Agency:

A. Does Agency exist?

- Test: (a) manifestation of consent that the other shall act for him and subject to his control and (b) consent of the other to so act.
- Arises from circumstances, not what the parties construe rel as.
  - Lender becomes principal when he exercises *de facto control* over the borrower. *(Doty - car; Cargill).*
  - Seller becomes agent when it is agreed that he is to act primarily for the benefit of the buyer and not for himself
    - (Seller (a) receives fixed P regardless of P paid by him; (b) acts in his own name; (c) has indep business in buying/selling sim prop).

B. Did agent have Authority to bind principal to third parties?:

1. **Liability of Principal to 3rd Pty in K:** P liable only for contractual promises agent had au to enter into on behalf of principal.

   - **(1) Actual Authority** (Based on communication b/t Principal and Agent)
     - (i) Actual Express
     - (ii) Actual Implied: steps necessary/incidental to express instructions.
       - (If Principal vague in his authorizations, read as instructions to do what one normally does).
   - **(2) Apparent Authority:** (Based on communication b/t Principal and 3rd pty).
     - (i) Classical App Au: (a) Manifestation/ holding out of Agent (can’t make yourself someone’s agent) and (b) Reasonableness of 3rd party belief
     - (ii) App Au by Estoppel: No holding out, but b/c of Principal’s dereliction of duty, imposter was able to lead person to reasonably believe he was Principal’s agent. *(Hoddeson).*
     - (To protect self, Principal shd take away reasonableness of 3rd party – inform them.)
   - **(3) Inherent Authority:** Agent acts contrary to principal’s instructions. *Both* principal and 3rd party are innocents, but the loss is imposed on the principal. *(Thomas Edison)*
     - R1: The loss is incident to the principal’s use of agents; the enterprise benefits, so shd also bear the inevitable losses;
       - R2: (Learned Hand): is good for principal b/c otherwise 3rd parties wd feel need to verify w/ principal every time.
     - Undisclosed Principal liable for harms caused by agent b/c clothed him w/ authority. *(Watteau: frontman for bar).*
   - **(4) Ratification:** “My agent didn’t have the right to enter into the K, but I’m glad she did. Accordingly, I’ll affirm the transaction and agree to be bound by the K.
     - (1) Act done w/ no authority to bind but done or professedly done on P’s account (i.e. agency relationship)
     - (2) Subsequent Affirmance:
       - (a) Acceptance of results; (b) intent to ratify; (c) knowledge of the material circumstances. *(Stefanovicz: Ts in Common)*

- **(1) Independent Contractor Defense:** Master SL for torts of Servant but not liable for torts of IC.
  - EE v. IC:
    - Rest §220(2) Factors. (EE/Agent if ER has right to control manner in which job is performed rather than result alone. Q is economic dependence.)
    - Borrowed Servant Defense: Normally my EE but today is someone else’s EE. Q is who has right of control on day in Q? There must have been complete abandonment of servant to other ER.
      - (Criticism: only gen’l ER has meaningful control, so only he shd bear liability).
  - Franchises:
    - Disclaimers don’t prevent agency liability (*Murphy v. Holiday Inns*). Q is Right to control (who retains mngmt control - details of day-to-day operation?; is there right to control even if control not exercised?).
    - Apparent Agency: (a) held out; (b) reasonable reliance
      - Less reasonable to rely now than before (*Humble* (1949) v. *Hoover* (1965)).
      - *Miller v. McDonald:* Centrally imposed uniformity raised issue of fact whether franchisors held out franchisees.
  - Majestic Exceptions to IC Defense: Tortfeasor is IC but ER still liable if:
    - (a) Incompetence of tortfeasor (R: D hired);
    - (b) Financial Irresponsibility of tortfeasor (R: D hired);
    - (c) Activity inherently dangerous and conducted negligently;
    - (d) Activity ultrahazardous (D is SL – P doesn’t even have to prove negl).
    - (The Exceptions virtually swallow the rule; Some exception generally always applies, so D virtually always liable despite IC.)

