US CORPORATE LAW & THEORY

PROF SLAIN

- Conference on Commission in Uniform Laws: public agency. Members are from several states are Commissioners.
    a. Introduce some uniformity in areas of the law where uniformity is essential.
    b. Uniform Code: commercial, partnership act, etc
    c. Updated in 2000
- Every state has the same number of Commissioners
- Not binding on anybody: proposals made to State Legislators. Getting them adopted state by state is a political process.

Montagne: experience is indeed the very best of teachers. The test comes first and the lessons come afterwards.

Reading cases you get to learn what happened to other people, and learn from that.

Letterman: NYU Law Review. Advantage of reading cases is sharing experience of other people.

ASSIGNMENT I

The Corporate Entity

Going into business

SOLE PROPRIETORSHIP

Smith: decides to open shop to sell neckties. Renting a store buying inventory, furniture and fixtures, opening the door and see what happens.

What Governmental permissions does he need: none![1] No agency of the government that has any role of any kind.

Name: sole proprietorship

- No difference in terms of his earning, tax purposes. No sense in which the business is separate from him. The same goes as to the debt and obligations.

Schedule C: deals with Sole Proprietor: list all the income, deductions and come to a net number.

GENERAL PARTNERSHIP

Smith: requires more capital and more time and attention, so he finds Max. Oldest business concept "s*ocietas*": general partnership. Organization of 2 or more people as co-owners to operate a business.

Gral Partnership Law: precisely derived of the Uniform Act

- Relationship among the partner: default
- Relationship of the partners to the outside world: not changeable. Each partner is personally and unlimitedly liable for all the debts and obligations of the firms.
- Default Rules: apply in the absence of other agreements.

[1] Use something other than his name. Fictitious name Statute: using a trade name other that his or her own name that name has to be registered with some state office: s 130 General Obligation. Non-Compliance: outlawry: you cannot sue on obligations that were created in your favor during the time of no compliance. NY law: not sue until you comply, then you can. Other states: misdemeanor.

First sue the partnership, take the partnership assets, and then go and enforce the judgment against the partners. Against all the partners and enforce it anywhere you can.

Ultimately tort victim, or contract claimant, you can collect from any partner or all of them.

Partnership is a tax reporter: files a tax return shows its income and deductions. Lists its partners and it shows how under the partnership agreement those partners have had allocated to them the incomes and the deductions.

Formalities: none. He became a partner without knowing. Only requirement (name FNA)
Agreement among the partners to remain partners for longer than one year (Statute of Frauds[2])

CORPORATION

Recognition Legal entity: have legal rights and obligations (able to sue and be sued), own property. Separate from those of the shareholders.

Modern American idea: only the State can create a corporation. Undisputed unchallenged. "Universitas". Dicey: there is no historical record of any society who had not developed the concept of the corporation. Enough people involved, and activity becomes necessary for the legal system to treat it as a legal entity separate from that of the owners.

Treat the university itself as the owner, it was a corporation (Oxford and Cambridge)

King James 1st: introduce absolute monarchy in England. Seizing to themselves all power in the society: exclusive eight to create corporation.
Commonwealth.

East India Company: trading companies had been formed were two-kind.
Massachusetts/ Virginia corporations for governmental offices.
Trading forms, vessels, crew sale someplace sell cargo bring it home, etc….One shot deals.

[2] Certain kind of agreements have to be in writing: contract that by its term cannot be fulfilled in one year, it has to be in writing. The enforceability of that agreement would require a writing signed by each.

- EIC 1698 had an ongoing business: no questions of liquidating it. Charter not limited by the lives of the people involved: perpetual. Capital put into this business was there forever. Provided that the interest of the investors were transferable.

Law of assignment: Am Revolution:

US History: Colonial, 1787 there were almost no entities in the US that you could recognize as a business corporation.
Alexander Hamilton: proposal that the national government had a monopoly in creating corporations.

No body else ever referred to him again: no one thought that this was a serious matter.

Constitution: power not reserved by the Constitution. The states have the power to create corporations.
In the Legislature: general pattern, unsure where a power resides, it does so in the Leg.

Charters were so fractional and incomplete; people came to court regularly to find out what their rights and duties were. Became quite usual for the court to play a very large role in corporate governance.

Lacuna:
Permanent, investment, corporation, shares transferable. What about the personal liability of the SH or the managers.

AM history: Mass case [Ellis v Michael] holds: the SH of a Massachusetts corporation have no personal liability for the debts and obligations of the firms, as do the managers. Making a formal rule out of what every other one understood that was the law.
1900 agreed that there was no personal liability.
Dividend:

1824 [Wood v Drummer] D Maine
STORY: were also the district judges. As to a Maine Corporation the capital put in by the shareholder was a permanent commitment. There was a trust fund for the benefit of the creditors, and cannot be withdrawn unless something happened (liquidation)

Leg charters: costumed tailored for every company.

1st General Statute for the creation of corporations New York 1830. The last state 1890.

Delaware statute is hard to read: general corporation law; routinely unjustifiably favorable to corporate managements. Finds some inconvenience you can often take the special situation and get the legislature to draft into the statute 8 pages of amendments to cover this odd situation.

NY stock corporation law: statute can be used for the formation and governance of any business corporation but for those for which there is a special statute: Education, banking, insurance, etc. Corp with another purpose, religious, labor organization, etc.

Differences are minimal:

State statutes do not in any way distinguish between corporations by reference to their size or to the number of shareholders.

German Soc Resp Lim: Limited Liability company now exists, not before.

Law: business corporation was exclusively state law, other than federal laws forbidding doing something→ zero federal oversight.

1933: change. Doctrine of **the Securities Act 1933** federal system of regulation on stock sold publicly.

1934 **Securities And Exchange Act**. Provides ongoing regulation of a vast number of companies.

Tax Statues: is a taxpayer, in exactly the same way any person is IRC Internal Revenue Code. Provisions, which could not apply to an individual, and things, that could not happen to a corporation. Leaving aside these, the statute applies to all.
Non-corporate tax payer: progressive system: rate goes up as your income goes up.

Corporations: flat rate. 34%

Tuesday, September 1st

FORMATION

Writ of Mandamus: "We order" Old English form of action. Require an official to do something, as to what the official has no discretion of any kind.

NY general charter dealing with Corporations

- Formation of a corporation: it is a matter of right
- S 401 NYPCL one or more natural persons over the age of 18 can form a corporation.

Delaware: even more liberal: person forming the corporation need not be a natural person, can be another corporation, trust, whatever.

Clearly stated. Remarkably alike: substantive provisions are alike
Model Business Corporation Act
Does not include number of important states: California, New York, Delaware, etc.
Uniformity. 2 or 3 rewritings, amendments.

→Prior to 1933 corporation law was entirely state law.
→ Overlay of Federal Securities Regulations

Limited Partnership (LP)

- General Partnership Law: form the partnership and the law finds it
- No filing: you have a general partnership, loose limited liability

LP: Statutory creature: must comply with the statute precisely and in every state you must do a filing.

Copy 1819 from the French Code:

- Entrepreneur (E)+ investors (I)
- E: Run a business; I: invest money
- Entrepreneur will be the general partner of this limited liab. company, the only right limited partners have Is the right to share the profits, NO management.
- Limited partner that became involved in the management became a general partner?

Ex: Mom and Pop businesses, farmer

Rights:
1) Entitled to receive our share of profits
2) Check books
3) Sue the general partner

No conflict of interest between gral. partner and the limited one. Simple businesses

Limited Partnership had use for real business: example: oil and gas drilling and theatrical productions. (high risk of failure, if they pay off the pay off big)

[Ltd Liab and tax purposes (pass though taxation)]

Modernly: used to finance the assets someone else is using in a business. [Reviera Congress Associate]
Run a hotel, Hotel, Financing
We are great operators

- Build in conflict of interest: nothing in play for gral. partner, Limited partners are invested with no other rights.

NEW Ltd Partn Act: provided them with some rights.

- 2001 another Ltd Partn Act: abolishes the provision that limited partners become general partners is they get involved in the management.

Limited Liability Company (LLC)

Organization
Members are partners to one another
No one other than them have any liability

Handful were created: tax story: IRC Internal Revenue Code s7701 c. Defines the word corporation: shall include association (an ass. To be taxable as a corporation need not be characterized as such under state law –partnership, trust- if it had a preponderance of corporate characteristics, for federal income tax purposes it is a corporation: 6 characteristics

- Associates (more than one principal)
- Business
- Centralized management
- Continuity of life

- Limited Liability
- Transferable interests

1936 Supreme Court decision.

IRS true only is you only don't understand centralized management: management. ???
Kept LLC, LP no matter what you did you were in fight with IRS.

Jan 1, 1997: Reg s 301-7701-3. Check the box regulation

- Entity formed under state law; a corporation only for tax purposes
- Organization 2 or more, not characterized as a corporation under state; can **elect** either to be a partnership or a corporation for tax purposes.

LLC requires state filing
1. Organizational Agreement: filed in the state public document
2. Operating Agreement: among the members as to the operation. Not a public document.

Difference LLC statues than any other form.

- Delaware: is long, hard to read.
- Uniform Acts: no states have adopted it.
- In almost every state you can have a one person limited liab. company. (sole proprietor when you can with minimum effort and expense become the only member of LLC with no liability to IIIrd parties)

"Be not the first by whom the new is tried, not yet the last to let decide." Alexander Pope.

❖ P, LP, LLC benefit over the corporation avoid the whole taxation.

$1 (1- ETR Entity Tax Rate) (1- ITR Investor Tax Rate)=

P (1- 0)(1- .33)= 67 cents
C (1-.35) (.33)= (65c) (15%)= 55,25 cents

S corporation: small business corporations. Ownership structure. No non resident aliens, no trust or corporations, just individuals. Income comes from doing active business (not royalties etc)

- Pass through entity: no income tax return, but income tax report. Shows what the income is, and what is taxable.
- Taxed like a partnership.

Decision to make: terminate S company:
Business becomes profitable: pay a salary: deductible to the corporation, taxable zero.
Small businesses never pay dividends, they pay salaries. Not improper.

Depends on there being partners: taxed on income they are not receiving. You become a partner in this firm providing $. Now the business makes $ and they want to keep the $ in the business for growth. You high tax bracket, constantly on $ you are not receiving. Conflict of interest.
???
Drafting contract: complex drafting.
Buy your shares: at a discount.

September 3, 2009

Avoid double taxation: P, LP, LLC if the only payoff for the investors in this business is the distribution. Business earns money, pays any taxes it owes and then distributes profits to investors. CHEAPER to be in a partnership.

Small business that doesn't t really matter: operating business+ modest number of shareholders= make an election "Sub S election": opt to be treated as a partnership. Opt out any time, only limitation cannot opt back in in 5 years.

- Early money loosing days, you are in the Sub s.
- When the lions cross, and start making money, opt out of sub s.
- Constant need for money.
- No distribution of profits, give them salaries: effect of corporate tax rate is zero

§ 7704 P including LLC, anything being tax as such, if that has transferable shares it is characterized as a corporation. A tradable share equals an association and therefore taxable as a corporation.

- Adv of a corporation: limited liability. Yes BUT:

Ex: financial statement: furniture, fixtures, don't have cash. Don't feel like shipping them 300,000 worth of goods. Personal guarantee: they get paid first. This becomes more attractive. w/out accepting the risk about unlimited liability you cannot start up a company: [**you don't start with limited liability, <u>you grown into it</u>**].

Joint venture company: two large corporations want to form a company to do sthg. quite specific. Elaborate contract: drafting. Form an LLC and don't pay additional tax.

LLP provision in the P act, that a P can register publicly as a LLP if that is done the members of the firm will have no personal liability except for their own conduct.

- Law firms, physicians: risk of malpractice, veterinarians to avoid malpractice.
    - Treat patient: harm, patient sues: can he sue every partner, yes, each partner is liable for the debts of the partnership.
    - This is avoided by the LLP. Partners unlimited liability for their own actions, limited liability regarding actions of the other partners.

INCORPORATION

Delaware more favorable, tax advantages
→insignificantly different from other statutes
→save money?

Incorporate in Del, run business in NY: will increase costs. There is no gain whatever. Only reason for forming a corporation in a place other than a place where we are trying to do business is IF there is a provision in the corporation law that you want to avoid.

S 630 NYBCL personally liable for employee wages. (not if the company has securities trading)

SHAREHOLDER TRAP

Cultural of American business, that if your business fails, you will be a pariah. If you don't pay them you will never be able to get back in the business

- Top 10 shareholders pay them

Closed Corporation: form it where you want to do business!

Corporation sells stocks to the public and go into competition.

- Ppal offices are going to be in NY
- Del to Washington: save filing fees in Del. Microsoft.
- Option of going to Delaware is Compellingly good: extremely sophisticated and well developed body of law created by the courts. 70% cases are Delaware
- Court of Chancery: special court. Different remedies something other than money you have to go to a court in equity. Corporate litigation is heard there: no jury, only a judge.

Corp. made a deal, circumstances the management of the corp. duty to find another buyer: agreement with the putative acquirer. Various. Shop duty to shop somebody has to do the shopping. The management and directors can have all kinds of personal interests in this situation, prefer one buyer over another, conflicts of interests. Everyone end in litigation.

- Keep everybody behaving properly: better than what you can get anywhere else.

Incorporation

§ 102 Name: name reservation: find if it is available, if it is you reserve it, Holds it for 30 days, you can renew once.

Document: **Certificate of Incorporation** (Articles of Incorporation) (Charter)

- Statute: § 402

  i) name,

  ii)purpose, carry **any lawful business**: specify the business to protect investors, cap it somehow.

  Iii) country

  Iv) Number shares, different classes: deals with the problem of **over issuing**. Protect shareholders: so that my investment is not diluted without my consent. Extra shares →they are not shareholders!

