STATE BAR OF TEXAS

April 2011

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Business Law Section Council Members (2010-11):

Business Law Section Newsletter

Message From The Chair

Fellow Section Members:

This Spring members of the Section and its Committees are busy monitoring the active Texas legislative session and the on-going federal rulemaking in response to last year's Dodd-Frank Wall Street Reform and Consumer Protection Act.

The Section's Business Organizations Code Committee and Commercial Code Committee drafted amendments to various provisions of the Texas Business Organizations Code and the Texas Uniform Commercial Code, respectively, and many of those amendments are included in bills filed in, and now being considered by, the Texas legislature. Those and other Committees of the Section are also evaluating a few other bills filed in the Legislature, which propose to amend other provisions of the TBOC and other Texas business-related statutes.

Federal securities and financial-institution agencies have been charged with promulgating rules by this Summer to implement the Dodd-Frank Act. Members of the Securities Law Committee and other Committees of the Section are continuing to carefully review various of the proposed rules. This Newsletter includes information about some of these activities. As always, all Section members are invited to join the Section's committees of interest and participate in their activities.

I hope that you find this Newsletter interesting and useful.

Rick Tulli
Chair of the Business Law Section, 2010-11

Business Organizations Code Committee Report - Summary of Certain Proposed Amendments to the Texas Business Organizations Code

For over the past year, the Section's Business Organizations Code Committee has been working diligently to consider and prepare amendments to various provisions of the Texas Business Organizations Code (the "Code"). Many (but not all) of the proposed amendments have been included in two companion bills filed in the 82nd Regular Session of the Texas Legislature. Those two bills are Senate Bill 748, filed by Senator John Carona, and House Bill 1873, filed by Representative Helen Giddings. As of the date of this article, April 11, 2010, Committee Substitute S.B. 748 has been passed by the Senate, and Committee Substitute H.B. 1873 has been passed by the House Business & Industry Committee and is awaiting passage by the entire House of Representatives. These bills include both substantive and technical amendments to the Code.

Substantive amendments to the Code that would be effected include the following: (1) eliminating the antiquated requirement for liability insurance or posting of a cash deposit or bond as a condition to the registration of a limited liability partnership, thereby conforming the Code in this area to the Uniform Partnership Act (1997) and the statutes of most other states; (2) conforming the vicarious liability provisions relating to limited liability partnerships in the Code to the approach taken in the Uniform Partnership Act (1997) and the trend in other states; (3) adding charging order provisions for partnership interests in general partnerships that are similar to the charging order provisions applicable to partnership interests in limited partnerships and membership interests in limited liability companies; (4) allowing the company agreement of a limited liability company and the partnership agreement of a limited partnership reasonably to restrict access by a member or limited partner, respectively, to the entity's books and records; and (5) amending the time periods for certain notices, demands and other ac-

Summary of Certain Proposed Amendments to the Texas Business Organizations Code (*Continued from Page 1*)

tions in the dissenters' rights provisions to make them more uniform and similar to the source provisions of the Texas Business Corporation Act and to establish a time limit on the procedure before recourse to a court.

Several more important technical amendments to the Code, which would make explicit what is implicit in existing law, include the following: (1) clarifying how a membership interest in a limited liability company is treated on the divorce of a member or the death of a member or member's spouse based on similar provisions for partnerships; (2) clarifying the effects in governing documents of references to prior law and synonymous terms; (3) clarifying that certain provisions in Chapter 101 that specify the requirements for establishment of a series limited liability company may not be waived by the company agreement; (4) clarifying the power to reinstate an entity pursuant to the Code if the entity was formed as a domestic entity or registered as a foreign entity under prior law; and (5) clarifying that a director, officer or member that has a conflict of interest in a transaction or due to a relationship cannot be subject to a claim for breach of duty if the director, officer or member follows the statutory procedure for approval of the conflict of interest transaction or relationship.

