

Corporations Outline

I Corporate Formation

A) Pre-Incorporation Ks: Promoters & Subscribers

- 1) Promoters: persons acting on behalf of a corporation NOT YET FORMED
 - (a) The corporation becomes liable on the promoter's pre-incorporation K when the corporation adopts the K by:
 - (i) the express BOD's resolution OR
 - (ii) Ratification: BOD impliedly adopts pre-incorp K through knowledge of K + acceptance of benefits.
 - (b) Promoter remains liable on pre-incorporation Ks until there has been a novation (an agreement bw promoter, corp & other K party that corp will replace promoter under the K).
 - (c) Possible fact situations:
 - (i) Promoter enters a preincorporation K but the corp is never formed: Promoter alone liable
 - (ii) Promoter enters a pre-incorporation K AND corp adopts the K: Both corp & promoter liable (promoter liable until novation) to 3rd party. Consequence: 3rd party has election of remedies & may recover from corp OR promoter – not both.
 - (d) Promoters are fiduciaries of each other and the corp. Consequence: can't make a secret profit on dealings w/corp (similar fiduciary duty partners owe to ea other).
 - (i) If promoter sells property (e.g., beef) to the corp + that it acquired before becoming a promoter: corp can recover profit only if property sold for more than FMV
 - (ii) If promoter sells property to corp + it acquired after becoming a promoter: corp can recover any profit
- 2) Subscribers: Persons or entities who make written offers to buy stock from a corp not yet formed,
 - (a) General rule: Pre-incorporation offer Irrevocable for 6 mo.

B) Formation Requirements for Corporate Status

- 1) Incorporators: sign & file Articles of Incorporation w/the State
- 2) Formation Requirements that Must be Included in the Articles: **Mnemonic: "A PAIN"**
 - (a) Authorized Shares: the number of maximum shs the corp is authorized to issue w/o amending article. May issue less but not more. Ceiling not floor.
 - (b) Purpose: general purpose & perpetual duration (unlike partnerships: limited duration) presumed
 - (i) Where there is a specific statement of purpose: a corp may not undertake activities unrelated to achieving the state purpose or they are "ultra vires."
 - (1) Remedies: 1) a SH may sue the corp to enjoin a proposed ultra vires act 2) the corp may sue officer/director for damages & 3) state may dissolve corp/enjoin
 - (c) Agent: The address of the registered office/corp's official legal representative.
 - (d) Incorporators: supra
 - (e) Name of corp: Name must contain some "indicia" of corp status (e.g., Inc, Corp etc)
- 3) No req corp adopt bylaws (laws by which corp is governed) to be a corp. BOD adopts them unless Articles give SHs power to adopt
 - (a) **Tip: Classic Red Herring**

- C) De Facto Corporation Doctrine: A business failing to comply w/reqs for corp formation is nonetheless tx as corporation if:
 - 1) organizers have made a good faith, colorable attempt to comply w/corp formalities AND
 - 2) have no knowledge of the lack of corp status.
- D) Legal Significance for Formation of Corporation: Limited Liability and Exception: Piercing Veil
 - 1) General Rule - Principle of Limited Liability:
 - (a) Bc a corp is considered to have separate legal personality and can enter into own Ks, debt obligations & commit torts, SHs are generally not personally liable for corporation's debts.
 - (b) Rather, SH's liability limited to paying the full consideration for the price of stock.
 - 2) Exception: Ct in equity will pierce the corporate veil to avoid fraud or unfairness and to render a active SH liable to a third party victim for the corporation's tort/K breach.
 - (a) 2 fact situations when ct likely to pierce:
 - (i) **Alter ego: failure to observe corp formalities** (E.g., controlling Sh, commingles personal & corp funds, doesn't file, have BOD meetings)
 - (ii) Undercapitalization at the time of formation: failure to maintain sufficient funds to cover foreseeable activities (esp watch for dangerous activities).
 - (b) Cts more likely to pierce if tort victim than K victim bc K victim voluntarily contracted
- E) Foreign Corporations:
 - 1) A corporation incorporated outside the state (e.g., NV) that wishes to engage in regular intrastate business must qualify by: 1) filing a **certificate of authority** w/the Secretary of State that includes 2) all the information required in the Articles (**A PAIN**)

II Issuance of Stock: When a Corporation sells it's OWN stock. **Tip: Heavily Tested**