  V) if different classes of shares, designation of each class and a statement of the relative rights.

  Ix) if other than perpetual it should state it.

  NY § 402 B (Del 102 b 7). Include any provision which exculpates any of the directors from any liability for mismanagement: limited only by intentional wrongdoing and bad faith.

  NY § 719 paying illegal dividends

  - 1987: Delaware [Smith v. Van Gorkem]

- Strength of Delaware Chancery court.
- Corporation, which was looking for someone to take them over.
    - CEO found a buyer: made a deal with him. Gave them no notice, ignored everybody who disagreed, got to vote for the sell.
    - Shareholders sued: CH analyzed the situation and concluded the manner of doing this deal was outrageous. Below good standards. Bad Process!
    - Mayor defense: a good deal. There was nobody around, with any offer.
    - Held: behavior appalling. Behavior CEO appalling. BUT it was a good deal.
        - Reversed by Delaware Supreme Court: held: Directors were all liable, remitted for application of damages. 13M personally liable to the SH.

- 102 b 7: one year later the statute was amended: harmless directors form liability anything other than conscious misconduct.
- A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under § 174 of this title; or (iv) for any transaction from which the director derived an improper personal benefit. No such provision shall eliminate or limit the liability of a director for any act or omission occurring prior to the date when such provision becomes effective. All references in this paragraph to a director shall also be deemed to refer (x) to a member of the governing body of a corporation which is not authorized to issue capital stock, and (y) to such other person or persons, if any, who, pursuant to a provision of the certificate of incorporation in accordance with § 141(a) of this title, exercise or perform any of the powers or duties otherwise conferred or imposed upon the board of directors by this title.

Certificate sent to Secretary of State.

§ 404 Organization meeting: with purpose of adopting by-laws.

- Directors, how many
- Officers: duties?
- Fiscal Year of the business, “end of…” “52, 53 week year” (resort business close on labor day).

- Meetings of the Board of Directors, SH when? where?

Agent of incorporation: serve the Secretary of State, serve the company.

EISENBERG NOTES ON Defective incorporation

Given the simplicity of incorporating the corporation no need for default rules. Retreated from that position in a later version. De Facto version.

- De Facto: statute under which we could have incorporated.
    - Substantial effort to incorporate is enough to be considered a de facto corporation
        - Did serious effort to comply with it
        - Went out and conducted business
        - Gone that far, the state would recognize the corporation as formed
    - Typical case: parties drafted it, signed, turned t over to the lawyer go never got to file it.
    - If the corporation doesn't exist: who is liable? I) All people incorporated the co. ii) Agency doctrine: warranty of authority: purported corporation which was not formed, liable to you is the person you dealt with. (NY law)

Ultra vires: old fashion issue: impossible to arise, not likely

September 8, 2009

Diversity jurisdiction: federal courts apply state law.

Ex 1: Idaho Corporation, employee traveling on business. Wonders all around the country to Rhode Island. Negligently injures somebody.
Could that person sue him in Rhode Island

- Place accident
- Can the Idaho Corporation be sued? Or be liable for the injuries?

    Yes, if the injury that he caused was caused while he was working on his employers business.
- Can the Employer be sued in Rhode Island? Depends on a couple of things

- Constitutional limitations on the power of the court to drag into it people that are not present in the estate.
- Long arm statute: permits them to reach anybody who is responsible for an injury caused by a automobile accident. Bring in the Idaho corporation and require him to litigate there. What law? Depend upon RI conflict of law rules. Substantive law applies, RI own.

Ex 2: Idaho Corporation sells products in RI. No plant in RI, no sale office, no employees, they advertise in RI.

- If RI would permit anybody else to sell x in the state, it MUST permit the Idaho Corporation.
- Cannot create a monopoly for local business.

Ex 3: If the Corporation had a Sales office and a plant. Idaho could only Bar them from doing business if they would bar a RI corporation. If a local corporation can, the Idaho one can.

- FN: RI requires that qualify "to do business". Essentially a misnomer: RI discretion about whether they would permit the Idaho do business, they don't have.
- File a copy of certificate of incorporation. Sued in RI, subject to tax. Pretty much a RI corporation.

Article 13 NYBCL
§ 371-85 Del GCL

"**Internal affairs doctrine**"

[Mc Dermott v Lewis]
Transaction: inversion transaction
Mc Dermott a company engages in construction around the world on a massive scale.
Locally: McDermott Delaware corporation main business Louisianna.
Foreign business: by a Panamanian subsidiary "International": 100% owned by McDermott Del.

- IRS control foreign corporation CFC provisions: if they apply, the income of controlled foreign corporation is taxed immediately to the US owners.
- International Panama: meet the standard: income taxed directly to the parent, McDermott Delaware. [Considerable great disadvantage to foreign and us competitors]

- What they are trying to do: Mc D becomes subsidiary, and International becomes a parent. International makes a tender offer.
    - International will no longer be a controlled foreign company. All shareholders of MC D Del were swapping their shares US citizens.
    - Controlled foreign corporation only count the five larger shareholders, in combination half stock:
    - SH approval required?
    - Mayority of SH exchanges their shares for international shares: they have to approve the transaction for this to happen. Far more than a simply majority.
    - International: 92%
    - Mc D still owned 10% of its parent company: plan of reorganization expressly that the shares will vote.
    - S 6 12 b.

Shares of International owned by Mc Dermott will be cancelled.
Management of international, caused MCD Del to vote on their own shares.

Del Law: impermissible arrangement, also in Louisiana, everyplace in the US. Permissible in Panama. What law applies?

- Panamanian law. "**Internal affairs doctrine**" internal governance of the corporation, SH and managers, directors, etc determined by reference to the law of the place of incorporation.

Governance of the corporation: that it has to be a single point of reference. It must be by reference to the law of the place of incorporation.
Not only a choice of law rule, but a Constitutional requirement as well:

Corporate law more uniform than it ever was.

Exception: California: corporation code, special category of corporation foreign corporations (Delaware, etc) majority of SH are Californians, majority business in California, employees and assets are in California. Securities are not publicly traded. Closely held company: Cal purports to apply its corporation law to such corporations

- Merger or fundamental change. Affirmative vote of all classes of stock. Non-variable provision.
- California's stringent limitations on the payment of dividends: can they do it?

- It has got to get to the Supreme Court:

S 1319 Apply NY law more broadly than the California law: reasonable be described as foreign but everything is local in California

- Proposed repeal of the section: no one has attempted to apply the statute, don't stir anything up. Appeal by desuetude:
- Miscellaneous odd collection of things that really don't matter much, no one motivated to do anything about it.
- Constitutional attack, found constitutional s 1315: 1991 Sh can ask for a list of the record of SH.

ECJ [Inspire Art] internal affairs doctrine in Europe. EC Treaty demands country to apply the internal affairs doctrine.

- Formed in the UK: proviso that it would never attempt to do business in the UK, form to do business in the Netherlands. Not meet minimum investment requirements of Netherlands, still allowed to do business there.
- Netherlands had to permit the company to perform acts.

[United Paperworkers v Penntech]

norm: corporation is formed its entity is respected by the legal system.
Occasionally: the entity of the corporation can be disregarded.

Federal court: diversity of citizenship. No union
Labor issues: s301 national labor relations act: federalizes all issues concerning a collective bargaining agreement. The contract law relating to CB agreement is not the law of the state it Is federal law. The agency law is federal law. No federal law in many cases, courts have to create it.

Arbitration clause: arguing they were going to execute it. Between the union

Argument corporate entity should be disregarded: Kanabeck who is the party to the contract. Treat them as the same corporation. Penntech (the parent)

- FN vocabularies dealing q disregarding corporate entity
  - Alter ego: another self.

K: around for 20 years, paper industry organized as a NY corporation moved its domicile to Maine. Business is in Main, assets, etc. what advantage of being NY corp? None, only additional taxes. Turn it into a Maine Corporation.

HOW? → K (NY) forms a subsidiary in Main called K(Me) It **mergers** itself into its subsidiary and all the outstanding shares of K NY are converted into shares of K Me.
K NY disappears, K Me remains**. Changes domicile**.

Collectible bargaining agreement with paper workers,

Went broke, closed doors, laid people off
Penntech properties decided it could be a success in this business where everybody else had failed, formed company TP. Corporate shell. Bought K.

Union- extended contract for at least a year. Why?
Shoes of Union business agent: K negotiate with you. Extend the bargaining agreement for a year. In contemplation of reopening the business. No other purpose.

- Need our agreement to open the doors.
- We want you to succeed, not too expensive.

Obviously somebody is coming along, as a condition of extending the contract, we want that party to become a party to this bargaining agreement. Did not ask for this. → get up and walk out. Goodbye. No point in asking people for sthg. they will not give you.

Legal standard: determining whether the entity should be regarded or disregarded.

- No fraud, deceit, misrepresentation
- Union can get Penntech by disregarding the entity of K. "ALTER EGO"
    - Control BD, SH one SH in this case
    - Control use for a wrongful purpose
    - Control must have caused the injury in question.

1929 Justice Douglas wrote article Yale Law Journal: employee or an independent contractor. Doctrinal literature on this and the various tests. Put all these in one simple straightforward test: run a business if not "e" (employee), if yes Independent contractor.

Here: is a business with real cash-flow, employees, assets etc….entity, if not no!

Standard seems to be: entity disregarded compelling argument that a federal policy can be frustrated by recognizing the entity, basis under the law of the state for disregard it. What law?

- Issue regard or disregard it: **internal affairs issue**, determined by reference to the law of incorporation.

Del Corporation.

- Does not seem to be a real business.
- Very few Del cases.

[Kodak]Subsidiary of Eastman Kodak. Keyboard.
Target defendant.

- District court: not disregard entity unless when entity used to defraud,
- Law Delaware: depends on not really being a business. There was a real company and no case.

[Riddle v Leuschner] what did they do? Cal supreme court, what do they get? By what are they offended?

Debts and obligations are the corporations, not any other else.

- Why a different rule here?
- California case: tests that the court is applying:
    - A) Unity of interest, ownership
    - B) Inequitable to treat them as different entities

Took "notes": personal transactions: loan describe it more unfavorably

- Cash flow: where the balance lies: L,

Borrowing transactions: formalities: not followed.

Combined the businesses of both corporations
Merged. Could they have merged them, yes, SH voting, piece of paper filed to the Secretary of State.

If you are a creditor.

❖ When are formalities important? They don't matter at all unless they matter. When things start to go wrong.

Dissenting judge: corporate entity is disregarded who is to be liable?
The Directors: Mr. Leuschner. No: did not own shares, NOT LIABLE
Shareholders: JR & Mrs Leuschner.

State more unwilling to disregard the corporate entity: NY

Defendant needed to lease a cargo ship. Formed corporation 100 dollars of capital: leased a ship incurring an obligation .5 million.

Disregard entity of leasing corporation: 2nd circuit: district court: this is determined under the law of NY. Entities are not likely disregarded unless there is an obvious **fraud**.

- NY courts would not: every other state would

[BARTLE V HOMEOWNERS COOPERATIVE] (NY 1953)
Contracts with people did carpentry, roofing, and foundations
Priced this houses at a very significant discount under the contracts they just made. Corporation set up to loose money.

Creditor: no reason to disregard the entity. You dealt with the corporation, it went broke, it matters not that it was set up in order to go bankrupt.

NJ case: [JASKEY V WEIRES] (NJ 1970)

House Building Corporation set up for the purpose of building houses, priced at a price at which the corporation was bound to be broke.

Probably she has no assets: treating Shareholders as in effect Partners, how do you collect?

NY treats the person to whom you just dealt as liable to you. Most states treat somebody as partners, as a general partnership.

Sept, 2009

CAPITAL

- K: money in the business. One of the three factors in the business
- (machinery, technology)
- Marx: K was the work.

- Anything that you can invest in the business to make it more valuable
- Wealth to create wealth.

✓ Legal concept of capital: the money paid into the corporation in respect to shares of its stock. The money that the SH pad for their ownership.

In the business: money they can't take away from me. $ that I have in this business where my continuance use of it is not dependant on anybody else.

If I own all the stock of the corporation: as a payment for stock, or the rest as a loan.
Control over the $: as investment in stock, loan.

Ex 1: Jill – Max 100,000 D, K structure: 50 thousand shares, buys all of them 2 dollars a share.

5 years→business is looking a lot better→take back K. I am going to sell back 10 TH shares at 2 dollars a share and get 20 thousand dollars back.

§ 61 IRC: is not a definition of income includes: gain is the excess of proceeds over the cost.

§ 301, 303: SH closely held company sell shares back to the corporation under any circumstances where there is no dramatic change in your '5 of ownership. Re-characterized for tax purposes, Sell of stock, but as a dividend. (Pay taxes in your own money, to get it out of there)

Put $ as a loan. Income tax deduction? NO, paid back item of income? No!! consequences on lending the money and get paid back: no income! Compelling reason for putting money as a loan. (and not paying taxes)

Corporate Governance: 6 times more complicated that it need be.

X =
(1-ETR)(1-ITR)

[RE MADER'S STORE]
Had a business loosing a little money. Should we expand and open a new store? lost a lot of money. Went broke. Bad business decision.

Receiver: 42TH, 149TH, 141TH general claims (not secured, not preferred not subordinated) screwed. Badly treated.

8TH out of the 42 cost of administration

Claims Preferred: wages. Amount you owe to your employees for their work, the government taxes (employment-sales tax).

1. State insolvency proceeding.
2. Bankruptcy: debtor being discharged for portions not paid off.

State cannot discharge any portion of debt. US Constitution Article 1 § 10. "law impairing the obligation of contracts" state cannot discharge debts.

