**Corps Outline**

1. **Agency**
   1. **Overview**
      1. Definition (RSA §1): Agency is a **fiduciary** relation which results from:
         1. The manifestation of consent by P to X that;
         2. X shall act on P’s behalf;
         3. Subject to P’s control; and
         4. Consent by the X so to **act**
            1. There does not have to be a contract;
            2. The agent need not promise to act as an agent;
            3. P loaning her car to X subject to the condition that only X drive the car and X agreeing to that condition establishes that the X is both acting on behalf of P and subject to her control. (*Gorton v. Doty*)
      2. Key Elements:
         1. Agent’s FDs (§ 13) include **obedience** (§385), **care and skill** (§379), **loyalty** (§387)
         2. **Loyalty**: duty not to make secret profit (*Reading*), usurp business opportunities (*Rash*); not to take property when leaving (*Town & Country*), confidential info, (RA § 386), profits arising from employment (§§ 388, 404); CoI (§389)
      3. Types of Authority:
         1. **Actual** (RA §7): A’s power to affect P’s legal relations by acts done in accordance w/ P’s manifestations to A
            1. Express: What P expressly stated (orally or in writing) that A could do
            2. Implied: Actual authority circumstantially proven that P actually intended the A to possess and includes such powers as are practically necessary to carry out the duties actually delegated.

**Test**: Did A reasonably believe b/c of P’s present or past conduct that P wishes for her to act in a certain way/have certain authority?

Key consideration: P’s prior conduct permitting A to exercise similar power w/o express indication that prior use of power was/is unacceptable

*Mill Street Church*: Implied auth to hire X b/c A had hired X to work on similar projects for P previously, P knew it and never objected.

* + - 1. **Apparent** (§8): Power to affect the legal relations of another person (X) by transactions w/ 3d persons, professedly as agent of X, arising from and in accordance w/ X’s manifestation to such 3d person.
         1. Two tests for Apparent Authority:

P acted in such a manner as would lead a reasonably prudent person to suppose that the agent had the authority he purports to exercise (see §27); or

If the 3d pty has no knowledge to the contrary, A has apparent authority to do those things which are usual and proper to the conduct of the business which he is employed to conduct (*Three-Seventy Leasing*).

* + - 1. **Inherent** (§8A): Power not derived from authority but solely from the agency relation, which exists for the protection of persons harmed by dealing w/ A.
         1. **R2A–Undisclosed Agency:** Undisclosed Principal liable for all acts within the authority **usually confided in an Agent** of that character; **usual to such business and on the principal’s account** (R2A §195; Watteau- barkeep secretly forbidden to buy Bovril and cigars) (*Watteau*; See undisclosed P)
      2. **Estoppel** (§8B): Acts or omissions, intentional or careless, causing appearance of authority in imposter; reasonable, good faith reliance on appearance; causing a change of position. (*Hoddeson*)
      3. **Ratification** (§82): IF (1) the principal accepts the results of the agent’s act; (2) the principal intends to ratify the act; and (3) the principal has full knowledge of all the material circumstances, THEN the principal has ratified the agent’s act.
    1. Types of Liability:
       1. **The Algorithm**:
          1. If servant, does potential liability arise from a servant’s intentional tort?

If yes, then it must be shown that the employee’s assault was in response to the π’s conduct, which was presently interfering with the employee’s ability to perform duties successfully. This interference may be in the form of an affirmative attempt to prevent an employee from carrying out his duties.

If no, then was the servant acting within SoE under R2d § 228?

If yes, then liable.

If no, then balance the factors in R2d § 229.

* + - * 1. If IC, does potential liability arise from the independent contractor’s torts?

If yes, then principal liable if (a) retains control of how the contractual work is to be performed; (b) the IC is incompetent (lack of skill, lack of experience, [maybe financial instability, no insurance]); or (c) the contracted work constitutes a nuisance per se (“inherently dangerous”: an activity that can be carried out safely only by exercise of special skill and care).

If no, agent or non-agent?

If agent, then liable.

If non-agent, then not liable.

* + - 1. Franchises: Franchiser liability, turns narrowly upon ∆’s right to exercise control over the alleged “instrumentality” which caused the harm. (*Miller v. McDonald’s*)To determine control, look at the terms of the franchise agreement. (*McDonald’s*)
         1. In *Miller*, the franchise agreement req’d 3K to use precise food preparation methods that McD’s established. Therefore, McD’s had the right to control the way in which 3K performed at least food handling and preparation. Therefore, a reasonable factfinder could conclude that McDonald’s had the right to control 3K in the part of its business that allegedly resulted in Miller’s injuries.
    1. Types of Agency Relationships (RSA §2):
       1. Master-Servant: IF (a) S has agreed to work on behalf of M; and (b) S has agreed to be subject to M’s control or right to control the “physical conduct” of S (that is, the manner in which the job is performed, as opposed to only result), THEN M-S.
       2. Employer - IC:Two Types
          1. Agent IC: Agreed to act on behalf of another, the P, but not subject to the P’s control over the “physical conduct” of task (how the result is accomplished).
          2. Non-agent IC: Operates indp-ly, simply enters into arm’s length transactions.
    2. Distinguishing Servant from Independent Contractor Factors (RSA §220; *Humble Oil*):
       1. Agreed extent of control over the details of work
       2. Distinctive occupation or business (e.g., Sunoco signs)
       3. Custom re: supervision (e.g. a lawyer is not hired as "your" employee)
       4. Skill req’d in the particular occupation
       5. Does P supply location, tools
       6. Duration of employment (at will may suggest more control)
       7. Manner of payment (by time or by job?)
       8. Part of P's regular business?
       9. Whether or not the parties believe they are creating the relation of M-S
       10. Whether or not Principal is in the business
           1. In the end it is about CONTROL to day-to-day operations
  1. **Cases**
     1. Agency Relationship:
        1. *Gorton v. Doty*: Teacher loaned out car, inherent liability under §§219, 228, court stretches control issue. Policy to compensate injured and to incentivize insurance
        2. *Cargill*: Cargill to be in a principal-agent relationship (not merely buyer-supplier or **debtor-creditor**) largely b/c of level of control.
     2. Authority:
        1. *Mill Street Church of Christ v. Hogan*: Church painter, subagent, **implied authority** b/c of past conduct; Sam believed his brother had authority, **apparent authority**
        2. *Ampex*: **apparent authority**, computer memory units. Kays lacked actual authority, had apparent, bound Ampex to agreement (K liability)
        3. *Watteau v. Fenwick*: liability of undisclosed principal/**inherent agency,** beerhouse manager, P liable for all acts within authority usually confided (§195, mngt)
        4. *Botticello v. Stefanovicz*: ratification,wife w/ property, NO ratif, husband not agent
        5. *Hoddeson v. Koos Bros.*: Estoppel, furniture shopping, fake salesman, π has burden
     3. Liability:
        1. *Humble Oil*: M-S, car rolled off station, hit someone, controlled manner of operation
        2. *Hoover v. Sun Oil Company*: fire in car due to neg, no control of day-to-day ops.
        3. *Murphy v. Holiday Inns*: franchise - no master-servant relationship, water from A/C
        4. *Miller v. McDonalds*: franchise relationship involving apparent agency
        5. *Ira S. Bushey*: expansion of SoE doctrine; foreseeability test for liability, drunk sailor
        6. *Manning v. Grimsley*: Fenway, SoE, §229 gen nature authorized to do
        7. *Majestic Real. v. Toti Contracting*: IC “goofs”; liability for inherently dangerous acti
        8. *Arguello v. Conoco*: min mistreatment, SoE (§228 factors) for tortious conduct, statutory claims, liability at Conoco-owned stores but not franchises,
     4. Duties:
        1. *Reading v. Regem*: DoL, cannot make secret profits from misuse of position (RTA §8.02), British sergeant, disgorgement to the Crown, **§404** **liability, use of P’s assets**
        2. *Rash*: DoL not to usurp business, Duty to DISCLOSE, scaffolding business
           1. RTA § 8.01: general DoL
           2. RTA § 8.03: prohibits agent acting as or on behalf as an adverse party (basic self-dealing: duty, power, incentive)
           3. RTA § 8.04: prohibits agent competing with principal (JVIC had own division)
           4. RTA § 8.06: OK if agent makes full disclosure of relevant information and gets the principal's explicit consent and approval
        3. *Town & Country v. Newbery*: DoL, duty not to use trade secrets, **RA 2d § 396**: no duty not to compete, but can’t take trade secrets; **implied DoL**

1. **Partnerships**
   1. **Overview**
      1. Definition (UPA §6(1), RUPA §101(6)): An association of two or more persons to carry on as co-owners a business for profit; All income/losses pass to individs (no dbl taxing).
         1. Written agreement not necessary, do not need to call it a pship, no filings req’d,
         2. Formation: Pship may be formed by oral or written agreement, or agreement implied through actions
      2. Look to totality of the circumstances to determine if pship exists; joint ownership and profit sharing not enough (*Southex*). Can have pship by **estoppel** if reasonable reliance.
      3. Buyout Agreements: Issues that should be considered in buy-out agreements:
         1. "Trigger" events
         2. Obligation to buy versus option
         3. Price
         4. Method of payment
         5. Protection against debts of pship
         6. Procedure for offering either to buy or sell
      4. Ltd Pships: avoid the bad tax consequences and trouble of the corp form while preserving limited liability **provided that ltd partners don’t participate in mngt**
   2. **Framework**
      1. Legal person status: Pships are treated as legal people for most purposes, but, **important**, not with respect to liability of debt and tax liabilities (liability is **personal**)
      2. Mngt Rights: Equal irrespective of contributions (UPA §§ 18(e), 18(h)), not assignable, no person can become P w/o consent of ALL Ps (UPA § 18(g)), each P is an agent of pship, all agency FDs carry over (§9)
      3. Profit sharing (UPA §18): each P is repaid capital contribution, and residual profits are divided equally. Loss sharing, ***absent other agreement***, is same as profit sharing. No P entitled to SALARY except for winding up.
      4. Liability: All Ps are liable for all acts, including wrongful acts, of each P done in the ordinary course of business. (UPA § 13)
         1. Tort Liability: joint and several liability for all Ps
         2. Contract Liability: joint liability, each P is liable only for pro rata share (UPA § 15b)
         3. Under RUPA 306, all liabilities are joint and several.
         4. Creditors must exhaust all pship property before going after Ps personally RUPA 307
         5. **Priority of liabilities**: (i) Liabilities (Ls) to creditors; (ii) Ls to Ps other than capital /profits (e.g., loans); (iii) Ls to Ps for capital; (iv) Ls to Ps for profits. UPA §40(b)
      5. Dissolution: At will and term; at will can be terminated at any time for any reason (§ 31(1)(b), 31(2) and RUPA §§ 601(1) & 602(a)); unless BAD FAITH (§38).
         1. Rightful dissolution: Any P may dissolve pship at will at any time, death of a P, Bankruptcy of pship, proper expulsion of a P, dissolution to avoid unlawful activity (i.e. business is outlawed), term or specific undertaking completed.
            1. Pship is wound up, liabilities, paid, each P gets her contribution plus share of any excess (surplus) capital and Ps all get paid in cash (§38(1)); or
            2. Other Ps might agree to continue pship or put it up for auction. The business does NOT necessarily break up just b/c one P leaves. There are issues of implementation, waiver, agreement.
         2. Wrongful dissolution: Pship terminated for breach of agreement, walking before time in term pship, or **judicial decree** (Occurs if one P makes continuing impossible (by behavior) or violates P agreement, or is equitable).
            1. Dissolving P does have the right to be paid off for his interest (BUT goodwill cannot be factored into the valuation of his share); BUT
            2. He may be paid **over time** (RUPA §701(h) – can delay payment of buyout until the expiration of the term or the completion of the undertaking) or in the **future**.
            3. He must pay damages for breach: e.g., causing pship to default on obligations, close business, repay the leases, damgs to clients, harm to customer relations.
            4. Other Ps have the *right to continue* pship with others (dissolving P can’t take his clients elsewhere). Other Ps may buy out wrongful P. UPA § 38(2)
         3. Default dissolution rules and consequences CAN and SHOULD be opted-out of:
            1. Good pships have explicit buy-sell agreements and they spell out rules, formulas, and procedures in detail, but it can still be messy.
         4. Dissociation (RUPA§601) where there are many Ps and 1 leaves.
         5. Dissolution (§801), where pship ends (Cf. Continuation agreement).
      6. Fiduciary Duties (UPA §§ 20 & 21 and RUPA § 404)**:** DoL and DoC
         1. **Loyalty**: 1) Render true and full info of all things affecting pship UPA § 20; 2) Account for all profit, property or benefit derived from pship. RUPA § 404(b)(1), 3) Refrain from dealing w/ pship as an adverse party, RUPA § 404(b)(2), or from competing with pship
            1. Cannot be generally waived, may waive specific acts that violate
         2. **Care:** Limited to refraining from (i) grossly negligent or reckless conduct, (ii) intentional misconduct, or (iii) knowing violations of law. RUPA § 404(c); An act that would make it impossible to carry on the ordinary business of pship violates this duty. UPA § 9(3)(c)
      7. Property Rights: Ps are co-owners in pship property, not assignable by individual ps. “Interest in the pship” (i.e. right to profits) is personal property and IS assignable.
      8. Fenwick Factors: Totality of the Circumstances test
         1. Co-ownership? (No)
         2. Loss-sharing? (No)
         3. Capital contribution? (No)
         4. Rights upon dissolution? (Upside only)
         5. Control and mngt rights? (No)
         6. Intention of parties (relevant, but not dispositive)? (Looks like intended pship)
         7. Profit-sharing (relevant, but not enough)? (Yes)
         8. Language in agreement (Says Ps, but employee lacks most ordinary rights of P)
         9. Conduct towards third parties (Held themselves out as Ps to Unemployment Commission and filed pship tax returns, but did not inform anybody else of pship)
   3. ***Cases***
      1. Determining Partnerships:
         1. *Fenwick v. Unemployment Comp. Com*: beauty salon receptionist shares in profits, finding **employee**; **totality of circ test**.
         2. *Martin v. Peyton*: KNK P, arranged a deal with Peyton, Perkins, and Freeman, typical covenants which allowed profit share and approval rights. **Lenders** not Ps; provisions were merely intended to give lender control to protect investment; no “continuous, ongoing control of pship.”
         3. *Southex. v. Rhode Island Assoc.*: K did not create pship, IC. **Totality of circ test**
         4. *Young v. Jones*: No pship by estoppel found, PW-Bahamas & PW-US not the same, πs didn’t rely on brochure (PW as worldwide org) in making investment decision
      2. Fiduciary Duties:
         1. *Meinhard v. Salmon*: expiring lease, **duty to disclose, duty of finest loyalty**, Judge Cardozo; RUPA §§404(b)(1) & 103(b)(3) Joint venture (just like a pship, but ltd in either time or purpose.): Must share beneficial info arguably acquired as part of Pship. Remedy: had to let Meinhard buy in. Severe remedy illustrates duty’s strength.
         2. *Day v. Sidley & Austin*: no Fds to disclose info regarding planned changes to the internal structure or mngt of pship, agreement clear enough
         3. *Meehan v. Shaughnessy*: grabbing and leaving, partners in law firm sent out letters to clients and denied intention to leave several times. OK to make preparations.
         4. *Lawlis v Kightlinger & Gray*: alcoholic partner, expulsion does not necessarily breach FD. Agreement existed. Second chance shows really REALY good faith
      3. Mngt & Property Rights:
         1. *Putnam v. Shoaf*: bookkeeper stole money, Putnam got out but wanted to recover. No recovery. Intended to convey her interest. If would have gone other way, Putnam wouldn’t have contributed.
         2. *Nabisco v. Stroud*: grocery store, every P’s action binds pship. Applies only when the P’s actions as agent affect the rights of a 3d pty, 3d pty doesn’t know about deadlock.
         3. *Summers v. Dooley*: **Partner deadlock.** Summers hired trash collector out of pocket and wanted reimbursement, B/c maj didn’t consent to the hiring of additional man (UPA §18(h)), pship need not reimburse. Cannot change rights btwn partners and pship w/o maj. Was hiring the guy to do HIS job.
         4. *Day v. Sidley & Austin*: P of DC office. Merger, co-head. No fraud, could’ve read agreement, needed to bargain specifically for DC office head indefinitely.
      4. Dissolution:
         1. *Owen v. Cohen*: bowling alley, all confidence and cooperation btwn the Ps has been destroyed, Irreconcilable conflicts btwn Ps. UPA §§ 31(1)(d), 32
         2. *Collins v. Lewis*: Cafeteria business, denial of ct dissolution petition, Lewis found to be competent mnger. Ct won’t issue a dissolution just b/c losses and capital-supplier must put in more money. Bargain for cost cap in agreement.
         3. *Page v. Page*: FD of good-faith and loyalty applies to exercise of dissolution power. **pships at will v. partnership for a term.**  Justice Traynor, brothers put money into linen supply co, unprofitable for a while. Began to turn. One wanted dissolution, other claimed term. Ct. looked to implied / Express evidence. Still duty of good faith.
         4. *Prestiss v. Sheffel*: equitable dissolution for failure to contribute to losses. Other Ps bid for pship with pship interest, ct says this is okay (actually got a better price).
         5. *Giles v. Giles* (KS): Family wants son disassociated from firm b/c son’s conduct makes it “not reasonably practical to carry on the business in pship with the P.” There was no trust. Broken relationships, and a complete lack of communication made it **reasonably impractical** to continue to work together. (UPA §601(7)(iii))
         6. *Kovacik v. Reed* (CA): K asks R to help him with some work, K contributes the money and R the labor. The work results in 8k in losses. K wants R to share in the losses despite the fact that he only agreed to share in profits. Generally, Ps share in losses and profits but that is usually in cases where both have contributed money, property, or the other was compensated. In cases where just labor is contributed by one and money by the other the losses have already been shared. This is case of split contribution so R does not need to share in the monetary losses because his labor has already been wasted. RUPA § 401(b) expressly rejects this.
      5. Buyout Formulas:
         1. *G&S Invs. v. Belman*: cocaine partner in apt. complex, G&S had the right to continue the partnership and owed Nordale’s estate. **Court equitable power**, judicial dissolution could have been warranted. b. Under the buy-out formula, Nordale is owed the sum of his capital account (what he contributed less any distributions) and the average of the prior three years’ profits. Not fair market value. (bargain for FMV)
      6. Limited Partnerships:
         1. *Holzman v. De Escamilla*: If participate in mngment, Gen P (need at least 1 GP)
2. **Corporations**
   1. **Overview**
      1. Policy:
         1. Corps best facilitate (i) an aggregation of large amounts of capital from many investors and (ii) the mngt and of firms with many owners, assets, and employees.
   2. **Comparison between Corporate and Pship Form**
      1. Investor Liability
         1. *Pships*:
            1. Partners (i) have joint and several liability for torts, (ii) have joint liability for other debts, (iii) must contribute to partnership losses, (iv) must share in other partners’ unmet contributions, and (v) are all made worse off by mutual agency.
         2. *Corps*:
            1. SHs are only liable for their subscriptions(not for corp debts). Veil-piercing is almost nonexistent in large Corps; it typically only arises with respect to (i) closely held Corps and (ii) parent/sub relationships.

