Business Associations — Outline — Fall 2013 — Hazen

I. Background & Introduction
  a. General Proposition – Corporate, partnership, and agency law are state law
  b. Publicly held company – stock publicly traded on stock exchange
  c. Closely held company – few shareholders (5-15); not publicly traded
  d. Limited Liability (*Cargill* p. 27)
    i. Liability for business is limited to your initial investment
    ii. Limits risk to your investment
  e. Type of Corporate Lawyers
    i. Planner – drafter of deal, transactional
    ii. Litigator

II. Introduction to Agency Law
  a. Agency law important because corporate person in the eyes of the law
    i. Not statutory
  b. Only way a corporation, LLC, or partnership can act is through an agent
  c. Definition: Agency is the fiduciary relation which results from the manifestation of consent by one person [the principal] to another [the agent] that the [agent] shall act on [the principal's] behalf and subject to [the principal's] control, and consent by the [agent] to act. Rest of Agency § 1(1).
  d. Agency Overview
    i. Fiduciary (most contractual obligations are not)
    ii. Not limited to contractual relationships, doesn't have to be verbal
    iii. Bilateral – requires consent of both principal and agent
    iv. Agent authority not unlimited to act on behalf of principal
      1. Any employee is an agent (i.e., bagger at Harris Teeter)
    v. *Gay Jenson Farms Co. v. Cargill* (p. 27)
      1. Limited liability case
      2. A loan is a type of limited liability investment if you are the lender
        a. Unlike agency and common law general partnership, a loan is limited liability
      3. Here, more than loan, Principal-Agent relationship
        a. **Degree of Control**
          i. Right of first refusal by Cargill
          ii. Cargill dealt in day-to-day activities of WG&S/micromanaged
            1. Salaries/other expenditures
            2. WG&S had to obtain Cargill's consent to invest, mortgage, borrow
          iii. This alone would not be enough to make a P-A relationship
        b. **Holding Out**
          i. Cargill's allowed Warren to use its name (business forms, etc)
          ii. Big one, but not enough alone to be P-A relationship
          iii. Creates apparent authority – P allowing A to use its name
        c. **Agent Acting for the Benefit of the Principal** (strategic investment)
          i. WG&S sent 90% of product to Cargill (90% for Cargill's benefit)
      4. Contrast with *Martin*
        a. No day-to-day control
        b. A lot of the same things, but different decision

        c. Good case of a lawyer drafting a document, but not good enough/conservative enough
  e. Fiduciary Obligations
    i. Duty of Care
      1. Don't be negligent
    ii. Duty of Loyalty
      1. Key Rules
        a. Unless otherwise agreed (implicit or explicit), an agent is under a duty to act ***solely*** for the benefit of the principal. (Duty of Undivided Loyalty)
        b. Unless otherwise agreed, an agent may not deal with the principal as an adverse party (**conflict of interest**).
          i. Conflict of interest has to at least be disclosed.
        c. Unless otherwise agreed, an agent who makes a profit while working for a principal is under a duty to give that profit to the principal.
          i. Corollary of rule is basis for the laws against **insider trading**
            1. *Use of confidential information*. An agent who acquires confidential information in the course of his employment or in violation of his duties has a duty . . . to account for any profits made by the use of such information, although this does not harm the principal. . . . So, if [a corporate officer] has 'inside' information that the corporation is about to purchase or sell securities, or to declare or to pass a dividend, profits made by him in stock transactions undertaken because of his knowledge are held in constructive trust for the principal. Rest. Agency 2d, § 388, Comment C.
      2. Insider Trading
        a. Unless otherwise agreed, an agent who makes a profit while working for a principal is under a duty to give that profit to the principal
    iii. Duty of Good Faith
      1. Included in duty of care and duty of loyalty, not enough to view as 3rd independent duty
  f. Authority
    i. Actual Authority: dependent on conversations, agreements, history between the principal and agent
      1. Express Actual Authority
        a. Job description
        b. Bylaws
        c. Contract
      2. Implied Actual Authority
        a. Ex: Job duty to make deposit, nothing about driving car to bank, court would imply authority to drive car to make deposit
    ii. Apparent Authority: runs from principal to third party
      1. Does not require reliance by third party
      2. Ex: Employee of company with title as director of human resources has both implied and apparent authority
        a. Apparent and implied authority to hire and fire employees
    iii. Principal is liable if there is any type of authority
    iv. Agent cannot create its own authority

v. Ratification
    1. A principal can after-the-fact ratify an unauthorized act
    2. Ratification relates back, adoption does not
vi. When agent acts within authority he is generally not personally liable
    1. Ex: signing a K in a representative capacity

g. Vicarious Liability
i. Principal liable for actions of agent that are within agent's authority
ii. *Butler v. McDonald's* (p.39)
    1. Action for negligence of McDonald's and franchisee for door shattering
    2. Franchise is not an agency relationship
        a. Can be made clear in agreement between franchisor and franchisee
    3. Apparent authority is a question of fact
        a. McDonald's could avoid apparent authority by having sign outside that says independently owned and operated
            i. Without sign, let jury decide whether there is apparent authority
        b. Difficult to predict

III. Partnership Law (General Partnerships)
a. What is a partnership?
i. UPA §§ 6, 7; RUPA §§ 101(6), 202(c)
ii. ***Common law***, supplemented by statute
iii. **Definition**: an association of two or more persons to carry on as co-owners of a business for profit
iv. Doesn't require a K
v. **Default method of doing business**
vi. Only form that exists at common law
vii. Unless a specific term is specified, a partnership is terminable at will
viii. Two Consequences
    1. Each partner is jointly and severally liable for the operations of the business
    2. Each partner is an agent of the business
ix. *Martin v. Peyton* (p. 44)
    1. Court found lenders were not co-partners in the business (could have gone other way)
    2. Possible Partnership—Features
        a. Control (day-to-day, right of entry, veto power over certain transactions (had to approve additional loans)
        b. Lenders had option to become partners
            i. Convertible bond – convert debt investment into equity investment
                1. Court holds still loan, this type of control needed because high-risk loan
        c. Profit Sharing
            i. Generally prima facie evidence of partnership
            ii. But here, profit sharing was a timing mechanism for repayment of the loan (lender not going to get more than loan plus interest, still fixed amount)
                1. Normally a loan is a fixed return (fixed amount + fixed interest rate)
                    a. Debt is a fixed return
                    b. Equity stock is NOT a fixed return

iii. Lease as profit sharing (percentage lease) is generally not a presumption of partnership
    3. Lender would have limited liability, partner would be jointly and severally liable
    4. **In a situation where money is loaned, it is good to have a *Formalized Agreement*, so that the court can look and see that the protection of the loan is the primary goal, together with the desire to avoid being involved in the business.**
    5. Distinguish from *Cargill*
        a. High-risk business: higher the risk, the more control that is reasonable
        b. Peyton had power to become partner but declined the opportunity to exert the power
x. Joint Tenancy or Tenancy in Common
    1. Not a partnership, look at facts to determine whether joint tenancy or partnership
xi. *Peed v. Peed* (p. 51)
    1. Circumstantial evidence of arrangement between an ex-husband and ex-wife—implied partnership in a dairy farm. In this case one partner provided the capital, and the other provided services.
    2. Question of fact for jury whether marital property or partnership property
        a. There are informal relationships that are not partnerships (like marriage) by definition but evidence indicates that relationship was partnership in legal sense (de facto partnership)
    3. Should have made clear whether marital or partnership before/during marriage

b. Partnership Fiduciary Obligations
i. UPA § 21
ii. Joint venture is a type of partnership
    1. No legal significance
    2. Partnership for a very limited purpose
iii. Hypo: Two individuals, A & B, decide to enter into a partnership. A puts up 90% of money and B puts up 10% of money. How do they share the profits? What are their relative voting rights?
iv. *Meinhard v. Salmon* (p. 52)
    1. P contributed money to D who managed the joint enterprise for the two men for a period of 20 years (partnership for a term). Near the end of their lease, D was approached by a third party for an option in a new business venture with the same property P was a part of, and D tried to take advantage of it by himself, without telling P while the original lease was still ongoing.
    2. Duty of Loyalty
        a. Partners have a fiduciary duty of loyalty to the other partners. Failure to include P was a breach of loyalty by D.
        b. Partners are held to something more than the morals of the market place; not honesty alone but the **punctilio of an honor the most sensitive** is the standard of behavior—D should have treaded P with it with respect to the new agreement
    3. Issue of Disclosure
        a. Fiduciaries at a minimum have disclosure obligation
        b. D should have at least disclosed the deal to P so that P could have had a competitive opportunity to make a deal on the same property

i. If D had waited until partnership had expired to negotiate renewal, instead of negotiating renewal before expiration of lease, then likely no problem

c. Disclosure crucial since D started acts before end of partnership because
i. *See* II.e.ii.1.a & c (Duty of Undivided Loyalty &Against Insider Trading)

c. Partners' Authority & Governance (Agency Revisited)
i. UPA §§ 9, 18; RUPA § 301
ii. Partner is an agent of partnership and can bind partnership when acting in the ordinary course of business
iii. UPA § 21 – partner is a fiduciary
iv. Could avoid problems with ***Partnership Agreements***
1. Formal written agreement, that specifies duties and obligations:
a. Partners given equal votes in partnership
b. Rule by a majority vote
c. Shares will vary according to a partner's production
d. Capital account
i. Partners contribute money to firm as part of business entity
ii. Viewed as an asset
v. UPA § 18—Rights of Partners absent an agreement:
1. All partners have equal rights of management
2. No pay for acting→just share in the profits
3. All parties must share in the admission of the other parties
4. Majority may resolve ordinary matters unless contradictory to the agreement, then all partners must agree
vi. *Summers v. Dooley* (p. 58)
1. 50-50 partnership
a. Potential pitfall of 50-50 is the potential for deadlock; 50-50 partnerships are often family businesses
b. Need device in place to resolve issues of "deadlock"
2. Partner didn't have **actual authority** as agent of partnership to hire a third employee after other partner said no because he didn't have consent of the majority
a. **Partners are bound in the ordinary course of business (don't need majority consent), but when it is extraordinary, there must be majority consent/support**
i. UPA §8; RUPA § 1
ii. Hiring additional employee was extraordinary because the course of conduct was for the two partners to the work and not hire additional employees.
vii. *National Biscuit v. Stroud* (p. 60)
1. Partner ordered more bread without consent of other partner, Stroud, after that partner told supplier he would no longer be liable for bread purchases.
2. Stroud liable because partner's agency extends to ordinary course of business
a. **Need majority to say no to something in ordinary course of business; no majority needed to keep doing what is in ordinary course**

d. Entity versus Aggregate
i. 1914 Act – Partnership not a separate entity apart from its partners—it's an aggregate of its partners

1. LLC, LLP, LP are **entities**—they have legal status as persons
2. 5 partners, 1 dies then end of partnership, if partnership carries forward then it's a new partnership
3. Unless specified, any partner can dissolve partnership at will
a. **Entities don't change when leadership changes**
4. Can't sell stake in partnership, can assign economic rights though
ii. Draft around partnership problem with ***Continuation Agreement***
1. Provides continuity of interest
2. No Continuation Agreement, then new partnership when composition changes
iii. Partnerships are treated as entities for some aspects such as service of process
iv. Partnership is generally not a taxable entity, whereas corporations are taxable entities
1. Partners taxed on their share even if it is not distributed to them
v. RUPA – partnership is an entity

e. Partnership Liabilities/Finances & Duties
i. Equal voting rights if no agreement, whereas corporation each has voting rights equal to share of ownership
ii. Partnership is not a taxable entity (taxes paid by partners on their pro rata share)
iii. Profits distributed per capita by default statute unless otherwise provided in agreement
1. UPA § 18(e) – after liquidation each partner gets per capita share not how much they put in
a. Losses and profits are allocated in same manner
iv. Partners are jointly and severally liable for partnership
1. Each partner can be liable for the whole
2. If partners allocate loss, plaintiff could still sue A for whole, A would have to sue B for contribution (A would have to K around it and likely disclose to B to not be liable to third party)
a. Allocation only internal

f. Partnership Dissolution and Dissociation
i. UPA §§ 29, 31; RUPA §§ 601, 701, 801
ii. Definition: end of the entity or the aggregate
iii. Partnerships don't have continuity of existence, need a Continuation Agreement in place before dissolution
iv. Partnership automatically dissolves when certain events happen (UPA § 31)
1. Termination of the definite term or particular undertaking specified in the agreement
2. Express will of any partner when no definite term or particular undertaking is specified
3. Express will of all the partners who have not assigned their interests or suffered them to be charged for their separate debts, either before or after the termination of any specified term or particular undertaking
4. Expulsion of any partner from the business
5. Event that makes it unlawful for the business of the partnership to be carried on or for the members to carry it on in partnership
6. Death of any partner
7. Bankruptcy of any partner or the partnership
8. Decree of court
v. RUPA partnership, LLC, LP
1. Same events in UPA § 31 may cause dissociation, but does not dissolve entity
vi. NO CONCEPT OF DISSOCIAITON IN CORPORATE WORLD

1. Corporations can still be dissolved by vote and other methods

vii. *Page v. Page* (p. 67)
1. No partnership agreement (partnership at will)
2. 50-50 partnership, equal contribution
3. Page1 opened up another company that loaned partnership money on a demand note, Page1 called note, partnership didn't have enough assets so had to liquidate
   a. Freeze-Out: moving forward with a deal without the other partnership
4. Page1 owed Page2 a punctilio o honor most sensitive—not fair for Page1 to take Page2's money to start and then kick him out when business is profitable
   a. Power to dissolve, but not the right to dissolve here
   b. Partnership obligations can transcend what is in the K

viii. Three stages:
1. Dissolution
2. Winding Up
3. Termination

IV. Limited Partnerships, Limited Liability Partnerships, & Limited Liability Companies

a. Business Trusts
i. Owners are beneficiaries
1. As beneficiaries of a trust they are not jointly and severally liable for the obligations/activities of the trust

ii. If tried in NC, then partnership, but if in Massachusetts, business trusts are recognized at common law as an unincorporated form for doing business.
1. Other states allow business trusts by statute, such as Delaware

iii. Real estate investment trust (REIT); several tax advantages

b. Limited Partnerships
i. ULPA; RULPA
ii. Statutorily created method of profit sharing by passive investors; permits investors to share the profits of a business with their risk of loss limited to their investment if investors comply with certain legal formalities
iii. Formed only by complying with statutory formalities
iv. 2 classes of partners:
1. **General**: complete control, manage the business, subject to full (unlimited) liability
   a. **There must be at least 1 general partner**
   b. Owe fiduciary obligations to limited partnership
   c. A corporation can be set up as a general partner **except** if all the limited partners are also shareholders of the corporation
2. **Limited**: subordinated to creditors if firm becomes insolvent or liquidated, does not take part in managing the enterprise, liability limited to amount of capital contribution
   a. Are not agents of partnership and do not have the authority to bind the partnership simply because of position as limited partner
   b. If limited partner asserts too much control he/she/it will lose limited partner status and become a general partner
      i. Can have power to elect general partner
      ii. Statutes over time have expanded the degree of control limited partners can have
   c. Where limited partner is not exercising managerial control, fiduciary duties to other partners will be much lower

v. Tax at an individual level
vi. Why do we need limited partnership?—2 possible areas where you want it
1. Mandate centralized management
   a. Can do it in nonmember managed LLC or LLP
   b. Want to be publicly traded (can be own category)
      i. Master limited partnership
      ii. Have to have centralized management
2. Family limited partnership
   a. Tax laws-to avoid estate tax
      i. Minority discount: minority owner share worth less than majority owner
         1. Divide business into 10 10% pieces, which will be taxed less than if passed by estate 100% of business would be taxed
   b. Estate planning device

c. Limited Liability Partnerships (LLPs)
i. RUPA § 1101
ii. LLP and LL for class purposes are fungible concepts (functionally the same)
iii. UPA § 1001 (p. 48 Supp.)
1. Any partnership can qualify to be an LLP by filing a statement of qualification that must contain the following from § (c):
   a. The name of the partnership;
   b. The street address of the partnership's CEO and, if different, the street address of an office in the State, if any;
   c. If the partnership does not have an office in the State, the name and street address of the partnership's agent for service of process;
   d. A statement that the partnership elects to be a LLP; and
   e. A deferred effective date, if any.

d. Limited Liability Companies (LLCs)
i. Form of choice
1. Basically like partnership except owners are members who enjoy limited liability
2. The purpose of forming an LLC is to create an entity that offers investors the protections of limited liability and the flow-through tax status of partnerships
3. **Changing general partnership to LLC doesn't erase current joint and several liability, only going forward**

ii. 2 Types
1. Member-managed
   a. Members working in partnership
   b. Member an agent
2. Non-member-managed
   a. Limited partners
   b. Member not an agent

iii. No mandated governing structure or centralized management
1. Owner could be only employee

iv. Used to have time limits because IRS rule—if look like a corporation, taxed like a corporation
1. What does corporation look like?
   a. Centralized management
   b. Free transferability

c. Unlimited duration
d. Separate legal person

2. **IRS Rule Today: Check the Box Rule-check how you want to be taxed, not time period**

v. Requirements
1. LLC operating agreement that determines rights, obligations, and duties of owners and the governing structure
2. File notice with Secretary of State

vi. Voting rights for members may be defined in operating agreement; if not, some states, following a partnership model, grant LLC members an equal voice while other states set voting rights based on proportional assets

vii. Does withdrawal of member trigger dissolution of LLC?
1. Some States: LLC must dissolve upon withdrawal of a member unless all remaining members consent to continue under a right to do so stated in the articles of the organization
2. Upon withdrawal, member is usually entitled to return of capital contribution

viii. Fiduciary Duties
1. Absent a statute look at LLC as a general partnership and then partners owe fiduciary duties at least to active partners
2. Most statutes have ability for partners to limit fiduciary duties

V. Corporations – Formation & Financing

a. Introduction to Corporations

i. **Incorporated under state law**
1. Although, federal securities law have impact on corporate law
2. Congress could nationalize corporate law and preempt states, **but** they haven't

ii. When in doubt, don't incorporate—make sure benefits outweigh costs
1. Considerations for Incorporation:
a. Limited Liability
i. Limited to capital contributions
b. Transferability of Ownership
i. Sell shares
ii. Hard to sell if not on NYSE or NASDAQ
iii. May be transfer restrictions
c. Continuity of Existence
d. Centralized Management
i. Separate from ownership control
ii. More significant as corporation gets bigger

iii. When in doubt, incorporate at home—where you have principal place of business
1. Additional costs to incorporate in DE if principal place of business elsewhere
a. Also requires DE lawyer to handle DE incorporation
b. Check DE case law

iv. Double taxation
1. If distribution of dividends then taxed as income
2. Shareholders only get taxed on the dividends they receive, not the profits

