All answers in format:

State Rule

P’s Argument

D’s Argument

No conclusion needed

“Upmost good faith and loyalty”

Contents

[I. Agency 1](#_Toc277847836)

[II. The Partnership 1](#_Toc277847837)

[a. Which state’s law applies? 1](#_Toc277847838)

[b. Formation 1](#_Toc277847839)

[c. Management and Control 3](#_Toc277847840)

[d. Financial Rights and Obligations 3](#_Toc277847841)

[e. Ownership Interests and Transferability 4](#_Toc277847842)

[f. Fiduciary Duties 5](#_Toc277847843)

[g. Dissolution 7](#_Toc277847844)

[III. The Corporation 9](#_Toc277847845)

[a. Introduction 9](#_Toc277847846)

[b. Formation 10](#_Toc277847847)

[c. Management and Operation 12](#_Toc277847848)

[d. Altering Corporate Norms by Contract 15](#_Toc277847849)

[e. Limited Liability and Piercing the Corporate Veil 17](#_Toc277847850)

[f. The Traditional Role of Fiduciary Duty 18](#_Toc277847851)

[g. Dissension in the Closely Held Corporations 24](#_Toc277847852)

[IV. The Limited Partnership 28](#_Toc277847853)

[a. In general 28](#_Toc277847854)

[b. Historical overview 28](#_Toc277847855)

[c. Formation 28](#_Toc277847856)

[d. Management and operation 29](#_Toc277847857)

[e. Financial rights and obligations 29](#_Toc277847858)

[f. Entity Status 29](#_Toc277847859)

[g. Limited Liability 29](#_Toc277847860)

[h. Fiduciary Duties 29](#_Toc277847861)

[i. Exit Rights: Dissociation and Dissolution 29](#_Toc277847862)

[V. The Limited Liability Partnership 30](#_Toc277847863)

[a. General 30](#_Toc277847864)

[b. Historical overview 30](#_Toc277847865)

[c. Formation 30](#_Toc277847866)

1. Agency
	1. 2nd Restatement – “fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act.” Agent – Principal relationship.
		1. Independent contractor – may or may not be an agent.
		2. If agent is a servant – vicarious liability may exist; respondeat superior
		3. **Disclosed** principal – agency relationship is known to third party, principal is known
		4. **Partially disclosed** principal – third party knows of agency relationship; does not know principal’s identity
		5. **Undisclosed** principal – third party thinks agent is the principal
	2. Authority
		1. ***Actual authority*** – manifestation of a *principal to an agent* that the agent has power to deal with others a as a representative of the principal (agent’s understanding)
			1. Express – oral/written statement
			2. Implied – inferred from principal’s prior acts
				1. ***Incidental authority*** – incidental acts related to authorized transaction
		2. ***Apparent authority*** – manifestation of *a principal to a third party* that another person is authorized to act as an agent for the principal (third-party’s understanding)
		3. Actual/apparent authority depend on to whom the representation is made; may result from title
		4. ***Inherent authority*** – power derived not from authority, apparent authority or estoppel, but solely form the agency relation and exists for the protection of persons harmed by or dealing with a servant or other agent.
			1. May exist in the absence of actual/apparent authority
			2. Not a separate concept in the 3rd Restatement; encompassed in other concepts
		5. ***Ratification***
			1. Express ratification – principal authorizes after the fact
			2. Implied ratification – principal accepts benefits without expressly authorizing
	3. Third party liability to principal
		1. Generally liable to principal
		2. May not be held liable in undisclosed principal situation if it is known third party would not have dealt with principal
	4. Agent liability to third party
		1. Generally not a party to the contract and not liable
		2. Agent who lacks power to bind principal is liable for breach of implied warranty (unless disclosed)
	5. The Agent’s Duty of Loyalty
		1. Fiduciary relationship
		2. Accountable for profits
		3. Act solely for benefit of principal
		4. Refrain from dealing with principal as an adverse party
		5. May not compete with principal in subject related to agency relationship
		6. May not use principal’s property for own or third-party’s benefit (including confidential information)
		7. Duty of care
		8. Duty to disclose
		9. Duty to act only as authorized
	6. Principal’s duties to agent
		1. Must perform contractual commitments
		2. Must not unreasonably interfere with agent’s work
		3. Must act fairly and deal in good faith
		4. Must indemnify agent for expenses or losses incurred in carrying out the principal’s instructions
	7. Termination of agent’s power
		1. Power to terminate always exists
		2. Right may be limited by contract
		3. To avoid apparent authority, notification may need to be made to third parties
2. The Partnership
	1. Which state’s law applies?
		1. UPA is Silent
		2. RUPA - § 106(a) – state in which the partnership has its chief executive office
	2. Formation
		1. UPA § 6 – “A partnership is an association of two or more persons to carry on as co-owners a business for profit.”
		2. UPA § 7 – Rules for determining the Existence of a Partnership
			1. Not partners to each other, then not partners to third party
			2. Ownership does not establish a partnership, regardless of profit sharing
			3. Sharing of gross returns not sufficient to establish a partnership
			4. Receipt of profits is prima facie evidence that a person is a partner unless payment for:
				1. Debt
				2. Wages
				3. Annuity to widow or representative of deceased partner
				4. Interest on loan
				5. Consideration for sale of good-will of business or other property
		3. RUPA § 101(6) – mirrors UPA § 6
		4. RUPA § 202 very similar to UPA §7; begins with presumption of partnership even if not intended
		5. **Partnership rules**
			1. Every partner may perform business and manage; equal voting power (absent other agreement)
			2. Partners share equally in profits (absent other agreement)
			3. Partners are personally liable to third parties for obligations
			4. Requires unanimous agreement to admit new partners
			5. Partners owe fiduciary duties to each other
			6. Every partner may dissolve an at-will partnership
		6. Partnership vs. Creditor-Debtor Relationship
			1. *Martin v. Peyton*, 158 NE 77 (NY 1927)
				1. Facts: Contracted for loan with intent to share in profits as payment.
				2. Issue: Did they intend to “carry on as co-owners of a business for profit”?
				3. Holding: No.
				4. Reasoning: Collateral was issued, insurance taken on owner, and right to inspect books. There was no indication that lender sought to run the business.
				5. **Rule:** “Statements that no partnership is intended are not conclusive. If as a whole a contract contemplates an association of two or more person to carry on as co-owners a business for profit a partnership there is.”
			2. Intent to do business trumps intent not to form partnership
		7. Partnership by Estoppel
			1. UPA § 16
			2. RUPA § 308 (largely similar)
		8. Aggregate vs. Entity Status
			1. UPA §§ 6, 10, 18(g), 24, 26-27, 29, 31-32, 41
			2. RUPA §§ 201, 307, 801-02
			3. *Fairway Development Co. v. Title Insurance Co.*, 621 F.Supp. 120 (ND Ohio 1985)
				1. Facts: Title insurance claim resulting from an unreferenced easement. Fairway Development I had three partners, Fairway Development II was formed when partners changed (two left and one new entered).
				2. Issue: Does contract exist?
				3. Holding: No.
				4. Reasoning: Ohio follows aggregate not entity status. The partnership was dissolved.

Aggregate – partnership is made up of partners

Entity – partnership is a legal entity

* + - * 1. **Rule:** Under aggregate theory, a new partnership is formed when partners change.
		1. Federal Tax Consequences
			1. Pass-through taxes
			2. Advantage – only taxed once
			3. Disadvantage – partners pay tax on share of income regardless of distribution.
			4. Under “check the box” regulation (26 C.R.F. §§ 301.7701-1 *et seq*.) may be taxed like a corporation –this is unusual
	1. Management and Control
		1. *Summers v. Dooley*, 481 P.2d 318 (Idaho 1971)
			1. Facts: Partner spent more than $11,000 without reimbursement from partnership. He hired third person despite partner’s “no” vote.
			2. Issue: Can he seek reimbursement?
			3. Holding: No.
			4. Reasoning: UPA § 18(h) Requires differences to be resolved according to will of majority.
			5. **Rule:** If a partner acts on own without approval of the partnership, cannot seek reimbursement for an expense effectively incurred for that partner’s benefit rather than for the benefit of the partnership.
		2. *Decision making:* UPA – majority of partners, TX – right to majority of profits (e.g. A – 90%, B, C – 5% ea.; if A yes, B,C no under UPA B,C wins in TX A wins).
		3. UPA § 18(e)/RUPA § 401(f) – all partners equal right to participate in management.
		4. UPA§ 18(h) – ordinary matters – majority, amendment to partnership agreement/extraordinary – unanimous; RUPA § 410(j) explicitly requires unanimous amendment/extraordinary
		5. *Partners may agree that subset controls the business; may be explicit or implicit*
		6. See problem 3-2 p. 159 discussing alteration of standard management agreements
	2. Financial Rights and Obligations
		1. Partnership accounting
			1. Absent agreement otherwise, each partner gets equal share at sale of partnership
			2. Default – all profits/losses shared equally
			3. **Draw** – cash distribution to partners
		2. Sharing Profits and Losses
			1. *Schymanski v. Coventz*, 674 P.2d 281 (1983)
				1. UPA § 18(a),(b),(f); RUPA § 401 (b),(c), (h)
				2. Facts: Two groups agreed to 50-50 cash contribution/ownership. One group claimed that additional work was to reduce their case contribution. Other party disputes, sought larger share at dissolution.
				3. Issue: Capital contributions.
				4. Holding: Remanded for further findings.
				5. Reasoning: Contribution of services may be sufficient.
				6. **Rule:** “in the absence of an agreement to such effect, a partner contributing only personal services is ordinarily *not* entitle to any share of partnership capital pursuant to dissolution. Personal services may, however, qualify as capital contributions to a partnership where an express or implied agreement to such effect exists.”
			2. *Kessler v. Antinora*, 653 A.2d 579 (NJ App. Div. 1995)
				1. Facts: Build and sell home. Contract divided profits but not losses. Kessler provided funds and resources, Antinora built the home. Losses were incurred ($78,917). No value given for Antinora’s services.
				2. Issue: Division on loss.
				3. Holding: For Antinora.
				4. Reasoning: The contract “evinced a clear intent that Kessler would be repaid his investment from the sale of the house only , not by Antinora.”
				5. **Rule:** “the law presumes that partners and joint andventurers intended to participate equally …” However, this does not hold when one party contributes money and the other contributes labor. The one who loses money is not entitled to recover from the one who provides labor. UPA § 18(a); RUPA § 401(b) – losses follow profits absent another agreement.
			3. **Joint Venture -** Partnership for a specific purpose
		3. Liability to Third Parties
			1. UPA §§ 4(3), 9, 13-15, 17; RUPA §§ 104(a), 201, 301, 305-307
			2. UPA
				1. P’ship liable for contracts entered into by partners w/ actual or apparent authority
				2. Does not state p’ship can be sued directly
				3. Partners are joint and severally liable under UPA § 13-14
				4. Parnters are jointly liable for all other p’ship debts and obligations including contracts
			3. RUPA
				1. P’ship can be sued udner RUPA §§ 201(a), 307(a)
				2. Parnters are joint and severally liable for all p’ship obligations
				3. Creditor may sue p’ship and partners; cannot collect judgment against partner w/out separate judgment against the partner and

