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GENERAL STRUCTURE

- **Features:** Separate entity, perpetual existence, limited liability, centralized management, transferability of ownership interests.
- **Financial Dimension:** Public for-profit, private/close for-profit, and not-for-profit

	SOLE PROP.	PARTNERSHIP	LIMITED P'SHIP	CORPORATION	LLC
Filing Req'd	No Reqs	No Reqs	Filing	Filing	Filing
Investor Liability?	Yes	Yes (GPs)	Yes (GPs, not LPs) (GP can = Corp)	No	No
$ Source	Self, Loan, Etc.	Partners (Self, Loan, etc)	Partners (Self, Loan, etc) + LP Investment	Stock, Bonds, Loans, Etc.	Member Contribution
Investor Control?	Yes	%	% (Only for GP)	No (Ds or 51% SH)	Optional
Investor $ Return?	Yes (Anytime)	Yes (Dissolution)	Yes (GP Dissolution)	No (Sell shares only)	RLLCA ("At-will" or for term)
Lifespan	Til Die/Withdraw	Til Die/Withdraw	Til GP Dies/Withdraws	Infinite/Dissolution	Optional
Tax Options	Individual	Individual/CTB	Individual/CTB	Yes (Unless S-Corp)	Optional
Interest Saleable?	No	No, Economic Assign Only	No, Economic Assign Only	Yes	Optional

- **ORG TYPES**
  - **(1) Corporation**– Legal entity distinct from its owners, state created, liability limited to contribution.
    - DGCL § 121 **–** Corp subject to DGCL, can do anything within.
      - DGCL § 122 **– [SPECIFIC POWERS ENUMERATED]**
    - **Limited Liability –** Applies.
      - **EXCEPTIONS:** (1) improper formation (i.e. no corp), (2) for unpaid capital contributions agreed to be made, or (3) piercing the corporate veil. Also (4) contractual agreements (ex: co-signing) loans, contracts.
    - **Double Taxation.** Taxation of payment of salaries, then taxation of earnings.
      - **Connects to public trading.** Arguably incentivizes corporate retention of funds.
    - **Capitalization –** Sale of stocks, etc for fund-raising.
    - **Capital Lock-In –** Risky, but ensures devotion, forces involvement
    - **S-Corp –** Allows flow-through taxation like partnership if desired, reqs low (<75) members.
    - **Members**
      - **Shareholders –** Common shareholders, preferred shareholders
        - **Individual Shareholder –** Persons, etc.
        - **Institutional Shareholders –** Mutual funds, Hedge Funds, Pensions etc.
          - **Hedge Fund –** Unregulated mutual fund for rich
          - **Mutual Fund –** Regulated business investing in other businesses.
      - **Boards of Directors –** Managing board elected by shareholders, part-time, managing.
        - ***Inside* Directors –** Board directors also employees
        - ***Outside* Directors –** Board directors outside corporation
      - **Officers –** Elected by boards of directors. C-level, etc.
        - **Employees –** Hired in corporate hierarchy, serve officers.
      - **Stakeholders** – Creditors, community, etc.
    - **Close Corporations**
      - **Usually involve "promoter's contract" or "shareholder's agreement"** to define specialized boundaries.
      - DGCL §§ 341-356 **govern special rules of close corps.**
  - **(2) General Partnership –** Two or more people, based in contract, unlimited liability, equal participation
    - **(a) General Partner –** Unlimited liability, may make decisions for partnership. **REQUIRED.**
      - **Can be corporation.** Thus, individuals can have unlimited liability where corp takes fall.
      - **Can effectually dissolve anytime via withdrawal.** Thus, bargaining issues.
        - **Policing available** to prevent squeeze-outs, bargaining, etc. *Wrongful disillusion"*
    - **(b) Limited Partner –** Limited to contribution, no voice in activity of corporation except for major decisions (dissolution, changing nature of business, removal of partner, etc). **Part of the "Limited Partnership" that requires formal formation.**
    - **Pass-through taxation –** No double taxation at all, earnings apportioned to individual partners.
      - **Might be useful if Corp Tax + Ind. Tax <Ind Tax.**
  - **(3) LLC –** Formed and managed by "members", with operating agreement, option to be taxed as partnership, variable management structure. Oral agreements sometimes allowed.
    - **Wide variability.**
    - **Limited liability.** Similar to corporation.
  - **(4) Sole Proprietorship.** Pretty much one guy working on his own. Liability, no formation procedure, etc.
- **Requisite Features**
  - **Documents:** Articles of Incorporation (or charter, certificate of incorporation – public, sent to state), bylaws (private, governing rules, etc).
- **Theories of Corporate Goals**
  - **SH-Primacy –** SH financial interests supersede all.

        - **Factors:** SHs need protection, residual claimancy, existence of nonprofits to do good work, more enforceable, less political involvement, higher incentive to invest, etc.
    - **"Stakeholder" –** Corp works for all potential stakeholders
        - **Factors:** SHs can opt in/out, constructive claims by non-SHs, corporate externalities, wasteful(?), employees and others vulnerable, other pressures restrict access, more discretion in social involvement, any purposes as dictated by AoI.
- **Theories of Corporate Structure**
    - **Berle-Means –** SH is the owner/principal, Ds are agents. SH > D
    - **Director-Central –** Directors more paternalistic to SHs. D > SH
    - **Nexus of Contract –** Popular in 80s, determined by interp of contract and common law.
    - **Team Production –** Directors as conflicts-resolvers and uninterested, BoD favored unless intruding on SH rights

FORMATION

- DGCL § 101. **Incorporators; how corporation formed; purposes. (a)** Any person, partnership, association or corporation, singly or jointly with others, and without regard to such person's or entity's residence, domicile or state of incorporation, may incorporate or organize a corporation under this chapter by filing with the Division of Corporations in the Department of State a certificate of incorporation which shall be executed, acknowledged and filed in accordance with § 103 of this title. **(b)** A corporation may be incorporated or organized under this chapter to conduct or promote any lawful business or purposes, except as may otherwise be provided by the Constitution or other law of this State. **(c)** Corporations for constructing, maintaining and operating public utilities, whether in or outside of this State, may be organized under this chapter, but corporations for constructing, maintaining and operating public utilities within this State shall be subject to, in addition to this chapter, the special provisions and requirements of Title 26 applicable to such corporations.
    - DGCL § 102. **Contents of certificate of incorporation.** (a) (1) [name of corp, including limitations on use of words like "Bank"], (2) [address of registered office], (3) [nature of business or purposes] (4) [share information, (5) [name and mailing address of incorporator or incorporators], (6) [names and mailing addresses of first directors if incorporator only temporary]
        - **Additional info allowed.** Extra info re:stock, etc.
    - DGCL § 106. **Commencement of corporate existence.** Upon the filing with the Secretary of State of the certificate of incorporation, executed and acknowledged in accordance with § 103 of this title, the incorporator or incorporators who signed the certificate, and such incorporator's or incorporators' successors and assigns, shall, from the date of such filing, be and constitute a body corporate [...]
    - DGCL § 107. **Powers of incorporators.** If the persons who are to serve as directors until the first annual meeting of stockholders have not been named in the certificate of incorporation, the incorporator or incorporators, until the directors are elected, shall manage the affairs of the corporation and may do whatever is necessary and proper to perfect the organization of the corporation, including the adoption of the original bylaws of the corporation and the election of directors.
    - DGCL § 108 – [(a) **Meeting required after incorporation filed.** Requires majority of directors or incorporators, all set bylaws, elect directors (if meeting of incorporators), elect officers, and do other acts to perfect corp. (b) 2 days written notice to each incorporator or director. (c) Any action permitted to be taken at meeting may be taken without the meeting of each and every director/incorporator]
    - DGCL § 109. **Bylaws [amending, etc]. (a)** The original or other bylaws of a corporation may be adopted, amended or repealed by the incorporators, by the initial directors of a corporation other than a nonstock corporation or initial members of the governing body of a nonstock corporation if they were named in the certificate of incorporation, or, before a corporation other than a nonstock corporation has received any payment for any of its stock, by its board of directors. After a corporation other than a nonstock corporation has received any payment for any of its stock, the power to adopt, amend or repeal bylaws shall be in the stockholders entitled to vote. In the case of a nonstock corporation, the power to adopt, amend or repeal bylaws shall be in its members entitled to vote. Notwithstanding the foregoing, any corporation may, in its certificate of incorporation, confer the power to adopt, amend or repeal bylaws upon the directors or, in the case of a nonstock corporation, upon its governing body. The fact that such power has been so conferred upon the directors or governing body, as the case may be, shall not divest the stockholders or members of the power, nor limit their power to adopt, amend or repeal bylaws. **(b)** The bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees.

GOVERNING LAW

- **Generally --**No fed. Delaware law, other states laws, etc.
    - **Federal law does influence –** Various admin regs, etc.
    - **Hierarchy:** US Const > Fed Regs and Statutes > State Regs & Statutes > Charter/AOI > Bylaws > Contracts.
- **Choice of Law**
    - ***Internal Affairs Rule* –** Choice of law for internal affairs is always situs of incorporation.
        - **Ex:** Right of shareholders to vote, receive distributions of corporate property, to get information, to limit powers of corporation to chosen fields of activity, to bring suit, etc.
        - **Cannot be superseded by state law.** Cali, for example, cannot attempt to grab out-of-state corp and regulate it internally even for good purposes. *Vantagepoint Venture Partners.*
    - ***"External Affairs"*** governed by law of the place of occurrence.
        - **Ex:** Labor law for specific shop, tax laws, etc.
    - **Other Choices:** Torts, Ks, Labor Laws, Income ->*Lex loci. Only* corporate internal affairs governed by incorp loc.
- **"Race to the Bottom" –** Tendency of jurisdictions to try to bribe corps over to them. Delaware?
- **Ex:** Cali special law re:voting did not overrule internal affairs rule and supersede Delaware corporate law. *Vantagepoint Venture Partners 1996 v. Examen, Inc.*

SOCIAL AND POLITICAL EXPENDITURES

- **Currently allowed.** *Citizens United*, finding corps to be people. Prior law: Tillman Act (1907) prohibited contributions to federal political campaigns, but court invalidated law prohibiting expenditures by banks and other corps in *First Nat'l Bank of Bos. V. Bellotti*(1978), then upheld prohibition by Michigan in Michigan on similar expenditures in *Austin v. Mich. Chamber of Comm.* (1990)
    - **SH primacy theory (See above) essentially a fiction, stakeholder system in reality.**
- **Charitable Contributions** allowed, but not exactly profit-maximizing(?)
    - **DGCL § 122(9) -** [Corp has ability to] make donations for the public welfare or for charitable, scientific or educational purposes, and in time of war or other national emergency in aid thereof; **[NO SH PRIMACY]**
    - **Pens. Bus. Corp. L. § 1715 –** Explicitly allows consideration of "all other pertinent factors" to corp, with ability to more or less ignore particular groups in the corporation. **[NO SH PRIMACY]**
- **Ex:** Usually cited for the proposition that corps have to be profit-maximizing, but this is not proven, seems to imply wider discretion by corp even despite shareholders. *Dodge v. Ford.* Corp owner could rightly refuse to hold baseball games at night despite other groups doing otherwise, no need to account for reasons or what other groups were doing. *Shlensky v. Wrigley*.

