

Business association outline

[Business](#)



I. Agency (Chapter 1) A. Who is an Agent i. Agency Definition Agency is a fiduciary relationship which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control and consent by the other to so act. 1. Contractual relationship is not necessary, nor do either need to receive compensation 2. Agent - the one to act 3. Principal - the one for whom action is taken 4. Agency means more than mere passive permission; it involves request, instruction, or command 5.

Agency cannot exist when it is against public policy or illegal 6. Agency is like an enforceable contract (offer + acceptance) but does not require consideration 7. 3 Different forms of agency: (1) Principal-Agent; (2) Master-Servant; (3) Employee-Employer or independent contractor 8. Principal cannot delegate a non-delegable act ii. Allocation of risk and responsibility based on principals of agency 1. A way to get someone to act on behalf of another 2.

Agency allows things to get done in a way that otherwise is not possible 3. Agents are force multipliers which allows a concentration of resources behind a collective purpose Principal-Agent-Third Party (PAT) Triangle 1. Principal is typically the lowest cost avoider and in the best position to mitigate damages 2. Agent - one authorized to act for another 3. Third Party - what does this party "see"? would a reasonable person believe that the agent had authority to bind the principal Gorton v. Doty

Facts: Gorton injured in an automobile accident after Doty loaned her vehicle to coach to transport Gorton and others to football game ROL: An agency relationship results from one person's consent that another will act on his

behalf and subject to his control and the other person's consent so to act

Gay Jenson Farms Co. v. Cargill, Inc Facts: Plaintiffs entered into grain contracts with Warren Grain & Seed Co. , which was financed and controlled by Cargill, Inc. , a separate entity ROL: A creditor who assumes control of his debtor's business may become liable as principal for the acts of the debtor in connection with the business 1.

One who contracts to acquire property from a third person and convey it to another is the agent of the other only if it is agreed that he is to act primarily for the benefit of the other and not for himself 3 Factors indicating that one is a supplier, rather than an agent: (1) that he is to received a fixed price for the property irrespective of the price paid by him - most important factor; (2) that acts in his own name and receives the title to the property, which he is to transfer; (3) that he has an independent business in buying and selling similar property Existence of agency may be proved by circumstantial evidence which shows a course of dealings between two parties Criticism and recommendations could be viewed as control B. Liability of Principal to Third Parties in Contract 1. Actual Authority (Express & Implied) Actual Authority: Agent must believe there is authority to act for the principal, must look through the eyes of the agent using reasonable person (RPP) standard Express Authority Express Authority: affirmative statement of authority to act, given either orally or in writing.

Principal can mistakenly grant express, actual authority, but authority must be given either orally or in writing Implied Authority implied authority: is actual authority circumstantially proven which the principal actually intended the agent to possess and includes such powers as are practically necessary to

carry out the duties actually delegated. Look through the agent's eyes- does the agent reasonably believe she is acting within the scope of the authority 3 ways implied actual authority can arise 1. Incidental - absent a clear, contrary instruction by the principal, the agent can use all reasonable means necessary to carry out the goals of the agency 2.

Custom - if it is customary in an industry for an agent to have certain authority, but the agent cannot unilaterally expand the agent's authority 3. Pattern of conduct between principal and agent- if principal fails to object to known actions of agent *Mill Street Church of Christ v. Hogan* Facts: Hogan was injured after he was hired by church employee to paint the inside of the church ROL: Actual authority exists until it is revoked, i. e. must be communicated. Implied authority is actual authority that is proven circumstantially to indicate that the principal intended to delegate powers to the agent that are necessary for carrying out the agent's duties, and one major circumstantial factor is prior work performed by agent for principal. 2.

Apparent Authority

Apparent authority is authority the agent is held out by the principal as possessing. It is a matter of appearances on which a third party comes to rely Person alleging agency and resulting authority has the burden of proving that it exists based on the totality of the circumstances (TOC) a mere statement cannot prove agency, but it can be established by circumstantial evidence including the acts and conduct of the parties such as the continuous course of conduct of the parties covering a number of successive transactions 3 Ways to Create Apparent Authority 1. Direct communication (or

conduct) by the principal to the 3rd party that the agent has actual authority, even though the agent does not. 2.

Inaction by the Principal: principal must deny the authority, when he does not, then apparent authority is created 3. custom: certain positions involve generally recognized duties that include certain authority. Two ways to create: (1) 3rd par has to know that the principal placed the agent in a particular position; or (2) must be customary for an agent in that position to enter into the type of agreement in question. Three-Seventy Leasing Corporation v. Ampex Corporation Facts: 370 Leasing executed a document provided by an Ampex Corp representative for the purchase of computer leasing equipment, but Ampex never executed the document ROL: an agent has apparent authority to bind the principal when the principal acts in such a manner as would lead a reasonably prudent person to suppose the agent had the authority he purports to exercise Absent knowledge on the part of the 3rd parties to the contrary, an agent has apparent authority to do those things, which are usual and proper (custom) to the conduct of the business that he is employed to conduct Principal can protect itself from agents action by hiring well, training agents, communicating to known 3rd parties, giving accurate titles to agents 3. Inherent Authority Inherent Authority: power of agent which is not derived from authority (actual or apparent), but solely from the agency relation and exists for the protection of persons harmed by or dealing with a servant or other agent PAT Triangle 1. Looking through the eyes of the agent - agent did not have actual authority. Agent holding out not required. 2. Looking through the eyes of the 3rd party - the 3rd party did not know the agent was working for the principal; therefore, no apparent

authority 3. rd party can avoid the situation, although economically inefficient, the principal is in a better position to avoid the appearance of authority Holding out: where the principal holds out the agent to the public as one having authority to act for the principal. 3rd party must have knowledge of both the principal, the agent, and the P-A relationship in order to have a holding out. Inherent authority is about economic efficiency- who should bear the loss? the lowest cost avoider; the party who could have most beared the cost. an undisclosed principal is subject to liability to a 3rd party who is justifiably induced to make a detrimental change in position by an agent on the principal's behalf without actual authority *Watteau v. Fenwick* Facts: Humble operated Fenwick's tavern under Humble's name and credit.

