**Corporations Outline**

1. **#AGENCY**

**Overview**

* **Two Questions:** (1) Liability. When is an institution bound by actions of others? (2) Fiduciary duty. What do affiliates owe in terms of duty to the principle?
* [Definition] **Agency** – Relationship which results from the manifestation of consent—(i) ***agreement***—by one person to another that the other shall (ii) ***act on his behalf*** and (iii) ***subject to his control***, and consent by the other so to act.
	+ (i) Agreement can be *express* or *implied*.
	+ (ii) A has power to affect P’s legal rights and duties.
	+ (iii) Whether agent is *actually* controlled is irrelevant; what matters is whether agent *agreed* to be controlled (*Cargill*).
		- Whether there is agency often turns on the sophistication of the parties.
* [Types Of Agents] – turns on ***type of control***.
	+ (1) **Independent Contract Agent:** Tells Agent *what* to get done, but NOT *how* to do it.
		- Can bind principle in contract.
	+ (2) **Servant** (Principle is called Master)**:** Agent is full-time and is controlled in details by P. Tells Agent *what* to get done AND *how* to do it.
		- Can bind principle in contract AND torts.
* [Types Of Authority]
	+ **Actual Express:** P explicitly tells agent to act on his behalf. Does NOT matter what third party knows (or if third party even knows principle exists).
	+ **Actual Implied:** Usually concerning something incidental / usually accompanies / reasonably necessary to what you’re explicitly asked to do. (*Mill Street v. Hogan*)
		- Depends on what A reasonably believes, based on present or past conduct of P.
		- E.g. Company hires auditing company, and company hires associate to help with work. Associate is implied agent of company.
	+ **Apparent Authority:** Involves a communication to third party. P ***holds out*** A as his agent, an appearance on which 3rd party comes to rely. Fundamentally different than previous two. Bound by what you tell third party. (*370 Leasing*)
		- Agent can create own apparent authority IF the statement is truthful when made.
		- Can still be bound to third party even if principle told agent specifically not to do something (3rd party wouldn’t know—though agent would be liable to principle).
	+ **Inherent Agency Power:** General agent who has neither express nor implied but is ***reasonably close*** to what they usually do. (*Watteau v. Fenwick*)
		- Requires (1) general agent; (2) state that adopts this doctrine; (3) acting as agents generally do.
		- **General Agent:** A who is authorized to engage in a series of actions w/o express or reauthorization of authority; ***continuous service***.
			* E.g. general manager, vice president. **Specialized agents**, like real estate agent, only authorized to act in individual actions.
		- Third party *cannot know* agent lacks authority, and agent must be acting in the interest of the principle.
		- IAP has bite when you have an undisclosed principle, and agents are acting *against* P direction.
	+ **Ratification:** a manner of binding ppl to actions of others where the other is not necessarily acting as agent, or where agent is acting beyond scope of authority. E.g. A claims to act on P’s behalf, and whether he is agent or not or whether you asked person to do it, principle says “I like it” and ratifies action.
		- Don’t have to have an agent, but need person purporting to act on behalf of P.
		- To ratify, need to make manifestation or do something that would only make sense if interpreted as being ratification 🡪 ***intent to ratify*** AND ***full knowledge of all the material classifications***.
			* Can’t ratify if circumstances significantly change (e.g. house burns down).
			* Mere non-action is NOT enough for ratification.
			* Usually all or nothing—either whole deal is ratified or not (otherwise would be thwarting intentions of the parties).
	+ **Respondeat Superior:** liability for torts by agents.
	+ **Estoppel:** If A falsely holds himself out as P’s agent AND P is negligent in allowing him to do so, then P is estopped from denying liability. (*Hoddeson*). MR: equity doctrine to get results court likes.

**General Agency Cases**

* [Issue Of Control] *Gorton v. Doty* (Teacher, unpaid and only be nice, loans car to football coach as long as coach drives. Accident occurs. Issue: Is teacher liable for injuries of people hit?)
	+ Court finds agent/principle relationship. Teacher gave coach *condition* 🡪 evidence of control.
		- For tort liability, need to find agency AND servant/master relationship. P could have sued high school (tells coach what to be done and how to be done), but sovereign immunity likely blocked.
		- MJ: obviously case is wrong and perverse. Teacher just lending car to be nice; coach not acting “on behalf” of teacher. Case turned out b/c court going after teacher’s insurance policy.
	+ **Dissent:** agency must be more than passive permission. For agency, need to have *agreement to act on behalf*.
* [Oversight Equals Control] *Jenson Farms v. Cargill* (Farmers selling seed grain to grain elevator Warren, who has financing/lots of oversight from Cargill. Warren sells new seed to farmers as agent of Cargill [specific project in past], and buying grain from farmers. Warren goes bankrupt after heavy monitoring by Cargill. Farmers seek compensation from Cargill. Issue: is Warren agent of Cargill?)
	+ **Yes.** Warren ***is*** Cargill agent b/c Warren is controlling what Cargill does (sending agents to supervise Cargill’s operations) 🡪 Warren is liable to all Cargill’s farmer accounts.
		- MR: Results driven court opinion. Issue of lender liability. Problem 🡪 creates an incentive for places like Cargill to shut down Warren too fast (maybe not crooked and will recover). Greater downside – if monitor too closely, you’ll be liable to all people your borrower is liable to. Cargill not trying to control firm, but trying to help company get over hump and determine if lender is run by crooks. Courts skirted black letter law to hold deep pockets liable.
		- Back office of company is different b/c they agreed to act on behalf of company, even if they’re crooks
* [Implied Authority] *Mill Street Church of Christ v. Hogan* (Church hires Bill Hogan to paint church [worked for church in past and had brother help] and discussed the possibility of Gary Petty helping Hogan. GP can’t be found, so hires brother. Brother falls on latter and hurts himself. Issue: does brother, Sam, have claim on church; did Bill have authority to hire Sam b/c Sam wants workers comp [only covers employees]?)
	+ **Yes.** Bill had ***implied authority*** AND ***apparent authority*** to hire brother. Sam had been hired in past (*created apparent authority*), had paid Sam for ½ hour he worked (*ratification?*), and Bill needed help (*assumed someone else would be hired*), and Sam thought Bill had authority.
		- Caveats: (1) Agents generally lack implied authority to hire another working in any job that involves substantial discretion. Courts want P to be able to choose. (2) Conduct in the past can create apparent authority in the present. Past conduct is “*manifestation to the world*” that A had authority to hire.
		- MR: common dispute 🡪 is agent authorized to hire sub-agent?
* [Apparent Authority] *370 Leasing Corporation v. Ampex Corporation* (Salesman, Kays, negotiating with friend, Joyce, who owns 370 Leasing for the sale of memory chips to 370. 370 then plans on leasing chips to EDS. Kays sends contract over to Joyce, and Joyce signs, then Ampex tries to get out of contract. Ampex never signs, and argues Kays couldn’t of signed b/c he’s only a salesman. Kays doesn’t have actual authority. Issue: did Kays have apparent authority?)
	+ Ampex is bound. Held Kays out as authorized representative. Apparent authority.
		- MR: whether apparent authority exists turns on what the customs in the industry are and what title in industry typically conveys. In this case, perception of authority/official statues came with name cards and other indications.
		- MR: moral here is **apparent authority** is not just what is communicated to 3rd party, but also how ***agent is held out to the world***.
* [Inherent Agency Power] *Watteau v. Fenwick* (Fenwick owns bar. Humble runs bar. Watteau is supplier. Humble buys Bovril and cigars from W, but F only authorized H to buy only beer from other parties. Watteau sues for goods, and discovers H doesn’t own bar [but H’s name is on door]. Issue: is F liable to W?)
	+ No actual express authority. No actual implied authority. No apparent authority (no communication from F to W, nor has W held H out as official representative to the general public [undisclosed principle]). No ratification (H didn’t purport to act on behalf of F). Court finds ***inherent agency power*** 🡪 if you have a general agent, and he is doing typical to what general agent does, principle is liable.
		- **General agent** = like a senior officer at the firm. Person can bind firm for which a person in her position can typically do.
	+ MR: why do we have inherent agency power? Contrary to intentions of parties. NOT the law in a lot of states, but 2nd restatement supports it. 3rd restatement basically repeals it, bases it on estoppel (if you knew what was happening and didn’t stop it).
		- IAP matters when you hire agent and give title. Only relevant when you have undisclosed principle (sort of an extension of apparent authority).
		- MR: *Watteau* is/was wrong case, but author of 2nd restatement liked the doctrine. Thrust to put liability on deep pockets, sort of a liability insurance. Didn’t want to parse if 3rd party knew about principle or not. Problematic, b/c knowledge was not priced in initial deal.
* [Ratification] *Botticello v. Stefanovicz* (Walter and Mary jointly owned land. Botticello wants to lease land with option to buy. Mary refuses terms, but B leases from W. B makes improvements, and wants to buy. Issue: did M ratify agreement?)
	+ Mary did NOT ratify it. **Ratification 🡪** “the affirmance by a person of a prior act which did not bind him but which was done or professedly done on his account.”
		- PP: Mary saw him making improvements and didn’t do anything, also took rent! Court: But M claims she had no notice of purchase option, and W didn’t purport to be acting on M’s behalf.
		- MR: need to know content of contract to constitute ratification. And need to be *purported to act on behalf* of principle. Not enough to simply be selling something that is jointly owned.
	+ Ratification cases involve **two critical questions**: (1) What types of acts constitute an affirmation by the principal? (2) What effect should we give to that affirmation?
* [Estoppel/Simple Negligence] *Hoddeson v. Koos Bros.* (Mrs. H buys furniture from conman acted as salesman. Furniture is not delivered; store has no record of purchased. Issue: whether or not the evidence circumstantiates the presence of apparent authority?)
	+ Not AA, but **estoppel.** Dereliction of duty by Koos enabled false agent to transact business in way where ***person of ordinary prudence*** to believe person was agent. **Store was negligent 🡪 so liable**.
		- Apparency and appearance of authority must be shown to have been created by the manifestations of the alleged principal, and not alone and solely by proof of those of the supposed agent.
		- MR: Just a tort. Store had duty of care to Mrs. H.
	+ Example – S&C associate books full bar at Yacht Club to get back for not making partner. S&C liable? Estoppel argument– owe duty of care to oversee actions of associates and stop event before it happens. Stronger if partner hears about scam and doesn’t do anything about it.
		- MR: Estoppel is equity doctrine to get results you like

**Liability of Principle to Third Parties in #Tort**

* Need (1) ***agency*** AND (2) ***master/servant relationship*** 🡪 hinges on type of control (*what you do* AND *how you do it)*
	+ MR: Sort of circular, in that if P is personally liable for torts A commits 🡪 much more likely to more closely control activities of A 🡪 A then is more likely to be found to be a servant.
* [Policy Explanation] – See servant/master relationship when it is sensible for P to monitor activities of A.
	+ **Economy** – Sometimes it makes sense for you to look into the background of your agents, and sometimes it doesn’t.
		- Taxi drivers are ICA, chauffeurs are SA.
		- It makes sense to investigate your chauffeur and be careful in choosing them. It doesn’t make sense for you to have to investigate every taxi driver you use.
	+ **Expertise** – Whether it makes sense to hold you responsible for supervising whatever they are doing.
		- Let’s say you have a junior investment banker and a client. It doesn’t make sense for the client to be supervising the banker to make sure they are doing it in certain ways.
		- If you have an investment advisor supervising the junior investment advisor, it makes sense to call the junior an SA, because senior can supervise them
	+ MR: Real life justification? Employees tend to be judgment proof, so we want P to take extra caution in supervising employees.
* [#Scope Of Employment] – **Which Torts are Masters Liable for?**
	+ **Traditional:** master is liable if four things are met 🡪
		- (1) ***kind of conduct*** servant is hired to do (*Arguello*);
		- (2) ***substantially within*** authorized time/place;
		- (3) ***motivated in part*** to serve master;
			* MR: What throws courts. Hard cases, especially in intentional torts. Most compelling compensation cases, there’s no way master would consider servant’s actions to be motivated to serve him (*Manning* – pitcher and heckler).
		- (4) if force involved, ***not unforeseeable force*** (e.g. bouncers using chokeholds to throw out drunks).
	+ Courts don’t often like this b/c lots of stuff falls out. Below cases take very different approaches.
* [Exception For Non-Agent Independent Contractors] (*Toti*)
	+ Three ways to get there:
		- (i) **Inherently dangerous / Nuisance per se**
		- (ii) **Negligent in choosing party / IC is incompetent**
		- (iii) **Activities are “ultra-hazardous” 🡪**P is liable even without negligence

**Tort Liability Cases**

* [Control Details] *Humble Oil & Refining Co. v. Martin* (Lady brings car to service station, didn’t put E brake on. Car rolls away while employee is filling and hits man. Station owner liable. Issue: is parent company liable?)
	+ **Yes.** Owner is servant 🡪 Humble is liable. Court says evidence that Humble controls the details 🡪 Humble sets hours, owns equipment and inventory, control over finances (Humble has to file reports), and Humble pays operating costs. Station owner no different than store clerk.
		- MR: Laundry-list approach is troublingly manipulable. A less cynical approach might be to ask whether the laundry lists conceal different patterns of financial exposure. More financial risk usually means more control.
* [Uncontrolled Details] *Hoover v. Sun Oil Company* (Barone owns station, franchise of Sun. Smiley, Barone’s employee, blows up gas while smoking. Issue: is Smiley servant for Sun?)
	+ **Sun NOT liable**. Barone sets hours, owns some of equipment, sells other goods besides Sun products, does not have to file reports, and B plays minimal rental (increased independence).
	+ MR: how to handle two cases? (1) distinguish cases based on facts. The distinctions tend to go to whose money is on the line. Sun doesn’t have big financial stake in Barone’s operation. Humble had more of stake. 🡪 party who loses money is more likely to exercise control. (2) See who can pay plaintiffs.
		- *Hoover* and *Humble* turn not on the factors, but whose money is at stake.
* [Control In Practice] *Miller v. McDonalds Corp.* (P bit into big mac that had sapphire in it. Franchisee owned. Issue: is McDonald’s liable?)
	+ **Liable.** “If, in ***practical effect***, the franchise agreement goes beyond the stage of setting standards, and allocates to the franchisor the right to exercise control over the daily operations of the franchise, an agency relationship exists.”
		- Agreement controlled a bunch of stuff (required “precise methods”), and little sign saying place is franchise requires greater sophistication than can be expected.
	+ MR: control is NOT sufficient, still need agreement for agency. Court only looked at control. And court should be asking about *servant*, not just agency.
* [Scope Of Employment]
	+ [Disregard Framework—Foreseeable] *Bushey v. United States* (drunk US sailor comes back to boat and turns water pumps. Boat falls off and damages drydock. US master, sailor is servant. Issue: is sailor within SoE?)
		- **Liable.** Immaterial that sailor’s precise action is not foreseeable. General rowdiness on way back to boat is foreseeable. AND needs to arise “out of and in the course of his employment.” US told sailor to come back to boat, so foreseeable damage on way back is within SoE.
			* Policy justification is NOT enough.
		- MR: Friendly said, “I don’t care about four factors. Rather, ask: is this foreseeable?” Makes it hard to sympathize with his opinion, b/c he obviously cares about policy analysis.
	+ [Motivated In Part] *Manning v. Grimsley* (Fans heckling pitcher while warming up at Fenway Park. Pitcher turns and throws at wire mesh, ball goes throw, hits plaintiff. Pitcher liable. Issue: are Orioles liable?)
		- Is this kind of conduct hired to do? Yes, arguably, as he’s warming up. Time/place? Sure. **Problem** 🡪 is this motivated, at least in part, by service to master. [Friendly said “I don’t care”]. Court said that pitcher, in order to do good job in warming up, threw ball at hecklers so they’d stop → motivated for employer.
			* MR: Of course he wasn’t doing it for employer, but at least this judge made an effort to craft explanation. Makes up a story to make opinion fit the four factors.
	+ [Against Prohibition] *Arguello v. Conoco* (Employees said racist slurs to and harass customers and two different stations. Issue: is Conoco liable?)
		- **No.** Employee obviously not hired to harass customers, but was hired to take credit card info and sell gas. Within SoE? Yes.
			* **Motivated to serve master?** Iffy question. Depends on how you characterize.
		- BUT, court here looks at agreement of franchise location. Says branded store is independent business → NOT an agent. Not liable for those cases.
			* MR: Surely the same language in hotel and McDonald’s cases. *This time, court looked at language*. Happens sometimes, but many courts ignore contract if they find sufficient control
* [Liability For Torts Of Independent Contractors] *Majestic Reality v. Toti Contracting Co* (City hires construction company. Worker puts wrecking ball too law and breaks in roof. Issue: is City liable for IA actions?)
	+ If actions of independent contractor are ***inherently dangerous and negligent*** → Principle is liable even if not an agent/servant.

