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## CORPORATIONS

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### I. Organization of New York Corporations

#### A. Formation Requirement – *people, paper, acts*

1. *Incorporators (people)*
  - a. Tasks – (i) execute & deliver the certificate to Dept of State, and (ii) hold organizational meeting
  - b. Requirements – (i) adult humans (no entities); (ii) need at least 1 incorporator
2. *Certificate of Incorporation (paper)* – Articles of Incorporation
  - a. Purposes of certificate – contract between (i) corporation & S/H; (ii) corporation & state
  - b. Information in certificate:
    - (i) **Names & addresses:**
      - (a) *Corporate name* – must include the words “corporation”, “incorporated”, or “limited” (or abbreviation)
      - (b) County in NY of the “*office of incorporation*” – need not be place of business
      - (c) *Designation of NY Sec of State as agent* for service of process –
      - (d) An address for forwarding process. can also name registered agent for service of process.
      - (e) Name & address of each incorporator.
    - (ii) **Statement of duration** – if silent, presumed perpetual existence
    - (iii) **Corporate purpose:**
      - (a) *General statement of purpose* – “to engage in all lawful activity, after first obtaining necessary state agency approval” is acceptable
      - (b) **Specific statement of purpose & Ultra Vires Rule** (beyond scope of the certificate):
        - *Ultra vires contracts are valid*
        - *S/H can seek an injunction* to enjoin any unauthorized act or transfer of property
        - Attorney General can institute a proceeding to annul or dissolve the corporation or to enjoin it from doing unauthorized business
        - **Responsible O & D’s are liable to corporation for ultra vires losses**
    - (iv) **Capital structure** – must include (i) authorized stock, (ii) # of shares per class, (iii) information about *par value*, relative rights, preferences & limitations of each class, (iv) information on *series* (subclass) if *preferred shares* are issued in *series* (subclasses)
      - NOTE: at least 1 class of stocks or bonds must have unlimited voting rights, & 1 class of stock must have unlimited dividend rights
      - (a) *Authorized stock* – maximum # of shares the corporation can sell
      - (b) *Issued stock* – # of shares the corporation actually sells
      - (c) *Outstanding stock* – shares that have been issued & not reacquired by the corporation
3. *Acts*
  - a. *Execution* – each incorporator signs certificate & acknowledges it before a notary
  - b. *Deliver* – incorporators deliver it to the NY Dept of State
  - c. *Filing – Dept of State files* the certificate (filing by the Dept is *conclusive evidence of valid formation*, meaning that it’s a *de jure* corporation)
  - d. Hold *organizational meeting* to – (i) adopt any *bylaws*; (ii) elect BoD who will then take over management

#### B. Legal Significance of Corporation

1. *Internal affairs* (duties, relationship among D, O, & S/H) governed by the New York law – authority to act is mainly derived from: (i) the BCL, (ii) case law, (iii) certificate of incorporation & (iv) bylaws
2. *Separate legal person* – can (i) enter contracts, (ii) transfer property, (iii) buy & sell securities (its own or others), (iv) sue or be sued, (v) make political contributions (ceiling 5K per year per candidate), & (vi) charitable contributions (NO ceiling)  
NOTE: To guarantee a loan that is not in the furtherance of corporate business, you need approval of 2/3 of the shares entitled to vote.
3. *Generally, D & O’s not liable for the corporation’s obligations, & S/H enjoy limited liability(not liable for corp debts)*
  - NOTE: permits incorporation for the very purpose of escaping personal liability, BUT, cannot form a corporation to defeat *existing* creditors (see *piercing the corporate veil* below)

#### C. De Facto Corporation Doctrine (very limited) & Corporation by Estoppel (abolished in NY)

1. Doctrines by which a business failing to achieve *de jure* corporate status nonetheless is treated as corporation
2. *De facto corporation* (defective incorporation) requires – (i) there’s a relevant incorporation statute; (ii) parties made a good faith, colorable attempt to comply with it; (iii) some exercise of corporate privileges (i.e Incorporators deliver a certificate but Dept of State does not file it.)

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3. *Corporation by estoppel* – one dealing with a business as a corporation, treating it as a corporation, may be estopped from denying the business's corporate status. NOT VALID IN NY BECAUSE IT IS ABOLISHED

#### D. Bylaws

1. *Internal documents* (not filed, outsiders not bound) that set up internal procedure, define responsibilities
2. If Bylaws conflict with the Certificate, the Certificate always wins.
3. Adopted by incorporators (initial status as S/H bylaws) – BUT not condition precedent to corporate formation
4. Amendment or Repeal – by S/H (BoD can amend or repeal only if the certificate or a S/H bylaws allows)

#### E. Pre-Incorporation Contracts

1. *Promoter* – a person acting on behalf of a corporation not yet formed, who provides the organizational initiative for the formation of a business & the formation of a corporation to carry on the business  
HYPO: On January 10th, P, acting as a promoter for a corporation not yet formed, leases a building from Charlie Whitebread and signs the lease “Oscar de la Rental Cars, Inc.” On February 20th, Oscar de la Rental Cars, Inc. is incorporated. Is the corporation liable on the contract? YES, if BoD approves or corp uses the leased premises.
2. **Liability** on pre-incorporation contracts:
  - a. Corporation isn't liable on pre-incorporation contracts, until it *adopts* the contract
    - (i) *Express adoption* – BoD approves it
    - (ii) *Implied adoption* – knowing acceptance of benefits of contract (e.g. corporation uses leased premise)
3. *Promoter remains liable* on pre-incorporation contracts, UNLESS
  - a. Contract clearly indicates that parties don't intend the promoter to be liable, OR
  - b. Until there has been 'novation' – an agreement of promoter, corporation, & other contracting party that corporation will replace promoter under the contract (corporation becomes the alter ego of promoters)  
HYPO: Will P be liable on the lease if Oscar de la Rental Cars, Inc. is formed and adopts the lease? Yes, promoter is liable until novation.  
HYPO: The adoption makes the corporation liable too, but does not relieve P. So on the facts here, who would be liable on the lease? Both the corp and the P

#### F. Secret Profit Rule – consent or ratification required

1. Promoters owe fiduciary duties to outside investors, thus promoters must account to the corporation for *profits from self-dealing* before “outsiders” come in, UNLESS “outsiders” had *notice* of these profits
2. Promoters can't make a *secret profits* on his dealings with the corporation – BUT, promoters won't be **liable**, even for profits, so long as (i) *BoD consents*; OR (ii) *BoD ratifies the profit*
3. Issue of calculating profits
  - a. Sale to corporation of property acquired *before* becoming promoter
    - (i) *Profit = price paid by corporation – FMV*
    - (ii) Price paid by promoter irrelevant
  - b. Sale to corporation of property acquired *after* becoming promoter
    - (i) *Profit = price paid by corporation – price paid by promoter*
    - (ii) Matters how much the promoter paid because he acquired the property *after* becoming a promoter

#### G. Foreign Corporations

1. *Foreign corporations* (i.e. one incorporated outside NY )
2. *doing business* in NY (i.e. regular course of *intrastate*, NOT *interstate* business)
3. *must qualify by applying to the Dept of State as agent for service of process* – by giving (i) information from its certificate, & (ii) proving that it's in good standing in its home state
4. Foreign corporations that transact business in NY without qualifying can still have valid transactions, BUT:
  - a. It must pay a penalty when the corporation finally does qualify, and
  - b. The foreign corporation cannot sue in NY, but it can *be* sued

## II. Issuance of Stock

### A. What is an Issuance

1. Occurs when a corporation sells or trades its own stock – method of raising capital
  - a. Issuance of Stock – investors become *equity* holders
  - b. BUT, issuance of Bond – investors become *creditors*, not owner (alternative method of raising capital)
2. Debenture – a loan, the repayment of which is not secured by corporate assets

### B. Subscriptions – written, signed offers to buy stock from the corporation (cannot be oral)

1. *Revocation of pre-incorporation subscriptions* – pre-incorporation offers are *irrevocable for 3 months*, unless they provide otherwise, or all subscribers agree (so people forming corp. can rely on money being there)  
HYPO: On January 10th, S signs a subscription, offering to buy 100 shares of C Corp., a corporation not yet formed.