Humble purchased goods from *Watteau* without Fenwick's express authority ROL: When a principal is undisclosed to 3rd parties, the actions taken by an agent in furtherance of the principal's usual and ordinary business binds the principal. Risk of loss in on the principal Restatements a. becomes the enunciation of the rules and if adopted by statues, they form a standardized or form contract and applies by operation of law; rules and the parties can modify rule through own agreements b. 3 Transactional costs: (1) the cost to " get the job done," what does it cost to complete the entire transaction; (2) the cost above and beyond the services/goods one is seeking; (3) the restatements provide certainty and uncertainty results in severe transactional cost c. principals of economic maximization - get the most out of it Agency a. most common business association is agency b. person includes natural persons, but also includes legal persons such as corporations, partnerships, non-natural people, NGO, legal personage c. An

agent's consent can be inferred from conduct d. Burden of proof (by mere preponderance of the evidence) falls on the party claiming that an agency relationship exists. (i) consideration is not needed; (ii) does not need to be formal or in writing, can be established through conduct; (iii) legal capacity is not necessary to form an agency relationship; i. e. , minor, as an agent, can enter into a contract on the principals behalf to bind the principal e. an agency relationship can exist even where the parties did not want, nor intend, that such a relationship to exist f.

On behalf of the principal (i) agent must act primarily for the benefit of the principal; (ii) must be the expectation that the acts of the agent are on behalf of the principal; (iii) must be the expectation that the acts of the agent are on behalf of the principal; (iv) Can have an agency even where the agent is not producing a benefit for the principal--no particular result is required g. Control: if the principal specifies the task the agent performs that is sufficient for control to be present; very little control is needed. C. Liability of Principal to Third Parties in Tort 1. Servant Versus Independent Contractor ROL: A master is liable for the torts of its servants under the doctrine of respondent superior. A master servant relationship exists when the servant has agreed to work on behalf of the mater and subject to the master's control or right to control the physical conduct of the servant 3 Important actors of business relationships: (1) duration; (2) control (more control--less liability protection); (3) risk of loss and return (existence of independent contract reduces risk) The test of an independent contractor applies to whether the company has retained the right to control the day to day operations of the service station: control or influence over results alone

being viewed as insufficient *Humble Oil & Refining Co. v. Martin* Facts: Martin was injured by a vehicle that rolled away from the service station owned by Humble Oil & Refining Co, but operated by another under contract ROL: Determining whether a master-servant relationship exists, rather than an independent contractor relationship, is a question of fact that will be answered in the affirmative when the master exerts a considerable amount of control over the responsibilities of the servant *Hoover v. Sun Oil Company* Facts: Hoover was injured when his car caught fire while a service station employee was fueling it.

ROL: A master-servant relationship does not exist when an independent contractor controls the day-to-day operations of the entity that is responsible for damages suffered by a plaintiff. Restatement of Law (Second) Agency § 220, Definition of Servant The principal is only liable for the actions of servant/employee Before assigning liability to the master must determine if the servants conduct is within the employment scope. In determining whether one acting for another is servant or independent contract, the following 10 matters of fact, among others are considered: 1. the extent of control which, by agreement, the master may exercise over the details of the work 2. whether or not the one employed is engaged in a distinct occupation or business 3. the kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the employer or by a specialist without supervision 4. the skill required in the particular occupation 5. whether the employer or the workman supplies the instrumentalities, tools, and the place of work for the person doing the work 6. the length of time for which the person is employed 7. the method of

payment, whether by time or by job 8. whether or not the work is part of the regular business of the employer 9. whether or not the parties believe they are creating the relation of master and servant 10. whether the principal is or is not a business 2. Scope of Employment servant's acts may be within the scope of employment although consciously criminal or tortious, but serious crimes are outside the scope. a servant's use of force against another is within the scope of employment if the use of force is not unexpected by the master such as a bouncer a single comment by a customer does not justify imposition of liability on the employer Manning v. Grimsley Facts: Grimsley threw a baseball at Manning in response to Manning's heckling at a baseball game ROL: to recover damages from an employer for injuries from an employee's assault, the plaintiff must establish that the assault was in response to the plaintiff's conduct that was presently interfering with the employee's ability to perform his duties successfully.

Presently interfering test: the interference may be in the form of an affirmative attempt to prevent an employee from carrying out his assignments D. Fiduciary Obligation of Agents (Duties During Agency) Under an agent's fiduciary duty to the principal, the agent is bound to the exercise of the utmost good faith and loyalty so that the agent did not act adversely to the interests of the principal by serving or acquiring any private interest of the agent or a third party from which the agent gets a benefit, i. e. , kickback Agent is bound to act for the furtherance and advancement of the interest of the principal General Automotive Manufacturing v. Singer Facts: Singer while employed by General Automotive Mfg, Co. secretly concealed profits earned by accepting personal orders from the plaintiff's customers ROL: An

employee will be held to his or her contractual duty of loyalty, and their fiduciary duty would forbid them from engaging in activities that are competitive with their employer. Agent is only entitled to receive what the agent agreed to receive from the principal, secret profits are illegal. If the principal knows and acquiesces to the agent's act of acquiring and furthering private interests of the agent that are similar to or the same as the principal's interests, then the agent will not be found to have breached the agent's fiduciary duty to the principal.

II. Partnerships (Chapter 2) A. What is a partnership? And Who are Partners? 1. Partners compared with Employees

Partnership is an association of two or more persons to carry on as co-owners of a business for profit. Burden to establish partnership is upon the one upon whom it is alleged the partnership exists. Totality of the Circumstances To Establish a Partnership. Court Looks at 8 Elements:

1. intention of the parties, agreement is evidential, but not conclusive
2. Right to share profits, evidential, but not conclusive. Strongly indicative of a partnership. No inference of partnership shall be inferred where received in payment as wages of an employee
3. obligation to share in losses
4. ownership and control of the partnership property and business
5. Community of power in administration - Control is strongly indicative of a partnership
6. Language in the agreement, either including or excluding one from the benefits or obligations of the partnership
- 7.

