

# Corporations

## Organization & Formation

### Characteristics of a Corporation

#### Limited Liability

For Owners, Directors, Officers

#### Centralized Management

Owners are not the Managers

#### Free Transfer of Ownership

By Sale of Equity Shares (Stocks)

#### Continuity of Life

#### Taxation as an Entity

Generally, taxed separately (C Corp.) If not, it's an S Corp.

### Other Forms

#### Sole Proprietorship

Owner Management; Fully Liable

#### Partnership

Partners are Owner/Managers & Liable

#### Limited Liability Company

Flexible: limited liability, but tax benefits of corp.

#### Limited Partnership

General (Liable) & Limited (\$) Partners

#### Limited Liability Partnership

Professionals: Still Liable for Malprac.

### Formation and Status

#### Formation

Created by compliance with a state statute for filing of Articles of Incorporation

#### DeJure Corporation

Compliance with all statutory requirements

#### DeFacto Corporation

Still corp. except state challenge

1. Statute allowing for incorp.
2. Colorable compliance, good faith
3. Conduct of business in corp. name

#### Corporation by Estoppel

If one dealt with corp. as corp., then one cannot deny its existence

## Piercing the Corporate Veil

Court eliminates the limited liability protection of a corporation. Grounds: (1) Alter Ego; (2) Inadequate Capitalization; (3) Fraud or Avoidance of Obligations. Result: active owners liable in tort or to creditors.

## Operation & Management

### Promoters

**Pre-incorp liabilities:** Promoter liable until novation. Corp. never liable unless adoption.

**Duty of loyalty:** To corp. No personal profit

**Duty to other promoters:** joint venture

### Officers

**Agents** of corporation

**Duties** very similar to directors

**Duty of Care, Duty of Loyalty**

### Indemnification

Directors, Officers, Employees

Mandatory, Discretionary, Prohibited

### Directors

#### Voting & Meetings

**Effective Board Action:** Quorum, major. of quorum wins. No voting agreements or proxies

**Board vacancy:** May be filled by other directors or by shareholders

#### Director Duties

**Duty of Care:** Business judgment rule

**Duty of Loyalty:** No Insider trading &

**No Self-dealing.** But OK if: full disclosure of material facts & vote of major. of disinter. dir. or shares. If not, remedy is rescission.

**Corporate Opportunity Doctrine:** Remedy: damages, constr. trust, or corp gets opport.

**Competition with corp.** Unrelated business OK. No competing bus. Damages or injunc.

#### Controlling Shareholders

In close corps, majority shareholders have duties to minority similar to directors.

Must refrain from taking special advantage or prejudicing minority shareholders. Treated as insiders under Securities & Exchange Act.

### Shareholders

#### Voting and Meetings

**Annual meeting** required. Court may order meeting.

**Special meetings** optional if board calls

**Shareholder action** w/o meeting OK w/ unanimous written consent

**Proxies:** Must be signed writing. Expires in 11 mo. or by terms Revocable unless coupled with interest

**Action at meeting:** Quorum necessary, and majority of quorum wins. Cumulative voting for board of directors only.

**Shareholder agreements:** Includes Pooling agreements; Voting trusts (on file, expires in 10 yrs); Stock transfer restrict. (if reasonable)

#### Other Rights

**Preemptive Rights:** Re newly auth. stock sold for cash

**Dividends:** No right to them. Once declared, irrevoc. unless insolv. Only payable from earned surplus, not stated capital

**Redemption, repurchase, distribution:** Other distributions

**Inspection Rights:** May only inspect records, books, shareholder lists, etc. (documents not plant). Proper purpose only.

#### Shareholder Derivative Suits

If successful, recovery to corp; individ. can get legal costs.

Requires:

1. Shareholder at time of wrong & time of suit
2. Prior demand on board unless would be futile
3. Post bond

# Capital Structure & Securities Regulation

## Capital Structure

### Debt Securities (Bonds)

Arise when corporation has borrowed funds from investors and promises to repay them. Holders have no ownership interest.