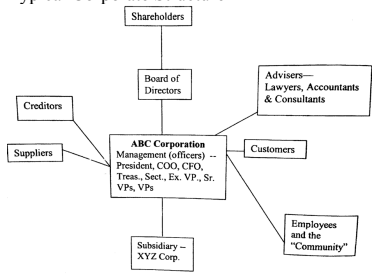
v. General Business Incorporation Act
1. Lawyers cannot incorporate under this
2. Banks cannot incorporate either
a. All states have banking incorporation act

i. BOA incorporated under DE General Incorporated Act, but it's a holding company, actual banks are incorporated under the banking act in each state

vi. Nonprofit Corporation Act—Parallels Profit Act

vii. What does it mean to be a corporation?
1. Corporations are owned by shareholders
a. By statute, shareholders elect board of directors to serve on governing board; directors appoint officers; officers may have (generally do have) the authority to hire new employees
2. Officers and employees are agents of corporation
a. Have to have at least 1 employee or officer
b. **DIRECTORS ARE NOT AGENTS**

viii. Lawyers represent the corporation not any of the individual groups (directors, officers, or employees)—Corporate lawyer is an adviser

ix. Where to look to find structure/rules? (in order)
1. Constitution→Statute→Articles of Incorporation/Certificate→Bylaws→ →Resolutions (binding only to the extent consistent with above)→Officers→Employees
2. Typical Corporate Structure
3. 

b. Start-up Companies & Corporate Promoters (Agency & Fiduciary Duties Revisited)

i. Promoter's Liability
1. Pre-incorporation—want to ensure there is interest in business before incorporating
2. **Promoter is not a legally defined term**
3. Venture capitalist, professionals, someone acting on behalf of business/getting business started
4. Promoter can enter into a K with a third party before the corporation is formed if the promoter is willing to assume the contractual liability
5. Promoter will be personally liable on contracts, as they cannot act as an agent for a non-existent corporation (one that was not incorporated at the time the contracts were made)
a. Exceptions
i. Other companies agree not to hold them personally liable
ii. Promoter enters contract, with a clause acknowledging that the corporation does not yet exist
1. No clause, then on hook because signed in principal capacity

6. Ratification
    a. Corporation cannot ratify promoter's K—corporation has to be in existence for ratification
    b. Liability relates back to the date the act could have been authorized—principal cannot authorize an action before its existence
7. Adoption
    a. Liability runs from the date of adoption
    b. Implied adoption – acquiesce in receipt of business with notice
        i. Knew of terms and accepted K
8. Novation
    a. Substitution of new K for old one
9. If promoter liable, remains liable even if corporation adopts the K, unless there is a novation (substitution of new K for old one)
    a. **Adoption does not automatically relieve promoter's liability**
10. A corporation is liable for breach of a pre-incorporation K made by a promoter on the corporation's behalf if:
    a. The corporation adopts the K expressly or impliedly
    b. The corporation accepts a desired benefit under circumstances making it inequitable to retain the benefit without paying for it

ii. *O'Rorke v. Geary* (p. 124)
1. Geary negotiated K on behalf of corporation to be formed and signed in a clearly representative capacity
    a. Generally not liable if signing as an agent of corporation, but here Geary wasn't an agent because he had no principal
        i. **An agent without a principal isn't an agent**
2. To not be liable Geary could have solicited an offer to be completed once corporation was formed.
3. **A person acting in a representative capacity for a non-existent principal, then person is on the hook**

iii. *Old Dominion* (p. 128)
1. Federal **shareholder derivative suit** (shareholder suing on behalf of corporation for injury to corporation)
2. Plaintiffs lose because shareholders were the ones hurt, not the corporation—the corporation ratified the overvaluation of shares
    a. Corporation is an entity and doesn't change when new shareholders added
    b. New shareholders who brought suit, did so after action by board
3. Common law fraud will not work in public securities market
4. Majority and legal view

iv. *Old Dominion II* (Mass. Sup. Ct. case)
1. Same facts as federal case but new defendant and brought in state court
2. Exception to general rule: where transaction set up like this one and set up to defraud future shareholders then shareholders are included in corporation constituency
3. Pragmatic view/exception to majority

v. Securities Act of 1933
1. Disclosure is focus of federal security laws—disclose everything to investors and let them make their own decisions

c. Mechanics of Incorporation
i. MBCA §§ 2.03, 2.01-2.02, 4.01, 4.02

ii. 90% of corporate formation can be done through commercial incorporation kit
iii. Lawyers role is n figuring out the terms and needs
iv. Pre-Checklist
1. Decide where to incorporate
2. Pre-incorporation agreement
    a. RMA § 7.32 – Shareholders Agreements

v. Checklist of Incorporation Steps—given by corporate statute (Professor Hazen)
1. Selection, clearance, and reservation of corporate name – Model Act (Ch. 4) § 4.01 et seq.
    a. If limited purpose, can't put different purpose in name
2. Securing pre-incorporation share subscriptions – Model Act § 6.20
3. Arrange for an office and in-state agent – Model Act Ch. 5
4. Draft articles of incorporation – Model Act § 2.02 (what must be in articles)
5. Incorporators (or initial directors) must sign the articles of incorporation for filing – Model Act §§ 2.01-2.02
    a. Initial directors/incorporators can be final directors
6. The duplicate originals of the articles must be filed with the Secretary of State upon part of filing fee. Upon filing the Corporate existence commences – Model Act § 2.03. The original articles of incorporation are to be filed in the corporation's registered office.
    a. AOIs should include corporate name; number and types of shares; address; name of corporation's registered agent (person who will receive service f process); each incorporator's names; and corporate purpose (most likely an all purpose clause)
7. Draft Bylaws – Model Act § 2.06
    a. Anything that can be in AOIs can be in bylaws
    b. AOIs can only be amended with majority of shareholders' approval
8. Hold organization meeting of directors – Model Act § 2.05
    a. Directors are selected
    b. Directors designate corporate officers
    c. Bylaws adopted
9. Comply with federal and state securities laws, if necessary.
10. Secure payment of share subscriptions by subscribers – Model Act §§6.20-6.21
11. Issue shares of stock – Model Act § 6.21
12. Qualify to do business in other states as foreign corporation. Model Act Ch. 15

d. Defective Incorporation – De Facto & Estoppel Doctrines
i. MBCA § 2.04
1. All persons purporting to act as or on behalf of a corporation, **knowing** there was no incorporation under this Act, are jointly and severally liable for all liabilities created while so acting.
    a. NC didn't adopt.
2. Some states that adopted it say this abolishes de facto and estoppel doctrines; others only abolishes de facto; others say the provision is to hold liable only those who knew there was n corporation at the time

ii. MBCA § 2.03
1. Corporation existence begins when AOIs are filed
    a. AOIs deemed filed when receive receipt from Sec. of State's office after SOS officer reviewed articles (has to be processed and put in the file)

iii. AOIs not filed, then partnership, so partners are jointly and severally liable

1. AOIs don't relate back

iv. *Pocahontas Fuel* (p. 138)
   1. **De Facto Corporation Doctrine**
      a. If make good faith effort to comply with statute to incorporate, then individual cannot be held personally liable for defect
      b. Use of corporate franchise – acting like a corporation
      c. Good faith effort requires correcting mistake when find out about it

v. *Cranson v. IBM* (p. 139)
   1. **Corporation by Estoppel**
      a. A way to find corporate existence without the formal creation of a corporation
      b. Prevents people who have dealt with the corporation believing it to be a corporation from thereafter trying to deny the corporation exists in order to hold officers personally liable on contracts (protects shareholders against parties who've dealt with the corporation believing it to be de jure)
      c. Fragile doctrine if equities change – IBM bigger corporation than M&P

vi. De Facto and Estoppel doctrines are **exceptions to the common law rule** of no incorporation then treat as partnership
   1. Do not protect guilty shareholders who know about defect

vii. A corporation may be dissolved by Attorney General, Secretary of State, or court if taxes aren't paid (i.e. corporate franchise tax)→no longer a corporation
   1. If corporation status is reinstated then state of corporation relates back, so not a partnership because purpose of statute is to get taxes paid

e. Overview of Corporate Finance

i. Bond = fixed return
   1. Debt instrument/IOU
   2. Generally sold to investors rather than a bank loan=note
   3. Do not have to be authorized by shareholders
   4. MBCA § 3.02(7) – power to borrow money is a general power—allows bonds to be issued by directors (**unless limited in AOI**)

ii. Stock
   1. Basic ownership interest/equity
   2. AOI must authorize shares that are to be issued (both common and preferred stock) [shareholders authorize shares]
      a. MBCA § 6.21 allows director to issue authorized shares
      b. More stock dilutes existing share value
   3. Types
      a. Publicly traded—on stock exchange
      b. Not publicly traded—not on stock exchange (illiquid)
   4. Par Value
      a. DE and some other states (Not NC); Model Act has done away with it
      b. Lowest price at which corporation may issue stock to shareholders
      c. **Corporation cannot issue stock below par value** (if it does then known as watered stock and shareholder assessed to par)
         i. **Par value is the minimum amount *corporation* can sell stock for**
            1. Others can sell shares for less
      d. Can put par value below share value (sell for less)
         i. Receive capital surplus
         ii. $0.01 nominal value; $0 par stock allowed

iii. Factors to consider in buying stock/investing in bonds/making other investments
   1. Rate of return – how much you get back/interest
      a. Dividends/interest payments
         i. Bonds more attractive because contractual right to interest
      b. Growth/appreciation
   2. Volatility
   3. Social issues/sustainability
   4. Risk
      a. Bonds less risky because creditors paid off first
      b. Inverse relationship between risk and reward
   5. Timing/time horizon
   6. Control
      a. Do you want it/how much
      b. Stock voting rights, bonds generally don't have these
   7. Liquidity
      a. Know how fast you can turn it into cash
      b. Cash – most liquid; other investments have some limitations on liquidity

iv. Risk of Loss:
   1. Limited Liability
   2. Priority: (Order debtors are paid on business liquidation)
      a. Secured debt
      b. Subordinated secured debt
      c. Unsecured debt (no direct claim on assets)
      d. Subordinated unsecured debt (may be taxed as equity)
      e. Preferred stock which is a debt/equity hybrid
         i. Stock has some preference over different kind of stock
         ii. Features of both stocks and bonds
            1. Usually fixed return (bond)
            2. No contractual right to dividend, conditional right (not like a bond)
         iii. Safer than common stock, but not as safe as debt because:
            1. Creditors get paid before preferred shareholders
            2. Interest payment on note/debt is a contractual obligation
      f. Common stock

v. Power of Control
   1. There must be at least one class of common stock with voting rights. Other classes of stock may have limited voting rights.
      a. Do not have to have class with complete voting right, unless only one class of stock.
      b. Can have non-voting common stock.
   2. Preferred stock (more like debt) may have limited or no voting rights except where mandated by statute.
      a. **Note**: N.Y. Stock Exchange will not list nonvoting stock.
   3. Debt generally has no voting rights. Sometimes there are contingent voting rights or the voting stock is controlled by a voting trust.

vi. Participation in Proceeds
   1. Profit-sharing
      a. *Martin v. Peyton* – still debt instrument because fixed return
   2. Dividends and liquidation:

a. Debt usually has a fixed return (but may be "participating" – see "participation rights", below)
    i. Generally not participating
b. Preferred stock generally has a fixed return (but may be "participating")
    i. Generally not participating
    ii. Generally redeemable (aka callable)—corporation has right to buy back at a certain price (so more like debt)
c. Common stock dividends depend on the directors' discretion.
    i. There cannot be a contractual right to dividends (see "cumulative dividends" – below)

vii. Continuity – Duration
1. Generally debt has a fixed term
2. Common stock is perpetual as long as corporation exists
3. Preferred stock frequently is redeemable (callable) which makes it more like debt
    a. May have short/limited duration

viii. Hybrid Features
1. Conversion Rights
    a. Debt or preferred stock may be issued with conversion rights. Holder has contractual right to convert – usually into common stock.
        i. Lender may have option to become owner (*Martin v. Peyton*)
        ii. Convert at predetermined ratio or price
    b. Convert if company doing well and you want to participate/get more interest
    c. Exercise convertible rights then lose befits of bond/stock
2. Exchangeable Bonds/Stocks
    a. Mirror image of convertible stock/bond
    b. Exchangeable at corporation's option, not shareholder's option
3. Redemption
    a. Corporation ("issuer") can at its option "call" in or redeem shares (or bonds) if provided for in the indenture or preferred stock description
4. Sinking Funds
    a. Certain bonds require the corporation to reserve funds for redemption or retirement of debt.
    b. Types
        i. Unfunded sinking funds
            1. Involve merely a restriction on the corporate accounts rather than an escrow account
            2. More common
        ii. Funded sinking funds
    c. Most stocks/bonds do not have these
5. Participation Rights
    a. Sometimes bondholders and preferred shareholders have a right to participate in profits along with the common stockholders.
    b. "Participating" bonds and preferred stock makes these investments more like equity.
6. Cumulative Dividends
    a. Preferred stock only

b. Like common stock, preferred stockholders do not have a contractual right to dividends. Preferred merely means that the preferred shareholders get their dividends before dividends can be paid on the common stock.
c. ***Cumulative dividends*** means that if no preferred dividends are paid in one year, they accrue to the next so that the preferred shareholders must be paid accrued and current dividends before anything can be paid on the common.
d. Most states noncumulative unless say cumulative
    i. Noncumulative = straight preferred

f. Limited Liability & *Ultra Vires*
i. Piercing the Corporate Veil; Equitable Subordination Compared
1. Can apply to LLP, LLC, and corporations
2. Piercing the veil = eliminating shield of limited liability
    a. Shareholder personally liable beyond their investment
3. Normally, the corporate entity shields shareholders from liability for corporate debts; that is, it acts as a veil between shareholders and corporate creditors. When the corporate veil is pierced, the corporate entity is disregarded and shareholders are subjected to unlimited liability for the corporation's unsatisfied debts. This doctrine assumes no defect in incorporation.
4. *Minton v. Cavaney* (p. 150) **ALTER EGO DOCTRINE**
    a. Minton sued D because his daughter drowned while swimming in his pool. The corporation had no assets, and P sought to hold D personally liable. Alter ego doctrine (which is different from the agency theory) held D liable. It was an abuse of corporate privilege when:
        i. Individual treats corporation assets as his own
        ii. Individual holds self out as being liable
        iii. Inadequate capitalization (aka thin capitalization
            1. Important factor, but not sufficient alone
5. *Walkovsky v. Carlton* (p. 154)
    a. D owned 10 2-taxi corporations with the minimum insurance required ($10k on each cab). P struck by cab, damages exceeded insurance on cab. P wanted to aggregate all 20 cabs.
    b. **Complex structure "plus" thin capitalization not enough to pierce veil**
    c. **Need to show/prove to pierce the corporate veil:**
        i. Alter ego language
        ii. Comingling of corporate funds
        iii. Annual shareholder meeting for each corporation
        iv. Corporate formalities
        v. 10 different balance sheets
    d. Plaintiff has to allege and establish corporation was the alter ego of the shareholder/establish agency:
        i. Express or implied authority or control
        ii. Show corporation was used in personal capacity solely for personal gains (i.e., only person to benefit from corporation success)
        iii. Disrespect for corporate form such as comingling/shifting of funds
    e. The court noted that the **observance of corporate formalities** will avoid piercing the veil on an ***agency*** theory. There is a public benefit in limited liability, although the P here suffered.
6. Difficult cases to prove; most cases piercing the veil argument will fail

7. **Factors court looks to in determining whether corporate veil pierced—Pages 164-65 (Caution flags—potential)**
8. When court is likely to pierce corporate veil:
    a. Usually for tort as opposed to contract claims; in contract claims, creditor has dealt with corporation and should be aware that corporation lacked substance; a tort claimant is an involuntary creditor having not had any business dealings with the corporation
    b. For non-public companies with few shareholders
    c. In the existence of fraud or wrongdoing
    d. Failure to follow corporate formalities
    e. Inadequate capitalization—investment is not commensurate with corporation's prospects and risks (usually this factor alone is not sufficient to pierce the veil in the context of a corporation with one or few shareholders)
9. **Circumstances under which courts will not pierce corporate veil:**
    a. **Closely held corporations**: courts will honor the corporate veil as long as there is no fraud or wrongdoing, the business is conducted on a corporate basis, and the corporation had adequate initial capitalization
    b. **Parent subsidiary corporations**: courts wont hold parent liable if there is no fraud or wrongdoing, there is no intermingling of respective business transactions, the subsidiary was adequately financed, and the parent and subsidiary are held out as separate corporations
    c. **Publicly held corporation**: courts virtually never pierce veil
        i. <u>To ensure limited liability</u>:
            1. **Obey corporate formalities**
            2. **Adequately capitalize**
                a. Test: <u>Was capital adequate at beginning</u>?
                    i. Courts won't pierce if lose capital later

ii. Equal Subordination Doctrine ("Deep Rock" doctrine)
1. A controlling shareholder makes a loan to the corporation (an IOU), which has outside creditors. The corporation becomes insolvent and is faced with bankruptcy.
    a. Should the controlling shareholder's claim have equal priority to those of other creditors?
        i. Under the doctrine of equitable subordination, if it would be manifestly unfair to permit the controlling shareholder equal priority, the court will subordinate his loan to other creditors.
            1. If sole shareholder apply equal subordination doctrine and make him stand behind other creditors
2. <u>Costello v. Fazio</u>: Prevents partnership from creating a corporation where their equity is turned into debt so that the owners of the partnership can be put on the same footing as unsecured creditors when claiming against the new found "corporation."
    a. In essence, the partnership owners created a corporation so that they could cut in line for bankruptcy. Thus we apply the doctrine of equitable subordination.
    b. Also prevents a parent company from subsidizing / abusing a subsidiary for its own purposes.

    c. This doctrine is applied when there has been fraud, abuse, mismanagement, undercapitalization, or commingling of funds.
3. **Fraudulent Conveyance Act:**
    a. Statute prohibits a corporation form transferring assets, unless they receive equivalent value for it. Assets must be sold for market value.
    b. Will take money back from somebody if it has been done for fraudulent reasons
        i. Bad faith attempt to take something away from creditors who are entitled to it
    c. It is okay to trade stocks for assets.
    d. Transfers between corporations must be bought/sold at market value.

