<u>CORPORATIONS</u>

Six fact patterns:
- organization of corporations
- issuance of stock
- directors and officers [heavily tested]
- shareholders [heavily tested]
- fundamental corporate changes
- controlling shareholders

On NY essay, mention "Business Corporation Law"

<u>Organization of NY corps</u>

1) **Formation requirements** – people, paper, acts

   a) **Incorporators** – people
      i) What they do:
         (1) Execute the certificate and deliver it to the Dept. of State, and
         (2) Hold an organizational meeting.
      ii) How many needed:
         (1) Just 1, or more
      iii) Who can do it:
         (1) Adult humans only.
         (2) No entities.

   b) **Certificate of incorporation** – paper (not "articles" of incorp.)
      i) Purpose of certificate
         (1) Contract between corp and shareholders
         (2) Also a contract between corp and state

      ii) Info on the certificate
         (1) <u>Names and addresses</u>
            (a) Corporate name – It must have "Corp." "Inc." or "Limited" in the name.
               (i) Corp name "Vance Refrigeration" is not acceptable.
            (b) Address is the NY county of the office of the corp, <u>not</u> the street address.
               (i) Office of the corp does <u>not</u> have to be a place where the corporation actually does business.
            (c) Name and address of each incorporator

         (2) Corp's <u>agent for service of process</u>
            (a) <u>Must</u> be the NY Secretary of State.
            (b) Also must provide address for forwarding process to corp.

(3) Statement of duration
   (a) May be made but if certification contains no statement of duration, then corp has perpetual existence.

(4) Corporate purpose statement is required
   (a) Can be: "engage in all lawful activity, after first obtaining necessary state agency approval."

   (b) What if the certificate says purpose is to manufacture refrigerators and the corp manufactures t-shirts?
      (i) **Ultra vires act** – beyond the scope of the certificate.
         1. At common law – contract could be voided.
         2. Today:
            a. Ultra vires contracts are valid.
            b. Shareholders (SH) can seek an injunction.
            c. Responsible managers are liable for ultra vires losses.

(5) Capital structure (stock)
   (a) Def:
      (i) **Authorized stock** – max number of shares corp can sell.
      (ii) Issued stock – number of shares corp actually sells.
      (iii) Outstanding stock – stock corp has sold and has not reacquired.

   (b) On certificate, must include:
      (i) Authorized stick
      (ii) Number of shares per class
      (iii) Information on par value, rights, preferences, and limitations of each class
      (iv) Information on any series (subclass) of preferred shares

   (c) At least one class of stock or bands must have unlimited voting rights and at least one class of stock must have unlimited dividend rights.

c) **Acts**
   i) Each incorporator signs the certificate and acknowledges it before a notary. Deliver it to the NY Dept. of State, and if it conforms to law and the filing fees are paid, Dept. files the certificate.
      (1) This is conclusive evid of valid formation. At this point, we have a de jure (legal) corp.

   ii) Incorporators then hold an organizational meeting (or can be done by written consent). At meeting:
      (1) Adopt any bylaws
      (2) Elect initial directors
      (3) Then Board of Directors takes over management

2) **Effect of forming a corp**
   a) Internal affairs doctrine
      i) Internal affairs of a NY corp are governed by NY law.
      ii) This is true even if corp only does business in France.
      iii) Internal affairs = duties, relationship among directors, officers, SH, etc.

   b) Corp is a separate legal person
      i) It has broad powers, including the power to enter contracts, transfer property, buy and sell securities, and to sue or be sued.

      ii) Corp can make political contributions, but no more than $5k per year, per candidate or organization. (NY election law)

      iii) Corp can make a charitable contribution. There is no ceiling.

      iv) Corp can guaranty a loan that is not in furtherance of corp. business if it is approved by 2/3 shares that are entitled to vote.

   c) Liability for what corp does
      i) Corp is liable to debt, breach of contract, or torts, not:
         (1) The people who run the corp. like directors or officers.
         (2) Shareholders are limited only to the price of their stock.
      ii) Corp is liable for what corp does, even if there is only 1 SH.

3) **De facto corp doctrine / corp by estoppel**
   a) Situation: in these cases, incorporators fail to form a de jure corp. They are afraid they will be personally liable for what the business does (because they just have a partnership).
      i) With these defenses, the business is *treated* like a corp, so SH are not personally liable.

   b) **De facto corp**
      i) Must show:
         (1) There is a relevant corp statute (business corporation law) (there is);
         (2) Parties made a good faith, colorable attempt to comply with it; and
         (3) Business is being run as a corp.
      ii) Then it will be treated as a corp for all purposes except:
         (1) In an action by the state.

iii) **In NY**
   (1) De facto corp was thought to be abolished, but case law suggests it is alive in limited circumstances, like this one only:
      (a) Incorporators put together a proper certificate and deliver it to the Dept. of State, but the Dept. failed to file it, without rejecting it.
         (i) It is not de jure, because it was not filed. So can argue for de facto corp.

c) **Corp by estoppel**
   i) Theory is that one dealing with a business as a corp, treating it as a corp, may be estopped from denying the business's corp status.
      (1) So the person cannot sue the individual proprietors.

   ii) **In NY – abolished**

4) **Bylaws**
   a) Are not required.
      i) Corp can exist without them.
      ii) But almost all corps have them, to set up procedures and responsibilities like officers, notice requirements for meetings, etc.

   b) If inconsistent with certificate:
      i) <u>Certificate controls</u>.
         (1) The certificate is a contract with the state.

   c) Not filed with the state – internal document, so outsiders not bound by them.
   d) The incorporators at the organization meeting adopts the initial bylaws.
   e) Changes to bylaws:
      i) SH can amend or repeal the bylaws or adopt new ones.
      ii) Board of directors can make changes to the bylaws only if allowed to by the certificate or SH bylaws.
         (1) Even in this case, SH can amend or repeal any director-adopted bylaws.

5) **Pre-incorporation contracts** [most important topic in this category]
   a) **Promoter** – person acting on behalf of a corp not yet formed.

   b) **Liability** of corp on pre-incorp contracts:
      i) Example: on 1/10, Promoter for a corp not yet formed, leases a building from Jim and signs the lease "Rental Cars, Inc." On 2/20, Rental Cars, Inc. is incorporated.
         (1) Is corp liable on the contract?
            (a) <u>Only if it adopts the contract</u>. Corp not automatically liable.

ii) Adoption can occur:
(1) Express adoption – by Board action.
(2) Implied adoption – if corp knowingly accepts a benefit of the contract.
(a) So in example, if corp moves into the leased premises and starts using it in the business.

c) **Liability of promoter** on pre-incorp contracts:
i) **Rule:** unless the contract clearly indicates otherwise, the promoter is liable on pre-incorp contracts unless there is a **novation**.
(1) **Novation** – agreement among the promoter, corp, and the other party that the corp will replace the promoter under the contract.

ii) Example: so in hype above, assume that the contract does not indicate that the promoter will not be liable.
(1) Will P be liable on the lease if Rental Cars, Inc. is never formed?
(a) Yes.
(2) Will P be liable on the lease if Rental Cars, Inc. is formed and adopts the lease?
(a) Yes – P is liable until there is a novation. Here, there is no novation.

iii) So adoption makes the corp liable too, but it does not relieve the promoter of liability. Corp will be liable under adoption and P will be liable because no novation.

