**GENERAL CORPORATIONS INFORMATION**

1. Terminology
   1. Shareholders—Owners of corporation (residual claimants); elects directors
   2. Directors—Part-time job; sets major corporate policy; hires officers
   3. Officers—President, Vice-President, Treasurer, etc. (run company day-to-day)
   4. Corporation “Legal Person”—Has assets, liabilities, contractual rights, credit rating, right to sue, be sued, due process rights, etc.
2. Owners v. Managers

|  |  |  |
| --- | --- | --- |
| **Business Form** | **Owners** | **Managers** |
| Partnerships & LLPs | Partners | Partners |
| Limited Partnership | Limited Partners  General Partners | General Partners |
| LLCs | Members | Members OR Managers |
| Close Corporations | Shareholders | Shareholders |
| Publicly Held Corporations | Shareholders | Officers |

1. Clean-Up on Business Entities
   1. General Partnerships—Partners have unlimited liability! (Requires no paperwork to create!)
   2. Limited Partnerships (LP)—Common for real estate ventures, hedge funds
      1. General partner has managerial duties, unlimited liability
      2. Limited partners must have limited managerial duties to get benefit of limited liability
   3. Limited Liability Partnerships (LLP)—Common for professional partnerships (e.g., lawyers, accountants)
      1. Partners liable for their own torts, but not for torts of their partners
      2. Partners may or may not be shielded from contractual liabilities of LLP—varies by state
   4. Limited Liability Companies (LLC)—Common for a wide array of businesses
      1. Owners are “members”; they are shielded from LLC’s tort and contractual liabilities
2. Note on Taxation
   1. S-Corporations (“Pass-Thru” Taxation)
      1. A corporation can elect to be taxed as a “pass-thru” entity (i.e., be an S-Corp) if it meets the following criteria:
         1. No more than 75 shareholders
         2. No corporate/entity shareholders
         3. No nonresident alien investors
         4. No more than one class of stock
   2. Subchapter K—applies to partnerships, LP, LLP, LLCs (“Pass-Thru” Taxation)
   3. Subchapter C (Entity-Level Taxation)
      1. Applies to “C” Corps
      2. “C” Corp pays income tax; Shareholders then pay tax on dividends; hence “double taxation”

**AGENTS AND EMPLOYEES**

1. Who is an Agent?
   1. Agency is a set of common law principles used to apportion risk and liability, it turns on the PRESENCE OF CONTROL
   2. Agency is a relationship that results from:
      1. The manifestation of consent by P to A that A shall act
         1. On P’s behalf
         2. Subject to P’s control
      2. A’s consent to so act

(*Restatement § 1*)

* 1. Agency relationship arises from OBJECTIVE CONDUCT of the Principal and the Agent, not their SUBJECTIVE INTENT
  2. Principal and Agent can’t “agree” to abridge the rights of a 3d party (3d party must be part of negotiations)
  3. Variable Costs = Costs that can be controlled or reduced (LITIGATION IS A VARIABLE COST OF DOING BUSINESS)

1. Liability of Principal to 3d Parties in Contract
   1. A principal is subject to liability upon contracts made by an agent acting within his AUTHORITY if made in proper form and with the understanding that the principal is a party (*Restatement 144*)
   2. *Restatement 3*
      1. General Agent—authorized to conduct a series of transactions involving a CONTINUITY OF SERVICE
      2. Special Agent—authorized to conduct a SINGLE TRANSACTION or a series of transactions not involving a continuity of service
   3. Actual Authority—arises from OBJECTIVE CONDUCT of Principal toward Agent
      1. Express (AEA)
         1. Principal tells Agent to perform task X; Agent performs task X; Principal is bound
         2. See *Dweck v. Nasser*; Buick/Wagoner Hypo
      2. Implied (AIA)
         1. Authority to conduct a transaction includes authority to do such acts which are incidental to it, usually accompany it, or are reasonably necessary to accomplish it
         2. See *Restatement 35; Dweck v. Nasser; Mill Street Church*
      3. Agency relationship, and existence of authority depends on information communicated (or not communicated) between the Principal and the Agent
   4. Apparent Authority
      1. AA arises from OBJECTIVE CONDUCT (“manifestation”) of Principal towards 3d party
         1. See *Restatement 8, 27*
         2. Woods/Buick Hypo
         3. *Gizzi* (Texaco Ads)
         4. Unless 3d parties are notified, principals can be found liable if agent does what is “usual and proper” within industry. (*370 Leasing Corp. v. Ampex Corp.* Cf. *Restatement 34(b)*)
      2. Apparent authority is the power to affect the legal relations of another person by transactions with 3d persons, professedly as an agent for the other, arising from and in accordance with the Principal’s manifestations to such 3d parties (*Restatement 8; Restatement (3d) 2.03*)
      3. Manifestations can be indirect or “traceable” (*See Dweck v. Nasser*)
      4. For Principal to be liable, (a) the facts must give rise to an OBJECTIVELY REASONABLE belief that agent has authority, and (b) 3d party must SUBJECTIVELY believe it too (*Restatement 8, comment C*)
      5. Creation of AA: General Rule
         1. Created as to a 3d person by written or spoken words or any other conduct of the principal which, REASONABLY INTERPRETED, causes the 3d person to believe that the principal consents to have the act done on his behalf by the person purporting to act for him (*Restatement 27*)
   5. Inherent Agency Power (Catch-All)
      1. Authority v. Power
         1. An agent may bind the principal even when the agent lacks any form of authority
            1. A power is an ability on the part of a person to produce a change in a given legal relation by doing or not doing a given act (*Restatement 6*)
            2. An agent’s power to bind the principal is broader than an agent’s authority to bind the principal (Inherent Agency Power—*Restatement 8A*; Estoppel—*Restatement 8B*)
      2. Policy
         1. If vendors can’t trust agents, vendors less willing to give credit, discounts. In addition, if Agent can’t bind Principal, efficiency of delegation is lost. (See *Restatement 161, comment*)
         2. Custom = efficient; don’t disrupt (*Watteau v.Fenwick*)
         3. Principal is often the best cost-avoider; she can hire faithful agent (*See Watteau*)
      3. Blackletter Law
         1. Turns on: Undisclosed principal; General agent exceeds authority; Transactions are “usual in such business” (*Watteau*; *Restatement 194, 195*)
         2. Turns on: General agent who exceeds authority; Actions are “usual” or “incidental” to agent’s authority; 3d party’s belief is objectively reasonable; 3d party has no notice (*Restatement 161; Restatement 3d*)
      4. Three Easy Steps for Using IAP
         1. Identify the classic situations in which inherent agency power is likely to be found
         2. Understand why, as a policy matter, it was appropriate to hold principal liable in them
         3. Apply that rational to the case before you
      5. *Watteau v. Fenwick*
         1. In the long run it is of advantage to business, and hence to employers as a class, that 3d persons should not be required to scrutinize too carefully the mandates of permanent or semi-permanent agents who do no more than is usually done by agents in similar positions (*Restatement 161*)
         2. An UNDISCLOSED PRINCIPAL who entrusts an agent with the management of his business is subject to liability to 3d persons with whom the agent enters into transaction USUAL IN SUCH BUSINESSES and on the principal’s account, although contrary to the directions of the principal (*Restatement 195*)
   6. Ratification
      1. Principal can be bound by action of a person professedly on his behalf if he or she affirms the contract to Agent or 3d party after the fact.
         1. *Restatement (2d) 82; Restatement (3d) 4.01*
         2. Woods/Disney Hypo
      2. 3d party cannot rely upon agent’s lack of authority to escape contract
      3. Timing of affirmation matters—delay cannot be used as an option contract!
      4. Affirmation must be made with knowledge of all material facts (*Botticello v. Stefanovicz*)
      5. *Atlantic Salmon A/S v. Curran*
2. Liability of Principal to 3d Parties in Tort
   1. Vicarious Liability
      1. Common Law: “For whoever employs another, is answerable for him, and undertakes for his care to all that make us of him. The act of a servant in the act of his master, where he acts by authority of the master” (Jones v. Hart (1698))
      2. Restatement (2d) 219(1): “A master is subject to liability for the torts of his servants committed while acting in the scope of their employment”
      3. Restatement (3d)
         1. 2.04 Respondeat Superior: “An employer is subject to liability for torts committed by employees while acting within the scope of their employment”
         2. 7.03(2): “An employee acts within the scope of employment when performing work assigned by the employer or engaging in a course of conduct subject to the employer’s control. An employee’s act is not within the scope of employment when it occurs within an independent course of conduct not intended by the employee to serve any purpose of the employer”
         3. 7.07(3): “For purposes of this section, (a) an employee is an agent whose principal controls or has the right to control the manner and means of the agent’s performance of work…”

