I. Economic and Legal Aspects of the Firm
   A. Economic Backdrop
      1. Comparative Search for the Best Investment
         a. Market economy means that investors are constantly searching for the maximum value for their investments
            1.) Rational investor takes both comparative and ex ante perspective
               a) Comparative—consider alternatives
               b) Ex ante—without knowing ex post what outcome will be try to predict which alternative will yield optimal result
         2. Risk and Return
            a. Try to determine expected return from investment options
            b. Characterize investors as
               1.) Risk adverse
               2.) Risk preferring
               3.) Risk neutral
         3. Transaction Costs and Choice of Organizational Form
            a. Transaction Costs impacted by
               1.) Bounded rationality—cognitive limits on our ability to act rationally
               2.) Opportunism—self interest that takes advantage of others lack of knowledge
               3.) Team-specific investment—asset has team specific value if it has higher value in use by team than in next best use.
                  a) The greater the team specific investments the greater the risk of opportunism
               4.) Deal with by making educated guess, relying on information cheaply available that can quickly process, relying on rules of thumb “heuristics,” relying on past experience
            b. Look at how best to make decisions collectively
            c. When deciding how best to structure relationships, look at transaction costs to determine most efficient organization
               1.) Implicit team—people use when
                  a) Lower risk
                  b) No team specific investments
               2.) Discrete and relational contracting
                  a) Use a contract to deal with the risk of opportunism
                  b) Discrete contracting is best suited for limited dealings with few exchanges between team members
                     i. Problematic because need contract to cover all contingencies
                  c) Relational contracting
                     i. Allows members to build structures that allow for a response to contingencies
               3.) Decision to organize as a firm
                  a) Limits to what can accomplish with contract
                     i. Discrete long term contract runs risk of self interest and opportunism and leaves team unprepared for contingencies
ii. Increased team specific investments mean increased opportunism—need something else to constrain opportunism—either law, market, or relationship

b) Ronald Coast’s theory of the firm—bring things inside the firm when it is cheaper than going out and engaging in market transactions—when can reduce transaction costs

B. Sole Proprietorship and the Law of Agency

1. agency law and the choice of sole proprietorship form
   a. created in the when ownership and control are consolidated in one person
   b. other team members join by agreeing to terms of owner
      1.) mutual assent creates relationship of principal ang agents
      2.) different from long term contract because law adds fiduciary duty as a limit to self-interested action

2. fiduciary limits on agent’s right of action
   a. limits on agent’s ability to act disloyalty
      1.) incentive to act in desired way
      2.) set up enforcement regime
      3.) employment at will
      4.) market forces
      5.) creation of fiduciary relationship
   b. more incentive to make team specific investments because law requires that agent prefer principals interests to his or her own
   c. Community Counseling Service v. Reilly
      1.) Employee of fundraising firm securing clients prior to leaving employer and was not honest about why he was leaving.
      2.) Held: Employee had no right to contact customers prior to termination because the employees primary duty was to promote the interests of the employer.
         a) Must be open and candid with employer
         b) General rule: can compete after termination but can not use trade secrets or confidential information.
            i. Employers may contract for greater protection, but noncompete agreements must be reasonable.
   d. Fiduciary duty can be seen as a device to economize transaction costs—a general obligation to act fairly, reduces negotiations between principles and agents
      1.) One way to do this is to use hypothetical bargaining and ask if the parties would have negotiated what would they have agreed to

3. Limits on the Proprietors Right to discharge an employee at will.
   a. General default rule: employment at will.
   b. Foley v. Interactive Data Corp.
      1.) An otherwise good employee was terminated after reporting that supervisor was under investigation for embezzlement by former employer
2.) Held: no wrongful discharge in violation of public policy because there was no public interest at stake only the private interest of the employer.

3.) Held: to overcome presumption of employment at will, evidence of contrary intent must be shown either by express contract or through course of dealing.
   a) Look at Pugh Factors:
      i. Employer practices
      ii. Longevity
      iii. Assurances by employer
      iv. Industry practices
   b) Breach of self-imposed limitations in employee guidelines may be enough

4.) Held: damages for breach of covenant of good faith and fair dealing are limited to contract damages

4. Agency Law and Relations with Creditors
   a. Traditional rule: principle must manifest consent before agent can bind the principle
      1.) Actual—agent has direct authority from principle to act
         a) Can be express or implied from conduct (i.e. silent acquiesce)
      2.) Apparent—reasonable belief of third party that agent is authorized to act on behalf of principle
      3.) Inherent authority—protect reasonable expectations of third parties
   b. Agency is a way of reducing transaction costs and facilitate commerce but allow reliance on agents.
   c. Blackburn v. Winter
      1.) Investment broker persuaded widow to invest in fake company and kept money.
      2.) Held: Reasonable belief that the investment broker was acting on behalf of his investment firm
         a) employment gave him the opportunity to commit the fraud
      3.) “least cost avoider”—winter is in best position to avoid costs until consumer realizes that agent lacks authority and then burden shifts back to consumer because they are in the best position to avoid costs.

C. Joint Ownership
   1. organizing team production as a sole proprietorship or jointly owned firm
      a. long term contracting not effective when need flexibility to adjust to changed circumstances and when have risk of opportunistic action
      b. sole proprietorship usually selected when one person has the most team specific capital at risk
      c. joint ownership when team specific capital will be spread more equally
      d. benefits passive and active partners by allowing them to avoid ex ante transaction costs and preserve flexibility
   2. The need for Rules allocating and limiting ownership rights
      a. Allocating decision making authority between joint owners
         1.) Full participation: used by small active firms
2.) Delegation: used when there are more owners and more passive owners
b. Need for voting rules
c. Need monitoring agents
   1.) Board of directors act as monitors to control management and ensure that the expectations of passive partners is met.
d. Need rules governing exit
   1.) Balance need to exit against risk of opportunism
3. Role of Entity Law
a. Joint ownership relies on entity law to
   1.) Govern relationship among co-ventures
      a) Different entity forms balance differently the needs of the firm of the firm to be flexible and to avoid participant opportunism and the individual’s need to be able to withdraw and to be protected from the firm.
      b) Standard form entities provide default rules that provide ex ante specification of ownership rights and duties and ex post gap-filling.
         i. Types of default rules:
            (a) Tailored rules—try to give parties the rule they would have chosen had they been able to bargain costlessly
            (b) Majoritarian rules—try to give parties the result that most other similarly situated parties would prefer
            (c) Penalty default rules—motivate a party to contract around the default
      c) Different entities provide different fiduciary duties
         i. Nexus of contracts approach: corporation is a nexus of explicit and implicit contract and market relationships between and among owners, agents, creditors, customers, and affected communities.
            (a) Fiduciary duty as a way to fill in the gaps taking into account ex ante expectations.
   2.) Govern relationship among co-venturers and outsiders
      a) liability to outsiders
         (a) entities allow owners to limit liability—desire for limited liability can impact choice of organizational form
   3.) Govern relationship between co-venturers and government
      a) Risk of double taxation: tax at entity level and at shareholder level
      b) May avoid by “zero out”—distribute all corporate income through deductible expenses—but may be challenged as disguised dividends
      c) May avoid by seeking pass-through entities: general and limited partnerships, limited liability partnerships, and limited liability companies
         i. “check box” whether want pass-through or corporate tax
b. role of lawyers—help find optimal mix of rules
c. Role of markets
1.) Markets affect governance and development of rules
2.) Protect expectations and avoid private ordering by ensuring that team members do their part
   a) Product market—need skill and diligence for competitive advantage
   b) Capital market—poorly run firms suffer from increased cost of capital
   c) National securities markets—easy to trade, easy to diversify risk
      i. “Wall Street Rule”—shareholders who don’t like the way a company is being run can sell stock and exit
   d) Labor markets—performance related to compensation
   e) Market for corporate control—poor management increased risk of hostile takeovers

   d. State v. federal law

II. Partnerships and Limited Liability Companies

A. Overview
   1. Traditional Noncorporate Business associations
      a. The general partnership
         1.) Relevant statutory Authority
            a) UPA § 6 Partnership defined
               (1) A partnership is an association of two or more persons to carry on as co-owners a business for profit.

               (2) But any association formed under any other statute of this state, or any statute adopted by authority, other than the authority of this state, is not a partnership under this act, unless such association would have been a partnership in this state prior to the adoption of this act; but this act shall apply to limited partnerships except in so far as the statutes relating to such partnerships are inconsistent herewith.
            b) UPA § 7 Rules for Determining the Existence of a Partnership
               In determining whether a partnership exists, these rules shall apply:
               (1) Except as provided by § 16 persons who are not partners as to each other are not partners as to third persons
               (2) Joint tenancy, tenancy in common, tenancy by the entireties, joint property, common property, or part ownership does not of itself establish a partnership, whether such co-owners do or do not share any profits made by the use of the property.
               (3) The sharing of gross returns does not of itself establish a partnership, whether or not the persons sharing them have a joint or common right or interest in any property from which the returns are derived.
               (4) The receipt by a person of a share of the profits of a business is prima facie evidence that he is a partner in the business, but no such inference shall be drawn if such profits
were received in payment:
(a) As a debt by installments or otherwise.
(b) As wages of an employee or rent to a landlord,
(c) As an annuity to a widow or representative of a deceased partner,
(d) As interest on a loan, though the amount of payment vary with the profits of the business.
(e) As the consideration for the sale of a good-will of a business or other property by installments or otherwise.

c) UPA § 15 Nature of Partner’s Liability
All partners are liable:
(a) Jointly and severally for everything chargeable to the partnership under § 13 and 14.
(b) Jointly for all other debts and obligations of the partnership; but any partner may enter into a separate obligation to perform a partnership contract.

d) UPA § 18 Rules determining rights and duties of partners
The rights and duties of the partners in relation to the partnership shall be determined, subject to any agreement between them, by the following rules:
(a) Each partner shall be repaid his contributions, whether by way of capital or advances to the partnership property and share equally in the profits and surplus remaining after all liabilities, including those to partners, are satisfied; and must contribute towards the losses, whether of capital or otherwise, sustained by the partnership according to his share in the profits.
(b) The partnership must indemnify every partner in respect of payments made and personal liabilities reasonably incurred by him in the ordinary and proper conduct of its business, or for the preservation of its business or property.
(c) A partner, who in aid of the partnership makes any payment or advance beyond the amount of capital which he agreed to contribute, shall be paid interest from the date of the payment or advance.
(d) A partner shall receive interest on the capital contributed by him only from the date when repayment should be made.
(e) All partners have equal rights in the management and conduct of the partnership business.
(f) No partner is entitled to remuneration for acting in the partnership business, except that a surviving partner is entitled to reasonable compensation for his services in winding up the partnership affairs.
(g) No person can become a member of a partnership without the consent of all the partners.
(h) Any difference arising as to ordinary matters connected with the partnership business may be decided by a majority of the partners; but no act in contravention of any agreement between
the partners may be done rightfully without the consent of all the partners.

e) UPA § 31 Causes of Dissolution

Dissolution is caused:
(1) Without violation of the agreement between the partners:
   (a) By the termination of the definite term or particular undertaking specified in the agreement,
   (b) By the express will of any partner when no definite term or particular undertaking is specified,
   (c) By the express will of all the partners who have not assigned their interests or suffered them to be charged for their separate debts, either before or after the termination of any specified term or particular undertaking,
   (d) By the expulsion of any partner from the business bona fide in accordance with such a power conferred by the agreement between the partners;
(2) In contravention of the agreement between the partners, where the circumstances do not permit a dissolution under any other provision of this section, by the express will of any partner at any time;
(3) By any event which makes it unlawful for the business of the partnership to be carried on or for the members to carry it on in partnership;
(4) By the death of any partner;
(5) By the bankruptcy of any partner or the partnership;
(6) By decree of court under § 32.

f) UPA § 38 Rights of Partners to Application of Partnership Property

1) When dissolution is caused in any way, except in contravention of the partnership agreement, each partner as against his co-partners and all persons claiming through them in respect of their interests in the partnership, unless otherwise agreed, may have the partnership property applied to discharge its liabilities, and the surplus applied to pay in cash the net amount owing to the respective partners. But if dissolution is caused by expulsion of a partner, bona fide under the partnership agreement and if the expelled partner is discharged from all partnership liabilities, either by payment or agreement under § 36 (2), he shall receive in cash only the net amount due him from the partnership.

