Business Associations Outline

Agency Relationships

I. Formation

- An agency relationship is formed when a principal (P) consents to have an agent (A) act on P's behalf and subject to P's control, and the agent consents to the relationship.
- P must have the contractual capacity to enter into the relationship. A does not need capacity but must have the mental capability to do what they have been appointed to do.
- Consent can be expressed orally or in writing, implied by P's conduct, or misinterpreted by a third party. Consideration is not required and writing is generally unnecessary.
- An agency relationship can be formed by estoppel when a third party relies on P's communication.
- **Types of agents**
  - Individual
  - Employee: paid hourly or for long periods, work is integral to P's business, and work is completed under P's direction.
  - Independent contractor: not subject to P's control over the physical conduct of A's work.
  - Gratuitous agent: no compensation for A's work.
  - Trustee: subject to the control of the settlor or beneficiary.
  - Subagent: appointed by A to perform the functions agreed to by A.

II. Termination

- **Termination by will:**
  - Either party can manifest intent to cease the relationship (P revokes or A renounces).
  - Effective when notice is received by the other party.
  - Can be terminated if the purpose of the agency is fulfilled.
  - P must give notice of termination to protect against liability to third parties who previously relied on the agent's authority.
    - Actual notice: to those who have previously dealt with A.
    - Constructive notice: to third parties who have not actually relied on P.
- **Termination by operation of law:**
  - Death
  - Loss of capacity: requires notice to third parties for termination to be effective against them.
  - Bankruptcy of the principal

    - Breach of fiduciary duty
    - Cessation of existence: applies to non-individual entities.
    - No notice required for death or lack of capacity.

Power of Agent to Bind Principal

I. Actual Authority

- Exists when the agent reasonably believes, based on P's manifestations, that P wants A to act.
- Created through words or conduct that reasonably cause A to believe P desires them to act on P’s behalf.
- A’s belief must be reasonable and in line with P’s objectives.
- **Types:**
    - Express: P gives clear and direct instructions for a specific task.
    - Implied: A has authority to do what is reasonably necessary to carry out express authority.
        - Incidental authority: to do acts incidental to or reasonably necessary to accomplish the transaction.
    - Ratification: P affirms A’s conduct that was originally unauthorized.
        - P must have knowledge of all material facts and capacity at the time of ratification.
        - P can ratify by manifesting assent or engaging in conduct only justifiable if they intended to ratify.

II. Apparent Authority

- Exists when a third party reasonably believes that A has authority to act based on P’s manifestations.
- Created by P’s words or conduct that lead the third party to believe A is authorized.
- Apparent authority cannot be created when P is undisclosed.
- Third party has a duty to inquire if they have reason to doubt A’s authority.
- **Agency by estoppel:** P is estopped from denying A’s apparent authority if they silently allow A to act on their behalf.

III. Inherent Agency Power

- A’s power to bind P even without actual or apparent authority based on the agency relationship.
- Exists to protect those harmed by A.
- P liable if A acts improperly and fails to inform the third party of exceeding their authority.
- **Scope:**
    - General agent: P liable for acts usually done in connection with authorized transactions, even if forbidden by P.
- **Rationale:** Fair for P to bear losses when A exceeds authority but acts in a way usual for the type of transaction.

- **Third Restatement:**
  - Eliminates inherent agency power but incorporates similar concepts into apparent authority.
  - Undisclosed P liable if third party detrimentally relies on A and P doesn't take steps to notify the third party.

Vicarious Liability of Principal for Acts of Agent

I. Contractual Liability

- P liable on contracts entered into by A with actual or apparent authority, by estoppel, by inherent agency power, or by ratification of an unauthorized act.
- **Extent of liability depends on P's disclosure to the third party:**
  - Disclosed P: third party knows A is acting for P and knows P's identity.
    - P is liable, A is not liable.
  - Partially disclosed P: third party knows A is acting for P but doesn't know P's identity.
    - Both P and A are liable unless otherwise agreed.
  - Undisclosed P: third party doesn't know A is acting for a P.
    - P is liable, A may also be liable.
    - General agent: P liable for usual or necessary acts, even if not expressly authorized.
    - Special agent: P liable only for acts done with authority (actual, apparent, inherent, ratification, estoppel).

II. Liability of Third Party to Undisclosed P

- Third party liable to P as if P made the contract unless P is excluded by the contract or P's existence was fraudulently concealed.
- A is still a party to the contract even if acting for an undisclosed P.

III. Tort Liability

- P liable for own torts and torts of A with authority.
- **Direct liability:**
  - P liable for negligence in hiring or supervising A.
- **Vicarious liability:**
  - P liable for A's torts if:
    - Master-servant/employment relationship exists.
      - A is an employee subject to P's control.
    - A's tort occurred within the scope of employment.
      - Act done to further P's interests.
      - Of the same general nature as authorized acts or incidental to authorized acts.
  - P is generally not liable for torts of an independent contractor unless:
    - Misrepresentations by the independent contractor are made for P's benefit.
    - Inherently dangerous activities are involved.