Shifts the risk of those in better position to bear, reduces transaction costs

THESIS: great invention from financial point of view, but can be abused

ANTITHESIS: Fraud and unfairness to creditors

* + 1. Investor Ability to Transfer Interests
       1. *Pships*:
          1. Rights in specific partnership property are not assignable by individual partners, mngt rights are not transferable at will, and there is no organized trading market for partnership interests. The only way someone can get a vote in a partnership is to become a partner, which requires consent of all other partners.
       2. *Corps*:
          1. SHs of Corps have multiple & variable rights according to different classes of stock, and common SHs have pro-rate (i) rights to dividends, (ii) rights to liquidity distributions, (iii) voting rights, (iv) information rights, **and all of these rights are transferable as a unit**.

Value of the rights depends on the corporation, not the individual seller, so there is no double issuer problem as there can be with partnerships.

Negotiable instrument and organized trading market; provides greater liquidity and lower cost

THESIS: liquidity

ANTITHESIS: Fraud and unfairness in securities trading

* + 1. Firms Legal Personality & Lifetime
       1. *Partnerships*:
          1. Can be terminated by each partner. Powers are often, but not always, vested in the partnership as a legal entity.
       2. *Corps*:
          1. Have the same powers as individuals, Corps have legal person status for all purposes, and Corps have perpetual lifespans.. Voluntary dissolution must be approved by the board of directors and then by SHs. SHs cannot initiate dissolution. Purpose of corporation is any lawful business purposes, i.e., to maximize profits.

Mechanical efficiency on who can carry out contracts, legal fiction as person status

Want to treat the big firm with a lot of owners as an individual legal entity with designated agents

VERY hard to dissolve, minimize disruption and preserve growing concern values

THESIS: maximize value for SHs subject to K obligations

ANTITHESIS: Corporation power and lack of social conscience

* + 1. Managerial power
       1. *Partnership*:
          1. All partners have equal rights (absent contrary agreement), every partner is an agent, and every partner is bound by every other partner’s admissions, knowledge, notice, and wrongful acts.
       2. *Corporation*:
          1. A corporation is managed by directors. **DGCL § 141**. SHs have very little say, but they can vote on director elections, and director-proposed organic changes such as mergers, sales of substantially all assets, and voluntary dissolution. Employees have little say except w/ director authorization or under principles of agency.

Importance of Centralized Managerial Power

THESIS: makes economic sense to consolidate power, efficiency purposes

ANTITHESIS: Opens the way for abuse when fiduciary given discretionary power for the purpose of others, may engage in self-dealing, may resist takeover offers b/c they don’t want to lose their jobs

1. **The Nature of the Corporation**
   1. **Piercing the Corporate Veil:**
      1. PCV more likely in tort liability than contract b/c becoming creditor is involuntary
      2. Test (*Sea-Land*): ***If:***
         1. There is such unity of interest/ownership (control) that the separate personalities of the corp and the individual/other corp no longer exist and
            1. Four factors: (1) the failure to maintain adequate corp records or comply with corp formalities; (2) **the commingling of funds or assets;** (3) undercapitalization; and (4) **treating corp assets as SH/other corp assets**

PCV usually can’t get to SH assets (unless small corp w/ true commingling)

* + - 1. Circumstances are such that adherence to the fiction of separate corp existence would sanction a fraud OR promote injustice;
         1. “Fraud” is an intentional wrongdoing
         2. “Injustice” is some wrong *beyond* a creditor’s inability to collect (*Walkovszky*)

**Name on product + claim of safety + inadequate capitalization** might count as sanctioning fraud/promoting injustice if untrue (*Silicone Gel*)

* + - * 1. DE:No req’d showing of fraudif subsidiary found to be mere instrumentality or alter ego **(**esp. for tort suit against parent**)**
      1. ***then*** the corp entity will be disregarded and the veil of limited liability pierced.
      2. REMEMBER! Limited liability is the rule NOT the exception
    1. No liability between subsidiaries of parent – Alter ego Theory (*Catholic Archbishop*)
       1. Unless (dicta indicates cts open to possibility) fraud and comingling across subs
    2. “Totality the of Circumstances” factors to pierce parent via sub (*Silicone* *Gel)*:
       1. Common Ds or Os
       2. Common business departments
       3. Parent and the sub file consolidated financial statements and tax returns
       4. Parent finances the sub
       5. Parent caused the incorp of the sub
       6. Sub operates with grossly inadequate capital
       7. Parent pays the salaries and other expenses of the sub
       8. Sub receives no business except that given to it by the parent
       9. Parent uses sub’s property as its own
       10. The daily operations of the two corps are not kept separate
       11. Sub lacks basic formalities; e.g., separate books/records and holding SH/BoD meetings
    3. PCV for Limited Pships: Ltd partners that are execs of the general partner (GP) corp cannot be held liable as GP so long as it has not perpetrated fraud or manifest injustice upon 3d persons who deal with the corp. (*Frigidaire*)
       1. Courts respect form, *especially* if 3d party has knowledge and/or LPs scrupulously adhere to form (*Frigidaire*- Ltd. Pship with Corp. as GP; LPs who are D/O of GP corp. are on BoD as agents of GP-Corp., not as LPs personally) – could be different for torts
    4. *Policy for PCV:* “[PCV] is not to protect every unsatisfied creditor, but to afford protection, where bad faith makes it inequitable . . . for corp’s equitable owner to hide behind corp veil.”
    5. Cases:
       1. *Walkovszky v. Carlton*: Instead of holding all his cabs in a single corp, created many 2-cab entities, each carrying the minimum insurance. The profits are “drained” as soon as they are made. Operator didn’t violated corp law and observed all formalities.
          1. This strategy is called “maximum asset partition,” and it’s legal
          2. Dissent wants new rule if corps intentionally undercapitalize for expenses “certain to occur in the ordinary course of business.” Are taxicab accidents *certain* to occur?
       2. *Sea-Land Services:* ∆, sole SH of Pepper Source (PS) and four other corps, dissolved insolvent PS. Creditor goes after both ∆ himself, the other corps (reverse-pierce).
          1. ∆ didn’t remember bylaws or AoI existed; inter-corps interest-free loans, all had the same phone line, office, and ∆ paid alimony/child support from corporate assets.
       3. *Catholic Archbishop v. Sheffield*: Guy never got his dog from the Swiss monks. Can’t go up the ladder to Pope then down to Bishop b/c the monastery is not an alter ego of Pope.
       4. *Silicone Gel Breast Implants*: Breast implants cause cancer and were marketed in Bristol’s name. There was substantial overlap between the BoDs and Bristol heavily financed MEC. Fraud/misconduct not needed to PCV, in tort.
       5. *Frigidaire Sales Corp v. Union Properties*: Frigidaire knowingly dealt w/ Ltd pship. There were two LPs were GP corp Os. Frigidaire goes after LPs, ct says no: absent fraud, no PCV b/c LPs made only mngt decisions in their capacities as Os of GP.
    6. Clark’s Theory for Understanding Veil Piercing Cases: *Fraudulent Conveyance Law* (FCL)
       1. **Uniform Fraudulent Transfer Act**
          1. Section 5(a):Transfer made or obligation incurred by debtor is fraudulent as to present creditors **if**:

Done without receiving "reasonably equivalent value in exchange" and

Debtor is insolvent or becomes so as a result of transaction

* + - * 1. Section 2: Insolvency means debts > assets at fair value. Presumed if debtor not generally paying debts as they become due.
        2. Section 4(a): Actual intent to defraud and unfair transfers/obligations done by business debtor who is as a result left with "unreasonably small capital" are fraudulent as to *future creditors* too
      1. Bernie Takoff Hypos
         1. Bernie buys a house with corp assets and transfers it to his brother with option to buy it back for $1. Plans to buy it back after going bankrupt. Not okay under §4(a).
         2. Bernie gives away a 10m house to daughter. No option this time. Not okay under §5(a), aided by §2, which presumes you insolvent if you’re not paying your debts.
         3. Bernie has debts of $30M and assets of $25M, most of which is in a $20M Aspen home. He sells this to his son-in-law for $10M. Not cool under §5(a)(1) – not an exchange for fair value.
      2. Intent v. Constructive Fraud:
         1. Intent to defraud: Puts assets in someone else’s name
         2. Constructive: Must satisfy legal obligations before non-“for-value”-conveyance
      3. Why is FCL not actually used? PCV requires less: To prove FC, you have to prove either that ∆ intended to defraud, or that he was insolvent at each relevant time.
         1. Fairness: Burden shouldn’t be on π to look at each transaction when Δ created mess
         2. Efficiency: Give incentive to controlling party not to make fraudulent transactions
      4. Intuition is that if corp isn’t respecting the corp form, then the cts won’t respect it either.
    1. Other ways of protecting SHs (Beside FCL and PCV (loose from of FCL))
       1. Contract law: parties might decide to create rules when they transact
       2. Statutes that address the limits on assets flowing out of business forms (statutory constraints on dividends or statutes that try to impose minimum insurance or minimum asset requirements – Many financial institutions has min. capital and insurance req’s)
       3. Equitable subordination doctrine
          1. Applies in bankruptcy procedure in the US
          2. If there has been fraudulent treatment of a class of creditors, insider SHs of the corp might be subordinated to the mistreated class
  1. **SH Suits**
     1. Business Judgment Rule (BJR)(DGCL § 141(a)):
        1. Court will interfere with arms-length transaction only if fraud, illegality, bad faith, self-dealing (by Maj of BoD), or nonfeasance
           1. BJR presumes BoD acted independently, in good faith, and w/ sufficient judgment
           2. DE: BJR defeated by insufficient process, irrationality, or bad faith (*Disney*)
           3. Burden of proof on π to rebut BJR (*Kamin*)
        2. Examples:
           1. Whether or not to declare dividend is BJ of BoD (*Kamin*)
           2. Decision to prioritize net income over tax benefit is BJ of BoD (*Kamin*)
           3. Employee compensation IS BJ (*Disney*)
     2. Direct v. Derivative Suits:
        1. KEY INQUIRY: Who suffered harm and who gets the benefit? (*Tooley*)
        2. **Direct** Suits: Individual; generally vindicate structural, financial, liquidity & voting rights
           1. No demand req
           2. Suit brought by SHs in their own name (even if class action)
           3. Cause of action belongs to SH in individual capacity and arises out of injury to SH
           4. Any monetary recovery goes directory to SHs
           5. SH may not get repaid by Corp. for legal expenses
           6. ***Grimes Test***: If the suit concerns an injury that is separate and distinct from that suffered by other SHs or the wrong involves a contractual right of a SH, independent of any right of the corp, then it is a direct suit.
           7. Examples:

SH relies on material misrepresentation or omission (MMO) in security exchange

False PR negatively affects stock price

Corporate reorganization wrongly dilutes SH voting power (*Flying* *Tiger*)

Right to call SH meeting

BoD gives away power to mgt, hurts SHs (*Grimes*- must be total “abdication of oversight”; huge buyout package not total abdication b/c BoD could fire anyway)

* + - 1. **Derivative** Suits: Arises out of an injury done to the corp as an entity.
         1. Demand Req UNLESS excused or irrepairable harm to corp will result
         2. Must post bond/securities (Some states)
         3. Must be SH when acts complained of occurred (“Contemporaneous ownership”)

“Continuing wrong”: If started before ownership but continued after, can sue

* + - * 1. Must still a SH at the time of the suit and continue until judgment
        2. SH bring suit on behalf of corp: cause of action belongs to corp as an entity
        3. Monetary recovery goes to corp
        4. If suit is successful, legal expenses paid by corp

**NB**: If settled, corp can pay legal fees of π and ∆. But if damages imposed on ∆, except as covered by insurance, corp req’d to pay damages and may be req’d to pay legal fees as well. DGCL §145b

* + - * 1. Examples:

ANY Fiduciary claim (duties owed to corp as whole, not indv SHs)

Corporate contract claims

BoD’s negligence in assessing Os’ self-dealing or other corp. trans.

Allegations of excessive pay, waste, etc.

**NB**: can also be brought for alleged violations of Rule 10b-5 and Rule 14a-9 (proxy anti-fraud rule) if the fraud was perpetrated on the corp. (*See* *Borak*)

* + - 1. Both **Derivative** *and* **Direct**:
         1. Wrongful refusal by mngt to provide SH list for proxy fight

Direct: SH’s right to inspection violated

Derivative: Duty of loyalty to corp violated

Incentive to claim direct in order to avoid procedure and sue as a class

* + - 1. *Policy Arguments on Derivative Lawsuits*:
         1. **For**:

Direct action won’t reach disloyalty– no lawsuit alternative

Other alternatives: SH voting, public enforcement have problems

AG may not bring case

Voting: Collective action problems

Want to allow private action in this context – mainly for cases where wrongdoers are BoD, top mngt

Leverages highly incentivized private parties

BoD always has option of creating SLC, and Zapata analysis leaves it ultimately up to the court to determine if the spirit of the law has been violated

* + - * 1. **Against**:

Conflicts with power allocation in corp form: BoD makes fundamental decisions

*General Tire*: SEC brings action and derivative suits settle for $500k in attorney’s fees. Given SEC’s oversight, not clear what value derivative suits add.

* + - 1. Cases:
         1. *Flying Tiger Line*: Suit to enjoin merger due to dilution of voting power. Issue of whether to post bond. Ruled a direct suit.
    1. Demands: To bring a derivative action SH must first make a demand or claim futility.
       1. Demands Made:
          1. Once Demand made, estopped from claiming it’s excused (*Grimes*)
          2. If demand is **accepted** the corp can either give SH right to go forward or retain it.

Unlikely that corp will accept but if it does it almost always takes control of suit

More likely corp will reject the demand, which likely kills the suit b/c very difficult to prove wrongful rejection (BJR).

* + - * 1. If demand is **refused** SH may claim wrongful refusal by alleging particularized facts raising reasonable doubt as to whether BoD acted independently or with due care.

If successful on wrongful refusal, its as if demand was excused (*see* *Grimes*)

No discovery - “tools at hand” (relevant corp records - DGCL § 220(b)) (*Grimes*)

* + - 1. No Demand Made: SH may proceed without demand if demand is excused for futility
         1. **DE Futility Test**:

π must allege particularized facts (using “tools at hand” before discovery) creating a reasonable doubt that the BoD is incapable of making a good faith decision on suit:

Maj of BoD has material financial or familial interest in transaction;

Any voting on D’s compensation = interested (*Marx* **NB:** NY Case)

Maj of BoD is dominated/controlled by alleged wrongdoer/interested parties (*Grimes*); or

Underlying transaction was not the product of a valid exercise of BJ.

BoD didn’t engage in minimally informed, adequate decision-making ***process***, didn’t hire competent expert; so outrageous it’s irrational

**NB**: Demand is not excused simply b/c π sues all Ds for a transaction in which they all participated. Must follow rule, *supra*. (*Grimes*).

* + - * 1. **NY Futility Test** - NY BCL §626(c):

A demand is excused for futility when a complaint alleges with particularity that:

A Maj of the BoD is interested (self-interested or controlled by a director who is self-interested) in the challenged transaction;

The BoD did not fully inform themselves about the challenged transaction to the extent reasonably appropriate under the circumstances; or

The challenged transaction was so egregious on its face that it could not have been the product of sound BJ of the directors.

