consented to his finder's fee by selling their stock; they could have avoided contributing to his fee by simply retaining their stock in the corporation. . . . ***Ratification is not effective in favor of the fiduciary and against the beneficiary if the beneficiary must act to protect his or her own interests or acts under duress imposed by the fiduciary.*** Cf Restatement (Second) of Trusts § 218(2)(c) (1959) (trustee cannot obtain beneficiary's ratification trough improper conduct); Restatement (Second) of Agency §§ 101,462 (1957) (agent cannot force principal to ratify under duress). Plaintiffs acted under duress and to protect their interests. They learned of the contract after a majority had already agreed to it and when they had only ten days to decide whether to participate. If they did not

> sell, plaintiffs would find themselves in a significantly different position: although still minority shareholders, they would no longer be involved in a family-owned company in which no one person owned a majority, but in a company controlled by a newspaper conglomerate.

Id. at 999 (emphasis added); *accord Williams v. Nat'l Housing Exchange, Inc.*, 949 F. Supp. 646, 650 (N.D. Ill. 1996) ("ratification does not occur where a principal must affirm a transaction to protect his own interests"); *Bingham v. Zolt*, 823 F. Supp. 1126, 1132 (S.D.N.Y. 1993) ("In this case, there is ample evidence that any action taken by the Estate [to ratify] was necessary to protect its own interests and avoid further loss"), *aff'd* 66 F.3d 553 (2d Cir. 1995), *cert. denied* 517 U.S. 1134 (1996).

Grigsby's actions in accepting payments under the LO1 and RTA and otherwise attempting to enforce these instruments presents a textbook case of why ratification should not be found where the beneficiary acts to avoid or mitigate his loss. As in *Landrum,* Grigsby's so-called ratification occurred "under protest and while insisting upon his rights" to both McEntire and Jamail. 616 S.W.2d at 363. If Grigsby had not reluctantly acceded to Respondents' coercion at the same time he protested vociferously to McEntire, signed the LO1 and accepted payments, he would have faced the typical lot of the oppressed and frozen out minority shareholder: deprived of income from the business, (because the Respondents threatened to refuse to make distributions), under great financial strain (due among other things to massive tax liabilities stemming from ProTrader's profits), and utterly powerless to ensure the proper administration of his investment (including compliance with the securities laws). See, e.g., *Hollis,* 232 F.3d at 512-15. This substantial loss stared Grigsby in the face on the night of

April 30, 2000, and the law permits Grigsby to mitigate his damages without waiving legal remedies or ratifying Respondents' fiduciary breaches.

By contrast, Grigsby's acceptance of payments does not prejudice Respondents at all. As in *Powell,* Grigsby's acceptance of payments has not "placed [Respondents] in any worse position." 242 S.W.2d at 661. Respondents fully agree that Grigsby is entitled to *at least* his payments under the LO1 and RTA. The only dispute is whether Grigsby is entitled to *significantly more* because of Respondents' oppression and concealment of the Instinet sale negotiations. Under these circumstances, Grigsby, like the plaintiffs in the cases cited above, had every right to act to avoid future loss, mitigate his damages, and bring suit at a later date within the limitations period.[5]

B. Grigsby Need Not Have Tendered Back the Payments Accepted Under the LO1 and RTA In Order to seek Rescission of These Agreements

Just as Grigsby was entitled to act to avoid or mitigate his loss without fear of ratification, the law does not require the absurdity of Grigsby offering to return payments to Respondents that even they acknowledge he is entitled to keep whether he wins or loses this lawsuit.

Respondents cite cases for the proposition that, to effectively rescind the LOI and RTA, Grigsby was required to restore the status quo *ante* by returning or offering to return the payments he accepted under the LO1 and RTA in order to

5 In support of their motion, Respondents also refer to the doctrines of speculative delay, laches and quasi-estoppel. See Motion at 19-20. Invocation of these doctrines adds nothing to Respondents' argument, however, which is the same regardless of the label. Respondents do not argue that different legal principles govern these related defenses, and Grigsy's response to them is consequently the same: under the facts of this case, and given his particular status as Respondents' beneficiary, his actions after April 30, 2000 and May 11, 2001 do not waive or bar his claims as a matter of law.

seek rescission of these instruments. See Motion at 14-16. But in this case, as noted above, there is no dispute that Grigsby is entitled to keep at least what he has already been paid by Respondents, any remaining payments under the RTA, and substantially more if the Panel finds in his favor. Given this agreement between the parties, it would be ridiculous to hold that Grigsby had to return LO1 or RTA payments when he will end up with those sums regardless of the outcome of the litigation. Nor does Texas law compel that bizarre result.

A party will not be estopped from seeking rescission based on his failure to return (or offer to return) the property or assets underlying the contract at issue if the particular circumstances indicate that doing so would not yield the more equitable result. See, e.g., *Ghidoni v. Stone Oak, Inc., 966* S.W.2d 573, 587 (Tex. App. – San Antonio 1998, pet. denied); *Boyter v. MCR Construction Corp.,* 673 S.W.2d 938, 941 (Tex. App. – Dallas *1984); Turner v. Houston Agricultural Credit Corp.,* 601 S.W.2d 61, 65 (Tex. App. – Houston [lst Dist.] 1980, writ ref'd n.r.e.); *McDonald v. Simons*, 280 S.W.2d 571, 573 (Tex. Corn. App. 1926). For example, in *Shenandoah Associates v. J & K Properties, Inc.*, 741 S.W.2d 470 (Tex. App. – Dallas 1987, writ denied), the Court of Appeals affirmed the rescission of a sales contract despite plaintiff's failure tender back benefits received under the contract because "a recognized exception to this rule [requiring restoration of the status quo *ante]* is when the purchaser terminates the contract and the court has examined the circumstances and determined that it would be more equitable to grant the rescission without the complete or partial restoration of the consideration." *Id.* at 476.

Similarly, in Pope v. *Darcey,* 667 S.W.2d 270 (Tex. App. – Houston [14 Dist.] 1984, writ ref'd n.r.e.) the court recognized that restoration of the status quo ante could be accomplished through the court's judgment:

> As a general rule, one seeking equity must do equity, and therefore one seeking cancellation of an instrument should offer or tender the consideration received. *Sudderth v. Howard, 560* S.W.2d 511, 516 (Tex. Civ. App. – Amarillo 1977, writ ref'd n.r.e.). However, the court may accomplish this result by its judgment. *Id.* The trial court here ordered Parsons to pay appellant the $27,500 he paid Boekelman plus interest from the date of the earnest money contract. We therefore find that the trial court properly cancelled the contract.

Id. at __. These principles also apply to settlement agreements and releases:

> The [rule requiring tendering back consideration prior to an action for rescission] is a rule of equity, and not a fixed rule of universal application. For example, in a common law action for damages for personal injuries and to cancel a release and settlement agreement executed by the plaintiff and the defendant, it is well established in this jurisdiction that such tender or offer to tender is not required. *Smith v. Atchison, T. & S.F.R.* Co., Tex. Corn. App., 232 S.W. 290; *Texas & P.R.* Co. *v.* lowers, 110 S.W. 946, writ refused; *International & G.N. R. Co. v. Shuford,* 36 Tex. Civ. App. 251, 81 S.W. 1189, writ refused; *Galveston, H. & S.A. R.* Co. *v. Cade,* Tex. Civ. App., 93 S.W. 124, writ denied.
>
> In such case the facts entitling a plaintiff to have the release cancelled negative the existence of any duty to tender back, for he is not entitled to have it cancelled unless he establishes injury, that is, that he has received less than he was entitled to receive. Manifestly, if he establishes that fact, no duty would rest upon him to make a tender. The rights of the defendant can be protected in the judgment by allowing a credit for the payment theretofore made. Similarly, in cases like the instant one, in order for a plaintiff to recover he must establish that he has been injured, that is, that he has a meritorious claim for compensation in an amount greater than that which he has received, and if he makes that proof, he should not be required to make a tender. The difference between the two classes of cases lies in the fact that no relief can be granted in cases like the instant one other than that of cancellation.

Texas Emp. Ins. Ass'n v. Kennedy, 143 S.W.2d 583, __ (1940).

The more equitable and rational result in this case would be for the Panel to simply restore the status quo ante between Grigsby and Respondents in its final judgment and award. Requiring the entirely artificial result of having Grigsby tender back payments that the Respondents will ultimately just hand back over to him, as a prerequisite to allowing him to pursue his claims for rescission, would be both inequitable and absurd. That is especially true because Grigsby has been forced to expend most of the money received as payment on legal fees to pursue recovery for Respondents' many violations of law. See, e.g., *Pattison v. Highway Ins. Underwriters*, 278 S.W.2d 207, 212 (Tex. Civ. App. – Galveston 1955, writ ref'd n.r.e.) (enough for plaintiff to plead and prove he could not return consideration); *Turner*, 601 S.W.2d at 65 (more equitable result is to forego tendering back consideration "where a defrauded party's inability to make restoration is due to the wrongful conduct of the fraudulent party"). The Panel should reject Respondents' argument that Grigsby's rescission claim is barred by his failure to return or offer to return LO1 and RTA payments.

C. <u>The Continuing Nature of Respondents' Oppression Precludes Summary Tudament</u>

The Panel should also deny Respondents' motion because it completely ignores the continuing nature of their shareholder oppression. Respondents conveniently assume – based largely on a misreading of Grigsby's deposition testimony – that the oppression they are alleged to have engaged in ended in May 2000 when Grigsby first accepted a dividend payment following the reorganization, and that Grigsby's actions thereafter must therefore constitute ratification of all that came before and after. That reading of the facts and

Grigsby's allegations is both self-serving and incorrect. In reality, Respondents have never lifted their oppressive conduct or offered to resume treating Grigsby lawfully. As a result, the oppression at issue in this case is continuing, and the law of ratification is clear that there can be no ratification until the conditions causing the duress or oppression are removed.

"The effect, as such, of the alleged ratification of a contract induced by duress has been denied where it appears that at the time of the alleged ratification, or up to the time that repudiation is sought or that duress is urged as a defense, the duress that originally induced the contract has continued to operate." 77 A.L.R.2d 426, § 11. Texas courts have adopted this elementary principle. For example, one of the decisions on which Respondents rely, United *States* v. *McBride,* 571 F. Supp. 596 (S.D.Tex. 1983), holds that "[t]he essential elements of ratification are the removal of duress and an intent to ratify." Id. at 613. As the Court similarly observed in *Meyer Farms,* Inc., in reversing a summary judgment granted in part on the basis of ratification, "where there is a counter-allegation of duress, the party asserting ratification must also show that there has been a removal of the conditions causing the duress." 1999 WL 125725 at * 5; see *also Hall* v. *Ordione,* 14 S.W.2d 870, 872 (Tex. Civ. App. – Austin 1929, writ dismissed) (emphasis added) ("the law is settled that a contract made under duress . . . may be ratified by the injured party *after the duress has been removed");* *Shelton* v. *Trigg,* 226 S.W. 761, 775 (Tex. Civ. App. – Amarillo 1921) ("a contract obtained under duress cannot be ratified by the servient party unless the so-called ratification is after all pressure and coercion have been removed"), *rev'd on other grounds, 249* S.W. 209 (Tex. 1923).

