* **AGENCY**
  + **Creation of Agency Relationship:**
    - **AGENCY = fiduciary relationship that arises when (1) the principal manifests assent to the agent that (2) the agent shall act on the principal’s behalf and (3) subject to the principal’s control, and (4) the agent manifests assent/consents so to act. [3rd Restatement, § 1.01]**
      * Agency arises ONLY when these elements are met. Whether are not the parties call it an agency in an agreement is not controlling. [3rd Restatement, § 10.3]
      * Manifestation of assent may be shown by circumstantial evidence, including showing a course of dealing between the two parties. BUT, CONSENT/ASSENT MUST BE EVIDENT. (Jenson Farms v. Cargill)
      * **3 characteristics that may indicate principal-agent relationship (Green v. HR Block):**
        + **The agent’s power to alter the legal relations of the principal;**
        + **The agent’s duty to act primarily for the benefit of the principal; and**
        + **The principal’s right to control the agent.**
        + These 3 factors are not conclusive or exclusive, but just indicators. Entire circumstances should be considered.
      * *Difference from 2nd Restatement = 3rd Restatement provides for manifestation of “assent,” not just “consent” that the 2nd Restatement uses. [Cf. 2nd Restatement §1].*
    - Terminology:
      * 3 Basic Forms of Agency (Gorton v. Doty) – **THE 3RD RESTATEMENT DROPS THESE DISTINCTIONS.**
        + (1) principal and agent
        + (2) master and servant

*2nd Restatement Definitions (§2):*

*Master = Principal who (1) employs an agent to perform service in his affairs and (2) controls or has the right to control (3) the physical conduct of the other in performance of the service.*

*Servant = An agent (1) employed by a master (2) to perform service in his affairs (3) whose physical conduct in the performance of the service is (4) controlled or subject to control by the master.*

* + - * + (3) employer or proprietor and independent contractor

*2nd Restatement Definitions (§2):*

*One who (1) contracts to act on behalf of another and (2) subject to the other’s control (3) except with respect to his physical conduct, is an agent and also an independent contractor.*

* + - * **Co-Agents** = Agents that have agency relationships with the same principal. [3rd Restatement, §1.04(1)]
      * **Disclosed Principal** = A principal is disclosed if (1) when an agent and a 3rd party interact, (2) the 3rd party has notice that the agent is acting for a principal and (3) has notice of the principal’s identity. [3rd Restatement, §1.04(2)(a)].
      * **Undisclosed Principal** = A principal is undisclosed if (1) when an agent and 3rd party interact, (2) the 3rd party has no notice that the agent is acting for a principal. [3rd Restatement, §1.04(2)(b)].
      * **Unidentified Principal** = A principal is unidentified if, (1) when an agent and a 3rd party interact, (2) the 3rd party has notice that the agent is acting for a principal (3) but does not have notice of the principal’s authority. [3rd Restatement, §1.04(2)(c)].
      * **Gratuitous Agent** = Agent acts without a right to compensation. [3rd Restatement, §1.04(4)].
      * **Power Given as Security** = A power to (1) affect the legal relations of its creator (2) that is created in the form of a manifestation of actual authority and (3) held for the benefit of the holder or a 3rd person. [3rd Restatement, §1.04(5)].
      * **Subagent** = A person (1) appointed by an agent (2) to perform functions that the agent has consented to perform (3) on behalf of the agent’s principal and (4) for whose conduct the appointing agent is responsible to the principal. (5) The relationship between an appointing agent and a subagent is one of agency. [3rd Restatement, §1.04(8)].
      * **Superior and Subordinate Co-Agents** = A superior co-agent has (1) the right, (2) conferred by the principal, (3) to direct a subordinate co-agent. [3rd Restatement, §1.04(9)].
    - Special Cases:
      * Agent v. Supplier
        + *One who (1) contracts to acquire property from a 3rd person and (2) convey it to another is the agent of the other (3) only if it is agreed that he is to act primarily for the benefit of the other (4) and not for himself. [2nd Restatement, §14K]*
        + Factors that indicate supplier, not agent (Jenson Farms v. Cargill):

That he is to receive a fixed price for property.

That he acts in his own name and receives title to the property which he is then to transfer.

That he has an independent business in buying and selling similar property.

* + - * Principal v. Creditor
        + *A creditor who (1) assumes control of his debtor’s business (2) for the mutual benefit of himself and the debtor, may become a principal, with liability for the acts and transactions of the debtor in connection with the business. [2nd Restatement, §14O]*
        + The point at which the creditor becomes a principal is when he assumes de facto control over the conduct of his debtor, regardless of the terms of the formal contract. (Jenson Farms v. Cargill)
  + **Principal’s Liability in Contract**
    - Basic Idea: A principal will be liable to 3rd parties in contract if his agent has authority to effect the contract. Authority may come from:
      * Actual Authority – Express and Implied
      * Apparent Authority
      * Inherent Authority
    - **Actual Authority** 
      * **Def. = An agent acts with actual authority when (1) at the time of taking action that has legal consequences for the principal, (2) the agent reasonably believes, (3) in accordance with the principal’s manifestations to the agent, (4) that the principal wishes the agent so to act. [3rd Restatement §2.01]**
      * **Creation: Actual authority is created by (1) a principal’s manifestation to agent that (2) as reasonably understood by the agent, (3) expresses the principal’s assent that (4) the agent take action on the principal’s behalf. [3rd Restatement §3.01]**
        + TEST = “Would a reasonable person in the agent’s position interpret the principal’s communication to encompass a particular act?”
        + Includes both express and implied – 3rd Restatement drops the distinction.
      * POWERS OF AGENCY ARE CONSTRUED NARROWLY. (Williams v. Dugan). **Scope of Actual Authority:**
        + **An agent has actual authority to (1) take action designated or implied in the principal’s manifestations to the agent and (2) actions necessary or incidental to achieving the principal’s objectives, (3) as the agent reasonably understands the principal’s manifestations and objectives (4) when the agent determines how to act. [3rd Restatement §2.02]**
        + What is “reasonable”:

Agent’s interpretation of the principal’s manifestation is reasonable if (1) it reflects any meaning known to the agent to be ascribed by the principal and (2) in the absence of any meaning known to the agent, (3) as a reasonable person in the agent’s position would interpret the manifestations in light of the context, including circumstances of which the agent has notice and the agent’s fiduciary duty to the principal. [3rd Restatement §2.02(2)]

An agent’s understanding of the principal’s objectives is reasonable if (1) it accords with the principal’s manifestations and (2) the inferences that a reasonable person in the agent’s position would draw from the circumstances creating the agency. [3rd Restatement §2.02(3)]

* + - **Apparent Authority:**
      * **Def = The power held by an agent or other actor (1) to affect a principal’s legal relations with 3rd parties when (2) a 3rd party reasonably believes the actor has authority to act on behalf of the principal and (3) that belief is traceable to the principal’s manifestations. [3rd Restatement §2.03]**
      * **Creation: Apparent authority is created by (1) a person’s manifestation that (2) another has authority to act with legal consequences (3) for the person who makes the manifestation, (4) when a 3rd party reasonably believes the actor to be authorized and (5) the belief is traceable to the manifestation. [3rd Restatement §3.03]**
      * 3 possible ways to establish apparent authority (Essco Geometric v. Harvard Industries):
        + By the principal expressly and directly telling a 3rd person that a second authority to act on the principal’s behalf.
        + By prior acts.
        + By position.
    - **Inherent Authority**
      * **Term NOT used in the 3rd Restatement.** 
        + *Difference from 2nd Restatement: 2nd said a general agent has inherent authority to act for a principal regarding acts done on the principal’s account which usually accompany or are incidental to transactions which the agent is authorized to conduct if the 3rd party reasonably believes the agent is authorized to do them, even if the acts are forbidden by the principal. [§161]*
    - **Ratification**
      * **Def. = Ratification is the (1) affirmance of a prior act done by another, (2) whereby the act is given effect as if done by an agent acting with actual authority. [3rd Restatement §4.01(1)]**
      * Occurs by: A person ratifies an act by (1) manifesting assent that the act shall affect the person’s legal relations, or (2) conduct that justifies a reasonable assumption that the person so consents. [3rd Restatement §4.01(2)]
        + But, a person is not bound by a ratification made WITHOUT KNOWLEDGE of material facts involved in the original act when the person was unaware of such lack of knowledge. [3rd Restatement §4.06]
        + Ratification must occur for the ENTIRE act – no partial ratifications. [3rd Restatement §4.07]
      * Timing: Generally, if the principal ratifies, the relevant time for determining legal consequences is the time of the agent’s act (RETROACTIVE). [3rd Restatement §4.02]
        + Exceptions: Ratification is not effective [3rd Restatement §4.02]:

In favor of a person who causes it by misrepresentations or other conduct that would make a contract voidable.

In favor of an agent against a principal when the principal ratifies to avoid a loss; or

To diminish the rights or other interests of other persons, not parties to the transaction, that were acquired before ratification.

* + - **Estoppel:**
      * **= A person who has (1) not made a manifestation that an actor has authority as an agent and (2) who is not otherwise liable as a party to a transaction purportedly done by the actor on that person’s account (3) is subject to liability to a 3rd party who is (4) justifiably induced to make a (5) detrimental change in position (6) because the transaction is believed to be on the person’s account, if (6) the person intentionally or carelessly caused such belief, or having notice of such belief and that it might induce others to change their positions, the person did not take reasonable steps to notify them of the facts. [3rd Restatement §2.05]**
      * Special cases:
        + Where a proprietor of a place of business, by his dereliction of duty, enables one who is not his agent to act as such, the proprietor cannot escape liability for the loss sustained by the customer. (Hoddeson v. Koos Bros.)
  + **Agent and Principal’s Liability to 3rd Persons**
    - **GENERAL RULE: IN ORDER FOR AN AGENT TO AVOID PERSONAL LIABILITY ON A CONTRACT NEGOTIATED IN HIS PRINCIPAL’S BEHALF, HE MUST IDENTIFY HIS PRINCIPAL. THE DUTY TO DISCLOSE IS ON THE AGENT. (Van D. Costas, Inc. v. Rosenberg)**
      * The disclosure of agency must embrace the name of the principal – use of a trade name is not sufficient. (Van D. Costas, Inc. v. Rosenberg)
    - **When the Agent is acting for a Disclosed Principal (Rstmt. 3rd Agency § 6.01)**
      * When an agent acting with actual or apparent authority makes a contract on behalf of a disclosed principal:
        + The principal and third party are parties to the contract; and
        + The agent is NOT a party to the contract unless the agent and third party agree otherwise.
    - **When the Agent is acting for an Unidentified Principal (Rstmt. 3rd Agency §6.02)**
      * When an agent acting with actual or apparent authority makes a contract on behalf of an unidentified principal:
        + The principal and the third party are parties to the contract; and
        + The agent IS a party to the contract unless the agent and the third party agree otherwise.
      * *Traditional Rule: Liability is joint and several.*
    - **When the Agent is acting for an Undisclosed Principal (Rstmt. 3rd Agency §6.03)**
      * When an agent acting with actual authority makes a contract on behalf of an undisclosed principal:
        + Unless excluded by contract, the principal is a party to the contract;
        + The agent and the third party are parties to the contract;
        + All parties have the same rights, liabilities and defenses against each other as if the principal made the contract personally.
      * *Traditional Rule: Liability is NOT joint and several between agent and principal.*
    - **Agent’s Implied Warranty of Authority (Rstmt. 3rd Agency § 6.10)**
      * A person who purports to make a contract, representation or conveyance to or with a third party on behalf of another person, lacking power to bind that person, gives an implied warranty of authority to the third party, and is subject to liability to the third party for damages for loss caused by breach of that warranty, including loss of the benefit expected from performance by the principal, unless:
        + The principal or purported principal ratifies the act; or
        + The person who purports to make the contract . . . gives notice to the third party that no warranty of authority is given; or
        + The third party knows that the person who purports to make the contract . . . acts without actual authority.
  + **Fiduciary Duty – Agent’s Duties to Principal** 
    - **GENERAL RULE: AN AGENT HAS A FIDUCIARY DUTY TO ACT LOYALLY FOR THE PRINCIPAL’S BENEFIT IN ALL MATTERS CONNECTED WITH THE AGENCY RELATIONSHIP. (Rstmt. 3rd Agency §8.01)**
    - **Fiduciary Duties Include:**
      * **Not acquiring material benefit from a 3rd party –**
        + An agent has a duty not to acquire a material benefit from a third party in connection with transactions conducted or other actions taken on behalf of the principal or otherwise through the agent’s use of the agent’s position. (Rsmt. 3rd Agency § 8.02)
      * **Not acting as or on behalf of an adverse party –**
        + An agent has a duty not to deal with the principal as or on behalf of an adverse party in a transaction connected with the agency relationship. [3rd Restatement, §8.03].

BUT, ministerial acts that require no exercise of discretion are okay. (§8.03, comment B)

* + - * **Not competing with the principal –**
        + Throughout the duration of the agency relationship, an agent has a duty to refrain from competing with the principal and from taking action on behalf of or otherwise assisting the principal’s competitors. During that time, an agent may take action, not otherwise wrongful, to prepare for competition following termination of the agency relationship. (Rstmt. 3rd Agency §8.04).
      * **To not use the principal’s property or confidential information –**
        + An agent has a duty (Rstmt. 3rd Agency § 8.05):

NOT to use property of the principal for the agent’s own purposes or those of a third party; and

NOT to use or communicate confidential information of the principal for the agent’s own purposes or for those of a third party.

* + - * **To act in accordance with contract between agent and principal -**
        + An agent has a duty to act in accordance with the express and implied terms of any contract between the agent and the principal. (Rstmt. 3rd Agency § 8.07)
      * **To act with care, competence and diligence –**
        + Subject to any agreement with the principal, an agent has a duty to the principal to act with the care, competence and diligence normally exercised by agents in similar circumstances.
        + Special skills or knowledge possessed by an agent are circumstances to be taken into account in determining whether the agent acted with due care and diligence. If an agent claims to possess special skills or knowledge, the agent has a duty to the principal to act with the care, competence and diligence normally exercised by agents with such skills or knowledge. (Rstmt. 3rd Agency §8.08).
      * **To act only within scope of actual authority and comply with the principal’s lawful instructions –**
        + An agent has a duty to take action only within the scope of the agent’s actual authority.
        + An agent has a duty to comply with all lawful instructions received from the principal and persons designated by the principal concerning the agent’s actions on behalf of the principal. (Rstmt. 3rd Agency §8.09)
      * **Duty to act in good conduct –**
        + An agent has a duty, within the scope of the agency relationship, to act reasonably and to refrain from conduct that is likely to damage the principal’s enterprise. (Rstmt. 3rd Agency § 8.10)
      * **Duty to provide information –**
        + An agent has a duty to use reasonable effort to provide the principal with facts that the agent knows, has reason to know, or should when

Subject to any manifestation by the principal, the agent knows or has reason to know that the principal would wish to have the facts or the facts are material to the agent’s duties to the principal; and

The facts can be provided to the principal without violating a superior duty owed by the agent to another person. (Rstmt. 3rd Agency §8.11)

* + - * **Duty regarding principal’s property –**
        + An agent has a duty, subject to any agreement with the principal,

Not to deal with the principal’s property such that it appears to be the agent’s property;

Not to mingle the principal’s property with anyone else’s; and

To keep and render accounts to the principal of money or other property received or paid out on the principal’s account. (Rstmt. 3rd Agency § 8.12)

* + - **The principal may consent to agent’s actions that would otherwise constitute a breach (Rstmt. 3rd Agency § 8.06):**
      * Conduct by an agent that would otherwise constitute a breach of duty does not constitute a breach of duty if the principal consents to the conduct, provided that:
        + In obtaining the principal’s consent, the agent:

Acts in good faith,

Discloses all material facts that the agent knows, has reason to know, or should know would reasonably affect the principal’s judgment, unless the principal has manifested that such facts are already known by the principal or that the principal does not wish to know them, and

Otherwise deals fairly with the principal; and

* + - * + The principal’s consent concerns either a specific act or transaction that could reasonably be expected to occur in the ordinary course of the agency relationship.
      * An agent who acts for MORE THAN ONE PRINCIPAL in a transaction between or among them has a duty:
        + To deal in good faith with each principal,
        + To disclose to each principal

The fact that the agent acts for the other principal(s), and

All other facts that the agent knows, has reason to know, or should know would reasonably affect the principal’s judgment, unless the principal has manifested that such facts are already known by the principal or that the principal does not wish to know them, and

* + - * + Otherwise to deal fairly with each principal.
    - **Principal’s Remedies when Agent Breaches Fiduciary Duty:**
      * **Actual injury is not necessary for a principal’s remedy – a violation of the fiduciary duty is enough for a remedy. (Tarnowski v. Resop).**
      * When the agent acquires material benefit from a 3rd party, the principal may recover monetary relief from the agent (value of benefit received from agent or damages for harm caused (that is reasonably foreseeable) from 3rd party). May have deduction for expenses agent incurred to get benefit. (Rsmt. 3rd Agency §8.02, comment E).
  + **Principal’s Duties to his Agent**
    - **Includes:**
      * **Duties created by contract –**
        + A principal has a duty to act in accordance with the express and implied terms of any contract between the principal and the agent. (Rstmt. 3rd Agency §8.13)
      * **Duty to pay reasonable compensation –**
        + Unless an agreement between a principal and agent indicates otherwise, a principal has a duty to pay compensation to an agent for services that the agent provides (but this does not extend to paying subagents, unless the principal agrees). (Rstmt. 3rd Agency §8.13 Comment D)
      * **Duty to indemnify –**
        + A principal has a duty to indemnify an agent

In accordance with the terms of any contract between them; and

Unless otherwise agreed,

When the agent makes a payment

Within the scope of the agent’s actual authority, or

That is beneficial to the principal, unless the agent acts officiously in making the payment; or

When the agent suffers a loss that fairly should be borne by the principal in light of the relationship. (Rstmt. 3rd Agency § 8.14).

* + - * **Duty to deal fairly and in good faith –**
        + A principal has a duty to deal with the agent fairly and in good faith, including a duty to provide the agent with information about risks of physical harm or pecuniary loss that the principal knows, has reason to know, or should know are present in the agent’s work but unknown to the agent. (Rstmt. 3rd Agency §8.15).
        + A principal has a duty to refrain from conduct likely to injure the agent’s business reputation or reasonable self-respect. (Rstmt. 3rd Agency §8.15 Comment D).
  + **Termination of Agency Relationship**
    - **Causes of Termination (Rstmt. 3rd Agency §3.06):**
      * **The agent’s death, cessation of existence, or suspension of powers; or**
      * **The principal’s death, cessation of existence, or suspension of powers; or**
        + Note: Termination is effective only when the agent has notice of the principal’s death. (Rstmt. 3rd Agency §3.07)
      * **The principal’s loss of capacity; or**
        + Note: Termination is effective when the agent has notice that the principal’s loss of capacity is permanent or that the principal has been adjudicated to lack capacity. (Rstmt. 3rd Agenct § 3.08)
      * **An agreement between the agent and the principal or the occurrence of circumstances on the basis of which the agent should reasonably conclude that the principal no longer would assent to the agent’s taking action on the principal’s behalf; or**
      * **A manifestation of revocation by the principal to the agent, or of renunciation by the agent to the principal; or**
        + Notes (Rstmt. 3rd Agency §3.10):

Revocation or renunciation is effective when the other party has notice of it.

Revocation, unless otherwise agreed, is ineffective to terminate a power given as security or to terminate a proxy to vote securities or other membership or ownership interests that is made irrevocable in compliance with applicable legislation.