6) **Secret profit rule** – promoter dealing with corp itself [rarely tested]
a) **Rule**: promoter cannot make a secret profit on her dealings with the corp. If she does, she is liable, has to account for the profit and return it to the corp.

b) Sale to corp of property acquired before becoming promoter:
i) Formula: profit = price paid by corp – FMV

ii) Example: 1/10, P begins as promoter. 4/4, P sells corp Greenacres for $40k. P bought it in 1931 for $1.98. Is there any profit?
(1) Maybe not. Apply test: profit = price paid by corp – FMV.
(2) If property is worth $40k or more, then there is no secret profit.

c) Sale to corp of property acquired after becoming promoter:
i) Formula: profit = price paid by corp – price paid by promoter

ii) Example: 1/10, P begins as promoter. On 2/20, P buys property for $18k. On 3/3, P sells that property to corp for $25k. Is there any profit?
(1) Yes of $7k. 25k-18k=7k.
(2) P is liable to corp for the $7k only if it was secret. If corp knows about it, then no liability.

7) **Foreign corps** [rarely tested]
    a) **Rule**: foreign corps doing business in NY must qualify.

    b) Def:
        i) Foreign corp is one incorp outside of NY.
            (1) So incorp in another state is foreign.
        ii) Domestic corp is one incorp inside of NY.

    c) Doing business:
        i) The regular course f intrastate business activity. Not sporadic activity.

    d) How to qualify:
        i) Foreign corp can apply to the NY Dept. of State and designate the Sec of State as agent for service of process.
            (1) Info given to NY Dept. of State:
                (a) Info from its certificate, and
                (b) Proof of good standing in home state.
        ii) Also has to pay fees to NY.

    e) What if don't qualify?
        i) Unqualified foreign corp cannot sue in NY until it qualifies and pays fees, taxes, penalties, and interest.
        ii) It can be sued and defend in NY without qualifying.

<u>Issuance of stock</u>

1) **Issuance**
    a) Issuance occurs when a corp sells its own <u>stock</u>.
        i) It is a way to raise capital.
        ii) Investors buy stock and become holders of an <u>equity security</u>.
            (1) They are <u>owners</u> of the corp.

        iii) Example: Family Guy sells 3k shares of Mayberry Inc stock. Is that an issuance?
            (1) No. <u>It is only an issuance if it is the corp selling its own stock</u>.

    b) In an issuance of bonds, the investor makes a <u>loan</u> to the corp.
        i) Investors hold <u>debt security</u>.
            (1) They are <u>creditors</u> of the corp.

        ii) <u>Debenture</u> – a loan, the repayment of which is not secured by corp assets.

2) **Subscriptions**
   a) A written, signed offer to buy stock from the corp.

   b) **Revocation of pre-incorp subscriptions**:
      i) Irrevocable for 3 months, unless:
         (1) The subscription provides otherwise, or
         (2) All subscribers agree to let you revoke.

      ii) Rationale: to allow the forming corp the rely on the money being there.

      iii) Example: On 1/10, S signs a subscription, offering to buy 100 shares of C corp, a corp not yet formed. A week later, S changes his mind. Can S revoke?
         (1) No, not for 3 months.

   c) **Revocation of post-incorp subscriptions**:
      i) They are revocable until accepted by the corp.
         (1) The corp and subscriber do not become obligated under a subscription until the Board accepts the offer.

   d) Corp cannot decide to sell only to some subscribers and not others. It must be uniform within each class or series of stock.

   e) If corp accepts the offer and subscriber defaults on payment:
      i) If subscriber paid less than half of the purchase price and fails to pay the rest within 30 days of written demand,
         (1) Corp can keep the money paid and cancel the shares.
         (2) Stock becomes authorized and unissued (so corp can resell it).

      ii) If subscriber paid half or more and fails to pay the rest within 30 days of written demand,
         (1) Corp must try to sell the stock to someone else.
            (a) If no one will pay the remaining balance, corp can keep the money and cancel the shares.
            (b) If someone will pay the remaining balance due, the defaulting subscriber recovers any excess over what she agreed to pay (but deduct from that the corp's expenses in selling to the new guy).

      iii) Example: I enter subscription to buy $5k worth of stock. I pay $3k and then default. Corp spends $50 to get new buyer, who agrees to pay $2500.
         (1) So corp collects $5500. The $500-$50 comes back to me.

3) **Consideration** – what must the corp receive when it issues stock
   a) **Form** of consideration
      i) Permitted forms:
         (1) Money (cash or check)
         (2) Tangible or intangible property
         (3) Services already performed for the corp
            (a) This includes services performed in the forming of corp.
         (4) A binding obligation to pay in the future in money or property (promissory note)
         (5) A binding obligation to perform future services having an agreed value.

      ii) Prohibited forms:
         (1) Anything other than the 5 above.
            (a) But it is almost impossible to come up with something prohibited.
         (2) If someone uses an improper form, it is called <u>unpaid stock</u> – and is treated as water.

   b) **Amount** of consideration
      i) **Par** is the minimum issuance price.
         (1) Example: if C corp. issues 10k shares of $3 par stock, it must receive at least $30k.
            (a) It is ok for C Corp. to get more than that – this is the minimum it must receive.

      ii) **No par** is no minimum issuance price and can be sold for any price.
         (1) The Board sets the price at which to sell no par stock, unless the certificate allows the SH to set it.

      iii) **Treasury stock** is stock that was previously issued and has been reacquired by the corp.
         (1) Corp can then resell it and it then becomes no par stock.
         (2) Example: C Corp is selling $3 par treasury stock. There is no minimum it must receive – it becomes no par.

      iv) Acquiring property with par value stock
         (1) Can C Corp issue 50k shares of $3 par stock to acquire a farm?
            (a) Step 1 – is the form of consideration ok?
               (i) Yes, property is acceptable consideration.
            (b) Step 2 – is the amount of consideration ok?
               (i) Yes, if the farm is worth at least $150k

         (2) When the Board determines the value of the consideration for an issuance, it is conclusive if made without fraud.
            (a) Example: Corp issues $1mil worth of its stock to pay a director's nephew for sweeping the office for 1 week.
               (i) This is fraud! A waste of corp assets.

v) Consequences of issues par stock for less than par value – **watered stock**
   (1) C Corp issues 10k shares of $3 par to X for $22k.
      (a) The corp (or creditors if the corp is insolvent) can sue for the $8k of water. Who to sue?
         (i) Directors are liable for the water if they knowingly authorized the issuance.
         (ii) X (the guy who bought the watered stock) is liable.
            1. There is no defense – he is charged with notice of par value of that stock.
         (iii) If X buys the watered stock and transfers it to a 3rd party, 3rd party is not liable if she acted in good faith and did not know about the water.
            1. But 3rd party's status has no effect on the liability of X and directors.

4) **Preemptive rights** [most heavily tested in this section]
   a) The right of an existing SH to maintain her percentage of ownership (not have it be diluted) by buying stock whenever there is a new issuance of common stock for money.

   b) Treasury stock
      i) If certificate is silent, a new issuance does not include sale of treasury stock.
      ii) Treasury stock is not new issuance for preemptive rights.

   c) Shares authorized by original certificate
      i) If the certificate is silent, a new issuance does not include sale of shares authorized by the original certificate and sold within 2 years of formation.
      ii) Dates always matter.

   d) Example: S owns 1k shares of C Corp. There are 5k shares outstanding. C Corp is planning to issue an additional 3k shares. If S has preemptive rights, then S has the right to do what?
      i) S owns 20% (1k/5k=1/5)
      ii) S has a right to buy 600 shares of the additional issuance. (1/5 * 3k)

   e) If certificate is silent on preemptive rights, **they do not exist**.
      i) Preemptive rights exist **only** if the certificate says so.

   f) Example: certificate provides for preemptive rights and C Corp is issuing stock to G to acquire Greenacres from G. Are there preemptive rights?
      i) No – this is not an issuance for money.
      ii) Be careful of this on exam.