Unable to obtain judgment against p’ship (“exhaustion requirement”)

P’ship is in bankruptcy

Partner has waived exhaustion requirement by contract

A court waives exhaustion requirement; or

Partner is independently liable (RUPA § 307(c),(d))

* + - 1. **CONTRACT:** *Burns v. Gonzalez*, 439 S.W.2d 128 (TX 1969)
				1. Facts: Partnership to operate ad agency for XERF. Burns enters into an agreement with one of the partners for the partnership to pay for periods of Burns’ lost income.
				2. Issue: Is contract binding on other partner (Gonzalez).
				3. Holding: No.
				4. Reasoning: UPA § 9(1), each partner can bind the partnership; however “burden of proof is on the person seeking to hold the non-participating partner accountable.” All other documents signed by both partners. The final agreement did not recognize the existence of the note in question.
				5. **Rule:** In order for apparent authority to exist, it must be in the “usual way [of] the business of the partnership.”
			2. **TORT:** *Sheridan v. Desmond*, 697 A.2d 1162 (CT 1997)
				1. Facts: Defendants were partners , owning commercial property. Desmond managed day-to-day operations. Desmond also owned an adjacent lot. During construction, blocking the Plaintiff’s fire exit caused the Plaintiff’s night club to be closed. Defendants (as partners) were held liable.
				2. Issue: Course of partnership?
				3. Holding: No.
				4. Reasoning: Their partnership on one property was in no way related to Desmond’s actions on his own property.
				5. **Rule for Tortious Act (sequential test):**

In course of business:

“kind of thing a [] partner [in the business] would do”

“occurred substantially within the authorized time and geographic limits of the partnership

“been motivated at least in party by a purpose to serve the partnership

Actions authorized by other partner:

“a general grant of authority to manage a business does not encompass authority to commit an intentional tort.”

Quotes 1 Rstmt (2d), Agency § 73, p. 181

* + 1. Indemnity and Contribution
			1. UPA §§ 18(a), (b), 40(b), (d); RUPA §§ 401(b), (c), 807(a), (b)
			2. Partner who pays is indemnified by pa’ship.
			3. Partners pay obligations according to loss shares
			4. If p’ship cannot pay, partners do
	1. Ownership Interests and Transferability
		1. Partnership Property
			1. UPA § 8(1), “All property originally brought into the partnership stock or subsequently acquired by purchase or otherwise, on account of the partnership is partnership property.” § 8(2) – presumption that property brought into p’ship is p’ship property.
			2. UPA – p’ship cannot own property
			3. RUPA – p’ship is an entity and can own property
			4. RUPA - Property become p’ship property when
				1. Acquired in p’ship name
				2. Acquired by partner with reference to status as partner or partnership
		2. Admitting New Partners vs. Assigning Partntrship Interests
			1. *Rapoport v. 55 Perry Co.*, 376 N.Y.S.2d 147 (NY 1975)
				1. Facts: Rapoports tried to transfer 10% interest to their children. After initially filing an amended p’ship certificate, the Parnes refused to execute an amended p’ship agreement.
				2. Issue: Passing of ownership.
				3. Holding: Not authorized.
				4. Reasoning: There was nothing in the agreement changing the standard law that unanimous consent is required to add new partners.
				5. **Rule:** Since p’ship agreement did not have language permitting the entry of children as partners, the addition of the children required the consent of all partners.
			2. Rights that can be transferred - financial
				1. Right to distributions
				2. Right to share of profits/losses
			3. Rights that cannot be transferred – management
				1. Right to participate in management
				2. Right to use partnership property
		3. The Rights of a Partner’s Creditors
			1. UPA – a judgment creditor may cause dissolution by putting the debtor-partner into bankruptcy
			2. RUPA – a debtor-partner’s bankruptcy will dissociate the partner from the partnership
			3. Under Bankruptcy Code, if partner and partnership are in bankruptcy partnership creditors have priority for partnership assets but are then on par with other creditors (UPA § 40(h) gave partnership creditors priority to both).
			4. *Hellman v. Anderson*, 284 Cal. Rptr. 830 (1991)
				1. Facts: Anderson’s interest in RMI was foreclosed and sold after judgment of $440,000.
				2. Issue: Can this happen without consent of other partners?
				3. Holding: “judgment debtor’s interest in a partnership (meaning the right to share in the profits and surplus) may be foreclosed upon and sold, even though other partners do not consent to the sale, provided the foreclosure does not unduly interfere with the partnership business.”
				4. Reasoning: Other partners may seek to prevent foreclosure to help the debtor partner. Also, without sale, partners may withhold distribution (since the interest foreclosed does not include management rights) to the judgment holder.
				5. **Rule:**

Property rights in partnership are:

Rights in specific p’ship property

Interest in p’ship

Rights to participate in the management

Only interest in p’ship (#2) is subject to foreclosure

Foreclosure is appropriate despite charging order because partners (including the debtor partner, who still retains management rights) may withhold distributions.

* 1. Fiduciary Duties
		1. The Common Law
			1. *Meinhard v. Salmon*, 164 N.E. 545 (NY 1928)
				1. Facts: Salmon & Meinhard were partners in a building leased out as shops. Slamon was managing party, Meinhard provided funding. At the end of the term of the lease, Salmon entered into a new agreement via a company owned by him alone. Meinhard sought to have the new lease deemed property of the joint venture.
				2. Issue: Breach of fiduciary duty.
				3. Holding: Breached.
				4. Reasoning: As managing “joint adventurer”, Salmon had a heightened requirement to inform Meinhard of the new offer. He was in a position that required selfless acts, but acted selfishly. The agreement was directly related to his position as manager of the joint venture.
				5. **Rule:** Every partner has duty of full disclosure of material facts
		2. Codification of Fiduciary Duty and Contractual Waiver
			1. UPA §§ 21-22, RUPA §§ 103, 404
				1. UPA § 21 is only express fiduciary duty
				2. UPA § 21(a) prohibits self-dealing
			2. RUPA § 404(a) states only fiduciary duties are laid out in § 404 (b) and (c)
				1. RUPA § 404 (b)

To account to partnership

To refrain from self-dealing

To refrain from competing with p’ship

* + - * 1. RUPA § 404 (c) deals with duty of care
				2. RUPA § 404 (d)

 “obligation of good faith and fair dealing”

Cannot eliminate duty of loyalty by contract (but can set measurement of good faith & fair dealing)

* + - 1. *Singer v. Singer*, 634 P.2d 766 (OK 1981)
				1. Facts: Oil p’ship. One of the partners purchased land that the p’ship was interested in.
				2. Issue: Competing with p’ship. Partnership agreement contained a clause allowing all partners to engage into business transaction conflicting with the p’ship.
				3. Holding: No breach.
				4. Reasoning: Partners agreed to allow competition.
				5. **Rule:** Partnership agreement can alter default rules.
			2. Fiduciary duty contracts in unincorporated firms
				1. Narrower discretion delegated, narrower duty of unselfishness
				2. Beneficiary can reduce costs by monitoring and restricting transactions by fiduciary
				3. Fiduciary’s conduct can be constrained through contract
				4. Beneficiary can exit the relationship
				5. Beneficiary can remove the fiduciary
				6. Fiduciary may have reputation concerns
				7. Non-managerial owners can rely on third-party monitoring
				8. Costs of fiduciary duties

Fiduciaries have costs of forgoing opportunities

There may be losses associated with preventing self-dealing

Duty of care may prevent profitable action by fiduciary due to risk involved

Prohibitions may prevent efficient compensation

Costs of enforcement

* + 1. The Duty of Loyalty
			1. *Enea v. Superior Court*, 34 Cal. Rptr. 3d 513 (2005)
				1. Facts: One partner rented office at below market value.
				2. Issue: Breach of fiduciary duty.
				3. Holding: “the fiduciary duties imposed on partners by operation of law unquestionably bar them from conferring such benefits upon themselves at the partnership’s expense.”
				4. Reasoning: Duty of loyalty is imposed by law.
				5. **Rule:** Partners cannot enrich themselves at the expense of the p’ship.
		2. The Duty of Disclosure
			1. UPA §§ 19-20, RUPA §§ 103(b), 403
			2. UPA – books must be made available on demand (narrow)
			3. RUPA – affirmative obligation of disclosure (broad, may be altered or eliminated by agreement)
			4. Is general partnership interest a “security”?
				1. “includes stocks, notes, and bonds, as well as substitutes for such securities including voting trust certificates and certificates for the deposit of securities.”
				2. Depends on whether it is considered an “investment contract”
				3. Test:

Volitional investment (e.g. contribution of capital, property, or services)

Common enterprise

Some courts – pooling of profits is sufficient

Others require commonality – vertical commonality is a link between promoter and investors; partners normally involve horizontal commonality

Expectation of profits solely from the efforts of others – not applied literally; if substantial efforts required by investor it is not a security

* + - * 1. P’ship interest can be designated a security if

Agreement among parties leaves little power in hands of partner (like an LLP)

Partner is inexperienced or unknowledgeable in business affairs; **or**

Partner is dependent on unique entrepreneurial or managerial ability of promoter or manager that he cannot be replaced

* + - * 1. If a security, fraud associated with sale or purchase may be punished under federal securities law
		1. The Duty of Care
			1. RUPA § 404(c)
			2. *Bane v. Ferguson*, 890 F.2d 11 (7th Cir. 1989)
				1. Facts: Retired partner claimed negligent management cost him retirement benefits.
				2. Issue: Duty of care.
				3. Holding: Not breached.
				4. Reasoning: Bane was not a partner, he was someone the firm dealt with.
				5. **Rule:** Fiduciary duty only extends to partners
		2. Remedies
			1. UPA § 21-22, RUPA § 405
			2. May assert claim against co-partner as part of accounting action
	1. Dissolution
		1. UPA
			1. §§ 29-33, 37-38, 40
			2. *Page v. Page*, 359 P.2d 41 (CA 1961)
				1. Facts: Partnership was not profitable. One partner sought to exit even after profits started. No term was stated.
				2. Issue: Right to exit.
				3. Holding: Can exit at will, as long as not seeking to gain benefits of p’ship for self.
				4. Reasoning: UPA allows dissolution at will. There is no requirement to remain a partner, even if the business is profitable.
				5. Rule: UPA allows dissolution at will. As well as

Event making it unlawful (e.g. loss of license)

Death of partner

Bankruptcy of a partner or the p’ship

* + - 1. Consequences
				1. Winding down – paying off after assets are sold

Non-partner creditors are paid

Partner creditors are paid

Partners receive return of capital contributions

Remaining profits distributed

* + - * 1. Partner may bind p’ship after dissolution
				2. Partner’s authority terminates upon

Dissolution when dissolution occurs other than by act, bankruptcy, or death of partner

Knowledge of dissolution when caused by act of partner

Knowledge or notice when cause by death or bankruptcy of a partner

* + - * 1. Under UPA dissolution occurs whenever any partner leaves
				2. UPA § 29 – does not always require liquidation, but UPA § 38(1)

“business must be liquidated ‘unless otherwise agreed.’ This agreement must be unanimous and must include the consent of any departing partners.”