ACCOUNTING AND VALUATION

BALANCE SHEET

ASSETS	LIABILITIES AND EQUITY
Current Assets(~1yr term) **|- Cash** (In hand, in bank, etc) **|- Marketable Securities** (that can be sold QUICKLY) **|- Accounts Receivable** (unpaid debts from customers, etc) **|- Inventories** (FIFO vs LIFO) **|- Prepaid Expenses** (Stuff done ahead) **Total Current Assets** **Property, Plant, and Equipment ("Fixed Assets")** **Land** (Purchase price or eval? Similar properties?) **Buildings** **Machinery** **Office Equipment** **Total PP&E** **(Accumulated Depreciation)** (Lowers value of PP&E) **Intangible Assets** (Eval of patents, GOODWILL) **Total Long-term Assets** **Total Assets** (All added together)	**Current Liabilities** **|- Accounts Payable**(Bills, etc) **|- Notes Payable**(Stuff ~immediately due) **|- Accrued expenses payable**(Not paid before) **|- Other liabilities**(?) **Total Current Liabilities** **Long-term Notes Payable** **Total Liabilities** **STOCKHOLDERS EQUITY** **Common Stock**(authorized amt?) **Legal Capital** (Par x Shares) **Add'l Paid in Capital** (Amt over Legal) **[Paid-in Capital**(if no par value)] **Retained Earnings**(Actual profit) **Total Equity** **Total Liabilities and Equity** (All added together)
STATEMENT OF INCOME	**STATEMENT OF CASH FLOWS**
Net Sales **(-) Cost of goods sold (COGS)** **= Gross Profit** (Sales – Cost of what was sold) **Operating Expenses** **|- Depreciation** **|- Selling and admin expense** **|- R & D** **Total Operating Expenses** **Operating Income**(GROSS PROFIT – OPERATING EXPENSES) **-Interest Expense**(Interest on loans, etc) **=Income before Taxes**(OP INCOME – INT EXPENSE) **-Income Taxes** **Net Income** (Income before taxes – Taxes).	**<u>From Operating Activities</u>** **Net Income** **(-) Accounts Receivable** **(-) Inventories** **(-) Prepaid Expenses** **(-) Accounts Payable** **(-)Accr. Exp. Payable** **Depreciation** **Total from Operating Activities** **Long Term Liabilities (If applicable)** **Total from Operating Activities ("EBIT")** **<u>From Investing Activities</u>** **+Sales of Machinery** **+Sales of office equipment** **+Sales of IP** **+Total from Investing Activities** **<u>From Financing Activities</u>** **Increase in short-term debt** **Total from Financing Activities** **CASH POSITION** (All totals)

ACCOUNTING PROCESS

- **THERE IS NO OBJECTIVE TRUTH IN ACCOUNTING.**
- **Process:** (1) Recording & Controls -> (2) Audit [verification of accuracy] -> (3) Accounting [classifies and analyzes].
  - **Accrual Accounting –** Recording finances when earned, not when cash in hand.
  - **<u>Realization Principle</u>** – Firm must recognize revenue in period earned.
  - **<u>Matching Principle</u>** – Firm must recognize expenses in period that earned revenue
- **Terms**
  - **<u>Working Capital</u>** – (Current Assets – Current Liabilities)
  - **<u>Current Ratio</u>**(Current Assets / Current Liabilities) – Preferred = 2:1
  - **<u>Liquidity Ratio</u> –** (Quick assets (cash, marketable security, accts receivable) / Current Liabilities)
  - **<u>Profit Margin</u>** – Sales : Total Profit
  - **<u>Goodwill</u>**– Estimated purchase value over face value of corp.
  - **<u>EBIT (Earnings Before Income Taxes)</u>** – Earnings from *fundamental* activities
    - **<u>EBITDA</u> -** (EBIT minus depreciation and amortization)
- **Valuation Methods**
  - (1) Stock Market

- (2) DCF (Discounted Cash Flow), EBITDA/EBIT, ROE (Return on Equity – Income / Last Year's Equity)
- (3) Book Value of Assets – Liabilities

FINANCIAL STRUCTURE OF THE CORPORATION / SECURITIES

	COMMON STOCK		PREFERRED STOCK		DEBT
VOTING POWER?	Yes, inc. determing BoD, voting on fundamental issues	>	Rarely	>	No (Except if takeover after insolvency)
RIGHT TO EARNINGS?	Dividends IF (1) BoD Declares and (2) Senior Creditors paid first	<	Preferred Dividends (Usually first in line?)	<	Interest
RIGHT TO ASSETS?	Residual Claim (left)	<	Liquid Pref (Amount of investment)	<	Return on principle in full first, plus interest
FIDUCIARY DUTIES?	Yes (Maj. SHs only)	>	Rarely	>	No
GOVERNING LAW?	AoI, Del. B. Code		AoI, Del. Bus. C., Directors Resolutions		Contract
PRIORITY?	4	<	3	<	[2] Unsecured < [1] Secured (if prop exists)

- **Corporate Securities**
  - **(1) EQUITY SECURITIES**
    - **Process:** *Authorization* leads to *issuance* to buyers or *outstanding* shares in corp structure <u>by BOARD OF DIRECTORS</u>
      - **"Treasury Shares" –** Re-purchased authorized and issued shares.
      - **<u>Pre-emptive Rights</u> –** Right for a shareholder to maintain percentage of control by being offered that percentage on any sale of stock.
        - DGCL § 157 **–** Authorizes (but does not require) corp to give preemptive rights.
      - **<u>Shareholder approval required</u>** to go beyond authorized number in AoI
      - DGCL § 152 –Consideration for stock set by Board of Directors, can be pretty much anything.
        - DGCL § 153 – (a) shares of stock with par value for not less than that, as determined by BoD or by stockholders if COI provides. (b) Without par value allows consideration by BoD (or SHs if CoI says so). (c) Treasury shares may be sold by any consideration by BoD (or SHs if CoI). (d) If CoI allows SHs to determine considerations, unless CoI requires greater, vote of majority required.
      - DGCL § 154 **–** May sell for other than capital, but par value is the floor.
      - DGCL § 160 **–** Corp can deal in own shares (buyback, etc)
      - DGCL § 161 **–** Authorized shares may be sold up to amount by CoI/AoI.
      - DGCL § 162 **–** If holder of stock has not fully paid, liable for the remaining amt.
    - **(A) COMMON STOCK** -Residual claim on both current income and assets. Contains voting power and a right to dividends.
      - **"Par Value" –** Base legal value of stock
        - DGCL § 153– Par value stock can be sold for that, without par value can be determined by BoD, treasury shares can be sold for amount as determined by BoD, if AoI requires shareholders must have say
        - **Ensures some minimal level of voting rights.**
        - **Shareholders liable for <u>at least par.</u>** Some states allow contribution beyond that if alleged sale amount even greater.
    - **(B) PREFERRED STOCK** – Dividend rights superior, usually no or limited voting rights.
      - ***Participating* preferred stock –** Ability to get bigger (multiple?) dividend upon distribution.
      - **"Blank Check Preferred Stock" –** Rights set upon sale, giving BoD wide control over necessity. Especially useful when preferred stock is issued in lieu of debt.
      - **Convertible Preferred Stock –** Can be converted to common stock.
  - **(2) DEBT SECURITIES**
    - **(A) NOTES, DEBENTURES & BONDS**
      - **Distinction**
        - **Note -** *Traditionally* short term
        - **Bond –** Usually long term secured
        - **Debenture –** Long term unsecured(?)
      - Contract for regular payments regardless of profit, can accelerate, can be regular payments or one lump sum.
      - **Convertible Debentures –** Can be converted to common stock or preferred stock.
      - ***Usually* no voting rights, no fiduciary duties.**
        - DGCL § 221 **–** Authorizes the issuance of debt with voting rights.
      - **Can be issued <u>without shareholder approval.</u>**
    - **(B) OPTIONS**
      - **Stock Option –** Give holder the right but not the obligation to purchase stock at a fixed price during or at a certain time.
        - ***Call Option* –** Right to purchase (more popular
        - ***Put Option* –** Right to sell

- ***Strike (or Exercise) Price* –** Price specified in contract
- ***Maturity (or Expiration) Date* –** Date specified in option contract

- **The Market**
  - **Risk –** Variation in outcomes. **Risk begets higher return.**

- **Dividends v. Debt**
  - **Capital Structure –** The way in which a company has raised funds using equity or debt.
    - DGCL § 244 **– Reduction of capital.** (a) Corp, by rez of BoD, **may reduce capital by** (1) reducing or eliminating capital rep by shares of retired capital stock, (2) applying to an otherwise authorized purchase or redemption of outstanding shares of capital stock some of all of the capital represented by the shares being purchased/redeemed, (3) conversion or exchange, (4) transferring to surplus (i) capital not represented by any particular class of capital stock, (ii) some or all of the capital represented by issued shares of its par value capital stock, which capital is in excess of aggregate par value, or (iii) some of the capital rep by issued shares of capital stock without par value. **(b) No reduction of capital unless assets sufficient to pay debts.**
    - **(1) EQUITY**
      - **Voting Dilution –** Dilution of voting power by introduction of new voting stock
        - **Dual class Stock –** Common with ventures, sets stock with higher voting power
        - **Preemptive Rights –** Right to purchase percentage of stock on new offering. Nowadays usually not found in AoIs, not default rule in Del Bus. C.
      - **Equity Dilution –** Dilution of value by selling under value other stockholder paid.
        - **Can work in reverse.** Sale of stock at higher price -> Equity concentration
      - **Dividends - *Not* tax exempt.**
    - **(2) DEBT**
      - **Leverage** – Ability to earn more interest on borrowed money than the interest cost of borrowed debt.
      - **Benefits**
        - **Tax Effects –** Good for debt, avoids large profits and thus avoids higher taxes
          - **Bond Interest Paid is Deductible.**
        - **Asset Protection –** Debtors get priority, meaning holders safer
        - **ROI –** Super-high for even stockholders, as higher profit means higher return for select stockholders.
          - **CAVEAT:** Failure of system w/ high debt (leverage) -> Insolvency
      - **HIGH RISK.**
      - **Creditors usually have standing if Corp goes bankrupt** to sue based on director behavior, etc.
      - **Defining "Debt" factors:** (1) names given to certificates, (2) presence or absence of a fixed maturity date, (3) source of payments, (4) right to enforce payments of principals and interest, (5) participation in management flowing as a result (6) the status of the contribution in relation to regular corporate creditors, (7) intent of the parties, (8) thin or adequate capitalization, (9) ID of interest between creditor and stockholder (10) source of interest payments (11) ability of corp to obtain loans from outside creditors (12) extent to which the advance was used to acquire capital assets (13) failure of the debtor to repay or seek to postpone the due date. *Slappey Drive Industrial Park v. US*.
        - **Necessary where hybrid securities rampant.** Many corps use hybrid securities to meet particular structure needs.
  - **DISTRIBUTION OF DIVIDENDS or REPURCHASE OF STOCK**
    - **Dividends**
      - **Corporation must have "Surplus" *OR* Net Profits ("Nimble dividend")**
        - **Surplus** – Accumulation of profits during the life of the enterprise.
          - DGCL § 170(a)(1) **– Surplus.** May give dividends from surplus.
          - ***Very* subjective.** Can easily define surplus by re-adjusting values of property, etc.
        - **Net profits** – must be of *last two years*
          - DGCL § 170(a)(2) **– "Nimble Dividend Rule** "May give dividends from surplus net profits.
        - **Can *never* declare dividend that creates insolvency (where R.E. zeroes out Legal Capital)**
          - **Cumulative dividends can just accrue.** I.e. preferred stock.
        - **Duty exclusive to directors.** Cannot force (unless in special close corp situations.
      - DGCL § 173 **–** Dividends may be paid in cash, stock, property, etc. If stock, no less than par.
      - DGCL § 174 **–** J&S liability for directors who willfully or negligently violate rules re: 173
        - DGCL § 172 **–** Directors immune from liability for good faith reliance as to surplusage, etc1.
    - **Stock Repurchase**
      - **Creates treasury stock,** subtracts cash
- **Poison Pill Issuance (SEE T.O. SECTION)**