<u>Directors and Officers</u> [remember – it is almost impossible to have a corp question on exam without directors and officers]

1) **Statutory requirements – Directors**
   a) **Number**
      i) One or more adult person.
      ii) Number is set by:
         (1) In the bylaws, or
         (2) SH act, or
         (3) By the Board, if a SH bylaw allows.
      iii) If the number of directors is not set by one of these ways, then there is <u>one</u> director.

   b) **Election**
      i) Initially elected by the incorporators.
      ii) After that, elected by SH at annual meeting.

      iii) Classified board
         (1) When the certificate or shareholder bylaw establishes 2, 3, or 4 classes of directors, with one class elected each year.
         (2) So there can be an election of all new directors each year or there can be staggered elections in this way.

   c) **Removal** of directors
      i) Can be removed for cause by SH.
      ii) Can be removed for cause by Board <u>only</u> if the certificate <u>or</u> SH bylaw allows it.
      iii) Can be removed by anyone <u>without</u> cause:
         (1) Only by SH, <u>and</u>
         (2) Only if certificate or bylaws allow.

   d) **Filling a vacancy**
      i) **General rule**: the Board selects the person who will serve the remainder of the term.
         (1) Special rule: [unlikely to be tested]
            (a) SH selects the person who will serve the remainder of the term when a director is removed by SH without cause.

   e) **Acts** of the directors – very strict
      i) Board can take a valid act <u>only</u> by:
         (1) Unanimous written consent
         (2) Act in a meeting
            (a) Meeting does not need to be in NY, can be anywhere in the world.
            (b) Meeting <u>can</u> be by conference call.

(3) If directors take an act in some other way, such as an individual conversation
    (a) The act is void unless it is ratified by a valid act.

ii) **Notice** requirements for Board meetings
  (1) Regular meetings
    (a) Notice is not required if the time and place are set in the bylaws.
  (2) Special meetings
    (a) Notice is required for the time and place, but the purpose need not be stated.

  (3) If notice of a special meeting is not given
    (a) Any action taken at the meeting is void unless the director not given notice waives the notice defect.
    (b) Waiver occurs by:
      (i) In writing, signed at any time (even after the special meeting occurs), or
      (ii) Attending the special meeting without objection.

iii) **Voting**
  (1) A director cannot use a proxy for voting.
    (a) This is void as against public policy. We need the director's independent judgment.

  (2) Directors cannot enter voting agreements on how they will vote.
    (a) Void as against public policy.

  (3) But need to keep this straight. SH can vote by proxy and voting agreement.
    (a) And when 1 person is a SH and a director, you need to make sure you know what hat that person is wearing to know what rules to follow.

iv) **Quorum** for a meeting
  (1) Majority of the entire Board is required to be present to do business.
    (a) Duly constituted Board is required – the full number of positions if no vacancies.

    (b) Example: there are 9 Board positions but 2 directors have retired and have not yet been replaced, so only 7 directors are serving. How many are needed for a quorum?
      (i) Need at least 5 – need majority of the entire Board, which is 9.

  (2) Once there is a quorum, passing a resolution requires a majority of those present.
    (a) Resolution – how the Board taken an act at a meeting.

(b) Example: if there are 9 Board positions, at least 5 directors must attend the meeting to constitute a quorum. If 5 directors attend, at least 3 directors must vote for a resolution for it to pass.

(3) Changes to quorum:
(a) Can be decreased to less than a majority of directors, by the certificate <u>or</u> bylaws, but it can <u>never</u> be fewer than 1/3 of the entire Board.

(b) Can be increased to greater than a majority of directors but in the certificate <u>only</u>, and not in the bylaws.
(i) So certificate can require that 90% of the entire Board must be present to do business.

(4) Changes to vote:
(a) Requirement of majority vote cannot be changed or reduced.
(b) A supermajority vote to pass resolutions is allowed but in the certificate <u>only</u> and not in the bylaws.
(i) So certificate can require that 60% of the directors present must approve the resolution.

(5) Example: there are 9 director positions on the Board. 5 directors show up to a properly-called meeting, but then one leaves the meeting. Can the Board continue to do business?
(a) No, <u>once a quorum is broken, cannot conduct business after that</u>.

2) What does the Board of directors do?
a) Generally, manage the business of the corp.
i) Set policies, monitor and supervise officers, declare dividends and other distributions, decide when to issue stock, recommend fundamental corp changes, etc.

b) **Committees**
i) If certificate or bylaws allow, a majority of the entire board can delegate substantial management functions to a committee of 1 or more directors.

ii) But Board cannot delegate <u>all</u> powers and responsibilities to a committee.

iii) Committee <u>cannot</u>:
(1) Set director compensation
(2) Fill a Board vacancy
(3) Submit a fundamental change to SHs
(4) Amend bylaws.
iv) But the committee can recommend any of these things for full Board action.

v) Committees are important in SH derivative suits.

3) **Duty of Care** – a director is a fiduciary
   a) **Standard**: A director must discharge her duty <u>in good faith</u> and with that <u>degree of diligence, care, and skill</u> that an <u>ordinarily prudent person would exercise under similar circumstances in like position</u>.
      i) Need to use these exact words on exam.

   b) **Nonfeasance** – director does nothing.
      i) Director is liable only if his breached caused a loss to the corp, which can be hard to do in the case of nonfeasance.
         (1) Just breach is not enough – also need causation.

      ii) Example: Director of C Corp fails to attend any of the Board meetings or to keep abreast of the business in any way. Will he be held liable for breach of duty of care?
         (1) Step 1 – identify the issue.
         (2) Step 2 – state the duty of care standard.
         (3) An ordinarily prudent person would attend some meetings. D never attended any meetings and did not stay abreast of the business, so he breached the duty of care. But he is liable only if his breach caused a loss to the corp.
      iii) Example: the nonfeasance director was an antitrust expert. He did not show up at the meetings and the Board approved an action that violated antitrust laws.
         (1) Director is liable in this case because there is breach and causation, because the Director could have stopped the action.

   c) **Misfeasance** – board does something that hurts the corp.
      i) **Business judgment rule** (BJR)
         (1) A court will not second-guess a business decision if it:
            (a) Was made in good faith;
            (b) Was reasonably informed; <u>and</u>
            (c) Had a rational basis.
         (2) A director is not a guarantor of success. So a director is not liable if she meets the BJR.

      ii) Example: Directors of Hot Tubs Inc vote to start a new product line of hot tubs with built-in wine coolers and video cameras. The idea is a disaster and the company loses money. Are the directors liable for breach of the duty of care?
         (1) Step 1 – identify the issue
         (2) Step 2 – state the duty of care standard.
         (3) Here, the directors' decision caused the corp to lose money but a director is not liable if she meets the BJR. Prudent people do appropriate homework, so depending on the facts, did they deliberate? Analyze? If yes, then not liable.