* + - 1. *Policy for Requiring Demands*:
         1. Avoids litigation by incentivizing alterative intra-corp remedies (*Grimes*)
         2. Brings potential beneficial litigation to corp’s attention but allows corp to control proceedings (*Grimes*)
         3. Deter costly, baseless suits by screening them through demand (*See* *General Tire*)
         4. Universal Demand: Dispense with necessity of case-specific determinations (*Marx*)
      2. *Cases*:
         1. *Grimes*: Compensation is BJ. If demand made, can’t claim futility. Wrongful refusal?
         2. *Marx*: Claim for corp waste against IBM for excessive comp. No demand made. NY Demand Futility Test 🡪 “so egregious” (Addition to DE test); ct reserving discretion
         3. *Stone v. Ritter*: πs attack entire BoD for inaction; demand not automatically excused
      3. Special Litigation Committee (SLC):
         1. If demand is excused or ct finds wrongful refusal, an SLC can investigate transaction and recommend whether litigation should proceed (DGCL §141(c))
         2. If SLC recommends dismissal:

NY: Recommendation gets BJR (Ct only looks at procedure) (*Auerbach)*

DE: Two step test to determine if recommendation gets BJR (*Zapata Corp*)

**Procedural Inquiry**: Show independence and good faith of SLC; and

No material business relationships, not on BoD at time of wrongdoing (*Zapata*: new Ds on SLC), no “Bias-producing” connections (*Martha Stewart*: friendship/outside bus relationship alone not enough), No professors whose universities receive large donations (*Oracle*).

Adequacy of SLC investigation; then

Full power to act on BoD’s behalf

Scope of investigation was broad, and there was a good-faith inquiry into all reasonable topics, areas, and subjects (*Auerbach*)

Investigative procedures are serious and report is credible

**Substantive Inquiry**: Ct, at its own discretion, applies own BJ on dismissal

Rarely used but provides incentives to use A LOT of process

Can overrule SLC Rec if SLC followed letter but not spirit of proc

* + - * 1. *SLC Policy*:

**For**: don’t want to allow one SH to incapacitate an entire BoD merely by leveling charges against them, gives too much leverage to dissident SHs (*Zapata*)

**Against**: allows BoD too much control

* + - * 1. Cases:

*Auerbach*: Foreign bribes, BoD launches own investigation. Substance outside scope of review (BJR). Ct could inquire into procedure and methodology.

*Zapata*: Excessive compensation case; demand not made b/c all directors named in case. Appointed SLC and recommends dismissal. DE standard.

*Oracle*: STANFORD case. Court will judge “real” independence using a principles-based approach; independence is a broad range of inquiry.

* + - 1. Burdens:
         1. **Before Demand or After Refusal**: SH has burden of *alleging particularized facts* to create reasonable doubt that BoD is disinterested/independent and made a valid BJ
         2. **After Demand Excused/Wrongful Refusal Found but Dismissed by SLC**: Corp has burden to prove the SLC’s independence, good faith, and a reasonable investigation/ (*limited discovery* may be ordered with respect to key issues like independence)
  1. **The Purposes of Corps**
     1. Clark: Tension between conceptions of corps Financial Institutions (profit maximizers) and Social Institutions (general welfare promoters)
     2. Primary Purpose: Corp’s Ds have a fiduciary duty to maximize SH value.
        1. Constraints:
           1. Corps must obey law (even if disobedience (factoring penalty) is profit maximizing)
           2. Corps must meet all obligations to non-SH constituencies
     3. Subject to caveats to pure SH value:
        1. Ds may cause corp to engage in charitable giving
        2. Ds may cause corp to stop clearly and seriously unethical action (e.g. genocide, apartheid) even when profit maximizing and legal (“Matters of Conscience” Exception)
     4. Charitable donations: Corps may make charitable donations that tend reasonably to promote corporate objectives. (A.P. Smith Mfg. Co. v. Barlow, N.J. 1953); **DGCL § 122(9)**. The decision to make charitable donations is governed by the business judgment rule.
        1. CA & NY allow donations without purpose of corporate benefit
        2. PA can consider ALL constituents
     5. *Cases*:
        1. *A.P. Smith Mfg. Co.*: Donation to Princeton but AoI before NJ’s charitable contribution power. Gift was lawful exercise of implied and incidental powers under common law.
        2. *Dodge*: Rejecting corporate act as outside corporate purposes.Ford stopped special dividends. Could have just made BJ argument instead told the truth: wanted to pay employees more and keep cars cheap. Cannot conduct business for *incidental* benefit of SHs. Ct: Be generous with your own money, not other people’s.
        3. *Wrigley*: Passed up on profitable night games out of concern for community. D’s judgment presumed in good faith and designed to promote best interests of corp.

1. **Duties**
   1. **Overview**
      1. Fiduciary Duties (FDs) Owed: Duty of Care, Duty of Loyalty, and Duty of Disclosure
      2. To Whom: In general, Ds and Os owe Fds to SHs **ONLY**.
         1. Exceptions: (i) Ds of an insolvent corp owe FDs to creditors, (ii) Bank Ds owe FDs to Depositors, and (iii) Reinsurance Ds owe FDs to Policyholders
      3. Burdens, generally:
         1. Breach of Duty of Care: **π** must show deficiency of process; BJR usually controls
         2. Breach of Duty of Loyalty: Burden on **∆**
      4. Three Categories of Challenged Transactions
         1. **Arm's lengths transaction** (Think DoC): BJR applies
            1. If π gets around BJR presumption ct will mostly looks at process
            2. SH ratified at this point requires π to prove waste.
         2. **Interested D/O transaction** (DoL): BoD must show *Intrinsic fairness of decision*
            1. No BJR, cts can look at merits/substance and overturn decisions if seem wrong
            2. Ratification by maj of disinter. Ds/SHs + full-disclosure = BJR (π must show waste).
         3. **Controlling SH-Arranged Mergers** (DoL): Same as #2 above
            1. Ratification by Maj of minority (MoM) SHs shifts burden to π (still fairness)

If controlled corp BoD sets up special committee of ind. Ds to negotiate and approve the merger, shifts burden but still entire fairness (*Kahn v. Lynch*)

If controlled corp used both a SC and preconditions merger on a MoM of SHs, shifts burden to π and standard to BJR (*Kahn v. M&F Worldwide*).

* 1. **Duty of Care**
     1. Overview:
        1. PROCESS DUE CARE, ***NOT*** SUBSTANTIVE!! (*Van Gorkom*)
        2. Ds and Os, in making all decisions in their capacities as corp fiduciaries, must act as a reasonably prudent person in their position would. (*Francis v. United Jersey Bank*)
           1. Ds must know rudiments of bus, keep informed, attend mtgs, review financial statement, do general monitoring (go through basic motions of being a D) (*Francis*)
        3. Rule: Apply BJR; Cts won’t review BoD discretionary judgment, just process (*Kamin*)
     2. Burdens:
        1. **π** has burden of rebutting BJR, showing breach of DoC and that the breach legally (i.e., proximately and factually) caused the loss. (*Francis*)
        2. If π rebuts BJR, burden on Ds to show the **intrinsic fairness** of the transaction.
        3. If SHs ratified, π must show **waste** to prevail (Which is a death knell)
     3. *Cases*:
        1. *Kamin*: Strong presumption of BJR; claim corp waste after dividend in kind of DLJ shares b/c lost $25m. Court won’t interfere just b/c judgment was mistaken.
        2. *Francis*: Limits on BJR; woman director of reinsurance company knew nothing about the business. Duty to be informed.
           1. *Clark Q*: Can “nonfeasance” exception catch less dramatic neglect of duty? *I.e.*, “shoddy feasance” as indicated by poor info gathering and poor process generally.
        3. *Smith v. Van Gorkom (DE 1985)*: Due care in the merger context. Breach of DoC for failure to inform themselves of all [material] info reasonably available and relevant to their decision.
           1. Problems:

Quick meeting: bad sign to the ct

No fairness opinion: Also bad sign: Hire investment firm for fairness opinion!

Big premium defense: NOT an indication of the company's intrinsic value; no valuation study done

Collective wisdom and legal advice: NOT valuation experts and not reasonable to rely on that advice

Market test defense: this was half-baked as it was carried out

* + - * 1. **Implication**, πs can get around BJR and show duty of care violation if they effectively attack decision making process (v. substantive merits) Cf. Disney
    1. Exculpation Clause (DGCL § 102(b)(7)): Corp can adopt AoI provision to limit individual D liability for Duty of Care violations.
       1. Enacted in response to *Van Gorkom* (There was a bit of a freak out in the industry)
       2. Only protects Ds from money damages, still allows for injunction of mergers, etc.
       3. **Cannot limit liability for**:
          1. Breach of Duty of Loyalty (Self-dealing)
          2. Acts or omissions in bad faith (intentional misconduct/ knowing violations)
    2. DGCL 141(e) (Protected by expertise): Where a D has relied in good faith on the records of the corp or information, opinions, reports or statements made by officers or employees or other persons that the D **reasonably** believes to be an expert or have professional competence and who has been selected with reasonable care by/for the corp, she is protected in the performance of her duties.
    3. Typical Process used in M&A post- *Van Gorkom*:
       1. Always hire an investment banking company and an outside law firm,
       2. Always involve BoD, especially the independents,
       3. Always consider “alternative strategies” and partners,
       4. Always get an elaborate outside valuation study and fairness opinion,
       5. Always prefer auction, at least have “real” market check; worry about deal protection agreements
       6. And always be sure to have long meetings and keep good minutes
    4. SH ratification: Cures breach of DoC only if the ratification is made by SHs who are fully informed about *all facts material* to their vote. (*Van Gorkom*)
  1. **Duty of Loyalty**
     1. **Self-Dealing (Interested D/O) Transactions:**
        1. General rule: If π challenges a *self-interested transaction* D must show both *good faith* and *intrinsic fairness* of the transaction to the corp. No BJR here.
           1. Self-Interest: O, D or controlling SH is on both sides of the transaction or has interest in some way opposed to the corp’s interest (financial, familial, etc.).
           2. ***INTRINSIC FAIRNESS***: Must be a (1) good corp bus purpose and (2) terms must be as good as would’ve been under an arms-length transaction. (*Bayer*)
        2. Remedy: If *any indication* of unfairness/undue advantage, transaction is presumed void. If can’t be voided, “restitutionary damages granted (disloyal D pays back unfair gains).
        3. Burden: ∆, *good faith* + *inherent fairness* – Safe Harbor: shifts to π, inherent unfairness
        4. Safe Harbor (DGCL §144(a)): Self-dealing transaction can escape invalidation by:
           1. Disclosing Material facts about *self-interest*, BoD in good faith authorizes by affirmative vote of Maj of *disinterested* Ds

May not have to disclose if BoD already knows of conflict (*Benihana*)

* + - * 1. Disclosing material facts about *self-interest* to SHs and Maj of SHs (*Benihana*)**/**outstanding disinterested SHs (*Fliegler*) approve in good faith

SH ratificationcures process defects if fully informed (*Wheelabrator*)

* + - * 1. Fairness: Deal is fair at the time it is approved (*Benihana*)

Fairness trumps even deficiency in process (*Bayer*)

* + - 1. Unresolved Issues:
         1. *What if primary purpose is good and collateral is not? Benihana* – primary purpose of financing, collateral purpose of diluting voting power of Rocky
         2. *What if diluting voting powers is good for corp?* Is altering relative voting powers for good reason violation of fiduciary duty? (*Benihana*)
      2. *Cases*:
         1. *Bayer (NY)*: Wife of CEO and a D of Celanese Corp., is selected to perform on the Celanese Opera Hour as a means of promoting the brand name.

Duty of Care (Waste) claim easily dismissed b/c *process* was adequate.

Inherent fairness b/c she was a legit singer, pay was less than others’, she wasn’t being explicitly promoted, and there was a plausible bus. purpose being served.

Advice: if you want to do something like this, have a *formal* board mtg, with *independent* Ds, and preferably at least one without wife and husband.

* + - * 1. *Benihana (De)*: Financing scheme that would benefit D of Benihana personally. BoD voted to approve the transaction, Safe Harbor of DGCL §144(a)(1). Burden shifts π to prove inherent unfairness.

CoI was not specifically discussed at mtg, but the ct is satisfied that everyone there knew about the conflict, so the §144(a)(1) pre-reqs are still satisfied.

If πs had pleaded their claims with specificity that D used confidential info in negotiating the financing deal, they would have had a good chance of winning.

* + 1. **Controlling SH-Arranged Transactions:**
       1. SH w/ FD?: SHs usually don’t have FD but Maj SHs do.
       2. Parent-Sub/Corp is Maj SH: Under DE law, when one corp owns a maj of another corp, controlling corp owes a FD to minority SHs.
          1. Plurality SHs: SHs who own less than 50%, CAN be found to be controlling SHs

BUT 22% owner wasn’t “**dominating**” so no FDs (*Wheelabrator*)

* + - * 1. Parent can avoid liability by having truly disinterested directors form special committee to negotiate with parent at arm’s length.
      1. SH Ratification:
         1. Disclosure of material facts + approval by outstanding disinterested D/SHs (*Fliegler*)

π must prove intrinsic unfairness (easier than rebutting BJR or proving waste)

* + - * 1. No disclosure/approval by outstanding disinterested Ds/SHs(*Sinclair*)

Δ must prove Good Faith + Intrinsic Fairness

Proportionately equal treatment?(No breach)

*Sinclair*: equal pro rata dividends to all Sinven SHs

**Limit:** *Zahn* (equally screwed b/c *withheld material info*)

* + - 1. Affirmative Duty to Disclose (ADD): Even in complicated situation where bargained about various rights, BoD/Maj SH has ADD(*Zahn*) – minority SH must be given a chance to protect their interests.
      2. Remedy: Outcome that would have had if not for breach of DoL
         1. *Sinclair*: interest on money wrongly withheld from debt pmt.
         2. *Zahn*: Class A SHs get what would have had if converted to B
      3. *Cases*:
         1. *Sinclair Oil (DE)*: Sinclair owned 97% of Sinven, and minority SHs owned the other 3%. Min SHs bring 3 claims: (1) Sinclair caused Sinven to pay more dividends than healthy, (2) Sinclair allowed Sin Int’l to breach K with Sinven to Sinven’s detriment, and (3) Sinven missed corp opportunities b/c Sinclair wanted them.

Dividends were distributed equally to all SHs; decision is protected by BJR.

Ct dismissed usurped opportunity claim b/c Sinven only operated in Venezuela, and the opportunities taken by Sinven were all foreign.

Breach of K favors π b/c clearly bad for Sinven to not collect on its contracts.

If advising a sub w/ min SHs, have all transactions approved by the *disinterested* Ds with full info, to shift burden and get the benefit of BJR.

* + - * 1. *Zahn (3d Cir.)*: Transamerica was the controlling SH of Axton-Fisher: it owned 66% of Class A stock and 80% of class B stock. It had elected a Maj of BoD. Class A stock got greater dividends, but could not vote. Class B stock had all voting power. Class A could be converted to B, or could be called by the company for $60/share. BoD called all the Class A stock, then liquidated, to appropriate to Transamerica all the value of the tobacco inventory it held. π claimed this was a breach of DoL, b/c Class A SHs would have received $240/share if not called before liquidated.

Tension btwn contractual rights re class A stock and Maj SH FD to minority.

π’s complaint was about disclosure, not about exercising contractual rights.

BoD has an affirmative duty to inform the class A SHs.

* + - * 1. *Fliegler (DE)*: Agau drops a sub, USAC, to hold some risky mining prospects. The prospects work out, so they want to sell the sub back to Agau. They have a SH vote, and a Maj of the SHs approve the transaction.

Maj of SHs who voted were interested. So no burden-shift under §144(a)(2).

Burden shifts and BJR protects a self-interested transaction if approved by MAJ OF MINORITY SHs even though §144(a)(2) doesn’t mention it.

* + - * 1. *Wheelabrator (DE)*: Waste owns 22% of WTI-1. It wants to increase its ownership to an amount that would make it clearly a dominant SH. The SHs voted for the deal, but the π minority SHs are still trying to challenge it. Issue: Burden of proof?

Court sets *standard* (NOT a bright-line rule) that anything over 50% is dominant interest, but the more important test is whether it exercises *de facto* control.

B/c a Maj of the minority SHs ratified the transaction, the burden shifted back to πs to prove waste/gift. πs could not carry burden.

* + 1. **Corporate Opportunity Doctrine** (COD)
       1. Policy: COD attempts to prevent D/O from misappropriating corp proprietary info.
          1. Ideally, offer opp to corp first. Get indep cmte to approve, then entire BoD or SHs.
       2. Burden: ∆ must show no usurpation of a business opportunity of the corp.
       3. Corp opportunity ***Balancing*** Test:
          1. (1) The corp is financially able to take the opportunity,
          2. (2) The opportunity is in the corp’s line of business,

Has fundamental knwledge, practical exp, ability to pursue opp (*Martha Stewart*)

*eBay* – Investing is a line of bus?

