**AGENCY LAW**

1. **For the purpose of [some consequence] is X an agent of Y?**
   1. An agent is a person/entity that by (i) mutual consent (informal or formal, express or implied) undertakes to act on behalf of another person/entity and (ii) is subject to their control.
   2. The existence of agency may be proven by circumstantial evid from course of dealing—no contract/express agreement required. (Cargill)
2. **For the purpose of binding principal to third parties is X an agent?**
   1. If agent has *actual authority* (express or impllied)🡪principal is bound to T (Lind)
   2. If no actual authority, did agent have *apparent authority*? If principal acts in such a manner as to lead T to reasonably believe that an agent has certain power to do something, then the agent has apparent authority and principal is bound to T.
      1. Agent’s manifestations may be enough to establish authority. (Kidd)
   3. If no actual or apparent authority, did agent have the *inherent agency*?
      1. Undisclosed principal is liable for acts of an agent done on his account, ordinary w/in his line of business, despite whatever limtiations principal puts on him. (Watteau)
         1. It does NOT matter if T does not know of principal’s existence.
         2. It does NOT matter if principal is not party to contract
      2. If a conduct is established in the industry, an agent acting w/in that industry possesses inherent authority to act on all such matters. (Kidd)
         1. This is true as long as deviations from express authority are “minor” and w/in industry custom
         2. T has a duty to verify whether agent had authority IF T is put on notice that the agent may not be acting w/ authority—ct will ask whether T’s belief was *reasonable*
         3. No apparent authority if T actually knows agent has no authority
   4. Even if agent lacked both the authority and the power to bind principal, *does estoppel apply to bind principal?* Principal is estopped if (Koos)
      1. principal creates an appearance thru intentionl or negligent words/acts/omissions an appearance of authority in a purported agent AND
      2. third party relies, reasonably and in good faith, on this appearance of authority
      3. third party changes her position w this reliance AND
   5. Even if agent lacked both the authority and the power to bind principal and estoppel does not apply, is there *ratification*?
3. **For the purpose of paying tort victim is the franchisee an agent of the franchisor?**
   1. A master-servant relationship exists where the servant has agreed to work on master’s behalf AND be subject to the master’s control, specifically the running of the day to day business (Humble Oil)
      1. Master-servant: generally P is liable; P has the right to control A’s physical conduct; liability only w/in scope of employment
      2. Ind contractor: generally P is not liable; P cannot control IC’s conduct, only dictate result/outcome.
         1. May create vicarious liability if P is negligent in choosing IC or IC is engaging in inherently dangerous activity
   2. Control has to be distinguished from mere influence over how the business is run as that may solely indicate mutual interest in franchisee’s success (Sun Oil, no agency)
   3. Franchisee’s representation as being part of the franchisor’s business is NOT dispositive (Sun Oil, no agency even though franchisee used advertising and uniforms). Courts will consider evid of control as manifested by who has a *greater financial stake/allocation of risk* (Humble Oil):
      1. Does the franchisor own the property? pay for the operating expenses? furnish equipment and products?
4. **For the purpose of paying creditors is the debtor an agent of the lender?**
   1. *Traditional rule:* The point at which the creditor becomes a principal is that at which he assumes de facto control over mgmt and its business decisions. (Cargill, R.2d, §14O.)
   2. *Modern rule:* Cts are relunctant to to impose agency relationship on lenders. Today, lenders can include following provisions w/out fearing that they will be held liable as principal:
      1. Power to stop lending or providing credit, Limit’s on party’s ability to take on additional debt, Right of inspecting books and records

**Partners as Agents of the Partnership**

1. **Is X a partner or mere employee or creditor?**
   1. *Defn:* A partnership is an association of two or more persons to carry on as co-owners a business for profit. UPA §6
      1. The fact that the parties had called themselves partners and had designated the relationship a “partnership” in an agreement is NOT enough. (Fenwick)
      2. Joint tenancy, joint property, common property is NOT enough. UPA §7
      3. The sharing of gross returns (revenue) is NOT enough. UPA §7
   2. *Designation.* Even if parties eschew the label, they may still be deemed a legal partnership. (Cargill)
   3. *Profit-sharing?* The receipt of a share in the profits is prima facie evid that a person is a partner BUT no such inference will be drawn if profits were received UPA §7
      1. as a debt payment\*
      2. as employee wages or rent to landlord\*
      3. as an annuity to widow/family
      4. as interest on a loan (though amount may vary w profit)
      5. as consideration for sale of a goodwill of a business or other property
      6. Note: \*It won’t be evid. unless there is profit-sharing AND control
   4. *Evid. of Co-ownership*. Court will consider the following as evid of partnership (Fenwick)
      1. Intention of parties
      2. Profit sharing
      3. Loss sharing
      4. Ownership and control over property
      5. Active control over business affairs (voting rights or otherwise)
      6. Language of written agreement
      7. Conduct toward Ts
      8. Rights on dissolution
   5. *Lenders.* Even if an agreement’s gen purpose is to est. a loan, it MAY effectuate a partnership if the loan provisions are extensive enough to exert control. (Peyton, not a partnership as control was “passive,” not active; cf. Cargill)
      1. Creditors may establish provisions such as profit-sharing, consultation as to risky ventures and accounting practice requirements w/out effectuating a partnership relationship. (Peyton)
      2. An option to join a firm demonstrates at most future intent btw lender and borrower to create a partnership but it does NOT form a partnership as date of agreement. (Peyton)
2. **If X is a partner, what are their rights?** Note: UPA’s default rules can be overridden by agreement.
   1. *Contributions, profits and losses* UPA §18
      1. All partners have equal rights in management and conduct of business.
      2. Each partner shall share equally in the profits and in the losses accord. to his share in the profits
      3. No partner is entitled to enumeration for acting in the partnership business, except that a surviving partner is entitled to reasonable compensation for his services in winding up the partnership affairs.
   2. *Indemnification* UPA §18
      1. Partnership MUST indemnify every partner in respect to payments and personal liabilities reasonably incurred in the ordinary and proper conduct of business or in preservation of its business.
   3. *Disputes* UPA §18
      1. Any dispute may be decided by a maj. but no act in contravention of an agreement btw partners may be done rightfully without unanimous consent
      2. Each partner has equal no. of votes
   4. *Property rights* UPA §8
      1. All property originally brought into the partnership or subsequently acquired, is partnership property.
      2. Unless the contrary intention appears, property acquired w partnership funds is partnership property.
   5. *Dissolution* UPA §31
      1. A partnership may be dissolved by the express will of any partner upon express notice to the other when no definite term or particular undertaking is specified
         1. Past partnership agreements are NOT sufficient evid to indicate a definite term (Page v Page)
         2. A common hope that the business will be profitable is NOT sufficient evid to indicate a definite term (Page v Page)
      2. Must be done in good faith. If dissolution is being done in bad faith or in violation of fiduciary duties because one partner is trying to appropriate to his own use the business without adequate compensation to the other(s), then a partner can be liable for damages for wrongful dissolution (Page v Page, UPA §38(2))
      3. A court may dissolve a partnership when a partner becomes incapable of performing under the partnership agreement, when a partner’s conduct tends to affect the business prejudicially, or when a partner willfully breaches the partnership agreement’s terms. (G&S Inv v. Belman, §32)
         1. Dissolution occurs by decree of court, NOT by filing
      4. In a partnership, it is important to include a ***buyout provision*** specifying how exiting partner’s share would be valued in a buyout (Page v. Page). Courts will construe such buyout provisions strictly (G&S Inv.)
         1. To prevent strategic resignations, buyout provisions should stipulate different accounting provisions depending on reason for dissolution—ex, ***capital account*** for resignation and fair market value upon death.
      5. There can be no reliance after dissolution of partnership if client was unaware that partnership existed in the first place. UPA §35
3. **If X is a partner, can they bind the partnership?** 
   1. Every partner is an agent of the partnership for purpose of its business (UPA §9)
   2. The act of every partner for “apparently” carrying on in the usual way the business of the partnership binds the partnership UNLESS (UPA §9)
      1. partner has NO authority to act for the partnership in a particular matter AND
      2. at the time, T knew of the lack of authority
   3. In the event of an even division of partners, no restriction can be placed upon a partner’s power to act unless there is a contractual agreement otherwise (National Biscuit)
      1. Note: In a partnership with an even number of partners, it might be good to have a tie breaker clause in the partnership agreement OR give one partner more voting rights than the other.
   4. No partner can do the following without unanimous approval (UPA §9)
      1. Giving partnership’s property in trust to creditors or in return of assignee’s promise to pay debts
      2. Disposing business goodwill
      3. Doing any act making business impossible
      4. Confessing a judgment against the partnership
      5. Submitting a claim by or against partnership for arbitration
      6. Any act in contravention of any agreement btw the partners
4. **If X is NOT a partner, can the partnership be bound by estoppel?**
   1. If one (i) represents itself as being a partner (or allows others to make the representation), (ii) and T reasonably relies on the representation and (iii) as a result conduct business with the enterprise, then the person who was represented as a partner is liable and others who made or consented to the representation are bound. UPA §16
5. **If partner, what is extent of liability?**
   1. A partner cannot escape liability by concealing his membership in the partnership (Watteau, UPA § 15)
   2. All partners are liable jointly and severally for a partner’s wrongful acts or a partner’s breach of trust to T AND jointly for all other debts and obligations of the partnership. UPA §15
   3. Partners can minimize liability exposure by creating a limited liability partnership.
      1. Old law: A limited partner shall not become liable as a general partner UNLESS he takes part in the control of the business in addition to his rights and powers as limited partner
      2. A limited partner shall not become liable as a general partner UNLESS he takes part in the control of the business in addition to his rights and powers as limited partner AND the person who he transacts business with reasonably believe based upon his conduct that the limited partner is a gen partner (RULPA §303)
      3. New law: NO liability even if the limited partner participates in the management and control of the limited partnership. ULPA 2001 §303

**Duties of Partners**

1. Partners owe each other a **duty of loyalty**. (Meinhard)
   1. NO defense to say partnership was a JV. A JV is distinguished from a partnership by having a narrow scope w/ a definite time frame. Fid. obligations are the same.
2. Partners have a **duty to disclose** to the other(s) opportunities that arise out of the incidence of the partnership or the person’s position as agent of the partnership. (Meinhard)
   1. To say that the other partner(s) would not be able to properly exploit the opportunity is NO defense.
   2. To say that the partner had no conscious purpose to defraud or otherwise hurt the partnership is NO defense.

