

# ASSOCIATION OF BUSINESS TRIAL LAWYERS

# abt1

# REPORT

## ORANGE COUNTY

Volume III No. 1 February 2001

### Q&A with the Honorable Stuart T. Waldrip



*[Editor's Note: Our judicial interview this time is with Judge Stuart Waldrip. A member of the Complex Civil Panel, Judge Waldrip was one of the founding judicial members of ABTL's Board of Governors.]*

**Q:** This time of year, many new litigation associates are just starting out their legal careers. What advice do you have for these young lawyers?

**A:** Don't panic if you think you don't know the "rules" in some area of the law. Chances are that none of us does, although we often "pretend." Don't pretend to know the answer to a question if you don't really know. Be straight with other lawyers and judges when you are caught off guard - then do the research and get back with a more educated response. In the end, you will earn the respect of others. Pretending will trip you up and ultimately damage your reputation and your character, even though you can get away with it initially sometimes.

**Q:** As a member of the complex panel, are you looking

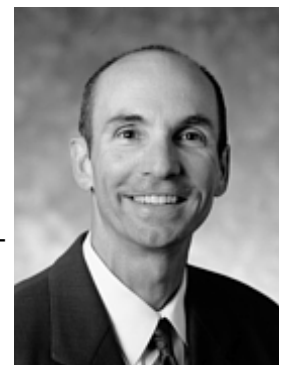
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### Litigating Oral Promises of Stock Options

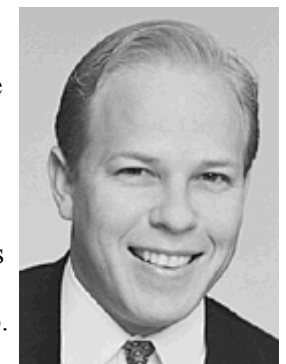
By Dennis Childs and Patrick Maloney

Stock options. These two words conjure up dreams of instant wealth. The buzz about stock options is everywhere. The media repeatedly profile stock option millionaires; job hunters compare stock option packages; soon-to-be-public companies find themselves with a growing circle of "friends and family."

The desire to be among those fortunate enough to ride stock options to riches has led to an ever-increasing number of suits to enforce oral promises of options. But no one ever said that litigating oral stock option contracts would be easy. There are obvious problems of proof, and defendants have a variety of defenses at their beck and call, including the Statute of Frauds and uncertainty, each of which are the subject of this discussion. Nevertheless, the windfall to a successful plaintiff can be enormous. In a recent Texas decision, for example, the victor recovered damages of \$17,775,686. *Miga v. Jensen*, 25 S.W.3d 370 (Tex. App. 2000).



Dennis Childs



Patrick M. Maloney

### Recent Changes In The California Commercial Code May Have Abrogated the Statute of Frauds Defense In Transactions Involving Certain Types of Securities

When oral contracts are at issue, savvy lawyers almost always assume that there must be some Statute of Frauds issue. Oftentimes, they are right. However, given several recent changes to the California Commercial Code, this may no longer be the case in suits involving stock options.

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## President's Message: Proud To Be An American Litigator

by Andrew J. Guilford, President



I'm proud to be an American litigator! In speeches as State Bar President, I often noted that the importance of our profession and the Judicial Branch was seen in the frequent comment that the most important issue at stake in the Presidential Campaign was the power to appoint judges. This suggests that the Judicial

Branch is more important than the Executive Branch. My stump speech gained even more power when our frustrated, divided country turned to litigators and the Judicial Branch to resolve the presidential election dispute. The election crisis reveals much about litigators and the Judicial Branch. Thus, litigators should study this election, and a good place to start is at our next ABTL meeting on February 7, 2001 entitled "*The Y2K Presidential Election: Lessons For Litigators.*"

Contrary to the shrill attacks leveled at litigators and our judicial system during the presidential election dispute, Americans should be proud of the important role played by litigators and judges in resolving this dispute. Because we are a nation of laws, we used litigators in this dispute to wage war over the words of the law, rather than using soldiers to fight battles with bullets and bombs. As litigators and judges struggle to interpret the law in our nation of laws, they become targets for those opposing their views, just as soldiers become targets for their enemies. But Americans should give thanks that we are arguing over words to see who is right, rather than fighting with violence to see who has might.

During this pressure packed partisan dispute, not all lawyers and judges have performed perfectly. But it is revealing to review all the players who have performed on this national stage. We saw David Boies fly from court to court, giving arguments without notes, and making momentous split-second decisions in oral argument that might have proven fatal. We saw other counsel forgetting the names of Supreme Court Justices! Pragmatically, I wonder how these performances will affect my next jury.