Dissolution cannot be prevented by agreement; deemed an agreement to create new p’ship.

* + - * 1. New partner is not personally liable for preexisting p’ship obligations.
			1. *Dreifuerst v. Dreifuerst*, 280 N.W.2d 335 (WI 1979)
				1. Facts: Plaintiffs dissolved p’ship. Unable to agree to winding-up. Defendant wanted to sell assets, plaintiffs wanted to divide assets.
				2. Issue: Can partner force sale of assets?
				3. Holding: Yes.
				4. Reasoning: Any partner who has not wrongfully dissolved p’ship has the right to have the assets liquidated.
				5. Rule: In-kind dissolution is limited

Situations where no creditors need to be paid

Ordering a sale would be senseless since only partners want assets; **and**

In-kind distribution is fair to all partners.

* + - 1. Wrongful Dissolution
				1. *Drashner v. Sorenson*, 63 N.W.2d 255 (SD 1954)

Facts: Plaintiff wanted to draw funds from p’ship to pay costs of reckless driving arrest and other debts. Plaintiff drank at a bar during business hours.

Issue: Can he force dissolution?

Holding: No.

Reasoning: Was not a p’ship at will because of requirement to last until $7500 advance was repaid.

**Rule:** Wrongfully dissolving partner has right to “value of his interest in the partnership, less any damages caused to his partners by the dissolution, ascertained and paid to him in case or the payment secured by bond approved by the Court.”

* + - * 1. Penalty for wrongful dissolution includes:

Expulsion

Damages for breach of contract

Distribution not reflecting goodwill

* + 1. RUPA
			1. RUPA §§ 201(a), 601-602, 701, 801-803, 807
			2. RUPA views p’ship as an entity
			3. Partner Dissociation
				1. Circumstances

P’ship has notice of partner’s express will to withdraw

Event agreed to in p’ship agreement causing partner’s dissociation occurs

Partner is expelled pursuant to p’ship agreement

Partner is expelled for misconduct under court order

Partner becomes debtor in bankruptcy

Partner dies

* + - * 1. May occur at any time, rightful or wrongful; **wrongful if prior to term or completion**

Partner expresses will to withdraw

Partner expelled by court

Partner becomes debtor in bankruptcy

Partner not a natural person is expelled or willfully dissolves or terminates

* + - * 1. Court may expel under RUPA §601(5)

Engaged in wrongful conduct adversely and materially affecting p’ship

Partner commits willful and persistent breach of p’ship agreement or duty

Partner engages in conduct relating to p’ship making it not practicable for him to continue in p’ship

* + - * 1. Wrongfully dissociated partner is liable for damages caused
				2. Does not discharge liability for p’ship obligations incurred before dissociation
				3. Not liable for obligations after dissociation
				4. If 3rd party believes partner is still a partner, potential liability for two years
				5. May file “statement of dissociation.”
			1. Partnership Dissolution
				1. RUPA § 801 (1) – may dissolve at-will p’ship at any time
				2. P’ship for term or particular undertaking dissolved

At expiration or upon completion

By unanimous agreement

Within 90 days of wrongful dissociation, by express will of at least 50% of remaining partners

* + - * 1. Assets are sold as part of winding up
				2. **Partner creditors on same footing as outside creditors**
				3. P’ship bound by partner’s act after dissolutions if

Act is appropriate for winding up business; or

Act would have bound p’ship before dissolution and 3rd party has no notice

* + - * 1. “Statement of dissolution” serves as notice
				2. Partners may agree that dissociation does not dissolve partnership unless RUPA § 801(40, (5), or (6) applies
				3. Partners may agree to abandon winding up and continue business

Must be unanimous

Must include dissociated partners if not wrongfully dissociated

* + - 1. Buying out Dissociated Partners
				1. “buyout price is the amount the dissociated partner would have received upon dissolution, assuming that the partnership assets were sold at the greater of liquidation or going concern value (the latter of which is measured without the dissociated partner’s participation).”
				2. If wrongful, reduced by damages
				3. If wrongful from p’ship for term or undertaking, not paid until expired or complete
1. The Corporation
	1. Introduction
		1. Comparing the Partnership and the Corporation
			1. More formal – must file with state
			2. Requires conscious decision
			3. Entity status – “corporation is an entity distinct from its owners in all jurisdictions.”
			4. Continuity of existence – “perpetual existence until and unless it is dissolved. Dissolution requires approval by the corporation’s board of directors and shareholders.”
				1. Closely held corporation – danger of lack of exit (cannot sell shares)

Small number of shareholders

No public market

* + - * 1. Minority shareholder may be oppressed in closely held corporation
			1. Centralized management
				1. Shareholders elect directors
				2. Board has ultimate authority
				3. In closely held corporations, shareholder typically expect to manage
			2. Limited liability
				1. Limited to loss of investment
				2. Creditors typically have no recourse against shareholders
				3. Most significant reason for choosing this form
			3. Free Transferability of Ownership Interests
				1. Easier to leave
				2. Easier to attract new investors
			4. Tax Status
				1. Corporation is taxed as a separate legal entity
				2. Dividends are taxed as income to shareholder
				3. Closely held corporations may request Subchapter S (IRC) status may not have:

More than 100 shareholders

Any non-individual shareholders (some exceptions)

Any nonresident-alien shareholders

More than one class of stock

* + - * 1. Subchapter S corporations are not taxed, but shareholders are taxed on share of income regardless of distribution
		1. Choosing a State of Incorporation
			1. Delaware is state of choice for most large, publicly traded corporations
			2. “Delaware facilitates rather than regulate”
			3. Must pay franchise tax (or similar state fee)
	1. Formation
		1. Incorporation and its Aftermath
			1. DGCL §§ 102-103, 107-109, 141, 151, 165, 211; MBCA §§ 2.01-2.07, 6.01-6.02, 7.03, 8.06
			2. Certificate of incorporation = Articles of incorporation
			3. Must include number of shares corporation is authorized to issue; illegal to issue in excess
			4. Incorporators/initial directors (if named) call organizational meeting
				1. Elect initial board of directors
				2. Approve certificate of incorporation
				3. Approve corporation’s minute book
				4. Approve form of stock certificate that will represent ownership of corporation’s shares
				5. Approve corporate seal
				6. Often elect officers and fix salaries
				7. Often accept offers to purchase shares for consideration fixed by board
				8. Often authorize opening of a bank account
				9. Usually adopt **bylaws**

Rules for calling shareholders’ meetings

Number of directors

Method of electing and removing directors

Rules for calling and conducting directors’ meetings

Identification of officers and the duties of each officer

Methods of electing and removing officers

Indemnification of directors and officers to the extent permitted by statute

Advancement of expenses to directors and officers who are sued as a consequence of their positions

Purchase of directors’ and officers’ insurance

Share certificates

Corporation’s fiscal year

Manner in which bylaws may be amended

* + - * 1. First annual shareholder meeting often immediately follows with election of board
		1. Financing the Corporation
			1. May issue shares for cash or property
			2. Subscription agreements
				1. Offers to purchase shares when issued
				2. Irrevocable for six months after made
			3. Types of shares
				1. Common shares (usually only type for closely held corporations)

Residual/ultimate ownership

Value after others receive contractual rights belongs to common shareholders

* + - * 1. Preferred shares

Dividend may be mandatory or discretionary

Mandatory - $2 dividend if able (financially and legally) each quarter

Discretionary – may not pay common dividend if no preferred

May be cumulative or noncumulative

Participating or nonparticipating

Participating – receive dividend w/ common shares

Nonparticipating – only receive preferred dividend

Normally have preference on liquidation

Often convertible to common shares at some ratio

Usually carry no voting rights unless some number of dividends missed

* + - * 1. Debt

From bank or investors

Loan secured by corporations assets – **bond**

Unsecured loan – **debenture**

Indenture – contract for long term obligation

Notes – typically mature faster than bonds or debentures

Debtholders have absolute contract right to receive principal and interest payments

* + - 1. Board usually determines whether dividends will be issued
		1. Preemptive Rights
			1. DGCL § 102(b)(3); MBCA § 6.30
			2. Existing shareholders’ right to subscribe proportionately to new issuance of shares
			3. Most publicly held corporations do not allow for preemptive rights
			4. Shareholder must make additional cash contribution
			5. *Katzowitz v. Sidler* – offering shares at a bargain to force a minority stockholder to invest or lose voting power is not legal
		2. Promoters’ Contracts
			1. Restatement (Second) of Agency §§ 84, 86, 326; Restatement (Third) §§ 4.04, 6.04
			2. Promoter – “someone who helps to found and organize a corporation. A promoter will often make contracts for the corporation’s benefit with the intention of causing the corporation to adopt the contracts once it is formed.”
		3. Defective Incorporation
			1. DGCL §§ 105-106, 329; MBCA §§ 2.03-2.04
			2. *Cantor v. Sunshine Greenery, Inc.*, 398 A.2d 571 (NJ 1979)
				1. Facts: Plaintiffs sued Sunshine Greenery and Brunetti, the president claiming he was a promoter and that Sunshine Greenery was not a de facto corporation. Brunetti signed lease as president. Cantor knew and expected lease to be with the corporation, not with Brunetti. Brunetti stopped payment on a check because the corporation repudiated the contract. Lease was signed on 16 Dec 1974, certificate of incorporation reserved on 3 Dec 1974, not filed until 18 Dec 1974.
				2. Issue: Was the contract with the corporation?
				3. Holding: Yes.
				4. Reasoning: Not a de jure corporation, but was a de facto corporation. There was a bona fide attempt to organize the corporation before the date of the contract, actual exercise of the corporate powers in negotiation with plaintiffs, plaintiffs knew they were dealing with the corporation.
				5. **Rule:** Act of executing certificate, bona fide effort to file it and dealing in the name of the corporation establish a de facto corporation. Administrative delay is not justifiable reason to deny existence of the corporation.
			3. De facto corporation
				1. Statute permitting
				2. Bona fide attempt to incorporate
				3. Actual use/exercise of corporate priviliges
			4. Corporation by estoppel
				1. Corporation may not avoid a contract based on defective incorporation
				2. Third party may not avoid a contract with a corporation based on defective incorporation
				3. Allows shareholders of a defective corporation to retain limited liability when third party understands contract to be with corporation.
		4. The Ultra Vires Doctrine
			1. DGCL §§ 102, 122, 124; MBCA §§ 2.02, 3.02, 3.04
			2. Transaction beyond the purposes of the corporation
			3. No longer a common issue because corporations can be formed “to perform any lawful act”
	1. Management and Operation
		1. Allocation of Power
			1. DGCL §§ 109, 141-142, 211, 220, 223, 228, 242; MBCA §§ 7.02-7.04, 8.01, 8.06, 8.08-8.10, 8.40, 10.03, 10.20, 16.05
			2. Shareholders elect board, board appoints officers. Officers run day-to-day, shareholders vote on extraordinary matters.
			3. *Charlestown Boot & Shoe Co. v. Dunsmore*, 60 N.H. 85 (1880)
				1. Facts: Directors refused to deal with committee appointed to close up its affairs. They also failed to maintain insurance and property was consumed by fire.
				2. Issue: Negligence.
				3. Holding: Not found.
				4. Reasoning: The law does not require directors to act with non-directors.
				5. **Rule:** Directors are not agents of the shareholders; are not subject to shareholders’ control; shareholders can elect new board
			4. Removal of directors
				1. MBCA 8.08(a) no cause needed (absent certificate/bylaws provision)