A week later, S changes his mind. Can S revoke? NO.

2. *Post-incorporation subscriptions* – revocable until acceptance
3. *Obligations under a subscription*
  - a. Corporation & subscribers become obligated under a subscription when BoD accepts the offer
  - b. Call must be uniform within each class or series (subclass) of stock
4. *Subscriber defaults on payments (RARELY TESTED)*
  - a. *If subscriber paid less than 50%* – if fail to pay the rest within 30 days of written demand, corporation can keep the money paid & cancel the shares (the shares then become authorized & unissued)
  - b. *If subscriber paid 50% or more* – if fail to pay the rest within 30 days of written demand, the corporation must try to sell the stock to someone else for cash
    - (i) If no one will pay remaining balance, defaulting subscriber forfeits what he paid & shares cancelled
    - (ii) If someone will pay *more* than the remaining balance due (plus the company’s expenses in selling), the original subscriber recovers any excess over the total he originally agreed to pay (don’t forget to include amount subscriber originally paid in calculating this)

**C. Consideration** – *what must the corporation receive when it issues stock*

1. **Form of consideration** – 5 permitted forms of consideration (anything else is prohibited)
  - a. *Money* (cash or check)
  - b. *Tangible or intangible property*
  - c. *Labor or services already performed for the corporation* – including forming the corporation, though promoters don’t get paid for being promoters
  - d. *Binding obligation to pay the purchase price in the future in cash or property*
  - e. *Binding obligation to perform for the corporation future services having an agreed value*  
NOTE: Paying with an improper form of consideration – it is unpaid stock and it is treated as water
2. **Amount of consideration**
  - a. *Par* – means ‘minimum issuance price’
  - b. *No par* – means ‘no minimum issuance price’ – BoD sets price unless certificate reserves the right to S/H
  - c. *Treasury stock* – stock previously issued & had been reacquired by corporation (corporation can then sell but has no minimum price (doesn’t matter if it was par when initially issued, you treat it like no par))
  - d. *Acquiring property with par value stock* – as long as property is worth the same value
  - e. *BoD always values the consideration in a par issuance* – in a no-par issuance, *BoD values consideration unless certificate allows S/H to do so*
  - f. *BoD’s valuation is conclusive, if made in the absence of fraud (i.e. director issues 1m in stock to his nephew for 1 week of cleaning services)*
  - g. **‘Watered stock’** – when BoD issues par stock for less than par value, corporation can sue for the ‘water’
    - (i) **D’s would be liable** if they knowingly authorized the issuance, AND
    - (ii) X (buyer) is liable for the ‘water’
    - (iii) BUT, if X transfers stock to 3<sup>rd</sup> party, they are not liable if acted in good faith & did not know. Third party does not have to pay value or be BFP, just can’t know.

**D. Preemptive Rights**

1. **Preemptive right** – the right of an existing S/H to maintain his percentage of ownership by buying stock, whenever there’s a **“new issuance”** of **“common stock”** **“for money”** (cash or checks)  
HYPO: Suppose the certificate provides for preemptive rights and C Corp. is issuing stock to G to acquire Green Acres from G? Are there preemptive rights? **NO. This is not “for money”**  
– Unless the certificate says otherwise, “new issuance” does **NOT** include the sale of:
  - (i) *treasury stocks*
  - (ii) *shares offered for consideration other than cash*
  - (iii) *shares subject to certain options*
  - (iv) *the sale of shares authorized by the original certificate & sold within 2 years of formation*
  - (v) *reorganization shares under an act of Congress*

2. **Whether preemptive rights exists, if certificate is silent** – depends on when corporation was formed:

Before Feb. 22, 1998	On or After Feb. 22, 1998
YES (unless certificate says no)	NO (unless certificate says yes)

3. **Expiration of preemptive rights** – after expiration of the time allotted for acting on preemptive rights, the corporation may sell the shares to anyone else not having preemptive rights at a price not less than that offered to the preemptive rights holder (if the stock is not sold w/in 1 year, the preemptive rights reattach)

**III. Directors and Officers**

**A. Statutory Requirements - Directors**

1. *Number of D's* – 1 or more adult natural persons (can be set in bylaws, by S/H action, or by BoD if a S/H adopted bylaw allows). If no directors stated, you have one director.
2. *Election of D's*
  - a. Incorporators elect initial D's – afterwards, S/H's elect D's at the annual meeting,
  - b. *Classified board* – in lieu of an entire B's being elected annually, the certificate of incorporation or a bylaw adopted by the S/H's may divide the B into classes, & provide that only 1 class will be elected at each annual meeting (no class can have fewer than 3 members)
3. *Removal of D's*:
  - a. *For cause* – (i) by vote of S/H, or (ii) by BoD if permitted in certificate or bylaws
  - b. *Without cause* – only S/H's may remove and only if permitted in certificate or bylaws (which are usually silent on the BAR)
  - c. *Special voting requirements for removal* – D's elected by class vote or cumulative voting may NEVER be removed by the BoD
  - d. *Removal by judicial action* – the attorney general or holders of 10% of the shares (voting or nonvoting) may sue for judgment removing a D for cause
4. *Vacancies* (serving the remainder of term due to removal, resignation, or death) – BoD voting
  - a. Replacing D's removed without cause – S/H's, unless BoD has power by certificate or bylaws
  - b. If a specific class of S/H's is entitled to elect a D, a vacancy of that directorship is to be filled by a *majority vote of the D's elected by that class* (unless there is no other D in office elected by the class)
5. **Formalities of BoD action:**
  - a. **Valid Act Requirements** – (i) a meeting, OR (ii) unanimous written director consent to act without a meeting
    - (i) If neither met, action is void, unless later ratified by a valid act
    - (ii) Conference call (as long as directors can hear all other directors simultaneously) or out of state meeting allowed
  - b. **Notice**
    - (i) *Regular meetings* – NO notice is required, if the time/place is fixed by the **bylaws or by BoD**
    - (ii) *Special meetings* – notice is required & can be set in bylaws
      - (a) If the required notice not given, the action is void; UNLESS those not given notice *wave* the defect in
        - (i) signed writing anytime or (ii) by attending the meeting without objection
        - (b) Notice need not state the purpose of the meeting
  - c. **NO proxies & NO voting agreements are allowed for Directors (violates public policy)**
  - d. *Quorum for a meeting:*
    - (i) **Quorum** – to do business, there must be a majority of the “entire B” (i.e., the *duly constituted B*, meaning the # of positions if there were no vacancies)
    - (ii) **Passing a resolution** – once there is a quorum, *majority of those present*
    - (iii) E.g. – if there are 9 directorship positions, *at least 5 D's* must attend for Quorum; if 5 attend, *at least 3* must vote for resolution to pass. If 9 positions, and 5 attend, but one leaves, the quorum is broken. If 9 positions, and 2 resigned, we still need 5 to show up.  
B can require a supermajority vote, but only in the certificate and not the bylaws.