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## DO YOU HAVE SOMETHING TO SAY?

If you are interested in submitting material for publication in any upcoming issues of the ABTL Orange County Report, please contact our Executive Director at 323.939.1999 or submit your material directly to [abtl@mediaone.net](mailto:abtl@mediaone.net).

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## The Great American Motion

By Hon. Elaine Streger

### Chapter 1

To be effective in law and motion, you must never forget that the purpose of your motion is to convince the judge or commissioner to give you something you want. A motion is not a rehearsal for a summation to the jury. It is not (or should not be) a technique for increasing your billable hours. It is certainly not a law review article. And, it is not a work of fiction (except perhaps for some attorneys' declarations).



The Great American Motion never won an Edgar for best mystery story. It is advisable to forget everything you learned in your high school creative writing class. Your motion should not contain a leisurely setting of the scene, a detailed character and plot development nor an emotional climax followed by a surprise ending.

The most important thing to keep in mind when drafting your motion is the reader. At Orange County Superior Court, the reader is someone who has read thousands of motions, who has a good working knowledge of civil law, who has heard or read more excuses than you can think of, and who does not have a lot of time.

Keep it simple. Keep it concise. Tell the reader in plain language who you are, what you want from whom and why you should get it. All this information should appear in the notice of motion. Line 5 tells who you are. It is irksome to look at line 5 and see "attorney for defendant" in a multi-party, multi-attorney case. The caption of the motion tells what you want, and cite to a code section there gives a clue as to why you should get it.

In the introduction to your motion, you should specify in detail exactly what you want the court to order. Attorneys have been known to become completely flustered and speechless (believe it!) in court when asked: "Counsel, what do you want?" Your introductory remarks should also include a very brief statement of the case.

Always start with your strongest argument. Successful motions are usually won within the first few pages.

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## ABTL December Dinner Program: The Latest Developments on Business & Professions Code §17200

By Sean Sherlock

Attendees of the ABTL's December dinner program were treated to an informative seminar on the latest developments under California's Unfair Competition Law (Business & Professions Code, §17200 *et seq.*). The program was presented by some of the most seasoned practitioners in this evolving area. Our panel was moderated by Glenn Dasso of Paul, Hastings, Janofsky & Walker, and also included the Honorable Robert E. Thomas of the Orange County Superior Court, Alan Mansfield of Milberg Weiss Bershad Hynes & Lerach, and Gail Lees of Gibson, Dunn & Crutcher.

Our panel discussed several developing issues under the Unfair Competition Law, including application of the four year statute of limitation, the lack of any right to a jury trial, the lack of traditional tort and equitable defenses, and the applicability of a potential defense where the defendant's conduct is authorized by statute. Perhaps most interestingly, our panel discussed the recent California Supreme Court opinions in *Kraus v. Trinity Management Company* and *Cortez v. Puralator*, and how these decisions open the door for consumer actions in the nature of class action lawsuits, but without the necessity of meeting class certification requirements.



Given the rapid growth in the numbers of §17200 cases being filed, the many difficult legal issues yet to be resolved, and the absence of any legislative intervention, this area of our law may still be in its infancy.

► **Sean Sherlock**  
Snell & Wilmer

**MARK YOUR CALENDAR:  
ABTL 28TH ANNUAL SEMINAR**

**OCTOBER 11—14, 2001  
La Quinta Resort & Club  
La Quinta, California**

(President: Continued from page 2)

Philosophically, I wonder whether citizens and future juries will think our justice system works well. Can we expect nonpartisan courts? As we review the players in the election dispute, we see that politicians in the Legislative and Executive Branches were understandably partisan. Journalists professing to be unbiased were also partisan. Even pastors were predictably partisan. Only lawyers, and particularly judges, took positions contrary to their partisan affiliations.

The first heroic example of nonpartisan judicial integrity in this dispute was shown by Circuit Judge Terry Lewis, a Democrat, who early in the dispute ruled in favor of Republican Secretary of State Katherine Harris. Near the end of the dispute, reviewing the absentee ballot issue, Judge Lewis again ruled contrary to his party affiliation, and was joined by Circuit Judge Nikki Clark who also was ruling against her party affiliation, and in favor of the party whose governor had blocked her appellate elevation! Perhaps the most momentous trial court decision favoring Republicans was made by another registered Democrat, Circuit Judge N. Sanders Sauls.

