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JAMIE DIMON DID NOT BREACH HIS OBLIGATION

OF LOYALTY TO BANK ONE SHAREHOLDERS

Jamie Dimon (“Dimon”) was an officer and director of Bank One. JP Morgan Chase (“Chase”) wanted to buy Bank One. Dimon, lead negotiator for the Bank One Board of Directors, stated the price would be “market” if Chase appointed him CEO of the merged companies immediately. Chase rejected Dimon’s overture, wanting to keep its own CEO in place immediately after the transaction. Chase then offered a purchase price that was a 14% premium over the market price of Bank One’s stock.

The Board of Directors of Bank One obtained a fairness opinion that the 14% premium transaction price was “fair” to the shareholders of Bank One, and disclosed the same in a proxy statement, but did not disclose Dimon’s overture to Chase that he become CEO for no premium. Bank One shareholders subsequently approved the transaction.

Certain shareholders of Bank One then sued the Board of Bank One, alleging the transaction price was too low, and that Dimon breached his fiduciary duty of loyalty to them by self-dealing for his own benefit. This article only addresses Dimon’s duty of loyalty to Bank One, and not whether the Bank One directors breached their duty of care in approving the transaction price.

The Court stated that since Bank One was a Delaware corporation, the laws of Delaware applied. The fiduciary duties owed by directors of a Delaware corporation are the duties of due care and loyalty. Delaware law is clear that the business and affairs of a corporation are managed by or under the direction of the board of directors.

The business judgment rule serves to protect and promote the role of the board as the ultimate manager of the corporation. Because courts are ill-equipped to engage in *post hoc* substantive review of business decisions, the business judgment rule operates to preclude a court from imposing itself unreasonably in the business and affairs of a corporation.

The business judgment rule creates a “presumption that in making a business decision, the directors of a corporation acted on an informed basis . . . and in the honest belief that the action taken was in the best interests of the company [and its shareholders.]”

This presumption can be rebutted by a showing that the board violated one of its fiduciary duties in connection with the challenged transaction. If the business judgment rule is rebutted, the burden shifts to the director defendants to demonstrate that the challenged transaction was “entirely fair” to the corporation and the plaintiff shareholders. Under the entire fairness standard of judicial review, the defendant directors must establish that the transaction was the product of fair dealing and fair price.

The Delaware Supreme Court has defined the duty of loyalty of officers and directors to their corporation and its shareholders in broad and unyielding terms: “Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its powers. The rule that requires an undivided and unselfish loyalty to the corporation demands that there be no conflict between duty and self-interest.”

Essentially, the duty of loyalty mandates that the best interest of the corporation and its shareholders takes precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally. The classic examples of director self-interest in a business transaction involve either a director appearing on both sides of a transaction or a director receiving a personal benefit from a transaction not received by the shareholders.

In this case, the Court held the plaintiffs failed to allege sufficient facts to show that Dimon was self-interested in the merger. There was no evidence that Dimon appeared on both sides of the merger between Bank One and Chase or that he received a personal benefit not shared by the shareholders. While plaintiffs alleged that Dimon’s negotiations to retain his CEO position at the proposed merged company constituted self-dealing, Delaware law has routinely rejected the notion that a director’s interest in maintaining his office is a debilitating factor unless there is proof that the director believed he or she was vulnerable to being removed. In addition, the record showed that the terms of the merger agreement were disclosed in the joint proxy statement. The merger agreement, which was approved by the Board and shareholders, disclosed Dimon’s succession to become CEO.

Plaintiffs cited case law in support of their argument that “proof of [Dimon’s] *undisclosed self-dealing*, in itself, is sufficient to rebut the . . . business judgment rule and invoke entire fairness review.” The Delaware court rejected that argument, finding that there were no allegations in this case that Dimon was on both sides of the merger.

Board members and corporate officers should not hesitate to contact us if they ever have a question about a potential conflict of interest in any proposed business transaction that might result in a violation of their duty of loyalty.

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YEAR END ESTATE PLANNING: 529 PLANS OFFER MANY BENEFITS

Since their introduction in 1996, Qualified State Tuition Plans (sometimes referred to as “529” plans) have attracted many investors who like the fact that contributions to the accounts grow tax-free and withdrawals are free from federal income tax as long as the funds are used for qualifying education expenses. The plans were intended to allow individuals to invest money for children’s education, but changes to the tax code over the years allowed estate and financial planners to develop alternative uses for 529 plans. In fact, 529 plans are attracting individuals who have no intention to use the plan to fund college tuition.