* + - * 1. (3) It is an opportunity in which corp has an interest or reasonable expectancy, and
        2. “A kind of safe harbor:” Presentation to BoD will help - *see* *Broz*
        3. (4) Taking will bring D/O’s self-interest into conflict with corp’s interest (*see* *ebay*)

No conflict/duty to new parent until deal **closes** - *see* *Broz*

* + - 1. Other Factors to Consider:
         1. Was opportunity offered to D/O ***b/c*** she was a D/O? (*eBay*)
         2. Did D/O learn of opportunity in individual or corp capacity? (*Broz*)
         3. Did D/O use corp resources to take advantage of opportunity?
         4. Was corp presented with opportunity? (*Broz*)
      2. Ratification: If opportunity is officially presented to BoD/SH this can all go away.
      3. *Cases*:
         1. *Broz* (DE): DE Corp Opportunity Doctrine from ***Guth v. Loft (DE)***. Broz is D of CIS and President and sole SH of RFBC. 3d corp wants to sell a service license, Mich-2. It solicits RFBC and PriCell (who is working on acquiring CIS) as buyers, but not CIS. Broz mentions idea to CEO and some Ds, they say go ahead. RFBC gets it; Broz is sued under COD. Ct found that CIS lacked financial ability, opp in CIS’s line of business, given that CIS was selling off licenses and the reactions of CEO/Ds, no interest or reasonable expectancy. No CoI unless Broz considered PriCell but ct said he didn’t have to until deal is final (there is some dispute whether the ct it right).
         2. *eBay* (DE): Goldman, who did the eBay IPO, allocated IPO shares to 5 top officers, who flipped them and made millions. Some work could have been done under R.2d of Agency § 338: Violation of duty to account for profits made by him on account of transaction conducted on behalf of principal but ct doesn’t go this way. Held: This opportunity should have gone to eBay, not to eBay’s directors.

eBay was financially able to take shares

Flipping securities was eBay’s line of business

Kick-backs should go to corp not D/Os

Created conflict with directors’ self-interest (always hire Goldman for kickbacks)

* 1. **Good Faith?**
     1. Background:
        1. Dyad or Triad of FDs?
           1. *Cede & Co. v. Technicolor* (DE) identified triad of FDs: 1) good faith, 2) loyalty, 3) care; indicates that GF was a freestanding fiduciary obligation.
           2. But *Stone v. Ritter* (below) held that GF fell under DoL (Therefore, **dyad** of FDs)
        2. Good Faith Pervades DE Corp Law:
           1. Indemnification of legal expenses: only Ds acting in GF entitled (DGCL §145).
           2. Reliance on corp records: only Ds, *inter alia*, relying in GF on corp books/ records/reports from Os/advisers are fully protected against claims (DGCL §141(e)).
           3. Interested transactions: partially insulated from judicial review if, *inter alia*, they’re approved by disinterested Ds/SHs in GF (DGCL §144(a)(1)-(2)).
           4. Business judgment rule: BJR presumes Ds, among other things, acted in GF.
        3. Bad faith is difficult to show ex post (see *Lyondell*)
     2. *Cases*:
        1. *Disney (DE)*: GF in Compensation Cases
           1. BJR covers compensation decisions, π must prove **bad faith**

**Bad faith**: (1) Conduct motivated by actual intent to do harm (subjective BF); or (2) Intentional dereliction of duty, conscious disregard for one’s responsibilities;

Gross negligence does not rise be bad faith without more (Exculpation avail)

DGCL §102(b)(7) cannot “exculpate” liability for BF or breach of DoL.

* + - * 1. Whether GF is a free-standing FD is punted but no BF here (not one of two above)
        2. ***Waste Claim****:*  Dead on Arrival, found “only in the rare, unconscionable case where Ds irrationally squander or give away corp assets; πs must show that exchange was “so one sided that no business person of ordinary, sound judgment could conclude that the corp received adequate compensation”
        3. *Brehm v. Eisner* Note: No “Substantive due care” under BJR in DE. In the decision-making context ONLY ‘***process due care****’*. Irrationality is the outer limit of the BJR.
      1. *Stone v. Ritter (DE)*: GF in Oversight Cases
         1. Ct adopted *Caremark* *Standard*: Necessary conditions for D oversight liability are 1) **sustained or systemic** failure of BoD to exercise oversight – i.e. Ds fail to implement reporting or info system – or 2) Ds failed to monitor implemented system
         2. In either case, imposition of liability requires showing that Ds fail to act in the face of a known duty to act, thus consciously disregarding their responsibilities (#2 above)
    1. Wrap-up: GF is an aspect of DoL (stretches previous notions), BF results in personal liability
  1. **Disclosure and Fairness**
     1. Securities Act of 1933 (SA):
        1. **Algorithm:**
           1. **Is it a Security within the meaning of the act?**

**Mention specifics and catch-all phrase**

**Mention specific attributes of these “securities” (pros and cons) - *Forman***

**Policy: Would the act want to cover these instruments?**

* + - * 1. **Was it the security registered?**

**Process**

**Exceptions**

**Consider who has burden in close cases**

**Remedy if didn’t comply with process (§12(a)(1))**

* + - * 1. **MMO: Express Private Right of Action**

**In RS? (§11)**

**In offer/prospectus? (§12(a)(2))**

**In either case, make claim with “PARTICULARITY!” (don’t say, they forgot to mention this thing generally; say, they said “X” and this was misleading/deceptive and material b/c “Y”**

**Remedy: Loss that occurred b/c of fraud; check if injunction makes more sense.**

* + - 1. SA regulates any public offering of securities in primary markets (offered by corp):
         1. Sec may not be offered for sale through mail or by use of other means of interstate commerce unless a registration statement (RS) has been filed with SEC (§5c).
         2. Sec may not be sold until the RS has become effective. (§5(a)) – 20 days (§8(a)).
         3. The prospectus must be delivered to the purchaser before a sale.
         4. EXEMPTIONS to registration:

**Regulation D** – Safe Harbors (**Private offerings** – *Doran*):

If <$1m, may sell to unlimited number of buyers w/o registration (Rule 504)

If <$5M, may sell to 35 or fewer buyers, but no more (Rule 505)

If >$5M, may sell to 35 or fewer sophisticated buyers (Rule 506)

Issuer cannot widely advertise the security

**Must file** a notice of sale (Form D) w/ the SEC not long after it issues the securities

"Accredited (Institutional, millionaire) investors” don’t count for buyer limits

Reg D exempts only initial sale, can only resell under another exemption

R. 144: If hold sec for year, resell in ltd volumes, can resell under Reg D.

Issuer has **BURDEN** to show this is a private and not a public offering.

* + - 1. Definition of Security**:** §2(a)(1) (definition in SEA §3(a)(10)very similar) divided into:
         1. List of specifics (e.g., “stock,” “notes,” “bond”)

Characteristics of stock: (i) dividend rights (pro rata); (ii) negotiability, (iii) ability to be pledged/hypothecated, (iv) voting rights in proportion to number of shares owned, (v) ability to appreciate in value" (*Forman*)

* + - * 1. List of gens (investment contracts, “any instrument commonly known as a security’”)

*SEC v. Howey* - Investment Contract: (1) investment of money, (2) in common enterprise (3) expecting profits (4) solely from efforts of others

“Solely” replaced w/ “economic reality” (meaningful control of investment)

* + - 1. Securities under SA and SEA?:
         1. Close Corp stock, YES, no problem under SA but 10b-5 applies if there are MMOs.
         2. Gen Partnership interests, NO, not in gen definition and fail *Howey* test (element 4)
         3. Ltd Partnership interests, YES, under *Howey* test; worry about when to register.
         4. LLC Interests, IT DEPENDS, no general answer; all depend on operating agreement
      2. Express Private Rights of Action (much better than common law fraud):
         1. **§11** (MMO in RSs) - no privity, reliance, causation, or scienter req. π can sue issuer, Ds, signing EOs, listed peeps (w/consent) as becoming Ds, accountants, underwriters, and lawyers (11a1-a5). If π shows MMO, ∆ has burden to show lack of causation (can also mitigate damages by showing MMO not sole cause ((11e), *BarChris*).

“Due Diligence” def: No affirmative duty of due diligence, but possible defense

As to RS parts expertise by others, “he had no reasonable ground to believe, and did not believe, there were MMOs at the time RS became effective

As to all others parts, “he had, after reasonable investigation, reasonable ground to believe, and did believe, the statements were true and MMOs”

* + - * 1. **§12(a)(1)** (statutory rescission) - right to rescind deal if the seller didn't comply w/ §5 (RS req’s). Strict liability on seller. Refund + interest or (if sold) damages.
        2. **§12(a)(2)** (MMO in offerings/prospectus) - MMOs not in RS. π *prima* *facie* case: 1) sale of sec.; 2) in interstate comm; 3) by means of prospectus/oral communication; 4) containing MMO; 5) by ∆-seller; and 6) ∆ knew/should have known of MMO. No reliance req. ∆ has diligence/reasonable investigation defense (*BarChris*).
      1. *Cases*:
         1. *Robinson*: definition of security**.** GeoPhone LLC and CAMA signal. Used *Howey* test to determine not an investment K or share. Exercised mngt control.
         2. *Doran*: Private placement exemption. Ct looked to four factors (Essentially first 4 of Reg D) to determine if transaction was exempt as “private offering” under §4(2).
         3. *BarChris*: Due diligence. Bowling alley company failing. Rosy statements in convertible bond offering. Sued under SA §11. Identified reasonable investigation.
    1. Securities Exchange Act of 1934 (SEA):
       1. Overview:
          1. Regulates securities in secondary markets of registered corps.

Corps whose (equity or debt) securities are listed on a public exchange (§12(a))

Corps w/ equity secs that have more than $10m in assets and at least 500 equity SHs of record (§12(g), SEC Rule 12g-1 (increases asset threshold to $10m)).

* + - * 1. Establishes system of periodic disclosures, most important, obligation to file annual, quarterly reports: Form 10 (once); 10-K (annually); 10-Q (quarterly), 8-K (episodic)
        2. Covers: 1) insider trading and other forms of secs fraud (10b-5), 2) short-swing profits by corp insiders (§16b), 3) regulation of SH voting via proxy solicitations (§14), 4) regulation of tender offers (§14e), and 5) req of periodic disclosures (§13).
      1. Implied Private Rights of Action (and express rights to SEC):
         1. §10(b): authorizes the SEC to make rules to make it unlawful to engage in deceptive or manipulative practices in connection with purchase/sale of sec (in interstate com)

Rule 10b-5: Forbids MMOs in connection with purchase or sale of securities

* + - * 1. §14(a) and Rule 14a-9: Mandatory disclosure regime for SH votes

Executive compensation, proxy statements, information about deals

Rule 14a-9: mirrors 10b-5 for soliciting proxies (MMOs in proxy statements)

* + - * 1. §14(e) and Rule 14e-3: prohibits fraudulent practices in connection with tender offers
      1. **Rule 10b-5**: Implied right of action (§ 20A)
         1. It is unlawful to (a) employ any device or scheme to defraud, (b) to make any material misstatement or omission, or (c) to engage in any act which operates as a fraud or deceit upon any person in connection with purchase or sale of sec.
         2. Elements of 10b-5 Claim: Burden on π

Jurisdictional Prereq: – Use of mails, national markets, (interstate comm) etc.

Standing: An actual buyer/seller of a sec (Blue Chip) or option (*Beneficial Corp*)

Scienter: False statement was made w/ "intent to deceive, manipulate, or defraud," (*Ernst*) (includes recklessness but not ordinary neg)

MMO **in connection with the sale of a Security**: Π must show MMO deceieved or manipulated (*Santa Fe Ind.)* and was connected the sale.

Should have remained silent or said “no comment” (*Basic* Fn 17)

Reliance: actual or, if appropriate, fraud on the market theory (*Basic*)

Economic loss, and

Causation: Causal connection between MMO and loss. (*Dura Pharmaceuticals*)

* + - * 1. **Materiality**:A M/O is material if there is a **substantial** likelihood that a reasonable investor would consider the M/O to significantly alter the total mix of info available (*Basic*).

Contingent or speculative info of events: “Materiality” depends on a balancing of the probability that the event will occur with the anticipated magnitude of the event in light of the totality of the company activity. (TGS)

Merger info likely to be material b/c highly sig events in corp’s life. (*Basic*).

Materiality is very fact-dependent/mushy (substantial, reasonable, important)

* + - * 1. **Fraud-on-the-market (FotM) theory**: Π-SHs, in lieu of proving individ reliance on MMO, can invoke theory that in an open and well-developed sec market, publicly available material mis-info affects the market price (Well-dev = competitive) (*Basic*).

There really can’t be 10b-5 class actions without FotM.

Π must show (1) that the alleged MMOs were publicly known, (2) that they were material, (3) that the stock traded in an efficient market, and (4) that π traded the stock between the time MMOs were made and when truth was revealed.

If ∆ makes any showing that severs link between the alleged MMO and price received (or paid) by π, it will be sufficient to rebut the presumption of reliance (basis for finding that MMO had been transmitted through market price is gone)

No FOM presumption if: (i) info is not public (broker tip), no market price effect, or (ii) if close corp (no well-developed market). (*West v. Prudential*)

* + - * 1. Remedy: Damages only recoverable to the extent they were related to fraud, §21D(e) limits damages taking into account post-transaction price volatility unrelated to MMO.
        2. *Cases*:

*Basic*: Corp denied merger talks. SH sold and sued. FotM. Materiality standard.

*West v. Prudential*: Broker told 11 ppl about merger. Info not public; no FotM.

*Halliburton*: SCOTUS says FotM stays but ∆ can rebut “price impact” at class certification stage.

*Santa Fe*: Min SH merger price wholly inadequate b/c based on fraudulent appraisal; breach of FD for state cts not 10b-5.

*Beneficial Corp*: Buyers of options have standing under 10b-5.

* 1. **Insider Information**
     1. Requirements on Insiders:
        1. SEA§16(a): Ds/Os/owners of > 10% of a security, must register w/ SEC
           1. §16(a)(2)(C): Must file changes in ownership by end of second bus day after a trade.
        2. **Regulation FD**: Non-insider trading-based mechanism for restricting selective disclosure
           1. If someone acting on behalf of a public corp discloses material non-public info to **securities market professionals** or holders of securities who may trade, **issuer must also disclose info to public**

Excludes person (entity) who:

Owe duty of trust/confidence to issuer (attorney, CPA, invest. banker, etc.)

Expressly agree to maintain the disclosed info in confidence

Has as primary bus issuance of credit ratings & info disclosed solely for this

* + - * 1. Intentional disclosure: Simultaneously disclose info to SEC via Form 8-K **OR** in manner designed to convey it to general public (press release, webcast, etc.)

Intentional: Knows/reckless in not knowing that info is material **and** non-public

* + - * 1. Unintentional disclosure: Public disclosure **promptly**

Promptly: Soon as reasonably practical after Senior Official learns of disclosure

Senior Official: D, Executive O, investor or public relations O, or similar

* + 1. Causes of Action:
       1. State Law: Hard to get at insider-trading, almost prove fraud. (*Goodwin v. Aggasiz*)
       2. 10B-5: **Disclose** info, wait for price to settle or **Abstain** from market (*SEC v. TGS*)
          1. 10b5-1 elements: (1) fiduciary relationship; (2) possessed material, nonpublic info; (3) traded; (4) “on the basis of” the info (scienter); (5) made profit or avoided a loss.

Trading “on basis of” presumed if aware of info when traded, **unless…**

Before becoming aware of the info the trader had (1) entered into a binding K to purchase/sale the security; (2) instructed another person to purchase/sale the security on the instructors account; or (3) adopted a written plan for trading securities.

SEA §21A: SEC cause of action to sue ITer for treble damages.

* + - * 1. SEA §20A Private Right of Action Standing: If (1) traded securities; (2) in opposite direction of the violation; (3) contemporaneous w/ the violation (same day).

Remedy: Limited to ITer’s profits or losses avoided (§20A(b)(1)), minus any SEC disgorgement (§20A(b)(2)), distributed pro rata among the π-class.

* + 1. Liability for Non-Insiders (Those with no FD to SHs):
       1. **Tippees**: If insider breaches FD to SHs by tipping, and tippee knows/should know tip was breach, Tippee inherits tipper’s FD. ***Test***: did insider get personal benefit? (*Dirks*)
          1. Tipper liability: Tipper and Tippee joint and severally liable (SEA §20A).
          2. Clark: IT rule should be broader than Dirks, should be “**improper purpose**” test.

Dirks would get off, and would catch people who didn’t get personal benefit

* + - 1. **Misappropriation Theory**: Outlaws trading on basis of nonpublic info by non-insider in beach of FD owed to *source* of the info. Designed to protect against abuses by outsiders who have access to material confidential info but have no duty to corp’s SHs. (*O’Hagan*)
         1. Per 10b5-2, also applies (non-exclusive list):

Whenever someone agrees to maintain info in confidence; or

When there is a pattern/practice of sharing confidences such that recipient of info knows/reasonably should know of expectation to maintain confidence; or

When material nonpublic info received/obtained from spouse/parent/child/sibling

These are rebuttable if recipient can show that they did not know/have reason to know (via past interactions or lack of agreement) that the source of the info expected confidentiality regarding the info.