While Respondents appear to concede the legal point that their oppression must have lifted before Grigsby's alleged ratification could become effective, see Motion at 12 (emphasis added) ("one may not avoid a contract on the grounds of duress if, *after* the duress is removed, the Plaintiff ratifies the contract"), their motion assumes there is no fact question about whether the oppression that gave rise to the LO1 and RTA continued to operate after May 2000. They base this assumption on the fact that, because Grigsby received a partnership distribution that month and later began receiving monthly payments, his financial hardship ended. See Motion at 6, 16. For support, they cite the following passage in his deposition:

> Q: When did the financial duress that you claim you were under as of April 30, 2000 end?
>
> A: Part of it ended on May 5, 2000. Part of it ended on May 19, 2000.
>
> Q: When you received the benefits of the Binding Letter of Intent, correct?
>
> A: When I received my money as we distributed it in the reorganization. It was my money.

Grigsby Depo., Exh. 3 at 343.

It is true, of course, that Grigsby's financial situation improved when he received the dividends, but this did not end Respondents' shareholder oppression. That oppression had a variety of elements, including the ouster of Grigsby from his positions with the companies; the elimination of his salary; the refusal to continue to treat him as a director as his attorney requested by letter in August 2000; the refusal to keep him informed about the companies in general and the negotiations with Instinet in particular (as his lawyer also demanded); and the fact that Respondents paid an unfair price for Grigsby's interests and never offered to pay a fair price (or the difference between the inadequate consideration offered on April 30, 2000 and a fair price). Respondents never reverted to treating Grigsby as a beneficiary, neither before April 30, 2000, when their oppression began, nor after that date, when it continued as it had before. Indeed, because Respondents never changed their way of dealing with Grigsby, it is clear that, had Grigsby returned the dividend and monthly payments as Respondents argue he should have, the financial pressure would have existed exactly as before, with Grigsby facing tax liabilities and no distributions to cover them. That is not a cessation of oppression or duress. To avail themselves of any claimed ratification, Respondents were required to treat Grigsby in a lawful manner, i.e., to stop the freeze out and to treat Grigsby as they had before it began. A fiduciary may not freeze out a beneficiary, pay an unfair price for the beneficiary's interest, maintain the freeze out, and then claim the oppression or duress is over simply because the inadequate consideration has been conveyed. That inadequate consideration is part and parcel of the oppression – not its remedy.

That the mere conveyance of unfair consideration does not suffice to lift shareholder oppression as a matter of law, as Respondents argue, is confirmed by the decision in *Meyer Farms.* There, the plaintiff contracted to sell gas to Texaco and alleged that Texaco breached their contract by claiming the right to change the sales price when it became unprofitable for Texaco. See id. at * 1. After Texaco notified plaintiff of its intention to pay a lower price for plaintiff's gas, plaintiff and Texaco negotiated new prices and then performed under their new agreements for four years. See id. When Plaintiff sued on the original contract, Texaco claimed ratification and obtained summary judgment. The Court of Appeals reversed, however, because Texaco had not shown as a matter of law that its duress – which consisted of its insistence on the illegal pricing structure instead of paying what plaintiff deserved under the original contract, see id. at "3 – had been removed: "Texaco had to show that the alleged duress was not in place when the ratification occurred. Consequently, Texaco did not conclusively establish every element of the defense of ratification." Id. at * 5.

Just as Texaco did not remove its duress merely by negotiating new agreements and paying the plaintiff in Meyer Farms consideration, neither did Respondents cure their duress by paying Grigsby the unfairly low consideration specified in the LOI. As long as Respondents continued to "threaten[] to do something [they] had no legal right to do," id. at *3, they failed to remove their oppression irrespective of the sums paid to Grigsby under the tortious LOI. Grigsby's supposed ratification was therefore ineffective, and as a result, the Panel should deny Respondents' motion.

D. <u>The Releases Contained in the LO1 and RTA Do Not Bar Grigsby's Breach of Fiduciary Claim</u>

Respondents also argue that the releases contained in the LOI and RTA bar Grigsby's claim for breach of fiduciary duties. See Motion at 21-27. This argument is meritless.

In the first place, Grigsby did not sign any document containing a release until he signed the RTA on May 10, 2001. Respondents misleadingly imply that the LO1 somehow acts to release Grigsby's claims against them, see Motion at 5 ("The BLI irrevocably committed all parties to a binding release"); 21 (same). But the LO1 does not contain a release – it simply provided that *"[u]pon the execution* of the *Redemption Agreement,* the parties will enter in Mutual Releases." Motion, Exh. 8 at 2 (emphasis added). Thus, the LO1 does not feature a release; it declares that if and when the parties execute an RTA, that instrument will contain a release. The LOI, then, cannot operate to release any of Grigsby's claims.

Second, as to the release contained in the RTA, Respondents make exactly the same argument about its ratification as they do earlier in their motion about ratification of the oppression surrounding the LO1 and RTA: that Grigsby's acceptance of benefits after supposedly learning of voidability constitutes ratification. See Motion at 22-27. This is to be expected, since releases are simply contracts and are judged by the same principles. See Williams v. *Glash,* 789 S.W.2d 261, ___ (Tex. 1990) ("Under Texas law, a release is a contract and is subject to avoidance, on grounds such as fraud or mistake, just like any other contract"); Grimes *v. Andrews,* 997 S.W.2d 877 (Tex. App. – Waco 1999) (same). Other than the special principles that favor beneficiaries where breaches of fiduciary duties are at stake, ratification does not operate differently when applied to an ordinary contract like the LO1 on the one hand, and a release like that contained in the RTA on the other. See *id.* Thus, Respondents' RTA release/ratification argument – that Grigsby's retention of a letter of credit to secure RTA payments and retention of the payments themselves from May to September 2001 ratifies the RTA's release – is subject to precisely the same deficiencies as Respondents' more general ratification argument that Grigsby's retention of the post-reorganization dividend and monthly payments from May 2000 to May 2001 ratifies their oppression before and after execution of the LOI.

In other words, just as the fact that Respondents acted in their own interests and at Grigsby's expense makes any ratification of their oppression inoperative, it has the same effect on the supposed ratification surrounding the RTA's release. See Point II(A), *supra*. Likewise, the principle that beneficiaries may act to avoid or mitigate their losses without ratifying means that Grigsby's retention of payments after execution of the RTA is not ratification of that instrument's release. See Point II(B), *supra*. In addition, the fact that Respondents' oppression continues to injure Grigsby until they resume treating him as a beneficiary, and that Grigsby cannot be said to have ratified their breaches until he accepts benefits after this occurs, mandates rejection of Respondents' ratification of the release argument. In sum, because Respondents' argument regarding the RTA release and acceptance of benefits is indistinguishable from their other ratification arguments, the Panel should reject it for the same reasons, discussed more fully in Points II(A) through II(C) above.

Finally, as Respondents correctly anticipate in their motion, Grigsby alleges that the RTA and its release were procured by fraud. See Motion at 22. Respondents concede that a release, like any other contract, is void if fraudulently induced, but argue the factual point that "Grigsby did not act promptly to rescind the RTA (and its release)." Id. Respondents' argument that Grigsby ratified their fraudulent procurement of the RTA and its release by his actions after May 11, 2001 is discussed in Section III, *infra*. As is set forth fully there, Grigsby did not ratify the RTA as a matter of law. Rather, he almost immediately put Respondents on notice that his continued acceptance of monthly payments was conditional; attempted to learn more about the Instinet transaction; and, the first time Respondents claimed that acceptance of payments would, in their view, constitute ratification, Grigsby began returning them. These facts will not support a finding of ratification at trial – much less such a finding as a matter of law. Thus, because there is at least a factual issue concerning whether Grigsby's conduct after May 11, 2001 ratified the RTA and its release, as set forth below, the Panel cannot grant summary judgment on the basis of the release.

III. Grigsby Has Not Waived His Fraud Claims By Virtue of His Actions After Signing the RTA

At the end of their motion, in the final two pages, Respondents also take a stab at arguing – not just that Grigsby ratified their oppression by his conduct after signing the LO1 – but that he also ratified their fraud in concealing the Instinet sales negotiations by accepting benefits and performing following his signature of the RTA in May 2001. See Motion at 28-29. Respondents allow as how the facts supporting this contention are "somewhat less dramatic," Motion at 28, but believe they establish ratification as a matter of law in any event. The Court should reject this half-hearted attempt to evade liability for Grigsby's various securities, statutory and common law fraud claims.

As an initial matter, all of Grigsby's arguments set forth at length above – that ratification is ineffective where fiduciaries act at the expense of beneficiaries, that beneficiaries are permitted to mitigate their losses without ratifying, and that Respondents have not removed their duress – apply with equal force to

Respondents' claim that Grigsby ratified the fraud by his actions after signing the RTA.