Anyone may contribute to a 529 plan for the benefit of a child. The contribution is not deductible for federal income tax purposes, but some states permit a deduction for state income tax purposes. (Illinois does not permit such a deduction.) Earnings are allowed to accumulate within the account untaxed until they are used to pay for the costs of the child’s higher education. When withdrawn to pay college expenses, the amount withdrawn is taxed at the child’s income tax rate. While the earnings are generally subject to taxation at the state level as well, some states exempt that income, including Illinois, from taxes when the plan proceeds are used for qualified education expenses.

If the balance of the 529 plan is greater than the cost of the education (or if the child doesn’t complete or attend college), the grantor controls the disposition of the funds. The grantor may name a new beneficiary who must be directly related to the prior beneficiary (*e.g.*, sister, brother, parent, child, aunt, uncle). The funds can continue to grow tax-deferred until withdrawn by the substitute beneficiary. The grantor may even demand the return of the funds in the 529 plan for a financial emergency; however, funds returned to the grantor or used by the beneficiaries for purposes other than educational purposes will be taxed at the beneficiary’s tax rate on the earnings, and beneficiaries will also be assessed a penalty determined by the individual states, but not less than 10% (the penalty is 10% in Illinois).

The most significant estate planning benefit of a 529 plan is that cash contributed to such a plan is *not* included in the taxable estate of the party who made the contribution. Consequently, 529 plans have become a highly favored strategy of financial and estate planners to reduce large estates subject to potentially large estate taxes. Each person can make annual \$12,000 contributions or an immediate contribution up to \$60,000 per beneficiary in a 529 plan, or \$120,000 for each married couple, without paying or incurring a gift tax, and, if the donor lives for five years after making the \$60,000 contribution, the assets in the 529 plan are not included in his or her taxable estate. (Contributions may be proportionately included in the estate if the donor dies within five years of a contribution exceeding the \$12,000 annual exclusion.)

Naming an educational trust as the owner of a 529 plan can provide the flexibility to allow the grantor to allocate or reallocate assets among children or grandchildren. Thus, if one child or grandchild receives a scholarship or decides not attend college, the funds can be used to pay for the education of another child or grandchild. Further, if all the funds in the plan are not used for educational purposes, the assets in the plan can be distributed to a trust for the benefit of a child or grandchild, with terms established by the grantor.

Please do not hesitate to telephone us if you have any questions about the use of a 529 plan in your estate plan.

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A PARTY TO A CONTRACT IS CHARGED WITH KNOWLEDGE OF ITS CONTENTS

More often than not, parties to a contract execute a contract without reading all the fine print. This is often a result of the inclusion of legal terminology in the contract which is not easily understandable to the average reader. However, it is very important that one reads and understands all the terms of the contract prior to execution because a party to a contract is charged with knowledge of and assent to an agreement which the party signed.

In the recent case Supreme Court case of *Melena v. Anheuser-Busch, Inc.*, a former employee of Anheuser-Busch filed suit, alleging she was discharged in retaliation for filing a workers' compensation claim. Anheuser-Busch moved to compel arbitration of the matter based on a provision in Melena's employment agreement which stated any disputes between employee and employer were to be submitted to mandatory arbitration. Melena argued the arbitration provision of the contract was unenforceable because it was made a condition of continued employment with Anheuser-Busch and therefore she had not assented to it.

In holding the provision enforceable, the Court found that inequality in bargaining power is not a sufficient reason to hold a provision of a contract unenforceable. The Court reasoned that although Melena was forced to accept this provision in the contract in order to maintain her employment, this factor alone was not sufficient to invalidate an otherwise enforceable agreement. The Court further held that Melena had accepted the offer of Anheuser-Busch to arbitrate disputes by continuing her employment and receiving compensation.

Another case which highlights the importance of reading and understanding a contract prior to signing is *Breckenridge v. Cambridge Homes, Inc.* In *Breckenridge*, the plaintiffs, purchasers of a new home, sued the defendant for breach of implied warranty of habitability, based on the defendant's failure to make certain requested repairs to plaintiffs' new home. The Illinois Appellate Court ruled plaintiffs were not entitled to recover because they had signed a contract which included a limited warranty. The Court held a party who has an opportunity to read a contract before signing, but signs the contract before reading, cannot later plead lack of knowledge. The Court held plaintiffs were charged with knowledge of what was contained in the contract and had acquiesced to the contract's terms when they executed the contract.

This issue was also addressed in *Regency Commercial Associates, LLC v. Lopax, Inc.* In this case, the parties negotiated a contract for the sale of land which contained a restrictive covenant ("covenant") which restricted uses of the surrounding land and prohibited the sale of the land to fast food restaurants that sold chicken. The seller of the land brought suit alleging the restriction did not restrict it from selling land to Buffalo Wild Wings, stating it was not a fast food restaurant. The court found that when parties agree to and insert language into a contract, the presumption is it was done purposefully and the language employed is to be given effect. The court stated the parties' intent is to be ascertained from the words of the contract itself where the terms are unambiguous. In this case, the court held the restrictive covenant did not apply to Buffalo Wild Wings, because it concluded Buffalo Wild Wings was not a fast food restaurant.