        - Apparent authority exists.
- **Agent not serving P’s interests:** P still liable even if A acts for their own purposes unless third party has notice.
- **Secret limiting instructions:** P liable even if A violates limitations not disclosed to the third party.

Fiduciary Duties Between Principal and Agent

I. Duties of Agent

- **Duty of care:**
    - Act with reasonable care and skill to achieve the intended result.
    - Gratuitous agents: held to a lower standard, only liable for gross negligence.
    - Third Restatement: duty of performance includes competence, diligence, good conduct, providing information, safeguarding P’s property.
- **Duty of loyalty:**
    - Place P’s interests above own.
    - Disclose all facts that threaten P’s interests.
    - Liable for profits gained from violating duty.
    - Includes duty to avoid competition and use of confidential information.
    - Post-termination: cannot use trade secrets or compete if bound by a reasonable non-compete covenant.
    - Third Restatement: duty of loyalty expanded to include:
        - Acting for P’s benefit in all matters.
        - Not acquiring material benefit for personal gain.
        - Not acting adversely to P.
        - Not using P’s property or information for personal gain.
        - Not competing with P.
- **Duty of obedience:**
    - Act within actual authority and follow P’s instructions.
    - Third Restatement: incorporated into duty of performance.
- **Duty to account:**
    - Account for violations of fiduciary duties and profits gained in breach of loyalty.

II. Duties of Principal

- Act in accordance with the contract terms.
- **Duty to indemnify:**
    - Reimburse A for payments and expenses incurred within the scope of authority.
- **Duty to deal fairly and in good faith:**
    - Provide information to A regarding risks of harm or loss.
    - Not injure A’s business reputation.

Creation of Partnerships

I. Types of Partnerships

- **General Partnership (GP):** Two or more general partners.
- **Limited Partnership (LP):** At least one general partner and one limited partner. GPs are personally liable for partnership obligations while LPs have no personal liability beyond their contributions.
- **Limited Liability Partnership (LLP):** Protects general partners from personal liability. Partners are not personally liable for the LLP's obligations, but are personally liable for their own wrongful acts.

II. Formation

- Partnerships are governed by the default rules of the Revised Uniform Partnership Act (RUPA), which may be modified by agreement.
- **Intent:** Two or more persons or entities must intend to carry on a for-profit business as co-owners.
  - No specific intent to form a partnership is required.
  - Intent may be implied through conduct such as profit sharing, joint title to property, or parties' designation as partnership.
- **Partnership agreement (PA):** Can be written, oral, or implied by conduct.
  - Generally governs relations between partners and the partnership.
  - Can opt out of most of RUPA's default rules, but cannot:
    - Unreasonably restrict a partner's access to books and records.
    - Remove the partner's duties of loyalty and care.
    - Disallow a partner's right to dissociate (but can require written notice of intent to withdraw).
- **Statute of Frauds:** A written agreement is not required for formation, but a contract that cannot be performed within one year must be in writing.
- **Filing:**
  - LP and LLP require filing a certificate with the secretary of state's office.
    - LP: must include "limited partnership" or an abbreviation in the name.
    - LLP: must include "limited liability partnership" or an abbreviation in the name.

Power and Liability of Partners

I. General Partners (in GP and LP)

- **Management:** Each general partner has equal rights to manage the partnership and conduct business unless the PA states otherwise.
  - Decisions within the ordinary course of business require a majority vote.
  - Decisions outside the ordinary course of business require unanimous consent of all general partners.
- **Authority:** A general partner binds the partnership when acting within the ordinary course of business.
  - Acts outside the ordinary course of business bind the partnership only if all general partners consent.
  - Apparent authority exists when a GP acts in the ordinary course of business unless:
    - The GP did not have authority to act in that particular matter.

        - The person with whom the GP is dealing knew or had notification that the GP lacked authority.
    - Actual authority can come from express agreement or a partner’s reasonable belief based on communication with other GPs.
- **Liability:**
    - Personally liable for all partnership debts, including torts committed by a partner in the ordinary course of business or with authority from the partnership.
    - Jointly and severally liable.
        - A partner may sue other partners for contribution if they did not pay their pro rata share.
        - New partners are not personally liable for obligations arising before they joined.
        - Outgoing partners are liable for obligations arising while they were a partner, unless there was payment, release, or novation.
    - Criminally liable only for their own crimes or participation.

II. Limited Partners

- **Liability:**
    - Not personally liable for debts of the LP, except for their capital contribution, even if they participated in management.
- **Rights:**
    - Right to seek information reasonably related to their interest as a limited partner.
        - Inspect and copy tax returns and other documents required by law.
        - Obtain information about the partnership’s financial condition and state of business.
    - No right to co-manage the partnership or engage in partnership business.