iii. *Ultra Vires* (& Social Responsibility)
1. *Ultra vires* = outside scope of company charter/company purpose
2. Before Model Act, all corporations had to state its purpose
3. *Wiswall* (p. 173)
    a. Company stated purpose to build and operate plank roads, company wanted to build and operate stage line (court holds outside purpose)
4. General Rule—Doctrine of Implied Powers (n.3 p. 176) – sometimes court will imply the power to engage in conduct that furthers the stated purpose if it was neither specifically nor generally authorized by the statement of purpose in its AOI.
5. Corporations cannot use ultra vires to get out of Ks (Rev. Model Act § 3.04)
6. 3 Ways to Challenge a Corporation's Power (Ultra Vires) [MBCA § 3.04 & Del. § 124]
    a. in a proceeding by a shareholder against the corporation to enjoin the act
    b. in a proceeding by the corporation, directly, derivatively, or through a receiver, trustee, or other legal representative, against an incumbent or former director, officer, employee, or agent of the corporation; or
    c. in a procedure by the Attorney General under § 14.30 (to dissolve the corporation)
7. Today, broad corporate purposes clauses ("all purposes clause"—"engage in all lawful purposes") are allowed (default by Model Act)
    a. Why have a limited purposes clause?
        i. Limit discretion of directors to exercise power (duty of obedience)
        ii. Nonprofit corporations—Creators want to define purpose so that donors know where their money is going
        iii. Older AOI before all purpose clause allowed and never amended them
8. Third party cannot raise ultra vires against corporation nor can corporation raise ultra vires against third party
    a. Can raise defense that K it entered into was with an agent without authority or K was to perform illegal acts and is void
9. Social Responsibility
    a. Milton Friedman: corporations have one social responsibility—to make money for shareholders
    b. B-Corporation = Benefit Corporation
        i. If incorporate under this statute you have goals/purposes that have social responsibilities

1. Hazen thinks unnecessary because can say in purpose of regular corporation to be socially responsible

c. *A.P. Smith Co. v. Barlow* (p. 180)
   i. Corporation made a $1500 donation to Princeton University. At the time of AP Smith's incorporation, the NJ reserved the power to change rules of incorporation…so there is no impairment of K. Model Act §1.02.
   ii. Court held that a corporation cannot give away corporate assets without justification:
      1. good will in the public eye
      2. duty of citizenship
      3. corporate America has a stake in education
      4. state policy (regardless of charter)
   iii. Many schools depend on corporate gifts. State passed stat that allowing a corporation to donate for education up to 1% of assets. Hazen said this was basically done to prevent socialism—if we didn't allow private schools to receive corporate donations, they would not be able to exist and everyone would have to go to public school.
   iv. Affect of post-incorporation statute (n.5, p. 188)—manufacturing company was formed under a state statute, later statute changed to permit charitable contributions.
      1. **Corporate charter = K between corporation and state.**
      2. Issue is whether the state may change the terms of the K between state and corporation?
         a. Dartmouth College Cases: NH amended the charter to expand number of trustees to get D back where the legislature wanted. Court says you can't do this…there is a formed K—state can't unilaterally amend a K. ***Vested Rights Doctrine***=US const. doctrine, not a K doctrine.
            i. However in A.P case reserve power clause so no K impairment. Model Act § 1.02

d. *Adams v. Smith* (p. 189)
   i. Payments to widows—ultra vires?
   ii. Court holds that unless there is in the charter a provision, which confers the power to give away the corporation's money, corporation CANNOT give away money in this way. Contrary to making money. **Court holds waste of corporate assets**
   iii. Court is not receptive to directors' decision to help widows because the corporation was giving away corporate assets where there is no consideration and no possible benefit to the corporation; the only way that this should have been done is with permission from shareholders. Giving away money without consideration is per say impermissible.
   iv. Statute allows contributions to charities recognized as nonprofits by IRS, doesn't include widows

   v. **Ultra vires still alive to prevent private, non-charitable gift giving/Social responsibility doesn't include gifts to non-charitable gifts**

e. *Dodge v. Ford Motor Co.* (p. 191)
   i. Shareholders made a demand to the controlling shareholder, Henry Ford to issue dividend. He tried to scale back the special dividends, in the interests of reducing profits to help benefit the consumer more and be more charitable. The courts ruled that a corporation is not a charity, and that the corporation is to return its profits to its shareholders.
   ii. General Rule: Board of directors have discretion to declare a dividend—lot of deference
      1. Here an exception to that rule because of a lot of unproductive money without any potential or imaginable use for funds
   iii. Change to tax code to impose an accumulated earnings tax, so large amount of money becomes tax issue

f. Other constituency statutes [i.e., other than shareholders] (n.2 p. 197)
   i. Allows board of directors to consider things other than maximizing shareholder value; not mandated
   ii. Not in NC, but can provide for in AOI

VI. Management of Corporations
   a. Corporate Structure & Distribution of Powers
      i. MBCA §§8.08, 8.09, 10.02, 10.2
      ii. Basic rule of corporate statute is that every corporation has a board of directors
      iii. State law governs corporate governance
      iv. Board of directors appoint officers—statutorily mandated
      v. Amendments to AOI must be approved by shareholders and board of directors
      vi. Bylaws can/must be adopted by directors (depends on state)
         1. Amended either by shareholders or directors unless bylaws reserve to shareholders
         2. **If bylaw adopted by shareholders, it can only be adopted or amended by shareholders (NC)**
         3. **Includes list of officers**
      vii. Separation of Powers Issues
         1. *Charlestown Boot & Shoe v. Dunsmore* (p. 202)
            a. 2 types of dissolution (always followed by liquidation or winding up)
               i. voluntary – MBCA § 14 by act of corporation
               ii. MBCA § 14.02 – board of directors recommend plan of dissolution to shareholders, if shareholders approve leads to winding up
            b. Board of directors are not agents of shareholders, they are trustees
               i. Statute says board must initiate dissolution, here shareholders voted to establish committee to work with board for dissolution, board ignores committee
               ii. Most states and under the MBCA § 8.08 can remove directors with or without cause if don't want to wait until meeting unless AOI limit with or without cause
                  1. DE an other states shareholders get to remove for cause and if the AOI provide for without cause

2. Shareholders of a corporation cannot remove or appoint/elect/hire (MBCA § 8.40)
3. Directors may remove officers at anytime with or without cause (MBCA § 8.43)
4. *Auer v. Dressel* (p. 204)
    a. Every corporation must have annual shareholder meeting
    b. Special meeting = anything other than an annual meeting (MBCA § 7.02)
    c. 10% of shareholders have ability to convene a shareholder meeting but only if for proper purpose
        i. **shareholders have power to request removal and replacement of president, cannot make resolution to remove and replace because only board of directors have power to remove and replace president**
    d. shareholders have right to express their views even when they don't have power to put them into action
5. *Campbell v. Loew's Incorporation* (p. 208)
    a. MBCA § 8.10 – vacancies can include newly created directors positions
    b. For vote to be valid need quorum
        i. Quorum = majority of fixed number of directors, unless amended by bylaws (MBCA § 8.24(a)(1))
        ii. **BUT** when directors remaining in office is less than a quorum, can fill vacancy by majority of those remaining in office (MBCA § 8.24(a)(3))
    c. **Where there is removal for cause, the directors charged with cause must be given the opportunity to defend themselves**
    d. **Management can use corporate funds to defend position, outsider has to foot his own bill to challenge management**
    e. Election/removal of directors generally lie with shareholders unless vacancies
    f. Cumulative voting
        i. Allows for minority representation
        ii. 100 shares, 13 directors for vote, 1300 shares to vote
            1. straight vote-100 shares, vote for only 1 director
    g. Use reverse cumulative voting if removal without cause, majority of shares if for with cause
    h. MBCA § 8.08(c) – If cumulative voting is authorized, a director may not be removed if the number of votes sufficient to elect him under cumulative voting is voted against his removal. If cumulative voting is not authorized, a director may be removed only if the number of votes cast to remove him exceeds the number of votes cast not to remove him.
    i. MBCA § 8.09 – 10% of shareholders may petition court to remove director regardless of how he directed for cause

viii. Judicial removal of directors
    1. Model Act for cause; DE limited

ix. MBCA § 10.03 AOI may be amended only by recommendation of directors and vote by shareholders

x. MBCA § 10.20 Amendment of bylaws by directors or shareholders unless reserved solely to the shareholders in bylaws (cannot reserve solely to directors)
    1. Default in many states is directors have authority
    2. Del. § 109 – unless AOI give power to directors, only shareholders have power

b. The Board of Directors

i. MBCA §§ 8.01, 8.20-8.25; *compare* MBCA § 7.01-7.08, 7.22, 7.25

ii. Housekeeping Requirements
    1. Meetings
        a. Directors may act only at meeting (no ability to act as individuals)
        b. MBCA § 8.21 – if **all** directors consent in writing, directors can take action without meeting (effective when last director signs on)
            i. DE allows shareholders to act without a meeting
            ii. If **all** say yes, then valid action, ***but*** if **majority** say yes, then not valid
                1. Can **ratify** action at next meeting and it relates back
    2. Notice of Meetings
        a. Regular—No notice required for regular meetings (MBCA § 8.22)
        b. Special—At least 2 days unless provided for otherwise (MBCA § 8.22(b))
            i. need not describe purpose of meeting
    3. Voting
        a. Proxy
            i. **NO**. Directors have to be at meeting
            ii. MBCA § 8.20(b) – unless AOI or bylaws say otherwise, can attend remotely provided **you can hear** what they're saying and **they can hear** what you're saying
        b. Quorum
            i. MBCA § 8.24 – unless AOI, bylaws, or act requires greater number, quorum is a majority of fixed number of directors
                1. (b) can fix or lower majority quorum, but no lower than 1/3
                    a. nonprofits can have lower
                2. (c) quorum present needed when vote taken
                    a. directors leaving the room can eliminate majority
                    b. abstentions count as no votes
        c. Requirements
            i. If quorum present at time of vote, action passes if majority of those present vote yes
                1. Ex) 13 directors, 7 present, takes 4 votes to pass
                    a. 3 yes, 4 abstain – will not pass for directors, but ill for shareholders
    4. Board Committees
        a. MBCA § 8.25 allows board of directors to delegate certain action to committees
            i. ***Cannot delegate the following to committees (MBCA § 8.25(e))***
                1. Cannot authorize distributions/declare dividends, except if board of directors adopted formula and committee declares it
                2. Cannot approve plan for merger, dissolution, etc.
                3. Cannot fill vacancies on the board of directors
                4. Cannot adopt, amend or repeal bylaws
            ii. Only board members appointed to committees and voting membership is limited to directors
        b. Common types of committees
            i. Audit Committee

1. Oversees financial operations; chair must be a financial expert; reviews operations, audit, and financials

ii. Executive Committee
1. Usually consists of CEO/President, Vice-President, other policy making officers, and directors involved in more day-to-day director decisions

iii. Compensation Committee
1. **Note**: directors are not presumed to be paid for their work→requires resolution of the board of directors
2. Committee that sets or recommends salary for executive officers; directors may be paid and may approve their own compensation (exception to conflict of interest)
3. Typically made up of "outsiders" (non-employee directors(
a. Thought of as outsiders monitoring insiders **but** structural bias (outside directors still part of the same club)

iv. Nominating Committee
1. Typically made up of outside directors who set slate and don't include directors up that year

v. Special Litigation Committee
1. Composed of directors who were not directors at time of wrongdoing, they can look at the merits of the suit and decide whether to dismiss or not

c. Inside and Outside Directors
i. At least for larger companies good idea to have some outsiders on board of directors
ii. Wise to have a majority of disinterested outsider directors to reduce potential conflicts of interest

d. Directors' Informational Rights
i. Directors have absolute right to information regarding their term of office (applies even after no longer a director)
1. NOTE: Shareholders have qualified right to inspect books and records for a proper purpose

c. Officers and Their Sources of Power (Agency Revisited)
i. MBCA §§ 8.40-8.44
ii. Officer is an agent of the corporation
1. May only act if have actual or implied authority

iii. Officers in Corporation (MBCA § 8.40)
1. President/CEO/GM/COO
a. Authority to hire and fire, supervise other employees, authority to enter into Ks on behalf of corporation
i. Doesn't have authority to enter into lifetime employment K
2. Vice-President
a. No inherent, apparent, or implied authority; at most authority to step in if President is not available
3. Secretary
a. Ministerial officer (doesn't get to decide issues other than did the board approve it), keeps corporate seal, certifier of corporation's actions
i. If wrong, but certifies action, the other party is protected

4. Treasurer/CFO
a. Ministerial position (keeps and signs the checks)
b. Can also be comptroller or CFO and may help set financial policy
5. Pre-1980 had to have the above, now not mandated in Model Act
6. Corporations not limited to these ***but*** same person cannot hold two offices if action requires both offices

iv. Giving person a title, gives him apparent/actual authority because it has traditional understanding
v. Can specify authority of officers in bylaws rather tan rely on title
vi. Officers appointed by board of directors and may be removed by board at anytime for any reason (MBCA § 8.44 – there may be K rights)
vii. *Evanston Bank v. Conticommodity Services, Inc.* (p. 234)
1. Corporate officer that has discretionary authority doesn't have apparent implied authority to delegate discretionary activities to outsiders
2. Bank president could not delegate investing decisions to a broker, broker should have asked for certification that president had powers from the bank secretary

d. The Duty of Care
i. MBCA §§ 8.30, 8.31
ii. Managers and officers are held to duty of care even without duty of loyalty
iii. Director's duty of care: directors must exercise the degree of skill, diligence, and care that a reasonably prudent person would exercise in similar circumstances; two ways that duty may be breached—negligence or inactivity
iv. Regardless of how the director violates this duty of care, the plaintiff must prove injury and causation for without such proof recovery is impossible
v. Corporations in most states may limit directors' liability for breaching duty of care, except for intentional misconduct, knowing legal violations, actions done in bad faith; can't be overly broad
vi. *Bates v. Dresser* (p. 241)
1. Shareholders for the bank brought suit against the president and Board of Directors for their negligence in failing to detect a thief working for the corporation who siphoned off a lot of money.
a. Directors held to be not liable because they relied on the report of a creditor who failed to uncover the fraud.
i. They were allowed to rely on the reports of corporation employees, where it was reasonable to do so (MBCA § 8.30(e))
ii. Board of Directors was an oversight/advisory board—not involved in the day to day activities, therefore not liable for every misstep (MBCA § 8.01(b))
iii. **Board has deniability** because might not have known facts because relied on president who didn't tell them
b. President was in a better position to be able to uncover the fraud.
i. Was held liable because he had warnings and should have been on guard

vii. **Hard to prove duty of care claim because board can rely on officers and be aloof of daily activity**
viii. *Barnes v. Andrews* (p. 247)
1. Standard: reasonable director in like circumstances
a. Director here didn't meet the standard—didn't attend meetings and was careless

b. Plaintiff established defendant was below standard, but didn't show causation (i.e., if director had gone to meetings and been diligent, he would have been able to prevent what happened)
2. Need causation—both actual and proximate
a. Burden on plaintiff
3. Need to show **below standard of conduct + causation**

e. The "Business Judgment Rule"
i. MBCA § 8.31; MBCA § 2.02(b)(4), Del. § 102(b)(7)
ii. If you make an informed decision with no loyalty conflict, you will be protected from liability, even if the decision is bad/wrong/stupid
iii. *Shlensky v. Wrigley* (p. 250)
1. No lights on baseball field case
2. Court says not going to interfere with business judgment of directors
3. Board made a decision not to put up lights—exercised their business judgment
iv. Directors' decisions must be based on good faith and reasonableness.
1. Courts don't want to meddle with directors' actions because directors have the expertise to be directors
2. Judges second-guessing business people with expertise is not a desirable situation
v. **Does not apply in conflict of interest situation** because BJR is for courts to defer to businessmen to make judgment because of no self-interest, but if director has self-interest then judgment may be biased and doesn't get benefit of BJR (*Emerald Partners v. Berlin* [p. 327])
1. **If there is no conflict of interest, there is no incentive for directors to make the wrong decision.**
vi. *Smith v. Van Gorkom* (p. 256)
1. Directors have a duty of care toward the corporation, which they can violate through inactivity or negligence. Failure to inform themselves of all reasonable material information before taking part in a business decision is one form of inactivity. Informing themselves includes satisfying their reasonable doubts or questions, consulting outside experts, etc.
2. Directors failed to adequately inform themselves by asking questions about the merger
a. Also Board did not seek a fairness opinion (*Weinberg*) [didn't go out and get an independent appraisal of what stock was worth]
3. Doesn't say what directors had to do, only that what directors did under these circumstances wasn't enough to inform themselves **[outside directors have a duty to inform themselves]**
a. **Reliance on experts okay** (*Disney* cases)
4. Controversial case, Hazen thinks rightly decided.
5. If came up today and board of directors had adopted an exculpatory provision under De. § 102(b)(7 [below], then claim would have been dropped
a. **HOWEVER**, if plaintiff can establish that the board of directors sank below best practices and reasonable director standard, that shows lack of good faith and Del. § 102(b)(7) doesn't apply.
i. **If you can show lack of good faith then Del. § 102(b)(7) doesn't apply, but need to show more than breach of duty** (*Disney*)
vii. MBCA § 2.02(b)(4) & Del. § 102(b)(7) limit or eliminate director's liability
1. Del. Statute doesn't apply in conflict of interests, but MBCA does
a. Conflict of interest can exist even if n direct financial benefit

2. Can't sue directors for negligence
3. Exculpatory provision
4. MBCA allows directors to indemnify corporation if sued for liability, some states (NC) allow corporation to indemnify director for liability in lawsuit

f. The Duty of Loyalty (applies when there is a conflict of interest; easier to establish claim than duty of care)
i. Basics
1. Del. § 102(b)(7) doesn't apply, so liability
2. BJR doesn't apply, so door remains open to question judgment
ii. Self-Dealing
1. Where fiduciary is on other side of K with principal or agent
2. Where a K is self-dealing, it is voidable
3. Not necessarily wrong or breach of duty
a. i.e, selling property to company at discounted price
4. Why compensation committee important to corporation
5. Strict English Rule: self-dealing by fiduciary is prohibited [not rule in US]
6. *Globe Woolen Co. v. UTICA Gas & Electric Co.* (p. 330)
a. Maynard was the president and chief stockholder of the Globe Woolen and a director of Utica. Utica promised the Globe a guaranteed savings if it switched it source of power from steam. Maynard did not vote on the proposal, and it turned out to be a losing deal for Globe.
i. Court held that, even though he didn't vote, he carried significant influence (600 lb gorilla)
ii. As a trustee, Maynard had a duty to warn/disclose; negotiations should have been at arm's length
1. Absent the special relationship (i.e., fiduciary), Maynard would not have had a duty to disclose
iii. Court said that they should have had an independent person to advise them
b. **Rule**: K with interested director is voidable (choice to void) by corporation unless it is cleansed
7. **Cleansing mechanisms for self dealing transactions** (if a financially interested director has to be counted to make up a quorum) [cleansing doesn't mean you're safe, K may be voidable for other reasons):
a. Ratification by disinterested board/disinterested majority
i. Need independent majority of directors; interested directors in be counted in quorum
ii. To be effective need disclosure of material facts
b. Approval or ratification by shareholders
i. Do this if no disinterested majority (5 directors, 4 interested)
ii. Full disclosure of nature of conflict and material facts
iii. Most companies don't do this
c. Prove K was fair (*Marciano v. Nakash*)
i. A showing that the contract is just and reasonable as to the corporation (in most states, if a transaction is clearly unfair, a court wont uphold even with director or shareholder approval)
1. MBCA doesn't allow interest shareholders or directors to vote, but Del. does.
iii. Other Conflicts of Interest