Some other important correcting or clarifying technical amendments to the Code include the following: (1) expressly acknowledging that a domestic entity may reimburse its present officers their reasonable expenses in advance of final disposition of a proceeding; (2) clarifying that written consents of governing persons, owners or members may be executed through the use of counterpart signature pages; (3) clarifying that a plan of merger may provide for the cancellation of ownership or membership interests in any entity that is party to the merger; (4) eliminating outmoded references to the "National Association of Securities Dealers, Inc." and "interdealer quotation system"; (5) clarifying the applicability of provisions in Chapter 21 relating to statutory preemptive rights and shareholder agreements; (6) correcting the record date provisions for actions by shareholders to limit the 10-day advance requirement to meetings of shareholders; (7) clarifying when an obligation is deemed to have been incurred by a limited liability partnership; (8) clarifying that the record date for an adjourned meeting of shareholders continues to apply to the date of adjournment, unless a new record date is set; and (9) clarifying that the definition of "beneficial owner" contained in Section 21.603 only applies to Subchapter M of Chapter 21 relating to affiliated business combination transactions.

Litigation Committee Report

Diamond Castle Partners IV PRC, L.P. v. IAC/InterActiveCorp, New York Appellate Division, First Department (March 3, 2011)

Purchase contract with conflicting boilerplate and indemnification clauses leads to litigation.

This New York case is not earth shattering, but is perhaps a good reminder of the potential pitfalls deal lawyers face when drafting transaction agreements. The plaintiffs in this matter were a group of private equity funds and affiliates that submitted a bid to purchase a company known as PRC, which was a subsidiary of IAC, for $285.6 million. PRC is a provider of telephone-based customer care services. IAC accepted the bid and plaintiffs formed an acquisition vehicle called Panther/DCP Acquisition, LLC ("Panther"). Accordingly, Panther was the entity that entered into the purchase agreement with PRC and IAC for the purchase of PRC.

The purchase agreement was signed on November 2, 2006. Following the closing, Panther was merged into PRC. By January 2008, PRC had filed bankruptcy and the interests of the private equity firms in PRC were extinguished by the bankruptcy. In August 2008, the private equity firms filed a lawsuit against IAC for breach of certain representations, warranties, and covenants in the purchase agreement and seeking indemnification under the purchase agreement.

IAC filed a motion to dismiss arguing that the "no third-party beneficiary" clause in the purchase agreement established that the plaintiffs lacked standing since they were not signatories to the purchase agreement. The trial court denied the motion and the appellate court affirmed. In affirming the trial court, the appellate court noted that although the purchase agreement contained the "no third-party beneficiary" clause, the purchase agreement also defined the parties in various parts of the agreement to include the affiliates of Panther. Perhaps most importantly, the indemnification provisions included affiliates of Panther as part of the indemnified parties. The court held that because the provisions of the contract have to be read together, the "no third-party beneficiary" clause had to be read to extinguish claims of anyone other than a party to the contract or an indemnified party under the contract.

The case points out the potential issues that can arise when boilerplate provisions are not harmonized with the other provisions of the contract. When provisions are left in conflict, a court will need to resolve the conflict and may do so in a way that the parties did not anticipate. Accordingly, it is important that boilerplate provisions are reviewed in light of the remaining provisions of the contract.

Galaviz v. Berg**, 2011 WL 135215 (N.D. Cal. Jan. 3, 2011).**

Forum selection clause in bylaws successfully challenged.

A federal district court in the Northern District of California recently refused to give effect to a forum selection provision for derivative claims contained in a company's by-laws. The court reached this decision despite the fact that such a provision was suggested in a recent Delaware Chancery Court opinion that spurred a number of companies to adopt similar provisions.

Litigation Committee Report (*Continued from Page 2*)

In these two consolidated cases, the plaintiffs brought shareholder derivative breach of fiduciary duty claims against Oracle's Board of Directors for losses caused by alleged overcharges to the federal government for certain software. Prior to the lawsuits but after the alleged wrongful acts, Oracle's Board had adopted a by-law provision that purported to require shareholder derivative claims to be brought in Delaware. Such a provision was suggested by a Delaware Chancery Court in *In re Revlon, Inc. Shareholders Litig.*, 990 A.2d 940, 960 (Del. Ch. 2010). Of course, Delaware is viewed as a favorable forum for corporate directors facing derivative claims. Based on this forum selection provision, Oracle's directors moved to dismiss the claims for improper venue.

