**Corporations Outline**

1. **Agency Law**
   1. Concept of Agency
      1. determines when the actions of agent make principal liable to 3rd party under contract or tort
      2. **Agency relationship results from:**
         1. **manifestation of *consent* by P to A that**
         2. **A shall act on P’s *behalf***
         3. **subject to P’s right of *control* and**
         4. **A’s *consent* to so act**
      3. four key elements of agency: manifestation, behalf, control, and consent
      4. it is very easy to create a principal-agent relationship (*see Gorton v. Doty*— teacher loaning football coach her car)
         1. can have one without even knowing you have one
         2. can have one even if you deny that you have one
         3. act like an agent and a principal and you are an agent and a principal
         4. can have one without a contract
   2. Three Types of Agency Relationships
      1. principal/agent—broadest relationship; minimal control needed to create
      2. master/servant—extreme form of control
      3. employer/proprietor and independent contractor
   3. Principal-Agent Relationship
      1. Creditor Acting As Principal (*Gay Jensen Farms)*
         1. creditor becomes a principal when “he assumes de facto control over the conduct of the debtor, whatever the terms of the formal contract with his debtor may be.” see RT 2nd of AG 14.0
         2. creditor vs. ordinary purchaser
            1. “one who contracts to acquire property from a third person and convey it to another is the agent of the other only if it is agreed that he is to act primarily for the benefit of the other and not for himself”
         3. holding: Warren is agent of Cargill: Cargill manifested his consent that Warren would be agent, Warren acted as agent by getting grain for Cargill, Cargill exercised extensive control over Warren’s operation
   4. Agency Relationships v. Agency Conflicts
      1. legal principal-agent relationship
         1. agent must act:
            1. on principal’s behalf and
            2. under principal’s control
         2. relationship mainly viewed from 3rd party perspective
      2. economic principal-agent conflict
         1. agent has different interest than principal and principal does not control agent
         2. viewed from principal’s perspective
         3. shareholders are the principal; directors (or mangers) are agents of the shareholders
   5. Liability of Principal to 3rd Parties In Contract [Must Establish Authority]
      1. A principal is subject to liability upon contracts made by an agent acting within his authority if (RT144):
         1. made in proper form
         2. with the understanding the principal is the party
      2. need to establish that person is an *agent* AND that he has *authority*
      3. types of authority
         1. actual authority
            1. actual express authority (AEA)
            2. actual implied authority (AIA)
         2. apparent authority (APA)
         3. ratification (R)
         4. inherent agency power (IAP)
      4. actual authority (AEA and AIA)
         1. **An agent has actual authority to take any action (RT 3rd AG, 2.02 (1)):** 
            1. **designated or implied in the principal’s manifestations to the agent, or**
            2. **necessary or incidental to achieving the principal’s objectives,**
            3. **as the agent reasonably understands the principal’s manifestations and objectives.**
         2. look to communication (i.e. manifestation) from principal to agent
         3. emphasis on *agent’s reasonable interpretation* of principal’s communication
         4. AEA: do this and do it this way; AIA: do it, but you have some discretion—may look at past dealings, what you have done in past
         5. agent can act against principal’s interest *even if agent has actual* *authority* (*Mill Street Church*—brother had implied authority when he hired his brother even though church didn’t want him to)
      5. apparent authority (APA)
         1. **an agent has apparent authority to affect a principal’s legal relations with 3rd parties when (RT 3rd AG 2.03):**
            1. **a 3rd party reasonably believes the actor has authority to act on behalf of the principal AND**
            2. **that belief is traceable to the principal’s manifestation**
         2. 3rd-party centric
            1. perspective of 3rd party; communications from principal to 3rd party
            2. emphasis on 3rd party’s reasonable interpretation of principal’s manifestation
            3. equitable rule to protect 3rd parties
         3. legal def. of manifesting consent under APA can be quite broad
            1. explicit statements/communications (notes, letterhead, email)
            2. assertive actions
            3. failure to correct mistaken assumptions
            4. conditional gifts
            5. job titles/descriptions
         4. permissible manifestations
            1. could be made directly to 3rd party
            2. could be made through a reliable intermediary (even the public) to the 3rd party
            3. in limited situations, it could come through agent’s communications with 3rd party [what situations?]
         5. in essence, when it comes to APA
            1. need to find some manifestation AND
            2. it needs to go back to principal
      6. ratification
         1. how to spot ratification: if there wasn’t actual authority but there is *ex post*
         2. timing issue. Ratification must occur before:
            1. communication of withdrawal by 3rd party
            2. material change in circumstances that would make it inequitable to bind 3rd party; or
            3. a specific time that determines whether a 3rd party is deprived of a right subjected to a liability [what does this mean]
         3. two-prong test for ratification: principal ratifies agent’s agreement and the timing is right
            1. a. 2nd-prong as ambiguous; fact pattern might play off of this
         4. wife’s acceptance of benefits was not enough, by itself, to prove ratification of husband’s sale of jointly-owned land (*Botticello v. Stefanovicz*)
      7. inherent agency power (IAP)
         1. **“Inherent agency power…is…the power of an agent which is derived not from authority, apparent authority or estoppel, but solely from the agency relation and exists for the protection of persons harmed by or dealing with a servant or other agent.” (RT 2nd 8A)**
         2. two types (*Watteau v. Fenwick*)
            1. hidden or “undisclosed” principal: Agent was a “general agent” for an undisclosed principal. Transactions in question were usual or necessary in such a business. Agent was acting on principal’s ’s “account” (i.e. in principal’s interests), although contrary to directions of principal.
            2. general agent: Agent acting as general agent for principal. Agent’s actions consistent with or incidental to transactions that this type of agent usually allowed to conduct (i.e. authority comes from the agent’s position).3rd party has no reason to believe A lacks authority.
         3. doctrine is needed to protect reasonable expectations of 3rd parties
         4. if this doctrine was not in place, could stay hidden and could intentionally make himself judgment proof
         5. **IAP Version II: disclosed principal liable for agent’s unauthorized acts, even absent actual/apparent authority, if:** 
            1. **agent acting as general agent;**
            2. **Agents acts usually accompany or are incidental to transactions which this type of agent (i.e. based on title/office) would usually be allowed to conduct;**
            3. **3rd party has reason to believe that agent is authorized and has no notice to the contrary (RT 161)**
         6. version 2 of IAP vs. APA
            1. in IAP, reasonable belief that agent is authorized
            2. in APA, reasonable belief is not enough—need manifestation
         7. **An undisclosed principal:** 
            1. **is subject to liability to a 3rd party who is justifiably induced to make a detrimental change in position by an agent acting on the principal’s and without actual authority if the principal, having notice of the agent’s conduct and that it might induce other to change their positions, did not take reasonable steps to notify them of the facts.**
            2. **may not rely on instructions given an agent that qualify or reduce the agent’s authority to less than authority a 3rd party would reasonably believe the agent to have under the same circumstances. (RT 3rd 206)**
      8. avoiding liability under contract
         1. give agent clear/unambiguous instructions
         2. avoid communication that might lead to APA
         3. ask agent to carry insurance
      9. how to analyze liability under contract
         1. focus on the specific event / contract
            1. did A have authority(AEA, AIA, ApA, …) to enter into the transaction/contract on P’s behalf
         2. ignore the general definition of an agency relationship; definition may or may not be satisfied.
            1. AEA, AIA 🡪 Yes. P-A relationship exists
            2. ApA 🡪 P-A relationship may or may not exist
   6. Liability of Principal to 3rd Party in Tort [Must show agent working on behalf of principal, under principal’s control, and acting in scope of employment]
      1. vicarious liability: general concepts
         1. “For whoever employs another, is answerable for him, and undertakes for his care to all that make use of him. The act of a servant *is* the act of his master, where he acts by authority of the master.” *Jones v. Hart* (1698)
         2. A master is subject to liability for the torts of his servants committed while acting in the scope of their employment. (RT Restatement 2nd AG 219)
            1. two elements: master-servant (employer-employee) relationship *and* acting in the scope of their employment
         3. servant: working on master’s behalf and controlled by master or subject to control by master; example: waiter
            1. rebuttable presumption that if you are employee you are an agent
         4. independent contractor: not controlled by nor subject to control by principal; may or may not be agent; example: plumber
         5. agent-type independent contractor v. non-agent independent contractor (note: principal NOT liable for either of them)
            1. agent-type: has agreed to act on principal’s behalf, but not subject to principal’s control of how result is accomplished; example: carpenter who buys lumber on credit account of homeowner to build homeowner a garage
            2. non-agent: operates independently and simply enters into arms-length transaction; example: carpenter who just builds the garage
      2. vicarious liability: control over physical conduct
         1. for person to be a servant, principal must have supervisory rights over the manner in which agent goes about completing the job/steps
         2. boundary between servant and independent contractor is hazy
            1. indicia/factors of control provide guidance: terms of relationship; agent paid by job or with unit wage; agent’s work part of principal’s regular business; who provides supplies, etc.,; extent of principal’s control over work details; etc. (RT 2nd AG 220)
         3. measuring extent of control (*Humble*)
            1. direct indicia of control rights: contractual allocation of principal’s control over agent’s physical conduct *and* principal practices control over agent’s physical conduct
            2. indirect indicia of principal’s “ownership” (i.e. residual claimant status): lease rather than title to inventory/equipment; contingent rent; profit/loss-sharing, etc.
         4. day-to-day operations
            1. in order for master-servant relationship to exist, master must retain rights to control details of day-to-day operations; it is not enough if master exerts control or influence *over results alone* (*Hoover*)
            2. no master-servant relationship found where franchisee was governed by regulatory contract (explained how franchisor’s trademark and assets could be used), but where franchisor had no control or right to control methods or details of doing the work (*Murphy v. Holiday Inn*)
      3. vicarious liability: scope of employment (three tests)
         1. traditional test (RT 2nd AG 228; *see also* 229(2): conduct of a servant is within the scope of employment if, but only if:
            1. it is of the kind he is employed to perform;
            2. it occurs substantially within the authorized time and space limits; and
            3. it is actuated, at least in part, by a purpose to serve the master, and
            4. if force is intentionally used by the servant against another, the use of force is not unexpectable by the master
         2. *Bushy “foreseeabilty”* test: an employer is held liable for a tort committed by his employee if it is foreseeable that it would occur within scope of the employment
            1. *in Bushy,* not necessarily foreseeable that seaman might turn valves of dry dock, but foreseeable that he might make mischief **n**ote: all three versions are still around