III. Transfer of Titled Partnership Property

- A partner may have authority to transfer titled partnership property in certain circumstances.
    - **Property held in the partnership's name:** A partner has the authority to execute an instrument of transfer in the partnership's name.
    - **Property held in a partner's name:** A partner has the authority to execute an instrument of transfer in the partner's name if:
        - The title to the property was in the partner's name before it became partnership property.
        - The property is held in the partner's name but the partner is identified as a partner in the instrument of transfer.
    - **A person owning all partners’ interests:** Effectively has title to all partnership property and the power to transfer title to himself.

Rights of Partners Among Themselves

- **Profits and losses:**
    - Profits are shared equally unless the PA states otherwise.

    - Losses are shared in proportion to the sharing of profits.
        - A partner who pays more than their share of losses has a right to contribution from partners who did not pay their share.
- **Management and control:**
    - Each partner has equal management rights and actual authority to conduct usual and customary partnership matters unless there is reason to consult other partners.
    - A majority vote is needed for ordinary business decisions.
    - Unanimous consent is required for matters outside the ordinary course of business and amendments to the PA.
- **Remuneration:** No remuneration for services except for reasonable compensation for winding up the partnership's business.
- **Reimbursement and indemnification:**
    - The partnership must reimburse a partner for loans made to further partnership business.
    - The partnership must indemnify partners for personal liability incurred in the ordinary course of partnership business.
- **Use of partnership property:** A partner cannot derive personal benefit from the use or possession of partnership property and must compensate the partnership for such use.
- **Access to records:** The partnership must permit partners and their agents to access all partnership records.
- **Lawsuits:**
    - The partnership may sue a partner for breach of the PA or violation of duty.
    - A partner may sue the partnership or another partner to enforce their rights under the PA or RUPA.
- **Settlement of account upon dissolution:** Each partner is entitled to a settlement of their account upon dissolution.
- **Property:**
    - Property acquired by the partnership is owned by the partnership, not the individual partners, and is not freely transferable.
    - A partner has no right to use partnership property other than for the benefit of the partnership.
    - **Titled property:**
        - Partnership property if titled in the name of the partnership or a partner (and noted in the title).
        - Rebuttably presumed to be partnership property if purchased with partnership funds.
        - Rebuttably presumed to be separate property if not purchased with partnership funds, even if used for partnership purposes.
    - **Untitled property:** Ownership is determined by common law criteria.
- **Interest:**
    - The economic right to an interest in the partnership is personal and transferable without dissolving the partnership.
        - The transferee is only entitled to receive distributions, the transferor retains other rights and duties.

Dissolution

I. Dissociation

- A partner has the power to dissociate or dissolve at any time.
- **Events causing dissociation:**
  - Partner's notice of withdrawal.
  - Partner’s expulsion due to the PA, unanimous vote of other partners, or bankruptcy.
  - Partner's death or incapacity.
  - Termination of an entity partner.
  - Agreed event or event that makes continuation unlawful.
  - Judicial order.
- **Wrongful dissociation:**
  - A partner is liable for damages caused by wrongful dissociation.
  - **Partnership unlimited by time or undertaking:** Wrongful only if in breach of the PA.
  - **Partnership for a definite term or undertaking:** Wrongful if the partner withdraws, is expelled by court order, is a debtor in bankruptcy, or is not an individual, trust, or estate and willfully dissolved or terminated before the term expires or the undertaking is completed.
- **Consequences of dissociation:**
  - Ends the partner’s rights to manage and conduct partnership business.
  - Partner remains liable for obligations incurred before dissociation.
  - Ends the partner's duties of loyalty and care going forward, but duties for matters occurring before dissociation continue.
  - The ongoing partnership must buy out the dissociated partner's interest.
  - The partnership must indemnify the dissociated partner against all partnership liabilities.

II. Dissolution

- **Causes:**
  - **Applicable to all partnerships:**
    - It becomes illegal to carry on the partnership's business.
    - Occurrence of an event specified in the PA.
    - A partner may file an application to dissolve the partnership if:
      - The economic purpose of the partnership is likely to be unreasonably frustrated.
      - Carrying on the business in conformity with the PA is not reasonably practicable.
      - Carrying on the business with a particular partner is no longer reasonably practicable due to their conduct.
  - **Applicable to at-will partnerships only:**
    - Dissolution occurs if one partner gives notice of their express will to withdraw.
  - **Limited Partnerships:**
    - If the sole general partner dissociates, the LP dissolves unless a new general partner is admitted within 90 days.

        - If the sole limited partner dissociates, automatic dissolution unless a new limited partner is admitted within 90 days.
- **Consequences:**
    - Partnership continues to exist only for the purpose of winding up the business.
        - Partnership terminates after winding up is complete.
    - Partners may waive dissolution by unanimous vote of partners who have not wrongfully dissolved.
- **Winding Up:**
    - Involves selling and settling partnership affairs before termination.
    - A person winding up the partnership may dispose of and transfer partnership property, discharge liabilities, and distribute assets to settle partners' accounts.
    - After dissolution, the partnership is bound by a partner's act appropriate for winding up and any act that would have bound the partnership before dissolution if the other party does not have notice of the dissolution.
        - Each partner is liable to the other partners for their share of partnership liability.
    - Creditors have priority over partners to the partnership’s assets.
    - The partnership may resume business as if dissolution never occurred before winding up is complete.
- **Distribution of Assets:**
    - Creditors are paid first, then partner creditors, then non-creditor partners' accounts (buy-ins), and finally, settlement of remaining assets.
    - Settlement: Partners must contribute or receive distributions of the +/- balance in proportion to their profit/loss sharing.