|  |  |  |
| --- | --- | --- |
|  | **Servant/Employee** | **Ind. Contractor/Non-Employee** |
| **Restatement (2d)** | Master or employer “controls” or has “right to control” the physical conduct of servant’s work (§§ 2(1), 219, 220(1)) | IC is subject to neither “control” nor “right to control” by Employer (§§ 2(3), 220(2)) |
| **Restatement (3d)** | Respondeat Superior, attaches for employee within scope of employment (§§ 2.04, 7.07(2); Employee Defined, § 7.07(3)) | No Respondeat Superior if outside scope of employment (§§ 2.04, 7.07(2)) or not an employee (§ 7.07(3)) |
| **Liability?** | YES | NO |

* + 1. DOCTRINE: Agreement between alleged employer/independent contractor is judged by objective standard, not what parties call it (See *Humble Oil; Sun Oil; Holiday Inn; Miller v. McDonalds*)
    2. PLANNING/POLICY POINT: Issue of ultimate control, leverage?
       1. E.g. Besty-Len owned premises, paid flat rate to Holiday Inn
          1. Substantial RISK OF LOSS in hopes of earning substantial RESTURN ON ITS INVESTMENT
          2. Had LEVERAGE with Holiday Inn (Franchisor); Schneider in Humble Oil did not
    3. Right to control, not necessarily exercise of control, is key. (See *Miller v. McDonald’s*)
       1. Franchisor may be willing to accept this risk
  1. Independent Contractor status determined by applying weighing multiple factors summarized in Restatement 220(2):
     1. Extent of control as defined by agreement?
     2. Distinct lines of business?
     3. Specialized work usually done w/o supervision ?
     4. Degree of skill?
     5. Who provides tools?
     6. Duration of employment?
     7. Paid by job or hour?
     8. Work w/I regular line of business?
     9. Belief of parties?
     10. Whether principal is in business?
  2. Scorecard

|  |  |  |
| --- | --- | --- |
| **CASE** | **OUTCOME** | **RATIONALE** |
| Humble | Principal LOSES | “mere store clerk” |
| Sun Oil | Principal WINS | Slightly less control |
| Holiday Inn | Principal WINS | Betsy-Len owns land; flat franchise fee |
| Miller v. McDonalds | Principal LOSES | 3K is employee, acted as apparent agent |

1. Fiduciary Obligations of Agents
   1. Duty of Care (“Thou shall not shirk…”)
   2. Duty of Loyalty (“Thou shall not steal…”) which includes:
      1. No kickbacks (*Restatement 388*)
      2. No secret profits
         1. From transactions with principal (*Restatement 389*)
         2. Or through use of position (*Restatement 404*)
      3. No usurpation of business opportunities (*See Singer*)
      4. No “grabbing and leaving” (*See Town & Country*)
   3. Fiduciary Duty
      1. “An agent is subject to a duty to his principal to act SOLELY FOR THE BENEFIT OF THE PRINCIPAL in all matters connected with his agency” (*Restatement 387*)
      2. “An agent who makes a profit in connection with transactions conducted by him on behalf of the principal is under a duty TO GIVE SUCH PROFIT TO THE PRINCIPAL (*Restatement 388*) (i.e., DISGORGEMENT)
      3. “UNLESS OTHERWISE AGREED” = DEFAULT