Second, Respondents overlook that ratification is not a valid defense to federal or state securities fraud actions because both the federal and Texas statutes contain anti-waiver provisions. See 15 U.S.C. § 77n; TEX. CIV. STAT. ANN. art. 581-33(L); *Haralson v. E.F. Hutton Group, Inc.,* 919 F.2d 1014, 1034 (5th Cir. 1990) ("Both federal and Texas laws void express waivers of rights under their securities laws. 15 U.S.C. § 77n; TEX. CIV. STAT. ANN. art. 581-33 L (Vernon Supp.1991). These anti-waiver provisions void waivers of rights by subsequent conduct"); *Duperier v. Texas State Bank,* 28 S.W.3d 740, 753 (Tex. App. - Corpus Christi 2000) (citations omitted) (ratification ineffective against Texas Securities Act and statutory fraud actions: "The common law defense of ratification will not save a transaction which violates a statute. In addition, ratification is not a defense available under the Act"); *Insurance Co. of North America v. Morris, 928* S.W.2d 133, 154 (Tex. App. - Houston [14th Dist] 1996) (common law defenses of estoppel and ratification unavailable in Texas Securities Act actions). Likewise, ratification is ineffective as to statutory fraud claims. See *Duperier,* 28 S.W.3d at *753.*

As to Grigsby's common law fraud claims, Respondents acknowledge, of course, that the RTA and release are void if procured by fraud. See Motion at 28-*29; Williams, 789* S.W.2d at *264; Lesbrookton, Inc. v. Jackson, 796* S.W.2d 276, 287 (Tex. App. - Amarillo 1990, writ denied). Moreover, as a matter of law, a release agreement cannot release a claim of fraudulent inducement to the agreement itself. See *Texacadian Fuels, Inc. v. Lone Star Energy Storage, Inc., 896* S.W.2d 233, 236 (Tex. App.-Houston [1st Dist.] 1995, writ granted without regard to merit). Instead, Respondents argue that Grigsby ratified the fraud. The party asserting ratification as a defense has the burden to prove that the plaintiff had full and complete knowledge of the fraudulent acts at the time of ratification. See *Johnson v. Smith, 697* S.W.2d 625, 630 (Tex. App. – Houston [14th Dist.] 1985, no writ); *Spangler,* 797 S.W.2d at 131. As one court held in rejecting a ratification defense where the plaintiff accepted a $332,200 payment after alleging and making inquiries of fraud:

> McGee must have had full knowledge of the fraudulent acts at the time he allegedly ratified. The burden is on Lone Star and deGraye to prove full knowledge of the fraud and to prove a voluntary, intentional choice to ratify the release agreement in light of that knowledge. In a summary judgment context, evidence favoring Lone Star's and deGraye's claim of ratification cannot be considered unless it is uncontroverted.
>
> McGee had heard rumors that the project had been completed at around $47,500,000, and he directed his attorney to inquire from Lone Star whether this was true. Lone Star never answered. It appears that McGee attempted to discover whether fraud existed, but he never knew that it did. He could not have ratified the fraud until he knew of it. Notice is not equivalent to full knowledge.
>
> If any fact question exists about whether McGee intended to waive the fraud claim through ratification, the summary judgment cannot be granted on this ground.

Texacadian Fuels, 896 S.W.2d at 236-7.

In this case, Respondents assert that "Grigsby with full knowledge elected to accept benefits under the RTA after learning of the potential sale of ProTrader to Instinet." Motion at 28. Grigsby did not learn of Instinet's interest in buying ProTrader until the non-binding sale was publicly announced on May 11, 2001. This public announcement obviously cannot possibly have informed Grigsby that Respondents had fraudulently induced him to execute the Letter of Intent

("LOI") more than a year earlier, on April 30, 2001. The May 11 announcement gave no indication as to when acquisition discussions between ProTrader and Instinet began. And the mere fact that Instinet and ProTrader had reached a non-binding letter of intent on May 11 could not notify Grigsby that, prior to April 30, 2000, Instinet and ProTrader had signed a confidentiality agreement and had begun sales negotiations. In fact, Respondents' fraud in connection with the LO1 remained unknown to Grigsby until Respondents answered discovery requests in this lawsuit. This is confirmed by the fact that Grigsby's original petition in state court did not allege that Grigsby's execution of the LO1 was fraudulently induced; it alleged fraud only in connection with the RTA. See Plaintiff's Original Petition, Exh 13. By the time Grigsby learned of Respondents' fraud in the inducement of the LOI, he had begun the practice of returning monthly payments, and had already filed this case. Thus, neither Grigsby's acceptance of benefits nor his entry into the release contained in the RTA was done with knowledge of Respondents' LOI-related fraud, and Grigsby cannot be deemed to have ratified it.

As to whether Grigsby's conduct after executing the RTA ratified fraud in connection with the RTA itself, the only actions that occurred after the announcement of the non-binding sale which Respondents allege constitute ratification are: (1) Grigsby's acceptance of four monthly payments, (2) his lawyer's letter referring to performance under the RTA after the Instinet sale, and (3) Grigsby's acceptance of a letter of credit which Respondents were obligated to provide to Grigsby. None of these comes close to establishing ratification as a matter of law.

First, as to the payments, the first of these was wired into Grigsby's bank account only five days after the sale announcement, at a time when Grigsby was investigating the sales transaction and seeking additional information from Instinet's counsel. By the time of the next wired payment only a few weeks later, Grigsby made it perfectly clear that his acceptance could not be construed as a ratification: "I conditionally accept the wire without prejudice to my claims that I may be entitled to far greater compensation or consideration due to recently discovered material information not disclosed to me prior to execution of the settlement for which there was a fiduciary duty to disclose." Exh. 9. He did the same with the August payment. See Exh. 10. Respondents claim these communications are of no importance, see Motion at 29, but they clearly and expressly evince Grigsby's intent not to ratify or affirm the RTA. And since ratification and waiver are necessarily matters of intent, these e-mails are highly probative and serve to controvert Respondents' affirmative defenses, rendering summary judgment inappropriate. *See Texacadian Fuels, 896* S.W.2d at 237 (summary judgment inappropriate where evidence of ratification controverted).

In addition, as soon as Respondents openly took the position, however dubious, that acceptance of benefits under the RTA constituted ratification, Grigsby stopped accepting them. On September 14, 2001, for the first time, ProTrader sent Grigsby his payment with a letter expressly purporting to condition the check on Grigsby's ratification:

> The deposit, cashing, or other negotiation of the enclosed check will constitute your client's acknowledgement and affirmance of the RTA and a waiver of any assertion by Mr. Grigsby that the RTA is for any reason void and unenforceable.

Exh. 11. In response, Grigsby returned the check with a letter making it equally clear that he had no intention of ratifying: "Given the conditions in your letter attaching to Mr. Grigsby's negotiation of this check, he is of course returning it to you, and to your client." Exh. 12. Grigsby has returned all subsequent checks to ProTrader as well. In sum, Grigsby's conduct with regard to the monthly payments between May and September 2001 does not establish ratification as a matter of law. The cases cited in Sections II(B) and II(C) above represent examples where the retention and non-return of consideration did not constitute ratification, but only a permissible attempt to mitigate loss. The outcome here should be the same.

As for the second and third examples of reliance, they are even weaker than Grigsby's conditional acceptance of payments. The letter from Grigsby's counsel was written on June 4, 2001, less than a month after the potential sale was announced, and before Grigsby had gathered much information about it. Nor does simply inquiring about how the sale would "affect ProTrader's performance of the Redemption Agreement" constitute express or implicit approval of that agreement. It merely asks for more information.

Finally, Respondents note that Grigsby received a letter of credit and represented it to banks as an asset. Because Grigsby has not used the funds secured by the letter, however, it is difficult to discern how the mere holding of it constitutes acceptance of a benefit, much less ratification. And, again, there is no dispute as to Grigsby's entitlement to sums at least as great as the monthly payments secured by the letter of credit. It was therefore entirely proper, and no ratification, for Grigsby to cite the letter to banks.

Respondents have failed to establish ratification of the RTA as a matter of law. Consequently, the Panel should deny their motion as to Grigsby's fraud claims.

IV. <u>At Most, Respondents' Ratification and Waiver Defenses Could Defeat Grigsby's Request for Rescission – Not Legal Damages</u>

Finally, whatever the strength of Respondents' ratification and waiver arguments, they are, at best, applicable only to Grigsby's request for the equitable remedy of rescission. See Grigsby's Third Amended Statement of Claim at 31-32. The equitable remedy of rescission works to cancel a contract and return the parties to the status quo *ante;* where this is impossible, because of the sale of stock for instance, the plaintiff may recover rescissory damages, which remain an equitable remedy. See, e.g., *Myzel v. Fields, 386* F.2d 718, 742 (8th Cir., 1967), *cert.* denied, 390 U.S. 951 (1968). Grigsby's Third Amended Statement of Claim states claims for, *inter alia,* breaches of fiduciary duty (both fraud and shareholder oppression), common law fraud, statutory fraud, and fraud under federal and state securities laws. Since Grigsby's ownership interest in ProTrader has since been sold to Instinet, it is impossible to restore the status quo *ante* by giving him back that interest. Accordingly, Grigsby seeks recovery of his actual legal damages, and, alternatively, equitable, rescissory damages.

While Grigsby has requested both legal and rescissory damages, Respondents' ratification and waiver defense applies only to the latter, and cannot bar the former. In *Fortune Production Co. v. Conoco, 52* S.W.3d 671, 676-679 (Tex. 2000), the Texas Supreme Court confirmed that earlier courts of appeal decisions holding that ratification waived both the right of rescission and the right to sue for damages "are overstatements of the law." Id. at 678. Rather, the court made clear that actions for damages were unaffected by ratification:

> In this case, as a matter of law, the limited acts of three of the plaintiffs in ratifying contracts with a stated term did not foreclose their right to sue for fraud damages. It is undisputed that Fortune and Tucker continued to deliver their gas to Conoco and to accept payment after they learned of the fraud. But these facts, standing alone, do not result in a loss of the right to sue for damages. Fortune and Tucker had the right to sue for fraud damages to obtain the benefit of their bargain with Conoco.

Id. at 679; *accord, e.g., Gannett Co., Inc. v. Register Pub. Co., 428* F. Supp. 818, 841 (D.Conn.1977) (permitting suit for compensatory damages for violations of Section 10b of the Securities Exchange Act of 1934 and SEC Rule 10b-5 despite holding that ratification waived right to rescind).

A plaintiff's right to ratify by knowingly accepting benefits and later sue for damages applies not only to fraud claims, but also to those for breach of fiduciary duty. Thus, in *Spangler*, the court held that the jury's finding that Spangler ratified the contract did not bar his claim for damages resulting from the defendants' breaches of fiduciary duty:

> The jury's findings that Jones breached his fiduciary duty to Spangler and that the agreement was not "fair" to Spangler are sufficient to entitle Spangler to judgment. The jury's finding that Spangler ratified Jones's acts does not affect Spangler's entitlement to judgment.

861 S.W.2d at 396. Indeed, most of the duress and ratification decisions cited by Respondents make expressly clear that they are barring plaintiffs' claims for rescission, not damages.[6] And after the Texas Supreme Court's decision in

[6] *See, e.g., Ware v. Cooper Cameron Iron Works, 2002* WL 1274793 at * __ (W.D. La. 2002) ("To properly rescind the contract . . ."); *Furnace v. Furnace, 783* S.W.2d 682,686 (Tex. App. – Houston [14th Dist.] 1990) ("the trial court properly granted appellees' motion for instructed verdict against appellant's rescission claim"); *First Texas Sav. Ass'n*

Fortune Production Co., there is no doubt that Grigsby's request for compensatory and other legal damages survives any supposed ratification, even in the unlikely event that the Panel finds his claims for equitable relief do not.