         3. RT 3rd AG 7.07 test
            1. an employee is subject to vicarious liability for a tort committed by its employee within the scope of employment
            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.
            3. 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 to the employer
      4. apparent agency (*McDonald’s*) (*In re Silicone Gel Breast Implants*)
         1. **“One who represents that another is his servant or other agent and thereby causes a third person *justifiably to rely* upon the care or skill of such apparent agent is subject to liability to the third person for harm caused by the lack of care or skill of the one *appearing* to be a servant or other agent *as if* he were such.” (RT 2nd AG 267)**
         2. hence, even in the absence of actual agency, a purported principal may be vicariously liable for the tortious conduct of its apparent agent
         3. applies to tort liability NOT contractual liability
         4. apparent agency is NOT apparent authority
         5. ap. agency creates tort liability for principal even though principal-agent or master-servant relationship does not exist
         6. designed to protect reasonable expectations of 3rd parties
      5. how to analyze liability under tort
         1. focus on the relationship
            1. did principal have sufficient control over agent that the relationship falls into the master-servant category?
         2. general definition of agency relationship matters
            1. must have principal-agent relationship + extra emphasis on control for it to qualify as master-servant relationship
         3. apparent agency, however, complicates things
   7. Liability of Agent to 3rd Parties
      1. tort v. contract
         1. if agent commits a tort, he is always liable to the 3rd party. Principal will only be liable under *respondeat superior*
         2. contract liability of agent is more complicated
      2. contract liability
         1. if principal is not liable under principles of agency, agent (or non-agent) may be liable to 3rd party on one of two grounds:
            1. common law fraud/deceit: non-agent willfully/recklessly misrepresents fact of agency; existence of agency is material; 3rd justifiably relies on misrepresentation; misrepresentation actually induces 3rd to enter contract.
            2. warranty of authority: non-agent who purports to enter contract of principal thereby becomes subject to an implied warranty of authority, unless agent manifests that he does not make such warranty or the other party knows that the agent is not so authorized
            3. hidden/partially-disclosed principal: A is liable as guarantor on the contract
      3. when principal is liable under agency law
         1. agent’s exposure is more limited (but not completely vitiated):
            1. disclosed principal: A is (essentially) not liable
            2. hidden/partially-disclosed principal: A is liable as guarantor on the contract
      4. avoiding/minimizing liability: have AEA or AIA and disclose principal
         1. agent can be liable as “guarantor” to a hidden/partially disclosed principal, even if agent had actual authority (AEA or AIA)
         2. constructive notice is not enough; agent must give actual notice of the principal’s identity (*Atlantic Salmon*); otherwise, agent will be a party to the contract
         3. advice to agent 🡪 disclose P’s identity (especially if have actual authority)—i.e, sign contracts: “Jane Doe, CEO and Agent of Doe, Inc.”
   8. Fiduciary Obligations of Agents
      1. An agent has a fiduciary duty to act *loyally* for the principal’s benefit in all matters connected with the agency relationship (RT 3rd AG 8.01)
         1. no secret profits for agent
         2. agent cannot deal with principal as an adverse party
         3. agent may pursue personal opportunities with principal’s consent
2. **Choice of Entity**
   1. Two Primary Business Forms (plus a couple of variations)
      1. corporation
         1. pro: limited liability
         2. con: entity level tax treatment (double-taxation)
      2. partnership/ sole proprietorship
         1. pro: “pass-through” taxation
            1. no double-tax penalty
            2. better treatment of business losses
         2. con: unlimited liability
            1. personally liable for partnership obligations
            2. each partner has authority to bind the partnership
   2. Partnership / Sole Proprietorship Variations
      1. general partnership (GP) (share responsibility)
         1. two people just go into business—and now a GP
         2. why can’t transfer management role in GP?
            1. consent of other partners; think law firm
         3. jointly and severally liable for partnership obligations, but can provide indemnification & insurance
      2. sole proprietorship [GP with only one person]
      3. limited partnership (LP) (split responsibility)
         1. file certificate with Sec. of State listing general partners
         2. general partners (active; bear full liability)
            1. protect general partner by making them judgment proof
         3. limited partners (passive investors; limited liability)
            1. can transfer interest because not really involved
            2. if limited partner gets involved in running and managing partnership, then treated as general partner
      4. limited liability partnership (LLP)
         1. file certificate with Sec. of State
         2. law/accounting/medical firms use this because they cannot form LPs
         3. unlimited personal liability for own actions (malpractice), but only liable for partner’s misdeeds to the extent of partnership’s assets
   3. Corporation Variations
      1. C Corp (entity taxation/double-taxation)
      2. S Corp (pass-through taxation)
         1. cannot have more than 100 owners (only one class of stock)
         2. gives you tax advantages
      3. Hybrid: Limited Liability Company (LLC)
         1. pass through taxation + limited liability
         2. file Articles of Organization with Sec. of State and must draft operating agreement
   4. Sources of Law
      1. partnership (based on common law)
         1. most states have general partnership and limited partnership act (primarily default terms)
         2. can be modified by partnership agreement
            1. ex: law firm—if partner dies, will continue to operate
      2. corporation
         1. state code (primarily default terms)
         2. can be modified by charter/ contract
            1. a lot of details not included in code; look to common law
      3. LLC
         1. first LLC statute created in 1979 (now available in all 50 states) (default terms)
         2. modified by LLC operating agreement (maximum contractual flexibility)
         3. veil piercing exists in this context
   5. Taxations Issues
      1. one of the main reasons to choose an entity
      2. can solve the double-taxation problem by:
         1. paying employees larger salaries and deducting the salaries, thereby having less entity tax to pay
            1. IRS might not like this—might see it as a disguised dividend
         2. giving employees benefits: health care, day care, etc.
         3. IRS won’t investigate
      3. taxation of losses
         1. important for businesses, for business planning
         2. good if losing money to have partnership
            1. can just deduct it
         3. bad if losing money to have corporation
            1. paying benefits doesn’t matter
3. **The Nature of the Corporation**
   1. Basic Features
      1. statutory creation
      2. limited liability
      3. indefinite life
      4. transferable ownership share/stocks
      5. legal “personhood”
   2. Use/Abuses
      1. risk/liability shield
      2. tax avoidance (sometimes)
      3. investment vehicle
   3. Other Limited Liability Entities (all cut from a similar pattern)
      1. LLCs, LLPs, S-Corporations, Limited P-Ships
   4. Sources of Law
      1. highly “statutized” area of law; lots of statutory interpretation
      2. background common law rules—especially fiduciary duties, but some others
      3. most corporate laws are *default rules*
         1. it can be costly/difficult to contract out of default
         2. may require changes in central governing documents (charter, initial bylaw)
   5. Steps to Form Corporation
      1. prom. arrangement
      2. choose where to incorporate
      3. create Certificate of Incorporation (the “Charter”, like a Constitution—hard to revise) and file with Secretary of State
      4. draft by-laws (like statutes—easy to revise)
      5. organize meeting
      6. elect board of directors
         1. adopt by-laws
         2. issue stock
         3. appoint officers
   6. What Must Be And Can Be In the Charter
      1. The certificate of inc. must set forth (DGCL 102(a)):
         1. name of corporation;
         2. address of corporation’s registered office;
         3. purpose of corporation;
         4. number of shares corporation is authorized to issue
            1. issued is subset of authorized
            2. issued less-than-or-equal to authorized
         5. name and address of each incorporator; and
         6. name and address of corporation’s initial directors (if they are specified)
      2. Delaware Code 102(a)(4) requires company to specify, if it has more than 1 type of stock, the characteristics of the stock and the number of stock authorized, etc.
      3. DGCL 102(b) specifies what can be in the Charter
         1. most famous provision: 102(b)(7): limits director’s personal liability arising from breach of fiduciary duty
   7. Promoters and the Corporate Entity
      1. liability for pre-incorporation activity
         1. promoter: someone who purports to act as an agent of business prior to its incorporation
         2. general fact pattern: promoter enters into K on behalf of yet-to-be-formed corporation
            1. if charter is not yet filed (or never filed), promoter is liable
            2. once Charter is filed, corporation only becomes party to the K if it expressly adopts it (typically by novation) or implicitly adopts it (ratify by accepting benefits)
            3. once charter is filed, promoter is liable if corporation breaches contract—“all persons purporting to act as or on behalf of a corp., knowing that there was no incorporation under this Act, are jointly and severally liable for all liabilities created while so acting” (MBCA 2.04)
            4. promoter is still liable even if corporation adopts contract. Promoter can only be released from liability by other party to the contract (i.e. novation of K)
         3. an aside: if have a sole proprietorship and want to change to a corporation to get limited liability, need to get parties to sign *ex post* a contract to put corporation on the hook
   8. De Facto Corporation v. Corporation by Estoppal (*Camcraft*)
      1. de facto corporation (applies to tort and contract claimants)
         1. treat firm as a corporation *and* grant shareholders limited liability if the organizers:
            1. in good faith tried to incorporate
            2. had a legal right to do so
            3. acted as a corporation
         2. will not protect you from the state if you were aware that the incorporation effort was defective at the time you purported to act on behalf of the corporation
         3. viewed from perspective of organizers
      2. estoppel (applies to contract claimants)
         1. treat firm as though it were a corporation and grant shareholders limited liability if the person dealing with the firm:
            1. thought it was a corporation all along
            2. would earn a windfall if now allowed to argue that the firm was not a corporation
         2. viewed from perspective of people dealing with the firm
            1. if accept benefits from corporation, can’t later deny its existence
         3. person doing business with the firm is estopped from denying corporate status (e.g. arguing promoters or shareholders personally liable OR no party to contract”
   9. Limited Liability and “Piercing the Corporate Veil”
      1. “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.” MBCA 6.22(b)
         1. note: risk of veil-piercing is increased for sole shareholders of a corporation
      2. types of piercing
         1. vertical piercing (corporation 🡪 person) (*In re Silicone Gel Breast Implants*—pierced subsidiary to get to parent)
            1. shareholder transgressed shareholder-corporation boundaries: blurred divide between shareholder and corporation (i.e., no separate bank accounts, no meetings for corp., etc.)
            2. can reach shareholder’s personal assets
            3. avoid personal liability by respecting corporate formalities
         2. horizontal piercing (“enterprise liability”) (corporation 🡪 sister corporation) (*Walkovsky*)
            1. sister corporations transgressed corporation-corporation boundary
            2. treats corporations as though they are one entity
            3. can reach sister corporation’s assets
            4. avoid enterprise liability by keeping companies