Conduct of the parties toward the third person

8. Rights of the parties on dissolution

Fenwick v. Unemployment Compensation Commission Facts: Cheshire and Fenwick entered into a partnership agreement regarding salon, pursuant to which Fenwick contributed all capital investment, possessed

exclusive control over the management of the business, and bore the risk of all business losses. ROL: the sharing of profits does not alone create a partnership, despite the parties' intentions

2. Partners versus Contract

Southex Exhibitions, Inc. v. Rhode Island Builders Assoc. , Inc. Facts: Rhode Island Builders replaced Southex Exhibitions as the promoter of its home how after termination a contract it had entered into with the plaintiff's predecessor ROL: Profit sharing alone insufficient to establish a partnership, rather the court must assess the totality of the circumstances--mutual control, contributions of valuable property by both parties, shared profits

B. The Fiduciary Obligations of Partners Meinhard v. Salomon Facts: Salmon terminated a lease belonging to his joint venture with Meinhard to enter into a new lease on behalf of his solely owned business. ROL: partners owe one another (1) the highest fiduciary duty of loyalty while the enterprise is ongoing, including as well (2) the duty of good faith and (3) duty to disclose. this ROL lowers transaction costs ??

A trustee is held to something stricter than the morals of the market place- at a minimum there must be disclosure?? Meehan v. Shaughnessy Facts: Plaintiffs, James Meehan and Leo Boyle, left the law firm of the Defendants, Maurice Shaughnessy et al. Plaintiffs wanted money they believed was owed to them under their partnership agreement, and Defendants countered that Plaintiffs violated their fiduciary duty and interfered with Defendants' business ROL: a partner has an obligation to provide true and full information of all things affecting the partnership to any partner ROL: Partners owe each other a fiduciary duty of " the utmost good faith and loyalty. As a fiduciary, a partner must consider his or her partner's welfare, and refrain from acting for

purely private gain-the partners cannot improperly lure away clients from the partnership ROL: fiduciaries may plan to compete with the entity to which they owe allegiance, provided that in the course of such arrangements they do not otherwise act in violation of their fiduciary duty Constructive trust - created by operation of law as a result of breach of a fiduciary duty by a partner, what money the partner received by the bad acts is held in " trust" for the partnership Fiduciary duties can be varied by the parties by contract Lawyers Departing from a partnership may (1) take steps to locate office space, secure financing, and alternative affiliations; (2) inform clients about departure from the partnership and the new practice but cannot solicit clients; (3) lawyer can remind client to retain counsel of the client's choice; (4) refrain from competing before disassociation 603(b)(3) 403(c)(2) 404(b) (3) 603(b)(2) C. The Rights of Partners in Management 1. All partners are jointly and severally liable for the acts and obligations of the partnership. 2.

Creditors can collect full amount of judgment against any individual partner. However if one partner pays more than his fair share, the partner can seek contribution from the other partners National Biscuit Company v. Stroud Facts: Freeman purchased bread from National Biscuit Co. , although his partner, Stroud, had informed Freeman and the plaintiff that he would not longer be responsible for additional bread purchases ROL: the acts of a partner, if performed on behalf of the partnership and within the scope of its business, are binding upon all co-partners ROL: every partner is an agent for the partnership with actual authority by the agent to bind the principal, i. e. the partnership.

A partner cannot restrict the power and authority of a partner from pursuing a going concern for the partnership, if such purchases are an ordinary matter connected with the partnership business unless there is a majority consent by the partners-50% is not enough In the absence of a partnership agreement, partners will have an equal vote in the management of the partnership Difficult for partnerships to remove apparent authority because it is hard to find all creditors to put them on notice that a partner does not have the authority to bind the partnership D. Partnership Dissolution - The Right to Dissolve Owen v. Cohen Facts: Respondent Russ Owen and Appellant Israel Cohen entered a partnership agreement to run a bowling alley. Within a few months Respondent moved for a dissolution of the business once the partners' relationship turned sour. ROL: Courts of equity may order the dissolution of partnership where the quarrels and disagreements are of such a nature and to such an extent that all confidence and cooperation between the parties has been destroyed or if a partner's misbehavior materially hinders the proper conduct of the partnership's business. E. Limited Partnership

Limited Partnership - a voluntary agreement entered into by two or more parties where one or more general partners are responsible for the enterprise's liabilities and management and the other partners are only liable to the extent of their investments General Partnership - a voluntary agreement entered into by two or more parties to engage in business whereby each of the parties share in any profits and losses equally and each participates equally in the management of the enterprise A limited partner shall not become liable as a general partner unless in addition to the

exercise of his rights and powers as a limited partner, he takes control of the business. Limited partner - investment is passive General Partner - directing management and control of firm If a limited partner takes part in the control of the business and is not a general partner, the limited partner is only liable to persons who transact business with the limited partnership and who reasonably believed based on their conduct, that the limited partner is a general partner. Holzman v. DeEscamilla Facts: The appointed trustee of a bankrupt estate, Plaintiff Lawrence Holzman, brought this action to hold Defendants, Ricardo de Escamilla et al. liable as general partners of the business at issue ROL: if a limited partner exercises control over the business he becomes a general partner and loses any limited partnership protection

III. Corporations (Chapter 3) A. The Nature of the Corporation a. Shareholders are the owners of the corporations with 2 fundamental rights: (1) residual value of the firm and (2) elect the member of the board of directors b. Directors are (1) elected by shareholders based on the shareholders percentage of ownership (proportional); (2) have a fiduciary duty to manage the firm on behalf of the shareholders; and (3) may have a responsibility to 3rd party by statute c.

Officers (CEO, CFO, CO, etc.) are (1) hired by the board of directors for day to day operations; (2) responsible to the BOD for day to day operations for the benefit of the shareholders; and (3) the certificates of incorporation or bylaws will define which roles are officer positions d. Promoters: (1) people who are doing the work to create the corporation; (2) before certificate of incorporation creates shareholders, directors, and officers; and (3) can become a shareholder, director, or officer e. 3rd Parties: something impacted

by the corporations including customers, suppliers, vendors, government, environment

B. Promoters and the Corporate Entity

Corporation: A distinct legal entity characterized by continuous existence; free alienability of interests held therein; centralized management; and limited liability on the part of the shareholders of the corporation

Southern-Gulf Marine Co. No. 9, Inc. v. Camcraft, Inc. Facts: Plaintiff, Southern-Gulf Marine Co. No. 9, Inc. , contracted with Defendant, Camcraft, Inc. , to buy a supply vessel from Defendant. Defendant refused to comply with the agreement, arguing that the contract was invalid because Plaintiff was not incorporated in Texas as the initial agreement stated.