Special Rules Concerning Limited Partnerships

- **Formation:**
    - Formed by filing a certificate of limited partnership with the secretary of state, signed by all named general partners.
    - Must have at least one general partner and one limited partner.
    - The certificate must substantially comply with statutory requirements or the entity may be considered a general partnership.
- **Limited Partner Rights:**
    - Limited partners have the right to vote as permitted under the PA and to inspect business and financial records.
    - They can lend money and transact business with the LP like a non-partner.
    - They have the right to seek information for a purpose reasonably related to their interest as a limited partner.
        - This includes the right to inspect and copy tax returns and other documents required by law, as well as to obtain information about the partnership’s financial condition and business.
    - Limited partners have no right to co-manage the partnership or engage in partnership business.
    - They can access required information in the LP's designated office upon 10 days’ demand.

    - They can inspect and copy information regarding the state of the LP’s activities and financial condition if:
        - The purpose is reasonably related to their interest as a limited partner.
        - They make a demand describing the information and purpose with reasonable particularity.
        - The information is directly related to the purpose.
    - Dissociated limited partners have similar rights to inspection and copying if the information pertains to the period they were a limited partner and they meet the requirements outlined above.
- **Limited Partner Duties:**
    - Duties of good faith and fair dealing.
- **General Partners:**
    - Have the rights and powers of a partner in a partnership without limited partners.
    - May contribute to the LP, share in profits and losses, and receive distributions.
    - Personally liable to third parties for LP obligations.
    - May withdraw from the LP by giving written notice to other partners.
- **Contributions:**
    - Partners can contribute cash, property, or services.
    - Partners are obligated to fulfill any written, enforceable promise of a future contribution.
- **Profits and Losses:**
    - May be allocated on any basis agreed to in writing.
    - Otherwise, allocated based on each partner's contributions.
- **Distributions:**
    - May be allocated on any basis agreed to in writing.
    - Otherwise, allocated based on how profits/losses are shared.
- **Assignment of Partnership Interest:**
    - A partner's interest in an LP is personal property that can be assigned in whole or in part.
    - The assignee generally only has rights to receive distributions.
- **Termination:**
    - Occurs after dissolution and winding up.
    - Dissolved upon:
        - Occurrence of a specified event.
        - Written consent of all general partners and a majority of limited partners owning distribution rights.
        - Withdrawal of a general partner.
        - Judicial determination.
    - Winding up:
        - Generally done by general partners, but limited partners may wind up if there are no general partners.
        - Assets are distributed first to creditors, then to partners.
- **Derivative Actions:**
    - A limited partner has the right to bring a derivative action on behalf of the LP.
- **Disclosure Requirements:**
    - LPs must maintain certain required information at their designated office, including:

        - List of partners with names and addresses.
        - Copies of the certificate of limited partnership, amendments, restatements, and powers of attorney.
        - Copies of articles of conversion or merger.
        - Federal, state, and local income tax returns and reports for the three most recent years.
        - Copy of the partnership agreement and any amendments.
        - Financial statements for the three most recent years.
        - Copies of the three most recent annual reports.
        - Records of consents and votes taken by partners.
        - Information regarding partner contributions, profit/loss sharing, and dissolution events.
    - General partners and the partnership must disclose information to other general partners, either without demand or upon demand.
        - Without demand: Any information reasonably required for the general partner to exercise their rights and duties.
        - Upon demand: Any other information concerning the LP's activities unless the demand is unreasonable or improper.
        - The LP may impose reasonable restrictions on the use of disclosed information and charge reasonable costs for copying.
    - The LP has a duty to disclose information to limited partners before they are required to give or withhold consent to a matter.
        - This includes all material information known to the LP, even if the LP does not know it is material.
- **Control Limitation:**
    - A limited partner is generally not personally liable for LP obligations solely due to being a limited partner, even if they participate in management and control.
    - Exceptions:
        - Limited partner's name is used in the LP name.
        - Limited partner is acting as a general partner.
        - Limited partner's participation in control creates a reasonable belief among those transacting business with the LP that they are a general partner (under certain jurisdictions).
    - Safe Harbor Provisions:
        - Certain activities, such as dissolving the LP, selling assets, or removing the general partner, will not expose limited partners to personal liability.
- **New Partners:** Bringing in new partners requires unanimous approval of the existing partners.

Formation of Organizations

I. Corporations

- **A. De Jure Corporation**
    - Formed when all statutory requirements for incorporation are met.