**#Fiduciary Duties of Agents**

* Two main duties:
	+ (1) ***Duty of Loyalty*** (not steal)
		- Any money A makes secretly from enterprise 🡪 legally obligated to pay back to enterprise, and A must *disclose* **conflicts of interest** to those whom duty is owed.
		- **Basic principle** 🡪 A cannot get benefit if the *only reason* A gets benefit is because of age
	+ (2) ***Duty of Care*** (not sleep on job)
		- Care that a *prudent & reasonable* person would exercise toward their affairs.
	+ It is irrelevant whether P is damaged or not.
	+ A and P can waive duties, but has to *be in advance*.
* [Secret Profits] *Reading v. Regem* (P is army sergeant in Cairo. Sues Crown for taking money he got from riding truck in uniform [getting contraband past police stops]. Issue: was Crown P’s employer at time of smuggling?)
	+ Crown keeps $$. P violated duty—gained money by virtue of employment (only reason Crown gets money). *Sole reason he got $$ was b/c of his employment*. Would have got $$ if got it off-duty unrelated to being an officer.
		- MR: Off time, own money 🡪 get to keep. If on time, own money 🡪 breach of contract and entitled to money, but employer can sue for breach damages. If using employers money 🡪 probably don’t keep (able to make $$ b/c of his employer).
	+ E.g. Harvard Professor consults off-duty, but gets paid $1k for consulting b/c he’s a Harvard professor. Gets to keep it? Depends on contract, but probably not under *Reading*. If selling drugs, then no. Harvard had nothing to do with it. If contract says 9 months, but works for 4. Breach of contract?
		- **Most common variant:** agent is dealing secretly with principle. E.g. CEO selling land he owns to corporation (w/o telling board he owns land). Conflict of interest. Need to disclose.
	+ *Town & Country* variant: can’t compete with principle.
		- E.g. Baker & Mackenzie lawyer poached by Skadden 🡪 can he take over his database? No. Created it on company time/resources. Can he reproduce from memory what he learned with old firm? Hard to say you can’t do that, but looks a lot like *Town & Country*.
		- Doesn’t matter if P is not harmed 🡪 agent still needs to disgorge benefit.
* [FD To Ex-Employer] *Town & Country House v. Newbery* (Cleaning business. D’s broke off and solicited P’s client pool. Issue: do D owe P anything?)
	+ Yes. ***Even after quitting***, still owe fiduciary duty. P is entitled to enjoin D from further solicitation of customers, or that some profits or damage should be paid P by reason of customers they enticed away.
		- **Reasoning:** what did they take? Took labor that P spent in building client base. *Made use of secret information*. Basically took P’s property.
		- RM: you have fiduciary duty to ex-employer as well.
	+ E.g. Ropes associate opening new Wachtell office. If you’re associate, can you solicit other associates? Maybe breach. Can you discuss moving with clients if you are junior partner? Depends on contract. You have FD to clients as well 🡪 maybe tell them where you can be reached? In practice, *when* you talk with clients is big. Not really realistic to say you can’t discuss with clients before you leave. MR: this is breach under *Town & Country*, but courts let it slide all the time.
1. **#PARTNERSHIP**

**Overview**

* **Partnership:** sharing ***(1) profits*** and ***(2) control***. Need the ***element of co-ownership***.
	+ *Default arrangement.* Don’t need contract or agreement or form (unlike corporations which only exist when paperwork is filed).
	+ Partnerships are usually formed for tax reasons. Other than tax, corps are usually better (limit liability).
* **When is a partnership formed?** Whenever you share profits and control (ppl form partnerships w/o realizing it).
	+ ***Fenwick* Factors**
		- Intentions of parties. Agreement is evidence, but NOT conclusive.
		- Right to share in profits.
		- Obligation to share in the losses.
		- Ownership and control of the partnership property and business.
		- Community of power in administration.
		- Language of Agreement.
		- Conduct of parties towards third persons.
		- Rights of parties in dissolution.
	+ **BoP** is on party trying to prove partnership.
	+ **Apparent partnership:** if person who represents himself, or permits another to represent him, to anyone as a partner in an existing partnership is liable to any who rep is made who has, ***on faith of representation***, given credit to the actual/apparent partnership.
* [Corporations v. Partnerships]
	+ **Limited liability.** Intuitive difference—corporations have ***limited liability*** 🡪 you can lose invested money, but cannot lose more than that. However, insurance can alleviate risks in partnerships. AND, banks often require executives to personally guarantee if business isn’t stable (forming corp. doesn’t get you out of recourse agreement). And banks will give non-recourse agreements to partnerships if business is stable.
	+ **Transfer.** Shares are ***freely transferable*** and partnership interest is not 🡪 new partners only admitted with ***unanimous vote*** by partnership.
		- But you can eliminate formal transferability in corporation structure (veto power over share transfer). And partnerships contractually eliminate veto power.
	+ **Life.** Partnerships ***endure forever***. Partnership terminates whenever partner ***dies/leaves***.
	+ **Flexibility**. Partnerships can be negotiated in a myriad of ways. Corporate documents more standard (but you don’t have to do this).
	+ **Centralized Management**. Corporations ***centrally controlled*** (run by officers w/ supervision of the board). Partnerships are run by ***majority vote***.
		- Misleading b/c corporate bylaws can dictate that shareholders make lots of decisions, and partnerships are not democratic institutions (e.g. law firms run by a handful of ppl).
		- You can contract around partnerships and corporations 🡪 make one look like the other. Or you can buy insurance for tort/contract liability.
			* E.g. you can limit transfer of corporate stock. And some partnerships contract around requirement that all partners approve additional partner
* [Legal Forms]
	+ **LLCs (Limited Liability Company):** operates like corporations, but recognized by IRS as like partnership. Corp organizational documents (can follow corporate case law), but taxed like partnership.
	+ **LLP (Limited Liability Partnership)** – does not give you full limited liability (e.g. wrongful acts of partners, fraud, etc.), but does take care of wrongful acts of paralegals.
		- Why aren’t law firms picking LLCs? Take LLP over LLC is that LLP only requires filing some form 🡪 nothing else changes. LLC is a completely different entity, so have to re-negotiate all complex, arcane partnership agreements.

**Partnership Cases**

**[When Do You Have A Partnership]**

* *Fenwick v. Unemployment Compensation Commission* (Owner of beauty shop and employee, Ms. Chesire, enter deal to give her portion of profits [additionally 20%]. Memorialized in “Partnership Agreement.” But O maintained controlIssue: if C is employee, shop has to pay into ECF. Issue: Is C a partner or employee?)
	+ **Employee.** Not a partnership, only profit sharing plan (only sharing of profits = not partnership). ***Essentially the element of co-ownership is lacking.*** Elements to consider:
		- Intentions of parties. Agreement is evidence, but NOT conclusive.
		- Share in profits.
		- Obligation to share in the losses.
		- Ownership and control of the partnership property and business.
		- Community of power in administration.
		- Language of Agreement.
		- Conduct of parties towards third persons.
		- Rights of parties in dissolution.
	+ **Uniform Partnership Act defines Partnership:** “an association of two or more persons to carry on as ***co-owners*** as a business ***for profit***.”
		- Q: is it profit sharing or wages? *Fenwick* 🡪 wages.
	+ E.g. law firms – partners don’t get salaries, but “draws.” And highly centralized. Are non-equity partners liable for law firms debt? Yes. Why different than *Fenwick*? Young partners are highly paid. Poor beautician should not be liable. Looks bad to hold them liable.
* [Anti Cargill] *Martin v. Peyton* (3 wealthy ppl, PPF, loaned ~$30m [today] money to investment bank KNK in exchange for risky securities owned by KNK. PPF think they’re just creditors. KNK’s other creditors sue PPF claiming PPF was in partnership with KNK 🡪 personally liable. Issue: partnership?)
	+ **No partnership.** Court looked at control & profits, and not enough to form partnership. Reason PPF has so much control is to protect investment.
		- Profits: PPF got 40% between certain range.
		- Control: PPF can veto certain actions and can limit scope, dictate some salaries, can fire partners, and designate who is control.
	+ MR: what is different than KNK and Warren Elevator (from *Cargill*)? Hard to give formal answer. (1) Latter is more sympathetic, and (2) cases separated by decades (courts less likely to enforce letter of contract now).
* [Partnership By Estoppel—Apparent Partnership] *Young v. Jones* (P sends $550k to bank, who sends it to SAFIG, who loses it. Sues PWC b/c they audited SAFIG. But it was PWC Bahamas audited it, but P is suing PWC-US. PWC has one entity—PCW LLC—and then sets standards for franchise offices. Issue: are PWC-US and PWC-Bahamas partners?)
	+ **No partnership, either apparent or by contract.** [UPA] As general rule, persons who are not partners as to each other are not partners as to third person. However, if person who represents himself, or permits another to represent him, to anyone as a partner in an existing partnership is liable to any who rep is made who has, ***on faith of representation***, given credit to the actual/apparent partnership. 🡪 There is ***no evidence*** or allegation that credit was extended on the basis of any rep of a partnership existing between PW-Bahamas and PW-US = no estoppel.
		- Why not apparent agent?
			* (1) Language of UPA at the time (see above). But firm here didn’t extend credit. Only invested in firm audited by PWC.
				+ MR: above doesn’t make sense, b/c there’s other reasons you want to hold partnership liable. Revised version has fixed this problem.
			* (2) Regular agency principles (partnership law does NOT displace regular agency principles). MR: not in case, but should have been.
			* (3) No reliance on any representation.
				+ MR: International organization is to set standards for brand recognition, but doesn’t say anything about partnership arrangement.
	+ MR: this (equitable estoppel) is all part of ***equity jurisprudence***. Requires reasonable reliance.

**[Fiduciary Obligations Of Partners]** - analogous to “corporate opportunity.”

* [Needed To Notify] *Meinhard v. Salmon* (Louisa Gary leases hotel to Salmon, who goes to buddy Meinhard for 20 year joint-venture. Salmon is manager, both put up $$, share profits and bear losses equally. [Not clear if it was short-term deal or long-term business expectation]. Salmon renews lease w/expansion but doesn’t cut in Meinhard. Issue: did S violate FD to M?)
	+ **Yes**. S excluded M from any chance to compete, from any chance to enjoy the opportunity for benefit that had come to him alone by virtue of his agency. Joint adventurers owe to one another ***duty of finest loyalty***. Needed to at minimum notify M (but maybe more as well).
		- **Reasoning:** S is managing partner, so acting on behalf of M (?). And deal was private between S and M, so Gary didn’t realize M was there 🡪 S had obligation to inform M at the very least. If G had known, he might have gone to both. “Thought of self was to be renounced, however hard the abnegation.”
	+ **Dissent:** but what did the parties *intend*? It’s a 20 year deal, just for the lease, why it’s called a joint venture.
		- MR: it’s a ***joint venture*** 🡪 which is a limited project. Makes Cardozo’s opinion puzzling, b/c not a partnership. Key question = what did parties have in mind? Problem is that S wasn’t just manager, but investor as well🡪 not really expected to wholly renounce thought of self, so Cardozo’s language isn’t really accurate.
		- What if lease is somewhere else in NY? Might make a different. Matters to Cardozo that it is renewal of specific lease. What if G learned about M beforehand? Perhaps. Cardozo isn’t overly clear in the test he lays out.
	+ E.g. Partner at law firm gets work outside the office. Can he keep profits? No. Clearest breach of fiduciary duty. Cannot dissolve partnership? You can always quit, and client is free to choose, but you don’t get to keep money if matter came to you when you were partner. Complicated by what is considered a “matter.” Is this fair to the client? Client gets to choose lawyer, but if you have to split profits, lawyer less likely to take work… If you expect cases to come in and quit, you get to keep matters.
* [Grabbing and Leaving] *Meehan v. Shaughnessy* (Two partners, M and B, planned to leave firm for more $ at end of year. For next 6 months, start recruiting other partners & associates, sign lease, remodel place, contact clients. But M and B deny to other partners that they’re leaving. Don’t tell firm what profitable clients they’re taking until clients have committed [stall telling firm]. Did M & B breach FD?).
	+ **Yes**. Partners owe each other a FD of “***the utmost good faith and loyalty***.” Partner must consider other partner’s welfare, and refrain from acting for purely private gain. FD includes duty of honesty (lied; stalled on client list). M&B gained an ***unfair advantage***.
		- Partners waived 3-month notice requirement, but in trouble b/c they didn’t give enough notice 🡪 ***lied about leaving***, and ***stalled with client requirement*** (gave themselves improper advantage). Also, in client letter they did not make it clear that clients could stay with firm.
	+ MR: interesting that rented space and recruiting clients and lawyers was NOT a problem. Unlike *Town & Country* (waited until they left). Court says contacting clients *prior to leaving* & recruiting associates is not a problem. Hard to square cases (but courts want law firms clients to go where they want). Contrast to *Meinhard v. Salmon* 🡪 **no language of renouncing all duty to self**.
		- MR: client contact is especially critical here b/c the cases are contingency fee 🡪 firm has put up $$ to front cases.
* [Expulsion] *Lawlis v. Kightlinger & Gray* (Lawlis is law firm partner and struggling alcoholic. Firm says “no second chance” and outlined obligations; L slips up and F gives second chance. Gets clean and asks for salary to be bumped back up. F kicks him out [not told all details]. L argues F had predatory intent 🡪 raises partner/associate ratio. Issue: did F act in “good faith”?)
	+ **Yes.** No genuine issue of good faith. Doesn’t matter why he was fired, because ***agreement had “no cause” expulsion clause***.
		- MR: clients probably want L gone. Even if L is not working on the matter, having L around hurts clients because it lowers the value of client’s work to other partners and incentivizes F to get L back quickly. Hard problem. If had hard rule against alcoholism in firms, lawyer’s buddies would not notice.
	+ **UPA:** expulsion must be “bona fide” or in “***good faith***” to not violate partnership agreement. Cannot be for “predatory purpose.”