**PARTNERSHIPS**

1. Defined
   1. A partnership is (a) an association of two or more persons (b) to carry on as co-owners (c) a business for profit. (*UPA 6(1)*)
      1. Created by OBJECTIVELY assessing conduct and contractual rights—“banana peel” quality
      2. Can arise without conscious intent to become partners
   2. (*UPA 7(4)*) Sharing of profits of a business is PRIMA FACIE evidence of partnership. But no inference from profit-sharing if:
      1. Payment of installment debt
      2. Payment to partner’s heirs
      3. Wages to employees
      4. Interest on a loan
      5. Rent to landlord
      6. Part of sale of business
   3. Hornbook Definition: 3 Prong Test (Fact-Specific Inquiry)
      1. What was the intention of the Parties? (i.e., what are their business objectives?)
      2. Who controls the business? (i.e., the “prerogatives of the principal”)
      3. Who shares in the profits?
   4. MULTIFACTOR TEST FOR PARTNERSHIP
      1. Intent of parties
      2. Share in profits
      3. Share in losses
      4. Control, ownership of partnership property
      5. Share in management
      6. Terms of partnership agreement
      7. Held out to 3d parties
      8. Rights on dissolution
   5. UPA 15: All partners are liable (a) jointly and severally for everything chargeable to the partnership under sections 13 and 14; (b) jointly for all other debts and obligations of the partnership
   6. UPA 40: In settling accounts between the partners after dissolution…the liabilities of the partnership shall rank in order of payment, as follows: (i) those owing to creditors other than partners; (ii) those owing to partners other than for capital and profits
   7. DEAL POINTS: RISK, RETURN, CONTROL, DURATION
2. Fiduciary Obligations of Partners
   1. Partnership law is built on agency law, but partnership fiduciary duty NOT always identical to Restatement analysis
      1. Partner presented with business opportunity CANNOT keep it for himself. (See Meinhard; See also Restatement 387)
      2. According to Judge Cardozo, partners owe each other the “finest loyalty.” Salmon had duty to disclose to Meinhard so that he and Meinhard could compete
         1. Call this “EQUAL FOOTING” rule
   2. Most statutory rules are default provisions; only a few are mandatory:
      1. Those affecting 3d party rights
      2. Limits on waiving fiduciary duties
   3. Fiduciary duties between Partners are more complex than Cardozo’s “finest loyalty”
      1. Salmon ONLY had duty to disclose
         1. EQUAL FOOTING rule enables competition between Salmon and Meinhard
         2. A deal between the two is thus likely…BUT Meinhard would have no legal duty to help Salmon finance his part of the project
   4. Fiduciary Duty in Modern Law Firms
      1. Partners use partnership agreement to define, limit their duties to one another
         1. Guillotine Method okay. (See Lawlis; Bonatch)
      2. In most cases, rewarding Partners according to their economic contribution to the firm may be the only stable, long-term equilibrium.
3. Why the UPA Default Rules Stink
   1. Management of Partnership
      1. ONE PARTNER, ONE VOTE. All partners have equal rights in the management despite different ownership stakes (UPA 18(e))
      2. UNANIMITY. Ordinary matters can be handled by majority vote, but all major decisions require ALL partners to agree (UPA 9(3), 18(h))
   2. Transferability of Ownership
      1. Partners may not transfer their rights as partners without the consent of all partners. (UPA 18(g) (No person can become a member of a partnership without the consent of all the other partners))
      2. Absent a BUY-OUT AGREEMENT, only way to get value is to force dissolution
   3. Apportioning Profits & Losses
      1. Profits are paid to partners EQUALLY, even when one partner made a larger initial contribution or advance (i.e., loan) to partnership. (UPA 18(a))
      2. No provision for interest on contributions
      3. Losses apportioned same way as profits
   4. Life/Duration of Partnership
      1. Limited Life
4. Unless otherwise agreed, partnership dissolves whenever any partner leaves partnership, goes bankrupt, or dies. The can cause LIQUIDATION of business.
5. If PARTNERSHIP AT WILL (the default rule), other partners have no legal recourse if leaving causes liquidation (UPA 31(b))
6. Capital and Management
   1. General Partnership = No limits on Partner/3d party dealings
   2. Special Partnership = Partner is limited in the terms he can offer or accept; dealings beyond this authority not binding on 3d parties “who have notice of the terms”
   3. “Every partner is an agent of the partnership for the purpose of its business, and the act of every partner, including the execution in the partnership name of any instrument, for apparently carrying on in the usual way the business of the partnership of which he is a member BINDS THE PARTNERSHIP, UNLESS the partner so acting has in fact no authority to act for the partnership in the particular matter, and THE PERSON WITH WHOM HE IS DEALING HAS KNOWLEDGE OF THE FACT THAT HE HAS NO SUCH AUTHORITY (UPA 9(1))
   4. UPA Default Rules
      1. Under UPA 9(1), every partner is presumed to have authority to transact “IN THE USUAL WAY the business of the partnership”
         1. In “usual way” context, each partner can bind partnership in K
      2. In NOT in “usual way,” partnership can still be bound if other partners agree (UPA 9(2))
         1. Look for agreement through IMPLIED CONDUCT here
         2. Operates similar to ratification in agency law
      3. Under UPA 9(3), there are several BIG things that a partner lacks the authority to do
      4. Under UPA 9(4), if 3d party knows that a partner lacks authority, that partner’s conduct is NOT binding on partnership vis-à-vis the 3d party
      5. Under UPA 18, “The rights and duties of the partner in relation to the partnership shall be determined, SUBJECT TO ANY AGREEMENT BETWEEN THEM, by the following rules…”
         1. Compare Restatement 379 to 398: UNLESS OTHERWISE AGREED
         2. Compare RUPA 103, which stays partnership agreement controls except…
         3. Default can be contracted around
      6. As a partner at a law firm:
         1. Your property rights as a partner include (1) your rights in specific partnership property, (2) your INTEREST in the partnership, and (3) your right to participate in the management (UPA 24)
         2. Your PARTNER’S INTEREST is your share of profits and surplus (UPA 26)
            1. Interest can be assigned to creditor, but creditors don’t get partnership rights (See UPA 27)
   5. Default Rules v. Private Contracts
      1. Read the statutes…do they work for your client?
         1. Nabisco and Dooley—Planning lesson and difference between dispute that is between partners v. 3d parties
      2. Read the partnership agreement…what is missing?
         1. Day v. Sidley & Austin—contracting away of management rights
         2. There may be an economic equilibrium that makes partnership terms less harsh
   6. Capital and Management
      1. When a partner can contractually bind partnership (UPA 9)
      2. Rights and Duties of Partners, which are subject to any agreement between them (UPA 18; Cf. Principal/Agent under Restatement)
      3. Distinguishing between partner’s rights and partner’s interest (UPA 24, 26, 27)
   7. What law governs the partnership?
      1. Written agreement?
      2. Oral agreement or implied terms through conduct or course of dealings?
         1. Given less weight (or no weight) if there is a written agreement. (See Day v. Sidley & Austin)
      3. Remaining terms by default supplied by statute (UPA or RUPA) depending upon jurisdiction
7. Dissolution
   1. Three Varieties Under the UPA:
      1. No Fault Dissolution (UPA 31(1)); No Damages (UPA 38(1))
         1. Express will of a partner; no term, undertaking (partnership-at-will)
         2. Term or undertaking is complete
         3. Agreement of all partners
      2. Dissolution Violates Partnership K (UPA 31(2)); Damages, Right to Run Business (UPA 38(2))
         1. Express will of a partner, which violates terms of partnership agreement
         2. Partnership is dissolved, but breaching partner is liable for damages to other partners
      3. Decree by Court Under § 32 (UPA 31(6)); May or May Not Be Damages
         1. Court dissolves because of conflict within the partnership
         2. Dissolving before court decree may adversely affect legal rights and liabilities
   2. Chronology & Terminology
      1. Time 1: DISSOLUTION = “point in time when the partners cease to carry on the business together.” (UPA 29, commentary)
      2. Time 2: WINDING UP = “the process of settling partnership affairs after dissolution” (UPA 29)
      3. Time 3: TERMINATION = “point in time when all the partnership affairs are wound up” (UPA 29)
   3. Buy-Sell Agreeements
      1. Two Types:
         1. Redemption Agreement—Partnership agrees to buy-out partner’s interest
         2. Cross-Purchase Agreement
            1. Individual partners have option (or duty) to buy out partner
            2. Pro rata, right to bid, order of seniority?
      2. Three Considerations
         1. Contingency—Type of Exit (Penalize early exit? Don’t penalize payment upon death, disability?)
         2. Valuation—Calculation of Value (Annual agreement? Appraisal? Indexed to revenues? What about goodwill?)
         3. Liquidity—Ability to Finance (Should partnership buy life or disability insurance? Installment payments okay? At what rate of interest?)
   4. Implied Term and § 38 Wrongful Party
      1. Is partnership a partnership-at-will (no damages) or partnership-for-term or –undertaking (possible damages)?
         1. Even if no EXPRESS term or undertaking in partnership K, one or the other been implied? (See Owen v. Cohen (until profits repaid loan))
         2. Owen saved from breach of partnership K because Cohen’s conduct warranted judicial dissolution under § 32(c), (d), & (f)
   5. Dissolution & Business Planning
      1. Collins v. Lewis = Planning Disaster
         1. Both partners could see upside of L-C Cafeteria, but nobody considered relatively obvious risks
            1. Collins needed cap on DUTY TO FINANCE
            2. Lewis needed mechanism to build and protect his SWEAT EQUITY
         2. Possible that Collins was using superior financial position to FREEZE-OUT Lewis at low price (Cf. Page v. Page)
      2. Page v. Page = Duty of good faith limits opportunistic behavior; “I cut, you choose” exit provision
      3. Pav-Saver v. Vasso = POORLY DRAFTED partnership agreement
         1. ¶ 11 “permanent” partnership in which patents/trademarks returned to dale upon “expiration” of partnership
         2. Dissent is probably right: parties were trying to contract around § 38(2)(B)
         3. Meersman agree to “whatever financing necessary.” (Cf. Collins v. Lewis)
      4. Kovatch v. Reed = Service Partnership
         1. Monetarizing Reed’s labor contribution is EQUITABLE…
         2. Slippery slope that raises contracting costs?
   6. Value of Good Drafting
      1. G&S Investment shows value of well-drafted buy-out provision
         1. Takes away unilateral ability force dissolution (and thus liquidation) of business
         2. Can shield remaining partners from:
            1. Bad tax consequences
            2. Liquidity problems to buy-out
            3. Sale during a bad market
            4. Honest disagreements on long-term prospects of investment