**CORPORATE LAW**

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| **Content of bylaws**   * Bylaws are easier to amend than the charter. As a result, anything not required to be in charter is put into bylaws.   + Under statute, either shareholders or the board of directors can amend bylaws. * Number of directors; what constitutes a quorum of directors (could give veto power to parties by requiring unanimity) * How to fill interim vacancies on board of directors (statutory default is that remaining directors choose interim successor) * Time and place of shareholders’ meeting * Officers (who appoints, what officers are there) * Indemnification provisions (company may indemnify officers sued by third parties or shareholders) |

**Governance of the Corp.**

1. **Power of officers:** Is there agency to bind the corporation?
   1. **Actual authority** of the officers to bind the corp may be in the state stat. (rarely), charter, bylaws (has broad description of duties) or board resolutions (has specific descriptions)
   2. There may be **implied actual authority:** Is it in the officer’s gen. description of duties? Has the officer done this in the past with the approval of the board?
   3. There may be **apparent authority**—did the board create to others an appearance of authority? (ex, by giving officer specific title like CEO)
      1. President of a corp. has only the authority to bind his company by acts arising in the **usual and regular course of business** and does NOT have the authority to bind the company to Ks of an extraordinary nature. (Lee v Jenkins)
      2. What is an agreement of **extraordinary nature**?
         1. Cost of transaction in relation to the company’s earnings and assets
         2. Extent of the risk
         3. Time span of the action
         4. Cost of reversing action—things that are expensive to undo (i.e. merger)
         5. Actions exposing the company to significant litigation
         6. Sale of a significant business or asset
         7. Entry to a new line of business
      3. Note: if an agent’s action seems “extraordinary,” the other party should request from the board secretary a certificate or a letter certifying a board resolution.
   4. There may be **inherent authority**—agent’s very position creates authority due to industry custom and business practice.
   5. T may also apply **estoppel and ratification** theories
      1. Was the board negligent in letting others think the agent had authority?
      2. Did the board know and acquiesce in an officer’s longstanding course of conduct?
2. **Power of directors**: Did the board confer authority properly?
   1. **Formal meeting requirement**
   2. Traditional rule: The directors MUST assemble a board meeting to issue proper authorization. No authority when permission from board is obtained individually. (Baldwin v Canfield)
   3. Modern rule: Boards can act without a meeting as long as ALL directors unanimously consent in writing. (Brown Deer, DGCL §141(f))
      1. A board member’s conflict of interest and inability to vote at a mtg is NO defense as to why their consent was not obtained. (Solstice)
      2. Boards and comm can hold meeting via telephone or any other conference equip. unless otherwise restricted by bylaws or charter. DGCL §141(i)
   4. Public policy rationale: deliberation produces better decisions, order of voting does not matter
   5. **Was the action w/in board’s governing power?**
      1. Board has power to **manage the corp** §141(a)
      2. BUT board cannot sell assets not in the regular course of business (§271), merge w another company (§251), amend the charter (§242), dissolve the corp without consent of shareholders (§275)
         1. To get approval board can call a special mtg of the stockholders which can only be compelled by the board or any other person designated in charter. DGCL §211(d)
         2. Del allows for major actions to go through with consent of maj of shareholders but this varies by state law (ex, supermaj. in Ill.)
         3. Bylaws/charter might have additional voting requirements.
      3. BUT Board does NOT have right to take measures that conflict with shareholder enfranchisement unless there is a **compelling justification**. (Blasius, Liquid Audio)
         1. In Liquid Audio, MM, a 7 percent shareholder, proposed to nominate two candidates to the five member board, which would have given it a maj. To nullify the effect of the new members, Liquid Audio expanded the board to 7 seats. Ct did not like this.
      4. Board has the power to **initiate amend to charter**, which is subject to shareholder approval §242(b)
      5. Board may have power to adopt, amend and repeal **the bylaws** if power is granted in charter §109.
         1. If the board does, this does NOT limit the power of shareholders to do so
         2. Board does NOT have the right to amend or repeal a bylaw amend. adopted by stockholders which specifies the votes needed for the election of directors. §216(4)
      6. Board may have power to **appoint a new director position** as long as the no. of seats on the board remain in the range provided for in the charter. §141(b)
      7. Board MAY have power to **remove a director.**
         1. Del: statutory default is that board does not have power to remove a director unless otherwise stated in charter
            1. **Due process:** Before removal, there should be service of specific charges, adequate notice and full opportunity for director to meet accusations by a statement in company’s proxy solicitation at the company’s expense. (Campbell)
            2. Compelling justification standard
         2. Maine: Directors can remove each other for cause.
         3. NJ: Directors can remove each other for cause only if in charter
      8. Board can appoint person to a **vacancy** unless prohibited in bylaws §142
3. **Did the board have the power to delegate to the committee?** 
   1. Board members can delegate many of the functions to committees EXCEPT §141(c)
      1. amend charter or bylaws
      2. adopt merger or consolidation agreement
      3. recommended to stockholders the sale/lease/exchange of all or substantially all of the corp’s property and assets
      4. recommend to stockholders a dissolution of the corp
   2. Committees can have the power to declare a dividend, to authorize the issuance of stock or to adopt a certificate of §253 merger ONLY IF provided by the bylaws or charter of the corp DGCL §141(c)
4. **Power of the shareholders:** What areas can shareholders exert authority?
   1. All shareholders have voting power
      1. Voting rights and ownership may be legally separated (Stroh). While shareholders typically have one share-one vote, there may be variations §151(a)
   2. Shareholders have power to adopt, amend, and repeal the bylaws DGCL §109
      1. Shareholders can force a mtg to amend bylaws (Auer)
      2. Shareholders CANNOT adopt or amend bylaws which would prevent the board from exercising their mgmt powers and fid duties—§109 must be read consistently with §141(a) (Computer Associates, bylaw requiring board to reimburse losing insurgents was invalid for lack of fiduciary out)
      3. While the bylaws put forth & adopted by the shareholders cannot mandate how board should decide substantive business decisions, they may define the process/procedures by which those decisions are made. (Computer Associates)
   3. Shareholders can make recommendations to the board EVEN IF nonbinding (Auer, recommendation to reinstate company’s former president)
   4. Shareholders have power to elect directors at annual shareholders mtg. DGCL §211(b)
      1. Charter can specify that certain classes of stock elect their own directors §151(a)
      2. There must be a quorum: a maj of shares entitled to vote (DGCL §216(a))
      3. For a director to be elected, he must get plurality of the votes (§216)
   5. Shareholders can force a mtg to remove director or the entire board (Auer)
      1. Ability to remove with or without cause varies with state stat.
         1. DGCL §141(k): with or without cause UNLESS charter says shareholders may remove only for cause
         2. DGCL §141(k)(1): If it is a staggered board, a director can removed only with cause
      2. For cause = Obstruction of the normal business BUT merely attempting to take over the corp or having disagreement over policies is not. (Campbell)
      3. Due process before removal: there should be service of specific charges, adequate notice and full opportunity for director to meet accusations by a statement in company’s proxy solicitation at the company’s expense. (Campbell)
      4. Some states allow directors to be removed in a judicial proceeding brought by the corp or by shareholders. (Model Act, NY, Cal.)
   6. Shareholders have the right to inspect books and records §220
      1. Shareholders lists are available to shareholders ten days before a shareholders mtg §219(a)
      2. Books and records and a shareholders’ list more than 10 days before the mtg are available for inspection upon a showing of “proper purpose” §220(b)
   7. Shareholders have the right to compel an annual mtg 30 days after designated date or 13 months if no date was designated §211(c)
   8. Note: for action to be valid at a shareholder mtg there must be a quorum which is typically a maj of shares entitled to vote or depending on the charter/bylaws can be as low as 1/3 (§216)(a). Shareholders can be present at mtg or cast vote by proxy. §212

**Governance: Shareholder Voting**

1. Classes of shareholder voting: allocating dividend and voting power
   1. Stroh v Blackhawk (Ill.): SHs get different classes of stock. SHs who want to exert more control over corp buy stock that has voting, but no dividend, rights
   2. One class of stock solution: All SHs get stock, but SHs who are to exercise less control can get less shares of the stock. To make up for the difference, they also receive senior securities—debt securities that has an interest rate mirroring that of dividends.
   3. Classes of stock with different voting rights: SHs get different classes of stock with different voting rights attached to each class. Right to different classes of shares will be in the charter.
   4. Voting trust: A shareholder can set up a voting trust. The shareholder will remain the beneficial owner of the dividends but will give voting rights to others who become the voting trustees. §218
   5. Voting agreement: Contract btw shareholders to say they will agree to vote on behalf of a percentage of the shares §218
      1. Voting agreements should be drafted in a way such that the arbitrator (referee) can enforce the decision through the power of attorney. (Ringling)
2. Proxy voting: Irrevocable proxies
   1. Shareholders can give others binding authority to vote their shares through irrevocable proxies. Unlike a regular proxy the shareholder-principal cannot change her mind and withdraw the proxy holder’s authority to vote her shares.
   2. The irrevocable proxy has to be coupled with an interest (interest in stock, economic interest in the corp or interest conferred by a shareholders’ agreement) §212(c)
3. SEC’s Role in shareholder voting
   1. The SEC’s authority over voting is procedural, not substantive which is an area for state law. It cannot control how voting rights are allocated but only how the voting process works. (Business Roundtable, SEC could not issue a rule requiring at least one vote per share)
   2. Under SEA §19c-3, the SEC has only the authority to regulate voting in “furtherance of the act”
   3. The stock exchanges, however, have adopted SEC R 19c-4: Companies may NOT change voting rights of existing shares as part of a dual-class recapitalization.
4. Empty voting: Empty voting—when the stockholder has solely voting but no economic interests—should be discouraged esp. when their interests conflict with other shareholders. (Perry and Myland Labs, hedge fund bought 10% of a corp’s shares, swapping the value of the shares in return for bonds, but keeps voting privileges in order to vote in favor of a merger, which may not be in the best interests of the rest of the shareholders.)
5. Vote buying: There is no vote buying if the shareholder retains the economic risks—even in the context of a disputed board election (Kurz v Holbrook)

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| 1. §14(a) of the 1934 Act: Proxy Fraud    1. Is there a **private right of action**? Securities Exchange Act of 1934 does not explicitly provide private right of action but the Supreme Ct has ruled that there is an implied cause of action for violations of §14(a). (J.I. Case co v Borak)    2. Is there a **false or misleading statement or omission**? R. 14a-9.       1. This may include statements of motive and opinion. (Virginia Bankshares, board thought the price in a freeze out merger was “fair”)    3. **Standard of materiality test:** Is the statement/omission material? Material if there’s a substantial likelihood that a reasonable investor would consider the information influential in making voting decision (Mills, Borak)    4. **Reliance** is NOT necessary    5. **Transaction causation:** Were the shareholders’ votes necessary?       1. Minority shareholder whose vote is unnecessary for approval of freeze-out merger and loses no rights under state law (e.g. appraisal rights) cannot establish causation. (Virginia Bankshares, proxies were not necessary as VBI could have forced merger through, they were mere public relations effort)    6. Note: P may also bring state law claims of breach of duty of candor. The materiality standard is the same. No need to show transaction causation. (Virginia Bankshares) |