* + - * **The occurrence of circumstances specified by statute.**
  + **Miscellaneous**
    - **NOTICE**
      * **In General (Rstmt. 3rd Agency § 5.01):**
        + **(3) A person has notice of a fact if he knows the fact, has reason to know the fact, has received an effective notification of the fact, or should know the fact to fulfill the duty owed to another person.**
        + Notification:

(1) A notification is a manifestation that is made in the form required by agreement among parties or by applicable law, or in a reasonable manner in the absence of an agreement or applicable law, with the intention of affecting the legal rights and duties of the notifier in relation to rights and duties of persons to whom the notification is given.

(2) A notification given to or by an agent is effective as notification to or by the principal.

(4) Notice of a fact that an agent knows or has reason to know is imputed to his principal.

* + - * **Notification given by or to an Agent (Rstmt. 3rd Agency §5.02)**
        + A notification given to an agent is effective as notice to/given by the principal if the agent has actual or apparent authority to receive/give the notification, unless the person who gives the notification knows or has reason to know that the agent is acting adversely to the principal.
      * **Imputation of Notice of Fact to a Principal (Rstmt. 3rd Agency §5.03)**
        + For purposes of determining a principal’s legal relations with a third party, notice of a fact that an agent knows or has reason to know is imputed to the principal if knowledge of the fact is material to the agent’s duties to the principal, unless the agent:

Acts adversely to the principal, or

Is subject to a duty to another not to disclose the fact to the principal.

* + - * + Notice will STILL BE IMPUTED from an agent who acts adversely to a principal if (Rstmt. 3rd Agency §5.04):

Necessary to protect the rights of a third party who deals with the principal in good faith; or

When the principal has ratified or knowingly retained a benefit from the agent’s action.

* **PARTNERSHIP LAW**
  + **Partnership Formation**
    - **GENERAL RULE: The association of two or more persons to carry on as co-owners a business for profit forms a partnership, whether or not the persons intend to form a partnership. (RUPA § 202).** 
      * This means that a partnership can be created informally – no written agreement or organizational documents must be filed with the state.
      * The Court will look at whether the parties INTENDED TO DO THE ACTS IN LAW THAT CONSTITUTES A PARTNERSHIP. (Beckman v. Farmer). Intent can be express or implied from actions. (Ziegler v. Dahl)
      * Factors to consider in determining if there is a partnership
        + From RUPA §202:

Joint tenancy, tenancy in common, common property, joint property or part ownership does not by itself establish a partnership, even if co-owners share profits made by the use of the property.

The sharing of gross receipts by itself does not establish a partnership.

A person who receives a share of profits of a business is presumed to be a partner in the business, unless the profits were received in payment:

Of a debt;

For services as an independent contractor or of wages or other compensation to an employee;

Of rent;

Of an annuity or other retirement or health benefit to a beneficiary, representative, or designee of a deceased or retired partner;

Of interest or other charge on a loan, including rights to income; or

For the sale of the goodwill of a business or other property by installments or otherwise.

* + - * + **Common Law factors (Schlumberger v. Swanson) – consider evidence of any/all guideposts:**

**An agreement to share profits (MOST IMPORTANT INDICATOR);**

**An agreement to share losses;**

**A mutual right of control or management of the enterprise; and**

**A community of interest in the venture.**

* + - **Partnership by Estoppel:**
      * **General Rule: Partners are liable when they represent that they are part of a partnership. (RUPA § 308):**
        + If a person, by words or conduct, purports to be a partner, or consents to being represented by another as a partner, in a partnership with one or more persons not partners, the purported partner is liable to a person to whom the representations is made (or to someone that hears the representation, if made in public), if that person, relying on the representation, enters into a transaction with the actual or purported partnership.
        + If partnership liability results, the purported partner is liability as if they were a partner. If no partnership liability results, the purported partner is liable with respect to that liability jointly and severally with any other persons consenting to the representation.
      * **When credit is extended on the belief of a partnership: A remedy will be given if (Cheesecake Factory v. Baines):**
        + **The credit was extended on the basis of partnership representations; or**

*Ask: What it reasonable for this to be one of the factors on which credit was granted?*

* + - * + **The alleged partner must have made or consented to representations being made in a public manner.**
    - **Partnership Agreement**
      * **Except as otherwise provided, relations among the partners and between the partners and the partnership are governed by the partnership agreement. To the extent the partnership agreement does not provide otherwise, RUPA governs relations among the partners and between the partners and the partnership. (RUPA §103).**
      * **The partnership agreement MAY NOT (RUPA §103):**
        + **Vary the rights and duties under Sect. 105 except to eliminate the duty to provide copies of statements to all the partners;**
        + **Unreasonably restrict the right of access to books and records;**
        + **Eliminate the duty of loyalty, but:**

The partnership agreement may identify specific types or categories of activities that do not violate the duty of loyalty, if not manifestly unreasonable; or

All of the partners or a number or percentage specified in the partnership agreement may authorize or ratify, after full disclosure of all material facts, a specific act or transaction that would otherwise violate the duty of loyalty.

* + - * + **Unreasonably reduce the duty of care;**
        + **Eliminate the obligation of good faith and fair dealing,** but the partnership agreement may authorize or ratify, after full disclosure of all material facts, a specific act or transaction that otherwise would violate the duty of loyalty;
        + **Vary the power to dissociate as a partner;**
        + **Vary the right of a court to expel a partner;**
        + **Vary the requirement to wind up the partnership business; or**
        + **Restrict the rights of third parties.**
    - **Capital Contribution**
      * **A contribution of cash, property or personal services** (if there is an express/implied agreement regarding such) **by a partner may count as capital contribution and create a right to share in partnership profits. (Schmanski v. Coventz)**
  + **Partnership as an Entity**
    - **General Rule: A partnership is an entity distinct from its partners. (RUPA §201).**
    - **What this means:**
      * **A partnership may sue and be sued in the name of the partnership. (RUPA §307).**
        + A judgment against a partnership is not by itself a judgment against a partner – a judgment against a partnership may not be satisfied from a partner’s assets unless there is also a judgment against the partner. (RUPA §307)
        + An action can be brought against the partnership and or all of the partners in the same or separate actions. (RUPA §307).
        + A judgment creditor of a partner may not levy execution against the assets of the partner to satisfy a judgment based on a claim against the partnership UNLESS the partner is personally liable for the claim AND:

A judgment based on the same claim has been obtained against the partnership and a writ of execution on the judgment has been returned at least partially unsatisfied;

The partnership is a debtor in bankruptcy;

The partner has agreed that the creditor need not exhaust partnership assets;

A court grants permission to the judgment creditor to levy execution against the assets of a partner… ; or

Liability is imposed on the partner or by contract independent of the existence of the partnership

* + - * + *Old UPA Law: A partnership is viewed as an aggregate of partners rather than an entity, so not clear whether a partnership could sue to enforce its own rights or be sued as a separate entity.*
      * **A partner is an agent of the partnership for the purposes of its business. An act of a partner, including the execution of an instrument in the partnership name, for apparently carrying on in the ordinary course of the partnership binds the partnership . . . (RUPA § 301).**
        + The partnership is NOT BOUND if the partner had no authority to act for the partnership in the particular matter AND the person with whom the partner was dealing knew or had received a notification that the partner lacked authority. (RUPA §301).
        + An act of a partner which is not apparently for carrying on in the ordinary course the partnership business or business of the kind carried on by the partnership binds the partnership ONLY if the act was authorized by the other partners. (RUPA § 301).
      * **Transferability of Partnership Interests**
        + **General Rule: The only transferable interest of a partner in the partnership is the partner’s share of the profits and losses of the partnership and the partner’s right to receive distributions. The interest is personal property. (RUPA § 502).**
        + Effect of Transfer (RUPA §503):

**Upon transfer, the transferor retains the rights and duties of a partner other than the interest in distributions transferred.**

A transfer, in whole or in part, of a partner’s transferable interest in the partnership:

Is permissible;

Does not by itself cause the partner’s dissociation or dissolution and winding up of the partnership’s business; and

Does not, as against the other partners or the partnership, entitle the transferee during the continuance of the partnership, to participate in the management or conduct of the partnership business, to require access to information concerning partnership transactions, or to inspect or copy the partnership books or records.

A transferee of a partner’s transferable interest in the partnership has a right:

To receive, in accordance with the transfer, distributions to which the transferor would otherwise be entitled;

To receive upon the dissolution and winding up of the partnership business, in accordance with the transfer, the net amount otherwise distributable to the transferor; and

To seek a judicial determination that it is equitable to wind up the partnership business.

In a dissolution and winding up, a transferee is entitled to an account of partnership transactions only from the date of the latest account agreed to by all partners.

* + **Rights of Partners**
    - **Every partner has the right to perform the partnership’s business and to participate in the management of the partnership. (RUPA §401).**
    - **Partners have equal voting power (default rule = 1 partner = 1 vote).**
      * A difference arising as to a matter in the ordinary course of business of a partnership may be decided by a majority of the partners. An act outside the ordinary course of business of a partnership and an amendment to the partnership agreement may be undertaken only with the consent of all the partners. (RUPA §401).
    - **Partners share equally in the profits and losses of the partnership (RUPA §401).**
      * **Default rule = losses apportioned in the same ratio as profits.**
        + If there is an agreement as to profits but not losses, losses follow profits.
        + If there is no agreement of any kind, both profits and losses are split equally among the partners.
      * Each partner is deemed to have an account that is (RUPA §401):
        + Credited with an amount equal to the money plus the value of any other property, net the amount of any liabilities, the partner contributes to the partnership and the partner’s share of the partnership profits; and
        + Charged with an amount equal to the money plus the value of any other property, net of the amount of any liabilities, distributed by the partnership to the partner and the partner’s share of the partnership loss.
    - **The partnership is liable for contracts entered into by partners acting with actual or apparent authority.**
      * A partnership shall reimburse a partner for payments made and indemnify a partner for liabilities incurred by the partner in the ordinary course of the business of the partnership or for the preservation of its business or property. (RUPA § 401).
    - **The partnership is liable for torts committed by partners acting with authority or in the ordinary course of the partnership business.**
      * A partnership is liable for loss or injury caused to a person, or a penalty incurred, as a result of a wrongful act or omission, or other actionable conduct . . . (RUPA §305).
      * **3 factors to consider before holding the partnership liable (Sheridan v. Desmond):**
        + **Is it the “kind of thing” a partner would do?**
        + **Did the actions occur within the authorized time and geographic limits of the partnership? And**
        + **Were the actions motivated in part by a purpose to serve the partnership?**
      * If, in the course of the partnership’s business or while acting with the authority of the partnership, a partner receives or causes the partnership to receive money or property of a person not a partner, and the money or property is misapplied by a partner, the partnership is liable for the loss. (RUPA § 305).
    - **No new partner may be admitted without unanimous agreement by the current partners. (RUPA §401)**
    - **A single partner may dissolve an at-will partnership.**
    - **A partner is NOT entitled to remuneration for services performed for the partnership, except for reasonable compensation for services rendered in winding up the business of the partnership. (RUPA §401).**
    - **A partner has the right to access to books and records. (RUPA §403)**
      * The right of access provides the opportunity to inspect and copy books and records during ordinary business hours.
      * A partnership may impose a reasonable charge, covering the costs of labor and material, for copies of documents furnished.
      * What must be furnished to a partner:
        + Without demand – any information concerning the partnership’s business and affairs reasonably required for the proper exercise of the partner’s rights and duties under the partnership agreement or RUPA;
        + On demand – any other information concerning the partnership’s business and affairs, except to the extent the demand or the information demanded is unreasonable or improper under the circumstances.
  + **Duties of Partners**
    - **Partners are personally jointly and severally liable to third parties for the obligations of the partnership. (RUPA §306)**
      * **Establishing partner liability:**
        + **Two ways to establish individual liability of a partner (Thompson v. Wayne Smith Construction Co.):**

**Prove a separate contract;**

**Prove that partnership assets have been exhausted (AFTER A JUDGMENT IS ENTERED AGAINST THE PARTNERSHIP AND RETURNED UNSATISFIED).**

* + - * + **The partnership creditor then becomes a creditor of the individual partner with the same rights and on the same level as the partner’s other individual creditors.**
      * The partners may modify this liability if agreed with by the claimant or provided by law.
      * A person admitted into an existing partnership is not personally liable for any partnership obligation incurred BEFORE the person’s admission as a partner or while the partnership was an LLP.
    - **Partners owe fiduciary duties to each other. (Meinhard v. Salmon)**
      * **“Not honesty alone, but the punctilio of an honor the most sensitive, is the standard of behavior.” (Meinhard v. Salmon)**
      * A partner is NOT true fiduciary. A true fiduciary occupies an altruistic position.
      * **Fiduciary duties (RUPA §404)**
        + **Partners only owe fiduciary duties to his CURRENT partners, NOT TO FORMER partners. This fiduciary duty extends until the partnership is terminated – even through preparing to leave the partnership. (Bane v. Ferguson).**
        + **The only fiduciary duties a partner owes to the partnership and the other partners are the DUTY OF LOYALTY and the DUTY OF CARE.**

Duty of Loyalty:

Limited to the following:

To account to the partnership and hold as a trustee for it any property, profit or benefit derived by the partner in the conduct and winding up of the partnership property, including the appropriation of a partnership opportunity;

To refrain from dealing with the partnership in the conduct or winding up of the partnership business as or on behalf of a party having an interest adverse to the partnership; and

To refrain from competing with the partnership in the conduct of the partnership business before the dissolution of the partnership.

Duty of Care: Limited to the following:

Refraining from engaging in grossly negligent or reckless conduct;

Intentional misconduct; or

Knowing violation of law.

* + - * + **A partner shall discharge the duties to the partnership and other partners under RUPA or under the partnership agreement and exercise any rights consistently with the obligation of good faith and fair dealing.**
        + **A partner does not violate a duty or obligation under RUPA or under the partnership agreement merely because the partner’s conduct furthers the partner’s own interest.**
    - **A partner may use or possess partnership property only on behalf of the partnership. (RUPA §401).**
  + **Property of the Partnership**
    - **General Rule: Property acquired by a partnership is property of the partnership and not of the partners individually. (RUPA § 203).**
    - Facts + circumstances + conduct of parties + intent determines partnership property or separate property. (Kay v. Gitomer)
    - **When property is partnership property (RUPA §204):**
      * **Property is partnership property if acquired in the name of:** 
        + **The partnership; or**
        + **One or more partners with an indication in the instrument transferring title to the property of the person’s capacity as a partner or of the existence of a partnership but without an indication of the name of the partnership.**
      * **Property is presumed to be partnership property if purchased with partnership assets.**
      * Property acquired in the name of one or more of the partners, without an indication in the instrument transferring title to the property of the person’s capacity as a partner or of the existence of a partnership and without use of partnership assets, is presumed to be separate property, even if used for partnership purposes.
  + **Partner Dissociation**
    - **Partner’s Power to Dissociate (RUPA §602)**
      * **General Rule: A partner has the power to dissociate at any time, rightfully and wrongfully, by express will.** 
        + A partner’s dissociation is wrongful only if:

It is in breach of an express provision of the partnership agreement; or

In the case of a partnership or a definite term or particular undertaking, before the expiration of the term or the completion of the undertaking.

* + - * + **A partner who wrongfully dissociates is liable to the partnership and to the other partners for damages caused by the dissociation.**
    - **Events causing a partner’s dissociation (RUPA §601):**
      * **The partnership’s having notice of the partner’s express will to withdraw as a partner or on a later date specified by the partner;**
      * **An event agreed to in the partnership agreement as causing the partner’s dissociation;**
      * **In the case of a partner who is an individual:**
        + **The partner’s death;**
        + **The appointment of a guardian or general conservator for the partner; or**
        + **A judicial determination that the partner has otherwise become incapable of performing the partner’s duties under the partnership agreement.**
      * **The partner’s expulsion by the unanimous vote of other partners if:**
        + **It is unlawful to carry on the partnership business with that partner;**
        + **There has been a transfer of all/substantially all of that partner’s transferable interest in the partnership, other than a transfer for security purposes, or a court order charging the partner’s interest; etc**
      * **On application by the partnership or another partner, the partner’s expulsion by judicial determination because:**
        + **The partner engaged in wrongful conduct that adversely and materially affected the partnership business;**
        + **The partner willfully or persistently committed a material breach of the partnership agreement or a duty owed to the partnership or other partners under RUPA; or**
        + **The partner engaged in conduct relating to the partnership business which makes it not reasonably practicable to carry on the business in partnership with the partner.**
      * **Related to partner’s bankruptcy – when the partner:**
        + **Becomes a debtor in bankruptcy;**

*Note: under UPA, this would cause dissolution of the partnership, not just partner dissociation.*

* + - * + **Executes an assignment for the benefit of creditors;**
        + **Seeking, consenting to, or acquiescing in the appointment of a trustee, receiver or liquidator of that partner of all/substantially all of the partner’s property.**
  + **Partnership Dissolution**
    - **Events causing dissolution – see RUPA §801**
      * **In a partnership at will, the partner’s having notice from a partner, of that partner’s express will to withdraw as a partner, or on a later date specified by the partner;**
      * **In a partnership for a definite term or particular undertaking . . . the express will of all of the partners to wind up the partnership business, or the expiration of the term or the completion of the undertaking;**
      * **An event agreed to in the partnership agreement resulting in the winding up of the partnership business;**
      * **An event that makes it unlawful for all/substantially all of the partnership to be continued;**
      * **On application by a partner, a judicial determination that:**
        + **The economic purpose of the partnership is likely to be unreasonably frustrated;**
        + **Another partner has engaged in conduct relating to the partnership business which makes it not reasonably practicable to carry on the business in partnership with that partner; or**
        + **It is not otherwise reasonably practicable to carry on the partnership business in conformity with the partnership agreement.**
      * **On application by a transferee of a partner’s transferable interest, a judicial determination that it is equitable to wind up the partnership business. (RUPA §801(6)).**
    - **Between Dissolution and Winding Up of Business:**
      * **The partnership continues after dissolution ONLY for purposes of winding of its business. The partnership is terminated when the winding up of its business is completed. (RUPA §802).**
      * At any time after the dissolution of a partnership and before the winding up of its business is completed, all of the partners . . . may waive the right to have the partnership’s business wound up and the partnership terminated. In that event (RUPA §802):
        + The partnership resumes carrying on its business as if dissolution had never occurred, and any liability incurred by the partnership or a partner after the dissolution and before the waiver is determined as if dissolution had never occurred; and
        + The rights of a third party arising out of conduct in reliance on the dissolution before the third party knew or received notification of the waiver may not be adversely affected.
    - **Partner’s Right to Wind Up Partnership Business**
      * **Rule: After dissolution, a partner who has not wrongfully dissociated may participate in winding up the partnership’s business.**
    - **Settlement of Accounts and Contributions Among Partners (RUPA §807):**
      * **Basic Rule: As between partners and the outside world, every partner is liable for partnership obligations. As between partnership and the partners, the partners bear losses in accordance with their loss shares.**
      * In winding up a partnership’s business, the assets of the partnership, including the contributions of the partners, must be applied to discharge its obligations to creditors. Any surplus must be applied to pay in cash the net amount distributable to partners in accordance with their right to distributions.
      * Each partner is entitled to a settlement of all partnership accounts upon winding up of the partnership business. In settling accounts among the partners, profits and losses that result from liquidation of the partnership assets must be credited and charged to partnership accounts.
  + **Miscellaneous**
    - **Remedies against Co-Partners**
      * **General Rules:**
        + **A partnership may maintain an action against a partner for a breach of the partnership, for the violation of a duty to the partnership, causing harm to the partnership. (RUPA §405).**
        + **A partner may maintain an action against the partnership or another partner for legal or equitable relief, with or without an accounting as to partnership business, to:**

Enforce the partner’s rights under the partnership agreement;

Enforce the partner’s rights under RUPA;

Enforce the rights and otherwise protect the interests of the partner, including rights and interests arising independently of the partnership relation.