The Supreme Courts of Florida and the United States have received much criticism for supposed partisan rulings. But even here, perhaps the harshest criticism of the United States Supreme Court came from its own Justice John Paul Stevens, appointed by a Republican, condemning a decision which helped the Republicans. Likewise, perhaps the harshest criticism of the Florida Supreme Court came from its own Chief Justice Charles Wells, appointed by a Democrat, condemning a decision favoring the Democrats. Thus, even in this self-criticism of these high courts, there are inspiring examples of judicial integrity.

It is hard to imagine legislators criticizing legislative action favoring their party, yet in America we can expect judges to give unbiased interpretations of the law contrary to their partisan interests. God save our honorable courts, so that they may save our nation of laws!

Do you agree or disagree? Come join your fellow business litigators in reviewing these issues at our dinner program on February 7, 2001!

► **Andrew J. Guilford**  
**Sheppard, Mullin, Richter & Hampton**

## **A Word from this Issue's Sponsor:**

# **MOSS-ADAMS LLP**

## **ALTER EGO: THE UNDER-CAPITALIZATION CASES**

By Jim Skorheim

### **Prelude**

Alter ego is one of the most litigated issues in corporate jurisprudence. The under-capitalization factor is present in almost all of the alter ego cases. Yet, with as much attention as has been heaped on the under-capitalization claim, objective standards of corporate conduct have not been forthcoming. The resolution of the accounting, finance and legal issues inherent in an under-capitalization case are less a matter of math and science than of art and feel. This article explores many of the issues relevant in the under-capitalization case and the sometimes conflicting approaches taken by the courts in their disposition.

### **Introduction**

"Alter Ego" in legal terms describes an attempt by a creditor of a corporation (or a limited liability company) to enforce and collect its claim against the stockholders or owners of the entity. The creditor argues that the corporation is merely the alter ego or instrumentality of the stockholders and should be disregarded for purposes of allowing the creditor to "pierce the corporate veil."

Piercing the corporate veil is one of the most litigated issues in corporate law. Whenever a corporation is financially unable to respond in damages, the frustrated creditor often seeks to press its claim against the owners of the enterprise.

However, a fundamental principle of corporate law is that stockholders of a corporation are not personally liable for the obligations of the enterprise beyond the capital they contribute in exchange for their shares. This notion, known as "limited liability," serves an important public policy. It encourages investment in American business and industry by limiting the exposure of the investor. It provides predictability for the corporate investor. The corporate attribute of limited liability for its investors assuages the investor's concern about unknown or uncertain contingent obligations in connection with his or her investment decision. As we shall see, however, the concept of limited liability is not absolute.

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Remember, the reader is very familiar with the law but not at all familiar with your case. Therefore, it is important that you explain how the facts of your case fit within the applicable statute and case law.

Avoid excess verbiage. The attorney who refers in his demurrer to the "purported" cause of action every time he mentions "cause of action" begins to look silly. The attorney who prefaces his arguments with ---"It is basic hornbook law..." or "It is black letter law..." --- elicits a basic groan and yawn from the reader.

Remember that one case on point is worth more than ten pages of string citations. As for the boilerplate citations which you feel are necessary in order to make your motion complete, why not list them at the end under the heading "boilerplate"?

Do not repeat the same information in the introduction, the argument and the declarations.

Show by your compliance that you have read the rules of evidence and the rules of court. An astounding 50% of the orders submitted after the court has granted a motion to withdraw as counsel are returned to the attorneys for non-compliance with CRC 376 (d). And there are many withdrawing attorneys who don't make it to the "order" stage the first time around because they have not complied with the court rule.

To make a favorable impression on the reader, consider the following: When attaching documents, make sure they are legible, particularly when the court is being called upon to interpret the document. It is helpful when you highlight the particular clauses at issue. (But be sure to highlight AFTER photocopying.) Tab your exhibits on the bottom of the page. Side tabs sometimes end up facing the inside fold of the file. Proofread your completed motion. Be sure that the pages are in order and facing the same way. Sloppy or non-existent proofreading detracts from the substance of your motion and from your professional reputation. Example: "Plaintiff contends that he attempted, in vain, to obtain other dental malpractice insurance. Consequently, he claims that he is now compelled to quit his dental malpractice because of insurer's nonrenewable. Plaintiff contends that this resulted in additional damages to him."

In summarizing the verbiage herein above pro-pounded, just remember that your written work will be

more persuasive if you do not lose sight of the purpose and the reader.

## **Chapter 2**

To be effective in law and motion practice, it is helpful to know the process and everybody's function in it.