**[Rights Of Partners In Management]**

* [Need Majority To Change Default] *National Biscuit Company v. Stroud* (One partner [F] bought bread when other partner [S] said not to. S ha called Nabisco directly and said partnership won’t pay. F ordered anyway. Issue: is supermarket liable for bread?)
	+ **Yes**. For **general partnership**, each partner has power to ***bind each other in any manner legitimate to the business***. Each partner has “equal rights in management and conduct of the partnership business.” Any disagreement over ordinary matters 🡪 decided by majority. Power to buy bread was default power, so to override it, S needed majority (impossible w/ 2 people). F can ***still bind*** partnership.
		- MR: case is about actual authority. S’s only option is to dissolve partnership or get F to agree with him.
	+ P. 118 G.S. 59-39 🡪 ***apparent authority***. Partner has authority to do regular actions unless other said has knowledge the partner has no such authority. I.e., if your actual authority disappears, you still have apparent authority.
* [Need Majority To Change Default] *Summer v. Dooley* (Two guys, trash business. Partnership agreement says if one partner is out, he must pay for replacement. S wants to hire more help; D refuses to hire additional man. S hires anyway. D wants to pay X out of partnership funds. Issue: is D liable for new guy’s wages?)
	+ **Yes.** Needed majority to change default arrangement, but S didn’t get it. Default says you pay out of pocket for hiring extra help.
		- MR: different outcome than *Nabisco* because default policy is different. Both cases the person who loses want to vary from the default arrangement.
* *Day v. Sidley & Austin* (Law firm merger. Day was chairman of DC office. Merger agreement said no Sidley partner would be worse off in any way as result of merger, including positions on committees. Post-merger D became co-chair in DC. Issue: did S&A misrepresent to D?)
	+ **No.** D was not deprived of any ***legal right*** as a result of reliance of merger statement. No mention of DC office or D’s status is mention in partnership agreement. D signed agreement with implicitly authorizes Executive Committee to create, control or eliminate firm committees. D could not have reasonably believed D’s status was inviolate.
		- D just has bruised ego.
	+ MR: most important 🡪 illustrates rule of partnership law that partners are free to make any agreement that suits them, w/o concern about niceties of partnership theory. “You made your bed, now you must lie in it.”
1. **PRELIMINARY CORPORATE ISSUES**

**Overview**

* [Formation Requirements]
	+ **Articles of Incorporation:** corporate charter. File with state of choice. Very short, fill-in-blank form.
		- Authorizes shares
		- States purpose (typically, does so very broadly)
		- Modifiable by vote of BOTH shareholders *and* directors
	+ **Bylaws:** details firm policies/procedures. Very long, and *much easier to change*.
		- Modifiable by vote of EITHER shareholders *or* directors (usually directors).
		- Don’t have to have bylaws, but need AoI.
* [Corporate Entity And Limited Liability] – corporation is a ***legal entity*** 🡪 only the corporation (and NOT shareholders) is liable = **limited liability**.
	+ **“#Piercing the Corporate Veil”:** court finds shareholders, directors or officers personally liable, usually in the name of fairness. D must control corp for ***personal benefit*** at *expense* of corp benefit (corp is just a shell). ***“Major scumbag” doctrine***. Criteria considered:
		- Business is a closely held corporation (never happened with public corp).
		- P is an involuntary (tort) creditor (voluntary creditors can anticipate risk and shouldn’t be rewarded by piercing veil).
		- D is a corporate shareholder (as opposed to an individual).
		- Insiders failed to follow corporate formalities, e.g. hold regular board meetings.
		- Insiders commingled business assets/affairs w/ individual assets/affairs.
		- Insiders did not adequately capitalize the business (not decisive—always inadequate capitalization when these cases arise).
		- D actively participated in business (less likely to hold liable inactive shareholders).
		- Insiders deceived creditors 🡪 *most important*, courts pierce in vast majority of deception cases.
	+ **“Reverse Pierce”:** judgment against shareholder, then reach assets of other firms he owns.
	+ **#Derivative suits (“derivate” to suit of corporation):** shareholder sues corp to force corporation action (sue another party). Classic way to address conflict of interest (e.g. CEO hurt company and board is full of buddies).
		- Can’t force Board to due anything unless it violated the **business judgment rule** 🡪 when to bring suit is subject to regular judgment of the Board. Absent *fraud, illegality, or conflict of interest* 🡪 courts will defer to directors.
		- Many states have bond-posting requirements (discourages frivolous suits aimed at extracting settlements).
		- If shareholder suffers #***direct/primary harm*** 🡪 can bring **direct suit**. NOT about loss to corporation.
			* Voting interest, payment of dividends, stock redemption rights, right to inspect books 🡪 *typically direct*. Delaware says direct right if ***separate and distinct harm*** or ***contractual right*** (“special injury test”)
			* Duty of loyalty/care claims 🡪 *derivative suits* (e.g. CEO steals from company).

**Corporate Issue Cases**

* [Authority To Pass Bylaws] *Boilermakers Local 154 Retirement Fund v. Chevron Corp* (Chevron and Fedex adopted bylaws provided that litigation relating to internal affairs should be conducted in Delaware. P argued adoption was beyond Board’s authority and contractually invalid, also argued breach of FD. Issue: what subject can bylaws addres?)
	+ **Within authority**. Bylaws have “procedural, process-orientated nature” 🡪 allowed to set “self-imposed rules/regulations…for convenient functioning.” Here, process-oriented b/c they regulate *where* shareholders may file suit, NOT *whether* S may sue. Would be regulating external matters if bylaws attempted to bind P’s in regard to tort claims. AND Board may unilaterally adopt bylaws 🡪 binding on shareholders (part of contractual framework in AoI).

**[Piercing The Corporate Veil]**

* *Walkovszky v. Carlton* (P is injured in car accident with a cab. Carlton is primary stockholder of 10 corporations—each corporation has 2 cabs and minimum required liability insurance. Doesn’t keep much $/assets in corporations [paid out dividends to C]. P sues Carlton, to pierce the corporate veil, contending that D was fraudulently holding out corporations as separate entities when they actually work as one large corporation. Issue: pierce corporate veil?)
	+ **No.** Law permits incorporation for very purpose of enabling proprietors to escape liability…but not without limits 🡪 pierce veil whenever necessary to “***prevent fraud or to achieve equity***.” Here, Carlton played by the rules (complied w/ all insurance requirements), so no fraud. Piercing is not justified merely when insurance is inadequate to cover injuries 🡪 remedy *lies with the legislature*.
		- Carlton would be liable if he ***controlled corp for personal benefit*** at expense of corporation.
		- MR: most real-word judges decide veil-piercing cases by a “**scumbag rule**” 🡪 judges do not check corporate formalities, but ask whether the shareholder is a scumbag. If not, then absolve, If he is, they scour corporate documentation for evidence of missed formalities. *Walkovskzy* is rare case when couldn’t find any missing formalities, so swallowed hard and let C go.
	+ **Dissent:** C were *intentionally undercapitalized* to avoid responsibility for harm that was bound to arise. In absence of a clear legislative statement, approval of a scheme having such serious consequences is not to be so lightly inferred.
* *Sea-Land Services, Inc. v. Pepper Source* (Sea-land ships peppers for Pepper Source, but PS doesn’t pay. PS is owned by Marchese, who owns many other companies that he is the sole owner of, and one that he is a joint owner. Marchese uses corporate accounts to pay alimony and other personal expenses. Sea-Land sues and tries to collect, but there is no money. Suit against Marchese to pierce corporate veil, and wants to then collect against each company [“reverse piercing”])
	+ Corporate entity will be disregarded if two requirements are met: (1) must be such ***unity of interest and ownership*** that separate personalities of person and corp no longer exist; and (2) circumstance must be such that adherence to fiction of separate corporate existence would ***sanction fraud or promote injustice***. Here, (1) is met; remand to see if (2) (unsatisfied judgment is NOT enough to show injustice). Factors to consider for (1):
		- (1) Failure to maintain adequate corporate records or comply with corporate formalities;
		- (2) Commingling of funds or assets;
		- (3) Undercapitalization; and
		- (4) One corporation treating assets of another corporation as its own.
			* (2) in this case. Under-capitalization is not enough. Has to be ***deliberate***. UC matters, but why is critical.
	+ Why not fraud? Fraud is a legal term that requires proof of intent. Injustice is not a legal term, so back-door way to decide case w/o going to trial.
		- Should formalities matter? Depends on claim—tort v. contract. Matter for contract, not as obviously relevant in tort claims
* [Shareholder Derivative Action] *Eisenberg v. Flying Tiger Line, Inc.* (Flying Tiger [FT] forms a subsidiary, FTC, who forms a subsidiary, FTL. FT then merges into FTL. FT disappears. Now, FTC owns FTL+FT. [When A mergers into B, A shareholders *can* get shares in B, but also can get cash]. Eisenberg is shareholder of FT, and gets stock in FTC. E argues that shareholding rights have been diluted [before could elect directors of operating company, but not can only elect directors of holding company]. )
	+ If gravamen of complaint is *injury to corporation* 🡪 **derivative**, but if injury is *one to P as a stockholder and him individually* and NOT to corp 🡪 **direct suit**. This is ***direct suit*** 🡪 **voting right**, which is right of shareholder, NOT right of corporation. Hard to categorize because E *had not been harmed* (no loss of $$).
		- DoC and DoL claims are all derivative claims.
		- Direct suits also include dividend issues.
	+ What is E complaining about? NOT arguing company will be run less well (would have to run company is not worth is much, which would mean derivative suit 🡪 *would have to post bond* [have to pay legal fees of corporations if lose]). Instead, argued about ***voting right***.
		- MR: what does this mean? All he is arguing is that he *liked* the voting right (not that it lost the corp $$). Silly b/c ppl buy votes to get $$. Hard to see how he is harmed.
	+ In Delaware, many courts us **“special injury” test** 🡪 if wrong is separate and distinct from that suffered by other shareholders…or a wrong involving a contractual right of a shareholder, such as voting rights or to assert majority control (exists independent of any right of corporation), then **direct suit**.

**[Role And Purposes Of Corporations]**

* [Charitable Giving To Universities] *A.P. Smith Mfg. v. Barlow* (Fire hydrant company. Board decides to give $1.5k to Princeton. Suit brought by shareholder. Issue: corp allowed to give gift?)
	+ **Donation allowed**. Donation needs to be relative to corporation and no conflict of interest. State legislation adopted in the public interest and applied to preexisting corporations under the reserved power has repeatedly been sustained by SCOTUS. Public policy at issue is *far greater* than alternation of preexisting rights of stockholders. Gift is lawful exercise of the corporation’s ***implied and incidental powers*** under common-law principles. Benefit to AP Smith? Court says yes – PR benefit; future employees; bolstering community.
		- PP: (1) certificate of corporation doesn’t say corp can give to charity; (2) NJ statute said charitable giving *after* corp was incorporated;
	+ MR: shouldn’t be relevant that increasingly more $$ is in corporate form. Essentially, rich ppl giving poor ppl’s money to rich ppl charities.
		- **Law:** corporations may make donations of this sort to approved charities.
* [Forcing Dividends] *Dodge v. Ford Motor Co.* (Dodge brothers want to force Ford to give dividends; had historically given big dividends but wants now to build smelting factory and invest in community. [Problem is that Ford being chased by Chevy, and Ford is getting worried].)
	+ **Can build smelting plant, but *must pay* dividend.** Refusal to pay dividends appears to NOT to be discretionary but ***arbitrary refusal*** to do what circumstances requires. Ford was trying to run company as essentially a charitable organization. NOT within power of court to shape corp decisions for merely incidental shareholder benefit.
		- Directors, and they alone, have power to declare of dividend. Courts will NOT interfere unless it is *clearly made to appear* that they are ***guilty of fraud*** or ***misappropriation of corp funds***, or refuse to declare a dividend when it has a ***surplus of net profits*** which it can, w/o detriment to its business, divide among its stockholders, and when refusal to do so would equate to fraud or breach of good faith.
			* Corp is organized and carried on *primarily for profit of stockholders*. Power of directors are to be employed to that end.
			* Court: not persuaded that we should interfere with expansion of Ford. Judges are NOT business experts.
			* MR: Wacky opinion b/c strange CEO. Court says, you really should be trying to make $$.
	+ MR: law does not force corp to issue dividends, but does cap (don’t want corp paying out all lenders $$). Most shareholders don’t mind b/c dividends are taxable. In this case, Dodge brothers and taking $$ and plowing money into rival company. Don’t have FD b/c not on board or officers or controlling shareholders (in other cases, 10% may be enough to be controlling shareholder). Couldn’t share stock b/c Ford is a private company.
		- This case is NOT the norm. See *Shlensky v. Wrigley*. No way court would force company to have certain strategy. Different if there is a conflict of interest (making $$ on side) or duty of care (playing golf all day).
		- If no taxes exist, there is no harm to Ford in this case. HF can just take dividend and plow it back into the company. But at time, taxes were **77%** 🡪 tax consequences of dividends are brutal; Ford didn’t want to see as tax-evader. Said at court that Ford’s purpose is “only incidentally to make money.” Dodge brothers won’t get $$ either, but were just trying to cripple comp.
* [Religious/Ideological Preferences—Current Rule] *Shlensky v. Wrigley* (Chicago Cubs not playing games at night 🡪 shareholder sues to get Cubs to install lights and play games to make more $$. Board refuses b/c they believe “baseball is a daytime sport” = rich ppl time, so will harm neighborhood. Wrigley says it’s because of *personal religious beliefs*. Issue: must Board install lights/shift game times?)
	+ **Don’t have to pay**. NOT court’s function to resolve for corporations questions of policy and business management. ***Presumption of good faith***, not questioned unless tainted with fraud, illegality, or conflict of interest.
		- MR: Court understands niche-market strategies that look really weird. Some work, but some hit it big. Only team with daytime games 🡪 could work? Oddity.
	+ MR: if Wrigley owned 100% White Sox as well 🡪 would fundamentally change case b/c courts know financial conflict. Simple and easy to identify. But court is thinking in this case: b/c of *Ford*, we’re requiring CEO’s to mouth platitudes. And strange ideas can be incredibly successful, and we don’t want to mess this up. So you can have *whatever theory you want, and court won’t stop you*.
1. **#FIDUCIARY DUTIES**

**Overview** – FD are partly about P’s desire to control agents, but also about manages wanting to tie hands to obtain investor $$.

* **Duty of Loyalty:** director/officer must not engage in ***undisclosed business transactions*** where there is a conflict of interest. If D/O does deal with the firm 🡪 needs to disclose or prove it was good for the firm.
	+ As agent for the company/shareholders, owes a “duty of absolute loyalty.”
* **Duty of Care:** should spend as much time/care as an ***ordinarily prudent person would in similar situation***. (Or amount of care you would exercise if it was own money—NOT what *decision* an ordinarily prudent person would make). Not a very high standard.
	+ But you are NOT insurer. Not liable if bet does not work out. Investors want risk taking.
	+ MR: Sometimes referred to as negligence, but it really *gross negligence* 🡪 pretty close to fraud. Fairly low standard. Basically translates into procedural prerequisites 🡪 if you do “right things” in evaluating decision, you’re good. NOT if the decision is right, but if you *went through proper procedures*. Theory: judges are bad at evaluating business decision after the fact, and investors should be careful about who they pick.
* **#Business Judgment Rule:** Court will defer to business judgment of officers as to the business and affairs of the corporation. NOT concerned about outcome. Court won’t be bothered absent ***fraud, conflict of interes****t* (DoL)*,* ***illegality, gross negligence***(DoC)or *#****waste***(decision was so inadequate in value that no person of ordinary, sound business judgment would deem it worth that which the corporation paid).
* **Caremark Claim:** Part of duty of care is to ***monitor for misconduct***—only a sustained or systematic failure of the board to exercise oversight will establish the lack of good faith that is a necessary condition to liability.
* [Dominant Shareholders] Shareholders do NOT typically owe fiduciary duties, BUT **dominant shareholders** do owe FD to minority shareholders (*Sinclair*).
* [Creditors] D/O owe duty of care to **creditors** when company becomes insolvent.

**The Obligations of Control: Duty of Care**

* [Good Faith And BJR] *Kamin v. American Express Company* (AE bought stock in DLJ for $30m and dropped to $4m. Board decided to distribute shares to shareholders [dividend in kind], but some shareholders want AE to sell and get tax benefit of loss. Board declined b/c worried about price of share [accounting statements would look worse]. Issue: is decision breach of duty of care?)
	+ Did Board exercise due care? NOT enough to allege an imprudent/mistaken decision 🡪 *more*must be shown—***fraud, oppression, arbitrary action, or breach of trust***. Directors are entitled to exercised honest business judgment, and allowed to do so as long as ***acting in good faith***.
		- “All directors have an obligation, using sound business judgment, to maximize income for the benefit of all person shaving a stake in the welfare of the corporate entity.”
			* Once court found no CoI 🡪 forgone outcome for Board.
		- MR: AE’s argument is bad. Investors already know DLJ stock is bad, so stock price has already incorporated loss. Court knows, but basically says: AE was very careful about this, so satisfied duty of care. (“action was *carefully considered*”). But there IS a hint of conflict of interest (selling stock would hurt director compensation), so would have been easy for court to go other way (court said only affect 4/20 directors—but this should trouble you b/c directors were insiders at company and basically threw away $8m).
* [Reasonable Care] *Francis v. United Jersey Bank* (Reinsurance brokerage firm. Two directors [sons of dead owner] took a bunch of $$ from company. Other director [wife of dead owner] didn’t pay attention to what was going on. Wife dies. Creditor sues to recover losses from Wife’s estate. Issue: did Wife breach duty of care?)
	+ **Yes**. Scope of duties encompassed ***all reasonable action*** to stop continuing conversion (ordinary prudent person standard). Failed to do this—need to develop rudimentary understanding of corporation and give oversight/monitoring OR step down. If you see problem 🡪 need to object and have dissent noted and then resign/do more perhaps (need to make “reasonable attempts to prevent misappropriation”). Wrongdoing of sons does NOT excuse Wife’s negligence.
		- Wife had FD to creditors b/c firm operated like bank (taking $$ from customers in trust), and b/c firm was insolvent (switches from shareholders to creditors). Directors usually don’t have FD to creditors (just get whatever they have negotiated).
		- Court didn’t excuse Wife’s sickness/alcoholism b/c she didn’t step down. Was she on notice? Yes. Raised sons, and Father told her the sons were crooks.
	+ MR: This isn’t negligence, but gross negligence. She didn’t do anything. If you have expertise 🡪 might be held to higher than normal standard.
		- Also, issue of causation: court says if Wife had done something, sons would have stopped.
		- What are you supposed to do? Vote against it on record. Think about contacting attorney and suing.