separate

* + - 1. reverse piercing (person 🡪 corporation)(*Sealand*)
         1. vertical in reverse
         2. go after shareholder, then get into other corporations after that
    1. test for piercing (vertical or horizontal)
       1. unity of interest and ownership (alter ego), *and*
          1. lack of corporate formalities
          2. comingling of funds and assets
          3. severe under-capitalization (fact-dependent; depends on type of business you have)
          4. treating corporate assets as one’s own
       2. refusing to allow PCV would either:
          1. encourage fraud or
          2. promote injustice

showing of unjust enrichment may satisfy this

* + 1. types of asset protection
       1. owner-shielding
          1. standard account of limited liability; protect owners personal assets from business liabilities
          2. nemesis = vertical piercing
          3. as lawyer, tell them to obey corporate formalities, not comingle funds
       2. entity-shielding
          1. protects business assets from personal liabilities of individual shareholders
          2. nemesis = reverse piercing
       3. sibling-shielding
          1. protects multiple businesses
          2. have different owners; separate employees
          3. nemesis = horizontal piercing
    2. types of creditors
       1. voluntary (*Sealand*)
          1. contractual parties/lenders/suppliers
          2. can protect themselves from liability contractually: ask for personal guarantee; charger higher interest rate; take secured interest in specific good; pay in installments
       2. involuntary (*Walkovszky*)
          1. tort victims: they are a creditor—you owe them money
          2. have no way to protect themselves
    3. limited liability: small v. large firms
       1. small firms
          1. single owner (and small) firms are significantly more likely to lose veil-piercing motions
          2. better predictors of outcomes than legal factors: undercapitalization, lack of formalities, commingling assets, domination/control, etc.
       2. large firms
          1. no publicly traded firm has EVER lost a veil piercing claim
  1. Internal Affairs Doctrine (*Examen*)
     1. “The internal affairs doctrine is a long-standing choice of law principle which recognizes that only one state should have the authority to regulate a corporation's internal affairs - the state of incorporation.”
     2. scope of internal affairs doctrine
        1. only applies to internal affairs of corp. (matters pertaining to the relationship among the corp. and its officers, directors, and shareholders)
     3. internal affairs doctrine is not simply a conflicts of law principle, but:directors and officers "have a significant right . . . to know what law will be applied to their actions" (*McDermott Inc.*)
     4. IAD separates choice of corp. law from location of business assets, shareholder, etc
        1. IAD, however, does not prevent federal regulation
        2. biggest threat to DE today may come from federal government
     5. policy behind IAD
        1. because only one state’s law can apply, corporations do not have to meet every state’s standards—this reduces cost of doing business

1. **Agency Conflicts/Fiduciary Duties**
   1. Strategies to Address Agency Conflict between Shareholders and Management
      1. fiduciary litigation
      2. shareholder voting/governance
      3. hostile takeovers
   2. Agency Conflicts: Vertical v. Horizontal
      1. vertical conflict
         1. between shareholders and management
         2. mangers own duties to corporate entity
         3. usually enforced derivatively
      2. horizontal conflict
         1. between majority and minority shareholders
         2. conflict: majority shareholders may use position to benefit them at expense of other shareholders
         3. *it is a direct claim;* it is not derivative—corporation is not hurt
         4. worried about horizontal conflict when dominant shareholders have different interests than minority shareholders
   3. Two Dimensions of Fiduciary Law
      1. the goal: toward what end should the corporation operate?
         1. shareholders, creditors, employees, etc.
      2. levels of judicial scrutiny
         1. how much discretion do managers/directors have?
         2. when do courts second guess managerial decisions
            1. something like strict scrutiny or very broad scrutiny
   4. Fiduciary Duties
      1. duty not to waste (BJR applies)
         1. regulates decisions that destroy corporate assets
         2. decisions must have rationale basis
      2. duty of care (BJR applies)
         1. regulates thoroughness and diligence in deliberations
         2. gross negligence standard
      3. duty of good faith (BJR applies)
         1. regulates indifference towards corporate welfare
         2. hybrid of duty of care/duty of loyalty
         3. note: same facts can often be argued under good faith or care
            1. if argue under good faith, get around 102(b)(7)
      4. duty of loyalty (BJR DOES NOT apply)
         1. regulates self-dealing transactions by management
   5. Business Judgment Rule (BJR)
      1. legal presumption that corporate officer/director has exercised care and good faith in carrying out her duties on behalf of the corp.
         1. courts give it deferential scrutiny
      2. burden on party complaining of breached fiduciary duty it; very rare for plaintiff to overcome this presumption
      3. generally, all corp. fiduciaries (board members, executives, dominant shareholders) get benefit of BJR
      4. courts won’t scrutinize decisions about how to maximize profits, but will scrutinize decisions about whether to do so (*Ford*)
         1. corporations should try to maximize shareholder returns
      5. BJR protects actions and considered inactions, but does not protect unconsidered actions; in other words, if you do not do anything because you are checked out, you are liable (*Francis*)
   6. Overcoming BJR
      1. challenger must show either:
         1. fraud, bad faith, illegality (lack of good faith
         2. lack of rational business purpose (waste)
         3. failure to become informed in decision-making (gross negligence)
         4. failure to oversee corporation’s activities
   7. BJR: Statutory Sources
      1. never explicitly articulated in the DGCL; but, BJR is often inferred from DGCL 141
      2. DGCL 141(a)
         1. board’s power to manage corporation’s affairs
         2. might be inferred that when give them this power then we should give them some discretion
      3. DGCL 141(c)
         1. power of delegation to committees/experts
      4. DGCL 141(e)
         1. board members are “fully protected” in relying on opinions & information generated by committees or others competent to render such opinions/information
   8. Substantive and Procedural Aspects of BJR
      1. substantive
         1. the standard of review to which director and board action should be submitted
      2. procedural
         1. the procedural burden of proof that requires challenging party to rebut presumption that directors act in good faith, in best interest of the company, and with adequate information
            1. because of this, BJR claims often dismissed before trial
   9. Two conceptions of BJR
      1. Doctrine of Judicial Abstention (process-based)
         1. as long as process is sound, court will not review board’s decision
         2. preconditions: no fraud; no illegality; no self-dealing; [must be informed decision]?
      2. Alternative liability standard (substance-based)
         1. applies shifting standards of judicial review
         2. no liability for negligence
         3. liability based on fraud, illegal conduct, self-dealing, or lack of any rational basis (i.e. criteria similar to gross negligence)
   10. Policy Justifications for BJR
       1. tradeoff between authority and accountability
       2. pros: might put some constraint on officer entrenchment
       3. cons: if every decision is reviewable by Court, then board of directors doesn’t matter
   11. Duty Not to Waste
       1. “waste” claims are extremely rare
       2. charitable contributions aren’t waste if they have a connection to the corporation and advance the corporation’s welfare (*Barlow*)
          1. they cannot be anonymous; the amount given is important—can’t be too much; can’t be a pet project
       3. while BJR gives discretion to managers in deciding *how* to pursue the corporation’s objective (e.g., maximize SH profits)…the “waste” limitation withholds such discretion for decisions about *whether* to pursue that objective (*Wrigley*)
          1. thus, in spite of BJR’s protection, management must be able to articulate a rational basis for decision; in practice, this if often relatively easy to do
   12. Duty of Care
       1. directors must make informed decisions (*Van Gorkom*)
          1. *Van Gorkom’s* legacy
             1. DGCL 102(b)(7): eliminates director’s (not officer’s) personal liability if they breach duty of care; does not apply to duty of good faith or duty of loyalty—if couch breach in good faith or loyalty, can get after director even if have DGCL 102(b)(7) protection
             2. “fairness opinions”: a report required in M&A context, authored by an investment bank and addressed to a company’s board of directors opining about the “fair” price for a company as a whole, a business unit, or owned asset
       2. directors must monitor management and screen for management abuse (*Francis*)
          1. in *Francis*, there was a complete omission to monitor, and therefore, no exercise of business judgment
       3. directors must install corporate monitoring system and reporting system to detect illegal behavior (*Caremark*)
          1. adequacy of monitoring left up to board’s discretion
          2. in order to overcome BJR, plaintiff must show:
             1. directors/officers knew or should have known that violations were occurring
             2. directors/officers took no steps in good faith to remedy situation; and
             3. their inaction proximately caused losses complained of
          3. cited as first duty of good faith case
       4. Sarbanes-Oxley (2002)
          1. passed in response to corporate accounting scandals (Enron, World-Com)
          2. only applies to publicly-held company
          3. publicly traded firms must include in their annual reports (10K) a report of management on the company’s internal control over financial report
          4. the CEO and CFO of each publicly traded firm must certify accuracy of all periodic reports filed with SEC
   13. Duty of Loyalty
       1. two types of conflict of interest
          1. direct: corporation and director party to same transaction
          2. indirect: the corporate transaction is with another person or entity in which the director has a strong personal or financial interest
       2. plaintiff must show conflict; if conflict, defendant must show fairness of DGCL 144 cleansing
       3. DGCL 144: Generally
          1. under DGCL, transactions shall not be voidable, if meet *one* of the following:
             1. (144)(a)(1) board vote, or
             2. (144)(a)(2) shareholder vote, or
             3. (144)(a)(3) entirely fair transaction
          2. 144(a)(1): Board Vote
             1. material facts disclosed or known to board and
             2. majority of disinterested board (even if > quorum) authorizes the contract or transaction in good faith
          3. 144(a)(2): Shareholder Vote
             1. material facts disclosed or known to shareholders and
             2. majority of disinterested shareholders authorize the contract or transaction in good faith
          4. Rule 144(a)(3): Entirely Fair
             1. contract or transaction is fair to corporation
             2. note: fairness is a very nebulous concept; depends on the judge you get
       4. DGCL 144: Defining Terms
          1. “disclosure”: board or shareholders have the key facts they need to deliberate
          2. “disinterested director”: status-based definition v. transaction-based definition
             1. status-based (NYSE): tough test to pass; majority of board must meet numerous requirements for independence—i.e., no “material” relationship, no employees or close family members of employees, etc.
             2. transaction-based definition (DE): somewhere in between *Aronson* (have lack of financial interest in this transaction) and *Oracle* (there is no structural bias)
       5. DGCL 144: “Cleansing” Director or Officer Actions
          1. duty of care suit (144 not binding)
             1. informed board of director vote: if truly informed and disinterested 🡪 BJR
             2. informed shareholder vote: absolute defense
             3. entire fairness: an affirmative defense, burden on defendant
          2. duty of loyalty (144 binding)
             1. informed board of director vote: disinterested 🡪 BJR; interested: go to (C)
             2. informed shareholder vote: disinterested 🡪 BJR; interested: go to (C)
             3. entire fairness: an affirmative defense, burden on defendant
   14. Duty of Loyalty: Corporate Opportunities Doctrine
       1. limits fiduciary’s ability to pursue new business prospects individually without first offering them to corporation
       2. it is a special type of self-dealing: opportunity is like property that belongs to corporation
       3. applications of particular interest/salience
          1. firms with significant human capital components
          2. corporations with overlapping directors
          3. parent/subsidiary
       4. four considerations that support existence of corporate opportunity (*Broz*):
          1. is corporation financially able to take opportunity?
          2. is it in corporation’s line of business?
          3. does corporation have interest or expectancy in opportunity?
          4. would embracing the opportunity create a conflict between the director’s self-interest and that of corporation?
       5. definition of corporate opportunity (plaintiff bears burden of proof)
          1. interest or expectancy (narrow test)
             1. interest = the firm already had pre-existing contractual right to the opportunity
             2. expectancy = something short of a legal or contractual right; reasonable for firm to expect to receive the opportunity
          2. line of business (broader test)
             1. more dynamic test; meant to capture the corporation’s expansion potential; not limited to the firms current interests or expectancies (*eBay*)
          3. ALI test
             1. holds corporate executives to a higher standard (1 & 2) than outside directors
          4. fairness test
             1. focuses on the fairness of holding the director/officer accountable for his outside activities; very subjective.
       6. defenses to corporate opportunity claims (*Broz*)
          1. corporate incapacity defense
             1. corporation could not pursue opportunity because of financial limitations (problem, but can always raise more capital), legal constraints, or other considerations
             2. most effective when alleged incapacity is observable to 3rd party
          2. source defense
             1. defendant became aware of opportunity through his personal capacity, unrelated to his service in the firm; hard to prove.
          3. corporation renounces opportunity
             1. under DGCL 122 (17), can reject it *ex ante*: provision in charter specifying that something is not an opportunity of the corporation