* + - **Solutions for Creditors:**
      * **On application by a judgment creditor of a partner or partners’ transferee, a court having jurisdiction may charge the transferable interest of the judgment debtor to satisfy the judgment. (RUPA §504).**
        + Charging order = a lien on the judgment debtor’s transferable interest in the partnership. The court may order a foreclosure of the interest subject to the charging order at any time. The purchaser at the foreclosure sale has the rights of a transferee.
        + The partner retains the full rights to participate in the management of the partnership 🡪 the transferee just gets profits.
    - **Which state’s law is applied to matters affecting the internal affairs of a partnership?**
      * UPA = silent on this issue.
      * General Choice of Law Principles:
        + A court should apply the law of the state with the most significant relationship to the partnership and transaction at issue, and the parties may vary this by agreement.
        + A choice of law provision in a contract will be invalidated only if:

There is no substantial relationship between the state whose law is chosen and the parties or the transaction at issue, and there is no other reasonable basis for the parties’ choice; or

The state whose law would otherwise have applied has a materially greater interest in the controversy and has a fundamental policy interest that would be contravened by application of the chosen state’s law.

* + - * **RUPA = Except as otherwise provided, the law of the jurisdiction in which a partnership has its CEO governs relations among the partners and between the partners and the partnership. (RUPA § 101(6)).**
    - **Joint Liability:**
      * **Pure Joint Liability: All debtors must be sued in the same case, and then each joint debtor is responsible for the entire amount of the debt.**
      * **Joint and Several Liability: Just one party may be sued at a time, but the creditor can collect against all.**
* **CORPORATION**
  + **Formation**
    - **Incorporation**
      * **Certificate of Incorporation**
        + **Rule: A copy of a certificate of incorporation, or a restated certificate of incorporation, or any other certificate filed in the office of the Secretary of State as required by law, WHEN DULY CERTIFIED by the Secretary of State, shall be received in all courts, public offices and official bodies as prima facie evidence of:**

**Due execution, acknowledgment and filing of the instrument;**

**Observance and performance of all acts and conditions necessary to have been observed and performed precedent to the instrument becoming effective; and**

**Any other facts required/permitted by law to be stated in the instrument.**

* + - * **Effective date (DGCL §103, §106)**
        + **General Rule: Effective Date of corporate existence = filing date.**
        + But, an instrument of incorporation may provide that it is not to become effective until a specified time subsequent to the time it is filed, but such time shall not be later than a time on the 90th day after the date of its filing.
      * **Incorporators** 
        + **Power of Incorporators (DGCL §107): 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 incorporators, until the directors are elected, shall:**

**Manage the affairs of the corporation;**

**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.

* + - * + Meetings of Incorporators/Initial Board: Can be called with a majority vote with two days notice. (DGCL §108).
    - **Financing the Corporation**
      * **Types of Financing:**
        + **Typical financing scheme for publicly held corporations involves:**

**Common shares;**

**Preferred shares; and**

**Debt.**

Corp may borrow money from a bank.

Corp may also borrow directly from investors, following an “indenture” (contract between corp and indenture trustee that represents borrowers):

If the loan is secured by corporation’s assets, investors have purchased a “bond.”

If the loan is unsecured, they have purchased a “debenture.”

Unlike shareholders, debtholders have an absolute contract right to receive principal and interest payments – they can enforce their obligations in bankruptcy.

* + - * + **For closely held corporations, there is usually just one class of common shares.**
      * **Issuance of Shares:**
        + The only statutory requirement for the issuance of shares is that their authorized number and terms appear in the certificate of incorporation. The corporation may place whatever labels it likes on particular classes and series of shares and define the terms however it wants.
        + **Differences between classes of shares:**

**Common shares;**

Get dividends, but after preferred shares.

These shares possess voting rights and elect the board of directors.

**Preferred shares.**

Typically have preference over common shares with respect to dividends. Dividends may either be mandatory or discretionary based on issuing terms. Dividends may also be cumulative or non-cumulative.

May be participating or non-participating. If the dividend is participating, after the preferred shares receive their dividend, the preferred shares are allowed to join any further dividend with the common shares.

Have preference on liquidation.

Often convertible into common shares at a pre-determined ratio.

Usually carry no voting rights unless a set number of dividend payments are missed and until they are made current.

* + - * **Pre-emptive Rights**
        + **Rule: The Certificate of Incorporation may grant to the holders of one or more classes of stock the preemptive right to subscribe to any or all additional issues of stock in the corporation, or to securities of the corporation convertible into such stock. Stockholders have a preemptive right ONLY if granted in the certificate of incorporation. (DGCL §102(b)(3)).**
        + Positives/Negatives of Preemptive Rights?

They give existing shareholders the ability to preserve their proportionate stake in the corporation’s assets, earnings and voting power.

Are more useful to closely held corp shareholders.

May restrict the freedom of the corporation in arranging new financing or making acquisitions (this is why they are rarely found in publicly held corporations).

* + - **Promoters’ Contracts**
      * **Promoter = someone who helps to create and organize a corporation. They will often make contracts for the corporation’s benefit with the intention of causing the corporation to adopt the contracts once the corporation is formed.**
      * **Relationship between promoter and the corporate enterprise 🡪 kind of like agency. Corp is principal, Promoter is Agent. (Illinois Controls v. Langham).**
        + Adoption:

The corporation may adopt agreements made by the promoter after its incorporation.

Adoption may be manifested by the corporation’s receipt of the contracts benefits with knowledge of its terms.

This is NOT ratification (b/c ratification requires the principal to exist when the contract is made).

* + - * + Liability:

The Corporation is liable on the breach of a contract ONLY when the corporation has adopted it.

The promoters of the corporation remain liable on the contract UNTIL the corporation is formed.

* + - **Defective Incorporation**
      * **DE JURE CORPORATION: Results when there has been conformity with the mandatory conditions established by the statute. (Robertson v. Levy)**
      * **DE FACTO CORPORATION/ CORPORATION BY ESTOPPEL:**
        + **A lack of formal meetings or resolutions or issuance of stock is not determinative as to the existence of the corporate entity. (Cantor v. Sunshine Greenery).**
        + **A (1) statute that permits incorporation + (2) a bona fide attempt to incorporation + (3) some actual use of corporate privileges is enough for a de facto corporation.**
    - **Ultra Vires Doctrine**
      * **Old Rule:**
        + **Every certificate of incorporation was required to include the specific purpose(s) for which the corporation was organized. A transaction beyond those purposes was “ultra vires.”**
        + “It is not within the lawful powers of a Board to shape and conduct the affairs of a corporation for the merely incidental benefit of shareholders and for the primary purpose of benefiting others.” (Dodge v. Ford Motor Co.)
      * **Modern Law:**
        + **Statutes permit a corporation to state that it is created to perform any lawful act or make a declaration of purposes optional. The ultra vires doctrine tends to only come into play when alleged conduct does not benefit the corporation in any manner.**
        + “Charitable” Acts:

Many courts take a broad view of a corporation’s power to make charitable contributions. (AP Smith Mfg Co. v. Barlow)

TEST: WILL THE BOARD’S ACTIONS RESULT IN RATIONALLY RELATED BENEFITS ACCRUING TO STOCKHOLDERS? (Revlon v. MacAndrews & Forbes)

* + - * “Tainted Shares Rule”: If a shareholder or director participated in the ultra vires act, he cannot thereafter seek remedy under an ultra vires claim. (Goodman v. Ladd Estate Co.)
      * **Effect of lack of corporate capacity or power:**
        + **General Rule (DGCL §124): No act of a corporation and no conveyance or transfer of real or personal property to or by a corporation shall be invalid by reason of the fact that the corporation was without power to do such act or to make or receive such conveyance or transfer.**
        + But, such lack of capacity/power may be asserted:

In a proceeding by a stockholder against the corporation to enjoin the doing of any act or transfer of property by or to the corporation. The court may set aside/enjoin the performance if it finds it equitable and award equitable compensation.

In a proceeding by the corporation against an incumbent/former officer/director of the corporation, for loss or damage due to the unauthorized act;

In a proceeding by the Attorney General to dissolve the corporation/enjoin the corporation from the transaction.

* + **Specific Powers of the Corporation (DGCL §122)**
    - **Have perpetual succession by its corporate name, unless limited by its certificate of incorporation;**
    - **Sue and be sued in all courts and participate, as a party or otherwise, in any other proceeding, in its corporate name;**
    - Purchase, receive, hold, grant, gift, etc and otherwise deal in and with real or personal property;
    - Appoint such officers and agents as the business of the corporation requires and to pay or otherwise provide them suitable compensation;
    - Adopt, amend and repeal bylaws;
    - Wind up and dissolve itself;
    - Conduct its business, carry on its operations and have offices and exercise its powers within or without this State;
    - 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;
    - Participate with others in any corporation, partnership, etc, or in any transaction, etc which the participating corporation would have power to conduct by itself, whether or not such participation involves sharing or delegating control with/to others;
    - Transact any lawful business which the corporation’s board shall find to be in aid of governmental authority;
    - **Make contracts, incur liabilities, borrow money, issue notes and other obligations which are necessary or convenient for the conduct, promotion or attainment of the business of the corporation;**
    - **Lend money for its corporate purposes, invest and reinvest its funds, and take, hold and deal with real and personal property as security for the payment of funds so loaned or invested;**
    - **Pay pensions and establish and carry out pension, profit sharing, stock option, stock purchase, stock bonus, retirement, benefit, incentive and compensation plans, trusts and provisions for directors, officers or employees;**
    - **Provide insurance for its benefit on the life of any of its directors, officers or employees;**
    - Renounce any interest or expectancy of the corporation in, or in being offered an opportunity to participate in, specified business opportunities or classes of opportunities.
  + **Management & Operation**
    - **Allocation of Power – Shareholders v. Board v. Corp. Officers**
      * **According to the traditional model of corporate governance…**
        + **The Board of Directors:**

**Appoints the officers and supervises the management of the corporation’s business.**

**The only limitation on the judgment/discretion of the directors is what the Corp may impose in its bylaws and by shareholders votes. (Charlestown Boot & Shoe Co. v. Dunsmore).**

**Are true fiduciaries – they have a duty to act solely in the best interests of the corporation.**

**They ARE NOT agents of the shareholders.**

* + - * + **The officers run the corporation’s day-to-day affairs.**
        + **The shareholders:**

**Elect the board;**

**Vote on extraordinary matters (with norm = 1 shareholder = 1 vote unless cert of incorp. provides otherwise)** (amending the cert. of incorporation, mergers, sales of substantially all of the corp’s assets, and dissolutions).

**Only “compelling circumstances” – not mere paternalism – will justify the Board acting contrary to stockholder vote (“interfering or impeding” exercise of the shareholder franchise). (Blasius Industries, Inc. v. Atlas Corp.)**

* + - * **Adoption/Amendment of Bylaws (DGCL §809)**
        + **The original bylaws of a corporation may be adopted, amendment or repealed by THE INCORPORATORS, THE INITIAL DIRECTORS, or IF BEFORE A CORPORATION HAS RECEIVED ANY PAYMENT FOR STOCK, BY ITS BOARD OF DIRECTORS.**
        + **After a corporation has received any payment for any of its stock, the power to adopt, amend or repeal bylaws shall be in the stockholders.**
        + **BUT, the certificate of incorporation may confer the power to adopt, amend or repeal bylaws upon the directors, BUT the stockholders power remains to adopt, amend or repeal bylaws.**
    - **Formalities Required for Board Action**
      * **General Rule: A Board of Directors may exercise its power ONLY as a body at a meeting duly assembled.** This means: (a) the independent approval of an act by each of the individual directors is not effective board action; (b) directors may not vote by proxy; and (c) formalities as to notice, quorum and voting must be fully adhered to. (Am. Bank & Trust Co. v. Freeman).
      * **Notice:** **In Delaware – No statutory provisions; required notice is usually addressed in the bylaws.**
      * **Quorum = A majority of the total number of authorized directors.** The bylaws or certificate may specify that any % greater or lesser than a majority constitutes a quorum, but cannot go less than 1/3.
      * **Vote Required for normal action:** **It takes a majority vote of the Board present to approve a matter, provided there is quorum.** The certificate or bylaws may specify that a supermajority board vote is required.
    - **Removal of Board members:**
      * **General Rule: Unless the certificate of incorporation or bylaws provide to the contrary, any director or the entire board may be removed by the shareholders with or without cause.**
      * Limitations:
        + If a corporation has a classified or staggered board, directors may be removed only for cause.
        + In a corporation that permits cumulative voting, if less than the entire board is removed, no single director may be removed if the votes cast against his removal would be sufficient to elect him.
        + Whenever a particular class or series of stock has the right to elect one or more directors, only the shareholders eligible to vote for such directors are permitted to vote on the removal of such directors.
    - **Authority of Corp. Officers:**
      * **President:**
        + **General Rule: The President only has authority to bind his company by acts arising in the usual and regular course of business but not for contracts of an “extraordinary” measure. (Lee v. Jenkins Bros.)**
        + Ordinary would include hiring and discharging employees and fixing their compensation as part of the regular course of business; giving employment for life or on a “permanent” basis are extraordinary. (Lee v. Jenkins Bros.)
      * **Secretary:**
        + **General Rule: The Secretary is the custodian of the corporation’s records and has authority to certify corporate records.**
        + The Secretary usually has no authority by virtue of his position to engage in business transaction.
      * **Treasurer:**
        + **General Rule: The treasurer’s duties are to receive, safeguard and disburse the corporation’s funds. The treasurer usually has authority to write checks against the corporation’s account.**
        + The Treasurer generally has no authority to act for the corporation in business matters.
    - **Shareholder Action:**
      * **Meetings of Shareholders:**
        + **The corporation is required to hold an annual meeting of shareholders at which directors are elected. Any other business may be conducted at an annual meeting.**
        + **Unless otherwise provided in the certificate or bylaws, only the Board may call a special meeting of shareholders.**
        + May be held by “remote communication,” including by the Internet.
        + Those owning enough shares to approve a particular matter may act by written consent in lieu of a meeting.
      * **Formalities Required for Shareholder Action:**
        + **Stockholders of Record (DGCL §213):**

**In order that the corporation may determine the stockholders entitled to notice of or to vote at any meeting of stockholders, the Board may fix a record date that is between 10-60 days before the meeting.**

* + - * + **Quorum and Required Vote for Shareholder Action (DGCL §216):**

**The certificate of incorporation or bylaws may specify the number of shares having voting power the holder of which shall be present or represented by proxy at any meeting in order to constitute a quorum AND the votes that shall be necessary for the transaction of business.** BUT, the number required for quorum cannot be less than 1/3 the shares entitled to vote at the meeting.

**In the absence of such specification in the certificate or bylaws:**

**A majority of the shares entitled to vote shall constitute a quorum at a meeting of stockholders;**

**In all matters other than the election of directors, the affirmative vote of the majority of shares present and entitled to vote shall be the act of the stockholders;**

**Directors shall be elected by a plurality of the votes of the shares present at the meeting and entitled to vote on the election of directors.**

A bylaw amendment adopted by stockholders which specifies the votes that shall be necessary for the election of directors shall not be further amended or repealed by the board of directors.

* + - * Straight v. Cumulative Voting
        + Straight Voting: Every shareholder votes the entire number of shares he owns for as many directors as there are seats up for election.
        + Cumulative Voting:

The certificate of incorporation may provide that at elections of directors, each holder of stock or any class or series thereof shall be entitled to as many votes as votes entitled to cast x number of directors, and that such holder may cast all votes for a single director or may distribute them among the positions to be voted for in any manner he chooses. (DGCL §214).

This provides minority shareholders with roughly proportional board representation.

* + - * **Shareholder Informational Rights**
        + **Inspection of Books & Records (DGCL §220)**

**Any stockholder shall, upon written demand under oath stating their purpose, have the right to inspect for any proper purpose, and make copies from:**

**The corporation’s stock ledger, a list of stockholders, and other books and records; and**

**A subsidiary’s books and records.**

* + - * + The corporation has the burden of proving that the stockholder’s request is based on an improper purpose.
        + “Proper” Inspection Purposes (Skouras v. Admiralty Enterprises)

A purpose that is “reasonably related to a plaintiff’s interest as a stockholder,” but must be specific;

To follow up on suspicions of corporate mismanagement;

To communicate with other shareholders in connection with a vote;

NOT for purposes adverse to the best interest of the corporation – harassing the corporation, satisfying curiosity, giving information to a competitor, etc.

* + **Altering Norms by Contract**
    - **Voting Trusts/Voting Agreements**
      * Old Law: Vote buying arrangements were per se illegal.
      * **New Law:**
        + **Basic Rule: One or more stockholders may enter into an agreement with any person(s) for the purpose of such persons, designated as voting trustees, having the right to vote their shares for any period of time determined by such agreement, upon the terms and conditions stated in the agreement. The agreement must be in writing and must be signed by the parties. (DGCL §218; Ringling Bros.-Barnum & Bailey Combined Shows v. Ringling).**
        + Methods of making voting agreements self-enforcing:

Irrevocable Proxy

= agency relationship, whereby one person gives another the power to vote shares on his behalf.

Form Requirements:

Proxy must be “coupled with an interest” to be irrevocable. Interest may be in the stock itself or an interest in the corporation generally or another interest.

Owner of shares must convey a signed authorization to the proxyholder.

Note: Authorization may be by electronic transmission, as long as it can be verified that it came from the shareholder sent the transmission.

Proxy is valid for 3 years by default, unless the authorization provides for a longer period.

Voting Trust

= legal title to the shares is vested in one or more trustees. Trustees vote, but original stockholders receive dividends and other disbursements.

Form Requirements:

Trust agreement must be in writing;

Copy of trust agreement must be deposited with corporation at its registered office and must be available for inspection; and

Shares subject to the trust must be transferred to the trustee 🡪 Corp. cancels shares of stockholder and issues new shares in the name of the trustee.

Stock is voted in accordance with the trust agreement, or by default, as directed by the majority of trustees.

Classified Voting

= Shares are divided into classes.

Benefits:

Useful for apportioning control of the Board of Directors.

May be used to prevent a deadlock on the Board.

* + - **Stockholders’ Attempts at Controlling the Board**
      * **Basic Rule: Stockholders cannot, by agreement, attempt to divest the Board of their power to manage the business of the corporation. Stockholders have the power to elect and remove Directors, but not to limit their activities. (McQuade v. Stoneham)**
    - **Supermajority Quorum and Voting Requirements**
      * **Basic Rule: The default quorum is a majority of the total number of directors, but the bylaws may require a greater number or lesser number (as long as not less than 1/3). (DGCL §141(b)).**
      * Policy:
        + Supermajority and voting requirements were once treated by hostility by the courts. (Benitendi v. Kenton Hotel.) Courts were concerned that providing veto power to minority shareholders would increase the danger of deadlock.
        + But, this lessens the investment risk for the minority 🡪 minority is more willing to invest.
    - **Share Transfer Restrictions**
      * **Basic Rules:**
        + **A restriction on the transfer of securities or on the amount of the corporation’s securities that may be owned by any person or group of persons is permitted as long as it is noted conspicuously on the certificate representing the security, or the restriction is in the bylaws or by an agreement of stockholders, or the holder has actual knowledge of the restriction. (DGCL §202(a)).**
        + **No restrictions imposed in the bylaws or by agreement are binding with respect to securities issued prior to the adoption of the restriction, unless the holders of the securities are parties to the agreement or voted in favor of the restriction. (DGCL §202(b)).**
      * **Share transfer restriction must be reasonable** (so that it is not an unreasonable restraint on alienation)**, clear and unambiguous**, and should specify:
        + whether the purchase is optional or mandatory;
        + the persons who may or must purchase the shares;
        + the sequence in which they may purchase;
        + the manner in which the price is to be determined;
        + the time periods during which persons may decide whether or not to purchase;
        + the events that are to be covered by the restriction.
      * **Common permitted share transfer restrictions:**
        + **An obligation to offer the shares to the corporation or the other shareholders at a specified price prior to selling to a third party (a first-option agreement);**

Sell price may be measured by:

A stated price;

Book value (=shareholders equity on balance sheet/total number of shares);

Capitalization of earnings;

Appraisal or arbitration.