Seven days prior to your hearing, the court computer generates a calendar sheet for each motion in each department. File clerks toil away in the basement to retrieve the file for each calendar sheet (usually more than 100 in a day). In a case consisting of many volumes, the clerk will retrieve only the volumes that appear pertinent to the motion. This is a time-consuming and tedious process. You can help by specifying in your caption what is important, such as which amended complaint or which defendant's cross-complaint is relevant. For example, a caption that says "motion for Summary Adjudication for the 2<sup>nd</sup> and 5<sup>th</sup> causes of action of the 3<sup>rd</sup> Amended Cross-Complaint of Cross-Complainant J.R. Sleeze" tells the clerk what to look for. After the file clerks retrieve the files, they deliver the files to the courtrooms. From this moment until after the hearing, the files are not available for inspection by interested parties or attorneys.

Six court days prior to the hearing, the courtroom assistant (that's the one whose desk is close to the railing) flags the files for legal research.

The courtroom assistant also continuously updates the alpha sheet (an alphabetical listing of the cases on calendar each hearing day) with the notations "continued" or "off-calendar." Motions in those categories are not sent back to research. It is important that you call the court as soon as you know that your motion is not going to go forward.

Next, all files for the day are delivered to the Supervising Attorney for assignment to the individual research attorneys for workup. Sometimes, there are reasons to put motions back on calendar; e.g., there was an ex parte order. Those motions are then sent back to research as "add-ons" and assigned for work-up.

One of the responsibilities of the Supervising Attorney is to see that the workload is equitably distributed, taking into account the difficulty and length of the motion and the variety of interests and capabilities of the attorneys on staff. This is done by examining parts of the motion and then deciding which of the legal research attorneys is best able to do the workup. Assign-

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*(Q&A: Continued from page 1)*

forward to the move to the panel's new location? What improvements will the new venue provide?

A: Yes, definitely! We will have new, modern facilities with convenient electronic evidence presentation equipment and adequate space for multiple counsel cases. The logistics of filing and file management will be much improved. We will be together in one facility with our support and legal staff and will be able to handle complex matters much more efficiently and on a more "user friendly" basis. With the inauguration of e-filing sometime in 2001, we will begin a new era in case management that will hopefully benefit all participants.

Q: Are there any plans to expand the complex panel, or does the current size adequately handle the caseload of complex matters?

A: "Complex Civil" is something of a moving target. I expect to see the traditional mix of cases modified somewhat as we adjust to meet the state-wide model for the Complex Civil Litigation Pilot Program. This is an ongoing study in which Orange County is participating that will stretch to 2003. Already non-complex eminent domain cases and writs of mandate, traditionally handled by the Panel in Orange County, are being reassigned to general civil departments. We have a 5th courtroom in the CX facility that will temporarily house a general civil department. When the time is right, I expect to see it occupied by a 5th Complex Panel judge.

Q: How can lawyers make a complex case more interesting to a jury?

A: Making a long, technical case interesting is a major challenge. Well-placed occasional humor helps, but can easily be overdone. Little things, like bringing treats for the jurors on a cooperative basis between counsel, help, as well. Well-managed photos, models, and visual aids heighten interest, but must be planned and cleared in advance. Counsel can be creative in handling mundane, repetitive testimony - perhaps by stipulation or by representative testimony of a few witnesses or a few alleged defects - even if the result is a bit less precise. The savings in time, expense and irritation is worth the "averaging" that occurs under such an approach. Just thinking ahead of trial about the benefits of conserving time and keeping interest up would be a good start.

Q: How involved are you in settlements? Do you think a higher percentage of complex cases settle than regular cases? Why or why not?

A: I am not as involved in the settlement process in most cases as I would like to be. As time goes on, I think we will see a decrease in caseloads so Panel judges can be more intimately involved in the management process. To a certain extent, the Legislature and the Judicial Council are encouraging movement in this direction. I think we do see a very high percentage of complex cases ultimately settle. I believe this occurs as a result of good counsel, talented outside mediators and the economic pressure of long, expensive and unpredictable trials.

Q: What are your pet peeves on the bench?

A: I don't have many. Most counsel I see are professional, courteous and well-prepared. Of course, this makes the occasional errant one stand out dramatically. Lawyers who bicker and snap at one another, who are impolite to the staff or the court, who fumble for exhibits or display obvious lack of preparation are the usual exceptions. I get most frustrated with wasting time in trial from lack of thoughtful preparation by counsel.

Q: As you end your tenure on the ABTL board, do you have any thoughts on ABTL and its future?

A: The ABTL is obviously a great organization. It has attracted the interest and participation of the very best "business" trial lawyers with excellent programs and other events. I would hope the organization would stay focused. The danger I see is the potential dilution of purpose by trying to be all things to all people. If we stick to the things that have worked so far, and do them well, we are assured of continuing success.

Q: If you could have any job in the world other than being a judge, what would it be and why?