1. Del. § 144; NC § 55-8-31; Handout
2. *Gilder v. PGA Tour, Inc* (p. 339)
    a. Identifying what is/is not a disinterested member is not easy
        i. Tainted if appointed by/served with tainted directors
3. *Marciano v. Nakash* (p. 344)
    a. **Ability to prove fairness without disinterested vote**
    b. **J**ordache and Guess jeans joined forces and couldn't agree on anything regarding production of their Gasoline jeans. Liquidation occurred, conflict over payment at liquidation. N had extended loan to corporation ($2.3M) to enable corporation to pay off bills**.** M challenged loan, terms of the loan, that loan was self-dealing transaction that M didn't consent to, arguing that loan was voidable. Court held that loan was not voidable.
        i. Court said loan was intrinsically fair
            1. Interested party has burden of proving intrinsic fairness
        ii. **Independent of statute, there is a requirement that K be intrinsically fair; if K is fair, even if the procedural cleansing is not satisfied, K will stand**
        iii. Without cash from N, corporation would go bankrupt; corporation turned itself around as a result of loan; under the circumstances, the terms of the loan were intrinsically fair to corporation
        iv. **KEY: intrinsic fairness test will cleanse transaction, even if you don't go through procedural loops**
        v. Ruling implies that an approval of an unfair K by a disinterested majority would not suffice to cleanse the transaction
            1. **PROCEDURAL CLEANSING WILL NOT SUBSTITUTE FOR FAIRNESS, FAIRNESS WILL SUBSTITUE FOR PROCEDURAL CLEANSING**

iv. The Corporate Opportunity Doctrine
1. General rule: if the business opportunity is the corporation's then the corporation's fiduciaries can't usurp the opportunity for themselves
2. *Guth v. Loft* (p. 350)
    a. Test to determine if corporate opportunity:
        i. Line of Business Test
            1. Is corporate opportunity in the corporation's <u>line of business</u>—Loft made candy, had candy stores, candy stores had sod fountains where they served cola, Pepsi in line of business
        ii. Fairness Analysis (NC)
            1. Does corporation have expectancy/interest in transaction?
            2. Did the corporation have the ability or the finances?
                a. Even if not, absence of cash and resources doesn't automatically deny a corporate opportunity—corporation should at least be offered opportunity
            3. Did the corporation negotiate for it?
            4. Did the officer become aware of the opportunity in his capacity as officer?
            5. Was the opportunity disclosed to the corporation?
            6. Is it essential to the corporation?
    b. Remedy

        i. If fiduciary breaches this duty, opportunity held in **<u>constructive trust</u>** for corporation; treated as if director had bought for corporation's benefit; benefits of the deal awarded to the corporation; corporation gets present value of what opportunity is
    c. Equitable considerations: whether the opportunity offered to director in official or individual capacity; was opportunity disclosed to board of directors; how opportunity came to fiduciary; can corporation afford or take advantage of opportunity; is this a unique opportunity or does it have unique value to company; was company in market for seeking opportunity or expanding business; was officer or fiduciary charged with obligation of finding these opportunities; did fiduciary or officer use corporate funds to develop opportunity; does opportunity put officer or fiduciary in position that is adverse with the company

v. Loyalty & Competition
1. *Lincoln Stores v. Grant* (p. 364)
    a. Employees and officers of Lincoln Stores saw opportunity across the street; decided to go into competition with their own store by buying the store right across the street without first offering the opportunity to Lincoln. Court held that this violated their duty of loyalty to the shareholders.
        i. D did all this on company time; agent owes principal utmost loyalty; everything that agent does while employ of the principal is for the benefit of the principal
            1. D should have explored competition in their own time; **what go them in trouble is not what they did but how they did it**—company had turned down similar opportunity
        ii. D used information they had obtained while working for company for the purpose of operating the new business (stole intellectual property)
        iii. D should have quit first and then put deal together; should not have taken customer lists, etc. prior to leaving employ of Lincoln stores
    b. General duty of agent to act solely for benefit of the principal
    c. Non-compete agreements/clauses/covenants not to compete
        i. Public policy encourages competition
        ii. Ks in unreasonable restraint of trade are illegal and unenforceable
            1. Courts look at (1) reasonable in terms of scope; (2) duration of agreement; and (3) location [look at substance]
    d. Non-compete for lawyers: Lawyers have to disclose and give existing firm its pitch to clients to preserve client's choice
2. *Duane Jones Co., Inc. v. Burke* (p. 368)
    a. Jones had a $9 million advertising business, but was an alcoholic, who's behavior cost the firm $6.5 million in accounts. The employees and directors for Jones left and formed their own firm. They solicited existing accounts from Jones, pre-sold clients on arrangement before disclosure, and ended up with over 50% of old employees/ numerous accounts. Jones was not informed of the new corporation.
        i. Court held that they breached their fiduciary duties to Jones by soliciting without informing.

ii. Also, ruling based on agency principle not to compete with principal
b. Damages will be money received from new business that was cultivated while working for old business

3. *Dalton v. Camp* (p. 373)
a. D has a K with KFI for newsletter, C was employee of D, K expired, C went to KFI and got K for himself (left working for D)
b. Rule: Lower level employees are not fiduciaries and do not owe a duty of loyalty in NC; Wisconsin comes out other way
i. Employees do have some duties such as duty not to do insider trading to profit

vi. Executive Compensation
1. Tax Consequences
a. Structure is to minimize ipact of tax laws
b. Deferred compensation—don't get taxed until get compensation
c. Sheltered benefits – healthcare, retirement
i. Pre-taxed dollars (not taxed on them)
2. Question of self-dealing
a. Contract between director and his or her corporation is voidable unless approved by disinterested majority of board or shareholders or even if not approved unless the transaction is fair
b. D has burden of proving fairness, in traditional self-dealing case, at least where there is no disinterested approval
3. Devices for Compensation
a. Stock Purchase Plans
i. Employer lets employee purchase stock at discounted price and not pay brokerage commission
b. Employee Stock Ownership Plan (ESOP)
i. Employee puts money into ESOP fund and ESOP purchases company stock, when retirement comes get benefits
c. Stock Option Plans
i. Employees get stock options that may be exercisable at future date
ii. Upon exercise, employee has to come up with cash to buy
iii. Shareholders want directors to increase value of stock; options encourage stock buying by the directors; given in lieu of pay; provide an incentive to push the price of stock up
iv. Qualified (deferred tax plan)
1. Taxed when sell the stock only
v. Non-qualified (no special tax treatment)
1. Taxed upon receipt of the option
d. Stock Appreciation Rights (SAR)/Stock Option Rights (not salary, but retirement benefit)
i. Each month employee gets right/script that will be fixed at current price of stock, when he retires (or at end of year), he gets the difference between the stock value at the time he retires (or at end of year) and the value when he got the right
ii. Don't actually get stock
e. Phantom Stock
i. Same as a SAR, except they get dividends as well.

f. Pension Plans
g. Bonus Plans
h. Golden Parachute
i. If there is a merger, this lets the officer bail out with lots of money
ii. If a raider shows up and sees employment Ks, the will be more hesitant to take over
iii. Anti-takeover device; defensive measure
4. Closely held corporations
a. High salaries is a good thing for company and employees
b. If corporation getting taxed like a corporation and owners take earnings out in dividends—double taxed, **but** if taken out in salary only taxed once and that is when in the hands of employees
c. Good plan calls for maximizing salary
d. Disguised Dividends Doctrine—IRS—looks at going rate of employee and company salaries, if salary more than going rate, extra amount taxed at the corporate rate
5. Disclosure—stock and options have to go by securities law
a. SEC requires detailed disclosure of compensation (duty of loyalty)
6. Doctrine of Waste—paying executives so much that it actually becomes corporate waste
a. Corporate fiduciary duties will not provide a remedy (*Rogers v. Hill* (p. 381) is an exception but only case of its kind in 150 years)
7. Sarbanes-Oxley Act 2002
a. If executives receive bonuses based on past performance and company restates its earnings, the executives who received compensation based on the first earnings have to pay back all the compensation tied to it
i. Hazen says forfeits ALL compensation based on those earnings
8. Say on Pay Vote
a. Publicly held companies subject to SEC disclosure
b. Shareholders get to vote on executive pay package as to whether they approve of what directors have done/are executives compensated fairly or too much
c. If majority of shareholders vote no to pay ***nothing*** happens, directors can continue compensation packages (may breach fiduciary duty—lawsuits pending)
d. Advisory vote—shareholders have right to let directors know what they think, directors have right to ignore shareholders

VII. Corporate Democracy – State Law
a. Shareholder Voting
i. MBCA §§ 7.01-7.08, 7.22, 7.25; *compare* MBCA §§ 8.20-8.25; Cumulative Voting Handout
ii. Cumulative Voting
1. If provided for in AOI, each shareholder gets to vote (number of shares they own) * (number of directors to be elected), then tally all votes, top vote getters get elected
2. Ensures minority representation
iii. Classified Directors or Staggering the Board
1. Ensures continuity
2. Can be anti-takeover device

3. Dilutes cumulative voting power
4. MBCA § 8.06 – limits extent to which can stagger board – can have no more than 2 or 3 groups with each group having ½ or 1/3 of board

iv. Contingent Voting
1. Have to be in AOI for rights to exist
2. "In event interest (or dividends) not paid for X years (quarters) then get voting rights"—not uncommon
3. Bonds, debt, and preferred stock typically don't have voting rights

v. Varying Shareholder Rights
1. Not all stock has to be voting stoc
   a. Under MBCA, nonvoting stock may get vote if rights of class change under an AOI amendment
2. Publicly traded shares tend to be voting stock
   a. **Stock traded on NYSE must be voting stock; non-voting stock cannot be traded on NYSE**
   b. Nonpublicly traded stock may have superior voting rights
3. Different classes of stock could elect different directors (needs to be in AOI)
   a. Different classes of corporate stock: (1) voting; (2) non-voting; (3) limited voting stock
4. *Lacos Land Co. v. Arden Group, Inc.* (p. 395)
   a. D tried to recapitalize by creating a new Class B common stock that would possess 10 votes per share; entitle the class to elect 75% of the Board of Dirs.; diminished the dividend rights; and placed restrictions on transfer. Exec said that if recapitalization was not approved then he was going to block transactions that might be in best interest of corporation.
      i. Court recognized the right to have stock with different voting rights, but said that the shareholders were being forced to give up an opportunity for a raider to come in and pay a premium for their shares
      ii. Recapitalization can occur, but cannot coerce shareholders into approving—not the way management is supposed to act
      iii. It is permissible to create unequal voting rights in stock in AOI
5. **Right to inspect books and records if can state a purpose (includes list of fellow shareholders—contact them in course of a proxy vote)**
   a. *Sadler v. NCR Corp.* (p. 403)
      i. NOBO – Non-Objecting Beneficial Owner
         1. Shareholders who park their shares with another to prevent discovery that they own them
         2. Shares held in street name (brokerage firm), but they belong to individuals and have rights, just listed in brokerage firm's name
         3. Brokerage firm forwards proxy solicitations to owners
            a. Record owner gets to vote, you just tell brokerage firm how to vote your shares, remain confidential
         4. **Beneficial owners have same rights as record owners**
      ii. CEDE – depository company whose business is holding shares
      iii. Corporation had to let shareholder inspect NOBO and CEDE lists

b. Shareholder Meetings & Informational Rights
   i. MBCA §§ 7.20, 16.02; Del. § 220; SEC Rule 14a-7

   ii. MBCA § 7.01 – every corporation must have annual meeting of shareholders
      1. Time and place fixed by bylaws
   iii. MBCA § 7.02 – special meetings (anything other than regular meetings)
      1. Board of directors can call by bylaws; 10% petition of shares entitled to vote can also call a special meeting
   iv. MBCA § 7.03 – if no annual meeting, 6 months later, shareholders can get court ordered meeting
   v. MBCA § 7.04 – allows vote without meeting if provided for in AOI
      1. Traditionally like directors can only be unanimous written consent
      2. Del. statute allows action by shareholders without meeting by a majority of shares; MBCA permits if in AOI
         a. Minority shareholder won't have opportunity to persuade because never have to call a meeting
   vi. Notice Requirement (MBCA § 7.05)
      1. Date, time, and place of each annual, regular, and special meeting required in notice
         a. For special meetings must include purpose (may have to include purpose for regular meetings if AOI or statute requires)
            i. If going to propose merger, needs to be in purpose in notice
      2. Notice required no fewer than 10 days or more than 60 days before the meeting
         a. Publicly-held companies need 30 or 40 days for notice because filings and review of filings by SEC
      3. MBCA § 7.06 – Can be waived by signing a written waiver of notice or by attending meeting
      4. **No unstated business may be transacted at the meeting**
   vii. **Cannot retime vote for purpose of undercutting shareholder democracy, not legitimate**
      1. *Schnell v. Chris-Craft Industries, Inc.* (p. 413)
         a. Board of directors set date of meeting and gave notice within statutory period; moved day of annual meeting because the sensed a proxy battle and less time would mean less time for opponents to get information to shareholders
         b. Court held not legitimate
   viii. MBCA § 7.22 – shareholders may vote by proxy (proxy=power of attorney)
      1. Freely revocable – filling out later proxy or showing up at meeting revokes proxy
      2. May be irrevocable if it is coupled with an interest (i.e., interest in shares)
      3. Record date – date records are closed, all shareholders of that date are entitled to vote (same method used to declare dividend)
      4. Norm in publicly-held companies
      5. Types:
         a. General – proxy holder has authority to make decision on how to vote
         b. Direct proxy holder how to vote on decision
   ix. Quorum Requirements (MBCA § 7.25)
      1. **Majority of shareholders entitled to vote (as opposed to those present)**
      2. Greater than majority is permissible if in AOI, nothing about lower
      3. Ordinary matters: a majority of shareholders present
      4. Extraordinary matters: 2/3 vote required
      5. **Quorum cannot be destroyed by a shareholder leaving the meeting**
      6. Special quorum requirements may be stated in the by-laws

7. Default, unless AOI change, **if a quorum is present, a plurality of votes are needed to pass action**
    a. For mergers, a majority of shares entitle to vote have to say yes, unless higher vote requirement by AOI

x. Shareholders Initiating Actions
1. Bylaw amendments or shareholder resolutions
2. ***CANNOT*** initiate AOI amendments, mergers, or dissolution
    a. Directors initiate these and then present them to shareholders for approval

xi. Shareholder Inspection Rights
1. Common Law Rule: right of inspection of books and records related to a proper purpose
2. Statutory Right (MBCA § 16.02)
    a. Coexists with common law (with NC exception)
3. SEC Rule 14a-7 – federal right to access shareholder lists
4. Proper Purpose:
    a. Books and records reasonably related to request have to be made available by corporation
    b. *Haywood v. Almbase Corp.* (p. 415)
        i. Court finds proper purpose for shareholders to view records about executive compensation because concerned about it.
    c. *State Ex. Rel. Pillsbury v. Honeywell, Inc.* (p. 418)
        i. P purchased stock and attempted to get the list of shareholders as to that he could petition them to prevent the company from making munitions for the Vietnam War.
            1. Court ruled that this purpose was not proper, because political reasons were not good enough; P may have won had he rephrased his argument.
        ii. **Motive is relevant to purpose—not proper purpose because of bad motive**
            1. However, DE trial courts have said motive irrelevant, should only look if proper purpose
    d. Factors for proper purpose
        i. Related to the interests as a shareholder
        ii. Related to mismanagement, value shares, determine financial status
        iii. Sometimes corporations require that you own the stock for a reasonable time before you can request such a list.
    e. Dangers of free inspection because shareholders have right to privacy

c. Proxy Contests
i. MBCA § 7.22
ii. *Campbell v. Loews, Inc.* (p. 424)
1. Management being challenged can use corporate funds to defend itself because supporting existing management policy
2. Management can use corporate funds to pay for reasonable expenses related to a challenge so long as it can show the challenge is over policy

iii. *Rosenfeld v. Fairchild Engine & Airplane Co.* (p. 427)
1. Shareholders sued to compel return of $260,000 paid out of corporate treasury to reimburse both sides in a proxy contest for their expenses. Court held:

    a. Reimbursement is permissible if the fight is over <u>Policy</u> rather than <u>Personal</u>
    b. Must be reasonable and proper expenses
    c. Even if managlement loses they **do** get a right for reimbursement fo proxy fight
    d. Outsiders who win **do not** have a right to reimbursement
        i. Shareholders can reimburse them, but new board cannot

iv. *Hewlett v. Hewlett-Packard Company* (p. 432)
1. Cannot sell vote—void against public policy
2. Cannot sever vote from share
3. Management cannot coerce shareholder vote