**LIMITED PARTNERSHIP (LP)**

1. General Information
   1. Limited Partnership is NOT creature of common law; it is created entirely by statute
   2. Two classes of partners:
      1. General Partner—manage/control business; subject to personal liability
      2. Limited Partner—no management/control rights, but enjoys limited liability

**LIMITED LIABILITY PARTNERSHIP (LLP)**

1. General Information
   1. Limited Liability Partnerships are also created entirely by statute
   2. Key Distinction is extent of partner liability:
      1. CONTRACT: ONLY LLP is liable for contractual debts of partnership, but creditors will often demand personal guarantees
      2. TORT: If partner commits a tort, ALL LLP PROPERTY is available to pay judgment, but only partners who committed tort (and those that supervised them) are PERSONALLY LIABLE

**LIMITED LIABILITY COMPANIES (LLC)**

1. Introduction, Comparison to Limited Liability Partnerships (LLPs)
   1. State Statute as “Off-the-Rack” Rules of Governance
      1. State statutes provide “off-the-rack” governance rules for all business forms
         1. UPA “fits” small partnerships best (consensus model)
         2. MBCA “fits” large corporations best (authority model)
         3. Businesses often hire lawyers to “tailor” formation document, contracting around default rules
      2. ULLCA emphasizes FLEXIBILITY; LLC members can opt for EITHER decision-making regime:
         1. Consensus = member-managed LLC (ULLCA 404(a))
         2. Authority = manager-managed LLC (ULLCA 404(b))
      3. A business is sometimes referred to as a “nexus of contracts” between owners, managers, employees, etc.
      4. In theory, the COST OF CONTRACTING is reduced by statutory default rules
         1. State statues are “off-the-rack” rules that supply contract terms between 2 or more people on:
            1. How business will be run
            2. How intra-business conflict will be resolved
      5. Principals often “contract” for DECISION-MAKING rules between the two statutory default regimes. These “contracts,” which are TAILORED by lawyers, take the following forms:
         1. Partnership “Consensus Model”-----------------Corporation “Authority Model” (continuum)

|  |  |  |
| --- | --- | --- |
| **FEATURE** | **PARTNERSHIP** | **CORPORATION** |
| Stakeholders  (profit from, control biz) | Partners | Shareholders, Directors, Officers |
| Number of Owners | 2 to 1500 or more | 1 to 10,000,000 |
| Information | Shared & Digested | Too much, must delegate, specialize |
| Decision-Making | CONSENSUS  Majority/Unanimity | AUTHORITY  Board sets policy, Officers execute |
| Disagreement/Transferability | Voice (because you CANNOT easily exit) | Exit (sell shares, move on) |
| Continuity | Ends with partner | Survives owner |

1. Formation, Entity, Operating Agreement
   * 1. Two important formation documents
        1. Articles of Organization—filed with SOS; PUBLIC DOCUMENT that can be relied upon by 3d parties who contract with LLC (ULLCA 101(1), 203)
        2. Operating Agreement—PRIVATE document that apportions rights, duties among LLC members (ULLCA 101(13), 103)
     2. If CONFLICT between Articles of Organization and Operating Agreement (ULLCA 203(c))
        1. Articles of Incorporation trump when 3d parties are affected
        2. Operating Agreement trumps with INTRA-LLC conflict
     3. LLC is a “LEGAL ENTITY distinct from its members” (ULLCA 201)
        1. Inclusion of LLC acronym in business dealings “discloses” to 3d parties that Principal is limited liability entity (See Westec)
        2. Common law agency rules survive LLC statutes. (See Westec)
        3. LLC Derivative Suits = members stepping into shoes of “injured” LLC (See Elf Atochem)
     4. LLCs reflect modern trend toward freedom of contract and permitting business people to privately order their affairs (See Elf Atochem)
2. Piercing the LLC Veil
   1. Principles and precedents of corporate law piercing are likely to apply to LLC context (See Kaycee; Tom Thumb)
   2. Common 2-Pronged Test:
      1. Entity ignores formalities and acts as the alter ego or instrumentality of member-owner;
      2. Limited liability results in injustice or is fundamentally unfair (See Tom Thumb)
3. Fiduciary Obligation
   1. Some rules more “corporate-like”
   2. Some rules more “partnership-like”
   3. Some rules unique:
      1. FIDUCIARY DUTIES vary with type of LLC. (See 409 (member-, manager-managed)); can constrict scope of duties by contract. (See McConnell)
      2. But NON-WAIVABLE PROVISIONS provide limit to contracting around default rules. (See 103)
4. Dissolution
   1. New Horizons—LLC is insolvent; requirements for piercing are not met
      1. Haack liable because she failed to follow statutory dissolution procedure
      2. The purpose of 807 notice procedure is to allow creditors to take action to protect themselves
      3. Failure to follow procedures, keep good records caused court to impose liability on Haack
   2. UPSHOT: Benefit of limited liability requires adherence to business formalities
5. Quick Tour of LLC Default Rules

|  |  |
| --- | --- |
| **LLC Operating Agreement** | **ULLCA Section** |
| Management/Fiduciary Duty | §§ 404(a)-(b), 409, 203(a)(6), 103 |
| Transferability/Membership | §§ 404(c), 502, Art. 6 & 7 |
| Profits & Losses | §§ 402, 403, 405, 203 |
| Life/Duration | §§ 411, 203(a), Art. 6 & 7 |
| Information | §§ 408, 103(b) |