this does not eliminate liability; it just ends the inquiry

purpose: a way to protect certain directors, who are highly qualified, but are in same line of business as corporation

* + - * 1. can also reject it *ex post* through action
    1. consequence of corporate opportunity status
       1. fiduciary must generally disclose the existence of the corporate opportunity (and her conflict of interest) to the board of directors and shareholders
       2. corporation has right of first refusal on project
       3. disclosure/rejection should be “formal” (i.e., full board should be involved)
          1. can cleanse this under DGCL 144 through shareholder vote
          2. 144 (a)(1) and (a)(2)—can cleanse board’s rejection; entire fairness (a)(3) can’t
       4. if fiduciary discloses corporate opportunity and corporation rejects it, fiduciary can appropriate the opportunity as long as there is nothing unique or excludable about it
       5. if the corporate opportunity is raising capital by selling stock, the fiduciary can sell the stock and still not appropriate the opportunity because the fiduciary can always create more stock (*Martha Stewart*)
  1. Duty of Loyalty: Fiduciary Duties Owed by Shareholders
     1. shareholder can be “dominant” with <50% of shares (>50% = “controlling” shareholder)
        1. courts usually presume dominance at 25%
     2. dominant or controlling shareholders owe fiduciary duty to minority shareholders
     3. conflicts between dominant and minority shareholders
        1. direct: dominant shareholder forced decision resulting in a non-pro-rata distribution of corporate “property” (e.g. cash, assets, info; corp. opportunities)
           1. in *Sinven*, Sinclair (dominant shareholder) allowed Sinclair International Oil to breach contract with Sinven
           2. court held that this was self-dealing because minority shareholders were not able to share in receipts of these profits
        2. Indirect: dominant shareholder forced a decision that didn’t result in a non-pro-rata distribution, but still favored the dominant shareholders outside business interests and not the minority shareholders
     4. intrinsic fairness standard (*Sinclair Oil*)
        1. applied when a parent is on both sides of a transaction with its subsidiary, when there is self-dealing
        2. self-dealing: when parent, by virtue of its domination of subsidiary, cause subsidiary to act in such a way that the parent receives something from the subsidiary to exclusion of, and detriment to, minority shareholder of subsidiary
        3. defendant parent can only prevail by showing fairness to shareholder, not corporation
     5. “cleansing” and dominant shareholders
        1. DGCL 144 gives only the requisite procedures for cleansing duty of loyalty transactions by director/officers
           1. but it has become so routine that courts have begun to analogize it to other contexts
        2. shareholders can only cleanse actions of interested dominant shareholders if the vote constitutes majority of disinterested shareholders, a majority of minority (*Fliegler v. Lawrence*)
     6. protection of minority shareholders in closely held firm
        1. minority shareholders are more vulnerable in closely held firms: don’t know what value of shares is; no exit; former employees most vulnerable
        2. can be “frozen out” or “squeezed out”
           1. employees can be fired; shares can get diluted down
           2. both actions subject to BJR
        3. majority shareholders owe a duty of “utmost good faith and loyalty” to shareholders in closely held firms
        4. “equal opportunity” rule: minority shareholders must have equal opportunity to sell shares to corporation on same terms as controlling shareholder (*Donahue v. Rodd*)
  2. Duty to Act in Good Faith
     1. traditionally subsumed in a court’s inquiry into the director’s satisfaction of her duties of care and loyalty
     2. if argue bad faith, can sidestep 102(b)(7)
     3. 3 categories of bad faith
        1. intentional act against corporation
        2. intentionally causes corporation to violate law
        3. intentionally fails to act in face of known duty to act
     4. proof of bad faith
        1. basis for rebutting BJR’s presumption
        2. separate basis for imposing liability on directors even in the absence of a showing that the directors violated their duty of care or loyalty (Disney)
     5. *Status of “Good Faith”*
        1. *Stone v. Ritter*
           1. court invokes *Caremark* decision as a test for failure to act in good faith
           2. duty to act in good faith *not* an independent FD; it is subsidiary of duty of loyalty
        2. labeling good faith as a subsidiary to the duty of loyalty raises the bar of proof in cases about gross negligence
           1. introduces a schizophrenic BJR in content of loyalty cases
           2. BJR does not apply in generic duty of loyalty dispute; BJR does evidently apply to duty of loyalty claims under the good faith doctrine