- **(2) Scope of Employment Defense:** Master liable for servants torts only if committed while in scope of employment.
  - Early Cases: Frolic and Detour Thry: Abandonment or temp abandonment w/ reentrance? Some cases still use (*Clover*).
  - Modern Cases: Forseeability Test (*Ira S. Bushy*): outer limits of forseeability: not unforeseeable in light of human nature; but are limits: some proximity and a little bit connected to the enterprise.
    - Tend to focus on both (a) time/place and (b) purpose to serve ER. (Spectrum of liability).
    - Factors: Rest §229(2) (a - j). Intentionally tortuous conduct/nonforseeability not dispositive (may be outweighed by other factors).
C. Fiduciary Obligations of Agents:

1. **Duties arising During Agency:** Duty of utmost good faith and loyalty: Must act solely for benefit of principal in all matters connected to the agency; must not to acquire any adverse/private interests of own. **Cannot earn anything more than the ‘deal’**.
   - **Cause** (fiduciary breach, so disgorgement) v. **Opportunity** (no disgorgement, only breach of K). (**Reading v. Regam**).
   - **Duty to disclose:** Shd (a) disclose all facts to ER. Then (b) is in ER’s discretion to decide what to do, and any profit wd be ER’s. (Remedy = Disgorgement). (**Singer**).

2. **Duties During and After Termination of Agency: Grabbing and Leaving**
   - **Rest §393:** Unless otherwise agreed:
     - Can plan but can’t compete while still employed.
     - Can compete after sever ties. BUT, even after severing ties, is duty not to disclose trade secrets. (Client list = trade secret if info not readily ascertainable but, rather, have been secured by yrs of business effort). (**T&C v. Newbury**).

**Partnerships:**

A. **Who are the Partners?**
   - Formed simply by oral or written agreement (is catchall). Partners are joint and severally liable and each act as agents who can bind the ptnshp.
   - UPA §6: Partnership defined: Association of 2 or more persons to carry on as co-owners of business for profit.
     - **Totality of the Circumstances Test:** (1) Shared control (not all in 1 person); (2) Shared Profits; (3) Shared Losses; (4) Each ptnr makes contribution to business (whether tangible or intangible); (5) Self-Labeling. (**Fenwick**).
     - **Partnership by Estoppel:** (UPA §16): Liable if: (a) Holding out (represents himself or permits another to represent him as a partner) (b) 3rd party relies (enters into transaction w/ the actual or apparent (purported) ptnshp).
   - (To make look like loan rather than ptnshp: (Outline p 22.).)

B. **Fiduciary Duties of Partners:**
   - Partnership owes **no fiduciary duty to frmr ptnrs** (overstatement). (**Bane v. Ferguson**).
   - **(1) Duty to disclose opportunity** discovered by virtue of agency alone: Must inform co-partner and give him chance to compete. Dicta says can then compete against him for the benefit. (**Meinhard v. Salmon**).
   - **(2) Duty of Care:** BJR shields ptnshp from liability for mere negl: must allege fraud, self-dealing, or deliberate sabotage (**Bane v. Ferguson**).
   - **(3) Grabbing and Leaving:** (**Shaughnessy**)
     - **Disclosure On Demand:** Don’t have to disclose plan to compete; but, if asked, must answer truthfully (UPA §20).
     - Can plan before leaving but **can’t acquire Unfair competitive adv** (can’t plan so extensively that don’t allow ptnshp any meaningful opportunity to compete).
   - **(4) Expulsion:** UPA§31 requires involuntary expulsion to be done in **good faith** in order to not violate ptnshp agreement. But, where **no cause expulsion clause** exists, expulsion is in “good faith” regardless of motivation (constitutes waiver of duty of good faith).
C. The Problem of Raising Add'l Capital:
   • Unable to solve short term cash shortfalls by selling shares to new pple (need unanimity to bring ptnr in). So need something in ptnshp agreement to deal.

D. The Rights of Partners in Management:
   • UPA Model:
     o UPA §18(e): Per Capita Control Rights (1 ptnr, 1 vote).
     o UPA §18(h):
       ▪ Differences as to ordinary matters must be resolved w/ majority vote.
         • (But each ptnr has right to participate; May be overruled by maj but has right to be consulted).
       ▪ But, Unanimity needed for acts in contravention of the agreement.
         • (If wd sig increase liability exposure beyond that originally contemplated, need unanimity).
     o But, can K around, so ptnshp free to import corp model of centralized mgmt. (UPA largely unworkable in large ptnshps).
   • Impact of UPA model in 2 person ptnshp is deadlock.
     o Nabisco: Gen’l ptnr has pwr to bind ptnshp in any matter legit to the business. Other ptnrs can take away actual au as to something in ordin course of business only w/ maj vote. (Took away app au, but not actual au. Wd have to w/draw and notify supplier).
   • Day v. Sidley and Austin (says concealed effects of merger until after he approved): No fiduciary duty to disclose information concerning internal changes in the structure of the firm so long as (a) has no financial impact and (b) ptnr doesn’t ask outright.
   • (In thry, all ptnrs are entitled to participate in decisionmaking. But doesn’t seem to be much of remedy for exclusion/breach. – See Prentiss next section: excluding ptnrs still get to bid in liquidation sale).