CONCLUSION

For the foregoing reasons, Claimant Russell Grigsby respectfully requests that the Panel deny Respondents' Motion.

Respectfully submitted,

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of Dallas v. Dicker Center, Inc., 631 S.W.2d 179, __ (Tex. App. – Tyler 1982, no writ) ("once a contract has been ratified by the defrauded party, the defrauded party waives any right to seek rescission");; *Shaddock v. Grapette* Co., 259 S.W.2d 231,234 (Tex. Civ. App. – Waco 1953, no writ) (ratification "has the effect of waiving the right of rescission"); *Gibson v. Lancaster*, 39 S.W. 1078 (Tex. 1897) (discussing rescission).

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CLAIMANT'S RESPONSE TO RESPONDENTS' MOTION FOR PARTIAL SUMMARY JUDGMENT THATGRIGSBY'S 10b-5 CLAIMS ARE BARRED BY THE STATUTE OF LIMITATIONS

INTRODUCTION

Claimant Russell Grigsby respectfully files this Response to the Motion of all Respondents except Instinet Group, Inc. ("Instinet") for Partial Summary Judgment That Grigsby's lob-5 Claims are Barred by the Statute of Limitations. Respondents have brought this motion although – because it does not affect Grigsby's claims under the Texas Securities Act or the common law of fraud – it has no prospect of altering what Grigsby will prove at trial, the length of the arbitration, or the scope of Grigsby's remedies.

Respondents' motion is based on the fact that Grigsby first asserted claims against them under Section lob-5 of the Securities and Exchange Act of 1934 more than a year after he learned they had successfully concealed their negotiations to sell their and Grigsby's companies to Instinet. They argue that the operative statute of limitations is one year, and that the limitations period expired before Grigsby first asserted a claim under Section 10b-5.

The Panel should deny Respondents' motion for two reasons. First, Respondents have entirely ignored the well-known and long-established "relation back" doctrine. Under both Texas and Federal law, Grigsby's addition of lob-5 claims more than one year after he learned of Respondents' duplicity in concealing the Instinet sale relates back to his original petition filed in Texas State Court, which alleged the same concealment and stated state law securities fraud claims. This petition was filed well within the one-year limitations period Respondents argue applies. Thus, Grigsby's lob-5 claims relate back to the date of filing of the state court petition and are timely.

Second, Respondents also virtually ignore the fact that Congress lengthened the one-year statute of limitations that formerly governed lob-5 claims when it enacted the Public Company Accounting Reform and Investor Protection Act of 2002 (hereinafter "Sarbanes-0xley"). Respondents relegate this point to a footnote and omit mention of the one decision to have ruled on the question. That decision correctly holds that claims, like Grigsby's, brought after the effective date of Sarbanes-Oxley are governed by the new two-year statute of limitations -- which makes Grigsby's lob-5 claims timely. The Panel should hold likewise and deny Respondents' motion.

BACKGROUND

I. Summary of Facts Underlvinn Griasbv's 10b-5 Claim

Grigsby's claims that Respondents violated Section lob-5 stems from Respondents' decision to hide their sale negotiations with Instinet from Grigsby at the same time they were angling to force him out of the company he helped found. See Claimant Russell Grigsby's Third Amended Statement of Claim, ¶¶ 32-40. In April 2000, at the same time Respondents were taking steps to oust Grigsby from the ProTrader entities and acquire his interests at a grossly deflated price, they were also negotiating to sell to Instinet – the industry giant of electronic trading. See *id.*, ¶¶ 32-37. Indeed, during that month, Instinet officials came to Austin to "kick the tires" for a sale, as Respondent McEntire has described it. See *id.* at ¶ 35. As Respondents themselves characterized the Instinet negotiations during this period: "There were numerous discussions and communications with Instinet . . . [D]iscussions relating to a potential sale progressed in the Spring 2000 [sic] such that on April 14, 2000, Instinet and ProTrader entered into a confidentiality agreement to govern the sharing of any information incident to discussions relating to a potential acquisition or strategic partnership." Individual Respondents' Response to Claimant's Interrogatory 8, and ProTrader Respondents' Response to Interrogatory No. 9, quoted in *id.*, ¶ *34.* Respondents concealed these negotiations and the confidentiality agreement from Grigsby and, on Sunday night, April 30, 2000, pressured him into signing a Letter of Intent ("LOI") promising to convey his stock in the Cornerstone/ProTrader entities to new ProTrader L.P. and L.L.C. entities in exchange for Respondents' agreement to negotiate the redemption of Grigsby's interests in the new entities.

Although Grigsby remained in the dark, sale negotiations between ProTrader and Instinet proceeded through spring and summer 2000. For example, on July 6, 2000, Instinet's Chief of Staff informed Instinet's CEO and other members of the executive committee that ProTrader's "principals" were "anxious" to sell to Instinet and would take unregistered Instinet stock as consideration. See id. at ¶ 38. By early 2001, the Instinet deal was close to completion – yet Grigsby had not been bought out of ProTrader because the Respondents had refused to complete the Redemption and Termination Agreement (RTA") necessary to effectuate the LOI. See id., ¶¶ 38-42. After months of dragging the heels and trying to renegotiate the terms of the Letter of Intent, Respondents suddenly pressed Grigsby to complete the RTA. See id., ¶ 42. On May 10, 2001, that document was finally executed by Grigsby and Respondents, and Respondents acquired Grigsby's interests in the ProTrader entities. See id. *The very next day,* on May 11, 2001, Instinet and Respondents announced Instinet's acquisition of the ProTrader entities for $150 million and other consideration. See *id.,* ¶ 44. The first Grigsby heard of Instinet's interest in purchasing ProTrader came with this announcement on May 11, 2001.

II. Procedural History of Grigsby's 10b-5 Claim

In light of the facts described above, it is hardly surprising that Grigsby believes Respondents deceived and defrauded him by pressuring him to acquire his ProTrader interests without informing him of the concurrent plan to sell to Instinet. Consequently, Grigsby filed suit in District Court in Travis County on October 2, 2001. See Grigsby Original Petition (attached hereto as Exhibit 1, without exhibits). Among his factual allegations were that Respondents had concealed material information – the sale negotiations with Instinet – from him before buying his interests in the ProTrader entities. See id. at ¶¶ 25-26. Grigsby further alleged that this concealment violated, *inter alia,* Section 33(B) of the Texas

Securities Act. See id., ¶¶ 35-36. Thus, these factual allegations and legal claims put Respondents on full and complete notice of the Instinet-related fraud Grigsby complains of.

On November 21, 2002, Grigsby filed his Statement of Claim in this arbitration, including the claims for relief under Section lob-5 Respondents now seek to dismiss. The facts and dealings underpinning Grigsby's lob-5 claims, outlined above with citations to his Statement of Claim, are precisely the same ones alleged in Grigsby's state court petition, filed on October 2, 2001.[1]

ARGUMENT

I. The Summary Judgment Standard

"A defendant moving for summary judgment on a statute of limitations affirmative defense must prove conclusively that defense's elements." *O'Reilly* v. *Wiseman*, 107 S.W.3d 699, 702 (Tex. App. – Austin 2003) (citing *Velsicol Chem. Corp. v. Winograd, 956* S.W.2d *529, 530* (Tex. 1997)); *Pure Distributors, Inc. v. Baker*, 285 F.3d 150, 152-56 (1st Cir. 2002) (same standards obtain under federal law). "When reviewing a traditional motion for summary judgment . . . every reasonable inference must be indulged in favor of the non-movant and any doubts resolved in its favor." *McStay v. Heady Financial Corp.,* __ S.W.2d __, 2003 WL 21710534 (Tex. App.-Eastland, Jul 24, 2003) (citing Tex. R. Civ. P. 166a; *Goswami v. Metropolitan Savings and Loan Association,* 751 S.W.2d 487, 491 (Tex.1988); *Nixon v. Mr. Property Management Company, Inc., 690* S.W.2d 546, 548-

[1] The description of Respondents' Instinet-related concealment and fraud cited herein comes from Grigsby's more detailed Third Amended Statement of Claim, not the First Amended Statement of Claim filed on November 21, 2002, which initially asserted the lob-5 claims. But Respondents do not contend these two statements of claim differ as to the basic factual allegations underlying Grigsby's 10b-5 claim. Grigsby's Third Amended Statement of Claim simply contains more detail, as a result of the ensuing discovery.

49 (Tex.1985); *City of Houston v. Clear Creek Basin Authority, 589* S.W.2d 671, 676 (Tex.1979)). In this case, there are no disputed facts at issue; the questions are only the legal ones of whether the relation back doctrine applies, and whether a one or two year statute of limitations governs.

II. Grigsby's 10b-5 Claims are Timelv Because They Relate Back to his Timely-filed State Court Petition

As set forth in Point III, Grigsby does not agree that a one-year statute of limitations to his lob-5 claims. Even if it does, however, Grigsby's claims are timely because they relate back to his state court petition, which was filed within one year of May 11, 2001 – the date Grigsby first learned of ProTrader's Instinet-related double-dealing and the date Respondents concede is the earliest the limitations period could begin to run for purposes of this motion.

Under the Texas Civil Practice & Remedies Code, a pleading tolls the limitation period for claims asserted in a later pleading or amendment as long as the later filing does not allege a new or different transaction:

> If a filed pleading relates to a cause of action . . . that is not subject to a plea of limitations when the pleading is filed, a subsequent amendment or supplement to the pleading that changes the facts or grounds of liability or defense is not subject to a plea of limitation unless the amendment or supplement is wholly based on a new, distinct, or different transaction or occurrence.

TEX. CIV. **PRAC.** & **REM. CODE** § 16.068. Thus, for limitations purposes, the later pleading or amendment "relates back" to – and is considered as having been filed at the time of – the initial pleading. See, *e.g., Stevenson v. Koutzarov, 795* S.W.2d 313, 319 (Tex. App. – Houston [lst Dist.] 1990, writ den.); *Meisler v. Republic of Texas* Sav. *Ass'n,* 758 S.W.2d 878, 881-882 (Tex. App. – Houston [14th Dist.] 1988, no writ).