**Duty of Loyalty**

* [Rigorous Scrutiny] *Bayer v. Beran* (Invent synthetic fabric. Spend $1m/year on advertising through radio, but President’s wife, JT, was the vocal/opera performer on the radio show. Issue: breach of duty of loyalty?)
	+ **No**, despite the lack of formal ratification. But **BJR yields to DoL**. If DoL in question 🡪 “entire transaction must be subjected to the ***most rigorous scrutiny*** to determine whether action was intended or calculated ‘to subserve some outside purpose, *regardless* of consequences to the company, and in a manner inconsistent with its interests.’” President has burden of proof to show ***good faith*** and ***inherent fairness*** 🡪 **strict scrutiny**. Here, there was an ungratified conflict of interest, but expenditure was not reckless or unconscionable.
		- Did NOT have board meeting, but court said “not fatal.” Informal decision-making was customary procedure of directors. IF you have board meeting 🡪 burden shifts to complaining shareholder.
	+ MR: Burden is on director if you have CoI that is not disclosed to Board. Fishy here b/c she got $555k from gig + professional bump. Worry is that picked bad advertising b/c of CoI.
		- Court said it was “rigorous scrutiny.” (But was it…?).
* [#Conflict Of Interest] In 19th century, all CoI were nullified at option of Board. By 20th century, you can get *enforceable CoI* 🡪 has to be (1) ***fair to the company*** AND (2) ***ratified by Board***. Modern statutes make it **either (1) OR (2)**.
	+ MR: Progressively easier and easier to do transactions. Is this a good thing? Transactions between company and those who are running company 🡪 larger and larger risk of theft. But also opens corporation up to larger array of transactions.
		- Shift is most beneficial for smaller firms (less risk of theft, and fewer transactions available), but bad for large corporations (higher risk of theft b/c low oversight by shareholders, and no lack of transactions).
* [Corporate #Opportunity Doctrine] *In re Ebay, Inc. Shareholders Litigation* (Ebay goes public, and Goldman “spins” off valuable stock to Ebay CEO and other officers who make a killing on them [essentially bribing Ebay CEO so GS will get more business].. Shareholder sues; argues stock was “corporate opportunity” that should have gone to Ebay and $$ should be paid to Ebay. Issue: breach of DoL?)
	+ **Yes.** **Corporate opportunity:** (1) in the corporations ***line of business***; (2) ***interest***; (3) ***expectancy*** (*Meinhard v. Salmon* – expected to get lease); or (4) ***necessity*** (e.g. mill on river that needs water for factory to run; CEO diverts water upstream). Basically, corp has legal right to something and CEO has stolen it 🡪 owe compensation.
		- Ebay ***is*** in “investment business.” MD: Court is trying to shoehorn case into CO framework.
	+ **Modern framework:** (1) corporate line of business (problematic for director if this is the only factor met; e.g. director on multiple boards in same industry); (2) learned about through work; (3) did CO arise with expectation that it would be passed onto the corporation.
		- Usually the courts ask (1). DoL could go beyond this set framework 🡪 *Regem* (did you get profit b/c of your connection to the company). Ebay officers were getting bribed.
		- **Selling private stock is NOT a CO.**
	+ MR: Basically a bribe. Court says that Ebay is in the business of selling stock, so this is a corporate opportunity and need to offer to Ebay. Breach of FD. Why do we care? Like British sergeant in Cairo. Opportunity that came to you *through your service* 🡪 need to offer to company.
		- CO is fine as a doctrine, but can be solved by using the *standard duty of loyalty*. Why do we have separate doctrine? Super common.
		- Traditional way for CO to arise is company had contractual right. A little more subtle case is *Meinhard v. Salmon* 🡪 partnership expected to get opportunity (“expectancy”). Third is necessity.
		- **Modern approach:** is this ***in the line of business*** of the company? Works reasonably well for senior officers; more difficult for independent directors.
		- Most common litigation point is whether company had *financial resources* for company to take CO. Usually company wins 🡪 it is the job of Senior Officers to raise the funds to make it happen.
	+ **Requirements of CEO if CO appears:** (1) go to Board and inform of CO. (2) Board needs to make decision. If vote no (rejected) 🡪 CEO can take. If Board does not reject (accept or silent) 🡪 cannot take CO.

**[Dominating Shareholders]**

* If majority shareholder, then obviously yes (owe FD). But you can be controlling (“dominating”) with less than 50%. Depends on how widely dispersed the other shares are. Sometimes courts will say the ***controlling shareholder*** has *fiduciary duty* to minority shareholder. Reasoning: director essentially owe job to dominating shareholder, so effectively, minority shareholders can’t look to directors to look out for interest. So courts, to make this work in real life, push the FD a level up to dominating/majority shareholders.
	+ MR: should bother you, b/c ppl become shareholder for different reason (to get rich *for you personally*) than to become director (*hired* to look out for company). If you’re only buying stock to invest, doesn’t make any sense to say you have FD. But courts do this anyway because it’s hard to get right result any other way (if controlling appoints board, then board won’t be looking out for minority ppl).
* [FD To Minority Shareholder] #*Sinclair Oil Corp. v. Levien* (Sinclair Oil Corp owns Sinven [determines who is on board] and Sinclair International. SI buys oil from Sinven, Shareholder of Sinven argued that Sinven is paying excessive dividends [Sinclair bleeding Sinven]. Issue: Breach?)
	+ **Dividends Issue.** Sinclair on both sides of transaction, which usually means “Standard of Intrinsic Fairness” but there’s no self-dealing here (b/c all shareholders, including Levien, is getting proportional share of dividend). **Self-dealing:** parent receives benefit to the *exclusion and at the expense* of subsidiary. So go to business judgment rule 🡪 deference unless can show ***improper motives*** or ***amounted to waste***.
		- Could be self-dealing if you have two classes of stock and only one class gets dividend.
		- If you are on ***both sides of the transactions*** 🡪 could have FD, even though shareholders typically don’t have any FD.
		- NOT excessive dividends b/c no potential for self-dealing 🡪 all shareholders getting dividends (so no benefit to exclusion of minority).
		- MR: Should Sinclair-Venezuela been making investments? No. 30 year oil rights were expiring and new leader comes into power who favors nationalization of oil (Sinclair is trying to get out).
	+ **Corporate Opportunities Issue.** What about corporate opportunities? Not a problem None came directly to Venezuela, and P didn’t show any particular reason why opportunities *should have gone* to Sivon.
		- MR: Court is basically saying OK to have country-specific subs for organizational reasons (even tho not legally required).
	+ **Breach of Contract Issue.** Sinclair loses. Self-dealing, and Sinclair failed to meet intrinsic fairness standard.
* [Preferring One Class Of Stock] *Zahn v. Transamerica Corporation* (Philip Morris buys Axton-Fisher. Capital structure: Three classes of stock—[1] Preferred [gets dividends *first* on a cumulated basis, $6/share, AND *liquidation preference*, so unpaid cumulated dividends are paid upon liquidation]; [2] “common” Class A [should be called “junior preferred”; gets dividend after preferred, $3.20/share, and *redeemable* at $60/share w/ accrued dividends and 60-day notice, but Class A can *convert* to Class B at anytime; also, if *liquidated* 🡪 A gets 2x what B gets]; [3] Common B [last in line, $1.6/share; no preference]. PM called Class A, then liquidated AF [only makes sense if liquidation results in $$$, which eliminates A’s 2:1 preference; whether A converts or not depends on whether the result would be above/below $60]. Issue: was call breach?)
	+ **Yes**. You have FD to “A” stockholders as majority “B” stockholder. ***FD to minority*** 🡪 need to prove fairness of transaction. Can’t do something *at expense* of minority (self-dealing), so not entitled to call shares at all.
		- **Will company call stock, and will A stock convert?**

|  |  |  |  |
| --- | --- | --- | --- |
| **Company has….** | **(1) $6000**  | **(2) $10,000** | **(3) $30,000** |
| Liquidate | $40A; 20B  | $66A; 33B | $200A; 100B |
| Redeemed/Call | 60A; 0B (B won’t call) | 60A; 40B (B will call) | 60A; 240B |
| Convert | 30A; 30B | 50A; 50B | 150A; 150B (A will convert) |

Ex. 100 Shares of A; 100 Shares of B

* + - Right to redeem is completely one-sided 🡪 right of company, but shareholder cannot force a sale.
		- Why bizarre capital structure? Different levels of risk preference (at poor performance, A’s get better treatment; but if at some point, A’s expected to convert to B’s). But you really don’t need b/c can mix stocks and bonds. But here, Class A probably designed to give old creditors from bankruptcy preference over common.
		- **Par value:** legally-mandated price at which the stock must ***initially*** be sold. Says *nothing* about re-sell price. Logic 🡪 to ensure everyone is paying the same amount. Quickly becomes problematic if stock is bought with non-cash assets, so sold above par value. Par value not used really anymore.
		- In practice, preferred stock almost always cumulates. Too easy to take advantage of PS otherwise. But default in corporate law is not cumulative, so cumulative nature is put in articles of incorporation.
		- If preferred stock dividends are missed for certain number of times 🡪 gives preferred stock voting interest equal to the common.
		- No stock is “entitled” to dividends. Company doesn’t have to pay dividends.
	+ **On remand**, the D court says that court’s decision didn’t make any sense. Whole point of corporate structure was to eliminate two classes of stock. Treated damages as if all A’s converted. Perfectly acceptable to convert, but HAVE to *disclose information* so shareholders will know if they should convert or not. Essentially held that PM engaged in insider trading.
		- MR: AF was not a publicly traded company, so not hard to understand that shareholders didn’t know how much liquidation was worth.
	+ MR: what is the role of an independent director in this case? Nothing in this case involves value of the company or general shareholder value, only allocating funds *between shareholders*. **Rule:** ***maximize returns to the junior-most security***. Why? Almost always gives clear answer, b/c it’s pretty easy to spot junior-most security. And b/c its clear 🡪 you can contract around it, and this is ok.

**[#Ratification]**

* [Burden Of Proof] *Fliegler v. Lawrence* (Derivative suit. Lawrence [President of Agau, mining company] buys land and offers first to company, but Agau says too risky and not sufficient $$ at the moment. L sets up USAC, puts $$ in company and gives Agau option of buying stock. Land is good; Agau buys USAC stock. P sues arguing CO that should have been given to Agau.)
	+ **D proved intrinsic fairness of transaction**. Court used BJR; did not apply *Gottlieb* 🡪 shareholder ratification of an “interested transaction,” although less than unanimous shifts the BoP to an objecting shareholder to demonstrate that the terms are so unequal as to amount to a gift or waste of corporate assets.
		- If ***no*** CO, BoP is on P and standard is ***waste***. (*American Express*)
		- If CO, and NOT ratified, then BoP is on D, and standard is ***fair & reasonable***. (*Bayer*; *Fliegler*)
		- If CO, AND ratified, then BoP is on P, and standard is ***waste***.
	+ [Repealing Common Law Provision] **8 Del. C. § 144(a):** no contract between corp and director shall be void solely for this reason IF (1-3)
		- (1) **Disclose and Ratify.** Material facts as to director’s interest are disclosed/known to *disinterested board*, and board in good faith authorizes transaction, even though the disinterested directors be *less than a quorum*.
		- (2) **Disclose and Ratify, Shareholders.** Same as above, but disclosed and ratified by majority of shareholders. *Fliegler* holds that must be ***majority of disinterested shareholders*** (even though statute seems to allow interested shareholder ratification).
		- (3) **Fair and Reasonable.** Contract/transaction is fair as to corp as of the time it is authorized, approved or ratified, by the board, a committee, or the shareholders

|  |  |  |  |
| --- | --- | --- | --- |
| Conflict of Interest? | Ratification? | Burden of Proof? | Standard? |
| No | No🡪 | Plaintiff | BJR; “waste” |
| (*Fliegler*) Yes | No🡪 | Defendant | Fairness and reasonable (intrinsic fairness test) |
| (*Gottlieb*) Yes | Yes🡪[shifts BOP] | Plaintiff | Waste |

**[Obligation Of Good Faith]**

* [Oversight—“#*Caremark* Claim” And Good Faith] *Stone v. Ritter* (Raises the question of board deciding that not worrying about negligence/misconduct is a reasonable thing to do. Here, subsidiary had been fined previously for failing to report suspicious activity [anti money laundering measure]. Shareholders file derivative suit to recover from directors for fines. Issue: did board exercise sufficient oversight?)
	+ **No.** *Caremark* held you *have to have an oversight system in place* to ***monitor misconduct***, and outlines necessary conditions for liability: (a) directors ***utterly failed***to implement any reporting or info system/controls; or (b) having implemented a system, ***consciously failed to monitor/oversee*** its operations. Both (a) and (b) require knowledge. Here, board made good faith effort, so P has no *Caremark* claim.
		- Here, P trying to equate a *bad outcome with bad faith*. In absence of red flags, good faith in the context of oversight must be measured by the directors’ actions “to assure a reasonable information and reporting system exists” and NOT by second-guessing after the occurrence of employee conduct that results in an unintended adverse outcome. Bank had *Caremark* system in place, but cannot catch everything. OK if you have a reasonable monitoring system in place.
	+ MR: dismissed for failure to excuse demand 🡪 demand on board is filed prior to a derivative suit. Absent fraud, illegality, CoI, or negligence, court defers to board’s decision. But sometimes, shareholders asking board to sue board 🡪 CoI, so demand is excused. CoI turns on whether they’re liable, which turns on 102(b)(7) in corporate charter (result of bad result in *Smith v. Van Gorkom*)—eliminates liability for breach of duty of care but NOT for breach of duty of loyalty or acts not in good faith. Made *Caremark* optional (which court hates). So court moves it out of duty of care and into duty of loyalty by saying “duty of good faith” is part of DoL.
* [Independence of Board] *China Agritech Inc. v. Shareholder Derivative Litigation* (Chinese fertilizer manufacturer that became U.S. company through reverse merger [target maintains existence]. CA is fraud; basically raising front to steal from investors. Issue: does P have to make demand on CA before derivative suit?)
	+ **Demand excused.** Basic question from *Stone*: determine whether directors are incapable of making an impartial decision regarding whether to institute such litigation. **Two tests:** (1) if *same board* that made decisions are still in office when suit is filed, standard is *Aronson* 🡪 must decide if reasonable doubt that (i) directors are disinterested and independent [duty of loyalty problem?] and (ii) challenged transaction was otherwise the product of a valid exercise of business judgment [gross negligence]; (2) if board did NOT participate in underlying decision, standard is *Rales* 🡪 whether the facts create reasonable doubt that the board could have *properly exercised its independent and disinterested* business judgment. Broader.
		- MR: no one makes demand b/c if you lose, can’t bring suit. So all litigation revolves around whether demand is excused, which turns on whether board is independent. Thus the court needs to look at (usually) merits of the case.
	+ Also, *Caremark* claim that directors did not act in #good faith. Failure to act in good faith may be shown, for instance, [1] where fiduciary *intentionally acts* with a purpose other than advancing the best interests of corp, [2] where fiduciary acts with *intent to violate* applicable positive law, or [3] where fiduciary *intentionally fails to act* in the face of a known duty, demonstrating a conscious disregard for his duties.
	+ E.g. associate siphoning off law firms retirement matching. Violation of FD. Fraud. Agent is stealing money from principle, and making all details correct doesn’t matter.
1. **#DISCLOSURE**

