> to arbitration in another state, the provisions must be set out conspicuously in print, type, or other form of writing that is bold-faced, capitalized, underlined, or otherwise set out in such a manner that a reasonable person against whom the provision may operate would notice. If the provision is not set out as provided by this subsection, the provision is voidable by a party against whom it is sought to be enforced.

The court noted that application of this provision of the Code is contingent upon meeting the requirements of section 35.53(a). One of these requirements is that former section 1.105 of the Code (currently renumbered as section 1.301) not be applicable to the agreement in question. Thus, if section 1.105 applies to the agreement, then section 35.53 does not.

**Section 1.105 provides that when transactions bear a reasonable relation to Texas and also to another state or nation the parties may agree that the law of either Texas or the other state or nation shall govern**

Section 1.105 provides that when transactions bear a reasonable relation to Texas and also to another state or nation the parties may agree that the law of either Texas or the other state or nation shall govern their rights and duties. The court found that the plain language of section 1.105 appears to conflict with the plain language of at least part of section 35.53. Specifically, section 35.53 applies to contracts that involve goods worth $50,000 or less, wherein at least one party is a Texas resident or business. By contrast, section 1.105 applies when a transaction involves consideration under $1,000,000 and the transaction bears a reasonable relation to Texas and also to another state. Since application of section 1.105 precludes application of section 35.53, a literal reading of both provisions would produce the anomalous result of only applying 35.53 to the situation where two parties in Texas negotiated an agreement that provided that the law of another state applied, even though the other state had no reasonable relationship with the transaction (a position advocated by BSN). The court found this construction unreasonable, as it would render section 35.53 superfluous.

The court instead held that the only reasonable reading of the two provisions was that the section 1.105 exclusion of section 35.53 only referred to the exclusionary provisions contained within 1.105(b). These exclusionary provisions refer to certain specified commercial transactions that have their own choice-of-law rules. The court reviewed the legislative history of both sections of the Code and concluded that the section 1.105 exclusion within section 35.53 was added as part of a broader collection of modifications to the statutory scheme. These modifications were relevant to choice-of-law and choice-of-venue provisions in multi-state contracts, and indicated a legislative intent to maintain the various components of this statutory scheme, including the conspicuousness requirement of section 35.53(b).

Because the transaction between Drug Test and BSN was not one of the transactions specifically enumerated in section 1.105(b), and because BSN did not dispute that the contract involved goods valued at $50,000 or less, the court held that section 35.53(b) was applicable to the agreement in dispute. Since the agreement failed to meet the conspicuousness requirements with regard to the choice-of-venue provision, the court held that the provision was voidable.

## MISCELLANEOUS

### U.S. SUPREME COURT RULES THAT CONTINGENT FEES PAID TO AN ATTORNEY CONSTITUTE INCOME TO THE PLAINTIFF UNDER THE INTERNAL REVENUE CODE

Commissioner of Internal Revenue v. Banks, 125 S.Ct. 826 (2005).

**FACTS:** In separate actions, taxpayers petitioned for redetermination of taxability of litigation settlement proceeds. In 1986, John Banks sued his former employer and hired an attorney on a contingent fee basis. The parties settled for $464,000. Banks paid $150,000 of this amount to his attorney. Banks did not include any of the settlement in his federal tax return and the Internal Revenue Commissioner issued Banks a deficiency notice. The Tax Court upheld the Commissioner's determination, finding all of the settlement, including the part that went to his attorney as a contingency fee, was gross income that should have been included on the tax return. On appeal, the Sixth Circuit held that the amount paid to the attorney was not part of Banks's taxable gross income.

In 1987, Sigitas Banaitis also sued his former employer and hired an attorney on a contingent fee basis. The parties settled for a total of approximately $8.72 million, about forty percent of which went to his attorney. Banaitis did not claim the amount paid to his attorney on his tax return and the IRS issued a deficiency notice. The Tax Court upheld the Commissioner's determination. On appeal, the Ninth Circuit held that under state law, the contingency fee was not part of Banaitis' taxable gross income.