Assets already transferred, sell assets to a new business and start all over again.

- Not a lot of money involved
- Federal courts sit on one or two cities.
- Cheaper state insolvency court.

Glad argued that he had made a **loan** rather than a **capital contribution** (subordinated to the claims of general creditors) the loan would not.

- Conceptual discontinuity general creditor: not secured, not preferred.
- This loan should be subordinated.
- Capital contribution: paid more money for the stock he already owns, ultimately you might say, he has a separate deal than everybody else on this money: PREFERRED STOCK?
- If the other says this: investment in a new class of stock, still rank behind the creditors. No difference. FROM CREDITORS point of view:
- Defendants: this court does not have power to re-characterize or subordinate this loan. They have the power to do it, but they do not do it. Inherent in equity jurisdiction.

General doctrine: SH- D- Officers make loans, cannot enforce their rights.

Suppose we had FRAUD OR EXTREME MISMANAGEMENT: we would have a case for equitable subordination. Not a necessary condition for it, but it is a sufficient one.

Elements:

(1) INTENTION TO REPAY IN ORDINARY COURSE OF BUSINESS.

(2) ADEQUATE K: Capital unreasonably small court does not know. Trial court relied on the fact that they were in urgent need of money. Time he made the loan there wasn't any capital. It should be taken into account: moment the company is being set up

Amount invested in the stock, less amount loss in the business = CAPITAL
Losses incurred does not mandate the re-characterization of the loans.

EXERCISE: We want the subordination agreement: senior to the other debt, we get paid in full.

- Debt is subordinated. Assignment. If the debt of G is subordinated to the bank, in the event of payment the bank gets its payment, the bank also gets any payment that is due to the junior subordinated debt.
- Implied assignment of the distributions.
- Our share and their share until we are paid out. (double dividends)

Equitable remedy

Most of them: contractual arrangements.

Mader store **COMPLETE SUBORDINATION**: contract your debt is completely subordinated to ours, no payment can be made in the principal until we are paid out in full. If liquidation, we take by assignment your share in that liquidation (implied assignment) Nothing comes out of the business until the debt pay out in full.

Notes of equitable subordination as a remedy (not contract as before)
[Taylor v Standard Gas Electric] (US 1939) **REMEDY**

- Classic example as subordination as a remedy.
- Issued preferred stock (if dividends are not paid over a period of time the preferred shareholders can get to the board of directors), demand loans
- Standard: came along as a creditor. Claims 100% of the assets.

- Supreme Court approved a decision of the bankruptcy court: S has mismanagement the company, the claim as a creditor will be subordinated to the preferred shareholders.

PROBLEM

Assets 400,000 thousand, 2 classes of shareholders (are we concerned about them? NO)

- Dividend of x %: hasn't been paid, not a claim in bankruptcy. Dividend becomes a claim after the directors have declared it a dividend

A) 1st Mortgage Loan: 250 thousand (35o was owed to them, additional 100 th is lost) (debt secured by interest in property**, Recourse**: we can go after the property and collect what we can out of the property, everything that we don't recover is still owed to us. General creditor for the other part, Non-recourse: anything that is not gotten from the property is gone!

[2nd Mortgage: claim against the property, meaningless property taken by senior claim, unsecured claim, however it is a recourse along with other creditors.]

B) Preferred claims: wage claims

C) General Claims: Accounts payable, Subordinated claim

All general claims paid **pro rata**: agreement bank loan and the subordinated creditors. (only by contract among themselves, not a difference in bankruptcy court)

Add up, 110 thousand in assets, (after paying 1st mortgage and wages)
14, 67% of the claim.

The bank is entitled to the distribution made to the subordinated creditors. Bank gets double dividends!

- SECOND ROUND of DISTRIBUTION NEW ASSETS:
  - $4 thousand dollars.

- Bankruptcy: cap on claim wages: 10 thousand. Anything else you are a general creditor.

September 17, 2009

ASSIGNMENT II

GOVERNMENT side of the corporation

Director's Role (1)

§ 141 A Delaware DCL
§ 701 NYPCL: Directors get to manage the corporation.

Governance responsibilities and duties of a director. Call these people anything you want but they will be held accountable as directors.

[Continental Securities v Belmont]
shares were given away
Plaintiff is suing the directors: Belmont
Derivative Suit. Unique anglo-american devise: corporation has sustained a harm. I am a SH of the corporation, harm to my interest. The directors will not enforce the claim.
Invention of the courts of equity, maintain its suit for the benefit of the corporation to enforce some claim which the corporation has, but which the directors will not enforce.
Two kinds: **demand required** D do not have any interest adverse to the corporation they have no conflict of interest that would keep them from enforcing the right. Directors have no conflict of i. I have to demand the directors before proceeding. D no! → Delaware this negative answer is dospositive. unless so wrong as to be characterized as waste. No possible logical reason for not maintaining it.
demand excuse. Cannot expect the D to make an objective judgment. They want to sue the directors!

FRCP: Rule 23.1 maintaining a derivative suit in federal court in a diversity case. Limitations: match perfectly with the substantive corporate law in every law
Demand that you show…
A) **CONTEMPORANEOUS OWNERSHIP**. Must have been a SH at the time of the events of which you are complaining. Shares devolved upon you from someone that was a contemporaneous owner (inheritance).

B) **FAIR REPRESENTATION**. Of the interests of ALL the SH.
C) **RES JUDICATA**: settled matter. No possibility of another persona bringing another action for the dame facts.
D) settlement or dismissal require the **PERMISSION OF THE COURT**!

Defendants assert that he Claimant cannot bring the claim: he did not ask the Shareholders. Demand required case?

Issue: Who has the power to govern the corporation?

Holding: Board of Directors. IF SH want the D to do sthg. they can adopt a resolution recommending that they do it, urging them…but cannot instruct them to do it. POWER: statute of the State gives them the power.

SH can elect the board of Directors. Transaction where affirmative vote of the SH is required. Initial step the D have to recommend that step to begin with.

Somebody who is in some relationship the law prohibits his normal right to prefer his own interest. The extent to what it changes is a movable feast. Different situations of fiduciary.

[Meinhard v Salmon] 1928
lease: co-adventureres
expiration of the lease, new lease, more buildings.
Claim 1: Did not take me in as a partner in this deal and you should have.
Claim 2: Did not give him a chance to compete

Stands for: permitted to participate as a partner in the new venture, or that all that Salmon was required to do was to tell him.

Elegance of the language. The duty of the finest loyalty. (prose) It will not consciously be lowered by any judgment of this court.
"Punctilio of an honor the most sensitive" is then the standard of behavior.

Impossible to make this standard operable. How can we measure?

Aspiration

Can by contract negate fiduciary duties? Quite unclear question? Can you spell in the contract what rights he is going to have at the end of this transaction? Yes you could.

Trial court: 25%, Appellate Division 50%, and the CA 49%.
Held: Salmon owed Meinhard a duty of care and he had breached it. Should have told him about the new lease.

Dissent: wrong! They were not partners! They were joint ventures, specific deal, the old lease, once it expires, he can do whatever he chooses.

[SEC v Chenery Corp]

Public utility: bound to make money. Foreign Corporation owned company of public utilities. Many subsidiaries.
Plan of rationalization and simplification. Turn the operating companies into business systems related to another.

Everybody else bought preferred stock is entitled to common stock, you are entitled to your money back.
Fiduciaries.
Commission: cant say that they were doing insider trading. Had they done that in 1935 might not have been illegal. Did not buy stock from people with whom they had direct personal dealings. Market transaction, broker put in the marker place. Why then can they not participate in exactly the same way others do?
Chanery II, III. Ours is Chanery I.
Adopted a Rule, Managers of a public utility holding company in reorganization could not participate on the same basis as anybody else. Dissenting opinion Jackson.
Saying that someone is a fiduciary does not spell out much. TO whom, for what, and what are the consequences.
Employee (duty act for the E benefit in the matters that have been given to him), trustee

September 22, 2009

Note on the divergence of standards of conduct/review

How should one conduct oneself, Std of CONDUCT
Court applied test to determine liability: Std of REVIEW.

Identical: drive carefully, whether he drove carefully.
So common se forget that there may be divergence between the two.
Divergence is common in corporation law: DUTY OF CARE
Std conduct applicable to D and officers S 4.01 ALI's Principles of Corporate Governance.

" A director or officer has a duty to the corporation to perform the D or officers function in good faith, in a manner that he or she reasonable believed to be in the best interest of the corporation and with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances".

Duty to monitor, of inquiry, make prudent decisions, employ a reasonable process to make decision.
Std review applied to the performance of these duties are less stringent that the standards of conduct on which the duties are based.
Reasonableness of the decision: **business judgment rule**: less stringent.

4 conditions: a) D must have made a decision. (failure inquiry not qualify for protection under BJR)

b) Informed himself with respect to the business judgment appropriately,
c) Decision made in good faith,
d) D must not have a financial interest in the subject matter of the decision.

If not satisfied: std review: **entire fairness** or reasonability [Cede & Co v Technicolor, Inc.]
If they are satisfied: limited std of review. Acted in good faith, rational, rational basis according to different courts.

[Francis v United Jersey Bank]

Trustees in bankruptcy. Representative of Lillian Pritchart (deceased)

Issue: Can a director personally liable for failure to prevent misappropriation by the others? (Charles and another D & Officers).

Facts: SH loans exceeded annual corporate revenues. Lillian did nothing. Omission would make her liable.

Personal disabilities did not excuse her.
At times a D might have to do more than just object, might have to resign or even bring a claims to avoid personal liability
MANAGING OTHER PEOPLE'S MONEY: trust. D are held to a much higher standard of care.

Working capital deficit
More debts than credits: cannot run the day to day business
Assets/Claims

BSheet
A Current must be paid with in one year
1 Current (cash/inventory) B Long Term beyond 1 year
2 Long Term (machinery/land/contracts) C SH Equity

Assets Liability

Excess off current assets over current liabilities.
Deficit: By 10 M$

Causation: she could have changed the result.

Applicable Law: New Jersey
Parties agree that that law is applicable. False conflict
NY conflict of law rule would point to law of NY
Difference? S717 NYPCL identical (Directors Duties). NY copied it.
Most of the cases, cited and relied upon were NY cases.

Under extreme circumstances a creditor could bring a suit vs directors.
D may have duties to creditors: not sure what the court means by that:
if her failures caused the corporation to fail in its duties to the creditors and therefore she is liable to the corporation.
If creditors can directly suit. No authority for that.

P 48 to widow, 26% each son. Reason doubtful about he legavy he was living his wife. [Geller: profession service provided by the lawyers]

Wrongly decided: Mrs. P would not be liable. Observation. [he could not disagree more]

If not a company handling other people's money, the case against her would have been much weaker.

§ 402B (1978) well after this case. Identical §102b7 Delaware
Exculpatory provision.

[Kamin v American Express]

bought shares, if sold: 20M loss

distributed them to existing Amex SH.

The times of: General utility doctrine: not a taxable event, not event or realization for accounting purposes, it was a non- event.

Sh sue: we want a declaratory judgment (some course of action is wrongful)

Held: already distributed, that issue was moot
Court should not intervene decision BOD unless there are significant grounds like: fraud.

Dishonest practices
Judicial deference to the BOD: **Business Judgment Rule. [BJR]**

Conflict of interest

Did they think about this

Motivated to do this for the benefit of the co. (did not want to show the losses, affect their share price)

1.- Efficient market Hypothesis

relevant information to the market, it will allocate the correct price.

WEAK FORM: markets do no have memories, prices neither. Relationship between a price today and the price yesterday is random.

SEMI STRONG FORM: judicial notice case of SC: treat it as a scientific fact uncontestable. Price of any publicly traded security accurately impounds all publicly available information related to its value.

STRONG FORM: if you have inside information would not help.

Mkts move towards efficiency. Long way from being a scientific fact.
Michael Lewis: money game

Is about it, not mentions it.

Baseball: mkt for baseball talent is systematically misstated. Overpriced and others underpriced.

2.- For whom are the Directors Fiduciaries? What duties are owed, where is the breach? What are the consequences?

UK: until recently: fiduciary duty run only to the corporation. Today: Statute that make it more slightly analogous to the American corporation.

U.S: Always accepted that the fid duty run to the Corp. and to the SH.
W there is a conflict of interest: which interest trumps? What if you have more classes of SH (there interests need not be the same)

Earlier UK rule: more rational solution: only to the CORP (his idea only!!)

outer limit BJR: WASTE almost never applied.

568 page Eisenberg.

TRANSITION: efficient market hypothesis

Revlon case

Public and academic dispute about the semi strong form of efficient market hypothesis: scientific science; total nonsense

Reconcile it with things that came up in Revlon

[Revlon v MacAndrews & Forbes Holdings]

Company successful business.

Strangers take it over by making a tender offer: public offer to by the common stock at some premium over the market price. (why is it worth more than that) Tolvin's Q: cost of replacement of the assets of companys on the NYSE and the mkt capitalization of those companies. (number of shares outstanding x mkt price) relationship of the cost of assets and the value of the stocks.

1995 median makt cap 15% of
1960 went up
then down
1979 25% total mkt capitalization was just about 25% of the replacement costs of its assets.

Intangible assets: take them into account just as land, machinery etc. the ones you develop yourself do not appear…do not go on the books as an asset, training a workforce.

Mkt cap not 25% it was about 10 or 12%.

Disparity between the market capitalization and the replacement costs of their assets.
What they anticipate will happen in the future.
1980 inflation rate 12%, US Treasuries paying 14%, banks charging 26% as a prime rate: tipping point prices skyrocketing. Inflationary mkt people do not want to own pieces of paper. They want physical things. BARRON's addition info of stock exchange+ mkt on commodity+ weekly reports of mkt price of paintings.