**Overview**

* **1933 Act – The “Securities Act.”** (*BarChris*)
	+ Concerns the initial registration of securities w/ SEC (form S-1 🡪 IPO’s). Bread/butter of securities lawyer. Primarily concerned with the primary market.
	+ NOT a minimum quality standard, but a *disclosure requirement* (does not say you cannot sell certain thing) 🡪 concerned with material info to investors and prevention of fraud.
		- MR: but firms already have incentive to disclose info, so does ’33 act make any sense (benefits > costs)? Filing S-1 is incredibly expensive.
	+ **“Blue-sky Laws”:** state statutes governing the sale of securities (before ’33, securities fraud was state-law matter).
	+ **§ 5** **(Basic Rules)**
		- **(a)** – Cannot sell through prospectus 🡪 *unlawful* to sell until registration statement has been filed with and cleared by SEC.
		- **(b)** – Cannot contact buyer before registration has been filed.
	+ *How do you get around S-1?*
		- **Play with def. of “security”?** No way out if selling stock/bond.
			* **Security:** any note, stock, treasury stock, security future, bond, debenture, investment contract, or, in general, any interest or instrument commonly known as “security.”
			* SCOTUS has defined as broadly as they can 🡪 **investment contract** is “a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.” Investment pool where you expect earnings will come exclusively from other ppl’s work. If you’re *involved in generating earnings* 🡪 NOT a security. *Is partnership an investment contract?* No. Not dependent on efforts of third party—have control. Limited partnership interest *is* a security (don’t have control). Horse-breeding schemes, pyramid schemes = security (relying one efforts of others).
	+ **§ 4 (Exceptions):** Section 5 does NOT apply to: (1) transaction by any other than an issuer, underwriter, or dealer [e.g. stockbroker reselling stock he bought—secondary market] (2) transactions by an issuer not involving any public offering [small firm selling stock to a few ppl privately].
		- MR: in practice, don’t want to rely on (2). If private party buys stock with a “*view to resell*” 🡪 then person is an underwriter (Sec. 5 applies). Private offering might not be private offering.
		- How do you get around this? Follow safe-harbor rules.
	+ **§ 11 (Civil Liability):**
		- Can sue (1) every person who signed registration statement; (2) director of the issuer; (3) every expert whose profession gives authority to a statement and prepared/certified registration statement (usually accountant); (5) every underwriter.
		- **Due Diligence Defense:** anyone who is NOT the issuer can escape liability if person, after *reasonable investigation*, had *reasonable ground* to believe (and did believe) that registration statements were true and there was no material omission.
		- In registration statement, there is expertised version and non-expertised version. See p.416-17.
			* *Non-expertised version (e.g. lawyer-written part):* Experts have no liability (11[a][4]). Non-experts not liable if after ***reasonable investigation*** believed statements were true 🡪 **“due diligence defense”**(11[b][3][A]).
				+ Worthwhile for company conduct due diligence.
			* *Expertised version (e.g. engineer written part):* Experts after RI believed statements were true or registration statement did not *fairly represent* expert statement (11[b][3][B]). Non-expert not liable if had ***no reasonable ground***to believe statements were untrue 🡪 easier defense (11[b][3][C])
* [Defenses] *Escott v. BarChris Construction Co.* (Bowling alley boom in ‘60’s, but collapses and BarChris’ clients default and can’t pay creditors. Sue for misstatements in SEC registrations. Issue: did registration statement contain false statements or omit “material” statements. If so, have D established affirmative defenses?)
	+ **Yes, material.** “Material” = those matters to which an ***average* *prudent investor ought reasonably to be informed*** before purchasing. NOT concerned with minor inaccuracies/errors.
	+ **Yes, many failed to meet DD defense.**
		- *Vitolo and Pugliese* (President/VP):No DD defense. Does not matter how educated you are. *Hire law firm*. It’s your job to make sense of it. No evidence they made investigation.
		- *Kircher* (director): Director is liable, no matter how new he is.
		- *Birbaum* (in house lawyer): No DD defense. Should have known obligations under statute.
		- *Auslander* (“outside” director): No DD defense. Director presumed to know responsibility when takes job. CAN have DD defense for audited portion (relied on reputation of accounting firm).
		- *Grant* (director, lawer; drafted registration statement): No DD defense. Tried to argue he couldn’t second-guess clients. Court says if want DD defense, this is what you have to do (and he’s a director). And *more* is required b/c he drafted statement. Higher than general director requirement.
		- *Peat, Marwick* (accounting firm): No DD defense. Too easily satisfied.
			* Due diligence defenses are NOT for the issuer, but for *individuals*. “Section 11(b) …no person, *other than the issuer*, shall be liable...).
1. **#INSIDER TRADING**
* *Where is the harm?* Ppl had already decided to sell. If insider didn’t buy, someone else would have. And there’s always a mismatch of misinformation. But “arbs” are hurt sort of 🡪 insider captured more of profit than them. But who cares? How is this any different than a whole bunch of transactions (e.g. selling a lemon, buying land you know has oil). Acquirer is also hurt under FD analysis. Agents are making $$ *only* due to their agency (*Reading*). But FD are waivable. P can cut any deal with A it wants. Also, insider buying can cause stock to go up 🡪 imposes larger costs on acquirer.
	+ Ppl buying stock in TO have no duty to target’s shareholders.

**Overview**

* **1934 Act – the “Exchange Act.”**
	+ Hodgepodge, and covers secondary market. Addresses ongoing reporting, insider trading (10[b][5]), liability for short-swing profits (16[b]), proxy rules, and tender offers.
	+ [RECENT CASE] Applying *Dirks* (Dell analyst tips off, and info gets to hedge fund guy 4 ppl down the chain, who sells stock. Court said hedge fund need to know the tip was breach AND get gain.)
* **Rule 10b­–5 (Principle Anti-Fraud Rule):** in connection with unregistered AND registered securities, unlawful to (a) to employ any device, scheme, or artifice to *defraud*; (b) make any *untrue statement of material fact* (or omit if it would be misleading in light of the circumstances); (c) engage in act, practice, or course of business which operates as *a fraud or deceit* upon any person.
	+ Rule originally NOT about insider trading, but fraud 🡪 *non-disclosure amount to fraud when there is FD* (agents aren’t supposed to make $$ as result of agency relationship, so non-disclosure is breach).
	+ For insider trading, needs to be ***material non-public information***.
	+ **General Rule: *“Abstain or Disclose”*** (*TGS*)
	+ **10b­–5(2) “Misappropriation Theory”:** recipient of MNI is deemed to have FD (1) whenever someone agrees to maintain info in confidence; (2) between two ppl who have a pattern or practice of sharing confidences such that recipient of info knows/reasonably should know that speaker expects the info to remain confidentiality; (3) when someone receives or obtains MNI from a *spouse, child, or sibling*.
		- Applies to outsiders who have *no FD* and is premised on deception to the source 🡪 breach of duty of trust or confidence owed to the source of the information.
	+ **“Temporary Insider”:** anyone who legitimately gets MNI solely for corporate purposes (lawyer, underwriter, accountant, consultant) falls under personal gain test of *Dirks*.
	+ **Tippee Liability (***Dirks***):** tippee *assumes FD* to shareholders not to trade on MNI ***only*** when insider has breached FD by disclosure AND tippee knows/should know there has been a breach.
		- Test of whether insider breached FD is whether the insider ***personally will benefit***, directly or indirectly, from his disclosure. Absent some *personal gain*, there has been no breach of FD duty to stockholders.
* **Rule 14e–3:** in connection with tender offer 🡪 ***fraud*** to trade stock based on nonpublic material information *acquired from acquirer, target, or any officer/director/partner/employee*.
	+ No FD is required to be liable. Gets rid of *Chiarella*—insiders who trade on TO buy stocks on basis of info obtained from acquirers (fine b/c no duty to target).

**Insider Trading Cases**

* [Disclose Or Abstain] *SEC v. Texas Gulf Sulphur Co* (TGS) (TG doing exploratory drilling Canada looking for ore. Finds massive cache [cores had high mineral content]. Keep it secret b/c want to buy land cheaply [ok; cannot lie, but no duty to disclose]. Senior executives start buying TG stock/options. Issue: is insider trading covered under 10b–5?)
	+ **Yes 🡪 makes insider trading a crime**. Violation of 10b–5. Anyone in possession of *material inside information* must either disclose OR abstain from trading until public knows. Material facts do NOT have to be disclosed immediately. Insiders weren’t trading on equal footing with outsiders (info clearly material).
		- MR: court uses fictitious history. Congress did not intend insider trading to fall under 10b–5. “core of [rule] is…that all investors should have equal access to the rewards of participation in securities transaction.”
		- **Material:** whether a *reasonable man* would attach importance…in determining his choice of action in the transaction in question. Insider needs to disclose/abstain only in “those situations which are essentially extraordinary in nature and which are reasonable certain to have a substantial effect on the market price of the security once disclosed.
			* Court looked to see what ppl with info did to see if they treated it as material. Insiders bought stock 🡪 must be material.
			* MR: pretty hard to come up with insider trader case that isn’t material info. If you traded on it 🡪 assumed to be material. Essentially defined out of existence.
	+ Coates waits till announcement is public, calls brother-in-law to buy up a bunch of stock. **Still liable.** Court says you need to wait until “news could reasonably have been expected to appear over the media of widest circulation…”
		- MR: basically have to wait until others make money on it. Can’t trade until ***info is incorporated*** (no longer any economic gain to be had on the info).
	+ Company releases misleading public statement. Violation of 10b–5? **Yes.** Court expands coverage to include public statements to be “in connection with the purchase or sale of any security” requirement. Doesn’t matter if company wasn’t engaging in securities transactions. Obvious purpose of Act is to protect investing public and secure fair dealing. Remand to lower court to determine if misleading.
	+ MR: *TGS* lays out a **“level playing field” theory** (“core of Rule 10b–5 is purpose that all investors should have *equal access* to rewards of securities transactions”)—NOT currently the law. Polar approach is worrying about whether agent is trading w/o disclosing to its principle (*Dirks*). Theories lead to different outcome. Problem with 1st is you sweep in all analysts that investigate firm (and no one can seriously argue every investor will take the time to acquire all the info). Problem with 2nd is tipees can then trade in insider info w/o breach fiduciary duties to anyone.
		- [FD APPROACH] *Chiarella* (Acquirer hires Skadden who then hires financial printers. Markup guy at printers figured out who was target of acquisition was and went and bought stock. Issue: insider trading?)
			* **No.** No *fiduciary duty to target* 🡪 SCOTUS rejects level playing field theory. No general duty between all participants in market transactions to forgo actions based on material, nonpublic info. W/o FD duty to shareholders, there is no fraud (test of 10B–5) b/c no duty to disclose. Has duty to acquirer, but NOT buying acquirer stock, but targets stock.
			* [MISAPPROPRIATION THEORY] **Burger dissent:** he *misappropriated info*! Fraud (violated 10B–5) b/c he violated terms of his agency (had employment terms to be silent).
		- In response to *Chiarella*, SEC comes up with new rule, **Rule 14e–3(a)** 🡪 if you have tender offer, fraud to use material information to buy stocks. Directly contradicts what SCOTUS said. Gets away with it in *O’Hagan*.
* [Gain] *Dirks v. SEC* (Dirks received material nonpublic information from “insiders” with which he had no connection. Upset employee told Dirks his life insurance firm was overstating earnings [had “forgery parties”]. WSJ and SEC rejected Dirks story. Dirks flew out to LA to investigate, then discloses this info to investors who relied it in trading shares. Issue: did Dirks violate 10b–5?)
	+ **No. Test:** does tippee (Dirks) know/should know that original tip was FD breach by *insider* (NOT about outsider, like Dirk). Test of whether insider breached FD is whether the insider ***personally will benefit***, directly or indirectly, from his disclosure. Absent some *personal gain*, there has been no breach of FD duty to stockholders (gain, in caselaw, has basically been financial). If breach, tippee inherits FD breach from tipper.
		- Recent Bahara case: court takes seriously benefit requirement.
		- MR: Court is saying that for FD breach we’re concerned about in 10b–5 is duty of loyalty, NOT duty of care (Goldman analysts chatting too much in elevator). DoC is not a breach for purposes of tips and *Dirks*.
	+ [Temporary Insider] **FN 14:** anyone who legitimately gets MNI solely for corporate purposes (lawyer, underwriter, accountant, consultant) becomes **“temporary insider”** and falls under personal gain test of *Dirks*. E.g. outside firm gets MNI and passes it on. Firm is tipper for sake of *Dirks*. BUT needs to be agent of firm/corp, not an individual.
	+ E.g. CEO talking to wife at track meet. Guy overhears. Breach of DoC, but NOT 10B–5 violation under *Dirks*.
* [Relationships Inherit Insider Duty] – SEC responds to *Chestman* problem (said spouses are NOT agents to each other). **10b5–2** (3 situations which person has duty for purposes of **‘misappropriation’ theory**). FD exists (1) whenever someone agrees to maintain info in confidence; (2) between two ppl who have a pattern or practice of sharing confidences such that recipient of info knows/reasonably should know that speaker expects the info to remain confidentiality; (3) when someone receives or obtains MNI from a *spouse, child, or sibling*.
	+ In response, 2nd Circuit start adopting the Burger dissent from *TGS*. MR: but it’s a dissent! (Jury didn’t consider it though, so ok).
	+ *Newman*; *Mussella*: *Mafena* – Court applies misappropriation theory, and SCOTUS denies cert.
	+ *Willis* (Wife of future Bank of America tells shrink. He trades. Insider trading?) **Yes.** Doctor/patient relationships involve a duty of confidence.
	+ Morgan Stanley finds out MNI as part of negotiating with target. Offer falls through, but MS buys stock of target. *Dirks* in FN 22 says ok. But in *Lund*, court says this is FN 14.
	+ *Winans* (WSJ reporter gathers public info, then writes article “Heard on the street.” Before publishes, gives to W to trade on it. Issue: insider trading?) Under *Chiarella*, no. But WSJ had internal rule banning reports from trading, so SEC argued W misappropriated information. 10b–5 violation.
		- MR: making a federal crime out of internal company rule?
* [Answering 2nd Circuit] *United States v. O’Hagan* (O’Hagan a lawyer at Dorsey &Whitney. GrandMet wants to hire Pillsbury and hires Cravath who hires D&W. Before tender offer announced, O’Hagan buys stocks/options in Pillsbury. Like Chiarella in that lawyer has no FD to target shareholders. Issue: insider trading?)
	+ **Yes.** Two questions: (1) is misappropriation theory good? (2) 14e-3 good law? **Yes to both.** Misappropriation is a violation of 10b–5. **“Misappropriation theory**” holds that person commits fraud “in connection with” a securities transaction (violates 10b–5) when he ***misappropriates confidential information*** for securities trading purposes, in breach of duty to source of the info. (*Chiarella* would have gone the other way under *O’Hagan*).
		- FN 7: O’Hagan would not have been ok if just disclosed to firm. And if everyone says ok, still liable under 14(e)–3.
		- Makes “level playing field” theory NOT correct.
	+ *Santa Fee Industries* 🡪 10b–5 is about *deception*. FD breach, in itself, is NOT enough to make it 10b–5 violation.