4) **Duty of loyalty**
   a) **Standard**: a director must act in good faith and with the conscientiousness, fairness, morality, and honesty that the law requires of fiduciaries.
   b) BJR does **not** apply in duty of loyalty cases.
      i) These situations involve conflicts of interest and when you see a conflict, throw out the BJR.

   c) **Interested director transactions**
      i) **Rule**: Interested director transactions will be set aside unless the director shows either:
         (1) The deal was fair and reasonable to the corp when approved, or
         (2) The material facts and director's interest were disclosed or known, and deal was approved by:
            (a) SH action, or
            (b) Board approval by a sufficient vote not counting the vote of the interested director, or
            (c) Unanimous vote of disinterested directors if disinterested directors are insufficient to take an act of the Board.

      ii) The interested director can count toward a quorum of the Board, but their vote does not count.
      iii) Example: X Corp has 9 directors. 5 of them are interested in an interested director transaction. All 9 attend the meeting to consider approving the deal. After appropriate disclosures, what vote would approve the deal?
         (1) Need all 4 disinterested directors. There are not enough disinterested directors to take Board action (need majority of those present – need 5 – and since 5 are interested, they can't get to that number). So the 3rd option of the rule applies here.

      iv) Director compensation – inherent conflict.
         (1) Board can set the compensation, but compensation must be reasonable and in good faith.
         (2) If excessive, it is a waste of corp assets.

      v) Stock options to director, officer, or employee
         (1) If stock is listed on stock exchange, then the options must be authorized under exchange policies.
         (2) If stock is not listed on stock exchange, it must be approved by SHs.

   d) **Competing ventures**
      i) Director cannot compete with the corp.
         (1) Very straightforward breach of loyalty. Director is a fiduciary.

      ii) If director does compete, corp gets a constructive trust on director's profits. Director needs to account to corp for her profits. (use this language on exam)

e) **Corporate opportunity**
   i) Director <u>cannot usurp</u> a corp opportunity. (use this language on exam)

   ii) Example: D is director of C Realty Corp, which develops condo projects. D learns of some land zoned for condos and buys it for himself as an investment. What are C Realty Corp's rights against D?
      (1) Step 1 – identify the issue – conflict, duty of loyalty
      (2) Step 2 – state the duty of loyalty standard.
      (3) Director cannot usurp a corporate opportunity. D cannot take the opportunity until she tells the Board and waits for the Board to reject it.

   iii) Corporate opportunity:
      (1) Something the corporation needs, has an interest or tangible expectancy in, or that is logically related to its business.

   iv) Remedy for usurpation:
      (1) Constructive trust – director must <u>account to corp</u>.
         (a) So in example, D must sell it to the corp at his cost. If D sold it for a profit, corp gets the profit.

5) Other state law bases of director liability
   a) **Improper loans of corp funds**
      i) Loans to director are ok only if the Board finds that the corp benefits.
         (1) Example: corp loans $ to director to attend conferences to become a better director. This would be acceptable.

      ii) Sarbanes-Oxley Act (never seen on exam before)
         (1) Federal law that restricts loans to executives in registered (publicly traded) corps.
         (2) Requires Board to establish an audit committee and oversee the work of registered public accounting firm. Chief executive and financial officers must certify accuracy and completeness of financial reports.

6) **Which directors are held liable**
   a) **Rule**: a director is presumed to have concurred with Board action unless her dissent is noted <u>in writing</u> in the corp records:
      i) In the minutes;
      ii) In writing to the corp secretary at the meeting; or
      iii) Registered letter to corp secretary promptly at the meeting.

   b) Director cannot dissent if they voted for the resolution at the meeting.

c) **Exceptions**:
   i) If director missed a meeting where Board approved something wrongful, he won't be liable if he registers his written dissent within a reasonable time of learning of the action.
      (1) Done by delivering the dissent or sending it by registered mail to the corp secretary, ensuring that the dissent is filed with the minutes for the meeting.

   ii) **Good faith reliance**
      (1) On information, opinions, reports, or statements by:
         (a) <u>Officers</u> or employees of the corp whom the director believes <u>competent and reliable</u>;
         (b) <u>Lawyers or pubic accountants</u> whom the director believes are <u>acting within their competence</u>; or
         (c) A <u>committee</u> of which the person relying is not a member, as to <u>matters within its designated authority</u>.

      (2) This exception is most likely in cases of improper distributions.

7) **Officers**
   a) Duties owed to corp:
      i) Same as directors – duty of care and duty of loyalty

   b) Officers are agents of the corp. They can bind the corp to acts taken on the corp's behalf if the officer has the authority to do so.
      i) Possible agency cross-over question

   c) Board may select a president, VPs, secretary, treasurer, and any others the Board may determine or the bylaws provide for.
      i) One person can hold multiple offices simultaneously.

   d) The Board selects and removes the officers, <u>unless</u> the certificate allows SHs to elect them.
      i) If the SHs elect them, only the SHs can fire them.
      ii) Even then, for cause, directors can suspend an officer's authority to act.

      iii) Example: directors of C Corp appoint J as president. What if the directors fire J from the presidency?
         (1) Corp may be liable for breach of contract damages.
         (2) Possible contract cross-over question.

   e) General rules – hierarchy:
      i) SHs hire and fire directors.
      ii) Board hires and fires officers.

f) Judicial action:
   i) The attorney general or holders of 10% of all shares may sue for a judgment removing an officer for cause.
   ii) Court can bar reappointment of a person so removed from office.

g) Compensation of officers
   i) Set by the Board. The Board monitors the officers.

8) **Indemnification of directors and officers**
a) Situation: a person is sued in her capacity as officer or director by or on behalf of the corp. She incurs costs, attorneys' fees, judgment, or settlement. She seeks reimbursement from the corp.
   i) Prohibited:
      (1) Reimbursement is prohibited if she was held liable to the corp.
         (a) It must be adjudicated.
   ii) Of right:
      (1) Corp <u>must</u> reimburse the director or officer if she was successful in defending the action on the merits or otherwise. Won a judgment.

      (2) Example: suppose a director or officer is successful in defending a suit against her, so she qualified for reimbursement of right from the corp. Corp refuses to reimburse her and she sues corp for reimbursement and wins. Can she recover atty fees for this suit against the corp?
         (a) No. She has to pay her own atty fees in case against the corp.

   iii) Permissive:
      (1) In any case not satisfying prohibited or of right, the corp may reimburse.
         (a) Applies when case settles.
      (2) Director or officer must show:
         (a) He acted in good faith, and
         (b) For a purpose reasonably believed to be in the corp's interest.

      (3) Reimbursement here is for settlement amount, expenses, and attorney's fees.
         (a) Not any judgment, though.

      (4) Eligibility for permissive reimbursement must be determined by disinterested parties:
         (a) The Board, with a quorum of directors being non-parties, or if there is no such quorum
         (b) SHs or a quorum of those directors who are disinterested, or
         (c) The Board pursuant to report from independent legal counsel.

b) The court can order the corp to reimburse the director or officer for litigation expenses and atty fees (not including a judgment against her, if it finds that she is reasonably entitled to it.

c) Corp can advance litigation expenses to director or officer, but it must be repaid if she is not entitled to reimbursement.

d) The certificate or bylaws can provide for indemnification by resolution of Board or SH or by agreement, <u>unless</u> the director or officer:
   i) Acted in bad faith,
   ii) Was deliberate and dishonest in a way material to the case, or
   iii) Wrongfully profited.

e) On exam, anytime you see a director arguably breaching a duty, so this:
   i) "The certificate may eliminate director liability to the corp or SHs for damages for breach of duty except:
      (1) If she acted in bad faith,
      (2) With intentional misconduct,
      (3) Received an improper financial benefit, or
      (4) Approved an unlawful distribution or loan."

<u>Shareholders</u> [heavily tested]

1) **Can shareholders manage the corp**
   a) General rule: no. The Board manages.

   b) **Close (or closely held) corp**
      i) Has few SHs and stock is not publicly traded.
      ii) SHs in a close corp can manage the business directly. For this to be the case:
         (1) There must be a provision in the certificate restricting or transferring Board power to SHs. Also need:
            (a) All incorporators or SHs (voting and nonvoting) (unanimous) approve it;
            (b) It is conspicuously noted on front and back of all shares;
            (c) All subsequent SHs have notice; <u>and</u>
            (d) Shares are not listed on an exchange or regularly quoted over the counter.

      iii) In a closely held corp, the managing SHs owe the duties of care and loyalty to the corp.
         (1) In a closely held corp, there is a trend toward imposing fiduciary duties on shareholders in their dealings with each other.
            (a) Controlling SHs cannot use their power for personal gain at the expense of minority SHs or the corp, or to oppress minority SHs or the corp. They owe a duty of utmost good faith.
            (b) Courts are more willing to protect minority SHs in a close corp because there are no protections from oppression – there is no market to resell your stock. Oppression defeats reasonable expectations of SH for buying her stock.

c) **Professional service corps**
   i) Licensed professionals cannot practice through a general business corp. They can form a professional service corp, P.C.
   ii) SHs, officers, and directors must all be licensed professionals.
   iii) Professionals are liable for their own malpractice but not for other's. But entity is liable for contracts entered by the P.C.
   iv) In general, same rules as for corps.
      (1) Certificate must have same requirements, with these changes:
         (a) Indicate entity is P.C.,
         (b) Must indicate the profession to be practiced, and
         (c) Must certify that each SH, director, and officer is licensed to practice the profession.
   v) If SH in P.C. dies or disqualifies from the practice, the P.C. <u>must</u> buy back his shares.