ROL: where a party has contracted with what he acknowledges to be a corporation, he is estopped from denying the existence or the legal validity of such a corporation

C. The Corporate Entity and Limited Liability Corporate veil

Corporate veil - refers to the shielding from personal liability of a corporations officers, directors, or shareholders for unlawful conduct engaged in by the corporation when corporate formalities are respected, the corporate veil will be left intact courts will disregard the corporate veil whenever necessary to prevent fraud or to achieve equity

Corporate veil makes risk finite in terms of liability to that which is invested to encourage investors to invest in those with managerial skills and contribution of capital into the business

The combination of capital and managerial expertise is key to effective business operation

Piercing the corporate veil is an act of equity

Walkovszky v. Carlton Facts: A pedestrian struck by a taxicab sued the corporation in whose name the taxi was registered, the cabdriver, nine corporations in whose names other taxicabs were registered, two additional

corporations, and three individuals. ROL: An individual can be held liable for the acts of a corporation through the doctrine of respondeat superior if it can be shown that the individual used his control of the corporation for personal gain. a. upon the principal of respondeat superior, the liability extends to negligent acts as well as commercial dealings b. however, where a corporation is a fragment of a larger corporation combine which actually conducts the business, a court will not pierce the corporate veil to hold individual shareholders liable Under capitalization is a value judgment Sea-Land Services, Inc. v. Pepper Source Facts: Plaintiff corporation, Sea-Land Services, Inc. , delivered a shipment of peppers for Defendant, Pepper Source, but was never paid and Pepper Source was dissolved before judgment could be enforced against it. Plaintiff wanted to hold Pepper Source and the other Defendants, Gerald Marchese and other corporations he controlled, liable.

ROL: Van Dorn Test: In order to pierce the corporate veil and impose individual liability, a creditor must show (1) that there was such a unity of interest between the individual and the corporate entity that separate identities no longer existed, and (2) that a failure to do so would promote "injustice" or sanction a fraud in some way beyond simply leaving a creditor unable to satisfy its judgment 4 Factors in evaluating the unity of interest: (1) failure to maintain adequate corporate records or comply with corporate formalities; (2) commingling of funds or assets; (3) undercapitalization; (3) one corporation treating the assets of another corporation as its own Possible for one corporation to be liable for the acts of another through a piercing of the corporate veil, in this case there was a reverse piercing, must

initially pierce the corporate veil to get to the other corporation. Reverse piercing puts Sea-Land into the position of a debtor instead of shareholder and would have a higher priority to receive funds. Commingling assets - combining of money or property into a joint account or asset. An unpaid judgment is insufficient to pierce a corporate veil - must examine to see if the shareholder treated the corporation as something different. Fulfilling corporate niceties are a transactional cost to the business. *Frigidaire Sales Corporation v. Union Properties, Inc.* Facts: Frigidaire Sales Corp, a creditor of Commercial Investors, a limited partnership, brought an action against the corporate general partner and its limited partners individually when the partnership failed to pay installments due on contract. ROL: Limited partners are not liable for the debts of a limited partnership simply by their status as officers, directors, or stockholders of the corporate general partner as long as they conscientiously keep the corporate matters. General partners are liable for the debts of limited partners. Officers generally not liable for corporate debts. Shareholders (owners of the company) rights: (1) money - residual value of the firm, usually by way of dividends or through appreciation of price stock trades. P/E Ratio where P is market price and E is earnings, divide profits by shares outstanding, 12 P/E means 2 years to get your money back; and (2) vote-for directors of the corporation. D. Shareholder Derivative Actions. Shareholder derivative lawsuit: lawsuit brought by shareholders on behalf of the organization to compel the organization to take certain action. Why? because shareholders feel the corporation is not protecting shareholder interest. The shareholder steps into the shoes of the corporation. When? typically found where officers have some relationship with third party or the third party is the corporate officers.

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Precondition of a derivative lawsuit: shareholder must demand corporation to act before suing. Some jurisdictions excuse the demand requirement where the demand would be futile (i. e. asking the director to sue self) Applies when? the corporation has suffered a loss. Distinguished from direct shareholder loss Institutional investor- people who have significant investments in a corporation Cohen v. Beneficial Industrial Loan Corp. Facts: Plaintiff brought a stockholder's derivative action in federal court. Defendant, Beneficial Industrial Loan Corporation, argued that a New Jersey state law requiring parties to secure a bond for payment of the opposing party's legal fees should be followed ROL: A shareholder's derivative suit will follow state non-procedural laws regarding the derivative suits when possible. E. The Role and Purposes of Corporations A. P. Smith Mfg. Co. v. Barlow Facts: Diversity lawsuit. Defendant stockholders, Ruth Barlow et al. , questioned the legality of a charitable donation to Princeton University made by Plaintiff corporation, A. P. Smith Manufacturing Company. ROL: State legislation adopted in the public interest can be constitutionally applied to preexisting corporations under the reserved power. Corporate gift-giving is an allowable method of increasing goodwill. Under Erie doctrine, state rules apply for substantive issues whereas, federal rules apply for procedural issues Business Judgment Rule (BJR) Doctrine that relieves corporate directors and/or officers from liability for decisions honestly and rationally made in the corporation's best interest BJR: In the absence of fraud, illegality, or conflict of interest, the court will not substitute its judgment for the judgment of the corporate managers Why? (1) there are identifiable transactional costs for hesitating; (2) designed to accommodate the appropriate level of risk, which is better for the economy as a whole Dodge v. Ford Motor Co. Facts: Plaintiff <https://assignbuster.com/business-association-outline/>

shareholders, Dodge et al. brought an action against Defendant corporation, Ford Motor Company, to force Defendant to pay a more substantial dividend, and to change questionable business decisions (expand factory capability by adding steel plant & use profits to lower price of its cars) by Defendant. ROL: The purpose of a corporation is to make a profit for the shareholders, but a court will not interfere with decisions that come under the business judgment of directors. Although a corporation's directors have discretion in the means they choose to make products and earn a profit, the directors may not reduce profits or withhold dividends from the corporation's shareholders in order to benefit the public. IV. The Duties of Officers, Directors, and Other Insiders (Chapter 5) A. The Obligations of Control: Duty of Care