P Mc Andrews affiliate Pantry Pride
Revlon target company

Tender Offer: transaction in which the company that wants to acquire the target company, decides that it cannot deal with the BOD and instead decides to buy stock to get control, then do whatever with BOD. Buy up all the stock.
Ignore stock exchange: make a public offer: we will buy stock of Revlon at this price if you tender the stock to us within x days.

Steps: shark-shock proofing itself (target)
Defensive measure: buy back your own stock: how will they pay for it. Issued NOTED, interest rate 11%. Had protective covenants: contractual provisions in the note intended to protect the holders from reckless conduct and management. Debtor (issuer) got to decide if the protection were to be lifted! Not the note-holders, the ones that received the protection.
Look for somebody else. Frostmann, PP had more $.

Degrees of permissibility: are you trying to keep the COMPANY INTACT?

the initial efforts to drive off PP were acceptable because the goal was to keep R intact.
->in the middle of all became obvious that it was going to be broken up anyway.

Different standard: maximize the benefits of the SH (only constituencies matters)

Directors: satisfy reasonable complaints of the SH. They owed fiduciary duties? Contractual duties, not fiduciary.

[Joy v North]

90 thousand invested in this building. End of a myriad of transactions later they wind up with approximately 6M dollars tied up in this building.
"the first loss is the best loss"

Dr Joy SH bank sue?
SH of the parent company of the bank. Double derivative suit.

US court decision [Burks]

SH of an investment company (mutual fund) incorporation in Maryland.
Management violated the Investment Company Act. BOD two set of people on it: D at times of the events about which the SH were complaining, then D became so afterwards were a majority voted to terminate the lawsuit.
BOD has power to terminate this lawsuit. SupremeCourt held claim belonged to the corporation, under MA law the BOD managed the corporation. If had no conflict of interest, they could decide whether to pursue or cancel it.

Immediately thereafter many companies: lets have BOD terminate the lawsuit, the D are the people being sued. Create vacancies; amend by laws adding directors; create a committee of the board.
Committee BOD decided should go forward? Good claim, corporation should pursue this lawsuit.

Committee analyzed the outcome of the derivative suits

Insiders def (7)
Outsiders (23) withdraw the action

Directors in the management: used to be a majority

Stock exchanges: demand today that a majority of "independent".

District court: what deference do we give to this decision.

Scrutiny: good faith, independence, thoroughness.

[Erie v Tompkins] 1938 Supreme Court
Diversity jurisdiction, US district court is functioning as another state court, apply the law of the case in which it is sitting.

Diversity case: CT, CT law.
Appealed 2nd circuit.
There isn't any ct law at all: how do we proceed.

Hindsight bias: psychological research. How likely this outcome would occur? → how would CT SC come out on this issue?

Page 887 Demand required/Demand Excused.

Demand required case: stuck with the BOD answer.

SH Ar&T no effort to collect, statute limitation run. Given away millions of dollars.
Required: no conflict of interest. → call attn of the BOD, decide they have a business reason, and its is over.

Ordinary situation: D themselves the intended defendants in that lawsuit.

…v Bennet]: NY CA decided the special litigation committee recommending to dismiss the lawsuit, always under all circumstances requires the permission of the court.
SLC moves to dismiss the case. Investigation, evidentiary hearing: 1) independent, 2) thorough job of investigating this case, 3) acting in good faith.
BJR applies: becomes like a demand required lawsuit.
District judge did, and there is an appeal.

As a matter of CT: no law. Process to determine what the CT supreme court would decide.
NY, DEL comm. Decision permits to become a moving party in a trial court asking or dismissal and making a case in favor of dismissal. How much weight? Treated as a document making an argument to the court. It is persuasive if it is. Presumption? NO

Legal standard: now in CT 1) inquiry into the comm.: thoroughness, independence, 2) business judgment. On balance is the corporation better off if it goes forward, or if it terminates? Ball park guess: a) potential recovery, b) costs. (direct costs: out of pocket, attorney fees, management time)

Corporation would have to indemnify an employee for an agent: incurred expenses by reasonable work. If you sue a D, and he is successful that D is entitled to recover indemnification for his defense. D win, Defendants paid by the corporation for their expenses.

Recovered-expenses= favorable? Substantial amount, lawsuit should go forward. If it is not substantial, maybe it shouldn't.

Arguments: Badly managed bank be out in the papers: loss reputation. Judge: reputation v gains after the derivative.

> If the case is not closed, then this should not be taken into account. When there is no anticipated substantial net return, this would be taken into account. (indirect costs)

Running a business badly is not illegal. Conduct by the D illegal: federal statute which covers banks whose deposits are insured FDIC, excess of 10% of the K, spread risk of your loans.

§ 402 B NY Exculpatory provision for Directors.

§ 102 B 7 may include the following provision

> Eliminating or limiting personal liability of directors for monetary damages for breach of the fiduciary duties.
> Can't limit liability for knowingly violating laws.
> Relied justifiably on the management to inform them: disposed of without a trial. Not because even if valid defense, trial!

Trustee: absent express contrary agreement, absent statute, a T is absolutely liable for any losses incurred by the trust. Duty to maintain the property of trust. Risk zero! Modified by statute: can run some risks now.

Hypothetical: loose money, liable to the corporation. (same standard than the T) BOD responsibility to run the business, to encourage you owe us the losses.

D: modes or relationship: 1) D, 2) full time employee, 3) also a major SH.
D liable for mismanagement, the more modes of service you have the higher your risks are.

[Graham]

grew out of what was called the electrical conspiracy, was a price fixing conspiracy among middle managements in a number of c whose business was building electrical generating equip for public utility companies.

Cost: skilled labor.

Secret. 6 levels below the BOD. Knew nothing.

Disclose: utilities sue, require to sue by the state. Recover substantial sum of money.

SH sue the D, evidentiary hearings, no evidence whatever that the has any knowledge that this was going on. Realistic, middle management.

P: D you have a duty to manage this copany in a way to obey the law and avoid lawsuits. Loss a lot of $, your failure, and you owe us the $

DEL Supreme Court: 1) D did not know about it , 2) Do not have a duty to create an espionage system: discover whether employees are carrying on illegal activity. (not todays view)

[Re Canemark]

huge company: several businesses, one of them: direct care for patients (Medicare/Medicaid). Anti-referral statute, makes it illegal for the supplies of goods or services, make payment for referrals.

5th level management down of BOD. Transactions which are referral payments.

Public policy matter criminalized.

Sequence of events: August 1994: federal indictment vs corporation, August 5 five derivative suits were filed

Not SH: 5 law firms specialized in derivative suits. They knew nothing about the case.

Interest of the SH? Zero

Only people that have an interest in the litigation are the lawyers

Unique DEL body of Law

NY 402B: exculpatory provision, similar to DEL, except for reason you know, no derivative suits [Aurebach v Benett] special litigation committee decision is binding. Smith v ,,,,Director ever state has the same provision, most states have some variation of the Model Business Corporation Act

S102 B 7…contemplates exculpatory provision. Broader than the one in NY.

Exculpation to the D for anything except a deliberate effort to injure the corporation.

Del complicated and messy q

[Caremark] direct care of patients.
Policies enforced by criminal process→almost always vague and uncertain.

[Graham v Allis-Chalmers] conspiracy violate anti-trust laws. Argument was they should have known.

Holding: Absent grounds of suspicion there is no duty upon the D to install and operate a corporate system of espionage to ferret out wrongdoing.

Mal in se: illegal because any rational moral order understands them wrong
Malo prohititem: the law makes it illegal.

D duty to have an adequate system that proves adequate to permitting senior management, have an informed judgment: compliance with the law. Business Judgment Rule

102B7: no public companies that don't have that clause. Management grossly negligent: zero possibility of liability

however, beyond gross negligent: violated a standard of good faith.

Approval for the settlement: derivative suits: need approval of the court.

Defendants agreed to pay the P lawyers.

Ex 1: Def in a derivative suit, careful analysis, no merit at all. Goes to trial we are going to win, the law is on our side as well as the facts.

Options A) IBM never settling with anybody: very few people sue them. B) go to trial, overpass motion to dismiss, discovery, interrogatories, very costly.

American rule: pays its own legal expenses. Not a system of the winner takes all.

Def wins: moral satisfaction, a huge amount of costs. →better course of action→settlement.

P: hell of a claim: fact investigation, long trial→settlement. More interested in collecting fees than in vindicating clients' claims.

To the end of litigation: guardian.

[Disney]
apply 141 e: rely on professional advise

business judgment rule; money involved; huge international company
Facts: subordinate: good working relationship (wells) killed in an accident. Need to hire someone new.

Derivative action filed on behalf of Disney for the Executive compensation contract of the second in command Michael Olvitz, non-fault termination contract.

Board: not adequately scrutinizing his appointment,
Claims: 1) you should not have hired him →case not succeed, BJR
Olvitz successful running specialized business. Hire him to run a multi billion dollars company worldwide, doing all kind of business.

140M nobody priced this out:
Compensation Committee: reasonableness:

141 e DEL BCL Crystal: high price compensation expert. Disney should sue him! Hired him to revise the contract

non-fault termination: firing for cause, they didn't consider this possibility. BOD protected: BJR, not having discovered the 140M dollar non fault termination clause, 141e gives them protection (expert checking), decision paying off rather than firing for cause, sensible.

The amount of $ involved.

(CEO compensation 1950: median compensation NYSE companies, 25 times the average salary of plant employees, today 700 times.)

Citicorp: 6 exe VP, while he was a chairman. The same happened with GE.

Salary escalation:

Serious/undesirable.

1950's: academization process by which training of business executives, became an academic matters, done at universities. That was not true before

CEO maybe not gone to college, went to work in the plant: developed ties to people with who they started.

Business schools: social disaster

Sports salaries: baseball

Accounting: disclosure→ transparency: Look at this escalation
Before simply salaries, pension benefits

Unintended consequences: amended S 162 IRCode ordinary expenses deductible
Added s 162M, over 1M not deductible: unless performance based

Opposite effect:

Warren Buffett: people who are not clients, who may become clients. From a compensation consultant point of view.

Stock option to buy the share during a period of years with today's price. No cost required to be recorded by the corporation on the issue of such options.

BOD: handsomely pay the CEO we give him stock option, exercises it. He sells to incoming shareholders…they are paying. It is not costing us anything

Dilution: increasing stock: decreasing the SH interest.
Masked by accounting rules.

Excess issue of stock: SH notice the dilution and raise hell about it. Conceptually it is true.

Dilution can be masked.
BOD exercise discretion buy-back the company stock
Buy the same amount in the market: at a higher price
Difference not treated as an expense.

Conceptually: the only cash impact of the option that could eve occur would be a cash-flow.

Purpose of accounting measure past transactions and the amount timing in certainty of future cash transactions.
Stock option is granted: no cash involved
Exercised: cash transaction yes: to the company.
Should not be recorded as an expense.

$ involved in the buy-back in stock: to mask the dilution is larger.

[McPadden]

derivative suit by a SH i2 vs BOD i2 and Mr Dubreville
subsidiary TSC

demand is excused→D can be held liable

Before they decide to sell: the BOD knew that Dubreville wanted to buy the corporation and that he formed a corporation to that effect

Make him responsible to making the deal.

Exculpatory Provision 102 b 7 limit: not in good faith
D move to dismiss: before: define if it a case of demand required or excused.

Demand required: personal conflict of interest.
material and reasonably available information was not considered by the board and that such lack of consideration constituted gross negligence, irrespective of any reliance on the Sonenshine fairness opinion

Transaction in q: end product of a reasonable business process? no Not reasonable: demand is excused!

Only gross negligence not bad faith + exculpatory provision= D not liable.

[Disney 5] outer limits of concept of bad faith.

Def actual purpose of injuring the corporation

Transaction is illegal

Abandonment: bad faith.

Demand required: no conflict of interest: court decided otherwise.

HELD: P failed to state a cause of actions against the BOD who benefit from the exculpatory provision, §102 b 7, and has not proven that they acted in bad faith.
However they do state a cause of action against Dubreville: fiduciary duty. He was an officer [Stone] Supreme Court: officer same fiduciary duties than the Director. →the exculpatory provisions do not protect officers.

[Northeast Harbour v Harris]

vs president of the golf course.
She owned land for years: now she wants to develop it.
Told about the purchase to the BOD after buying it.

Legal issue: she usurped a business opportunity

Trial court: buying real estate not in the course line of business, she acted in good faith buying it. She did not breach her fiduciary duties.

Main Supreme Court: she did breach her fiduciary duties. Did not act in the interests of the corporation. Should have told the BOD the land was on sale, and given them the opportunity to buy it.

Reasoning: Precedents: look at the historic line

Consider the issue ab-inicio

Delaware test: line of business: everything is in the grey area.

Massachusetts: fairness test.

Minnesota S.Court: Miller test. Combined: no answer.
Dismissed both possibilities
American Law Institute (ALI) Professional Organization, not state sponsored.
Publish Restatements of the Law. Corporate Governance: s 5.05 ALI **duty to inform**: don't do anything they waive their right to object.
Cover most employees
ALI section: cover middle management and up

Mass Case:[v Pierson] 1929
Buy a pond, cut the ice and you start putting layers in an ice house: stay intact all summer: Ice House
C: ice business
D: driver,
Noticed a pond: was for sale: bought the pong
Claim: usurped their business opportunity, duty to bring it to them. Claimants were right, he had a duty.

S 713 NYBCL: (S 144 DEL GCL)
Dealings between the company and the senior management.
1900 American rule: any transaction between them (D or officers) was voidable for any reason or no reason by the corporation.
S 713 legitimating standard: what the procedures are to legitimizing the transaction.