E. Partnership Dissolution:
   • UPA §29 (Dissolution Defined); UPA §31: Causes of Dissolution: (death, etc.)
     o Is presumption of ptnshp at will. Term may be implied (Ownes v. Cohen: ptnshp for term reasonably required to repay the loan) but must be some evidentiary basis that the parties have understanding as to how long it will last (Page v. Page).
     o Even right to dissolve ptnshps at-will is subject to obligation of good faith (Page: was content to share in losses; dissolution to appropriate new prosperity of at-will ptnshp for self w/out adeq comp wd be breach of oblig of good faith).
     o Prentiss: Maj ptnrs who have excluded min ptnr from mgmt nevertheless are allowed to purchase the ptnshp assets at dissolution sale (R: no indication that exclusion was done for wrongful purpose of obtaining ptnshp assets rather than merely b/c of inability of ptnrs to get along; Moreover, D wdn’t be injured – wd actually increase price). But must be for fair value.
   • UPA §32: Judicial Dissolution:
     o Won’t be granted merely b/c ptnrs are at loggerheads/bad blood if jury thinks they may still be able to make profit. (Collins v. Lewis).
     o Denial of Judicial Dissolution doesn’t mean ptnr is stuck in unprofitable situation. There is always inherent pwr, as opposed to right, of dissolution – just must pay damages for breach.
   • UPA §38: Dissolution Process:
o If Dissolution w/out Fault: Funneling: Winding Up → Liquidation (sale of assets) → Termination of business.

- Dissolution w/ Fault: Ptnrs who have not dissolved wrongfully have choice b/t Funneling and Continuation of the Business (for term of ptnshp). Also get damages for breach.

- Can’t K around §38 and, upon dissolution of ptnshp, UPA (not ptnshp agreement) necessarily control. (Pav-Saver). If dissolution not wrongful, pties can provide for mngmt of winding up process in ptnshp agreement (Meehan v. Shaughnessy).

- The Sharing of Losses: §18(a): upon dissolution, each ptnr shall be repaid his contributions and must contribute toward the losses according to his share in profits.
  - Kovacik v. Reed: K contributed $10,000 (no services; R contributed services (no capital). Ct says they have shared equally in the losses: R’s services (for which he drew no salary) worth same as K’s capital (b/c they impliedly agreed they’d be valued equally). (Preamble says “subject to any agreement b/t them.”)

- Absent continuation or buyout agreement, death of ptnr causes dissolution. (Belman).
- Any income generated during the windup of unfinished business is allocated to the frmr ptnrs according to the original ptnhp interest. (Jewel v. Boxer).
  - (R: Under UPA dissolved ptnshp continued until completion of winding up, and, under UPA §21, no ptnr is entitled to extra compensation for services rendered in completing unfinished business). But ptnrs entitled to reimbursement for overhead.
  - 2 fiduc duties owed b/t the frmr ptnrs: (1) duty to wind up and complete unfinished business of dissolved ptnshp; (2) duty not to take any action w/r/t unfinished business which leads to purely personal gain.
  - Ptnrs are free to include written provisions for completion of unfinished business/winding up (e.g. Meehan v. Shaughnessy).

F. Creditors/Partnership Property:
- UPA very protective of ptnshp creditors (joint and several liability) but personal creditors can attach only the ptnr’s share of the property (Ptnr’s int in the ptnsh is his share in the profits and the surplus - §26).
- §24: Ptnr’s property rights: Right in Specific Ptnshp Property (only a tenancy possessory right - §25 – creditors can’t attach; The Ptnshp owns the prop); (b) Interest in the Ptnshp; (3) Right to participate in mngmt.
- §28: Charging order rechanneling payments from ptnr directly to creditor.