A: I think I have the best job there is. With the exception of the penurious compensation, I am excited about this vital part of the legal profession. It is a fundamental component of our way of life and system of government. It really is fun to have a hand in the resolution of difficult matters that are important to individuals and businesses. Judges also have a unique opportunity to help shape the mechanisms by which we endeavor to provide for the orderly and peaceful resolu-

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(Q&A: Continued from page 6)

tion of disputes. It is a most satisfying job - I look at it more as a calling, and I am delighted to serve. I can think of nothing I would rather be doing in a professional sense.

► **Hon. Stuart T. Waldrip**  
**Orange County Superior Court**

(Motion: Continued from page 5)

ing the files takes between two and three hours per day.

What do they do in legal research? They grade papers. If you can visualize a giant intellectual trash compactor, you've got the idea. They determine what the moving party wants (it's very helpful if you tell them), what the really important issues are (it's surprising how often the attorneys waste time and paper arguing issues that are not the deciding factors), which statutes and/or cases are applicable and whether you have met the burden involved in your motion. They then prepare a concise summary (you would be amazed at how often a huge motion can be condensed to one page), and make a recommendation. The completed workup and file are delivered to the judicial chambers approximately 72 hours prior to the hearing.

The judge or commissioner then has to find the time, amidst trials, MSCs, and other hearings, to prepare to rule on approximately 10 to 20 cases coming up for hearing that weekday.

By the time of the hearing, a variety of people have spent many hours processing the workload and getting prepared for your shining moment in court.

You will serve your clients best when you make it easy for the Court to give you what you want. You do this by understanding the important issues of your case, knowing and following the rules, and expressing yourself clearly and concisely.

*\*Prior to her appointment to the bench in 1997, Judge Streger served the Orange County Superior Court as a Legal Research Attorney for 15 years, including 9 years as Supervisor of the Legal Research Department.*

► **Hon. Elaine Streger**  
**Orange County Superior Court**

(Alter Ego: Continued from page 4)

**Background**

While there is a strong presumption in the law favoring the legal separateness of the corporation and its stockholders, the courts have nevertheless been willing to apply the alter ego doctrine to disregard this separateness and to redress certain corporate abuses.

In California, one of the lead cases that discusses the application of the alter ego doctrine is *Associated Vendors, Inc. v. Oakland Meat Company, Inc.*<sup>1</sup> "The basic rule stated by the Supreme Court as a guide in the application of this doctrine is as follows: The two requirements are (1) that there is such unity of interest and ownership that the separate personalities of the corporation and the individual no longer exists, and (2) that, if

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**ABTL DINNER PROGRAM**

Wednesday, February 7, 2001

**The Y2K Presidential Election and  
the Judicial System: Lessons For  
Litigators**

*Featuring.....*

**Wylie A. Aitken**

Law Office of Wylie A. Aitken

**Professor John C. Eastman**

Assoc. Professor & Director of the Center  
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University School of Law

**Andrew J. Guilford**

Immediate Past President, State  
Bar of California,  
Sheppard, Mullin, Richter & Hampton

Westin South Coast Plaza  
6 p.m. Reception  
7 p.m. Dinner & Program



Before January 1, 1997, California Commercial Code Section 8319(1) provided that a contract for the sale of securities was not enforceable, unless it was evidenced by some sort of a writing. Although California case law on the application of Section 8319 is sparse, defendants in other jurisdictions successfully defended suits involving oral promises of stock options by asserting provisions identical to Section 8319. E.g. *Kunica v. St. Jean Financial, Inc.*, 1998 WL 437153, \*4-5 (S.D.N.Y. Aug. 3, 1998). Nevertheless, a plaintiff could attempt to avoid the writing requirement of Section 8319 by demonstrating that the stock options at issue were not "securities," and hence that Section 8319 was not applicable.

However, even if the plaintiff were successful in dodging the writing requirement of Section 8319, he or she would still need to negotiate the writing requirements contained in California Commercial Code Sections 1206, 2201 and California Civil Code Section 1624, each of which codify the common law Statute of Frauds.

Now, however, the days of the plaintiff seeking to characterize the options he was promised as something other than "securities" are long gone. Effective January 1, 1997, Commercial Code Section 8113 replaced Commercial Code Section 8319. Section 8113 abrogates the Statute of Frauds' writing requirement in transactions involving securities, providing as follows: A contract or modification of a contract for the sale or purchase of a security is enforceable whether or not there is writing signed or record authenticated by a party against whom enforcement is sought, even if the contract or modification is not capable of performance within one year of its making.

In light of Section 8113, a plaintiff will surely attempt to show that the stock options at issue are "securities," as that term is defined by Commercial Code Sections 8102 and 8103, in order to avoid the Statute of Frauds defense.