2) When dissolution is caused in contravention of the partnership agreement the rights of the partners shall be as follows:
   (a) Each partner who has not caused dissolution wrongfully shall have:
      (I) All the rights specified in paragraph (1) of this section, and
      (II) The right, as against each partner who has caused the dissolution wrongfully, to damages for breach of the agreement.
   (b) The partners who have not caused the dissolution wrongfully, if they all desire to continue the business in the same name, either by themselves or jointly with others, may
do so, during the agreed term for the partnership and for that purpose may possess the partnership property, provided they secure the payment by bond approved by the court, or pay to any partner who has caused the dissolution wrongfully, the value of his interest in the partnership at the dissolution, less any damages recoverable under clause (2aII) of the section, and in like manner indemnify him against all present or future partnership liabilities.

(c) A partner who has caused the dissolution wrongfully shall have:

(I) If the business is not continued under the provisions of paragraph (2b) all the rights of a partner under paragraph (1), subject to clause (2aII), of this section,

(II) If the business is continued under paragraph (2b) of this section the right as against his co-partners and all claiming through them in respect of their interests in the partnership, to have the value of his interest in the partnership, less any damages caused to his co-partners by the dissolution, ascertained and paid him in cash, or the payment secured by bond approved by the court, and to be released from all existing liabilities of the partnership; but in ascertaining the value of the partner's interest the value of the good-will of the business shall not be considered.

g) RUPA § 301 Partner Agent of Partnership
Subject to the effect of a statement of partnership authority under Section 303:

(1) Each partner is an agent of the partnership for the purpose of its business. An act of a partner, including the execution of an instrument in the partnership name, for apparently carrying on in the ordinary course the partnership business or business of the kind carried on by the partnership binds the partnership, unless the partner had no authority to act for the partnership in the particular matter and the person with whom the partner was dealing knew or had received a notification that the partner lacked authority.

(2) An act of a partner which is not apparently for carrying on in the ordinary course the partnership business or business of the kind carried on by the partnership binds the partnership only if the act was authorized by the other partners.

h) RUPA § 306 Partner’s Liability

(a) Except as otherwise provided in subsections (b) and (c), all partners are liable jointly and severally for all obligations of the partnership unless otherwise agreed by the claimant or provided by law.

(b) A person admitted as a partner into an existing partnership is not personally liable for any partnership obligation incurred before the person's admission as a partner.
(c) An obligation of a partnership incurred while the partnership is a limited liability partnership, whether arising in contract, tort, or otherwise, is solely the obligation of the partnership. A partner is not personally liable, directly or indirectly, by way of contribution or otherwise, for such an obligation solely by reason of being or so acting as a partner. This subsection applies notwithstanding anything inconsistent in the partnership agreement that existed immediately before the vote required to become a limited liability partnership under Section 1001(b).

i) RUPA § 401 Partners Rights and Duties
(a) Each partner is deemed to have an account that is:
(1) credited with an amount equal to the money plus the value of any other property, net of the amount of any liabilities, the partner contributes to the partnership and the partner's share of the partnership profits; and
(2) charged with an amount equal to the money plus the value of any other property, net of the amount of any liabilities, distributed by the partnership to the partner and the partner's share of the partnership losses.
(b) Each partner is entitled to an equal share of the partnership profits and is chargeable with a share of the partnership losses in proportion to the partner's share of the profits.
(c) A partnership shall reimburse a partner for payments made and indemnify a partner for liabilities incurred by the partner in the ordinary course of the business of the partnership or for the preservation of its business or property.
(d) A partnership shall reimburse a partner for an advance to the partnership beyond the amount of capital the partner agreed to contribute.
(e) A payment or advance made by a partner which gives rise to a partnership obligation under subsection (c) or (d) constitutes a loan to the partnership which accrues interest from the date of the payment or advance.
(f) Each partner has equal rights in the management and conduct of the partnership business.
(g) A partner may use or possess partnership property only on behalf of the partnership.
(h) A partner is not entitled to remuneration for services performed for the partnership, except for reasonable compensation for services rendered in winding up the business of the partnership.
(i) A person may become a partner only with the consent of all of the partners.

(j) A difference arising as to a matter in the ordinary course of business of a partnership may be decided by a majority of the partners. An act outside the ordinary course of business of a partnership and an amendment to the partnership agreement may be undertaken only with the consent of all of the partners.

(k) This section does not affect the obligations of a partnership to other persons under Section 301.

(j) RUPA § 601 Events Causing Partner’s Dissociation
A partner is dissociated from a partnership upon the occurrence of any of the following events:
(1) the partnership's having notice of the partner's express will to withdraw as a partner or on a later date specified by the partner;
(2) an event agreed to in the partnership agreement as causing the partner's dissociation;
(3) the partner's expulsion pursuant to the partnership agreement;
(4) the partner's expulsion by the unanimous vote of the other partners if:
   (i) it is unlawful to carry on the partnership business with that partner;
   (ii) there has been a transfer of all or substantially all of that partner's transferable interest in the partnership, other than a transfer for security purposes, or a court order charging the partner's interest, which has not been foreclosed;
   (iii) within 90 days after the partnership notifies a corporate partner that it will be expelled because it has filed a certificate of dissolution or the equivalent, its charter has been revoked, or its right to conduct business has been suspended by the jurisdiction of its incorporation, there is no revocation of the certificate of dissolution or no reinstatement of its charter or its right to conduct business; or
   (iv) a partnership that is a partner has been dissolved and its business is being wound up;
(5) on application by the partnership or another partner, the partner's expulsion by judicial determination because:
   (i) the partner engaged in wrongful conduct that adversely and materially affected the partnership business;
   (ii) the partner willfully or persistently committed a material breach of the partnership agreement or of a duty owed to the partnership or the other partners under Section 404; or
   (iii) the partner engaged in conduct relating to the partnership business which makes it not reasonably practicable to carry on the business in partnership with the partner;
(6) the partner's:
(i) becoming a debtor in bankruptcy;
(ii) executing an assignment for the benefit of creditors;
(iii) seeking, consenting to, or acquiescing in the appointment of a trustee, receiver, or liquidator of that partner or of all or substantially all of that partner's property; or
(iv) failing, within 90 days after the appointment, to have vacated or stayed the appointment of a trustee, receiver, or liquidator of the partner or of all or substantially all of the partner's property obtained without the partner's consent or acquiescence, or failing within 90 days after the expiration of a stay to have the appointment vacated;

(7) in the case of a partner who is an individual:
(i) the partner's death;
(ii) the appointment of a guardian or general conservator for the partner; or
(iii) a judicial determination that the partner has otherwise become incapable of performing the partner's duties under the partnership agreement;

(8) in the case of a partner that is a trust or is acting as a partner by virtue of being a trustee of a trust, distribution of the trust's entire transferable interest in the partnership, but not merely by reason of the substitution of a successor trustee;

(9) in the case of a partner that is an estate or is acting as a partner by virtue of being a personal representative of an estate, distribution of the estate's entire transferable interest in the partnership, but not merely by reason of the substitution of a successor personal representative; or

(10) termination of a partner who is not an individual, partnership, corporation, trust, or estate.

k) RUPA § 801 Events causing dissolution and winding up of partnership business

A partnership is dissolved, and its business must be wound up, only upon the occurrence of any of the following events:

(1) in a partnership at will, the partnership's having notice from a partner, other than a partner who is dissociated under Section 601(2) through (10), of that partner's express will to withdraw as a partner, or on a later date specified by the partner;

(2) in a partnership for a definite term or particular undertaking:
(i) within 90 days after a partner's dissociation by death or otherwise under Section 601(6) through (10) or wrongful dissociation under Section 602(b), the express will of at least half of the remaining partners to wind up the partnership business, for which purpose a partner's rightful dissociation pursuant to Section 602(b)(2)(i) constitutes the expression of that partner's will to wind up the partnership business;
(ii) the express will of all of the partners to wind up the partnership business; or
(iii) the expiration of the term or the completion of the undertaking;
(3) an event agreed to in the partnership agreement resulting in the winding up of the partnership business;
(4) an event that makes it unlawful for all or substantially all of the business of the partnership to be continued, but a cure of illegality within 90 days after notice to the partnership of the event is effective retroactively to the date of the event for purposes of this section;
(5) on application by a partner, a judicial determination that:
(i) the economic purpose of the partnership is likely to be unreasonably frustrated;
(ii) another partner has engaged in conduct relating to the partnership business which makes it not reasonably practicable to carry on the business in partnership with that partner; or
(iii) it is not otherwise reasonably practicable to carry on the partnership business in conformity with the partnership agreement; or
(6) on application by a transferee of a partner's transferable interest, a judicial determination that it is equitable to wind up the partnership business:
(i) after the expiration of the term or completion of the undertaking, if the partnership was for a definite term or particular undertaking at the time of the transfer or entry of the charging order that gave rise to the transfer; or
(ii) at any time, if the partnership was a partnership at will at the time of the transfer or entry of the charging order that gave rise to the transfer.

2.) General Partnership created when there is an association of two or more persons to carry on as co-owners for profit.
   a) Mutual expression of intent to carry on as co-owners all that is needed—partnership exists even if no written or oral K.
   b) Can not try to avoid just by calling something different
   c) Archetypical general partnership = small, intimate firm where each partner participates in all aspects of the business

3.) Ownership and Management Functions—Each partner shares =
   a) Residual claimant
   b) Day-to-day operations
   c) Oversee business policies

4.) Favors individual flexibility over the firm’s
   a) Partner may leave at will—partnership dissolves
   b) But partnership has to dissolve to get rid of partner

5.) Unlimited personal liability—each partner jointly and severally liable
6.) Each partner owes fiduciary duty to the others

b. Joint ventures
   1.) Less permanent and less complete merger than general partnership
   2.) Factors:
      a) Specific agreement
      b) Intent to be joint venturers
      c) Each contributing property, skill, financing, knowledge or effort
      d) Each has some joint control over venture
      e) Provision for sharing of both profits and losses.