For classified/staggered board, may only be removed for cause

Cumulative voting – no director may be removed if the votes against removal would be sufficient to allow him to be elected

Only shareholders of class eligible to elect may vote to remove.

* + - * 1. When for cause only

Entitled to notice of charges, opportunity to be heard, and hearing

Some jurisdictions allow courts to remove directors

Board generally lacks power to remove; split as to whether certificate can change

§ MBCA 8.09 – provides grounds for removal by court

* + 1. Interference with the Shareholder Franchise – directors cannot except for “compelling circumstances”
		2. Formalities Required for Board Action
			1. DCGL §§ 141, 229; MBCA §§ 8.20-8.25, 14.30
			2. Board can only exercise power at duly assembled meeting
				1. Shareholders deserve discussion and deliberation
				2. Independent approval by each director is not board action
				3. Directors may not vote by proxy
				4. Formalities as to notice, quorum, and voting must be adhered to
			3. Directors may act by unanimous written consent in lieu of meeting
			4. Directors may participate by any method (e.g. teleconference)
			5. Board may delegate most matters to committees comprised of one or more directors
			6. Delaware – bylaws dictate notice requirement
			7. Model Act – bylaws for normal meeting; special meeting – 2 days w/ date, time & place
			8. Directors may waive notice
			9. Quorum – majority unless modified by bylaws, no less than 1/3
			10. Majority – of directors present
			11. Even though failure to hold meeting might prevent actual authority, apparent authority may still exist.
			12. Closely held
				1. Meeting requirement is usually meaningless formality
				2. Outsiders cannot verify formalities – easy way to avoid undesired transactions
				3. Assent or acquiescence by all directors generally equivalent to formal board action
				4. When all shareholders approve, courts generally ignore requirement that board, not shareholders, approve
			13. *Gearing v. Kelly*, 182 N.E.2d 391 (NY 1962)
				1. Facts: Director (closely held) sat out meeting to avoid quorum. Sought to set aside election of new director. Only two directors were present, three required for quorum.
				2. Issue: Propriety of election.
				3. Holding: Upheld.
				4. Reasoning: Results would be the same.
				5. **Rule:** None; in Tomlinson v. Loew’s Inc., court reached opposite end (no estoppel, voluntary absence is not equivalent to resigning)
		3. The Authority of Officers
			1. Officers are chosen according to bylaws
			2. Usually, board appoints officers
			3. Officers governed by law of agency
			4. *Lee v. Jenkins Brothers*, 268 F.2d 357 (2d Cir. 1959)
				1. Facts: Lee was asked to stay on to help new owners run company. Claims he was promised pension at age 60 “no matter what” and that, if the company refused, the manager would pay it. He left at age 55 and waited to 65 to file suit. Lee took coverage under Jenkins pension plan, claiming these were in addition to the promised pension.
				2. Issue: Authority.
				3. Holding: No issue of fact. Apparent authority question of fact for jury.
				4. Reasoning: By-laws & certificate not in evidence; nor was course of dealing evident.
				5. **Rule:** Officers cannot bind company to extraordinary contract. Employment for life or permanent employment are generally deemed extraordinary.
			5. Implied authority due to acquiescence may exist
			6. Board may ratify officer’s actions
			7. President can bind to “ordinary” contracts
			8. Secretary has apparent authority to certify records, but not engage in business transactions
			9. Treasurer can write checks but not act on behalf of the company in business matters
		4. Shareholder Action
			1. Formalities Required for Shareholder Action
				1. DGCL §§ 211, 213, 216, 219, 228-229; MBCA §§ 7.01-7.02, 7.04-7.07, 7.20, 7.25, 7.27-7.28
				2. Annual shareholder meetings required

Notice required – Date, time, place

At least 10 days, not more than 60

Shareholders may waive notice defects in writing or by attending w/out objection

* + - * 1. Special Meetings

Notice must include purpose

Delaware

board of directors may call special meeting

May be modified by bylaws or certificate

Model Act

Owners of at least 10% of shares may call special meeting

Articles may alter percentage, but not raise above 25%

* + - * 1. Rigth to vote

Delaware – record date set (at least 10 days, not more than 60 before mtg.)

Model Act – record date not more than 70 days before meeting

* + - * 1. Shareholder list

Delaware – 10 days

Model Act – 2 days

* + - * 1. Quorum – majority of shares

Delaware – bylaws may alter but not lower than 1/3

Model Act – may increase above majority

* + - * 1. Ordinary matters

Delaware – majority of shares present (abstention is a no)

Model Act – if yes exceed no (abstentions not counted)

* + - * 1. Directors are elected by plurality vote
				2. Supermajority

Delaware – may be imposed by bylaws or certificate

Model Act – requirement must appear in articles

* + - * 1. Delaware – remote communication meetings

Corporation must be able to verify ID of shareholders/proxies

Shareholders/proxies must have reasonable opportunity to participate

Corporation must maintain record of actions taken by shareholders/proxies

* + - * 1. Approval without meeting

Delaware – those owning enough shares to approve can do so by written consent without a meeting

Model Act – unanimous written consent

* + - 1. Straight vs. Cumulative Voting
				1. Straight

Every shareholder votes shares for each seat

Majority shareholder can elect all board members

* + - * 1. Cumulative

Number of shares multiplied by number of seats; allocated as desired

Increases minority participation

Given number of shares (S), number of directors (D); X – shares needed to elect N directors:

 $X= \frac{S ×N}{D+1}+1 \left(vote\right)$

Ex. 1000 shares, A – 60%, B – 40%, 3 Directors

A needs 501 shares to elect two members

$X= \frac{1000 ×2}{3+1}+1 \left(vote\right)=501$

Given Number of Shares owned by shareholder (Y), how many directors can he elect (N) :

$N= \frac{Y(D+1)}{S} $

Ex. 1000 shares, A – 60%, B – 40%, 3 Directors

A can elect two (**always round down**)

$N= \frac{600(3+1)}{1000}=2.4$

Unless entire board removed, shareholders may not remove director if votes cast against would be sufficient to elect him.

* + - * 1. Most states have direct as default, some have cumulative
				2. Staggered Board

Reduces impact of cumulative voting

Some states hold that staggered board illegal w/ cumulative voting

* + - 1. Informational Rights
				1. DGCL § 220; MBCA § 16.02
				2. *Skouras v. Admiralty Enterprises, Inc.*, 386 A.2d 674 (DE 1978)

Facts: Minority stockholder in Admiralty, closely held family corporation, seeks to inspect books, fears mismanagement. Admiralty owns stock in other companies owned/controlled by family members. Others contend he is trying to get the company to buy his stock back.

Issue: Right to inspect.

Holding: Not granted.

Reasoning: Ownership of another company is not improper.

**Rule**: Burden is on stockholder when demanding inspection of books rather than stock list. Ulterior motives are irrelevant if proper purpose established.

* + - * 1. Investigating mismanagement is proper purpose; clear indication needed

Delaware – corporation must prove shareholder’s purpose is improper

Model Act – silent to burden of proof (cases tend to follow shift burden to corporation once proper purpose is alleged)

* + - * 1. Shareholder lists must be given to shareholders for proper purpose

Communication regarding vote – proper

Seeking to sell shares – improper

Political communicate (gun manufacturer) – improper

Some jurisdictions – communication always proper

Publicly held corporations – normally in street name (brokers, dealers, depository)

Non-objecting beneficial owners list – NOBO

Companies need not have

If they do have, it is required to produce

* + - * 1. In litigation, shareholder may use discovery to review records and books.
	1. Altering Corporate Norms by Contract
		1. Voting Agreements
			1. DGCL § 141, 151, 212, 218; MBCA § 6.01, 7.22, 7.30-7.31, 8.08
			2. *Ringling Bros.-Barnum & Bailey Combined Shows, Inc. v. Ringling,* 53 A.2d 441 (DE 1947)
				1. Facts: Two stockholders had agreed to vote together. They were unable to agree upon 5th director (out of 7). The board was eventually composed of members named by their “arbitrator”.
				2. Issue: Voting agreement validity.
				3. Holding: Valid contract; votes of non-complying stockholder vacated.
				4. Reasoning: Stock pooling agreements are legal.
				5. **Rule:** Stock pooling is legal, must be written and signed by the parties.
			3. Vote buying is illegal.
			4. Self-enforcing voting mechanisms
				1. Irrevocable proxies must state irrevocable and “coupled with interest”

Delaware – Coupled with interest not defined (e.g. job or loan)

Model Act – given in favor of:

A pledgee

One who has purchased or agreed to purchase shares

A corporate creditor under contract requiring proxy

Corporate employee under contract requiring proxy

Party to a voting agreement

* + - * 1. Voting trusts

Legal title to shares vested in trustee(s)

Delaware

Trust agreement must be in writing

Copy must be deposited w/ corporation and available for inspection

Shares must be transferred to the trustee(s); corporation cancels shares and issues new shares in the name of trustee(s)

