# IN THE SUPREME COURT OF TEXAS

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NO. 00-0932
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DENNIS L. MIGA, PETITIONER

v.

RONALD L. JENSEN, RESPONDENT

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ON PETITIONS FOR REVIEW FROM THE
COURT OF APPEALS FOR THE SECOND DISTRICT OF TEXAS
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**Argued on October 24, 2001**

JUSTICE O'NEILL, dissenting, joined by CHIEF JUSTICE PHILLIPS

Although simple and easy to apply, the Court's time-of-breach damage measure is founded on an economic fiction that woefully deprives Miga of the benefit of his bargain. But worse, it encourages promisors to breach stock-option agreements in a rising market, allowing them to cap their liability while reaping the very profit potential that was promised in exchange for the promisee's performance. Numerous courts across the country, both state and federal, have recognized that applying the rule to stocks is "very inadequate and unjust." *Galigher v. Jones*, 129 U.S. 193, 200 (1889). On the other hand, awarding damages at the highest price the stock attained up to the time of trial has the potential to put the promisee in a better position than if the breach had not occurred because it unrealistically presumes, in hindsight, that the promisee would have sold the stock at precisely the right moment. This approach, too, has been widely rejected. I would apply a damage measure that minimizes the potential to over- or under-compensate the injured party and more closely approximates the value of the benefit lost, that is, the stock's highest intermediate value between the date of breach and a reasonable period in which the injured party could have entered the market and replaced the stock. Because the damage question submitted in this case did not confine the jury to this measure, it was defective. Consequently, I would reverse and remand the case for a new trial. *See Arthur Andersen & Co. v. Perry Equip. Corp.*, 945 S.W.2d 812, 817 (Tex. 1997). Because the Court holds otherwise, I respectfully dissent.

I

Over the past decade, stock options have become an increasingly common form of executive compensation. They are often conferred in lieu of more traditional compensation, like salary or cash bonuses, to reward outstanding performance and provide an incentive for hard work to increase the company's, and therefore the option's, worth. Just as stock options have become more and more common, so has litigation involving their value, and "[i]t would be a herculean task to review all the various and conflicting opinions that have been delivered on this subject." *Galigher*, 129 U.S. at 202. Although courts have taken a variety of approaches when measuring damages in this context, most have centered on three general damage models: (1) the stock's value when the wrongful conduct occurred, which is the measure the Court applies, (2) the stock's highest market value between the time of the wrongful conduct and trial, which is the measure the court of appeals approved, and (3) the stock's highest intermediate price between the wrongful conduct and a reasonable time for replacement, which is the approach I favor.

The problem with the Court's damage measure was articulated over 100 years ago by the United

States Supreme Court in *Galigher v. Jones, supra*. There, the Court recited the general rule that, as to goods that have a fixed market value at which they can be easily replaced, the measure of damages is their value at the time of conversion, or, for breach of contract, at the time fixed for their delivery. *Id*. at 200. But the Court emphasized that "the application of this rule to stocks would . . . be very inadequate and unjust," because the real injury sustained "consists not merely in the assumption of control over the stock, but in the sale of it at an unfavorable time, and for an unfavorable price." *Id*. Limiting damages to the stock's value when the wrong occurred subjects the wrongdoer "only to nominal damages" and, "in most cases, afford[s] a very inadequate remedy" or "no remedy at all." *Id*. This case provides a perfect example. If Jensen had sold the stock that rightfully belonged to Miga at the optimal time, the Court's time-of-breach damage measure would require Jensen to pay Miga a little over $1 million while allowing Jensen to reap for himself a windfall in excess of $16 million. Surely Jensen's wrongful conduct should not be so handsomely rewarded.

As long ago as 1849, we recognized that time-of-breach damages are often inadequate to compensate a person injured by another's failure to sell or deliver goods whose value fluctuates. In *Randon v. Barton*, 4 Tex. 289 (1849), analogizing to a contract for the delivery of stock, we held that a plaintiff injured by the defendant's breach of an agreement to deliver certain land certificates was entitled to the highest value of the certificates up until the time of trial. 4 Tex. at 295-96. Such a rule, we observed, "would be most consonant with justice." *Id*. at 296. We later declined to apply the *Randon* measure when

> money or *other consideration* for the article contracted for, has not been paid in advance . . . or when extraordinary circumstances have occurred to produce extreme prices in the article during a long period of time, and the suit has been protracted without any fault of

> the defendant, or when the article contracted for is of a perishable nature, or such as is to be readily parted with if delivered, or *when there are other circumstances attending the transaction, not in the ordinary course of trade, calculated to render such a measure of damages inequitable and unjust*.

*Heilbroner v. Douglass*, 45 Tex. 402, 407 (1876) (emphasis added). But we emphasized that "[t]he true measure of damages in all cases is that which will completely indemnify the plaintiff for breach of the contract." *Id.* at 408.