Fiduciary Duty: a legal obligation to act for the benefit of another, including subordinating one's personal interests to that of the other person Business Corporation law: permits actions against directors for failure to perform duties in managing corporate assets option: the right to buy X shares at Y price for Z amount of time Kamin v. American Express Company Facts: Stockholders brought a derivative action, asking for a declaration that certain dividend in kind was a waste of corporate assets ROL: Whether or not a dividend is to be declared or a distribution made is exclusively a matter of business judgment for the board of directors, and the courts will not interfere as long as the decision is made in good faith.

ROL: A complaint alleging some course of action other than that taken by the board would not have been more advantageous does not give rise to a cause of action for damages Errors in judgment are not sufficient grounds for

equity interference for the powers of the entrusted with corporate management are largely discretionary-courts will not interfere with such discretion unless it first appears that the directors are acting in bad faith or for a dishonest purpose Smith v. Van Gorkam Facts: Plaintiffs, Alden Smith and John Gosselin, brought a class action suit against Defendant corporation, Trans Union, and its directors, after the Board approved a merger proposal based solely on the representations of the CEO of Trans Union, fellow Defendant Jerome Van Gorkom.

ROL: The business judgment rule presumes that, when making business decisions, directors act on an informed basis, in good faith, and in the company's best interest ROL: the business judgment rule shields directors or officers of a corporation from liability only if, in reaching a business decision, the directors acted on an informed basis, availing themselves of all material information reasonably available. 1. Director may only rely on credible information provided by competent individuals, after taking reasonable measure to substantiate it 2. Directors have a duty to be informed to go about their responsibilities in a deliberate manner - hire outside experts (attorneys and investment bankers) 3. Gross negligence is the standard Directors are fully protected in relying in good faith on reports made by officers.

The term " report" has been liberally construed to include reports of informal personal investigations of corporate officers There is no protection for directors who made unintelligent or unadvised judgment Valuing the Business Intrinsic value - what the company is really worth - no one knows what this is 3 Value indicators of a business: (1) cash flow; (2) asset value;

(3) share price Discounted Present Value (DPV) - what is the present value of the income stream. What would you pay to get X dollars tomorrow - a dollar today is worth more than a dollar tomorrow because of inflation. DPV is just one value indicator of a company's value Leveraged Buyout

Leverage Buyout - purchase of a company financed by a relatively small amount of equity and a large amount of debt. Management Leveraged Buyout (MLBO) - inherent conflict in that the management would be making money. (1) Sellers are the shareholders and they want to get the highest price possible, represented by the BOD; (2) Buyers want to pay as little as possible, in a MLBO, the BOD are the one's buying the firm. In a MLBO, the directors are on both sides of the bidding table; therefore we need to have a disinterested director or 3rd party value the firm BJR 1. If the BJR applies, then the analysis ends, no further inquiry needed 2. If BJR does not apply, then look to see if there is a breach of duty 3.

A combination of fiduciary duties of care and loyalty give rise to the requirement that a director discloses to the shareholder all material facts bearing upon a merger vote 4. Five Factors to consider in the fairness of the transactions: (1) timing; (2) initiation; (3) negotiation; (4) structure of the transaction; (5) disclosure to and by the directors and shareholders Francis v. United States Facts: Plaintiffs, the trustees in bankruptcy of Pritchard & Baird Intermediaries Corporation ("P&B"), filed suit against Defendant, the executrix of the estate of Lillian Pritchard, for a breach of fiduciary duty as a director of P&B. Lillian Pritchard did not exercise ordinary care in monitoring the finances of P&B when her sons, other members of P&B management, misappropriated funds ROL: Directors have the duty to act honestly and in

good faith and with the same degree of diligence, care and skills that a reasonably prudent person would use in similar circumstances ROL: Liability of a corporations directors to its clients requires the following to be demonstrated: (1) a duty existed; (2) the directors breached that duty; (3) the breach was a proximate cause of the client's loss ROL: A director's general obligation make it incumbent upon directors to discharge their duties in good faith and with that degree of diligence, care, and skill which ordinarily prudent men would exercise under similar circumstances in like positions. The general rule is that Directors are not personally liable for the debts of the corporation ROL: a director should acquire at least a rudimentary understanding of the business of the corporation . 1) a director should become familiar with the fundamentals of the business in which the corporation is engaged. (2) Because directors are bound to exercise ordinary care, they cannot set up as a defense lack of knowledge needed to exercise the requisite degree of care ROL: Directors are under a continuing obligation to keep informed about the activities of the corporation and cannot rely on reports/information by officers if the director knows or should have known that such information is not reliable ROL: Usually a director can absolve himself of liability by informing other directors of the impropriety and voting for a proper course of action. 1) Conversely, a director who votes for or concurs in certain actions may be liable to the corporation for the benefit of its creditors or shareholders, to the extent of any injuries suffered by such persons, respectively, as a result of such action. (2) A director who is present at a board meeting is presumed to concur in a corporate action taken at the meeting unless his dissent is entered in the minutes of the meeting or filed promptly after adjournment ROL: if the business judgment rule does not

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apply, determine if the decision of the director was a breach of fiduciary duty and establish if it was the proximate cause of the damages

B. Duty of Loyalty

Bayer v. Beran Facts: Plaintiffs, Bayer et al. filed a derivative shareholder action against Defendant directors, Beran et al. , contesting their decision to pay for radio advertising that employed a director's wife. Plaintiffs also argued that Defendants needlessly renew the employment contract of Dr. Henri Dreyfus.