2) **Shareholder liability**
   a) General rule: no. The corp is liable for what it does.
   b) Exception: **Pierce the corporate veil** (PCV)
      i) SH might be personally liable for what the corp did if the court PCV.
      ii) PCV applies <u>only</u> to <u>close corps</u>.

      iii) To PCV and hold SH personally liable:
         (1) <u>They must have abused the privilege of incorporating, and</u>
         (2) <u>Fairness must require holding them liable</u>.
            (a) To prevent fraud or to achieve equity. (Always say this in PCV answer.)

      iv) SH could be another corp. So if a parent corp forms a subsidiary to avoid its obligations, the court might PCV through the subsidiary and hold parent liable.

      v) Classic fact pattern: <u>Alter ego</u> (identity of interests, agency, excessive domination)
         (1) X and Y are SHs of C Corp. [close corp] X is also the CEO. X commingles personal and corp funds, uses the corp car as her own, and uses the corp credit card for personal purchases. Can creditor of corp who has been unable to collect its claim from the corp collect from either X or Y?
            (a) Step 1 – state general rule, that SHs are generally not liable for debts or acts of corp.
            (b) Step 2 – state PCV standard and explain PCV.
            (c) Step 3 – did SHs abuse the corp?
               (i) Yes, X treated the corp assets as her own, but in NY there is no PCV if the corp has any mind, existence, or will of its own.
                  1. NY has a very strict standard. [???]

(d) Step 4 – does fairness require PCV?
   (i) Arguably, because creditors are not being paid.
(2) If court did PCV here, it would probably only be X who is liable, as Y did not do anything wrong.

vi) Classic fact pattern: <u>Undercapitalization</u>
(1) Undercapitalization – failure by SH to invest sufficient money to cover prospective liabilities. [put in answer]

(2) S is SH of Glowco Inc. a corp that hauls and disposes of nuclear waste. Glowco does not carry insurance and has an initial capitalization of $1k. V is injured when one of Glowco's trucks melts down. Can V sue S?
   (a) Step 1 - state general rule, that SHs are generally not liable for debts or acts of corp.
   (b) Step 2 - state PCV standard and explain PCV.
   (c) Step 3 – the corp was undercapitalized when formed. SHs failed to invest enough to cover prospective liabilities. It is a dangerous business but they did not buy insurance and only put in $1k as capitalization.

(3) Undercapitalization by itself is <u>not</u> enough for PCV in NY.
   (a) Also need excessive domination or fraud or illegality.

vii) PCV expected to be found more in tort cases than contract.
(1) If someone enters a contract, the other party can take action to find out about undercap.

c) **Wages**
   i) In close corp, the 10 largest shareholders are personally liable for wages and benefits for the corp's employees.

3) **SH derivative suits** (SH as plaintiff)
   a) In a derivative suit, a SH is suing to enforce the corp's claim (not her own claim). Corp is not pursuing its own claim, so a SH steps in to prosecute the claim.
      i) So always ask – could the corp have brought this suit? If so, it is probably derivative.

      ii) S sues Board of directors of C Corp for usurping corp opportunities.
         (1) This is a derivative suit. Duties of care and loyalty are owed to the corp, so a breach hurts the corp.
      iii) S sues Board of directors of C Corp for issuing new stock without honoring her preemptive rights.
         (1) This is not a derivative suit – it is a direct suit for S's personal claims.

iv) S sues to compel declaration of dividend.
    (1) Questionable whether derivative. Probably not, but maybe if it could be arguably based upon a breach of duty to the corp.
    (2) It might be derivative if it is part of mismanagement because then breach to corp. (probably not) [??]
v) S sues regarding waste of corp assets.
    (1) This is always a derivative suit – breach of duty of loyalty.

b) When SH <u>wins</u> the derivative suit:
    i) The corp gets the recovery because it is the corp's claim.
    ii) SH gets costs and atty fees, usually from the judgment won for the corp.
        (1) SH may get damages directly in the derivative suit if recovery by the corp would return money to the bad guys.

    iii) Example: a close corp has 3 SH, each of who owns 1/3 of the shares and participates in management. One breaches the duty of loyalty by engaging in a competing venture. In a derivative suit, the corp wins a judgment to recover the bad guy's profits. But giving the recovery to the corp will return 1/3 of it to the bad guy.
        (1) Court might let the other SHs recover directly.

c) When SH <u>loses</u> the derivative suit:
    i) S does not recover costs and expenses.
    ii) S is probably liable to defendants for their costs because winner usually recovers costs from the loser.
    iii) Other SH cannot later sue the same defendants on the same transaction.

d) **Requirements for bringing a SH derivative suit**
    i) <u>Stock ownership when claim arose</u>
        (1) Person bringing suit must have owned stock (or held a voting trust certificate):
            (a) At the time the claim arose, <u>or</u>
            (b) Have gotten it by operation of law from someone who owned the stock when the claim arose.
                (i) Examples: inheritance, divorce decree.

    ii) <u>Stock ownership when the action is brought and through entry of judgment.</u>
    iii) <u>SH must adequately represent the interests of the corp and SHs</u>
        (1) Always state this as a separate requirement.
    iv) <u>SH can be required to post a bond for defendant's costs</u>.
        (1) Exception: if SH owns 5% or more of the stock or her stock is worth more than $50k. Then SH is not required to post bond.

v) <u>SH must make a demand on directors that the corp sue.</u>
   (1) Exception:
      (a) SH need not make a demand if it would be futile to do so.
      (b) It is futile when:
         (i) Majority of the board is interested or under the control of interested directors, or
            1. This is the most likely – look for where defendants are the very directors on the Board.
            2. You will not be required to demand that the directors sue themselves.
         (ii) Board did not inform itself of the transaction to the extent reasonable under the circumstances, or
         (iii) The transaction is so egregious on its face that it could not be the result of sound business judgment.

   (2) Special pleading requirements
      (a) Plaintiff must plead with particularity her efforts to get the Board to sue or why a demand would be futile.

vi) <u>The corp must be joined in the litigation as a defendant.</u>

e) If SH makes a demand that the corp sue and the Board refuses. SH can <u>only</u> bring the suit anyway if:
   i) She can show that a majority of the Board is interested, or
   ii) The Board's procedure was incomplete or inadequate.

f) <u>Special litigation committee</u>
   i) A committee of independent directors.
   ii) Arises when SH brings a derivative suit and the corp wants it dismissed. It can move to dismiss based on a finding by independent directors that the suit is not in the corp's best interests.
      (1) I.e., case has a low chance of recovery, or that cost of suit will exceed recovery.
   iii) In deciding whether to dismiss, if these are met, then the court will dismiss:
      (1) The independence of those making the investigation, <u>and</u>
      (2) The sufficiency of the investigation.

g) Dismissal or settlement of a derivative suit:
   i) <u>Only</u> with court approval.
   ii) Court may require notice to SHs about whether to settle or dismiss.

h) Suit by officer or director:
   i) A director or officer can sue another director or officers to compel her to account for breach of duties.
   ii) This is not a derivative suit – director or officer sues in her own name and does not have to meet derivative requirements.
      (1) However, <u>recovery will still go to the corporation</u>.