- Incorporators file articles of incorporation with the Secretary of State, which must include:
  - Corporate name
  - Number of authorized shares
  - Agent information
  - Incorporator information
  - Statement of incorporation
- Lawful corporate purpose and perpetual duration are presumed.
- Substantial compliance with the statute is sufficient.
- **Ultra Vires Acts**
  - Acts beyond the scope of the corporation's stated purpose.
  - Common law: UVAs may be void and unenforceable.
  - RMBCA: UVAs generally enforceable, but can be challenged by:
    - Shareholder suit to enjoin the proposed UVA
    - Corporate action for damages against directors, officers, or employees who engaged in the UVA
    - State action to dissolve the corporation for committing the UVA

- **B. Defective Incorporation**
  - Occurs when there is a defect in the incorporation process.
  - **De Facto Corporation**
    - Treated as a corporation with limited liability if:
      - Organizers made a good-faith effort to comply with the incorporation process.
      - Organizers have no knowledge of the defect.
    - Defense is available except against the state seeking dissolution.
  - **Corporation by Estoppel**
    - Parties who acted as if there were a corporation are estopped from denying its existence.
    - Cannot avoid liability in contracts, but not applicable to tort victims.
    - Piercing the corporate veil is not available to reach shareholders.
- **C. Limited Liability Company (LLC)**
  - Owners (members) have limited liability.
  - Legally treated like corporations in most aspects.
  - Terminology and taxing features differ from corporations.
  - Analyze LLCs under general corporate law principles.
  - **Piercing the Corporate Veil**
    - Courts may pierce the veil if:
      - LLC is being used as a façade for a dominant shareholder's personal dealings (alter ego or mere instrumentality).
      - There is unity of interest and ownership between the LLC and its members, making it unjust or inequitable to uphold limited liability.
    - Factors considered: undercapitalization, disregard of corporate formalities, commingling of assets, self-dealing, siphoning of funds, using the corporate form to avoid legal requirements, shareholder domination, and fraudulent dealings with creditors.
- **D. Professional Corporation (PC)**

- Formed by licensed professionals.
- Shareholders are personally liable for their own malpractice but not for the malpractice of others.

Pre-Organization Transactions

I. Promoter Liability

- **A. Pre-Incorporation Contracts**
  - A promoter acts on behalf of a corporation not yet formed.
  - Promoters are personally liable for obligations under pre-incorporation contracts.
  - Liability continues even after the corporation is formed, unless:
    - Novation releases the promoter from liability.
    - Third party looks only to the corporation for performance.
    - Promoter had no actual knowledge that the corporation's charter was not yet issued.
  - **Adoption of Contract**
    - Corporation can become bound by the promoter's contract through:
      - Express adoption
      - Implied adoption by accepting the benefits of the transaction
- **B. Fiduciary Duty**
  - Promoters owe fiduciary duties to the corporation.
  - Can be liable to the corporation for breach of fiduciary duties.
  - Duties continue until novation occurs.
- **C. Compensation**
  - Promoters may seek compensation or reimbursement for expenses related to pre-incorporation activities.
  - Cannot compel the corporation to pay because the acts were not undertaken at the corporation's direction.

Piercing the Corporate Veil

I. General Principles

- **A. Limited Liability**
  - General rule: Shareholders are not personally liable for the debts of the corporation, only for their investment.
  - Exceptions: Courts may pierce the veil to prevent fraud or injustice.
- **B. Factors Considered**
  - Courts consider various factors when deciding whether to pierce the veil, including:
    - **Unity of interest and ownership** (alter ego or mere instrumentality)
    - **Undercapitalization**
    - **Disregard of corporate formalities**
    - **Commingling of assets**
    - **Self-dealing**
    - **Siphoning of funds**

        - **Using the corporate form to avoid legal requirements**
        - **Shareholder domination**
        - **Fraudulent dealings with creditors**
- **C. Types of Cases**
    - Courts are more likely to pierce the veil in:
        - Tort cases rather than contract cases
        - Cases involving small, closely held corporations

II. Application to Specific Entities

- **A. Corporations**
    - Factors considered are the same as general principles.
- **B. LLCs**
    - Focus is on unity of interest and ownership and whether upholding limited liability would be unjust or inequitable.

III. Consequences of Piercing the Veil

- **A. Shareholder Liability**
    - Shareholders become personally liable for the corporation's debts and obligations.