- |                          |                                    |
|--------------------------|------------------------------------|
| 1. Secured debt (Bonds)  | 1. Pay to holder (Bearer / Coupon) |
| 2. Unsecured (Debenture) | 2. Pay to reg. owner (Registered)  |

### Equity Securities (Stocks)

**Authorized Shares:** Shares described in Articles of Incorporation.

**Issued and Outstanding:** Shares that have been sold

**Authorized but Unissued:** Reacquired: buyback / redemption

**Classification:** May have only one type of ownership interest (common stock) or classes or series with varying rights. Articles of Incorporation must describe the classes & rights (E.g. "Class A Preferred")

**Stock Subscriptions:** Subscribers promise to buy corp. stock

**Par value:** Set in Articles of Incorporation. Very rare modernly.

**Watered stock:** Sold less than par: directors liable for "water"

**Unpaid stock:** Shareholder has not paid. Creditors may reach.

## Fed: Section 16(b)

### of the Securities & Exchange Act of 1934

Orig. insider trading provision, only for SEC Reporting Companies (On a nat'l exchange OR 500+ shares & \$10 mil in assets)

**Short swing trading:** Insiders (officer, director, or 10%+ shareholder) can't sell / purch., or purch. / sell corp's stock in 6 mo.

**Strict liability:** Irrebutable presumption of misconduct. No fault

**"Terror damages":** Lowest price in, highest price out in 6 mo.

## Fed: Rule 10b-5

### of the Securities & Exchange Commission

The general anti-fraud provision (1943)  
Applies to trade in ANY security

**1. Standing:** Plaintiff either bought / sold security based on fraud or omission, and suffered damages.

**2. Jurisdiction:** Federal case if defendant used means of interstate commerce or stock exchange

**3. Materiality:** The fact misstated or omitted one reasonable investor would attach importance to.

**4. Scienter:** Intentionally, knowingly, or with (extreme?) recklessness. Must plead w/ particularity

**5. Reliance:** (aka transaction causation) In fraud cases, plaintiff relied on misstatement in trading

**6. Causation:** (aka loss causation) The plaintiff must show that the fraud caused her damages. If plaintiff benefited from trade, no case.

**7. Connection:** "In connection with" the buying / selling of a security. Close in time.

## Rule 10b-5 & Insider Trading

**Fraud by omission:** Insiders duty to "abstain or disclose" re. trading on inside information

**Reliance:** Loss causation too hard to prove. Use reasonable investor or fraud on the market.

**Who's liable:** Insiders, Tipsters, Tippees, & Misappropriators

## Fed: Sarbanes-Oxley Act (2002)

New reporting requirements, civil and criminal penalties for accountants & lawyers aiding fraud

# Fundamental Changes in Structure

## General Procedure for Fundamental Changes:

- (1) Board adopts a resolution;
- (2) Written notice to shareholders;
- (3) Shareholders approve by majority of votes entitled to be cast; and
- (4) the changes in the form of the Articles of Incorporation are filed with the state.

## Merger

**General Rule:** Directors & shareholders of both corporations must approve, shareholders by majority of shares entitled to vote

**Short form merger** does not require shareholder approval

### Appraisal

Rights of dissenting shareholder Requirements:

1. Written objection before meeting
2. Vote against merger or abstain
3. File written claim

## Sale of Assets

### Director & Shareholder Approval

If sale, lease or exchange of substantially all corp. assets is outside the ordinary course of business, then requires approval of majority of directors and majority of shares entitled to vote

### De Facto Merger

If sale of assets is de facto merger, triggers possible rescission or appraisal rights & purchasing corporation may be liable for debts & liabilities

## Amendment of Articles

Corporation can amend articles. No appraisal rights.

## Bylaws

Board of directors may amend or repeal bylaws unless articles exclusively reserve power to shareholders

## Dissolution & Liquidation

### Approval Needed

Majority of directors and majority of shares entitled to vote must approve (no quorum concept)

### Creditors' Rights

If liquidation, pay outside creditors first