When applying Section 16.068, the test is whether the claim asserted in the later or amended pleading grows out of the previously alleged transaction or occurrence. See, e.g., *Ex parte Goad, 690* S.W.2d 894, 896 (Tex. 1985); Leonard *v.* Texaco, Inc., 422 S.W.2d 160, 163 (Tex. 1967). As the Texas Supreme Court emphasized in Goad: "If the amended motion does not allege a wholly new, distinct or different transaction, then it relates back to the original filing and is not subject to a limitations defense." 690 S.W.2d at 896 (emphasis in original). Finding there that the plaintiff's "basic complaint is still the same" as that asserted in the timely-filed pleading, the Supreme Court rejected defendant's argument. Likewise, in *Hill v. Heritage* Resources, Inc., 964 S.W.2d 89 (Tex. App. -- El Paso 1997 pet. denied), the Court of Appeals rejected a limitations defense by broadly construing the term "transaction" in Section 16.068 to mean "that set of facts which gives rise to the cause of action . . . in other words . . . the totality of events which entitle a plaintiff to bring suit." *Id.* at 121; *accord Williams v. Khalaf,* 802 S.W.2d 651, 658 (Tex. 1990) (plaintiff's fraud claims held timely, though filed six years after the alleged fraud, because they related back to earlier, timely-filed breach of contract claims arising out of the same occurrences).

The federal law of "relation back" is essentially identical to Section 16.068. Fed. R. Civ. P. 15(c) provides that an amended pleading relates back to the date of the filing of the original pleading when "the claim or defense asserted in the amended pleading arose out of the same conduct, transaction, or occurrence set forth or attempted to be set forth in the original pleading." Factors federal courts consider in determining whether a claim "arose out of the same conduct, transaction, or occurrence" include: "(1) whether the defendant had notice of the claim that the plaintiff is now asserting, (2) whether the plaintiff will rely on the same kind of evidence offered in support of the original claim to prove the new claim, (3) whether unfair surprise to the defendant would result if the court allowed the amendment to relate back." 3 James W. Moore, *et* **al.,** **MOORE'S** FEDERAL PRACTICE § 15.19[2].

The rationale underlying the "relation back" rule is entirely sensible, as well as applicable here: it prevents a party from claiming unfairness or surprise when the facts at issue gave rise to related claims asserted earlier. Once a defendant knows of litigation involving a particular set of transactions or occurrences, he/she has received all the notice and protection the statute of limitations requires. See *FDIC v. Conner, 20* F.3d 1376, 1386 (5th Cir. 1994) (damage caused by loans arose out of same conduct as identified in complaint and defendant may not rely on statute of limitations to protect against addition of related claims).

In this case, there can be no real doubt that Grigsby's 10b-5 claims relate back to his original state court petition, which was filed within the one-year limitations period Respondents argue governs. That petition sets forth the "set of facts which gives rise" to Grigsby's 10b-5 claim, *Hill* 964 S.W.2d at 121: that Respondents pressured Grigsby to sell out without disclosing Instinet's interest in buying the companies and the sale negotiations. As the State Court petition alleged:

> *24.* However, none of the Defendants ever disclosed any pending negotiations with Instinet. Completely without knowledge of these negotiations, Mr. Grigsby signed the Redemption and Termination Agreement ("Redemption Agreement") on May 10, 2001 . . . The following day, on May 11, 2001, ProTrader announced that Instinet Group, Inc. ("Instinet") would acquire ProTrader LP for $150 million. Mr. Grigsby only subsequently, and for the first time,

learned of the planned transaction from friends who forwarded to him news releases of the deal on May 11, 2001.

> 25. Obviously the ProTrader LP partners, to the exclusion of Mr. Grigsby, had been negotiating the sale of ProTrader LP to Instinet for some period of time prior to the announcement of the acquisition on May 11, 2001. Such negotiations or any information about a possible sale of ProTrader LP were never disclosed to Mr. Grigsby. Additionally, the valuation of ProTrader LP under the Instinet sale constitutes a valuation that is 4.3 times higher than the valuation used in the Redemption and LOI.

Grigsby Original Petition, Exhibit 1. Likewise, in stating his claims under the Texas Securities Act, Grigsby pled:

> 36. Defendants Jamail, Burch, Kershner and McEntire, in order to induce Mr. Grigsby to sign the Redemption Agreement and to accept a much lower valuation of ProTrader LP, each deliberately failed to disclose material information regarding negotiations for the sale of ProTrader LP to Instinet and the consequent valuation of ProTrader. Their material omissions and failure to disclose constitute violations of the Texas Securities Act, section 33(B) and entitle Mr. Grigsby to rescission of the Redemption Agreement and to damages incurred.

Id. These are plainly the same factual allegations as those underlying the lob-5 claim Respondents now seek to dismiss.

Indeed, in their motion, Respondents essentially concede that Grigsby's state court petition made this same "basic complaint." Goad, 690 S.W.2d at 896. In describing the state court petition, Respondents write: "Six months after notice [on May 11, 2001, when Grigsby learned of the sale to Instinet], he filed a lawsuit *asserting state securities fraud based on the failure to disclose Instinet."* Motion at 6 (emphasis added). The fact that Grigsby later added federal securities fraud claims based on the same transactions does not make those claims untimely.

Rather, under Section 16.068 and Rule 15(c), the lob-5 claims simply relate back to the earlier-filed, timely state court petition. Having been put on notice of Grigsby's fundamental complaint about Respondents' hiding the Instinet negotiations at the same time they were buying his interests, Respondents cannot persuasively claim that Grigsby's lob-5 claims are somehow stale or surprising, or that there is any unfairness in having to answer it along with the earlier-filed, parallel state securities fraud claim. And, obviously, Grigsby will "rely on the same kind of evidence" to prove both the timely-filed Texas Securities Act claim as the later-filed federal claims. 3 MOORE'S FEDERAL PRACTICE § 15.19[2]. This case presents a paradigmatic example of the proper application of the "relation back" doctrine.

In sum, Grigsby filed his state court petition within one year of when Respondents concede, at least for purposes of their motion, he learned of the Instinet sale. While that petition did not include the lob-5 claims, it did assert state securities fraud claims based on exactly the same factual allegations as underpin the subsequent lob-5 claims, as Respondents acknowledge. Thus, Grigsby's lob-5 claims relate back to this earlier-filed pleading and are timely.

II. Grigsby's 10b-5 Claims Are Timelv Under The New Two-Year Statute of Limitations, Which Applies Here

Respondents are incorrect, in any event, that the statute of limitations applicable to Grigsby's lob-5 claims is one year. In fact, Congress changed the statute of limitations to two years when it enacted Sarbanes-Oxley. Under that statute's new, applicable two-year statute of limitations, Grigsby's lob-5 claims are timely even without relation back to his state court petition.

Congress enacted Sarbanes-Oxley on July 26, 2002, and President Bush signed it into law on July 30, 2002. See Pub. L. No. 107-204. Sarbanes-Oxley changed the former one-year statute of limitations applicable to lob-5 claims by adding the following new language:

> [A] private right of action that involves a claim of fraud, deceit, manipulation, or contrivance in contravention of a regulatory requirement concerning the securities laws, as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)), may be brought not later than the earlier of-
>
> (1) 2 years after the discovery of the facts constituting the violation; or
>
> (2) 5 years after such violation.

Pub. L. 107-204, Title VIII, § 804(a). Sarbanes-Oxley further provided that the new, two-year limitations period "shall apply to all proceedings addressed by this section that are commenced on or after the date of enactment of this Act." Id., § 804(b). In other words, in Sarbanes-Oxley, Congress adopted a two-year statute of limitations and made it applicable to "all proceedings . . . commenced on or after the date of enactment of this Act," which is July 30, 2002.

There is no question that Grigsby brought his lob-5 claims: (i) after July 30, 2002, and (ii) less than two years after the date Respondents concede Grigsby learned of the Instinet concealment (May 11, 2001). Thus, by the plain terms of Sarbanes-Oxley, the new, two-year statute of limitations governs this case and Grigsby's lob-5 claims are timely. Despite the clear language of Sarbanes-Oxley, however, Respondents contend that the new law did not become effective until Grigsby's lob-5 claims were already barred under the old statute of limitations, and that Sarbanes-Oxley does not evince a Congressional intent to revive time-barred claims. See Motion at 7 n.1. This argument is without merit.

Congress can extend a "previously applicable limitation period that ha[s] already commenced running and . . . enact a new limitation rule so as to revive claims already barred under a prior rule." *United States v. Hunter*, 700 F. Supp. 26, 27 (M.D.Fla.1988) (citing Chase Sec. Corp. *v.* Donaldson, 325 U.S. 304, 311-12 (1945)). That is exactly what Congress has done in Sarbanes-Oxley. The only court to have considered this question has held that Sarbanes-Oxley applies to all claims brought after July 30, 2002, even if they were already untimely as of that date. See *Roberts v. Dean Witter Reynolds, Inc.*, __ F. Supp. __, 2003 WL 1936116 (M.D. Fla., March 31, 2003) (attached hereto as Exhibit 2). In *Roberts, the* plaintiffs complained of conduct that occurred outside of the former statute of limitations, and defendants made the same arguments as Respondents, citing the same Fifth Circuit decision, *Resolution Trust Corp. v. Seale,* 13 F.3d 850 (5th Cir. 1994). See *id.* at * 2.

Nonetheless, the *Roberts* court concluded that Sarbanes-Oxley revived plaintiffs' otherwise untimely claims:

> The plain language of the amendment provides that the extended limitations period "shall apply to all proceedings addressed by this Section that are commenced on or after the enactment of this Act." The effective date, which is July 30, 2002, hinges on the date that "proceedings" commence or commenced rather than on the date the violation occurred. *This language, standing alone, seems to presume that the Act affords redress for violations that had already occurred before July 30, 2002.*

Id. *2 (emphasis added) (statutory citations omitted). Because Sarbanes-Oxley makes no specific mention of retroactive application, the court also looked to the new statute's legislative history, which, it concluded, supports the view that the lengthened statute of limitations applies to claims barred at the time of enactment:

As a whole, the history reveals that Congress intended to lengthen the statute of limitations to enable people who lost their life-savings to companies like Enron to recover some of their investments. To do so, the amendment must be given retroactive application.

Evidence of the intent of Congress may be discerned from the words of Senator Leahy of Vermont on July 10, 2002, when he stated the following:

> When I look at places such as Washington State alone where the pension funds of firefighters and police lost $50 million because of the fraud of the leaders of Enron, I don't feel too sympathetic. We already have a very short statute of limitations in here anyway. We *ought to at least have that so people might be able to recover* some of *the money they have lost,* if it is at all possible, instead of just a few executives going up and building their $50 million mansions and hiding it there. There ought to be some way for the people who lost their pensions, lost their life savings, to get it back . . .
>
> Florida lost $335 million because of Enron; the University of California, $144 million-all the way down to Vermont; we lost millions of dollars. *These are people who would like, in these kinds of cases, at least to have a statute* of *limitations such that we can go after them.*
>
> I am here to try to protect people and give them an opportunity-when there has been such enormous fraud and all the pension funds have been lost, and all the people who have lost their life-savings ---- *give them at least some chance to recover something, especially as the executives of these companies walk off with tens of millions of dollars.* We go two-five instead of one-three. That was negotiated and voted on in the Judiciary Committee, and the final bill was passed unanimously.