G. Limited Partnerships:
- (1) Limited liability for limited ptnrs but unlimited liability for gen’l ptnrs.
- (2) Centralized Management: Gen’l ptnrs control (if lim ptnrs exercise control, become liable as gen’l ptnrs: Holzman v. Escamilla).
- (3) Separation of ownership and control (Gen’l ptnrs control regardless of amnt of ownership int).
- (4) Fiduciary Duty: Gen’l ptnrs owe limiteds same fiduc duty owed b/t gen’l ptnrs in gen’l ptnshp.
- (5) Formation: need writing and filing of certificate (is on public record).
- UPA §6: UPA applies to Limited Partnerships as well.
• Can form limited partnership with corporate general partner (so no one personally liable). Get both tax benefits (tax shelter and no double taxation) and limited liability. (*Frigidaire*, O p 48).

**Corporations:**

(Corporations Compared with Partners: O p 44)
(Means of Influencing Corporate Behavior: O p 49)

**A. Promoters/Pre-Incorporation Liability:**
- **Promoter** is liable on a contract entered into on behalf of not-yet-formed corporation unless: (a) get(s) understanding of the third party that, once the corporation comes into existence, they’ll look solely to the corporation for performance; (b) the corporation comes into existence; (c) the corporation expressly or impliedly (by acceptance of the benefits) adopts the contract.
- **Mutuality**: Both promoter and the corporation which didn’t exist at the time of the contract but now exists can enforce the contract against third parties. (*S. Gulf* - estoppel).

**B. Piercing:**
- 2 elements: (1) Failure to respect formalities; (2) Failure to pierce would be inequitable/sanction fraud (something more than being unable to collect - deception etc).
  - Piercing subsidiary: (a) Substantial domination by parent (Factors); (b) Fraud/injury. (*In Re Silicone Gel Breast Implants*).
  - Can pierce corporate general partner of limited partnership (*Frigidaire Sales*).

**C. Shareholder Derivative Actions**: Suits by stockholders trying to get the corporation to file an action.

*Direct v. Derivative*: Remedy to corp v. remedy to shareholder. (*Flying Tiger*: right to vote - direct).
- If derivative, *Attorney’s fees* paid out of recovery to corp.

**Procedural Obstacles:**
- (1) **Contemporaneous ownership** requirement: To have Standing, must own stock at some point during wrongdoing and throughout the litigation.
- (2) **Bond** Requirement:
  - Triggered if P has small interest and the corporation invokes it.
  - Is rarely invoked b/c might provide ‘proper purpose’ necessary to trigger shareholder inspection right to shareholder list under MBCA §16.02(c).
  - Doesn’t apply if suit is direct rather than derivative (*Flying Tiger*).
- (3) **Demand** Requirement:
  - If make demand, are conceding that Bd is independent, so can’t later argue that it was demand excused case. Bd’s rejection of demand entitled to BJR protection. (*Grimes v. Donald*).
  - Demand Excused if Majority of Bd not independent: (must plead with particularity)
    - (a) Majority interested in the underlying transaction (familial or financial interest: receive benefit from the transaction that’s different from that received by shareholders generally – *Marx v. Akers*).
    - (b) Majority of board dominated/controlled.
    - (c) Underlying transaction not result of valid BJ (no procedure, not informed, etc.) – Indicates that Bd is not independent.
      - (*Grimes*: Big severance pkg not abdication of mgmt au).
**Special Litigation Committees:** If Bd is interested (demand excused) it can’t move to dismiss, but SLCs, if indep, can.

- **NY Approach:** SLC decision to dismiss subject to plain vanilla BJR analysis: inquire only whether SLC mbrs are indep and whether process sufficient (no inquiry into substance). (*Auerbach*).

- **Del Approach: Modified BJ Analysis:** (1) Inquire into methodology (independence of SLC; sufficient process; reasonable investigation), then (2) Inquire into appropriateness of substantive decision to dismiss. (*Zapata v. Maldonado*). Burden is on bd (no presumption of good faith as w/ regular BJ analysis).
  - Good substantive decision can’t overcome bad process (*Oracle*).

**Corporate Purpose:**

- Ultra Vires thry not used any more (now ‘any lawful purpose.”)
- Purpose of business is private profit (*Dodge v. Ford*). But cts give great deference to directors’ BJ that philanthropy will be good for business (*Wrigley*: ct finds sua sponte).