3.) Key is intent of parties—look at substance of K not form

c. Limited Partnership
   1.) Relevant Statutory Authority
      a) RULPA § 101 Definitions
         A partnership is dissolved, and its business must be wound up,
         only upon the occurrence of any of the following events:
         (1) in a partnership at will, the partnership's having notice from a
             partner, other than a partner who is dissociated under Section
             601(2) through (10), of that partner's express will to withdraw as a
             partner, or on a later date specified by the partner;
         (2) in a partnership for a definite term or particular undertaking:
             (i) within 90 days after a partner's dissociation by death or
                 otherwise under Section 601(6) through (10) or wrongful
                 dissociation under Section 602(b), the express will of at least half
                 of the remaining partners to wind up the partnership business, for
                 which purpose a partner's rightful dissociation pursuant to Section
                 602(b)(2)(i) constitutes the expression of that partner's will to wind
                 up the partnership business;
             (ii) the express will of all of the partners to wind up the partnership
                 business; or
             (iii) the expiration of the term or the completion of the
                 undertaking;
         (3) an event agreed to in the partnership agreement resulting in the
             winding up of the partnership business;
         (4) an event that makes it unlawful for all or substantially all of the
             business of the partnership to be continued, but a cure of illegality
             within 90 days after notice to the partnership of the event is
             effective retroactively to the date of the event for purposes of this
             section;
         (5) on application by a partner, a judicial determination that:
             (i) the economic purpose of the partnership is likely to be
                 unreasonably frustrated;
             (ii) another partner has engaged in conduct relating to the
                 partnership business which makes it not reasonably practicable to
                 carry on the business in partnership with that partner; or
(iii) it is not otherwise reasonably practicable to carry on the partnership business in conformity with the partnership agreement; or

(6) on application by a transfeee of a partner's transferable interest, a judicial determination that it is equitable to wind up the partnership business:

(i) after the expiration of the term or completion of the undertaking, if the partnership was for a definite term or particular undertaking at the time of the transfer or entry of the charging order that gave rise to the transfer; or

(ii) at any time, if the partnership was a partnership at will at the time of the transfer or entry of the charging order that gave rise to the transfer.

b) RULPA § 201 Certificate of Limited Partnership 1985

Amendments

(a) In order to form a limited partnership [A] two or more persons must execute a certificate of limited partnership [D]. The certificate shall be [D] MUST BE EXECUTED AND [A] filed in the office of the Secretary of State [A]. [A] [D] and [D] [A] THE CERTIFICATE SHALL [A] set forth:

1. the name of the limited partnership;
2. the general character of its business;
3. the address of the office and the name and address of the agent for service of process required to be maintained by Section 104;
4. the name and the business address of each general partner (specifying separately the general partners and limited partners);
5. the amount of cash and a description and statement of the agreed value of the other property or services contributed by each partner and which each partner has agreed to contribute in the future;
6. the times at which or events on the happening of which any additional contributions agreed to be made by each partner are to be made;
7. any power of a limited partner to grant the right to become a limited partner to an assignee of any part of his partnership interest, and the terms and conditions of the power;
8. if agreed upon, the time at which or the events on the happening of which a partner may terminate his membership in the limited partnership and the amount of, or the method of determining, the distribution to which he may be entitled respecting his partnership interest, and the terms and conditions of the termination and distribution;
9. any right of a partner to receive distributions of property, including cash from the limited partnership;
10. any right of a partner to receive, or of a general
partner to make, distributions to a partner which include a return of all or any part of the partner's contribution; (11) any time at which or events upon the happening of which the limited partnership is to be dissolved and its affairs wound-up; (12) any right of the remaining general partners to continue the business on the happening of an event of withdrawal of a general partner; and (13) any other matters the partners determine to include therein.

(b) A limited partnership is formed at the time of the filing of the certificate of limited partnership in the office of the Secretary of State or at any later time specified in the certificate of limited partnership if, in either case, there has been substantial compliance with the requirements of this section.

c) RULPA § 202 Amendment to Certificate
   (a) A certificate of limited partnership is amended by filing a certificate of amendment thereto in the office of the Secretary of State. The certificate shall set forth:
   (1) the name of the limited partnership;
   (2) the date of filing the certificate; and
   (3) the amendment to the certificate.
   (b) Within 30 days after the happening of any of the following events, an amendment to a certificate of limited partnership reflecting the occurrence of the event or events shall be filed:
   (1) a change in the amount or character of the contribution of any partner, or in any partner's obligation to make a contribution;
   (2) the admission of a new partner;
   (3) the withdrawal of a partner; or
   (4) the continuation of the business under Section 801 after an event of withdrawal of a general partner.
   (c) A general partner who becomes aware that any statement in a certificate of limited partnership was false when made or that any arrangements or other facts described have changed, making the certificate inaccurate in any respect, shall promptly amend the certificate, but an amendment to show a change of address of a limited partner need be filed only once every 12 months.
   (d) A certificate of limited partnership may be amended at any time for any other proper purpose the general partners determine.
   (e) No person has any liability because an amendment to a certificate of limited partnership has not been filed to reflect the
occurrence of any event referred to in subsection (b) of this [D> 
Section <D] [A> SECTION <A] if the amendment is filed 
within the 30-day period specified in subsection (b). 
[A> (F) A RESTATED CERTIFICATE OF LIMITED 
PARTNERSHIP MAY BE EXECUTED AND FILED IN THE 
SAME MANNER AS A CERTIFICATE OF AMENDMENT. 
<A]
d) RULPA § 303 Liability to Third parties
a) Except as provided in subsection (d), a limited partner is not 
liable for the obligations of a limited partnership unless he [or 
she] is also a general partner or, in addition to the exercise of 
his [or her] rights and powers as a limited partner, he [or she] 
[D> takes part <D] [A> PARTICIPATES <A] in the control of 
the business. However, if the limited [D> partner's participation 
<D] [A> PARTNER PARTICIPATES <A] in the control of 
the business [D> is not substantially the same as the exercise of the 
powers of a general partner, <D> he [or she] is liable only to 
persons who transact business with the limited partnership [D> 
with actual knowledge of his participation in control <D] [A> 
REASONABLY BELIEVING, BASED UPON THE LIMITED 
PARTNER'S CONDUCT, THAT THE LIMITED PARTNER 
IS A GENERAL PARTNER. <A] 
(b) A limited partner does not participate in the control of the 
business within the meaning of subsection (a) solely by doing 
one or more of the following:
(1) being a contractor for or an agent or employee of the limited 
partnership or of a general partner [A> OR BEING AN 
OFFICER, DIRECTOR, OR SHAREHOLDER OF A 
GENERAL PARTNER THAT IS A CORPORATION; <A] 
(2) consulting with and advising a general partner with respect 
to the business of the limited partnership; 
(3) acting as surety for the limited partnership [A> OR 
GUARANTEEING OR ASSUMING ONE OR MORE 
SPECIFIC OBLIGATIONS OF THE LIMITED 
PARTNERSHIP; <A] 
(4) [D> approving or disapproving an amendment to the 
partnership agreement <D] [A> TAKING ANY ACTION 
REQUIRED OR PERMITTED BY LAW TO BRING OR 
PURSUE A DERIVATIVE ACTION IN THE RIGHT OF THE 
LIMITED PARTNERSHIP; <A] [D> or <D] 
[D> (5) voting on one or more of the following matters: <D] 
[A> (5) REQUESTING OR ATTENDING A MEETING OF 
PARTNERS; <A] 
[A> (6) PROPOSING, APPROVING, OR DISAPPROVING, 
BY VOTING OR OTHERWISE, ONE OR MORE OF THE 
FOLLOWING MATTERS: <A]
(i) the dissolution and winding up of the limited partnership;
(ii) the sale, exchange, lease, mortgage, pledge, or other transfer of all or substantially all of the assets of the limited partnership [D> other than in the ordinary course of its business <D];
(iii) the incurrence of indebtedness by the limited partnership other than in the ordinary course of its business;
(iv) a change in the nature of the business; [D> or <D]
(v) [A> THE ADMISSION OR <A] removal of a general partner [D> . <D] [A>] ; <A]
[A> (vi) THE ADMISSION OR REMOVAL OF A LIMITED PARTNER; <A]
[A> (VII) A TRANSACTION INVOLVING AN ACTUAL OR POTENTIAL CONFLICT OF INTEREST BETWEEN A GENERAL PARTNER AND THE LIMITED PARTNERSHIP OR THE LIMITED PARTNERS; <A]
[A> (VIII) AN AMENDMENT TO THE PARTNERSHIP AGREEMENT OR CERTIFICATE OF LIMITED PARTNERSHIP; OR <A]
[A> (IX) MATTERS RELATED TO THE BUSINESS OF THE LIMITED PARTNERSHIP NOT OTHERWISE ENUMERATED IN THIS SUBSECTION (B), WHICH THE PARTNERSHIP AGREEMENT STATES IN WRITING MAY BE SUBJECT TO THE APPROVAL OR DISAPPROVAL OF LIMITED PARTNERS; <A]
[A> (7) WINDING UP THE LIMITED PARTNERSHIP PURSUANT TO SECTION 803; OR <A]
[A> (8) EXERCISING ANY RIGHT OR POWER PERMITTED TO LIMITED PARTNERS UNDER THIS [ACT] AND NOT SPECIFICALLY ENUMERATED IN THIS SUBSECTION (B). <A]
(c) The enumeration in subsection (b) does not mean that the possession or exercise of any other powers by a limited partner constitutes participation by him [or her] in the business of the limited partnership.
(d) A limited partner who knowingly permits his [or her] name to be used in the name of the limited partnership, except under circumstances permitted by Section 102(2), is liable to creditors who extend credit to the limited partnership without actual knowledge that the limited partner is not a general partner.

e) RULPA § 403 General Powers and Liabilities
   (a) Except as provided in this [Act] or in the partnership agreement, a general partner of a limited partnership has the rights and powers and is subject to the restrictions of a partner in a partnership without limited partners.
   (b) Except as provided in this [Act], a general partner of a
limited partnership has the liabilities of a partner in a partnership without limited partners to persons other than the partnership and the other partners. Except as provided in this [Act] or in the partnership agreement, a general partner of a limited partnership has the liabilities of a partner in a partnership without limited partners to the partnership and to the other partners.