**HOLDING:** Reversed.

**REASONING:** Contingent-fee arrangements are an anticipatory assignment of income to the attorney. The IRS Code states gross income includes all gains that are not otherwise exempted, regardless of the source. 6 U.S.C. §61(a). The anticipatory assignment of income doctrine states a taxpayer cannot exclude economic gain from gross income by assigning it to a third party. Contingent fee agreements act as anticipatory assignments of the client's income to the attorney. The person who pays the taxes on the assigned income is the person who controls the source of the income. In the contingent-fee arrangement context, the lawsuit acts as the income-generating asset, because it is derived from the client's injury. The client retains control of the lawsuit throughout its course, thus retaining dominion over the income-generating asset. The client makes critical decisions concerning the lawsuit, the attorney merely makes tactical ones, and therefore the client is the one in control.

Banks and Banaitis each hired their respective attorneys and maintained control over their lawsuits throughout their course. By agreeing to a contingency-fee arrangement with their attorneys, they assigned their incomes over to the attorneys in anticipation of a favorable outcome of the suit. Therefore, the contingency fees paid to the attorneys were part of Banks' and Banaitis taxable income and they should have disclosed the money paid to their attorneys on their federal tax returns.

**DEBTOR CAN EXEMPT IRAS FROM BANKRUPTCY ESTATE UNDER FEDERAL LAW**

Rousey v. Jacoway, 125 S.Ct 1561 (2005).

**FACTS:** After termination from their employment, Richard and Betty Jo Rousey put lump-sum distributions from their employment pension fund into Investment Retirement Accounts ("IRAs") in each of their names. Under the Internal Revenue Code ("IRC"), IRA account balances are non-forfeitable. In addition, the IRC caps yearly contributions to IRAs, subjects withdrawals before accountholder reaches age 59 ½ to a 10 percent tax penalty, and defers income taxation on contributions until assets are withdrawn. The balance in the account must begin to be distributed by April 1 following the calendar year end in which the accountholder reaches age 70 ½.

**The purpose of a petition for Bankruptcy is to allow the debtor a fresh start.**

Several years after setting up the IRAs, the Rouseys filed for Chapter 7 bankruptcy in the United States Bankruptcy Court for the Western District of Arkansas. The Rouseys attempted to shield the IRAs' balances from creditors by claiming it as exempt property under federal bankruptcy law. The bankruptcy estate administrator objected to the set-aside of the IRAs. The Bankruptcy Court sustained the objection to the set-aside. The Bankruptcy Appellate Panel and the Court of Appeals for the Eighth Circuit both affirmed the bankruptcy court. The Rouseys appealed.

**HOLDING:** Reversed and remanded.

**REASONING:** The purpose of a petition for Bankruptcy is to allow the debtor a fresh start. To help the process along certain items are excluded from the estate, as long as the items fell below a certain value. The Bankruptcy Code, 11 U.S.C. § 522(d)(10)(E), allows a debtor to exempt certain payments from his/her bankruptcy estate if the following requirements are met: 1) the right to receive payment must be under stock bonus, pension, profit-sharing, annuity, or similar plan or contract; or 2) the right to receive payment must be on account of illness, disability, death, age, or length of services; or 3) the right to receive payment is exempt only to the extent reasonably necessary for the support of the debtor and any dependent of the debt. Only the first two requirements were at issue in this case.

The Court first examined the second requirement of the statute. The Court found that even though the account balance in the IRA is non-forfeitable and can be withdrawn at any time, the 10% penalty for early withdrawal before age 59 ½ is substantial enough to deter the accountholder from withdrawing funds before reaching age 59 ½. Therefore, under an IRA, the right to receive payment would be causally connected to age.