- A) The Consideration the Corporation Must Receive When it Issues its own stock:
 - 1) Valid consideration: any tangible/intangible property or benefit to the corp.
 - 2) Corp can either: 1) issue stock w/par value: set forth a minimum issuance price or 2) issue stock w/ "no par" value
 - (a) Par value: The corp can always issue stock for more but never less E.g., 10,000 sh at \$3 par. \$30K min
 - (b) No par: the corp may receive any valid consideration deemed adequate by the BOD
 - (c) Consequences of Issuing Par Stock for less than Par Value: directors are liable for authorizing bc did acts unauthorized/possible breach of fiduciary duty AND shs personally liable for paying full consideration for sh. 3rd **party has election of remedies** but can't recover from both
 - 3) Treasury stock: stock that was previously issued and that has been reacquired by the corp and can be re-sold. No par stock (any valid consideration).
- B) Pre-emptive Rights:
 - 1) the right of an existing SH to maintain her percentage of ownership by buying stock whenever there is a new issuance of stock for cash. Prevents dilution of control.
 - 2) **Rights must be expressly granted in Articles. Not presumed.**

III Directors & Officers

- A) Statutory Requirements for Directors
 - 1) Corporations must have a BOD – a centralized management team - w/at least 1 member

- 2) Directors elected by SHs & may be removed by Shs with or w/o cause
- 3) Valid meeting required for all BOD activity UNLESS ALL directors consent in WRITING to act w/o a meeting
 - (a) Notice of directors' meeting can be set in bylaws
 - (b) Proxies or voting agreements of directors not permitted. Directors must appear in person/conf call (contrast w/Sh proxy & voting agreements)
 - (c) Req to take action: QOURUM: a majority of ALL directors (unless bylaws set forth diff %)
 - (d) Req to pass a resolution: Only a MAJORITY VOTE from those who are PRESENT (E.g., if 100 total directors and only 10 directors present. To pass res only need 6 votes).
 - (i) Each director presumed to concur in Board action UNLESS dissent/abstention in writing
- B) Liability of Directors to their own corporation AND to Shs
 - 1) Duty to Manage:
 - (a) Delegation of duty permissible: Directors may delegate management functions to a committee of 1+ directors that makes recommendations to the BOD.
 - (b) Directors protected from liability for innocent mistakes of business j'ment: BUSINESS J'MENT RULE – presumes Ds manage corp in good faith + w/corp's best interests.
 - 2) Directors as fiduciaries who owe corp a 1) duty of care AND 2) duty of loyalty
 - (a) Duty of Care: Director must act as a prudent person would w/r/t her OWN business UNLESS Articles have limited liability for breach (v duty of loyalty). E.g., not attending mtgs, sleeping
 - (b) Duty of Loyalty: D may not receive an UNFAIR benefit to the detriment of the corp/Shs UNLESS
 - 1) there has been a material disclosure AND 2) independent ratification.
 - (i) Facts where unfair benefit exist:
 - (1) Self-dealing: D, relative, or her business receives unfair benefit in transaction w/own corp. Both sides of transaction.
 - (2) Usurping corp opportunity: D receives unfair benefit by usurping an opportunity which corp would have pursued.
 - (ii) Even if D receives an unfair benefit, D may avoid liability if material discloses & independent ratification.
 - (1) Independent ratification through: 1) majority vote of INDEPENDENT/disinterested directors
 - 2) Majority vote of committee of at least 2 independent directors OR 3) majority of independent SHs
 - (c) Doctrine of Waste: Directors have a duty not to weate corporate assets by overpaying for property or employment services.
 - (d) Interested Director Doctrine: Modern law: K is invalid unless Board approves K after disclosure by director OR K itself is fair
- C) Officers:
 - 1) Owe the same duties of care & loyalty as directors
 - 2) Are AGENTS of the corp and bind the corp by their authorized activities
 - 3) Corps must have a President, Secretary & Treasurer
 - 4) Directors have virtually unlimited power to select officers & may remove them from office at any time- but will be liable for breach of K damages

- D) Indemnification of Directors and Officers: When Litigation Costs Incurred (e.g., judgment or settlement etc) & they seek to recapture expenses
- 1) Corp may never indemnify director/officer who is held liable to the corp (e.g, duty of loyalty)
 - 2) Corp must indemnify director/officer who wins a lawsuit against any party, inc corp
 - 3) Corp MAY indemnify if 1) liability to 3rd party/settlement w/corp & 2) director/officer shows she acted in good faith + believed acts in corp's best interest
 - (a) Who determines permissive indemnification (4):
 - (i) Majority of independent directors
 - (ii) Committee of at least 2 independent directors
 - (iii) Majority of independent shareholders
 - (iv) Special legal counsel's opinion