Note: Courts generally enforce these type of agreements, even when the sale price is well below the FMW of the shares at the time the option is triggered 🡪 enforcing contract terms.

* + - * + **An obligation to offer the shares to the corporation or the other shareholders at the same price, and on the same terms, offered by a third party (a first refusal agreement);**
        + **An obligation to obtain the consent of the corporation or the shareholders prior to selling to a third party (a consent agreement);**

Note: Often viewed with hostility by courts because of fears that such agreements would be exercised arbitrarily and would function to prevent any transfer of shares.

* + - * + **An agreement that gives a shareholder the opportunity or obligation to sell, and the corporation or other shareholders the opportunity or obligation to purchase, shares at a specified price upon the happening of certain events (a buy-sell agreement);**
        + **A provision prohibiting transfer to designated classes of persons.**

Note: Courts will usually enforce as long as such provision is not “manifestly unreasonable.”

* + - **Statutory Close Corporations**
      * **Definition of Close Corporation (DGCL 342, 343):**
        + **A close corporation is a corporation whose certificate of incorporation provides that:**

**The corporation is a close corporation;**

**There will be no more than 30 shareholders;**

**All of the issued stock shall be subject to restrictions on transfer; and**

**The corporation shall make no “public offering” of its stock.**

* + - * + Case law:

Some states say that you can have a close corporation by acting like one, even if you don’t apply with statutory requirements.

Other states (including Delaware) say you cannot have a close corporation unless the certificate states you are one. (Nixon v. Blackwell).

* + - * Termination of Close Corporation Status (DGCL §346)
        + A corporation can voluntarily terminate its status as a close corporation by amending its certificate of incorporation with a default 2/3 vote of each class of stock outstanding.
        + A close corporation’s certificate may specify that a greater than 2/3 is required to make this amendment.
      * Stockholder’s Option to Dissolve Close Corporation (§355):
        + The certificate may include a provision granting to any stockholder, the holders of a specified number or percentage of shares of any class of stock, an option to have the corporation dissolved at will or upon the occurrence of any specified event.
        + The certificate may be amended to include such a provision by an affirmative vote of all holders of outstanding stock (default), or by the number of votes authorized by the certificate, provided such requirement is not less than 2/3.
      * **Agreements Restricting Discretion of Directors:**
        + **Basic Rules (DGCL §350) –**

**A written agreement among the stockholders of a close corporation holding a majority of the outstanding stock entitled to vote may interfere with the discretion or powers of the board of directors.**

The effect of this type of agreement will be to relieve the directors and impose upon the stockholders who are parties to the agreement the liability for managerial acts or omissions which is imposed on directors by the agreement.

* + - * **Management by Stockholders:**
        + **Basic Rules (DGCL §351):**

**The certificate of a close corporation may provide that the business of the corporation shall be managed by the stockholders of the corporation rather than by a board of directors.**

So long as this provision is in effect:

No meeting of stockholders need be called to elect directors;

Unless the context clearly requires otherwise, the stockholders of the corporation shall be deemed directors for purposes of applying DGCL provisions; and

The stockholders of the corporation shall be subject to all liabilities of directors.

* + **Limited Liability**
    - Purpose of incorporation: to enable a group of persons to limit their liability in a joint venture to the extent of their contributions to the capital stock.
    - **Basic Rule: The default rule is that stockholders of a corporation shall not be personally liable for the payment of the corporation’s debts (unless they are personally liable by their own conduct). A provision within the bylaws may however impose liability on stockholders. (DGCL §102(b)(6)).**
    - Policy justifications for limited stockholder liability in corporations:
      * Decreases the need to monitor the corporation’s business activities because the investment is less risky.
      * Makes the identity of other shareholders irrelevant and thus decreases investment costs.
      * Gives managers incentives to act efficiently by promoting free transfer of shares.
      * Makes it possible for market prices to impound additional information about the value of firms.
      * Allows more efficient diversification.
      * Facilitates optimal investment decisions because lowers risk.
    - **Piercing the Corporate Veil**
      * **General Rule:**
        + **Courts will “pierce the corporate veil,” whenever necessary to “prevent fraud or achieve equity.” (Walkovszky v. Carlton).**
        + **This requires showing “such unity of interest and ownership that the separate personalities of the corporation and the individual no longer exist and that, if the acts are treated as those of the corporation alone, an inequitable result will follow.” (Minton v. Cavaney). Court will look for “undue domination and control” over the corporation, lack of “observing corporate formalities,” and whether the corporation was a “device or sham used to disguise wrongs, obscure fraud, or conceal crime.” (Perp. Real Estate Servs. v. Michaelson Prop.)**
      * Two types of veil piercing:
        + Horizontal: all corporations are liable for the debts of any one corporation.
        + Vertical: making the director liable for debts of his corporation; or make parent liable for subsidiary.
      * Examples where the corporate veil will be pierced (Minton v. Cavaney):
        + When the owners of a corporation treat the corporate assets as their own and add/withdraw capital from the corporation at will;
        + When owners hold themselves out as being personally liable for the debts of the corporation;
        + When owners provide inadequate capitalization and actively participate in the conduct of corporate affairs.
  + **Fiduciary Duty in Corporations**
    - **Directors and officers owe fiduciary duties to the corporations they serve. These duties take primarily two forms:**
      * **A duty to exercise care in the management and operation of the corporation; and**
      * **A duty to exercise loyalty by putting the corporation’s interests before personal interests.**
    - **Duty of Care:**
      * **Two distinct areas where duty of care arises:**
        + **Oversight**

**Directors are obligated to use care in monitoring the activities of the officers and the general affairs of the corporation as a whole.**

This duty includes a duty to attempt in good faith to assure that the corporate information and reporting system, which the board concludes is adequate, exists. Absent cause of suspicion, the board has no duty to ensure that the information provided by the system is accurate. (In re Caremark Int’l Derivative Litigation)

**Directors cannot shut their eyes to corporate misconduct – he has a duty seek to correct the misconduct. (Francis v. United Jersey Bank)**

Possible disputes in this area:

Allegations that directors were inattentive to what officers and corporate employees were doing.

* + - * + **Decision-Making**

**Directors are obligated to use care in making decisions that affect the corporation’s welfare, but they are given discretion and their actions enjoy a presumption of good faith. (Shlensky v. Wrigley)**

**BUSINESS JUDGMENT RULE:**

**If a director or officer makes a decision:**

**In good faith,**

Note: Engaging in an illegal action is by its nature bad faith and business judgment rule cannot protect the act.

**With a reasonable decision-making process, and**

Requires the decision to be an informed one – the director must consider all material information reasonably available to them. (Smith v. Van Gorkum)

**With no conflict of interest;**

**Then a court will uphold the decision so long as it can be attributed to a RATIONAL BUSINESS PURPOSE.**

**Even though the Business Judgment Rule acts as a presumption in favor of the directors, if the plaintiffs shows that the directors breached their duty of care or of loyalty or acted in bad faith, the burden then shifts to the directors to demonstrate that the challenged act was ENTIRELY FAIR TO THE CORORATION AND ITS SHAREHOLDERS. (In re The Walt Disney Co. Derivative Litigation)**

Reliance on Records of Corporation (DGCL §141(e)):

A member of the board shall be fully protected in relying in good faith upon the records of the corporation and upon such information, opinions, reports or statements presented to the corporation by any of the corporation’s officers or employees or by any other person as to matters the board member reasonably believes are within their professional or expert competence and who has been selected with reasonable care by the corporation.

Policy justifications for the Business Judgment Rule (Joy v. North):

Shareholders voluntarily undertake the risk of bad business judgment by investing.

After-the-fact litigation is an imperfect device to evaluate corporate business decisions – business decisions are inherently made on the basis of incomplete information.

Because potential profits correspond to potential risk, the law should not create incentives for overly cautious corporate decisions.

Possible disputes in this area:

Allegations that directors were not reasonably informed in making a decision;

That the decision itself was substantively unwise.

* + - * **A party seeking to hold a director liable for damages from breach of duty of care must not only prove the breach of duty, but that harm to the corporation or its shareholders was suffered and that the harm suffered was proximately caused by the director’s challenged conduct. (Francis v. United Jersey Bank)**
    - **Duty of Loyalty**
      * **In general, the duty of loyalty requires directors and officers to put the corporation’s interests ahead of their personal interests 🡪 generally prohibits self-dealing.**
      * **Issues arise in two contexts:**
        + **When directors/officers enter into transactions with the corporation (CONFLICT OF INTEREST TRANSACTIONS);**
        + **When directors/officers take potential corporate opportunities for themselves.**
      * **Conflict of Interest Transactions:**
        + **Basic Rule (DGCL §144): No transaction between a corporation and its directors shall be void solely for this reason, if:**

**The material facts as to the director’s relationship or interest are disclosed, and the board in good faith authorizes the transaction by the affirmative votes of a majority of the disinterested directors; or**

**The material facts as to the director’s relationship or interest are known to the shareholders entitled to vote thereon, and the transaction is specifically approved in good faith by a vote of the shareholders; or**

**The transaction is fair as to the corporation as of the time it is authorized, approved or ratified, by the board of directors or the shareholders.**

* + - * + **When self-dealing is demonstrated, the burden shifts to the director to prove that the transaction was FAIR. Even if DGCL §144 is met, the transaction must still be FAIR. (Marciano v. Nakash).**

**Fair = entire fairness = fair dealing + fair price.**

Fair dealing: Considers…

When the transaction was timed,

How it was initiated, secured, negotiated, disclosed to the directors, and

How the approvals of the directors and stockholders were obtained.

Fair price: Relates to the economic and financial considerations of the proposed transaction, including all relevant factors:

Assets

Market value

Earnings

Future prospects, and

Any other elements that affect the intrinsic or inherent value of the transaction.

* + - * **Corporate Opportunity**
        + **In Delaware, the corporation may renounce, in advance, a claim to specific corporate opportunities or classes of opportunities in its certificate of incorporation or by resolution of its board of directors. (DGCL §122(17)).**
        + **Tests for determining what constitutes a “corporate opportunity” (NE Harbor Golf Club v. Harris):**

**“Line of Business Test”** – asks whether the opportunity was so closely associated with the existing business activities as to bring the transaction within that class of cases where the acquisition of the property would throw the corporate officer purchasing it into competition with his company.

Factors that weigh on whether the opportunity is within the corporation’s line of business (Ostrowski v. Avery):

Whether the business opportunity was one in which the complaining corporation had an interest or an expectancy growing out of an existing contractual right;

Whether there was a close relationship between the opportunity and the corporation’s business purposes and current activities; and

Whether the business areas contemplated by the opportunity were readily available to the corporation’s existing business, in light of its fundamental knowledge, practical experience, facilities, equipment and personnel.

**“Fairness Test”** – looks at the particular circumstances surrounding the transaction.

**2 Prong Miller Test** – first asks if in line of business, then looks at fairness.

**ALI Test** – A director may not take advantage of a corporate opportunity unless:

The director first offers the opportunity to the corporation and makes disclosure concerning the conflict of interest and the corporate opportunity;

The corporate opportunity is rejected by the corporation; and

Either:

The rejection is fair to the corporation;

The opportunity is rejected in advance, following such disclosure by disinterested directors; or

The rejection in authorized in advance or ratified, following such disclosure, by disinterested shareholders and the rejection is not equivalent to a waste of corporate opportunities.

**“Interest or Expectancy Test” –** An opportunity is open to a fiduciary unless:

The corporation has an “interest already existing in the opportunity;

The corporation has a substantial need for the opportunity.

* + - * + **Breaching the duty of loyalty may also result from use of corporate property for personal purposes, or competition with the corporation.**

**Use of corporate property:**

**Basic Rule: A corporate fiduciary should not use corporate property for personal purposes.**

Possible defenses:

Proof of advance authorization or later ratification, after full disclosure, by disinterested directors or shareholders.

**Competing with the Corporation:**

**Basic Rule: A corporate agent should not compete with the employer while employed.**

Former employees may compete with former employers. Courts will carefully scrutinize contracts not to compete.

How far the current employee can go:

Soliciting the employer’s customers – not okay.

Soliciting one’s fellow employees to leave and join the new venture – maybe ok.

Concealing intent to leave and set up a competing business – not ok.

* + - * **Executive Compensation/Waste Doctrine**
        + General Pros & Cons of Compensation:

A proper compensation arrangement motivates the executive to work in the company’s best interests.

Executive compensation in closely held corporations is often the preferred mechanism for distributing the financial returns of the business.

Compensation may be a problem if shareholders view it as excessive.

* + - * + Relevant considerations for setting salary (Wilderman v. Wilderman):

What other executives similarly situated received

The ability of the executive

Whether or not the IRS has allowed the corp to deduct the amount as salary alleged to be unreasonable

Whether the salary bears a reasonable relation to the success of the corp

Amount previously received as salary

Whether increases in salary are geared to increased in the value of services rendered

The amount of the challenged salary compared to other salaries paid by the employer

* + - * + Compensation in Closely Held Corps

Situations where executive compensation may be challenged in closely-held corporations:

First, because compensation amounts in a closely held corp may include de facto dividends, a termination of employment can have the effect of excluding an investor from her rightful share of the company’s dividend distributions.

Second, because of the tax incentive for closely held corps to distribute profits as compensation, rather than as dividends, the IRS often sues to disallow the deduction of “unreasonable” amounts of compensation.

Actions brought on behalf of a corporation may be brought in an effort to recover the excess of “unreasonable” amount of compensation paid to executives.

Why compensation may be more susceptible to attack in closely held Corps:

Directors at closely-held Corps are more likely to set their own compensation, creating a conflict of interest, whereas at public corporations, compensation committee comprised of disinterested outside directors set compensation.

Public corporations tend to be more careful in observing the procedural formalities necessary to comply with directors’ duty of care.

Shareholders of closely-held Corps may have more information about Board acts than their public corporation counterparts.

Executive compensation tends to be a much larger percentage of profits of a closely-held Corp.

* + - * Typical remedies:
        + Restitutionary – requiring the director to relinquish whatever he has improperly obtained;
        + Punitive Damages;
        + Ordering the fiduciary to repay any salary received from the corporation during the breach of duty;
        + Ordering the fiduciary to pay the corporation’s attorney fees incurred in establishing breach of duty.
    - **Duties of Shareholders** 
      * **General Rule: A shareholder normally has no duty to the corporation or the other shareholders.**
      * **BUT, common law has imposed duties on controlling shareholders of closely held corporations to the corporation and minority investors.**
        + **Controlling shareholder = an investor with the power to direct corporate affairs.**
        + Duty is not a true fiduciary duty – each shareholder has legitimate selfish interests as an owner of the business. Duties owed by controlling shareholder focuses on fairness rather than selflessness.
        + Effect of Ratification of Controlling Shareholder’s actions by Minority shareholders: Shifts the burden of proof, but does not change the standard of review. (Rosenblatt v. Getty Oil).
        + **We analyze the controlling shareholder’s action with the ENTIRE FAIRNESS TEST – fair dealing + fair price.**
      * **Sales of Control:**
        + Because the person who possesses control has the power to direct the corporation’s affairs, purchasers are willing to pay a premium in order to obtain control.
        + Transfers of control can benefit a corporation (business synergies and/or replacement of inefficient management may result), sales of control can also harm a corporation and its minority shareholders (i.e. intent to loot assets).
        + **General Rule: A controlling stockholder is free to sell and a purchaser is free to buy the controlling interest of a corporation at a premium price. Minority shareholders do not get to share in this premium. (Zetlin v. Hanson Holdings, Inc.).**
        + **BUT, the controlling stockholder does not have the right to sell their interest to persons they know intend to loot the corporation’s treasury – as a fiduciary, they must be “reasonably vigilant” to ensure this does not occur. (Gerdes v. Reynolds).**

“Reasonably vigilant” = must investigate only when suspicious circumstances are present (most courts); some courts say seller must always investigate buyer

What factors should make a seller suspect the possibility of looting?

An excessive price that is willingly paid by a purchaser

Liquid and readily salable assets owned by the corporation

A purchaser’s insistence that the company’s assets be made available immediately

A purchaser’s lack of concern with the operations of the company

A purchaser’s plan to use the corporation’s assets to fund the purchase and

The prior history of the purchaser

* + - **Exculpation** 
      * **General Rule (DGCL §102(b)(7)):**
        + **The Certificate of Incorporation may contain a provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision does not eliminate or limit the liability of a director:**

**For any breach of the duty of loyalty to the corporation or its stockholders;**

**For acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law;**

**For any transaction from which the director derived an improper personal benefit.**

* + - * + The Certificate can only limit liability prospectively – cannot eliminate liability for acts occurring prior.
    - **Indemnification/Insurance**
      * **General Rule:**
        + **A corporation MAY indemnify any person who was/is/is threatened to be made a party to any action, whether civil or criminal, by reason of the fact that the person is/was a director, officer, employee or agent of the corporation, against expenses, judgments, fines and amounts paid in settlement actually and reasonably incurred by the person in connection with such action IF the person acted in good faith and in a manner the person reasonably believed to be in the best interests of the corporation.**
        + **No indemnification shall be made in respect of any claim, etc, as to which such persons shall have been adjudged to be liable to the corporation.**
        + **If the person was successful on the merits or otherwise in the defense of the action, the Corp. MUST indemnify them.**
        + The corporation can purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent, whether or not the corporation would have the power to indemnify such person.
      * What the rule means:
        + A corporation’s grant of indemnification cannot extend the statutory bounds. (Waltuch v. Conticommodity Servs.)
        + A corporation can circumvent the “good faith” requirement of indemnification by purchasing an insurance policy and providing director/officer relief that way. (Waltuch v. Conticommodity Servs.)
      * Advancing expenses:
        + Modern statutes allow a corporation to advance expenses to a prospective indemnitee before a dispute is resolved.
        + If it is ultimately determined that the prospective indemnitee is not entitled to indemnification, the advanced sums must be repaid to the corporation.
  + **Dissension in Closely-Held Corporations**
    - **Dissolution**
      * What it is: The dissolution of a corporation involves the termination of the corporation’s existence, the sale of the business, the repayment of debt to creditors, and the pro rata distribution of any remaining assets to shareholders.
      * **In each state, three types of dissolution are usually possible: (1) voluntary dissolution, (2) involuntary dissolution, and (3) administrative dissolution.**
        + **Voluntary dissolution**

**= dissolution that is not ordered or compelled by a court or a state.**

**(DGCL §275): Dissolution requires: (a) Resolution by majority of the Board + (b) majority vote of outstanding stock** 🡪 **Certificate of Dissolution then filed with Sec. of State.**

In many jurisdictions, a corporation can also be dissolved upon a specified event or at a specified time if such provisions are included in the articles of incorporation.