The Court then examined the first requirement of the statute, specifically whether IRAs share characteristics common to the stock bonus, pension, profit-sharing, or annuity contract so that it would be considered a "similar plan or contract". The Court found that IRAs are similar, because the IRA, like the other accounts mentioned in the statute, provides a substitute for wages, defined as compensation earned as hourly or salary income, and are not mere savings accounts. The Court reasoned that the IRA is a substitute for wages because the IRA requires distributions to begin, at the latest, in the calendar year after the year in which the accountholder turns 70 ½. Failure to take requisite minimum distributions results in a 50% tax penalty on funds improperly remaining in the account, which encourages the accountholder to withdraw the funds during retirement. Additionally, IRA income is tax-deferred until distributed, encouraging the accountholder to wait until retirement to withdraw funds, and withdrawals before 59 1/2 are subject to tax penalty, restricting pre-retirement access to funds. Therefore, the Court found the IRA to be a "similar plan or contract" as it was a substitute for wages rather than a mere savings account.

**NONPAYMENT OF THE RECITED NOMINAL CONSIDERATION DOES NOT PRECLUDE ENFORCEMENT OF THE PARTIES' WRITTEN OPTION AGREEMENT**

1464-Eight, Ltd. v. Joppich, 154 S.W.3d 101 (Tex. 2004).

**FACTS:** In July 1997, Gail Ann Joppich ("Purchaser") entered into an earnest money contract with 1464-Eight, Ltd. and Millis Management Corporation ("Developer"). Under the contract the Purchaser agreed to buy, and Developer agreed to convey, an undeveloped residential lot located in a subdivision being developed by Developer. The property was sold to the Purchaser pursuant to an option agreement stating that the purchaser gave the Developer the exclusive right and option to repurchase the property under certain conditions in consideration for $10.

Purchaser filed suit against Developer, seeking declaratory judgment that the option contract was unenforceable. Developer filed a counterclaim for specific performance of the option contract. Purchaser argued that the option agreement was unenforceable because the recited nominal consideration was never tendered or paid to the Purchaser. The trial court granted summary judgment in favor of the Developer, holding that the Purchaser was required to sell the property in compliance with the terms of the option agreement. The Court of Appeals for the First District of Texas reversed and remanded, holding that failure to deliver the consideration recited in the option agreement precluded enforcement of the agreement. Developer petitioned for review.

**HOLDING:** Reversed.

**REASONING:** As a matter of first impression, the Texas Supreme Court reasoned that Developer's failure to pay the recited nominal consideration of ten dollars did not preclude enforcement of the option contract. The court noted that the option would have been enforceable under Restatement (Second) of Contracts § 87(1)(a), which provides that a false recital of nominal consideration is sufficient to support the irrevocability of an offer, so long as the underlying exchange was fair and the offer was to be accepted within a reasonable time. The offer to sell the property was binding as an option contract because the offer was in writing and signed by the Purchaser, acknowledged the receipt of nominal consideration of ten dollars, and proposed an exchange on fair terms within a reasonable time. The court reasoned that where a contract recites the payment of a nominal amount of money as consideration, the contract is valid, even if the nominal sum identified is not actually paid. The nominal consideration merely created an obligation to pay such sum, which may be enforced by the other party. The real consideration provided in the option agreement was the obligation to pay the ten dollars, and it was of no consequence whether the ten dollars was paid or not. The court held that Restatement (Second) of Contracts § 87(1)(a) should be incorporated into the common law of Texas. Thus, the nonpayment of the nominal consideration did not preclude enforcement of the written option agreement. The Texas Supreme Court ourt reversed the judgment of the Court of Appeals and remanded the case.

**As a matter of first impression, the Supreme Court reasoned that Developer's failure to pay the recited nominal consideration of ten dollars did not preclude enforcement of the option contract.**

## AWARD OF $1 MILLION IN PUNITIVE DAMAGES FOR FRAUDULENT BILLING PRACTICES WAS CONSTITUTIONALLY EXCESSIVE

Kemp v. American Telephone and Telegraph Co., 393 F.3d 1354 (11th Cir. 2004).

**FACTS:** American Telephone and Telegraph Company ("AT&T") carried calls to a 900 number that operated a gambling game called "Let's Make A Deal" ("LMAD") modeled after the popular TV show. AT&T provided billing and collection services for charges incurred for this 900 number that were billed at $3.88 per minute. These charges were included in the customer's telephone bill where they appeared as long distance charges. During the period from early 1990 until December 1992, AT&T billed $360,252.40 and collected $287,360.59 from customers in Georgia. In Georgia, this type of gambling was illegal and these gambling debts could not be lawfully collected.