VIII. Closely Held Corporations
a. Overview
i. No special statute for closely held corporations, except for some states (DE)
ii. Common law case treatment law will apply even if fail to qualify as CHC under statute, except in DE—if want to be treated special as CHC have to qualify under statute
iii. Small number of shareholders
1. Control allocation
2. Deadlock—MBCA allows court to resolve
iv. Employment Ks at will, need to secure job with job tenure
v. Restrictions on Transferability
1. No ready market for the corporate stock—illiquidity
    a. Shareholder cannot vote with their feet; no one to sell to
    b. Dependent on dividends for return on their investment
2. Transferability can be restricted by K
vi. Can elect subchapter S tax treatment (corporation with less than 75 shareholders, all US residents, and active business) (takes majority of shares to de-elect subchapter S.
vii. Substantial majority stockholder participation in management, direction and operation of corporation; usually family and friends
viii. CHC is run more like a partnership than a corporation
1. Trust, confidence, and absolute loyalt
2. Higher standard than a public corporation
3. Minority shareholders cannot dissolve

b. Heightened Fiduciary Duties (& Involuntary Dissolution)
i. *Donahue v. Rodd Electrotype Co. of New England, Inc.* (p. 442)
1. Corp bought back the shares of the owner's stock at a premium price, but the same deal was not offered to the minority stockholder.
2. Court found a breach of fiduciary duties in not providing similar opportunity to the minority shareholders—can't have a special deal for the controlling shareholder.
3. **Equal opportunity rule:** when a controlling shareholder sells shares to the corporation, the corporation must extend an equal opportunity to the minority shareholders to sell their shares at the same price
4. Court says that close corporations are more like partnerships—typically shareholders are active in business—treated as incorporated partnership
    a. **Stockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe one another**

b. That standard of duty is one of utmost faith and loyalty (punctilio of honor the most sensitive)

ii. Dissolution
1. Voluntary (MBCA §14.02)
a. By act of corporation
b. Process same as mergers→Board of directors recommend dissolution followed by approval by majority of shares entitled to vote
c. 14.01—dissolution by directors if business just starting up
2. Involuntary
a. Someone other than corporation petitions court to dissolve corporation
b. MBCA § 14.30 Grounds for involuntary dissolution
i. Include administrative dissolution for nonpayment of taxes, proceeding by creditor because corporation insolvent;
ii. Shareholders may bring if directors deadlocked, shareholders deadlocked, coronate assets being misapplied or wasted, abandonment of business, or abuse of power

iii. *Meiselman v. Meiselman* (p. 457)
1. MBCA § 40.3.(a)(2)(II) – shareholders may bring action for dissolution when the directors or those in charge of the corporation are acting, or will act in a manner that is illegal, oppressive, or fraudulent
2. Two brothers in were owners of their father's business in this case. Their father's policy in the corporation was: no dividends, never borrow money, pay out salaries. Michael was older son; Ira was younger son. Michael invited a non-Jewish woman home for dinner with him; Ira was married and had family; father gave control of business to Ira (owned bulk of stock). Two different shareholders with two different investment goals**.** As the business made $$, Ira wanted to keep surplus in business so that the business grew in value. Michael, because he is a bachelor, letting illiquid stock grow does nothing for him; his goal is to maximize salary and payout surplus as dividend. Michael sues Ira for a buy out of his shares.
3. Before this case, in NC precedent said that if minority shareholder wants rights other than traditional principles of law, the only way to get them is with well drawn shareholders agreement—hence the controversy over this case—Meiselman didn't even cite to this precedent
4. However, here the court held that in the context of closely held corporations, reasonable expectations of shareholders should be upheld.
5. **Effect of Meiselman:** In a closely held corporation, in the absence of written agreement, where there is no bargaining power for the minority, then a court will at least listen to a minority shareholder's claim that over time some reasonable expectations that were known by and concurred in by controlling shareholder had somehow been established

iv. **Ways in Which the Majority Shareholder can "Freeze Out" Minority:**
1. Access to corporate treasury to sell shares
2. Refuse to declare dividends
3. Pay outrageous salaries
4. Pampering of special people through leases or grants
5. Refuse to hire minority shareholders

c. Shareholder Voting Agreements
i. MBCA §§ 7.30, 7.31, 7.32, 7.22; Del § 218

ii. Vote pooling agreement: written agreement among shareholders to vote their shares a certain way on specified issues; generally valid if the agreement is in writing, doesn't defraud shareholders or creditors, complies with statutes and public policy; drawback to these types of agreements is that if a party to one does not comply, usually have to go to court for specific performance

iii. Elements of a voting trust: (must comply with statutory mandates to be valid)
1. Voting rights are separated from other attributes of ownership
2. Voting rights are irrevocable for its limited term
a. A duly executed proxy will be irrevocable if it states that it is irrevocable and is couple with an interest sufficient to make it irrevocable at law (interest in stock itself or an interest in the corporation generally)
3. Principal purpose is to acquire voting control of the corporation
4. Must have a limited term
5. Voting trust must be open and notorious, it cannot be secret

iv. Voting trusts are used for several purposes:
1. **To protect creditors**
a. Creditors want company's assets protected from waste
2. **Preserve control**
a. Family might need trustees where founder has no successor in the family that can take control and operate the business
3. **Ensure professional management**
a. **D**esigned to put professionals in charge, instead of the children of a family corporation
4. **Divestiture**
a. Anti-trust decree (divest control for anti-trust purposes)

v. Voting trusts are preferable to vote pooling arrangements because trusts do not have the enforcement problems that pools have. Pooling arrangements can be secret; trusts cannot be secret.

vi. *Ringling v. Ringling Bros. Barnum & Bailey Combined Shows, Inc.* (p. 475)
1. P and D shareholders agreed to vote their shares of stock together in one vote. Each held 315 shares, while a third shareholder, North, held 370. They agreed to act jointly and to give the other first option on right to purchase stock; consulted for voting; agreed to use an arbitrator for when they disagreed.
2. Court found that the voting agreement was valid and enforceable as between P and D.
a. **Rule:** shareholder voting agreements are not void for violating public policy of separating ownership from control (they are enforceable Ks)
3. This is not a voting trust since the parties vote their shares
4. Court upheld agreement but would not specifically enforce because meeting coming up where party to agreement could correct its wrong
a. Courts conflicted as to whether to specifically enforce—an equitable and extraordinary remedy

vii. MBCA § 7.31(b) – Voting agreement created under act is specifically enforceable

viii. MBCA § 7.22(d) – party to a shareholder agreement has a sufficient interest to make proxy irrevocable
1. Time limit

ix. *Abercrombie v. Davis* (p. 489)
1. D and 9 other oil companies formed a joint venture corporation to drill for oil. The corporation was structured so that no one shareholder had control. D and

several of the other companies formed an 8-person committee who owned 54% of the stock and could elect 8 directors. They entered into a formal ten-year agreement to act as a unit and to arbitrate any deadlocks.

2. Court held that:
    a. An agreement that is a voting trust has to comply with Del. § 218 (MBCA § 7.30); if not, it's illegal
        i. Requirements: (1) 10 year duration, renewable for another 10 years (many states have since abolished, NC still has); (2) has to be on file with books and records at corporation's office (has to put other shareholders on notice of trust)
3. This agreement looked like a voting trust
    a. Consisted of a deposit of the stock with irrevocable stock powers conferring upon a group of fiduciaries exclusive voting powers over the pooled stock
4. Court found it invalid because it was secret and not open and notorious
    a. **Secret voting trusts are not allowed**
5. If you get too close to a voting trust, then it will be considered one
    a. As a pooling agreement in substance and purpose approaches more and more nearly the substance and purpose of the statute, there comes a point at which, if the statute is not complied with, the agreement is illegal
    b. This was a failed effort to get in under the Ringling Bros rule (MBCA § 7.31) by arguing that agreement was a pooling agreement like the one at issue there

x. *Lehrman v. Cohen* (p. 498)
1. Two families owned equal voting power in the Giant Food Corp., each owning different classes of stock. They created a third class of stock for purposes of preventing a deadlock; they elected a fifth director. The third class stock was $10 par, no dividends, no dissolution rights; redeemable if four directors voted for it. The court found that the creation of a new class of voting stock did not create an unlawful voting trust (voting rights not divorced from incidents of ownership)

xi. *Oceanic Exploration Co. v. Grynberg* (p.505)
1. Corp ran into trouble when the principal shareholder started running it into the ground. Creditors put pressure on the corp to freeze out the shareholder. Agreement looked like a voting trust-court said it was part of an integrated plan. Voting trust statute is not all inclusive--doesn't apply to every interest where voting is transferred to trustee. Basic policy of the voting trust statute was not violated here because the voting trust agreement was open and notorious.
2. Mere technical noncompliance may not destroy a voting trust if no public policy concerns are implicated—secrecy being the main one

d. Voting & Quorum Requirements
i. MBCA § 7.25
ii. One way to provide for a minority voice in corporate operations is to have high quorum and voting requirements thus giving the minority an effective veto power. One problem with such an arrangement is that it increases the chances of deadlock.
iii. *Benintendi v. Kenton Hotel* (p. 510)
1. Bylaw for closely held corporation contained provision that required unanimous stock vote for election of directors. All shareholder action had to be unanimous; all had to be present in person or proxy.

    a. Court said this unanimity requirement cannot be upheld—directors cannot act by proxy, could act unless all directors present—deadlock would be very likely; no express statutory authority to do this, no common law basis for this; violates concepts of corporateness; bad because deadlocks likely
2. **Judicial distaste for unanimity**

iv. *Blount v. Taft* (p. 510)
1. Corp owned by 2 families (41% each). All shareholders agreed to a bylaw that executive committee would have power to hire and fire, provided they acted unanimously. Bylaws were amended to eliminate hiring provision over objection of one family group; no longer required a unanimous vote. Bylaw was amended by majority vote. The claim here was that the Shareholder bylaw could not be amended unless all shareholders approved.
2. Makes no sense for parties to agree to unanimity if they can unagree by simple majority; bylaw needed to say can only be amended by unanimity and then court probably would have upheld it (court wont enforce because of drafting error)
3. If parties are going to go to the trouble of having a shareholder agreement, court will not enforce unless it is a well-drafted shareholder agreement.

v. *Gearing v. Kelly* (p. 515)
1. P, 50% owner, sought to set aside election of a director. P says that there must have been 3 of the 4 vote for transaction to be valid; only 2 were present because 1 intentionally stayed away. Court says that where preventing quorum was intentional, director should not be allowed to challenge outcome of vote.
2. **Every director who doesn't attend meeting may be estopped from claiming that there wasn't a quorum present**

e. Shareholder Agreements & Director Discretion
i. MBCA § 7.32; NCGS § 55-7-31 Handout
ii. Agreements restricting director discretion in a close corporation are usually valid if they comply with applicable statutes and they don't harm creditors or minority shareholders.
iii. *McQuade v. Stoneham* (p. 518)
1. Involved an agreement among shareholder directors to: (1) to elect themselves as director (this would be an agreement among shareholders) AND (2) agreed to retain themselves as officers (agreement among directors). President decided to fire Treasurer, treasurer brought suit.
2. Court felt that agreement interfered with their discretion as directors to remove an officer at any time for any reason; this was a limitation on their discretion; void as against public policy

iv. *Clark v. Dodge* (p. 521)
1. NY court upheld similar agreement because was unanimously supported by shareholders.
2. NC makes this distinction
    a. No unanimously adopted agreement shall be invalidated on the grounds that the parties had agreed to treat corporation as if it were a partnership
    b. A written agreement that is unanimous or less than is not invalid on the ground that it infringes on managerial or directors' discretion—even a non-unanimous agreement may be enforceable even though they limit some discretion
    c. A shareholder agreement may restrict discretion of directors up to a point, but may go further if it is unanimous

v. ****Unanimity gives people agreeing the broadest ability to limit discretion; allows them to treat corporation as if it were a partnership

f. Restrictions on Transfer (& Buy-Out Arrangements)
   i. Types of Restrictions: (require notice and must be reasonable if going to be upheld)
      1. **Consent** (RMA/DEL)
         a. requires approval of shareholders before stock can be sold
         b. cannot be manifestly unreasonable
         c. unreasonable restraint on alienation comes in
      2. **Right of First Refusal**
         a. existing shareholder gets a chance to buy
         b. generally upheld
      3. **Option Arrangement**
         a. option to buy back the stock
         b. there is an inherent problem with the pricing.
         c. option contingent on certain events
         d. courts generally follow a corporation's valuation procedures
      4. **Mandatory Buyout (Buy/Sell Agreements)**
         a. usually when one shareholder dies
         b. can be tough for close corps, with respect to getting to the money to buy the shares
         c. Wide disparities in price with respect to the market value are often held up by the court
   ii. *St. Louis Union Trust Co. v. Merryl Lynch, Pierce, Fenner, and Smith Inc.* (p. 538)
      1. Merrill Lynch adopted rule mandating that when a broker died, corporation would buy stock; attempt to keep same rule—that to be owner had to be an active shareholder and that when a shareholder dies, has to pay taxes, government doesn't take stock as payment, so it is best to turn share into cash. Can't mandate buyback by corporation without a showing of a benefit to the corporation. Reason for buyback—give widow $$ to pay taxes; solely benefit to survivor of shareholder.
      2. §202(c) of Delaware statutes: benefiting shareholder is a valid reason for a mandatory buyout
         a. transfer restriction in the hands of the corporation is not invalid on the grounds that it benefits the shareholders as opposed to the corporation; don't have to show a corporate benefit
         b. in a state without such a statute, shareholders may have a claim that corporation may act only for corporate benefit and any agreement mandating buyout sterilizes directors
      3. **Mandatory buyouts are permissible** and buyout at book value here is not an unreasonable restraint on alienation because contracted for it

IX. Duties of Controlling Shareholders
   a. Do Controlling Shareholders Owe Fiduciary Duties? (Self-Dealing Revisited)
      i. Outside of exception with closely held corporations (shareholders treated as partners and therefore owe one another fiduciary duty), there is no traditional rule of law for imposing fiduciary duty between majority and minority shareholder. The following cases highlight some exceptions to the rule.
      ii. *Sinclair Oil Corp. v. Levien* (p. 544)

1. The majority required the subsidiary to pay out enormous dividends for their own purposes, but the minority wanted to use the dividends to capitalize and not liquidate; claimed that the majority had no bona fide business purpose.
2. Parent company has the fiduciary duty as a dominating force on the board of the subsidiary.
3. **Business Judgment Rule** should control here, instead of the **Intrinsic Fairness Rule**
   a. Business Judgment: informed decision + no breach of loyalty
   b. Intrinsic Fairness: look at the transaction itself (parent-subsidiary cases usually)
4. Intrinsic Fairness is applied only:
   a. When self-dealing by the parent
   b. When the majority receives something to the exclusion of the minority
   c. Motives are usually not the test, unless there is **WASTE**

iii. *Zahn v. Transamerica* (p. 550)
   1. 3 classes of stock in A-F:
      a. class A: more speculative; Cumulative dividend $3.20/yr; 2:1 liquidation preference; 1:1 convertible to B; callable at $60/share
      b. class B: control stock; $1.60 dividend
      c. preferred: safer
   2. What is P's complaint?
      a. Transamerica caused AF to redeem its class A stock for Class B stock—something that AF had a right to do
      b. AF knew that it was going to liquidate, but would make more $$ if shares were called in first so that liquidation preferences wouldn't have to be paid
      c. Why didn't corporation have a right to do this?
         i. Directors of AF were the instruments of Transamerica and were directors voting in favor of their own special interest and did not exercise an independent judgment in calling the Class A stock but made the call for the purpose of profiting for their true principal, Transamerica
      d. What should have happened here
         i. AF should have notified class A shareholders about liquidation and calling of stock
         ii. Class A shares were convertible; could have been converted to class B stock which would have allowed them to share equally in liquidation
         iii. Essentially this case is all about disclosure
         iv. Controlling shareholders do owe duty to minority shareholders—duty of disclosure in this case

iv. *Jones v. H.F. Ahmanson & Co.* (p. 560)
   1. Close corporation where the majority shareholders sold their shares at a great profit, but didn't allow the minority shareholders to participate. The majority shareholders (D) created UF by making a public market for its shares that rendered Association stock unmarketable, except to United Federal, and then refused to give P the same opportunity. P was frozen out, dividends cut, and D offered to buy them out way under price. Court found a breach here because:

a. Majority created a market and denied minority access to that market; they may not use that position for benefit of themselves or to detriment of minority.
b. Must benefit all shareholders proportionately, with the burden of proving fairness on the controlling shareholders.
c. Applies to situations of sale of the controlling block
d. The majority shareholders were entitled to a PREMIUM for their shares:
    i. **Permissible to receive premium for control; must be good faith, inherent fairness**
e. Fiduciary duty owed to the minority shareholders in the close corporation to include in process.
f. UF denied Association the opportunity to go public, so the only way to cure is to allow the minority shareholders the opportunity to participate in the market with UF

b. Sale of Control Transactions
    i. General rule: controlling shareholder does not have to split premium from sale of shares with other shareholders unless transaction is tainted by fraud or nondisclosure, unless the buyer is known looter or raider, unless the sale is really a sale of office (control of the board)
    ii. *Zetlin v. Hanson Holdings, Inc.* (p. 571)
        1. D sold shares for a premium of $15/share; D controlling shareholder. P claims equal opportunity—that he should share in the premium
        2. **General Rule: Premium for control is legitimate absent some other problem**
        3. Premium goes with control—just a market reality
        4. **Control seller can keep his premium**
        5. Note: Securities and Exchange Act of 1934 § 14
            a. Accepts an equal opportunity approach
            b. If someone offers to purchase control using a tender offer and tender offer for less than all shares, **all** shareholders have opportunity to participate even if more shares are offered than needed
    iii. *Gerdes v. Reynolds* (p. 572)
        1. **Exception 1 to *Zetlin* rule**: control seller has a duty to investigate control purchaser and where investigation would have revealed something, such as selling to a looter, seller will be held accountable
        2. **Exception 2**: When premium is for sale of office (Board of Directors) position, then have to give back premium
    iv. *Essex Universal Corporation v. Yates* (p. 578)
        1. Seriatim resignation agreement of board of directors and sale of control (28% working control) upheld by court because agreement eased the transition and sped up the process of him replacing board (would've eventually happened)
        2. SEA 1934 Act § 14(f) & Williams Act: If public company has agreement for turning over control has to be fully disclosed
    v. *Perlman v. Feldmann* (p. 586)
        1. Dominant shareholder sold stock at a premium. There was no substantial loss, but the president got a premium. Court says it is okay for D to sell at a premium, except:
            a. Can't sell to a looter
            b. Can't sell corporate assets (such as board's discretion who to sell to)

            c. Can't sell office (cant sell non-controlling block of stock on the condition that seller will arrange the resignation of the directors he controls)
            d. Can't sell readily identifiable corporate asset
    vi. Large premium should put seller on notice that something unusual is going on.
        1. There is no measuring stick
        2. Premium of 30-50% is probably okay
        3. Premium of 74% (*Pearlman*) and 125% (*Gerdes*) turned out to be excessive

X. Publicly-Held Companies – the Federal Securities Laws
    a. Overview of the Federal Securities Laws
        i. 1934 Act §§ 12(a), 12(g), 13(a), 13(b); SEC Rule 12g-1
        ii. Focus on investor protection
        iii. State Blue Sky Laws (not federal, but first securities laws were state)
            1. Required disclosure in public offerings of securities
            2. Allow merit analysis
        iv. Securities Act of 1933
            1. Disclosure
            2. Governs initial issuance of stock
            3. When company has public offering, there needs to be full disclosure
                a. Perspective = disclosure document
            4. Applies only to public offerings
        v. Securities Exchange Act of 1934
            1. Created SEC
            2. Regulates sale of stock to the public exchanges, OTC, broker-dealers (covers pretty much everything 1933 Act didn't)
            3. Covers more than just public companies, basically whole security industry
            4. Permits and establishes self regulatory offices (SROs), which incudes the exchanges
                a. Exchange rules subject to SEC approval
        vi. Public Utility Holding Act of 1935
            1. Broke up the public utilities
            2. Repealed around 2000
        vii. Trust Indenture Act of 1939
            1. Governed sale of bonds to the public
            2. What has to be put in bonds
            3. When company sells bonds to public have to be worried about '33, '34, and '39 Acts
        viii. Investment Company Act of 1940
            1. Regulates mutual funds and non-bank money market funds
        ix. Investment Advisors Act of 1940
            1. Regulates investment advisors-someone who renders advice on securities sales as part of their job
            2. Stock brokers exempt because registered under 1934 Act
        x. Security Investor Protection Act of 1970
            1. Like FDIC insurance for banks
            2. Insured up to statutory amount
        xi. SEC
            1. Created by 1934 Act
            2. Does a lot of rule making
                a. 2 types

i. Interpretive rule making
    1. SEC says what it thinks law is
    2. Safe harbor rule—if you do a, b, c we'll treat you as safe—you may be able to do d but we won't save you
ii. Delegated rule making
    1. Ex) 1934 Act § 10(b) gives SEC authority to define scope of act