* 1. Management
     1. Articles of Organization must state whether LLC is manager-managed; if so, name & address of each manager. (See 203(a)(6))
     2. If member-managed, members have EQUAL RIGHTS to management; most matters settled by majority vote (See 404(a))
     3. If manager-managed, managers have equal right to management; most matters settled by majority vote of managers (See 404(b))
     4. Fiduciary duty varies by LLC type:
        1. Member-managed: only duties of care, loyalty (See 409(a))
        2. Manager-managed: only managers have duty (See 409(h))
  2. Transferability/Membership
     1. All LLC members must agree to admit new LLC member. (See 404(c)(7); cf. UPA 18(g))
     2. Under 502, “A transfer of a distributional interest DOES NOT entitle the transferee to become or to exercise any rights of a member. A transfer entitles transferee to receive, to the extent transferred, only the distributions to which the transferor would be entitled”
     3. See also Articles 6 & 7, which deal with “dissociation” of member from LLC
  3. Profits & Losses
     1. Members have duty to make agreed upon CONTRIBUTIONS of money, property, other benefits (402(a))
     2. Members who make loans to LLC entitled to reimbursement, interest from other members (403)
     3. Any distributions must be in equal shares to all members (405(a))
     4. In Articles of Organization, members can personally guarantee LLC’s debts (203(a)(7))
        1. The ability to contract for inequality = flexibility
  4. Life/Duration
     1. Articles of organization must state “whether LLC is a ‘TERM COMPANY’ and, if so, the term specified” (203(a)(5))
     2. If term expires and members continue business, “the LLC continues as an AT-WILL COMPANY” (411(b))
     3. See also Articles 6 & 7, which permit member to “dissociate” from LLC without causing dissolution
        1. LLC member has power to “disassociate” at any time, but remaining members have right to buy-out
        2. LLC survives death of member

**CORPORATIONS**

1. Important Threshold Concepts and Formation
   1. Corporate Formation
      1. Three Simple Steps:
         1. PAPER—articles of incorporation + names & addresses of incorporators, directors, registered agent and corporate name with 1 of 4 magic words: “Inc.,” “Corp.,” “Limited,” “Co.”
         2. PEOPLE—Incorporator(s) signs articles of incorporation; after formation, call first meeting of shareholders/directors to elect officers/directors, adopt by-laws; then usually exits
         3. ACT—Articles and other paperwork must be filed with SOS. Acceptance by secretary is conclusive proof of valid formation
      2. Important Documents
         1. Articles of Incorporation: Public document filed with SOS; Identifies Corp name, incorporators, initial directors, types/amt of stock to be issued
         2. By-Laws: Document adopted after incorporation; deals with internal governance; Articles of Incorporation always trump By-Laws; Articles of Incorporation harder to change
      3. Southern-Gulf v. Camcraft
         1. Camcraft can’t rely on Southern-Gulf’s deficient incorporation to get out of K unless “its substantial rights might thereby be affected”
      4. De Facto Corporation Doctrine
         1. A court may treat a firm not properly incorporated as though it was, in fact, a Corp if the organizers:
            1. Had LEGAL RIGHT to organize Corp.
            2. Attempted to do so in GOOD FAITH; and
            3. In 3d party dealings, ACTED AS A CORP
      5. Corporation by Estoppel Doctrine
         1. A court will also treat a firm not properly incorporated as though it was a Corp if the 3d party dealing with firm:
            1. THOUGHT it was a Corp all along
            2. Would earn a WINDFALL if allowed to argue that the firm was NOT a Corp
   2. Basic Terminology
      1. Shareholders—owners of corporation (residual claimants); elects directors
      2. Directors—part-time job; sets major Corp policy; hires officers
      3. Officers—President, Vice-President, Treasurer, etc. (run company day-to-day)
      4. Corporation “Legal Person”—has assets, liabilities, contractual rights, credit rating, right to sue, be sued, due process rights, etc.
      5. Close Corporation—Corp. with small number of shareholders
         1. SHs often serve as directors & officers
         2. Shares not sold on public market (NYSE, NASDAQ, etc.)
         3. Can operate FUNCTIONALLY the same as partnerships in terms of decision-making
   3. Fiduciary Obligations & Promoters (Art/Paula Hypothetical)
      1. Baseline rule is that agent must DISCLOSE conflict of interest to principal. (Restatement 388)
         1. If agent fails to disclose, DISGORGEMENT is remedy. (See General Automotive)
         2. True even when principal is Corp.
      2. However, even if economic substance of transaction is IDENTICAL, in some cases, form of transaction can sever purported agent’s liability
   4. Private Law v. Default Rules
      1. Most statutory corporate law is merely “off-the-rack” default rules that can be contracted around
      2. Sources of Law
         1. Articles of Incorporation (private law)
         2. Corporate By-Laws (private law)
         3. “Other” Contracts (private law)
         4. Common law duties (e.g., fiduciary duty)
         5. Statutory default rules
2. Limited Liability & Piercing the Corporate Veil
   1. MBCA 6.22(b): “Unless otherwise provided in the articles of incorporation, a shareholder of a corporation is not personally liable for the acts or debts of the corporation except that he may become personally liable by reason of his own acts or conduct”
   2. Limited Liability & Piercing
      1. Limited Liability = strongly encourages pooling of capital among strangers
         1. SH has LIMITED DOWNSIDE (price of stock)
         2. UNLIMITED UPSIDE (Microsoft in 1985)
         3. Facilitates CAPITAL FORMATION among strangers
      2. In limited circumstances, shareholder can be personally liable (i.e., corporate veil can be pierced). (See MBCA 6.22(b))
         1. Piercing doctrine filled in through state common law process
   3. Two-Pronged Piercing Test: Sea Land—Corp veil pierced if:
      1. There is a “Unity of Interest” such that separate personalities of Corp and individual no longer exist
         1. Poor corporate records, lack of formalities? Commingling of funds or assets? Undercapitalization? One corporation treating assets of another corporation as its own?
      2. Adherence to fiction of separate Corp existence would (a) sanction a fraud, OR (b) promote injustice.
   4. Totality of Circumstances Test
      1. Common directors or officers
      2. Common business departments
      3. Consolidated financial statements
      4. Parent finances Subsidiary
      5. Parent causes incorporation of Subsidiary
      6. Subsidiary has grossly inadequate capital
      7. Parent pays expenses of Subsidiary
      8. Parent uses Subsidiary’s property as its own
      9. Daily operations are not separate
      10. Subsidiary doesn’t observe basic corporate formalities
   5. Piercing and Other Theories
      1. Piercing the Corporate Veil. (Sea-Land)
      2. Enterprise Theory (Walkovsky)
      3. Agency Theory (Cf. Cargill)
      4. Improper Dividend
      5. Fraudulent Conveyance
      6. Fraud (the five-element tort)
   6. Piercing and Red Herrings
      1. Limited partners acting as officers of a Corporate General Partner does not alter the PVC analysis
      2. GROWN-UP PRIVATE LAW
         1. If Corp form being abused, piercing available…
         2. BUT Frigidair know who/what it was contracting with
            1. Formalities scrupulously followed
            2. Could have negotiated for personal guarantees!