	<i>Decrease # required</i>	<i>Increase # required</i>
<i>Quorum</i>	YES ( <i>certificate OR bylaws</i> ) ( <i>BUT never fewer than 1/3 of directors</i> )	YES ( <i>certificate only, not bylaws</i> )
<i>Passing Resolution</i>	NO	YES ( <i>certificate only, not bylaws</i> )

**B. Role of Directors**

1. General role – BoD manages the corporation's business: (i) sets policy, (ii) monitors & supervises O's, (iii) declares dividends & other distributions, (iv) recommends fundamental corporate changes, etc.
2. *Committees* – if the certificate or bylaws allow, a majority of the “entire B” can delegate substantial management functions to a committee of *one or more D's*
  - a. BUT, the BoD can NOT delegate *all* powers & responsibility to the committee
  - b. Committee can NOT – (i) amend, repeal or adopt bylaws, (ii) recommend/submit fundamental corp change to S/H requiring S/H approval, (iii) fill a BoD vacancy, or (iv) set D compensation
  - c. Committee can recommend these for BoD action

**C. Duty of Care**

- ⇒ **Duty of Care Standard** – D is a fiduciary. **A D MUST DISCHARGE HIS DUTIES IN GOOD FAITH & WITH THAT DEGREE OF DILIGENCE, CARE & SKILL THAN AN ORDINARILY PRUDENT PERSON**

**WOULD EXERCISE UNDER SIMILAR CIRCUMSTANCES IN A LIKE POSITION**

1. **Nonfeasance** – need *causation*
  - D is liable *only if his breach caused a loss to the corporation* (difficult to show)
2. **Misfeasance** (causation is clear) – need **recklessness or grossly negligent**;
  - a. D is not liable if he meets the *business judgment rule* (BJR)
  - b. **Business Judgment Rule** – a court won't second guess a business decision if it was *made in good faith, was reasonably informed, & had a rational basis*  
Prudent people do appropriate homework

**D. Duty of Loyalty**

⇒ **Duty of Loyalty Standard** – D must act in *good faith* & with the *conscientiousness, fairness, morality & honesty* that the law requires of fiduciaries (because these cases involve *conflicts of interest*, BJR not applicable)

1. **Interested director transactions**
  - a. Any deal between the corporation & one of its D's (or business of which its D or O is also a D or O, or in which he has a substantial financial interest); UNLESS
  - b. Tests interested D transactions – if either test is met, transaction cannot be voided
    - (i) **Fairness test** – deal is *fair & reasonable* to corporation (D need not disclose under this test); OR
    - (ii) **Approval test** – material *facts & his interest were disclosed or known* AND deal was *approved* by;
      - (a) *S/H vote*,
      - (b) *BoD approval by sufficient vote not counting the votes of interested D's*, OR
      - (c) *Unanimous vote of disinterested D's, where interested D's are needed to make a quorum*
  - c. **Compensation to directors (waste)**
    - (i) BoD can fix compensation of D's in any capacity, unless certificate or bylaw says they can't – compensation *must be reasonable & in good faith*; if excessive, *waste of corporate assets*
    - (ii) *Stock options* as an incentive to service
      - (a) If corporation is publicly traded – must be authorized pursuant to exchange policies
      - (b) If not publicly traded – must be approved by S/H vote
2. **Competing ventures**
  - a. D cannot go into competition with his corporation
  - b. **Remedy** – corporation recovers D's profit via constructive trust, & there may be damages if he harms his corp
3. **Corporate opportunity (usurpation)**
  - a. D cannot **USURP corporate opportunity** – D cannot take it for himself until he (i) *informs* the BoD of its existence & (ii) waits for the BoD to *reject* it
  - b. Corporate opportunity – defined as something the corporation (i) *needs*, (ii) has an interest in, or (iii) tangible expectancy in, or (iv) is logically related to its business
  - c. **Remedy for usurpation** – constructive trust – D must sell it to the corporation at his cost; if he made a profit, the corporation gets the profit
  - d. look out for the “classic combo”: usurpation + interested D transaction
4. **Insider trading**
  - a. *State law* – D & O may not trade on undisclosed inside information (fiduciary duties); profits to corp.
  - b. *Fed law* – (i) §16(b) allows corporate recovery for profits made by D's, O's, (ii) *Rule 10b-5* allows virtually anyone injured to recover

**E. Other state law bases of Director Liability**

1. **Acts for which D's can be liable**
  - a. *Ultra vires acts* – liable for ultra vires losses
  - b. *Watered stock* – liable for knowing issuance of watered stock
  - c. **Improper loans** – Loans or guarantees for loans to Directors need

On or Before Feb. 22, 1998	After Feb. 22, 1998
S/H vote (unless certificate allow BoD)	BoD conclusion that it benefits the corp. (if benefits the corporation)

- d. *Sarbanes-Oxley Act restricts loans to executives in registered Corporations.*
- e. **Improper distributions** (see below):
  - (i) Declaring a dividend or other distribution contrary to the BCL or certificate;
  - (ii) Repurchasing by the corporation of D's own shares contrary to the BCL or certificate
  - (iii) Distributing assets after dissolution without adequately providing for known liabilities of corporation
2. **Which D's are liable** (meaning of “vote for” or “concur in”)
  - a. **General Rule** – D is presumed to have concurred with BoD action, UNLESS his dissent is noted *in writing* (oral dissent isn't enough) in corporate records,

- (i) in the minutes; (ii) in writing to corporate secretary at the meeting, or (iii) registered letter to the corporation promptly after adjournment
- b. Exceptions – D is NOT liable if:
  - (i) *Registers written dissent* within reasonable time after learning of the action (which is filed in the minutes); OR
  - (ii) Relied in **good faith** on information, opinions, reports or statements by:
    - (a) O's or employees of the corporation whom the D or O believes competent & reliable;
    - (b) Lawyers or public accountants whom the D or O believes are acting within their competence; or
    - (c) Committee of which person relying is not a member, as to matters within its designated authority
- c. *nature of liability* – accused D is entitled to contribution from other D's who are liable
- d. NOTE: no D is liable who has discharged his duties in good faith & with requisite duty of care

**F. Officers – owe same duties of care & loyalty as D's**

1. *Status* – O's are agents of the corporation (i.e., they can bind the corporation)
2. BoD may select a president, 1 or more VPs, a secretary, a treasurer, & any others for which the bylaws provide (1 person can hold multiple offices simultaneously)
3. *Selection & Removal* – Always BoD, unless the certificate allows S/H to elect (if S/H elect, only S/H can fire S/H elected O's)
  - a. *Corporation may be liable for breach of contract damages when they fire an O*
  - b. *General Hierarchy* – S/H fire & hire BoD; BoD fire & hire O's
4. *Judicial action* – NY attorney general, or holders of 10% of all shares may sue to remove an officer for cause
5. *Compensation* – BoD sets O's compensation