* + - * + **Involuntary dissolution**

**= dissolution that is ordered or compelled by a court.**

Modern involuntary dissolution statutes typically allow a shareholder to petition for court-ordered dissolution on various grounds, including director or shareholder deadlock, misapplication or waste of corporate assets, and fraudulent, illegal or oppressive actions by directors or those in control.

* + - * + **Administrative dissolution**

**= dissolution for noncompliance with certain requirements of the state, such as the failure to pay taxes or fees.**

Under most statutes, a state official is empowered to bring a proceeding for dissolution.

* + - **Deadlock**
      * **General Rule: Irreconcilable differences among an evenly divided Board do not mandate dissolution in all cases 🡪 circumstances must show imminent danger to the corporation. (Wollman v. Littman; Hall v. Isaacs & Sons Farms)**
    - **Oppression**
      * Minority shareholders & Closely-Held Corps – Why there can be problems:
        + In a closely-held Corp., a shareholder typically expects an active participatory role in the company via management + employment + a return on investment.
        + Closely-held Corp lacks an active market for stock; only potential purchaser of minority’s shares may be the oppressive majority.
        + Through control of the Board, a majority shareholder has the ability to take unjustified actions that are harmful to a minority shareholder’s interest – can “freezeout”.
        + **Common freezeout techniques:**

**Termination of a minority shareholder’s employment;**

**Refusal to declare dividends;**

Or issuing “de facto” dividends – dividends disguised as compensation – once the minority shareholder’s employment is removed.

**Removal of a minority shareholder from the board;**

**Siphoning off of corporate earnings through high compensation to the majority shareholder.**

* + - * **When we ask whether the shareholder is controlling, we ask (1) If they have the majority of shares or (2) based on the % required for a vote, they have veto power. (Smith v. Atlantic Properties, Inc.)**
      * **Protecting Minority Shareholders from Oppressive Majority Conduct**
        + **Protection via Contract:**

**A minority shareholder who is cognizant of the risks of oppressive majority conduct could seek to protect his rights by contract before committing capital to the venture.**

* + - * + **Protection in the absence of Contract:**

**Two basic approaches:**

**Common law doctrine designed to protect minority shareholders from oppressive majority conduct.**

**Refuse to develop common law rules for minority shareholders 🡪 oppressed investor must use traditional legal principles. (DELAWARE TAKES THIS APPROACH).**

* + - * + **“SPECIAL RULES APPROACH”**

**MASSACHUSETTS Rule: Stockholders in Close Corps owe one another substantially the same fiduciary duty that partners owe to one another – “utmost good faith and loyalty.” (Donahue v. Rodd Electrotype)**

Application to Corp purchase of majority shares:

Rule: The controlling stockholders must cause the Corp to offer each stockholder an equal opportunity to sell a ratable number of his shares to the corporation at an identical price. (Donahue v. Rodd Electrotype)

**NEW YORK Rules**

**(Wilkes v. Springside Nursing Home): When minority stockholders in a Closely-Held Corp. bring suit against the majority alleging breach of duty of good faith, we ask two questions:**

**1 – Is there a legitimate business purpose?**

**2 – Could the same objective have been achieved through an alternative course of action less harmful to the minority’s interest?**

**(In re Kemp & Beatley, Inc.): Oppression arises when the majority’s conduct SUBSTANTIALLY DEFEATS the minority’s stockholders REASONABLE EXPECTATIONS (at the time they purchased the stock) that the majority was aware of.**

**Some states allow dissolution when a corporation’s controlling faction is found guilty of oppressive action toward the complaining shareholders. (NY – In re Kemp & Beatley, Inc.)**

* + - * + **“NO SPECIAL RULES” APPROACH (specifically, Delaware; Nixon v. Blackwell):**

**The parties must elect Closely-Held Corp. status to get the statutory benefits.**

**Minority stockholders should contract for protection when they initially bargain for shares. The court will not provide remedies outside of the contract.**

Problems with this approach/why minority stockholders often fail to adequately contract:

Because close corporation owners are frequently linked by family or other personal relationships, there is often an initial atmosphere of mutual trust that diminishes the sense that contractual protection is needed.

Close corporation owners are often unsophisticated in business and legal matters such that the need for contractual protection is rarely recognized.

It is difficult to foresee all of the situations that may require contractual protection.

Parties usually seek to avoid harming their relationship during the contracting process.

A similar concern exists that any “hard feelings” created by the bargaining process will hinder the parties’ abilities to work together in the future.

* + - **Remedies for Dissention**
      * **Appointment of Custodian or Receiver of Corporation**
        + **Rule (DGCL §226): The Court of Chancery, on application of any stockholder, may appoint 1 or more persons to be custodians, and if the corporation is insolvent, to be receivers for any corporation when:**

**At any meeting held for the election of directors, the stockholders are so divided that they have failed to elect successors to directors whose terms have expired/are about the expire; or**

**The business of the Corp. is suffering/threatened with irreparable injury because the directors are so divided respecting the management of the affairs of the Corp. that the required vote cannot be obtained; or**

**The Corp. has abandoned its business and has failed within a reasonable time to take steps to dissolve, liquidate or distribute its assets.**

* + - * + TX LAW: Similar Custodian/Receiver Statute as Delaware
        + How this works:

The custodian has the power to take over and maintain all operations of the deadlocked corporation until the parties can reach agreement and resume management of the corporation’s affairs. The custodian effectively replaces the Board as the decision-making body.

May potentially negatively impact the company’s relationship with its creditors, suppliers and customers.

* + - * + Alternative Court appointment – Provisional Director

= A neutral 3rd party who is appointed by the Court and vested with the rights and powers of a director to vote at Board meetings. They act as an in-house arbitrator with the power to vote to break deadlocks.

Advantages:

It avoids the dissolution of the corporation and enables the business to continue operating

Buys the parties some time to cool off and attempt to reestablish cooperation with each other.

Allows the parties to stay in charge of the company and involves less disruption to business

Does not draw the same alarm from creditors and suppliers as the appointment of a custodian or receiver

Disadvantages:

Deprives resisting shareholders of their right to veto managerial decisions by vesting that power in the provisional director.

If parties have become completely incompatible, the appointment of a provisional director may be futile.

* + - * **“Buy-Out” of Aggrieved Minority Shareholder**
        + **Most jurisdictions will allow “buy-out” of the minority’s shares at “fair value” as an equitable remedy. This may be paired as an alternative – the Corp must be dissolved, or the majority must buy out the minority.**

“Fair Value”:

Two different ways of calculating:

Fair value = fair market value

Means that the court values an oppressed minority’s shares by considering what a hypothetical purchaser would pay for them 🡪 gives a “minority discount” + “marketability discount”

“minority discount” = adjusts for lack of control in the corporation

“marketability discount” = adjusts for lack of liquidity in one’s interest in an entity

Even if jurisdiction has an appraisal statute that uses FMV w/ discounts, those discounts are arguably not valid when the majority is buying the minority’s shares – they aren’t really buying on the market + discounts could be used by majority to further oppress minority. (Brown v. Allied Corrugated Box Co.)

Fair value = pro rata share of the company’s overall value

Means that no discount is given for lack of control or lack of liquidity

Courts typically look to appraisal/dissenter’s rights statutes in the jurisdiction for guidance in determining “fair value.”

Establishing “fair value” tends to become a battle of experts between the parties.

Date of filing lawsuit = valuation date for shares

* + - * + TX DOES NOT provide for this by statute, but court may order as an equitable remedy where less harsh remedies are inadequate to protect the rights of the parties. (Davis v. Sheerin)
      * **Court-ordered Dissolution:**
        + Problems:

Court is dissolving an otherwise profitable business.

Dissolution sale may not generate a fair value for the business, because:

The business may be so dependent on the skills of the majority himself is the only realistic purchaser of the business;

Even if the minority shareholder could run the business himself, he may not have enough capital to bid competitively at the sale;

Many dissolution sales are “fire sales” in that the business sales are sold separately, usually yielding less than if the business were sold as a going concern;

The business “is not always operated between the appointment of the receiver and the date of sale” and as a result, customers may develop relationships with other vendors;

Dissolution sales usually require payment of the entire purchase price and may drive out those that cannot pay all at once;

Purchase prices at dissolution sales are depressed because it is difficult to ensure that the buyer will reap the benefits of the seller’s goodwill.

* + **Securities Fraud**
    - **Basic Rule: It is against the law to misrepresent or fail to disclose material information in connection with the purchase or sale of securities. (15 USC 78j(b); 17 CFR 240.10b-5). The plaintiff must prove scienter – intent to deceive + reliance. (Michaels v. Michaels)**
      * **Material = “there is substantial likelihood that, under all the circumstances, the omitted or misstated fact would have assumed actual significance in the deliberations of the reasonable shareholder,” based on what the DEFENDANTS knew at the time the PLAINTIFF acted. (TSC Industries v. Northway; Michaels v. Michaels).**
        + Examples of immaterial things:

Preliminary negotiations (Michaels v. Michaels)

* + - * **“In connection with the purchase or sale of any security” = the plaintiff must be an actual purchaser or seller of a security; not a potential buyer/seller. (Blue Chip Stamps v. Manor Drug Stores).**
      * **Reliance = “But for” causation (If the plaintiff would have entered into the identical transaction despite the defendant’s fraud, there is no basis for recovery) + proximate causation**
    - Damages = calculated by “out-of-pocket” rule
      * = the difference between the transaction price and the actual value of the securities at the time of the transaction.
      * Some courts also give:
        + Benefit-of-bargain damages = difference between the value of the securities represented and the actual value of the securities at the time of the transaction.
        + Disgorgement measure = focuses on preventing the unjust enrichment of the defendant rather than compensating the plaintiff for his losses.
  + **Fundamental Transactions**
    - **Sale of Assets**
      * **Basic Rule: The corporation may sell, lease or exchange all or substantially all of its property and assets, as its board of directors deems expedient and for the best interests of the corporation, when authorized by a resolution adopted by a majority of the outstanding stock of the corporation. Dissenting shareholders will NOT be entitled to appraisal rights for their shares. (DGCL §262, 271).**
      * TX Rule: Two alternate procedures for authorizing a sale when all/substantially all of the property/assets are to be sold (Rudisill v. Arnold White & Durkee PC):
        + If in the “usual and regular course of business of the corporation” (meaning that after the sale, the corporation will continue to engage in one or more of its businesses): Can be authorized by the board without shareholder approval.
        + If NOT: the Board must obtain approval from 2/3 of the outstanding shares entitled to vote on the sale. Dissenters will have the right to redeem shares for fair value.
    - **Mergers**
      * **Definition:**
        + **Merger = combination of 2 or more entities into a single corporation, with one of the constituent corporations as the surviving entity.**
        + **Consolidation = two or more corporations combine to form a new corporation.**
      * **How to make a merger happen (§251):**
        + **Board of directors must approve a resolution setting forth the merger agreement, containing: (a) the terms and conditions of the merger, (b) such amendments as are desired to the certificate of incorporation of the surviving corporation, and (c) the merger consideration.**
        + **The shareholders must then approve the merger agreement by a majority of the shares entitled to vote.**
        + **If shareholders approve the merger agreement, it is filed with the Sect. of State, and the merger becomes effective.**
      * “Small Scale” Merger (§251(f)):
        + = A merger where:

The surviving corporation’s certificate of incorporation is not amended by agreement of merger;

The shares of the surviving corporation are identical before and after the merger;

The number of voting shares of the surviving corporation must not increase by more than 20%.

* + - * + The “small scale” merger must be approved by the surviving corporation’s Board and by the Board and shareholders of all other entities participating in the merger. The shareholders of the surviving corporation have no right to vote on the merger and have no appraisal rights (but those of the subsidiary do). (§251, 262).
      * Impact of merger:
        + The surviving corporation succeeds by operation of law to all the assets and liabilities of every corporation participating in the merger. (DGCL §259(a)).
    - **Dissolution**
      * **Must be approved by the (a) Board of Directors and (b) a majority of the shares entitled to vote. (DGCL §275).**
      * **In order to dissolve the corporation without giving rise to an action for breach of fiduciary duty, the majority must demonstrate that (Grato v. Grato):**
        + **No alternative to dissolution was available; and**
        + **In dissolving the corporation, the majority secured no benefit over the other shareholders.**

But, the notion of fair treatment does not mean that a minority shareholder can require the majority to provide an equal opportunity to participate in any newly formed business ventures. (Grato v. Grato).

* + - **Appraisal Rights**
      * SEE ABOVE FOR DETERMINATION OF FAIR VALUE. Also, note:
        + If the transaction creates value, dissenters DO NOT share in the created value.
        + Ways to calculate market value:

Delaware Block Method (Piedmonte v. New Boston Garden Corp.): considers…

Average earnings of the Corp. for the past 5 years;

Uses multiplier which reflects the prospective financial condition of the corporation and the risk factor inherent in the corporation and the industry.

By any “valuation method employed by the financial community” (Weinberger v. UOP, Inc.), including:

Discounted cash flow method – projects a corporation’s cash flow in future years and discounts this cash flow to present value using a discount rate that appropriately reflects the corporation’s risk level and prospects.

* + - * **Basic Rules (DGCL §262):**
        + **Appraisal rights shall be available for the shares of any class or series of stock of a constituent corporation for the following transactions:**

**Merger/Consolidation of Domestic Corporations and LLCs (DGCL §251);**

**Merger/Consolidation of Domestic and Foreign Corporations (DGCL §252, 258);**

**Merger/Consolidation of Domestic and Joint-Stock or other Association (DGCL §254);**

**Merger/Consolidation of Domestic and Non-Stock Corporation (DGCL §257);**

**Merger/Consolidation of Domestic and Non-Stock Corporation (DGCL §257);**

**Merger/Consolidation of Domestic and Partnerships (DGCL §263); and**

**Merger/Consolidation of Domestic and LLC (DGCL §264).**

* + - * + **Any stockholder who (i) holds shares of stock on the date of the making of a demand, who (ii) continuously holds such shares through the effective date of the merger/consolidation, who has (iii) neither voted in favor of the merger/consolidation nor consented thereto in writing SHALL be entitled to an appraisal by the Court of Chancery of the fair value of the stockholder’s shares of stock.**
        + **Any corporation may provide in its certificate of incorporation that appraisal rights shall be available for shares as a result of (a) amendment to its certificate of incorporation, (b) any merger or consolidation in which the corporation is a constituent corporation, (c) or the sale of all or substantially all of the assets of the corporation.**
      * Special Merger Situations:
        + A de-facto merger, through a sale of assets or use of other statutory technique, does not result in appraisal rights to dissenters. (Hariton v. Arco Electronics Inc.)
        + When merger accomplishes a “freeze-out” in a closely held corporation:

Dissenting minority shareholders can receive appraisal rights + possibly other equitable relief for breach of fiduciary duty. (Coggins v. NE Patriots Football Club). Issue is whether the receiving fair value of shares (basic appraisal rights) adequately compensates the minority for their investment.

If it is a freeze-out, the majority will have the burden of proving the entire fairness of the transaction. (Weinberger v. UOP).

* + **Derivative Suits**
    - **Direct suit = enforcement of individual rights belonging to a shareholder.**
      * **Damages are awarded directly to shareholders. (Glenn v. Hoteltron Systems).**
      * Actions that are properly brought as direct suits UNDER THE “SPECIAL INJURY” TEST:
        + Compel the declaration or payment of a dividend
        + Prevent interference with the shareholder franchise or a particular shareholder’s voting power;
        + Vindicate preemptive rights;
        + Permit a shareholder to examine the corporation’s books and records;
        + Enforce a shareholder’s agreement;
        + Challenge ultra vires conduct; and
        + Effect dissolution.
      * Delaware once accepted the “special injury” test. Now, Delaware simply asks who suffered the alleged harm, and who should receive the benefit of recovery. (Tooley v. Davidson)
    - **Derivative suit = action brought by one or more shareholders to vindicate rights belonging to the corporation.**
      * **A derivative suit is proper when the shareholder is alleging harm that ALL SHAREHOLDERS will experience in proportion to ownership (i.e. drop in value of shares).**
      * **Any recovery obtained will be for the benefit of the corporation (awarded to the corporation). (Glenn v. Hoteltron Systems).**
      * Policy behind derivative suit:
        + Normally, the Board of Directors decides whether to prosecute litigation on the corporation’s behalf. However, if the directors are guilty of misconduct that has harmed the corporation, it is unlikely that the directors will sue themselves. Thus, the derivative suit performs a useful social function. It provides a remedy for many corporate wrongs that would not otherwise be addressed. The derivative suit also serves as a deterrent.
        + Derivative suits can:

Prevent multiplicity of suits by individual shareholders; and

Provide damages to the corporation that are available to satisfy claims by the corporation’s creditors.

* + - * + On the other hand, the derivative suit often allows a plaintiff with a small stake in the corporation to force the corporation to pursue expensive litigation that may or may not be in the corporation’s best interests. In other words, the derivative proceeding may be used as a strike suit to procure settlements and attorneys’ fees based on claims of questionable merit.
      * **Demand Requirement (by Shareholder, on Board):**
        + **Basic Rules:**

**When filing a complaint for a derivative action, the plaintiff must allege with particularity the efforts, if any, to obtain the action he desires from the Board, and if necessary, from the shareholders/members, and the reasons for his failure to obtain action or for not making the effort. (Johnson v. Steel).**

**Demand is not required where demand would be futile. (Johnson v. Steel)**

Futile = a majority of the directors are interested with respect to the transaction in question.

*Some jurisdictions disagree and still require a demand be made, even if the shareholder thinks it will be futile.*

* + - * + Delaware law used to require demand on shareholders too – no longer necessary. (Del. Ch. Ct. R. 23.1).
      * **Shareholder Standing**
        + **Basic Rules (Bangor Punta Ops v. Bangor & Aroostook Railroad Co.):**

**Contemporaneous Ownership Rule: To have derivative standing, a plaintiff must have owned his shares at the time of the alleged misconduct + must own his stock continuously through the completion of his suit.**

Exceptions: A plaintiff who did not own his shares at the time of the alleged misconduct may still bring a derivative suit if:

He acquired his shares by operation of law; or

The alleged misconduct began before the plaintiff’s acquisition of shares, but continued after the acquisition; or

The plaintiff is involuntarily deprived of his stock.

This means that a creditor cannot bring a derivative suit.

**Adequate Representation: A derivative plaintiff must be an adequate representative of the corporation on behalf he sues – cannot have a conflict of interest, must have a competent attorney.**

**Tainted Shares Rule: A shareholder may not complain of acts of corporate mismanagement if he acquired his shares from those who participated in or acquiesced in the allegedly wrongful transactions (or he did them himself).**

* + - * Payment of Expenses:
        + If the plaintiff wins, resulting in “substantial benefit to the corporation”- their attorneys fees will be paid by the corporation.
        + But if they lose, no payment of fees and may have to pay the corporation’s legal fees.
      * Settlement of Derivative Litigation
        + Historically, the power of shareholder-plaintiffs to control derivative litigation was thought to include the power to settle such litigation without judicial supervision.
        + Now, a derivative proceeding may not be discontinued or settled without the approval of the court. If a settlement affects the interests of shareholders other than the plaintiff, notice must be given to those shareholders so that they have an opportunity to object to the settlement.
        + In reviewing a proposed settlement, the trial court must determine whether the settlement is fair, adequate and reasonable. Among the factors to be considered in reviewing a settlement are:

The size of the potential recovery and the size of the suggested settlement;

The probability of ultimate success;

The financial position of the defendants;

The costs to the corporation of continuing the suit;

The degree to which shareholders intervened to object to the settlement; and

The extent to which the settlement was the product of arms-length bargaining.