IV Rights of Shareholders

- A) SH Derivative Suits:
- 1) Function: A Sh is suing to enforce the CORPORATION's C/A - the corp could have brought the suit (but directors unlikely to bring suit against corp).
 - 2) Reqs for SH derivative suits: Blurb: A Sh may sue on behalf of the corporation if 1) the Sh was a SH at the beginning, during and end of lawsuit 2) SH owned shs at time of alleged wrong 3) SH first demands BOD enforce corp's rights & demand is refused/shs shows it would be futile and 40 demand is made on SHs to bring suit where SHs can ratify the wrong.
- B) Direct Action: When the SH wants to enforce right as a SH: must show that directors have breached a fiduciary duty to him as a SH (e.g., repurchase of stock affects his right as SH, if insolvent & buys back – corp may cease to exist)
- C) Voting
- 1) Who has the right to vote: Shs of record on the record date may vote at the upcoming mtg. Record date can't be more than 70 days before the mtg. Doesn't matter whether the Sh sold the shs before the next mtg. Shs may vote the shs in person or in proxy.
 - 2) SH Voting by Proxy: Requirements 1) a writing (fax/e-mail) 2) signed by record Sh 3) directed to secretary of corp 4) authorizing another to vote the shs & 5) valid for only 11 mo.
 - (a) Proxies freely revocable UNLESS: 1) state they are irrevocable AND 2) coupled w/an interest (e.g., sale of shares).
 - 3) Where SHs Vote: 2 places
 - (a) At a properly noticed annual meeting: Every corp must have an annual mtg at which at least 1 director position is open for election AND must provide proper notice which includes the 1) time & 2) place of mtg
 - (b) Specially noticed special mtg: May be called by the BOD, the President or holders of 10% of voting shares. Purpose: vote on a proposal or fundamental corporate change. Requires 1) special notice & 2) must contain notice of the meeting's special purpose and nothing other than the purpose can take place or it is void.
 - 4) Quorum: **Tip: Highly tested**

- (a) There must be a quorum represented at the meeting: a majority of outstanding SHARES (not shareholders) when the meeting begins. If not, SH action invalid absent unanimous written consent.
 - (i) If a quorum is present, action is approved if the votes cast in favor of the proposal > the votes cast against the proposal.
- (b) Pooled Voting: permits minority Shs to increase influence by pooling their votes and voting alike.
 - 2 ways
 - (i) Voting Trusts: a **formal delegation of voting power** to a voting trustee enforceable for 10 yrs.
 - (1) Requires (6): Written trust agreement + filed w/corporation + **transfers shs to voting trustee + shs get trust certificates AND retain all other rights except for voting**
 - (ii) SH Voting Agreements: Written agreement + to vote shs in a certain manner + is binding & enforceable on the signatories. No time limit & no filing requirement (v voting trusts).
- (c) Cumulative Voting:
 - (i) General rule is 1 sh = 1 vote
 - (ii) Under cum voting: Sh entitled to a number of votes times the number of directors to be elected. Total number may be divided among candidates in any manner SH desires. Esp effective if all directors elected at same time v staggered.
 - (iii) Must be specified in Articles.
- D) Right of H to examine books/records of corp on notice & at proper times
- E) Dividends:
 - 1) Board has complete discretion whether or not to declare dividends but BOD personally liable if declare dividends if corp is insolvent/declaring dividends would render corp insolvent.
 - (a) BOD defense: good faith reliance on financial officer's representations re solvency
 - 2) Priority of Distribution:
 - (a) Preferred Shareholders: Paid first w/specific dividend preference (E.g., 20K sh w/\$2 dividend pref: pay out \$40K first)
 - (b) Common shs: get paid last and paid equally.
 - (c) Preferred Participating Shs: get paid twice. 1x as preferred and again as Common Sh.
 - (d) Cumulative Shs: may receive dividends from years in which no dividends paid (get paid first, then Common Shs) – Ask Hillman. Cumulative, Preferred Participating & then Common?
 - (e) **NOTE: articles may provide that certain classes of shs may be reacquired by corp at discretion of BOD**
- F) SH Agreements to Eliminate Corp Formalities: the Closely Held Corp
 - 1) An agreement among Shs to eliminate corp formalities:
 - (i) must be a unanimous **abnd appear in the Articles, bylaws or in a filed written agreement** AND
 - (ii) there must be a reasonable restriction on transfer of shs to maintain closely held status (e.g., no public trading).
 - (b) No piercing the veil of a closely held corp
 - (c) **Possible subchapter S corporate status: treated as partnership for tax purposes if 1) no more than 100 Shs 2) 100 Shs are American residents and 3) No more than 1 class of stock**
- G) Professional Corp:
 - 1) Licensed professionals (e.g., Ls, accountants, doctors) may incorporate as PC