* + - * 1. No private right of action, SEC only.
    1. Insider-Trading on Tender Offers (See M&A section for more):
       1. SEA §14(e): Unlawful for any person to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any TO
       2. Rule 14e-3(a):
          1. Once *substantial steps* have been taken to commence a TO (or TO has commenced);
          2. Any person who has possession of material info;
          3. Who *knows/has reason to* know that such info is non-public; and
          4. Who *knows/has reason to know* that info has been acquired *directly/indirectly* from:

Offering person [A]

Issuer of securities sought by TO [T]; or

O/D, Partner or employee or any other person acting for A/T

* + - * 1. Is prohibited from purchasing/selling or causing to be purchased/sold any securities,
        2. *Unless* within a reasonable time prior to purchase/sale such info and its source are publicly disclosed by press release or otherwise
    1. Policy:
       1. Against Rule:
          1. IT compensates entrepreneurs: good
          2. IT helps market pricing of securities
          3. IT can’t be stopped; wasteful to try
          4. Let States decide
          5. Let individual corps and their investors contract about it
          6. At least let corps opt out
       2. For Rule:
          1. No secret profits reasoning; harm to capital markets
          2. Slows the release of info (Insiders have incentives to keep it all quiet)
          3. Legal rules deter a significant amount of IT; particularly when put in jail
          4. Feds have comparative advantage, markets are nat’l
          5. Corps may just move to most favorable states; high transaction costs
          6. Collective action and agency problems: need legal default rule
          7. Hmm…who cares? No one would vote for that in a proxy.
    2. *Cases*:
       1. *Goodwin v. Agassiz*: State law.D/O buy shares w/ nonpublic info about copper deposits. Did NOT have to disclose. No evidence of fraud**.**
       2. *SEC v. TGS*: FED law. Drilling found lots of minerals. Not disclosed and denied rumors. D/O bought shares on info. Disclose-or-abstain rule under 10b-5.
       3. *Dirks*: Tippee**.** Discovered insurance fraud. Did not INHERIT b/c no benefit to insider.
          1. *Chiarella*: printing co. employee who deduced identity of merger Target owed **no duty- no relationship** w/SHs or co.
       4. *O’Hagan*: Misappropriation. Lawyer on Pillsbury deal, Made $4.5m.
          1. Rule 14e-3(a) approved under §14(e).
  1. **Short-swing Profits (SEA § 16(b)) – Always Derivative!!**
     1. Rule: Os, Ds, and Beneficial SHs (own 10%+ of shares) of corps subject to SEA must surrender profits gained on the sale/purchase (both req’d, in any order) of *equity securities* (v. any security for 10b5) w/in a six-month window.
        1. Unrelated to IT. Bright-line, prophylactic rule. No need to show scienter.
        2. **Always Derivative!!**
     2. Unconventional Transactions (See *Kern*): Don’t count (e.g., exchanging stock in merger). Transactions tend to be conventional if: 1) Transaction is volitional; 2) Beneficial owner has any influence over transaction; and 3) Beneficial owner had access to confidential info about transaction/issuer.
     3. Remedy: Disgorgement to corp – (**derivative suit** so no benefit to individual SHs (unlike §10(b)/Rule 10b-5) but π’s lawyers have incentives) If multiple sales/purchases, match the lowest purchase price with the highest sale price in six-month period, even if net is negative.
     4. *Cases*:
        1. *Reliance*: Can sell in stages.Sold from 13% to 9.96%, sold rest. Only liable for first sale.
        2. *Foremost-McKesson v. Provident Sec.*: Must be 10%+ at both sale and purchase.
  2. **Indemnification and Insurance**
     1. DGCL §145: Indemnification of Os, Ds, employees/agents – overview of subsections:
        1. (a) May indemnify expenses (legal fees/judgment/settlement) in 3d party suit. If ∆ acted in GF & w/ reasonable belief that actions were in/not opposed to best interest of corp
           1. Crim cases: AND had no reasonable cause to believe that her conduct was unlawful.
        2. (b) May indemnify expenses only in derivative suits IF as above and ∆ not adjudged liable to corp [but…] Ct can order if fair & reasonable when found liable.
        3. (c) Must indemnify expenses if ∆ is successful on the merits/otherwise
           1. “Otherwise” – ∆ didn’t pay anything (SoL, etc.); settlements don’t count.
        4. (d) Who decides the “if” – independent Ds, counsel (written opinion of GF), SHs
        5. (e) May advance expenses even if ∆ later found not to be entitled to the benefits by signing a letter promising to repay them if not entitled to them
        6. (f) §145 doesn’t replace other rights under bylaw/agreement/vote of SHs/disinterested Ds
        7. (g) May buy D&O insurance, can go toward expenses whether or not power to indemnify
     2. *Cases*:
        1. *Waltuch*: CEO spent $1.2m on legal fees for ∆. Can’t bypass good-faith req.145a gives discretion. 145c obligates when SUCCESSFUL ON MERITS (even if corp pays for ∆).
        2. *Citadel Holding Corp* (DE): obligation of advancement of expenses OK under bylaws
  3. **SOX & Dodd Frank**
     1. Major sources of corporate governance changes:
        1. Federal Sarbanes-Oxley Act of 2002 (SOX)
        2. NYSE corporate gov. rules, listing requirements in mid-2003 (“NYSE CG Rules”)
        3. Governance rating systems by independent agencies (“GRAs”) like “ISS”
        4. Stricter tone in state case law (e.g. Oracle, Disney)
     2. Sarbanes-Oxley:
        1. Audit-related Changes:
           1. Conflict-reducing rules

Limits on multiple rules and services by auditors

Shift of power to hire and compensate the external auditors to audit committee (all independent)

Reduction of interpersonal bonding between auditors and the audited (personnel changes)

* + - * 1. Action-forcing rules:

Req’d internal control processes

Certification of Financial Reports

Financial literacy and financial expertise on Audit Committees

New Auditing Process Regulator (PCAOB)

* + - 1. Board-related Changes:
         1. Conflict-reducing rules: (May create more costs than benefits; MONITORING v. MNGT)

Maj of independent directors (NYSE listing requirements)

Stricter definitions of independence (not employee for 3 yrs, no close relatives, not officer in corp. that does substantial business, director of charities that receive substantial contributions) (NYSE CG rules)

Key committees can have only independent directors

Companies must have key committees: audit, compensation, nominating

SuperMaj of independent directors – Ratings Agencies (ISS) recommendation

Independent chairpersons – rating agency rec.

Regular executive sessions w/o mngt (to remove subtle psychological pressure) – NYSE CG

* + - * 1. Action-inducing standards:

Audit Comm: Financial literacy (ALL) and expertise (one, or explain)

Limits on over-boarding – ISS

Director stock ownership – ISS

Governance guidelines and codes of ethics

Self-assessments

* + 1. Dodd-Frank Act:
       1. Mandatory [though advisory] say-on-pay votes by SHs
       2. SEC authority to make proxy access rules
       3. Bounties (rewards) for whistleblowers (10-30% of the SEC’s recovery)
       4. Tougher clawback provisions

1. **Problems of Control**
   1. **Proxy Fights**
      1. Definition & Background:
         1. Proxy fights are battles over the right to vote on behalf of SHs, to act as their “proxies.” They result when insurgent group tries to oust incumbents and elect its own reps to BoD.
         2. Few SHs attend annual meeting, so outcome generally depends on who collects most “proxies.” SHs can appoint an agent (“proxyholder”) to vote on their behalf; SHs appoint their proxy via a “proxy card.” Proxy solicitors must supply proxy statements (PSs) (Form DEF 14A; see Rule 14a-3), providing material facts of issues SH are to vote.
         3. **Rule**: Incumbent can use corp funds in proxy fight if not illegal, unfair, or excessive, and fight extends to “deep policy” issues, not just personality of BoD. (*Levin*)
            1. Successful insurgents can be repaid for expenses w/ SH approval (*Rosenfeld*).
      2. Regulatory Structure:
         1. §14(a) (Gives SEC broad power to reg proxies): A person, by use of mails, any facility of nat’l securities ex, or otherwise, can’t solicit a proxy relating to any registered security (under §12 SEA) in contravention of any SEC laws. Proxy solicitation construed broadly (*Studebaker Corp. v. Gittlin* – SHs banding together to get enough shares to get SH list to in turn solicit proxies is ruled a solicitation)
         2. §14(b): Gives SEC power to reg exchanges, broker/dealers, banks re: proxies.
      3. SEC Rules:
         1. **Rule 14a-1**: definitions; note “solicitation” (14-1(l)) can be a request for a proxy for a request that SH withhold proxy from another or furnishing a proxy form to SH in manner reasonably calculated to result in procurement, withholding, or revocation of a proxy
         2. **Rule 14a-2** (Exceptions, Supp. 292):
            1. Exceptions (14a-2(a)) include brokers asking beneficial owners how to vote shares, requests by beneficial owners to obtain proxy cards from brokers, newspaper advertisements that identify proposal and tell SH how to obtain proxy docs.
            2. Solicitations that are exempt from filing, disclosure, and distribution requirement but are subject to Rule 14a-9 (fraud) include solicitations by people not seeking proxy authority and w/o substantial interest in the matter, non-mngt solicitations to less than ten people, advice by financial advisors in the ordinary course business.
         3. **Rule 14a-3** (see also Rules 14a-4, 14a-5, and 14a-11) **Mandatory Disclosure**: Req’d to send a “proxy statement” with all solicitations, containing info relevant to the decision SH must make (specified in Schedule 14A, which lays out the info req’d; Rule 14a-4).
         4. **Rule 14a-4**: Requirements of proxy, wording
         5. **Rule 14a-5**: Info must be presented clearly
         6. **Rule 14a-6**: Filing requirements, timing
         7. **Rule 14a-7** (Obligations of registrants to provide a list of, or mail soliciting material to, SH): Ds/Os have choice of 1) mailing insurgent group’s material to SHs directly (group pays) or 2) giving group copy of SH list and letting it distribute material. Ds/Os almost never do (1) to keep SH list confidential (but SH might have right to list under state law).
            1. Fed rule compatible w/ state rights. DGCL §220; *Pillsbury*: gives SH right to inspect lists, books, records for proper purpose (PP), (reasonably related to interest as SH); burden on SH to show PP for books/records but on corp to show im-PP for lists.
            2. See also Rule 14d-5 (giving corp similar mail-or-list choice in tender offer context)
         8. **Rule 14a-8** (**SH PROPOSALS**): Proposal can be submitted by SH holding at least $2,000 in market value or 1% of company’s voting securities for at least one year (prior to proposal; securities must be held through the meeting) (14a-8(b)(1)); except otherwise noted, burden on corp to show it’s entitled to exclude proposal (14a-8(g)). Corp has right to include in proxy statement reasons why SH should vote against proposal (14a-8(m)).
            1. No longer than 500 words
            2. No more than one proposal
            3. **REASONS FOR EXLCUSION** (14a-8(i)):(1) not a proper subject for action by SHs under state law, (2) violations of law, (3) violation of proxy rules, (4) Personal grievance or special interest, (5) Relevance – relating to operations accounting for <5% of company’s total assets or net earnings and gross sales, and not otherwise significantly related, (6) absence of power/authority, (7) Mngt functions, (8) Relates to election, (9) Conflicts with corp’s proposal, (10) Substantially implemented, (11) Duplication, (12) Resubmissions within 5 calendar years, (13) Specific amount of dividends.
            4. **SEC Referee**: Can provide no action letter to corps or bring enforcement actions
         9. **Rule 14a-9** (Anti-fraud rule. False or misleading statements,) – PSs can’t contain MMOs.
            1. Implied right of action, direct and derivative (*Borak*); SEC lacks sufficient resources.
            2. **Elements must show:** 1) MMO; 2) causation (*Borak*)

**Solicitation**: Defined broadly

**Materiality**:Substantial likelihood that reasonable SH would consider it important in deciding how to vote (*TSC Indus., Inc.*): Ds’ CoI (*Mills*)

**Scienter**: unclear, but negligence might be enough for insiders??

**Causation**: presumed if (i) there was a MMO in PS and (ii) the proxy solicitation was an essential link in the accomplishment of the transaction. (*Mills*)

**Remedies**: Rescission only in extraordinary circumstances (*Mills*), injunction, damages (generally difficult to determine); to effectuate congressional purpose, π may get attorney’s fees even if no monetary recovery (See *Borak*).

* + - 1. [Rule 14a-11: Proxy access rule, SH nomination] – overturned by Cts
         1. Rule 14a-11**:** must include nominees of 3% SH, could only put forward a “short slate”(1 nominee or 25% of BoD, whichever greater). STRUCK DOWN.
         2. Now you can use DCGL §112 for proxy access rules, as well as current 14a-8
      2. Rule 14a-12: Solicitations before furnishing PS is okay but see stipulations
    1. *Cases*:
       1. *Levin* (NY): Incumbent reimbursement of reasonable expenses allowed for corp defense.
       2. *Rosenfeld* (NY): Ds acting in *good faith* over *policy* (not personal) may be reimbursed. **Successful** insurgents may be reimbursed w/ SH approval.
       3. *Borak*: Implied private right of action under Rule 14a-9. Direct or derivative.MMO in merger statement (NB: Not PS but proxy materials).
       4. *Mills*: MMO causation in proxy. Causation existed if proxy solicitation itself (as opposed to particular defect) was an essential link in transaction. **“**Total mix” materiality test.
          1. **Remedies:** Enjoin a merger before it happens, COULD unscramble merger but would be extreme, DAMAGES but hard to compute
       5. *Bartz*: D compensation could be material but valuations of stock options are not.
       6. *Lovenheim*: **Rule 14a-8(i)(5)** exclusion doesn’t necessarily apply. OTHERWISE SIGNIFICANTLY RELATED. Social and ethical considerations even though <5% sales.
       7. *AFSCME v. AIG*: Proposals about **procedures** governing elections not exempted.
          1. DGCL §109(a) gives SH power to amend or repeal bylaws (w/o the corp’s consent)
       8. *CA, Inc*: **DGCL §109 v. DGCL §141.** Req’d expense reimbursement for nominations is excludable under Rule 14a-8(i)(2) b/c violates DE Law (DoC) - No Fiduciary-out
       9. *Crane v. Anaconda*: State law right to list b/c TO is business purpose. Wanted SH list to target certain large SH.
       10. *Pillsbury*: Vietnam bombs. No proper purposeto inspect books/records via DGCL §220.
           1. **DGCL §220(c)** shifts the burden between SH lists and other books and records
           2. Burden on Corp. to withhold SH list; burden on SH to demonstrate proper purpose
       11. *Sadler*: AT&T uses Sadler to demand NOBO list. Aftermath: § 1315 was amended, explicitly not requiring corp to deliver NOBO list not currently in its possession.
  1. **SH Voting**
     1. Overview & Rule:
        1. **DGCL §151(a)** (Classes and series of stock; redemption; rights) – every corp can issue one or more classes of stock/one or more series of stock within a class; any or all of the classes may have full, limited, or no voting powers, as shall be stated in AoI or any amendment or BoD resolutions issued pursuant to authority vested by AoI.
        2. **Rule:** Control of corp determined by number of voting shares as laid out in the AoI, unless defined otherwise by statute. (*Stroh*)
     2. *Cases*:
        1. *Stroh v. Blackhawk*: Corp may limit/deny voting rights. Argued that Class B not stock. Illustrates the gen point about disparity btwn voting rights, economic interest (Allowed).
  2. **Closely Held Corps**
     1. Generally:
        1. Overview:
           1. Rule: Voting arrangements can be altered and controlled using stock pooling agreements. (*Ringling Bros-Barnum v. Ringling (DE)*)
           2. Rule: SH agreements can’t limit/affect the power over the administration of internal affairs given to BoD by law (141(a)); election of Os and their compensation is w/in that power. SHs may combine in order to elect Ds. (*McQuade v. Stoneham (NY)*)
           3. Rule: When Ds are the sole SHs of a company, ct will not interfere with an agreement btwn them controlling how they will control corp. (*Clark v. Dodge*)
           4. Rule: Closely-held corps have more leeway with SH agreements if all SHs are involved, there’s no public/creditor injury, no complaining minority interest, and no clearly prohibitory statutory language. (*Galler v. Galler* (IL))
           5. Rule: Pooling agreements may be valid outside close corps. (*Ramos v. Estrada* CA)
        2. DGCL On Close Corps
           1. §342(1): Close corp status can be elected by corps w/ not more than 30 SHs.
           2. §351: AoI of close corp may provide that business of corp shall be managed by SHs rather than BoD. [Compare to §141(a)]
        3. Characteristics of Corp
           1. Limited liability - still good.
           2. Easy transferability - do not necessarily want.
           3. Separation of mngt and ownership - do not necessarily want.
           4. Hard to kill legal personality of corp form - may be bad, close corps hard to liquidate.
        4. Solutions
           1. Contracting: Tools to get around problems include 1) SH voting agreements to elect each other as Ds, 2) elaborate employment agreements, and 3) buy-sell agreements (also known as buyout agreement, governs what happens if co-owner dies, is otherwise forced to leave or chooses to leave corp), 4) other agreements that indicate what happens if stuff goes wrong between people in corp.
           2. Judicial doctrines
           3. Legislative provisions for handling close corps (e.g., easier dissolution statutes)
           4. Different form of organization (e.g. **LLC**)
        5. SH Agreements, Voting Trusts, and Involuntary Dissolution
           1. Agreements are fine: e.g. NYBCL §620; Cal. Corps Code §706(a)
           2. N.Y. Business Corp Law §620; restricting BoD’s power is valid as long as in AoI

620(a): Barnum, SH pooling agreements are ok as long as in writing and signed

620(b): SH agreements restricting directors (Clark/McQuade) are valid if:

Restrictions are specified in the charter

Unanimously approved by corps or ALL of the SHs

Subsequent SHs have notice or give consent

* + - * 1. Voting trust: SH who wish to act in concert turn shares over to trustee, who creates trust and votes shares in a block (useful for family to maintain control when worry about some members of family voting against rest of family - *Ringling*).