Default rule – voted according to majority of trustee(s)’ direction

No time limit

Model Act

Similar process

Expires in 10 years unless extended for another 10

Dividends pass through to equitable owners

* + - * 1. Classified voting

Dividing shares into classes

Parties can have equal voting rights but different financial right

Ex. Class A shares have voting rights Class B do not

Able owns 20 A and 60 B, Baker owns 20 A

Both have equal voting rights, but Able receives 80% of dividend (and distributions upon liquidation)

Different classes can also elect separate members to the board

Ex. Class A elects 2 members, Class B elects 2 members

Able owns 60 A, Baker owns 40 B

Both elect two member, but Able receives 60% of financial benefits

May prevent deadlock on board

Ex. Lehrman v. Cohen; AL – Lehrmans elected 2, AC – Cohens elected 2, AD – Corporate counsel elected 1 (AD had no financial rights)

Court upheld agreement

* + 1. Controlling Matters Within the Board’s Discretion
			1. DGCL § 141; MBCA § 8.01
			2. *McQuade v. Stoneham*, 189 NE. 234 (NY 1934)
				1. Facts: As part of sale of stock, three agreed contracted to keep each other on the board, as officers, and fix salaries. Eventually two of them fired the third.
				2. Issue: Legality of contract.
				3. Holding: Void and illegal.
				4. Reasoning: Stockholders cannot contract to fix salaries, permanently set board, etc.
				5. **Rule:** Contracts restraining board are illegal. Duty is to company, not individuals. Requires harm to someone (e.g. public, minority shareholder).
			3. *Clark v. Dodge*, 199 N.E. 641 (NY 1936)
				1. Facts: Two men are shareholders of two pharmaceutical companies. After one Clark agrees to disclose formulae to Dodge’s son in exchange for guaranteed employment, Dodge fires Clark.
				2. Issue: Legality of contract.
				3. Holding: Upheld.
				4. Reasoning: No harm to anyone. Did not “attempt to sterilize the board” like McQuade.
				5. **Rule:** Some restrictions are legal, as long as no harm is involved.
		2. Supermajority Quorum and Voting Requirements
			1. DGCL § 109, 141(b), 216, 242; MBCA §§ 7.25, 7.27, 8.24, 10.20
			2. *Frankino v. Gleason*, 1999 WL 1032772 (DE 1999)
				1. Facts: Board added a requirement to bylaws requiring 80% supermajority to change Article III (dealing with board – preventing Fankino from expanding board). Fankino, 55% shareholder, voted to delete provision then voted to expand the board and elected seven new members to board.
				2. Issue: Was Frankino’s deletion of the supermajority requirement effective?
				3. Holding: Yes.
				4. Reasoning: Bylaws clearly stated requirements for amendment. Supermajority requirement was not extended to the Article including it.
				5. **Rule:** Standard contract law applies – clear language of document
		3. Share Transfer Restrictions
			1. DGCL § 202; MBCA § 6.27
			2. *Allen v. Biltmore Tissue Corp.*, 141 N.E.2d 812 (NY 1957)
				1. Facts: Bylaws allow corporation to purchase shares of stock belonging to stockholder who dies.
				2. Issue: Legality of provision.
				3. Holding: Legal.
				4. Reasoning: Restriction is akin to a first-option provision. First-option does not serve to prevent sale, but to provide the company a chance to buy.
				5. **Rule:** “To be invalid, more than mere disparity between option price and current value of the stock must be shown.”
			3. Operation and Legality of Share Transfer Restrictions
				1. Types DGCL § 202(c); MBCA § 6.27(d)

Obligation to offer shares to corporation or other shareholders at a specified price (first-option agreement)

Obligation to offer shares to the corporation or the other shareholders at the same price and on same terms offered by a third party (first-refusal agreement)

Obligation to obtain consent of corporation or other shareholders to sell to a third party (consent agreement)

Obligation (or opportunity) to sell to corporation or other shareholders upon certain events (buy-sell agreement)

Prohibiting transfer to designated classes of persons

* + - * 1. Strictly construed; should include:

Optional or mandatory

Persons who may or must purchase

Sequence in which they may purchase

Manner for price to be determined

Time period during which persons may decide (if option)

Event to be covered (e.g. proposed sale, bankruptcy, family gift)

* + - * 1. Must be reasonable
				2. Methods of setting price

Stated price

Book value

Capitalization of earnings

Appraisal/arbitration

* + 1. Statutory Close Corporations
			1. DGCL §§ 141(a), 342-343, 350-351, 346, 355; MBCA § 7.32; Model Stat. Close Corp. Supp. §§ 3, 20-21, 31, 33
			2. Allows varying from corporate norms
			3. Eligibility
				1. Delaware

No more than 30 shareholders

Shares subject to restriction on transferability

No public offering of its shares

* + - * 1. Model Act – no eligibility requirements
			1. Existing corp. meeting requirements may elect status two-thirds vote of each class of shares
			2. Benefits
				1. Delaware

Greater power to vary corporate norms

Written agreement among majority shareholders may restrict the board

Unanimous vote – shareholders, not directors, will manage corporation

May elect to allow for dissolution by owners of certain percentage of shares

* + - * 1. Model Act

Similar provision

Requires all shareholders to be party to written agreement restricting board

* + - 1. May terminate status by eliminating statement from certificate that it is a close corporation
			2. Rarely used due to complex legal requirements
			3. Model Act – allows any corporation to vary corporate norms by unanimous agreement of shareholders appearing in articles or bylaws, or by written agreement made known to corp.
	1. Limited Liability and Piercing the Corporate Veil
		1. DGCL § 102(b)(6); MBCA § 6.22(b)
		2. Policy Justifications for Limited Liability
			1. Decreases need to monitor
			2. Reduces costs of monitoring other shareholders
			3. By promoting free transfer of shares, limited liability give managers incentives to act efficiently
			4. Market prices impound additional information about firms
			5. Allows more efficient diversification
			6. Facilitates optimal investment decision
		3. Tort Cases
			1. *Walkovszky v. Carlton*, 223 N.E.2d 6 (NY 1966)
				1. Facts: Defendant owns 10 corporations, each with two cabs carrying the minimum insurance on each cab. Plaintiff was hit by a cab owned by one of the corporations. Claimed that structure was actually a single entity.
				2. Issue: Piercing the veil.
				3. Holding: Not applicable.
				4. Reasoning: Insufficient pleading. Does not allege that individual was conducting business. Sharing resources not sufficient.
				5. **Rule:** Intermingling of funds or other inappropriate activity is required. Common purpose or cooperation is no sufficient (consider independent contractors)
			2. *Minton v. Cavaney*, 364 P.2d 473 (CA 1961)
				1. Facts: Girl drowned in pool. Parents sought personal liability from pool owner. Pool had been incorporated but did not ever function as a corporation.
				2. Issue: Piercing corporate veil.
				3. Holding: Pierced, but cannot apply judgment.
				4. Reasoning: No attempt to provide adequate capitalization, no corporate formalities, did not have three directors. Cavaney was not party to original suit.
				5. **Rule:** In order to pierce, target must be joined in suit; look at capitalization, participation in corporate affairs and functioning as a corporation (**lack of formality is not sufficient**).
		4. Horizontal piercing – peer organizations
		5. Vertical piercing – parent-subsidiary (or owner) relationship
		6. Contract Cases
			1. P*erpetual Real Estate Services, Inc. v. Michaelson Properties, Inc.*, 974 F.2d 545 (4th Cir. 1992)
				1. Facts: Defendant incorporated for joint-venture real estate. Plaintiff seeks indemnification for settlements after losses in suits.
				2. Issue: Piercing corporate veil.
				3. Holding: Not pierced.
				4. Reasoning: Plaintiff knowingly entered into contract with corporation.
				5. **Rule:** Dominance by an individual is insufficient, “plaintiff must also establish ‘that the corporation was a device or sham used to disguise wrongs, obscure fraud, or conceal crime.’”
			2. TX requires fraudulent behavior to pierce veil.
		7. Parent-Subsidiary Cases
			1. Will not pierce if parent has no control over subsidiary’s operations
			2. Generally, cash management not sufficient
			3. Overlapping boards of directors not an issue (this is common)
			4. “single economic entity”
			5. Exercise of control as stockholder does not create liability
			6. May be pierced if used to disguise wrongful behavior (e.g. fraud) of shareholder
			7. “actual control test”
		8. Empirical Evidence
			1. Public corporations less likely to be pierced
			2. Fewer shareholders, more likely to be pierced
			3. Passive shareholders rarely pierced
			4. Contract more often than tort
	2. The Traditional Role of Fiduciary Duty
		1. The Duty of Care and the Business Judgment Rule
			1. “duty to act as a reasonably prudent person would act in the circumstances.”
				1. Oversight
				2. Decision-making
			2. The Oversight Context
				1. *Francis v. United Jersey Bank*, 432 A.2d 814 (NJ 1981)

Facts: Defendant allowed payments to her sons (also officers). She was inactive, did not understand the business, and did not pay attention to the corporation.

Issue: Director’s liability for misappropriation of trust funds by others.

Holding: Breach of duty of care.

Reasoning: She failed to perform any oversight. She could have resigned; her failures were not in good faith. Performed no monitoring, did not review records or take any action upon discovering illegal activity.

**Rule:** Negligence must be a cause-in-fact for loss. (three part test: (1) loss, (2) breach of duty, (3) proximate cause).

* + - * 1. Internal affairs doctrine – governed by law of state of incorporation
				2. Duty is to corporation, not individual shareholders
				3. Derivative action – brought by a shareholder on behalf of the corporation
				4. Distinction may be made between internal and external directors
			1. The Decision-Making Context
				1. Substance

The Basics of the Business Judgment Rule

MBCA § 8.31; ALI Principles § 4.01

*Shlensky v. Wrigley*, 237 N.E.2d 776 (IL 1968)

Facts: Derivative suit for decision not to play night games.

Issue: Cause of action?

Holding: No.

Reasoning: Decisions must be sound, not best possible.

**Rule:** If no fraud or illegal activity, courts are unlikely to act.

**Good faith**

Honesty of purpose

Genuine care for fiduciary’s constituents

Bad faith

Purpose other than a genuine attempt to advance corporate welfare

Known to violate law

Rational business purpose

Minimum standard – conduct can be explained

Court can determine rational business purpose on its own

The Justifications for the Business Judgment Rule

*Joy v. North,* 692 F.2d 880, (2d Cir. 1982)

Shareholders risk bad judgment

After-the-fact litigation not effective evaluation of decisions

Profit is associated with risk, shareholders do not want courts to remove incentives for profits

Cannot distinguish bad decisions from good that have bad results

Removes liability due to hindsight bias

MOLL: close corporations are in greater need of judicial review because there is insufficient oversight

* + - * 1. Process

DGCL § 141(e); MBCA § 8.30(d), (e), (f)

*Smith v. Van Gorkum*, 488 A.2d 858 (DE 1985)

Facts: Van Gorkum, CEO, arranged buyout of Trans Union to cure tax issue (taxable income to offset investment tax credits). Van Gorkum did not disclose report determining buyout value of $55 to $65. Board approved merger at $55.