- 2) Requirements (5):
 - (i) File Articles w/name designated "PC"
 - (ii) Shs must be licensed professionals
 - (iii) Corp may practice only ONE designated profession (can't have L & doctor)
 - (iv) Professionals personally liable for OWN malpractice BUT NOT liable for each other's malpractice or obligations of corp itself

V Fundamental Corp Changes

A) Recognized Fundamental Corp Changes (5):

- 1) Merger (A becomes B)
- 2) Consolidation (A & B become C)
- 3) Dissolution:
 - (a) Involuntary: ct has no inherent power to dissolve but states allow corporation may be dissolved by SHS action if 1) directors become deadlocked in management 2) directors committing fraud or illegal acts or 3) corp assets being wasted by directors. E.g., illegal to purchase back shs if doing so would render corp insolvent – just like issuing dividends
 - (b) Voluntary: voted on
- 4) Fundamental Amendments of the Articles v ministerial
- 5) Sale of Substantially All of the Corp Assets (not purchase)

B) Procedural Requirements for Recognized Fundamental Corp Changes (5)

- 1) Resolution by a board at a valid meeting
- 2) Notice of a Special Meeting
- 3) Approval by Majority of all shares entitled to vote AND by a majority of any voting group adversely affected by the change
 - (a) **EXCEPTION:** No SH approval required for "short-form" merger where parent corp owns min 90% of the stock in a subsidiary & merges w/subsidiary
- 4) Possibility of dissenting SH right of appraisal: Sh who does not vote in favor of fundamental change has right to force corp to buy back her sh at "fair value". Reqs:
 - (a) SH must file written notice of objection AND intent to demand payment before SH vote
 - (b) SH must not vote for the proposed change (may abstain)
 - (c) SH must make prompt written demand to be bought out
 - (i) If the corp & SH can't agree on FMV: the ct has power to appoint an expert appraiser to value the Shs. Appraisal binding on the parties.

VI Federal Securities Law

A) 10B Anti-Fraud Section: Fraud in the buying/selling of stock. Elements of Liability:

- 1) Scierter: intent to deceive
- 2) Deception: matrial misrepresentation or misappropriation of material non-public information (e.g., trading on/tipping inside information)
- 3) In connection w/the ACTUAL purchase or sale of securities (not just planned)

B) 16B: Short Swing Trading Profits.

- 1) Absolutely prohibits any buying or selling of stock w/in a SINGLE 6 mo period. Fraud/insider info not required

- 2) Applies to reporting corporations: listed on national exchange OR at least 500 SHs & 10 M assets
 - 3) Applies "Big shot Ds" – officers, director or more than 10% Sh
 - 4) Remedy: All "profits" from short-swing trading RECOVERABLE by corp. (To determine profits: see if there was a purchase at a lower price than sale price w/in 6 mo. Start w/sale date & work way back)
- C) Sarbanes-Oxley Act 2002
- 1) Applies to Reporting Corporation
 - 2) Requires: CEO & CFOs to certify that based on the Officer's knowledge, reports filed w/SEC: 1) don't contain material misreps/omissions AND 2) fairly present company's financial position.
 - 3) Consequence:
 - (a) Criminal Prosecution: Wilfully certifying a false report could bring 20 yrs jail
 - (b) Fine: 5 M
 - (c) Civil Suit:
 - (i) If false reports + must be restated + may recover Officer's profits made from trading w/in 12 mo after false reports filed + any incentive-based compensation
 - (ii) Corps may also recover any profits made by officers + during "black out periods" of at least 3 days + when at least 50% of EEs + prohibited from trading
 - 4)