* + **Miscellaneous**
    - Why choose Delaware for Incorporation
      * The internal affairs of a corporation are normally governed by the jurisdiction of incorporation.
      * Why Delaware?
        + Delaware has a liberal corporation statute that seeks to facilitate rather than regulate corporation transactions.
        + Delaware has an extensive body of corporate case law that many states lack, so corporate planning is more certain in Delaware.
        + Delaware has a talented bench and bar that specialize in corporate transactions.
    - Subchapter S Corporation
      * Under Subchapter S of the Internal Rev. Code, shareholders in closely-held corporations may elect to be taxed in a partnership-like manner.
      * To qualify for Subchapter S status, a corporation may not have:
        + More than 100 shareholders;
        + Any non-individual shareholders;
        + Any nonresident-alien shareholders; or
        + More than one class of stock.

**Chapter 5: Limited partnership [Law = RULPA (1985)]**

* **A. Historical Overview** – (pg. 762)
  + Basics:
    - Hybrid Entity - Like a partnership in that partners get pass-thru tax treatment and structural flexibility, but like a corp in that there is limited liability for the limited partners and a LP can only be created by complying w/ statute.
    - Comprised of at least 1 general partner and at least 1 limited partner. The general partner bears unlimited liability for the debts/obligations of the firm, but the limited partner has none.
  + “Linkage” and “De-linkage”
    - Applicable law in most states is RULPA, but general partnership law (RUPA) may be used at certain times when RULPA is silent. (Though ULPA de-links the two.)
* **B. Formation** – (pg. 764)
  + **1. General Requirements** – (pg. 764)
    - **RULPA §201**
      * LP is formed when the cert is filed w/ the Sect of State (or at a later time specified by the cert) as long as there is substantial compliance w/ the statutory reqs.
        + if doing business in more than one state, should file in all states – purpose of cert is to provide notice to 3rd parties.
      * The certificate must contain:
        + Name of LP
        + Address of LP or its agent for service of process
        + Name and business address of each partner
        + Latest date upon which LP is to dissolve
    - Partnership Agmts
      * The partnership agmt details the rights & duties of the partners and is a separate, non-public doc. The partnership agmt supersedes the statute reqs.
      * A partnership agmt is not required nor does it need to be in writing.
    - Partners in a LP are usually required to make a contribution to the capital of the venture
    - LPs are taxed like corps if “publicly traded partnership” and the interests of the limited partners are usually considered investment Ks (thus are securities for trading purposes).
    - **Problem 5-1:** This agreement doesn’t contain the addresses of the general partners.

* + **2. Formation Defects** – What is “substantial compliance?” (pg. 767)
    - ***Direct Mail Specialist v. Brown*** - *Defects included: ineffective acknowledgements, technical violations, and failure to record w/ the Sect of State. Now creditors are trying to collect and argue they are not a LP b/c did not follow the statutory rules of formation. Brown argues it is an LP b/c were in ‘substantial compliance.’*
      * **Rule:** In order to be in ‘substantial compliance,’ you must file w/ Sect of State, so that you give notice of your LP status to creditors.
        + Since Brown had not filed, creditors who checked w/ Sect of State would have seen only a partnership; this denies them the ability to know that only some partners (the general partners) are liable – creditors had no way of knowing there were partners that would not be liable (limited partners).
        + Had they filed correctly, the other mistakes likely would have been enough to get substantial compliance.
* **C. Management and Operation** [RULPA §302, 305, 402-3] (pg. 770)
  + Anything having to do with Management and Operation of an LP is usually not in the case law, usually it’s about K
  + **RULPA §403(a)** - Links to general partnership law (RUPA) on the rights, power, and restrictions of a general partner, but these linked rights/powers are only default rules (P’ship agmt can alter them)
    - **General Partners** basically have all the rights a partner in a general partnership would have – i.e., the ability to participate in mgmt, bind the LP via apparent authority, inspect books/records, and vote.
    - **Limited Partners** may be limited [by K, not RUPA/RULPA] …
      * MAY Inspect records and have right to info per **RULPA §305**
      * May NOT:
        + Participate in mgmt and control of the business

if they do, may be subject to liability (**RUPLA §303**).

* + - * + Vote, per **RULPA §302**, BUT partnership agmts may specify otherwise and allow voting on *any* matter, including removal of a general partner or an amendment to partnership agmt.
        + Arguably may not bind the LP - have no agency authority
* **D. Financial Rights and Obligations** – (pg. 774)
  + **RULPA §503-504** – Profits, losses, and distributions are allocated on the basis of the contributions made by each partner to the extent they have been received by the partnership and have not been returned
    - Note - This is NOT like the equal sharing rule of general partnership!
    - UPLA is the same, but allocates w/out regard to whether an LP has returned any contributions.
  + Provisions designed to prevent partners from abusing their financial rights to the detriment of Creditors:
    - Creditors can enforce an LP’s promise to contribute to the venture per **§502**
    - Partner distributions are prohibited if such would make the LP insolvent per **§607**
    - Partners are liable to the LP for wrongful distributions per **§608** (and sometimes rightful distributions under RULPA, but not ULPA).
* **E. Entity Status** – (pg. 775)
  + **General Rule:** Courts generally treat LPs as entities separate from their owners – unless there is a strong policy reason otherwise.
    - LP can bring derivative lawsuits on behalf of the LP (**§1001**)
    - Dissociation of a partner (general or limited) does not necessarily result in the dissolution of the LP (**§801**)
  + ***Currier v. Amerigas Propane, L.P.*** *– Δ (DE LP) comprised of 2 partners (one GP/one LP). Currier was injured while working at facility owned by Δ. Currier was employee of GP and received worker’s comp under insurance policy owned by GP.* 
    - Is the immunity of a general partner of a LP extended to the LP itself?
      * **Rule:** For the purposes of workers compensation, at the least, a LP and its general partner are NOT separate entities.
        + Isn’t a LP an entity distinct from its GPs?

Yes, but here we are asking what the policy is under the Worker’s Comp statute –

Point of Worker’s Comp claims is that employee waives the right to a separate tort action against his employer in exchange for the acceptance of benefits.

* + - In this case, since the GP is liable for the LP’s debts, the GP would end up having to pay the entire compensation amount – this would allow a gigantic end-run around Worker’s Comp laws.
* **F. Limited Liability** [RULPA §303] – (pg. 778)
  + **RULPA §303**
    - A limited partner is not liable for debts of the venture beyond the loss of their investments unless:
      * 1) Lim partner is also a general partner
      * 2) Lim partner participates in the control of the business
        + IF the persons who transacted business w/ the LP reasonably believed, based on the limited partner’s conduct, the limited partner was a general partner.
    - Defining control… a Lim Partner does NOT exercise control solely by one or more of the following:
      * Being an agent, e’ee, officer, director or shareholder of the LP
      * Consulting w/ & advising a general partner w/ respect to business
      * Acting as surety or guaranteeing/assuming specific obligations of the LP
      * Taking any action to pursue a derivative action
      * Requesting/attending a mtg of partners
      * Proposing/approving/disapproving by vote any of a number of things listed in §303(6)
      * Winding up the LP
      * Exercising any right permitted under RULPA
    - A limited partner who knowingly permits his name to be used in the name of the LP (except if so allowed by §102(2)) is liable to creditors if they extended credit w/out actual knowledge the limited partner is not a general partner.
  + **1. The Control Rule** – Limited partners can lose their limited liability protection if s/he participates in the control of the business. The difficult question is what conduct or activity indicates “control.”
    - ***Holzman v. De Escamilia*** *– LP ran farming business. There was 1 general partner and 2 limited partners. Creditor/trustee sued the 2 limited partners alleging they exercised sufficient control to be considered general partners and thus liable for the LP’s debts.*
      * This case was decided under the **1916 ULPA**, where the standard was: **Participated in Control.**
      * Factors the court considered sufficient to hold the limited partners liable:
        + MAJOR factor: One of the limited partners had to sign in order for the general partner to w/draw $ from bank accts

This is an “affirmative power” - can control by refusing to sign for expenditures.

This is not just a “veto power”

* + - * + Limited partners forced the general partner to resign and then appointed another in his place
        + Limited partners actively dictated which crops to plant – sometimes against the order of the general partner.
      * **POLICY: Limited Partners lost their limited liability – is this a good rule?**
        + In the Corp context, SHs can be involved in everything and still maintain their LL, so why is this any different?

Problem is 3rd parties – if the limited partner exercises too much control, others will assume they are a general partner or may even think they are dealing w/ a General P’ship.

* + - ***Gateway Potato Sales v. G.B. Investment Co.*** – *Gateway sues Sunworth, LP, Sunworth, Inc (GP), and GB investments (LP) under claim that GB has engaged in control that causes them to lose their liability.* 
      * Sunworth told Gateway that GB was actively involve in running the business and that they are a major financial institution – GB is helping Gateway try to attach liability onto GB b/c they want to share the liability with GB.
      * This case was decided under the **1976 ULPA**, but added a “source requirement” – Ct says even if Gateway had knowledge, GB might still NOT be liable if the source of the knowledge was not the limited partner himself – Direct Contact required!!!
        + Ragazzo has no idea what this court was thinking in imposing the source requirement, BUT the legislature liked it so much, they put a source requirement into RULPA 1985 – but it doesn’t require Direct Contact!!
      * **The evolution of ULPA reflects a narrowing of LP liability:**
        + ULPA 1916: (“Participated in Control”) Merely engaging in "control" was enough to cause limited partners to lose their limited liability. If control, liable.
        + ULPA 1976: (“Control Plus”) A limited partner’s “Control” will subject him to liability for the obligations of the partnership if:

Control + (“comes in two flavors”):

“Substantially the Same” as the control exercised by the General Partner (hard to prove)

-OR-

3rd party must have actual “Knowledge” of control

Note: The 1916 cases are still good law defining the standard for “Control”

* + - * + RULPA 1985: (“Control Plus” and “Source Limitation”) A limited’ partner’s control of the business will subject him to liability for the partnership obligations if:

Control +

3rd party’s “Reasonable Belief” that the limited partner will be liable

Source of Reasonable Belief IS the Limited Partner’s Conduct (“source limitation”)

Reasonable belief req’t does NOT req Direct Contact w/ the limited partner

Of course, this rule excludes situations where the Gen Partner LIES to 3rd parties b/c that is not based on the conduct of the limited partner.

* + - * + RULPA 2001: (All prior law is wrong – limited partners are NOT liable.)

Limited Partners are simply not liable for debts of limited partnership regardless of control.

Rationale: In a corporation, there is nothing wrong with a shareholder being a director or officer, so LP's should be afforded the same flexibility

* + - * POLICY: As in our discussion of agency and partnership, the law punishes those people who pass an invisible “control” threshold. In fact, shouldn’t the law encourage more control because it lowers the cost of doing business and the cost of borrowing?
        + Doesn’t this rule weaken the quality of mgmt b/c the risk of liability for participation in control deters limited partners from monitoring the general partners?
    - **Problem 5-2:**
  + **2. Control of the “Entity” General Partner** – (pg. 791)
    - Corporate General Partners 🡪 when the general partner of an LP is an entity w/ it’s own limited liability (i.e. corp) and it’s managers/officers/directors are limited partners of the LP.
      * ***Delaney v. Fidelity Lease Limited*** – Creditors of LP sued for breach of a lease agreement, naming the LP itself and all the limited partners as Δs.
        + The personal liability that attaches to a limited partner when he exercises too much control cannot be evaded merely by acting through a corporation.
    - There was concern that the requirement of one general partner could be circumvented by limited partners operating the partnership thru a corp w/ minimum capitalization and minimum liability
      * Nevertheless, entity general partners are common.
    - **Problem 5-3:**
* **G. Fiduciary Duties** [Linkage - RULPA §107, 305, 403, 1105 & RUPA §404] (pg. 794)
  + **1. General Partners** – (pg. 794)
    - ***Gotham Partners v. Hallwood Realty, LP*** – *Parent company of corporate general partner funds a plan for the partnership to do a reverse split and then buy back, by option plan selling those shares to officers and E’ees, shares under an odd lot tender offer; LP alleges GP breached its fiduciary duty to the limited partnership and the partners.*
      * Useful Definitions:
        + Reverse Split: Reduces number of shares and increases the value for each share

E.g., $10/share, Reverse 4 to 1 stock split, every share now worth $40

Rationale: It changes the perception of the stock as being more "valuable"

But, negative implications:

Decreases liquidity: harder to buy 1 unit

Creates "Odd Lots"

Shares usually sold in groups of 100

But, this reverse split results in holders who used to own in multiples of 100s, now own odd lots

Creates fractional shares (E.g., 10 shares now are 2.5 shares)

* + - * + Odd Lot Tender Offer: This solves the problem of Odd Lots; company purchases fractional shares back.
      * Default Rule – GP owes the traditional fiduciary duties of loyalty and care to the limited partnership and its partners.
        + Where the GP has engaged in a self-dealing transaction, the default fiduciary rule is the standard of Entire Fairness whereby the GP must conduct Fair Dealing at a Fair Price

Fair Dealing: A bargaining process designed to replicate how bargaining would occur among independent, third parties

Fair Price: The terms of the dealings must be substantially equivalent to what they would be on the market

* + - * BUT, the Partnership statutes provide for the ability to define fiduciary duties by K (in partnership agmt) as long as they are not unreasonable
        + DE Supreme Court has said that such duties cannot be eliminated completely; accordingly the court will construe any provision that attempts to eliminate such duties very strictly

Subsequently, the **DE legislature said they could be eliminated nearly entirely**, but that an implied contractual covenant of good faith remained

Benefits of the DE rule: Allows parties to allocate the market risks as they choose; consistent with DE law on creating maximum flexibility and enabling transactions

Drawbacks of the DE rule: Raises cost of money to corporations; reduces inefficiencies whereby partners won’t need to constantly watch their backs

* + - * + Majority Rule: Fiduciary duties may be contracted for, but not eliminated; the contracted terms must be reasonable
      * **Remedies:** Where the remedy of rescinding a K is not a viable solution (because of concerns about solvency), an appropriate way to remedy the effects of a transaction that expanded the power of the majority at a low price is either (a) applying a control premium to money damages or (b) sterilizing the voting rights of those shares purchased at a discount.
    - ***Labovitz v. Dolan*** *– LPs are unhappy that GP isn’t paying any distributions. This caused the LPs to pay hefty taxes. Right now, the LPs aren’t getting any dividends, yet they are paying heavy taxes and the GP offers to buy their stock at 2/3 the value of the stock…LP sued that they were forced to sell at a low price. Pship agrmt says that management decision are w/in the GP’s “sole discretion”*
      * **Rule:** Despite broad discretion granted to the general in the Articles or partnership agmt, s/he still owes his limited partners a fid duty encompassing the duty of exercising good faith, honesty, and fairness in his/her dealings w/ them and the funds of the partnership.
        + Fid duties exist **“concurrently”** w/ the obligations set out in the LP agmt.

Partners are free to alter the relationships, but it may not destroy the fiduciary character.

Burden of Proof – lies w/ general.

The fiduciary must show by clear and convincing evidence that a transaction is equitable/just/in good faith.

* + - * Note: In a LP, **DGCL §141** is done completely by K – LP’ship agreement must vie that authority to someone – here, they gave it to Dolan.
      * What about the provision requiring “willful misconduct” – is that legal?
        + Seems like no under **RUPA §103(b)** b/c it eliminates his duty of care entirely.
        + However, in **DE** – this provision would be entirely legal b/c you can eliminate duties!!
      * Does ***Dolan*** (1989) come out the same after ***Nixon***?
        + Has something to do w/ Wilkes, Donahue, Kemp, and Nixon and Meinhard
        + Why doesn’t Nixon upset the result in Dolan?
      * **RULPA §107** 🡪 unless prohibited by K, a partner may lend $ to and transact other business w/ the LP and has the same rights and obligations w/ respect thereto as a person who is not a partner. However, this does not alter a general’s fiduciary duties.
    - **Entity Rationalization: A Judge’s Perspective**
      * Courts do not lightly give up fid duty doctrine.
      * To determine whether fid duties have been preempted by K, look at whether employing the fid duty would further or interfere w/ the partnership agmt
      * If the agmt displaces some, but not all, fid duties and the mgmt seems to be overreaching, courts apply fid principles to protect investors.
      * If the articles/agmt displace fid duties altogether, the court will use K law in a manner that protects investors.
    - **Problem 5-4:**
    - ***In re USACafes, LP*** – *LP’s general partner was a corporation run by 2 50/50 SHs, who were also limited partners in the LP. Πs are also holders of limited partnership units and sued after the GP Corp received cash payment, loan forgiveness, and other personal benefits in connection w/ the sale of all the LP’s assets to 3rd P*
      * **Rule:** D/O of a Corp General Partner owe a fid duty directly to the limited partners and the LP’ship.
        + DE Rule - Not as settled in other states, but still argue if no other law on point.
        + At least in this case, we shouldn’t allow officers/directors to hide behind the corporate shield.
      * How else could we sue O/D under tort law?
        + Vicarious liability
        + Aiding & Abetting liability – requires that 1) someone breach a duty; 2) you know of their breach; and 3) you rendered “substantial assistance” to them.
        + Breach of Duty of Care – Requires mens rea – but it’s lower than “knowledge”

DE – mens rea is gross negligence, meaning you don’t have to know you are helping someone to be acting illegally.

* + - * Policy: Doesn’t this disregard the separate entity status of the corp?
        + The GP and LP will often have competing interest – standard is unclear as to how to balance this. Seems that the duties owed by the corp general partner to the limited partners actually trumps the duties owed by the D/O of the corp general partner to its SHs.
  + **2. Limited partners** [RUPLA §101(8) & ULPA §305] (pg. 819)
    - RULPA (1985) does not address the fiduciary duties of limited partners, so according to §1105, Gen P’ship law applies – where all parties owe duties to each other. Where does this leave us?
    - ***KE Property Mgmt. v. 275 Madison Mgmt. Corp*** – *KE Property (GP) is granted SJ in its suit to enjoin 275 (managing GP) from continuing to act as general partner (managing general was forcing bankruptcy of LP) after removal of its GP status by KE Property’s affiliate KJ Capital (LP) b/c of its agent’s misappropriation of $2M. Partnership Agmt states that a limited partner may expel any general “as a result of his fraud or willful misconduct.” – this provision is a complete disaster.* **[RIGHT RULE – WRONG FACTS!!]**
      * What’s wrong w/ the provision requiring 25% vote of unit holders and fraud or willful misconduct?
        + It needs to require at least a Maj vote and it should be automatic.
      * Does fraud by the managing general partner justify its removal by a limited partner?
        + 275 Madison Corp argues the limited acted in bad faith by removing him, which requires the assumption that the limited owed the general a fid duty.
      * Argument: While not addressed by RULPA, **UPA §17-110** states that all partners owe each other fid duties; thus, the limited partners are also subject to the obligation to act in good faith.
      * **RULE:** To the extent that a P’ship agreement empowers a limited partner discretion to take actions affecting the governance of the limited p’ship, the limited partner may be subject to obligations of a fiduciary, including the obligation to act in good faith as to other partners.

Ct held there was a fid duty b/c the partnership allows the limited partners to de-thrown the managing general partner for “fraud or willful misconduct”

Ragazzo – the court’s decision would only make sense if the limited partners had a veto decision about the bankruptcy – here, they only have the ability to remove the managing general partner; the remaining general partner could’ve still declared bankruptcy.