Problems:
Del at least one director, ONE VOTE more than the next highest candidate
(Plurality of votes)

Stockholders Meeting and Roles (2)

[Schnell v Chris Craft]

Def challenging management decision by which they amended by-laws date of the general SH meeting from January to December. Dissenting SH could not wage a proxy war due to time constraints.

Background: prior 1967 re-writing Del Corp Law: by-laws could only be adopted by SH→ After that § 109: could give the Directors authority to amend them.

SC **Held**: nullified. Management contends that it applies strictly. Inequitable conduct may not become permissible simply because it is legal.
Frustrating possibility of SH choice you cannot do that.

[Blasius Case] 1988
Long complicated story

P: largest SH of the D Blasius
Corporation formed by two men: Delano, and other. Bought under 10% of the stock. Have to file (13 D) with SEC why they buy this stock.
Restructuring proposal that will make the co. highly leveraged. Increase the value of the co stock: program:
Gold mining operation: diversified into other business, bought company concrete, Brocton shoe industry.

- Over-paid for the businesses. Running company were mining people, not about construction business, anything al all about shoes, do not run them well. SELL Them and distribute cash.
- Management: proposal unfeasible. Selling shoes and cement.
- Other proposal: leveraged business: become deeply indebt. Sell off future production of gold, other financial transactions. Distribute 35M dollars cash to SH, give them: subordinated secured gold index debenture. Really a bond because it has a security (mortgage) dollar amount not fixed, variable: price of gold.
- Market: trying to sell: subordinated bond, with a dollar amount that is not fixed. Not sell it for face value, 30, 40 cents on a dollar.
- Management: terrible idea
- Delano & L: a) signed a written consent resolution recommending BOD develop and implement the proposal, b) amend the by-laws: expand BOD from 7 to 15, c) fill 8 extra position.
-
- Court described the resolution as **PRECATORY:** Preyer.
- Recommended the BOD to do this, why not say the BOD is mandated, ordered to do so. S 701 NYBCL shall be managed by the BOD, Sh cannot order them to do anything.

- S 228 DEL BCL: not unanimous consent: larger enough voting group can without a meeting affect the same result by filing a consent to that effect signed by the SH involved and filing it with the company. Own 51% without anybody else involved.
    - Unintended consequences: idea: tender offer, bought up 90% of it, want to do things, amending by-laws, merger, etc.
    - Sh meeting get to vote, D may be hostile hard time getting a meeting.
    - Own most of the stock: obviously want to have a meeting, why not let them doing it outside the meeting by signing a consent document!
      File consent, have 60 days to reach out to others.
    - S 109 if certificate incorporation says so Directors can amend by law laws (power normally within the Sh powers)
    - Amended them, enlarged the BOD.
- History Del, permissible action defending corporation efforts taking over. 1930 Chefies v Mathius???
- Chancellor Allan: permissible activity for member BOD to engage in moves whose purpose is to frustrate object taking over business. BJR, standards of review: self perpetuating their own power, hence reviewable: authority for the proposition that it is all right to protect the company whose incoming management proposals strikes the BOD as not a good thing.
- BOD

Blasius: transaction which he thinks almost anybody could conclude was sound. (presumption underlying the proposal was that the SH would, marketable for the amount→ lucky to sell it to anybody, at a discount)

BOD notion that this was a catastrophic bad idea, is true.
Are they protected by the BJR? No.

Structure a transaction: SH 1) amend by laws, right to do so. [S 109. Right to elect D, yes].
Statutory rights. Tied to a high level of protection than any other right.
Good faith violation of fiduciary duty: for the protection of the company.

Anything done to interfere with these rights, should be impermissible? Does the Chancellor take this position. He can't anticipate all the different situations: opportunity to decide on the justification.

S 228: BOD period of time before this could become effective: this consent. 60 days

[Auer v Dressel]

action at law, (not equity) Mandamus

Injunction: always addressed to the discretion of the court.

Mandamus: order to a public official, or officer requiring him to do sthg. in what he has no discretion at all.

In this case: it as stipulated in the by-laws that D had to call a meeting.

If not in the by laws, they don't have a right, only the statutory ones, an annual meeting.

In the absence of that by-law this case could not arise

In DEL: § 228. If they want a meeting, and are a majority: ask for it.
2 classes of shares, common, and class A.
fired Bauer: they want to have a meeting:

half the total number, not less that one third would constitute a quorum.

Elect the successors of the D:
Remove the 4 common D

Amend organic documents: only people entitled to vote on those vacancies are the people represented: because there are enough shares of common stock remaining, the common stock would outvote them. D being removed, the people to get to vote on that replacement are the people who are being represented:

Insufficient knowledge: know if they were SH
Not entitled unless you propose to do sthg. that Sh are allowed to vote on that meeting.

1. endorse Auer: § 701 not in this case: BOD SH cannot elect the president that is for the BOD. They can express themselves: precatory resolutions are proper subjects for SH.

2. SH power to remove Directors. They can elect, is only logical that they can remove them. For cause. What is cause? No discussion on what is cause. Del case [Campbell v Loewes Incr]

Antitrust law mayor film studios Lowes broke up, MGM-Loewes.
Majority Board, represented 1 SH, Management represented another SH.
(management rid off the SH) removal proceedings.
Could they hold a SH meeting to remove this D for cause: claims for cause:

1) D who represented meyer would not cooperate w the management (so what? No duty to cooperate w you),
2) Trying to seize control of the company (so what? If they can do it better),
3) Investigating the affairs of the company (so what?),
4) Carrying on this investigation that they have paralyzed the corporations of the company main office (injury to the business: grounds for removal) on that issue you can have a meeting. Who votes: SH

removal of D, who had voted to fire Auer: are the SH. Auer will have a proxy to vote the common shares. The person you have to persuade, is Auer: confidence in your powers of persuasion.

NY § 709 D may be given the authority to remove other D.
Del statute has no such provision. D remove D.

Veto power over removal: effort to remove common D,

3) SH right amend by-laws, can empower D to do so. Does not remove the power from the SH
amending certificate of Incorporation: SH could move forward, not true in NY, DEL today!
242 B 1 NY
s803 a Del

amendment Certificate of Incorporation start resolution BOD calling a meeting on the subject, SH vote in the meeting.

By laws: SH can amend them themselves.

[Galler v Galler]
Company Chicago Phonebook: how are things going? We are still in litigation. 1964→1990

In business in Chicago: looking for a job: spent time, energy money in litigation, an eventually they broke the company.

Disaster: 50% same case as Francis, lawyers set up an arrangement which had catastrophe written all over it. Widow at mercy of sons, here two families that don't get along have 50% of the company.

2 Brothers
problems and disputes
family takes over when somebody dies. See it as an annuity: right to that income.

Malpractice!!!

Representing small businesses is an easy practice that doe not require intellectual effort. Harder than representing public companies. Closed corporation figuring out who they are, what they want.

[Carey v Penn]

- people vote by proxy. Proxy law amalgam of federal and state law. Penn Statute: like NY & DEL
- Public Co. procedure go through: solicitation of proxy by the management requires a filing w the Federal Securities Exchange Commission, production of document proxy solicitation, accompanied by annual report to SH.
- State: BOD can set a time frame for the record. Time frame: 10 days before meeting up to 60 days before meeting. People entitled to vote→SH on record on the record date.

Street name: name of your broker: why? Safety, negotiable instrument: delivered to somebody properly endorsed the person to whom it is transferred is the owner. If you want to sell the stock, you can do it within seconds.

Stock certificate in your Name: yes, you can do it. Guarantee your signature. Deliver this to your broker, etc.

Penn Ent: to Smith Barney, are those shares on the record: Cede & Co. (certificate company owns the shares of records which are being held on street names by corporate dealers)

Proxy: agency to vote stock. Statutory in every State

NY & DEL essentially the same:
§ 609 NYBCL

- Overriding by the Federal Proxy Rule: applicability to public companies. § 212 B makes it inapplicable.
- Proxy Solicitation, minimum of 10 to 20 days: who is entitled to vote and to get proxys.
- Every State provides for a Record Date: s 604 New York. 10 and 60 days prior to the meeting day. BOD calls a meeting setting a record date. →extremely significant. People who are SH as of the record date. Voting population is fixed.

Record date announced: Cede & Co executes a simple document "omnibus proxy", [technical ownership and the economic ownership]
Step 1: Cede omnibus document runs to every one of the firms for which they hold the securities: in respect of the stock for apple record date we grant a proxy with this documents to every member firm for whose account we are holding, to vote that number of shares which we are holding for their account. Cede→to member firms
Step 2 those firms transfer it to their customers
Firms→customer

Proxy materials sent by member firms: customer gets them, executes the proxy form and mails it back to the member firm: instruction from their customer, and they vote that number of shares in accordance to that instruction.

Proxy is an agency: instantly terminated by any conduct of the ppal from which the inference can be drawn that the principal no longer wants to be represented by the agent.

- Dated: most of them are not, no telling which came first and second. Postmarks are not legible.
- Potential to over-vote: several instructions several votes: broker over-vote.

Corporation Trust Company: provide inspectors for elections: determine the authenticity of the proxies, come and certif. result of the election.

1960→risk securities trading would collapse under burden moving paper round: under investment of the securities firm on the back-office ('technical end of the business) physical

take it to the buying broker, transfer new stock certificate, etc…more than half the stocks is held in street names: nominal holders: member firms:

Stock Split:

- 100 shares of tock outstanding: every share is a ten% ownership of the equity in the business.
- Increase from 10 to 20. Same interest: why do it. Easier to transfer it, become cheaper.
- Stock we a re selling 10$ a share, now sell for $5. No….it will sell for a premioum $5,50. →more people want to buy.

Bad news for Carey: required amendment Certificate of the Incorporation, SH vote: proxy solicitations.

- Carey solicited proxies: show up in the meting and vote against the amendment: did not want it to go forward.
- Spend money in a proxy solicitation
- Critical margin of the company success in this process are the shares called in the DRIP plan: appending money to save SH penies.
- Fractional shares: owned: record owner: Trust Bank: plan trustee holds on this shares until the SH can take them back and sell them. Nominal owner is certificate company subsidiary….
- DRIP plan cannot have shares in street name: is not in street name cede comes not into play.
- Prospectus DRIP: you ll be able to vote your shares, along with the shares you own.
- Carey's position: fractional shares cumulatively voted, were improperly voted: who was the record company? Subsidiary of the economic owner,
- Loreal could have issued an omnibus proxy to all beneficial owners. That cede issues to the member firms: people for whose account the shares were being held.
- Corporation Service Co. →provides inspectors in the election: decide whether or not properly voted, they were properly voted: DRIP Plan documents gave them the right to vote.
- Deference to inspectors: willing to defer, trier of facts: however, the q of who is entitled to vote, is a q of Pennsylvania Law, capable of determining as they are

  Held: Penn Law simple: stock can be voted by record-holders, or someone that has a proxy from the record holder.

Corporate Law

- Tort Law: basis of document: "Misrepresentation"
- Seriously in error:
  - Materiality
  - Scientes: knowledge
  - Reliance
  - Loss causation

Dealer no better means of info than you. [lack of science]

1931 NY case, [Ultramares v Touche Yves]

- made loans on account receivable: looking for financing; people form whom they were getting the financing wanted to see an audited financial statement; prepare financial statements
- Executed financial statements: delivered to the 8 potential lenders, one lender made the loan: turned out that the account receivable grossly overstated
- Negligently prepared this statements, knowing that we re going to rely on them: encouraged loss.
- NY CA held: court unwilling [Judge Cardozo] to create liability indefinite amount doe an indefinite period to an indefinite class, and therefore, negligent misrepresentation as a cause of action will only lie against someone in privity: directly dealt with the defendant.
  - Sue the company: usually broke
  - Underwriters: did not deal directly with them: only a fraud claim→ knowledge: difficult to prove because it was nor true.

Lacuna: commercial register: publicly file financial statements

- Only public filing: com not subject to SEC: filing tax returns: completely secret.
- Sh seeking info about the company of which he is a SH: can come to court and get an order to inspect the books. Cero system for information to a SH. True in 1930 and true today.

Corporate law was solely state law.

- Market collapse 1929
- Rosevelet elected, new deal prosposed

- March 1933: **Securities Act**. Cohen: general counsel of State Department. ["Dutch kitchen"] tidily drafted
    - Hardly been amended since
    - One group were seriously structural.
    - Single purpose legislation: when a company offers securities to the public there is a requirement for a procedure called registration. Creation of a selling documents of a prospectus: required to be used to sell the securities. DUTY creation.
    - No regulation to the after market, only a duty when selling the securities.

Securities Exchange Act 1934:

- Different structure
- Disparate things. All relate to the trading market of the securities.
- Hugely amended.

§ 4 created an agency to administrate the Act: SEC (Securities Exchange Commission)

- Independent agencies in the executive branch
- 5 commissioners

§ 6 licensing national securities exchanges: enormous rule making power over their own member: securities industries professionals. Law making power by congress to private parties.

§ 7 gives an agency power to regulate margin requirements: put in some of the money, the broker is putting the rest. Buying on margin.

- Before the crash: buy stock putting only 5% of the price.
- SEC enforces the margin, set by Federal Reserve Board.

§ 15 registration (licensing) of broker-dealers: securities professional.

- Regulation by SEC: § 15 34 act, register
- Members of stock exchanges: subject to more detailed regulation by the exchange
- 1934: not many where member of the exchanges: know someone who handles their purchases

§ 15A: National Securities Association: membership association of broker-dealer: NASD (nasdak association of securities dealers) →everybody joined→ s 15 (e)(1) may adopt a by law which will provide that no member firm will deal with a non member except at retail priced

- OTC over the counter market: telephone market: 15 thousand companies subject to SEC reporting system: 12 thousand are not. Public company x

§ 12: security registered in the exchange in which it is traded: if not→ unlawful to trade it.