Plaintiff was a customer of AT&T long distance services. Plaintiff's grandson called the LMAD 900 number several times in 1992, which generated $115.05 of charges on plaintiff's long distance bill. When plaintiff challenged these charges, he was told by a customer service representative to pay the charges or his phone service would be disconnected. Plaintiff paid his bill and then brought suit under both federal and state RICO statutes.

At trial the jury found AT&T's billing practices were fraudulent and that its activities constituted illegal gambling and illegal collection of a gambling debt. The trial court awarded treble compensatory damages of $345.15 and punitive damages of $1 million. AT&T moved for judgment as a matter of law and for a reduction of the punitive damages award. The district court denied both motions and AT&T appealed.

**HOLDING:** Reversed and remanded.

**REASONING:** The appellate court agreed with the jury that AT&T acted fraudulently and knowingly collected gambling debts. There was sufficient evidence to justify an imposition of exemplary damages under state law. The U.S. Supreme Court in *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408, 416 (2003), however, created substantive limits on the amount of punitive damages a state may impose. Courts must consider three guideposts: (1) the degree of reprehensibility of the defendant's conduct; (2) the disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award; and (3) the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases.

In this case the court used these guideposts to review the punitive damage award de novo. The court found that AT&T participated in "large-scale corporate malfeasance" and that it merited a "substantial penalty." In *State Farm*, the Supreme Court did not set a maximum ratio but expected that a single digit multiplier between compensatory and punitive damages would be the normal situation. The appeals court agreed with the district court that a mechanical application of the Supreme Court's single-digit multiplier formula would not adequately take account of the seriousness of AT&T's misconduct. The court believed the facts of this case clearly supported a significant award and the state had an important interest in deterring this type of activity. Although there was no algorithm that yielded a precise figure, the court was persuaded that an award that was less than $250,000 would not serve a meaningful deterrent to a corporation like AT&T. An award greater than this amount, however, would prove an unconstitutional windfall.

### CLASS ACTION CERTIFICATION VACATED

Unger v. Amedisys, Inc., 401 F.3d 316 (5th Cir. 2005).

**FACTS:** The Amedisys Corporation ("Amedisys") provided health care, nursing, home infusion therapy and ambulatory surgery services. Their stock was traded on the NASDAQ Over the Counter Bulletin Board. Ninety percent of Amedisys' revenue came from the Medicare program. Plaintiff's alleged Amedisys willfully manipulated the Medicare prospective payment system ("PPS") program to inflate costs for their services Amedisys issued a statement admitting they had overstated their revenues, which occurred inadvertently as a result of their new software program used with the PPS. Frances Unger ("Unger") sued Amedisys for alleged violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5. Unger also attempted to certify a class of all persons and entities who purchased Amedisys stock between certain dates. Unger alleged a fraud on the market theory as the basis for presumed reliance on Amedisys misrepresentations. Amedisys responded by seeking an interlocutory appeal on two issues including: (1) the adequacy of the lead plaintiff's qualifications; and (2) the sufficiency of the plaintiff's evidence to support the fraud on the market presumption.

**HOLDING:** Vacated and remanded.

**REASONING:** On the first issue, the court found no abuse of discretion in determining the plaintiffs were qualified to initiate the litigation. To be qualified, the class representatives must satisfy the court that they, not their counsel, are directing the litigation by showing they are sufficiently informed about the litigation effort. The district court fully evaluated the evidence, including depositions and testimony of class representatives, and determined the plaintiffs were fully informed about the litigation and therefore qualified to bring the litigation.

On the second issue, the court determined that the district court failed to conduct a thorough analysis of the plaintiff's evidence presented to establish the fraud on the market theory. In order to certify the class, the plaintiffs must prove the circumstances surrounding each plaintiff's alleged reliance on Amedisys's misrepresentations were the same. To establish a rebuttal presumption of the same reliance for all members of the class, the plaintiffs must prove the fraud on the market theory, which requires the stock to be traded in an efficient market, which was established by evaluating market efficiency factors.