1. **Procedural Enforcement of Fiduciary Duties**
   1. Direct and Derivative Suits
      1. direct suit
         1. director/officer misconduct rearranged the relative slices of the piece (e.g. removing dividend rights held by particular class of stock)
         2. claim for dilution—“my stock was watered down”
         3. note: pie analogy doesn’t always work—see voting rights (*Flying Tiger*) and injunction (*Grimes*)
         4. direct suit often brought as a class action on behalf of class of shareholders
      2. derivative suit
         1. director/officer misconduct decreased size of pie (e.g. selling away corporate assets to the CEO’s sister at a low price)
         2. your harm is derivative of harm to corporation!
         3. corporation is nominally referred to as a defendant; complaining shareholder is nominally referred to as the plaintiff—but, more like party representative in class action
         4. NOT a class action and is *res judicata* (even for SHS who were unaware of litigation)
            1. important that case is effectively argued on behalf of all shareholders
      3. the pie analogy: limitations and exceptions
         1. use the pie analogy when talking about financial claims
         2. don’t use it when talking about governance right
            1. right to vote (*Eisenberg*)
            2. abdicating board’s rights to make decision: more likely to be treated as direct and not derivative because relating to breach of board’s duty to shareholders (*Grimes*)
         3. example of breach that affects both types of pies
            1. pay out a huge dividend to one kind of stock but not another: shrinking the pie, but hurting a specific group
         4. derivative and direct are constructively, legally mutually exclusive
      4. two prong-standard for determining direct v. derivative (*Eisenberg*)
         1. who suffered alleged harm, corporation or suing stockholders, individually?; and
            1. note: harm could include loss of voting rights or other non-financial loss
         2. who would receive benefit of any recovery or other remedy, the corporation or the stockholders, individually?
      5. recovery: individual or corporate?
         1. in general, monetary recovery from a derivative suit will be paid over to the corporation rather than either the named shareholder-plaintiff or the shareholders as a class
         2. individual recovery should be ordered when it is “equitable in the circumstances and adequate provision has been made for the creditors of the corporation.” (ALI Principles)
            1. primarily used in close corporations
         3. pro rata when recovery goes straight to the individual—if plaintiff-shareholders own 50% of stock and defendant’s potential liability is $1 million, plaintiffs awarded $500,000, plus interest and costs
      6. problem of “strike suits”
         1. plaintiff counsel has incentive to bring derivative suit
            1. corporation must pay successful plaintiff’s litigation costs (i.e. attorney fees)
            2. typically a percent (20-25%) of damages recovered
            3. success includes settlement and judgment
            4. “bounty hunter” situation—shareholder who owns .05% of stock and attorney who is driving litigation; heavily rewarding and incentivizing plaintiff side
         2. management has incentive to pay law permits
            1. indemnification of individual defendants’ litigation costs after a settlement, but not if there is an adverse verdict
            2. creates incentive to settle
         3. judges are busy and approving a settlement is easy
      7. answer to “strike suits”: procedural hurdles
         1. four key procedural hurdles
            1. bond-posting requirements (*Flying Tiger*)
            2. special pleading/eligibility requirements (FRCP 23.1/DE Chancery Court Rule 23.1)
            3. demand requirements (*Grimes v. Donald*)
            4. special litigation committees (*Aurbach; Oracle*)
      8. procedural hurdle: bond-posting requirements
         1. plaintiff suing derivatively on behalf of corporation must post security for the corporation’s costs
            1. in *Flying Tiger*, plaintiff tried to argue case was direct not derivative (it was), in order to get around this requirement
      9. procedural hurdle: special pleading/eligibility requirements
         1. shareholder must have owned shares at time the misconduct occurred (FRCP 23.1; MBCA 7.41)
         2. shareholder continued to own shares throughout trial (MBCA 7.41)
         3. named plaintiff must be a fair and adequate representative of the corporation’s interests (MBCA 741(2))
      10. procedural hurdle: demand requirement [review flowcharts]
          1. most states (including DE) require shareholders to approach board and demand that board pursue legal action…
          2. unless the shareholder can claim valid excuse why demand on board would be pointless (“futile”)
          3. a“demand”:letter from shareholder to board of directors—“at a minimum, a demand must identify the alleged wrongdoers, describe the factual basis of the wrongful acts and the harm caused to the corporation, and request remedial relief.” *Allison v. Gen. Motors Corp.*
          4. if demand is not excused, board has discretion to dismiss lawsuit
             1. BJR = “presumption” of due care
          5. If demand is excused, board cannot cause dismissal
             1. *but,* can still move for dismissal, on advice of Special Litigation Committee
          6. if demand is required, you lose no matter what

hope it is not, then talk about demand excused

* + - 1. demand futility depends on what the shareholder is challenging:
         1. Board Decision: two-part *Aronson* test
         2. “Non-Board” Decision: one-part *Rales* test
      2. *Aronson test:* demand is deemed futile only if plaintiff can allege particularized facts showing that either:
         1. as of the time the complaint is filed, a majority of the board is not disinterested / independent; or
         2. challenged transaction was *not* the product of a valid exercise of business judgment
      3. *Rales* test: demand is deemed futile only if plaintiff can allege particularized facts showing that:
         1. as of the time the complaint is filed, the board of directors could *not* have properly exercised its independent and disinterested business judgment in responding to demand
      4. tips for surmounting *Aronson* test
         1. do allege (with particularity) that the board is “interested” (or not disinterested) in outcome of case; i.e., they are closely connected to interested parties or seemingly independent board members are “dominated / controlled” by other interested defendants
         2. do not sue all the current board members (or at least a majority) or claim that “structural bias” among board members renders them *ipso facto* untrustworthy
      5. key case: *Grimes v. Donald*
         1. brought direct director abdication claim: he is personally harmed: “I elected you. It harmed to me as a shareholder”
         2. Grimes argues that demand should be excused as futile—but, he sent a demand letter; it is an either/or
         3. in practice, no one sends demand letters
         4. Grimes loses, but can claim that board “wrongfully refused”
      6. doctrine of “wrongful refusal
         1. if demand is refused by board, could say that board made wrong decision and then cane attempt to bust through BJR
         2. much harder than futility under *Aronson*
      7. universal demand (MBCA; 11 or so states)
         1. plaintiff always required to make demand on the board in derivative action
         2. burden is on plaintiff if majority of board is independent; burden is on defendant if majority is not
    1. procedural hurdle: special litigation committees (SLCs) and *Auerbach*
       1. if SLC is not “independent,” its recommendation are meaningless
          1. independence factors: non-defendants; no domination by named directors; full delegation of board’s authority to SLC; access to reasonable budget; access to counsel
       2. if SLC is independent:
          1. procedures used by SLC scrutinized under (something like) gross negligence standard
          2. substantive decision of SLC gets protection of BJR
       3. “tootsie-pop defense”
          1. two-tiers: what board did (candy center) and what SLC decided (candy shell)
          2. second tier (candy shell) insulates first tier (candy center) form judicial scrutiny
    2. procedural hurdle: special litigation committees (SLCs) and *Zapata*
       1. *Zapata* (DE):2-part (conjunctive) test for demand-excused cases
       2. SLC recommendation (dismissal) will only be followed if it satisfies both of the following:
          1. procedural inquiry: did SLC act independently, in good faith, and with a reasonable investigation (burden of proof on defendant)? and
          2. substantive inquiry: does dismissal pass independent judicial inquiry into business judgment?
       3. result: DE listens to SLC, but regards its recommendation with great suspicion