**G. Indemnification of Directors and Officers (WILL BE HIT ON BAR EVENTUALLY)**

1. When D or O is sued, in an action by or on behalf of the corporation, 3 possibilities for reimbursement:
  - a. *Prohibited* – if the O or D was held liable to the corporation
  - b. *Must indemnify as a matter of right* – if the O or D was successful in defending the action, on the merits or otherwise (BUT, corporation reimburses ONLY the underlying suit and NOT costs in a suit for reimbursement against corporation)
  - c. *Permissive indemnification* – the O or D
    - (i) *Requirements* – must show (a) acted in good faith, & (b) for a purpose reasonably believed to be in the corporation's best interest
    - (ii) Reimbursement in permissive category can include (a) settlement amount; (b) expenses & attorneys fees (but NOT any judgment)
    - (iii) *Eligibility* for permissive category is determined by:
      - (a) BoD – with a quorum of D's being non-parties, BUT, if there's no such quorum, go to (b)
      - (b) S/H's or a quorum of those D's who are disinterested, OR
      - (c) BoD, pursuant to a report from independent legal counsel
2. Certificate or bylaws can provide for indemnification by BoD or S/H resolution, or by agreement, unless (i) the O or D acted in *bad faith*, (ii) was *deliberate & dishonest* in a way material to the case, or (iii) he *wrongfully profited* – NOTE: reimbursement not allowed if it would be contrary to a provision in the (i) certificate, (ii) bylaws, (iii) BoD resolution, or (iii) S/H resolution or agreement in effect at time the cause of action accrued
3. *Court order* – court can order indemnification if it finds the O or D is *fairly & reasonably entitled to it* but it cannot include a judgment against the O or D
4. *Advancement of litigation expenses* – corporation can make advancements, but must be repaid if it turns out that O & D not entitled to indemnification
5. *Insurance* – a corporation can buy insurance to cover D & O liability

**IV. Shareholders**

**A. Holding Shareholders liable for debts of corporation**

1. **General rule – a S/H is not liable for the debts or acts of a corporation**
  - BUT a court may '*pierce the corporate veil*' (PCV) & hold S/H's personally liable if:
    - (i) abused the privilege of incorporating, & (ii) fairness demands that the S/H's not have limited liability
2. **Piercing the Corporate Veil**
  - a. *Standard* – (i) to *prevent fraud*, OR (ii) to *achieve equity* (to prevent the use of the corp as a cloak for illegality)
  - b. **Alter ego** (identity of interests, agency, or excessive domination)
    - (i) O or D *commingles personal & corporate funds*, treating the corporation as his alter ego
    - (ii) NO PVC if corporation has *any* mind, existence, or will of its own
  - c. **Undercapitalization** – S/H's failed to invest enough to cover prospective liabilities; *not enough for PCV in NY* – also need (i) illegality, (ii) fraud, or (iii) excessive domination as well

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3. **Wages** – in closely held corporation, 10 largest S/H's are personally liable for wages & benefits to employees

## B. Shareholder Management of Corporation (close corporations)

1. **Closely held corporation** (i.e. few S/Hs & shares not publicly traded) – S/H can manage business directly
  - a. Certificate provision can restrict or transfer BoD power to S/H's or others – if:
    - (i) All incorporators or S/H's (voting & nonvoting) *approve*;
    - (ii) All subsequent S/H's have *notice*;
    - (iii) *Conspicuously noted* on front & back of all shares, AND
    - (iv) *Shares NOT listed on an exchange* or regularly quoted over-the-counter (no public market)
  - b. *Managing S/H's* owe the duties of care & loyalty
  - c. **Duty of utmost good faith** – *controlling S/H's* cannot use their power for personal gain at the expense of *minority S/H's* or the corporation, OR to *oppress* minority S/H's or the corporation
2. **Professional Service Corporations (P.C.)** – formed by licensed professions (e.g. doctors, lawyers)
  - a. S/H's, Officers, and Directors must be licensed professionals; professionals liable for personal malpractice – BUT not liable for contracts entered by entity or rent due on leases under entity name
  - b. If one S/H dies or disqualifies from the practice – P.C. must purchase his/her shares
  - c. Basic corporation law for P.C.s, but on certificate must indicate profession practice, and must be a certification that each is a licensed professional

## C. Shareholder Derivative Suits

1. Definition – S/H is suing to enforce **the corporation's claim** (not S/H claims) because the corporation isn't pursuing its own claim

Ask this question: Could the corporation bring this suit? If yes, then it is probably a derivative suit.

HYPO: S, shareholder of C Corp., sues X for breaching its contract with C Corp. Derivative suit? YES -- because C Corp. could sue X for this breach.

HYPO: S sues the board of directors of C Corp. for usurping corporate opportunities. Derivative suit? YES. Duties of care and loyalty are owed to the corporation. A breach hurts the corp, so this is the claim.

HYPO: S sues board of directors of C Corp. for issuing new stock without honoring her preemptive rights.

Derivative suit? NO -- this is a "direct suit," for S's personal claim.

HYPO: S sues to compel declaration of dividend. Derivative? Probably not. Maybe, though, if it could be arguably based upon a breach of duty to the corporation.

HYPO: S sues regarding waste of corporate assets. YES. Always derivate

2. **Recovery:**

- a. **Successful derivative suit** – generally, recovery goes to the corporation
  - (i) S/H gets costs & attorney's fees
  - (ii) S/H can only recover damages directly if recovery by corporation only returns money to defendants
- b. **Unsuccessful derivative suit** – S/H can't recover costs & expenses & might be liable to the corporation for costs (and maybe attorneys' fees, if S/H sued without reasonable cause)
- c. Other shareholders cannot later sue the same defendants on same transaction? It is Res judicata

3. **Requirements for bringing a derivative suit:**

- a. **Stock ownership** – person bringing suit must have
  - (i) **Owned stock** (or held a voting trust certificate) **at the time the claim arose** (or have gotten it by *operation of law* from someone who did (via inheritance and divorce decree));
  - (ii) **Own stock when the action is brought** & through entry of judgment (can be brought by O, D, or S/H); AND
- b. **Adequately represent the interests of corporation & S/H's**, AND
- c. **Make a demand that D's bring suit unless it would be futile:**
  - (i) NOTE: a demand might be futile if
    - (a) Majority of the BoD is interested or under control of interested D's;
    - (b) BoD didn't inform itself of the transaction to the extent reasonable under the circumstances; or
    - (c) Transaction is so egregious on its face that it couldn't be the result of sound business judgment
  - (ii) **If demand is made & refused** – S/H can't sue unless show a majority of the BoD is interested or its procedure was incomplete or inadequate
- d. Plaintiff must plead with particularity her efforts to get the board to sue, or why demand is excused.
- e. **Security for expenses** – the S/H can be required to post security for costs UNLESS
  - (i) S/H owns 5% or more of any class of stock; OR
  - (ii) S/H's stock is worth more than \$50,000