**CONFLICTS WITH CLOSE CORPORATIONS**

1. Control of the Close Corporation
   1. Separation of Ownership & Control in Business Forms
      1. PUBLICLY-HELD CORPS usually have separation of ownership and control
         1. SHs (owners) v. directors/officers (control)
         2. Separation carries risk of agency costs
            1. Shirking (directors not monitoring, Enron)
            2. Stealing (officers/directors looting, Tyco)
      2. CLOSE CORPS typically have owners who also manage (i.e., no separation)
         1. Agency costs mitigated…
         2. But CONFLICTS OVER CONTROL become paramount
         3. Voting trusts, voting agreements, and shareholder agreements are often used to manage conflict
   2. 3 Ways to Accommodate Close Corps
      1. Unified Strategy—same Corp. Code applies to close and public Corps
      2. Statutory Close Corporations—special statutes for Close Corps
      3. New York/Model Business Act—permits SHs to “lock-up” control
   3. 3 Types of Agreements Affecting Close Corps Under MBCA
      1. AGREEMENT IS DEFINED BY FUNCTION, NOT LABEL
      2. Voting Trusts (§ 7.30)—allows a pre-determined party to cast votes on behalf of the SHs
      3. Voting Agreements (aka Pooling Agreements) are about electing directors (§ 7.31; Ringling)
      4. Shareholder Agreements are about electing directors AND setting future corporate policy (MBCA § 7.32; McQuade; Clark; Galler)
         1. McQuade v. Stoneham: SH agreements that abrogate independent judgment of directors are void against public policy, but agreement to elect specific directors (i.e., voting agreements) okay
         2. Clark v. Dodge: SH agreements CAN abrogate judgment if ALL SHs AGREE; McQuade rule applies only when 3d party rights (e.g., minority SHs) are potentially affected
         3. Galler v. Galler: Non-unanimous SH agreements may be enforceable if: [1] no apparent public injury, [2] the absence of a complaining minority interest, and [3] no apparent prejudice to creditors
            1. Cf. MBCA 7.32 (codifying and formalizing Clark unanimity requirement, among other provisions)
         4. Stock certificates must provide “conspicuous” notice of agreements to protect 3d party buyers of stock
         5. Agreement is invalidated once shares of Corp become publicly traded
   4. Cumulative v. Straight Voting (SEE NOTES)
      1. Who becomes a director?
         1. How many votes do you need to guarantee that your candidate wins?
            1. FORMULA: (total votes to be cast/(number of directors seats + 1)) + 1
         2. Straight Voting
            1. Maximum of 1000 votes PER director’s seat, each SH can vote maximum number of shares on each seat
            2. Often allows minority SHs NO VOICE
         3. Cumulative Voting
            1. How many directors can a SH elect under cumulative voting?

Total Votes held by SH/(Votes Needed Formula)

* 1. Corporate Planning by Use of Employment Contracts
     1. McQuade or Clark’s lawyer should consider:
        1. Duration—10 years as GM or treasurer? Define “for-cause” provision narrowly? Must have Buy-Sell agreement
        2. Compensation—High salary preferable to collecting dividend? Bonuses/options for good performance?
        3. Duties or Status—Ability to have outside employment (e.g., Corp. director)?
        4. Termination—Limit duty to mitigate (to avoid lower status job); liquidated damages, buy-sell agreement, to avoid litigation
        5. Effect of Merger—specify client’s rights, possibly demand personal guarantee from majority SH

1. Fiduciary Obligations, Abuse of Control & Oppression
   1. Nature of the Close Corporation
      1. Statutory law assumes separation between SH (passive) and Directors/Officers (active)
      2. But in Close Corp, SH/Owners may invest only if they are CERTAIN they will also be a Director and/or Officer. Voting Trusts, voting agreements, SH agreements provide this CERTAINTY
      3. In Close Corp in which SOME but not ALL SHs have jobs within Company, there are only two stable equilibriums:
         1. Pay only FMV salaries AND distribute dividends
         2. Have a STRONG BUY-OUT AGREEMENT, which reduces benefit of oppressing minority SH
   2. Dynamics of Close Corps
      1. Minority SH in a Close Corp has no legal entitlement to either DIVIDENDS or EMPLOYMENT. But right can be secured through:
         1. SH Agreement
         2. Employment Contract
      2. In contrast, Controlling SH can force himself to be ELECTED AN OFFICER; also can force GENEROUS (but not excessive) salary
      3. Thus, value of minority bloc of stock is likely worth less than if Corporation was sold as going concern and minority SH received pro rata share
      4. Business may be worth $2M as going concern (selling 100% of stock)
         1. But majority SH’s 60% worth MORE than $1.2M if sold alone—CONTROL PREMIUM
         2. And minority SH’s 40% worth LESS than $800K if sold alone—MINORITY DISCOUNT
   3. Economic Stability of Close Corps

|  |  |  |
| --- | --- | --- |
| **PERSON IN CORPORATION** | **PAYOFFS** | **PAYOFFS** |
|  | **Public Corp** | **Close Corp** |
| **Shareholders** | 1. Dividends 2. Higher share price | 1. No dividends 2. No market for shares |
| **Directors** | FMV Salary | No Salary |
| **Officers** | FMV Salary | Salary > FMV |