2.) Separation of ownership and management functions
   a) Limited partners have no management function and no power to act as agent but have limited liability—not personally liable unless they take part in control
   b) General partner makes the management decisions and acts as an agent
   c) Firm’s continuity and adaptability to changed circumstances favored over individual
      i. General partners may withdraw at will but the withdrawal does not necessarily trigger the dissolution of the partnership

2. Emergence of Limited Liability Entities as the Norm
   a. Rise in lawsuits aimed at professional partnerships led to increase in limited liability entities
      1.) Make it harder to “pierce veil”
   b. Limited Liability Companies
      1.) Relevant Authority
         a) ULLCA § 202
         b) ULLCA § 203
         c) ULLCA § 303
         d) ULLCA § 404
         e) ULLCA § 601
         f) ULLCA § 701
         g) ULLCA § 801
      2.) Have to file “constitution” or “articles of organization with Sec. Of State.”
      3.) Partnership-like or centralized management—members are residual claimants and by default have all management function (similar to general partner) OR fall-back rules that assign management functions to managers (similar to limited partners or corporations)
         a) Members who are not managers have no authority to bind company
      4.) Both members and management have limited liability—can participate in management without losing limited liability.
      5.) Some statutes allow for easy exit, some make it harder (i.e. dissolution by majority vote)
   c. Limited Liability Partnerships
      1.) Relevant Statutory Authority
         a) RUPA § 306
         b) RUPA § 1001
         c) DE § 1515
d) DE § 1544

2.) Also register with Sec. Of State

3.) Limited liability—many eliminate general partner’s vicarious liability for professional negligence and others are similar to LLC statutes

4.) Limitations on distributions which would result in partnership’s insolvency—protecting creditors

3. Continuing Role of General Partnership Law
   a. Partnership law still key since may entities are still so new

B. Fiduciary Duty
   1. The Traditional Framework
      a. Applicable law
         1.) UPA § 20
         2.) UPA § 21
         3.) UPA § 22
         4.) RUPA § 403
         5.) RUPA § 404
         6.) RUPA § 405
         7.) ULLCA § 408
         8.) ULLCA § 409
         9.) ULLCA § 410
      b. Fiduciary duty serves to protect the expectations of all partners
      c. Meinhard v. Salmon
         1.) Salmon was the managing partner in real estate venture. Salmon took for himself opportunity for more expensive property, entering into a new agreement without telling Meinhard.
         2.) Held: Joint ventures owe each other a fiduciary duty. No duty to continue lease, prolonging venture, but while still co-venturers had duty to tell of opportunity.
            a) Heightened duty for managing partner
            b) Dicta: Different outcome if opportunity not related to venture.
         3.) States that require (RUPA § 403; UPA § 20) partner to give other partner on request full and complete information about partnership on demand still have Meinhard duty to disclose all material facts.
         4.) Fiduciary bears burden of showing they met obligations.
   2. Fiduciary Duty and Private Ordering
      a. Applicable law
         1.) RUPA § 103
         2.) ULLCA § 103
      b. Two views on private ordering’s impact on fiduciary duties
         1.) Fiduciary duty immutable
         2.) Fiduciary duty can be contracted around
      c. Exxon v. Burglin
         1.) Exxon acquired Gulf but did not tell limited partners about new well tests.
2.) Held: Partners may alter standard form fiduciary duties so that the general partner is only bound by the terms of the K and has a more limited implied duty in a buy-out situation b/c acting as an adversary.

d. Some courts put burden on plaintiff to show why court should depart from terms of K and imply duty when parties could have K differently but did not.

e. May not broadly contract around 404 duty of loyalty but can provide that specific examples that partners agree do not violate the duty as long as not manifestly unreasonable

C. Power to Manage and Bind the Firm

1. Responsibility for the Acts of a General Partner
   a. Applicable statutes:
      1.) UPA § 9
      2.) UPA § 13
      3.) UPA § 14
      4.) UPA § 15
      5.) UPA § 18
      6.) RUPA § 301
      7.) RUPA § 305
      8.) RUPA § 306
      9.) ULLCA § 301
      10.) ULLCA § 302
      11.) ULLCA § 303
   b. Partnership bound by contracts made by general partner in course or apparent course of partnership’s business

2. UPA § 9
   a. “apparently carrying on in the usual way the business of the partnership” is not clear if the usual way is for other similar partnerships or that particular partnership—RUPA § 301 takes more narrow view
   b. LLC’s have similar agency issues

3. Authority of Joint-Venturers
   a. Some courts say less agency power
   b. Need express or implied authority from nature of agreement

4. Participation in Management and Control
   a. Applicable statutes
      1.) UPA § 9
      2.) UPA § 18(e) and (h)
      3.) RUPA § 301
      4.) RUPA § 401 (f) and (i)
   b. UPA § 18(e) and (f) gives partners equal rights in management and conduct of partnership business
   c. UPA § 18 (h) suggests that decisions are by a vote
   d. Covalt v. High
      1.) Covalt was partner in CSI and in real estate holding company. Covalt remained partner in Real Estate only and High did not agree to raise rents.
2.) Held: General Rule is that all partners have equal rights in
management and conduct of business and partners have no right to
impose their will on others. No damages because no breach of
fiduciary duty.
3.) Parties could have K differently.

5. Limited Partner’s Participation in control
a. Relevant Statutory Authority
   1.) RULPA § 303
      a) ULPA § 7 said not liable unless takes part in control—RULPA §
         3030 provides more specificity including safe-harbors but explicitly
         relies on decisions interpreting § 7
   b. Holzman v. DeEscamilla
      1.) Limited Partners in Farm agreed what crops would be planted, visited
twice a week and general partner had no power to withdraw money
unless
      2.) Held: Limited partners took part in the control of the business and
became liable as general partners.

III. Corporate Form and the Specialized Role of Shareholders
   A. The Corporate Form
      1. Statutory Norms
         a. Overview
            1.) Archtypical corporation separates ownership and management
functions into:
               a) Directors
               b) Shareholders
               c) Officers
            2.) Corporate form provides hierarchical structure that is more flexible
and adaptable because the corporation exists as an entity apart from
the corporate actors
               a) Corporation exists until majority of shareholders + board of
directors decides to dissolve
         b. Directors
            1.) Center of all power and authority—while they are not the residual
claimants they may own personal shares
               a) Make major policy decisions and monitor officer
            2.) Centralized control in board is supported by deference given by
courts and regulators
            3.) Who are Directors?
               a) Closely held company: may be major shareholders
               b) Large publicly traded corporation: 7-16 members, trend to have
majority of outside directors
                  i. Inside directors serve as a link between the corp. and the
board
                  ii. Outside directors offer oversight and advice
         c. Officers
            1.) Officers—day to day management of company
2.) Do not share in residual profits unless they own shares
3.) CEO is often also the chair of board of directors

d.) Shareholders
1.) Shareholders rights and responsibilities
   a) Shareholders—residual claimants and riskbearers
   b) Elect board of directors approve changes to governing rules and structures
   c) Shares = ownership interests = fungible property
      i. Get value of investment by selling to third party not forcing corp. to provide liquidity
      ii. Limited liability to amount of investment reduces transaction costs in buying and selling shares
2.) Who are the shareholders in a publicly traded corporation?
   a) Historic model—fragmentation of share ownership precludes shareholder participation in corporate governance (Burley & Means)
      i. Separation of ownership from control because many small stake passive investors rubber stamp the decisions of officers
      ii. Officers have effective control over company—nominate directors who shareholders approve
      iii. Rational apathy—rational small stakes investor would not become fully involved
         (a) Wall street rule—more rational to try to sell shares than to try to correct
   b) Emerging model—concentration of shareownership allows active shareholder participation in corporate governance
      i. Institutional investors—large stakes investors have the power to influence corporate behavior
         (a) Arbitrageurs—try to help trends that make them money
         (b) Value investors—try to influence management to get more $ from underperformers
         (c) Relational investors—purchase large blocks seeking long term relationships
         (d) Social investors—priority to social needs
      ii. Increase informal involvement in management—not just voting rights
      iii. Higher exit costs makes it harder to use the wall street rule, less costly to become involved in corporation and management
      iv. Not all big stakeholders—pension plans, insurance companies—want to become activists
3.) Proxy Voting
   a) By signing proxy, shareholder does not have to be present to vote—means to collect power in advance of election
   b) Proxy
      i. Legal relationship
      ii. Person given power to vote
      iii. Document that forms relationship
c) Regulated by SEC

2. Obtaining and Modifying the Statutory Norms
   a. Formation
      1.) Relevant statutes
         a) MBCA § 2.01
         b) MBCA § 2.02
         c) MBCA § 2.03
         d) MBCA § 2.04
         e) MBCA § 2.05
         f) MBCA § 2.06
         g) Del. G.C.L. § 101
         h) Del. G.C.L. § 102
      2.) Complete forms and file with state—articles of incorporation are public documents
         a) Bylaws fill in gaps and can be amended by directors alone or shareholders if so provided—not public documents
   b. Creating Classes of Shares
      1.) Relevant statutes
         a) MBCA § 6.01
         b) Del. G.C.L. § 151
      2.) May have different classes of shares but must have a class with voting rights and power to select directors and class to be residual claimant
         a) Common shares= residual claimant + voting rights
         b) Preferred shares= less uniformity, but often dividend or liquidation preference but decreased voting rights
   c. Using Articles and Bylaws to change legal norms
      1.) Most state law norms are default rules and can be changed by private ordering in contracts or in the articles of incorporation or bylaws

3. State Corporation Laws as Competing sets of Standard Form Rules
   a. Corp. chooses state of incorporation
   b. State has incentive to provide favorable rules because they get fees and taxes
   c. Source of law
      1.) Most states based on MBCA
      2.) Delaware—over ½ companies incorporated in Delaware
         a) Offers reliability for changing to new circumstances and predictability in case law
   d. Shift from special chartering to general corp. norms

B. The National Market System and the Efficient Market Hypothesis
   1. Overview
      a. Need minimal levels to be traded in markets—enough volume to justify
      b. Markets provide:
         1.) Liquidity
            a) Reduce transactions costs
         2.) Valuation
            a) Competition provides reliable market price
3.) Monitoring

2. National Market System
   a. Centralized—NYSE and decentralized—NASDAQ
   b. Possibility of panic reduced by specialists who coordinate trading

3. Efficient Market Hypothesis
   a. The more confidence people have in the market, the more capital will be raised
   b. Efficient market hypothesis
      1.) “weak form”—stock prices reflect all relevant information from past prices
      2.) “semi-strong”—stock prices instaneously reflect all publically available information relevant to the value of the stock
         a) if semi-strong then best to invest in a way that matches the market
      3.) strong form—stock prices instaneously reflect both publicly available and non-publicly available information about securities
         a) if markets are not strong form efficient then “insiders” can make a profit trading on non-public information
   c. “noise traders”—irrational actors

C. Shareholders’ Governance Role
   1. State Law Restrictions on Shareholder’s Direct Management Power
      a. Relevant statutory law
         1.) MBCA § 2.06
         2.) MBCA § 8.01
         3.) MBCA § 8.40
         4.) MBCA § 10.01
         5.) MBCA § 10.02
         6.) MBCA § 10.03
         7.) MBCA § 10.04
         8.) MBCA § 10.20
         9.) Del.G.C.L. § 109
         10.) Del.G.C.L. § 141(a)
         11.) Del.G.C.L. § 142
         12.) Del.G.C.L. § 242
      b. Management of corporation is given to directors, unless articles of incorporation otherwise provide
      c. How can shareholders affect policies?
         1.) Trouble amending articles of incorporation—limited by default rules which say that changes in articles of incorporation must be initiated by directors
         2.) Most states, shareholders can change bylaws—but not to make ordinary business decision or to establish corporate policies
         3.) Can “suggest” new action or policy
   2. Forum for Political Persuasion—State Law Rules Affecting Shareholder’s Voting Rights
      a. Relevant Statutes
         1.) MBCA § 7.01
Electing and Removing Directors

a. Normal Rules
   1.) Default rule: directors elected each year by plurality vote of 1 per share
   2.) Default rule: make remove directors w/o cause at special meeting called for that purpose
   3.) Tension between shareholders governance and directors control

b. Changing the Normal Allocation of Voting Power
   1.) Relevant statutes
      a) MBCA § 8.04
      b) MBCA § 7.32
      c) MBCA § 7.28
      d) Del. G.C.L. § 141(d)
      e) Del. G.C.L. § 212(a)
      f) Del. G.C.L. § 214
      g) Del. G.C.L. § 216
   2.) Class voting and Dual-Class Voting Schemes
      a) General rule—all shareholders elect directors
i. Articles of incorporation can limit by class
ii. “dual class common”—gives more voting power to founders per share and selling shares with less power to public
   (a) disfavored by SEC