Generally must be created according to a statutory procedure that requires a written agreement filed with the corp; can only be for a specified term of less than ten years and that is irrevocable during term

* + - * 1. Dissolution provisions: Provisions for involuntary dissolution by ct order can provide bail-out remedy for SHs who fail to enter into effective control/buy-sell agreements.
      1. *Cases*:
         1. *Ringling Bros*. (DE): **voting agreements aren’t illegal**, can contract anyway you want. Cumulative voting. Haley’s votes weren’t counted.
         2. *McQuade v. Stoneham (NY*): Agreement precluding D from changing Os is illegal – but see *Clark*; amended NYBCL. NY Giants Baseball team. McQuade is magistrate.
         3. *Clark v. Dodge (NY*): upholding voting agreement whereby O is to be kept in position. Manager of drug company. Disclosed secret formula.

NY changed statute **(NY BCL §620)** 🡪 restricting board’s power is valid as long as in AoI.

* + - * 1. *Galler v. Galler (Ill)*: Galler equal Ds. Wife of one sues post death. Dividends mandatory of $50k with covenant of $500k surplus. Salary continuation upheld b/c of 1) **no apparent public injury**, 2) **absence of complaining minority interest**, and 3) **no apparent prejudice to creditors**.
        2. *Ramos v. Estrada (Cal. App. 1992)*: Spanish language TV deal vote pooling arrangements regarding elections of Ds aren’t illegal under CA law. Agreement is specifically enforceable; **CCC** **§709(c)** expressly permits specific enforcement.

Statutory provision: cts can grant equitable remedies under §709(c) (includes recission, reformation, specific performance)

* + 1. Abuse of Control (Freeze-outs) in Close Corps:
       1. Overview
          1. Rule: SHs in close corp owe **similar FDs as partners**, which is utmost good faith and loyalty. Two part test: (1) Removing min SHs of position and salary can only be done with a legitimate business purpose. (2) Then the π can argue there was a better alternative less harmful to the π’s interests. (*Wilkes v. Springside Nursing Home MA; Donahue v. Rodd Electrotype Co (MA)*)
          2. Rule: Employment will not be protected where the SH status is subservient to the employment, such as with an express buy-sell agreement providing for sale-back at termination of employment. (*Ingle v. Glamore Motor Sales NY*)
          3. Rule: Remedy for unreasonable freeze-out of min SHs, look for what their reasonable expectations were and try to restore those, but don’t give them more than deserved. (*Brodie v. Jordan, MA*)
          4. Rule: Min SHs can have FDs, depending on their degree of power (effective veto). (*Smith v. Atlantic Properties, MA*)
          5. Rule: Controlling SHs may have a duty to disclose relevant facts to other SHs when they might make a material difference in their decision. (*Jordan v. Duff and Phelps*)
       2. *Cases*:
          1. *Wilkes v. Springside Nursing Home* (MA): SHs in close corp. have same duties to one another as partners. Home sold property to Quinn, Wilkes made him pay higher price. Wilkes cut out from distribution. **Duty of utmost good faith and loyalty**. **Two step approach:**

Maj SH must show legitimate business purpose for action.

If they do this, min SH can then try to show that the legitimate business purpose could have been achieved by a less harmful (to π) alternative course of action.

* + - * 1. *Donahue v. Rodd Electrotype* (MA): SHs in close corps owe each other substantially the **same FDS that partners owe**. Repo situation. Maj SHs refused to allow min SHs equal opportunity to sell a ratable number of shares to corp at the same price
        2. *Ingle v. Glamore Motor Sales, Inc. (NY*): Ingle terminated and Glamore bought shares under option “cease to be employee”. **Employment at-will upheld.** Distinguish duty to SH and duty to employ.

W/ Wikes, fundamental doctrinal clash between employment-at-will doctrine and partner-like rights of minority SHs in close corps.

* + - * 1. *Brodie v. Jordan (MA 2006)*: **Remedy in freeze out.** Wife of deceased partner excluded from mngt. Remedy cannot put her in better position (i.e. create a market where one did not exist). Maybe just dividends? (case settles – buyout)

Scale of severity: dividend 🡪 buyouts 🡪 dissolution(as in pship law)

* + - * 1. *Smith v. Atlantic Properties (MA)*: breach of duty by min SH with ad hoc controlling interest (4 SHs, 80% voted needed to make changes). Tax concerns, reinvestment into property rather than dividend. Effective veto created FD.
        2. *Jordan v. Duff and Phelps (7th Cir)*: Easterbrook/Posner opinion. Jordan leaving, corp advises him to stay another 6 weeks to get a better value for shares. Didn’t tell him about a huge merger. 10 days after he left, corp announced merger; shares rose 20x π received. Deal falls through, but another deal comes for 80% of original deal.

π: Corp’s failure to tell him is 10b-5 omission and breach of SHs’ DOL to him.

Easterbrook (holding) Correct. **Under basic K law, SHs are not allowed to take opportunistic advantage of each other (reasonable expectations).** This is supported either under the 10b-5 duty (for large public corps) OR under the FD of loyalty of SHs to each other (for close corps). Remedy: Remand for causation finding (i.e. would he have left if he’d known?).

Posner (dissent): π was just a employee-at-will, so “SH-at-will”, and the corp could have fired him whenever they wanted, so they didn’t owe him a duty.

* + 1. Statutory Dissolution, Control, Duration:
       1. Overview
          1. Statutory standards allowing cts to order dissolution of close corps have over time gotten more liberal (more favorable for min SHs seeking dissolution):

AK "oppressive" standard: Dissolution can be ordered when acts of Ds are illegal, fraudulent, or oppressive or corp assets are being wasted (*Alaska Plastics*)

MN "unfairly prejudicial"/"reasonable expectations": Judicial dissolution upon 1) finding of deadlock among Ds/SHs, 2) waste of assets, or 3) finding that those in control have acted fraudulently, illegally, or in a manner unfairly prejudicial to one or more SHs. In fashioning remedies (equitable relief, dissolution, or a buy-out), ct shall consider reasonable expectations of close corp SHs (*Pedro*).

CA: CCC §1805(b)(5): Provides for the involuntary dissolution of a close corp (35 or fewer SHs) when liquidation is "reasonably necessary for the protection of the rights or interests" of the complaining SHs (*Stuparich*).

DE Ltd Liability Company Act §18-802: Permitting the ct to decree dissolution of an LLC "whenever not reasonably practicable to carry on the bus" (*Haley*).

Reminiscent of UPA §32(1)(d) (ct shall decree dissolution when P conducts himself in manner such that business isn’t reasonably practicable to carry on) and RUPA §801(5)(iii) (dissolution upon judicial determination that it is not reasonably practicable to carry on pship).

* + - 1. Overview of Approaches in Close Corps
         1. Stage 1: K law can be adjusted to deal with close corps (e.g. pooling agreements)
         2. Stage 2: General FD concepts for close corps
         3. Stage 3: Legislative responses and how they play out in disputes 🡪 particularly dissolution statutes, evolution:

Started with fraud or oppression

Easier: concerned with prejudicial conduct

Easier: no need to show bad conduct, reasonable expectations

Adjusted the statutes to meet the needs of close corps

* + - * 1. Stage 4: New form of business organization: LIMITED LIABILITY COMPANIES
      1. Framework: **Four things to pay attention to in statutory dissolution**:
         1. Role of the parties' reasonable expectations as illuminated by prior practice. Does ct pay attention to it?
         2. Remedies. Can ct order a buyout as a less disruptive solution? Is it authorized by statute or is it based on generally equitable powers? Aggressive?
         3. Is dissolution statute restricted in any way to close corps? An aspect of it? Eg buyout
         4. How do the statutes interact with contractual rights? Can the parties opt out of the statutory life and be held to an alternative method? How explicit does it have to be (*Haley*)?
      2. *Cases*:
         1. *Alaska Plastics, Inc. v. Coppock (AK)*: Ex-wife and SH cut out of operations and gets no money. If oppressive conduct, ct can order a buy-out. TRIGGER: Illegal, oppressive, or fraudulent acts by controlling persons or Waste of corporate assets. REMEDY: Dissolution, or equitable authority to order buyout remedy
         2. *Pedro v. Pedro (MN)*: 3 bros own corp; two brothers stealing from it, 3d gets upset, they fire him. Breach of FD and employment K. TRIGGER: unfairly prejudicial. REMEDY: ct may order alternative remedy of buyout at fair value
         3. *Stuparich v. Harbor Furniture Mfg. (CA)*: Closely held family corp, bro dominated, 2 sisters had different ideas, want dissolution. Furniture and Trailer Homes. No dissolution. Their interests adequately taken care of b/c of large dividends. TRIGGER: reasonably necessary for the protection of the rights or interests.
         4. *Haley v. Talcott (DE)*: Redfin Grill, 2 owners w/ 50% split. Talcott could maintain status quo to his advantage. LLC like Partnership. Default rule that ct can order dissolution. Manager outbids for $3.2m. Buyout agreement would have given $1.5m.
    1. Transfer of Control:
       1. Overview:
          1. Conventional STATE LAW Doctrine: Generally ok for controlling SH to sell just their control block for a premium (control premium), unless the sale (1) is to a known looter, (2) diverts a corp opportunity, (3) is fraudulent, (4) or may involve other misconduct. (*Zetlin v. Hanson Holdings*)
          2. Some exceptions: if the control premium actually represents a corp opportunity do to special conditions in the market (such as a scarcity of steel during the Korean War) (*Perlman v. Feldman 2d Cir*)
          3. A uniform equal opportunity rule (whereby premium would have to be shared with min SHs) is common in other markets (U.S. is an exception).
          4. “Naked” sales of office are not legitimate b/c it conflicts with the officeholders FDs. However, if buyer purchases effective control block (even if less than 50%), then might be ok to promise to deliver immediate control of BoD (just hurries it up). (*Essex Universal v. Yates 2d Cir*)
          5. Take-me-along rights: Cts hold rights of first refusal narrowly in order to discourage SHs from bringing those suits. (*Frandsen v. Jensen-Sundquist Agency 7th Cir*)
          6. Types of Contractual Restrictions on transfer:

Flat prohibition (likely not valid);

Prior approval of SH: Stock transfers subject to consent of BoD or other SHs

First refusal: SH may not sell to outsider w/o first offering Corp/other SH right to buy at same price and terms.

First-purchase option: Like first refusal, but price predetermined by op agreement

Stock buy-back: Corp allowed to buy back holder’s shares on occurrence of certain events whether holder wants to sell or not, but corp not obligated to do so

Mandatory buy-sell: Like buy-back, but Corp obligated to go through w/ purchase (B-S can also be the naming of a price and the other party can then chose to buy or sell at that price – encourages fair price)

* + - 1. *Cases*:
         1. *Perlman v. Feldmann* (2d Cir): Exceptions - taking of corp opportunity. Korean steel, companies wanted to control allocation. Must share premium with all SH.
         2. *Essex Universal Corp v. Yates* (2d Cir.): Replacement of BoD in one swoop rather than waiting 3 cycles. Naked sale of BoD would not be allowed, but control is allowed to attach BoD seats. Friendly says should limit to 50%. Block was 23%.
         3. *Zetlin v. Hanson Holdings, Inc.* (NY): No general rule that you have to share premium with min SHs unless there is one of these exceptions (above) “Other misconduct” includes seller switching type of deal: If buyer offers to buy outright and seller talks him into just buying control block at premium, Ct may take away seller’s premium, sometimes goes to corp, sometimes pro rata to minority SHs.
         4. *Frandsen v. Jensen-Sundquist Agency* (7th Cir): J-S was owned by a maj Block, Frandsen, and others. Its main asset was First Bank of Grantsburg. Frandsen had a right of first refusal on any sale of maj Block’s J-S stock. First Bank of Wisconsin wanted to buy FBG, but they do it by buying J-S stock b/c Frandsen would buy it instead. So J-S decides to just sell its FBG stock to FBW, and then to liquidate J-S. Frandsen complains that this is exactly like just selling the control group of J-S stock so his right of first refusal still applies.

Held (Posner): This is ok. Frandsen’s *reasonable expectations under K* were he couldn’t get pushed around by different control group inside JS wasn’t frustrated.

R 145, exchange of shares in merg can be seen as sale of current shares, purchase of new shares, suggesting right of first refusal would have been triggered.

Form v. Substance Debate (Posner looks at substance).

1. **Mergers, Acquisitions and Takeovers**
   1. **Overview**
      1. M&A Judicial Standards in DE: 7 Standards
         1. **BJR, sometimes** [Consider relation to DoC; *Van Gorkom*] (in order to attack, π would need to show defect of process (e.g. deliberation/info-gathering) or irrationality - understood as waste)
            1. Never for end-of-life transactions
         2. **Inequitable action/motivation constraint** (*Schnell v. Chris-Craft*, numerous other cases). Cf. "bad faith" cases (cts can look at motives, intervene w/ something that's technically legal but sketchy – Board mtg in northern most city in AK)
         3. **Unocal/Unitrin:** *Enhanced* judicial scrutiny of defensive measures, includes scrutiny of deal protections in negotiated deals - 2-prong test
            1. Finding of threat;
            2. Proportionate response - is it within "range of reasonableness"
         4. **Revlon:** Best deal duty in *Revlon* mode (stricter test than Unocal, still enhance scrutiny)
         5. **Compelling justification** test for vote-thwarting defenses (*Blasius, Stroud v. Grace*)
         6. **No impermissible restrictions** of BoD authority and FD (*Quickturn, Omnicare*)
            1. Mechanisms (e.g., no hand poison pills) can’t interfere with BoD’s FD to corp and SHs to discharge mandate of §141(a) (to manage corp), and any provision that requires BoD to act in manner that limits its exercise of FDs is unenforceable (BoD can’t disable itself – must have fiduciary out).
         7. **Entire fairness test in freeze-out mergers** (*Weinberger* and more recent cases)
      2. Reasons for Acquisition
         1. Increase economic value: generate efficiencies (synergies), eliminate common costs, produce economies of scale.
         2. Take advantage of undervalued stock
         3. Combine to suppress competition (possible antitrust problems)
         4. Empire building
         5. Tax considerations: use losses to offset other income.
      3. Overview of Merger Techniques
         1. Substantial sale of assets plus liquidation: Acquiring corp (A) buys all the assets of target corp (T) for cash, T then liquidates, using the cash to buy out SHs. A usually doesn’t inherit unforeseen liabilities as it would under a statutory merger.
            1. SH vote: States vary (DE: yes for sale all/substantially all)
            2. Appraisal Rights: States vary (DE: no appraisal in liquidation) (PA does in sale)
            3. A Corp: SH vote is not triggered for A b/c the corp is just buying assets. There is no need to worry about proxy statement rules or SA/SEA registration statement rules.
            4. DE Approach:

Sale of Assets: DGCL §27: Need SH vote to sell **all/substantially all** of the assets (§271a) but not if assets sold to sub (§271c)

Notwithstanding authorization or consent to a sale, BoD can abandon proposed sale w/o further action by SHs (§271(b)).

Liquidation: DGCL §275: BoD maj can adopt resolution for dissolution; after adopted, SH meeting is held, if **maj of outstanding SHs** approve, dissolution occurs (BoD resolution + SH vote). Dissolution can also be authorized w/o consent of BoD if all SHs entitled to vote consent in writing §275(b)

* + - * 1. Federal Law

Fed law for **sale + liquidation**: NB when asking for a SH vote for a registered corp (under SEA), proxy statement rules apply (e.g., §14, Rules 14a-1 to 14a-12).

* + - 1. Statutory merger (or consolidation):Combination accomplished by using procedure prescribed in state corp laws. Approval by votes of BoDs and SHs of both Corps is req’d (But see exceptions below). Fed securities law proxy statement requirements (**SEA**) apply on both sides, and if the surviving corp issues new shares, it must comply w/ **SA** registration statement rules
         1. Other mergers that can work like Statutory merger:

***Stock Swap*:** A buys stock in T w/ stock. (Don’t have to sell, but if BoD + maj of SH can enact “plan of exchange” req’ing exchange, works like statutory merger)

* + - * 1. **Voting Rights:** Both SHs (maj of outstanding voting shares) and BoD
        2. **Appraisal Rights:** In DE, SHs of each corp who voted against merger would have appraisal right (see DGCL §262) subject to the §262(b) exceptions
        3. **Disclosure Req**: issuance of stock in merger is a sale under **SA** R145, req prospectus
        4. DE Approach:

**Statutory Merger:** **DGCL §251** (Merger or consolidation of domestic Corps): Any two or more Corps existing under the law of the state can merge into a single corp, which may be one of the existing Corps or a new corp (§251(a)). The BoDs must adopt a resolution approving a merger agreement (§251(b)) and submit the resolution to SHs at a meeting – a maj of SHs must approve (**§251(c)**). Any merger agreement *may* contain a provision that the agreement may be terminated by BoD at any time before it has become effective, notwithstanding the consent of SHs (§251(d)).

Two Steps: BoDs vote on approval and recommendation, submit to SHs.

**Exceptions**: No vote of SHs of a *acquiring*/*surviving corp* is req’d if 1) agreement doesn’t amend AoI, 2) each share of stock before and after the merger is identical, and 3) either no shares of stock are issued under the merger or those that are authorized to be issued (or converted) do not exceed 20% of shares of common stock outstanding prior to the merger. (§251(f))

Appraisal Rights DGCL §262(a): SHs have appraisal right (The right to have a court *determine* the value of SH’s shares) ***If***

Submitted written demand for appraisal **before vote** on merger

Continuously hold shares through effective date of merger (or consolidation)

Didn’t vote in favor of merger

***Then***: Entitled to fair value of shares (determined by considering all relevant factors), w/ interest, exclusive of any element of value arising from accomplishment/expectation of merger (§262(h))

Ct may equitably shift fees ((§262(j))

Ct shall direct payment for this fair value (with interest) by the surviving or resulting corp to the entitled SH (§262(i))

**Exception** (DGCL §262(b)(1)): No app right if stock at record date was listed on nat’l securities exchange or held by 2k+ SHs, BUT (b)(2), appraisal rights shall be available if not paid in stock

* + - * 1. Proxy and Registration

Both sets of SHs will need to be issued proxy statements

SA problem - new registration statement for the newly issued shares. Have to make a registration statement whenever making a public offer or sale

Exchange of stock in a merger is treated as buying new shares **Rule 145**.