**LLCs:**

(The Principal D/As of Ptnshps, Lim Ptnshps, and Corps: O p 57)

- **Benefits** of LLC Form: Lim Liability for all (although still risk of piercing); Not fragile like ptnshps; Tax benefits of ptnshps (passthrough, no double taxation like corps); Flexible like ptnshps (choice as to mngmt and voting).

- LLCs must include “Limited Liability Company” or “LLC” in name (otherwise treated as ptnshp w/unlimited liability; necessary to protect 3rd pties). (*Water Waste & Land*).

- LLCs owe each other same fiduc duties as pttnrs in gen’l ptnshp. Can be waived. (*McConnel*: Free to compete agreement waived duty of loyalty w/r/t competition).
- Cts have been importing from corporate caselaw to fill in gaps of sparse state LLC statutes.

**Duties of Officers, Directors, and Other Insiders**

**A. Duty of Care** (as to quality of decision-making; is obligation accompanying control)

- BJR protects against liability for mistakes so long as no fraud, illegality, or conflict of interest and followed due care in process (*Kamin v. AmEx*: dividends).
  - (R for BJR protection: reward follows risk; appropriate for cts to evaluate process, but not substance of mngmt decisions; if shareholder unhappy, can leave – liquidity).
  - For BJ to be informed, directors must have informed selves prior to making BJ, of all material info reasonably available. Standard is gross negl (gross failure to
inform self).  \(Smith v. Van Gorkam\): merger w/ 3 day deadline; blind reliance on uninformed officer).

- **BJR protects directors’ reliance on expert** if (a) was reasonable to believe expert’s advice was w/in her professional competence; (b) expert was selected w/ reasonable care.

- **Duty of Attention: Standard is negl.** \(Francis v. United Jersey Bank\)
  - Director must acquire reasonable understanding of business of the corp and stay informed. B/c bound to exercise ordinary care, lack of knowledge not excuse.
  - Upon discovery of misconduct, director must (a) object, (b) resign, (c) consult counsel and (d) file suit. Proximate cause exists b/c cd have prevented harm.
  - Directors have fiduc duty to shareholders but generally not to creditors unless corp is bank or banklike (holding funds for others in trust).

- **Duty to** attempt in good faith to assure that a corp [Oversight Program](which \(bd\) concludes is adequate to monitor compliance) exists. Otherwise, director liable for losses caused by non-compliance. \(In Re Caremark\).
  - BJR protects bd’s decision on whether program is adequate, but doesn’t protect decision to opt-out of compliance (illegal).

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### B. Duty of Loyalty (APs to all agents; not just managerial-types but also EEs).

- **Self-Dealing transactions** (personal transactions of directors w/ their corp) are not entitled to BJR protection; they are subject to rigorous scrutiny. \(Bayer\)
  - If motivated by private purpose/int rather than corp purpose/int, burden is on director to show substantive fairness of decision (from perspective of corp).
  - \(Lewis\): breach of duty of loyalty to run one corp for sole benefit of another corp.

- **Usurpation of Corporate Opportunities**: 
  - \(Guth v. Loft\): 4-Factor Test of Corporate Opportunity: (a) Whether company has financial capacity to pursue the opp; (b) Whether the opportunity is w/in the line of business; (c)Whether company has interest or expectancy in the opportunity; (d) Whether, in embracing the opp, D wd create a conflict of interest. \(Broz\: No factor dispositive).
  - **Defenses**:
    - (a) Financial Incapacity;
    - (b) Legal incapacity;
    - (c) Not Same Line of Business (not natural expansion opportunity: maybe not sold/mkted through same channels; maybe much higher level of risk involved);
    - (d) Disclosure and Refusal (Presents “safe harbor”; Even disclosure to CEO and not whole Bd might suffice: \(Broz\).
    - (e) Scope of Employment (opp didn’t present itself while in scope of employment; agent didn’t exploit opp while on company time or using company resources.)

  - **ERs can K around these defenses or may waive the duty.**
    - \(In Re Ebay\: Spinning; w/in line of business; conflict of int; scope of empl.)
    - Can’t cash in when mkt has shortage \(Perlman v. Feldmann\: Korean war; shortage; D sold control to end user. Constituted usurpation of corp opportunity. Narrow decision – see Sale of Control §).