4) **Shareholder voting**
   a) Who votes?
      i) **General rule**: record owner as of record date has the right to vote.
      ii) Def:
         (1) Record owner is the person shown as the owner in the corporate records.
         (2) Record date is a voter eligibility cut-off, set no fewer than 10 and no more than 60 days before the meeting.

         (3) Example: C Corp. sets the annual meeting for 7/7 and the record date for 6/6. S sells B her C Corp stock on June 25. Who votes at the meeting?
            (a) S votes because she is the owner as of 6/6. It is irrelevant that she does not own on the date of the meeting.

      iii) **Exception** to the rule that record owner on record date votes:
         (1) <u>Corp does not vote treasury stock.</u>
            (a) I.e., Corp reacquires stock on 1/10. Record date is 1/15. Corp does not itself get a vote on this treasury stock.
         (2) <u>Death of shareholder</u> – executor gets to vote the shares.
            (a) I.e., S owns stock in C corp. S is the record owner. S dies after the record date. S's executor gets to vote the shares.
         (3) <u>Proxies are ok for SH voting</u>
            (a) Remember, directors cannot vote by proxy.
            (b) Proxy is:
               (i) A writing
                  1. Fax or email is ok.
               (ii) Signed by the record SH or authorized agent
               (iii) Directed to the secretary of corp
               (iv) Authorizing another to vote the shares

            (c) Example: on 2/2/2010, S sends letter to secretary of C Corp authorizing J to vote her shares. Can J vote S's shares at the 2010 annual meeting in 7/2010?
               (i) Yes, this is a proxy. OK for SHs, never for director voting.
            (d) Example: based on this same proxy, can J vote S's shares at the 2011 annual meeting?
               (i) No. <u>Proxies are only good for 11 months, unless it says otherwise.</u>
                  1. On exam, it will likely be silent.

(e) Example: before the 2010 meeting, S writes to the secretary of C Corp to say that she was B to vote her shares at the 2010 meeting.
   (i) This is ok. S revoked J's proxy.
   (ii) <u>Proxy can be revoked even though it states that it is irrevocable</u>.

(f) <u>Proxy coupled with an interest</u>
   (i) It is irrevocable.
   (ii) Example: S sells B her shares after the record date but before the annual meeting. S gives B an irrevocable proxy to vote the shares at the annual meeting.
      1. Can S revoke this proxy?
         a. No, because:
            i. It says it is irrevocable, <u>and</u>
            ii. The proxy-holder has some interest in the shares other than voting. Can be any interest in the stock – option to buy would be ok.

iv) **Voting trusts and voting agreements**
(1) Situation: X, Y, and Z own relatively few shares of C Corp. They decide that they can increase their influence on corp policy by block voting – voting alike.

(2) **Voting trust**
   (a) **Requirements for a voting trust**
      (i) Written trust agreement controlling how the shares will be voted;
      (ii) Copy to the corp;
         1. No secret trusts.
      (iii) Transfer legal title of the shares to the voting trustee; <u>and</u>
      (iv) Original SHs receive voting trust certificates and retain all SH rights except for voting.

   (b) Time limit on voting trusts
      (i) 10 year max under BCL.
      (ii) But within 6 months of expiration, can extend for another term of up to 10 years.

(3) **Voting agreements** (pooling agreement)
   (a) **Requirements for a voting agreement**
      (i) SH can enter these, but not directors.
      (ii) Must be in writing and signed.
      (iii) It is irrevocable if it says so.

   (b) Not specifically enforceable.
      (i) In NY, cannot get specific performance or enforcement of the agreement.

(c) Example: 2 SH agree to vote to elect each other as directors.
(i) This is OK because electing directors is something SHs do.
(ii) They are not allowed to agree about what actions to take once they are directors because this would violate rule against voting agreements among directors.
1. However, this is probably ok if these are the only SHs in the corp.

b) **Where do SHs vote**
i) Only ways SH can take a valid act:
(1) Written consent, signed by the holders of all voting shares; or
(2) Meeting.

ii) Kinds of meetings (need not be held in NY)
(1) **Annual**
(a) Where directors are elected.
(i) Highest vote-getter for each seat wins, even if not the majority of votes. Just need a plurality.
(b) If annual meeting is not held, court can order one.
(2) **Special**
(a) Can be called by:
(i) Board, or
(ii) Anyone provided in the certificate or bylaws.
(b) Only certain business is conducted.

iii) **Notice**
(1) Requirements:
(a) Must given written notice;
(i) Email is ok
(b) To every SH entitled to vote;
(i) If notice not given to everyone entitled to vote, then the action at the meeting is void. But:
1. Action can be upheld if those not given notice waive the notice defect. Waiver occurs:
a. Express: in writing and signed anytime, or
b. Implied: if SH attends the meeting without objection, then objection is waived.
(c) For every meeting;
(i) Annual or special
(d) Between 10 and 60 days before the meeting.

(2) Contents of notice
(a) Time and place of meeting
(b) If action proposed at the meeting is something on which SH would have appraisal rights, the notice must say so and tell why and include the statute about appraisal rights.

(c) Notice of special meeting must state who called it and purpose of the meeting.
  (i) Because this is the only business that can be conducted – the purpose specified in the notice.
  (ii) Example: supposed a proper person calls a special meeting of SH and the purpose is to remove a certain officer.
    1. Cannot do this because SHs do not remove officers.
    2. Purpose must be for a proper SH action.
    3. Would be ok if it were to remove a director.

c) How do SH vote?
  i) **Quorum**
    (1) There must be a quorum represented at the meeting.
    (2) Determined by looking at the number of <u>shares</u> represented, not number of SH.
    (3) Quorum requires a majority of outstanding shares.

    (4) Example: X Corp has 120k shares outstanding. X Corp has 700 SH. [irrelevant] What is a quorum?
      (a) At least 60k + 1 share.

    (5) Certificate or bylaws can reduce a quorum to less than a majority but it cannot be less than 1/3 of the shares entitled to vote.
      (a) But can never reduce the requirement of majority approval.

    (6) Certificate can require a supermajority of shares entitled to vote to be represented to constitute a quorum. Certificate can also require a supermajority vote of shares to pass a resolution.
      (a) Cannot be done in bylaws.
      (b) Same rule as directors.

  ii) If quorum is met, a majority may act to bind the corp.
    (1) Majority is of the shares actually voting. Abstentions don't count.

    (2) Example: X Corp has 120k shares outstanding. 62k shares are represented at the meeting but only 50k shares vote on a particular proposal. How many votes are needed for it to be accepted?
      (a) At least 25k + 1 share. Look at only those voting.

  iii) Once a quorum is established at a meeting, it **cannot** be lost if people leave the meeting.
    (1) This is different from the rule from the Board.

d) **Cumulative voting** [rarely tested]
   i) It is only available when SHs are voting to elect directors. Used to help small SHs get representation on the Board.
   ii) Formula:
      (1) Number of shares * number of directors to be elected

      (2) Example: You own 1k share of stock in C Corp. C Corp has 9 directors to be elected. You want N to be director. Under cumulative voting, how many votes can you cast for N?
         (a) 9k. (1k*9 directors being elected)
         (b) You can then divide up your votes however you want.

   iii) <u>Must</u> be provided for in the <u>certificate</u>.
      (1) If certificate is silent on whether SH can vote cumulatively, they cannot do it.
      (2) So on exam, they will tell you that there is cumulative voting.

   iv) % of shares required to elect 1 director if cumulative voting is in place.
      (1) 1 more share than 100/# directors being elected + 1

      (2) Example: if 9 directors are being elected, what would you need to elect 1 director?
         (a) 1 share more than 100/9+1 = 10%
         (b) So 1 share more than 10% to elect one director.