3.) Cumulative Voting and Minority Representation
   a) Straight voting—general rule of 1 vote per share
   b) Cumulative voting—votes = shares x positions
      i. To elect X directors, shareholder must have more than SX/(D+1) (S = shares voting, D = directors to be elected)
      ii. For cumulative voting:
         (a) Allows rep. Of minorities through voting blocks
         iii. Against cumulative voting
             (a) Are corporations better off without minority points of view?

c. Staggered Terms—Adaptability versus Stability
   1.) Relevant statutes
      a) MBCA § 8.06
      b) Del. G.C.L. § 141(d)
   2.) Most states allow corporations to adopt longer and/or staggered terms for directors
      a) Staggering constrains shareholder ability to respond to changed circumstances by naming new directors
      b) Makes takeover harder
   3.) Centaur Partners. National Intergroup
      a) Tried to expand board
      b) Held: Needed 80% supermajority to amend the by-laws, clearly and unambiguously specified in charter, overcoming presumption of majority rule
         i. If bylaws inconsistent with law or certificate of incorporation, by law is null

d. Removal of Directors and Other Midstream Private Ordering

D. Regulating the Shareholder Communication Process
   1. Overview of Federal Regulation
      a. States provide substantive law for relationship of corporation and shareholders but federal law regulates vote related communication.
      b. SEC has broadly interpreted 14(a) to allow it to ensure that proxy process best resembles a town-hall.
      c. Relevant Statutory authority
        1.) Securities Exchange Act of 1934 § 14(a)
        2.) 1934 Exchange Act Rule 14a-3
        3.) 1934 Exchange Act Rule 14a-4
        4.) 1934 Exchange Act Rule 14a-5
        5.) 1934 Exchange Act Rule 14a-7
        6.) 1934 Exchange Act Rule 14a-8
        7.) 1934 Exchange Act Rule 14a-9
d. Rules Primarily Affecting Solicitation of Proxies by management or shareholders
   1.) 14a-3 ensures that prior to proxy solicitation, the shareholder gets the proxy statement that contains information that informed voters would possess
   2.) 14a-5 ensures that the proxy statement is readable, presented in tabular form, and organized
   3.) 14a-4 governs the form of the proxy—must have opportunity to do more than just sign off—limits amount of discretionary authority can give solicitor—must be able to give opinion on each matter
   4.) 14a-9 catchall that prevents making false or misleading statements

e. Rules Primarily Regulating Shareholder Access to Communication with other shareholders
   1.) 14a-7 gives shareholders right to solicit proxies with specified assistance from corporation.
      a) Corporation has choice: give list or directly mail shareholder’s proxy material (shareholder pays costs)
   2.) 14a-8—qualifying shareholder may require corporation to include shareholder proposal
      a) qualifying shareholder—at time of submitting proposal own at least $2000 in stock or 1% of outstanding stock for at least a year
      b) 500 words
      c) 1 per meeting

2. Socially Significant Shareholder Proposals
   a. Relevant statutes
      1.) Exchange Act Rule 14a-8(i)(5)
      2.) Exchange Act Rule 14a-8(i)(7)
   b. Corporations try to exclude socially significant proposals through “economic irrelevance” unless “otherwise significantly related” test and “ordinary business tests”
      1.) SEC’s approach to “ordinary business exception”: reversal of cracker barrel no action letter and case-by-case approach to exceptions for significant social policy issues
   c. Lovenheim v. Iruquois Brands
      1.) Lovenheim had a shareholder resolution opposed to force feeding geese and in favor of committee to investigate practice—a small part of defendants business.
      2.) Held: Even though not economically significant, the proposal still cannot be excluded because the proposal raises policy questions “significantly related” to defendant’s business
      a) Significantly related—not just economic

3. Independent Proxy Proposals
   a. Relevant Statutes
      1.) Exchange Rules 14(a)-4(c)
      2.) Exchange Rules 14(a)-4(e)
      3.) Exchange Rules 14(a)-4(f)
b. Shareholders try to avoid 14(a)-8 by making independent solicitation for proxies
   1.) Raises Q: Can management ask for proxies that give discretion to vote against any possible independent proxies?
      a) SEC-14(a)-4(c)—to get discretion must make shareholders aware of the nature of the proposals

c. UNITE v. May Dept.
   1.) UNITE advised May that it was considering bringing 3 shareholder proposals. May’s original proxies advised that it would vote against independent proposals. After UNITE issues its independent proxy solicitation, May issued supplemental proxies that only had to be returned if they did not want May to use the original proxy.
   2.) Held: To keep discretion, a company must disclose the nature of the independent proxy proposal and how it intends to exercise its discretionary authority
      a) Court reluctant to give benefits of 14a-8 when plaintiff has chosen other way to bring proposal.

4. The Chilling Effect of Overbroad Restrictions on Persuasive Communication
   a. Relevant Statutes
      1.) Exchange Rules 14(a)-1(1)
      2.) Exchange Rules 14(a)-2
   b. SEC tries to balance preventing harmful conduct with allowing shareholder governance
      1.) 14(a-1(l) (1)(i)—defines solicitation as a request for a proxy, request to execute or not execute a proxy, or the furnishing of a proxy or other communication “Reasonably calculated” to result in procurement, withholding, or revocation of proxy
      2.) Exemptions:
         a) 14a-2(b)(2)—any solicitation of 10 or fewer persons
         b) 14a-1(l)2(iv) solicitation does not include communication that states how a shareholder will vote and why
   c. Long Island Lighting Co. v. Barbash
      1.) A political candidate bought stock and another group published a critical ad. LILCO claimed this was a concerted action to influence proxies.
      2.) Held: Publications of general circulation can be subject to SEC rules because the rules apply to direct and indirect requests, the key is whether the communication is reasonably calculated to influence the vote—which is determined by the context and nature of the request.
         a) Extent of first amendment protection depends on whether or not the request is a solicitation
      3.) 1992 amendments to SEC rules made clear that decisions like LILCO were overly broad and that mere expressions of opinion were exempt.

5. Shareholder Access to Corporate Records and Shareholder Lists
   a. Relevant Statutes
      1.) MBCA § 7.20
b. Under SEC § 14a-7 assistance the corporation can either mail shareholder’s proxy solicitation or provide with list—corporations usually choose to mail so that they retain control

c. State laws usually provide for access to list on demand for proxy solicitation and “other proper purposes.:
   1.) Corp. has duty of proving not proper purpose.
   2.) MBCA gives even more access

IV. Fiduciary Duty, Shareholder Litigation, and the Business Judgement Rule
   A. Introduction to Fiduciary Duty and Business Judgement Rule
      1. Overview
         a. Relevant Statute
            1.) MBCA § 8.30
         b. Fiduciary duty tries to reduce the chance of self-interest thought duty of loyalty and duty of care
            1.) Normally directors owe duty to corporation, not individual shareholders—but some circumstances individuals can bring derivative action on behalf of corporation or direct action for directly owed duties
            2.) Scope and enforcablity of directors fiduciary duty impacted by judicial doctrines, legislation, and corporate planning which determine
               a) Whether corporation may indemnify director’s liability
               b) Shareholder’s control of litigation
               c) Sanction for conflicts of interest
         c. Business judgement Rule
            1.) Common law shield from liability that assumes that court should not second guess the decisions of directors
            2.) Presumption: Directors acted in good faith, without self-dealing, and with reasonable diligence
            3.) Party challenging bears burden
      2. Director’s Discretion to Determine General Business Policies
         a. Shlensky v. Wrigley
            1.) Shareholder argued wrigley was being unreasonable in refusing to allow night games.
            2.) Held: The presumption is that the directors act in the best interests—it is for the directors to make policy decisions as long as no fraud, illegality or conflict of interest (or at least something that borders on these elements).
               a) No allegation of damage to corporation

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3. Director’s Discretion to consider interests of non-shareholder constituencies
   a. Constituencies
      1.) Offices
      2.) Directors
      3.) Shareholders
      4.) Employees
      5.) Suppliers
      6.) Customers
   b. Revlon—may consider interests of other constituencies if there is “some rationally related benefit accruing to stockholders”
   c. About 30 states have “other constituencies” statutes that allow directors to consider
   d. Dodge v. Ford Motor Company
      1.) Ford did not pay dividend but instead lowered the price of cars and spread the benefits to works
      2.) Held: While the end goal is benefit to shareholders, directors have discretion over long term plans as long as primary goal is for shareholders—not for court to 2nd guess.

B. Fiduciary Duty of Care
   1. Overview
      a. Relevant Statutes
         1.) MBCA § 8.30
         2.) MBCA § 8.31
      b. Some states, Delaware included, common law
      c. Other states use pre-1998 MBCA 8.30(a)(2) and require directors to act like reasonable person in similar situation
         1.) Amendments make clear that duty should be distinguished from Tort standard and limit liability
      d. Joy v. North
         1.) The standard for breach of duty of care is not a negligence standard—shareholders know the risk of bad business decisions, it is hard to evaluate ex post business decisions made ex ante and profit is often correlated to risk
   2. Duty of Care in the Decisional Setting
      a. Gross negligence is not protected by business judgement rule
         1.) Doctrine of procedural due care—look at how the directors made a decision not what the decision was
      b. Smith v. Van Gorkom
         1.) CEO of Trans Union (Van Gorkom) tried to find a leveraged buy-out and decided on a price for company based on the availability of a leveraged buy-out, and did not tell board how the price was arrived at
         2.) Held: Business judgement rule does not protect decision because decision was not well-informed—the directors did not inform themselves of all material information reasonably available to them.
a) Decision was not informed because: directors did not inform themselves of Van Gorkom’s role, did not know value of the company, and were grossly negligent in context—fast decision.
b) Premium alone is not enough because the directors had no way of knowing if the premium was adequate without knowing the value of the business
c) Market test not adequate because no real auction.
d) No exigent circumstances like Signal.
e) Advice of lawyer meaningless without adequate information to make a decision.
f) Treat directors as group because considerations of good faith irrelevant.
g) Stockholder vote does not cure directors decision if stockholder decision was informed—stockholders did not have all germane to decision.

c. If the plaintiff meets burden of showing that the defendant did not act with duty care, then the defendant most prove that the action was entirely fair—need fair dealing + fair price.
d. Disincentive to be a director? Del. G.C.L. 102(b)(7) allows companies to agree in articles of incorporation to indemnify directors for breaches of duty of care—not duty of loyalty.