148 Cong. Rec. S6524-02, * S6534-35 (emphasis added). The language referring to victims of Enron recovering damages indicates the intent to retroactively apply the statute of limitations.

Id. "3.

The *Roberts* court also noted the section-by-section analysis of Title VIII of Sarbanes-Oxley, which was made a part of the record "in order to provide guidance in [its] legal interpretation." 148 Cong. Rec. S7418-01, * S7418. The section-by-section analysis provides:

> This provision . . . states that it is not meant to create any new private cause of action, but only to govern all the already existing private causes of action under the various federal securities laws that have been held to support private causes of action. This provision is intended to lengthen any statute of limitations under federal securities law, and to shorten none. The section, by its plain terms, applies to any and all cases filed after the effective date of the Act, regardless of when the underlying conduct occurred.

Id. As the Roberts Court correctly acknowledged, "[t]he phrase 'regardless of when the underlying conduct occurred' demonstrates that Congress intended for the extended statute of limitations to apply retroactively." Roberts, 2003 WL 1936116 at *4.

In addition to Roberts, at least one commentator has also concluded that the new statute of limitations in Sarbanes-Oxley governs claims that would be untimely on July 30, 2002:

> This provision is applicable to all proceedings commenced after the enactment date of the Act. This has retroactive applications, at least for a period of time, in that actions filed after the date of the Act it permits an action to be brought within a period of time that at the date of the Act would have been barred under the statute of limitations as it existed prior to the adoption of the Act. Senator Leahy, who sponsored Title VIII in the Senate, left no doubt in that and other regards by creating legislative history through extended remarks as of the day the Act was passed by the House and the Senate.

Harold S. Bloomenthal, *Sarbanes-Oxley in Perspective*, SEC-SOAP § 74 at 2, September 2002 (attached hereto as Exhibit 3).

Because of the "relation back" doctrine discussed above, Respondents are incorrect that Grigsby's lob-5 claims are untimely under the old, one-year statute of limitations. But even if Grigsby's claims did not relate back to an earlier and timely pleading, Respondents' motion would fail because Sarbanes-Oxley has extended the applicable statute of limitations. The Panel should adhere to the plain language of the new law, as well as the only decision construing it, and hold that Grigsby's lob-5 claims are timely because they was filed after July 30, 2002 and were brought within two years of Grigsby's discovery of Respondents' double dealing with regard to Instinet.[2]

CONCLUSION

For the foregoing reasons, Claimant Russell Grigsby respectfully requests that the Panel deny Respondents' Motion for Partial Summary Judgment That Grigsby's lob-5 Claims are Barred by the Statute of Limitations.

Respectfully submitted,

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[2] As Respondents acknowledge, the timeliness of Grigsby's lob-5 claim ensures the timeliness of his claim under Section 20(a) of the 1934 Act that Respondents are liable as controlling persons. See Motion at 7-8.

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RUSSELL GRIGSBY Claimant, V. PROTRADER GROUP MANAGEMENT, L.L.C., PROTRADER GROUP LIMITED PARTNERSHIP, INSTINET GROUP, INC., DAVID R. BURCH, DAVID D. JAMAIL, ANDREW S. KERSHNER, JOHN A. McENTIRE, OVERUNDER, LLC, ZONE TRADING PARTNERS, LLC and ZONE EQUITY PARTNERS, LP, Respondents.	§ § § § § § § § § § § § § § § § §	**AMERICAN** **ARBITRATION** **ASSOCIATION**

CLAIMANT'S BRIEF REGARDING DUTIES OWED BY PARTNERS AND CONTROLLING SHAREHOLDERS
<u>AND THE IMPACT OF THE TEXAS REVISED PARTNERSHIP ACT</u>

This brief addresses the level of duty owed among partners and controlling shareholders. While the Texas Revised Texas Revised Partnership Act clarified that partners do not owe trustee duties to one another, they continue to owe the duties of full disclosure, loyalty, good faith, candor and fair dealing to another, and these duties include the duty to pay a fair price in a partnership buy-out.

A. <u>Duties Owed under General Texas Partnership Law</u>

Both the Texas Revised Partnership Act ("TRPA"), art. 6132b Tex. Rev Civ. Stat., effective January 1, 1999, and its predecessor, the Texas Uniform Partnership Act ("TUPA") contain provisions that the Partnership Act is supplemented by the common law. *See* section 1.04(a) of the TRPA and section 5 of the TUPA. Section 1.04(a) of the TRPA states: "Unless displaced by a particular provision of this Act, the principles of law and equity supplement this Act." See art. 6132b-1.04(a). The almost identically worded predecessor to this provision has been interpreted to mean that "common law rules continue in force in any case not provided for in the Act." *Chien v. Chien*, 759 S.W.2d 484, 491 (Tex. App.-Austin 1988, no writ). Thus, common law partnership duties continue, unless the TRPA expressly indicates that a particular duty has been displaced.

Texas courts of appeals have consistently recognized that under both the Texas Uniform Partnership Act and the common law, partners have a duty to one another to make full disclosure of all matters affecting the partnership. *Brosseau v. Ranzau*, 81 S.W.3d 381, 394 (Tex. App.-Beaumont, *2002; Bohatch v. Butler & Binion*, 905 S.W.2d 597, 602 (Tex. App.- Houston [14th Dist.] 1995), aff' d, *977* S.W.2d *543* (Tex.1998); *Hawthorne v. Guenther*, 917 S.W.2d 924,934 (Tex. App.-Beaumont 1996, writ denied); Tex.Rev.Civ. Stat. Ann. art. 6132b § 20 (Vernon 1970). Partners also owe one another a strict duty of good faith and candor. Id. Section 20 of the TUPA, which requires partners to disclose "full information of all matters pertaining to the partnership," was carried forward into Section 4.02 of the TRPA. Thus, it is beyond dispute that the TRPA did not in any way alter or displace a partner's statutory and common law duty to make full and complete disclosure.

Partners also owe to each other a common law duty of good faith and fair dealing. The Texas Supreme Court stated:

> We have long recognized as a matter of common law that "[t]he relationship between ... partners... is fiduciary in character, and imposes upon all the participants the obligation of loyalty to the joint concern and of the utmost good faith, fairness, and honesty in their dealings with each other with respect to matters pertaining to the enterprise." *Fitz-Gerald v. Hull*, 150 Tex. 39, 237 S.W.2d 256,264 (1951).

Bohatch v. Butler & Binion, 977 S.W.2d 543, 545 (Tex.1998). The Texas Supreme Court has also recognized a partner's duty of good faith and fair dealing requires a partner purchasing another partner's interest to pay fair consideration:

> This necessity for good faith and the making of a full disclosure of all important information applies in the case of sale by one partner to another of his interest in the partnership. Such a sale will be sustained only when it is made in good faith, for a **fair considerationand** on a full and complete disclosure ofall important information as to value.

Johnson v. Peckham, 132 Tex. 148, 120 S.W.2d *786,787* (1938); *see also Johnson v. Buck, 540* S.W.2d 393, 399 (Tex. App.-Corpus Christi 1976, writref' d n.r.e.) ("Partners do not deal with each other at arm's length, and in a sale by one partner to another of his interest in the partnership, . , . , when challenged, will be sustained only when it is made in good faith, for**fair considerationand** on a full and complete disclosure of all information as to value.") (emphasis added). This duty to pay fair consideration does not derive from trustee-like obligations; rather, as the excerpt above from *Johnson v. Peckham* confirms, it is part and parcel of the basic duties of good faith and fair dealing.

Respondents and their expert Amon Burton appear to contend that Section 4.04(f) of the TRPA displaced a partner's common law duty of good faith and fair dealing and effectively overruled *Johnson v. Peckham*, 132 Tex. 148,120 S.W.2d 786,787 (1938). Section 4.04(f) of the TRPA states:

> Trustee Standard Inapplicable. A partner, in that capacity, is not a trustee and is not held to the same standards as a trustee.

The Bar Committee Comment to section 4.04 provides:

> Unlike the title of TUPA § 2 1, but like its text, Section 4.04 does not use the term "fiduciary." This section defines partner duties and implies that they are not to be expanded by loose use of "fiduciary" concepts from other contexts or by the rhetoric of some prior cases. Similarly, subsection (f) specifically states that a partner as such is not a trustee and is not held to the same standards as a trustee, thus further attempting to restrict reliance on the unfortunate language of prior law. The term "fiduciary" is inappropriate when used to describe the duties of a partner because a

> partner, unlike a true trustee, may legitimately pursue the partner's own self interest and not solely the interest of fellow partners or the partnership. . . .
>
> As noted above, subsection (f) specifically negates the trustee standard that has sometimes been applied to partners.

Neither the statute nor its comment states that a partner's common law duty of good faith and fair dealing has been displaced or abrogated. Rather, the statute and its comment only indicate that a partner does not have the same fiduciary duty as a trustee, that is, not to pursue his self interest or place his interest before that of his beneficiary. *See Slay v. Burnett Trust,* 187 S.W.2d 377, 378-79 (Tex. 1945) (duty of loyalty prohibits trustee from using the advantage of his position to gain any benefit for himself at the expense of his cestui que trust and from placing himself in any position where his self-interest will or may conflict with his obligations as trustee).

The Texas Supreme Court has recognized that the "duty of good faith and fair dealing" ***is not the same*** as the more onerous duty requiring a fiduciary to place the interest of the other party before his own:

> Although a fiduciary duty encompasses at the very minimum a duty of good faith and fair dealing, the converse is not true. The duty of good faith and fair dealing merely requires the parties to "deal fairly" with one anther and does not encompass the often more onerous duty which requires a fiduciary to place the interest of the other party before his own, often attributed to a fiduciary duty.

CrimTruck & Tractor Co. v. Navistar International Transportation Corp., 823 S.W.2d 591, 594 (Tex. 1992). Thus, while section 4.04(f) of the TRPA may have clarified that partners do not owe one another trustee's duties, it has not displaced the "duty of good faith and fair dealing" recognized in *Johnson v. Peckham.* In fact, *Johnson v. Peckham* has been cited as authoritative by a Texas court of appeals as recently as May 22, 2003. *See Voght v. Warnock*, 107 S.W.3d 778, 782-83 (Tex. App.-El Paso 2003). Furthermore, the 2002 Edition of the Business Texas Pattern Jury Charge, page

1 1 1 - 12, specifically cites *Johnson v. Peckham* and incorporates its fairness requirement into PJC 104.2. See *id.* (setting forth partnership duties).