Ignoring the fundamental policy underlying *Heilbroner*, the Court concludes that the *Randon* measure does not apply because Miga had not paid for the options before Jensen refused to perform. ___ S.W.3d at ___. But whether stock is converted or withheld contrary to the parties' agreement should not yield different results when the injury suffered is the same – the plaintiff's lost ability to control when to optimize profits. *See, e.g., Schultz v. Commodity Futures Trading Comm'n*, 716 F.2d 136, 141 (2d Cir. 1983) (holding that *Galigher* rule applies whether stock is "converted, not delivered according to contractual or other legal obligation, or otherwise improperly manipulated," and noting "many cases" that have applied the conversion measure to breach of contract) (citations omitted); *Lucente v. IBM Corp.*, 117 F. Supp. 2d 336, 356 (S.D.N.Y. 2000) ("Courts have sought out an intermediate ground in cases where the defendant's breach or tortious conduct deprived plaintiff of the opportunity to sell securities at an optimal price.").

The superficiality of the Court's distinction is particularly apparent here, where Miga tried to pay the options' exercise price but Jensen refused to accept it. Moreover, the Court's analysis ignores the fact that Miga was granted the options, in part, to reward his past performance. By refusing to deliver the stock as promised, Jensen, in effect, converted compensation that Miga was due for services he had provided. There is no dispute that Miga exercised his option and would have paid the exercise price had Jensen not prevented him from doing so by refusing to honor his contractual obligation.

The Court also reasons that Miga was not entitled to recover the stock's increased market value as "lost profits" because there was no evidence that Miga suffered "business losses," ___ S.W.3d at ___, and because "Miga did not testify about what particular profit he expected, or that the parties contemplated a particular resale of the stock." ___ S.W.3d at ___. But whether or not the stocks' increased market value is properly characterized as "lost profits" in the traditional sense, there is ample evidence to show that the actual benefit bargained for was the potential to reap profits that an increase in the stocks' market value would yield. Both Jensen and Miga were reasonably certain that PGE would become profitable and eventually go public. *See* 25 S.W.3d at 379. Jensen's own testimony that he gave PGE stock options to his children to avoid estate taxes is some evidence that he anticipated an increase in the stocks' value. Miga was not required to demonstrate "business losses" in order to recover lost profit potential that was a natural, probable, and foreseeable consequence of Jensen's breach. Moreover, numerous courts have refused, as the court of appeals did in this case, to require a person who has been prevented from obtaining goods by the wrongful act of another to establish a particular sale in order to recover. *See, e.g., id.*; *Duncan v. Theratx, Inc.*, 775 A.2d 1019, 1022 (Del. 2001); *American Gen. Corp. v. Continental Airlines Corp.*, 622 A.2d 1, 10 (Del. Ch. 1992). Requiring Miga to prove a particular sale "is to require him to prove that he would have taken the 'very steps' that defendant's 'wrongful act . . . precluded him from taking." *American Gen.*, 622 A.2d at 10 (quoting *Kaufman v. Diversified Indus., Inc.*, 460 F.2d

1331, 1336 (2d Cir. 1972)).

The Court concludes that "[t]he proper way to compensate Miga for his lost investment opportunity is through the award of interest on his time-of-breach damages." ___ S.W.3d at ___. But to say that interest on time-of-breach damages will somehow fairly compensate Miga for the benefit lost by Jensen's breach ignores the nature of the transaction at issue. Pre- and post-judgment interest do not compensate for lost opportunities, but merely serve to make the injured party whole by providing compensation for the lost use of funds that the defendant rightfully owed. *See Cavnar v. Quality Control Parking, Inc.*, 696 S.W.2d 549, 552 (Tex. 1985).

While the Court's time-of-breach damage measure deprives Miga of the very benefit he bargained for and rewards Jensen's breach, the measure that the court of appeals approved – the highest value the stock attained before trial – has the potential to overcompensate Miga and place him in a better position than if the breach had not occurred. Such a measure allows Miga to avoid any risk of market downturns and, in hindsight, pick the precise moment when the stock reached its highest point. This approach, too, has been widely rejected. *See, e.g., Galigher*, 129 U.S. at 201 (recognizing "[t]he hardship which arose from estimating the damages by the highest price up to the time of trial, which might be years after the transaction occurred . . . ."); *Schultz*, 716 F.2d at 140 (considering highest price before trial unfair in granting plaintiff the benefit of hindsight and allowing him to choose precisely the market's most favorable price).

Rather than allocate all of the market risk to Jensen, or deprive Miga of his anticipated profit potential, I would follow a damage measure that allows Miga to recover market increases that occurred before the expiration of a reasonable time in which he could have mitigated his damages by entering the market and replacing the stock. This measure is patterned on the so-called "New York rule," which the United States Supreme Court approved in *Galigher* as "the true and just measure of damages in these cases," that is, "the highest intermediate value of the stock between the time of its conversion and a reasonable time after the owner has received notice of it to enable him to replace the stock." 129 U.S. at 201. The Court concluded that this rule "has the most reasons in its favor," and adopted it "as a correct view of the law." *Id*. at 202. The balance this damage measure strikes was ably described by the Eighth Circuit in *McKinley v. Williams*, and bears repeating here:

> Compensation is the general standard for the measure of damages. It is the actual and proximate loss caused by the wrong for which the plaintiff is entitled to indemnity. Hence the general rule is that the measure of damages for the failure to deliver property according to the contract, or for its conversion, is the value of the property at the time it was to be delivered, or at the time it was converted. This general rule, however, has been found inadequate to furnish just indemnity for the losses occasioned by the conversion of, or the wrongful failure to deliver, stocks and other properties of like character, the values of which are subject to frequent and wide fluctuations. The general rule gives to the agent, broker, or person in possession of such property, that is really valuable, frequent opportunity to convert it to his own use, at a time when its market price is far below its actual value, and thus offers a prize for the breach of duty, while it often leaves the injured party remediless. To prevent this injustice . . . an exception has been ingrafted upon this general rule. It is founded upon the proposition that he who deprives another of the possession and control of such property ought to assume the risk of the fluctuations in its market value, until its owner, by purchase or sale, can restore himself to the condition in which he would have been if his property had not been wrongfully taken. . . . The exception is that the measure of damages for the failure to sell or to deliver stocks and like speculative property, or for the conversion thereof, is the highest market value which the property attains between the time when the contract required its sale or delivery, or the time of its conversion, and the expiration of a reasonable time, to enable the owner to put himself in statu quo, after notice to him of the failure to comply with the contract, or of the conversion. This measure of damages in such cases has not been universally adopted. There are many and conflicting decisions relative to its form and its justice. But, after a careful consideration of all the authorities and the reasons which justify it, the supreme

> court adopted it in 1888, and that must conclude the discussion in this court.

74 F. 94, 102-103 (8th Cir. 1896) (citing *Galigher*, 129 U.S. 193)); *see also Clements v. Mueller*, 41 F.2d 41, 42 (9th Cir. 1930) (same); *Schultz*, 716 F.2d at 141 (holding damage measure to be higher of the stock's "(1) . . . value at the time of conversion or (2) its highest intermediate value between notice of the conversion and a reasonable time thereafter during which the stock could have been replaced had that been desired"); *Stoddard v. Manufacturers Nat'l Bank of Grand Rapids*, 593 N.W.2d 630, 636-37 (Mich. App. 1999); *Haft v. Dart Group Corp.*, 877 F. Supp. 896, 902 (D. Del. 1995).

In this case, the court of appeals held that Miga's damages were properly measured as of the time of trial, rather than within a reasonable period after the breach, because Miga could not afford to pay the $12 per share opening price when the stock went public. 25 S.W.3d at 378. But an injured party is not required to actually replace the stock in order for the reasonable-time-after-breach measure to apply. *See Schultz*, 716 F.2d at 140. To require the injured party to actually reenter the market and take on additional financial risk in the hope of avoiding future potential losses could result in increased damages and frustrate the rule's intent to make the injured party whole. *Id*. Instead, this damage measure subsumes concepts of mitigation without subjecting plaintiffs or defendants to open-ended risks of market fluctuations. *Stoddard*, 593 N.W.2d at 634, 639; *see also Theratx, Inc.*, 775 A.2d at 1023. What amounts to a reasonable period during which reentry into the market would be "both warranted and possible" will vary, of course, depending upon the facts of the case, but reentry into the market "establish[es] the outer time limit of a reasonable period during which the highest intermediate value of the lost stock could be ascertained." *Schultz*, 716 F.2d at 140 (citing *Letson v. Dean Witter Reynolds, Inc.*, 532 F. Supp. 500, 503 (N.D. Cal. 1982)).

In determining what constitutes a reasonable period of time in which to replace the stock, courts have factored in some time allowance for the injured party to obtain advice and to evaluate the market. *See, e.g., Stoddard*, 593 N.W.2d at 636 (reasonable period is "that which is necessary to make and effectuate a considered judgment"); *Burhorn v. Lockwood*, 75 N.Y.S. 828, 830-31 (1902) ("[T]he customer is entitled to a reasonable opportunity to consult counsel, to employ other brokers, and to watch the market for the purpose of determining whether it is advisable to purchase on a particular day, or when the stock reaches a particular quotation . . . ."). This period, as already said, will vary from case to case and normally will present a question for the jury. *See, e.g., Stoddard*, 593 N.W.2d at 634.

When Jensen failed to deliver the stock as promised, all PGE stock was privately held and unavailable on the open market. If the evidence were to show that Miga could not have obtained the stock from another source until PGE went public some eighteen months later, then the $12 per share opening price would represent the highest value the stock attained between the breach and the time for replacement, and Miga would be entitled to recover the difference between that price and the option's exercise price, or $5,925,864.[1] But the record in this case does not establish as a matter of law that this was the first opportunity Miga had to replace the stock. Accordingly, rendition of judgment in Miga's favor for this amount is inappropriate, and the case should be remanded for a new trial with a proper damage instruction.

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[1] Miga's option entitled him to purchase 4.8%, or 497,222 shares, of Jensen's PGE stock at a cost of $40,800, and the undisputed evidence shows that the stock's opening price was $12. Thus, 497,222 x 12 - $40,800 = $5,925,864.

Because the Court adopts an improper damage measure in this case, I respectfully dissent.

Harriet O'Neill
Justice

OPINION DELIVERED: October 31, 2002