3. Board’s Responsibility to Monitor and Prevent Illegal Activity

a. Graham v. Allis-Chalmers (old)
   1.) Derivative action stemming from anti-trust violations
   2.) Held: Duty of care is really duty to control—no duty to look for bad behavior if no reason to believe it exists. Duty is relative to the nature of the company and the circumstances—look at areas the directors had actual control over.
      a) Duty to act as “ordinary and careful and prudent man under similar circumstances”
         i. But later cases like Cede v. Technicolor clarify that not controlled by tort principles
      b) Dicta: Different result if trusted untrustworthy employee, refused or neglected duty, or ignored obvious warning signs.

b. In Re Caremark International Inc. Derivative Litigation
   1.) Employees violated health care provider laws about bribes.
   2.) Held: Directors have a duty to monitor to make a good faith effort to ensure that there is a reporting system to ensure that they have appropriate information necessary to supervise and monitor.
   3.) Held: To show breach of duty to of care by failing to control employees, would have to show: knew or should have known that violations occurring and took no good faith steps to prevent or remedy and that failure to do so proximately caused loss.
      a) Failure to monitor = must show sustained or systematic failure of the board to exercise reasonable oversight

C. The Fiduciary Duty of Loyality
1. Overview
   a. Director must put corporation’s interests before their own and must be completely candid with corporation and shareholders

2. Corporate opportunity Doctrine
   a. Broz v. CIS
      1.) Broz bought cellular license for his own company. CIS knew that he had own company and Broz mentioned to CEO and other directors informally that he would take opportunity—CIS not in a position to take, about to be bought out by PriCelluar—never mentioned to PriCelluar.
      2.) Held: While offering the corporation an opportunity which has come to the director invididually is a complete shield, failure to offer the opportunity is not necessarily improper ursurption of a corporate opportunity and breach of fiduciary duty.
         a) Conflict of interest:
            i. Corporation financially able to take
            ii. In the line of corporate business
            iii. Practical advantage to corporation/
            iv. Corporation has interest or reasonable expectancy in opportunity
            v. Taking opportunity is contrary to fiduciary duties to corporation
         b) May take if:
            i. Opportunity comes in individual not corporate capacity
            ii. Opportunity not essentitial to corporation
            iii. Corporation has no interest or expectancy in opportunity
            iv. No wrongful use of resources
         c) No duty to PriCelluar—not required to consider a contingent, uncertain acquisitions or other future events.
   b. ALI approach—disclosure is determinative
   c. Middle Ground: Ostrowski v. Avery
      1.) Special weight to disclosure to board but still use Broz’s multi-factor analysis
      2.) If no disclosure need clear and convincing evidence of no harm

3. Conflicting Interest Transactions
   a. Overview
      1.) Relevant Statutes
         a) Delaware G.C.L. § 144
      2.) Old Common Law Rule: A contract between a corporation and a director was void for conflict of interest
      3.) Now: Okay if fair to corporation and full disclosure
      4.) Del. G.C.L. § 144 (similar to old MBCA § 8.31) provides that a transaction is not void if
         a) Authorized by majority of disinterested shareholders or
         b) Approved by shareholders in good faith or
         c) Fair to corporation at time authorized
b. Effect of Distinterested Approval
   1.) Lewis v. Vogelstein
      a) Mattel granted directors large stock options which was approved by shareholders.
      b) Held: No breach of duty to disclose or duty of loyalty. Shareholder approval shifts test from one of fairness to one of waste.
         i. Waste standard = plaintiff has to prove exchange so one sided no reasonable person would make trade. No waste if get substantial consideration and good faith judgement that worthwhile.
         ii. Shareholder ratification different from ratification by single individual—problems with collective action, not granting authority but rather saying consistent with duty of loyalty
   2.) Executive compensation: look at size, duration, what was getting before, if it is likely to motivate

D. Corporation’s Right to Control Derivative Litigation
   1. Overview
      a. General Rule: corporations can choose when to litigate and choose only those actions with net benefit to the corporation
         1.) But management has a conflict of interest in suing self for breach of fiduciary duty
         2.) Individual shareholder actions would be too small and likely to be a waste
         3.) Shareholder derivative suit:
            a) Action against corporation for failure to bring a suit
            b) Action on behalf of corporation for harm
            c) Judgement goes to corp but shareholder collects attorney’s fees
            d) Balance against risk of “Strike” suits
   2. Demand Requirement
      a. Overview
         1.) Relevant statutes
            a) MBCA § 7.42
            b) ALI, principles, §7.03
         2.) Most jurisdictions require a pre-suit demand letter, then no right to pursue case unless directors decision to not institute litigation is outside the business judgement rule.
            a) Exception were demand would be futile.
            b) Move towards universal demand requirements.
         3.) Aronson v. Lewis (Del.)
            a) Stockholder challenged compensation arrangement between Meyers and Fink who was director and major stockholder and loans. Stockholder said demand would be futile because Fink controlled board.
            b) Holding: To be excused from demand requirement, need facts that with particularity create reasonable doubt not just reasonable
inference that the board was protected by the business judgement rule.

i. Two part test:
   (a) Were directors disinterested and independent? Interested majority—business judgement rule does not apply and inquiry stops.
      (1) Threat of litigation not enough.
      (2) Stock ownership alone, at least when not a majority, not enough to excuse—need to show “beholden”—a link between the control action
   (b) Look at substantive nature of challenged transaction and board’s approval?

ii. Directors: Action by self-interested directors not protected, directors not protected when failed to inform selves of material facts.

b. Review of Director’s Ability to Impartially Consider Demand
   1.) Rales v. Blasband
      a) Plaintiff alleged that majority stockholders, Rales brothers, misused poseeds from a sale of Senior Subordinated Notes to buy junk bonds. But decision was made by board prior to becoming wholly owned subsidiary in merger.
      b) Held: Aronson test does not apply where: 1) the board made a business decision but the majority of the directors have been replaced, 2) subject of suit is not a business decision, 3) like here, decision was made by board of different company. Instead test is, whether the plaintiff has alleged with particularity facts that create a reasonable doubt that the board could have exercised independent and disinterested business judgement in responding to demand. Demand excused because directors were not disinterested.
      i. Look at nature of demand and whether board was free to act without self-interest or improper influence to inform themselves and weigh alternatives.
      c) Directorial interest under Aronson –
         i. divided loyalties or
         ii. receiving a benefit from the challenged transaction not shared equally by stockholders or
         iii. decision can impact director but not corp.

3. Dismissal of Derivative Litigation as the Request of an Independent Litigation Committee of the Board
   a. Relevant statute
      1.) MBCA § 7.44
   b. Interested board delegates authority to disinterested committee
      1.) Three early views:
         a) Deference of normal business judgement rule—indepenence, good faith, reasonable investigation
b) No more deference than interested board

Middle Ground: Zapata Corp. v. Maldonado
i. 4 years after litigation started, company appointed litigation committee which recommended dismissal of the actions
ii. Held: While an independent committee can move to dismiss an action, trial courts should apply a two-step test: corporation must show independence, good faith, and reasonable basis for conclusion then, court may determine by applying its own business judgment whether motion should be granted giving special considerations to policy, equitable concerns, and law.

V. Corporation as a Device to Allocate Risk

A. Piercing the Corporate Veil
   1. Overview
      a. General Rule: Shareholders have limited liability and are not personally liable for corporate debts, but veil pierced when corporate form is used to evade obligations, circumvent statutes, or commit fraud, crime or injustice.
      b. Powell’s 3 part test
         1.) Complete Control and domination
         2.) Conduct in using corporate form was Unjust, fraudulent or wrongful towards plaintiff
         3.) Plaintiff was harmed as result
      c. Factors:
         1.) Contract vs. torts claims (theoretically should be more reluctant to pierce in contract claims since parties bargained) (Thompson’s study casts doubt)
         2.) Indendity of person behind veil (theoretically should be more willing to pierce to reach companies) (Thompson’s study casts doubt)
         3.) Closely held vs. public corporations (theoretically should be less likely to pierce publicly held corporation since shareholder have less control) (Thompson’s study confirms)
      d. Some LLC statutes explicitly incorporate veil piercing principles
   2. Piercing the Corporate Veil to Reach Real Persons
      a. Contract cases
         1.) Key: Is there a reason for court to not trust bargain?
         2.) Consumer’s Co-op v. Olsen (Wis.)
            a) Olsen and his parents were sole shareholders of ECO which went bankrupt. Consumers had continued to extend credit. Olsen subsidized corporation with personal assets and did not draw salary.
            b) Held: Undercapitalization alone is not reason to pierce the veil, must also have evidence of failure to follow corporate formalities or evidence of pervasive control.
               i. “Instrumentality or alter ego doctrine” requires complete domination and control, used to commit fraud or wrong, violate statute or legal duty, or dishonestly and unjustly defy plaintiff’s rights, and control and breach of duty must cause harm.
3.) Easterbrook and Fishel—should pierce to cure fraud/misrepresentation

b. Tort Cases
   1.) Western Rock v. Davis (Tex)
      a) Fuller was director of Western Rock, gave money, actively involved, in touch with supervisors, made decision to continue blasting.
      b) Held: Pierce veil because director was dominating force, corp. was shell for him to carry on activities and be insulated.

VI. Mergers and Other “Friendly” Control Transactions
   A. Overview
      1. Friendly = supported by board of directors
      2. Principal Legal Form = Statutory Merger
         a. Special governance rules apply—board and shareholders of participants must approve, dissenters rights.
   B. Merger’s and Dissenter’s Rights
      1. Mergers
         a. Applicable statutes
            1.) MBCA § 11.01
            2.) MBCA § 11.03
            3.) MBCA § 11.04
            4.) MBCA § 11.05
            5.) MBCA § 11.06
            6.) Del. G.C.L. § 251
            7.) Del. G.C.L. § 253
            8.) Del. G.C.L. § 259
            9.) Del. G.C.L. § 260
            10.) Del. G.C.L. § 261
         b. Statutory merger= two or more corporations merge into one “surving corporation” which gets all of the assets and liabilities of the consitutent corporations
         c. Each board has to adopt a plan of merger including consideration to shareholders of disappearing corporation and changes to articles of incorporation. Must file documents with Sec. Of State.
            1.) Consideration—typical is shares of survivor, but can get any consideration
         d. Shareholders then approve and terms apply to all.
         e. Old laws required unanimous approval, but later laws required a supermajority of 2/3 majority of each corp. shareholders, now ½ states require only “absolute majority” of all shareholders entitled to vote.
         f. Exceptions to voting:
            1.) De minimis change—merger will not significantly affect pre merger shareholders rights or require a change in articles of incorporation. MBCA §11.03 defines as increase of not more than 20% of outstanding shares.
2.) Short form merger—allows merger with subsidiary if own 90% or more without shareholder approval

2. Dissenter’s Rights
   a. Relevant Statutes
      1.) MBCA § 13.02
      2.) MBCA § 13.25
      3.) Del. G.C.L. § 262
   b. Enables dissenting shareholder to get fair value for shares under procedures outlined in the appraisal statute or in a judicial proceeding
      1.) Traditional approach (Del.): Take risk of getting less money and bear corporations expenses.
      2.) MBCA: get money as soon as corporate action consummated of good faith judgement of fair value. Less liability for expenses and costs.
   c. Only get appraisal rights when have voting rights.
   d. Del. § 262(b)(1) and (b)(2) provide “market exception” and shareholders do not get appraisal rights if shares are traded on national market/exchange or held by 2,000 or more shareholders and consideration receive is stock in new or other companies or cash in lieu of fractional shares.

C. Contracting around appraisal and Voting Rights
   1. Use of Alternative Transactional Forms
      a. Can contract around default rules by choosing different transational forms
      b. Sale of Assets
         1.) Relevant Statutes:
            a) Del. G.C.L. § 271
            b) MBCA § 12.01
            c) MBCA § 12.02
         2.) Do not automatically go out of business
         3.) Need not transfer all of assets
         4.) Liabilities do not always pass to purchasers
         5.) But can structure to be effectively like a merger
            a) Selling most of assets outside course of normal business must submit to shareholder vote (no appraisal rights in Del.)
            b) Acquirer’s shareholders have not rights
            c) Less than all—is transaction qualitatively and quantively significant enough to go to shareholder vote?
               i. Del: “out of the ordinary and substantially affects existence and purpose of corporation
      c. Triangular Mergers
         1.) Parent company merges the target company into a subsidiary.
            a) Choose to eliminate voting and appraisal rights of shareholders of acquiring parent
         2.) Forward subsidiary merger—acquired corporation merges into acquiring subsidiary
         3.) Reverse subsidiary merger—acquiring subsidiary merges into acquired corporation
d. Compulsory Share Exchanges
   1.) Relevant statute
      a) MBCA § 11.02
   2.) Allows acquirer to get all shares of target, but leave target in existence
   3.) Need only board approval of acquirer and simple majority vote of target (get appraisal rights).