Issue: Did directors reach an informed business decision, if not were subsequent actions sufficient to cure infirmity in their actions

Holding: not an informed decision.

Reasoning: (a) not adequately aware of Van Gorkum’s role in sale (b) uninformed of intrinsic value and (c) grossly negligent in approving sale in two hours without prior notice and without emergency. Approval by shareholders did not cure.

**Rule:** Directors must inform themselves and give all material facts to shareholders.

Directors are protected when relying in good faith on information from officers, employees, and experts.

Still requires (1) negligence, (2) damages, (3) causation.

**Response to Van Gorkum: DGCL § 102(b)(7)** – allows a corporation to eliminate the personal liability of its directors in certain circumstances.

* + 1. The Duty of Loyalty
			1. Put corporation’s interests first
				1. Situations

Directors or officers enter into contracts with the corporation

Directors or officers take potential corporate opportunities for themselves

* + - * 1. Remedies

Conflict of interest

Recission

Damages

Opportunity – constructive trust

Other sanctions

Punitive damages

Ordering fiduciary to repay any salary received from the corporation during the time of the breach of duty

Ordering fiduciary to pay corporation’s attorney fees & other expenses

* + - 1. Conflict of Interest Transactions
				1. DGCL § 144; MBCA §§ 8.60-8.63
				2. Common law – rule of fairness
				3. *Cookies Food Products, Inc. v. Lakes Warehouse Distributing, Inc.*, 430 N.W.2d 447 (IA 1988)

Facts: Minority shareholder developed distribution plan and new product line. Eventually became majority shareholder and exercised control over company. Company became profitable, but never paid dividends. Four sisues:

Extended distributorship agreement

Warehousing agreement

Compensation for product development

Compensation increases

Issue: Breach of fiduciary duty – conflict of interest.

Holding: None found.

Reasoning:

Fair dealing proven

Distributorship agreement was key to success, fees were appropriate

Warehousing was at “going rate” and board had rejected construction of storage facilities because warehousing arrangement was cheaper

Herrig was fairly compensated for profitable taco sauce

Consultant fee was reasonable for services rendered

**Three circumstances for self-dealing without clearly violating duty of loyalty**

**Discloses/known to board or committee which authorizes, approves, or ratifies the contract or transaction**

**Disclosed/known to shareholders and they authorize**

**Contract or transaction is fair and reasonable**

**Rule:** Directors must establish that they have dealt in good faith, honesty, and fairness when dealing with corporation.

* + - * 1. *Marciano v. Nakash*, 535 A.2d 400 (DE 1987)

Facts: Nakashes made loans to Gasoline; Nakashes owned 50% Marcianos owned 50%. Marcianos argued that loans agreements were voidable under DGCL § 144.

Issue: Standard of fairness.

Holding: Intrinsic fairness test was applicable.

Reasoning: § 144 is not sole test and does not apply. § 144 “presupposes the functioning of corporate constituencies capable of providing assents.”

**Rule:** “Just as the statute cannot ‘sanction unfairness’ neither can it invalidate fairness if, upon judicial review, the transaction withstands close scrutiny of its intrinsic elements.”

* + - * 1. DGCL § 144(a)(1) or (a)(2) fairness requires

Full disclosure of all material facts

Good faith

Authorization of transaction by majority of disinterested directors – even if not quorum.

* + - * 1. Intrinsic fairness – fair to company at time of transaction or contract
				2. Delaware treats controlling shareholders different

Director authorization or shareholder approval still shifts burden to plaintiff

Standard of review is entire fairness, not intrinsic fairness

* + - * 1. Texas “interested directors” statute (conflict of interest statute)

Otherwise valid contract upheld if

Material facts of relationship and contract are known and it is authorized by a majority of disinterested directors (even if not a quorum); **or**

Material facts are disclosed to shareholders entitled to vote and approved in good faith; **or**

Contract or transaction is fair as of the time it is authorized, approved, or ratified by the board, committee, or shareholders

* + - * 1. Issues

Disinterested directors may owe their position to interested parties

Group dynamics – wanting to get along

Shareholders (especially in widely held corp.) ill-suited for decision

* + - * 1. **Interested director or officer**

Delaware - a financial interest (not necessarily “material”)

Model Act

Party to transaction or conduct;

Has business, financial, or familial relationship with a party to the transaction and that would reasonably be expected to affect judgment

Party or business, financial or familial tie with pecuniary interest and that would reasonably be expected to affect judgment

Subject to controlling influence of someone with material pecuniary interest and would reasonably affect judgment

* + - * 1. Conflicting interest – Model Act

Director knows of interest that would reasonably affect judgment

* + - 1. The Corporate Opportunity Doctrine
				1. ALI Principles § 5.05
				2. *Northeast Harbor Golf Club, Inc. v. Harris*, 661 A.2d 1146 (ME 1995)

Facts: President of a golf course corporation purchased several parcels of land while discouraging development of the corporation’s land. President began developing, was asked to step down and sued.

Issue: Breach of duty.

Holding: Breached.

Reasoning: Never offered the opportunity, cannot argue that failure to offer was fair.

**Rule:** Disclosure is supreme; **ALI Test used**.

Line of business Test

Closely associated with business

Weak because it is vague

Fairness (*Durfee*) Test

Unfair “when the interest of the corporation justly call[s] for protection.”

Weak because it provides no guidance

Combination

Two step-analysis of above

Common link – cannot serve self and corp at same time

ALI Test – may not take advantage of corporate opportunity unless:

Offers to corporation & discloses conflict of interest

Corporation rejects opportunity; and:

Either:

Rejection is fair to corporation

Opportunity is rejected in advance, following disclosure, by disinterested directors; or

Rejection is authorized in advance or ratified by shareholders

Definition of corporate opportunity

An opportunity which director or senior executive becomes aware either:

1. In course of duties
2. Through use of corporate information

Closely linked to business

Burden of proof

Generally on plaintiff

Director/officer has burden of proving fair

Ratification of defective disclosure – cures

Delayed offering not sufficient if

Good faith belief not a corporate opportunity; and

Within reasonable time of filing suit the corporation rejects opportunity

Interest or expectancy test – opportunity is open to fiduciary unless

Corp had an existing interest in the opportunity;

Corp has an expectancy in the opportunity from existing right; or

Corp has substantial need for the opportunity

* + - * 1. 1996 Delaware decision reinterprets *Guth* (on which *Northeast Harbor* relied)

*Broz v. Cellular info Sys., Inc.*, 673 A.2d 148 (Del. 1996)

Corporate officer/director may not take opportunity for own if

Corp is financially able to exploit the opportunity

Opportunity is within corp’s line of business

Corp has an interest or expectancy in the opportunity; and

By taking for his own, the corporate fiduciary would be placed in a position inimicable to his duties

* + - * 1. In *Guth*, corollary that director/officer may take an opportunity if:

Opportunity is presented in individual, not corporate capacity

Not essential to corporation

Corporation has no interest or expectancy; and

Resources of corporation not wrongly employed in pursuit/exploitation thereof

* + - * 1. Use of Corporate Assets and Competition with the Corporation

**Usurpation of corporate opportunity**

Taking an opportunity of the company

See interest and opportunity discussion

**Use of corporate property for personal purposes**

Manipulating dividend policy for personal objective

Precluding from engaging in a profitable business opportunity

Securing a benefit in connection with relinquishment of office

Misuse of information

Use of property for personal benefit

**Competition with corporation**

Soliciting employers customers

Borderline – soliciting fellow employees to leave

Concealing intention to leave and establish competing business

* + - 1. Executive Compensation and the Waste Doctrine
				1. CEO is usually on board
				2. Closely held corporations tend to avoid dividends to avoid double taxation

Fair value of labor provided plus de facto dividend

Termination may result in depriving investor of return on investment

Termed “shareholder oppression”

IRS disallows unreasonable compensation

Corporation may

Duty of loyalty claim – conflict of interest

Procedural duty of care claim asserting board gross negligence

Substantive duty of care claim – board committed waste

* + - * 1. *Wilderman v. Wilderman*, 315 A.2d 610 (DE 1974)

Facts: Tile business after a divorce. Ex-wife bookkeeper claims ex-husband CEO has excessively paid himself.

Issue: Excessive compensation.

Holding: Forced to return funds.

Reasoning: Based upon comparable salaries and IRS estimate.

Rule: Conflict of interest & fairness overcome business judgment rule (would apply DGCL § 144 as well, case is old)

* + - * 1. “waste doctrine prohibits ‘ an exchange that is so one sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration.’”
				2. Testing stock options

Will corporation receive sufficient consideration?

Includes, inter alia, the retention of services or gaining new employee if relation between value of services and value of options

Insures expected consideration

* + 1. **Business Judgment Rule Evaluation**
			1. Courts will not impose liability for bad decisions, “a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action was taken in the best interests of the company.”
			2. Components
				1. Good faith (aspect of loyalty)
				2. Reasonable decision making process (process)
				3. No conflict of interest (loyalty)
			3. Challenging
				1. Default

Duty of Care – Substance

Standard: Irrational decision

* + - * 1. To leave BJR, challenge components:

Gross Negligence in Decision Making Process

Duty of Care – Process

Standard: Gross negligence

Conflict of interest

Duty of Care – Loyalty

Burden shifts, must prove fair and reasonable to corporation

Can be cured by approval of actions

* + 1. Duties of Controlling Shareholders
			1. Some courts impose duties upon shareholders of closely held corporations to treat one another with utmost good faith and loyalty
			2. Delaware – shareholder only owes fiduciary duty only if
				1. Majority interest or
				2. Exercises control over the business affairs of the corporation
			3. Not true fiduciary duty – no requirement of selflessness
			4. Conflict of Interest Transactions
				1. Ratification in the Controlling Shareholder Context

Effective approval/ratification shifts burden of proof, but does not change standard of review

Entire fairness may supplant business judgment rule

Parent-subsidiary mergers are special case

* + - * 1. Entire fairness standard is same for controlling shareholder or director/officer – **unitary inquiry into fair dealing and fair price**
				2. Stock ownership is not sufficient to prove domination or control – must be compounded with facts to show relationship
				3. Most common violation of fair dealing is failure to disclose
		1. Exculpation Statutes
			1. DGCL § 102(b)(7); MBCA § 2.02(b)(4)
			2. Director and Officer (D & O) Insurance to protect from liability
			3. Some states limit liability
			4. Some expand right to indemnify directors in derivative suits
			5. Charter option statute
				1. Allows indemnification for breach of fiduciary duty
				2. Exception