4. **Corporation can move to dismiss the derivative suit** – based on the finding by independent D's (or a committee of independent D's 'special litigation committee'), that the suit isn't in the corporation's best interests (i.e. low recovery); requires (i) independence of making investigation, & (ii) sufficiency of investigation
5. Corporation must be a party, as well as a **nominal defendant**, because it didn't bring the suit on its own

6. **NO dismissal or settlement without court approval** – court may notify other S/H’s whose interests will be substantially affected by discontinuance of the case

**D. Voting**

**1. Voting eligibility**

- a. **Record owner** – person shown as the owner in the corporate records *as of record date has right to vote*
- (i) “**Record date**” (*voter-eligibility cut-off*) – may not be less than 10 or more than 60 days before the date of the meeting  
 HYPOTHESIS: C Corp. sets the annual meeting for July 7 and record date for June 6. S sells B her C Corp. stock on June 25. Who is entitled to vote the shares at the meeting, S or B? S, because she owned it on June 6
- (ii) **EXCEPTIONS** – (a) corporation does not vote treasury stock; (b) death of S/H; (c) proxies
- b. **Proxies**
- (i) Any S/H entitled to vote at a meeting may authorized another person to act for him by proxy
- (ii) They must be (a) in **writing** (including *faxes and email*), (b) **signed** by the record S/H or authorized agent, (c) **directed to secretary of the corporation**, (d) **authorizing another to vote** the shares
- (iii) **Expiration** – proxies are good for **11 months**, unless it says otherwise
- (iv) **Revocability** – *proxies are revocable*, even if it says otherwise  
 – BUT, a proxy is irrevocable if:  
 (a) *It says it’s irrevocable*; AND  
 (b) **The proxy-holder has some interest in the shares other than voting (Proxy coupled with an interest)**

c. **Voting trusts & Voting Agreements**

(i) **Comparison**

	<i>Voting Trust</i>	<i>Voting Agreement</i>
<i>Requirements</i>	- written Trust Agreement controlling how the shares will be voted - <b>copy to Corporation</b>	- written & - signed
<i>Duration</i>	10-year maximum (but renewable)	can be perpetual
<i>Share Ownership</i>	Legal ownership transferred to trustee; S/H retain beneficial ownership	S/H retain BOTH legal & beneficial ownership

- (ii) **Voting Agreements** in particular
- (a) Voting agreements are NOT specifically enforceable in NY
- (b) A proxy given subject to a voting agreement is irrevocable if it says so
- (c) **NOTE:** 2 S/H’s can agree to vote to elect each other as D’s, BUT, they cannot agree as to what they’ll do when they become D’s
- This would violate rule against voting agreement between directors
  - BUT, can be okay if these are the only 2 S/H’s of the corporation
  - Also, it is okay to agree to use your best efforts to cause the corporation to act in a particular way

**2. Shareholder Actions**

a. **Methods of valid action:**

- (i) **Unanimous written consent signed by the holders of all voting shares to act** – (can be without a meeting, if allowed by certificate and S/H’s agree in writing); OR
- (ii) **A meeting**
- b. **Shareholder Meeting**
- (i) **Annual meetings** (can be held anywhere) – S/H’s elect directors; courts can order if not held
- (ii) **Special meetings** (can be held anywhere) – can be called by (i) the BoD, or (ii) anyone else provided in certificate; a special meeting **MUST** be held if there’s a *failure to elect a sufficient # of D’s to conduct the corporation’s business*
- c. **Notice requirement** – must give written notice (including email) to *every* S/H entitled to vote, for every meeting (annual or special) *between 10 & 60 days* before the meeting
- (i) **Contents of Notice** – when & where meeting will be held
- (a) Must inform if the proposed action would entitle S/H’s to *appraisal rights* & tell why (even include the statute about appraisal rights)
- (b) Must state *who called the meeting & its purpose* – this limits what can be done at the meeting
- (c) **Meeting must be for proper purpose** – convening a meeting of S/H’s for the stated purpose of *removing a particular O* is an improper purpose, because S/H’s *don’t fire O’s*. If meeting was to remove a D, that is OK, because S/H have the ability to remove D’s.
- (ii) **Failure to give proper notice** – action taken at the meeting is *void* unless those not receiving notice *waive the notice defect*, waive either (i) *expressly* (in writing & signed anytime), or (ii) *impliedly* (they attend the meeting without objection)

**3. Mechanics of Voting** (quorums & supermajorities)

a. **Quorum** – requires a *majority of outstanding shares* (based on # of shares, not # of S/H's)

HYPO: X Corp. has 120,000 shares outstanding. X Corp. has 700 shareholders. What's a quorum? 60,001 shares.

HYPO: X Corp. has 120,000 shares outstanding. 62,000 shares are represented at the meeting, but only 50,000 shares vote on a particular proposal. How many shares must vote for the proposal for it to be accepted by the shareholders? We need 25,001.

	<i>Decrease # required</i>	<i>Increase # required (supermajority)</i>
<i>Quorum</i>	<b>YES (certificate OR bylaws)</b> <i>(BUT never fewer than 1/3 of shares)</i>	YES <i>(certificate only)</i>
<i>Passing Resolution</i>	<b>NEVER</b>	YES <i>(certificate only)</i>

b. *Passing resolution* – majority may act to bind corporation UNLESS the certificate requires a *higher* vote

(i) Majority means a *majority of shares actually voting* (i.e., abstentions don't count)

(ii) SO, a **quorum is NOT lost if people leave the meeting** (remember, this is unlike the rule for BoD)

c. *Cumulative Voting* (ONLY by certificate for D voting) – # of shares multiplied by # of D's to be elected

(i) Only available in *voting for D's* – helps small S/H's get representation on the BoD by allowing them to pool votes in 1 at-large election, rather than having separate elections for each D

(ii) *Formula for election* – one share more than percentage of  $[100 / (\# \text{ of directors being elected} + 1)]$

HYPO: 9 Directors =  $(100/9+1)=10\%$ . So you need one share more than 10% to elect a director.

	<i>Annual S/H Meeting</i>	<i>Special S/H Meeting:</i>	<i>Special S/H Meeting To elect D's:</i>	<i>Regular/Special BoD Meeting</i>
<i>When</i>	as bylaws provide	(i) BoD directs; or (ii) persons authorized in the articles or bylaws	After failure to elect D's (i) within a month after the date fixed for the annual meeting, or (ii) 13 months after the last annual meeting	as bylaws provide
<i>Notice Requirements</i>	personally given; or by mail <i>(10 &amp; 60 days before meeting; must include time &amp; place)</i>	personally given or by mail <i>(10 &amp; 60 days before meeting must include time &amp; place, who called the meeting, &amp; its purpose)</i>		as bylaws provide
<i>Proxy</i>	Yes			NO

**E. Sale of Stock by Shareholder**

1. *Free transferability* of individual shares

2. *Amount of consideration* – S/H can sell his stock for less than par, because par is an issuance rule and is inapplicable to *sales by individuals* (only relevant when the corporation is selling its *own* shares)

HYPO: S has 100 shares of \$4 par, C Corp. stock. Can S sell her shares for less than \$4 a share? Yes. Par Rules only apply to issuance.