Under 34 act what are registered are classes of securities: preferred, general stock, etc,

Under the 33 act: you don't register securities, you register transactions in securities

In 1934: companies were subject to the registration requirement under § 12: all public that have securities listed for trading in the securities exchanges. 5% at that time.

Only 30 years alter, would the rest be subject to this requirement

File a document: § 13 subject to as the **continuance disclosure system** under this section, file with the Commission, annual report 10-K, quarterly 10-Q, monthly report 8-K. Detailed exposure to great deal of things.

§14

§ 16 A requires is you are subject to the registration requirement, file report with SEC report changed: Sarbanes Oxley: report them on the internet on the next day. TRAP

§ 16 B TRAP: prevent use of inside information: access to inside information is irrelevant: people reporting under § 16A, puts with the management of the company: is that a defence? Not at all…if you have the status, you have the transactions that fall under this section, you have liability: you did not have info is irrelevant!!!

§ 16 A if there is any change in your position you have to report that change: no net change in my position: two transactions to report: gift and purchase: report on the next day basis.

Profit: which is an economic loss: **recapturable** profit: any six month period: look for two transactions: one in and one out: look for the highest out and the lowest in: and ignore all losses:

Sold 1500 at $8

Buy 500 $ 7

1-10 100@$10

2-10 100@$9

3-10 1500@$8 (12000)

4-10 50@$7

5-10 1000@$6

the SH can sue in the right of the company if the company does not sue.
Derivative suit [joy v north] federal rules 23.1 reflects the substantive law: contemporaneous ownership: been a SH at the times of the events of which you are complaining. Does not apply to § 16 B actions: courts decided this.

1934-2009= 90% pf the plaintiffs it is an industry: small bar which is a § 16 B bar:
Form 3, and 4 filings: found a purchase, share: clerks that worked for law-firms. Buy one share of stock and start the law suit.

§ 16 c: people referred to in § 16 A, insiders. Short selling: of any equity or security of this issuer.

Different from § 16B: transaction in 16 B illegal, go to jail. This is a crime.

Director would have an influence to effect negatively the company.

Regulations apply to the registered companies.
Companies were totally outside most of this regulatory system, unchanged until 1964: broad re-drafting of the securities acts

§ 12B:

1964→ applicable to all companies whose securities are publicly traded.

§ 19A and B, 1933 Act
§ 13 B of 1934 Act SEC power over accounting. Exercise power by self- making accounting rules, he does not think that would be good.

Delegated the authority to the accounting profession.

October 29, 2009

PROXIES:

- Handful cases: state litigation, v. successful proxy contesters: remedy: public election.

- American tabaco company: SH meetings: diffused stockownership: 1920 trouble having meetings→paying good dividends: behind the check a proxy.
- 34 Act enacted: regulation of proxy solicitation was in really need. 14 a, class security pursuant to §12:

    Regulation 14 a:

    [Long Island Lightning v Barach]

    - Nuclear power plant Long Island: close it down. Proxy contest:
    - Newspaper ad violated the proxy
    - Made no representation regarding it: only attacked the business

    2nd circuit: communication had the practical effect of inducing people to seriously consider the manner in which they were going to vote: the "proxy solicitation".

    Dissent: protected by the Fifth Amendment: not subject to being enjoined. Still actionable for damages.

§ 14 (a)(3): send them a proxy statement
§ 14 (a)(4) if your are management: you must receive annual report to shareholders: closely described document: most important part of it the financial statements.

Publicly used:
Proxy rules 10 days before you used them file them to SEC: no requirement that you wait for the approval.

- Exceptions: vanilla solicitations: no requirement to pre file: only business being conducted: election of directors: approval minutes of a prior meeting…
- No action letter: informal advice: moving quickly on things. you WAIT until you hear from them.

§ 14 (a)(8) Sh proposal to be included in proxy.

you are a SH start a proxy contest: sure. SH list.
Make one proposal to be presented, up t 500 words for the proposal and your argument: place on the proxy form for SH to vote for or against your proposal.

Eligible to make such a proposal: 2000 dollars worth of stock+ held for one year.

[Lovenheim]

Include his proposal in the proxy documents: the company refused to allow the information to be included.

- Vote on something: recommending: consider and study and report on the methods of treating geese in France.
- § 701 NY: Sh can only recommend, precatory.
- No action letter: commission asked this division for a recommendation, this division will recommend that the COMM makes no action. Very reliable: 100% came up with that procedure 1934.
- Starts a lawsuit: inference should the court draw form the fact that the commission has issued a no action letter: formally cannot draw inference: no legal effect. →decided a case significantly because one of the parties has received a no action letter, district court SEC has already stated the issue, SEC no! no legal standing

Proposal excluded: §14 a 8 c-5: exception: if the proposal relates to less than 5% economic significance, or otherwise significant.

- Lovenheim: ethical and social significance to the business of the company.
- Held: yes he was right.

Dividends:
[Ca v AFSCME Employee Pension Fund] 2008

- extremely unusual: gov. federal agency to decide a q of state law: only in the west side of the country.
- Del amended the constitution to provide for this: deal with certified questions by Court of Appeal, so or the SEC

1st q: proper subject for the SH action?
2nd any law would be violated if the by law were adopted?

§14 a 8 amend the by laws § 109.
Del 109 b.

Sh adopt amend bylaws yes.
Particular by law properly adopted→inconsistency § 141a: Corporation managed by BOD.

Election of directors: heart of the governance concept: SH role. →

141 e→by law or advancing litigation expenses: statutory base.

Bad thing?
NYSE Listing Rules. Director Independence, Warren Buffet Berkshire: NYSE are hardwash.

November 3rd

Rule14 a-2(b)(1) communication within the proxy rules. 14 (a) (9).
NYTimes.

Sarbanes Oxley 2002:
Departure in american securities law.
33, 34 act→had one thing in common: regulated things which were largely unregulated under state law. No displacement in the statutes of state law.

SO: override state corporate law (1)

33, 34 act: SEC authority over accounting. Agency never used, delegated it to others.
1995: amend 34 act, Division: regulation over auditing process.

2000 collapse: number of companies accounting deficiencies.
Enron: power company: trading company: more exotic kinds of trading. Financing schemes: all depended that none of the Sh understood what was going on.
Arthur Anderson: 26billion dollars

Serious Reform:

- Board: no authority in respect of accounting. Its only authority is AUDITING.
- Madoff His hedge fund audited: registered investment advisor: reports to SEC, store front: one helper:
- Certified Public Accountant.
- Informally: public offerings, big 8 accounting firms: monopoly: the functioning deteriorated over the years

1955: Cravath: observed most senior people were the technical partners:
2000: marginalized? Enron financial statements were subject to audit by Arthur Anderson, the engagement partner, referred a number of technical q relating to enron's accounting, to Arthur Andersons technical partners in Chicago: NO No NO, don t permit any of this. The engagement partner ignored all warning and signed the statements.
Managing partner at AA: imposed a rule: each year to sell 300, 000 of not audit services to clients (consulting), to remain partner. Internal drain brain. Brightest people went into consulting services.
AUDITING is for the benefit external constituents: creditors, Sh, Government

Peer Review: big 8 accounting firms, review each other's audit work. 25 years, no review found a flaw in any audit.

Preparing new audit standards→waste of time. Nothing wrong with the ones we have→proper enforcement is needed.

Change the internal dynamic of managing accounting firms: marketing people went out of management; professionals were back at the center.

SO should have stopped here.

GOES ON

- Chief E Statement: personally certify the accuracy.
- Porsche: copy of SO: I am not an accountant: I am an engineer: I cannot abide by this→not list my co.

Nestle never listed in the exchange: coming in the NY when enacted the management said forget it.

Nobody knows that: should not have been enacted.

§ 404 Judge Allen's opinion in [CAREMARK]
Internal audit: company assures itself that the policies of the BOD have been carried out legally. Desirable. Is the cost to doing it, reasonable proportionate to the benefits achieved. Costs out of proportion.

Smaller public companies→casual. Today this is changing. Problem: they cannot afford it.

Audit Committeess: departure American corporate law. Committees of the BOD: source of their authority by-laws: made by SH.

Not now: authority comes from **federal stature 1934 Act**. Overrides state law.
OTHER PROFESSORS: Effort by SEC to take control of American corporate law: Prof Bainbridge: prevent another Enron/ effective in eliminating the kinds of securities fraud, which arise from the activities of middle management. (channel stuffing) enhanced internal audit will prevent this.

Changed the dynamics of the accounting firms.

§ 10 Rules of SEC: audit committee fires the auditors.

Auditors reporting to the audit committee, not the management.

Registration of auditors of hedge funds could be a good thing.

Audit committee: "independence"
303 A 1 NY Listing, and 2:

Berkshire Annual Report: have a lot at stake if things go wrong. Motivation to keep them on track!
It ought to be a pre-condition to be independent. (own stocks)

ASSIGNMENT 3

Issuing Stock and Paying Dividends

§ 402: Document Certificate of Incorporation ("Articles")

Mandatory provisions: state maximum number of SH. OVER-ISSUE (1000 shares:200, 20% of stock) issue another quantity: people who buy them are not SH, right to sue.
Shares registered to an identifies person. Numbered.
Par value F: 1) floor consideration for which the corporation can issue stock. 2) factor in permissibility of paying dividends.
Who sets the par value?

Corporation cannot sell shares for less than the par value of the company.

Balance sheet 10-31-09

Cash	100	CL	50
Other CA	250	CTL	800
	350		850
FA	1650	Re	<100>
		CIPP	1000
		Com	250
			1150
	2000		2000

other current assets CA: money, or something that will in the short term turn into cash. (in the operating cycle) account receivable, inventory.

Fixed Assets: FA machinery…intangible.

CL claims: current liabilities. By their terms have to be paid within 12 months of the day of this balance sheet.

Long term liabilities:
Total liabilities
Assets- Liabilities= SH equity: right to the stockholders differ depending on their nature.
RE: retained earnings: it's a negative number
Common Stock: 250. Number of shares outstanding, par value.
Capital Contributed in Excess of Par.

- § 510: NYBCL. Can distribute $100 dividend. Legal standard.

§ 510. Dividends or other distributions in cash or property.

(a) A corporation may declare and pay dividends or make other distributions in cash or its bonds or its property, including the shares or bonds of other corporations, on its outstanding shares, except when currently the **corporation is insolvent** or would **thereby be made insolvent**, or when the declaration, payment or distribution would be contrary to any restrictions contained in the certificate of incorporation.

(b) Dividends may be declared or paid and other distributions may be made out of **surplus only**, so that the net assets of the corporation remaining after such declaration, payment or distribution shall at least **equal the amount of its stated capital**;

Dividends
Did not matter: U.S Public corporation pay extremely small dividends. No demand from SH to dividends: tax inefficiency: getting income out of the corporation is so tax inefficient that there has never been a desire to do that.
Change→ another kind of transaction functionally the same: redemptions: buybacks of corporations of their own stock. Same impact on creditors that dividends have: inadequacy of protection in this point it is a serious matter.
§102 a) 12)
sum of : par value of shares issued (250 shares)
amount consideration of other shares not par value:

250 Comm
CCIP: 250 x 4= exceess contributed capital. Sold them above par value

Returned earnings: negative number: this company does not have accumulated history of profits but losses! Liabilities grown faster than the assets. Loosing money.

Pay $4 a dividend

NY § 510: a) **insolvency** (impose a more restrictive on itself yes!)

Def: Inability pay debts as they come due. (in the equity sense)

Liabilities exceed your assets. (bankruptcy test)

Definition terms: §102 (a) (8)

B) out of **surplus**: excess of net assets over stated capital.

Go on reducing the assets by voluntary distribution of SH, so long as their reduction on the balance sheet can be absorbed on these accounts together who make up surplus on the statutory.

- Notionally we could pay 900.
- DEL Law: is identical: statute § 170:
- NY statute now provides that 510 dividends and other distributions: buy-back in shares.
    - Most state dividends statues: define distribution: say include both.

- Model Act recent version
    - 6.40→ Equity insolvency, second part insolvency in the bankruptcy.

    - In CA: § 114 all financial calculations made for purposes of the Cal Corp. Law must be made in accordance with the GAAP.

- Book value: baseline: COST subject to adjustments.

- S 640 MBCA: use GAAP if we want, judgment of BOD: market value
- NY 1940 case: purpose of determining the availability of surplus, you can quantify them at the best judgment of the BOD (dont need to quantify them by cost)

Del 1997: unsettled: [Klang v Smith's Foor Drugs]

- may use GAAP or may decide not to. Market value of the stock those are the assets are worth.

- Value is in the **future**: anticipated profits. Cost is in **the past**.
- Consensus of estimates that cannot be verified.

- Creditor: historical system here: actually happen. Cost has been incurred. No question about what they are. If talking about value: things you expect to happen. Creditor prefer to see the cost value.

[Randall v Bailey]

  - Brooklyn buildings (30) used to bring freight into the city, brake it out in smaller units.
  - Business of running bus terminals, unprofitable: almost from the beginning. Lost money operating every year.
- BOD hired a real estate operation: building for 2 million dollars.
- Creditors sued for distributing illegal dividends

Held: judgment matter: if they thought it was a good way to estimate value, that is good enough.

- Defect in dividend law: long time.
- U.S. Sh do not buy them to own them, buy them to sell them: economics of ownership are not very favorable.

- Why large buy-backs:

- Del Corp. Article 9 § 3

§3. Issuance of stock.

- Section 3. No corporation shall issue stock except for money paid, labor done or personal property, or real estate or leases thereof actually acquired by such corporation.