Indeed, in *Lawton v. Nyman,* 2002 WL 221621 (D.R.I. 2002), a case with facts remarkably similar to those here, the Court explained that a partner's duty of full disclosure is broader than that under the securities laws:

> When directors of a closely held corporation are purchasing a minority stockholder's shares, fiduciary duty imposes an obligation of "complete candor" to disclose "all information in their possession 'germane' to the transaction," O'Neal & Thompson, O'Neal's Close Corporations § 8.12 at 129 (3d ed. 1995 Supp.). The fiduciary duty of disclosure is more stringent and far-reaching than the duty of disclosure imposed by the securities laws. Thus, corporate officers who contemplate a possible sale of the company must reveal that possibility to minority stockholders from whom they seek to purchase shares even ***though sale negotiations have not yet taken place.*** *See Mansfield Hardwood Lumber Co. v. Johnson, 263* F.2d 748,756 (5th Cir. 1959).

Id. at * __.[1]

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[1] The fiduciary duties Respondents owed continued after the May 1, 2000 reorganization of ProTrader into a Delaware limited partnership. Texas law applies because, even after the reorganization, Texas is still the state with most significant relationship to this controversy. In any event, Delaware law regarding fiduciary obligations of partners is the same as Texas law. In fact, a Delaware court even cited Texas law as authoritative on this point. *See* Sussex *Life Care Associates, v. Strickler,* 1998 W.L 156833 (De. Ch. 1989) ("There can be no question but that partners owe fiduciary duties to their fellow partners, *Boxer* v. *Husky Oil* Co., Del.Ch., 429 A.2d 995 (198 1), and this duty has been held to encompass a duty of full disclosure by a selling partner to the buying partners. *Johnson* v. *Buck,* Tex. Ct. App., 540 S.W.2d 393 (1976)"); *Boxer* v. *Husky Oil* Co., Del.Ch., 429 A.2d 995, 997 (1981) ("The fiduciary duty of fair dealing by a general partner to a limited partner is no less than that owed by a director to a shareholder. The form of the enterprise does not diminish the duty of fair dealing by those in control of the investments"); *Sonet v. Timber Co.,* Del. Ch., *722* A.2d *3* 19, *322-23* (1998); *In re USA Cafes, LP Litigation,* Del. Ch., 6900 A.2d 43, 48-50 (1991).

On the other hand, the business judgment rule generally protects the actions of general partners, affording them a presumption that they acted on an informed basis and in the honest belief that they acted in the best interest of the partnership and the limited partners. *See Dean v. Dick,* Del Ch., C.A. No. 16566, Mem Op. at 8-14, Chandler, C. (June 10, 1999). A plaintiff can rebut the presumption by showing that the general partner de rived a personal benefit from a transaction or engaged in self

Thus, while a partner may not have a duty to put another partner's interest before his own, he still has a duty of good faith and fair dealing and to pay fair consideration his partner's interest. Section 4.04(f) of the TRPA does not permit a partner to oppress and coerce another partner to sell his partnership interest for an unfair price.

B. Duties Owed by General Partner of Limited Partnership

Furthermore, Section 4.04(f) of the TRPA did not alter the fiduciary duties that a managing partner or a general partner in limited partnership *owes its limitedpartners,* which are the highest that are recognized in the law. Before the Letter of Intent was signed on April 30, 2000 and the reorganization occurred, Grigsby,Jamail, Burch andKershner were not merely de facto partners and shareholders in Texas Subchapter S corporation, Cornerstone Securities Corporation. They were also partners and managers in a Texas limited partnership, Cornerstone Securities Partners, L.P. ("Cornerstone LP"), which managed the business of Cornerstone Securities Corporation. Cornerstone LP's general and managing partner was Cornerstone Securities Management LLC. The LLC's Regulations expressly reserved management of the Company to its members. The members and managers of the LLC were Jamail, Burch, Kershner and Grigsby, and they therefore owed the same fiduciary duties that a general partner owes the limited partners in a limited partnership.

These duties are described as follows:

> Managing partners owe their copartners the highest fiduciary duty recognized in the law. *Huffington v. Upchurch, 532* S.W.2d *576, 579* (Tex.1976); *Crenshaw v. Swenson,* 611 S.W.2d 886, 890 (Tex.Civ.App.-Austin 1980, writ ref d n.r.e.). **Furthermore, in a limited partnership, the general partner stands in the same fiduciary capacity to the limited partners as a trustee stands to the beneficiaries**

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dealing. *See Seaford Funding,* L.P., 672 A.2d at 70. The burden then shifts to the defendant general partner to prove the "entire fairness" of the challenged transaction. *See Nebenzahl,* C.A. No. 132065 at 6. "Under the entire fairness standard of judicial review, the defendant [general partner] must establish that the transaction was the product of both fair dealing and fair price." *Id.*

> **of a trust.** *Crenshaw*, 611 S.W.2d at 890 (citing *Watson v. Limited Partners of WCKT, Ltd.*, 570 S.W.2d 179 (Tex.Civ.App.-Austin 1978, writ ref d n.r.e.)).

Hughes v. St. David's Support Corp, 944 S.W.2d 423, 425-26 (Tex. App.-Austin 1997, writ denied) (emphasis added). This trustee like fiduciary duty also extends to the managing or controlling partner of the managing partner of a limited partnership. *In re Bennett*, *989* F.2d 779,790 (5th Cir. 1993). Therefore, although partners in a general partnership may not owe each other trustee-like fiduciary duties, it is well established under Texas law that a managing or general partner of a limited partnership does owe such duties because it has complete control of the partnership's assets and business.

Similarly, after Grigsby was ousted from his position of having any management or control over the business ofProTrader, the Respondents who were the managers of theProTrader's general partner owed Grigsby the highest fiduciary duty recognized at law. At a minimum, this duty encompassed the duty of good faith and fair dealing recognized in *Johnson v. Peckham*, 132 Tex. 148, 120 S.W.2d 786,787 (1938).

This is also the law in Delaware. It is well settled under Delaware law that the general partner of a Delaware limited partnership[2] and the directors of a corporate General Partner who control the partnership,[3] like the directors of a Delaware corporation, have the fiduciary duty to manage the partnership in the partnership's interests and the interests of the limited partners. See *Boxer* v. *Husky Oil Co.*, Del.Ch., 429 A.2d 995,997 (1981). As a result, Delaware law requires the general partners of limited partnerships to exercise due care and to act in the best interest of the

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[2] *Sonet v. Timber Co.,* Del. Ch., 722 A.2d 319, 322-23 (1998) (citing, *Boxer v. Husky Oil Co.,* Del. Ch., 429 A.2d 995,997 (198 1)).

[3] *In re USACafes, L.P. Litigation,* Del. Ch., 600 A.2d 43, 48- 50 (1991).

partnership and the limited partners! Courts have also recognized that the fiduciary obligations of a general partner prohibit it from attempting to "squeeze out" a limited partner. *See Labovitz v. Dolan*, 545 N.E.2d 304, 3 10, 3 13-14 (Ill. App. 1989) (Plaintiffs "entitled to a trial in which Dolan must prove he acted fairly and not as his limited partners' business adversary").

C. **Duties Owed by Controlling Shareholders, Directors and Officers of Close Corporation**

Texas courts have also recognized and enforced the fiduciary obligations that majority shareholders and officers owe minority shareholders in a close corporation. See, e.g., *DeBord v. Circle Y of Yoakum, Inc.,* 9.51 S.W.2d 127, 133 (Tex. App.-Corpus Christi 1997), *rev'd on other grounds, 967* S.W.2d *352* (Tex. *1998);Gaither* v. *Moody*, 528 S.W.2d 875,877 (Tex. App.-Houston [14th Dist.] 1975, writref d n.r.e.). Additionally, officers and directors of a closely held corporation, such as McEntire, owe fiduciary duties when negotiating to buy a shareholder's interest:

> It is well established that corporate officers and directors owe a fiduciary duty of good faith and fair dealing to the corporation and its shareholders and that such duty imposes a standard of conduct that is "stricter than the morals of the marketplace." (citation omitted). In the case of a closely held corporation, the duty is enhanced and has been described as one of "utmost good faith and loyalty," (citation omitted), which is "similar to [the duty] imposed upon partners in a partnership." (citation omitted). . . .
>
> When directors of a closely held corporation are purchasing a minority stockholder's shares, fiduciary duty imposes an obligation of "complete candor" to disclose "all information in their possession 'germane' to the transaction." O'Neal & Thompson, O'Neal's Close Corporations § 8.12 at 129 (3d ed. 1995 Supp.).

Lawton, *2002* WL 221621 at * __ .

The fairness requirement incorporated into the Texas Pattern Jury Charge has also been imposed by Texas courts in the context of the buyout of a minority shareholder. In *Miller v. Miller*,

[4] *See Nebenzahl v. Miller,* Del. Ch., C.A. No. 13206, mem. op. at 5-6, Steele, V.C. (Aug., 29, 1996) ("Delaware law requires directors to exercise due care in carrying out their fiduciary duties and to act in the best interest of the shareholders and the corporation.") (citing *Cede & Co. v. Technicolor, Inc.,* Del.Supr., 634 A.2d 345, 360 (1993)).

700 S.W.2d 941 (Tex. App.-Dallas 1985, writ ref'd n.r.e.), the court of appeals held that the recognition of a fiduciary duty in that case was based, not only on the personal relationship between Howard and Judy, but also on Howard's position as a founder, officer, and director of InteCom. *Id.* at 945. In addition, the court held that "in establishing the fairness of a transaction between a fiduciary and his beneficiary, some of the most important factors are whether the fiduciary made a full disclosure, ***whether the consideration is adequate*** and whether the beneficiary had the benefit of independent advice." *Id.* Thus, for a transaction to be fair, not only must full disclosure of material facts be made, but the consideration must be fair and adequate.

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I hereby certify that a true and correct copy of the above and foregoing Claimant's Brief Regarding Partnership Duties and the Impact of the Texas Revised Partnership Act has been served on the following counsel via hand delivery on this _____ day of November, 2003:

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BIOGRAPHY

Martin J. Siegel was born and raised in Houston. He earned a B.A., Highest Honors, from The University of Texas at Austin in 1988, where he majored in the Plan II Liberal Arts Honors Program and graduated *Phi Beta Kappa.*

Siegel received his law degree, *Cum Laude*, from Harvard Law School in 1991. Following law school, he served as law clerk to the Honorable Irving R. Kaufman on the United States Court of Appeals for the Second Circuit in New York City.