ROL: A director does not breach his fiduciary duty by approving a radio advertising program in which the wife of the corporate president, who is also a member of the BOD, was one of the featured performers

ROL: A director has a fiduciary duty to support the corporation's interest over his or her own conflicting interests, and any competing interests renders the business judgment rule inapplicable.

i. f the BJR does not apply, the directors have the burden of proof, to prevent a conflict of interest, demonstrating they dealt at an arm's length with the specific transaction

ii. if a disinterested majority of directors have ratified a contract and if the complaining party could not prove it unfair, the courts generally hold the contract valid

C. Corporate Opportunities

Broz v. Cellular Information Systems, Inc. Facts: Defendant, Robert Broz, was the sole stockholder of RFB Cellular, Inc. (" RFBC") while also acting as an outside director for Plaintiff Cellular Information Systems, Inc. (" CIS"). Plaintiff brought an action against Defendant when Defendant purchased a cellular license for RFBC over a bid by CIS.

ROL : The corporate opportunity doctrine holds that an officer or director of a corporation can take a corporate opportunity (1) if the opportunity is presented to them in their individual capacity; (2) the opportunity is

nonessential to the corporation; (3) the corporation has no expectation for the opportunity; (4) and they have not wrongfully utilized corporate resources to take advantage of the opportunity. HC ROL: Under the doctrine of corporate opportunity, a corporate fiduciary must place the corporation's interest before his own interests in appropriate circumstance, but a corporate fiduciary does not breach his or her duty by not considering the interests of another corporation proposing to acquire the corporation in deciding to make a corporate purchase.

Usurpation of Corporate opportunity factors: (1) corporation is financially able to take advantage of the opportunity; (2) the opportunity is in the corporate line of business; (3) corporation has an expectancy interest; and (4) accepting the opportunity would create a conflict of interest In Re eBay, Inc. Shareholders Litigation Facts: Shareholders of eBay brought derivative action against certain eBay officers and directors for usurping corporate opportunities when they accepted thousands of initial public offering shares at the initial offering price from eBay's investment banker, Goldman Sachs ROL: Where a corporation regularly and consistently invests in marketable securities, a claim for usurpation is stated where it is alleged the corporation's officers and directors accepted the IP share allocations at the initial offering price instead of having those shares allocated to the corporation.

ROL: A claim of aiding and abetting a breach of fiduciary duty is stated where it is alleged that an investment banker has allocated lucrative IPO shares to a corporations insiders knowing(1) that the insider owed a fiduciary duty to the corporation not to profit personally at the corporations expense i.

e. created a conflict of interest; (2) the corporation regularly invested in marketable securities, i. e. , in the line of business; and (3) the company was financially able to take advantage of the opportunity

E. Dominant Shareholders

Sinclair Oil Corp. v. Levien Facts: Plaintiff, Francis Levien, brought suit as a minority shareholder of Sinclair Venezuelan Oil Company ("Sinven") which was a subsidiary of Defendant, Sinclair Oil Corporation. Plaintiff alleged that Defendant caused Sinven to pay out excessive dividends, and that Defendant breached their contract with Sinven.

CB ROL: A standard of intrinsic fairness will be applied in any self-dealing transaction by a parent corporation whose majority ownership places a fiduciary duty upon the parent corporation, but the transaction only be self-dealing if the transaction is to the detriment of minority shareholders.

Self Dealing: transaction in which a fiduciary uses property of another, held by virtue of the confidential relationship, for personal gain. Shareholders do not have a fiduciary duty to one another

3 Cause of Action Arguments

(1) Excessive dividends (Self-Dealing): No self dealing because each shareholder received a proportionate share of divided payment

(2) Usurpation of corporate opportunities: No opportunities presented to Siven independently and which Sinclair either took for itself or denied to Sinven.

OK to use different subsidiaries in other countries for different business opportunities-apply BJR

(3) Breach of contract: self-dealing involved and Sinclair required to account to Sinven

Intrinsic Fairness Test (IFT) ROL: IFT should not be applied to business transactions where a fiduciary duty exist but is unaccompanied by self dealing

IFT is a defense to a claim that a director engaged in an interested transaction by showing the transaction's

fairness to the corporation when the situation involves a parent and subsidiary, with the parent controlling the transaction and fixing the terms, the test of intrinsic fairness, with its resulting shifting of burden of proof, is applied.

The basic situation for the application of the rule is the one in which the parent has received a benefit to the exclusion and at the expense of the subsidiary if such a dividend is in essence self-dealing by the parent, then intrinsic fairness standard is the proper standard for example, suppose a parent dominates a subsidiary and its board of directors. The subsidiary has two classes of stock, X and Y. Class X is owned by the parent and Class Y is owned by minority stockholders of the subsidiary. If the subsidiary, at the direction of the parent, declares a dividend on its Class X stock only, this might well be self-dealing by the parent. If would be receiving something from the subsidiary to the exclusion of and detrimental to its minority stockholders.

This self-dealing, coupled with the parent's fiduciary duty, would make intrinsic fairness the proper standard by which to evaluate the dividend payment

Dominant Shareholder Some fiduciary duties imposed (1) controlling shareholders can control the board. It is possible to control the board with less than 50% ownership (2) Some corporate actions require the shareholder vote and if the shareholder uses the vote in an unfair manner, the court will hold the shareholder liable. Intrinsic Fairness Test is triggered when one party is on both side of the transaction. The controlling shareholder has the burden of proving that transaction was fair to the corporation

F. Ratification *Fleigler v. Lawrence*

Facts: Plaintiff, Irving Fliegler, brought a suit on behalf of Agau Mines, Inc. , against Defendant directors, John Lawrence et al. , after they voted to exercise an option to purchase shares of another company. CB ROL: Shareholder ratification of a transaction between the corporation and an interested party will not be legitimate if the majority of the shareholders are the interested parties. G. Disclosure and Fairness ?? H. Delaware General Corporation Law Section 144 Rule 10b-5 (a) unlawful to defend or make untrue statements in connection with purchase or sale of securities-Look for deception or manipulation (i) disclosures must be honest (ii) allows for a private cause of action (iii) companies are required to speak to tell things to the market and when they disclose it must be honest (iv) if a company discloses information to the market, whether required to disclose or not, must make an honest disclosure (v) typically, companies refrain from disclosing unless required by the SEC or required by market forces. Basic Inc. B Levinson Facts: Respondents, Max Levinson et al. , held shares in Petitioner Corporation, Basic Inc. Respondents brought this action after 3 misleading statements concerning a potential merger induced them to sell their shares at a depressed price. CB ROL: Misleading statements during merger discussions will be material under Rule 10b-5 if the misstatements would have changed the view of the total information by a reasonable investor.