Oracle made the argument that the by-law provision was essentially a contractual forum selection clause. Accordingly, Oracle argued that the provision should be enforced like a contractual forum selection clause, which is often upheld. *See, e.g., M/S Bremen v. Zapata-Offshore Co.*, 407 U.S. 1 (1972); *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585 (1991). The Court refused to apply the contractual standard because it found that the by-law provision was not like a contractual forum selection clause. The court noted that the by-law provision was the result of a unilateral act by one party as opposed to a bilateral agreement, and hence could not be enforced like a contractual forum selection clause. Because the provision was adopted without the consent of the shareholders and after the alleged wrongful acts had taken place, the court found no reason to disregard the plaintiffs' choice of forum.

Fernea v. Merrill Lynch Pierce Fenner & Smith, Inc., Texas Court of Appeals, Third District (January 7, 2011).

Company subject to control person liability under Texas law if the company had the power to stop the securities transaction.

This case concerns the standards for establishing "control person" liability under section 1 of article 33F of the Texas Securities Act. In this case the plaintiff purchased a business from a Merrill employee that the employee owned as a separate business apart and aside from his employment at Merrill. The plaintiff believed that the Merrill employee failed to honor the agreement and committed a number of torts relating to the transaction. In addition to suing the Merrill employee, the plaintiff also sued Merrill, even though the transaction and the business were both unrelated to the employee's work for Merrill.

Merrill moved for summary judgment and the trial court granted the motion on all counts. The court of appeals affirmed most of the trial court's decision, but reversed as the "control person" liability claims under the Texas Securities Act. In doing so, the court noted that Merrill could be a "control person" even though the transaction and business were unrelated to any work performed for Merrill. The court noted that Merrill had the power to stop the transaction and that Merrill's policy arguably made the employee obtain permission from Merrill before consummating the transaction. Merrill argued that this was irrelevant because it had no knowledge regarding the transaction. Even though the court found that Merrill had conclusively proven that it had no knowledge about the transaction or that it was taking place, the court held that although this would show was that Merrill lacked a duty to control its employee's outside business activities, it would not establish that Merrill lacked the ability to control the employee's outside business activities. Since control was the only part of the control person claim that was challenged, the court reversed this portion of the trial court's order.

The lesson from this case is that business attorneys need to reassess whether their clients could be "control persons" in order to manage legal risk. In looking at this issue, business attorneys must pay attention to the company's policies, the actual employee-employer relationship, and various other factors. The key take away is that ignorance regarding the transaction, at least according to this opinion, will not negate a "control person" claim. If the client has the power to stop the alleged improper securities transaction, the client will likely be deemed to have sufficient "control" under the test for "control person" liability.

E-Commerce Committee

Chair:
Ronald L. Chichester

Description:
The E-Commerce Committee monitors developments and issues relating to e-commerce, with particular attention to Texas specific issues. Such issues include proposed and new state and federal legislation (i.e. UCITA, UETA, E-Signatures), Privacy, Internet Taxes, and recent E-Commerce cases.

Get Involved:

If you would like to join the E-Commerce Committee please contact Ron Chichester at complaw@gmail.com.

Dodd-Frank Poses New Challenges for Texas Investment Advisors

By James A. Deeken[1]

The recently enacted Dodd-Frank Wall Street Reform Protection Act will impact a number of the regulations and required registrations affecting investment advisors operating in the State of Texas.