* 1. Summary of Key Legal Doctrines
     1. Freeze-Out is 2 Steps: (Page v. Page (partnership); Wilkes; Ingles)
        1. Step 1: Deny economic benefits of ownership
        2. Step 2: Offer low-ball price
     2. Reasonable Expectations Doctrine (Wilkes; Wolfson; SH Agreement w/ buyout is better option than litigating and waiting)
        1. Baseline of Good Faith
        2. D’s Burden: Must show LEGITIMATE BUSINESS JUSTIFICATION
        3. P’s Burden: Must show LESS HARMFUL ALTERNATIVE
  2. Planning Issues
     1. Provision in SH agreement gave Glamore right to buy-out Ingle if Ingle “ceased to be an employee for ANY REASON”
     2. During first few years of agreement, $96K buyout was probably disincentive to fire Ingle; but inflation changed it to an actual incentive
     3. Ingle needed at least TWO THINGS:
        1. Mechanism to push buy-out price up as value of business increased (e.g., formula, appraisal)
        2. Employment contract saying he could only be fired FOR CAUSE (defining cause narrowly)
  3. Key Concepts Applicable to Directors/Officers
     1. Duty of Care (Shirking)—negligence, gross negligence, recklessness, egregious misconduct
     2. Duty of Loyalty (Stealing)—conflict of interest (e.g., self-dealing)
     3. BUSINESS JUDGMENT RULE
        1. Used as affirmative defense for errors in judgment
        2. Judicial standards for reviewing decisions by Corp officers/directors
        3. N/A if there is: Fraud, Illegality, Conflict of Interest, Negligence (degree?)

1. Duration and Statutory Dissolution
   1. Corporate Dissolution
      1. Blunt, expensive remedy used when parties have failed to agree EX ANTE on a comprehensive buy-sell provision (See Alaska Plastics)
      2. Plaintiff must make statutory showing. For example:
         1. OPPRESSION. MBCA 14.30(2)(ii)
         2. WASTE. MBCA 14.30(2)(iv)
      3. Threat of liquidating valuable business spurs parties to negotiate & actually compromise
   2. Under MBCA, Four Scenarios Permitting Dissolution Order
      1. Director Deadlock (14.30(2)(i))
      2. Controlling SH Oppressing Minority SH (14.30(2)(ii))
      3. SHs Deadlocked, resulting in inability to elect directors (14.30(2)(iii))
      4. Misapplied, Wasted Corporate Assets (14.30(2)(iv); cf. Atlantic (retained earning cause penalty tax to be assessed))
   3. Dynamics of a Dissolution Proceeding (MBCA 14.34)
      1. Within 90 days of commencement of a dissolution action, Corp or individual SH have right to purchase shares of unhappy minority SH
      2. If right is exercised, parties have another 60 days to agree on price
      3. If parties can’t agree, court has authority to determine buy-out price, including:
         1. Imposition of installment terms
         2. Award of interest to minority SH (unless they spurred good faith offer from majority)
         3. Award of attorneys’ fees
2. Transfer of Control
   1. Overview
      1. Sale of a controlling interest in Corp will command CONTROL PREMIUM that exceed stock’s market price. WHY?
         1. Controlling SH can GIVE JOBS to herself, kids at > FMV SALARIES
         2. Controlling SH can oust complacent management; FRESH IDEAS & FRESH MANAGEMENT can make Corp MORE PROFITABLE
         3. Controlling SH can LOOT corporation (illegal but difficult to get caught)
   2. Equal Opportunity Rule
      1. If a 3d party offers to buy the stock of the other two principals, you would have option of participating on a pro rata basis. Thus, you are GUARANTEED to share in any control premium. Clause applies to all parties.
   3. Review
      1. Frandsen—A small patch of contract language can do a whole lot of work:
         1. “Clause (i)” (Right-of-First-Refusal) language:
            1. Ensures that Frandsen wouldn’t be stuck with new, unwanted, majority SH
            2. Preempts Jensen family’s ability to get a control premium from 3d party buyer
         2. “Clause (ii)” language ensures that Frandsen will SHARE IN CONTROL OF PREMIUM even if he:
            1. Lacks LIQUIDITY to exercise right-of-first refusal
            2. Doesn’t want JSA (e.g., it’s overpriced)
      2. But Clauses (i) and (ii) only covered transactions between Majority SH and 3d Party—NOT:
         1. Transaction #2: Sale of JSA, Inc.
         2. Transaction #3: Sale of JSA, Inc.’s assets (FSG)
      3. A right-of-first-refusal that ALSO covered merger or sale JSA assets would have foreclosed an AUCTION
         1. Such a clause would not come for free!
      4. EOP business start-up Problem:
         1. Solved as CLOSE CORPORATION
         2. …but could have been a PARTNERSHIP
         3. In real life, LLC is most likely choice
      5. PLANNING LESSONS similar for all three
         1. Basic knowledge of default rules is important
         2. More developed case law for Corps and partnerships can be persuasive authority to resolve problems of LLCs as they arise. (Cf. Flahive (applying corporate law piercing test to LLCs)).