* + - 1. Stock purchases: Corp A offers to buy shares of Corp B for cash or Corp A stock. Doesn’t need to get votes of Corp B’s BoD or SHs and there wouldn’t be appraisal rights b/c Corp A is dealing with the individual SHs of Corp B. Once Corp A gained sufficient control (usually 90%), it could use a “short-form merger” to merge Corp B in to Corp A (see **DGCL §253**, allowing short-form merger when corp owns at least 90% of each class of outstanding voting shares of another corp and one of the corps is incorporated in DE)

|  |  |  |
| --- | --- | --- |
| **Summary of Sale v. Merger:** | **Sale (for cash)** | **Merger (for stock)** |
| 1)T’s SHs’ investment | Terminated | Continued, though changed |
| 2) A’s consideration given | Replaces assets | Extends assets |
| 3) A’s SHs’ investment and voting rights | Smaller impact | Larger impact |
| 4) Target: | Corp life may end (eg on liquidation) | Corp life does end |
| 5) Mngt | Dual -> unitary | Dual -> unitary |
| 6) Technical: inclusion of assets and liabilities in the transfer | Piecemeal, by affirmative acts | Global (corp gets assets and liabilities), by operation of statute |
| **Consequences** |  |  |
| Tax (cf. diff # 1, cont. of interest?) | Taxable “sale” – SH pay tax | Tax-**deferred** “reorganization” |
| Accounting treatment (cf. diff #2) | Purchase accounting | Purchase accounting (formerly “pooling”) |
| Antitrust (cf. similarity #5) | Anticompetitive? | Anticompetitive? |
| Securities Regulations | Proxy statement by T (**SEA**) | 1) Proxy statements by both corps (**SEA**)  2) Registration statement from A issuing stock (**SA**) |
| Bus. Corp. Statutes (Del.) | T’s SHs: vote, no appraisal  A’s SHs: no vote (thus, no appraisal) | T’s SHs: Vote, appraisal  A’s SHs: Vote, appraisal  In both, appraisal is subject to DGCL §262(b) exceptions. |

* + - 1. Subsidiary Merger: acquiring corp forms new sub and Target (T) merges into sub. Reasons for sub merger include 1) avoiding having to get the vote of acquiring corp SHs (only the BoD needs to approve), 2) while getting the technical efficiencies of a merger (Vs. buying from T SHs, easier to deal with hold-outs; Vs. corp-level sale/purchase deal: all assets automatically transfer) and 3) keeps the liabilities of T in a separate corp entity.
         1. Can do “reverse sub merger” where sub merges into T and makes T a sub. Same advantages as normal sub merger + extinguishes min SHs and preserves T as an entity (better preserving K’s and tax advantages).
    1. Appraisal Rights:
       1. **Procedure:** Before voting on merger, SH tells corp. he wants appraisal. Corp tells SH if merger goes through, then SH must demand appraisal w/in 20 days (**§262(d)**).
          1. If unpaid 120 days post-merger, petition Ct of Chancery for appraisal
          2. Ct determines “Fair value” excluding any element of value arising from merger/consolidation, considering relevant factors

Ct can award interest, equitably shift fees, SH waiting can’t vote/get dividends

* 1. **De Facto Merger Doctrine**
     1. Rule: Acquisition of assets that seem too close to mergers may be found to be de facto mergers and require appraisal rights. (*Farris v. Glen Alden*)
     2. Rule: No de facto mergers in DE. Transactions determined by form. (*Hariton v. Arco Elec.*)
     3. *Cases*:
        1. *Farris v. Glen Alden (PA)*: **Substance of deal over form.** Minnow (GA) swallowing whale (List) in order to avoid appraisal rights. Completely changed composition of corp
           1. DE law req’d approval of List SH but didn’t give them appraisal rights; under PA law, however, GA SHs would’ve had appraisal rights
           2. Aftermath**:** PA leg. modified law to defeat de facto merger
        2. *Hariton v. Arco Elec* (DE): No de facto merger doctrine. Statutes are of “**equal dignity**”.
           1. Under §271 (sale) and §275 (liquidation): No appraisal rights
           2. Under §251 (merger): Appraisal rights
     4. De facto non-merger doctrine: Cash-out mergers are not the same as preferred stock redemptions in DE, so merger can happen w/o req’ing redemption. (*Rauch v. RCA*)
        1. Conversion of shares to cash (per DGCL §251) is legally distinct from redemption (DGCL §151(b) (enabling corp to make any class of stock subject to redemption) and DGCL §160(a) (enabling corp to redeem shares that it has authority to)).
        2. Action taken under one § is legally independent of the reqs of another. **Equal dignity.**
  2. **Freeze-Out Mergers**
     1. Definition: A corp acquires a maj voting position and effects a merger whereby the min SHs lose their stock for some consideration (if cash, merger is a cash-out merger)
     2. Standard of Review**:**  ***ENTIRE FAIRNESS***, Enhanced Scrutiny, two-part analysis
        1. Fair dealing: includes the timing of transaction (*Rabkin*), how it was initiated, structured, negotiated, disclosed to Ds, and how approval of Ds and SH was obtained (*Weinberger*)
           1. Includes “**complete candor**”: maj must show (even when the burden has shifted entirely to π) that it has completely disclosed all material facts.
        2. Fair price: ct will look to economic/financial considerations of merger, esp. all relevant factors (assets, market value, earnings, future prospects, anything else affecting value)
     3. Burdens of Production and Proof:
        1. ***π*** must first “allege specific acts of fraud, misrepresentation, or other misconduct” indicating unfairness and demonstrate “some basis for invoking the fairness obligation”
        2. Maj SH (and BoD) has burden to show entire fairness
        3. *Burden can shift to the* ***π*** IF merger was approved by
           1. an ”informed vote of a maj of min” (MoM) SHs as long as maj SHs does not “dictate” the terms of merger; OR

Clark: In practice, not just fully informed, also uncoerced (whatever that means)

* + - * 1. An Independent committee (IC) w/ “real bargaining power that it can exercise w/ maj SHs on an arms’ length basis”;
        2. **BUT** standard remains entire fairness (π must show deal was unfair) (*Kahn v. Lynch*)
        3. Differs from the case of interested D transactions, where an IC or SH vote shifts the burden and changes the standard to the BJR
      1. ∆ retains the burden of proof to show fully informed/fully disclosed
      2. *Kahn v. Tremont* (DE): Entire fairness even when IC used b/c “the underlying factors which raise the **specter of impropriety** can never be completely eradicated and still require careful judicial scrutiny”
      3. *Kahn v. M&F Worldwide* (DE): Burden shifted and BJR restored if and only if:
         1. Controlling SHs **condition** merger on the approval of both an IC and MoM SHs;
         2. IC is empowered to freely select its own advisors and to say no definitively;
         3. IC meets its DoC in negotiating a fair price (procedural);
         4. MoM is informed; AND
         5. MoM SHs not coerced.
    1. Remedies:
       1. Typical: for cash-out mergers, limited to appraisal under DGCL §262. The appraisal should be conducted in a liberalized fashion that takes into account “all relevant factors” (DGCL §262(h)) and includes proof of value by any technique considered acceptable in the financial community. (*Weinberger*)
       2. Other Remedies: appraisal is not the only remedy and may not be adequate in cases of 1) fraud, 2) misrepresentation, 3) self-dealing, 4) deliberate waste of corp assets, or 5) gross and palpable overreaching. In these cases, ct has right to look to any form of appropriate equitable and monetary relief. **π may want to enjoin agreement or rescind it after.**
    2. Planning (after *Weinberger*):
       1. Have controlling SH form IC (w/ real authority, bargaining power), 2) IC should hire new ind investment bankers to do valuation and hire ind counsel, 3) IC should take time and really negotiate for a better price, 4) promote full disclosure to min SHs, and 5) un-waivably condition the merger on approval by IC and MoM. (Get the BJR from MFW!)
    3. *Cases*:
       1. *Weinberger v. UOP, Inc. (DE)*: Entire fairness standard (fair dealing, fair price). Burden always on ∆ to show full disclosure. Signal owned maj of UOP. Feasibility study revealing $24/s; accepted $21/s. NO BURDEN SHIFT from MoM approval b/c not fully informed. No longer business purpose dies.
          1. Fair Price: no more “DE Block”. Adopts new financial valuation methods (above)
       2. *Coggins v. NE Patriots* (MA): MA Embraces **business purpose test**. Coggins was SH of Patriots and didn’t want to be pushed out. Sullivan wanted to use Corp for personal loan obligations. EF standard. Burden on maj SH. Recission damgs based on present value.
       3. *Rabkin v. Hunt Chemical* (DE): Timing of buyout to avoid 1-year price provision. **Remedies beyond appraisal.** Bad faith covered by EF standard?
  1. **Takeovers**
     1. Overview:
        1. **Types of Defensive Measures**: (i) Exclusionary self-TO (*Unocal*; now forbidden by SEC Rule 13e-4(f)(8)), (ii) PP (SH rights) plan (as in *Moran*), (iii) Asset lock-up (corp agrees to sell off big division at below-market price in the event of trigger) (as in *Revlon*), (iv) share lock-up (if stock is traded on NYSE, SHs must approve lock up of more than 20% of shares) (as in *QVC*), (v) large termination fee (as in *Revlon*), (vi) K preventing removal of existing defensive measures (*QVC*); (vii) greenmail (*Cheff v. Mathes*).
        2. **Poison Pill** (PP): Attaches right to shares. SH right to purchase new shares of stock becomes exercisable at a distribution event (typically acquisition/announcement of intent to acquire specified percentage of issuer's stock by outsider). Elements of a PP include:
           1. Flip-in Element: Triggered typically by actual acquisition of specified percentage of stock, entitling the holder of each right to buy two shares of stock at half price; this causes massive dilution to T stock.
           2. Flip-over Element: Triggered when T is merged into A, entitling holder to purchase common stock of A at half-price (again causing dilution).
           3. Redemption Provision: BoD usually can redeem rights at nominal price any time before it is exercised; this right coupled with the fact that pill remains active even if a maj of SHs approve transaction gives BoD leverage to bring A to bargaining table.
           4. Generally fine as long as redeemable (*Moran*)
        3. **Impermissible Poison Pills**:
           1. “Dead-hand” PP: Can be redeemed only by Ds who were in office when PP became exercisable. Thus, A won’t be able to get around PP by conducting proxy contest to elect new BoD. [Struck down in *Carmody* in part b/c it disenfranchised SHs.]
           2. “No-hand” PP: For six months, prevented all members of newly elected T BoD, whose maj is nominated/supported by A, from redeeming PP to facilitate acquisition. [Struck down in *Quickturn*, interfered w/ BoD’s FD to discharge §141(a) mandate.]
     2. Williams Act:
        1. Set of amendments to SEA, regulates stock purchases that affect corp control; it applies to companies whose securities are registered under §12.

|  |  |  |
| --- | --- | --- |
| **Section** | **Rule** | |
| 13(d) | Disclosures by 5 %+ owners (“persons” or group for same purpose) to SEC, corp, exchange on which traded w/in 10 days; also identity and source of funds and any bus purpose. (Schedule 13D) | |
| 13(e) | Takes SEC rules and regs that apply to TOs and applies them to **Issuer repurchases** (self-TOs) | |
| 14(d) | Disclosures req’d of tender offerors (Schedule TO – §13d info + terms of offer, intentions, etc) | |
| 14(e) | **General antifraud rule** (R14e-3; cf 10b-5 and 14a-9), it is unlawful for a person to make an MMO or engage in any fraudulent, deceptive, or manipulative acts in connection with any TO. | |
| **“Traffic rules” and fair treatment of SHs** | | |
| 14(d)(5) | Withdrawal rights (for tendered shares – seller can buy them back while offer is open, R14d-7) | |
| 14(d)(6) | Pro rata (in buying shares submitted) rule (**R14d-8** – while offer open, no first come first serve) | |
| 14(d)(7) | Best price rule (all tenders get it, include those previously purchased, R14d-10) | |
| R14d-10 | Equal Treatment rule: TO must be open to all security holders in class + Best Price Rule -14(d)(7) | |
| R14e-1 | Unlawful tender practices; Minimum offer period (20 **bus** days, 10 more if price raised). | |
| R14e-3 | **General Anti-fraud rule**: fraudulent, deceptive, manipulative to trade on material non-public info “in connection with TO of reg. securities received from the **offeror**, **T corp**, or **employee** | |
| R14e-5 | Bidder cannot buy “outside” tender offer | |
| **Issuer Rules** | | |
| R13e-4 | | Generally regulates self-TOs in the same manner as third-party TOs. (e.g. R13e-4(f)(8) – issuers who make a self-TO must make the offer available to all SHs |
| R13e-1 | | Exception: issuer may purchase outside of offer – must file a statement w/ SEC |
| DGCL§160(a) | | Every corp can purchase, redeem, receive, take … and otherwise deal in and with its own shares. |

* + 1. Greenmail
       1. Definition: Buying out a potential acquirer (pay not to takeover); not effective and subject to 50% IRS penalty tax.
       2. BoDs have broad powers to repurchase their own stock (DGCL § 160(a)), and there is no req of equal or pro rata treatment among SHs. However, when a corp offers a greenmail premium to re-acquire shares owned by a hostile bidder, certain duties arise b/c of CoI in the fact that BoD may be acting to preserve control rather than to protect corp.
       3. *Cheff v. Mathes* (DE): Corp can purchase own stock in defense against hostile takeover but only if BoD has a **sincere belief that the buyout was necessary to maintain proper business practices.** (Facts: Maremont looked to buy Holland Furnace to change business practice. HF thought threat of liquid and model, and employees were leaving out of fear)
       4. Burden**:** On BoD b/c intrinsic CoI of using corp funds for personal gain
       5. Test: 1) reasonable grounds for believing the takeover to be a threat (good faith and reasonable investigation), and 2) that primary purpose was NOT retention of control (i.e. need business purpose); THEN:
       6. SoR: BJR for using corp funds to repurchase (as long as no personal / pecuniary interest)
       7. Aftermath: Greenmail is not frequently used now, b/c (i) there is a 50% tax on greenmail profits (IRC § 5881) and (ii) there are many better defenses available.
    2. *Unocal*: Takeover Defense Two Prong Test
       1. Standard of Review: Conditional BJR, b/c “**Omnipresent specter that a BoD may be acting primarily in its own interests**.” If not satisfied, defenses invalidated.
          1. No automatic BJR, concern about entrenchment/CoI in maintaining mngt position.
       2. Burden**:** initially on BoD to meet Unocal (enhanced scrutiny) two prong test
          1. If Ds successful, burden shifts to π to rebut BJR (likely game over).

If π (somehow) rebuts BJR, burden shifts back and SoR is entire fairness.

* + - * 1. If Ds **NOT** successful, defenses invalidated (actually EF but effective invalidation).
      1. *Unocal* Test: defensive responses to **unwanted takeover attempts (is this an attempt?)**
         1. Step #1 Authority: Did BoD have authority to adopt defenses? (Look to AoI, bylaws, statute, etc.)
         2. Step #2 THREAT: Does BoD have reasonable grounds to believe that the takeover attempt threatens corp policy and effectiveness? Cts reluctant to fault for honest mistakes (*Cheff*) so show…

**Show good faith and reasonable investigation**

Reasonable Invest: Meet to discuss offer, show sound procedure (see *Time*)

Good Faith: proof of GF and RI are **materially enhanced** if maj of BoD are outside Ds and ***even better* if IC formed** and it presents decision to full BoD.

Threats to Corp policy/effect: (*Mentor Graphics*- three basic categori threats)

**Opportunity Loss**: Hostile offer might deprive T SHs of opportunity to select superior alternative offered by T mngt/other bidder

Changes bus model/threat to preexisting strate/long term plan (*Time*)

Impact on non-SH constituencies (*Cheff* - employee unrest)

Offer from known raider (*Unocal* – Pickens, nat’l rep as liquidator)

Timing of TO following T’s proxy notice designed to upset/confuse SHs

**Structural Coercion**: Risk that disparate treatment of non-tendering SHs might distort SHs’ tender decisions

*Unocal*- ct assumes coercion when **two-tiered front end-loaded TO**: Sell no or freeze-out!

**Substantive Coercion**: Risk that SHs will mistakenly accept underpriced offer b/c they disbelieve mngt’s representations of intrinsic value.

*Time*- **broad conception of threat** includes compromising planned merger

Quality of consideration offered (*Unocal* -junk bonds w/same face value)

Ds’/Os’ loss of corp office is not a threat but mixed motives are fine if ***primary purpose*** is permissible (*Cheff*)

* + - * 1. Step #3 REASONABLENESS: Is the defense proportional to the threat posed?