2. “De Facto” Mergers
   a. Shareholders may ask that courts call alternative structure “de facto merger” to get voting and appraisal rights
      1.) Farris v. Glen Alden Corp. (Pa)
         a) Held: Fundamental change that causes a corp. to lose its essential nature, alter the relationship of stockholders to each other and corp. gives shareholder appraisal rights.
         i. Merger if forcing to give up shares and accept shares in new company.
      2.) Applestein v. United Board and Carton Co. (NJ)
         a) Held: De Facto Merger when use alternative form to bring about virtual merger
   b. Hariton v. Arco Electronics (Del.)
      1.) Plaintiff contested complete asset sale and dissolution as de facto merger.
      2.) Held: Delaware law allows to use asset sale to achieve same result as merger—indepedent statutes must be read independent of each other.
   c. MBCA § 13.02—greater concern for shareholders of acquired company rather than acquiring
   d. NY approach: Actual merger must take place soon after initial transaction and seller corporation quickly ceases to exist.
   e. ALI Principles § 7.21
      1.) Shareholders of parent company get appraisal rights as if parent company was direct participant even if use subsidary

D. Intersection between Apprasial Remedy and Fiduciary-Duty Based Judicial Review
   1. Cash-out mergers and Bussiness Purpose Test
      a. Relevant statute
         1.) MBCA § 13.02(b)
      b. Business purpose test: Cash-out mergers typically receive heightened scrutiny because cash was traditionally not available in merger
         1.) Singer v. Magnavox
            a) Controlling shareholders attempting to freeze out minority shareholders must show valid business purpose for cash-out merger. “Entire Fairness” Review
   2. The Weinberger Approach
      a. Growing number of suits contested cash-out mergers via class action rather than appraisal actions
         1.) Lynch v. Vickers Energy Corp.
a) Applied Delaware block method which weights, assets, market, and earnings value to arrive at “fair value” but court later stressed, that the trial court was not limited by the traditional block method because unlike the typical appraisal action had breach of fiduciary duty.

b. Weinberger v. UOP

1.) Class action lawsuit by minority shareholders who contested a cash-out merger that eliminated minority shareholders.

2.) Held: General Rule: Majority shareholder has burden of proving by preponderance of the evidence that the transaction was fair, but plaintiff must show some basis for invoking the fairness obligation. But when, majority of minority shareholders through informed vote approve the transaction, then the burden shifts to plaintiff to show that the transaction was unfair to the minority, but the defendant retains the obligation of showing that they disclosed all material facts. Here, the burden did not shift because the vote was not informed—the stockholders did not know of valuation study performed by the directors which showed that a small difference to Signal (the parent) meant a huge difference to the minority and all conflicts of interest were not disclosed..

a) Directors for two companies owe same duty of care to both.

b) Fairness= fair dealing and fair price

i. Fair dealing = timing, initiation, structure negotiation, disclosures (duty of candor) and approval.
   (a) Signal set the structure, little negotiation, fairness opinion suffered from 4 day time constraints, lack of information to minority shareholders

ii. Fair price= assets, market value, earnings, future prospects and other considerations—look at all relevant factors not just Delaware Block method

c) Ordinarily confined to appraisal proceeding like here, but trial court’s discretion especially where fraud, misrepresentation, self-dealing, deliberate waste of corporate assets or gross and palpable overreaching involved.

d) Even where burden shifts, business judgement rule does not protect.

3.) Where transaction is conducted at arm’s length, it is possible to fulfill fiduciary duty in negotiations without disclosing the top price willing to pay.

4.) Kahn v. Lynch

a) Even where do not have fair dealing, may still have entire fairness.

E. Appraisal and Entire Fairness Relief After Weinberger

1. Valuation under statutory Appraisal

a. Relevant statutes:
   1.) MBCA § 13.01(3)
   2.) Delaware G.C.L § 262(h)
b. Cede & Co. v. Technicolor
   1.) Techicolor argued that value of company should be considered under “Kammerman” plan not “Perleman plan” that had been implemented prior to merger.
   2.) Held: Delaware 262(h) “expectation of merger” exclusion allows courts to consider all relevant factors but not speculation, value added before the merger is a part of the going concern and must be considered.
   a) General Rule: Value created by merger is not part of the going concern that stockholders have interest in, but here Perleman plan was part of operative reality of corp. at time of merger.
   b) Valuation should determine if future earnings will affect fair value of shares.
   c. Delaware limits appraisal to valuation only—can’t take into account breach of fiduciary duty, but CA can add misconduct to appraisal proceeding.

2. Appraisal as the exclusive Remedy
   a. Relevant Statutes
      1.) MBCA § 13.02(b)
      2.) California Corp. Code §1312
      3.) ALI principles of Corporate Governance § 7.24
   b. Stringer v. Car Data Systems (OR)
      1.) Plaintiffs contested value of shares alleged breach of fiduciary duty, and civil conspiracy.
      2.) Held: OR law requires unlawful or fraudulent conduct before can challenge corporate action and plaintiffs have not alleged fraud or misrepresentation, thus plaintiffs are limited to appraisal proceedings since only disagreement is to price.
   c. Delaware ➔ Weinberger more liberal.
   d. Some states have rejected more liberal MBCA approach

3. Third-Party Mergers
   a. Unlike transactions with controlling shareholder—begin with business judgement rule.
   b. Delaware: Appraisal is not only remedy and entire fairness review applies.
      1.) Smith v. Van Gorkom did not make clear whether Weinberger applies to 3rd party, arm’s length situations.
      2.) Cinerama v. Technicolor suggests a greater duty of care in such situations and allows recissory damages.

VII. Hostile Acquisitions
   A. Market for Corporate Control
      1. Mergers require consent and allow board to act as gatekeeper and keep an inefficient management team in place
      2. ways around this:
         a. Make tender offer seeking to buy enough shares to get control of board or
         b. Launch proxy fight
3. In hostile takeovers, balance concerns about directors acting opportunistically with concerns that shareholders or others could be taken advantage of
   a. § 14(d)(1) of 1934 act mandates disclosure when proxies are solicited or in tender offer
4. What do high premiums reflect?
   a. Disiplinary Hypothesis—pay premium because believe will get better returns with better management
   b. Synergy hypothesis—target has unqiue value to acquirer because whole will be greater than sum of parts
   c. Empire building hypothesis—overpay to build empire:
      1.) More money for management
      2.) More security
      3.) More prestige and visibility
      4.) More market power
      5.) More opportunities for executives
   d. Expolitation hypothesis: Trap target shareholders in prisoner’s dilemma with choice between low price by bidder and risk of lower price in future—allowing to exploit a temporary depression in the market
   e. Bidding theory—tend to overestimate value of target “winner’s curse”
   f. Misinvestment hypothesis—price reflects bad cash flow distributions by management
   g. Market hypothesis—market does not accurately value
5. Defensive Tactics
   a. Acquirer=bidder or ratider
   b. Bust-up takeover—sell off target in pieces
   c. White knight—second bidder to rescue from hostile
      1.) White squire—gets large block of stock
      2.) Arbs or Arbitragers seeks to profit from short-term purchase of stock
   d. Front-end Loaded tender offer—first step is tender offer which offers more than the consideration in the second step merger
   e. Golden parachute—compensation given to target management
   f. Greenmail—target buys own shares back for premimum
   g. Lock-up option—given to preffered bidder to get most valuable assets—crown jewels
      1.) May also give termination fees or stock options at a bargain price to compensate for being a stalking horse
   h. Posion pills—rights or warrants to stockholders to ward off takeover
   i. Shark repellants amendments/porcupine provisios to charter or bylaws that require shareholder approval
      1.) Supermajority amendements
      2.) Fair prive amendents
      3.) Staggered board meetings
      4.) Dual class capitalization (banned by SEC 19c-4)
   j. Recapitalizations and Leveraged Buyouts by Management (MBOs) to respond to hostile bid by offering shareholders new financial package

B. Judicial Review of Tender Offer Defenses
1. Enhanced Scrunity Framework
   a. Unocal v. Mesa Petroleum
      1.) Minority shareholder Mesa made a front-loaded tender offer to gain control. In response, corporation made a selective self-tender offer that excluded Mesa.
      2.) Held: Directors had power to oppose Mesa by making a selective stock exchange in good faith after a reasonable investigation in furtherance of their duty to protect the corporation and were protected by the business judgement rule absent a showing by preponderance of the evidence that their decision was based primarily on a desire to keep themselves in office or breach of fiduciary duty.
         a) Here had reasonable good faith investigation that showed concern about greenmail and approval by majority of outside independent directors.
         b) Two Part Test:
            i. Directors have burden of showing that they have a reasonable basis for believing there was a threat to corporate policy and effectiveness.
            ii. Defensive measures must be reasonably related to threat.
               (a) Concerns that may be considered
                  (1) Inadequacy of price offered
                  (2) Nature and time and timing of offer
                  (3) Questions of illegality
                  (4) Impact on constituencies
                  (5) Risk of nonconsumation
                  (6) Quality of securities being offered
                  (7) Stockholder interests
               (b) Intermediate between fairness and business judgement review—some say pretty much business judgement rule in practice
   b. Revlon v. MacAndrews and Forbes
      1.) Pantry Pride made a tender offer. Revelon whose board did not consist of a majority of outside independent directors in turn entered into a lock-up, no-shop, cancellation fee arrangement with Forstman and gave only Forstman certain confidential information.
      2.) Held: Once it became clear that the company was dissolving, the board essentially became an auctioneer whose primary duty was to maximize shareholder value.
         a) Selective dealing like lock-up, cancellation, and no-shop not per se wrong, but in auction setting must be designed to maximize shareholder value, not unocal protection/preservation of company. Arrangements with Forstmann did not foster bidding but rather destroyed it
         b) Less flexibility than Unocal, enhanced scrutiny
         c) Only consider other constituencies like noteholders when rationally related benefit to shareholders
c. Refining Revlon and Unocal

1.) Paramount Communications v. Time, Inc. (The Time-Warner Case)
   a) Time-Warner structured merger with stock swap that allowed
      Warner to preserve equity and Time to preserve “Time Culture.”.
      Paramount announced all cash-offer after proxy materials went out
      and Time-Warner restructured to preserve deal.
   b) Held: Directors have duty to manage without regard to fixed time
      frame and absent Revelon duty has no duty to maximize short term
      value for shareholders.
      i. Revelon not triggered because not clear that break-up was
         inevitable—Time was only taking defensive measures not
         abandoning long-standing strategy.
         (a) Revelon Triggered where:
            (1) Corp. initiates bidding process to sell or break-up
                company or
            (2) Corp. abandons long-term strategy and seeks alternative
                amounting to break-up
      ii. Unocal satisfied because decision to merge with Warner
          was proper exercise of business judgement—deliberative
          approach as a result of several years searching for best fit and
          efforts to preserve time culture. Board had reasonable basis for
          believing that the paramount offer was a threat to corporate
          policy and defensive measures were reasonably related to
          threat.
          (a) Different kinds of threats, not just coercion and inadequate
              price. 3 types:
              (1) opportunity loss—deprive opportunity for better deal
              (2) structural coercion—structure of offer might influence
                  decisions
              (3) substantive coercion—risk that will accept undervalue
                  because disbelieve management
          (b) Reasonable response:
              (1) Evaluation of Corp. objective threatened
              (2) Alterative ways to protect
              (3) Impacts of defensive action and other relevant factors