5) **Transfer of stock by a SH** – corp ownership is transferable
   a) Amount of **consideration**
      i) Does not have to be par value. Par is an issuance rule and only applies when corp sells it own stock.
      ii) So stock can be sold for more or less than par value.

   b) **Stock transfer restrictions**
      i) Restrictions on transfers of stock are set in:
         (1) Certificate, or
         (2) Bylaws, or
         (3) By agreement.

      ii) Will be upheld if reasonable. Not an undue restraint or alienation.

      iii) Example: F is SH of Famous Inc. His stock is subject to a stock transfer restriction that requires him to offer it first to the corp. This called a <u>right of first refusal</u>. F sells stock to G in violation of the agreement.
         (1) <u>A right of first refusal is acceptable as long as the price offered is reasonable</u>.
         (2) This hypo is ok if corp offered to pay price that matched G's offer. Not undue restraint.

        iv) Action against transferee of stock
            (1) Look for her knowledge or notice.
            (2) Even if restriction is reasonable and valid, it cannot be invoked against the transferee unless either
                (a) It is conspicuously noted on the stock cert, or
                (b) Transferee had actual knowledge of the restriction.

6) **Right of SH to inspect books of corp**
    a) <u>Minutes of SH proceedings and record of SHs</u>:
        i) Can be demanded by:
            (1) Any SH on <u>5 days written demand</u>

        ii) Corp can demand that SH give an affidavit that his purpose is:
            (1) Not other than in the interest of the corp, <u>and</u>
            (2) He has not within 5 years tried to sell any list of SHs.

            (3) If SH refuses to provide this affidavit, the corp can deny access.

        iii) This info would not help you determine the value of stock.

    b) <u>List of current directors and officers</u>:
        i) Can be demanded by:
            (1) Any SH on <u>2 days written demand</u>

        ii) Corp <u>cannot</u> require an affidavit here.

    c) Corp's <u>latest annual balance sheet</u>, <u>P&L statement</u>, and <u>latest interim statements distributed to SH or public</u>:
        i) Any SH can make a written request and corp must provide the documents.
        ii) Corp can respond by mail.
        iii) This is the info you'd need to determine what stock is worth.

    d) Common law right to inspect:
        i) For all SH, to inspect records at a reasonable time and proper place for a proper purpose (related to her role as a SH).
            (1) May be broader, cover more docs, than BCL.
        ii) Any inspection question – bring this up.

    e) Director's right to inspect = unfettered access to corp books and records.

7) **Distributions**
   a) Payments to SH by corp. Can be:
      i) Dividend, or
      ii) Payment to repurchase shares, or
      iii) Redeem shares
         (1) Forced sale to corp at price set in certificate

      iv) Distribution is <u>not</u> a stock split.
         (1) Stock split gives SH more shares than she now has, but reduces the value of each share proportionally.

   b) <u>Declared at the Board's discretion</u>.
      i) There is no SH right to a distribution <u>until</u> it is declared.
      ii) The court will <u>only</u> interfere and order a distribution if there is a showing of bad faith or dishonest purpose.

   c) **Dividends**
      i) Example: Board of C Corp declares a dividend of $400k. Who receives what if the outstanding stock is:
         (1) 100k shares of common stock?
            (a) $4/share.

         (2) 100k shares of common and 20k shares of preferred with $2 dividend preference?
            (a) <u>Preferred means pay first</u>.
               (i) So the 20k preferred shares get their $2 preference first. Totals $40k. Leaves $360k.
            (b) Common stock gets the rest - $3.60/share.

         (3) 100k shares of common and 20k shares of $2 preferred that is participating?
            (a) <u>Participating means pay again</u>.
               (i) So these 20k shares get paid twice. Once as preferred and again because they are participating. Preferred payout totals $40k. Leaves $360k.
            (b) Now $360k gets split between 120k shares. All shares get $3/share.

         (4) 100k shares of common and 20k shares of $2 preferred that is cumulative (and no dividends have been paid in 3 prior years)
            (a) <u>Cumulative means add them up</u>.
               (i) So in years where no dividend was paid, corp owes cumulative holders dividends. Then add this year's dividend declared. So corp owes them 4 years of their $2 preference.
               (ii) 4 yrs*$2 = $8/share*20k = $160k. Paid to preferred shares. Leaves $240k.
            (b) Common gets the rest - $2.40/share.

d) Funds used for any distribution (dividend, repurchase, or redemption)
   i) Surplus
      (1) Surplus = assets – liabilities – stated capital

e) Funds that cannot be used for distribution
   i) Stated capital
      (1) Par value of stock goes to stated capital. Excess over par goes to surplus.

      (2) Example: C Corp issues 10k shares of $2 par stock for $50k. Allocated?
         (a) $20k par value to stated capital.
         (b) $30k over par value to surplus.

      (3) If no-par issuance:
         (a) Within 60 days of the issuance, Board can allocate any part, but not all, to surplus.

f) Corp can make distribution even though it lost money the prior year.
   i) Corp cannot make distributions if insolvent or if distribution would render it insolvent.
      (1) Insolvent = corp is unable to pay its debts as they come due in the ordinary course of business.

g) Liability for unlawful distributions
   i) **Directors are personally liable for unlawful distributions**.
      (1) Remember that there is the possible defense of good faith reliance.
   ii) **SHs who knew the distribution was unlawful when they received it are personally liable too.**

   iii) This is the corp's claim, so it could be a derivative suit.

h) Redemption
   i) Set in the certificate
   ii) Must be done proportionately within each class of stock
i) Repurchases
   i) Individually negotiated.
   ii) Corp can discriminate in repurchases except maybe in close corp. Close corp may have to give equal opportunity to all SH – unclear in NY.

<u>Fundamental corporate changes</u> (moderately tested)

1) Characteristics of fundamental corp change
   a) So fundamental that most require <u>both director and SH approval</u>. Most also require corp to notify the Dept of State by delivering a document that Dept files.

   b) <u>Dissenting SHs right of appraisal</u>
      i) Right to force corp to buy your stock at fair value.

      ii) Actions that trigger right of appraisal:
         (1) Some amendments to the certificate
         (2) Consolidation
         (3) Your corp merges into another corp
         (4) Your corp transfers substantially all of its assets
         (5) Your corp's shares are acquired in a share exchange. (unlikely tested)

      iii) BUT even if corp does one of these, there is no right of appraisal if the corp is listed on a national securities exchange or NASDAQ.
         (1) You don't need appraisal rights if there is a public market for your shares.

      iv) SH actions to perfect the right:
         (1) <u>Before SH vote, file a written objection and intent to demand payment;</u>
         (2) <u>Abstain or vote against the proposed change; and</u>
         (3) <u>After the vote, make a written demand to be bought out</u>.
            (a) If SH and corp cannot agree on fair value, corp sues and the court determines the value.
            (b) There is **no** minority discount – reduced value because minority shares might be worth less.