- Also CL rule that agent is under duty to account for profits obtained personally in connection w/ transactions related to his/her company. \(In Re Ebay\)
C. Duty of Loyalty Held by Dominant Shareholders  
(Obligation arises from Control; Not necessarily Maj shareholder)

- **Self-Dealing: Controlling Shareholder cannot run corp to receive benefit for itself to detriment of minority shareholders.** (Self dealing transact doesn’t get BJR – intrinsic fairness standard).
  - (Sinclair: Dividends not self-dealing b/c paid to minority as well; but refusal to prosecute breach of K against own company was self dealing b/c while other company received benefit of goods for free, min shareholders did not).
  - Controlling shareholder breaches fiduciary duty to minority shareholders by concealing from them material information.
    - (Zahn v. Transamerica: D caused corp to issue call to redeem Class A; didn’t tell Class A mbrs of plan to liquidate so that only Class B mbrs cd participate in liquidation; if Class A mbrs had known, wd have converted to Class B shares).

- **Effect of Shareholder Ratification:** (Fliegler v. Lawrence: Shareholder ratification of a director’s “interested transaction” by a fully informed majority of shareholders will shift burden to complaining shareholders to show the terms were so unfair as to constitute a gift or waste.
  - But here, only 1/3 of ‘disinterested’ shareholders ratified. Read this as insufficient under Del §144 (even though doesn’t violate express lang).

D. Duty of Disclosure and Fairness (See Securities Laws Below).

E. Indemnification and Insurance (Outline at p 77; Book at p 520)

- **Del Gen’l Incorp Law §45:**
  - §145(a): Indemnification in suits by third parties.
    - Allowed (in certain circumstances) for “expenses, judgments, fines, and amnts paid in settlement.”
    - Corp “shall have pwr.” - This provision allows corp to indemnify; need indemnification agreement in order to obligate corp to indemnify.
    - Power to indemnify only if D acted in good faith.
  - §145(b): Indemnification in derivative suits (i.e. suits “by or in the right of the corporation”).
    - Indemnification only for expenses.
    - If the person seeking indemnification has been found liable for the corporation, indemnification allowed only w/ judicial approval.
    - Corp “shall have pwr.” Need indemn agreement to make obligatory.
  - §145(c): Expenses must be reimbursed if D was successful.
  - §145(e): Advancement of expenses
  - §145(f): Indemnification not exclusive of other rights which D (person seeking indemnification) may be entitled to by virtue of, for example, any agreement w/ corp.
  - §145(g): Insurance is authorized.

- **Waltuch (Del):**
  - **Is no pwr to indemnify bad faith D.** (The good faith requirement of §145(a) cannot be overridden – not by §145(f)’s nonexclusivity provision nor by any employment agreements.)
    - 145(g), on the other hand, explicitly allows a corp to circumvent the ‘good faith’ clause of §145(a) by purchasing directors and officers liability insurance.
Is Very low standard of success for §145(c) Manditory Indemnification provision: escape of adverse J for whatever reason (even if only b/c corp paid huge settlement).

THE SECURITIES LAWS: Outline p 67 – 78:

(1933 Act)
A. Definition of a Security
• §2(1) of Securities Act (Book p 415): ‘stock’, ‘note’, ‘bond’, etc.
• Howey (Investment K): (1) Investment of Money; (2) In a Common Enterprise; (3) W/ an expectation of Profit; (4) Derives profits solely from efforts of others.
  o Robinson v. Glynn (not security b/c not passive investor; was financial guy, was on bd, etc): Not everything requires protections of securities laws. Mbr passivity must exist for security law protection to apply (must derive profit solely from efforts of others). Q is, as an economic reality, does investor need protection of the securities laws?
  o On other hand: Landrath: stock always security; even if 100% of CHC owned by 1 indiv.
• Consequences of being security: Must either register or qualify for exemption; regardless are liable for anti-fraud provisions.

B. Registration
• §5 of ’33 Act requires registration of securities prior to sale. Must deliver a prospectus (a disclosure document) to prospective purchaser prior to sale.
• Remedy for selling unregistered security is strict rescission.

Exemptions: Ultimate Q is whether the offering is to those who are able to fend for themselves such that there’s no practical need for application of the Securities Act.
• If exemption exists, are exempted from registration requirement, not from compliance w/ anti-fraud provisions.