SECURITIES REGULATION

GENERALLY

- **Regulation of Securities**
  - **Securities Act of 1933 –** Regulates primary public market and has antifraud provisions
  - **Securities Act of 1934 –** Regulates secondary market, requiring continual disclosure with antifraud
    - **Rule 10b-5:**[Unlawful to commit fraud in connection with the sale or purchase of securities]
      - **(1) Material Misstatements/Omissions**
      - **(2) Insider Trading**
      - **(3) Price Manipulation** (false trades)
      - **All require scienter.** Stockholders given implied right to sue.
- **Regulation of Commodities**
  - **Spot Market** (buying *actual* stock) v. **Derivative market** ("gambling" on stock, interest rates, &c.)
  - **Commodity Exchange Act –** Allowed regulation of the "gambling" with commodities, enforcement of debts
    - **CFMA (2000) –** Legalized virtually all forms of "gambling" on derivatives, enforced
  - **Clearing –** Actually putting down cash
    - **Dodd-Frank –** In part seeks to "privatize" the "gambling" by requiring clearing by intermediary.
- **Public Offering** ([Truth in] Securities Act of 1933)
  - **Generally**
    - **Public companies must be registered and may only sell after registration**
    - **Must provide "statutory prospectus":** (1) a description of the company's properties and business; (2) a description of the security to be offered for sale; (3) information about the management of the company; and (4) financial statements certified by independent accountants.
  - **EXCEPTIONS**
    - **(1) Transactions other than Issuer**
      - I.e. secondary sales, sales by brokerage firms, etc -> PRIVATE SALE
    - **(2) Transactions by issuer not involving public offering** (Private placement)
      - Presumably sophisticated purchasers, no need for reg.
    - **(3) Offerings of Limited Size; Intrastate Offerings**(Regulation D)
      - Exempts for "persons resident within" one state by corp "incorporated by and doing business in" state
    - **(4) Securities of Municipal, State, and Federal Governments**
    - **(5) Small offering with streamlined disclosure requirement** (Regulation A)
  - **Punishment: Ability to rescind the entire sale *plus interest***
- **Ex:** Revaluation of corporate assets was proper, even where revaluation created surplusage that allowed corporation to repurchase stock. *Klang v. Smith's Food & Drug.*

PIERCING THE CORPORATE VEIL

GENERAL

- **Focus:** Finding people who abuse corporate structure and holding them liable despite attempt at hiding.
  - **The most litigated issue in business law,** insofar as small corps are concerned.
- **FACTORS**
  - **(1) Disregard of Corporate Formalities –** Neglect of corporate structure, division, etc.
    - **Asset Intermingling –** Mixture of personal and corporate money or affairs
    - **Draining Assets –** May indicate that corporation is sham, used as shield
    - Election of self to BoD, failure to hold meetings, etc.
    - "[H]ave so far neglected the legal requirements [of operating in the corporate form that] they should be taken to have forfeited its protections" Posner in *Browning-Ferris Indus. Of Ill.*
  - **(2) Undercapitalization –** Lack of sufficient financing, etc
    - **Less money, indicating a "fall guy" sort of organization.**
    - **Insurance –** Possibly related to how much responsibility corp actually intends to take. *May moot a claim of undercapitalization.*
    - **Anemic Balance Sheet –**General weakness.
    - "[E]nteprises engaged in potentially hazardous activities should be prevented from externalizing the costs of those activities, by being required to maintain or at least endeavor to maintain a sufficient capital cushion to be answerable in tort" Posner in *Browning-Ferris Indus. Of Ill.*
  - **(3) Complete Control**
    - **One person running the whole show,** etc.
    - **Not supported by Posner as a justification.** May fold into disregard of corp. Formalities?
  - **MISSOURI RULES –** (1) Complete domination by owner of economic, power, stock, etc. (2) Control used by owner to commit wrong. (3) Control and breach of duty must proximately cause injury.
- **Enterprise Liability –** Attacking corporations *as a group* (so multiple corps could be hit if owned by same person or the like)
- **Tort v. Contract Creditors -** Contract cases *tend* to pierce veil more, but this is predominantly because contract claims include common law fraud claims (ex: director tricking third party into believing he is personally guaranteeing loan).
- **Ex:** Veil not pierced where man owned 10 different cab corps where all had limited amounts of insurance, etc. Dissent argues that undercapitalized, mixed-managed nature of corps indicated veil piercing proper. *Walkovszky v. Calton.* Even where company was undercapitalized and carried very little insurance, no piercing. *Radaszewski v. Telecom.*

RIGHTS OF OFFICERS, SHAREHOLDERS, AND DIRECTORS

OFFICER RIGHTS/POWERS (AGENCY LAW)

- DGCL § 142. **Officers; titles, duties, selection, term; failure to elect; vacancies. (a)** Every corporation organized under this chapter shall have such officers with such titles and duties as shall be stated in the bylaws or in a resolution of the board of directors which is not inconsistent with the bylaws and as may be necessary to enable it to sign instruments and stock certificates which comply with §§ 103(a)(2) and 158 of this title. **[Secretary]** One of the officers shall have the duty to record the proceedings of the meetings of the stockholders and directors in a book to be kept for that purpose. [Same person can hold multiple offices] **(b)** Officers shall be chosen in such manner and shall hold their offices for such terms as are prescribed by the bylaws or determined by the board of directors or other governing body. Each officer shall hold office until such officer's successor is elected and qualified or until such officer's earlier resignation or removal. Any officer may resign at any time upon written notice to the corporation. **(c)** The corporation may secure the fidelity of any or all of its officers or agents by bond or otherwise. **(d)** A failure to elect officers shall not dissolve or otherwise affect the corporation. **(e)** Any **vacancy** occurring in any office of the corporation by death, resignation, removal or otherwise, shall be filled as the bylaws provide. In the absence of such provision, the vacancy shall be filled by the board of directors or other governing body.
- **Duties between Principal (P), Agent (A), and Customers/Third Parties (C)**
  - **P -> A –** Money, indemnity
  - **A - > P –** Duty of Care(aka Obedience) and Loyalty
  - **P(a) -> C –** Duty re: Apparent Authority
- **Types of Agency**
  - **(1)*Actual* Authority**
    - Rest. 2d Agency § 26 – "... authority to do an act can be created by written or spoken words or other conduct of the principal which, reasonably interpreted, causes the agent to believe that the principal desires him so to act on the principal's account."
    - **Express –** Granted by contract, etc.
    - **Implied –** Granted by context.
  - **(2)*Apparent* Authority –** Protects third party via reliance.
    - Rest. 2d Agency 27 – "... apparent authority to do an act is created as to a third person by written or spoken words or any other conduct of the principal which, reasonably interpreted, causes the third person to believe that the principal consents to have the act done on his behalf by the person purporting to act for him."
    - *May* give rise to higher burden for third party to investigate authority.
  - **(3)*Ratification* –** Later approval by principal of agent's actions.
    - **Resolution of BoD** generally required.
  - **[4] *Inherent* Authority –** Authority per title itself – "Status-based authority" (like *Respondeat Superior*)
    - Rest. 2d Agency § 161 – agents inherent authority subjects principal to liability for acts which (1) usually accompany or are incidental to transactions which the agent is authorized to conduct if, although they are forbidden by the principal, (2) the other party reasonably believes that the agent is authorized to do them and (3) has no notice that he is not so authorized.
      - ***Koval* rule –** If two innocent parties harmed [by inherent auth issue], loss should fall on party most at fault.
    - Officers **may bind company by acts arising in the usual and regular course of business** but *not* in extraordinary circumstances.
      - **"Extraordinary Circumstances" –** Broad interpretation, but may include massive changes to the corporation, etc.
    - **Cannot** act in a way as explicitly prohibited by BoD or in "Extraordinary" ways/fashions.
    - **"Agency Costs" –** Costs associated with the use of agents where agent may act outside bounds.
    - **Methods of Assuring Authority:** (1) Statutory Law, (2) AoI/CoI, (3) Bylaw of company, (4) Resolution of BoD, (5) evidence that corp has allowed officer to act in similar matters and has recognized, ratified, and approved such actions.
      - **Resolutions as affirmed by secretary w/seal.**
    - ***Variable* depending on nature of BoD:** BoD may set parameters in any manner of ways.
- **Ex:** Inherent authority applied where president of Dage corp signed contract after a series of board rejections, Menard (third party) reasonably relied on president in contract. *Menard v. Dage-MTI*

DIRECTOR RIGHTS/POWERS

- DGCL § 141(b) – Composition of BoD, qualifications (lenient), resignation, etc.
- **Powers**
  - **(1)** Select, compensate [§ 141(h)], and fire officers,
  - **(2)** issue dividends,
  - **(3)** Issue equity and debt securities,
  - **(4)** Buy/sell "Extraordinary" assets, conduct other "Extraordinary" transactions,
  - **(5)** Initiate "Fundamental Corporate Changes" (which later go to the stockholders),
  - **(6)** Change the bylaws [in limited circumstances, as usually granted by AoI] (§ 109(a))
    - Shared with SHs. *CA v. AFSCME*, requiring that power to amend under 109(a) "shall not divest the stockholders ... of ... nor limit" their power.
  - **(7)** Subject to presumption of SH right, fill vacancies. (§ 223(a))
- **Procedure**
  - **(1) Notice –** Reqired by common law in most situations, but not explicitly by DGCL.
    - DGCL § 229. **Waiver of notice.** [When notice req'd] a written waiver, signed by the person entitled to notice, or a waiver by electronic transmission by the person entitled to notice, whether before or after the time stated therein, shall be deemed