* + - * Corporation Context:
        + Could a Min SH owe a duty to a Maj SH?

Yes! Smith v. Atlantic Prop – Minority SHs have a fid duty to other SHs when they exercise power or control.

* + - * Compare to ***Dolan***:
        + Under ***Dolan***, just as the controlling partner can’t absolve himself of fiduciary duties on the grounds that the K gave him the power, here, likewise the limited partner can’t absolve himself of fiduciary duties if he has a veto power!
      * **After this case:** 
        + ***Bond Purchase v. Patriot Tax Credit Properties*** – Another way to view/limit this rule:

K.E. Rule is limited to situations in which a “p’ship agmt empowers a limited partner discretion to take actions affecting the governance of the Lim P’ship”

* + - * + ***In re Villa West Associates*** – Eliminating the rule: Mere concert of action, w/out more, does not establish a fid relationship.
    - **ULPA §305** 🡪 Limited partner does not have any fid duty to the LP or any other partner solely by reason of being a limited, however, a limited “shall discharge its duties/exercise its rights w/ good faith and fair dealing.
* **H. Ownership Interests & Transferability** – (pg. 827)
  + **1. Overview** – (pg. 827) RUPLA §101(10), 301, 401, 702, 704
    - Default Rule:
      * Like general partnerships, financial rights are transferable (while mgmt rights are not unless written consent of each partner *or* as otherwise provided by the partnership agmt per **§401**).
      * Thus, an assignee has the right to become a limited partner if and to the extent that the assignor gives that right in accordance w/ the P’ship agmt or all the other partners consent.
  + **2. Entity General Partners** –
    - The transfer of shares of a Corp GP is technically distinct from the transfer of a GP’s interest
      * The Corp maintains its identity even if 100% of its shares are sold to a 3rd party.
      * Selling only a block of shares, however, shifts the control of a corporate general partner to the new owners.
        + This may adversely affect the interests of limited partners

**7y WRITING BREAK HERE**

* + - ***In re Asian Yard Partners –*** *Anti-assignment (no transfer) clause in the Pship agrmt, LP owns 100% stock of Corp GP and wants to sell BOTH their LP share AND the 100% stock in the Corp GP to Lincoln.* 
      * **RULPA §401** (Default rule) – you cannot add general partners (transfer) unless provided by the partnership agmt or by written consent of all partners.
      * At issue here is whether the partnership agmt “no transfer” clause prevents the Corp GP from transferring 100% of its shares – thereby maintaining its entity, no change in mgmt.
        + K – No Transfer… no partner may sell, assign, transfer, give, hypothecate or otherwise encumber, **directly or indirectly**, or by **operation of law or otherwise**, any interest in the partnership w/out prior written consent of all partners.

Ct construed this provision very strictly – make sure agreements have the above highlighted phrases!!

* + - * Court holds the clause clearly prohibits this transfer for the following reasons:
        + Clause is broadly stated – uses the words “directly or indirectly” which allows for a plain meaning reading which encompasses this type of transfer
        + After the transfer prohibition, there were exceptions – indicative of the fact that the parties intended the first broad phrase to apply to everything excluding the specific exceptions.
      * Suppose there were no K in this case:
        + LP could sell their interest in the profits of the P’ship, but not their 49% share of LP
        + LP could also sell the 100% stock they own in the Corp GP b/c this is not implicated in **§301** addressing the addition of new partners.
    - ***Baybank v. Catamount Construction*** *– Connors are guarntors on a promisory note. Baybank (creditor) sought to reach the Connor’ interest in the LP, where Connors are limited partners. Baybank requested charging order, appointment of receiver, and dissolution. Superior court granted charging order and ordered disoolution of LP and appointed a receiver to dispoke of Connors’ interest in LP to satisfy debt.*
      * Under **RUPLA §703**, a creditor of a limited partnership my seek a charging order which is the right to distributions of partnership assets (though NOT the assets themselves).
        + However, RUPLA does not provide a method for enforcement, so can look to **UPA §28.**
      * **Rule:** To enforce a charging order under RULPA, a creditor may seek the appointment of a receiver to collect the partner’s share of distributed profits, may seek a sale/foreclosure, but may NOT obtain an order of Dissolution.
        + UNLESS, However, under **RUPLA §802**, the court may grant dissolution when it is not reasonably practicable to carry on the business in conformity w/ the partnership agmt.
      * Here, the court was not convinced it was not reasonably practicable to carry on the business & thus dissolution granted by the trial court was improper.
      * Ragazzo: We missed a step: Ct skipped the foreclosure sale (which is OK under UPA §28 – nothing in LP Act that is inconsistent.

**Chapter 6: Limited LIABILITY partnership**

* 1. LLP is generally like a Gen P’ship, w/ a few Differences:
     + - 1. Can’t form by accident – you must register your LLP with a state official (usually Sec of State)
       - 2. MAJORITY (TX) – TX created the LLP and everyone has followed.
         * When you register your LLP, you get certain benefits:

You are NOT liable for all the torts of the P’ship.

Only liable for your own conduct and those you are supervising.

Liable for the all Ks of P’ship.

* + - * 3. MINORITY – Some states say you are also not liable in K b/c any 3rd party can check with state records to verify that you are an LLP

**Chapter 7: Limited LIABILITY Corporation [Law = DLLCA]**

* **A. Historical Overview** – (pg. 869)
  + LLC = noncorporate business structure that provides it’s owners (i.e. members) with a number of benefits:
    - LL for obligations of venture, even if the member participates in control
    - Pass-through tax treatment
    - Tremendous freedom of K
  + Like a P’ship w/o the General Partner (only Limited Partners)
  + Preferred business structure for many closely held business
* **B. Formation** – (pg. 873)
  + **Separate Legal Entity?**
    - **DLLCA §18-201(b)** – YES. LLC, as a separate legal entity, is formed at the time of the filing of the Initial Certificate of formation or at any later date or time specified in the certificate of formation if there has been “substantial compliance” with the requirements of this section, and shall continue until cancellation of the LLC’s Cert of Formation.
    - **ULLCA §§ 201-202** – YES. LLC, legally distinct from its members, is formed when the Articles of Organization are filed – filing is “conclusive proof that the organizers satisfied all conditions precedent to the creation of a LLC.” (This is similar to **MBCA §2.03** handles it in the Corporate context)
  + **Contribution?**
    - **DLLCA §18-101(3)** – LLC members are required to make a contribution – cash, property, and services count as contributions.
  + **Problem 7-1:**
* **C. The Role of Contract**– (pg. 876)
  + LLC statutes typically contain few or no default rules on meetings, quorums, and notice, so the parties’ agreement is often the only supplier of certain governance and operating terms
  + ***Elf Atochem North America, Inc. v. Jaffari*** – *P claims Jaffari is stealing biz from the company and also stealing money from the “member-managed” LLC. K provided for arbitration of all direct claims.*
    - Jafari breached his fiduciary duty to the LLC b/c he was:
      * 1. Stealing $ - payed for personal expenses out of the LLC bank account (DERIVATIVE)
      * 2. Usurped a Corp Opp – giving business to another company (DERIVATIVE)
      * 3. Threatens to make “bad” chemicals that violate EPA rules, so that all their Ks fail and he can take business for himself. (DERIVATIVE)
      * 4. Failed to make disclosures to Elf. (DIRECT – clear that arbitration clause applies to this claim)
    - Are the 3 Derivative claims w/in the scope of the Arbitration clause – “arising out of or related to the agreement” or do they fit under the forum-selection clause – “transactions contemplated by the agreement”?
      * Arguably, they do arise out of or relate to the OA b/c it makes Jaffari the manager of the LLC.
    - Assume the Arbitration clause covers these 3 Derivative Claims – Is the LLC Bound, even though they didn’t sign the OA?
      * All the members signed the OA, the LLC didn’t sign b/c it didn’t occur to anyone that the LLC had to sign if ALL the members had signed.
      * DE statute has made it clear that LLC is bound by LLC Agreement – **DLLC §18-101(7).**
        + Note: some states take a different view – if LLC doesn’t sign then the LLC is not bound.
* **D. Management and Operation** – (pg. 886)
  + **1. General Governance** –
    - **LLCs come in two (three) flavors:**
      * Manager-managed: Centralized management (like Corp)
      * Member-managed: Each owner has management rights (like a Gen P’ship)
        + \*\*\*Every state has a default rule, but they are all different
        + **DLLCA §18-402** – Default Rule = Member-managed
      * Mix: Some LLC statues allow the management function to be divided b/s members and managers.
    - **Voting:**
      * ½ LLC statutes default to members voting on a per capita basis (one vote per member), while the other ½ default to members voting on a pro rata basis (by % contribution to firm)
      * Ordinary matters – Majority vote typically
      * Extraordinary matters – Some statutes requires super-majority vote.
      * Manager-Managed LLCs – majority vote of managers (by number); extraordinary: specific vote of members as well.
    - **Allocation of Financial Rights Among Members:**
      * ½ LLC statutes default to members sharing profits and losses on a per capita basis , while the other ½ default to members sharing on a pro rata basis
    - **Classes of LLC Ownership Interests:**
      * **DLLCA §18-302(a)** – allows for creation of multiple classes of LLC ownership interests with diff rights and privileges.
        + This is analogous to a Corp and the ability to have multiple classes of stock with varying rights and priv.
    - **Rights to Inspect:**
      * **DLLCA §18-305, ULLCA §408** – provides members with defined rights to inspect the records of the venture.
  + **Problem 7-2:**
  + **2. Authority** – Members (managers) in member-managed (manager-managed) LLCs possesd P’ship-like agency authority to bind the LLC, but members in manager-managed LLCs usually (ULLCA §301(a)) have no authority to bind the venture at all. (Cf. **DLLCA §18-402** – members and managers have authority to bind LLC, absent K agreement otherwise)
    - ***Taghipour v. Jerez*** – *Jerez Took out a $25K loan and put up LLC property as security, then left town. Jerez didn’t have authority to do that under the OA (loans require permission of majority vote of the members). This is a manager-managed LLC and Jerez is the manager. Bank wants to foreclose on the loan.*
      * In Corporations –
        + This provision requiring vote of members (SHs) would be illegal under **DGCL §141** (***McQuade***, ***Longpark***) – this would sterilize the board.
        + Jerez would only have apparent authority to bind the Corp in his capacity of Pres IF borrowing money was in the ordinary course of business.

P’ship context? – same standard!!

Seems like Jerez would have NEITHER Actual or Apparent Authority in Corp or P’ship context b/c borrowing money is NOT in the ordinary course of this business.

* + - * Why does the Bank win here??
        + Utah Statute – Any manager/member binds the LLC when he signs anything “providing for the acquisition, mortgage, or disposition of property of the LLC”, whether or not he has authority.

POLICY: This statute protects property rights – certainty of land titles is more important than giving member what they bargained for. (This provision has since been revised.)

* + - * + Bank should’ve protected itself by: Ask secretary of Co. to certify that Pres has authority – ask for docs to show that authority – secretary has at least Apparent Authority to certify records of Co – even if it ends up being untrue. (Same procedure when dealing with Corp!!)
* **E. Financial Rights and Obligations** – (pg. 894)
  + LLC statues tend to provide either:
    - P’ship-like equal allocation
    - Corp-like pro rata allocation based upon contributions to the firm
  + ***Five Star Concrete, LLC v. Klink, Inc*** – *Klink wants to withdraw from LLC, other members are made b/c they aren’t getting distributions and they are having to pay their share of taxes, even though not getting distributions. Klink wants more than the $31K they are giving him, he wants the “fair value” of his share from the date he withdrew, even though they haven’t done their yearly accounting. Here, his share went up by 50% during this time period.*
    - Klink is entitled to a distribution equal to his fair value of his share upon withdrawal, but he wants more!!
    - Problem is we don’t know what OA provides for –
      * OA should provide for you to get your Fair Value AND whatever is in your capital account AND whatever would be in your capital account after we do our fiscal year accounting.
      * OA should also specify when $ is put into your capital account.
* **. The Nature of the LLC: Regulatory Issues** – (pg. 898)
  + ***Meyer v. OABLEC*** - *In OK, a GP and LP can own a liquor license. An LLC would like to own a retail liquor license in OK, but they aren’t allowed to get a license.*
    - Statute didn’t list LLC as one of the entities able to get a liquor license (P’ship and Individuals), but also not listed under who cannot get one (Corp, Business Trusts, or Secret P’ships)
    - LLC were not around when the statute was enacted, but OK seems to think they have pre-empted the field here – so the Ct has to decide if LLC is more like Corp or P’ship.
* **G. Entity Status** – (pg. 903)
  + As a separate “legal person,” an LLC can exercise rights and powers in its own name – can bring a lawsuit and own property – but judicial treatment of LLC is not always predictable.
  + ***Premier Van Schaack Realty, Inc v. Sieg*** – *Sieg entered into an agreement with Coldwell Banker; CB had the exclusive right to sell property for 7% commission. Sieg created an LLC and transferred property (real estate) in exchange for 40% membership interest in LLC.*
    - Sieg says he didn’t “sell or exchange” – all he did was make a capital contribution.
    - Ct struggles here to make this LLC more like a P’ship as to not hold Sieg liable to CB.
    - Ct says this is not the type of sale or exchange the K contemplates, so this isn’t doing an end run around brokers rights, but the Ct is arguably wrong –
      * The other members of LLC that Sieg formed are people the broker identified as prospective buyers.
    - Real Q is not “What kind of animal is the LLC?” – In deciding how to apply a contractual clause, you have to think about the point of the contractual provision and what the drafters had in mind – then you decide Corp or P’ship!
* **H. Limited Liability** – (pg. 910)
  + **1. The Scope of Limited Liability** – (pg. 910)
    - ***Pepsi-Cola Bottling Co. v. Handy*** – *Sale of property to Pepsi…there are wetlands on the property Pepsi bought; Handy never disclosed that before Pepsi bought it. All of the non-disclosure actions happened before the LLC was formed. Pepsi doesn’t sue LLC b/c probably they have no $ and are thinly capitalized. Pepsi sues Handy directly and wants to hold him individually liable.*
      * Held: Δs are not protected by the **DLLCA §18-303** b/c the wrongful acts were committed before LLC was formed.
        + **§18-303** deals w/ liability of LLC members to third parties.
        + At the time of the fraud, they were a P’ship, so all the partners are liable.
    - ***Water, Waste & Land, Inc. v. Lanham*** – *Westec did some work and didn’t get paid. Westec thinks they’re dealing with Lanham, not with PII, an LLC. A reasonable person would think that Westec is dealing only with Lanham.*
      * Is Westec liable on K?
        + Generally, if the Principle is liable, the 3rd party is also liable, UNLESS the Principle is undisclosed and either the Agent or the Principle knows the 3rd party would not have entered into the K had the 3rd party known the identity of the Principle.
      * LLC confesses that it is liable, are the Agents liable?
        + Std: Agent can be liable for K if Principle is only partially disclosed OR undisclosed.
      * NOTE: This case is NOT stripping you of your LL, it’s just enforcing the liability you already have.
  + **2. Piercing the Veil** –
    - ***Kaycee Land & Livestock v. Flahive*** – *Can the veil of an LLC be pierced in the same way as you do in the corporate context? Yes.*
      * Corp Statute that applies to allows piercing the corp veil if he engages in misconduct
      * LLC Statue says member are NOT liable, but leaves out the veil piercing sentence in the case of misconduct.
      * Ct held that although purpose of LLC is to shield yourself form liability, if the member is using the LLC as a cloak for misconduct, then court can pierce the veil just as it does a corporation.
      * Provisions here are sloppily drafted, but the Ct is probably correct.
      * It is MORE DIFFICULT to pierce the veil in LLC than in Corporation –
        + One of the main reasons to pierce the veil in Corp is failure to follow formalities, but in LLC, you don’t have to follow any of those Corp formalities, so a whole category of reasons to pierce the veil are gone!
* **I. Fiduciary Duties** – (pg. 928)
  + ***VGS, Inc. v. Castiel* –** *Manager-managed LLC (3 members); 2 of the managers merged the LLC into a DE corporation w/o Castiel (the 3rd member’s) consent. Castiel used to own 75%, but after merger Castiel’s interest is only 35%. Castiel is upset b/c the merger takes away his interest.*
    - Casteil owned ¾ of interest in LLC, so he get 2 managers on board – he appointed himself and Quinn
    - Does LLC’s OA speak to the vote required to approve this transaction?
      * Says managers can vote to approve merger.
    - Since the statute doesn’t address voting requirements, and OA doesn’t address it – we could say Legislature would also think simply majority is enough for manager-managed LLCs.
      * Also, manager-managed is more like a Corp where the default rule is also simple majority!
    - But, Ct didn’t look to statute – they simply said OA meant simply majority b/c:
      * There are certain matters where Sahagen had a veto power – and why would he need a “veto power” over stuff like mergers if the vote was unanimous.
    - So, this case worked out OK b/c the OA had other provisions that showed what the OA really meant!!
    - Easy to read this case in line with ***Meinhard***, ***Donahue***, ***Wilkes***, etc., but hard to read it in line with ***Nixon*** (another DE case).
  + **Problem 7-4:**
  + **Problem 7-5:**
  + ***McConnell v. Hunt Sports Enterprises*** – *National hockey league franchise case. McConnell competed for the very franchise the LLC was trying to get. Court held that he was allowed to compete. K allows McConnell to compete in any other business.*
    - Is McConnell Usurping a Corp Opp?
      * No – Hunt turned it down.
      * Yes – McConnell’s acceptance undercut Hunt’s bargaining power
    - Had there been no K, would McConnell have done something wrong?
      * Yes – members have a fid duty to each other in LLC, especially not to steal the bus from each other (***Meinhard***, ***Page***, ***Donahue***)
    - Ct said K was clear, but there are at least two interpretations of “any other business”
      * 1. Business other than pursuing the NHL franchise
      * 2. Business other than pursuing business of LLC (Ct said it was this one – every other business is “another business” and you can do anything)
    - Is this K legal?
  + ***Anderson v. Wilder*** – *Πs were expelled from an LLC by a vote of the Δs. They bought out the Πs shares at $150, then re-sold it to 3rd party for $250 per unit. Majority basically ousted the Minority.*
    - LLC OA says that a majority of members may expel, but why did they do it – it cannot be for a “bad reason” –
      * Δs said the reason was to prevent the Δs from voting on making large distribution. Obviously a pretext b/c some of the expelled members weren’t on management committee anyway.
      * Πs said the reason was oppression and forcing them to sell their interests to Majority, increasing the value of the Majority’s ownership interests.
    - **RULE:** A majority interest holder in an LLC stands in a fiduciary relationship to a minority interest holder, and this will trump the LLC K.
      * Court cites ***Wilkes*** case: Mass ct held that there is a fiduciary relationship b/c SHs of a CHC.
  + ***Barbieri v. Swing-N-Slide Corp.*** – *2 directors of SNS formed an LLC and made a tender offer to buy SNS. Π’s argue that the directors breached there fiduciary duties and were on both sides of the transactions. Π’s sue the legal entities (the LLC).*
    - Corp Context – Directors must disclose to SHs, but an independent 3rd party doesn’t have to say a thing
    - **Rule:** Directors of an LLC that is a partner in a General Partnership have a duty to disclose to the SHs of a Corporation to which the General Partnership is making a tender offer, even though they are acting through the LLC.
      * **DE:** You can disregard the LLC personally to see through it to get to the D/O of the LLC (***USACafes***) **????**
    - Does the “Holdings” P’ship owe a Fid Duty to the SHs of SNS?
      * Ct says P’ship is not liable b/c not all members of the P’ship owe a duty so it would be unfair to 3rd party (Capital)s
      * The important thing is whether Mgmt LLC is controlling the P’ship –
        + If it is exerting control – then fiduciary duty should be attributable to the P’ship
        + If it is not exerting control – no fiduciary duty attributable to the P’ship

Ragazzo thinks it really should matter who is in control of P’ship.