3. *Share transfer restriction* – may be contained in certificate, bylaws, or a separate agreement

a. Action against seller – look to validity of restriction

(i) Such restrictions will be upheld provided they're reasonable under the circumstances (not an undue restraint on alienation). Can't allow the corp to refuse for no reason at all – this is unreasonable.

(ii) **Right of first refusal** – S/H is subject to a stock transfer restriction that requires him to offer his stocks first to the corporation (upheld if the price offered is reasonable)

b. Action against buyer – look for buyer's knowledge

– Buyer who violated the stock transfer restriction won't be liable unless (i) it's conspicuously noted on the stock certificate, or (ii) the transferee has *actual knowledge* of the restriction

**F. Right of Shareholder to Inspect the Books & Records of the Corporation**

1. S/H's has the right to inspect and copy for *any proper purpose* (D's have unfettered access to the records b/c they manage the corp)

a. 5 days written demand – (i) minutes of S/H proceedings, & (ii) record of S/H's

b. 2 days written demand – list of current O & D's

c. Written request – corporation's latest *annual balance sheet, profit & loss statement & latest interim statements* distributed to S/H's or public. This can be done by mail.

2. S/H may be required – give an affidavit that (i) his purpose is not other than in the interest of the corporation, & (ii) he has not within 5 years tried to sell any list of S/H (Corporation may not judge purpose). Corp cannot demand more

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than this. If no affidavit, corp can deny access.

- a. Allowable – if S/H wants to solicit other S/H's for tender offers
  - b. BUT, inspection of the records to determine alleged misuse of S/H's assets & funds has been found to be an impermissible purpose – the proper remedy being a derivative action
3. *Common law right to inspect* – gives all S/H's the right to inspect records at a reasonable time & proper place for a proper purpose (i.e. related to your role as a S/H) (unclear how broad this is)

**G. Distributions** – payments to S/H's (dividends, or payment to repurchase or redeem shares)

**1. Distributions are declared by BoD's discretion**

- a. S/H's have ***no right to distribution until declared***
- b. Once dividends are lawfully declared, affected S/H's take the status of creditors
- c. Courts won't interfere with BoD's discretion *absent bad faith or dishonest purpose (tough for P to win)*
- d. NOTE: distribution is different from a *stock split*, which just gives a s/h more shares than he has, reducing value proportionately

**2. Dividends**

- a. *Holder of preferred shares* are generally entitled to have stipulated dividends declared on their shares *before* any dividends are declared/calculated on *junior* (usually *common*) shares
- b. **Calculations** – which S/H get dividends (hypo: B declares a dividend of \$400K) (**rarely tested**)
  - (i) If 100,000 Common Stock: \$4 per share
  - (ii) If 100,000 Common Stock; 20,000 Preferred Stock with \$2 dividend preference:
    - (a) Preferred S/H's: \$40K (20,000 preferred stock/preference \* \$2 = \$40K) = \$2 per share
    - (b) Common S/H's: \$360K left for the Common S/H's = \$3.60 per share b/c 100,000 common shares
  - (iii) If 100,000 Common; 20,000 shares of \$2 preferred stock that is ***participating*** (i.e., pay again):
    - (a) Preferred S/H's: \$40K + they get paid again, meaning that the \$360K is divided by 120,000 shares (total # of common & preferred S/H's) = \$2 + \$3 = \$5 per share
    - (b) Common S/H's: \$360K/120,000 = \$3 per share
  - (iv) If 100,000 Common; 20,000 shares of \$2 preferred that is *cumulative* (i.e., add them up for years dividends not paid); & no dividends for 3 prior years:
    - (a) Preferred S/H's: \$160K (\$8 \* 20,000 shares) corporation owes the cumulative holders for 3 prior years (when there were no dividends), PLUS this year's dividend = \$8 per share
    - (b) Common S/H's: \$240K (\$400K – \$160K) = \$2.4 per share

**3. Funds for Distribution**

- a. *Surplus* – computed by *Assets – Liabilities – Stated Capital*
  - (i) Surplus can be used for distribution – after a dividend, net assets must at least equal stated capital
- b. *Stated capital* – sum, in dollars, of:
  - (i) For par shares – consideration received (excess over par value is surplus);
  - (ii) No par shares – consideration received (except BoD may allocate part, but not all, to surplus within 60 days after issue), &
  - (iii) Amounts transferred from surplus by BoD (all or part of surplus may be transferred) to stated capital  
HYPO: C Corp. has issued 10,000 shares of \$2 par stock for \$50,000 and 4,000 shares of no par stock for \$70,000. On the par stock, 20k goes to stated capital and 30k goes into surplus. For the no-par, board may allocate any part to surplus within 60 days

**4. Making Distributions**

- a. Corporation can make distributions *even though it lost money* for that year
  - (i) Can NOT make distributions if it's *insolvent* or the distribution would render it insolvent (*unable to pay debts as they come due in the ordinary course of business*); after a distribution, net assets must at least equal stated capital
  - (ii) D's are personally liable for unlawful distributions, as are S/H's who knew the distribution was unlawful when they received it – D or O can sue on behalf of the corp.
  - (iii) D's have a defense of *good faith reliance*.
- b. Redemptions – are set in the certificate & must be done proportionately within each class of stock
- c. Repurchases – are individually negotiated, & can discriminate (except in close corporations, where corporation must give equal opportunity to all S/H's)
  - Can NOT be made for improper purpose such as paying “greenmail” to potential raiders

**V. Fundamental Corporate Changes**

**A. Characteristics of Fundamental Corporate Change**

These are so fundamental that, most of them require both that the directors approve and that the shareholders approve.

**1. Approval**

- a. Most fundamental changes require both BoD and S/H approval – usually, the corporation must notify the Dept of State by delivering a document which it files
- b. Generally, **fundamental corporate change** must be approved by 2/3 of *all outstanding shares entitled to vote* (not just those represented at a meeting)
2. **Right of Appraisal** – right of a S/H to force the corporation to buy his shares at fair value
  - a. **Trigger** of S/H right of appraisal – (i) some amendments to the certificate, (ii) consolidation, (iii) corporation merges into another, (iv) corporation transfers substantially all of its assets; or (v) corporation’s shares are acquired in a share exchange
    - NEVER a right of appraisal if the company is listed on a national securities exchange or NASDAQ
  - b. **Perfection** of S/H right of appraisal, a S/H must:
    - (i) Before S/H vote, **file written notice of objection & intent** to demand payment
    - (ii) During meeting, **abstain or vote against the proposed change**, AND
    - (iii) After the vote, **make written demand to be bought out**
  - c. If S/H & corporation can’t agree on fair value, the corporation sues & courts determines the value – no *minority discount* is allowed (to reflect that minority shares are worth less cause they carry no control)

**B. Amendment to Certificate of Incorporation (Not heavily tested)**

1. *Minor changes* – BoD (e.g. those relating to office locations, registered agent, etc.)
2. **Amendments** – must approved by **BoD + majority of shares entitled to vote** (much tougher since it is not majority of shares that attend meeting or actually vote)

HYP0: The directors approve an amendment and recommend it to the shareholders. If there are 4,000 outstanding shares entitled to vote, how many must vote for the amendment? **2001**