§ 152. Issuance of stock; lawful consideration; fully paid stock.

- The consideration, as determined pursuant to subsections (a) and (b) of § 153 of this title, for subscriptions to, or the purchase of, the capital stock to be issued by a corporation shall be paid in such form and in such manner as the **board of directors shall determine**. The board of directors may authorize capital stock to be issued for consideration consisting of cash, any tangible or intangible property or any benefit to the corporation, or any combination thereof. In the absence of actual fraud in the transaction,

the judgment of the directors as to the value of such consideration shall be conclusive. The capital stock so issued shall be deemed to be fully paid and nonassessable stock upon receipt by the corporation of such consideration; provided, however, nothing contained herein shall prevent the board of directors from issuing partly paid shares under § 156 of this title.

§ 153. Consideration for stock.

(a) Shares of stock with par value may be issued for such consideration, having a value not less than the par value thereof, as determined from time to time by the board of directors, or by the stockholders if the certificate of incorporation so provides.

(b) Shares of stock without par value may be issued for such consideration as is determined from time to time by the board of directors, or by the stockholders if the certificate of incorporation so provides.

(c) Treasury shares may be disposed of by the corporation for such consideration as may be determined from time to time by the board of directors, or by the stockholders if the certificate of incorporation so provides.

(d) If the certificate of incorporation reserves to the stockholders the right to determine the consideration for the issue of any shares, the stockholders shall, unless the certificate requires a greater vote, do so by a vote of a majority of the outstanding stock entitled to vote thereon.

- Investor protection: inadequacy: kept it from being important: tax system.

3million shares earning/ 1 million outstanding= $3 dollars per share (EPS: earning per share) $48 dollars per share: divide it by 3= 16 16/1 selling at a multiple 16 times of the value of last year's earnings.

- Corporate rate 48%
- 14 to 92% tax
- dividends: ordinary income
    - $1 (1-ETR) (ITR)

      $1 (.52)(.40): 20.8 cents

- Miller Emilliani: rationally no reason for SH to want dividends. Completely indifferent.

- If not paid: accretion to the value of the corporation. Reflected in the stock price.

If I sell the stock: long term capital gains: max tax rate: 25%

$(.52) (.73): 39 cents

2003 tax rate on dividends became flat **15%**.
Resistant to paying dividends. Reason to hold on to the money.

Redemption: discretion BOD: nobody else gets to vote. Unless contractual relations: lenders. Absent that, entirely within the control of BOD. Restriction on dividends (buy-backs) weak restrictions on dividends.

Microsoft: never paid a dividend: paid massive dividend. Did not do anything at all to the stock price. Non-event.

Buyback not seen as a company expense, and therefore it does not reduce your earnings. Earning remain the same, number of SH outstanding goes down, price SH goes up.

Buy stock, sell it on the market, company does not pay.
Ex: 5 year option, exercisable at today's market price. Suppose Earning are flat for each of the five years.

	Dividends	By backs
Earnings		
PriceEarnRatio		
Shares outstanding		DOWN
Earning per Shares		UP
In the money/out	out	IN

Buy backs: protective of management.
Distributions [dividend distribution only limit on buy-back]

- Valuing the assets: not by reference to cost, but by reference to "value" (mkt value not reliable) what will these assets earn in the future.

[Klang v Smith Food and Drugs]

- California dividend statute: provision loan agreement. Restricting dividends on behalf of the creditors

- ATTITUTE INDIVIDUAL AND INSTITITIONAL INVESTORS DIFFERS:
  - how long our dividend law will be tolerable.
  - Same law dividends and buy-back
  - Buy-backs involve much more money.
  - Institutional investments will prefer buy-backs
  - Hedge funds: buyers of stock: good dividends, or increase in price?

- 8% DIVIDEND.
- 2% FOR FUND, 20% EARNINGS

  - FROM 8%, AFTER HEADGE FUNDS 20%, I AM LEFT WITH 6.4%. TAKE THE 2% FOR THE FUNS, 4.4%

PREFERRED STOCK

PREFERRED TO THE COMMON STOCK

- ANY KIND OF A PREFERENCE
- [SHINTOM LTD. V AUDIVOX CORP.] ONLY PREFERENCE AS TO LIQUIDATION AND NOTHING ELSE.
- WHO BUYS IT? PRIMARILY OTHER CORPORATIONS: USUALLY AN ALTERNATIVE FOR THE CORORPATION TO ISSUING BONDS. ADVANTAGES? 1) BUYING CORPORATION AS INVESTOR THE PREFERRED STOCK IS SIGNIFICANTLY BETTER DEAL THAN A BOND. (BOND: TAXED AT THE CORPORATE RATE ON THE INTEREST, 35%, ON THE DIVIDENDS § 243 IRC: CORPORATE DIVIDEND RATE, SPECIAL RATE FOR DIVIDENDS TAXED TO OTHER CORPORATIONS) 2) CASUAL BUYER, 70% OF THE DIVIDEND EXCLUDED FORM THE INCOME OF THE DISTRIBUTEE CORPORATION:
- 10.5%: LARGELY EXPLAINS THE ISSUING OF THESE SHARES.
- ISSUING CORPORATION→ ADDITIONAL ADVANTAGEIF YOU DON'T PAY THE INTEREST IN A BOND: EVENT OF DEFAULT, EXALERATION CL, OWE THE WHOLE THING TOMORROW YOU ARE NOW IN BANKRUPTCY.

        - DON'T PAY THE DIVIDEND: BECOMES A DEBT ONLY WHEN IT IS DECLARED BY THE BOD> UNTIL THEN, IT IS NOT A DEBT.
        - DIVIDEND CUMULATIVE: CANNOT PAY DIVIDEND ON ANY JUNIONR SECURITY: UNTIL YOU HAVE PAID ALL CURRENT AND ACCULUMATED DIVIDENDS.
        - NON-CUMULATIVE: STOCK ISSUED TO A JUNIOR CLAIMANT IN A BANKRUPTCY REORGANIZATION; MERGER.
        - PARTICIPATING: UNUSUAL, BUT EXIST: AFTER THE PREFERRED DIVIDEND, CAN PARTICIPATE IN FURTHER DISTRIBUTIONS
        - VOTING RIGHTS: MORE OFTEN PREFERRED STOCK IS NO VOTING.
        - CLASS VOTING: 1) SINGLE VOTING POPULATION: HOLDERS OF ALL OUTSTANDING SHARES OF STOCK. 2) VOTED UPON, APROVAL REQUIRED OF EACH CLASS OF SH VOTING SEPARATELY.
            - CALIFORNIA: STATUTORY MERGER EACH CLASS OF STOCK OUTSTANDING VOTE SEPARATELY AND HAVE TO ACCEPT IT.
        - LIMITED VOTING RIGHTS:
        - STOCK CONVERTIBLE TO THE COMMON.
    - COMMON STOCKS: PAY LOW DIVIDENDS. GIVE UP A DIVIDEND MUCH HIGHER THAN A DIVIDEND YOU CAN ANTICIPATE ON THE COMMON STOCK: BEST OF BOTH WORLDS. HIGHER INCOME, FROM THE COMMON; WHAT ABOUT THE PRICE OF THE PREFERRED COSTS MORE! SELLS AT A PRIMIUM: WHEN YOU WANT YOU CAN CONVERT IT TO THE COMMON STOCK.
    - COMMON STOCK HOLDERS IT IS A LOUSY DEAL: EARNING PER SHARE: EARNING PER SHARES OUTSTANDING DIVIDE IT BY EARNINGS.
    - REDEMPTION: TRANSACTION REMEEDMING AN ENTIRE CLASS OF STOCK.
    - BUY BACK NUYING ISOLTED NUMBER FROM THE MARKET.

preferred stock at least voting rights triggered by no payment of dividends: if al least they don t have this right they cannot be listed.

[Baron v Allied Artist Pict] 1975

P: Baron Shareholder
D: Allied Delaware corporation
Baron wants to declare election of D illegal. 1979 and 1974
1964: 6 quarterly dividends have passed.

After that two major successes of company: Cabaret; Papillion.
Argues that the BOD perpetuating themselves by refraining to pay dividends due, and hence stopping preferred from electing the BOD.

Fiduciary: begins the analysis: for who?

BOD elected by preferred stockholders. For who?

Claiming ruining their business: no

Owe fiduciary duty? YES, to whom? People elected me.

- Fid duty to SH? Yes, common-preferred.
- 50%-50% owe a fiduciary duty.

Del independent legal significance doctrine

[Rothschild v Liggett]

now incorporated in Del, originally in New Jersey: downstream merger (merge the parent company into the subsidiary now share of common stock becomes a common stock of the new company) moved this corporate domicile from NJ to Del.

Kinds of stock outstanding:

1) issued Preferred stock 7%. $100 par value cumulative.

2) Common Stock

3) $ 5, 25 convertible preferred.

7%: 60 dollars traded on the stock exchange. The company may not be doing that way: high risk involved in buying this preferred and hence it sells at a discount.

Market interest rates have gone up.

Chesterfield cigarettes: making money.

Now: 5% on treasury bonds, etc.

Market interest rate at 14% better to buy a government obligation than a private one.

7 dollars divided by 60 x 100: 11.66%: people buying this preferred stock where willing to pay for it an amount which the 7% stock gave them an 11.66% interest rate.

Tender offer:

Buy up common stock at a moderate premium: $67, offer to the $5 dollars preferred $14,50. → no par preferred. State the preferences in a dollar amount as you can t state them as a %.

Worth of $5, 24/11.66% (demanded rate of return)= $45 this is what the 5 dollar stock is worth in the market in a world were the people a re requesting an 11% rate.

They have a vote

They are convertible: worth at least the market price of the shares of the common stock into which it could be converted, plus a s surplus for the dividend it is entitled to.

- Set up another company→merge the old into the new: unusual form of merger: NY, Del expressly contemplates: **cash out merger**:
  - A into B: Sh of A end up with shares of company B
  - Another possibility: A merged into B, Sh go get shares of company B paying cash.
    - People who didn't sell were bought at 70 dollars.

- Arguments with more force: this is a **de facto liquidation**: set it up as a statutory merger, but is really is a liquidation:
- Sell all the assets: dispose the liabilities: come up with a NET cash amount and we would distribute it to the SH.
- Plaintiff:
  - In the case: transferring assets to a new owner, paying out the SH.
  - It isn't different: pay me $100 dollars a share, functionally you did liquidated the company, but you a paying me $70 dollars, you shorted me by $30 dollars.
  - Action vs Directors, majority SH.
- Court: it was a merger, both figures are different.
- Del **"independent legal significance doctrine":** del statute provides a multiplicity of ways in which you can affect the same transaction: get rid of a minority SH: merge bought out for cash; liquidate the company and pay them out.

Court: Rights are contractual. Case generally cited for the proposition that No fiduciary duties owed to the preferred SH.

Certificate of incorporation only one methodology to getting us out of the picture:
liquidation: s 525 Del statute. 7% silent on the subject you can't do it→merger provisions necessarily forms part of the Charter.
No implied preferences: rights you don't have stated you haven't got!

Rights are not preferential the company owes them the same fiduciary duties as to the common SH.

Last two paragraphs in this opinion: let us not discuss them here: why even discuss it.

[Jedwab v MGM Grand Hotels] 1986

fiduciary duty owed to SH: laugh to read those cases…McFarlane v North American Cement 1928, Dolton v…. same facts: company has 2 classes f stock outstanding: company comes along and makes a cash offer to the BOD for the whole company: 100 dollars for the common stock and another for the preferred: not enough for the common: cut preferred down, 10 more for the common: breach of the fiduciary duty: clearly is a breach but that transaction is OK.

First serious effort at rationalizing the law of duties to the preferred is located at Judge Allan decision in Jedwab.

- Preferred SH. Of MGM: company proposal for a cash-out merger: leaving the BOD the allocation of $ to each class.
- Preferred had a 20 dollars preference in a liquidation scenario
- BOD allocated $14 dollars to the preferred.
- Allan: distinguish the matter that do to the limitations between the classes, from the rights asserted vs the preferred stock.

No fiduciary duty owed to the preferred: no grounds for a lawsuit.
Dividing line, matters of contract and other matters is rational.

Fiduciary Duties of D to Preferred Shareholders:
Stock in Rothschild: amount of preferred dividend is said in contract.

- Suppose interest rate environment is such, that 7% is small. No one is gonna buy unless it is 25%.
- Owners of the preferred sue BOD: "we own a preferred stock 7$ small amount money, afford to pay us more. Entitled to that because you have a fid duty to us.

- As to this matter→ no fiduciary duty
- Oversight draftsman: nothing about liquidation rights. Owner of the stocks have any? → company liquidated, BOD give common stock 200 times their investment originally, give the preferred stock amount equal to ½ original investment. Do owe fiduciary duty!

ASSIGNMENT 4

Fundamental Changes

- Transactions that are outside the usual corporate law rule: "a corporation shall be managed by the BOD". §141 Del, §701 NY

    - Every one of these transactions in any or all states requires the approval of shareholders!
    - Some of these confer rights to SH that have no contractual voting rights. → 1) voting right given to people in a class that would otherwise would have none, 2) people that have voting rights, have class voting rights. (i.e. separate approval is required for the transaction, approval by each class)
    - Sh who is not happy with this deal can dissent of this transaction and demand that the co. buy him out. Unable to agree on an amount, separate judicial proceeding, called **APPRAISAL**.
    - Merger one goes into the other, Consolidation two companies merge into a new one. A-B=A, A-B=C

    Types that require this approval:

1. Amendment of the Corporate Charter of the incorporation, articles of incorporation→ SH approval.
2. Statutory Merger/Consolidation→ SH approval
3. Sale of all or substantially all assets→ SH approval
4. Liquidation→ SH approval

- What Sh gets to vote, varies from transaction to transaction, state to state. Approval extended to all kinds of transactions, almost any possible kind of stock, other states narrower: DEL, NY

[Trustees of Darmouth College v Nordwood] 1819

1818: State of New Hampshire decided to change the deal: Trustees objected to that and sued.