**Short-Swing Profits**

* **§16b (of ’34 Act):** drafted to cover insider trading. 10B–5 is not applied until later. Takes prophylactic rule approach.
	+ Has to be a certain type of insider: ***directors, officers,* or *10% stockowner***. Have to be correct insider at *first transaction* (but not necessarily at the second—only second matters if 10%). E.g. need to be 10% shareholder immediately before first transaction.
	+ Recoverable by the issuer (the company). Does NOT include criminal sanctions or a shareholders right to recover any offsetting loss (but shareholder can bring derivative suit).
	+ Has to be security of company that is ***registered under ‘34 act*** (excludes equity interests such as partnerships, small-business stocks). Only 16b problem when registered under ’34 act OR traded on a national exchange.
	+ Has to be purchase AND sale ***within six months*** (in either order—can be sale then purchase).
	+ Matching purchases and sale: whatever combination results ***in the most $$*.** Does NOT matter if you can prove which shares were sold.
		- E.g. CEO sold all shares and lost money, but 16b liability for the subset of shares he made $$ on.
	+ DOESN’T cover bonds. Options *are* and convertible debt *can* be covered.
* [Time Of Sale] *Reliance Electric Co. v. Emerson Electric Co.* (Emerson is acquirer; Dodge is target. E buys 13.2% stock, then D merges into Reliance and E can’t acquire anymore. E sells stock in two steps—3.3% and 9.9% [trying to avoid paying 16b profit recovery on 9.9%]. Issue: is 9.9% recoverable y Relieance?)
	+ **No.** At *time of sale*, not a 10% shareholder.
		- Corporation may recover profits realized by an owner of more than 10% of its shares from a purchase and a sale of its stock within any six-month period, provided that owner held more than 10% “both at the *time of the purchase AND sale*.”
	+ PP: but substance over form! Transaction specifically designed to avoid 16b liability.
* [Immediately Prior To Purchase] *Foremost-McKesson v. Provident Securities Company* (P sales assets to F for convertible securities. Split the sale into two transactions so won’t have to pay anything on 2nd transaction. Issue: is person a “beneficial owner” at time of purchase if purchase took them over the 10% threshold?)
	+ **No.** Need more than 10% *immediately prior* to purchase.
* P.488 Problems \*\*find more to do.
	+ 1. ’34 company. Officer (so doesn’t matter if 10%).
		- (a) Yes. Liable for (50-10) x 200k
		- (b) Liable for all. Doesn’t about % b/c he’s CEO.
		- (c) Liable. Officer at the time of purchase.
	+ 2. 16b? Yes. Over 10% threshold.
		- (a) Not liable. Not 10% prior to purchase
		- (b) Liable for 2nd purchase. 50kx(50-10)
		- (c) Can’t consider 2nd sale or last purchase (not 10% immediately prior).
		- E.g. S1 70k at $50. S2 130k at $10. B1 110k at $100. B2 90k at $8.
			* Lost money, but we don’t care. How do we calculate gain? What is most painful to the person 🡪 70k at $42 gain, and 20k at $2 gain.
	+ 3. Yes. 100k x 10.
	+ 4. Yes. 10% shareholder on a convertible basis. Ask, *were she to convert*, how many would she have?
	+ 5. Liable for second transaction. Second purchase *is covered*. 50k(50-10). But not liable if only sold A stock 🡪 not matching purchase.
		- **FN p. 481** – 10% of *any class of equity security*.
* [Exception] *Kern County* – 16b doesn’t apply to hostile acquirer if purchase is ***forced*** by white knight merger. But form almost always triumphs over substance.
1. **#PROXY FIGHTS**

**Overview**

* **Default:** “Business affairs of company shall be *managed by the board*.” Directors, NOT shareholders, run firm (shareholders not allowed to intervene). Board owes FD to *all shareholders* and therefore is looking out for all interests.
	+ At smaller companies, smaller shareholders want more of a direct say. Can structure where shareholders call shots.
	+ Shareholder meetings have to be held once a year (elect directors), before major event (merger, liquidation). There are elaborate notice requirements, and minority shareholders can call special meetings.
	+ Often, shareholders sign **“proxy card”** authorizing someone to vote your shares at meeting (proxy is *agent*). Called “sending in your proxy.” Proxy card is NOT a ballot, but authorization of agency.
	+ Proxy fights governed by state law, but also highly regulated by ’34 Act.
		- SEC requires that anyone soliciting proxies from public shareholders must file with SEC and distribute to shareholders specified info in a “proxy statement.”
	+ **E.g. Nabisco** – Officers are TL, S, B. Owner (minority) is GRRM (running for peace prize). TL wants to buy Philip Morris, but GRRM opposes it.
		- Can GRRM bring derivative suit? Sure, but no CoI, so he’ll lose. It’s a business decision.
		- Proxy fight? Sure but very $$$. Can’t try to pass resolution, “don’t invest in addictive products” (part of business of company, which is prerogative of directors).
			* Shareholders can pass *resolution*, but directors aren’t forced to do anything. Trying to embarrass company into taking certain action (goose force-feeding case).
* **Reimbursement of Costs for Proxy Fights**
	+ ***Incumbents:*** Not required to sit idly by. Reimbursed for expenses if…
		- Act in *good faith* in a contest over policy. (Courts will disallow for personal power, individual gain or private advantage.)
		- Incur reasonable and proper expenses for solicitation of proxies.
		- No requirement of shareholder vote.
		- Does NOT matter if they win/lose.
	+ ***Insurgents:***
		- If they *lose* 🡪 NO reimbursement.
		- If they *win* 🡪 ***can*** be reimbursed by corporation for expenditures if…
			* A majority of shareholders vote and agree to reimburse.
			* Expenses are reasonable.
			* A policy matter was at issue (policy pretty much *always* at stake).

**Proxy Fight Cases**

* [Proxy Costs For Incumbents] *Levin v. MGM* (Two groups of MGM stockholders—Levin and O’Brien. O’Brien is soliciting proxies, hiring agencies w/ corporate funds [L using own funds to do the same]. L argues that O is agent charging principle to keep agent. Issue: Can O use corporate funds to pay for proxy campaign?)
	+ **Yes.** Incumbents can charge expenses to firm **as *long as they’re reasonable***. O’s costs were not unreasonable or illegal, and shareholders were notified of expenses.
		- MR: Levin was front for the Jewish Mob, so more sympathetic for the court.
	+ MR: Strange that agent can charged principle for costs to convince P to keep A, but most proxy meetings are uncontested, and directors would be less likely to serve if forced to pony up costs.
* [Reimbursement If Policy] *Rosenfeld v. Fairchild Engine & Plane Corp.* (Stockholder brought suit to compel return of $$ spend on proxy fight, which had be approved by majority of shareholders. Issue: is it chargeable to company?)
	+ When directors act in ***good faith*** in a contest over ***policy***(NOT purely personal power) 🡪 have right to incur reasonable/proper expenses for solicitation of proxies and in defense of their corporate polices (subject to scrutiny of courts). Also, **successful contenders** can be reimbursed by corp. for their expenditures by affirmative vote of stockholders (have to win, and then get shareholders to vote).
		- Courts will disallow if $$ was spent for personal power, individual gain or private advantage.
	+ **Dissent:** when in the real world are you going to have an insurgent contest on anything other than policy? If reimbursement depends on policy dispute, then you’ll *have a policy dispute* (will make something up). Also, if purpose of fight is *ultra vires* 🡪 need unanimous shareholder vote. And get 100% for insurgents will never happen (incumbents will always have some stock).
		- MR: very odd and unrealistic result. No insurgent will make wacky argument that it’s only about personal power.

**[Shareholder #Proposals]** – SEC through ’34 act allows shareholder to propose different things. Originally just business related, but later in the 20th century saw more social/political issues. But in ‘90’s, large pension funds and other institutional investors begin to do business related proposals (e.g. corporate governance).

* + Management *always* opposes. By definition, if management liked it then they would have incorporated it. About 1/3 are sent out (others are negotiated away).
* [Significantly Related] *Lovenheim v. Iroquois Brands* (L bought 200 shares to change way it sourced it’s pate [geese being forced-fed]. Proposed that I formed committee to study methods about how pate is made. I refused under § 14(a) of ’34 act—company may exclude proposal if “proposal relates to less than 5% of assets and less than 5% of net earnings and gross sales in recent year, AND is not *otherwise significantly related* to issuer’s business.” Issue: is proposal “significantly related”?)
	+ § 14(a) is NOT limited to “economic significance*,”* but also includes ***“ethical and social significance.”***Some cases follow this, but others don’t.
		- MR: why didn’t L demand they stop sourcing? Prior caselaw says company *can excluded proposal* if
			* **(1)** it is an issue that is not a proper subject for action by shareholder;
			* **(2)** related to the ordinary business affairs of company;
			* **(3)** <5% NOR;
			* **(4)** violates proxy rules [e.g. false statement or misleading];
			* **(5)** can’t do anything about it [e.g. national policy issue like ACA];
			* **(6)** personal grievance;
			* **(7)** past performance tests [e.g. if proposal had been previously proposed, and it only made <3%], gradually rising thresholds that you need to meet [can’t keep on going back to the company and asking same thing; need a certain amount of support].
				+ How to get around these? Ask the committed to study something. But then company *doesn’t have to do anything* 🡪 completely non-binding, but has PR value. Why not under (2)? Forming a committee is not the ordinary business of a company. If L had said, “stop sourcing,” then would have violated (1) and (2). Also, SEC likely didn’t have ethical and social issues when they drafted § 14(a).
		- Directors run company 🡪 why this is phrased as a *recommendation*. Proposal would not be proper action by shareholder. And would be relevant to the ordinary operations of a company. Overlaps. Establishing committee is not ordinary business b/c companies don’t ordinarily do this.

**[Shareholder #Inspection Rights]** – Company will almost always opt to (1) mail it out on insurgent’s behalf and then charge them instead of (2) handing over shareholder list 🡪 options under ’34 act. But insurgents may have state-law based reasons to force list. ***Good or “proper” reasons under common law?*** Evaluate investment, look into allegations of mismanagements, inspect dividends, solicit proxies, etc. ***Bad reasons under common law?*** Try to get trade secrets and sell, want a mailing list to sell to junk mailer, or attempting to communicate about social/political issues (*Honeywell*).

* [M&A As Proper Purpose] *Crane v. Anaconda* (Crane requests shareholder list from Anaconda as part of tender offer [to notify shareholders directly of TO]. A denies, first b/c C doesn’t hold stock, and then argues that it is not in the “business of the company” [control of company has nothing to do with mining]. Issue: is it?)
	+ **Yes.** State-law statute should be *liberally construed* in favor of stockholder. Whenever company faces a situation having potential substantial effect on its wellbeing or value, shareholders are *necessarily affected* and business of corp ***is*** involved 🡪 matter was of great interest to shareholders.
		- Excluding shareholder proposals is different body of law than “proper purpose.” PP is *purely state law* matter.
	+ MR: if you said “control of company” is not within “business of company,” then no one would ever be able to successfully request list, b/c list is *only requested* when trying to take control.
* [No Economic Interest] *Pillsbury v. Honeywell, Inc.* (P finds out that Honeywell is building shrapnel for Vietnam, so purchased stock to force H to stop. Issue: is this a “proper purpose”?)
	+ **No.** Under Delaware statute, ***shareholder*** must prove a proper purpose to get lists (“proper purpose shall mean a purpose reasonably related to such person’s interest as a stocker”🡪 care about $$). Purpose of P is NOT germane to ***economic interest*** of company, not interested in long-term well being of Honeywell or the enhancement of the value of his shares. Sole purpose = *social political concerns*, irrespective of any economic benefit.
		- MR: P would have been fine if he was coached to argue his motivation in economic terms 🡪 shrapnel hurt PR and thus sales.
	+ **Burden of Proof.** BoP is on company to show that he has *improper purpose*. If for other business records, BoP shifts to shareholder.
* [Review] Have to hold shareholder meetings 🡪 ordinary cost of business. And you can charge company for uncontested meeting 🡪 so what happens if it *is* contested? *Can charge*. Incumbents always get reimbursed (*MGM*). *Fairchild* goes a bit further 🡪 Incumbents can reimbursed even if they lose, and challenges can get reimbursed *if they win AND majority shareholders approve*. Dissent wants unanimous approval, but this would never work b/c incumbents would always vote against. Has to be reasonable expenses and over business policy (not personalities).
	+ The above is **state law**. *Lovenheim* is **federal law** under ’34 act.
1. **CONTROL ISSUES**

**Overview**

* **Motivations for Control**
	+ Players are not foolish. Sophisticated shareholders who want non-standard arrangements 🡪 (1) employment [start-up getting talent to join firm] and (2) credit agreements.
		- (1) E.g. engineer that leaves Google to work at startup. Will want control over management of company to reduce risk of leaving lucrative career. Can’t buy stock b/c has expertise, not $$.
		- (2) Also see these options used in **loan agreements** 🡪 creditor wants some say in what company does (*Cargill*), but do not have vote b/c not a shareholder. E.g. voting trust as bank officer as voting trust, give bank irrevocable proxies.
* **Ways to Allocate #Control in Small Corporations**
	+ **Different Classes of Stock:** different voting rights (Stock A selects 1-5 members of board and Stock B selects 6-9 members of board)
		- Under *Stroh*, **voting + nothing else stock** (no dividends, financial reimbursement, etc.), with company option to buy back stock on termination of employment. Details need to be *specified in articles of incorporation* (company charter).
		- **Non-voting stock:** earlier form of the above. Company in *Stroh* was getting around this type of stock getting banned.
	+ **Cumulative Voting:** gives shareholder who has substantial but non-majority interest in the stock the ability to pick board members equivalent to the % interest of shares held.
	+ **Structure a voting trust** (*Ringling*, before they put in voting agreement), where stocks are put in trust and are voted by trustee.
		- Separating vote from financial instruments. Dividends still go directly to owners of stock (investors). Some states only allow this mechanism to split economic and voting rights. May be limited 10 years by statute or for specific purpose (e.g. securing a loan).
		- Trust is maintained as long as employee is at company.
	+ **Sign a voting pooling agreement** (*Ringling*). Agree, in advance, to give control of vote to third party according to agreed-upon instructions (e.g. lawyer who knows parties intentions or engineer who is being lured to join firm).
	+ **Irrevocable Proxy.** Typical proxies are revocable at will, and happens when you send in new proxy. Irrevocable proxies not irrevocable forever, but *coupled with interest* (employment contract for engineer or irrevocable proxy). Investors give engineer proxy to vote stock as long as engineer is employee.
* **General Rule:** shareholder can *bind themselves* as shareholders (agree to elect each other) but NOT as directors to *act in a certain way* (fiduciary duties to all shareholders, so can’t agree to certain salary or management appointments).
	+ Exception if there is no damage (*Clark*) or no one complains (*Galler*).
* **#Freeze outs:** taking a minority shareholder and removing their financial interest. Problem particular to small corporations where there is no market for stock (can’t sell stake if unsatisfied). *Wilkes* is classic example. Unlike partnership where you can quit and liquidate assets.
	+ Is there a way out of freeze out if you don’t put a shareholder agreement in? In some states, you can force company to buy stock or forces auction of company.
* **#Cash out merger:** all stockholders get cash. *Very different* than *Wilkes* (*Jensen Sunquist*). Why do you see these? In part b/c of *Sinclair* 🡪 trying to get rid of small minority shareholder that causes grief. Anytime you have empire with multiple subs interacting 🡪 asking for trouble. Cash-out merger gets around minority shareholders holding out.

**Control Issue Cases**

* [Only Voting Stock] *Stroh v. Blackhawk* (Stroh had stock in Blackhawk. Two classes: class A has voting rights + dividends/liquidation rights, class B has *only voting rights* [no dividends/liquidation rights]. B sold at $.25, A at $3.40, then sell A stock to public at $4. B shares exist so inside investors who own A can maintain voting control. Public takes risk by thus not having control. Issue: are B shares “shares” if they have *no economic interest*?)
	+ **Yes**. Still stock. Vote, but no dividends/liquidation rights is ***still valid stock***. “Our present constitution requires only that a shareholder not be deprived of his voice in management.” Economic rights may be *removed and eliminated*.
		- MR: so what? Don’t typically have this, but have stock that doesn’t vote (accomplishes same thing 🡪 lock up control by selling non-voting stock to public). Didn’t do this b/c Illinois constitution banned non-voting stock (the standard corporate procedure). Blatant attempt to get around constitution, and court ratified it. Perfectly good reasons to do this (allows talented people to risk leaving lucrative jobs to start new company).