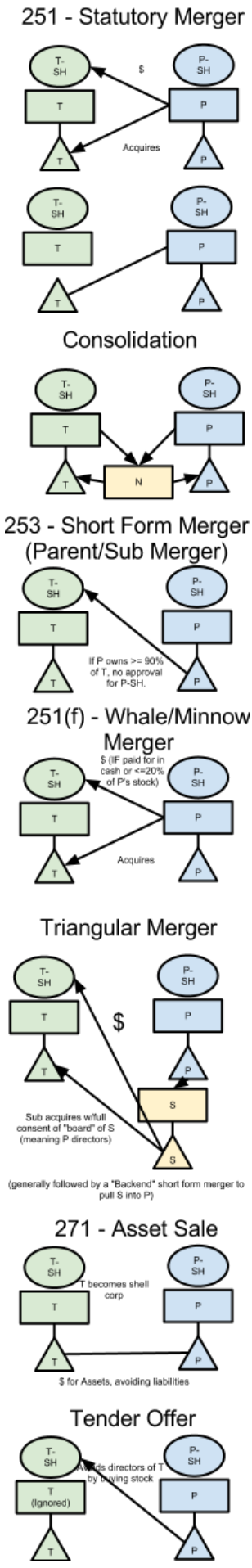
equivalent to notice. Attendance of a person at a meeting shall constitute a waiver of notice of such meeting, except when the person attends a meeting for the express purpose of objecting at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened. [Purpose or business of meeting need not be disclosed in most circumstances]

- **(2) Quorum –** Meeting requires a minimum percentage with a majority vote
  - DGCL § 141(a) **- Quorum can be as low as 1/3,** but majority still required (unless 1-person board).
  - DGCL § 141(j) – Nonstock corp can have less than 1/3 and can be governed differently.
- **(3) Meeting rule. Proxy voting not allowed.** Emphasis on collegiality, formalities, debate ("Meeting Rule")
  - Stockholders empowered to
  - **EXCEPTIONS TO MEETING RULE:** (1) Unanimous Directorial Consent (i.e. no need to meet), (2) Committee Decision, [3] Emergency, [4] Unanimous SH approval(?) [5] Majority shareholder-director approval, [6] *Maybe* decisions by close corps ("custom and practice" in *White v. Thatcher Financial Group*)
  - DGCL § 141(i) -Conference calling allowed.
- **(4) Committees** subvert majority voting for convenience
  - DGCL § 141(c) **–** Governs committees. Very complicated.
  - **Cannot** (1) make fundamental changes alone or (2) make changes to bylaws alone.
  - **Generally** comprised of compensation committees, audit committees, executive committees, etc.
- **(5) Chairman usually sets agenda,** but agenda usually more or less makes itself.

- DGCL § 141(h) **- Allows board to determine compensation alone,** but this is considered a conflict. Usually done by committee, attacked by reformists.

SHAREHOLDER RIGHTS/POWERS

- **Powers:**
  - **(1)** Appointment/Removal of Directors (211(b))
  - **(2)** Remove Directors (141(k))
  - **(3)** Veto or Approve "Fundamental Changes" (**257** [merger/consolidation, subject to rules below], **275** [dissolution], **242** [amendment of CoI], **271** [sale of most/all assets]),
  - **(4)** Change By-laws (**109(a)**)
    - ***Simultaneous* with BoD.** *CA v. AFSCM.* , requiring that BoD power to amend under 109(a) "shall not divest the stockholders ... of ... nor limit" their power.
  - **(5)** Make *nonbinding* ("Precatory") "Resolutions,"
  - **(6)** Repeal of BoD changes to AoI (**109**)
  - **Methods of Voting**
    - **Cumulative Voting –** Vote x Positions. Can be weakened by staggered voting, etc.
    - **Class Voting –** Set up by CoI or the like, establishing different classes of shareholders with different voting powers or different directorial offices.
  - **(1) APPOINTMENT/REMOVAL OF DIRECTORS**
    - **Board proposes nominees, Shareholders vote.**
      - **Rules may allow shareholder proposal.** Requires bylaw amendment. DGCL § 112/113. See section on proxy stuff.
    - DGCL § 141(b) **–** Director's resignation can be declared effective upon events such as failure to receive reelection votes.
    - DGCL § 216 **–** If shareholders have adopted a bylaw am that specifies the amount of vote necessary for election, BoD cannot amend/repeal law.
    - DGCL § 141(k) **–** May be removed with or without cause.
      - **Dispute over whether AoI may limit to only with cause.** No attempts -> Lawyers likely presume disallowed.
      - **"Cause" –**Not having different vision or trying takeover – only actively trying to destroy corp.
        - Can include even some harassment, as in *Campbell v. Loew's*.
        - **Must give** "service of specific charges, adequate notice and full opportunity of meeting the accusation". *Auer v. Dressel.*
      - **Exception:** Staggered boards (DGCL § 141(d)) and cumulative boards, which require cause.
    - **All directors elected at annual meeting,** except for staggered boards.
    - **BoD Size**
      - **Set by Bylaws.** May be modified by DGCL 109.
      - DGCL § 223(a)(1) **- Vacancies** *may* be filled by BoD, but presumptive Shareholder right.
        - **Shareholders always win** in dispute.



- **Cumulative voting** may be enforced here to protect minority shareholders.

- **(3) FUNDAMENTAL CHANGES**
  - **For all:(1) VOTING RIGHTS** and **(2) APPRAISAL FOR STATUTORY MERGER** (262)
  - DGCL § 242 – **["Fundamental Changes"** include (1) changing corp name, (2) change, substitute, enlarge or diminish nature of business or corporate powers or purposes, (3) increase or decrease authorize capital stock or to reclassify it somehow, (4) cancelling or otherwise affecting rights of any class of shares to receive dividends accrued but not declared, (5) creating new classes of stock prior and superior or subordinate or inferior to any existing classes of stock, (6) to change the period of the corp's duration]
  - DGCL § 251 – **Merger**
    - **(1) FORMS OF MERGER**
      - **(1)** DGCL § 251 **Statutory Merger**
        - **THE ONLY FORM THAT ALLOWS APPRAISAL**
        - **Requires:** Both boards to agree, SHs vote with abs. Maj. Of outstanding shares.
        - DGCL § 251 –Majority of outstanding shares (an absolute majority) of P and T must approve the merger.
          - **SUBJECT TO (3) AND (4) as exceptions re:size.**
        - DGCL § 262(b) – **Appraisal rights** available IF (1) entitled to vote on merger and (2) the "market out" exception does not apply.
          - **Appraisal Rights –** Right to "Cash out" and get money for shares where the shareholder wants out given the merger.
          - **SEE BELOW ON PROCEDURE OF APPRAISAL RIGHTS.**
      - **(2) Consolidation.** Rarely used due to major tax implications.
      - **(3)** DGCL § 253 - **Short Form Merger**
        - **Reqs:** 90% or greater ownership of T. No P approval, only T (to protect minority)
        - **Used as a backend for the triangular merger.**
      - **(4)** DGCL § 251(f) - **Whale/Minnow Merger**
        - **Reqs:** Normal merger paid for in cash or less than 20% of outstanding stock (of purchaser). Only T-SH gets voting rights/appraisal
        - **Dilutive issuances** prohibited if over 20% on NASDAQ/NYSE
      - **(5) Triangular Merger**
        - **Requires:** T bd/SH approval, no approval from P (P's bd controls 3rd party corp).
        - DGCL –**P shareholders do not vote. Only O and T shareholders vote**, and O is owned by the BoD. No appraisal rights for P shareholders, but appraisal rights for T shareholders.
      - **(6)** DGCL § 271 - **Asset Sale** (Buyout all stuff owned)
        - DGCL § 271(a) –T shareholders must approve **where "all or substantially all"**, but they do not have appraisal rights.
          - **Must be qualitatively and quantitatively fair.** *Gimbel v. Signal*
          - **"The unusual nature of the transaction must strike at the heart of the corporate existence and purpose."** *Gimbel v. Signal*
          - Conglomerates more likely to be held not selling "substantially all" where selling off a division. *Gimbel v. Signal.*
      - **(7) Tender Offers** (Purchase from T shareholders)
        - DGCL **silent,** but generally P has no appraisal rights, and T shareholders "accept" via selling their shares to P.
        - **Tender Offer =** "If _ tender, then $_ /share"
          - **Avoids holdouts, etc.**
        - Williams Act – Best [same] price rule, Pro rata purchase (per percentage for each stockholder)
          - **(A) DISCLOSURE – (i)** Form 15-d if > 5% owned & **(ii)** disclosure of tender offer
          - **[B] PROTECTIONS**
            - **SHs can change mind.** Allows competition
            - **Minimum period of 20 days open**
            - **Pro rate rule** if over percentage requested
            - **Best Price Rule** – if price raised, applies to everyone
            - **All Holders Rule –** T.O. to ALL shareholders, no discrimination. *May* be able to discriminate based on classes of shares.
          - **(B) DEFENSES**
            - **Repurchase** of shares – i.e. T.O. by corp itself
            - **POSION PILL**
              - **(1)** Issue "preferred" shares *on blank check ability per AOI* or right to purchase preferred shares.
                - **(a) "Flip-in" –** Right to buy stock of same company.
                - **(b) "Flip-over" –** Right to trade stock in for surviving company post-merger

- **Trigger: (i)** If someone gets <10% stock, then everyone but that person gets to flip in, **(ii)** Merger *except* for the parties proposing the merger.
- **(2)** Directors have the power to redeem power at any time and limit the activation of the pill to old directors
  - **"Dead Hand Pill" –** Only "continuing" directors can redeem pill.
  - **"Slow Hand Pill" –** Only directors around for > 6 mos.
  - **BOTH ILLEGAL.**
- **White Knight –** Third party buyer with sweetheart deal like a lockup option
- **Staggered Board ("Shark Repellant")**
- **Greenmail –** Paying off T.O. offeror by offering 3x stock price buyback, etc
- DGCL § 203 – **Higher interested transaction rule** for >5% controlling SHs.
- **NYSE antidilution rule** still applies.

- **(2) APPRAISAL (DGCL § 262)**
  - **(1) Notice** to SHs of Record
  - **(2) Dissent** by SHs *before the vote*
  - **(3) Vote** against
  - **(4)** Upon approval, **tender of shares to corp with demand** for certain price
  - **(5)** Corp **pays** a "Fair price" for shares
    - Not required to pay demanded amount, but SH can sue if unfair.
  - **(!) "Market Out Exception"** – If stock publicly available on NYSE/NASDAQ, corp can tender *other* publicly available stock for payment
    - **From efficient market theory.** Somewhat disputed.
- DGCL § 271 – **Sale of All or Substantially All Assets**
  - **"Substantially All"** – Quality AND quantity. **"Outside the ordinary course of business"** for quality.
  - Division of company, even if large, may not qualify. *Gimbel v. Signal.*
- DGCL § 275 – **Dissolution**
  - **(1)** Board resolves to dissolve AND absolute majority of outstanding shares agree, OR
  - **(2)** Shareholders have unanimous vote to dissolve.
- NYSE – **DILUTIVE ISSUANCE**
  - **If listed on the NYSE, stockholders must vote for issuances greater to or equal than 20%.**
- **FIDUCIARY DUTIES IMPLICATED.** Fair value opinion needed, etc.