Supreme Court: Corporate Charter is a contract among the incorporators, the corporation itself and the state. US Constitution says that a state cannot alter the obligations of a contract, that contract cannot be amended unless the consent of all parties to the contract is given.

- Concurring opinion Justice Story: however, states can in every case reserve to themselves a right to change it.

Every state has done it. Constitution, or corporation statute: reserved this right for himself.
Del s 394 DEL G C L
NY 110

Exam
Half: Short answers. Two words, number, sentence.
Short Essay Question
Long Essay Question

VALUATION

[Piemonte v New Boston Garden Corp] 1979

- Del block method: values stock as a separate asset, value the business. Market price of stock irrelevant.

- Reconstruction market price: other companies easily valued, because their stock is publicly traded. Use the valuation metric that we get from that company, to value this business as a whole. Divide that by number shares outstanding: give us a reconstructed price value.
    - Low value: same characteristics as sport companies: controlled by a family, or few large investors.
  - Court could have gone either way. Ignored market price, used it, used the reconstruction market price.
  - Earnings. Factor? After you take the earnings: accounting earnings you have to capitalize them: 10% should apply because 2 players have two great starting careers.
  - State Supreme Court say: discretion
    - Boston garden 300,000: wrongly valued: net amount tat they had paid for it. Fair market price. Not bought at an arms length transaction: long lease on the property, that had lowered the value.
    - Bruins franchise
    - Concession operation

- Judge constrained to apply: SC he was not constrained by anything. We could accept one of the expert opinions, take another approach: **discretion was unlimite**d.

- 15/20 years ago: Law Reviews: every issue would have one or two articles of interest literate and sophisticated practicing lawyer: Tennessee: appraisal proceedings: reviewed appellate set aside court decision.
  - Could not find one case in which an appellate case on the relative weighing of earning, stock price and asset value.--> relative weighting of those items is important.
  - Appraisal: asking because not happy with the deal: one legitimate reason, they are getting out with much less of what they thought they had.
  - Earnings of the acquiring co bad, stock price cheap, a lot of investment in assets.
  - Sport franchise: family owned: small group wealthy investors, high corporate income, high corporate income tax. Operated on a basis to maximize value without realizing income:
  - § 260 (1) (b): Delaware: no appraisal rights for listed companies.

- [Valuation of Common Stock of Mc Loon Oil] 1989 Supreme Court of Maine at odds with [Sterling v Mayflower]

SH in Sterling Mayflower were only entitled to value of the shares, not the liquidation value. In this case is the other way around. Square contrary holding.

Maine court is following a recent precedent of the Del court.
Difference: this only a close corporation!!!
Only apply to close corporations, not easily tradable and marketable.
Better off looking for appraisal remedy in a closely held corporation.

Only buyer: controlling shareholder: give you very little.
Defendant argues: Price derived by valuing business: reduced because you can't get anything like your % interest in the business, if nobody will buy it.
Respecting contract arrangements: however: creature of rationality: minority Sh bought this small price of the business: some way to come out in contemplation.
Never get ppal back, get income: counsil: debt instrument/ zero coupon: not income but you get the ppal back. Buy a counsil zero coupon! NO!!!!
Discount the shares of the minority shareholders: minority status.

Publicly traded securities: sell it in the market and get fair value.

If fair value means a % interest in the value of the interest, if you were selling a whole business, can you be confident that the guy bought your stock you would have paid an equivalent amount.

- Shares traded at a lower value than the liquidation value.
- 60's selling at a huge discount.
- Getting a value that I could not have gotten in any other way! No appraisal for publicly traded securities. NY/DEL
- Expert valuation: co expert was higher than the plaintiff's.
- Methodologies:
  - Defendants: Discounted cash flow basis
  - Claimants: net asset value basis.
  - Appraisal: mix of the value: mix discounted cash flow and the asset value.
  - Market price: irrelevant no market for the stock.

- Cash flow statement/income statement
  - Operating cash
  - Investing cash
  - Financing cash
- Take the operating cash→this is what this business would generate: let us capitalize this: what is the value of the assets that is producing this cash.

- Discounted cash flow is less good than discounted earning which are terrible.

- Del Supreme Court: **short form merger**: in which a controlling SH wanted to get rid off a very small number of shareholders. Created subsidiary: merger into the subsidiary: Did not seek them sued alleging a tort: affected a merger in which this people were taken out as sh **without any business purpose**. Non-business reason for a merger?

- [Magnabox] Supreme Court: no compelling reason in putting this two companies together, to provide some value to the acquiring company, only reason get rid of this tiny number of SH.

- Taking this people out of a merger in the absence of a business purpose, was a **tort**: what is the remedy: conversion value of the property: different from appraisal?
    - At that time, 76,DEL appraisal rights were much more limited: procedural: no way to combine the claims of a multiplicity of people seeking appraisal, everyone covering its own costs.
    - Legislature respond to that: winner take all: attorney fees. If co made exiguous offer: better price at the end of the day, not only that attny fees as well. →impact on the quality of the offers!\
    - Del S C tried to rationalize this.

[Wainberger]

---

1. **Amendment Cert of Incorporation**: a. Resolution Board of Directors adoptong the proposed amendments and recommending it to the SH.

Sh cannot act without BOD iniciative.

Vote: Del § 242 (b) (2): majority vote, unless § 242 (b) (4) certificate says there is a greater number.

Ny § 803 authorization to make the amendment.

Majority +Majority of class vote if there is any. Any class that is negatively affected is allowed to vote (NY § 804 (3)).

Model Act 10.3: no requirement of majority. Affirmative vote at a meeting in which there is quorum.

Ex. 1000 SH

NY-Del: 501 votes to pass. If class vote, maj of that class

Model: 251 majority of quorum.

Problem in states which allow issue of preferred stock to many people in small quantity: need their approval for everything: buy them.

Acquisition Transactions

1. Statutory Merger

A→B= A

Del §250(a); NY § 906.

Surviving Corporation succeeds the disappearing corporation in property, debts and obligations (known and unknown), potential lawsuits: entire legal position is know A's.

a. BOD adopts a plan of merger and recommends it to SH. NOTICE to all SH even if not allowed to vote, may have appraisal rights. (NY normally they have, Del not always)
b. Both BOD and SH approve the merger!
c. Who votes? NY majority of shares outstanding. (501 to go through)
    i. NY prior 1998: 2/3 for M, after 98: **simple majority**
    ii. Del provides for cash out merger, instead of issuing stocks of the surviving corporation give them cash.

NY 903 A 3, Model 11.02 b 3

2. Purchase of assets

a. Del approval majority votes at a meeting in which a quorum is present.
b. Decision by BOD. No SH approval: unless BOD needs to issue more stock than that authorized in the Cert.
    i. NYSE Listed: SH approval policy s 312.02 C: if 20% or more of outstanding shares are being issued, the exchange will not list the additional shares.

Documents, transfer→more complicated **BUT:** avoid acquiring all liability of the disappearing company.

Federal Overlap

Tax s 368 (A) (1): "Reorganization" transactions being characterized as such are tax-free. A: statutory merger, B:, C: sale of all or substantially all assets in exchange of all assets (continuity of interest: owns stock before and after the transaction)

State law: buy out: cash taxable.

[Harinton v Arco] SC Delaware 1963
Agreement that A would sell all assets to Loreal. Loreal in exchange would give stock (s 368 1 c)

P argues that this is a disguised merger. Del no appraisal rights under this transaction!!, under Merger yes!!

Held: sale of assets and merger statutes are independent statutes, **independent legal significance**, can choose whichever they want. [Rothchild v Ligett] 1984

1. **Short Form Merger Del § 253**
   - ❖ BOD resolution, if owns more than 90%
   - ❖ Del of all voting stock, NY of all classes of stock.
   - ❖ Appraisal right available in every state.
2. **Small Form Merger Del § 251 f NOT NY**
   - ❖ Buying company issues shares of its stock for all assets. BOD decision. Only if not enough and needs amendments of certificate of incorporation will need SH approval.
   - ❖ NYSE Sh approval rule: more 20%

Appraisal Rights

Before, significant change required Sh unanimous approval. Veto power exchanged by appraisal right.

Before transaction takes place, inform that you are going to exercise your right: company needs to know how many, and if it will be buy them all out.

Company makes offer, not happy: procedure to determine the fair value of your shares.

Exclusivity: App statutes say it is exclusive. California means it! NY exclusive of only seeking legal remedy (money), equitable claim by passes the exclusion. Del the same, sue for fraud and you will by pass this limitation. [Cede v Technicolor]

Valuation: how can you value it? What does the SH own?
[Sterling v Mayflower]

P, stockholders of Mayflower Hotel, sue to enjoin the merger. Hilton does not have enough to do short form merger. Unfair to them because this is really a sell of all assets: giving a com valued at 10M, receiving 5M worth of stock!

Held: not a sell of assets! It is a merger! Different transaction. Sh will continue to be Sh in on ongoing business. Hotel still exists. Not entitled to the liquidated value of the assets!

Legal Standard judge transaction: BJR no! on both sides of the transaction, **ENTIRE FAIRNESS**: entitled to securities substantially equivalent in value to what you had.

[Bove v Community Hotel]
purpose: get rid of cumulative dividends on Community preferred stock. OK!

December 1st, 2009

[Weinberger] cash out merger: parent company does not have enough stock to do a short form statutory merger.
Legal standard: interested party transactions: ENTIRE FAIRNESS

Burden of proof: introduce evidence, risk of non persuation. Who bears these?

1. Proponent, interested party. Both
2. Before: objecting party raise adequate doubts to impose such a duty on the other party (in this case the hurriedness of the transaction when there was no reason)
3. If transaction approved by informed vote of majority of the minority: the burden is shifted again to the objectors of the transaction. (proponent must establish complete candor in disclosure before benefiting form this last shift)

Issue here is the PRICE: is it fair?
Mkt Price 14, wants to pay 21 remember [Van Gorkem] good price→bad procedure to get the transaction done.

2 D Signal employees, and Directors of UOP. Analysis good investment 24$, did not communicate this to the entire Signal BOD. Breach fiduciary duty.

FN7: bargaining at arms length. Should have appointed an independen committee.

Fair price- fair dealing!

[Rabkin]
nuys majority, 63%, if they decide to buy the rest, pay the same price for a year.

Waited more than a year, and offered less for share.

Held: wrong! [Schnell] not because it impossible, it is legal, inequitable! (inequitable to deny SH rights: moved forward the Sh meeting, could not do a proxy war, not just any standard)
[Glasman]
shart form merger: went through FN7 Committee.

Held: did not need to! Unilateral act of the parent suffices. Only remedy appraisal.

Tender offers

Before 1960: almost unknown.
Take over a company:

1. proxy contest: it never worked! +expensive, Sh would not vote against management, did not like them, sell their shares.
2. Buy stock: go to the Floor Exchange: shares quickly raise, very expensive.
3. Find Agent: Tender offer in newspaper: terror!!! Everybody sell, price goes down. Never failed!!

Williams Act SEC regulate tender offers.

§14 (d) unlawful to make a TO for any equity security registered pursuant to §12 (does not apply to bonds)

§14 (e) applies to any kind of security. Antifraud provision. BROADER

SEC Rule 14 (e)(1) To must be open for minimum 20 days
14 (e)(5) illegal to buy alongside the TO
more shares tendered: buy them pro rata, does not matter WHEN you tender.
Right to wothdraw before the shares are bought)opportunity for competing offers)
14 (d)(10) Same price! If increase the price tener offer, everybody gets that price.

T.O Statement: disclose, who you are, money where comes from, intentions.

Definition T.O SEC does not give it anywhere!
[Wellman v. Dickinson] 8 factors

1. Active and widespread solicitation of public shareholders for shares of an issuer

2. Solicitation made for a substantial percentage of an issuer's stock
3. Offer to purchase made at a premium over the prevailing market price
4. Terms of the offer are firm rather than negotiated
5. Offer contingent on the tender of a fixed number of shares and possibly specifying a maximum number of shares
6. Offer only open for a limited time period
7. Offeree subject to pressure to sell stock
8. Public announcements of a purchasing program that precede or is coincident with a rapid accumulation of shares

[SEC v Carter]
Calif Company, $23- $30
Did not want to be taken over by LTD CO.

Defenses: 1) sell block preferred stock (convertible 22% of all voting power) 2) gave general cinam crown jewel option to buy Waldon Books at a bargain price, 3) Buy stocks themselves for $33.

Made it harder for bidder to gain control with block option, and value lessened by crown jewel option. Buy back reduced number shares outstanding.

SEC argues buying up shares during TO was itself a TO comply with §13d.

Held: after applying the Wellman 8 factor test: not a tender offer: no fixed price, instead bought mkt price, no contingency, were buying as they could.

Rule 14 (d)(10) Same price all SH, all price rule Must be open toe vertbody who own that class of security , and pay the same price.

[Epstein v MCA]
Music Corp of America. Biggest Sh Wasserman $351M

TO friendly W wants special deal: tax free transaction, sell stock new corporation exchange that co preferred stock. M agree redeem out preferred stock upon death W or wife.

$1 (1-ITR)(1-ETR)
(1-.25) (1-.65)= 26, 25
if however upon death

(0) (1-.65)= 35 cents on the dollar.
Capital gain tax: 25
Estate Tax 65

Death new event: instead of paying gains over the 135M, bought 15 thousand, new event, as if it was bough at 135M, sold at same price, no gains!