**[Control In Closely-Held Corporations]**

* [Pooling Agreement] *Ringling Bros. v. Ringling* (Circus starts as informal partnership of Wisconsin family—7 brothers, 1 sister. By early 20th century, only one sibling and children/spouses left. Partnership interest is not automatically inherited. Circus hits massive problems with 1929 market crash. Creditor force remaining Ringlings to incorporate [John, Aubrey, Edith] and terms state A & E put stocks in trust [designed to give John control over circus]. Paid off loan, so voting trust disappeared. A&E want to take control from John, so create vote pooling agreement [didn’t like trust] 🡪 force John to resign. Circus goes up in flames, and Aubrey’s husband Haley [VP] is prosecuted and goes to jail for 1 year. John befriends Haley, and so when he gets out, Haley and Aubrey want to break pooling agreement and vote with John. Edith sues to enforce agreement [to get 3/7 directors]. Trial court agrees. Issue: is pooling agreement valid?)
	+ **Yes (Haley in breach).** Voting pooling agreement is ***valid*** (various ways to separate out vote from stock, and voting trust is just one). Did NOT enable parties to take any unlawful advantage of outside shareholder, or of any other person. Offends no rule of law or public policy. BUT, agreement had no power to enforce (did not give lawyer *authority to vote stock*) 🡪 so Haley and Edith end up with 3 directors each (worse off than after trial court loss).
		- Under **accumulative voting**, multiple shares by number of directors, and can put all votes on one director. In standard voting, you *vote by slate*. Idea is that you have pockets of disparate votes and this allows them to each get a voice on the board. Prevents minority shareholders from being excluded.
	+ MR: see here the result of trying to invent new legal instruments. In aftermath, statutes said that voting pooling agreements *are* specifically enforceable 🡪 *Ringling* problem is no longer a problem. Or can do an i**rrevocable proxy**.
		- Courts will, for the most part, agree to enforce shareholder agreements on *how will they vote*. Different outcome when agreement goes further to say, “and once we’re on board, we’ll appoint X to be an officer.” Makes courts nervous (and skeptical) b/c shareholders are NOT fiduciaries. Whole corporate structure is based on the notion that board is independent and will look out for the interest of ALL shareholders. If some shareholders collude for director action 🡪 no longer looking out for them all. Basic approach is in *McQuade*.
		- Courts eventually came around and said that for small corporations, we’ll enforce the voting deals ppl make.
* [Agree To Select Officers] *McQuade v. Stoneham* (McQuade, McGraw [manager of Giants], and Stoneham [corrupt stockbroker] get together to buy NY Giants. Agree to use best efforts to keep each other as directors AND officers [and set salaries]. McQuade is forced out and sues to enforce contract. Issue: is this agreement valid?)
	+ **No.** Shareholders *can* combine to elect directors(*who is elected*), but CANNOT bind each other to ***act in a certain way*,** i.e. elect each other as officers, set salaries or policies, promise to elect each other to the board once directors. Directors may *not* by agreements entered into as stockholders abrogate their independent judgment. ***Cannot agree to control director judgment***. FD to corporations, NOT to McQuade.
		- But an independent board can pass long-term employment contracts. Can attack though as FD breach.
	+ MR: similar to *Sinclair* in the sense that there is an duty to minority shareholders, but in *Sinclair* the court says not realistic 🡪 so we won’t wait for breach of FD and just say majority shareholder has direct duty to minority shareholder. Here, the court could of waited for breach of FD, but very hard to evaluate after the fact, so we’re going to stop at outset (not enforceable).
* [Exception If No Damage] *Clark v. Dodge* (Clark owned 25% and Dodge owned 75% of medicine company. C knew secret formula, and agreed to give D’s son formula in exchange to keep C on as officer. C tells; D fires C. C sues. Issue: agreement enforceable?)
	+ **Yes.** Qualifies *McQuade*. If enforcement of contraction between ALL shareholders ***damages nobody***—not even, in any perceptible degree, the public—no reason to hold it illegal. Directors were ***sole owners.*** Damage suffered/threatened is a logical and practical test.
		- Purpose of *McQuade* is to protect minority shareholder.
* [If Minority Doesn’t Complain…] *Galler v. Galler* (Benjamin and Isadore [brothers] agree to preserve joint ownership of company [salary continuation agreement; worried about families]. But also minority shareholder named Rosenberg. On Benjamin’s death, Isadore decided to not keep agreement [agreement was pre-textual; never intended to keep it]. Issue: is it enforceable?)
	+ If *no complaining minority interest*, no fraud or apparent injury to public or creditors, and no clearly prohibitory statutory language is violated 🡪 **no valid reason** for precluding parties from reaching any agreement ***agreeable to all***.
		- Here, even though Rosenburg probably wouldn’t agree with deal, he *didn’t complain*.
		- MR: but Rosenberg didn’t know about it! So of course he didn’t complain. The result of *Galler* is subtle coaching of minority shareholders to complain.
	+ MR: if we have no Rosenberg 🡪 *Clark* and agreement enforceable. If we have Rosenberg 🡪 *McQuade* and you think agreement would be invalid (because of minority interest).
* [Penalty That Gets Around McQuade] *Ramos v. Estrada* (Two groups competing for television deal—Broadcast [Ramos, Estrada, and others] and Ventura 41. Both groups join to form corp and stock is split between groups, with Broadcast getting 2 extra shares at 6 months [allows Broadcast to elect 5 of 9 shareholders]. Broadcast cuts deal to vote together according to majority. If party breaks agreement 🡪 shares are sold to other members. Estrada, after some time, votes with Ventura 41 to kick Ramos as president. Ramos then gets majority of Broadcast to vote for new slate than excludes Estrada. Estrada then votes with Ventura 41 b/c she’s not on slate. Issue: did Estrada breach agreement?)
	+ **Yes (valid, enforceable and supported by consideration)**. Deal was not procured by fraud, duress or other wrongful conduct. Estradas had full and fair opportunity to consider it in its entirety.
		- MR: OK to make agreement ***on how to vote stock*** (*Ringling Bros*). Different thing if agreement was about what directors would do, compensation, etc. Here, agreement was about *who is director*, NOT about what directors would do once you’re on the board. Original issue NOT governed by agreement.
		- MR: this case doesn’t touch *McQuade*, *Dodge*, and *Galler* b/c agreement is not about what you would do once you’re director. But they have **penalty clause** that allows them to enforce *implicit agreement* about how they will vote once directors. Allows them to use formally legal agreement to do something that would not have been legal if formalized in agreement (never would have gotten away with).
	+ In California, close corporations statutes say you can opt in to make *McQuade* type agreements (allowing shareholders to agree on *how* they will vote) if it is unanimous. But makes shareholders owe fiduciary duties (b/c board is no longer independent).

**[Abuse Of Control In Closely Held Corporations]** – Unique to closely held corporations b/c there is no market, and w/o dividends, there’s not way to get $$ out.

* [FD To Minority Shareholders] *Wilkes v. Springside Nursing Home* (Wilkes and three friends incorporate and start nursing home on land they buy. Relationship sours, so Wilkes want to sell stock at appraised value in response to freeze out—others refuse to elect Wilkes to board, give him his bloated salary for maintenance work, etc. [but no contractual right to do so]. No dividends are being given, but salaries to avoid tax [salary + disguised dividend). Issue: did others breach FD to Wilkes?)
	+ **Yes.** In **closely held corporations**, stockholders owe one another *substantially same FD* that partners owe each other but w/ modification (need for flexibility that *Donahue* doesn’t provide): Court must ask whether controlling group has ***legitimate business purpose*** for their actions. (MR: strange approach)
		- Controlling group must have room to establish business policy. Large discretion, e.g., in declaring dividends, deciding when to merge/consolidate, establish salaries, dismissing directors, and hiring/firing employees. BUT minority can show that *same legitimate object* can be achieved through alternative course of action LESS harmful to minority 🡪 court must weigh legitimate business purpose against practicability of less harmful approach.
		- MR: in this case, investors didn’t come up with any legitimate business purpose. Court says that if minority complains *Donahue* duty is broken, majority must show business purpose. BUT minority can then show less harmful alternative (burden of proof switches back).
	+ MR: Directors already had ***duty to shareholders*** 🡪 didn’t have to invent new law here (completely unnecessary holding). AND as controlling shareholders, owe duty to other shareholders under *Sinclair* (cannot self deal, and here, shareholders are paying out through salary w/o paying Wilkes). Could have just said breached FD b/c not giving fair dividends. In public corporations, dividends do not matter 🡪 if company does give dividends, can just sell stock b/c value of dividend is imbedded in stock price.
		- MR: *Wilkes* is odd approach, and many states don’t follow this.
	+ MR: In practice, **partnerships are essentially the same as closely held corporations**. So why allow flexibility (lower FD duty) for CHC? Court doesn’t explain this. Also, if you want difference, why don’t make it big difference? Provides choice between partnership and CHC. And how is this different than *Sinclair*?
	+ **Agreements that would have mitigated Wilkes’ problem**. Two kinds:
		- (1) *Restrictions on Sale*. Make sure ppl are the same in CHC.
			* Consent. Seller has to get other shareholders consent before sale.
			* Right of first refusal (get to buy stock instead of buyer).
				+ Problems? Seller can be held up, but right of first refusal allows you a way out (still doesn’t solve everything b/c makes it harder to get bids).
		- (2) *Forced Purchases*. Want some way to turn investment into cash.
			* Force sale.
			* Force Redemption.
				+ Problems? Can hold up other shareholders to threaten to force purchase (hard if other shareholder doesn’t have $$). Also, (a) Sec. Act. May have problem with ’33 Act if buyer of stock has view to resell to public 🡪 kicks in registration requirements and voids exemption. (b) Close corp statutes. Need to make sure co-investors, by re-selling stock, don’t take you outside closed corporation statutes. (c) S-Corps. S-Corps has limits on how ppl can own stock. (d) Death.
				+ Also, *no market price*. Fair market value? Appraisal is common option (but need to figure out how you pick appraiser). Or use formula e.g. value = cash flow / interest rate. But hard to nail down number for the formula. Or us book value (*Duff & Phelps*) 🡪 often times a lot less than firm worth, but could be more. Very easy to calculate.
		- Between (1) & (2**)**, **two considerations:** (i) care about who you work with; and (ii) being able to liquidate your investment (not an issue w/ publicly traded firm). For (ii), you can have agreement to force other shareholder to buy your stock (allows you to choose where stock goes), OR you can have option to redeem investment (just goes to company).
		- MR: these problems don’t arise with partnerships. To (1), each partner has default veto over transfer of interest (prevent new partner from coming in). To (2), a partner can force other partners to buy you out (force them to the table). In corporations, the defaults run the other way.
* [Ordinary Business Disputes] *Smith v. Atlantic Properties, Inc.* (Wolfson and three others invest in property [industrial real estate firm]. W wants to take income and redirect to repairs; others want dividends. Agreement gives any shareholder veto power [need 80% of director vote]. IRS penalizes for excess cash holdings [accumulated earnings tax] 🡪 large marginal tax brackets so ppl kept $$ in corporations. Issue: does corp have to pay dividends?)
	+ **Yes.** W is being unreasonable, and stockholders in close corporation owe one another FD duty 🡪 “stockholders may not act out of ***avarice, expediency or self-interest***in derogation of their duty of loyalty.” Breached duty of *utmost good faith and loyalty* 🡪 refused to act and caused loss (NOT a freeze out [*Wilkes* and *Donahue*], but just an ordinary business disagreement). Problem here is that they’re *playing brinkmanship* and bad things happened.
		- MR: why is it Wolfson’s fault? Hard to see how it’s a duty of loyalty breach (both party being selfish). Duty of care breach? Both playing brinksmanship and playing hard. But this is just part of hard negotiating. All four should be liable or not liable. If violation of DoC, *all* would have paid proportional share (traditional approach). Court says no, W is controlling shareholder b/c of veto 🡪 he is liable.
		- MR: each stockholder was going to be taxed at different rate for dividend. Explains a lot of case.
	+ MR: *Smith* shows that freeze out doctrine can’t handle ordinary business disputes.
* [Disclosure To Employee] *Jordan v. Duff and Phelps, Inc.* (Jordan was employee and received stock options [at will employee]. Agreement said if left company, stocks would be bought back at book value. Leaves job for family reasons, stayed ‘til end of year to increase book value, but corp didn’t tell him merger was about to happen. J argues FD breach, which includes disclosure. Issue: did corp breach a duty to J?)
	+ **Yes.** Closed corp that purchase their own stock must disclose to sellers all material information. But *did corp have duty to J*? Yes. At-will employee relationships still have (implied) contractual relation that prevents ***opportunistic conduct*** 🡪 corp breached implied pledge to not exploit. But, J still needs to establish causation for damages (needs to prove he would have stayed around).
		- Material b/c even though J can’t sell stock, its indicative to *value of company* and a future merger may happen (he might have stayed). In Easterbrook logic, there is **abstain v. disclose** 🡪 can’t abstain (b/c J is quitting), so needs to disclose. Posner responds: J is at will, so *no right to stay* 🡪 so no right to information. Question this boils down to: did corp have right to fire J? Easterbrook, in Illinois, there are implicit limitations (bars opportunistic conduct). Posner says no 🡪 J *waived* those rights when bought stock (said “this stock gives me no right to continue employment”).
		- MR: J is in two relationships: he’s an employee AND investor (owed FD duty from company). Which one trumps? Posner says former; Easterbrook says latter.
		- Why not straight-forward 10b–5 violation? **Posner:** it’s about choice, and J has no choice (does not have *right* to stay if at-will employee) 🡪 info would not have made a difference AND he waived shareholder rights. **Easterbrook:** he *could have* stayed! And can’t fire if opportunistic (though can fire if legitimate). Also, seems like Franchik resolution suggests that even if fired, he could hold onto stock (and thus has choice).
	+ MR: what if public company (*Wilkes* won’t apply)? Disinterested board has FD to shareholders to keep merger quiet. Seems like duty is to fire employee if he wants to quite, so he doesn’t have a choice, and thus board doesn’t have to disclose. Seems odd (can’t be realistic answer). But here, seems like J waived rights under *Wilkes* when he signed stock agreement.
	+ **Posner Dissent:** *no duty to disclose!* At-will employee. Could have fired J any time for any reason.

**[Transfer Of Control—Control Premiums]** – Cases show a little bit of suspicion about why control block is selling for more than minority shares. *Good reasons for high price?* Price naturally goes up when someone is amassing control. Or your control will allow you to increase firm profitability (encourages value-creating behavior). *Pernicious explanation for control premium?* Using control block to steal from firm, so paying more $$ for it. **Default rule:** allow control block transactions, and ***no duty*** to share premium with minority.

* [No Obligation To Minority] *Zetlin v. Hanson Holdings* (Zetlin owns 2% of Gable. D owe 44%, and sold to Flintkote for $15 a share and market price was $7.38. Issue: is Z entitled to share of $15 price premium [D owe duty to bring minority shareholders along in sale negotiation?])?
	+ **No. *Free to sell control block for premium*** (added amount to have control). Plenty of rational reasons for control block premium (e.g. corporation is badly run and want to turn it around), and impugning duty would force buyer into tender offer.
		- “Absent *looting of corporate assets, conversion of corporate opportunity, fraud or other acts of bad faith*, a controlling stockholder is free to sell, and a purchaser is free to buy, that interest at premium price.” No FD breach, and no damages.
		- Have to pay premium if trying to assemble control block on open market, so it make sense to pay premium if control block is already assembled by another.
* [No Implied Clauses] *Frandsen v. Jensen-Sundquist Agency* (J-S is holding company that owns bank. Jensen family owns 52%, and Frandsen owns 8%. J and F sign agreement that says if J tries to sell stock, F has option to buy [right of first refusal]; also, if J is selling, they have to offer to buy F’s stock at same price [duty to buy]. Jensen family negotiate merger with FWC for cash. F tries to exercise right to buy stock. Issue: does F have right to buy stock?)
	+ **No.** ***Rights of first refusal are to be interpreted narrowly*** 🡪 the “right is enforceable but *only if* the contract clearly confers it.” Two negotiated clauses does NOT imply third clause—If J negotiates merger, than F has right to enjoin merger and buy stock. F’s right was never triggered, and clauses are different. Other reasons to negotiate first 2, but not 3rd: F could have cared about (i) taking advantage of stock-sell premium, or (ii) maintaining identity of investors, or (iii) maintaining ownership of bank..
		- To (i), ALL shareholders get premium in merger (NOT *Zetlin*). To (ii), no reason to include implied clause (negotiated clauses cover this concern). To (iii), if you wanted bank, should have negotiated implied clause and clause to prevent sale of bank. F’s fault he didn’t hire lawyer 🡪 don’t get to claim ignorance after the fact.
		- FWC never offered to buy J-S stock, and is not interested in becoming a majority shareholder.
* [Case Of Looting] *Perlman v. Feldmann* (Feldmann dominant shareholder, President and Chairman of Newport Steel. F sells control block to Wilport, who buy in order to make Newport personal steel manufacturer. P contend that stock sale included compensation for sale of a corporate asset, a power held in trust for corp by F as fiduciary [power to allocate product line]. Issue: need to share profits with shareholder?)
	+ **Yes.** Minority entitled to share of bonus. Opposite of *Zetlin*. F got FMV of stock that includes value of interest free loan. *Essentially a case of looting* 🡪 bought controlling block to steal from firm (allocate steel to themselves). “In time of market shortage, where a call on a corporation’s product commands an unusually large premium, in one form or another, we think it sound law that a fiduciary may not appropriate to himself the value of this premium.”
		- MR: in *Zeltin*, was not as plausible as here that looting was occurring. But why is seller responsible? Kind of like accomplice in a tort.
	+ **Easterbrook:** how to you determine between looting and buying to improve? Look at stock price after sell.
* [Corporate Efficiency] *Essex v. Yates* (Essex wants to buy stock of Republic Pictures. Yates own 28%, and contracts to sell shares and includes clause that 8/14 directors will be replaced with Essex ppl [directors currently Yates’ buddies] 🡪 Essex didn’t want to wait to replace w/o cause removal staggered board [3 year terms].
	+ ***Cannot sell office, but CAN sell control block*** (*Zetlin*).
	+ **Lumbard:** *Illegal to sell corporate office or management control by itself* (control is not personal property) BUT here, selling control block, and corporate efficiency justifies handing over control to buyer. He’d get it anyway in due course, so burden is on Yates to show that buyer won’t get control quickly anyway. ***We want to facilitate quick control***.
	+ **Clark:** we don’t have facts, so need more facts.
	+ **Friendly:** Investors *deliberately constructed staggered board*, but don’t want to apply this retroactively, so concur. Clause is violation unless it is “entirely plain that a new election would be a mere formality.”
1. **#MERGERS & ACQUISITIONS**