- **(6) REPEAL**
  - **Shareholders can repeal certain decisions by BoD.**
- **Stockholder List** maintained per requirement, but purchase through corps like CEDE & co may complicate. CEDE & co allows, upon request, list to be made.

- **Procedure**
  - **Annual and Special Meetings**
    - **(1) Calling a Meeting**
      - **Annual** and **Special** meetings
        - DGCL § 211 –**BoD have obligation to call annual meetings**.
          - DGCL 211(c) - Stockholders may sue for annual meeting if not held in 13 months.
      - DGCL § 211(d) – Stock ownership is not a qualification for calling a meeting; **only BoD or those authorized by CoI may call [special] meetings.**
        - DGCL § 211(b) **- Board has obligation to call yearly.** May also call special meetings.
      - DGCL § 213 **– Record date** – date of determination of eligible shareholders.
      - **Nobo list/etc** necessary to determine who gets info.
    - **(2) Notice**
      - **Date of annual meeting fixed.**
      - DGCL § 222 **–** (a) Notice required with place, date, hour, means of remote comm, etc. **(b) No less than 10 days before, no more than 60.** (c) If adjourned to another place and time, no more notice IF info given at meeting at originally announced place.
      - DGCL § 213(a) **–** Permits but not requires BoD to fix one record date for shareholders to get notice and a *separate* date to determine voting eligibility.
    - **(3) Quorum**
      - DGCL § 216(1) **- Usually a majority of the shares** (unless otherwise provided for, but cannot be less than 1/3**.**
        - DGCL § 216 **– Majority of shares** may amend corp's AoI or bylaws to increase or reduce quorum req.
      - DGCL § 212(a) **–** Unless otherwise specified, one vote per share.
      - DGCL § 141(k) – **Removal of directors requires majority of all shares.**
      - **Exception:** Cumulative Voting (DGCL 214).
        - Each voter gets one vote per seat, allowing minority shareholders to help force BoDs in.
    - **(4) Action by Written Consent**
      - DGCL § 228 **–** Majority of shareholders entitled to vote may do so via written consent (proxy). Default provision.

        - **SEE SECTION BELOW ON <u>PROXY REGS</u>.**
    - **Often removed by AoI.**

FEDERAL PROXY REGULATION

- **Corp sends out <u>proxy form</u> and <u>proxy statement</u>**
    - DGCL § 212 – No time limitation for validity of proxy vote from time of execution.
        - DGCL § 212(d) –Allows any form of writing/fax/whatever for proxy.
    - 14a-13, 14b-1, 14b-2 – Require corp to attempt to communicate with beneficial owners through record owners (i.e. pull CEDE&Co list and find beneficial owners and ask them for vote).
        - NYSE Rule 452 – Brokers may not vote for directors, vote not "routine"
    - 14a-* **- Disclosure requirements.**
    - 14a-9 **– Antifraud provisos.** Material misstatements/omissions.
        - **"Federalizes" corporate law.** Misstatements on proxy statements can become federal issues.
        - **Requires standing, damages, materiality, etc.** Slightly hard to raise.
        - Lying about deliberation can even count. *Gantler v. Stephens*.
    - **<u>E-proxy</u>** now allowed, either under "notice and access" (mailed notice and internet access to vote), "full set delivery" (online and by mail) or some combo.
- **Shareholder Proposals**
    - **Hinges on "proper subject".** Depends on law of state of incorp. *Transamerica.*
    - **Procedural Rules**
        - 14a-8(b) – Requires $2,000 worth of or 1% of shares and eligibility to vote *for at least one year by dare of proposal submision.* Securities must still be held during proposal. Must prove registered holder of securities if not recorded by corp.***90 days before meeting, 120 days before proxy sent.***
        - 14a-8(c) – One proposal per shareholder per meeting.
        - 14a-8(d) – No longer than 500 words.
        - 14a-8(e) – Deadline in last proxy statement, but generally not less than 120 calendar days before date of company's proxy statement.
        - 14a-8(h) – Must actually attend meeting.
        - 14a-8(f) **– If defect,** notice within 14 days UNLESS irremediable issue. If fail to hold number of securities, exclusion allowed for any following two years.
        - **Advance Notice Rules**
            - Special proviso in some bylaws requiring advance notice before nomination of directors.
            - **Sometimes demanded.** Allow company to respond, provides SHs time to contemplate, enables board to make recommendations.
            - **Considered an action against SH rights.** See below.
    - 14a-8(i) **– GROUNDS FOR EXCLUSION**
        - **Burden on company to exclude.** 14a-8(g).
            - **Company may submit to Division of Corporate Finance of the SEC for advice.** Generally looking for interpretation that allows them to omit.
        - (1)**Not proper for action by SHs.**
            - **"Proper" governed by state law.**
            - **No mandates, requirements, etc.** *But* may amend bylaws.
            - *CA v. AFSCME* **– CANNOT REGULATE SUBSTANTIVE DECISIONS, may only regulate <u>procedure</u>** of those decisions.
                - **Substance:** Specific business decisions, expenditure of cash, etc.
                - **Procedure:** Number of directors, number of quorum, vote requirements, reimbursement in proxy contest where fiduciary duties not violated.
        - (2) **Violation of Law –** Causing company to violate some state, federal, or foreign law it is subject to
            - **Including duties re: care, waste, etc.** SHs could not force reimbursement of ALL proposed election expenses in *CA v. AFSCME* because in certain circumstances it would result in waste.
        - (3) **Violation of proxy rules [**false/misleading statements under 14a-9**]**
        - (4) **Personal grievances or special interests. -** "If the proposal relates to the redress of a personal claim or grievance against the company or any other person, or if it is designed to result in a benefit to you, or to further a personal interest, which is not shared by the other shareholders at large;"
        - (5) **Irrelevant.** "relates to operations which account for less than 5 percent of the company's total assets at the end of its most recent fiscal year, and for less than 5 percent of its net earnings and gross sales for its most recent fiscal year, and is not otherwise significantly related to the company's business;"
            - **Cracker Barrel rule.** May allow some proposals re: policy, but disputed. *Lovenheim v. Iroquois Brands* seemingly allows on pate de foie gras issue.
        - (6) **Absence of power/authority [on part of corp]**
        - (7) **Management functions.** "If the proposal deals with a matter relating to the company's **<u>ordinary business operations</u>**;"
            - **Probably does <u>not</u> prohibit <u>public policy</u> issues.** SEC defines as "where proposals involve business matters that are mundane in nature and do not involve any substantial policy or other considerations, the subparagraph may be relied upon to omit them". **Thus, policy probably <u>not</u> omittable under 7.**
        - (8) **Relation to election process/relating to the election of directors**

- **DGCL v. CA v. AFSCME**
  - DGCL §§ 112/113 – Corp can *amend bylaws to* grant shareholders right to include nominees by proxy solicitation, can adopt by-law providing for corporate reimbursement in proxy battle. Adopted after *CA v. AFSCME*.
  - ~~SEC Proxy Access Rule – Substantially similar (sc pp 537), with criteria for eligibility, not available to those seeking takeover, must meet objective criteria for independence, and nominee must file disclosure statement re: relationships.~~
    - **BRT v. SEC –** Tossed out rule, no proof of benefit
  - *CA v. AFSCME* may limit, depending on interpretation of procedural.
  - **General:** Delaware protected territory by 112/113, which requires amendment rather than blanket rule. SEC passed, but was overruled. Some questions as to whether 112/113 actually actable due to *CA v. AFSCME* procedure rule.
- **(9)Directly conflicts with company proposal.**
- **(10) Substantially implemented [already]**
- **(11) Duplication [of another proposal already on record]**
- **(12) Resubmissions [from something submitted in past 5 yrs]**
  - **Exception:** 3/6/9 rule. If get 3% or more of SH in first round, then can resubmit. Then 6%, then 9%.
- **(13) Specific amount of dividends.**

- **Solve issues of** (1) finding other shareholders, (2) sending stuff, and (3) to a lesser degree, "Rational apathy"

- **BOARD ACTION AGAINST SHAREHOLDER RIGHTS**
  - ***Blasius* Rule –** May take defensive maneuvers against shareholder action <u>with compelling justification</u> (like SS/CSI)
    - **Generally:** when directors know a better direction <u>except as to the composition of the board.</u>
    - **Cannot be in bad faith.**
    - **<u>EXCEPTION:</u> Board Composition.** to prevent "platonic masters"
      - **Exception to the exception –** Super SH tender offer.
  - **May limit control of a poison pil via AoI,** but bylaws probably not allowed.
    - **CANNOT AMEND WITH PILL THAT VIOLATES FIDUCIARY DUTY.** *Quickturn*, citing *Revlon*. Idea that "poisoning" future BoDs with limitations forces violation of duty of loyalty, meaning the amendment cannot stand. *Quickturn.*
  - **Defensive maneuvers against takeover likely allowed,** though limited by fiduciary duties.
  - <u>Advance Notice Requirements</u>
    - **Response to widening proxy access rules,** requiring lots of different things, including higher proxy access bar, advance notice to directors before access, etc

- **Ex:** Stockholders properly allowed to propose amendment allowing for only stockholder filling of vacancies by removal, no violation of AoI. *Auer v. Dressel.* Misleading proxies discussing amount of deliberation over proposals violated proxy rules. *Gantler v. Stephens.* Board attempt to pack board in order to prevent possible takeover by 9% shareholder inappropriate – inequitable even though legal. *Blasius.* Delayed redemption provision that would have disallowed new directors to manipulate poison pill proactively violated new director's fiduciary duties, was illegal – but other defensive maneuvers may have been legal. *Quickturn.*

SHAREHOLDER RIGHTS TO INSPECTION

- DGCL § 220 – Allows any stockholder "upon written demand under oath stating the purpose thereof, have the **right during the usual hours for business to inspect for any proper purpose**"
  - **NO REQUIREMENT OF MINIMUM PERCENTAGE,** but some states require.
  - **(1) Written Demand under Oath –** Generally a formality
  - **(2) Proper Purpose –** Even for litigation, but hinges (somewhat) on stockholder's purchase
    - DGCL § 220(b) – ...A proper purpose shall mean a purpose reasonably related to such person's interest as a stockholder...
    - **Purchase of stock for inspection** probably prohibited, but disputed. *State ex rel Pillsbury v. Honeywell* (disallowing)
      - **Social or political policies** probably inspectable in certain circumstances, esp. if related to duties or money
    - **Availability of info from other sources may destroy right.** *Polygon Global*
      - "The scope of inspection should be circumscribed with precision and limited to those documents that are necessary, essential and sufficient to the stockholder's purpose". *Polygon Global.*
    - **Purchase date of stock *not hard cut-off.*** No point limiting inspection to post-purchase info. *Saito v. McKesson HBOC.*
      - **Bar to litigation, *not* to inspection.** Court in *Saito* cedes that one cannot buy a lawsuit, but argues one could inspect to compel boards in other ways.
    - **Generally**
      - **Proper:** Removal of directors, stopping mergers, soliciting purchases of shares, derivative suits, investigating wrongdoing, etc.
      - **Improper:** Harassing the corporation, getting trade secrets, harassing or profiting off SHs, etc.
  - **[3] Subject Matter**
    - **Virtually anything.** Especially used for pre-litigation factfinding.
    - DGCL § 220(c) – **IF SHAREHOLDER LIST, BURDEN SHIFT ON CORP TO PROVE IMPROPER PURPOSE.** High pressure on corp, pending stockholder proves (1) he is a stockholder (2) he complied with the form and manner of 220, and (3) the inspection is for a proper purpose.
      - DGCL § 220(d) – Directors may examine stock ledger, etc for a purpose reasonably related to director's position as director.
    - <u>Cede & Co Breakdown</u> -Breakdown of holdings by CEDE members.