**Governance: Contested Elections**

1. **Extent of corporate financing:**
2. Incumbents may make **reasonable** use of corp assets to inform shareholders of its position in a proxy fight. (Levin) Fight **must be over policy** rather than personnel decisions. (Rosenfeld)
3. Insurgents who don’t win seats generally do not get reimbursed. Only if a new group of directors defeat ALL of the incumbents AND shareholders approve of the reimbursement, then they are entitled to reimbursement UNLESS that money has been spent for a personal power contest rather than a policy contest OR the expenses were not reasonable (Rosenfeld)
   1. Shareholders may adopt a bylaw requiring the reimbursement of reasonable election-related expenses by insurgents seeking to seat fewer than a maj. of directors on the board as long as there is a fiduciary out. (Computer Associates)
   2. Shareholders can adopt other types of bylaws regulating reimbursement. §113
4. **Invalid board defensive measures:** 
   1. Board does NOT have right to prevent shareholders from exercising their voting rights. **BJ does not apply** despite good faith intentions (Blasius)
      1. Liquid Audio: Power to amend bylaws cannot be done in a way deliberately designed to prevent shareholders from being able to vote on board membership. (Proxy election was in play to for shareholders to elect directors to fill vacancies at a special mtg, ahead of the mtg the board amended a bylaw to enlarge the board and they appointed the vacancies)
      2. Blasius: Increasing the board size and then filling the resulting vacancies to nullify an insurgent’s pending consent solicitation to take control is not allowed. (Atlas responded to takeover attempt by Blasius by expanding the size of its board from seven to nine. Since under the Atlas charter there could be no more than fifteen directors, this effectively precluded Blasius from taking control via a proxy fight.)
      3. Carmody v Toll Brothers: Poison pills which can be only be invalidated by the incumbents or their successors is not allowed.
      4. Other examples: advancing the annual meeting date if it would burden insurgents in a pending proxy contest; postponing the annual meeting date if opposing proxies already gathered by an insurgent would expire by the time of meeting; etc.
      5. Compare with Unitrin: Repurchase plan upping mgmt shares from 23 to 28% plus shark repellent (requiring supermajority vote with any shareholder controlling more than 15% of shares) does not make proxy fight “untenable.”
   2. In such instances the court will apply a **compelling justification standard** which is very difficult to overcome. (Blasius)
5. **Shareholder Proposals**
   1. **SEC R. 14a-7:** Requires mgmt to mail, either separately or together with the corp’s proxy materials, any shareholder’s soliciting material. This will be done at corp expense. Alternatively, corp has to provide shareholder list. Then, shareholders can mail them on their own at their own expense. See inspection rights below.
   2. **Rule 14a-8:** If shareholders are asking the co to do the mailing, they have to meet the following requirements:
      1. Any shareholder who has owned (beneficially or of record) 1 percent or $2,000 worth of a public company’s shares for at least one year may submit a proposal
      2. Shareholders have to send proposals in a timely fashion as set in the company’s bylaws (for an annual mtg this is typically four mos. in advance)
      3. If management excludes the proposal from including in the proxy materials, they have to file the reasons why which is then reviewed by the SEC. If the SEC agrees, they send mgmt a “no action” letter
      4. Mtg can exclude if the proposal is not the “proper subject” for shareholder action under state law.
         1. Phrasing proposals to be **precatory**—advisory suggestions rather than mandates—further assures their propriety under state law. (Auer)
         2. Bylaw amendments that require specific action are proper subjects of a proposal if they relate to process and not substance (Computer Associates)
         3. Bylaw amendments giving shareholders “proxy access” (ability to place nominee directors on ballot) are proper subjects of a proposal (AIG) and are valid under Del. law (§112)
         4. Proposals related to nomination or election of directors can be exempted.
         5. Proposals that relate to company’s “ordinary business operations” can be exempted.
      5. Even if mgmt excludes with SEC approval, the shareholder can still sue the company directly.

**Shareholder Inspection Rights**

1. §219 : Shareholders can ask the corp to send them shareholders list.
   1. In Del, the burden is on the shareholders to show the **purpose is proper**
      1. Proper purpose includes putting forward a proposal, investigation of corp wrongdoing (ex, fiduc. breach), bringing a shareholder lawsuit, initiating a takeover or a proxy contest, seeking info for appraisal purposes
      2. Improper purpose includes giving names to competitors or sending junk mail
      3. Cf w. NY which presumes challengers have a legitimate purpose in seeking NOBO list, burden is on corp to show why list should not be released (Sadler)
   2. Typically co. only has to provide a NOBO (Non objecting beneficial owner) list already in possession. (Del.; cf w. NY which require compilation if list is not at hand)
2. §220: Shareholders can ask the corp to allow them to inspect books and records
   1. In Del, the burden is on the shareholders to show the **purpose is proper**
   2. Request can be refused if it not “necessary, essential and sufficient” to the purpose.
      1. Ct will regard court as unnecessary if information sought is already publically available (Polygon)
      2. Ct will regard the purpose invalid if plaintiff does not have standing to sue because breaches of fid duty occurred before stock purchase. (Polygon)

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| **The Limited Liability of the Corporation**   1. Threshold question: Does the default rule apply? Absent an assumption of personal liability (through a written contract, perhaps), lenders (debt investors), shareholders,. managers and employees are not responsible for corp obligations. **DGCL §102(b)(6)** 2. Liability during incorporation process:    1. When a promoter contracts with a third party on the behalf of a corp that has not been formed, who is going to bear the liability of defaulting on the contract?       1. Under **novation doctrine**, a corporation can unilaterally bind itself to a contract signed by its promotoer prior to incorporation by ratifying the contract. Until then a promoter will accept liability under the contract until the entity is incorporated, adopts the contract and is substituted in promoter’s place.       2. If the corp is never formed🡪promoter will be liable absent some agreement otherwise    2. Will the corporation be held liable for defaulting if there is a defect in the corp status?       1. **De facto corporation:** If promoters in good faith tried to incorporate, had the legal right to do so and thought they were a corp, then courts will treat them as such.       2. **Corp by estoppel:** If the other party thought it was dealing with a corporation, relied on that fact and would earn a windfall if allowed to argue it is not a corporation, then the courts will treat the entity as a corp. (Southern Gulf Marine Corp)          1. NO defense to say the corporation that is formed is different from the one initially contemplated (ex, incorporation in Cayman rather than Tex.)          2. Doctrine applies only to contract, not tort, cases       3. Note: These are equitable doctrines and court will weigh all the factors. 3. **Piercing the corporate veil:** When can courts pierce the corp veil to hold shareholders, corp insiders and parent companies liable?    1. Threshold assumption: Corp is obligated bc agent had the authority to bind the corp. (Agency issues, including respondent superior when it comes to tort victims)    2. However, courts are likely to pierce to hold shareholders and other insiders liable, in the following situations, with no single element being dispositive:       1. Business is closely held corporation (Walkovsky)       2. Insiders failed to follow corp formalities such as holding assets, generating income, holding board mtgs or issuing stock (Kinney)       3. Insiders commingled business assets/affairs with individual assets/affairs, possibly misleading creditors on the corp’s capitalization (Victoria Elevator, D incorporated his grain business but never transferred title to property from sole proprietorship to corporation)       4. Insiders did not adequately capitalize the business as a means of avoiding liability (Walkovsky, cab companies did not have enough insurance to cover tort accidents)    3. In addition to piercing the veil to hold shareholders/insiders liable, courts will also pierce the veil under **enterprise liability doctrine** to disregard multiple incorporations if the business under common ownership is functionally the same (Walkovsky, taxi sibling corps owned by the same controlling and dominant shareholder) or to disregard “shell” corps that bear all the risk (Kinney)    4. Courts will also hold **parent liable for subsidiary under alter ego theory** when the parent fails to keep business separate: (In re Silcone Gel, Bristol Myer, a public corp, was sole shareholder and found liable for product liability of sub)       1. There are overlapping boards with directors serving in both companies       2. Parent sets employment policies       3. Parents makes major financial decisions       4. Parent provides accounting, legal and tax services at no cost       5. Parent controls annual budgets       6. Parent allows name to be used in ads and packaging (apparent authority idea, customers may have relied on the parent name)       7. Failure to follow formalities (in Silcone Gel, there were no board meetings, no dividends, members of board didn’t even know there was a board)       8. Public polilcy note: Courts will also also balance benefits of subsidiary structure (cheaper credit monitoring while still providing economies of scale from having multiple business units in same corp) against values veil piercing protects (forces firms to follow corp structure, prevents abuse of corp structure, ensures creditors will known when a corp has been undercapitalized)    5. As long as corp formalities were followed, ct will NOT pierce the veil of a corp that is a general partner EVEN IF the officers of the corp are also the limited partners. (Frigidaire Sales Corp.)    6. NO defense to say plaintiff was a voluntary creditor and assumed the risk of inadequate capitalization—courts have pierced the veil in both tort (Walkovsky) and contract cases (Kinney, Victoria Elevator)       1. Note: while assumption of risk is not a complete defense courts may consider whether voluntary creditors should have known that the business was inadequately capitalized. Did they adjust the credit terms in the agreement in response to the undercapitalization? Or were they mislead by comingling of assets, for example?       2. Even if the company was undercapitalized courts will NOT pierce corp veil as long as the corp scrupulously observe corporate formalities (thereby misleading no one about the corp’s real assets). (Frigidaire Sales Corp)    7. NO defense to say there was no outright fraud. |