• Intrastate Exemption
• Private Placement Exemption (§4(2)):
  o Doran: Weigh 4 Factors: (1) Number of offerees (not number of purchasers) and relationship to eachother and to issuer; (2) Number of units offered; (3) Size of the Offering; (3) Aid and manner of the Offering.
    ▪ When multiple offerees, must look to needs of all.
    ▪ Investor sophistication not sufficient to give rise to the exemption: Must be provided w/ the information necessary to enable them to exercise such sophistication in deciding whether to invest. Q is, did they have access to info despite lack of registration? (Such info necessary but not suff).
      • Need either (a) actual disclosure or (b) access to info plus close rel to issuer so can actually get info.

• §11 enacted to discourage pple from serving on Bds unless actually intended to fulfill their requirements as director.
- Anyone who signed the registration statement is a potential defendant. (Who must sign: Issuer, majority of board of directors, principal exec officers, every accountant, engineer, or appraiser, every expert, underwriters).
- **Due diligence defense**: Investigation reasonable person wd do w/r/t own prop.
  - Available to all Ds except the issuer
  - Applies differently to different categories of them depending upon (1) portion of the registration statement where the misstatement occurred (expertised and non-expertised); and (2) Type of D:
    - Liability of an expert for an omission in a non-expertised section of the regulation statement
      - None. §11(a)(4).
    - Liability of non-experts for the non-expertised section that’s misstated
      - Made a reasonable investigation, and had reasonable grounds to believe it was true. §11(b)(3)(A)
    - Liability for experts for the expertised section that’s misstated
      - Same standard as (4), but found in §11(b)(3)(B)
      - As to portion that he prepared, he must’ve made a reasonable investigation and has to have had a reasonable grounds to believe it was true
    - Non-expert for the expertised section that’s misstated?
      - Must have no reasonable grounds to disbelieve the statement. § 11(b)(3)(C).
  - Issuer SL.

(1934 Act)

**C. Rule 10b-5: (Addresses insider trading but has much broader reach).** Is Fraud to (a) make any untrue statement of material fact or (b) to omit to state a material fact which is necessary to make statements made not misleading… *in connection w/ purchase/sale of any security.*
- APs to any security (including securities in CHCs to which Securities Act generally don’t AP).
- Must be someone who bought or sold securities to have standing.
  - (Mere offerees lack standing; must be purchaser or seller: *Blue Chip Stamps*).
- **Affirmative Misrepresentation**: Elements: *(Basic*: 3 press releases denying merger talks)
  - (1) Sciento (for aff misstatement, must show specific intent to deceive, not mere negl);
  - (2) Materiality (reasonable shareholder wd consider imp in deciding how to vote; significantly alter total mix)
  - (3) Reliance
    - Fraud on the Mkt Thry: Even if P investors didn’t actually read the misstatements, they relied on the stock price (which was artificially deflated by the misleading statements) and thereby were damaged. So **reliance is presumed.** (Effectively Ps no longer have to prove).
      - This presumption applies only where D Publicly misleads *(West v. Prudential)*.
D. Duties Relating to Inside Information

(a). Pre 10b-5: Liability only for affirmative misrepresentation.

(b). 10b-5: in addition, imposed liability for omission of material fact necessary to make statements made not misleading.
- Elements: (1) D (a) made material misrep/omission (b) in connection w/ purchase/sale of security; (2) reliance; (3) Scienter; (4) Causation.
- Insider/Agent in possession of material inside info must either (a) disclose to investing public or (b) abstain from trading or recommending while undisclosed. (R: Are Agents).
  - “In Connection With…” requirement satisfied of, while D didn’t itself buy or sell, its actions caused reasonable investors to rely and caused them to purchase/sell corp’s securities. (Tx Gulf Sulpher: Struck Mineral; Issued Gloomy Press release; b/t release and disclosure, 3 Ps traded.).
- 10b-5 Liability attaches only to insiders or constructive insiders (accountant, lawyer, etc: info is legitimately revealed solely for corp purposes) b/c the duty to disclose or abstain arises from relationship of trust b/t corp’s agents and its shareholders (i.e. w/ the traders on the other side of the transaction). (Chiarella).
- BUT outsiders (Tippees) can inherent insiders’ (Tippers’) duties derivatively if:
  - (1) Tipper disclosed info to the outsider in breach of his fiduciary duty (acted for personal gain) to his corp (Tipper liable only if insider);
  - (2) Tippee knew/shd have known
    - (a) That Tipper was breaching fiduc duty
    - (b) That the info was nonpublic
    - (c) That the info was material.
  - (If no primary breach, can be no derivative breach: Dirks: Tippers were motivated by desire to expose the fraud).
- Outsider also liable under 10b-5 where he misappropriates inside information in breach of fiduciary duty to source of the information (O’Hagan).