Summary of Current Law

Generally, an investment advisor in the State of Texas who provides investment advice for compensation is required to be registered as an investment advisor with the Texas State Securities Board. A limited exception exists for advisors who provide advice exclusively to large institutional investors and private investment funds that have a two year lock-up on investor redemptions. The exemption is typically used by investment advisors to private equity and real estate funds since those funds tend to invest in illiquid assets and thus generally do not allow investors to redeem interests within two years of purchasing them. The exemption is largely inapplicable to hedge funds or other pooled investment vehicles who, because of the more liquid nature of their investments, tend to allow investors more frequent redemption rights.

The result of these rules is that investment advisors to hedge funds are typically registered as investment advisors with the State Securities Board (or, as discussed below, the Securities and Exchange Commission), while investment advisors to private equity and real estate funds are not.

In the event that an investment advisor is otherwise required to register with the State Securities Board, but has more than $25 million under management, it may opt under *current law* to register with the SEC instead of the State Securities Board (with such registration with the SEC, in lieu of the state, generally becoming mandatory under current law once an investment advisor has more than $30 million under management, unless the advisor takes advantage of a current exemption from SEC registration for advisors who provide investment advice to less than 15 clients or funds). Registration with the SEC negates any need to register with the State Securities Board as well.

Two Important Changes in Current Law

Under provisions of Dodd-Frank that become applicable later this year, the threshold for SEC registration as an investment advisor is increasing from $25 million to $100 million (unless an investment advisor is exempt from state registration, in which case the required threshold for SEC registration is $25 million, or is an advisor to a registered investment company or business development company). In effect, in many cases the "dividing line" between state and federal registration is increasing from $25 million to $100 million and, as a result, many investment advisors with less than $100 million under management that are currently registered with the SEC will generally be required to switch their registration from SEC registration to State Securities Board registration.

Under currently proposed rules, all SEC-registered investment advisers will be required to file an amendment to their SEC registrations no later than August 20, 2011 reporting their then-current assets under management. If an advisor has less than the required amount of assets under management, the advisor will be required to withdraw its SEC registration **by no later than October 19, 2011** under the currently proposed rules.[2] To facilitate the number of advisors who will need to switch their registrations from SEC to state registration, the State Securities Board has set up a process whereby advisors can "dual register" now with the state, while leaving their SEC registration intact until later this year.

In addition, Dodd-Frank is eliminating the exemption from SEC registration requirements for advisors who advise less than 15 clients. The result is that Texas investment advisors who have more than $100 million under management and who are currently registered with the state in lieu of the SEC, pursuant to the current 15 client exemption, will need to switch their registration from state registration to SEC registration and several investment advisors who not are currently registered with any regulatory agency will need to effectuate SEC registration as they register with a regulatory agency for the first time. Such requirements are currently set to become applicable in July of this year, although the SEC has stated that it will consider, in final rules yet to be adopted, extending the timeframe for compliance until the first quarter of next year.

Certain exemptions to registrations with the SEC that would otherwise be required exist under Dodd-Frank, including exemptions for advisors exclusively to small business investment companies, venture capital funds (narrowly defined to exclude private equity and leveraged buy-out funds), family offices and advisors exclusively to private funds who have less than $150 million in the aggregate under management. Even if exempt from SEC registration under Dodd-Frank, an investment advisor in Texas will still need to continue to consider whether it is required to registered with the state under state law or whether it continues to qualify for an exemption from state registration, such as the two year lock-up exemption.

Dodd-Frank Poses New Challenges for Texas Investment Advisors (*Continued from Page 4*)

As a result of the increase in the threshold for SEC registration from $25 million to $100 million, a number of investment advisors who are currently registered with the SEC will need to switch to state registration. Conversely, a number of investment advisors who are currently registered with the state and who have in excess of $100 million under management will need to switch from state registration to SEC registration due to the elimination of the 15 client exemption. In addition, many investment advisors who are neither registered with the state in reliance on the two year lock-up exemption or the SEC in reliance on the 15 client exemption, will need to evaluate for the first time whether SEC registration is necessary.

Registration with the SEC will typically take up to sixty days after the filing of a related application with the SEC, so advisors who need to effectuate registration with the SEC should start planning now, with a view to filing an application later this year. Registration with the state may take longer and advisors who feel that they may need to switch to state registration should consider "dual registering" now with the state to assure their state registration is effective in a timely manner.