If you don't read or understand a legal document, seek advice or be prepared to live with the consequences of your silence.

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FOR WARRANTY EXCLUSIONS, SEE OUR CATALOG

Every sale of goods involves the negotiation of a variety of terms and conditions. In some circumstances, terms and conditions may be imposed by the Uniform Commercial Code (“Code”). The Code contains specific provisions dealing with warranties, and the limitation or exclusion thereof. Application of these provisions was illustrated in the 2007 Illinois case of *Accurate Transmissions, Inc. v. Sonnax Industries, Inc.*

Accurate purchased various parts from Sonnax that Accurate used in rebuilding torque converters. One of these parts was a stator cap labeled by Sonnax as GM-WP12-OE (“WP12”). According to Accurate, the WP12s Sonnax sold to Accurate were defective and caused the failure of some torque converters.

Sonnax raised several defenses to Accurate’s claims, including a defense that warranties contained in Sonnax’s catalogs effectively disclaimed any implied or express warranties that would otherwise apply. The warranty stated in pertinent part that Sonnax would repair or replace, at Sonnax’s option, each part manufactured or supplied by Sonnax, when that part is found to have been defective in material or in factory workmanship, under normal use and service. This language was followed by a statement that read: **THIS WARRANTY IS THE ONLY WARRANTY APPLICABLE TO NEW PARTS MANUFACTURED BY SONNAX, AND IS EXPRESSLY IN LIEU OF ANY OTHER WARRANTIES, EXPRESS OR IMPLIED, INCLUDING ANY IMPLIED WARRANTY OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE. THERE ARE NO WARRANTIES WHICH EXTEND BEYOND THE DESCRIPTION ON THE FACE HEREOF.**

Accurate argued that the warranty disclaimer was not conspicuous and therefore ineffective. It also argued that the catalogs did not form the basis of the parties’ bargain, and that any warranty disclaimer contained in the catalogs was also ineffective.

The court noted that when parties contract for the sale of goods, Illinois law implies a warranty of merchantability, *i.e.*, the goods “must be at least such as (a) pass without objection in the trade under the contract description; and . . . (c) are fit for the ordinary purposes for which such goods are used” It further noted that a seller may “exclude or modify the implied warranty of merchantability or any part of it” by using language that “must mention merchantability and in case of a writing must be conspicuous.”

Under Illinois law, a term or clause is “conspicuous” when it is so written that a reasonable person against whom it is to operate ought to have noticed it. A printed heading in capitals (such as: **NON-NEGOTIABLE BILL OF LADING**) is conspicuous. Language in the body of a form is “conspicuous” if it is in larger or in a contrasting type or color. Whether a term or clause is “conspicuous” must be decided by the court. The test is whether a reasonable business person is expected to notice the disclaimer.

Sonnax cited several cases where courts enforced disclaimers contained in catalogs and booklets, including one where a disclaimer on page 19 of a 107-page manual was considered conspicuous. In these cases, the disclaimers appeared in bold lettering, heavy black line framing or in other ways that set-off the text. The court noted that although none of these cases was binding authority, they were useful in demonstrating that warranty disclaimers in catalogs – even large catalogs – can effectively disclaim a warranty.

Here, in both the 2000 and 2003 catalogs, Sonnax's disclaimer came directly after and on the same page as its warranty policy. The disclaimers themselves were in capital letters, unlike the text of the warranty. This was considered consistent with the Code provisions stating that language in the body of a form is "conspicuous" if it is in larger or other contrasting type or color.

The court held the disclaimers were conspicuous, particularly because the catalogs could only be read with a page and its facing page both open, causing a person searching for the warranty policy to only glance slightly to the facing page to notice the disclaimers. The court noted that a limited warranty contained in a manufacturer's catalog may be considered part of the basis of the parties' bargain, so long as the purchaser received the catalog and had an opportunity to read the warranty prior to or at the time of sale. In fact, a buyer need not have actual knowledge of the disclaimer, so long as the disclaimer is in the buyer's possession at or before the time of the sale. As a result of the foregoing, the court ruled Accurate could not recover incidental and consequential damages, and Accurate's remedies were limited to repair or replacement of the defective products.

If you are a manufacturer with a question about the effectiveness of a warranty, or a consumer with a doubt about the enforceability of a warranty, please give us a call.