Whether the California courts will hold that stock options are securities remains to be seen. Commercial Code Section 8102 defines the term "securities" broadly, as have many of the Courts that have considered the issue. See e.g. 7 William D. Hawkland, *Uniform Commercial Code Series*, 8-102:2 (2000). Section 8103, however, limits the broad definition of "securities" set forth in Section 8102. Among other things, Section 8103 states that certain types of options are not securities. Even so, a grant of options issued by the company to an

employee or founder may arguably qualify as a security. See 7A Id. 8-102:01, 8-103:06.

Even if the plaintiff is successful in persuading the court that the stock options at issue are securities, there remain good arguments that Section 8113 should not apply to all stock option transactions. The official comment reveals that Section 8113 is an effort to recognize that "With the increasing use of electronic means of communication, the statute of frauds is unsuited to the realities of the securities business." Cal. Com. Code 8113 cmt. (emphasis added). This statement, when coupled with the general tenor of Article 8, supports the argument that Section 8113 was intended to apply to only transactions between third parties and their stock brokers, not direct contracts between the issuer of a security and the employee, founder, or venture fund plaintiff. This is particularly true given the growing popularity of on-line securities trading, which is conducted almost exclusively through electronic means of communication.

Delaware corporations may find some relief in Delaware's General Corporation Law. Section 157 of that law provides that the terms of a stock option grant must be separately stated in the corporation's certificate of incorporation or in a resolution adopted by the board of directors. Del. Code Ann. tit. 8, 157. Failure to comply with this requirement renders an option void, and may be powerful evidence that there was no oral promise. See e.g. *Niehenke v. Right O Way Transportation, Inc.*, 1995 WL 767348, \*3 (Del. Ch. Dec. 28, 1995).

### **Uncertainty Is Often, But Not Always, Dispositive In Litigation Involving Oral Contracts For Stock Options**

As with the Statute of Frauds, uncertainty is a frequent defense in cases involving oral contracts. A stock option agreement generally includes a variety of provisions, the absence of which renders the contract unenforceable. Some of the important terms in a contract concerning stock options include price, exercise date, and the number of options to be issued. When evidence of these key terms is not present, enforcement of the oral contract is simply not possible. But where it appears that the parties have reached an agreement, a plaintiff may be successful if he or she can adduce evidence on these points.

### **A. Cases In Which The Oral Promise Was Too Uncertain To Be Enforced**

One of the few reported California decisions concerning an oral promise of stock options is *Barton v. Elexsys Int'l, Inc.*, 62 Cal.App.4th 1182 (1998). There,

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*(Stock Options: Continued from page 8)*

plaintiff alleged that prior to being terminated from Elecsys, two members of the company's management made promises that modified the terms of written stock option contracts between plaintiff and Elecsys. The court held that a promise made in "general terms" to the effect that the company would "take care of" its key executives was "too vague and uncertain to support a claim that the parties' written stock option agreement had been modified thereby." *Id.* at 1189-90. Similarly, a remark by a company executive that plaintiff had 100,000 shares of stock, when in truth plaintiff had a far smaller number of vested options, was insufficient to modify the written stock option contract.

Analogous cases from other jurisdictions reach the same result. For example, in *Niehenke*, 1995 WL 767348, applying New York law, the Delaware Chancery Court found an oral promise of stock unenforceable because plaintiff did not meet the heavy burden of proving the existence and terms of the agreement. Plaintiff's case was doomed because even those witnesses who testified that the parties discussed stock options conceded that there had been no agreement to key elements of the claimed contract, including: the number of shares outstanding and available for options, the price per share, the attributes of the shares to be optioned, the exercise period, and the definition of terms that would affect vesting.

### **B. Uncertainty Does Not Always Provide An Absolute Defense**

While uncertainty is dispositive in many oral stock option contract actions, it is no panacea. In *Miga*, 25 S. W.3d 370, the court went to great lengths to ascertain the terms of the parties' agreement and enforced an oral stock option contract. *Miga*'s facts, which are recited below, reveal that plaintiff was extraordinarily successful in developing strong evidence of the parties' stock option agreement.

Prior to the events underlying the suit, the parties in *Miga* had a pre-existing business relationship. In 1990, defendant Jensen hired plaintiff Miga to run a new long distance company, Matrix Telecom, and gave Miga a 6% interest in the company. When Matrix Telecom became a wholly-owned subsidiary of Matrix Communications, Miga's 6% interest in Matrix Telecom was converted to a 4.8% interest in Matrix Communications.