**Disclosure Duties Upon Issuance of Corp Securities (Bonds, Stocks)**

**1933 Securities Act**

1. Securities Act of 1933, **§5 prohibits the sale of any security without filing a disclosure document with the SEC**, which is shared with investors as prospectuses.
   1. SEC has no authority to stop an offering simply because it has doubts about its merit or the firm’s business plan. It is enough that these matters were disclosed to investors.
   2. §12 imposes strict liability for violations of §5 and allows a private right of action against the sale of unregistered securities for which no exemption applies
   3. **Exemptions** to §5 include:
      1. Intrastate offerings—any offering made and sold ONLY to residents within a single state will be excluded as these will be governed purely by state law
      2. Private placement offerings—any offering made to a small group of accredited, sophisticated buyers as defined in §4(2). Reg D defines various categories of such buyers including venture capital firms
      3. “Small offerings”—small companies raising small dollar amounts (less than $5m)
2. §11 allows any purchaser to recover damages from the issuer and others involved in the distribution **if the registrations statement contains any falsehoods or omissions concerning any material fact.**
3. **Materiality test:** What a reasonable investor would consider important when deciding to invest.
   1. NO need to show bad motive or intent to do harm
   2. NO need to show reliance on the claimed untruths or omissions
   3. NO need to show claimed misinformation was the cause of their losses
4. **What defenses are available?**
   1. NO defense to say you were not in privity with the investors—§11 violators include the issuer, the issuer’s inside and outside directors, the issuer’s senior execs, the underwriters, and any other expert whose opinion is used in the registration statement including inside and outside counsel.
   2. Due diligence defenses for experts (BarChris)
      1. No liability for nonexpertised portions §11(a)(4)
      2. Experts are liable for expertised portions *only* UNLESS (i) after a reasonable investigation (ii) they had a reasonable ground to believe and did believe that the information was true §11(b)(3)(B)
   3. Due diligence defenses for nonexperts (BarChris)
      1. Nonexperts are liable for nonexpertised portions UNLESS (i) after a reasonable investigation (ii) they had a reasonable ground to believe and did believe that the information was true §11(b)(3)(A)
      2. Nonexperts are liable for expertised portions UNLESS there was (i) no reasonable ground to believe and (ii) they did not believe information was false §11(b)(3)(C)
5. **What is a “reasonable investigation”?** One which an ordinary, prudent person would show if her own money was at stake §11(c)
   1. For outside directors, there is a scienter requirement for joint and several liability. If outside director did not know, he is only liable proportional to his responsibility for what happened.
   2. For experts, ct will look to prof. standards to determine due diligence (BarChris)
6. **Damages** can be nore more than the difference btw initial price and price to which security falls once misrepresentation is discovered. §11(e)
   1. Defendants have a comparative causation defense if the plaintiff’s losses were due to factors other than misinformation. This serves to reduce damages.**Contractual Duties of Bondholders and Borrowers**
7. Bondholder’s rights are in contract only:
   1. Board and mgmt have **NO fiduciary duty of loyalty** to bondholders. (Katz)
      1. Public policy rationale**:** (1) Bondholders and shareholders have conflicting interests—management could not satisfy fid duties to both. (2) Bondholders know mgmt does not work for them and this is why they demand covenants that protech their interests
   2. The only duties corp officials owe are what ever is specified in the **indenture agreements**. (Metropolitan Life, case upheld corp’s refinancing even though it would increase the bondholder’s risk, since the maneuver was not expressly forbidden activity)
      1. This includes a duty of **good faith and fair dealing** as matter of contract law—test is whether the parties would have agreed to proscribe the act later complained of as a breach had they thought to negotiate it. (Katz)
      2. However, cts will not impose good faith/fair dealing if it would create a burden parties did not bargain for—**esp if bondholders could have foreseen and mitigated the risk** by negotiating more aggressively (Metropolitan Life, SDNY)
8. Interpreting bond agreements.
   1. Courts construe covenants of an indenture **w/ assumption that they protect bondholders,** NOT bond issuers (Sharon Steele, ct refused to interpret successor obligor clause as giving corp the complete freedom to get rid of public debt through sale of assets)
   2. **Boilerplate is interpreted strictly**—meaning does NOT change due to changed circumstances (Sharon Steele)
   3. Cts **will not imply a duty not to frustrate the purpose of the debtholder’s k** (i.e. maintain high credit rating) if it goes against text of indebture (Metropolitan Life)
9. **Firms may shift risk from stockholders to debt holders via a merger, sale of assets, issuance of more debt (i.e. LBO), or simply moving to riskier industry.**
10. Sale of assets/Liquidation: When corp becomes insolvent or dissolves, creditors are entitled to payment before equity shareholder (Sharon Steele)
    1. This right may be overridden by **successor obligor clauses** which allow corp to sell public debt to another as long as corp sells the debt w/ “all or substantially all” the assets
    2. **Step transaction approach**: Cts will interpret sale of all the assets to mean the sale to a single purchaser in a single step. A sale of the assets does NOT mean selling to purchaser cash derived from previous sales of the assets. (Sharon Steele, J. Winter)
       1. Whether step transaction approach is used may depend on timing.
11. Leveraged buy-outs/Mergers: UNLESS forbidden by the terms of the indebture, corp is free to consolidate, merge or sell its assets
    1. Check terms of **successor obligor clause**
    2. Preservation of market value (i.e., protection of investment-grade bond rating) is not an interest that is implicitly protected in debenture agreements. (Metropolitan Life, LBO which entailed sale of shareholder stock and acquisition of more public debt, was OK per terms of agreement even though credit rating of bonds dropped dramatically)
    3. Institutional bondholders like Metlife should negotiate for **event risk provisions** which trigger the repayment of debt or increase the interest rate on the bond at the event of a change in control or a substantial downgrade of the credit rating.
12. Tender-offers in which Stock Purchase Agreement is contingent on debt retirement: Courts will uphold exchange offers that have **exit consent provisions** (in exchange for cashing in their securities, holders agree to amend covenant provision) if the indenture agreement does not prohibit the corp from providing inducements to bondholders in exchange for consent
    1. **Case ex**: Katz, Allied Signal agreed to buy out Oak on the condition that Oak first reduce its long term debt by 85%. Thus Oak issued an offer to holders of its long term debt to purchase it above the market price on condition that they vote for an amend. P argued that the offer was coercive bc the amend would make the debt less valuable and those who voted for it wont be affected by outcome
    2. **NOT per se coercive** for the corp to offer incentives to the bondholders EVEN IF this means those who don’t agree to exchange offer may be worse off
    3. Ct will consider the **sophistication of institutional bondholders** and their ability to avoid the prisoner’s dilemma by coordinating collective action.
13. Redemption: Corporations can redeem bonds at any time UNLESS the covenant’s **call protections**, which place restrictions on how redemption can be timed, structured and financed, do not allow it. (Morgan Stanley, Morgan owned ADM bonds that were “nonrefundable”—under the terms of the k, ADM could not finance bond redemption through cheaper bonds.)
    1. Courts may apply **tracing rule** and say redemption and call protection provisions will NOT be applicable if D can show non-restricted source of funds (ex, stock offering).
    2. Parties can add a **make whole provision:** Allows borrower to pay off remaining debt early. The borrower has to make a lump sum payment derived from a formula based on the net present value (NPV) of future coupon payments that will not be paid bc of the call.
    3. Or parties can simply require that the bonds be noncallable for X amount of years.
14. Borrower’s rights
    1. **Cessation of funding clauses** (which allow creditor to unilaterally stop funding) have an implicit notice requirement as part of the creditor’s good faith duties—especially where debtor would otherwise be entirely at the mercy of creditor. (KMC, 6th Cir.)
       1. NOT all courts will treat cessation of funding clauses as requiring notice.

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| Summary of Protections for Creditors   * **Add restrictions** on dividend payments to shareholders; limits on the occurrence of new debt; provisions for dealing with mergers and sale of assets, etc. * Demand that modification clauses, governing changes in k, have **supermaj. provisions** * **Diversify portfolio**   + Diversification protects bondholder from idiosyncratic risks specific to a particular firm   + Buy stock or convertible bonds in the company so that there is no net change, from risk shift from equity holders to debt holders   + Hold bonds in acquiring company so that there is no net shift in risk * **Event risk provisions** (covenants requiring repayment or change in interest rate under certain circumstances)   + Self-enforcing (generally don’t require litigation)   + Make acquisition of the firm more expensive (acquirer will need to pay off the debt holders either pursuant to covenant or modification clause) (Katz v. Oak Industries)   + Prevalence depends on perceived likelihood of LBO and credit market (market responded to MetLife v. RJR Nabisco with more sophisticated event risk provisions) * **Non-refundable provision**—prevents borrower from calling bonds by using proceeds from debt at lower interest rates. * **Successor obligor clause**—specifies who can assume debt in the event of a merger or liquidation * **Make whole provision**: A type of call provision on a bond allowing the borrower to pay off remaining debt early. The borrower has to make a lump sum payment derived from a formula based on the net present value (NPV) of future coupon payments that will not be paid because of the call. * **Refuse to include call provision**, under which borrower may redeem bonds before they mature |

**Fiduciary Obligations**

**Fiduciary Duties of ALL Employees to the Corp.**

* Agent has a fiduciary duty to work for his principal with undivided loyalty. He cannot work for principals with conflicting interests. (Bancroft)
  + Courts will be suspicious if agent conceals his actions from employer principal
* Officers and directors are NOT permitted to use their position of trust to further their private interests at the expense of the company by

1. Raiding company on behalf of a competitor: by deliberately misleading principal about competitor’s efforts to raid employees; supplying competitor w a selective list of desirable employees with their salary information and actively participating in recruitment/poaching (Bancroft Whitney)
   1. Company can protect itself by making employee sign a ***non-compete, no hire or no-solitic contract***. Courts look at non-competes to see if they are reasonable in deciding whether to enforce them. Reasonableness may be determined by geography, time restrictions & scope. Some jurisdictions never honor them (ex, Cal.)
   2. When a competitor is aware of or ratifies an agent’s breach of his fiduciary duties and cooperates with the agent in that breach and receives benefits of the agent’s infidelity, then the competitor will be liable for unfair competition.
2. Misappropriation of trade secrets: Information that is “unique, personal and confidential” to the business will be considered a trade secret that an agent may NOT use, EVEN IF that agent quits his job with the co. (Town & Country)

**Fiduciary Duties of the Board:**

**When Do They Arise?**

|  |
| --- |
| 1. In the absence of illegality, fraud or conflict of interest, directors are entitled to the ***business judgment rule.*** (Shlensky)    1. Rationale for business judgment rule: 1) By voting for board directors, shareholders assume the risk, 2) Cts recognize that litigation is imperfect device for evaluating business decisions which are often done quickly without perfect information, 3) Law should not create incentives for overly cautious corp decisions, 4) We want to incentivize successful people to serve on boards (Joy v North)    2. Business judgment rule is highly deferential! If there is any rational business purpose based on an informed decision, ct will uphold it. See examples       1. Kamin v Am Ex: board chose to distribute a bad investment to shareholders in order to hide those from their accounting net income figures. Directors won under BJ rule even though there was *a better course of action*       2. Shlenksy v Wrigley: mere *failure to follow the crowd* (having night games) is not dereliction of duty under BJ rule    3. If conflict of interest🡪NO BJ presumption. (Joy v North). Bring duty of loyalty claim. 2. Business judgment rule is a presumption that in making a decision, the directors of a corp acted on an (i) informed basis, (ii) in good faith and in the honest belief that the action was taken in the best interest of the company (Smtih v Gorkom 1985) 3. To rebut the presumption, plaintiffs must show that the board … |