3. 5 person commission
4. Requires registration of certain companies under § 12 (no continuous reporting system)
    a. Have to file reports with SEC (Qs and Ks)
    b. 10K – annual financial report filed to SEC, must have been audited with GAP by an independent CPA
    c. 10Q – quarterly report, doesn't have to be audited
    d. 8K – must be filed after the occurrence of certain material events (change in control of registrants, resignation of directors, changes in accountants and bankruptcy)

xii. What makes a public company?
    1. §12(a) of 1934 Act—if you have a security (stock or bond) traded on national security exchange then subject to §12 and have to register **OR**
    2. §12(g)(1) of 1934 Act
        a. Any company that has more than 500 shareholders of record of class of equity securities; and company has $10M in assets; once you become a reporting company under this section, stay one until shareholders of record drop below 300
        b. limited to equity securities—stocks or bonds convertible into stock

b. Federal Proxy Regulation
i. 1934 Act § 14(a); SEC Rules 14a-1-14a-9
ii. 1934 Act § 14(a) is not self executing, requires SEC rule making—delegated rule making
iii. Law of proxies determine by the state
iv. **Rule 14a-3:** proxy statement must include:
    1. description of the matter for which the shareholder vote is required
    2. proxy form
    3. must be filed with SEC before being distributed to shareholders
    4. annual report (if filed by management and if involves election of directors)
v. Note: Brokers are required to forward proxy materials to beneficial owners; only the beneficial owners are entitled to vote
vi. **Rule 14a-4:** form proxy has to follow
vii. **Rule 14a-6:** filing requirements
viii. **Rule 14a-7:** federal counterpart right to state right to get list of other shareholders
ix. *Long Island Lighting Co. v. Barbash* (p. 662)
    1. D sought to replace the company with a municipal utility and they bought radio/newspaper advertisements without complying with the SEC proxy rules. By using the media, they were soliciting shareholder's votes for the conversion.
    2. Court says that ad to general public is a proxy solicitation—rules apply to direct solicitations and also communications which may indirectly accomplish such a result or constitute a step in a chain of communications designed to accomplish such a result
    3. **Broad definition of proxy statement**

4. **The test is whether the challenged communication is "reasonably calculated" to influence shareholders' votes; applies equally to management, non-management, shareholders, non-shareholders**
    a. **"**solicit" includes: (acc to SEC rules)
        i. request for proxy
        ii. request to execute or not or revoke a proxy
        iii. furnishing of a form of proxy or other communication to security holders under circumstances reasonably calculated to result in the procurement, withholding, or revocation of a proxy
5. Shareholders allowed to converse with each other in small number without it being a proxy solicitation (so long as do not contact more than 10)
6. Consequences of communication falling within the definition of a solicitation:
    a. filing requirements before or after solicitation is made
    b. solicitation is subject to Rule 14a-9's prohibition against materially misleading statements

x. **Shareholder Proxy Proposals (Rule 14a-8)**
1. Doesn't tell what is a proper matter for shareholder consideration—state law
2. **Tells when management must include shareholder proposal in its proxy statement**
3. **Rule 14a-8 (p. 593 Supplement):** if a shareholder of a registered company that gives timely notice to management of his intention to present a proposal for action at a forthcoming meeting, management must include the proposal, with a supporting statement of not more than 500 words, in its proxy statement and afford security holders an opportunity to vote for or against it in the management's proxy. ***See* 14a-8(i):**
    a. bases for exclusion of shareholder proposal:
        i. proposal not proper under state law
            1. sate of incorporation and anyother state law
            2. violation of law generally
            3. violates SEC rules
                a. ex) too vague or materially misleading and violates 14A-9
            4. Personal grievance
            5. Relevance (*Aflac* Rule)
                a. Relates to less than 5% of companies business each year
                b. *Lovenheim v. Iroquois Brands, Ltd.* (p.669)
                    i. Test is objective and subjective—must fail scrutiny under both before it may be excluded
                    ii. Objective test is the 5% thresholds
                    iii. Subjective test is that it is not otherwise significantly related to company's business—something that falls below the 5% threshold may still be excludable on these grounds; socially relevant issues are a matter of shareholder concern despite the bottom line.

iv. Shareholder here wanted to include information in the proxy that related to how the Geese were treated in the production of pate. Because the proposal had economic significance, it was allowed.

6. Absence of power of authority
    a. i.e., oppose war, want management to oppose it—not within businesses power to end
7. Ordinary business operations
    a. Management decisions for day-to-day
8. Relating to election to office
9. Contradicting management proposal
10. Substantially implemented (mootness)
11. Duplication
12. Resubmissions, excludable if:
    a. Introduced once in last 5 yrs, less than 3% of vote
    b. Introduced twice in last 5 yrs, less than 6% of vote
    c. Introduced thrice in last 5 yrs, less than 10% of vote
13. Dividends
    a. Proposal related to amount, formula for dividends excludable, one related to dividend policy in general is not excludable

4. No-action letter process
    a. No-action letter is an informal process by which SEC will give an advisory opinion; someone writes letter to SEC requesting a "no-action" response; letter sets forth basis for exclusion from management proxy; SEC in a no-action letter states that is wont initiate an enforcement action as a result of this exclusion
    b. Not binding precedent; SEC is not bound by its letter; but published so indicative of agency policy
5. Schedule 14A Item 20 – include any other proposal management reasonably believes will come up at the meeting
    a. If excluded from proxy statement have to put it here because shareholder may show up
6. Reg S-K: what has to be disclosed
7. Reg S-X: financial information

xi. **Rule 14a-9:** antifraud rule
1. Allows for private cause of action for violation of federal proxy rules
2. Remedies: injunction, rescission (if necessary and equitable), damages (hard to prove)
3. **Rule 14a-9:** proxy materials must not contain omissions or material misstatements of fact
    a. Test for determining materiality: a fact is material if there is a substantial likelihood that a reasonable shareholder would consider important in deciding how to vote
    b. Who is entitled to sue for a violation of this rule:
        i. SEC
        ii. Individual shareholder
        iii. Corporation

4. Fairness wont let directors off the hook—fairness doesn't change the fact that the solicitation was misleading and doesn't effectuate the goal of the proxy rules

XI. Securities Fraud
a. SEC Rules 10b-5, 14a-9, & Private Remedies
    i. Common Law Fraud Elements (SEC does not have to show 3,4,5)
        1. Misstatement of material fact
            a. Omissions are not actionable under Common Law
            b. Misstatement of immaterial fact is not fraud
        2. Scienter (intent to deceive)
            a. Something more than negligent
                i. Negligent misrepresentation is recognized in some states
            b. Fraud is an intentional tort
        3. Reliance
            a. Actual **and** Reasonable
        4. Causation
            a. Transactional—fraud caused transaction to occur
            b. Loss—transaction caused loss
            c. Damages must have been caused by reliance on misstatement
        5. Damages
    ii. SEC Rule 10b-5
        1. Permits the SEC to prohibit by rule any manipulative or deceptive device or contrivance with respect to any security
        2. **Applies to any company, large or small, public, private or closely held**
        3. Makes it unlawful for any person to use the mails or facilities of interstate commerce to employ, in connection with the purchase or sale of any security, any manipulative or deceptive device or contrivance in contravention of SEC rules
        4. Trigger is purchase or sale of security using an instrument of interstate commerce
        5. 5 year statute of repose
        6. **private remedy**
        7. **materiality essential element of any 10b-5 claim**
        8. **no duty to speak so say no comment or nothing at all**
    iii. SEC Rule 14a-9
        1. Limited to publicly held companies because proxy rule and only applies to fraud (material misstatements and misrepresentations) in the proxy statement
        2. Private plaintiff can still sue under
b. Materiality
    i. *TSC Industries, Inc. v. Northway, Inc.* (p. 701)
        1. P claimed that a joint proxy statement was materially misleading because it failed to state that the transfer by TSC of 34% of the interests had given National control of TSC. The materiality standard was an objective one here—whether there is a substantial likelihood that a reasonable shareholder would consider it important.
        2. Court held than an omitted fact is material if there is a **substantial likelihood** that a reasonable shareholder **would consider it important** in **deciding how to vote**
            a. Don't have to show that shareholder did consider it important
            b. Doesn't have to be but for cause
            c. Doesn't have to be the reason that merger went through
            d. It is enough to show that a reasonable shareholder would have considered it important
        3. 14a-9 claim here, but same result under 10b-5

a. 14b-9 materiality connected with votes
b. 10b-5 materiality connected with deciding to purchase or sell shares

ii. **Mixed question of fact and law**

iii. *Basic Inc. Levinson* (p. 709)

1. 10b-5 because no proxy solicitation
2. P brought a class action claiming that the officers of Basic three times denied their involvement in on-going merger negotiations. The class included shareholders who bought and sold stock after the statements were released, but before the merger.
3. Absent some line item disclosure (SEC form requiring disclosure,) these preliminary negotiations do not have to be disclosed
   a. There is no obligation to disclose a fact simply because it may be material
   b. Court recognized that you can't conduct merger negotiation in a fishbowl, must be negotiated secretly so that parties feel free to be open with one another
   c. Price and structure threshold: up until point that negotiations have agreed on basic structure of deal and that there is a general agreement on price, the deal is iffy enough that company is free to deny merger negotiations and this denial is an immaterial misstatement
   d. Further instruction: whether merger discussions are material depends on the facts; apply **probability and magnitude test**;
   e. in order to assess the **probability** that the merger will occur, a fact finder will need to look to indicia of interest in the transaction at the highest corporate level:
      i. Board resolutions
      ii. Instructions to investment bankers
      iii. Negotiations between principals
   f. To assess **magnitude**, consider:
      i. Size of two corporate entities
      ii. Potential premium over market values
4. **Bottom line: company should answer no comment when asked about merger negotiations**
   a. **Definitive merger agreement is material**
5. **Materiality is not a bright-line test**

iv. The mere fact that a fact is material doesn't mean it has to be disclosed unless line item statement on disclosure form (you make a misleading statement by not including it)

c. The "In Connection With" Requirement (& Standing to Sue)

i. In order to be actionable under 10b-5, fraud must be made in connection with sale or purchase of security; in order to be actionable under 14a-9, must be made in connection with proxy solicitation

ii. SEC has standing, DOJ can sue because of statue

iii. *Blue Chips Stamps v. Manor Drug Stores* (p. 715)

1. ***Birnbaum* rule: in order to bring 10b-5 claim for damages, the plaintiff must have been a purchaser or seller of the security**
   a. **Cannot be holder or would-be seller or purchaser**
2. **RULE: Only actual purchaser or seller of security has standing in 10b-5 claim for damages**
   a. **Exception:** SEC doesn't have to be a purchaser or seller

3. Defendant doesn't have to be purchaser or seller, only has to be person directly or indirectly commits fraud or material misrepresentation or omission by providing information that is reasonably calculated to affect investment decisions in connection with a purchase or sell of securities.

iv. *SEC v. Zandford* (p. 719)

1. "in connection requirement" applies to both SEC and private party
2. construed broadly for SEC; narrowly for individual
3. Stockbroker embezzled client funds, but didn't actually violate 10b-5 because didn't purchase or sell securities, SEC makes connection that his customers were his customers because he was a stock broker and purchasing and selling stock is in his business
   a. SEC allowed to sue
   b. Private party would not have been able to bring action

v. How close does connection have to be? What if fraud somehow touches the sale of a security?

1. In connection with means that there is a significant nexus between fraud and purchase and sale security, even if D never bought or sold security, still sufficient connection

d. The Standard of Culpability – Negligence or Scienter?

i. 10b-5: Must have Scienter in order to pursue a private cause of action.

1. Negligence not enough, severe recklessness sufficient; actual intent not required; heightened pleading standard—pledged specifically

ii. 14a-9: no Scienter required, negligence is enough

iii. *Ernst & Ernst v. Hochfelder* (p. 725)

1. Court assumes Scienter means intent to deceive, doesn't include negligence
   a. This isn't in 10b-5(b), but §10(b) authorizes SEC to adopt rules dealing with manipulative and deceptive practices
2. **10b-5(b) has to be limited to deceptive conduct and Scienter**
3. **in private 10b-5 action Scienter is required**
4. **In SEC 10b-5 action, Scienter must be proved**

e. The Deception Requirement

i. *Santa Fe Industries v. Green* (p. 737)

1. Short form merger that amounted to equitable fraud as a result of the gross unfairness of the deal. Court of Appeals reasoned that if P could prove equitable fraud, this would be sufficient to find a violation of 10b-5. Supreme Court held that **EQUITABLE FRAUD IS NOT A BASIS FOR A 10b-5 VIOLATION.**
   a. Equitable fraud does not satisfy deception requirement because deceit is an active concept; deception means that someone was duped into doing something; shareholders were not deceived because there was nothing they could do about merger anyway, because these shareholders owned only 5% of the corporation anyway;
   b. Equitable fraud is not based on deception but on unfairness; this is case of unfairness as opposed to a case of deception
   c. Bottom line: mere unfairness is no violation of 10b-5; **gross unfairness is no violation of 10b-5 absent some showing of deception**; 10b-5 cannot be used to federalize corporate mismanagement

ii. *Goldberg v. Meridor* (p. 745)

1. Denial of a state court remedy can be sufficient to state deception; but there must be deception

f. Causation in Private Rights of Action
    i. Transactional Causation
        1. *Mills v. Electric Auto-Lite Co.* (p. 750)
            a. RULE: Material misleading proxy solicitation must have been an essential link in transaction
            b. The defect has to have a significant propensity to affect the voting process—if they had had full disclosure, they would have offered a better price
            c. Don't have to show that transaction would not have happened, but have to show that transaction would have happened on different terms
        2. *Virginia Bankshares, Inc. v. Sandberg*
            a. Where vote not required then proxy causation cannot be established
    ii. Loss Causation
        1. Prove after proving transactional causation
        2. Plaintiff has to come into court and have compelling evidence there was a loss
        3. Material misstatement affected price of stock adversely
        4. Difficult to prove damages
            a. Need to point to corrective disclosure
        5. Transaction as occurred caused out of pocket loss to plaintiff
g. Reliance in Private Rights of Action (Including "Fraud on the Market")
    i. SEC doesn't have to prove, but private plaintiff does
    ii. *Basic v. Levinson* (p. 764)
        1. Issue is whether a person who traded a corporation's shares on a securities exchange after the issuance of a materially misleading statement by the corporation may invoke a rebuttable presumption that in trading he relied on the integrity of the price set by the market.
            a. Plaintiff doesn't have to establish actual reliance (he read and relied on the misstatement)
        2. **Fraud on the market theory**: in the open market, the price of stock is determined by the available material information regarding the company and its business; misleading statements will defraud purchasers of stock even if purchasers do not directly rely on the statements
        3. Reliance is an element of a 10b-5 cause of action
        4. **TEST:** reliance will be presumed and D will have to rebut presumption
h. Litigation Reform
    i. 1934 Act § 21D
    ii. **Securities Litigation Reform Act of 1995**
    iii. Purpose is to protect investors and maintain confidence in capital markets – prevent abuse of filing law suits.
    iv. Procedural Reforms:
        1. Requiring a named P to file a statement saying not a tool of an atty
        2. Prohibiting broker-dealers from taking fee for finding class members
        3. Ct appointee lead P to pick an atty
        4. Barring disclosure by P while mtd pending
        5. Requiring full disclosure of terms of any settlement
        6. Restricting atty fees
        7. Plt/atty post security bond in case of violation of Rule 11.
    v. **SLUSA: Securities Litigation Uniform Standards Act**

        1. Mandates class actions with more than 50 class members to be brought in fed court if deal with securities – no state court by pass
        2. Rule 11 penalties.
i. Projections & Other "Soft Information"
    i. 1934 Act § 21E
    ii. **Hard Information**
        1. Facts – if a known fact is material, it must be disclosed
    iii. **Soft Information:**
        1. Soft refers to things other than facts, such as projections, speculation, opinions, contingent events, etc
        2. Common Law: opinion is not actionable because not facts
        3. Modern Law:
            a. Opinion by management **is** actionable if: (*VA Bankshares v. Sandberg* (p. 791))
                i. Is about own company
                ii. Can prove management really didn't believe what they said
                iii. It was unreasonable for investors to rely on opinion
        4. **Item 303 of Reg. S-K (p. 790) MOST SIGNIFICANT DISCLOSURE ITEM**
            a. Important part of disclosure process is **Management Discussion and Analysis**, a narrative of every 10Q and 10K, must include any known trends or uncertainties that have reasonable expects will have a material favorable or unfavorable impact on operations.
        5. **Safe harbor:** 21D of 24 Act says that if management makes forward looking statement in good faith and w/reasonable basis, there is no 10b-5 liability.
        6. **Bespeaks Caution Doctrine:** company wont be held liable for forward looking statement made in good faith that is accompanied by a meaningful cautionary statement identifying important factors that could cause actual results to differ materially from those in statement
            a. Boiler plate language is not enough to prevent misinformation
            b. Statement must be substantive and tailored to **specific** future projections, estimates or opinions that P challenging.
        7. **No duty to update, but duty to correct if statement is not accurate or is based on materially misleading information**