2) **Amendment to certificate**
   a) Minor changes (office location, registered agent, etc) can be made by Board alone.

   b) Other amendments must be approved by:
      i) Director action; and
      ii) A majority of shares entitled to vote.

      iii) Example: directors approve an amendment and recommend it to SHs. If there are 4k outstanding shares entitled to vote, how many must vote for amendment?
         (1) At least 2,001 – majority of shares entitled to vote.
      iv) Example: now assume only 2,400 shares attend the meeting to vote on the amendment and only 2,200 shares actually vote. How many must vote for it?
         (1) At least 2,001 – does not change.

c) If amendment will change or strike a supermajority quorum or voting requirement for <u>SH</u> voting (not director), you need director approval <u>and 2/3 of shares entitled to vote</u>.

d) If amendment is approved, deliver certificate of amendment to Dept of State for filing.

e) There are dissenting SH rights of appraisal if the amendment alters or abolishes a preference, changes redemption rights, alters or abolishes a preemptive right or limits voting rights. (unlikely to be tested)

3) **Mergers** (A Corp merges into B Corp) **or consolidations** (A Corp and B Inc form C Corp)
   a) Requirements
      i) Each company's Board adopts a plan or merger or consolidation, <u>and</u>
      ii) Shareholder approval from each corp.
         (1) Not needed if parent corp owns more than 90% of each class of stock of a subsidiary that is merged into a parent (called short-form merger). (unlikely to be tested)
            (a) Right of appraisal does exist here, even though the SH did not vote.

         (2) Example: A corp has 6k outstanding shares entitled to vote. How many shares must vote for the proposed merger into B Corp?
            (a) At least 3,001 – majority of shares entitled to vote.

      iii) Deliver certificate of merger or consolidation to Dept of State for filing.

   b) Dissenting SH rights of appraisal
      i) Exist for the SHs of the corp that no longer exists.
      ii) Does not exist for the surviving corp.

   c) Effect
      i) Surviving corp succeeds to all the rights and liabilities of the disappearing corp. Successor liability.

4) **Sale of all assets not in the ordinary course of business or share exchange** (very unlikely on exam)
   a) These are fundamental changes for the selling corp only. Not for the buying corp.
   b) Requirements:
      i) Each corp's Board authorizes the deal, and
      ii) Approval by <u>selling</u> corp's SHs.
         (1) Need majority of shares entitled to vote, just like before.
         (2) Rights of appraisal for the SHs of the selling corp only.
      iii) No filing with the Dept of State is required.
         (1) Share exchange (never seen on exam) requires filing of plan with Dept.

c) **General rule**: corp acquiring assets <u>will not be liable</u> for the torts of the corp whose assets it acquired <u>unless</u>
   i) The deal provides otherwise, or
   ii) Purchasing corp is a mere continuation of the seller, or
      (1) Same managers, same officers, etc.
   iii) Deal was entered fraudulently to escape such obligations.

   iv) This is different from a merger because we don't expect successor liability here.

5) **Dissolution**
   a) Voluntary
      i) <u>No board vote necessary</u>.
      ii) <u>SH vote needs to be majority of shares entitled to vote</u>.
      iii) Deliver certificate of dissolution to the Dept of State for filing.

   b) Involuntary (judicial – someone is asking for a court order of dissolution)
      i) By Board resolution or resolution of majority of shares entitled to vote, stating that:
         (1) Corp has insufficient assets to discharge liabilities or
         (2) Dissolution would be beneficial to SHs.

      ii) ½ or more of shares entitled to vote may petition if:
         (1) Directors too divided to manage, or
         (2) SHs too divided to elect directors, or
         (3) Magnitude of internal dissention makes dissolution beneficial to SHs.

      iii) Any SH entitled to vote may petition if SH unable to elect directors for 2 annual meetings.

      iv) **20% or more of voting shares in corp whose shares are not traded on a securities market** (close corp only) **may petition on either of these grounds**:
         (1) **Management is illegal, oppressive, or fraudulent towards SHs**
            (a) Oppression = defeats SHs reasonable expectations for buying stock.
         (2) **Management is wasting, diverting, or looting assets**

         (3) Management = Board or managing SHs.

         (4) Court may deny dissolution if there is another way for SH to get a fair return on investment, such as ordering a buy out.
            (a) Corp can try to avoid dissolution by:
               (i) **Within 90 days of the petition, buy the petitioner's stock at fair value on terms approved by the court.**
                  1. Even if the parties agree on a value, you <u>still need court approval</u>.

c) Dissolution does <u>not</u> end corp's existence.
   i) Wind up assets (liquidating)
      (1) Gather all assets
      (2) Convert to cash
      (3) Pay creditors (they had been given notice earlier), and
         (a) They are always first. SHs cannot agree to be paid first.
      (4) Distribute remainder to SHs, pro-rata by share unless there is a dissolution preference.
         (a) Similar to dividend preference – pay first. Also must be specified in the certificate.

<u>Controlling SHs</u> (not tested a lot)

1) Traditional rule: outside the close corp, SHs generally do **not** owe fiduciary duties to each other or the corp.
   a) They can act in their own self-interest.

2) **Controlling SH**
   a) Def: SH who also occupies a control position (such as director) or whose ownership is such that she has working control over the corp.

   b) <u>Owes a fiduciary duty</u> to minority SHs and sometimes to others and the corp.
      i) She cannot use her position for individual advantage at expense of minority SHs or corp.
      ii) Most likely a problem in close corps.

   c) Sale of controlling interest
      i) She can generally sell at a premium and generally, she can keep that premium.

      ii) Courts may impose liability if:
         (1) Controlling SH <u>sold to looters</u> without making a reasonable investigation.
            (a) Look for facts that would put a reasonable person on notice of a problem. Such as agent acting on behalf of an undisclosed principal.
            (b) Seller must disgorge profits and may be liable for all damage to the corp.

         (2) Controlling SH <u>de facto sells a corp asset</u>.
            (a) All SHs should share in the premium paid by the buyer. [???]

         (3) Controlling SH <u>sells a position on the Board</u>.
            (a) Seller must disgorge profits.

3) **Freeze out**
   a) All mergers must have a legitimate *corp* purpose, even though approved by the requisite number of shares.
      i) Watch out for freeze-out merger aimed solely at cashing out minority SHs unfairly. Majority SH cause their corp to merge with another corp they own. Minority shares are purchased for cash so they have no interest in either corp.
      ii) Courts are increasingly protective of minority.
   b) Court will look at the transaction as a whole. Fair price + fair course of dealing.
      i) Whether deal is tainted by self-dealing or fraud
      ii) Whether minority SHs are dealt with fairly
      iii) Whether there is any legitimate business reason for the merger.

4) **Insider trading**
   a) <u>Market trading on inside information</u>
      i) Director or officer engages in market (public) trading of her corp's stock based on inside information from corp. She makes a profit. In NY, she has breached a <u>duty to the corp</u> by doing this.
         (1) Corp can sue to recover her profits.

   b) <u>Nondisclosure of special facts</u>
      i) All directors and officers owe a <u>duty not to trade on special facts</u> in a securities transaction with a non-insider.
         (1) They cannot trade secrets. They must abstain or ensure disclosure so others are on the same footing.
         (2) This is common law insider trading:
            (a) Special facts – those a reasonable investor would consider important in making an investment decision.
      ii) Suit can be brought by SH with whom the director or officer <u>deals</u> and violates the special facts doctrine.

      iii) Damages
         (1) Difference between price paid and value of stock a reasonable time after public disclosure.
         (2) This is a direct suit, so SH recovers.
            (a) Not a derivative suit.

iv) Example: B is a director of Q Corp. He learns that the corp has a new development that will change the market. Q Corp's stock is now worth \$10/share. Estimates are that the stock will go to \$50/share with the new development. S, a SH, is not aware of this. S calls B to complain about the corp and says she wishes she never bought the stock. B offers to buy her stock at \$20/share. S sells to B. After development, stock increases to \$50/share. Can S sue B under the special facts doctrine?

(1) Information is a special fact because a reasonable investor would consider it important.

(2) S is a SH who does not know the inside information. B traded on his inside knowledge without disclosing it, so he breached a duty to S.

(3) S can recover the difference between the price paid and the price after the news affects the stock value.

    (a) \$50-\$20=\$30 per share.