- **NOBO List –** List of Non-objecting Beneficial Owners of funds, etc.

- **Ex:** Stockholders do have the power to remove directors for cause, have the right to fill newly created directorships, and may rightly remove a director from a board where their "cause" is that he intended to make a takeover and, in the process, caused a lot of drama. *Campbell v. Loew's Inc.* Sale of all assets was proper, shareholder of *purchasing* corporation could not recover rights via de facto merger because dissolution of the seller was not necessary, ditto for that of a corp selling all assets and getting stock. *Hariton v. Arco Electronics.*Sale of one major division of company was within powers and not "substantially all" assets, and thus stockholder approval not necessary.*Gimbel v. Signal Companies.* Availability of alternative sources of information defeated proper purpose under 220. *Polygon global*

DIRECTORS' FIDUCIARY DUTIES

DIRECTORIAL FIDUCIARY DUTIES

- **To the shareholders and to the corporation** – sometimes not the same thing.
  - **Directors usually vote in unanimity**. Disagreement usually a sign of something afoot.
  - **Powers generally subject to scrutiny**:(1) Selection of employees, (2) Monitoring employees, (3) Routine stuff (dividends, choosing an auditing firm, etc), (4) Bless "Interested transactions" of officers, (5) React to emergency.
- **Applies to officers, directors, and controlling shareholders**
  - **WAVABLE in partnerships, LLCs.** Depends on jurisdiction, some specific reqs may be unwavable.
- BUSINESS JUDGMENT RULE– *Presumption* [really: standard] that directors acted on an ***informed basis***, in ***good faith*** and the ***honest belief*** that the action taken was in the best interests of the company. Courts will defer to the judgment of the BoD absent *highly unusual circumstances*, such as a conflict of interest or gross inattention. *Aronson v. Lewis*
  - **GROSS NEGLIGENCE STANDARD.** Unless gross negligence, no refutation.
    - ***Van Gorkom*** emphasizes that this is actually violable – before, not worried about too much.
    - **Presumption that Directors are experts re: corp.** Thus, procedure (via BJR) is the real method of judging competency.
  - **(1) "Informed" –** Informed self of all material information reasonably available. -> **PROCESS** -> **DUTY OF CARE**
    - **Substance and Procedure dimensions.** *Van Gorkom*
    - DGCL § 141(e) – "Directors are fully protected in relying in good faith on reports made by officers"
      - **"Board Book" –** book provided to directors before meeting giving info.
      - **"Fair Value Opinion" from investment bank** usually gotten for mergers post-*Van Gorkom*.
        - **Lockup options** may prevent shopping, thus refuting presumption of information re: value of shares.
    - **(A) WASTE.** Seems to be implicit in the "substance" dimension of *Van Gorkom*.
  - **(2) "Bad Faith"** – Acting against SHs to harm them or to harm the corporation. -> **GOOD FAITH** -> **DUTY OF LOYALTY**
    - **Ex:** Intentionally violating law, conscious disregard of duties, intentionally not acting in corp's best interest.
  - **REFUTATION = PERSONAL LIABILITY.**
- **(1) DUTY OF CARE (*not* obedience)**
  - Duty directors owe to act in the corporation's best interests and to exercise reasonable care in making decisions and in overseeing the corporation's affairs.
  - **GENERALLY:** Directors should act in the matter of the ordinary reasonable director. -> ***PROCESS ISSUE.***
    - **(1) BECOME INFORMED** and **(2) REACT TO INFORMATION/TAKE ACTION**
      - **Includes:** Attending meetings, reading financials, knowing work and business of corp, respond to reasonable red flags, monitor other Ds, get outside counsel if necessary. Ex: Drunk wife in *Francis v. United Jersey Bank*.
      - **General presumption even informed decisions will be less than 100% accurate due to RISK.** *In re Citigroup* ("red flags" not enough, especially where procedure generally followed and info known).
      - **Process is incredibly important, no deference to experience.** *Van Gorkom*.
  - **(A) DUTY OF OVERSIGHT (*Caremark* claims)**
    - ***Caremark*** – "Generally where a claim of directorial liability for corporate loss is predicated upon ignorance of liability creating activities within the corporation ... only a **sustained or systematic failure of the board to exercise oversight** – such as an utter failure to attempt to assure a reasonable information and reporting system exists – will establish the lack of good faith that [creates liability]"
      - **Requires internal controls to establish oversight.**
        - **"Internal Controls" –** Monitoring to ensure employee compliance, etc.
        - General duty to monitor corporate affairs and policies, including, to some degree, the financial status of the corp.
      - **NECESSARY CONDITIONS:**
        - **(a)** Directors utterly failed to implement any reporting or information system or controls; **OR** *Stone v. Ritter*.
        - **(b)** having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention. In either case, imposition of liability requires a showing that the directors knew that they were not discharging their fiduciary duties. *Stone v. Ritter*.
        - **Basically bad faith standards.**
  - **(B) DUTY TO AVOID WASTE**
    - Generally, business deference applies. *But* "waste entails an exchange of corporate assets for consideration so disproportionately small as to lie **beyond the range at which a reasonable person might be willing to trade**". *Brehm v. Eisner* (excessive compensation claim struck down)
    - **HIGH BAR.** As long as one is not burning money to the money gods, no issue.
  - **(C) DUTY TO AVOID ILLEGALITY**
    - **Prima facie actual damage, so justification for suit.** *Miller v. AT&T* (illegal campaign donations), etc.
  - **[D] SPECIAL DUTIES DURING HOSTILE TAKEOVER**
    - *UNOCAL* – Creates a special BJR for boards during hostile takeover.
      - UNILATERAL THREAT ONLY. Does not apply IF SH approval (for obvious reasons).
    - ***UNOCAL* HOSTILE TAKEOVER BJR**
      - **(1) Threat to corporation.** Must determine in (i) good faith, (ii) with reasonable investigation, and (iii) ideally by a special board of disinterested directors. [In essence, trad'l BJR in determining threat]
        - **"Threat" –** Can include inadequate price or harm to stockholders.

        - **Does not need to be immediate.** Can be reasonably impending, to some degree.
    - ***Revlon* Auction Exception.** If an auction begins, duty shifts to short term duty to get best price. Thus, if sale is inevitable, must take action to promote.
        - i.e. Legal obligation to maximize share value
        - **Mergers** do not count. Must be a complete sale where office essentially going away.
- **(2) Action reasonable in light of threat.** Must not be excessive, focusing on SHs and stakeholders alike.
    - ***Air Prods* Rule –** Can maintain poison pill to avoid hostile takeover
        - **Requires good faith and no *Revlon* auction.**

- **[E] AVOIDING THE DUTY OF CARE**
    - **(1) EXCULPATION OF LIABILITY**
        - DGCL § 102(b)(7) – AoI can exculpate directors from monetary liability for breach of duty of care, *but not for conduct that is not in good faith or that breaches the duty of loyalty.*
            - **EXCEPTIONS:** (1) Breach of duty of loyalty (2a) Intentional misconduct (2b) Bad faith (3) Violation of 174 [unlawful dividends], (4) Transactions involving improper personal benefits.
            - **Requires AoI incorporation to be effective.**
            - **Limitations:** Breach of loyalty to corp or shareholders, acts or omissions not in good faith, intentional misconduct, knowing violations of law, and transactions which the director has obtained improper personal benefit (like insider trading)
    - **(2) INDEMNIFICATION**

Third Party Suits 145(a)	**If Successful –** *Strong* preference for indemnification, **mandatory** under 145(c).	Requires good faith and reasonable belief act was for corp, + believed to be lawful
	Settlement - Permissive. 145(a), 145(b).	
	Finding of Wrongdoing - Permissive. 145(a), 145(b).	
Corp/Deriv. Suits 145(b)	No indemnification, minus attorney's fees, insurance, etc. Not settlement amount.	N/A

        - DGCL § 145 **–Statutorily authorizes indemnification.**
            - DGCL § 145(a) – **Third party actions.** Permits indemnification of officers, directors, employees, and agents for attorney's fees and other expenses as well as judgments or amounts paid in settlement cases. Requires good faith and reasonable belief to be in best interests of corp.
            - DGCL § 145(b) – **Claims by corporation**. No indemnification, etc, only indemnification for attorney's fees and related expenses. Only generally in derivative suits, and limited to where there was no finding of personal liability of a director.
            - DGCL § 145(f) – **"Nonexclusive",** implying more indemnifications may be allowed.
            - **Issue re: standard required for indemnification.**
            - **Disclosure required of these expenditures**.
        - DGCL § 145(d) **- Permissible methods of declaring indemnity right**: Voting, absolute rule of indemnification, *maybe* ad hoc determinations
        - **Issues**: SHs may end up indemnifying for derivative suits they bring
    - **(3) DIRECTORS AND OFFICERS' (D&O) INSURANCE**
        - **Expanded market to go beyond indemnification.** Includes derivative suits, can coverm ore conduct, etc. Excludes lots of different intentional actions. See pp 717.
        - **No restriction whatsoever in DGCL.** *But* restriction in fact – can't insure intentional torts (including breaches of the duty of loyalty!), etc.
        - DGCL § 145(g)**-** Allows purchase of D&O Insurance.
- **(2) DUTY OF LOYALTY**
    - Duty that requires directors act in the good faith belief that their actions are in the best interests of the corporation and its stockholders rather than in their personal interest.
        - BAD FAITH / LACK OF A HONEST BELIEF SOMETHING IS IN THE BEST INTERESTS OF THE CORP
        - **Intentional tort** and thus uninsurable.
        - **Shifts burden to defendant until disproven.** Thus, 144(a) series defenses incredibly valuable.
    - **(A) DIRECTOR SELF-DEALING**
        - **Gen:** Any dealing to profit oneself. (TRANSACTION -> 141 DEFENSES)
            - **"Self"** – Self, immediate family members, people you owe a fiduciary duty, etc. **BROAD.**
        - **Old:** Absolute voidability of any transaction.
        - **Now: Rule of Fairness.**
            - DGCL § 144(a) **– [Interested transaction may be ratified IF] –**
                - (1) The material facts as to the director's or officer's relationship or interest and as to the contract or transaction are disclosed or are known to the [disinterested] board of **directors** or the committee, and the board or committee in good faith authorizes the contract or transaction by the affirmative votes of a majority of the disinterested directors, even though the disinterested directors be less than a quorum; or
                    - **Presentation by interested director allowed,** but cannot set terms of deal, deceive board, or dominate/control approval of disinterested directors. *Benihana.*