The court stated the district court erred by devoting insufficient attention to evaluating all the market efficiency factors and relying only on high stock trading volume, market makers trading the stock, and a cause and effect relationship between corporate events and price movement. First, the district court relied on two internet printouts reflecting a high stock trading volume without a baseline trading volume; therefore without the baseline the printout information was unreliable. Second, the court relied on one internet printout and affidavits by plaintiff's witnesses without opportunity for cross examination, stating the presence of twenty-two "market makers" as evidence for an efficient market when the mere number of market makers, without further analysis, had little bearing on market efficiency. Third, the court relied on a showing that Amedisys' stock price rose following positive announcements by the company and dropped the day the company announced an overstatement of revenues. Many other variables have the potential to affect the market price; therefore, relying on this evidence alone was insufficient to prove an efficient market. Finally, the court failed to evaluate a number of additional market efficiency factors to prove Amedisys stock was traded in an efficient market. The class certification was vacated and the case remanded.

### STUDENT LOAN DEBT CAN BE PARTIALLY DISCHARGED IN BANKRUPTCY

In re Lisa Fields, ____ B.R. ____ (B.A.P. 6th Cir. 2005).

**FACTS:** Lisa Fields ("Debtor") filed a voluntary Chapter 7 bankruptcy petition less than two months after payments on her student loan debt became due. The Debtor sought discharge of student loans totaling $129,801.05. The bankruptcy court found that the Debtor failed to show undue hardship under the *Brunner* test, *Brunner v. N.Y. State Higher Educ. Serv. Corp.*, 831 F.2d 395, 396 (2d Cir. 1987), but that she had demonstrated that repayment of the full amount of the loan would be an undue hardship due to "other factors", the most significant of which was the substantial amount of her student loan debt. The bankruptcy court sought a remedy which would afford the Debtor a financial fresh start, while holding her accountable for the portion of the cost of her education that she could repay while still maintaining a basic standard of living. A portion of the Debtor's student loan debts was declared dischargeable as an undue hardship pursuant to 11 U.S.C. § 523(a)(8) and § 105(a). Sallie Mae Servicing Corporation and Educational Credit Management Corporation ("the Creditors") appealed.

**While the Debtor did not demonstrate undue hardship as to the total amount of the student loan debt under this test, the bankruptcy court was correct to consider "other factors."**

**HOLDING:** Affirmed.

**REASONING:** The Bankruptcy Appellate Panel ("BAP") relied on the rule that when a debtor does not make a showing of undue hardship with respect to the entirety of her student loans, a bankruptcy court may contemplate granting a partial discharge of the debtor's student loans. *Miller v. Pa. Higher Educ. Assistance Agency*, 37 F.3d. 616, 623 (6th Cir. 2004).

The BAP recognized while "undue hardship", the standard for the discharge of student loans, is not a defined term in the Bankruptcy Code, the Court of Appeals for the Sixth Circuit had adopted the three requirements for undue hardship set forth in *Brunner*. While the Debtor did not demonstrate undue hardship as to the total amount of the student loan debt under this test, the bankruptcy court was correct to consider "other factors." The so-called "other factors," including a debtor's expenses, standard of living, amount of outstanding debt, and ability to maximize income, were later incorporated into the *Brunner* test. The BAP agreed with the bankruptcy court that the case was appropriate for equitable intervention under 11 U.S.C. § 105(a) and these other factors justified a partial remedy.

The BAP agreed that the partial discharge of student loans is improper where a debtor has not shown undue hardship as to that portion of a student loan debt to be discharged. In this case, however, the Debtor had shown undue hardship as to a portion of the student loan debt. The factors the bankruptcy court relied on, such as the substantial size of the student loan debt, the overwhelming interest accruing on the debt, the Debtor's maximization of income, her continued contact with creditors and her exploration of other repayment alternatives were properly considered and supported the finding that repayment of the entire indebtedness would impose an undue hardship on the Debtor.