XII. Insider Trading
    a. Common Law
        i. The purchaser of an article is under no obligation to disclose facts unknown to the opposite party that may affect the value of the property.
        ii. **No general duty to disclose in buyer/seller relationship. (***Landlaw v. Organ* (p. 842))
        iii. Common law fraud combined with directors' and officers' fiduciary obligations doesn't work to deal with insider trading in the stock market [open market] (*Goodwin v. Agassiz* (p. 847))
            1. Directors have obligation if transaction not on an impersonal market, but a 1-1 transaction because director targeted seller and induced seller to sell is shares
                a. Director has duty to speak/disclose to individual reason for buying
        iv. New York Approach
            1. *Diamond v. Oreamuno* (p. 856)
                a. Officers sold off lots of stock because they were aware of a bad earnings report, which made the stock drop from $28 to $11. Issue was whether officers and directors may be held accountable to their corporation for

gains realized by them from transaction in the company's stock as a result of their use of material inside information.
    b. Court said that there was insider trading and that the officers were responsible for the amount of profits; based decision on agency principles
    c. Injury was reputational
    d. Agent cannot profit from employment relationship
2. *Freeman v. Decio* (p. 860)
    a. Insider trading on the public market by directors on material non-public information
    b. Court does not follow *Diamond* because would be a shareholder derivative action and the plaintiff must show actual damage
        i. Courts disagree on this, FL follows, but DE asserts liability of insider to corporation based on unjust enrichment and follow *Diamond*

b. Section 16 of the Securities Exchange Act of 1934
    i. Reporting Requirements & Persons Subject to Section 16 (Section 16(a))
        1. 1934 Act § 16(a) [**reporting provision**], SEC Rules 16a-1 *et seq.*
        2. Reporting Requirement
            a. All officers and directors and beneficial owners of more than 10% of any class of equity security must file an appropriate notice with the SEC within 10 days of becoming an officer, director, or beneficial owner
                i. Policy behind rule: corporate officers, directors, and beneficial owners have special influence, access, and control that provides access to inside information not available to others; §16 seeks to identify these people and to require them to report their stock transactions publicly; this is intended to have a prophylactic effect on those who might abuse their position or take advantage of their special position and knowledge to profit
                ii. Violation of filing requirements may result in criminal sanctions
                iii. No private right of action under §16 or SEC rule thereunder
            b. Helps uncover § 16(b) violations
        3. Persons Subject to § 16
            a. Officers
                i. Title may not make one liable: duties/function rather than titles are determinative of whether an employee is an officer—court calls this an "objective" test (*C.R.A. Realty v. Crotty* (p. 867))
                ii. Officers are decision-makers, policy makers, executive officers covered
            b. Directors
            c. 10% beneficial owners (of a class of equity shares)
                i. Husband is statutory insider—director—wife had no position with company; as director husband was entitled to purchase shares; wife sells her shares; no indication that this was a planned sell, buy short swing scheme; court willing to concede that they exercised independent discretion; court holds that wife's transactions are deemed to be husband's; **wife is a beneficial honor** if we didn't have this rule, then there would be a huge loophole
                ii. **Rule is prophylactic-casts wide net, includes innocent conduct**

            d. Note: if in any one of the categories, have to file form with the SEC that tells stock ownership in company
        4. **Deputization—**incurring §16 liability through deputization
            a. Deputization will apply when someone is sitting on board as strawman to pass inside information from one corporation to the next. Courts will look at situations pragmatically—why was the interlocking director sitting on both boards? If informational, then court may apply deputization rule.
    ii. Disgorgement of Short-Swing Profits (Section 16(b); Note on Short Sales)
        1. 1934 Act § 16(b) [**liability provision]**, SEC Rules 16a-1 *et seq.*
        2. Rule to **prevent** the potential for improper profits
        3. Imposes liability for short swing profits upon **officers, directors, and 10% beneficial owners**
            a. Must disgorge to corporation any profit realized as a result of purchase or sale of securities within a 6 month period
        4. **No fraud or misconduct required, only purchase or sale within a 6 calendar month period**
            a. Liability is easily avoided by waiting 6 months and 1 day before entering into a matching transaction
        5. Private remedy on the part of shareholders to recover profits made by insiders; shareholder first has to made demand on insider, the corporation has 60 days to determine whether to have the corporation bring suit against the insider
            a. Shareholder does not need to have been a contemporaneous shareholder
        6. Statute of limitations is 2 years
        7. Test
            a. Look for purchase and sale or sale in purchase within 6 months
                i. *May be able to match spousal purchases and sells*
            b. Then look to determine if profit
                i. If yes, then goes back to corporation in a suit that is like a derivative suit
            c. **Beneficial owner has to be beneficial owner both at time of sale and time of purchase, DOES NOT apply to officers or directors—have to be it at either time**
                i. The purchase that puts beneficial owner over 10% threshold does not count as a purchase for purposes of this rule
        8. Damages = discorgement of profit
        9. **Broad definition of profit**
            a. 2nd Circuit: match highest sell price in period with lowest sell price in period
                i. Courts disagree
        10. Options Transaction
            a. **Rule: Day you get the option is the day of the purchase because that is when you get the right**
            b. In other transactions, use pragmatic test, ask whether transaction gives director access to info §16(b) meant to prevent and that is day of sale
        11. Short Sales (§16(c))
            a. Prohibited by insiders (officers, directors, 10% beneficial owners)
            b. These are transactions in which stock is sold without owning it; stock is borrowed for delivery in the sale transaction and purchased later to repay the loan

c. If the stock price falls as predicted, the short seller will be able to buy the stock for repayment of the loan at a lower price than the sale price at the time of the short sale

iii. Insider Trading as Securities Fraud (Rules 10b-5 & 14e-2; 10b5-1, 10b5-1)

1. SEC Rules 10b-5, 10b5-1, 10b5-2, 14e-3; 1934 Act §§ 20A, 21A
2. Common Law fraud doesn't work to address insider trading
3. **Limited to fraud and deception, not unfairness**
4. **10b-5 Actions:**
   a. Not designed to deal with insider trading, contains no reference to insider trading
   b. Penalty: three times insider's profit
   c. Statute of limitations:
      i. One year from the date of discovery or three years total
         1. If you don't discover in three years--lose the right
         2. If you discover, and don't file within one year--lose right
   d. As a general matter, 10b-5 prohibits deception connected with stock transactions; the most common type of violation is insider trading. 10b-5 doesn't prohibit conduct that is merely unfair because it is considered a disclosure provision. In proving that the D acted unfairly doesn't constitute fraud in a 10b-5 action
5. Disclose or Abstain Rule
   a. **Once insider is in possession of confidential, material, nonpublic information then he cannot trade until that information is disclosed** (10b-5 imposes a disclose or abstain rule)
   b. *SEC v. Texas Gulf Sulphur Co.* (p. 902)
      i. Various Ds accused of purchasing TGS stock based on inside info regarding a potential ore strike that was denied in a press release to the public. After TGS announced the strike, the Ds traded heavily in the hour before the news made it to the news wire. There was not a simultaneous release of the information--about an hour lag between the breaking news in Canada and America. The court held:
         1. If you get a tip, you can ABSTAIN or DISCLOSE it to the public
         2. 10b-5 applies only to material information
            a. Educated guess not sufficient
            b. Material: not too remote; info that a reasonable investor would want to know
      ii. **INSIDERS CANNOT TRADE ON INFORMATION UNTIL IT IS EFFECTIVELY DISSEMINATED**
         1. Basis for the rule:
            a. Fairness to the market and those who do not have the information
            b. Fairness to the corporation whose information is being used
   c. Can be extended to some "tippers" and "tippees" (non-insiders who had information and traded on it knowing it not public)
6. Misappropriation
   a. *Chiarella v. United States* (p. 916)

i. A printer was able to make out the names in a document being used for a tender offer and he purchased stock on this inside information and made about $30,000. Issue was whether the printer was liable for buying stock based on non-public information without disclosing of the takeover, before he purchased the stock. Court held:
   1. There was no duty between Chiarella and the public to disclose the information; the mere fact that one has non-public information, knowing that this is non-public, does not create a duty to disclose; the only possible duty that Chiarella owes is to his employer and might have breached this duty.
   2. Court could not convict Chiarella without recognizing a general duty between all participants in market transactions to forego actions based on material, non-public information—court did not recognize any sort of duty here

ii. **10b is a fraud statute and requires a special relationship to disclose or abstain from trading and Chiarella didn't own target company or its shareholders a duty**

iii. **Mere possession and use of nonpublic information under Rule 10b-5 cannot be enough**

b. *United States v. O'Hagan* (p. 921)
   i. Grand Met was client of law firm; O'Hagan was partner in law firm. O'Hagan knew that Grand Met was planning a take over of Pillsbury. O'Hagan bought Pillsbury stock; tender offer goes through, stock goes up, O'Hagan makes huge profit. The only theory of getting O'Hagan under 10b-5 would be breach of duty to his employer. This was a tender offer, so even if misappropriation fails, still get him because 14e-3 does not require a duty.
   ii. Supreme Court holds that the misappropriation theory lives; deception is required under 10b-5; in this case, the deception lies with the employer—traded on something without employer's consent (the securities transaction and the breach of duty coincide
c. *United States v. Chestman* (p. 934)
   i. 10b-5 violation:
      1. NO. Stock broker had material nonpublic information from his client and traded on it but no violation because no stock broker-customer fiduciary duty
   ii. 14e-3
      1. Stock broker violated it and 14e-3 does not require independent basis for duty
      2. Only applies to tender offer
      3. Used to capture someone not under 10b-5 duty
d. **14e-3: <u>SEC rule dealing with tender offers</u>**
   i. It is fraud for anyone with inside information to trade on it, where there had been a substantial step to commence a tender offer.
   ii. Knowledge of tender offer- you are cooked if you trade on it
   iii. Only fill in the gap for tender offers
e. 10b5-2

i. imposes the duty to disclose or abstain rule
ii. 3 examples
1. agree to maintain information in confidence (K relationship)
2. person communicating information to other person have history of confidence (*Kim*)
3. Presumption spousal relation creates duty of confidence)
a. Some courts don't follow

f. *United States v. Kim*
i. Young executive goes to a YPO meeting gets insider information regarding a tender offer from another member of YPO, trades on information despite confidentiality agreement among group.
ii. Kim got off; the confidentiality agreement among trade association is not a formal agreement and does not give rise to duty
iii. May come out differently today because 10b5-2 now enacted
1. Mark Cuban case—fact-finder can infer from confidentiality agreement that nonuse was inferred

7. Speculative Information:
a. If the insider information is speculative, its materiality is determined by the probability-magnitude test:
i. The probability that the speculative information may turn out to be true is balanced against the magnitude of its impact on the corporation's future earnings if true

8. **IF THERE EXISTS AN INDEPENDENT BASIS FOR DUTY, THEN GOING TO BE LIABLE IF TRADE ON INFORMATION**
a. **Where agreements or relationships impose legal obligations, 10b-5 will attach**

9. Thief who breaks I through window and physically steals hard-drive to computer does not violate 10b-5, **but** thief who masquerades as someone else such as using a password that is not his then violates 10b-5 (i.e., thief gains access through doorman into office—deception)

iv. Tippee Liability
1. *Dirks v. SEC* (p. 936)
a. Dirks was an analyst who interviewed a CA corporation and kept up with their public statements and finds that the corporation is overstating their revenues. He offers to share this with the SEC and the Wall Street Journal, but no one buys his story. He then tells his clients to dump their stock based upon his inquiries. Dirks confirmed the fraud through interviewing former employees. Then SEC goes after Dirks
b. Supreme Court says that Dirks is the tippee is tipped by the insider (employee of the corporation); but is not liable
i. Insider had not breached a duty to employer; blowing the whistle is not a breach of duty
ii. In order to get the tippee, the tipper must have breached a duty in disclosing the information (derivative liability does exist)
iii. AND there must be some benefit to the tippee
c. **When tipper passes on information for his own personal benefit, then the tipper will have violated 10b-5**

i. **Personal benefit broadly defined, not limited to economic benefit**

2. Tippee may assume duty if information has been made available improperly; thus a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material non-public information only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should have known that there was a breach
a. If the tippee is liable, so is the tipper

v. Use vs. Possession
1. **Use Test:** possession is not enough for insider trading liability; insider information must be used
a. If you show possession, trade, and duty SEC may draw inference of use (thus if you prove possession without proving use, you may be successful in lawsuit)
2. **Safe Harbor:** SEC adopted 10b5-1 providing a safe harbor under a use test
a. Provides a safe harbor that permits the insider to adopt in advance a trading plan or appoint a disinterested party to direct trading in securities in the insider's company
3. **Civil Liability**
a. To provide incentive for people to blow the whistle on insider trading, §21 provides that up to 10% of any civil penalty recovered by the SEC may, in the SEC's discretion, be paid as a bounty to any person or persons who provide information leading to the imposition of the penalty
b. If any person violates the Act or any rule thereunder by trading on insider information or by communicating such information, the SEC can go to court to seek a civil penalty of up to 3 times the amount of profit gained
c. SEC is not subject to statute of limitations
d. Sanctions give SEC tremendous leverage in settling

XIII. Mergers & Acquisitions
a. Forms of Corporate Combinations (Merger, Consolidation, Share Exchange, Purchase/Sale of Assets, Purchase of Shares)
i. MBCA §§ 11.01-11.05, 12.01-12.02; Del §§ 251, 253, 271(a)
ii. Mergers
1. Long Form
a. 2 corporations A and B; B is target corporation (disappearing corporation); A is surviving corporation; after merger A acquires all assets and liabilities of B; each board adopts plan and then presents matter to shareholders for vote; plan of merger dictates what happens to B's shareholders (cashed out, get A stock, etc.); **both sets of shareholders get statutory appraisal rights**; both shareholders get vote if both of equal size
2. Short Form
a. If a parent owns 90% of subsidiary, there is no shareholder vote required for parent or subsidiary; **shareholder of parent don't get appraisal rights; shareholders of subsidiary do get appraisal rights**
3. Triangular
a. Acquiring company, P, sets up subsidiary often called NewCo, B, target company, merges into subsidiary. Shareholders of B get whatever consideration offered by A and approved in plan of merger

b. Why Use?
    i. A's shareholders don't get to vote, don't get statutory appraisal remedy because not voting on anything; B's shareholders still get vote and appraisal remedy
4. Reverse Triangular
    a. Subsidiary merges into B

iii. Consolidation
1. 3 corporations, rather than 2; B and A are going to combine into 1; B and A form a new corporation C; B and A disappear and are consolidated into C; each set of shareholders gets to vote on plan approved by each set of directors; all assets and liabilities are consolidated
2. No longer statutory term in Model Act states because § 11.03 procedure known as share exchange, still exists in DE
3. Appraisal rights for shareholders of both A and B
4. Why Use?
    a. Ego: don't want to be the company taken over or disappear—neither company survives
    b. Corporation from 2 different sates want to be DE corporation, easier to set up new corporation in DE and consolidate

iv. Sale of Assets Transaction
1. May want only part of business
2. Sale of substantially all assets, not in normal course of business requires director approval and shareholder vote of selling corporation (MBCA 12.01 & 12.02)
    a. Normal course of business: doesn't have to go to shareholders for approval
    b. Substantially all assets: 80% is rule of thumb, but some cases hold less than 80% as substantially all
        i. If productive assets remain (business still remains) less likely to be sale of substantially all assets
        ii. If passive assets, more likely sale of assets
        iii. **REAL TEST: sale of all the productive assets, going to be judgment call**
    c. Less than substantially all doesn't require director or shareholder approval
    d. **Successor liability:**
        i. If you sell off substantial assets and leave liabilities, you have to leave enough assets in corporation to take care of liability
3. Model Act: where shareholder vote required, triggers statutory appraisal remedy
4. DE: triggers vote but no statutory appraisal remedy

v. Purchase Stock/Tender Offer
1. can go to shareholders directly to purchase their shares; never get as good a deal as with merger because there will always be some recalcitrant shareholder that holds out; bypass directors

vi. Corporate Divisions
1. Get rid of unwanted corporate assets;
2. spin off – new company
3. split up – 1 company splits into 2, shareholders get shares in subsidiary that contains unwanted assets
4. split off – similar to split up but exchange of shares, some shareholders own stock in 1 company and other shareholders in the other company

5. common way to get rid of unwanted assets
    a. IRS to get tax deferred has to be 5 years after acquisition

vii. **Successor Liability in a De Facto Merger**
1. **De facto merger**: merger in substance as opposed to in form; factors relevant to consideration of whether there has been a merger:
    a. Whether the selling corporation continued to exist after the sale of assets
    b. Whether, after the transaction, the selling corporation possessed substantial assets with which to satisfy debt
2. Issue: in a de facto merger, to what extent does purchaser assume the liabilities of the seller?
    a. General rule: a mere sale of corporate property by one company to another does not make the purchaser liable for the liabilities of the seller
    b. Exception: liabilities of the seller may be imposed on the purchaser when
        i. Purchaser expressly or impliedly agrees to assume liabilities
        ii. Transaction amounts to a merger of the seller into the purchaser
        iii. Purchasing corporation is merely a continuation of the selling corporation
        iv. Transaction is entered into fraudulently to escaper liabilities
3. **Successor liability:**
    a. Should leave enough assets in selling corporation to deal with remaining liabilities (known claims and reasonably foreseeable contingent claims)
    b. Under doctrine of successor liability (also de facto merger), the acquiring corporation that did not leave enough assets to take care of liabilities will assume liability

b. Dissenters' Rights – The Statutory Appraisal Remedy
i. MBCA § 13.02; Del. § 262 & De Facto Merger Doctrine
ii. Three corporate changes usually give rise to appraisal rights:
1. Mergers/Consolidation
2. Sale of assets (Not DE)
3. Article amendment that would fundamentally alter class of shares
4. **Exceptions**:
    a. Sale of assets for cash
    b. Shareholders of surviving corporation do not get rights (short-form merger; whale-minnow merger)
    c. **Market Out Exception (MA & DE) MBCA § 13.02(b)(1):** even if appraisal rights, if shares are publicly traded then market fairly values shares
5. Model Act: If own 1,000 shares have to seek appraisal remedy for **all** or **none** of your shares
    a. Loser in appraisal may have to pay cost for appraisal
        i. Appraiser gives more than shareholder gotten corporation loses, if less than or equal to shareholder loses

iii. Fair Value: → assessed on the day immediately before the vote to make change
1. Block Method: each value gets a certain weight (weighted average
    a. Earning Value:
    b. Market Value
    c. Dividend value
    d. Asset value

i. Determine by liquidation, replacement, market, going concern, or book value
e. Anything else
f. No longer exclusive method

2. New Appraisal Method: post ***Weinberger:***
   a. Appraisers are no longer limited to above factors
   b. Can look to fairness of price, fairness of treatment to minority, independent negotiations, etc
3. ANY modern valuation can be used:
   a. **Comparison method**--look at premium paid in similar deals
   b. **Discount flow method**--look at cash generated and determine what amount of money would be required to generate that much cash
   c. **Break up value**--liquidation of assets

iv. Exclusivity of Statutory appraisal rights:

1. **Delaware:**
   a. Are exclusive (with possible changing in law currently) unless P specifically alleges fraud, misrep or other misconduct
2. **Model Act §13.02(d)**
   a. Are exclusive unless:
      i. Transaction not procedurally correct; or
      ii. Was procured as a result of fraud or material misrep
3. *Farris v. Glen Alden Corp*. (p. 1023)
   a. Glen Alden is purchaser; there was a vote because there was an increase in share; not vote to require purchase of assets, no appraisal rights. However, P (who is shareholder of Glen Alden) argues that the combination so fundamentally changes the corporate character of Glen Alden and the interests of P therein that to refuse him appraisal rights would in reality force him to give up his shares in 1 corporation and accept shares in another.
   b. Court looks to consequences of consolidation to P:
      i. Seller had influence—actually Glen Alden is being bought in substance (List directors control combined company) because bulk of shares held by List; buyer was smaller than seller (small company acquired larger company-minnow swallowing the fish)
      ii. This transaction was designed solely to deny minority shareholders of Glen Alden their appraisal rights
      iii. Substance over form approach—here, in substance the transaction was a merger so shareholders of Glen Alden should have been granted appraisal rights
4. *Heilbrunn v. Sunn Chemical* (in Delaware, seller does not get appraisal rights) (p. 1030)
   a. Here seller is seeking appraisal rights. Shareholder of selling company claims that this is a de facto merger and wants statutory appraisal rights.
   b. Court says that this was a transaction of equals (unlike **Farris**); doesn't accept doctrine of de facto merger
   c. In Delaware, deal can be structured to get around appraisal rights
5. *Hariton v. Arco Electronics, Inc.* (p. 1034)
   a. DE doesn't follow the de facto merger doctrine
      i. Merger statute and sale of assets statute are separate