1. ***breached their duty of good faith***
   1. Defs could have acted in bad faith if (i) they were **motivated by actual intent to do harm** (fraud, illegality, conflict of interest) OR
   2. if (ii) they had an **intentional dereliction of duties and a conscious disregard of their responsibilities** (Eisner, Walt Disney)
      1. The dereliction MUST be intentional, this is not negl.
      2. Conscious disregard ≠ inadequate/flawed effort (Lyondell)
      3. **Two contexts of bad faith:** failure to implement or monitor an oversight regime (Stone v Ritter) and failure to failure to review compensation/severance package (Eisner)
      4. Failure to act in good faith also = breach of duty of loyalty. This means there can be a duty of loyalty-type claim WITHOUT any conflict of interest by defendant. (Stone v Ritter, failure to exercise oversight and prevent a Ponzi scheme)
      5. Bad faith CANNOT be exculpated DGCL §102(b)(7)(ii)
2. ***breached their duty of care by failing to be properly informed***
   1. **Substance:** Whether a decision was informed turns on whether directors informed themselves of all (i) material information (ii) reasonably available to them (Eisner, Disney)
      1. Informed decision ≠ being informed of every fact
      2. Informed decision = in reliance on board committee, co. records, officers and employees and other experts IF (i) reliance was on good faith, (ii) there was reasonable care in selecting the expert and (iii) there was reasonable belief in the competence of the expert §141(e)
         1. It does NOT matter what expert says ex poste
      3. Directors can rely on honesty of subordinates (Allis-Chalmers) but they must implement a system that ensures reasonable reporting of important information (Ritter)
   2. **Procedure.**Defects in the decision making process may include short or no meetings, lack of familiarity with reports, failure to get a fairness opinion (Smith v Gorkum) *and* a market check (Cinerama) before approving merger
   3. Note*:* In Del, it is a **gross negl standard**.
3. ***failed waste test*** which asks whether the exchange of consideration for corporate assets (ex, exec compensation) was so one sided that no business person would think it was reasonable (Eisner)
   1. Does it comply with the provisions in the charter? **DGCL §157**: Subject to any provision in the certificate of incorporation, every corp may create and issue … rights or options entitling holders to acquire any shares of its capital stock …
   2. A plan for executive compensation is valid ONLY IF **consideration** passes to the corp at the time the plan is put into effect and there is a **reasonable relationship** betw compensation plan and the consideration received (Lieberman)
      1. Market value of the stock is NOT too speculative an element to form basis of executive compensation. (Liberman)
      2. In the absence of fraud, judgment of the directors as to the consideration and the sufficiency thereof will be conclusive. (Zupnick, DGCL §157(b)).
      3. Past performance can serve as consideration in this context. (Zupnick)
   3. When diversion of corp assets (ex, exec compensation) is approved by an interested director, \*\*\*see duty of loyalty claims\*\*\*
   4. Waste standard is difficult to meet when no conflict of interest/breach of duty of loyalty is being alleged!
   5. If court finds waste, only **unanimous consent of shareholders** will validate the decision (Lewis v. Vogelstein)

***Duties of care AND good faith: monitoring and compliance***

1. **Traditional view:** Directors may rely on the honesty of their subordinates. There is NO need to monitor in the absence of red flags. Only when there is a known violation is there a duty to investigate. (Grahm v. Allis-Chalmers)
2. **Modern view:** While director can rely on the honesty of subordinate, directors MUST also exercise oversight over an information gathering and reporting system that ensures reasonable reporting of important information even in the absence of red flags (Caremark dicta)
   1. Courts will likely following Caremark, esp. if there are relevant fd sentencing guidelines punishing corporations for failing to monitor legal compliance (Caremark)
   2. While courts apply Caremark rule to legal compliance, they will NOT extend it to failure to monitor business risk (Citigroup)
3. **Gross negligence standard** applies to monitoring and compliance cases:
   1. Only if there is an utter failure to implement a reasonable monitoring system OR a systematic failure to exercise oversight of the system will there be liability. (Caremark)
   2. Court will NOT evaluate whether the system itself is adequate, only whether board exercised sufficient oversight. If they did BJ rule applies.
   3. BUT if there are red flags (past violations), the court will hold a higher standard of care and determine whether the system was good or not, rather than referring to BJ rule. (Ritter)
      1. Reasonable monitoring system may delegate monitoring responsibilities to employees such as: a specialized regulations officer, a compliance department, a corp security department that polices suspicious activity, a special committee; adoption of the Board of various regulatory policies and procedures; reliance of the Board of period reports from coghjmpliance employees. (Ritter)
   4. Red flag = specific instance of misconduct within the company ≠ NOT bad news about industry/economy (Citigroup)
4. Directors may be exculpated for breach of duty of care. However, in monitoring/compliance cases, there is also liability under duty of good faith (Ritter), which is a subset of duty of loyalty which CANNOT be exculpated. DGCL §102(b)(7)
5. Bad outcome/financial loss ≠ breach. To do so, would make it a strict liability. (Ritter, court held for defendants even though compliance system didn’t work; Citigroup)

***The duty of loyalty: self-dealing transactions***

1. Does a director have a conflicting interest in a corporate transaction?
   1. Self dealing can be **direct**. Examples are transactions btw director and company involving sales and purchases of property; loans to and from the corp; and furnishing of services by a non-mgmt director (like a lawyer or accountant)
   2. Self dealing can be **indirect**. Examples are transactions: with close relatives (Bayer v Beram); with an entity in which director has a significant financial interest; btw companies with interlocking directors (Lewis v SL&E)
2. If no conflict of interest🡪BJ applies and plaintiff bears burden of proof.
3. If yes AND the conflict was **unratified**🡪D has to bear burden of proof to show transaction was **fair**
   1. Common law rule which automatically voided the transaction for self interest does NOT apply under modern safe harbor stats. §144
   2. Even if a transaction was not formally ratified at the time of the transaction, it will be upheld by the court if it is found to be fair to the corp at the time it was authorized. (Bayer v Beran, DGCL §144(a)(3))
4. If yes BUT the conflict was “**ratified**”🡪burden is on plaintiff to show transaction was unfair
5. **Was the transaction ratified under the requirements of §144?**
   1. IF a majority of disinterested directors on the board /committee
   2. OR a majority of shareholders
      1. Alternate/maj. reading: A majority of *disinterested* shareholders must approve of the transaction (Fleiger v Lawrence, holds that 144 has a “drafting error”)
   3. Were informed🡪ratification
      1. Informed = full disclosure of material facts
6. **Alternative/substantive interpretation of §144.**Ratification serves to remove taint of self interest—NO need to apply fairness test. Instead court should apply business judgment rule. (Benihana of Toyko)

***Waste claims: executive compensation***

1. Where there is (i) no conflict of interest and (ii) ratification by disinterested directors and shareholders, the **business judgment** rule applies. (Lieberman v. Becker)
   1. Waste = exchange of corp assets for consideration so small as to be a “gift”
2. **Was there consideration?** (i) In the absence of fraud, (ii) the judgment of the directors as to the consideration for the issuance of options and the sufficiency there of shall be conclusive. §157.
   1. If consideration🡪there will be no finding of waste EVEN IF transaction seems unreasonably risky ex poste (Lewis v Vogelstein)
   2. Valid consideration can be retention of company loyalty (Liberman v Becker, deferred stock compensation plans OK) or reward for past services (Zupnick, ten years of service by CEO)
   3. The case for arguing that there is no consideration is stong when the executive compensation is one-time grant as in Lewis v Vogelstein (Mattel case)
3. **If court finds waste, only unanimous consent of shareholders will validate the decision** (Lewis v. Vogelstein)

***The duty of loyalty: usurpation of corporate opportunity.***

1. Did the corp manager usurp a “corporate opportunity”? Corp managers are NOT flatly prohibited from taking outside business opportunities.
   1. **Line of business test**: Is opportunity similar or like the line of business the company is in?
      1. Was the opportunity in the line of business at the time? In Broz, it was material that CIS was divesting its licenses, not acquiring them.
   2. **Expectancy test:** Is this an opportunity the corp has an existing expectancy in?
      1. What “hat” were the managers wearing when they exploited this opportunity? If the opportunity came to the manager in his individual (not corporate) capacity, courts are more likely to conclude that the opportunity was not corporate. (Broz v Cellular)
      2. Was T planning on giving the offer to the corp? In Broz, it was material that the brokerage firm declined to consider CIS as a potential bidder for the license.
      3. Was corp financially able to undertake opportunity? In Broz, it was material that the corp was not in good financial stead to exploit.
2. If it was a corporate opportunity, was it fair to the corporation …
   1. **Did the managers disclose their activities?** 
      1. NO defense to say manager didn’t lie or mislead. Fiduciary’s silence = stranger’s lie. (Energy Resources Corp)
      2. T’s refusal to deal is NO defense. Fiduc is not required to persuade T to offer the opportunity to the corp to the “point of futility.” However, fiduc should disclose to give corp the opportunity to respond. (Energy Resources Corp)
         1. Rationale: without disclosure it is too speculative to determine whether the corp indeed had the institututional/financial capacity to take the opportunity. Further, disclosure rule incentivizes the fiduc to help the company find the capacity to seize the opportunity.
   2. Did managers divert any corp assets (i.e. use facilities/resources)?
   3. Did the corp benefit in anyway?
3. OR did the corporation “consent”?
   1. *Types of consent:*
      1. Consent can be informal (Broz)
      2. NO requirement for consent to come from shareholders. (Broz)
      3. NO requirement for a formal presentation to the board, even though fiduc may use it as a safe harbor (Broz v Cellular)
      4. NO requirement for fiduc to refrain from the opportunity merely because another company is contemplating the purchase of the corp. (Broz)
   2. *Seeking consent:*
      1. Fiduc can ask board to renounce any interest in categories of business opportunities or any interest in a specific deal by amending its charter or passing a board resolution under DGCL §122.
      2. Fiduc can ask for a formal board resolution permitting him to undertake opportunity
      3. Note: This may be considered a self-dealing transaction and so plaintiff can bring duty of loyalty claim.
4. If the corp consented OR was incable to seize opportunity🡪no liability on fiduc.