- (2) The material facts as to the director's or officer's relationship or interest and as to the contract or transaction are disclosed or are known to the **stockholders** entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the stockholders; or
  - **"Classic" form required –** SHs must be asked to approve of action directors are already capable of doing minus the CoI in order to approve interested transaction. *Gantler v. Stephens.*
- ~~(3) The contract or transaction is fair as to the corporation as of the time it is authorized, approved or ratified, by the board of directors, a committee or the stockholders.~~
  - **Now: *Common law rule* of fairness that *supplants* 144(a).** *Marciano v. Nakash* (loan favorable to corp need not be ratified, esp. where board split etc)
    - "courts would review such a contract and subject it to rigid and careful scrutiny, and would invalidate the contract if it was found to be unfair to the corporation"
- **If successfully defended with 144(a), RATIFICATION JUDGED BY BJR** (that is, duty of care – waste or BJR issue, no duty of loyalty issue anymore).
- **TWO VOTES if SHs have to vote on issue anyway.** *Gantler.*

- **"Interest"**
  - **Reasons:** Keeping jobs *other than that of director*, making a profit for self or someone you have a fiduciary duty to, immediate family profiting, etc.
    - ***Gantler* –** Directors striving to maintain business rels, so controlling board -> financial interest.
  - **Not Reasons:** Friendship and other "constructive biases", pressure, influence, keeping job as director, *de minimis* interests (i.e. really low amounts of cash).
  - **Voting against alleged interest irrelevant.** Still counted out of vote.

- **(B) CORPORATE OPPORTUNITY DOCTRINE**
  - **Forbids a director, officer, or managerial employee from diverting to himself any business opportunity that "belongs" to the corporation.** Common law doctrine.
    - ***Potential*, not actual harm.** Even if corp may have plausibly rejected opportunity, can still sue.
    - **(1) "Opportunity"** – Business opportunity in which the corporation has an interest for a "Valid and significant corporate purpose". Opp need not be "of the utmost importance to the welfare of the corporation" to be protected.
      - **TESTS – TYPES OF OPPORTUNITIES**
        - **(1) Interest or Expectancy ("Taking" what corp needs or expects)**
          - Corporation has an interest or expectancy to get job.
          - "Something much less tenable than ownership – less than a legal right to exclude independent third parties from acquiring the project, and less even contingent contractual claims"
          - *Nebraska Power* – Diverting hydroelectric dam's water for own uses.
        - **(2) Line of Business ("Competing" with corp)**
          - Prior claim if the opportunity falls within the firm's particular line of business.
          - Where corp has an interest for a "valid and significant corporate purpose" – "need not be 'of the utmost importance to the welfare of the corporation'" but must "fit into the present activities of the corporation or fit into an established corporate policy which the acquisition of the opportunity would forward." *Farber.*
            - Alt: "Sub. Rel" to "Primary purpose". *Farber*
          - Like (1), but involves **realistic evaluation of corporation's ability**, with some understanding that corporations may extend boundaries for safe bets, etc.
          - **Multiple obligations by one person** may result in a more lax test.
          - *Guff* – CFO of drink corp personally buys Pepsi formula offered to him in his capacity as CFO.
        - **(3) Fairness ("Use" of Corp. Resources, including position, for personal gain)**
          - Looks to the fairness of taking advantage of an opportunity
          - *Guff* – Learned of fact BECAUSE CFO.
          - Contra *Johnson v. Greene* – Found patent in same field but in independent capacity.
          - **INSIDER TRADING**
            - **Director "analogous to a fiduciary".** Cannot use inside information, *even if use does not harm corp.* Emphasis on *fairness.*
            - **Delaware law requires *actual harm to corp* for recovery.**
              - Implied harm re:
            - ~~**Federal law allows *without* proof of harm.**~~
              - ~~Rest. 2d Agency § 388 Com. C – 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.~~
              - **Overruled by denial to follow.** *Diamond v. Oreamuno* controversial, possibly pointless.
    - **(2) Allowable Opportunities.**

- **[a] Ratification/Permission by Ds/SHs.** May be like Del. C. 141 functionally.
- **(b) [Lack of] Economic Capacity –** If a corp is financially incapable of exploiting business proposition, no ownership. *Berg v. Horn* Jurisdictions vary on nature of capacity – liquid funds vs other.
  - **But dissent in *Berg*** encourages behavior better than "morals of the marketplace"
- **(c) Corporate Rejection.**
- **(d) DGCL § 122(17) Omnibus waiver.** Certificate of corporation waiving right in specified opportunities.
- **[e] Absence of legal obligation (NY only?).** Where there was no express or implied legal duty to bring business opportunities to corporation.
- **[f] Own time.** No actual involvement of corp whatsoever.

- **Ratification may remove cause of action.**
  - **Implicit Ratification** also possible via *Berg*
  - **May not be ratified by benefitted:** "The violation of their duty by corporate directors cannot be ratified by the action of those who were guilty of participation in the wrongful acts, even though they constitute a majority of the directors or of the stockholders"
- **Remedies –** Benefit held in trust for corp. *Disgorging benefit*, less any sort of added labor(?)
  - **Usurpation of corporate opportunity** may require assessment of both (1) potential and (2) actual profits.

- **[C] PROTECTING AND SELLING CONTROL**
  - **May take many steps to protect corp,** pending their actions (including selective stock repurchases) do not evince that the directors acted "solely or primarily out of a desire to perpetuate themselves in office". *Unocal Corp v. Mesa.*
  - **Where a mere buyout is involved, economic interests govern.** *Revlon v. MacAndrews & Forbes.*
- **[D] Executive and Director Compensation**
  - **Executive Compensation –** Numerous issues raise – "pay for performance", "structural bias" (directors also being CEOs of other corps), jobs being less ethical (Robert French), Competitiveness (winner take all), ratchet effect, etc. *Ceo tenure has gone down since.*
    - **Fed intervention:** '93 – IRC "pay for performance" if over one million leads to more stock issuance to execs. Disclosure rules becoming onerous -> higher. SARBOX -> no personal loans to execs from company (?). Dodd-Frank (2010) S.E.A. 14(a) requires precatory, nonbinding "say on pay" by shareholders.
      - **"Say on Pay" = Ratification?**
  - **Director Compensation** –Usual approach: pay self very little to avoid lawsuit.
    - DGCL § 141(h) - Unless otherwise restricted by the certificate of incorporation or bylaws, **the board of directors shall have the authority to fix the compensation of directors.**

- **(3) EX POST SH RATIFICATION.** Cannot be done without full information, highly unlikely they would if they knew (1) or (2) were violated.
- **Ex:** Where director did not even remotely care about biz where officer was blatantly stealing via "loans", director violated duty of oversight. *Francis v. United Jersey Bank.* Directors, despite their high amount of knowledge, did not have time to learn about the details of the corp enough to appraise buyout offer, violated duties. *Smith v. Van Gorkom ("the Transunion Case").* No duty for Citigroup directors that had some, but not many or substantial, red flags as to MBS practice – risky business, understood risks, etc. *In re Citigroup Shareholder Derivative Litigation.* Caremark factors not met where litigation was over alleged failure re red flags. *Stone v. Ritter.* | Interested deal with financing corporation allowed due to knowledgeable directorial ratification. *Benihana.* Director-family properly gave loan to corp where ratification was impossible due to split board and SH population, and 144(a)(3). *Marciano.* | Where director purchased adjoining land and sold contingent to corp sale instead of offering land to corp first, opportunity taken, ratification null. *Farber v. Servan Land Company.* Liability for use of confidential info for insider trading even if corp not harmed. *Diamond v. Oreamuno.* | Board has the ability to take many steps to prevent takeover where offer clearly levied to screw certain shareholders with junk bonds. *Unocal Corp v. Mesa Petroleum.*

DUTIES OF CONTROLLING SHAREHOLDERS

GENERALLY

- **Controlling shareholders have duties to corporation.** Not similar to that with directors.
- **"Control"**
  - *Generally* means the power to determine the policies of a corporation's business.
  - **Factual inquiry.**
    - ***De jure* control** – 51% Control. Safe route, auto-determination.
    - ***De facto* control** – More or less majority control – ex: controlling major block of publicly traded company. Controversial?
    - ***Incumbency* control** – Incumbent directors and managers with stock hold control via longevity in company.

INTERESTED TRANSACTIONS

- **(1) TRANSACTIONS WITHIN THE CORP**
  - Standard **BJR governs for decisions without self-dealing.**
  - **Intrinsic Fairness standard governs with shareholder self-dealing to *minority* shareholders. *Sinclair Oil***
    - **Fairness** may also be subject to "Fair dealing, fair price" rule of *Winberger*
    - **Hinges on *disparate treatment.*** Equal transactions = no issues with minority shareholders = no problems. *Sinclair Oil*
    - **Ex:** Equal dividends provided to SHs = no issue. *Sinclair Oil.*
- **(2) CASH-OUT TRANSACTIONS**
  - Most litigated issue.
    - Involves a corp SH trying to "cash out" of a corporation by selling it, getting a lot of dividends, etc.
  - **Methods**
    - **(1) Cash-out Merger.** P uses control of S to arrange a merger to push out minority shareholders with cash or in an appraisal (DGCL 262).
    - **(2) Tender offer, then short-form merger.** Buyout of at least 90% of corp, then merging with a short form merger.
    - **(3) Sale to Outside Buyer.** P sells S to outside buyer, where all receive consideration as part of outside merger.
  - ***Weinberger* Rule**
    - **Entire fairness standard.** *Weinberger*
      - **But still some duty on Plaintiff pre-standard:** Must allege "Specific acts of fraud, misrepresentation or other items of misconduct to demonstrate the unfairness of the merger terms to the minority". *Weinberger.*
      - **Approval by DDs, etc shifts burden back to Plaintiff.** Otherwise, fairness must be proven by party proponent of original transaction. **SEE SECTION ON DEFENSES**
      - **Aspects of Fairness (per *Winberger).***
        - **(1) Fair Dealing -** Duty of candor, no rushing, negotiations, etc. Must disclose information, etc.
          - "When the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained." *Weinberger*
          - **Equality of shareholders** a factor in *Lynch II*, but some harm to some shareholders not 100% dispositive.
          - **Initiation not dispositive.** The mere initiation of a transaction does not make it per se unfair, not per se "specter of coercion." *Lynch I/Lynch II.*
        - **(2) Fair Price –** Economic considerations, including assets, market value earnings, etc.
          - "relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock" *Weinberger.*
          - **Valuation via generally accepted financial methods allowed.** Open-ended. ("Open season") *Lynch II.*
          - DGCL § 262 **–** Allows consideration of "all relevant factors" re price.
    - **Defenses**
      - **(1) Approval by Independent Comm. DDs ->** BURDEN SHIFT (D proves fairness, P must refute) *Lynch I/ Weinberger*
        - **PRESUMPTION AGAINST.** Mere burden shift because there is a presumption that the cont. SH dominates even ind. Directors.
        - **Requires information.** Must have full information.
        - **Independent committee approval requires (1)** Majority shareholder not dictate terms of merger AND **(2)** special committee must have real bargaining power. *Lynch I/Weinberger*
          - **Translation:** Must exert *real bargaining power.* The "power to say no".
      - **(2) Approval by Shareholders ->** BURDEN SHIFT (D proves fairness) *Weinberger*(?)
        - **SLIGHT PRESUMPTION AGAINST.** Burden shift reflects presumption that cont. SH will attack minority SHs if given chance.
        - **Requires information.** Must have full information.
        - Even minority shareholders may be pushed out, so great skepticism and entire fairness standard required. *Citron v. EI Du Pont De Nemours.*
        - ***Minority* shareholders** generally, but really cumbersome to determine.
      - **(3) Fairness.** If proven, no issues.