1. Merger get appraisal remedy, sale of assets then no appraisal remedy
   b. Equal Dignity Rule: Merger and sale of assets statutes deserve equal dignity
6. Appraisal remedy in DE is exclusive except in self-dealing, fraud

c. Judicial Challenges to Fairness of Corporate Combinations (Including: Are Appraisal Rights Exclusive?)
   i. *Sterling v. Mayflower Hotel* (p. 1050)
      1. Mayflower Corporation had 1 producing asset (the hotel); Hilton acquired a majority of shares in Mayflower; Hilton buys additional 21,000 shares at $19.10; made tender offer to buy more shares at this same price; most Mayflower shareholders sold shares; at end of the transaction. Hilton owned 5/6 of all shares in Mayflower; Hilton wants to get rid of minority 1/6; Hilton proposed a merger of Mayflower into Hilton (long form merger) and the Mayflower shareholders were offered $19.10 cash or 1 share of Hilton stock for each share of Mayflower; evidence indicated that immediately before merger, Hilton was trading at $14.75, Mayflower was trading at $16.25 Issue is whether the 1:1 exchange was fair. There was additional evidence that if Mayflower had sold assets, the liquidation value was much higher than going concern value (could make more from selling land and property than keeping business going)
      2. Court refused to give much weight to liquidation value; court says that this transaction was fair.
         a. Cant rely on liquidation value because corporation is not being liquidated
         b. 1:1 is fair—
            i. market value of Mayflower stock was fictitious—higher than would be justified in a free and normal market uninfluenced by Hilton's desire to acquire it;
            ii. synergy of combining two corporations—getting Hilton value;
   ii. DE 2 part test where appraisal right not exclusive in a freeze-out transaction
      1. Defendant has to prove transaction had business purpose; and
      2. Transaction was intrinsically fair
      3. *Weinberger v. UOP* (p. 1071)
         a. **Appraisal remedy exclusive in the absence of fraud, illegality, or any other wrongdoing**
            i. **When self-dealing is alleged, appraisal remedy is not exclusive**
         b. **In looking at fairness of price, fairness of treatment of minority will factor into analysis**
         c. D (Signal) made a tender offer for $21 for the shareholder's shares, which were valued at $14. The shareholders over-subscribed, and the bidder only wanted 50.1% of the shares. D's management then did a study that showed they could go up to $24 to buy the remaining at-large shares. In a meeting with the UOP President, he agreed that $21 was a fair price and the outside directors agreed.
         d. **Weinberger court says that from this day on, the appraisal remedy is available to shareholders upon a showing of fraud or other wrongdoing; also expands valuation method (from 4 block method) to all relevant factors**
         e. Some UOP directors had information from Signal that was not shared with entire board

i. **Signal had commissioned an internal study that found that $24/share was a fair price; Lehman Brothers was not privy to this information**

f. What could Signal have done this differently? Signal directors on the UOP board should have excused themselves from voting; could have set up a negotiating committee that has no relationship to Signal who can negotiate on plane and make independent decisions with the benefit of the business judgment rule; OR Signal could have made full disclosure; court assumes that if Signal directors are not part of the decision then the Signal directors do not have to disclose; but the bottom line is that there has to be some kind of cleansing mechanism to avoid conflict of interest (cleanse interlocking directors)

g. **As of this case, appraisal rights are exclusive: appraiser has to look at fairness of price and fairness of process**

d. Defending Against Hostile Takeovers (Duty of Loyalty Revisited)

i. **Overview:**

1. It is the fiduciary duty of officers and directs to do what is best for the corporation and NOT act in self-interest, but they also want to keep their jobs.
2. Thus, takeover attempts often put the business judgment rule in conflict with self-interest bc there are self-interested directors who want to keep their jobs
3. Since self-interested, **Duty of Loyalty** owned, ***BJR does not apply***.

ii. Defensive Measures: measures to repeal an unwanted takeover

1. **Nancy Reagan Defense**:
   a. Director recommend to SH to "just say no"
   b. BUT the offer to the SH is usually more than the prevailing market price; thus the SH are likely to sell anyway
2. **White Knight Defense**:
   a. Directors find a better offer for the SH and the company (a white knight) buys the company instead
3. **Shark Repellant/Porcupine Defense**:
   a. Add provisions to the AOI to make it extreme difficult for corp to be taken over
   b. Examples: provision that have large number of directors and staggered elections so takes long time to change; erect barriers to 2nd step transaction
4. **Greenmail Defense**:
   a. Directors buy back some of own shares from aggressor above premium paid – in essence paying aggressor to walk away
   b. If the directors are justified in buying back stock to protect the company, it is not wrong for directors to use corporate funds.
      i. ***Cheff v. Mathes*** and ***Unocal*** (as long as corporate purpose and response was proportional)
5. **Poison Pill Defense:**
   a. Something that is not harmful until the corp is taken over, lethal weapon
   b. Example: A company gives its SH a right that can be redeemed for a nominal amount and in the event of a takeover, this right can be sold back to the corp for $100
   c. Basis idea is that no one will want to take over a company in which there are outstanding rights that will greatly diminish the worth of the company
   d. Types

i. Preemptive – PP there even before someone trying to take over
   1. DE says okay
ii. Post-emptive – PP put in to react, defensive
   1. Okay applying Unocal test

6. **Lock-up Arrangement/Crown Jewel:**
   a. Board of the target enters an agreement to sell the major asset (crown jewel) to another entity so that the company is no longer worth taking over by the aggressor.
      i. Likely apply Revlon in takeover cases
7. **Pac-Man Defense:**
   a. Target responds by trying to acquire the aggressor first
8. **Scorched Earth Defense**:
   a. Rather than being taken over by aggressor, the target destroys itself as it previously had existed
9. **Acquiring Additional Assets**:
   a. Target acquiring undesirable assets or a regulated asset that will require regulatory approval before take over (radio, television asset)
10. **Break-up fees:**
    a. Once found friendly acquirer will contain break up fees or termination fees that will increase the cost of backing out
11. **Diluting Shares**:
    a. Will dilute control of aggressor that currently has
    b. Could issue employee stock ownership plan – giving management more shares and therefore more control of keeping directors in place
12. **Defensive share repurchase program:**
    a. Alternative to issues add'l shares, just repurchase shares on the stock to drive up the price to be more than aggressor is offering.
    b. However, the less amount of shares outstanding will increase control of aggressive.
13. **Golden Parachute:**
    a. Provide for an extraordinary high severance payment to target management in the event they are ousted as part of a takeover
       i. Increases price for aggressor but ALSO removed the conflict of interest from board members.

iii. **STANDARD:**

1. Defenses Tactics will be judged under the ***Unocal*** test if there is a reasonably perceived threat, UNLESS the corp abandons its long term strategy and seeks an alternative transaction involving the breakup of the corporation. ***Revlon Test***
2. ***Unocal* Test:**
   a. Does management reasonably perceive a threat to currently policy?
      i. Not "bad", just changing from the way things were being run
      ii. Threat may be to ongoing merger negotiation with a preferred bus
         1. ***Revlon***
   b. If yes, is the response must be reasonable and proportional to threat
      i. Consider nature of takeover bid, effect on enterprise, timing, illegality, inadequacy of price
      ii. Shown by good faith and reasonable investigation
3. ***Revlon MOMENT***:
   a. Applies when company is "up for sale"; or

i. Old policy no longer going to be in place
ii. Company will be extensively changed

b. Break up is inevitable – defensive tactics failed – cant continue

4. ***Revlon* Standard:**
   a. Once a company has reached the point where "for sale" or in inevitable breakup → board can ONLY maximize shareholder value and cannot do anything to interfere with the "action" taking place for the company
   b. Board changes to auctioneers and try to get best price for SH
   c. Management/Board must act to maximize SH profit
   d. Management can encourage SH not to sell to certain companies and may seek other white knights/buyers so long as good price.
5. ***Time* Interpretation:**
   a. Narrows the Revlon decision –
   b. If company participating in a friendly merger that is part of its long term plan (to expand, merger, etc) and that long term plan was put into place before the hostile merger attempt → Directors don't have to comply with ***Revlon*** ruling.
      i. Time had corporate culture that aligned better with WB
   c. Will be considered under the ***Unocal*** decision.
6. **If breaking up company part of defense, then *Revlon* applies; do Unocal to preserve existing corporate policies, Revlon applies because nothing to presser breaking up company**
7. Unocal basic test of DE. Revlon applies only when
   a. Company broken up either way
   b. If defensive tactic results in abandonment of visiting corporate policies
   c. Transaction results in loss of control

e. Federal Regulation of Takeovers & Tender Offers (the Williams Act)

i. 1934 Act §§ 13(d), 13(e), 14(d), 14(e), 14(f); SEC Rules 14d-1 *et seq.*, 14e-1 *et seq.*

ii. Purpose
1. The Williams Act is codified in 5 sections of the 1934 Act.
2. The purpose was to give **investors** in public companies adequate foreknowledge of potential control changes of their company if they get a vote.
3. They were NOT designed to protect management,
4. LIMITED to publically held companies – subject to §12
   a. Traded on national exchange
5. 12(g) - $10M in assets and 500 shareholders in each class

iii. **The Williams Act Sections of the 1934 Act**
1. **§ 13(d)** Early Warning Provision (public companies only)
2. **§ 13(e)** Buyback Provisions (public companies only)
3. **§ 14(d)** Tender Offers (public companies)
4. **§ 14(e)** Tender Offers (**ALL** companies – based on commerce clause)
5. **§ 14(f)** Change in Management (public companies only)

iv. Overviews of Each Williams Act Section
1. **§ 13(d): Early Warning Provision**
   a. Designed to give the investing market early warning
   b. **Requires that anyone who has <u>acquired 5%</u> of an equity security of a § 12(g) public company MUST file a Schedule 13D w/SEC w/in 10 days.**

i. This means that from the date you first cross the threshold, you have 10 days to acquire as much stock as you want w/o disclosing anything.

   c. This Schedule 13D requires the filer to tell who he is, what his intentions are in acquiring the stock, how got shares, who financed.
   d. The reporting requirement is ***continuous disclosure***, so if your intentions later change you have a duty to amend your Schedule 13D
   e. The rule also applies regardless of how you get your 5%
   f. **Doing nothing counts–** if the corp. buys back/redeems some of its shares and that means you own a higher percentage, you still have to file
2. **§ 13(e): Buyback**
   a. Gives the SEC the authority to pass rules that deal with a company's buying back of its ***own shares***.
   b. Parallel rules applying to tender offers by third party offers.
   c. Thus, many of the provisions that apply to third party tender offers also apply to buying back a corp's own shares.
   d. §13e-4 – triggered by tender offer
3. **§ 14(d): Tender Offers for Shares of Public Companies**
   a. Any 3rd party that is going to make a tender for a public company (dependent on target, not offeror)
   b. "tender offer" for equity securities in a PUBLIC company.
   c. Limited to THIRD PARTY offers.
   d. **Schedule TO: *before*** you make a tender offer for shares in a public company, you MUST file a Schedule TO.
      i. Full disclosure form
      ii. Tells who you are, what y our intentions are, number of steps involved, terms of the offer, what intend to do after offer
      iii. Any changes must be reflected in an amended or new filing
   e. **Best Price Rule: §14(d)(7)**
      i. Have to give equal price (the best price) to all those tendering shares under the same offer.
      ii. Do this by giving everyone the highest price paid to any tendering security holders.
      iii. Different types of consideration can be paid – shareholders get to pick – and the highest value of any type goes to all shareholders electing that type.
   f. **All Holders Rule:**
      i. NO exclusionary tender offers are allowed (like in Revlon and Unocal).
      ii. Tender offers must be open to all holders of the class of securities sought.
   g. **Pro Rata Rule: §14(d)(6)**
      i. If the offer is for less than all the outstanding shares of the class and more than you offered are tendered, then there is a pro rata rule – you have to accept in the SAME proportion from everyone.
   h. **Withdrawal Rights: §14(d)(5)**
      i. The shareholder has the right to withdraw the tender of his shares until the tender offer period has closed (20 business days)

ii. If want to withdraw after period has closed, then up to the company

4. **§ 14(e): Tender Offers for Shares of ALL Companies [all corps]**
   a. "tender offer" for equity securities in ***any type of corporation.***
   b. **14e-1: Duration Requirement:** a tender offer has to remain open for at L**EAST 20 BUSINESS** days.
   c. **14e-2: Requires Management to take a Position:** the target *management* **must** within 10 days after an offer has been made to do one of three things to tell the public what their position is b/c management's view is important to investors:
      i. Support the offer and file a form explaining it
      ii. Denounce the offer and file a form explaining it
      iii. Specifically take no position
      iv. Any statement made by management must be filed publicly under 14d-9
   d. **No Trading Requirement (§ 14e-3)**
      i. Prohibit anyone who knows of upcoming tender offer to trade in advance
      ii. Chiarella rule
      iii. If a tender offer is going to be made, it is illegal for anyone other than the bidder to buy shares in advance of a tender offer being announced.
   e. **14e-5:**
      i. Once the TO has been announced, all purchases by the offeror ***must*** be through the tender offer, subject to the above equal opportunity rules.
      ii. Can not go into market and buy additional shares during the tender off, by private negotiations or public market
      iii. However, can purchase ***before*** the tender offer
5. **§ 14(f): Disclosure of Change in Management**
   a. Requires disclosure of any change in management that will result from any arrangement for sale of a public company

v. **Defining a Tender Offer**
1. **General Definition:** a person goes to SH and offers to buy a large amount of shares for a certain price or exchange shares for shares.
   a. **All-offer:** will buy as many shares as tendered
   b. **Limited TO:** will buy up to a certain percentage of shares
      i. If more are tendered – pro rate requirements
2. Can announce TO, but can't make details public until file (filing requirement immediate)
3. **8-factor test the Court set forth in *Wellman*:**
   a. Active and widespread solicitation of public shareholders for the shares of an issuer?
   b. Offer made for substantial percentage of issuer's stock?
   c. Made at a premium over the market price?
   d. Are the terms of the offer firm rather than negotiable?
   e. Was the offer contingent on a fixed number of shares?
   f. Was the offer open only for a limited period of time?
   g. Was the offeree subject to pressure to sell? (bear hug)

   h. Were there announcements that preceded this?
4. Not all of the 8 have to be met – if it avoids just a few to cover up what is a tender offer, it will still be one.
5. **Things that are clearly NOT tender offers:**
   a. **Open market purchases** ("street sweeps"): no matter how widespread (***Carter Hawley Hale)***
   b. **Privately Negotiated:** as long as you aren't using secretive, high-pressure tactics. (***Hanson Press***)
      i. ***Dickenson****:* says some private negotiations can be tender offer if **secrecy and high-power and deception**.

vi. **Deception and Tender Offers**
1. As with typical 10b-5 cases, the Santa Fe rules still apply: mere unfairness is NOT enough to trigger 10b-5 liability
2. **There MUST be some kind of deception**.
   a. TOs are permissible under federal law if fully disclosed (and comply w/ other rules).
3. **Although the substantive provisions of § 14 may not technically be in accordance w/ Santa Fe b/c they do not necessarily prohibit deception, but they have all been upheld thus far in order to give full effect to disclosures.**

vii. **Disadvantages of Having a Tender Offer (v. just buying shares)**
1. You have to immediately disclose the tender offer rather than having the benefit of waiting 10 days when you just buy shares
2. Avoid the All Holder's Rule, Pro Rata Rule, and Best Price Rule (equal opportunity rules) required by 14(d).

f. State Regulation of Takeovers

i. **Job of the State v. Job of the Feds**
1. The job of the state is one of corporate governance, job of Fed. is some kind of national investor protection.
2. Thus, in anything that involves national investor protection, federal law will trump state law.
3. Likewise, state law trumps in corporate governance matters.
4. **Extra-territorial statutes:** any co. incorporated outside the state that has more than 50% of its business in this state is subject to these statutes
   a. NC statute (40%) has since been repealed b/c of decisions that indicate that that is going too far
   b. Cannot regulate corporate governance of foreign corporations.
5. **Stake-holder Statutes:** corporate directors may consider other factors besides shareholder wealth maximization (anti-Revlon statute)

ii. **State statutes:**
1. So long as state legislation does not (1) alter the Williams Act basic neutrality between tender offerors and target management; or (2) impose burdens that conflict with the Williams Act regulations, the state statutes can survive.
2. 1st Generation of Cases:
   a. Imposed a variety of disclosure requirement, waiting periods, and fairness thresholds for tender offers
   b. Mite – said no; state statutes can't impose an excessive burden on interstate commerce.
3. 2nd Generation:
   a. Best Price Statute – prevent two tier front end loaded

b. Two tier front loaded offer:
    i. Two tier: tender offer then merger
    ii. Front end loaded: tender off giving $125 at front, if don't go along with majority at $125, then will be forced out at a lower price
        1. Encourages tendering a lower price by semi-coersion
c. State adopted a best/fair price statute:
    i. Two tier offer is prohibited – if a second step within 2 years, then must be same price as first price offered
d. Control Shares:
    i. If a tender offerer buys up to 1/3 of vote, before able to exert any control must call a SH meeting and get majority of a vote from disinterested SH to be able to exert control.
e. ***CTX*** – don't upset the Williams Act – not invalid – no burden on interstate commerce
    i. The possibility that the Indiana TO ACT will delay some TOs is insufficient to require a conclusion that the Williams Act pre-empts the state legislation
    ii. If Congress had intended to pre-empt all state laws that delay the acquisition of voting control following a TO, it would have said so explicitly
    iii. The regulatory conditions that the state legislation places on TOs are consistent with the text and the purposes of the Williams Act

4. **3rd Generation**:
    a. Merger moratorium – wait a certain amount of years before second step – Ct upheld
    b. Extraterritoral – Ct struck down

g. **Sarbanes Oxley 2002:**
    i. Requirement All publically traded corps to:
        1. Have "audit committees" composed of independent directors
        2. Disclose whether there is a financial expert on audit committee
        3. Disclose if have a code of ethics
        4. Ban loans to directors and exec officers
        5. Lawyers must take specific steps to become aware of wrongdoing
        6. Certification of internal controls when file SEC reports
        7. Imposes blackout periods on trading by

Extras

Derivative action barrier – unless demand would be futile, shareholders have to make demand of directors to bring derivative action suit

Contemporaneous ownership rule of derivative actins – individual shareholder suing on behalf of corporation must have been shareholder at time of breach and at time of trial