Breach of director’s duty of loyalty to the corporation or its stockholders

Acts or omissions not in good faith

Intentional misconduct

Knowing violation of law

Improper distributions; and

Any transaction from which the director derived an improper personal benefit

* + - 1. Self-executing statute
				1. Alters standard of liability
				2. Director only liable if breached or failed to perform duties through wilful misconduct or recklessness
			2. Cap on money damages
		1. Indemnification and Insurance
			1. DGCL § 145; MBCA §§ 8.50-8.59
			2. Inappropriate in certain situations
			3. Should be permitted only where it will further sound corporate policies
			4. Three categories of exclusions for insurance coverage
				1. Conduct exclusions
				2. Other insurance exclusions
				3. “Laser” exclusions – specific risk related to insured corporation
	1. Dissension in the Closely Held Corporations
		1. Dissolution in General
			1. DGCL §§ 273, 275, 355; NY bus. Corp. Law § 1002; MBCA §§14.02, 14.20, 14.30; Model Stat Close Corp. Supp. § 33
			2. Steps
				1. Termination of existence
				2. Sale of business
				3. Repayment of debt to creditors
				4. Pro rata distribution of remaining assets to shareholders
			3. Types
				1. Voluntary

Usually majority of shares

Typically requires agreement of board as well

Also, specified time or event

* + - * 1. Involuntary

Shareholder may petition court

Deadlock, misapplication or waste of assets, and fraudulent, illegal or oppressive actions by directors or those in control

* + - * 1. Administrative

Noncompliance with state requirements, e.g. nonpayment of taxes

May require action of state official or be automatic

* + 1. Deadlock
			1. DGCL § 273; NY Bus Corp Law §§ 1104, 1111; MBCA §§14.30, 14.34
			2. *Wollman v. Littman*, 316 N.Y.S.2d (1970)
				1. Facts: Plaintiffs claim company’s directors at odds created difficulties leading them to start their own competitive business (this is a countersuit).
				2. Issue: Dissolution due to irreconcilable differences.
				3. Holding: Does not mandate dissolution
				4. Reasoning: The disputing interests perform separate functions and dissolution would only enable the wrongful purpose of the plaintiffs.
				5. **Rule:** Delaware dissolutions: corporation with two 50% shareholders engaged in joint venture unable to agree upon desirability of continuing. Common law expands.
			3. Other alternatives to dissolution include buyouts and provisional directors.
		2. Oppression
			1. The Minority Shareholder’s Plight
				1. Publicly held – typically shareholder seeks only return on investment
				2. Closely held – typically investor seeks to have management role

No active market

Return normally provided through compensation and dividends

Board usually controlled by shareholder(s) holding majority of voting power

* + - * 1. “Freeze-out” or “Squeeze-out”

Termination of minority shareholder’s employment

Refusal to declare dividends

Removal of minority shareholder from the board

Siphoning off earnings through high compensation to majority shareholder

* + - * 1. No state allows minority shareholder to force a buyout (requires provision)
				2. No right for minority shareholder to dissolve the corporation
			1. Protecting Minority Shareholders from Oppressive Majority Conduct
				1. Protection Through Contract

Enter into contract prior to committing capital

Shareholder agreements, supermajority requirements, and buy-sell provisions

* + - * 1. Protection in the Absence of Contract

Typically articulated as a fiduciary duty or right to dissolution on the grounds of oppressive conduct by majority

Delaware (and others) - no special common law rules for closely held corporations

**The “Special Rules” Approach**

**Breach of Fiduciary Duty**

*Donahue v. Rodd Electrotype Co*., 328 N.E.2d 505 (MA 1975)

Facts: Majority owner distributed shares to his sons. His sons (and a lawyer) were on the board. When he resigned, his shares were purchased for $800 per share by the company. Donahue offered shares to company on same terms and was refused.

Issue: Breach of fiduciary duty.

Holding: Breach found.

Reasoning: Was a freeze-out;

**Rule:** “Just as in a partnership, the relationship among the stock-holders must be one of trust, confidence and absolute loyalty if the enterprise to succeed. Close corporations with substantial assets and with more numerous stockholders are no different from smaller close corporations in this regard.” **All shareholders must have equal opportunity (not for all things).** Majority cannot use its position to acquire special advantages.

**Close corporation definition:** “(1) a small number of stockholders; (2) no ready market for the corporate stock; and (3) substantial majority stockholder participation in the management, direction and operations of the corporation.”

“[any] proposal for automatic buy-out rights in closely held corporations, although supposedly based on partnership law, actually goes well beyond existing doctrine.” Because dissolving partner may be liable for “wrongful” termination.

Oppression doctrine deals with interference with:

Employment expectation

Management expectation

Dividend expectations

All relate to return on investment

*Wilkes v. Springside Nursing Home, Inc.,* 353 N.E.2d 657 (MA 1976)

Facts: Four men purchased a building and turned it into a nursing home. Wilkes was fired, not reelected to the board or as an officer after a personal fallout with Quinn.

Issue: Breach of fiduciary duty.

Holding: Found.

Reasoning: Cutting off Wilkes’ compensation out of avarice, when the company has never declared a dividend, ensures no return from investment.

**Rule:** (1) salary is principal return on investment; (2) is there a legitimate business purpose to firing; (3) can minority shareholder show efficient alternative course of action.

*Merola v. Exergen Corp*, 668 N.E.2d 351 (MA 1996)

Facts: Stockholder fired.

Issue: Claimed breach of fiduciary duty.

Holding: No breach found.

Reasoning: No evidence hurt as a shareholder (skipped step one); should have asserted stockholders had a right to employment in this company.

**Rule**: The expectation of employment is not sufficient, must be a general policy of stock ownership is associated with employment

Employment was not part of return on investment

Consider contract law v. oppression doctrine

Contract law would not uphold employment

Statute of frauds – no writing

Definiteness – how long would he be employed?

See Model Bus. Corp. Act. § 14.30 (2)

**Dissolution for “Oppressive” Conduct**

*In Re Kemp & Beatley, Inc*., 473 N.E.2d 1173 (NY 1984)

Facts: Plaintiffs left company claiming that they did not receive any share of earnings. State allowed for holders of 20% to seek dissolution.

Issue: Oppressive conduct.

Holding: Found.

Reasoning: Majority froze-out minority.

**Rule:** Investor expectations when entering enterprise; (1) oppression occurs “when the majority conduct substantially defeats expectations that, objectively viewed, were both reasonable under the circumstances and were central to the petitioner’s decision to join the venture.” (2) consider total circumstances and whether something short of dissolution is appropriate (the party seeking to avoid dissolution has burden of proof); (3) order of dissolution must allow purchase at fair value

(In NY and TX) Oppression: those in control frustrate reasonable expectation of minority shareholders

De Facto Dividends

Dividend – pro rata distribution of earnings to shareholders

Dividends are not subject to tax deduction for compensation

De facto dividends – distribution of earnings disguised as compensation for tax purposes; compensation actually has two parts

Fair market compensation

Extra portion = de facto dividend

**Multi-factor test to determine**

Type and extent of services

Scarcity of qualified employees

Qualifications and prior earning capacity

Contributions to business venture

Net earnings of employer

Prevailing compensation for comparable employees

Peculiar characteristics of employer’s business

**“Independent investor” test**

What rate of return would an investor expect on a similar business?

If officer’s salary does not defeat return expectations, the salary is presumed reasonable

**General and Specific Reasonable Expectations** – closely held corporations

Specific – expectation to participate in management

General – still retain traditional shareholder rights; expectation of return on investment

Defining oppression

“burdensome, harsh and wrongful conduct”

“conduct that constitutes a violation of the strict fiduciar duty of ‘utmost good faith and loyalty’ owed by partners”

“conduct which frustrates the reasonable expectations of the investors”

Concerns abuse of power – does not matter if it is a shareholder, director, or officer

**The “No Special Rules” Approach**

DGCL §§ 341-356

*Nixon v. Blackwell*, 626 A.2d 1366 (DE 1993)

Facts: Non-employee class B stockholders claimed employee class B stockholders were given liquidity option not available to the non-employees. Plaintiffs claimed breach due to (1) attempting to force sale of stock at discount through negligible dividends, (2) excessive compensation, and (3) liquidity measures (only ‘3’ is on appeal)

Issue: Breach of fiduciary duty.

Holding: Not found.

Reasoning: ESOP and key man life insurance policies are normal business practices that benefit the company. Plaintiffs were not

Employees

Entitled to share in an ESOP

Qualified for key man insurance

Protected in the certificate of incorporation, by-laws, or a shareholder agreement.

**Rule**: Fair does not mean equal. Even if Business Judgment Rule does not apply, the standard is fairness to the company not to the plaintiff.

**Dicta**: stockholder in a closely-held corporation must make bargain at time of purchase; [later holders (e.g. beneficiaries) are bound by the bargain as well]; Subchapter XIV of DGCL contains all applicable special rules for closely held corporations;

**MOLL**:

Closely held corporations often involve familiar relationships

Often initial trust reduces perceived need for contractual protections

Initial inability to perceive all future potential problems

Minority shareholder may be reluctant to raise an issue due to potential for damage to relationship

Minority shareholder burdened by both business and familiar relationship

Delaware case law still does not address a classic freeze-out

Trade-off between lack of certainty (w/out special common law rules) and minority protection (w/ special rules)

* + - 1. Reconsidering the Role of Contract in Oppression Disputes
				1. *Gallagher v. Lambert*, 549 N.E.2d 136 (NY 1989)

Facts: Gallagher fired. Owned stock with mandatory buy-back provision at book value; provision was through 31 JAN 1985, he was fired on 10 JAN 1985. Gallagher wants post 31 JAN 1985 calculations to be used. Claims bad faith in firing in order to avoid higher price.

Issue: Breach of fiduciary duty.

Holding: Not found.

Reasoning: At will employee. Plaintiff received the benefit of his bargain. Employee rights and stockholder rights are separate.

**Rule:** Courts will enforce contracts; employee and stockholder rights are separate; a claim of unfairness is insufficient.