1. **Problems of Control**
   1. Shareholder Voting Control
      1. shareholders get to vote on two types of matters:
         1. indirect control: electing the directors
            1. annual SH meeting (required once/year)
            2. less meaningful than it appears (like elections in the USSR—only one set of candidates runs)
         2. direct control: get to vote directly on mergers, major asset sales, reorganization, charter amendments and other matters required by corporate charter
            1. meaningful but only applies to a very limited list of actions
   2. Shareholder Voting Rights
      1. can vote at annual meetings
      2. can call special meetings (MBCA 7.02, DGCL 211 (d))
         1. if you and all your friends amount to 10% shareholders
         2. can specify in your charter exactly what you want
      3. action without meeting (a.k.a. written consensus)
         1. in many jurisdictions written consent must be unanimous
         2. compare DGCL 228 (a)—action by consents okay if same # of shares consent as would be needed at a meeting
   3. Typical Annual Meeting
      1. nominating committee of the incumbent board of directors nominates a slate of directors to be elected at next annual meeting
      2. incumbent board identifies other issues to be put to vote
      3. at company expense
         1. management prepares proxy statement and card\
         2. management solicits shareholder votes (typically with aid of proxy solicitor)
   4. Voting at Annual (or Special) Meetings
      1. most matters require a majority of shares present at a meeting at which there is a quorum
         1. A matter is approved if votes cast in favor > votes cast against (MBCA 7.25 (c))
         2. Decisions must be approved by the vote of a majority of the shares present (DGCL 216)
      2. a few matters require approval by a majority of the outstanding shares, e.g.: mergers, amendments to the charter
      3. election of director requires a plurality of votes cast: e.g., Al (35%), Beth (40%), and Carol (25%)—Beth wins by a plurality, even though she didn’t get a majority
      4. cumulative voting
         1. gives more power to shareholders with less shares
         2. used in closely-held corporations
   5. Quorum
      1. in order for shareholders to take action, there must be a quorum at the meeting
      2. default rule for a quorum: majority of shares entitled to vote (see MBCA 7.25(a))
   6. Shareholder Voting: Mandatory or Default Rule?
      1. two “types” corporate rules
         1. default rules (parties can easily modify contractually)
         2. mandatory rules (parties can’t modify or can only do so at significant cost)
         3. SH voting is like a mandatory rule:
            1. shareholders elect directors and vote on structural changes (mergers, liquidations, etc.)
         4. but, it is also like default rule (see DGCL 212):
            1. can control how many votes people get
            2. can say certain types of shareholders don’t get to vote
            3. can say certain classes of stocks don’t get to vote
   7. Flexibility of Shareholder Voting
      1. (DGCL 212) Voting rights of stockholders: “Unless otherwise provided in the certificate of incorporation … each stockholder shall be entitled to 1 vote for each share of capital stock”
      2. can have a class of stock with 10 votes per share; common stock can be non-voting
      3. note: cannot have one class of stock and take away voting rights; there must be at least one class of shares that can vote on required matters (i.e. electing directors)
      4. additional flexibility: can modify vote thresholds, cumulative voting, quorum requirements use of written consents, create classified boards, etc.
   8. The Blackhawk Conflict(*Stroh v. Blackhawk Holding Corp.*)
      1. holding: A ‘proprietary’ right is not just an economic right, but also includes the right to participate in control
      2. not illegal to separate voting rights and economic rights, but creates weird incentives
         1. if have voting rights but no economic interest (and no morals):
            1. could destroy company and then could say that if you don’t pay me I won’t go away
            2. or could destroy value, drive down Class A stock, buy it, and then bring value up
      3. ways to give one class of investors disproportionate control
         * 1. non-voting (or super-voting) stock
           2. classified board (each class of stock elects specified number of board seats); like Rhode Island—don’t have many people, but get two votes
           3. add protective provisions to charter (must have class X’s vote to do…)
           4. voting trust (place stock in trust and give controlling party right to direct vote)
           5. irrevocable proxy (must be coupled with an interest in the firm)
   9. Public Corporation v. Closely-Held Shareholders
      1. public corporation shareholders
         1. usually own small % of shares as part of diversified portfolio
         2. interested in share price
         3. have little influence on board or management
         4. if dissatisfied, use “Wall Street Rule”: easier to sell than fight
         5. use the proxy system because not everyone may show up
      2. close corporation shareholders
         1. often undiversified
         2. interested in company’s performance and dividends, not share price
         3. minority shareholders may have little influence on or management
         4. personality conflicts can lead to deadlock or oppression
         5. do NOT use proxies
   10. Proxy Voting
       1. shareholder appoints a proxy (aka proxy agent) to vote his/her shares at the meeting
       2. appointment effected by means of a proxy (a.k.a. proxy card)
          1. can specify how shares to be voted or give agent discretion
          2. revocable
       3. normally proxy is unopposed
          1. just a way to rubber-stamp the board’s composition & any special actions desired by management
   11. Proxy Card Requirements (mostly SEA Rule 14a-4)
       1. must identify each matter to be voted upon
       2. may give discretionary authority to vote in the proxies discretion on other matters that may come before the meeting, but not elections to office for which a bona fide nominee is not named
       3. for, against, and abstain boxes required for each matter other than election of directors
       4. for and withhold authority boxes for election of directors so that a shareholder may withhold authority to vote for individual directors
       5. proxies may be revoked and if more than one proxy is given, the latest proxy governs
   12. Proxy Contests
       1. a shareholder (a.k.a. the insurgent) solicits votes in opposition to the incumbent board of directors
       2. electoral contests: insurgent runs a slate of directors in opposition to slate nominated by incumbent board
       3. issue contests: shareholder solicits votes against some proposal
          1. e.g., Shareholder urges fellow stockholders to vote no on a merger
   13. Regulation of Proxy Voting
       1. two layers of regulation
          1. state corporate law (see DGCL sec. 212)
          2. federal law: Securities Exchange Act (34 act) and SEC rules (14a-1 to 14a-9)
       2. the state law story (focus is facilitative)
          1. all corporations required to have annual shareholder meeting.
             1. if only little stock, rational apathy 🡪 very low SH turnout
          2. creates quorum rule problem (DGCL 216)
          3. no quorum leads to invalid vote
          4. state law response is to facilitate proxy voting
       3. the federal story
          1. Securities law (33 and 34 acts) increase disclosure and insure that shareholder have accurate info.
          2. gets into proxies because the proxy card, which contains a proxy statement, is a big way in which shareholders get information
          3. Section 14 (a) of 34 act regulates anyone who solicits a shareholder
             1. company 🡨🡪 SH communications
             2. SH 🡨🡪 SH comm. (relaxed in 1992 amendment)
          4. if you solicit proxies must give each SH a “proxy statement” (14a-3 to 14a-5)
             1. more disclosure required for contested meetings
             2. must file material with SEC (14a-6)
          5. proxy fight: management can either
             1. mail insurgent group’s proxy to SHs (usually does this) or
             2. give list of all corp. SHs so insurgent can directly mail (14a-7)
          6. management proxy (paid for by corporation)
             1. incumbents get funding for election; but, insurgents don’t
             2. hard to be an insurgent
          7. feds also regulate “fraudulent” proxy statements (14a-9) and SH proposals (14a-8)
   14. Basic Rules from *Levin* and *Rosenfeld*
       1. The corporation may not reimburse either party unless the dispute concerns questions of policy
       2. The corporation may reimburse only reasonable and proper expenses
       3. The corporation may reimburse incumbent whether they win or lose
       4. The firm may reimburse insurgents only if they win, and only if shareholders ratify the payment
   15. Proxy Fight v. Tender Offers
       1. proxy fights 🡪 replace board
          1. can be expensive
          2. this is a free rider problem: you bear all the costs and everyone else reaps the benefits
          3. if you own enough stock, you will do this
             1. but, if you don’t owe that much, proxy fight doesn’t make sense
       2. tender offer 🡪 buy stock 🡪 replace board
          1. expense is buying the entire company
          2. costs go way up and so did the benefits
   16. Shareholder Proposal (Rule 14a-8)
       1. proxy fights and tender offers suffer a common problem: they are expensive (especially tender offers, i.e. takeovers)
       2. by contrast a shareholder proposal can be fairly inexpensive
       3. qualifying shareholders can add a proposal to the company’s proxy statement
          1. expenses thus borne by the company
       4. even if proposal passes it does not require board to actually implement any new safety precautions (merely precatory or advisory) (Rule 14a-8(i)(1))
          1. if not precatory, board can exclude it
       5. proposal cannot make corporation change, but may create publicity or embarrass company into making a change
       6. proponents of shareholder proposal: hedge and private equity funds; pension funds; individual activists; charities (religious groups)
   17. Company Responses to Proposal
       1. exclude on procedural or substantive grounds
          1. must have specific reason to exclude that is valid under Rule 14a-8
          2. corporation must file reasons for exclusion with SEC staff (seeking no-action letter) Rule 14a-8(i)
             1. include with opposing statement
       2. negotiate with proponent
          1. wide range of possible compromises
          2. adopt proposal as submitted
   18. Rule 14a-8(i)(5): Relevance (*Lovenheim*—foie gras case)
       1. corp. can exclude if proposal relates to operations which account for:
          1. <5% of total assets
          2. <5% of net earnings or gross sales, and
          3. is not otherwise significantly related to Corp.’s business
             1. “otherwise significantly related” applies to more than non-economic concerns and ethical concerns
   19. Rule 14a-8(i)(1): Relates to Election (*AFSCME*—shareholder-nominated candidates on ballot)
       1. shareholder proposal that seeks to amend corporate bylaws to establish a procedure by which shareholder-nominated candidates may be included in corporate ballot does not relate to an election within meaning of the Rule and cannot be excluded from proxy
   20. Shareholder Inspection Rights
       1. not a topic shareholders get to vote on…more like a FOIA-like (Freedom of Information Act-like) request
          1. shareholder list; books and records; minutes from board meetings
       2. this information is valuable in shareholder voting contests because it tells shareholders who owns the most shares
          1. also useful for derivative actions where you need to plead with particularity
       3. federal law inspection rights (Rule 14a-7(a))
          1. in a proxy contest, corporation has a choice: can give you the list or can mail it themselves at your expense
          2. they do not give out the list; would rather do the mailing because they know the list can be used against them
       4. state law inspection rights (DGCL 220)
          1. as long as you are a shareholder and have proper purpose, you can inspect the books and records
             1. proper purpose is one related to money, not social causes (*Pillsbury*—stopping production of fragmentation bomb)
2. **Mergers and Acquisitions**
   1. The 3 “M”: Conceptual Dimensions of Mergers & Acquisitions
      1. motivation
         1. strategic acquisitions
            1. whole may be greater than sum of parts; some synergy
         2. financial acquisitions
            1. buy this company because it is a good deal, it is underpriced
      2. mutuality
         1. friendly (with management’s consent)
         2. hostile (without management’s consent)
      3. means
         1. statutory merger: DGCL 251, 253
         2. assets
            1. buy all the assets
         3. stock sales (i.e. tender offer)
            1. federal law
            2. Williams Act
            3. work with shareholders, not management
   2. Alternative M & A Structures (see hand-drawn diagram)
      1. statutory merger (DGCL 251)
         1. traditional
            1. like fusion (two firms are merged into one)
            2. one firm is deemed the surviving entity
         2. triangular
            1. acquirer creates subsidiary corporation (Merger Co.)
            2. target then statutorily merged into subsidiary
            3. allows big companies to merge with small companies; the corporation is the shareholder here—formed a little subsidiary and voted all their shares
            4. way to get around shareholder vote (often, in big companies, impractical to ask every shareholder to vote)
      2. asset acquisition
         1. acquirer buys target’s assets directly (transfer of liabilities complicated)
         2. appraisal remedy may not be triggered by asset sale
            1. varies state to state; see DGCL 262 (c)
         3. have to list out all assets (but, can choose to buy some, not all assets): will be very burdensome in a large company
      3. stock acquisition
         1. acquirer buys stock directly from target shareholders
         2. typically through a tender offer (subject to federal disclosure requirements)
         3. can pay with either cash or stock
            1. cash has tax implications; stock is used more often; especially if company is publically held company
            2. problem arises if company is a private company—especially regarding valuation
   3. Alternative M & A Structures: Authorizing the Deal
      1. statutory merger
         1. target: board and shareholders (majority of all outstanding)
         2. acquirer: board and shareholders (depends on state and size of deal)
      2. triangular merger
         1. target: board and shareholders (majority of all outstanding)
         2. acquirer: No SH vote (and no appraisal rights)
      3. asset acquisition (type C)
         1. target: board and shareholders if deemed “substantially all” assets)
         2. acquirer: may need board if large deal (don’t need shareholders)
      4. stock acquisition (type B)
         1. target: no board or shareholder vote needed (just need shareholders to sell through tender offer)
            1. not contracting with target firm but target shareholders
         2. acquirer: board + needs to comply with tender offer rules (Williams Act)
         3. note: tender offer often coupled with a short-form merger (type A)
            1. after acquiring 90%+ interest, parent can merge with subsidiary (no shareholder votes on either side!!!!!!!!)
   4. Freeze-Out (or Squeeze-Out) Mergers (*Weinberger*)
      1. parent merges with subsidiary
      2. merger calls for minority shareholders of subsidiary to be given cash (in a “cash-out” merger) or some other consideration
         1. minority shareholders are pushed out; majority shareholders of subsidiary are now in control
      3. subject to review under an “entire fairness” standard that requires fair dealing and fair price
         1. fair dealing is duty of candor
            1. primarily goes to same issues as 144(a)(1) & (a)(2)
         2. fair price: goal is to determine fair value taking “into account all relevant factors”
            1. finance experts brought in to testify regarding the firm’s valuation
      4. appraisal
         1. it is the exclusive remedy for a dissenting shareholders (provided shareholders could not show unfair decision-making process and no procedural defects)
            1. plaintiff is forced to give up her stock and cannot ask for an injunction or seek to block the merger in any other way
         2. to exercise right to appraisal (*see* DGCL 262):
            1. hold onto shares through effective date of merger
            2. perfect right by sending written notice to the corporation prior to the vote
            3. and can’t vote in favor of merger
3. **Takeovers** 
   1. Takeovers and Dating: the Lousy Boy(Girl)Friend
      1. hostile takeovers: one solution to agency conflicts between shareholders and management
      2. analogy to high school dating
         1. takeovers in the dating context: threat of break-up and partner finding new boy(girl)friend
            1. ex ante makes you want to be attentive
         2. management wants to do a good job because worried they might be kicked out
   2. Takeover Economics: Friendly v. Hostile
      1. friendly: with board/management blessing
         1. typically structured as either a merger (triangular or normal)or an asset sale
         2. acquirer often gets blessing of target board by offering job protection or a bonus
      2. hostile: without board/management blessing
         1. typically a tender offer to shareholders directly
         2. typically better for shareholders
   3. Takeover Law 1.0 (after *Cheff*)
      1. BJR with burden of proof on directors; no presumption that board acted in shareholders interest; directors must affirmatively demonstrate:
         1. reasonable investigation: gave board grounds to perceive danger to corporate policy and effectiveness; and
         2. good faith actions
      2. inside directors may be held to a higher standard (*Cheff*)
      3. level of scrutiny: deferential
   4. Takeovers by Tender Offer
      1. regulation of tender offers: the Williams Act (1968)
         1. insures disclosure in connection with any tender offers
         2. regulates timing of tender offers (slows down the process so that company has a chance to seek other offers or defend against the tender offer)
         3. key provisions:
            1. purchaser of at least 5% of stock must identify themselves to the company within 10 days of acquisition (SEA 13(d)(1))
            2. purchaser must aggregate purchases that form part of single plan (SEA 13(d)(3))
            3. purchaser must leave window for tender offer open for at least 20-days (SEA 14e-1(a))
         4. it protects:
            1. target shareholders because it ensures fairness and a high price; but, it might prevent deal from going through
            2. management because the 5% lets them know if someone is trying to take them over
            3. the winner: target management; the loser: acquirers: somewhere in the middle: target shareholders
      2. junk bonds: the currency of a tender offer
         1. high yield corporate bond (i.e. junk bonds)
            1. issued by corporations (transferable)
            2. low investment grade rating (BBB)l; higher likelihood of default
         2. intermediate priority in bankruptcy
            1. Senior Debt (paid first in bankruptcy)
            2. Junk Bonds & other junior debt (paid next)
            3. Equity (paid last = the residual)
         3. value depends on interest rate relative to the likelihood of default (i.e. Bankruptcy)
         4. corporate raiders issue junk bonds, sell them to junk bond buyers, and use the money to fund their tender offer
            1. once they acquire the company, they can pay off the bonds by using the target firm’s assets
   5. Takeover Law 2.0: The Unocal 2-Pronged Test
      1. two-pronged test
         1. “threat” prong: board must show that it acted independently, in good faith, and with due care, and had reasonable grounds to conclude that a danger exists to corporate policy and effectiveness
         2. “proportionality” prong: board’s action must be reasonable in relation to threat posed
      2. threat prong
         1. there is only a threat to corporate policy and effectiveness if there is a policy conflict between the board of directors and the would-be acquirer; it must not be a personal conflict
         2. BJR with burden on the board; but, easy to satisfy
         3. “Board’s power to act derives from its fundamental duty and obligation to protect the corporate enterprise, which includes stockholders, from harm reasonably perceived, irrespective of its source.” (DE 141(a) and 160(a))
      3. proportionality prong
         1. no BJR protection; gives court power to review substance of board’s action
      4. level of scrutiny: moving close to intermediate
   6. Takeover Defenses
      1. in hostile takeover, board takes action and uses takeover defenses
      2. most anti-takeover tactics either:
         1. increase the cost to acquirer
         2. increase the time necessary to gain control
      3. purpose behind such tactics
         1. good for shareholders
            1. to pursue a “long-term” strategy
            2. to avoid massive layoffs, closing of factories; local economic development
            3. to bargain for a higher price from whatever bidder prevails
         2. bad for shareholders:
            1. entrench current board/management
            2. to “play favorites” among would be acquirers
      4. there is judicial ambivalence toward defense tactics, which fall between duty of care and duty of loyalty
         1. reasons for deference
            1. boards are supposed to make decisions and plan long-term strategy
            2. implicit decision: not to sell/bust up firm
            3. or, if sell, obtain best price possible for shareholders
         2. reasons for scrutiny
            1. managers may have self-preservation incentives (don’t want to lose their jobs)
            2. if a takeover attempt is “worth it,” it may be because board/management is doing a poor job
      5. types of takeover defenses
         1. greenmail: buying hostile acquirer’s shares of your company at a premium (*Cheff*)
            1. not tax-advantaged: (IRC 5881) 50% tax on income related to greenmail
            2. greenmail is usually not in target shareholder’s interest