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NEW FILING REQUIREMENT FOR SMALL EXEMPT ORGANIZATIONS

The IRS has kicked off an educational campaign to the more than 650,000 small tax-exempt organizations that may be required to submit a new annual notice, Form 990-N, "Electronic Notice (e-Postcard) for Tax-Exempt Organizations Not Required to File Form 990 or 990-EZ." The campaign follows through on a Pension Protection Act of 2006 ("PPA") change requiring exempt organizations that are not required to file annual information returns to file annual notices with the IRS.

The PPA amended the Internal Revenue Code (the "Code") to require that organizations that are not otherwise required to make an annual filing because their gross receipts are less than \$25,000 to file an annual notice with the IRS containing basic contact and financial information. The annual filing requirement is effective for notices and returns with respect to annual periods beginning after 2006.

The IRS is mailing educational letters to affected organizations to make certain small exempt organizations know about the "simple and straightforward" e-Postcard requirement, and to caution them that ignoring the requirement could imperil their tax-exempt status. Under the Code, any organization that fails to meet its annual reporting requirement for three consecutive years automatically loses its tax-exempt status. An organization that wants to regain its exempt status must reapply for recognition as a tax-exempt organization.

Please contact us if you have received an IRS letter and need additional guidance.

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**PRECISE DRAFTING IS IMPORTANT IN ALL CONTRACTS,
ESPECIALLY MARITAL SETTLEMENT AGREEMENTS**

The recent Illinois case of *Allton v. Hintzhse* provides yet another example of the importance of precise drafting of contracts; in this case, a marital settlement agreement.

In *Allton*, Guy Allton purchased a life insurance policy in the amount of \$100,000 shortly after he was married. Allton designated his wife as the beneficiary of the policy. Three years later, when he was getting divorced, Allton and his wife agreed in their marital settlement agreement that they each would:

. . . maintain a life insurance policy upon his or her life, such that upon the death of said party, each child of the parties shall be entitled to receive death benefits, in an amount of not less than \$50,000 per child. Each party shall be obligated to maintain said policies so long as the parties have an obligation to support the children or contribute to their post-secondary education.

The marital settlement agreement also provided that Allton would “execute any and all instruments and documents as may be designated herein or as may be reasonably necessary to make effective the provisions of this agreement.”

When Allton died in an automobile accident without having changed the beneficiary on the existing \$100,000 policy, Allton’s former wife filed a declaratory judgment proceeding claiming she was entitled to the proceeds of the policy as the beneficiary. The administrator of Allton’s estate, however, responded that the insurance proceeds should be paid to Allton’s children pursuant to the marital settlement agreement. The trial court agreed with Allton’s former wife, awarding her the proceeds, and the administrator appealed.

On appeal, the Appellate Court ruled that the marital settlement agreement was ambiguous because it was subject to two reasonable interpretations. Under one interpretation, Allton was required to *change* the beneficiary on his existing policy to his children in order to comply with the requirements of the marital settlement agreement. Under the alternative interpretation, Allton was required to *obtain* new insurance with the proceeds to be paid to each of his children. Since there were two equally plausible interpretations of the marital settlement agreement, the Appellate Court found that the trial court must hear extrinsic evidence to determine the intent of the parties. Hence, more delay and more legal expense.

The outcome in the *Allton* case was avoidable had the parties drafted the insurance provision with more precision. A properly drafted insurance provision would have clearly stated whether Allton was required to *change* the beneficiary on the existing insurance policy to his children or *obtain* new policies in which the children were designated as beneficiaries.

Whether you are drafting a business agreement or any other memorandum of understanding, attention to wording will avoid disputes, delays and unnecessary legal expense. Please telephone us if you need assistance in preparing any document with legal implications.

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LEGAL ISSUES FOR EMPLOYERS TO KEEP IN MIND

FOR HOLIDAY OFFICE PARTIES

Employers should refer to the event as a “holiday” party to avoid claims of religious discrimination.

The Illinois Workers’ Compensation Act excludes from coverage injuries from employee participation in voluntary social events. Hence, employers should avoid compulsory attendance at office parties.

Illinois courts have held employers liable for employee injuries sustained, both during and after the party, as a result of intoxication. Employers are cautioned to monitor alcoholic consumption and to take action, including provision of transportation, in the event it is obvious that the consumption is excessive and an employee has become debilitated.

With heightened awareness about sexual harassment, employers should remind employees that inappropriate personal conduct at the party will not be tolerated. Neither employers nor employees should hang Mistletoe.

Finally, employers should consult their insurance agent to be certain that their general liability insurance policy will provide adequate protection in the event of an incident resulting in liability.

Happy holidays!

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From *The Lawyer Joke Book*:

Counselor Gaynor was interviewing prospective jurors before the trial.

“Do you know anything about the trial?” he asked one of them.

“Nope.”

“Have you read anything about it.”

“Can’t read.”

“Have you formed any opinion about this case?”

“What case?”

“Your Honor, the defense accepts this man.”

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