ROL: whether a company's state is material, in the context of merger discussions, requires a case-by-case analysis of the probability that transaction will be consummated and the significance of the transaction to the issuers of the securities ROL: an investor's reliance on material, public,

misrepresentations may be presumed under the fraud-on-the-market theory for purposes of a Rule 10b-5 action. Materiality importance-the degree of relevance or necessity to the particular matter, a fact based inquiry (1) to fulfill the materiality requirement there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total" mix of information available. Does the statement made by the company change the total mix of the information available? 2) materiality depends on the significance the reasonable investor would place on the withheld or misrepresented information (3) As the probability of the event increases, it becomes more and more material and increases the need to disclose (4) As the magnitude of the event increases, it becomes more and more material and increases the need to disclose (5) Probability x Magnitude = Materiality SEC Securities and exchange commission encourages transparency through disclosure of information that is material. Fraud on Market (FOM) FOM the price of a company's stock is determined by the available information regarding the company and its business. Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements. The market must be able to recognize the information and reflect the information in an adjustment in the price of stock. Dissent in Basic he court should not endorse the fraud on market theory for 3 reasons: (1) common law doctrine of fraud and deceit; (2) the court presumption of reliance also assumes that buyers and sellers rely not just on the market price, but on the integrity of that price; and (3) many investors purchase or sell stock because they believe the price inaccurately reflects the corporation's worth. Therefore, Efficient Market Theory (EMT) is a deep and

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liquid market, The market takes into account all available information and no one has any additional, valuable information if that's true, over the long term you can't beat the market because the market will always have more information than an individual over time. Therefore, for Rule 10b-5 action the court presumption is that the shareholder relied on the price of the stock. now the burden of proof is on the defendants to prove that the shareholders actions were not in reliance on the price of the stock but some other reason.

Reliance

Reliance provides the requisite causal connection between the defendants misrepresentation and a plaintiff's injury we previously dispensed with a requirement of positive proof of reliance, where a duty to disclose material information had been breached, concluding that the necessary nexus between the plaintiff's injury and the defendant's wrongful conduct had been established Reliance of individuals on the integrity of the market price may be presume; however, that presumption can be rebutted Misc because most publically available information is reflected in the market price, an investor's reliance on any public material misrepresentation. The court adopted the TSC Industries standard of materiality for 10b5, which concludes that an omitted fact is material if there is a substantial likelihood that reasonable shareholder would consider it important in deciding how to vote. (a) further to fulfill the materiality requirement, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available. b) there must be reliance on the statement or omission. (1) there is more than one way to demonstrate the casual

connection between the misrepresentation and the plaintiff's injury--no requirement of positive proof of reliance, (2) the class action is extremely important because it allows the plaintiffs to secure counsel to pursue claims that otherwise would be cost prohibitive; (3) The court held that there is a presumption of reliance. Agreement in Principle Test Preliminary merger discussions do not become material until agreement in principle as to the price and structure of the transaction have been reached between the would be merger partners. rationales are offered in support of this (1) an investor should not be overwhelmed by excessively detailed and trivial information and focuses on the substantial risk that preliminary merger discussions may collapse (2) it helps to preserve the confidentiality of merger discussions where earlier disclosure might prejudice the negotiations. (3) the test also provides a usable, bright line rule for determining when disclosures must be made. In Basic, the shareholders sold stock based on their reliance on the integrity of the price set by the market, but because of Basic's material misrepresentation that market prices had been frequently depressed Probability/Magnitude Approach materiality will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity (1) to assess the probability, a fact finder will need to look to indicia of interest in the transaction at the highest corporate levels--board resolutions, instructions to investment bankers, and actual negotiations between principals or their intermediaries may serve as indicia of interest (2) to assess magnitude of the transaction to the issuer, a fact finder will need to consider such facts as (a) the size of the two corporate entities and (b) the

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potential premiums over market value Why allow private individuals to press claims? allows people with a real stake in the claim to pursue it encourages reaching the larger statutory goal of disclosure by having mini-private-attorney generals--basically a multiplier for the SEC West v. Prudential Securities, Inc. Facts: Plaintiffs, Dean West et al. brought an action under the fraud-on-the-market doctrine after a stockbroker for Defendant, Prudential Securities, Inc. , gave them non-public tips that were fraudulent. CB ROL: A fraudulent statement needs to be made publicly accessible in order for a plaintiff to claim that the statement caused a loss on the investment. ROL: Unless the information reaches the market, there can be no fraud on the market to satisfy the reliance factor Santa Fe Industries, Inc. v. Green Facts: Plaintiffs, Green et al. , were minority shareholders of Kirby Lumber Corp. Plaintiffs brought this action to recover a greater share price after Defendant majority shareholder, Santa Fe Industries, Inc. , forced Plaintiffs to sell their shares.

CB ROL: Section 10(b) of the Securities Exchange Act and Rule 10b-5 prohibit conduct involving manipulation or deception, but are not so expansive as to govern incidences of fiduciary breach. ROL: before a claim of fraud or breach of fiduciary duty may be maintained under 10b-5, there must first be showing of manipulation and deception Manipulation and Deception inadequate compensation does not rise to level of manipulation or deception when all facts are disclosed No manipulation or deception; therefore, the shareholders filed the wrong cause of action and should have sought an appraisal remedy In addition, state law generally governs the internal affairs

of a corporation, such as fiduciary responsibility Remember Rule 10b-5 is a federal cause of action