it creates incentives for acquirer’s to acquire shares in order to get greenmailed; this is not good for company

* + - * 1. target can avoid greenmail, *ex ante*, by running company well so that stock price is high enough to prevent acquirer from acquiring stock
      1. poison pill: give dormant right to shareholders to redeem their shares for a good price; but, right only is activated if acquirer obtains a certain amount of target’s stock
         1. scorched earth: all money goes out to shareholders and in the end target becomes nothing—all target’s assets are going out to pay shareholders
         2. golden parachutes & “change of control” provisions

CEO gets a huge payout if company taken over

* + - 1. find alternative acquirer (“white knight”)
         1. allocate “lockup” rights to first/preferred bidder
      2. self-tender offers
         1. buy stock back from stockholders at a high rate
      3. the “Pac-Man” defense
         1. if acquirer is a public firm, eat them before they eat you

buy the acquirer

* + - 1. staggered board
  1. Takeover Law 2.1 (Modern Takeover Law)
     1. if board action suggest sale, change of control, or break-up is:
        1. *not inevitable* 🡪 apply the standard *Unocal* test (threat + proportionality)
        2. *is inevitable* 🡪 duty (a “Revlon duty”) is to get highest price for shareholders, is to maximize short-term shareholder welfare
           1. board becomes auctioneer
     2. *Unocal* still good law, but *Revlon* just adds another element to it
     3. takeover defenses receive intermediate scrutiny
     4. consequences of flunking applicable test
        1. unenforceability of defense measures
        2. no liability for directors (absent more)

1. **Federal Securities Law: Overview** 
   1. Origins
      1. stock market crash of 1929
      2. Depression blamed (in part) on deceptive/fraudulent trading
      3. state law protections inadequate 🡪 federal regulations (33 & 34 Acts)
      4. securities laws not so about telling people what to do, but about having sufficient disclosure
   2. Two Statutes
      1. Securities Act of 1933
         1. regulates the offering and sale of new securities (IPO
         2. registration statement filed with SEC
      2. Securities Exchange Act of 1934
         1. regulates secondary market activity of registered companies
         2. periodic reporting: Form 10-K (annual); Form 10-Q (quarterly); Form 80K (episodic)
      3. anti-fraud provision 10(b)
         1. became SEC Rule 10b-5
   3. Purpose of Securities Law
      1. full disclosure
         1. make sure that investors have all the information they need to make informed decisions
      2. prevention of fraud
         1. insures accuracy of disclosed information
   4. The SEC
      1. 1934 Act created the Securities and Exchange Commission (aka SEC)
         1. independent agency
         2. enforce the securities laws
         3. promulgates laws and regulations to implement those more effectively
   5. A Security
      1. “The term ‘security’ means any note, stock,…bond, debenture…investment contract…or, in general, any interest or instrument commonly as a ‘security.’”
      2. two types
         1. listed financial instruments
            1. “note, stock…bond, debenture”
         2. generic catch-all terms
            1. “investment contract”
   6. *Per Se* Rule or Case-by-Case ?
      1. some instruments are *per se* securities
         1. stock
      2. others are rarely treated as securities
         1. general partnership interests (because partners have legal right to control the firm a general partnership interest is not a security)
      3. “investment contract” test (four-factor *Howey* Test):
         1. a contract, transaction or scheme whereby a person invests money
         2. in a common enterprise,
         3. and is led to expect profits,
         4. solely from the efforts of the promoter or a third party (*Robinson*—not a security because Robinson was too involved)
            1. note: item 4 gets most of litigation; “solely” means mostly
   7. Consequences of Being a Security
      1. if an instrument is a security, this has two important consequences:
         1. triggers SEC registration (33 Act) & periodic reporting (34 Act)
            1. note: there are numerous exceptions to this (private company; qualified buyer)
         2. triggers Securities Antifraud Rule (Rule 10b-5)
            1. unlawful for any person to make false or misleading statements or omissions “in connection with the purchase sale of any security”
   8. Rule 10b-5: the text
      1. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
         1. To employ any device, scheme, or artifice to defraud,
         2. To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
         3. To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security