***Burden shifting: Fairness test.***

1. If plaintiff overcomes BJ presumption in a duty of care case OR it does not apply as in duty of loyalty cases in which conflict was unratified, D will have to prove entire fairness test when it comes to transactions. Test is a balancing, not a bright line:
   1. Must show **fair dealing** (Cinerama) AND
      1. *Timing.* Did the fiduciary manipulate timing to benefit himself at stockholder’s expense?
      2. *Initiation.* Was it third party or an interested director?
      3. *Negotiation.* Arms-length, independent bargaining parties?
      4. *Structure of deal.* 
         1. If there was a “no-shop clause,” did the board reserve its right to provide information to, and engage in discussion, with competing bidders? (Ex, in Cinerama, No-shop provision was OK because Technicolor could provide info to other bidders, even though it could not solicit them.)
         2. If not, was there a valid reason why? \*\*\*See p. 28 Omnicare
      5. *Disclosure.* Were material conflict of interests disclosed to shareholders?
      6. *Approval by board*. Was there reasonable reliance on experts? was it dominated by an interested member?
      7. *Shareholder approval.* Ratification is evid of fairness
   2. **fair price** reasonably available under the circumstances (Cinerama)

***Other defenses: exculpation***

1. DGCL §102(b)(7): A charter MAY contain a provision eliminating or limiting the personal liability of a director to the corp OR its stockholders for monetary damages for breach of duty of care
2. Provision may NOT exculpate director for
   * 1. brech of duty of loyalty
     2. breach of duty of good faith
     3. for acts/omission involving intentional misconduct or knowing violation of the law
     4. any transaction from which director derived an improper personal benefit
3. Plaintiffs challenging directors conduct have the burden of alleging well-pleaded facts that the conduct falls within the exceptions of exculpatory provision 102(b)(7). Otherwise, case may be dismissed. (Malpiede v Townsend)
4. Under 102(b)(7), can courts still dismiss claims that have both breaches of loyalty and breach of care?
   1. When claims of care violations are mixed w claims of disloyalty and lack of good faith, the question of exculpation arises only after a finding that the transaction was not entirely fair. Only then can the trial court decide whether the unfairness arose from exculpated care claims or from nonexculpated loyalty/bad faith claims. (Emerald Partners II)
   2. Thus, directors charged w both care and loyalty/good faith violations, must go through full trial on both claims before interposing affirmative exculpation defense!

**If Shareholders Have a Claim, What Kind of Suit Can They Bring?**

1. Can the shareholder bring a **direct claim**?
   1. To avoid procedural requirements that apply to derivative suits, shareholders will often seek to characterize their suit as direct. (Eisenberg v Flying Tiger, P tried to characterize the suit as direct to avoid a bond posting requirement)
   2. Often these are losses to shareholders rights: voting rights, registration rights, failure to receive dividends
2. **How should the court determine whether the suit is direct or derivative?**
   1. Court will categorize depending on (i) whether corporation or indiv. suffered the alleged harm and (ii) whether it would receive the benefit of the recovery or remedy. (Tooley)
      1. If there is a loss to shareholder rights🡪direct
      2. If there is a loss to corp🡪derivative
   2. When it comes to categorizing a suit, the plaintiff’s classification is NOT binding. (Tooley)
3. **If the suit is derivative, what procedural requirements does the plaintiff face?** 
   1. Contemporaneous ownership requirement: plaintiff must have been shareholder at time of harm AND time suit is filed FRCP §23.1
   2. Securities-for-expenses requirement
      1. In Cal and NY, courts require the plaintiff to post security (pay a bond) for the defendant’s litigation expenses as condition for maintaining the action. Del. does NOT have this req.
      2. In NY, the security-for-expense requirement is exempted for shareholders with a specified percentage of ownership (10 percent). Note that this would typically require shareholder to get shareholders’ list.
4. **If derivative🡪was demand mandatory?**
   1. **Demand excused:** If demand was excused, claim goes forward. Demand is excused when plaintiff meets burden of proof that demand would have been futile by showing (Levine v Smith)
      1. doubt that a maj.of the board on whom demand would have been made are disinterested (no financial interest, Aranson) and independent (free from dominant conflicted board member) OR
         1. Note, that it is about the MAJORITY of the board members. Look at each indiv involved in transaction.
         2. Do not look at structural bias at this point (Beam v Stewart)
      2. doubt that the underlying transaction would have been approved under business judgment rule (duty of care claim)
   2. **Wrongful demand claim:** If demand was mandatory and board refuses to act, plaintiff can bring a wrongful demand case.
      1. The board’s response receives deferential review from the courts under business judgment rule
      2. The court does not apply the business judgment to the challenged transaction, but only on to the decision not to sue.
      3. As a practical matter, plaintiffs will prefer to say demand was excused, as this claim is easier to make than demand is wrongful argument. Esp since making a pre-suit demand tacitly concedes that the directors are independent!
5. **Has plaintiff alleged particularized facts?**
   1. DGCL §220 permits limited discovery of corp books and records. Derivative suit litigation is a “proper purpose” under the stat.
   2. DGCL §220 will generally be plaintiff’s only means of obtaining discovery for proving demand futility (Beam v. Stewart)
   3. Plaintiff seeking to establish demand futility should use §220 in order to find whether (Beam)
      1. there was a nominating comm to select directors
      2. conflicted director controlled the nominating process
      3. the process incorporated procedural safeguards to ensure director independence
      4. the meeting minutes revealed how directors handled the conflicted director’s proposal or conduct in various context, etc.
   4. §220 can NOT be used for investigating the underlying transaction.
   5. §220 can NOT be used for discovery of information that is already publicly available (Polygon)
   6. Burden of proof is to a reasonable doubt—which is pretty high
6. **If demand is excused, plaintiff files the derivative suit, and the company uses a special litigation committee (SLC) to investigate under DGCL §144, should the court uphold the SLC’s recommendation?**
   1. NY Approach (Aurbach): Question is about *process*. Was the SLC disinterested and independent? Did it follow adequate procedures? Was it a good faith inquiry into the issues or avoidance?
      1. Here the burden is on the defendant to prove the process is adequate in order to dismiss the claim.
      2. Substantive decision not to sue is protected by BJ.
   2. Del. Approach (Zepata v Maldonado):
      1. Stage 1 is the same as NY (looks into procedure) with a special emphasis on the totality of personal and financial relationships betw SLC members and non-independent directors (Oracle)
      2. Stage 2 allows an independent judicial inquiry into the *substantive* decision not to sue. Ct will exercise its own judgment.
         1. Rationale: This is because the Del. courts are concerned that the SLC may be biased towards the board. Also, institutional competence concern is less pressing—courts are well suited to determine whether litigation should continue. (Joy v North)
7. Note on Independence of the Comm:
   1. According to J. Strine, SLC inquiry has a different flavor on the term of “disinterested.” Disinterested goes beyond whether the comm member had a financial interest and **covers structural bias** such as:
      1. Kahn v Tremont: Comm member helped controlling shareholder in a proxy fight two years earlier.
      2. In re Oracle: Comm members and director shared common ties through Stanford.
   2. On the other hand, structural bias has a limit. **Del. Supreme Ct has not applied this outside the SCL context.** In determining the independence of the board, it held that personal friendships and social relations are NOT enough to find someone not independent esp. since these people have their own reputations to uphold outside of their friendship with the conflicted director. (Beam v Stewart)

**What Protections Do Board and Senior Execs Have? Indemnification**

***Three sources of indemnification***: charter, statutory and contractual indemnification and directors’ and officers’ insurance. Note,§145 permits company to indemnify nondirector officers, employees and agents to the same extent as directors.

1. Advancement of litigation expenses. The corp MAY advance litigation expenses if provision is in charter. DGCL §145(e)
   1. This permissive condition may be made mandatory by placing in co. charter or in a private contract btw company and individual. (Citadel Holding)
   2. A company cannot avoid advancement by arguing that the director would not be indemnified, per contractual provisions, if found guilty (Citadel, 16b-violation exception to indemnification was found irrelevant)
   3. There is NO pre-condition of good faith
   4. Del. courts will read a ‘reasonableness’ standard into indemnification agreements. It will not be contigent on specifics of underlying indemnification rights. (Citadel v. Roven)
2. **Derivative suits:** Was the director **successful** in defending the action? If the director is sued because of her corp position and she defends successfully, corp MUST indemnify the director for litigation expenses, including attorney fees. §145(c).
   1. When is a defense “successful on the merits or otherwise”?
      1. Successful does NOT mean moral exoneration. (Waltuch, 2nd Cir.)
      2. Successful = dropping of charges or suit, regardless of the D’s culpability (Waltuch)
   2. If the defense was successful, is indemnification as provided in the charter/contract consistent with overall stat. scheme ?
      1. A corp must indemnify provided that corp agent acted (i) in good faith, (ii) in a manner the person reasonably believed to be in the best interests of the corp and, in the case of crim proceedings, (iii) had no reasonable cause to believe his conduct was unlawful. DGCL §145(a)
      2. It is NOT enough that the charter contains a blanket indemnification clause—indemnification has to be consistent with other provisions of DGCL §145 (Waltuch)
      3. It is NOT enough that §145(f) states that the stat is not exclusive and that the charter can add extra protections. These extra protections simply cannot be contrary to public policy. (Waltuch)
   3. If the indemnification as provided by the charter is not consistent with DGCL §145 requirements, is their **insurance** to cover liability corp could indemnify?
      1. §145(g) allows corp to purchase ins. to shield against ANY liability
3. **Derivative suits:** If the director was **not successful** AND the action was brought by or on behalf of corp (derivative suits), the director cannot obtain indemnity unless (i) he meets standard of conduct (good faith, etc) and (ii) the ct gives approval. §145(b)
4. **Direct suits:** If the director was not successful AND the action was brought by a third party, was he justified in his actions?
   1. Indemnification is permitted only if corp agent acted (i) in good faith, (ii) in a manner the person reasonably believed to be in the best interests of the corp and, in the case of crim proceedings, (iii) had no reasonable cause to believe his conduct was unlawful. §145(a)
   2. A judgment, order, settlement or no contest plea is NOT conclusive as to whether director meets this criteria. §145(a)
   3. Indemnification must be authorized by (i) maj vote of nonparty directors, (ii) by a special committee of nonparty directors, (iii) indp legal counsel or (iv) the stockholders §145(d)