Response cannot be **Draconian** (i.e., Preclusive or Coercive) *Unitrin*

P**reclusive**: Can’t deprive SHs of right to all TOs or preclude bidders from seeking ctrl by fundamentally restricting proxy contests/otherwise (*Unitrin*)

Adopting staggered BoD can be preclusive (takeovers take **a long time**)

Essentially anything that prevents/prematurely terminates a bidding-war

C**oercive**: Anything essentially forces SH to take a mngt-sponsored alternative to a hostile offer (cram mngt alternative down SHs’ throats)

Dead-hand Pills: Forces SH to re-elect incumbent Ds (*Carmody*)

Extreme cancellation fees or share or asset lock-ups, etc.

BoD has discretion to chose defensive measures from among alternatives that are w/in the “range of reasonableness” (*Unitrin* quoting QVC)

**Fiduciary outs in ALL defenses** that could circumscribe D’s FDs. (*Omnicare*)

Defenses are considered together when determining proportionality (*Unitrin*)

* + - * 1. **Must have power and authority to use that defense (both statute and charter)**
      1. Application: Boone Pickens (Mesa). Offered a two-tiered “front loaded” cash TO for Unocal, seeking to buy 37% of Unocal shares at $54 and would then buy the remaining shares in exchange for securities (junk bonds). Self-TO to battle (but would exclude Pickens from TO). Would buy 49% if Mesa hit trigger. Plan satisfied both prongs.
      2. Aftermath**:** SEC prohibited selective issuer TOs (Rule 13e-4(f)(8)) PPs are still allowed.
      3. ***Omnicare v. NCS Healthcare*** (DE): Must have fiduciary out (even negotiated mergers).
         1. Unocal Claim – Maj: Deal protections (even in friendly deals) must meet Unocal.
         2. Fiduciary Claim – Board is req’d to have a fiduciary out (p. 818-19)

Cannot tie your hands and lock up a deal to prevent carrying out duties

Clark: Corps ALWAYS ties their hands, however.

* + - * 1. Facts: Genesis v. Omnicare in bidding war for NCS. Genesis deal was ABSOLUTE lock up b/c of 1) §251(c) provision (NCS will submit G deal to SH vote even if NCS BoD withdraws recommendation) and 2) ***SH Voting Agreement*** with controlling SHs
    1. Blasius Test: **Compelling Justification** SoR for Vote-Thwarting Defenses
       1. **Issue of control**: BoD takes action that purposefully disenfranchises SHs, changes power relationship between BoD and SHs
          1. Institutes staggered BoD, w/ high % SH vote to change (*Hilton Hotels*- 80% vote)
          2. Increases number of Ds
          3. Ct will look at circumstantial evidence, such as:

Timing: avoid SH vote, avoid takeover

Entrenchment: same Ds involved, get more power

Stated Purpose of BoD: No credible justification

Benefits of BoD Plan: even if some benefits, may not be OK

Effect of Action: Precluded from electing maj of Ds

Failure to Obtain IRS Opinion on effects of plan

* + - 1. **Prohibited unless** “**compelling justification**” (not just reasonable instead of rational, or enhanced scrutiny, but more!)
      2. **Policy**: SH only have two protections: sell stock or replace incumbent BoD
      3. *Blasius v. Atlas* (DE): adopted in *Stroud v. Grace*
         1. BoD action intended to thwart free exercise of SH franchise must satisfy heavy burden of demonstrating “compelling justification.” Even if action is normally permissible and adopted in good faith and with proper care, BoD can’t undertake such action if primary purpose is to disenfranchise SHs in light of proxy contest.
      4. *Hilton Hotels v. ITT (NV)*: Putting casinos in sub to change governance, stagger BoDs. Unocal & Blasius apply
    1. *Revlon*: Duty To Maximize Near-Term SH Value
       1. Standard of Review: Enhanced Judicial Scrutiny
       2. Claim:Breach of duty to maximize SH value in the short term (Essentially DoL?).
          1. Must consider the SHs and may only think of other constituencies provided that there are rationally related benefits to SHs. CANNOT PLAY FAVORITES.
       3. **Test**: The “**role of the BoD shifts from defending the corp bastion to seeking the best short-term value reasonably available to SHs**” when actively trying to sell the corp, *regardless of the interests of* ***non-SH constituencies***. TRIGGERS:
          1. **Embarks on a Sale of Corp**: Not triggered just b/c corp “in play”, only when corp “***embarks*** on a transaction – on its own initiative or in response to an unsolicited offer – that will result in ***a change of control*** (CoC).” (*Lyondell*)

Breakups/reorganization are CoC: Corp can survive break-up *Revlon*

Change of Control: No change of control if ownership goes from no controlling SH to same (“fluid aggregation of SHs”). *QVC* distinguishes *Time* on this.

End of Corp Life: **REMEMBER** last chance for SHs get a control premium!

Rationale: SHs shouldn’t miss the opportunity to get a control premium. (*QVC*)

* + - 1. Burden: First on Ds, due to “omnipresent specter…”
         1. *D’s Showing*: **There’s only one Revlon duty: get the BEST price for SHs**. Ct can’t tell BoD exactly how to do this b/c BoDs will face unique circumstances. (*Lyondell*)

There is NO “Canonical Checklist” for satisfying this duty.

* + - 1. Application: Forstmann v. Pantry Pride for Revlon. Revlon preferred F and gave him: 1) asset lock-up (crown jewels for $100m discount, not subject to approvals), 2) $25m cancellation fee; and 3) No-shop provision. Unfairly favored F over PP in a bidding war breached DoL to SH.
    1. Paramount Cases: Refining Revlon Duties
       1. No Shop provisions are viewed unfavorably (*Revlon*, *Time*, *QVC*). Req Fiduciary outs.
       2. Paramount-Viacom: Stock Option Agreement seen as most significant deterrent device
       3. *Paramount v. Time* (DE): When Revlon duty arises
          1. Arises when corp 1) initiates an active bidding process seeking to sell itself or to effect a business reorganization involving a clear break-up; or 2) in response to unwanted takeover offer, arranges a breakup of corp (disagrees w/ Chancellor Allen)
          2. **Scrutiny under Unocal:**

Threat prong: Broad interpretation of what constitutes threat

Reasonable Response: Proportionate and reasonable

* + - * 1. Chancellor Allen: Not triggered by actions of Time BoD b/c not for change of CONTROL. Still owned by “**fluid aggregation of SHs**”
        2. Facts: After long period of planning, Time decided to pursue stock-for-stock merger with Warner. Paramount came in with a better offer. Time BoD did not want to accept, so they restructured their Warner deal so that it would not require SH vote.

Defense: share exchange agreement w/ Warner and confidence letters from banks – they promised not to finance 3d-pty attempts to acquire Time; no-shop clause

***Revlon claim***: Time didn’t put itself up for sale nor abandon long-term strategy.

***Unocal* claim**: Two prongs were satisfied. Threat to business strategy, response was “reasonably related” (Ct. argues **b/c Paramount could buy merged corp**)

* + - 1. *Paramount v. QVC* (DE):
         1. Adopts Chancellor Allen’s theory in *Time*. Viacom (not public) would control
         2. When a corp undertakes a transaction that will cause 1) change in corp control **or** 2) break-up of the corp entity, Ds obligated to seek best value reasnbly available to SHs
         3. Rationale:This was the ONLY chance for the SHs to get a control premium
         4. Facts: Viacom and QVC both wanted to buy Paramount. Paramount [now T] agrees to a merger with Viacom. Array of defenses (PP; No shop provision; $100 million termination fee; **Lock-up option on 19.9% of Paramount’s common stock**). QVC intervenes with its own, facially more generous merger proposal, but offer is conditioned on cancellation of defenses. T BoD refuses to conduct a formal auction on the grounds that it would be inconsistent with T’s contractual obligations to Viacom. Did NOT remove defenses in renegotiating with Viacom.
      2. *Lyondell Chemical Co. v. Ryan* (DE):
         1. B/c AoI contains exculpatory provision (pursuant to DGCL §102(b)(7)), Ds cannot be liable for DoC. Given that BoD was independent (not motivated by self-interest), issue whether BoD breached DoL by failing to act in GF – imposition of liability req’s showing of conscious disregard for ones known duties (see *Stone v. Ritter*).
         2. No specific Revlon requirements: Trial court incorrectly read Revlon as creating set of req’s that must be satisfied during sale process: **there’s only one Revlon duty – to get the best price for SHs**. No ct can tell BoD exactly how to accomplish this since each BoD will face unique circumstances.
         3. **Distinction between DoL and DoC**: If they failed to do all they should have under the circumstances, Ds breached DoC, but only if they knowingly and utterly failed to undertake their responsibilities, would they have breached DoL (via GF).

In this case, there was no such breach since Ds 1) met several times to discuss offer, 2) were generally aware of value of corp, 3) solicited and followed advice of advisers, 4) attempted to negotiate higher offer, and 5) approved the merger agreement b/c it was too good not to pass along to SHs.

* + - * 1. Facts: Chemical corp and Basell billionaire. B bought 8% L stock through OPP. Absolute home run. 99% of shares voted to approve.
    1. Anti-Takeover Legislation:
       1. Types of State Anti-Takeover Statues:
          1. **Fair price provision**: requires same price in 2-tiered offer (*cf*. Unocal)
          2. **Control share acquisition statutes** – inhibits offers: Loses voting right unless gets approval of maj of disinterested shares (*CTS*)
          3. **Business combination statutes (**DGCL §203 - Anti-takeover, moratorium statute**)**

If bidder gets 15% of T stock, 3 yr prohibition on squeeze out mergers unless:

Bidder acquires 85%;

T BoD approved a TO *before* bidder acquires 15%; or

T BoD (likely post proxy fight and A gains control of BoD) approves a merger *after* the 15% threshold AND 2/3 of non-bidding SHs approve.

**Corps allowed to opt-out in AoI or by-laws**

Clark: not actually that burdensome

* + - * 1. **Non-SH constituency statutes (PA – More draconian than DE)**

Changes FDs of Ds – “*allowed*” (not req’d) to consider ALL constituencies (employees, customers, suppliers, creditors, local community) for Revlon duty

Allows discretion and excuses – not really protecting other constituencies nor taking them into consideration during normal business operations

Approx. 31 states, NOT DE (DE: Must be rationally related to interests of SHs)

* + - * 1. **Explicit authorizations of discriminatory poison pills**
        2. **Disgorgement of gain from sale w/in 18 months of seeking control** (unless SH/Board gives an exception) - ***YIKES***
      1. MITE**:** SCOTUS strikes down Illinois Business Takeover Act bc/o 3 key factors.
         1. 20-day pre-commencement period: mgmt. could talk to SHs, ***but A couldn’t***

Williams Act: can announce offer and contact immediately.

* + - * 1. No deadline for BoD hearing about TO – could ***delay indefinitely***
        2. Fairness of TO had to be evaluated by ***Illinois Sec’y of State***
      1. *CTS*: SCOTUS upholds Indiana anti-takeover act (control share acquisition statute)
         1. If A 20% ownership, must get maj vote of disinterested SHs (not votes of A or Os/employees) to get control
         2. Have to hold SH meeting w/in 50 days, vote for control (unlike IL, BoD **must hold**)
         3. A must pay for meeting
         4. Can condition TO on getting control 🡪 Helps prevent coercive offers

1. **Policy Themes**
   1. **Key Policy Arguments**
      1. Greater duty on Ds engaging in interested transactions
         1. Specter of impropriety
         2. Con: Desire to protect business judgment, which is why cts allow for flexibility in the standard and do not address ex post analysis of various reasonable alternatives
      2. Cost of implementation of corp governance
         1. Cost-Benefit analysis is generally inconclusive
         2. No mechanisms for adjusting promulgations once implemented and no safety-valve for empirical research. Based largely on anecdotal and theoretical assumptions.
         3. BANDWAGON effect
         4. Section 404 (attestations and internal controls) costs are way higher than predicted by SEC; also costs are regressive (economies of scale)
         5. Contra, OTC disclosure requirements reducing volatility (Ferrell)
      3. Including all FD in statute:
         1. E.g. SOX rule against personal loans to Os and Ds
         2. Pro: creating clear guidelines and bright-line rules may be more helpful for planning purposes; SHs would know when they have a cause of action, provide clear deterrence to unfaithful Ds seeking to push the limits (form v. substance). FDs around takeover are a bit clumsy (inherent conflict suggests strict scrutiny, but position of BoD to respond suggests BJR); and process oriented
         3. Con: adaptability, difficulty of enumerating every circumstance of FD (b/c either lobbying or institutional limitations), may discourage board members, ct have generally wanted to limit the creation of excessive / redundant duties (e.g. *Stone v. Ritter*, good faith; *Weinberger*, business purpose test was redundant (although kept in Coggins))
         4. Con: DE’s comparative advantage
         5. Con: over and under inclusive
         6. Also, might be merit to distinguishing best practices from minimum req (econ. argument)
            1. DE cts can provide DICTA, to which most competent legal counsel will adhere
         7. Cardozo in Meinhard: “trustee is held to something stricter than the morals of the marketplace. Not honestly alone, but the punctilio of honor most sensitive”
         8. Federalist view – allow states to experiment. Powell in CTS; internal affairs doctrine
      4. Proxy Access:
         1. Allows SH to shake up BoD (may be against best interests/motivate BoD to appease SHs)
         2. Can allow special interests (unions, HFs) to win out over passive SHs or best interests
         3. Proxy fights can be won: if want to shake up BoD, put your money where your mouth is
            1. Reimbursement for expenses can be allowed in winning situations under state law/by SH ratification
      5. Classified Boards
         1. Deadly to TOs, make it very difficult to get BoD in place to redeem poison pills (*Hilton*)
            1. Not negated under Blasius as long as classified before takeover
         2. Professors Subramanian, Bebchuk and Coates have published empirical studies that classified BoDs are negative to SH value and destructive to takeover efforts. Leads to mngt entrenchment.
         3. Distinction between two types of corp power: 1) power over the assets of corp and 2) power relationship between BoD (mngt) and SHs
         4. SHs generally only have two ways of exerting any influence in corp setting/protections against inadequate performance: 1) selling shares or 2) voting out incumbent Ds
         5. Strongest evidence here, and SH rights. Not BoD independence (Clark)
      6. D Independence/Independent Chairperson
         1. SOX requirements v. Rating agency and high governance standards
         2. Collegiality vs. policing force / Monitoring v. Managing functions
            1. Impartial judges v. role as sounding board for strategy & FORMAL role in major decisions
            2. EX ANTE impact on behavior of manager
         3. Subtle psychological pressure exerted in non-independent context; may be bolder about saying NO (reason by NYSE requires key committees to be fully independent)
         4. Ex-ante procedures and heightened level of analysis presentation to BoD will induce
         5. Can be solved by independent “lead D” who controls the flow of info to the BoD
         6. Want people on BoD who really KNOW the business and can make highly analytical judgments about business considerations
         7. Pro: Outsiders do not receive maj of salaries from position; want to protect their reputations and avoid lawsuits; less likely to be controlled by CEO; outside perspective
         8. Con: Spent much less time w/ corp and much lower understanding (so lower contribution to managerial role); May meddle too much in corp affairs; **may NEVER be truly indep**
      7. Poison Pills:
         1. PPs deter TOs and aid mngt entrenchment and often prevent SHs from getting value from an acquisition that they would prefer, since it gives the mngt far more power to say no. This infringes on SHs’ liquidity rights (one of the core purposes of the corp form) and pits it against centralized mngt.
         2. Passivity: Omnipresent specter of CoI; should not be able to use corp resources for entrenchment purposes / put up obstacles to SH value
         3. Board Activism: Long-term value, centralized mngt, unique insight, best negotiating position to bargain on behalf of dispersed SH interests. W/o BoD, opens up SHs to coercive bids. Also can protect non-SH constituents (query whether allowed)
         4. But on the other hand, DE case law already limits the extent to which we can use PPs in a preclusive manner (*Unocal*), having stuck down the dead and no and slow hand pills as overly preclusive (*Carmody*, *Quickturn*).
         5. HOWEVER, PPs can be effectively used to bring opportunistic activists to the table and maximize value for SHs in the long term.
         6. May not want SHs to impeded on mngt’s strategic decisions, thereby undermining a key element of the corp form (Centralized mngt)
         7. SH Empowerment/Removal of Entrenchment devices (e.g. staggered boards, limits to SH bylaw amendments, superMaj req’s for charter amendments, PPs, golden parachutes) empirically enhance SH value (Bebchuk)
      8. Allocation of Power btwn mngt & SHs:
         1. Contract rights
         2. Not one size fits all, varies among jurisdictions, allows states to work it out w/o imposing same standards
      9. Enforcement Mechanisms for Corp Law Matters (mostly left to States):
         1. W/in province of state law rather than responding to scandals
         2. Allocation of law making authority between the fed gov’t and the states
         3. DE’s competitive advantage (Mark Roe)
   2. **Disclaiming by Agreement**
      1. Value of strong default rules
   3. **Best Practices & Separate Listing**
      1. E.g. Bovespa
      2. Aftermath in M&A Practice; standard scripts and rituals to avoid breach of Due Care
   4. **Form v. Substance**
   5. **Buyout & Buy/Sell Agreement (v. Dissolution)**

Concluding Thought:

Can you understand virtually all of the issues and legal doctrines studied in this course as deriving from one or more of the four fundamental features of the corp form?

* Limit Liability for investors (piercing corp veil is response)
* Liquidity of assets
* Strong legal personality, Corp form is hard to terminate (Serious problem in Close corp – freeze-outs, oppression)
* Centralized Mngt (FDs are response to avoid the corruption of power)

Which of the four accounts for more of the legal action?

* Clark didn’t say but it is probably centralized mngt