In 1992, Miga introduced Jensen to the principals of a new start-up company, Pacific Gateway International ("PGI"), and Jensen invested in and acquired an 80%

interest in PGI. In July 1993, Jensen gave Miga an oral option to buy PGI stock.

When Miga approached Jensen about "settling his account," Jensen terminated him and demanded that Miga sign a termination agreement. Jensen told Miga that the termination agreement would not terminate his rights to the oral option contract.

After repeatedly seeking to exercise his options, Miga filed suit. During the trial, Jensen did not deny that he had given Miga an oral option. Further, Jensen and Miga offered conflicting testimony about the terms of the oral options, including price, quantity, and term. The jury found in Miga's favor.

Jensen appealed the jury verdict, asserting, among other things, that the oral option agreement was too uncertain to be enforced because it did not provide a quantity provision and also did not have an expiration date. The Texas Court of Appeal affirmed the jury's verdict. With respect to the amount of stock to which Miga was entitled, relying on Miga's testimony and evidence of other stock option grants, the court found the quantity term sufficiently certain to be enforced. The Court rejected Jensen's second claim of error — that the contract did not include an expiration date — because Jensen had testified that the option was open until December 31, 1994. Miga had attempted to exercise his options on December 5, 1994.

As the foregoing decisions reveal, where it appears that the parties have done nothing more than discuss stock options, the courts will not enforce the claimed oral contract. Where, however, there is strong evidence of the existence and terms of the contract, oral contracts for stock options may be enforced.

### **Conclusion**

The number of cases involving oral stock options will probably increase given the recent changes to the Commercial Code. Nevertheless, defendants may still successfully employ the Statute of Frauds as a defense in these cases, so long as the options are not classified as securities. Where the options are classified as securities, uncertainty will likely provide the best defense.

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the acts are treated as those of the corporation alone, an inequitable result will follow.”<sup>2</sup>

While the Supreme Court’s formulation is informative, it is lacking in definition as to the acts that are contemplated and specific standards of corporate conduct to be applied in the determination. The trial courts have been largely left to their own devices in carving out the relevant factors and standards. The appellate court in *Associated Vendors* explored a number of factors relevant to the first prong of the Supreme Court’s test: the unity of interest requirement. Some of the more significant factors include:

- Common ownership;
- Pervasive control;
- Commingling of assets;
- Failure to adhere to corporate formalities;
- Absence of corporate records;
- No dividend payment;
- Improper stockholder distributions;
- Non-functioning of officers and directors; and
- Under-capitalization.

### **Under-Capitalization**

It is apparent upon review of the cases that alter ego is an intensely fact-based inquiry. Typically, several of the above-noted factors were found to be present when the courts “pierced the corporate veil.” In fact, under-capitalization or thin capitalization was present to some degree in all alter ego cases by definition. In other words, an alter ego finding would be unnecessary in each of these cases if the corporation had sufficient assets to respond to the creditor’s claim. Consequently, the under-capitalization issue has been extensively debated throughout the alter ego literature.

Once again, however, the absence of clear standards in the under-capitalization arena is striking. Rather, the courts are left with a patchwork of possible considerations and sometimes conflicting authorities. A number of the significant considerations in the under-capitalization cases follows.

First, it should be noted that the fact that the corporation has not been capitalized sufficiently to satisfy the subject claim is not in and of itself a sufficient showing of under-capitalization in the alter ego sense. The under-capitalization for alter ego purposes must be tied to some perceived breach of duty by the owners. This “duty” has been articulated by the courts: “It is inherently unfair to potential claimants for stockholders to

operate a corporation without providing it with at least a certain minimal level of assets in light of the business in which the corporation is engaged.”<sup>3</sup> Several issues arise in determining whether the stockholders have met their burden of providing the corporation with “a certain minimal level of assets.”

### **Timing of Capitalization**

The timing issue highlights the tension between the ideal of limited liability and the minimum capitalization concept. If the stockholders’ initial capitalization is sufficient, will subsequent events which reduce the capitalization below the threshold level require an additional commitment of resources by the stockholders? The courts have generally found that the capitalization requirement is measured at the time of corporate formation and is unaffected by subsequent events.

However, this is not always true. For instance, some courts have held that subsequent stockholder distributions may be relevant. One court opined that “The obligation to provide adequate capital begins with incorporation and is a continuing obligation thereafter . . .”<sup>4</sup>

### **Sole Reliance on Under-Capitalization Factor**

Will under-capitalization alone support a finding of unity of interest? As mentioned above, the courts typically find several of the factors enumerated in *Associated Vendors* before extending liability to stockholders. In *Minton v. Cavaney*,<sup>5</sup> however, a California court reasoned that “the equitable owners of a corporation . . . are personally liable . . . when they provide inadequate capitalization and actively participate in the conduct of corporate affairs.” In this case, the court found that under-capitalization alone was sufficient to pierce the corporate veil. It should be noted, however, that the *Minton* rationale has not gained general acceptance and most cases hold that alter ego must involve a number of factors.