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| **Types of transfers of control**  **Sale of assets:**   * Del. law requires maj. approval from target stockholders (DGCL § 271) but not acquiring shareholders if target is worth less than 20% of new firm. * Dissenting shareholders have no appraisal rights. DGCL § 262. * Del. does not recognize de facto merger doctrine, which allows courts to give voting and appraisal rights to transactions that look like mergers.   **Merger:**   * Shareholders in both companies entitled to vote to approve merger. DGCL § 251   + Exception: if surviving entity’s shareholders will hold more than 80% of the merged corp, a vote by them is not required. §251(f) (Ex, Paramount v Time) * Dissenting shareholders in both companies will have appraisal rights if they had the right to vote on the merger, they voted against the merger, there are fewer than 2,000 total shareholders or the stock is not traded on public stock exchange before and after the merger §262   **Triangular merger (Alpa sets up Sub which merges with Sigma; Alpha remains sole shareholder)**   * Target shareholders gets voting rights * Target shareholders gets appraisal rights if they had the right to vote on the merger, they voted against the merger, there are fewer than 2,000 total shareholders and the stock is not traded on public stock exchange §262   **Exchange/Tender offer:**   * No need for cooperation of target’s management * Shareholders in target will have no appraisal rights, though if remainder of target is bought up in a short-form merger, appraisal rights will attach.   **Short-form Merger under §253:**   * Minority holders of subsidiary stock will have no voting rights * Minority holders of subsidary stock will always have appraisal rights in a §253 merger.   **Benefits of mergers and acquisitions:**   * Shareholders in both firms typically benefit, with target firm doing better. * Value-maximizing:   + Synergies (economies of scale, economies of scope, financial synergies)   + Reduction of agency costs (replacing inefficient managers, increasing management’s equity in the corporation) * Non-value maximizing:   + Risk shifting to bond holders   + Breaking non-contractual promises to employees (incumbent managers may be unwilling to sell employees out)   + Means of reducing corporation’s variance, thus protecting risk averse managers   + Hubris (manager mistakenly believes he can better valuate target than the market can) (Richard Roll)   **Drafting merger agreements:**   * Time lag between announcement and completion of the transaction caused by Hart-Rodino-Scott Act antitrust review, transfer of licenses, etc. The time lag creates risk for both parties: buyer is worried an interloper will make a competing bid, effectively stealing its discovery value, seller is worried it will be left at the altar. * Managing risk for buyer:   + No shop provision will need a fiduciary out clause– if another firm makes a better bid, they must take it.   + Breakup fee. * Managing risk for seller: reverse breakup fee. * Other provisions: indemnification provisions, material adverse change clauses (allocating economic risk to firm during period when merger is pending), collars (adjust price of deal based on stock prices). |

**Duties of Controlling Shareholders and Parent Cos.: When Do Fiduciary Duties Arise?**

1. General rule is that shareholders do not have duties to other shareholders except when there is a controlling shareholder/parent co.
   1. Controlling shareholder = 20 percent of stocks for publicly owned co.
   2. Common scenarios of abuse betw parent and partially owed subsidiaries
      1. Dividend policy. The subsidiary declares dividends to a cash strapped parent at the expense of internal expansion.
      2. Shares transactions. The sub issues shares to the parent at less than fair value OR the sub purchases shares from the parent at more than fair value
      3. Parent-sub transactions. The sub enters into ks on terms unfavorable to the sub/
      4. Usurpation of opportunities. (Sinclair Oil, combination of i. and iv. which failed.)
   3. Controlling/maj. shareholder has fiduciary duty deriving from the directors it controls. Parent may also have fid. duties based on agency principles if appointed directors are employees of the parent
2. **Ordinary business dealings:** Was there self-dealing—did the parent receive a benefit to the exclusion and at the expense of the minority stockholders? NO self dealing if parent corp gets same pro-rata share as sub. (Sinclair Oil)
   1. In the absence of self-dealing/preferential treatment, BJ rule applies.
   2. The minority shareholders have the burden of proof that the transaction was not fair to overcome business judgment rule. (Sinclair Oil)
   3. If there was self-dealing, then the burden is on the def to show fairness. (Sinclair Oil)
3. **Sale of control blocks (large block of stock):**
   1. *Traditional law:* A control premium must be shared among all stockholders if it represents the transfer of a corp asset. (Perlman v Feldman)
      1. Equal opportunity rule: When the sale of control block commands a premium, it should be considered a corp asset and all shareholders should receive their pro rata share.
   2. *Modern law:* Controlling shareholders may demand a control premium for the sale of their block of stock and are not required to share that premium with the other shareholders (Zetlin v Hanson Holdings) UNLESS
      1. There is a sale of office in which the buyer could not have elected his own slate otherwise (Essex Universal v Yates, not a bare sale of office when contract promising the resignation of the board comes with a 28% controlling block; compare with In re Caplan, 3% was not enough and constituted sale of office)
      2. Or it is a sale to “looters:” Seller cannot go thru w/ transaction if he suspects buyer will steal corporate assets or engage in self-dealing (Perlman)
4. Sale of offices: A controlling shareholder may sell control of the corporation but may NOT sell its offices. (Essex Universal Corporation v. Yates)
5. **Short-Forms under §253—two step process of 90% tender offer + short form merger**
   1. Is the approval of minority shareholders needed*?* NO. When a parent corp owns 90% or more of a sub, they can merge without approval by shareholders of either corp. Only approval of parent’s SHs is required. §253
   2. Do minority shareholder get fairness review?
      1. For a parent, a two-step process of buying shares to receive at least 90% ownership and then conducting a short form has the added benefit of avoiding entire fairness analysis. (Solomon v Pathe Comm, no “fair price” review for tender offer by parent in the hopes of getting 90% ownership)
      2. UNLESS there is coercion or breach of duty of disclosure during the tender offer process (Siliconix). Del. appellate cts are split on coercion question:
         1. Not coercive to say you are only “planning” to do the back end short form merger (Silconix, J. Noble)
         2. Coercive unless (i) offer must be subject to a “maj. of minority” condition, (ii) a promise to engage in a prompt back-end short form merger at the same price as tender offer and (iii) not involve in retributive threats. (In re Pure Resources, J. Strine)
   3. Appraisal remedies are always available for §253 mergers (Glassman v Unocal Exploration)
6. **Squeeze-out mergers—two step process of tender offer plus stat. merger**
   1. **Is it a “controlling” shareholder?** A controlling shareholder is one who owns a maj of shares OR who owns a substantial number and exerts influence over the board. (Kahn v Lynch, controlling shareholder owed 43% and had 5 directors on a 11-member board)
      1. Controlling SH has fiduc duty to minority SHs via control of board
      2. Directors cannot favor one co. over another when they have conflicting fiduc duties (Weinberger)
      3. Normally indep comm has cleansing role—but not when there is a controlling shareholder (Kahn)
   2. **Was it entirely fair?** No BJ rule. Squeeze-out mergers are subject review under entire fairness test that requires (Weinberger v UOP)
      1. Fair dealing AND
         1. timing: did the board have enough time to bargain?
         2. initation: was it initiated by the controlling stockholder?
         3. structure: were there any outside directors or experts involved?
         4. negotiation: were controlling shareholders’ directors on both sides of table?
         5. disclosure: was there disclosure of relevant facts and conflicts of interest to outside board members and shareholders?
         6. how approval of directors and the stockholders was obtained: was the fairness opinion a “rush” job?
      2. Fair price
         1. Court will be less likely to find fairness where compensation for the acquisition is not pro rata (e.g. controlling shareholder is cash hungry and bargains for this at the expense of getting a more lucrative stock deal)
   3. Note: **Same burden shifting and ratification standards apply as in reg. duty of loyalty context**—burden begins on the D SH/parent as BJ does not apply (Kahn)
7. **Negotiating merger on behalf of corp:** 
   1. Can implicate self dealing if parent corp/controlling SH receives a non-pro rata dividend (McMullin v Beran)
   2. While the board can rely on the maj. SH to conduct prelim negotiations of a stat. merger, it ultimately has to make an **independent and critical assessment** (Beran)
   3. In absence of an independent board assessment, ct applies **entire fairness analysis.**

**Appraisal Remedies in a §251 Merger**

1. **Is it a “merger” or sale of assets?**
   1. *Del:* Dissenting shareholders of the acquired corp in a merger receive the right to an appraised, fair value of their shares if they had the right to vote on the merger, they voted against the merger, there are fewer than 2k shareholders and the stock is not publicly listed §262
      1. §262 does NOT include sales of assets which are regulated by §271 which provides voting rights only. (Arco Electronics)
      2. Appraisal rights are determined by the court which assesses the “fair value” of the shares §262(h)
   2. *De facto merger jurisdictions:* If sale of assets has the effect of merger, shareholders are entitled to voting and appraisal rights. (Farris v Glen Alden, Pa.)
      1. “Sale of assets” will have the effect of a merger if the outcome is “seller” owning maj shares of “buyer” (Farris, List solds its holdings but received 76% of shares of GA for List stockholders)
      2. Note: Under Pa. law, sellers of assets get appraisal rights. Farris court could have also recast Glen Alden as seller rather than “buyer” instead of relying on merger doctrine to get appraisal rights.
   3. Where there is no arms’ length negotiating, court will be more inclined to require appraisal rights (Compare Glen Alden with Arco Electronics which was also a swap of assets for stock. Difference was that transaction was arms length)
2. **What should be included in the “fair value”?**
   1. §262(h): Ct should determine fair value exclusive of “any element of value arising from the accomplishment or expectation of the merger or consolidation.”
   2. Cede/Weinberger interpretation of §262(h): The value created by acquirer during step one and step two of a two step merger may be considered in appraisal proceedings as long as such value was effective on the date of merger. Only speculative elements in appraisals should be excluded. (Cede, valuation included implementation of new management’s plans because those plans had already begun to be implemented.)
   3. Court can consider not only the Del. block method but also discounted cash flows and other financial techniques. (Weinberger)
3. **Is there an equitable remedy as an alternative to appraisal?** Normally court grants appraisal rights (value of shares at time of merger). It would be very unusual for a court to actually require that a merger be undone. Where the court finds the latter to be an appropriate remedy, it will likely refuse specific performance and require defendant pay what the value would be today but for the merger. Only possible if the company remains the same. (Coggins v. Patriots)