Financing the Organization

I. Sources of Finance

- **A. Equity Financing**
    - Issuing equity securities, such as common and preferred stock, to investors.
    - Represents ownership in the corporation.
    - Shareholders have voting rights and may receive dividends.
    - **1. Common Stock**
        - Basic ownership interest.
        - Entitles holders to vote on corporate matters.
        - May receive dividends if declared by the board of directors.
    - **2. Preferred Stock**
        - Has preference over common stock with respect to dividends and distributions upon liquidation.
        - May have different voting rights than common stock.
- **B. Debt Financing**
    - Borrowing money from creditors.
    - Creditors do not have ownership interest.
    - Corporation is obligated to repay the principal and interest.
- **C. Consideration for Shares**
    - Shares can be issued for various forms of consideration, including:
        - Cash
        - Property
        - Services performed

        - Contracts for future services
    - Consideration must be adequate to make the stock fully paid and non-assessable.
- **D. Stock Subscriptions**
    - Agreements to purchase shares in the future.
    - Pre-incorporation subscriptions are irrevocable for six months, unless otherwise agreed.
- **E. Stock Rights, Options, and Warrants**
    - Give holders the right to purchase shares in the future at a specified price.
    - Can be issued by the board of directors.
- **F. Preemptive Rights**
    - Right of existing shareholders to purchase newly issued shares to maintain their proportional ownership.
    - Can be waived in writing.
- **G. Securities Registration**
    - Required for public offerings of securities.
    - Corporation must file a registration statement with the Securities and Exchange Commission (SEC).
    - Buyers must receive a prospectus.
- **H. Distributions**
    - Typically in the form of cash dividends.
    - Authorized by the board of directors.
    - Limitations on distributions:
        - Corporation cannot distribute if it is insolvent or if the distribution would make it insolvent.
        - Directors can be personally liable for unlawful distributions.

Management and Control

I. Board of Directors

- **A. Role and Responsibilities**
    - Manages and directs the corporation's business and affairs.
    - Appoints officers.
    - Oversees officers.
    - Makes high-level corporate decisions.
- **B. Composition and Election**
    - Must have at least one director.
    - Directors must be natural persons.
    - Elected by shareholders at the annual meeting.
    - Term is typically one year.
- **C. Meetings**
    - Regular meetings may be held without notice.
    - Special meetings require two days' notice of date, time, and place.
    - Can act by unanimous written consent without a meeting.
- **D. Voting**
    - Majority vote of directors present is required for board approval.

- Quorum (majority of directors) must be present for a valid act.
- Pooling agreements (agreements between directors on how to vote) are generally unenforceable.
- Directors cannot vote by proxy.

- **E. Committees**
  - Can be formed to handle specific tasks.
  - Exercise powers granted by the board, articles, or bylaws.

II. Officers

- **A. Role and Responsibilities**
  - Responsible for day-to-day management of the corporation.
  - Elected by the board of directors.
  - Authority:
    - Actual authority: defined by bylaws or the board
    - Implied authority: to perform tasks necessary to carry out duties
    - Apparent authority: if the corporation holds the officer out as having authority
- **B. Duties**
  - Same fiduciary duties as directors.
  - CEO and CFO of publicly traded companies are subject to additional duties under Sarbanes-Oxley Act.

III. Shareholders

- **A. Rights and Responsibilities**
  - Elect directors.
  - Vote on major decisions that affect fundamental changes.
  - Have limited liability for corporate obligations.
  - **1. Meetings**
    - Annual meeting is required to elect directors and conduct other business.
    - Special meetings can be called by the board or shareholders owning at least 10% of voting shares.
    - Shareholders must receive timely notice of meetings.
  - **2. Voting**
    - Requires a quorum of shares represented at the meeting.
    - Majority vote of shares present is generally required for approval.
  - **3. Proxy Voting**
    - Allows shareholders to authorize others to vote their shares.
    - Must be in writing, signed, sent to the corporation, and valid for a limited time.
  - **4. Shareholder Agreements**
    - Can restrict share transfers.
    - Can allocate authority among shareholders.
  - **5. Derivative Suits**
    - Shareholders can sue on behalf of the corporation to enforce its rights.
    - Demand requirement: shareholder must first demand that the board take action, unless it would be futile.

        - Litigation expenses may be reimbursed by the corporation.

Fiduciary Duties

I. Duty of Care

- **A. Definition**
    - Directors and officers must act with the care that a person in a like position would reasonably believe appropriate under similar circumstances.
    - Must use special skills and knowledge.
- **B. Business Judgment Rule**
    - Protects directors and officers from liability for good-faith business decisions.
    - Court will not disturb decisions made in good faith, in the absence of fraud, illegality, or self-dealing.
    - Reliance defense: directors and officers can rely on information from reliable sources.
- **C. Overcoming the Business Judgment Rule**
    - To overcome the business judgment rule, a plaintiff must show:
        - Fraud
        - Illegality
        - Self-dealing
        - Lack of good faith
        - Failure to become informed

II. Duty of Loyalty

- **A. Definition**
    - Directors and officers must act in the best interests of the corporation and avoid conflicts of interest.
- **B. Self-Dealing Transactions**
    - Transactions where a director or officer receives a substantial benefit from the corporation.
    - Must be disclosed and ratified by:
        - Disinterested directors
        - Disinterested shareholders
        - A court finding the transaction fair
- **C. Corporate Opportunity Doctrine**
    - Directors and officers cannot usurp or steal corporate opportunities for themselves.
- **D. Duties of Controlling Shareholders**
    - Controlling shareholders may owe fiduciary duties to minority shareholders.
    - Must act in good faith and fairness when dealing with the corporation and minority shareholders.