### **Meaning of Capitalization**

Capitalization in a strict accounting sense refers to the relative amounts of debt and equity used by the owners of the enterprise to fund its operations. A corporation could have high levels of debt and a thin layer of equity capitalization and still have sufficient assets to respond to a damage claim. A focus on capitalization alone may reflect only one element of the corporate balance sheet in determining if creditors are being fairly treated. The courts have shown a willingness to look beyond capitalization to determine if “sufficient assets or other resources” are available to creditors. For in-

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stance, courts have often looked beyond the limited notion of stockholders equity capitalization to consider insurance coverage, loans made by stockholders and retained earnings in disposing of a creditor's under-capitalization claim.

### **Tort vs. Contract Creditor Issue**

A contract creditor in a strong negotiating position who has requested and received accurate financial information about the debtor corporation may be in a much different position than an innocent and unwilling tort creditor. While the tort creditor is typically uninformed about the corporation's financial condition and is an unwilling participant, the contractor likely knew of the financial weakness of the corporation and could have acted to protect itself. Should both creditors have equal access to the alter ego doctrine for protection? The courts have generally been unwilling to adopt a clear distinction in alter ego cases between contract and tort creditors. Nevertheless, the status of the plaintiff has been considered by the courts in weighing the relative injustice of respecting the corporate separateness in the particular circumstances.

### **Who is Liable?**

In the Minton case noted above, the court would extend liability "to . . . those equitable owners . . . who actively participate in the conduct of corporate affairs."<sup>6</sup> On the surface this formulation appears sensible. It encourages active investors to provide an adequate level of assets, yet facilitates investment by protecting purely passive investors. However, the difficulty comes in the application of the rule. What degree of participation is necessary for a finding of liability? Should all employee-shareholders be liable or only director-shareholders? What if an employee-shareholder is aware of the under-capitalization problem but is powerless to cure it? Or, what about the director-shareholder who does not understand the extent of the problem? Is his or her ignorance a bar to liability? Again, with no clear standards available, the courts are left adrift to wrestle with the unique facts and circumstances of each case, sometimes with disparate results.

### **Adequacy of Capital**

Finally, the capitalization cases consider the measurement of the adequacy of capital. A common theme among the cases suggests that piercing the corporate veil should be an unusual remedy. They hold that the corporation must be "grossly undercapitalized;"<sup>7</sup> that "the inadequacy of capital must be obvious;"<sup>8</sup> or that

"the capital was trifling compared with the . . . risk of loss."<sup>9</sup>

Yet even when requiring an obvious or gross under-capitalization, the courts' task is still not simple. The courts must consider a multitude of factors without definitive standards. They must consider the level of corporate assets, its liabilities, the amount of stockholder contributions and distributions, insurance coverage's and changes in these variables over time. The court must consider the capitalization of comparable companies and perhaps the appropriate level of insurance protection and other stop loss tools. The courts must consider the extent to which appropriate funding levels later become insufficient and inquire into the reasons for the decline. Facts concerning the participation, knowledge and intent of the stockholders must be ascertained. All of these factors and more may play into the court's final determination.

### **Conclusion**

When considering the results of the under-capitalization cases, it appears that in the main the courts reached the proper decisions. However, it is clear that there are no bright-line objective standards to aid the courts in their deliberations on the alter ego challenge. Each court must delve into the complex world of accounting and finance to discern the factual underpinnings of each case and reach a decision more by gut feel and art than by science and arithmetic.

#### *Footnotes:*

1. 210 Cal. App. 2d 825, 26 Cal. Rptr. 806 (1962).
2. *Id.* at 837.
3. Harvey Gelb, *Piercing the Corporate Veil – The Under-capitalization Factor*, 59 Chi.-Kent. L. Rev. 1,2 (1982).
4. *DeWitt Truck Brokers v. W. Ray Fleming Fruit Co.*, 540 F. 2d. 681 (4<sup>th</sup> Cir. 1976).
5. *Minton v. Cavaney*, 56 Cal. 2d. 576, 580, 15 Cal. Rptr. 641, 643 (1961).
6. *Id.* at 643.
7. *See DeWitt*, above at 685.
8. *Anderson v. Abbott*, 321 U.S. 349, 362 (1944).
9. *See Minton*, above at 580.

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