**Overview**

* **#Freeze Out or #Cash Out Merger:** Problem is production lines by subs are rarely generic and sold in the open market, but designed for other sub. Also hard to determine price. 🡪 *Inviting litigation*. So how to solve? Ask minority shareholders of sub to sell, but won’t happen (holdouts). So create sub, *merge the two* and force minority shareholders to cash out. **Procedure:** Need (1) boards of two parties approve (which they will); (2) shareholders to vote (majority will approve). Want to set *fair price*, but always litigation brought by minority shareholder in **cash-out transaction**. How should court evaluate?
	+ *Singer* (1977): TMC, having failed in a tender offer for sub Magnovox, merged it with other sub and cashed out remaining shareholders. Court said invalid 🡪 need a ***“business purpose.”***
	+ *Tanzer* (1977): Is the “business purpose” requirement of *Singer* need to be at the shareholder level (parent) or at the acquiror level (sub)? ***Shareholder level is good enough*** (e.g. Sullivan buying back Patriots to pay off personal debt).
	+ *Weinberger* (1983): *Singer* requirement of “business purpose” *makes no sense!* Don’t need it anymore. And ppl will just invent purpose. Instead, need: **(i) *fair price*** AND **(ii) *fair procedures***. We’re judges, not appraisers (easier to determine if procedures are fair). BoP is on shareholder to prove (i) and (ii). If you have ratification of majority of minority shareholders 🡪 switches BoP if misconduct on majority is shown (what you need to get in door).
		- Signal wanted to acquire UOP (current market value is $14). Signal does TO for $21 🡪 gets majority control. 3 years later, wants to get rid of remaining shares through cash-out merger. How much to pay? Tells two officers at Signal to determine price 🡪 say ~$24 (maximum reservation price). Both UOP board and shareholders overwhelmingly approved merger. Signal merges at $21. Under *Sinclair*, does majority have to disclose reservation price to minority shareholders? Probably not. Court says two problems: (1) two officers were *also* directors of UOP (had FD to *all* shareholders, and used internal info to price UOP on behalf of signal, and then did not disclose); (2) Signal only gave UOP board 4 days to vote on merger, and outside financial firm only had 3 days to check price (unnecessary time constraints).

**M&A Cases – After *Weinberger***

* [Standard Of Review] *Kahn v. M&F Worldwide Corp.* (MF Holdings wanted to acquire MF Worldwide [take it private; owned 43%]. MF puts two conditions on merger: (1) approval of special committee that can use corporate funds to hire bank/law firm [independent directors of non-holding company]; (2) ratification of non-MFH shareholders 🡪 board level and shareholder ratification. Self-dealing SoR is typically “entire fairness.” Issue: what is standard here?)
	+ If and only if have both procedures – (1) independent, adequately-empowered Special Committee that picks own advisors and fulfills DoC AND (2) uncoerced, informed vote of majority of minority shareholders 🡪 **SoR is *business judgment rule***.
		- Special Committee must be empowered to select own advisors and say no definitively.
		- Vote of minority must be informed and un-coerced.
		- BOTH are important 🡪 procedural protection so that board is not pressured by shareholders or vice versa.
	+ If only one procedure is used 🡪 BoP shifts to P to disprove “entire fairness.”
		- **If no ratification** 🡪 BoP is on D to show fairness (analogy to Sec. 144).
		- **If ratified by either disinterested board *or* shareholders** 🡪 BoP is on P to show unfairness.
		- **If have BOTH ratify** (*Kahn*) 🡪 BoP is on P to show waste (BJR).
	+ In practice, **“independence”** of directors = no financial dependence or blood/marriage relations.
* [Mass Freeze Out Law] *Coggins v. New England Patriots Football Club* (Sullivan forms NE Patriots, offers non-voting stock to public. Eventually S gets pushed off board by other team owners. Lends $$ from bank to regain control in exchange for team equity [secures personal loan with corp agency] 🡪 FD breach, so has to get ride of outstanding stock. Mergers old Patriots into new Patriots. Non-voting get $15/share, and approved by board and shareholders. Minority sued [football fans]. Issue: entitled to relief?)
	+ **Yes.** D bears BoP of proving (1) merger was for a legitimate business purpose, AND (2) considering the totality of circumstances, it was *fair to the minority*. Re-adopts *Singer* (but ignores *Tanzer*—which would have made it OK in Delaware). Here, S fails test.
	+ **Relief?** Cannot undue merger (10 years ago), but shareholders entitled to current value of stock if had not been cashed out = $80.
		- Standard remedy in most state corporate law is **appraisal** 🡪 gives you value of company *immediately prior to merger* for those who voting against merger (no longer a market for closed corporations) 🡪 “dissenters rights”. But abolished in Delaware for **publicly traded firm** (there is a market, so no dissenter rights).
* [De Facto Non-Merger] *Rauch v. RCA Corp* (GE merges RCA into GE sub. RCA has two classes of stock—preferred and common w/ clause in Articles that says corporation *may* redeem preferred at $100. In merger approved by shareholders, preferred get $40, and common gets $66. P argued that merger was redemption under corporate charter, then followed by merger. Issue: entitled to $100 as de-facto redemption?)
	+ **No.** Redemption is NOT a right of shareholder to put stock for sale to corporation, but a right to call of the *corporation*. Preferred have limited upside benefits and downside costs. Action taken under one section of Delaware is legally independent (even if they have same outcome) 🡪 various provisions are of ***equal dignity*** and a corp can resort to one section w/o having to answer for consequences that would have arisen from using different section.
		- **Equal dignity:** Delaware law allows for *different choices*, and you get to choose. Each statutory provision is of equal dignity, and court will not re-characterize one as the other (asset sale as cash-out merger).
			* MR: no “should be” for various options. No statutory section trumps another.
		- Delaware *rejects* **de-facto merger doctrine** and **de-facto non-merger doctrine**. Other states don’t reject.
		- In Delaware, no dissenter rights in **cash-out merger** for public firms. Appraisal rights are optional.
	+ MR: extremely likely that shareholders would have waived redemption right anyway 🡪 will take too much money from common stock, who then won’t vote for merger (no buyer).
		- Under *Zahn*, duty to the most junior class of stock.
1. **#TAKOVERS -** mostly about what mechanisms managers can use.

**Overview**

* When buying company, can negotiate with Board (merger) or shareholders (tender offer). Often go to Board to buy off directors 🡪 **“friendly acquisition”** (friendly to board). Tender offers 🡪 **“hostile takeovers”** (hostile to board, but very friendly to shareholders).
	+ **Williams Act** (set of acts that amends ’34 Act): makes TOs harder.
		- (1) No creeping TO (what Maremont was doing in *Cheff*). If you cross 5%, need to notify in 10 days.
		- (2) Pricing rules. If you raise TO price, need to raise it for everyone. And shares need to be bought pro rata (can’t by all shares of the first 51% of shareholders; have to buy same % of everyone who tenders).
		- (2) File elaborate documents in TO. Once hit 5% threshold, need to notify SEC.
		- (3) No Saturday night specials 🡪 wait until super inconvenient for target’s legal teams to announce TO with short window. Now, need to *keep TO window open 20 days*.
	+ *Downside w/ less TO*: firms are less well-run. Managers don’t have to work as hard to keep raiders away.
* **#Greenmail:** the purchase by a corporation of a *potential acquirer’s stock* at a premium (*Cheff*). Disadvantageous; basically a dividend to certain shareholders. BoP for Directors:
	+ **Outside Directors**🡪 Must show board reasonably perceived a threat to corporate policy. Burden is met by showing ***good faith*** and ***reasonable investigation***.
	+ **Inside Directors** 🡪 Must show that it was ***fair and reasonable to corporation***. Higher BoP b/c of inherent CoI.
* **“Proportionality Test” in Challengers to Takeover Defenses** (for *outside directors*)
	+ Board must ***reasonably perceive*** the bidder’s action as a threat to corporate policy. Satisfies this burden by showing ***good faith and reasonable investigation*** (*Cheff*).
	+ Takeover defense must be ***reasonable response to threat posed*** to come w/in BJR (*Unocal*).
		- At some point, duty of board ***switches to that of an auctioneer*** 🡪 duty to get highest bid for shareholders. (*Revlon*).

**Takeover Cases**

* [Greenmail] *Cheff v. Mathes* (Holland Furnace, sold coal furnace when gas coming online, and adapts to competitive disadvantage through shady sales techniques. Maremont wants to merge and starts buying stock. Holland refuses merger and appointing M to board. Then agree to buy back M’s stock at premium—“greenmail” [hit taken by Hazelbank & public shareholders]. Challenged as breach of FD. Issue: is greenmail ok?)
	+ **Depends.** Companies can buy own stock (redemption), but NOT if true motive is to perpetuate control (*selfish motive*). If sincere belief that benefits business 🡪 business judgment rule. **BoP:** in **greenmail purchases**, there is *necessarily* a conflict of interest so burden is ***on directors*** to justify purchase as one primarily in the corporate interest. Framework:
		- **No CoI** 🡪 BJR and BoP on plaintiff.
		- **If CoI** 🡪 BoP on defendant to show “fair and reasonable.”
		- **Greenmail purchases** 🡪 CoI for both insiders & outsiders, but different level of BoP. For insiders (Cheff, lawyer) 🡪 “fair and reasonable.” For outsiders (other directors) 🡪 “not same standard” as insiders, but “*reasonable ground* to believe there was a danger to corporate policy,” illustrated by “*good faith and reasonable investigation*.”
			* MR: outsiders standard is carried to future cases.
	+ MR: if you pay greenmail, the value of the remaining stock has to fall 🡪 like you paid dividend only to shareholder that was bought out.
* [Reasonable In Relation To Threat Posed] #*Unocal Corp v. Mesa Petroleum Co.* (Mesa does two-tiered TO w/ freeze out merger on back out—characterized by the Court as coercive [incentive to tender at first tier so not get less $$ at second tier; but both tiers are *more* than market]. Unocal board responds by offering to buy back stock at higher price *if* Mesa gets 51% [no one will then offer!!], as not really “scorched earth defense” [shoveling $$ to stockholders] but to de-incentivize shareholders to tender. Mesa wants to be included in stock buyback, arguing Board has FD to *all* shareholders. Unocal argues it Board, in good faith and reasonable, employed device to protect company [say offer is coercive and inadequate]. Issue: can Unocal do this?)
	+ **Yes.** Board is fiduciary and has duty to evaluate if offer is in best interests of company. May *selectively* acquire its own shares as TO defense, provided directors have not acted “out of sole or primary purpose to entrench themselves” 🡪 show by meeting *Cheff* BoP standards (*intermediate standard*). AND defensive measures must be ***balanced*** 🡪 must be ***reasonable in relation to threat posed***.
		- This entails “an analysis by the directors of the nature of the takeover bid and its effect on the corporate enterprise” (concerns include: inadequacy of price offered, nature/timing of offer, questions of illegality, impact on stakeholders [rejected in *Revlon*], risk of non-consummation, and quality of securities being offered.)
		- SEC responds to *Unocal* by prohibiting discriminatory self-tenders.
		- MR: Court, here, says Board can fight off two-tiered TO because it’s coercive.
* [Revlon Duties] *Revlon Inc. v. MacAndrews & Forbes Holdings* (Pantry Pride offers to buy Revlon; R rejects, citing offer inadequate [stock trading at $33. PP responds with TO at $47. Marty Lipton advises on poison pill 🡪 R gives each share a right to force company to buy back stock at $65 if anyone acquired 20% or more of R stock [“Stock Repurchased Plan”; and Board can redeem at 10 cents]. Also, R commences stock buyback [bought back 1/3 of company way over market value with issued notes, essentially huge dividend]. PP put new TO at $42 [PP had decreased in value], and also states they’d increase price if poison pill were redeemed. R then agrees to LBO by Forstmann [white knight], but waves buyback note covenants to do so and management buys stock in new company by “golden parachutes” [contract to give sacked managers $$ in acquisition]. Also, agree to “lock up of crown jewels” and cancellation fee. Issue: are these moves legal?)
	+ **No.** Directors had FD to shareholders, which include protecting company (*Unocal* duties). If break-up of company becomes inevitable 🡪 director’s role changes from defenders of company to ***auctioneers charged with getting best price***. CANNOT play favorites with contending factions (*white knight*), and lock up/cancellation fee killed auction process.
		- **Note holders problem:** Forstmann agrees to take care of them, but court says cannot do this. Protecting note holders (creditors) is NOT sufficient 🡪 a board may consider stakeholders, provided there are *rationally related benefits* accruing to stockholders.
			* MR: doesn’t quite make sense. Either managed by BJR, or it is legally valid claim and R can’t breach contract.
		- MR: why does this changed duty only kick in at a certain point? Isn’t the board’s duty *always* to get most $$ for shareholders? And lock ups can raise price. But court is saying here, not ok. Some courts will allow in certain contexts.
	+ **Court is looking at three things:** (1) Notes – Buyback; (2) NPRP – Poison Pill; (3) Lock-up and Cancellation Fee with Forstmann.
		- (1) – ok to get price up.
		- (2) – ok to get price up.
		- (3) – NOT ok. Prevented shareholders *getting highest price*.
	+ MR: court talks about “intrinsic value” 🡪 bogus. Company is valued at $$ it brings in. Lipton poison pill is all about trying to stop two-tiered TO. Note gives right to $65 *if* To goes through, but it won’t b/c no one will tender as they are waiting for $65. The redemption/cancellation term is saved for white knight. And golden parachute is NOT meant for managers to *stay in power* 🡪 should not happen.
* *When do Revlon duties kick in?* Ok to initially resist acquirer in order to boost price. At some point switches to close the deal and get best price.
	+ **No clear line.** But get a sense from a couple of cases:
		- *Paramount v. Time*. Time wanted to acquire Warner Bros. Paramount then tries to acquire T at 100% premium. T resists. Can they do this? Court says yes. Notes shareholder confusion? *Revlon* duties kick in when ***company goes to look for white knight***. Here, T never looked for third party so never put company up for sale. MR: odd. Makes no sense.
			* P argues not coercive and not inadequate price (NOT *Unocal*).
		- *Paramount v. QVC*. Took *Time* back. QVC and Viacom try to acquire P. Court says *Revlon* duties apply and should get higher price. Difference w/ *Time*? No control shift in Time, because public before and after. MR: court struggling to find identifiable point where Revlon duties kick in.
	+ ***If you sell of assets, try to find white knight, try to tack firm private*** 🡪 sorts of things that kick in *Revlon* duties.

**Random Info**

* Directors CANNOT bind corporation. Only board can bind collectively when they vote.
* Principals can be liable for the fraud of their non-servant agents.