III. Duties in LLCs

- **A. Duty of Care**

- Managers and members must act with reasonable care and skill.
- Standard of care may vary depending on the state's LLC statute.
- ULLCA: liability only for gross negligence or recklessness.
- Revised ULLCA: ordinary negligence standard, but subject to the business judgment rule.

- **B. Duty of Loyalty**
  - Managers and members must act in the best interests of the LLC and avoid conflicts of interest.
  - Similar to the duty of loyalty in corporations.
- **C. Business Judgment Rule**
  - Protects LLC managers from liability for good-faith business decisions.

IV. Remedies for Breach of Fiduciary Duties

- **A. Injunction**
- **B. Damages**
- **C. Rescission of Transaction**
- **D. Removal from Office**
- **E. Disgorgement of Profits**

Close Corporations and Special Control Devices

I. Characteristics of Close Corporations

- **A. Small Number of Shareholders:** Close corporations typically have a limited number of shareholders, often who are family members or close acquaintances.
- **B. Shareholders are Often Directors and Officers:** The same individuals may serve as both shareholders, directors, and officers, blurring the lines between ownership and management.
- **C. Stock is Not Publicly Traded:** Shares are not traded on public exchanges, making it difficult to determine fair market value and exit the corporation.
- **D. Relaxed Corporate Formalities:** Close corporations may operate with less formality compared to publicly held corporations.

II. Special Control Devices

- **A. Share Transfer Restrictions:** Agreements among shareholders that restrict the transfer of shares to outsiders. These are designed to maintain control within a select group and prevent unwanted third parties from becoming shareholders. They must be reasonable to be enforceable.
  - **1. Types of Restrictions:**
    - **a. Right of First Refusal:** Requires a shareholder who wants to sell their shares to first offer them to the corporation or other shareholders before selling to an outsider.
    - **b. Consent Restraint:** Requires the consent of the corporation or other shareholders before a shareholder can transfer their shares.

        - **c. Buy-Sell Agreement:** Obligates the corporation or other shareholders to purchase a shareholder's shares upon the occurrence of certain events, such as death, disability, or retirement.
    - **2. Validity:** To be valid, share transfer restrictions must be:
        - **a. Adopted Lawfully:** Properly included in the articles of incorporation, bylaws, or a shareholder agreement.
        - **b. Reasonable:** Not an undue restraint on alienation.
        - **c. Conspicuous:** Clearly stated on stock certificates to provide notice to potential transferees.
- **B. Voting Agreements:** Contracts between shareholders that specify how they will vote their shares. These agreements ensure that a particular group of shareholders can maintain control of the corporation.
    - **1. Enforceability:** Generally enforceable, but courts may scrutinize them to ensure they are not used to oppress minority shareholders.
- **C. Shareholder Management Agreements:** Agreements that modify the traditional corporate management structure by giving shareholders more direct control over the corporation's business.
    - **1. Deviation from Statutory Norms:** These agreements can allow for deviations from the default rules of corporate law regarding the roles of directors and officers.
    - **2. Validity:** Must be properly adopted and not violate mandatory provisions of corporate law.
- **D. Preemptive Rights:** Rights of existing shareholders to purchase newly issued shares in proportion to their current ownership, preventing dilution of their ownership interests.
    - **1. Purpose:** Protect existing shareholders from having their ownership and voting power diminished by the issuance of new shares.
    - **2. Waiver:** Shareholders can waive their preemptive rights in writing.

Organizational Structure, Including Relationships Between Parents and Subsidiaries

I. Parent-Subsidiary Relationships

- **A. Definition:** A parent corporation is one that owns a controlling interest (usually more than 50% of voting shares) in another corporation, known as a subsidiary. This control allows the parent to elect the subsidiary's board of directors and dictate its policies.
- **B. Separate Legal Entities:** Parents and subsidiaries are generally treated as separate legal entities, meaning the parent is not typically liable for the debts and obligations of the subsidiary.
- **C. Piercing the Corporate Veil:** In certain circumstances, courts may "pierce the corporate veil" and hold a parent corporation liable for the debts of its subsidiary. This usually occurs when the parent has exerted excessive control over the subsidiary, commingled assets, or used the subsidiary to commit fraud or injustice.
    - **1. Factors Considered:**
        - **a. Undercapitalization:** Subsidiary is not provided with enough capital to operate independently.
        - **b. Disregard of Corporate Formalities:** Failure to maintain separate books, records, and bank accounts; or hold separate board meetings.

        - **c. Commingling of Assets:** Parent and subsidiary's assets are mixed together.
        - **d. Domination and Control:** Parent exerts excessive control over the subsidiary's operations, treating it as a mere department rather than a separate entity.
        - **e. Fraud or Injustice:** The subsidiary is used to shield the parent from liability for its own wrongdoing.