HYP0: Same facts, but suppose only 2,400 shares attend the meeting to vote on the amendment, and only 2,200 shares actually vote. How many must vote in favor of the amendment for it to pass? **2001**

- a. E.g. (i) change of name, (ii) purpose or duration, (iii) increase or decrease of shares or par, (iv) creation of new classes of stock, (vi) denial or grant or limitation of preemptive rights
3. *Other Amendments*
  - a. **Change or strike supermajority quorum or voting requirements for S/H voting**
    - BoD approval + 2/3 S/H approval (*shares entitled to vote*)
  - b. **Change or strike supermajority quorum or voting requirements for BoD voting; OR strike a provision restricting BoD’s authority**
    - (i) BoD approval + S/H approval

On or Before Feb. 22, 1998	After Feb. 22, 1998
2/3 S/H ( <i>entitled to vote</i> ) approval	Majority S/H ( <i>entitled to vote</i> ) approval

4. *Filing* – certificate of amendment must be delivered to the Dept of State for filing
5. *Right of appraisal* for dissenting S/H (*assuming not publicly traded*) – if amendment (i) alters or abolishes a preference, (ii) changes redemption right, (iii) alters or abolishes preemptive right, or (iv) limits voting right

**C. Merger (A & B = A) or Consolidations (A & B = C)**

1. *Requirements:*
  - a. **BoD approval** – each corporation’s BoD adopts a plan of merger/consolidation; AND
  - b. **S/H approval** – each corporation (EXCEPT for short-form mergers, where a parent corporation owns 90% or more of each class of stock of a subsidiary that’s merged into the parent) :

On or Before Feb. 22, 1998	After Feb. 22, 1998
2/3 S/H ( <i>entitled to vote</i> ) approval	Majority S/H ( <i>entitled to vote</i> ) approval

2. *Filing* – certificate of merger/consolidation must be filed with Dept of State
3. *Right of appraisal* for dissenting S/H’s (assuming not publicly traded):
  - a. *S/H’s of both companies in a consolidation* – YES, because they disappeared
  - b. *S/H’s of acquired company in a merger* (including short-term merger) – YES, because it disappeared
  - c. *S/H’s of surviving company in a merger* – NO, because they didn’t disappear
  - d. *Short Form Merger* - YES
4. *Successor Liability* – the surviving company succeeds to all of constituent company’s rights & liabilities
5. *Lawful Purpose* – merger must have legitimate purpose, & not just for purpose of “freezing out” minority S/H

**D. Transfer** (assets transfer or share exchange)

1. Transfer (not just mortgage) of *all or substantially all of the assets not in the ordinary course of business or share exchange* (i.e., one corporation acquires all the outstanding shares of 1 or more classes of another corporation) – fundamental corporate change for the **selling** corporation only. The buying corporation does not vote because it is not a fundamental corporate change for the buying company.

2. Requirements
  - a. BoD approval – each corporation’s BoD authorizes the deal
  - b. S/H approval – ONLY S/H of selling corporation

On or Before Feb. 22, 1998	After Feb. 22, 1998
<b>2/3 S/H (entitled to vote) approval</b>	<b>Majority S/H (entitled to vote) approval</b>

3. *Filing* – share exchange (YES); **assets transfer (NO)**
4. *Rights of appraisal* – for S/H of *selling corporation only*; BUT NOT if the sale of assts is for cash & selling company will dissolve & distribute cash to S/H’s within 1 year (because the corporation is dissolving anyway)
5. *NO successor Tort liability in asset transfer* – UNLESS, (i) deal provides otherwise, (ii) buying corporation is mere continuation of selling corporation, or (iii) deal was entered into fraudulently to escape such obligations. Why? Because the corp selling its assets still exists.

#### E. Dissolution (Hot topic)

1. *Voluntary Dissolution*
  - a. Requirements – BoD vote NOT necessary, but S/H vote required:

On or Before Feb. 22, 1998	After Feb. 22, 1998
<b>2/3 S/H (entitled to vote) approval</b>	<b>Majority S/H (entitled to vote) approval</b>

- b. *Filing* – certificate of merger/consolidation must be filed with Dept of State
2. **Involuntary (judicial) Dissolution** – someone is asking for a ct order of dissolution by:
  - a. *BoD resolution or resolution of majority of shares entitled to vote* – stating that the corporation has insufficient assets to discharge liabilities OR that dissolution would be beneficial to S/H’s
  - b. *½ or more of shares entitled to vote* – may petition if (i) D’s too divided to manage, (ii) S/H’s too divided to elect D’s or (iii) magnitude of internal dissention makes dissolution beneficial to S/H’s
  - c. *Any S/H entitled to vote* – may petition if S/H’s unable to elect D’s for 2 annual meetings
  - d. **20% or more of voting shares** (assuming not publicly traded) – may petition on either grounds:
    - (i) **Management’s illegal, oppressive acts towards complaining S/H’s; OR**
    - (ii) **Management’s (D’s or managing S/H’s) wasting, diverting, or looting assets**
      - Court may deny dissolution if there’s some other way the complaining S/H can obtain a fair return on his investment (e.g., ordering a *buy out*)
      - Court considers whether liquidation is necessary to get a fair return on investment
      - **Avoiding Dissolution** (by corporation or non-complaining S/H) – *within 90 days of the petition, buy the petitioners’ shares at fair value, on terms approved by the court*
3. *Liquidating* – (i) gather all assets, (ii) convert to cash, (iii) pay creditors, and (iv) distribute remainder to S/H’s, pro-rata by share unless a dissolution preference (must be in certificate)  
Shareholders cannot agree that they will be paid before creditors at liquidation.

#### VI. Controlling Shareholder Considerations (close corporations)

##### A. Traditional Rule

- Outside close corporations, S/H’s don’t owe fiduciary obligations to each other, & can act in self-interest

##### B. Controlling Shareholder

1. **Duty of utmost good faith** – a S/H who occupies a control position (such as a D position) or whose ownership is such that he has *working control* over the corporation owes a fiduciary duty to minority S/H’s, & sometimes, to others (including the corporation) . Cannot use his dominant position for individual advantage.
2. **Sale of controlling S/H’s interest**
  - a. Can be *sold at a premium* (because of control, a controlling S/H is able to sell his shares at a *premium*);
  - b. CAN **keep the premium money**, BUT, courts CAN impose liability if:
    - (i) **Controlling S/H sold to looters without making a reasonable investigation** (watch for facts that put a person on notice of a problem – e.g., agent approaches on behalf of *undisclosed principal*)
      - *Disgorge seller’s profits & probably liable for all damage to the corporation*
    - (ii) **Controlling S/H de facto sells a corporate asset**
      - All S/H share in the premium paid by buyer (controlling S/H has no right to sell corporate asset)
    - (iii) **Controlling S/H sells a corporate office** (e.g., position on B) – fiduciaries can’t sell their position in return for an agreement to resign from BoD
      - Disgorge profits
3. **Freeze-out mergers** – aimed solely at *cashing out minority S/H’s unfairly*  
*Controlling S/H merges corp with another corporation that they own..*
  - a. Courts will look to the transaction as a whole – fairness of terms & treatment of minority S/H