* 1. Rule 10b-5: two applications
     1. insider trading liability (individuals who trade)
     2. corporate liability for false/misleading statement of omissions
  2. Rule 10b-5: “a judicial oak has grown from little more than a legislative acorn”
     1. in 1942, the SEC created 10b-5
        1. in response to a company president who contacted his shareholders and offered to repurchase their stock, without disclosing that his company had just landed a valuable government contract
           1. action not prohibited under the common law: corporate officials do not owe a duty directly to shareholders 🡪 could trade based on this information
           2. cannot lie to shareholders if asked a direct question about certain events, but no general duty to disclose
     2. very broad and ambiguous statute
        1. could mean a lot of different things; not well constructed
     3. SEC has authority to bring suit—early cases suggest that; but, there is also a private cause of action now
     4. you don’t have to be one of the buyers or sellers
        1. *Basic*—Levinson is not a buyer or seller
     5. SEC tries to make rules confusing so as to not give investors a roadmap for how to violate financial rules creates more fuzzy rules
  3. Rule 10b-5: Early Case Law
     1. 1961: *In re Cody Roberts & Co.*
        1. imposed on “corporate insiders” an “affirmative duty of disclosure…when dealing in securities”
           1. insider aware of material non-public information must either abstain or disclose
           2. only have an affirmative duty to disclose if want to trade
     2. 1968: *SEC v. Texas Gulf Sulphur Co.*
        1. insiders liable for buying TGS stock after ore strikes—they did not abstain or disclose
        2. more than doubled in price; wanted to keep it private; wanted to buy land for lower price than what it is worth
        3. corporation also liable for misleading press releases
           1. corporation did not actually trade in its own shares
     3. later cases extend Rule 10b-5 to private actions
        1. often enforced through class action lawsuit
  4. Elements of 10b-5 lawsuit
     1. plaintiff suing under 10b-5 must show:
        1. scienter: defendant acted with an intent to deceive, manipulate, or defraud. Negligence does not suffice, but recklessness is generally sufficient
        2. causation: the misstatement caused the damage (i.e. affected the price of stock)
        3. materiality: reasonable investor would consider the misstatement important
           1. note: materiality and causation get lumped together
        4. reliance: pre-*Basic* plaintiff must show that they relied on affirmative misrepresentations
           1. rebuttable presumption that if company did not disclose key facts, plaintiff relied on it

1. **Federal Securities Law: *Basic v. Levinson*** 
   * 1. Combustion wanted to buy Basic
     2. sporadic negotiations over two years (1977-1978)
     3. rumors of a possible merger caused large fluctuations in Basic’s stock price
        1. Basic makes three public statements that they are not in negotiations
        2. affirmatively deny ongoing merger negotiations
   1. Defining a Class of Plaintiffs: Generally
      1. plaintiff class is a group of investors who either sold (or bought) stock subject to false/misleading information
         1. plaintiffs are sellers when company is hiding good news (affirmatively lying about bad news) and buyers when corporation hiding bad news (affirmatively lying about good news)
      2. class period is defined by two dates
         1. beginning date: when false/misleading information first appears
         2. end date: when false/misleading information is correct
            1. if correct earlier, limit class window to smaller group
            2. correct does not have to come from company—a news agency could report it
      3. class definition affects materiality element
   2. Analysis: Materiality
      1. *Basic* court adopts reasonable investor approach, and suggests that materiality depends on the probability that uncertain even will occur and magnitude if it does.
         1. essentially this is standard cost-benefit analysis
         2. an event is material if: p \* m > threshold
            1. note: very high magnitude—even for low probability might have materiality
            2. almost a presumption that merger negotiations are material; defense has to argue that probability is 0% to win
      2. risk of hindsight bias: court determines materiality after uncertain event has occurred
         1. after it has happened overestimate event that it will happen
   3. “No Comment”
      1. companies argue that there are valid business reasons to keep preliminary merger discussions secret
      2. an appropriate response for a corporation is to have a “no comment” policy; see FN 17, KRB 144
      3. adopt a total no-comment policy related to merger negotiations and always use it
      4. notice that 10b-5 allows “silence” as long as it does not cause another affirmative statement to become misleading
         1. but, as long as always silent, shouldn’t be a problem
      5. concern that 10b-5 actually reduces disclosures
         1. corporations give political-like responses—don’t say anything
   4. Reliance: Fraud-on-Market
      1. not relying on official statements but relying on fact that market price is not adulterated by false or misleading information
      2. rebuttable presumption of reliance; plaintiff’s rely on the “integrity of the market price”
         1. shifts burden to defendant to show that plaintiff did not actually rely
         2. “fraud-on-the-market” makes it easy to certify a class
   5. *Basic*: In Conclusion
      1. makes it easier for plaintiffs
         1. to show materiality
         2. to show reliance, and
         3. to certify a large class of plaintiffs
      2. coupled with fact that 10b-5 applies to *any* purchase or sale of Co. stock, even if Co. is not buying/selling
         1. damages could be astronomical
         2. created modern securities class action lawsuit
         3. made many plaintiff lawyers very rich
   6. Primary Market vs. Secondary Market
      1. two basic types of stock trades
         1. primary market: corporation is direct party to the transaction: selling (or buying) its shares to an investors
            1. example: IPO, self tender
            2. privately-held firm does this: when start-up firm wants to raise capitalist; have VC fund
         2. secondary market: corporation is not a party to the transaction: most transactions over NYSE, NASDAQ
      2. under Rule 10b-5 corp. may be liable in both markets (*Texas Gulf Sulphur*)
   7. Application of Rule 10b-5 to Publicly Held and Privately Held Companies
      1. publicly held: need to constantly comply with Rule 10b-5
         1. secondary market activity is a daily occurrence
         2. need to closely monitor ALL corporation disclosures
            1. Executives need to be informed of risks before making only publicly statements. Big risk of liability.
      2. privately held: only need to worry about Rule 10b-5 when buying/selling own stock in the primary market
         1. important, but limited risk of liability
         2. private companies that have no secondary market
2. **Federal Securities Law: Insider Trading** 
   1. Generally
      1. insider trading liability is based on Rule 10b-5
      2. standard fact pattern: defendant failed to disclose (i.e. omission) material nonpublic information, and traded on the basis of that information
      3. examples:
         1. CEO knows that company revenues are going to be down and sells her shares prior to disclosure of this information
         2. lawyer knows that client is about to be acquired, and buys shares prior to the merger announcement
      4. reoccurring question: when does defendant have a duty to disclose???
   2. IT Law 1.0: Abstain or Disclose
      1. when (anyone) poses material nonpublic information must ABSTAIN or DISCLOSE
      2. need to disclose before you buy/sell stock
      3. it is often just abstain
      4. alternatively, you can abstain from trading
         1. disclosure may be impractical/illegal
      5. abstain or disclose rule set forth in *SEC v. Texas Gulf Sulphur Co.*
         1. tried to keep ore finding secret; company issued press releases saying that they didn’t find it
         2. dicta rule applies to anyone in possession of material inside information
         3. equal access test (i.e. create a level playing field)
      6. equal access test: imposes a duty to disclose on people completely unrelated to company
         1. could bring in lots of people
         2. next couple set of cases pull this back, then it gets broader
   3. Classical Theory v. Misappropriation Theory
      1. rule of thumb: silence is OK absent a duty to disclose
      2. reoccurring themes of IT Law:
         1. what duty triggers abstain or disclose obligation, and
         2. who is subject to this duty?
      3. classical theory
         1. duty to abstain or disclose arises from fiduciary obligation owed to a corporation and its shareholders
         2. duty applies primarily to insiders
      4. misappropriation theory
         1. separate duty owed to the “source” of information
         2. potentially extends liability to outsiders
   4. Classical Theory: Duty applies to “Insiders”
      1. *Chiarella v. United States* (1980)
         1. Chiarella was an employee of a financial printer
         2. prepared tender offer disclosure documents
         3. Chiarella broke ID-codes to discover name of acquisition targets
         4. bought target co. shares and then sold for a large profit when tender offer was announced
         5. holding: Chiarella does not owe a duty since he was not a fiduciary of a target corporation
         6. court rejects the equal access test
   5. IT Law 2.0
      1. when insiders posses material nonpublic information, must abstain or disclose
      2. core question: who are “insiders”?
         1. permanent insiders (management and officers) are insiders
         2. what about temporary insiders and tippees?
   6. Temporary Insiders and Tippees (*Dirks v. SEC*)
      1. Secrist tips Dirks that EFA Co. may be engaged in fraudulent practices; wants Dirks (securities analyst) to investigate and disclose
      2. Dirks investigates and notifies SEC and WSJ; also passes his findings onto his clients (double tippee); clients dump shares of EFA (avoiding large losses)
      3. SEC brings IT suit against Dirks
      4. *Dirks* extends IT liability to two groups
         1. temporary insiders: owe temporary fiduciary duty to client and to shareholders
            1. examples: lawyers, accountants, consultants, I-bankers, etc.
         2. tippees: only liable if:
            1. insider breached fiduciary duty in making tip and
            2. tippee knows or should have known of breach
            3. note: tippees liability is derivative of the tipper’s fiduciary breach; ultimately need to tie this back to some fiduciary duty owed by either a permanent or temporary insider
   7. IT Law 2.1
      1. when [ ] possesses material nonpublic information, must Abstain or Disclose
         1. permanent insiders
         2. temporary insiders, and
         3. tippees, if
            1. insider breached fid duty by tipping and
            2. tippee knows of breach
   8. Misappropriation Theory—Outsider Liability
      1. classical theory premises liability on fiduciary breach by permanent or temporary insider
      2. tippee liability only extends this to outsider if:
         1. the information ultimately come from insider and
         2. insider breached fiduciary duty by tipping
      3. outsiders may learn material nonpublic information in other ways and there may be strong policy rationales for holding outsider liable
      4. as noted in *O’Hagen*: “it makes scant sense to hold a lawyers like O’Hagan a 10(b) violator if he works for a law firm representing the target of a tender offer, but not if he works for a law firm representing the bidder.”
   9. U.S. v. O’Hagan
      1. O’Hagan was a partner at Dorsey and Whitney and D and W represented Grand Met in its acquisition of Pillsbury (target)
      2. O’Hagan bought Pillsbury (target) options before tender offer was announced, and sold for $4.3 million afterwards
      3. problem: he is also not an insider or tippee
         1. he got it because he worked at Dorsey and Whitney
      4. answer: he breached duty to the source of the information (D and W)
   10. IT law 3.0
       1. when [ ] possess material nonpublic information, must Abstain or Disclose
          1. permanent insiders,
          2. temporary insiders, and
          3. tippees, if
             1. insider breached fiduciary duty by tipping and
             2. tippee knows of breach
          4. outsiders: if breach duty owed to source of the information
       2. law is still abstain or disclose
          1. if outsider, need to disclose to source