II. Mergers and Acquisitions

- **A. Mergers:** Two or more corporations combine into a single surviving corporation, with one corporation absorbing the other. Requires approval by the board of directors and shareholders of both corporations.
    - **1. Dissenter's Rights:** Shareholders who vote against a merger may have appraisal rights, allowing them to receive the fair value of their shares in cash.
    - **2. Short-Form Merger:** A simplified merger process available when a parent corporation owns a very high percentage (often 90% or more) of a subsidiary's stock. In this case, the merger can proceed without the approval of the subsidiary's minority shareholders.
- **B. Asset Acquisitions:** One corporation acquires all or substantially all of the assets of another corporation. Requires approval by the board of directors and shareholders of the selling corporation.
- **C. Stock Acquisitions:** One corporation acquires a controlling interest in another corporation by purchasing its stock.

Shareholder and Member Litigation: Direct, Derivative, and Class Litigation

I. Direct Actions

- **A. Definition:** Shareholder lawsuits brought to enforce the shareholder's own rights, with any recovery going directly to the shareholder.
- **B. Examples:**
    - **1. Breach of Shareholder Agreement:** A shareholder sues another shareholder for violating the terms of a shareholder agreement.
    - **2. Denial of Voting Rights:** A shareholder sues the corporation for improperly denying them their right to vote their shares.
    - **3. Failure to Pay Dividends:** A shareholder sues the corporation for failing to declare a dividend when the shareholder believes a dividend is warranted.
- **C. Standing:** To bring a direct action, a shareholder must show that their individual rights have been harmed.

II. Derivative Actions

- **A. Definition:** Shareholder lawsuits brought on behalf of the corporation to enforce the corporation's rights. The shareholder acts as a representative of the corporation, and any recovery goes to the corporation.

- **B. Examples:**
  - **1. Breach of Fiduciary Duty:** A shareholder sues a director or officer for breaching their duty of care or loyalty to the corporation.
  - **2. Corporate Waste:** A shareholder sues to stop the corporation from engaging in wasteful spending.
- **C. Standing:** To bring a derivative action, a shareholder must have been a shareholder at the time the alleged wrong occurred and must continue to be a shareholder throughout the litigation.
- **D. Demand Requirement:** In most jurisdictions, a shareholder must first make a demand on the corporation's board of directors to take action before filing a derivative lawsuit. This demand gives the board the opportunity to address the alleged wrong internally.
  - **1. Futility Exception:** The demand requirement can be excused if making a demand would be futile, such as when the directors themselves are the alleged wrongdoers.
- **E. Recovery:** Any recovery in a derivative suit goes to the corporation, not the individual shareholder who brought the lawsuit.
- **F. Attorney's Fees:** If the derivative suit is successful, the shareholder's attorney may be entitled to have their fees paid by the corporation.

III. Class Actions

- **A. Definition:** Lawsuits brought by a representative shareholder on behalf of a large group of shareholders who have suffered similar harms.
- **B. Rule 23 Requirements:** To bring a class action, the shareholder must meet the requirements of Rule 23 of the Federal Rules of Civil Procedure (or a similar state rule). These requirements include:
  - **1. Numerosity:** The class must be so numerous that joinder of all members is impractical.
  - **2. Commonality:** There must be questions of law or fact common to the class.
  - **3. Typicality:** The claims or defenses of the representative shareholder must be typical of the claims or defenses of the class.
  - **4. Adequacy of Representation:** The representative shareholder must fairly and adequately protect the interests of the class.
- **C. Federal Securities Class Actions:** Class actions are frequently brought under federal securities laws, such as Rule 10b-5, which prohibits fraud in the purchase or sale of securities.
  - **1. Elements of a Rule 10b-5 Claim:** To state a claim under Rule 10b-5, a plaintiff must allege:
    - **a. Material Misstatement or Omission:** The defendant made a false or misleading statement, or omitted to disclose material information.
    - **b. Scienter:** The defendant acted with an intent to deceive or with recklessness.
    - **c. Reliance:** The plaintiff relied on the misstatement or omission.
    - **d. Causation:** The misstatement or omission caused the plaintiff's damages.

IV. Shareholder Litigation in LLCs

- **A. Direct and Derivative Actions:** Members of LLCs can also bring direct and derivative actions to enforce their rights and the rights of the LLC. The principles discussed above regarding direct and derivative actions in corporations generally apply to LLCs as well.
- **B. Demand Requirement:** The demand requirement for derivative actions may apply to LLCs, but the specific rules vary depending on the state's LLC statute.
- **C. Standing:** Members bringing derivative actions in LLCs typically must have been members at the time the alleged wrong occurred and must continue to be members throughout the litigation.
- **D. Oppression Claims:** In close corporations, shareholders may bring claims for "oppression," alleging that the majority shareholders have acted unfairly to freeze them out of the corporation's decision-making or to deny them their rightful share of profits. This concept has been extended to LLCs in some jurisdictions, allowing members to assert oppression claims against controlling members.

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