**Dissent:** Plaintiff alleged breach of duty to him as a shareholder

Claim of bad faith discharge was related to an attempt to recapture his shares at an unfair low price – claims this was breach in terms of

Duty of good faith in shareholders agreement

Fiduciary duty to minority shareholder for majority to “refrain from purely self-aggrandizing conduct”

If plaintiff was not an employee, similar conduct would be barred

Implied good faith in contract law

Defendants should remain free to fire employee, but must show a business purpose in reference to him as shareholder

1. The Limited Partnership
	1. In general
		1. Has at least one general partner and one limited partner
		2. Like partnership
			1. Pass through taxation
			2. Structural liability
		3. No liability for debts beyond investment for limited partner(s)
		4. Foundation for LLPs and LLCs (which will likely cause the limited partnership to go away)
	2. Historical overview
		1. RULPA (1985) §§ 101(7), 403, 1105
		2. RULPA (1985) refers to RUPA for clarification; ULPA (2001) (not widely adopted) de-links from general partnership
	3. Formation
		1. RULPA (1985) §§ 101(2), 102, 104, 201, 204, 501; ULPA (2001) §§ 102(2), 108, 201, 204, 501
		2. Limited partnerships require filing of certificate with state (and appropriate fee)
		3. Rights and duties are contained in the partnership agreement
	4. Management and operation
		1. RULPA (1985) §§ 302, 305, 402-403; ULPA (2001) §§ 302, 304, 402, 406-407
		2. Limited partners are generally denied the right to management (or risk unlimited liability)
		3. Limited partners have no agency authority (according to case law)
		4. Default rule – limited partners have no voting right (agreement may provide rights on some issues)
	5. Financial rights and obligations
		1. RULPA (1985) §§ 101(2), 501-504, 601, 604, 607-608; ULPA (2001) §§ 102(2), 406, 501-505, 508-509
		2. Default rule – Profits/losses allocated according to “the basis of the value … of the contributions made by each partner to the extent they have been received by the partnership and have not been returned.”
		3. ULPA (2001) does not refer to return of contributions
		4. Distributions are not allowed if would leave firm insolvent
	6. Entity Status
		1. ULPA (2001) § 104
		2. RULPA (1985) does not explicitly state separate entity, ULPA (2001) does.
	7. Limited Liability
		1. The control rule
			1. RULPA (1976) § 303; RULPA (1985) § 303; ULPA (2001) § 303
			2. Partners can lose limited liability through exercising control
			3. *Holzman v. De Escamilla*, 195 P.2d 833 (CA 1948)
				1. Facts: Escamilla is GP. P’shipt went bankrupt. Holzman was trustee of estate of bankrupt.
				2. Issue: Claimed limited partners became general by exercise of control.
				3. Holding: General partners.
				4. Reasoning: Could withdraw funds and replace general partner by refusing to sign checks for bills general partner contracted for.
				5. **Rule**: Exercise of control removes liability limit.
		2. Statutory evolution of control rule
			1. Becomes progressively more protective of limited partners
			2. RULPA (1976) control had to be similar to general partner
			3. RULPA (1985) increased liability only as to parties believing he was general partner
			4. ULPA (2001) eliminates control rule (in light of LLPs and LLCs)
			5. Many jurisdictions have also eliminated
		3. Control of the “Entity” General Partner
			1. RULPA (1976) § 303; RULPA (1985) §§ 101(5), (7), (11), 303, 403; ULPA (2001) § 102(8), (11), (14)
			2. Liability cannot be evaded by exercising through an entity (e.g. general partner is a corporation)
	8. Fiduciary Duties
		1. General Partners
			1. DRULPA § 17-1101; RULPA (1985) §§ 107, 305, 403, 1105; ULPA (2001) §§ 112, 408, UPA § 21; RUPA § 404
			2. Generally related to general partnership law (ULPA de-links but is identical to RUPA)
		2. Limited Partners
			1. RULPA (1985) §§ 101(8), 1105; ULPA (2001) §305
			2. Generally related to partner, but do not fill roles typically requiring fiduciary duty
	9. Exit Rights: Dissociation and Dissolution
		1. Dissociation
			1. RULPA (1985) §§402, 602-604; ULPA (2001) §§ 601-607
			2. Voluntary withdrawal (subject to p’ship agreement), removal, bankruptcy
			3. FLP used to minimize taxes, but voluntary exit rights eliminates federal tax benefit
		2. Dissolution
			1. RULPA (1985) §§ 801-804; ULPA (2001) §§ 801-808, 812
			2. RULPA (1985) § 801
				1. Time specified in certificate
				2. Occurrence of events in p’ship agreement
				3. Written consent of all partners
				4. Withdrawal of a general partner under § 402
				5. Entry of a decree of judicial dissolution under § 802
2. The Limited Liability Partnership
	1. General
		1. Partnership with limited liability for firm’s tort obligations or both tort & contract
		2. General partnership law applies where not altered by LLP law
		3. All partners have right to participate in management
	2. Historical overview
		1. LLP born in Texas 26 August, 1991.
		2. Designed to avoid risk of loss of personal assets due to malpractice of partner or event out of own control
		3. Created for lawyers and accountants
	3. Formation
		1. Tex. Rev. Civ. Stat. art. 6132b § 3.08; RUPA §§ 101(5), 201, 1001-1003
		2. “[A]n association of two or more person to carry on as co-owners a business for profit.”
		3. Required to file with the state: name (incl. LLP), address, statement of business or purpose
		4. Some states require specified amount of liability insurance or a pool of funds
		5. Failure to comply with insurance/pool of funds loses limited liability protection
		6. To approve LLP registration – unanimous, majority in interest, or majority may apply (varies by state)
		7. LLP status may begin at registration or may depend on creditors’ expectations
		8. Registration fees, must renew registration
		9. Limit only applies for debts and obligations incurred while registered
	4. Limited Liability
		1. *Kus v. Irving*, 736 A.2d 946 (CT 1999)
			1. Facts: Lawyer filed suit after already collecting insurance in order to get higher fee. Lawyer’s partners seek summary judgment to dismiss charges against them.
			2. Issue: Limited liability.
			3. Holding: Summary judgment granted.
			4. Reasoning: The partners had no knowledge of or dealings in the case and did not share in the fee.
			5. **Rule**: Not liable for acts of others unless under direct supervision and control
		2. Most states limit liability in all cases
		3. Personal liability may be had under a piercing of the veil theory.
	5. The Limited Liability Limited Partnership
		1. Tex. Rev. Civ. Stat art 6132a-1 § 2.14; art 6132b, § 3.08; ULPA (2001) §§ 102(9), 108, 201, 404; RUPA § 306
		2. Limited partnership registers as an LLP
		3. Reduces liability for general partner
3. The Limited Liability Company
	1. General
		1. Limited liability even for those who participate in control
		2. Pass-through tax treatment
		3. Freedom to contractually arrange internal operations of the venture
		4. Preferred structure for closely held organizations
	2. Historical Overview
		1. Company’s sought to be taxed as partnerships
		2. IRS eventually developed “check-the-box” regulation for all unincorporated businesses to be taxed as partnerships or corporations
		3. Statutes refer to partnerships, corporations, and limited partnerships
	3. Formation
		1. DLLCA §§ 18-101(3), (7), (11), 18-102, 18-104, 18-201, 18-301, 18-901; ULLCA § 101(13), 103, 105, 108, 201-201, 401, 1001
		2. File articles of organization with state & fee
		3. Operating agreement
	4. The Role of Contract
		1. DLLCA §§ 18-101(7), 18-101(7), 18-1101; ULLCA § 103
		2. LLC statutes have few default rules
	5. Management and operation
		1. DLLCA §§ 18-101(10\_, 18-210, 18-302, 18-401 to 18-402, 18-503; ULLCA §§ 101(11), (12), 203, 404
		2. Member management default
		3. Voting may be pro rata or by member
		4. May have multiple classes of ownership
	6. Financial Rights and Obligations
		1. DLLCA §§ 18-502 to 18-504, 18-601, 18-607; ULLCA §§ 402, 404-407
		2. Default may either be like partnership (equal) or pro rata depending on jurisdiction
		3. Members may be liable for distributions rendering company insolvent
	7. Entity Status
		1. DLLCA §§ 18-201, 18-701; ULLCA §§ 112, 201, 501
		2. Is an entity
	8. Limited Liability
		1. Scope of Limited Liability
			1. DLLCA §§ 18-215, 18-303, 18-607; ULLCA § 303
			2. Pepsi-Cola Bottling Co. v. Handy, 2000 WL 364199 (DE 2000)
				1. Facts: Defendants, as individuals, contracted to purchase property. They intended to form a company and develop for residential. Upon discovering wetlands, they sold to Pepsi, did not disclose wetlands and lied about testing. The individuals sought to be removed from the case due to LLC.
				2. Issue: Limited liability.
				3. Holding: Not granted (for motion to dismiss purposes).
				4. Reasoning: Cash distribution caused LLC to be insolvent, LLC was not formed until after acts had been committed.
				5. **Rule**: (1) LLC only protects for events during its existence (2) cash distributions causing the LLC to be insolvent can result in liability for members
		2. Piercing the Veil
			1. DLLCA § 18-303; ULLCA § 303
			2. Failure to follow formalities cannot be considered under some statutes (may be a factor in others)
			3. Reverse veil piercing – seeking to hide assets in LLC to become judgment proof
	9. Fiduciary duties
		1. DLLCA §§ 18-406, 18-1101; ULLCA §§ 103, 409
		2. Members/managers owe fiduciary duty to LLC (to each other in some jurisdictions)
		3. *VGS, Inc. v. Castiel*, 2000 WL 1277372 (DE 2000)
			1. Facts: Castiel formed an LLC to enter satellite industry with Sahagen. Castiel controlled 75% and Sahagen 25%. After falling out, Sahagen conspired with second of three members of the Board of Managers to merge the LLC into VGS. Sahagen issued promissory note to VGS of $10 million, then owned 62.5% and Castiel 37.5%. Secrecy was necessary to avoid Castiel replacing third member.
			2. Issue: Fiduciary duties.
			3. Holding: Duty of loyalty breached.
			4. Reasoning: Managers had a duty of loyalt to the LLC, its investors, and their fellow manager.
			5. **Rule**: Even when no notice is required by statute, it may be imposed under duty of loyalty.
	10. Ownership Interests and Transferability
		1. DLLCA §§ 18-701 to 18-704; ULLCA §§ 501-504
		2. Ownership rights
			1. Distributions and share of profits and losses (financial rights)
			2. Right to participate in management (management rights)
		3. Cannot freely transfer full ownership (but can be modified by contract)
		4. Management usually only transferred by unanimous vote (some majority or majority of interest)
		5. Charging orders may be used against a member’s interest
			1. Does not dissolve (NC example statute)
			2. Forced sale of membership interest not permitted (NC example statute)
	11. Exit Rights: Dissociation and Dissolution
		1. DLLCA §§ 18-603 to 18-604, 18-801 to 18-804; ULCCA §§ 101(2), (19), 601-603, 701-704, 801-808
		2. Dissociation usually occurs through withdrawal, resignation, death, or bankruptcy
			1. Usually results in buyout of dissociating ownership interest or dissolution
			2. Many states are curtailing buyout requirement due to check-the-box regulation
		3. LLCs face similar oppression dangers as owners of closely-held corporations
		4. Dissolution: at time specified, majority interest vote, judicial decision.