2.) Decision not to redeem poison pill is a defensive measure

3.) Paramount v. QVC Network (The QVC Case)
   a) :Paramount entered into agreement with Viacom including
      defensive measures of no-shop provision, termination free, and
      stock-option agreements whereby Viacom’s majority shareholder
      Redstone would become majority of new enterprise. QVC made a
      tender offer.
   b) Held: Because the Paramount-Viacom deal amounted to change in
      corporate control, Viacom failed to satisfy its obligation to
      maximize shareholder value and failed to re-evaluate the defensive
      measures in light of the changed circumstances resulting from the
QVC offer, did not take advantage of opportunities, were not
adequately informed, and did not seek alternatives.

i. Revlon duty triggered in sale of control, court gives
   heightened scrutiny to disparate treatment of bidders
   (a) Were shareholder interests enhanced
   (b) Were measures reasonable in light of threat
   (c) Was decisionmaking process adequate

ii. Paramount directors had a duty to be diligent and vigilant,
   act in good faith, act with due care on material information to
   compare alternatives to determine best value to stockholders,
   and negotiate actively and in good faith with both
   (a) Did deal Fullfill duty?
      (1) Did deal adversely affect value to stockholders?
      (2) Inhibit or encourage other bids?
      (3) Enforceable in light of fiduciary duty?
      (4) Advance or retard obligation to get best value?
   (b) “Fiduciary out” recognition that no-shop may be breach of
      fiduciary duty, so have provision in agreement that we can
      talk to other bidders if fiduciary duty so requires
   (c) another way to consider: deal is structured so that at the end
      of the deal ownership and control converge and board no
      longer has ultimate authority for running business

VIII. Federal Law Affecting Corporate Transactions

A. Overview
   1. Importance of Disclosure
      a. Disclosure key mechanism used by federal laws to deal with problem of
         management taking advantage of passive shareholders
      b. Each triggering event (quarterly and annual reports, proxy solicitations,
         tender offers, acquisition of more than 5% of stock by third parties or the
         issuer or insider trading) has own requirements

   2. Disclosure and Markets
      a. Structure of securities acts reflects post-great depression reality and
         emerging efficient market hypotheses.
      b. Provide incentive for dislosure, but also potential for waste.
         1.) Some argue markets and private ordering sufficient to protect
             investors.

B. Liability Under Proxy Rules
   1. Rule 14a-9
      a. Relevant statute
         1.) 1934 Act § 14(a)
      b. Misrepresentations or Omissions of a Material Fact
         1.) TSC v. Northway
            a) Shareholder argued that proxy materials for merger failed to
               disclose matters about control of National over TSC and
               attractiveness to shareholders.
b) Held: Materiality means that omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.
   i. Substantial likelihood that disclosure of omitted fact would have been viewed as having significantly altered the total mix of the information made available.
   ii. Not necessary that in fact investor would have changed mind or done something differently

c) SEC guidelines suggest that if an omission or misstatement has less than 5% impact, statement assumed to be immaterial, more than 10% impact, assumed to be material. But also relies on qualitative factors.

2.) Virginia Bankshares, Inc. v. Sandberg
   a) Investor alleged that board of directors in soliciting proxies for merger had not believed that the price offered was high or fair but had recommended as high and fair to ensure continued as board members.
   b) Held: Statements of opinion and belief can be material if meet TSC test:
      i. Material
      ii. Disbelief not enough—must actually be defective
      iii. Need knowledge that defective
   c) Just b/c have also disclosed truth not enough if statement remains materially misleading.
      i. “Buried facts doctrine”—no fair disclosure to disclose in way no one will know
   d) Deferred issue of exactly what sciernt required

C. Rule 10b-5 applied to Corporate Transactions
   1. Overview
      a. Relevant Statute
         1.) Securities Exchange Act of 1934 § 10(b)
         2.) Securities Exchange Act of 1934 § 18
         3.) SEC Rule 10b-5
      b. 10b-5 broad catchall addressing fraud in connection with the purchase or sale of securities
      c. SC confirmed a private right of action under 10b-5
   2. Elements of Common Law Fraud applied to Rule 10b-5
      a. Misrepresentation of Omission of a Material Fact
         1.) Basic v. Levinson
            a) Stockholders sold shares after company continually denied that merger talks were happening despite fact that they were ongoing.
            b) Adopted TSC standard of Materiality for § 10(b) and Rule 10b-5 cases. Balancing test for preliminary merger type information: weigh probability that event will occur and magnitude of event in light totality of company activity.
            c) No comment would have been fine b/c not materially misleading.
2.) In Re Time Warner Securities Litigation
   a) Investors alleged that Time Warner had mislead by not updating on chances of reaching their business plan, not disclosing alternatives under consideration when strategy of seeking strategic partners failed and decided to go with new stock offering.
   b) Held: Duty to update when orginal statements become materially misleading, but no duty here b/c statements were not positive projections just statements of hope.
   c) Held: Duty to disclose alternatives when material and when have duty to disclose. Duty to disclose when necessary to prevent prior statements from becoming misleading—not just when considering mutually exclusive alternatives.
   d) Not liable for statements by unidentitfied corporate insiders
   e) No affirmative misreprestations—no VA bankshares situation because no allegation that the directors did not really have opinion or that opinion was not based in fact.

3.) Safe Harbor For Projections
   a) 1995 Legislation added safe harbor
      i. 1934 Act § 21E
      ii. 1933 Act §27A
      iii. protects projections, statements of pplans for future if forward looking statements are accompanied by “meaningful cautionary statements identifying important factors that could cause actual results to differ materially.”
      iv. Codifies “bespeaks caution doctrine”—no securities fraud if had meaningful cautionary statements if did not affect “total mix.” Has to be specific—not generic warnings.
      v. Can point out orally where written cautionary language is available
   b. Sciente
      1.) Ernst & Ernst v. Hochfelder
         a) Claim that accounts aided and abetted securities fraud by company whose books they audited. SEC said that intent to defraud was not required just effect on stockholders.
         b) Held: “Manipulative” conotates willful conduct designed to defraud and mere negligence is not enough—must have scienter.
            i. “highly unreasonable omissions or misrepresentations not just negligence but extreme departure from ordinary care that either must have or should have known.
         c) Circuits spilt on whether recklessness is sufficient scienter
   c. Reliance and Causation
      1.) Basic v. Levinson
         a) Stockholder traded shares after issuance of materially misleading statement.
         b) Held: Stockholder may rely on rebuttable presumption that in trading he relied on integrity of price set by the market.
i. “Fraud-on-the-market” Theory—do not need direct reliance because market reflects all available information including misstatement.
   (a) Relying on assumption of efficient market but efficient capital market thesis may not apply to every company
   (b) Not certain what development of “noise theory will mean for Fraud on the market theory”. Is it possible to have a market which is informationally efficient but stock prices might still not adequately reflect value?

ii. Rebut by showing market-makers knew truth or if the plaintiff believed otherwise.

iii. Courts least likely to presume reliance based on affirmative misstatements and face-to-face transactions.

2.) 1995 amendments
   a) § 21D(b)(4) of 1934 requires private plaintiff to prove that defendant’s wrongful conduct cause the loss for which plaintiff seeks to recover.
   i. Accompanying report said plaintiff has to prove that the price was artificially inflated as result of misstatement.

IX. Insider Trading
   A. Overview
      1. Relevant Statute
         a. Rule 10b-5
      2. Rule 10b-5’s “deceptive device” has been construed by courts to extend to insider trading
         a. Prior to this relied on § 16(b) of Securities Act of 1934 requiring officers, directors, and 10% shareholders to show any profits made on purchase and sale.
         b. Prior to this common law, majority rule was that directors had no fiduciary duty to shareholders
            1.) Minority rule: fiduciary duty/unjust enrichment (Diamond v. Oreamuno, NY)
            2.) Alternative rule: “special facts doctrine”—ordinary relationship does not require disclosure, but special facts may require
      B. Rule 10b-5 as a regulator of Insider trading
         1. In Re Cady, Roberts & Co.
            a. Held: corporate insider with material non-public information has duty to abstain or first disclose information. Obligation rests on: relationship giving access to information and inherent unfairness in taking advantage of information.
         2. “Classic” Insider Trading as Fraud
            a. Alternative views on insider trading:
               1.) Don’t have general duty to disclose in Real Estate or other areas where it would discourage productive activities
               2.) Insider trading as contributing to efficient market by getting information out
3.) Insider trading as management compensation

b. Harms from insider trading
   1.) Delayed disclosure
   2.) Corporate injury
   3.) Investory injury
   4.) Loss of public confidence in markets

c. Chiarella v. United States
   1.) Chiarella worked for printer and figured out name of target of corporate hostile takeover bids and bought shares in target.
   2.) Held: Duty of corporate insider to abstain from trading or dislose stems from relationship of trust and confidence. Here Chiarella had no relationship with the sellers of the target company.
      a) Similar to “warehousing”—no violation when buyer purchases on basis of information unknown to seller—not every act of unfairness insider trading.

d. 10b-5-1 Does there have to be trading on basis of information
   1.) prior to rule there was a split some said just being possession of information was enough others said had to have actually used information.
   2.) 10b-5-1 resolved and said trade on basis of information = aware of it when made decision to sell

3. Extensions of the Classic Theory
   a. Tippee Liability and Constructive Insiders
      1.) Dirks v. Securities and Exchange Commission
         a) Dirks, an analyst got material non-public information from insiders as part of investigation, others traded on basis of information.
         b) Held: Not insider trading because not agent, fiduciary, or person in whom seller had placed trust and confidence. Tippee only liable where insider has breached his fiduciary duty to the corporation by tipping and the tippee knows or should have known of breach.
            i. Test is was there a benefit to the insider?
               (a) Consideration, gift, trade
               (b) Tips to relatives or friends—treat as if insider engaged in insider trading and made gift of profits.
         c) Footnote 14: Constructive insider: got information by virtue of special confidential relationship: underwriter, account, lawyer, consultant.
         d) Regulation F-D (fair disclosure) now says companies not permitted to selectively disclose material information to certain people, but not inclined to bring enforcement under it.
            i. Result: Conference calls now open to others
   b. Misappropriation under Rule 14e-3
      1.) United States v. O’Hagan
         a) O’Hagan was a partner in law firm and learned material non-public information about tender offer and bought stock in target (Pilsbury).
b) Held: Adopting “misappropriation theory” of liability. Insider trading when misappropriate confidential information in breach of duty owed to the source of the information.
   i. “in connection with satisfied” because unlike embezzlement the fraud consummates in the purchase of securities—no other use for information.
   ii. Disclosure to source of information cures (if owes duty to two entities ie law firm and clients then have to disclose to both of them that going to trade).

c) Held: Adopting rule 14(e)(3) which did not require breach of fiduciary duty in tender offer situations when trading on material nonpublic information was not exceeding corporation’s authority.

d) One way to look at: Certain asymmetries of information are good because they result from individual effort, bad asymmetries do not result from individual effort.