- b. Factors – whether (i) there was self-dealing or fraud; (ii) minority S/H’s are dealt with fairly; & (iii) there is a legitimate business reason for merger
- 4. **Market Trading on Inside Information** – corporation can through, direct or derivative suits, recover any profits
- 5. **Nondisclosure of “special facts” or “special circumstances” (special facts doctrine)**– all D & O’s owe an affirmative duty to disclose special facts in a securities transaction with a non-insider
  - a. *Special facts* – fact that a reasonable investor would consider important in making an important investment decision
  - b. *Duty* – **must either disclose or abstain from trading**
  - c. *Who can sue?* – (i) a S/H dealing with an insider who violates the special facts doctrine, & (ii) corporation can sue the insider, to recover his profit made from *market* trading on inside information
  - d. *Measure of damages* – difference between **price paid & value of stock** at reasonable time after public disclosure

**SUMMARY OF CORPORATE CHANGES**

<i>Type of Corporate Change:</i>	<i>Approval requirements On or before 2/22/98: (usually, 2/3 of S/H)</i>	<i>Approval requirements After 2/22/98: (usually, majority of S/H)</i>	<i>Rights of Appraisal (assuming not publicly traded)</i>
<i>Amendment to Certificate</i>	1. BoD approval, & 2. <b>2/3</b> of shares (entitled to vote)	1. BoD approval, & 2. <b>Majority</b> of shares (entitled to vote)	1. Alters/abolishes a preference, 2. Changes redemption rights, 3. Alters or abolishes preemptive right, OR 4. Limits voting rights
<i>Merger or Consolidation</i>	1. BoD approval, & 2. <b>2/3</b> of shares (entitled to vote)	1. BoD approval, & 2. <b>Majority</b> of shares (entitled to vote)	1. S/H of both companies in a consolidation 2. S/H’s of acquired company in a merger <i>(NO S/H’s of surviving company in a merger)</i>
<i>Shares transfers or Assets transfers</i>	1. Each corp’s BoD, & 2. <b>2/3 of SELLING corp’s</b> shares (entitled to vote)	1. Each corp’s BoD, & 2. <b>Majority of SELLING corp’s</b> shares (entitled to vote)	Only for dissenting S/H’s of SELLING corporation <i>(BUT NOT if the sale of assts is for cash &amp; the company will dissolve &amp; distribute cash to the S/H’s within 1 year)</i>
<i>Voluntary Dissolution</i>	<b>2/3</b> of shares (entitled to vote)	<b>Majority</b> of shares (entitled to vote)	

<p><i>Involuntary Dissolution</i></p>	<ol style="list-style-type: none"> <li>1. By BoD resolution or resolution of majority of shares entitled to vote, stating that the corporation has sufficient assets to discharge liabilities OR that dissolution would be beneficial to S/H's</li> <li>2. ½ or more of shares entitled to vote may petition if (i) D's too divided to manage, (ii) S/H's too divided to elect D's or (iii) magnitude of internal dissention make dissolution beneficial to S/H's</li> <li>3. Any s/h entitled to vote may petition if S/H is unable to elect D's for 2 annual meetings</li> <li>4. <b>20% or more of voting shares in corporation whose shares aren't traded on a securities market may petition if (i) management is illegal, oppressive or fraudulent acts towards complaining S/H's, or (ii) management wastes, diverts, or loots</b></li> </ol>	
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<b>CORPORATIONS – ESSAY QUESTIONS</b>
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**I. QUESTION – 73**

- A. Issue is the fiduciary duty of a promoter to outside investors of the corporation
- B. Whether a promoter has a right to be compensated for his services to the corporation
- C. Breach of a director's fiduciary duty for self-dealing
- D. Whether a director may compete with this corporation

**II. QUESTION – 89**

- A. Whether directors violated their fiduciary duty to S/H when they sold their shares to buying corporation
- B. Whether corporation can redeem its stock
- C. What are the requirements for S/H approval of a merger
- D. Whether a merger must have a legitimate purpose

**III. QUESTION – 30**

- A. Whether a corporate president has standing to bring action under the corporate opportunity doctrine
- B. Whether director/shareholder is required to make a demand upon the board prior to commencing a suit
  - 1. Director
  - 2. Shareholder issue – demand would be futile
- C. Whether the requirements of the shareholders agreement will be enforced
  - 1. Authorization of number of directors – consider formulation after Feb 22, 1998
  - 2. Voting agreement

**IV. QUESTION – 2**

- A. Whether S/H has preemptive rights and, if so, whether he can exercise them so to block the issuance of the shares to another party
- B. Whether S/H is liable for breaching the bylaws restricting the transfer of shares
  - 1. Reasonable restrictions
  - 2. Right of first refusal
- C. Whether restrictions on share transfer are binding on third party buyer

**V. QUESTION – 38 (& NY PRACTICE)**

- A. Issue of obtaining information in time to respond to other party's motion – answer: subpoena a nonparty to take an oral disposition at least 20 days prior to the date of the deposition

**VI. QUESTION – 11 (& CONTRACTS)**

- A. Whether B (director & minority SH) has any grounds to bring an action against the corporation, if so, what can be recovered) – in a closed corporation the majority sells all the assets of the corporation
  - 1. D's motion to dismiss grounds on P's failure to state a claim upon which a relief may be granted – court must determine adequacy
  - 2. Standing – if bring a direct suit as director (not by SH) under his own name (without complying with requirements for SH derivative suits)
  - 3. Consider whether sale met appropriate BOD & SH approval
  - 4. B can also consider a demand appraisal rights as SH

**VII. QUESTION – 45 (& CONTRACTS)**

- A. Whether the Corp contract is void or voidable under the “*interested directors*” doctrine
  - 1. Contract is **Voidable** unless director shares all *material facts* of his extra-corporate interest before any corporation takes action – Corp cannot approve the transaction under statute
  - 2. BUT parties to the transaction may still enforce if they establish transaction was fair and reasonable to the corporation at the time it was made
- B. Whether prevention of a takeover constitutes valid grounds for the denial of inspection rights – whether potential takeover SH corp has right to inspect the books
  - 1. Any SH may demand (entitled) inspection for any purpose reasonably relation to such person's interests as SH

**VIII. QUESTION – 82 (& CONTRACTS)**

- A. Whether a sale of substantially all of a corp's assets may be approved by 40% of the shares
  - 1. BCL requires that any sale, lease, exchange, or other disposition of all or substantially all of the corp's assets requires SH approval
    - a. BOD must first authorize the sale & majority of SH must approve
    - b. Dissenting SH have right of appraisal (i.e. to receive the fair market value for their shares)

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- B. Whether arbitration clause in the sale agreement (of corp's assets) is binding
    - 1. Because the agreement never became effective and binding – thus clause could not be binding
    - 2. BUT by NY ruling, party is always entitled to seek arbitration no matter what grounds of his claim might be

**IX. QUESTION – WW2**

- A. Issue whether a *petition for dissolution* should be denied where there has been minority shareholder oppression in a *closely held corporation* – should not have been denied
- B. Issue whether a *buyout provision* in a shareholder agreement is controlling when one of the shareholders is *judicially required to sell his shares* – not govern
- C. Issue whether a *restrictive covenant not to compete* in a shareholder agreement should be enforced against a former employee – must be reasonable & service unique