The Court granted which relief that could be granted (a) federal law was asserted violated because the merger was undertaken without prior notice (b) the low valuation placed on the shares in the cash exchange offer was itself said to be fraud that is actionable under 10b-5 (c) the purpose of getting rid of the minority shareholder helps to eliminate the fiduciary duty and also if you can buy the minority shareholders out at a lower price, there's more money to be made (d) 10b-5 cause of action is based on market manipulation and there can also be a 10b-5 action when there is no sufficient disclosure, but not for insufficient compensation 10b-5 reach for minority shareholder squeeze out 0b-5 reaches breaches of fiduciary duty by a majority shareholder against a minority shareholder without any charge of misrepresentation or lack of disclosure Neither misrepresentation nor non-disclosure are necessary elements of rule 10b-5 starting point of every 10b-5 case involving construction of a statute is the language itself--the language gives no indication that Congress meant to prohibit any conduct not involving manipulation or deception Two factors determine whether Congress intended to create a federal cause of action: (1) language of the statute; and (2) whether the cause of action is traditionally relegated to state law. Absent a clear indication of congressional intent, the Courts are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities, particularly where established state policies of corporate regulation exist. 2 Reasons Sante Fe is an appropriate case for an appeal 1) the district court's order marked an substantial

extension of the fraud on the market approach Basic held that because most publicly available information is reflected in the market price, an investor's reliance on any public material misrepresentation-that public information trades quickly and influences securities prices (2) Few securities transactions are litigated to conclusion, so a review of this novel and important legal issue may be possible only through the Rule 23(f) device (a)it is hard to see how Hofman's non public statements could have caused changes in the price of Jefferson's Savings stock -found the fraud on the market doctrine on a causal mechanism with both theoretical and empirical power, for non public information there is nothing comparable (b) there is non public information and securities prices, let alone show that the link is as strong as the one deemed sufficient (c) Blue Chip Stamps court held plaintiff had no cause of action under 10b-5 because it had neither bought or sold shares, plaintiff argued because the corporation negatively painted their position, it exercised the right not to purchase share on which they would have made a profit. (d) Ernst v.

Ernst court held that liability for issuance of a false or misleading statement requires proof of a state of mind referred to scienter, court also held recklessness would be sufficient (e) Central Bank court held that there was not implied private right of action against those who aid and abet violation of Rule 10b-5 I. Inside Information Securities and Exchange Commission v. Texas Gulf Sulfur Co. Facts: Plaintiff, the Securities and Exchange Commission, brought this suit against Defendants, Texas Gulf Sulphur Co. , et al. , after Defendants bought shares of Texas Gulf while they secretly had positive information regarding mining activities carried out by the company.

CB ROL: Insiders cannot act on material information (information that a reasonable man would deem important to the value of the stock) until the information is reasonably, publicly disseminated. ROL: it is unlawful to trade on material inside information until such information has been disclosed to the public and has had time to become equally available to all investors ROL: A company press release is considered to have been issued in connection with the purchase or sale of a security for purposes of imposing liability under the federal securities laws, and liability will flow if a reasonable investor, in the exercise of due care, would have been misled by it. The essence of Rule 10b-5 is that anyone, would have been misled by it.

In the securities if a corporation has access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone may not take advantage of such information knowing it is unavailable to those whom he is dealing Rule of Disclosure or Abstention Anyone in possession of material inside information must either disclose it to the investing public, or if he disabled from disclosing it in order to protect a corporate confidence, or he chooses not to do so, must abstain from trading or recommending the securities concerned while such inside information remains undisclosed. Becomes a Rule of Abstention insider must either disclose or abstain. in this instance the company prohibited the insider from disclosing the information..

Thus even if the insider quit the company and sought to disclose, the insider's fiduciary obligation to the company prohibits the insider from disclosing the information (i) because the information is private information of the company, it ultimately results in requiring the insider to abstain from

trading (ii) insiders must refrain from trading until the market digests the information

Materiality Test the basic test of materiality is whether a reasonable man would attach importance in determining his choice of action in the transaction in question. (i) this encompasses any fact which in reasonable and objective contemplation might affect the value of the corporation's stock or securities. ii) thus, material facts include not only information disclosing the earnings and distribution of a company, but also those facts which affect the probable future of the company and those which may affect the desire of the investors to buy, sell, or hold the company's securities

Required Disclosures 10Q - quarterly earnings 10k - annual earnings 8k - material events that occur between reporting periods.

Insider Information anyone in possession of material inside information must either disclose it to the investing public or if he is prevented from disclosing to protect corporate confidence, or he chooses not to do so, must abstain from trading in or recommending the securities concerned while such inside information remains undisclosed.

a) the insider's duty to disclose information or his duty to abstain from dealing in his company's securities arise only in situation which are essentially extraordinary in nature and which are reasonably certain to have a substantial effect on the market price of the security if the extraordinary situation is disclosed (b)the test of materiality is whether a reasonable would attach importance in determining this choice of action in the transaction in question (c) corporations are only required to disclose that information that is required to be disclosed--there is a duty to disclose every annually, quarterly, and between quarters those events and activities that are extraordinary information (d) a survey of the facts establish that knowledge of the results of the discovery hole K 55 1 would

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have been important to a reasonable investor and might affect the price of stock (e) a major factor in determining discovery was material is the importance attached to the drilling result by those who knew about it (1) once the information is disclosed, the market will adjust (2) the insider traders can start trading as soon as the market can digest the information (in modern society that's quickly) Holding: All transactions in TSG stock or calls by individuals apprised by the drilling results were made in violation of Rule 10b-5 V. Problems of Control (Chapter 6) A. Proxy Fights Proxy is the right to vote someone else's shares Proxies are need to establish quorums (50%+1), which are typically required for an election to count The outcome of voting will depend on which group has collected the most proxies: Under corporate law, shareholders may appoint an agent to attend the meeting and vote on their behalf and hareholder proxy holder Incumbent managers of large firms solicit proxies from shareholders directly Both Tender offers and proxy fights are subject both to the 1934 Securities Exchange Act and to state corporate statutes SEC - Federal Rules Require Certain Disclosures when Soliciting Proxies Proxy statement must be given-- statement must disclose material information Proxy battles is a way to change the way a firm is manage Proxy Contest proxy contest is a struggle between two corporate factions to obtain the votes of uncommitted shareholders. A proxy contest occurs when a group of dissident shareholders mounts a battle against corporations managers 1.

Strategic Use of Prox