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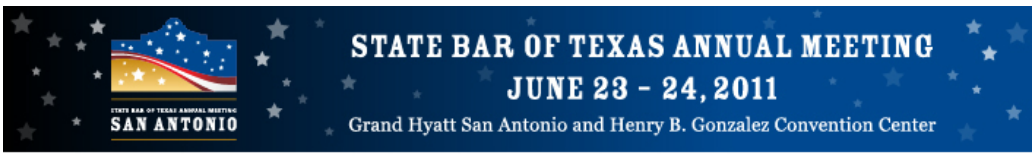
1 James A. Deeken is Vice Chair of the Business Law Section's Venture Capital/Private Equity Committee and is a Partner in the Investment Funds and Private Equity Section of Akin Gump Strauss Hauer & Feld LLP, located in Dallas, Texas.

2 On April 8, 2011, the SEC issued a letter stating that it will consider extending, in the final rules, the August and September deadlines until the first quarter of next year to give investment advisors more time to make the transition.

Weekly Legislative Reports Available

During the regular 2011 Texas legislative session, the Section is posting on its website weekly legislative reports. The reports include a list of bills filed in the Texas Legislature that are believed to be of interest to Texas business lawyers. The bills are listed by categories, beginning with ones that were originally drafted by, or are of particular interest to, the Section and then grouped by the principal topics of the bills: business entities, UCC, securities, financial services and financial institutions, business liability (including privacy and related matters), taxation and related topics, and real estate and related topics. The report includes only a brief description and an abbreviated history of each bill, but the report links to the Texas legislative website and all of the information regarding the bill at that site. Therefore, by clicking on a bill in the report, the reader has access to extensive information about the bill, including the texts of the bill, the bill analysis for the bill, and the legislative history of the bill. The reports are posted weekly and are available to all Section members.



The State Bar Annual Meeting returns to San Antonio June 23 – 24, 2011 (Thursday – Friday) for two full days of CLE that will educate, motivate, and inspire. This year's conference features a variety of lectures, panels, and discussions on a wide range of topics by leading experts. From sessions on law practice management to ethics to legislative updates, there is something for the first year associate to the seasoned professional.

Newsletter Submissions

If you would like to submit an article for inclusion in the Business Law Section's Newsletter, please email it to our Newsletter Committee Vice Chair, Wendy Curtis, at wcurtis@akingump.com. The Newsletter Committee reserves the right to edit contributions for clarity and content.

Keeping Your Email Address Updated

With the electronic distribution of the newsletter, it will be important for every Section member to keep an updated email address with the State Bar of Texas since that agency will distribute the email on behalf of the Section. You may update your email address at the MyBarPage of the State Bar's website. Please note that the Section will not sell or distribute your email address to anyone, including the State Bar's CLE Division.

UPCOMING CLE PROGRAMS

STATE BAR OF TEXAS
BUSINESS LAW SECTION

State Bar of Texas
Attn: Business Law Section
P.O. Box 12487
Austin, Texas 78711

We're on the Web!
www.texasbusinesslaw.org

UPCOMING CLE PROGRAMS

Choice and Acquisition of Entities in Texas 2011:

Hyatt Hill Country Resort & Spa, San Antonio, Texas – May 27, 2011
Presented by State Bar of Texas
Section members get a $25 discount

Free CLE at State Bar of Texas Annual Meeting:

Grand Hyatt Hotel and Henry B. Gonzalez Convention Center, San Antonio, Texas
June 23-24, 2011
Presented jointly by the Business Law Section and the Corporate Counsel Section
Admission is free to all members of either section

Advanced In-House Counsel Course:

Westin Galleria, Dallas, Texas
July 28-29, 2011
Presented jointly by the Business Law Section and the Corporate Counsel Section
Section members get a $25 discount

Business Law Section members take a break at Bernhardt Winery in Plantersville, Texas.