**CONFLICTS WITH CORPORATIONS GENERALLY**

1. Corporate Purpose and the Business Judgment Rule
   1. Return of Economic Agency Costs
      1. In publicly held Corp, dispersed owners (SHs) don’t have large incentive to monitor their agents (directors and officers). Economic agency costs therefore proliferate:
         1. Shirking—Agents can thus become complacent, lazy, unmotivated
         2. Stealing—Agents are also less likely to get caught diverting Corp resources, opportunities to themselves
   2. Usual Rule: “Directors of a Corp, and they alone, have the power to declare a dividend of the earnings of the Corp, and to determine its amount.”
   3. Ford v. Dodge = extremely rare case where a court upsets business decision of Corp directors
      1. Ford refused to offer business purpose of his actions
   4. Shlensky v. Wrigley = example of deference supplied by BJR.
      1. Court supplies much of the business purpose
   5. Why is rule so lenient?
      1. Preserving efficiency of centralized decision-making?
      2. Permit socially responsible agency costs?
      3. Unhappy SHs can exit?
   6. Cases:
2. Duty of Care, Duty of Good Faith, and the BJR
   1. Key Delaware Corp. Statutes
      1. § 141. Directors—elected SHs; set policy (e.g., hiring Officers)
      2. § 251. Mergers—negotiated by Directors, Officers; voted on by SHs
      3. § 271. Sale of Assets—negotiated by Directors, Officers; voted on by SHs
   2. Duty of Care
      1. Duty of care liability appears to turn on PROCESS of business decision, no the SUBSTANCE of the decision itself (See Eisner; Cf. Van Gorkom; Francis)
         1. Even business experts can’t make informed judgment without adequate information
         2. Safeguards
            1. Detailed management reports
            2. Consultants
            3. Read and review documents
      2. Content of Duty of Care
         1. Obtain rudimentary knowledge
         2. Know what is going on in business
         3. Review finances
         4. If any red flags, inquire further
         5. Object when co-workers are committing a crime
      3. Director Owes Duty To: SHs, UNLESS….Corp is insolvent, then creditors
      4. Proximate Cause: To prevail, plaintiff must prove that director’s breach was proximate cause of loss.
   3. Smith v. Van Gorkom
      1. Did Directors “conscientiously execute” their duties?
         1. Merger approved without ANY written terms, documentation
         2. TransUnion couldn’t solicit other buyers; when “cured,” new timeline kills potential for auction
         3. Van Gorkom signed Merger K without reading it; after amendments, van Gorkom STILL failed to read K
         4. Disclosure to SH was INADEQUATE: puffed Roman’s LBO calculation into a 141€ report; no factual basis to justify claim that $55/share constituted a “substantial” premium
3. Derivative Actions: Distinguishing between Direct and Indirect Actions
   1. Basics of a Derivative Lawsuit
      1. Corp is a “legal person” in the eyes of the law. Derivative lawsuit (FRCP 23.1) can redress injuries to this “person”
      2. Usually Directors & Officers (D&O) can initiate lawsuit on behalf of Corp…
         1. But if D&O were wrongdoers, getting their approval is unlikely (“FUTILE”)
         2. Thus, SH can STEP INTO SHOES OF CORP and sue the wrongdoing party
         3. Recovery goes to Corp, not SH. But courts will typically award attorneys’ fees on a percentage-of-recovery basis. Can be very lucrative
      3. Demand Requirements
         1. Policy Justifications:
            1. Forces NON-LITIGATION DIALOGUE between Directors and SHs (Voice/Exit)
            2. Respects DECISION-MAKING AUTHORITY of Board by giving them opportunity to CONTROL LITIGATION (Board Sets Policy, Not SHs)
            3. Provides a process for identifying CONFLICT OF INTERESTS (Demand futility; Wrongful refusal)
      4. Demand Futility
         1. Must allege with PARTICULARITY that either
            1. MAJORITY of board is INTERESTED (Financial conflict? Familial conflict? Domination/control?)
            2. OR challenged transaction is NOT product of a VALID BUSINESS JUDGMENT (duty of care, waste?) (Failure of process? (See Van Gorkom) Failure to implement reasonable controls? (See In re Caremark) Irrationality (Corp Waste)? (See Kamin))
4. Duty of Loyalty, including Usurpation of Corporate Opportunities
   1. Background
      1. 19th Century—Trustee Rule: Any contract between director and Corp raises specter of self-dealing; any SH who protests can void agreement
         1. PROS: Low risk of fraud and theft by insiders
         2. CONS: Miss out on some valuable opportunities and expertise; more acute in Close Corp
      2. 20th Century—Modern Approach: Much more flexible. States permit contracts, transactions between Corp and Directors if certain conditions are met. (See, e.g., 8 DE Corp Code 144)
         1. PROS: Fewer losses of potentially good deals, which can really help close Corps (not so important for large public companies)
         2. CONS: Higher risk of fraud and theft (see Enron)
   2. Del. Gen. Corp. Law § 144
      1. Under 144(a), Contracts between Directors/Officers & Corp are not AUTOMATICALLY VOIDABLE if:
         1. All material facts are disclosed AND majority of distinterested directors approve (BJR); OR
         2. All material facts are disclosed AND shareholders approve (majority of distinterested?) (BJR); OR
         3. Deal was fair at the time it was approved by (conflicted) Board (Intrinsic Fairness)
   3. Summary
      1. Absent a conflict of interest, plaintiff has the burden of proof and will probably lose because of BJR
      2. If there is a conflict of interest, two possible ways to evaluate:
         1. Intrinsic Fairness: Defendants must prove that challenged transaction was fair and reasonable (intrinsic fairness) (See Bayer)
         2. BJR: Defendants fully disclosed conflict and obtained authorization from (a) majority of disinterested directors, OR (b) majority of (disinterested?) SHs
      3. Corporate Opportunity Doctrine
         1. Insider Can’t Take Opportunity (w/o disclosure & rejection) If:
            1. Corp has FINANCIAL ABILITY to take it
            2. Opportunity is in Corp’s LINE-OF-BUSINESS
            3. Corp has INTERST, REASONABLE EXPECTANCY in opportunity
            4. There is CONFLICT between insider & Corp it insider takes opportunity
            5. Extra Factor: If opportunity didn’t surface through D’s Corp duties, burden to show adherence to fiduciary duties “is thus lessened” (See Broz v. Cellular Information Systems (citing Guth v. Loft))
         2. Duty of loyalty bars insider from usurping a corporate opportunity. (See Guth v. Loft (setting forth 5 factor test); In re eBay SH Litig.)
         3. SAFE HARBOR: Not actionable if (a) insider discloses and (b) majority of disinterested directors approves.
   4. Duty of Loyalty
      1. Under Trustee Rule self-interested transactions were void
         1. 144 must be interpreted against old rule
      2. If one of the three subsections of 144(a) is present then transaction is not automatically void (DE courts determine standard of review):
         1. Vote by disinterested directors
         2. SH ratification
         3. Fairness to Corp
5. Dominant Shareholders Problems and a Primer on Corporate Finance
   1. Overview of Controlling Shareholder Problems
      1. As GENERAL RULE, only directors and managers owe fiduciary duty to Corp.
         1. Directors owe duty because they set policy and monitor affairs of Corp
         2. Managers owe duty because they execute policy and have best information
      2. SHs invest to make money, NOT to look out for other people’s interests
      3. HOWEVER, when one DOMINANT SH effectively controls the Corp, courts will impose fiduciary duties on SH
         1. Common situation is Parent-Subsidiary relationship in which Sub has outside investors (i.e., Sub is not “wholly owned” by Parent) (See Sinclair Oil)
      4. When dominant SH can profit at expense of minority SHs, BJR DOESN’T APPLY; instead dominant SH has burden of proving “INTRINSIC FAIRNESS”
   2. Intrinsic Fairness Test
      1. According to the Court, when is the Intrinsic Fairness Test applied to Parent-Sub transactions?
         1. Mere Parent-Sub relationship will evoke the intrinsic fairness test. This standard will be applied only when the fiduciary duty is accompanied by self-dealing…Self-dealing occurs when the parent, by virtue of domination of the subsidiary causes…the parent to receive something from the subsidiary to the exclusion of, and detriment to, the minority stockholders of the subsidiary
   3. Review
      1. Controlling SH owned FIDUCIARY DUTY to minority SH (Cf. Zahn (contractual duty owned to preferred SHs))
      2. Two standards of review for transactions between Corp and Controlling SH
         1. If P can show self-dealing, controlling SH bears burden of showing INTRINSIC FAIRNESS. Sinclair Oil (favoring 100% owned sub over 97% owned sub was self-dealing)
            1. But cf. Wheelabrator (if majority of minority SH ratify, then P bears burden of proof)
         2. Otherwise, BJR (Sinclair Oil; Wheelabrator).