* **J. Ownership Interests and Transferability** – (pg. 954)
  + Ownership Interest in LLC entitles a member to:
    - 1. The right to receive distributions and to share in the profits and losses of the venture (financial rights)
    - 2. The right to participate in the management and control of the business (management rights)
* **K. Exit Rights: Dissociation and Dissolution** – (pg. 956)
  + Typically, LLC statutes state that a member dissociates from a venture upon the occurrence of certain specified acts (e.g., withdrawal, resignation, death, or bankruptcy).
  + Before check-the-box regulations, member dissociation usually resulted in:
    - 1. a buyout of the dissociating member’s ownership interest
    - 2. dissolution of the LLC
  + ***Lieberman v. Wyoming.Com LLC* –** *Lieberman withdrew as a member of Wyoming.com but still maintains an equity interest in the LLC. The OA has no specific provision dealing with a buy-out of equity interest. D.Ct. ordered liquidation of Lieberman’s equity interest at its capital account value as of the date of his withdrawal as member. He appeals. (“locking in a member”)*
    - **RULE: Ask 2 Questions –** 
      * Whether the member can withdraw?
      * What are the consequences of his withdrawal?
    - Is Lieberman allowed to withdraw?
      * If the OA provides that he can withdraw or all the members agree that he can withdraw – he is allowed to withdraw here!
    - Is Lieberman entitled to a dissolution?
      * No – OA does not address this.
    - Dissent: Having accepted his withdraw, we should imply a requirement that the remaining members compensate the withdrawing member for his interest.
      * Absent a provision in the OA, a member’s equity interest should be valued at what he would have received had the business been dissolved on the day he terminated his membership in the LLC.
      * Fair market value would be a reasonable alternative estimate of the departing member’s shares.
    - But, Lieberman wanted what the Majority member offered to buy him out at - $400K
      * Lieberman is only entitled to distributions of profits – he’s just like a Creditor that got a charging order – LLC can just stop making distributions:
        + If they did this it would be a classic freeze-out scheme and all the Corp Law would be equally applicable (***Castiel*** – DE is squarely on board with freeze-out scheme cases)
        + He is a “Locked In” minority member
  + ***Dunbar Group, LLC v. Tignor* –** *Tignor had commingled funds and Dunbar wants to expel him based on the OA provisions for misconduct. 50/50 ownership interests in Xpert. Robertson was sole member.*
    - District Court ordered dissolution. S.Ct. Reversed.
    - **Virginia S.Ct Rule:** Ct may order a dissolution of the company only when the ct concludes that present circumstances show that it is not reasonably practicable to carry on the company’s business in accord w/ its articles of organization and any OA.
    - This leaves Tignor is exactly the same place as Lieberman – he is entitled only to the distributions of the LLC – except here, Tignor’s misconduct put him in this position.
      * Arguably a horrible result b/c these guys hate each other and this will only lead to further judicial resolution down the road.
  + **Problem 7-6:**
* **L. Explusion of an Owner** – (pg. 977)
  + ***Walker v. Resource Development Co. Ltd, LLC*** - *Bush’s former cousin…the 3 other members want to expel him for misconduct, but Walker refuses the Severance Agreement.*
    - Walker misrepresented his qualifications; he was supposed to obtain financing from Norris, but ended up borrowing money from him for personal use.
    - Can they expel Walker from LLC?
      * No. Under DE law, these are NOT grounds for expulsion – this is like Corp where Ct has no authority to take away his interest.
      * Remedies – sue Walker for misconduct or breach of K.
    - What should these guys have done?
      * OA should’ve provided for expulsion upon breach of K or when % of members agreed.
    - In DE – you must provide for expulsion in OA!!
    - Could Walker get DE Ct to dissolve LLC?
      * Yes**. §18-802** – Ct can dissolve LLC when no longer reasonably practicable
    - DE does NOT allow someone like Walker or Tignor to end up in “LLC Limbo” – if OA allows for expulsion, member either gets price specified in OA or fair price.
      * Problem: You can’t expel the bad guy!
      * DE goes a long way toward protecting rights of **Minority** owners
        + NOTE: This is different from most DE situations (***Nixon v. Blackwell***)
    - They can’t kick Walker out for the purpose of continuing the Maldova deal without him – why?
      * ***Meinhard***, ***Page***, ***Wollman***
      * This would probably be equally illegal in LLC context.
      * They would have to offer to buy him out at a fair price

**Chapter 1 of Supp: Insider trading**

1. **Federal Regulation**
2. Elements of Common Law Fraud and a **Rule 10(b)-5** actions:
   1. Lie
   2. Material
   3. Told w/ Scienter
   4. Reliance
   5. Loss Causation
   6. Damages
3. **True Insiders**
4. ***SEC v. Texas Gulf Sulphur Co.*** – *Insiders of TGS knew about the results of drilling survey of land in Canada. The results indicated that it was likely that there were commercial quantities of valuable minerals in this area. The insiders started buying TGS stock after the first test drill.* 
   1. Q: Did they violate **Rule 10(b)-5**? Court says yes!
      1. Lie: affirmative misrepresentation, half-truth, or an omission
         1. Here the TGS insiders remained silent.
            1. Silence is a lie when you have a duty to disclose
         2. Did they have a duty to disclose?
            1. Court says yes because as Directors and Officers they owe fiduciary duties to the Company and the SHs
            2. ***Cady & Roberts:*** Anyone who, trading for his own account in the securities of a corporation has “access, directly, or indirectly to information intended to be available only for a corporate purpose and not for the personal benefit of anyone” may not take “advantage of such information knowing it is unavailable to those with whom he is dealing” (i.e. the investing public)
            3. Common Law Rule is different: There is no duty to disclose and insider trading is ok.

Federal law has pre-empted the field here and pre-empted the state common law rule.

* + - 1. Policy Q: Should insider trading be ok?
         1. Argument that insider trading is Bad: When you trade on inside information there is less risk to you, but it increases the risk of others trading at the same time as you on the market. If trading is riskier the investor will require a greater return. Therefore permitting insider trading would increase every company’s cost of raising capital.
         2. Argument that insider trading is Good: The market responds when insiders buy. (D & O’s have to disclose everything that they buy and sell in their own company). D & O’s presumably know more about their company than others, so people look to see what they are doing when they buy or sell on the market.
      2. TGS lied because they had a fiduciary duty to disclose either under state law or federal law.
  1. Side Note: The company TGS can also be liable for putting out the misleading press release.

1. ***Chiarella v. United States (1st person ever convicted of insider trading)*** – *Chiarella works for a printing company that prints tender offers. Chiarella was able to figure out who the companies were. He took this information and would buy the stock at $50/share and then the tender offer would be announced and the price of the stock would go up to $75 or close to that and then he would sell.*
   1. Chiarella → Printer→ Acquiring Co.→ Target Co.
      1. Side Note on Tender Offers: A tender offer is made by an acquiring company to the stockholders of a target company. A tender offer usually offers to buy the stock at a 50% premium (ex: stock selling at $50 offer $75).
   2. When he buys stock of target company is this fraud?
      1. Is there a lie?
         1. Lie of Omission but does he have a duty to the Target Company?
            1. No. He may have a duty to the Printer or the Acquiring Co. but he does not have a duty to the Target Company
         2. If there is No Duty there No is Lie which means there is NO Fraud!
   3. Under State Law does Chiarellas have a duty to the Target Co?
      1. No! This gets the court in trouble because it is decided under state law
2. **Tippers and Tippees**
3. ***Dirks v. SEC*** – *Dirks is a broker who received information from a former officer of Equity Funding, Secrist. Secrist informs Dirks that Equity Funding is overstating its assets. Secrist gives this information to Dirks after he tried to tell the Wall St. Journal and the SEC and they ignore him. Secrist tells Dirks so that Dirks can force the price down, which gets the SEC interested.*
   1. Equity Funding → Secrist → Dirks → Dirk’s Clients
   2. Dirks says “I haven’t done anything wrong” because:
      1. Dirks, citing Chiarella, argues that he didn’t lie because he didn’t have any duty to the SHs of Equity Funding
   3. Could Secrist have sold his stock in Equity Funding knowing what he knows?
      1. No because he has a duty to disclose. Secrist can’t profit from this information
   4. The SEC argues that if Dirks learned the information from someone who is prohibited from trading that Dirks can’t trade either.
      1. Court rejects this argument b/c it is inconsistent w/ Chiarella
   5. Court’s test for Tipping Liability:
      1. Tipper must breach fiduciary duty
      2. Tippee must be aware of this breach
      3. Tipper must gain from this breach
   6. **Is this 3 Part Test Consistent with Chiarella?**
      1. Yes. When all three elements of the test are met, the Tippee is helping the Tipper vioate his State Law duty. Tipper can’t help Tippee breach his state law duty if elements are not met. (***Dirks***)
   7. If Secrist had benefited from the tipping, he would have been liable for the losses of the people who traded with Dirks and Dirks’ firm
      1. You are responsible for the tippees of your tippee
   8. Dirks clients are not liable because they didn’t know about Dirks’s conduct
4. **Misappropriation Theory**
5. ***United States v. O’Hagan*** – *O’Hagan is a partner in a law firm, D & W. The law firm represents Grand Met; Grand Met is trying to acquire Pillsbury. O’Hagan is not working on this transaction for Grand Met. O’Hagan uses the information he knows about the transaction to buy the Pillsbury stock at $39/share and he then sells it at $60/share (this is a 50% profit)*
   1. Rule 10b-5 and the Misappropriation Theory:
   2. O’Hagan says “I don’t owe a duty to Pillsbury SHs” therefore “I didn’t lie”
   3. O’Hagan loses this case under 10b-5 because of the Misappropriation Theory
      1. The misappropriation theory holds that a person commits fraud “*in connection with*” a securities transaction, and thereby violates Rule 10b-5, when he misappropriates confidential information for securities trading purposes, in *breach of a duty owed to the source of the information*
   4. To whom did O’Hagan lie?
      1. Yes. He lied to his law firm and their client, Grand Met. O’Hagan feigned a duty of loyalty. His status in the law firm is a representation that he won’t divulge confidential information of other partners’ clients.
   5. **Hypo:** There is no **10b-5** violation if there is no lie. Could O’Hagan call Grand Met and tell them I am planning on using this information (breaking the confidentiality) and then hang up and buy stock?
      1. Yes. Under the above scenario there is no **Rule 10b-5** violation but there is probably a state law violation
      2. The court should fixed this problem by saying this is a matter of federal law. Then the scenario would be a violation of **Rule 10b-5**
   6. The Misappropriation Theory would catch Chiarella today!
6. **4 Ways the Court Closes the Loop-holes left by Chiarella (i.e. ways to keep people from insider trading who have no fiduciary duty)**
   1. Quasi-Insider Doctrine
   2. Tipping Liability
   3. Misappropriation Theory
   4. **Rule 14(e)(3)**
      1. Last Remaining Loophole: Suppose you are at a restaurant and you hear people who you know are directors and officers of a company discussing the fact that the are about to release very valuable information about the company to the public tomorrow. You go out and buy stock right then and then get rich. Is this legal?
         1. Yes.
            1. No **14(e)(3)** violation because it is not a tender offer
            2. No **10(b)(5)** violation because it is not a lie; random person at the restaurant doesn’t owe fiduciary duty to anyone.
         2. Should this be legal?
            1. No because it gives you an unfair advantage over every one else.
7. **Short-Swing Profits:**
   1. **§ 16** **of the Securities Exchange Act** is designed to curb insider trading
   2. **§ 16** covers issuers who are required to register
      1. Registration is required for 2 types of issuers:
         1. issuers who securities are traded on a national securities exchange and
         2. issuers w/ assets exceeding $10 million that have a class of equity securities held of record by at least 500 persons
   3. Any trading in the issuer’s securities must be reported within 2 business days
      1. These trading reports are closely followed by the market
   4. For issuers and individuals who are covered by **§16**, there is an important limitation on trading:
      1. Any profits made on a pair of opposite transactions in the issuer’s securities within any 6 month period may be recovered by the corporation in a direct or derivative suit.
         1. SHs do not have to be a contemporaneous SH to bring a derivative suit
   5. This statute is under-inclusive:
      1. b/c it permits insider trading
      2. You can buy stock with valuable information before that information is announced and then all you have to do is wait 6 months before you sell it
   6. This statute is also over-inclusive:
      1. If you bought stock without any inside information and you sell it within 6 months, you still have to give back your profit
8. ***Gratz v. Claughton:***
   1. Challenges the constitutionality of **§ 16(b)**
   2. The court says that there is a reasonable relationship between **§ 16(b)** and the purpose
   3. ***Gratz by Example:*** (what we actually talked about in class)
      1. Suppose a director conducts the following series of transactions:
         1. Jan 1st Dir. buys 1,000 shares at $30/share
         2. Feb 1st Dir. sells 1,000 shares at $25/share
         3. Mar 1st Dir. buys 1,000 shares at $20/share
         4. Apr 1st Dir. sells 1,000 shares at $15/share
      2. **RULE:** In any 6 month period, if there is a selling price that is larger than a buying price the director must pay the company back
         1. APPLYING THE RULE: within any 6 month period, match the highest selling price against the lowest purchase price. It makes no difference which transaction happened first. Then match the second highest selling price against the second lowest purchase price. Keep applying this system until you run out of selling prices that are higher than purchase prices.
            1. Losses do not offset gains
      3. There was a question in class about what happens when the transactions involve a different number of shares…Do you still match them?
9. ***Kern County Land Co. v. Occidental Petroleum Corp***. – Involving an attempted hostile takeover. Occidental wanted to take over Kern. Kern wanted to avoid this, so they entered into a merger agreement w/ Tenneco.
   1. Occidental Transactions:
      1. April Occidental had 1900 shares of Kern (.04% of Kern)
      2. May 18th Occidental buys roughly 11.7% of Kern
      3. May 31st Occidental buys roughly 8.7% of Kern
      4. June 8th Occidental buys roughly .1% of Kern
      5. Total = 20.51%
   2. The merger agreement between Kern and Tenneco stated that for every 1 share of Kern stock the SHs will get 1 share of Tenneco preferred stock (valued at $105/share)
      1. June 2nd Occidental enters into an option agreement with Tenneco
         1. Occidental was eager to avoid being locked in as a minority SH of Tenneco
         2. Option Agreement: Occidental granted Tenneco an option to purchase at $105/share all of the Tenneco preference stock to which Occidental would be in entitled to when the Kern-Tenneco merger was closed.
         3. The terms of the option specify that the option could not be authorized prior to Dec. 9th (6 months and 1 day since the last Occidental transaction in Kern stock)
      2. Aug. 30th the merger closes
      3. Dec. 11th Tenneco exercises option
   3. Problem transactions are the May 31st and the June 8th transactions because before that time Occidental was not a 10% SH and was therefore not covered by the statute
      1. You must be a 10% SH at both the time of purchase and sale
      2. The purchase that makes you a 10% SH for the first time does not count
   4. Question: Was the merger a sale?
      1. The merger happened within 6 months of the May/June transactions
      2. If the merger was a sale then Occidental can lose money made from the May/June transactions
      3. Argument that the merger is a sale:
         1. Definition of sale in the statute: “any contract to sell or otherwise dispose of”
         2. Occidental gave up Kern stock and got Tenneco stock in exchange
   5. 2 Arguments:
      1. There is a strong argument that § 16(b) should be applied w/o exceptions
      2. There is a strong argument that this was a voluntary sale by Occidental
10. Another Problem to think about: If a director buys stock and resigns and sells the stock within 6 months this is illegal!
    1. Because the guy bought the stock when he was a director and had inside information
    2. You don’t have to a Director during all transactions to be liable.
11. But consider: If a person buys stock and then later becomes a director and sells stock within 6 months this is legal!
    1. When the first transaction was made there person had no inside information because they were not a director.

**Chapter 2 of Supp: Federal Proxy Regulation**

1. **Proxy Fraud**
   1. Proxy- the grant of authority by a SH to someone else to vote the former’s shares. The relationship is one of principal and agent
      1. Because proxy involved agency law it is governed by state law
      2. BUT proxies are subject to a Federal Proxy Regime
   2. The SEC requires that no solicitation of a proxy be made unless each person is furnished at the same time a proxy statement setting forth the information specified in **Schedule 14a**
   3. In addition, if a solicitation is on behalf of management and relates to an annual meeting of SHs at which directors are elected, the proxy statement must be accompanied or preceded by an annual report of the corporation
      1. Annual Report must include: info about the company and its management, management’s discussion and analysis of the company’s financial condition, audit balance sheets for the last 2 fiscal yrs, and audited statements of income and cash flows for each of the last 3 fiscal years
   4. SEC requires that the proposed proxy statement and form of proxy be filed w/ the SEC at least 10 days prior to the date definitive copies are sent to all security holders
   5. Final copies of the proxy statement and form of proxy, along w/ any other soliciting material must be filed w/ the SEC concurrently w/ the sending of such materials to security holders
2. ***Mills v. Electric Auto-Lite Co –*** *this was a proxy solicitation in connection with a merger between AutoLite and Mergenthaler. The SHs of AutoLite will get Mergenthaler shares in exchange for their AutoLite shares.*
   1. The rule that you can not commit fraud in connection with a proxy solicitation comes from the common law.
      1. Common Law Elements of Fraud:
         1. Lie
         2. Material
         3. Mens Rea
         4. Reliance
         5. Loss Causation
         6. Damages
3. ***Virginia Bankshares v. Sandberg* –** *Merger of Subsidiary into Parent co. The Parent owns 85% of the Subsidiary.*
   1. This is a short form merger. In DE (**DGCL § 253**) all you need is a 90% vote of the Parent Co. directors. But this is Virginia and apparently all they need is an 85% approval.
      1. SHs of the subsidiary co. have appraisal rights
   2. Why do they even give the SHs a vote?
   3. If the Parent owns enough shares of the Subsidiary to secure the SH approval then why do they solicit proxies?
      1. When you have a SH vote if the minority objects to the approval, the controlling/majority SH would have to prove the Entire Fairness of the Transaction
         1. Entire Fairness: 1) fair price and 2) fair dealing
      2. But if a majority of the minority SHs have approved the transaction the burden of proving Entire Fairness shifts to the plaintiffs!
   4. Didn’t talk about Materiality in class, but they were material lies
   5. Mens Rea- See above.
   6. Essential Link?
      1. Court says that the proxy solicitation was not an essential link
      2. Even though they had enough voting power to approve the merger on their own, the merger still may not have gone through had the minority SHs known this information b/c:
         1. Shame value- The directors may not have been willing to do the transaction if they had to be truthful w/ the minority SHs because they would have gotten a lot of bad PR for abusing the minority SHs
         2. Getting Proxies gets them around the total fairness test. They do not want to prove entire fairness.
            1. Once you disclose this information; the Min will vote against the transaction and then the Maj will retain the burden of proving fairness.
      3. The court cuts this uncertainty about whether the transaction would have happened anyways in favor of the wrong-doer.
      4. The court says that because we don’t know what would have happened there is no essential link.
         1. ***Francis v. United Jersey Bank***- That court cut the uncertainty against the wrong doer (assumed diligence would have prevented the stealing)
      5. What does this mean?
         1. You can NEVER win a proxy fraud case, if the wrong-doer had enough votes to accomplish the transaction anyways