From 1992 to 1994, Siegel was an associate in the Washington, DC office of Jenner & Block. At Jenner, he worked on appellate, commercial, intellectual property, and environmental matters. He assisted in the Supreme Court briefing for respondents in *U.S. Nat'l Bank of Oregon v. Indep. Ins. Agents of America*, 508 U.S. 439 (1993); represented MCI in patent, antitrust and other matters; and helped develop the evidence for, draft and present a petition for post-conviction relief to the Maryland state trial court on behalf of death row inmate Kevin Wiggins. Although the court denied the petition, the U.S. Supreme Court eventually granted it in a decision vacating the death sentence and setting new standards for counsel in the sentencing phase of capital cases. *See Wiggins v. Smith*, 539 U.S. 510 (2003).

From 1995 to 2000, Siegel served as an Assistant United States Attorney in the Civil Division in the Southern District of New York, where his practice focused on bringing civil rights actions, defending statutes from constitutional challenge, and defending federal agencies and officers from suits based on government action. Civil rights cases brought by Siegel include a complaint under the Voting Rights Act following fraud in a Bronx school board vote, resulting in a new election; some of the first cases in the United States brought under the Freedom of Access to Clinic Entrances Act; an action based on discriminatory zoning in violation of the Americans with Disabilities Act; and an investigation of the New York City Parks Department for employment discrimination. In a case of first impression, Siegel successfully defended provisions of the 1996 immigration and welfare reform laws (invalidating local rules against disclosing the immigration status of aliens to federal law enforcement) from constitutional attack under the 10th Amendment brought by New York City. *See City of New York and Rudolph Giuliani v. United States and Janet Reno,* 179 F.3d 29 (2d Cir. 1999).

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In all, Siegel tried eight cases in federal district court and briefed and argued twelve appeals to the Second Circuit. He received the Department of Justice's Director's Award for Superior Performance as an Assistant United States Attorney in 1999 for the successful trial defense of the former chief of the CIA's Technical Services Division in a case involving the agency's experimentation with LSD in the early 1950s.

In 2000-01, Siegel was detailed to serve as Special Counsel on the minority staff of the Senate Judiciary Committee, where his responsibilities included drafting and analyzing legislation on election reform, the McCain-Feingold campaign finance bill, criminal justice, immigration and other issues.

From 2001-06, Siegel was a partner at Watts Law Firm in Houston, where he worked on commercial, franchise, patent, trade secret, false advertising, product liability and personal injury litigation. In 2002, he successfully represented Texas beer distributors against Anheuser-Busch after it wrongfully prevented a $60 million sale of their distributorship, achieving a highly favorable confidential settlement. In 2003, he helped represent the founder of a securities trading firm forced out of the business he founded before its sale for $150 million, winning a $43 million arbitral award. In 2005, he successfully represented Stabar Enterprises, a small Austin pet products company, in multiple lawsuits arising from a licensing dispute with one of the country's largest makers of animal products, securing the dismissal of a related suit against Stabar and a favorable confidential settlement that included the sale of the company's assets.

In 2006, Siegel successfully represented the Texas Democratic Party in its suit to prevent the Republican Party of Texas from replacing Tom DeLay on the general election ballot for Congress following DeLay's withdrawal as a candidate. Siegel wrote the Democratic Party's briefs in the Fifth Circuit on an expedited schedule and co-argued the appeal, resulting in a complete victory for TDP's position under the Constitution's Qualifications Clause and state election law and an order barring the replacement.

In 2007, Siegel opened the Law Offices of Martin J. Siegel to focus on appellate advocacy. He remains of counsel to Watts Law Firm.

In 2004 and 2007, *Texas Monthly* named Siegel a "Texas Super Lawyer Rising Star," an award given to lawyers under 40 chosen by other lawyers throughout the state.

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Siegel has written frequently on legal topics. In 2007, he was named to the Board of editors of Litigation, the magazine published by the ABA's Section on Litigation. Siegel's writings include:

- *Zealous Advocacy vs. Truth*, 33 LITIGATION 31 (Fall 2006);
- *The Myth of Dem, GOP Justice*, HOUSTON CHRONICLE, September 10, 2006, at E4;
- *We Don't Have Kings in Texas*, HOUSTON CHRONICLE, May 29, 2005, at E4;
- *Congressional Power over Presidential Elections: The Constitutionality of the Help America Vote Act Under Article II, Section 1*, 28 VERMONT L. REV. 373 (Winter 2004);
- *Bryant Case Tosses a Lifeline to the Laws Against Adultery*, LOS ANGELES TIMES, August 13, 2004, at B13;
- *Why Texas Republicans Should Love the Trial Lawyers*, HOUSTON CHRONICLE, April 20, 2003, at 4C; and
- *For Better or For Worse: Adultery, Crime and the Constitution*, 30 J. FAMILY L. 45 (1991-92).

Siegel has also served as an adjunct professor at the University of Houston Law Center, as a guest lecturer there and at business and graduate school classes at Princeton and UCLA, and as a speaker at CLE seminars and workshops in Houston and elsewhere.

APPELLATE AND BRIEF WRITING EXPERIENCE

Martin Siegel has an extensive background in appellate and trial-level briefing and argument cutting across a broad range of substantive and procedural areas, including constitutional law, commercial disputes, product liability, personal injury, federal preemption, consumer protection, jurisdiction, removal and remand, governmental immunities, employment law and others.

Siegel's experience began as a federal appellate law clerk and deepened over years of representation of corporate defendants, the United States and individual plaintiffs. He has briefed and argued appeals in the United States Courts of Appeals for the Second Circuit and Fifth Circuit, the Texas Supreme Court (briefed only), and several state appellate courts, and has assisted with briefs written for the United States Supreme Court.

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Some of Siegel's more significant cases include:

- *Texas Democratic Party v. Tina Benkiser, Chairwoman of the Republican Party of Texas*. The Texas Democratic Party sued the Republican Party of Texas to prevent it from substituting a new Congressional candidate for Tom DeLay after his withdrawal from the 2006 election. TDP argued that it was too late to substitute candidates, while RPT claimed replacement was permitted because DeLay had moved to Virginia and was therefore constitutionally ineligible to serve. Siegel handled most of the briefing in the district court, wrote the briefs for TDP in the Fifth Circuit on an expedited schedule and shared oral argument with the party's full-time counsel, obtaining a complete vindication of TDP's position that it had standing to bring the case and that DeLay's replacement would violate the Constitution's Qualifications Clause and state election law. *See* 459 F.3d 582 (5^{th} Cir. 2006).

- *City of New York and Rudolph Giuliani v. United States and Janet Reno*. New York City challenged provisions of the 1996 welfare and immigration reform laws that invalidated local rules against disclosing the immigration status of aliens to federal law enforcement. In a case of first impression, the Second Circuit held that the federal provisions do not violate the Tenth Amendment's bars on interfering with state operations or conscripting state officials to carry out federal tasks. *See* 179 F.3d 29 (2d Cir. 1999). Siegel wrote the federal government's trial and appellate briefs and successfully argued the appeal in the Second Circuit.

- *Grigsby v. ProTrader Group Management LLC, et al.* In this arbitration, Grigsby claimed that the defendants violated securities laws and committed minority shareholder oppression by squeezing him out of the company he co-founded shortly before it was sold for $150 million. As part of the team representing Grigsby, Siegel briefed and argued summary judgment motions and other issues, including ratification, duties owed under the Texas Revised Partnership Act, the statute of limitations for 10b-5 claims under Sarbanes-Oxley, standards for recovery for shareholder oppression, and others. The arbitrators accepted Grigsby's legal positions and awarded him $43 million in compensation. Case No. AAA 70 180 00648 02.

- *Barahona v. Toyota Motor Corp., et al.* The plaintiff sued Toyota when his son was rendered a quadriplegic, alleging that the defective design of the Toyota

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Echo's seatback caused the injuries. Toyota twice filed writs of mandamus in the Court of Appeals and once in the Texas Supreme Court attacking various discovery and other rulings. Siegel wrote the plaintiff's responses, obtaining denials of Toyota's petitions. *See* 191 S.W. 3d 498 (Tex. App. – Waco 2006, mandamus denied, Case No. 06-0449, TX Sup. Ct., June 5, 2006). Siegel also briefed several *Daubert,* summary judgment and other motions, resulting in rulings favorable to the plaintiff.

- *Ayala v. Ford Motor Co.* In this wrongful death case, Ford argued that it complied with applicable federal safety standards and was therefore not liable under TEX. CIV. PRAC. & REM. CODE § 82.008(a). When the plaintiffs responded that Ford's inadequate disclosures to NHTSA rebutted the presumption of nonliability under § 82.008(b)(2), Ford replied that subsection (b)(2) is impliedly preempted under the reasoning in *Buckman Co. v. Plaintiffs' Legal Comm.*, 531 U.S. 341 (2001), a position the Sixth Circuit and other courts have adopted. Siegel handled the plaintiffs' briefing, and the district court agreed with the plaintiffs that federal law does not conflict with § 82.008(b)(2) and that *Buckman* preemption applies only to fraud-on-the-agency theories of liability, not traditional state product liability claims. Case No. 2-04CV-395 (E.D. Tex. 2005).

- *Rivera v. Heyman, Secretary, Smithsonian Institution, et al.* Siegel represented the Smithsonian in this employment discrimination case raising the novel question whether the Smithsonian, a unique and independent federal trust instrumentality dating to 1836, is subject to § 501 of the Rehabilitation Act, which covers only executive branch employees. Following Siegel's briefing and argument, the district court agreed with the government that the Smithsonian is not in the executive branch and therefore not subject to § 501. As a result of the case, Congress amended the Act to include the Smithsonian. On appeal, which Siegel also briefed and argued, the Second Circuit upheld the remainder of the district court's decision holding that the plaintiff had no additional remedy under § 504 of the Act – a question on which several circuit courts had split – or state and local civil rights laws. *See* 157 F.3d 101 (2d Cir. 1998).

- *Good Samaritan Hospital Regional Medical Center, et al. v. Shalala*. Three hospitals and Medicare providers sued HHS seeking to compel review of a decision not to reopen the hospitals' claims for reimbursement of various significant expenses. Siding with the government after Siegel's briefing and argument, the Second Circuit held that jurisdiction to undertake the requested review was lacking, and that challenged HHS regulations were permissible in

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light of the Medicare Act. The Second Circuit reached this conclusion despite Ninth Circuit precedent to the contrary. *See* 85 F.3d 1057 (1996).

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