- **Ex:** Where parent is on both sides of a transaction involving a subsidiary, intrinsic fairness standard governs. *Sinclair Oil v. Levien.* Dealing where information withheld from minority shareholders and price questionable resulted in unfair transaction. *Weinberger.* Where independent committee not independent to make terms of merger, entire fairness must still be proven, no burden shifting. *Lynch I.*

SALE OF CONTROL

- **Duty of care to prevent purchaser abuse.**
  - **NEGLIGENCE STANDARD.** Not BJR. "Should have known" standard, generally hinging on proof of knowledge of looting. *Harris v. Carter* (sale to looters).
    - **Incompetence difficult to prove.** Thus, "should have known of incompetence" doesn't exist, probably hinges on proof of actual dangerousness (i.e. looting, etc).
  - "When the circumstances would **alert a reasonably prudent person to a risk that his buyer is dishonest or in some material respect not truthful**, a duty devolves upon the seller to make such inquiry as a reasonably prudent person would make, and generally to exercise care so that others who will be affected by his actions should not be injured by wrongful conduct." *Harris v. Carter.*
    - I.e. **Notice (of dishonesty/etc) -> Duty to Investigate**
- **Duty of loyalty to not explicitly sell good will or control**
  - **Roughly like taking corp. Opportunity.** "Taking" of good will, etc.
  - "When the sale necessarily results in a sacrifice of this element of corporate good will and consequent unusual profits to the fiduciary who has caused the sacrifice, he should account for his gains". *Perlman v. Feldman.*
- **Ex:** Sale to owner who would basically raid company created duty to ensure wrongful conduct would not arise. *Harris v. Carter.* Sale involving control to move steel supply was unjust given the sacrifice of corporate goodwill via exploitation of Korean War era market shortage. *Perlman v. Feldman.*

SALE OF OFFICE

- **Gen:** If sale of control, forcing election OK. Otherwise, not allowed.
- **Illegal to sell office alone.** Generally, can't sell small amount of stock and promise of some office or management control. *Essex v. Yates.*
- **Generally allowed to institute election upon majority sale, *contingent on the ability to elect via working control.***
  - **Thus, majority sale** must include the ability, via classification or otherwise, to win election. But disputed – may be allowed without absolute majority. Dissent thinks it should be a requirement in *Essex v. Yates*
  - ***May* get premium for selling controlling block.** No harm there.
  - **Dispute over *de facto* control issues –** Can they be proven sufficiently to allow forced elections?
  - **BURDEN ON PLAINTIFF to show nonmajority.** *Essex v. Yates.*
- **Ex:** May sell stock contingent on office control, even though this raises worries – but must prove actual ability to elect. *Essex Universal Corp v. Yates.*

CLOSE CORPS

IN CLOSE CORPORATIONS

- **"Close" Corp –** Varies by state, but usually infers some low number of SHs, etc.
- **Special remedies usually the key.** Not uniform or standard, but usually established to circumvent unique issues that spawn from close corps that cannot be remedied by duty requirements.
- **Usual Features**
  - **Class or cumulative voting** may be needed to avoid abuse.
    - **Class Voting –** Stock divided into classes, with each class getting different directors.
    - **Cumulative Voting –** Each share gets directors x share amount of votes, allowing concentration into a single candidate.
      - **DGCL § 214 –** Cumulative voting only available if parties say so in articles.
  - **Preemptive rights to new stock issuances** or other odd contractual agreements may be present
  - **Restrictions on saleability** present in some (esp. family) corps.
- **Family member disputes are common,** and tend to influence judicial decisions.
- **Equal Treatment and Minority Control**
  - **Flexibility given to majority shareholders,** but loss of absolute value of shares may raise eyebrows.
  - **Likely no duty to provide minority shareholders a job,** though complete destruction of share value via loss of job and no dividends (as in *Wilkes*) will piss off the court.
    - **MAY IMPLY DUTY TO DISTRIBUTE DIVIDENDS?** Otherwise never allowed. See *Wilkes v. Springside Nursing*
    - ***Wilkes* Rule:** Complete destruction of share value where some implied agreement to job/etc may create some form of duty. Vague and not uniform. *Wilkes v. Springside*
      - "stockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another" *Donahue* in *Wilkes.*
- **Ex:** Push-out of member who worked on corp with presumption of availability of employment was unjust, inference of longstanding policy of providing employment. *Wilkes v. Springside Nursing Home.* Where shareholder was terminated from employment with no promise of employment or loss of stock value, no breach of fiduciary duty. *Merola v. Exergen Corp.*

SHAREHOLDER LITIGATION

DIRECT SUITS

- **Generally available.** Cover *claims where an individual SH or group of SHs (or individual D, etc) have a claim.* Remedies to the individual plaintiffs, but litigation costs to the individual plaintiffs.
- **Ex:** Fraud to SH inspection right, SH right to attend meeting, single class of stock issues, dissolution & dividend stuff in certain circumstances.

CLASS ACTIONS

DERIVATIVE SUITS

- **Brought on behalf of corporation**, with (often *both*) attoney's fees paid from damages and corp recovering all profits.
  - **Hinges on *rights to the corporation.*** Remedies to the corp, right owned by the corp, etc.
  - DGCL § 141(a) – Business and affairs of corp "shall be managed by or under the direction of" the BoD.
  - **Ex:** Duty of Care, Duty of Loyalty, 100% SH issue, Waste.
- **Requirements**
  - **(1) DEMAND**
    - FRCP 23.1/ Del. Chancery Ct. Rule 23.1 – Requires suit "allege with particularity the efforts, if any, made by the plaintiff to obtain the action plaintiff desires from the directors and the reasons for the plaintiff's failure to obtain the action or for not making the effort".
      - **Demand + Rejection = loss of suit.** BJR governs decisions not to pursue suit.
    - **Demand Futility** - Showing by P that demand was impossible **where Ds made decision.** *Aronson v. Lewis*
      - Only allowed where "Facts are alleged with particularity which create a reasonable doubt that the directors' action was entitled to the protections of the BJR." *Aronson v. Lewis*
      - **REQUIRES PROOF OF DOUBT that**
        - **(1) the directors are disinterested and independent AND** *Aronson v. Lewis.*
          - Basically implies "decision" must be made by DDs if made. **No DDs, no demand necessity**.
          - **Counts:** All disinterested, all approved transaction
          - **Doesn't Count:** Alleged board domination, all directors named as defendants ("bootstrapping")
        - **(2) the challenged transaction was otherwise the product of a valid exercise of the BJR**. *Aronson v. Lewis.*
          - **Need only plead facts,** not evidence. Ex: some extraordinary lack of process, etc.
          - **Inspection rights under** DGCL § 220 allow finding of facts.
          - **In addition to failure at time of transaction.** So BJR would have to apply *both* for the transaction (if applicable) AND the choice not to litigate.
        - **[3] IF DIFFERENT BOARD THAN DECISIONMAKER:** "reasonable doubt that, as of the time the complaint is filed, the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand" *Rales v. Blasband.*
        - **Must plead more than "conclusory allegations".** *Aronson v. Lewis*
      - **SLC (Special Litigation/"*Zapata*" Committee) Modification**
        - SLCs are "independent" boards who make determinations as to whether to pursue suit
        - ***Zapata* two-prong test for honoring SLC determinations**
          - **(1) Independence and good faith of committee.** Burden of proving independence, good faith, reasonable investigation, etc.
          - **(2) Court-determined independent judgment of whether motion [to dismiss derivative suit] should be granted.** Evaluate where corporation is trying to prematurely get rid of stockholder grievance or not.
  - **(2) JUDICIAL OVERSIGHT**
    - **Parameters:** (1) P's lawyer, (2) Terms of settlement, (3) Attorney's fees [not in 23.1, but de facto].
    - FRCP 23/23.1 – Court must **review settlements**, compromises, discontinuance, or dismissals.
      - ***Polk* test:** (1) Probable validity of claims, (2) apparent difficulties of enforcing claims through the courts, (3) collectability of any judgment recovered, (4) delay, expense, and trouble of litigation, (5) amount of compromise as compared with the amount and collectability of a judgment, and (6) views of the parties involved, pro and con.
      - **Strong paranoia in derivative cases of law firm abuse.** Quick settlement for quick cash, etc.
    - **Attorney's Fees**
      - **Allowed for either party for victory.** Generally facilitates such suits.
        - **Generally more likely for plaintiff**
        - **Some courts closely scrutinize.** May lower attorneys fees.
      - **Methods of Calculation**
        - **(a) Lodestar Method.** (Hours x Reasonable hourly rate) = Lodestar. Lodestar x Multiplier (risk, etc)
        - **(b) Percentage of recovery.** Fee as percentage of recovery, usually evaluated against lodestar method as cross-check.
    - **Representation**
      - One line of cases prohibits corporation and individual defendsants being represented by corp counsel.
      - A second approach is to prohibit dual rep when plaintiffs allege fraud, intentional misconduct, or self-dealing.

- **M.R. Prof'l Conduct 1.13 Cmt 13** – Derivative action "may be brought nominally by the organization, but usually is, in fact, a legal controversy over management of the org.
    - **Cmt 14** – If "the claim involves serious charges of wrongdoing by those in control of the organization, a conflict may arise between the lawyer's duty to the organization and the lawyer's relationship with the board"

- **(3) STANDING REQUIREMENTS**
    - **FRCP 23.1/ Del. Chancery Ct. Rule 23.1 –**Requires [1] SH at the time of the transaction/breach/claim, [2] SH at the time of suit (very implicit)
    - **DGCL § 327. Stockholder's derivative action; allegation of stock ownership.** In any derivative suit instituted by a stockholder of a corporation, it shall be averred in the complaint that the plaintiff was a stockholder of the corporation at the time of the transaction of which such stockholder complains or that such stockholder's stock thereafter devolved upon such stockholder by operation of law.