**Tender Offer/Takeover Situations**

1. **Filing requirements in 13d:**
   1. Bidder is required to file a Sched. 13 disclosure when acquiring beneficial ownership of more than 5% of the shares SEA §13(d). Must be filed w/in ten days after the 5% threshold is passed. The bid must be left open a minimum of 20 business days. R.14e-1. Must be open to all holders. Rule 14d-10(a)(1). When the bidder seeks only a portion of all the shares and shareholders tender more than the bidder seeks, the bidder must purchase the tendered shares on a pro rata basis. SEA §14(d)(6). Bidder may change the price but the offer must be left open for an additional ten days.
      1. If persons who collectively hold more than 5 percent agree to act together for the purpse of affectring control, they (as a group) become subject to the §13(d) reporting requirement.
2. **Sched 13d disclosure must include**
   1. the acquirer’s (and any group member’s) identity and background
   2. the source and the amount of funds for making the purchases
   3. the number of the target’s shares held by the acquirer
   4. any arrangements that the acquirer has with others concerning shares of the target
   5. the acquirer’s purpose for the acquisition and his intentions w respect to the target
3. **Regulation of deception under SEA §14(e):**
   1. Did the bidder deceive shareholders? SEC prohibits any **false or misleading statement**—as well as any fraudulent, deceptive or manipulative act—in connection w any tender offer or any solicitation for or against tenders. SEA §14(e)
   2. Same **materiality standard** as in shareholder voting: there is a substantial likelihood that the information would have been considered important by a reasonable investor.
   3. **Does not regulate unfairness**. §14(e)’s prohibition against “manipulative acts” regulations only deception and cannot be the basis to challenge a tender offer’s substantive fairness nor be used to regulate defensive tactics. (Schreiber v Burlington)
4. **In the absence of coercion or material disclosure violation, the adequacy of a price in a tender offer does not give rise to cause of action. (Soloman v Pathe Comm)**
5. **Fiduciary duties and defensive tactics (entrenchment) in face of hostile takeover**
   1. There is NO fiduciary duty to take defensive actions (Easterbrook’s passivity rule) even though boards have the right to do so if they think it is in the firm’s best interest (Unocal)
   2. Under the **Unocal standard of intermediate review**, court will find no breach of duty of care IF
      1. the board in good faith reasonably perceived the bidder’s action as a threat to corp policy (**reasonable test)**
         1. Was the board independent? independence of the board as indicated by presence of outside directors materially enhances their reasonableness
         2. Did they obtain fairness opinion from invest. bank not affiliated w mgmt?
         3. Consider: price of bid, timing of offer, effect of offer on co., regulatory issues, bidder’s intentions, bidder’s financing, ultimate price bidder may be willing to offer
         4. Facts: Mesa threatened a two-tier front-loaded cash tender offer for shares of Unocal – stockholders who waited for second-step merger would receive less than those who tendered. The price Mesa offered was below what investment banker believed was fair. As a defense, Unocal bought up its own stock in a tender offer in which Mesa was not eligible to participate.
      2. and the defensive measures adopted are reasonable to the threat posed (**proportionality test**)
         1. Was the tender offer coercive, creating a prisoner’s dilemma with a two tier transaction? was the price inadequate? did offer have a tight deadline?
         2. Timing/uncertainty/risk that shareholders might not understand more strategic alternatives = coercive tender offer (Time-Warner)
         3. Is a proxy vote “technically” possible? Shark provision requiring supermaj. vote for merger plus “mild” stock repurchase program entrenching mgt (holdings upped from 23% to 28%) is proportional. (Unitrin)
      3. Defensive tactics that interfere with shareholder voting rights will not pass Unocal test. In these cases the courts will apply a higher standard of review—the **compelling justification standard.** (Blasius; Carmody, dead hand provision favored incumbents at the expense of shareholders)
         1. Note: Dead hand provisions invalid in Del. §141(a)
      4. If pass Unocal standard🡪adopt **BJ**

**Deal Protections and Transition to Auction**

1. **When do Revlon duties attach?**
   1. **Is it a bust up?** The board has a right to defend the company from a takeover which might result in dissolution, BUT once the board authorizes the negotiations of a merger with a competing bidder, the break-up of the company or its sale to one suitor or another became inevitable, then they have a duty to run an **impartial auction**. (Revlon)
      1. SHs, NOT other constituents, are the priority in a sale.
      2. If there are benefits to other constituents they must be rationally related to shareholder wealth maximization.
   2. **Is it a sale?** 
      1. Revlon duties imposed when co. seeks on its own an active bidding process (easy case); a target, in response to a bidder’s offer abandons a long term strategy and bust up of co. seems inevitable; or when a merger is a substantial change in control. **(Paramount II)**
         1. Time-Warner was not a substantial change in control bc ownership remained with public shareholders.
         2. Paramount II was a substantial change in control bc merger would turn Paramount’s public stockholders into minority holders and they would lose voting power to approve mergers, elect directors; etc.
      2. Where a change in control is not inevitable, directors do not have a duty under Revlon to maximize short term shareholder value at the expense of long term business plans. **(Time-Warner)**
         1. Time-Warner facts: Time was undergoing stock-for-stock transaction and Paramount made a cash-for-stock offer for Time at a substantial premium. Ct found that Time was right to reject offer bc they believed merger w Warner would better preserve long term shareholder value.
      3. **Being in play ≠ sale (Lyondell)**
         1. A mere filing of 13D and/or purchase of block of stock, signaling a possible takeover, does NOT constitute a sale triggering auction duties
         2. No single blueprint at running an auction: in the absence of bad faith, the wait and see approach is OK.
2. **When do deal protections become burdensome?**
   1. Deal protections merit enhanced judicional scrutiny and will be upheld ONLY IF they are **not preclusive OR coercive** (Omnicare)
      1. Deal protections cannot make it “**mathematically impossible** and realistically unattainable for . . . any other proposal to succeed.” (Omnicare)
      2. Termination fees in the range of **2-3%** are generally acceptable. (Revlon)
      3. Is there a **fiduciary out**? Pre-commitment devices are subject to fiduciary outs and it is the duty of the board to negotiate them. (Capiral Re, Omnicare)
         1. Board will not be liable for breach of contract if ignoring no-talk provisions, voting agreements and force the vote clauses means they can more effectively run an auction. (Capital Re)
         2. Does NOT matter if fiduciary outs technically can only be exercised at advice of counsel—ultimately it is the board’s decision. (Capital Re)
      4. Do minority shareholders have control of outcome? A voting lockup entered by controlling SH is NOT coercivewhen deal is approved by a maj. of minority shareholders who retained the power to reject the deal (Orman v Cullman)
   2. If they are not preclusive or coercive, were they **reasonable** in relation to threat posed (i.e., bidder walking away)? (Unocal)
   3. Omnicare applies even if company does not have Revlon duties. (Capital Re)

**Insider Trading**

1. Is trading fraudulnet under **R. 14(e)(3)?** In the context of an **unannounced tender offer**, Rule prohibits trading by anyne (other than the biddder) who has material, nonpublic information about the offer that he knowns (or has reason to know) was obtained either from the bidder or the target
   1. NO need to prove that tipper breached a fid duty for personal benefit
2. Is trading fraudulent under **SEA §10b-5**? Insiders may not take advantage of inside information unavailable to others in the market when trading in their own securities. They must wait for full disclosure by the corp. (Texas Gulf)
   1. NO defense to say disclosure was forbidden by corp.
   2. Full disclosure = disclosure + dissemination
3. **Is the information material?**
   1. Whether a fact pertaining to the future of the co. would be material to a reasonable investor depends on the (i) probability of the event occurring and the (ii) anticipated magnitude of the event in light of the totality of the co. activity
   2. Event studies could indicate whether the event was “material” to the stock market—did the price change in response to disclosure of the information?
4. **Was the person an insider?**
   1. Traditional theory of insider trading: In order to violate 10b-5, person must be a corp insider—one who owes a fiduc. duty to shareholders (Chiarella)
      1. Officers, directors and other permanent insiders as well as temporary insiders like attorneys, accountants and consultants
   2. Derivative fiduc duty theory: Tippee has derivative fiduc duty stemming from his obtaining info from insiders improperly. (Dirks)
      1. Improperly = insider **had a duty** not to reveal & tippee knows/should have known AND
      2. The insider received a **personal gain**, causing him to breach his duty to SH.
      3. There can be fiduc duty btwn husbands and wives. Rule 10b(5)-(2)
   3. Misappropriations theory: A person commits fraud in “connection with a” securities transaction when he misappropriates (i) confidential information (ii) for securities trading purposes (iii) in breach of a duty owed to the source of the information. (O’Hagan, attorney whose client was bidding to merge with Pillsbury, traded in Pillsbury stock)

**Disclosure Requirements under Rule 10b-5**

1. Does the plaintiff have a **cause of action**?
   1. A private damages action under Rule 10b-5 is confined to actual purchasers or sellers of securities. NOT enough to say you “would” have bought the securities. (Blue Chip Stamps)
   2. Rule 10b-5 regulates only deception, NOT unfair corp transactions or breaches of fid duty. (Santa Fe, unfairness in a §253 merger is not a proper claim under this Rule)
2. Was there a misleading statement “**in connection with the purchase or sale of any security**”?
   1. Statement does not have to be formal or official.
   2. Statement does not have to be made directly to the investor (Levinson, one of the statements denying merger was made was a comment to a newspaper reporter)
3. Was it **material?**
   1. **Agreement-in-principle** theory, which says merger discussion does not become material until agreement as to price and structure of the deal has been reached, is NO defense. (Levinson)
   2. No defense to say mortality rate of merger is too high
   3. Standard to be applied is **the probability/anticipated magnitude** test of Texas Gulf
      1. The relevant factors in determining probability include board resolutions, instructions to investment bankers, negotiations btw principals and their close intermediaries
      2. And for magnitude: size of the two corp entities, potential premiums over market value
4. Was it **intentional**? A plaintiff in a 10b-5 action must plead and prove the D’s scienter, a mental state embracing intent to deceive, manipulate or defraud. Mere negl is NOT enough. (Hochfelder)
5. Was there **reliance** on the information?
   1. Ct will apply fraud on the market theory: If the stock price incorporates materially misleading information🡪we can assume that the investor relied on this price in deciding whether to buy/sell.
   2. D can try to prove the market was not efficient OR that the plaintiff had relied on something else

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| **Public Policy Cheat Sheet**   * **Jensen and Meckling:** In a corp. there is a separation of ownership and control: ownership rights are not held by individiuals who manage corp. Firms are therefore not profit maximizers bc managers will seek to maximize their own utility (happiness, pleasure) which will not be the same as maximizing the firm’s profits bc managers obtaine non-pecuniary benefits which are neither convertible to cash nor available to nonmanaging owners. As a result, there must be time and effort spent to align managers’ incentives w owner’s preferences—agency costs. Investors discount the value of the shares of a corp in anticipation of this problem. * **Reasons why debt is good:**   + Tax benefit: payment of interest is a business expense (unlike payment of dividends)   + Avoid equity agency problem: keeping management and ownership in same hands preserves the efficient pecuniary to non-pecuniary benefit tradeoff   + Leverage: greater potential gains from investments. * **Smith and Watts:** Recognizes but rjects tax effects theory. Instead firms use executive compensation packages to align the manager’s incentives w firm value maximization (i.e. mitigate agency problem) * **Easterbrook and Fischel:** Defensive tactics in response to a tender offer decrease shareholder’s welfare. Institutionally, tender offers are a method of monitoring the work of mgmt. This process of monitoring by outsiders poses a continuous threat of takeover if performance lags. |