(c). 14e-3(a): The Special Case of Tender Offers: Liability even in absence of fiduciary duty.
- Where any person has taken a substantial step to commence a tender offer, is violation for any other person
  - (a) in possession of material information relating to such tender offer
  - (b) which he knows/has reason to know is (i) nonpublic and (ii) has been acquired from offeror, offeree, or EE
  - (c) to buy/sell or cause to be bought/sold securities, unless such info and its source are publicly disclosed.

(d) Short Swing Profits: §16(b)
- Relevant only to publicly traded corps – those required to register their securities. Seeks to prevent insider trading.
- Says officers, directors, and 10 percent shareholders (beneficial owners) must pay to the corp any profits they make from buying and selling the firm’s stock w/in a six-mo period. §16(b) must be applied formalistically.
  - Beneficial owner must own 10% of class of stock, not total stock.
- **Beneficial owners may engage in 2-step:** sell enough to bring their holdings down below 10% and then later (but still w/in 6 mo) sell add’l shares w/out being required to pay over the profits. (*Reliance*).
- **In purchase sale sequence,** beneficial owner must **acct for profits only if he was a beneficial owner** (i.e. had 10% of class of stock) **before the purchase.** (*Foremost-McKesson*).
- **Officers’** trades cannot be paired w/ transaction that occurred prior to his/her appt but can be paired w/ one that occurs after he ceases to be officer/director.
- **Deputization** if firm’s EE acts as director of another corp and the firm trades in the corp’s stock.
- **Unconventional transactions** aren’t matchable sales. Test: Whether transaction is (a) volitional, (b) one over which beneficial owner has any influence, (c) whether beneficial owner had access to confide info about transaction or issuer.
  - *Occidental:* Merger is unconventional transaction (nonmatchable sale) where it is involuntary in that it is approved by others and beneficial shareholder has no choice but to exchange its shares.
  - SEC says treat acquisition of option as purchase/sale of underlying stock.
- Suits to recover the profits may be instituted by the corp (issuer) or by shareholder derivatively.

**Problems of Control**

1. **Proxy Contests:**
   - Governed by **SEC Rule 14a** (§14(a) of ’34 Act).
   - Rule 14a-7: If want to elect own BOD, can’t force corp to include your proxy materials in its. Must do own proxy solicitation. Mgrs can either (a) mail and charge or (b) give list.
   
   **A. Reimbursement of Costs:**
   - **Mgmt** can seek reimbursement even for uncontested meeting; As to contested meeting, can charge the costs of proxy solicitation.
     - But must be in good faith. Disgorgement if: (a) excessive; (b) methods are illegal (bribes etc); fight is just about personalities/personal concerns (such as desire just to keep jobs) rather than policy differences. (*Rosenfield*).
   - **Insurgents** can get reimbursed by an affirmative vote of the stockholders; so, as a practical matter, must win to get reimbursed. (*Rosenfield*).

   **B. Private Actions for Proxy Rule Violations:**
   - §14(a) (and the rules thereunder) give rise to private cause of action (both derivative and direct). (*Borak*).
   - Solicitors must provide shareholder w/ proxy statement containing info material to the decision. **Rule 14a-9 prohibits material misstatements/omissions in proxy statement.**
     - **(1) Materiality:** Misstated/omitted fact wd have assumed actual significance in reasonable shareholder’s deliberation. WD change the total mix of info available (not just add more of same). (*Mills:* isn’t redundant if necessary to put shareholder on guard).
(2) Causation: Exists so long as votes are needed (Mills).
(3) Scienter: Negligence is sufficient (Seinfeld).
Remedy: (a) Injunction to force disclosure (if before transaction); (b) Rescission (if after transaction); (c) Damages (at least attorney’s fees).

**Shareholder Proposals: Rule 14a-8**
- 14a-8(i)(5): Relevance: Not limited to economic relevance (Lovenheim: ethical/social significance).
- 14a-8(i)(7): Ordin Buis Operations: While healthcare relates to ordinary business matter, don’t exclude b/c will have large financial consequences for Dole. (Dole).

2. **Shareholder Inspection Rights:** (Afforded by State Law: Must meet (a) threshold eligibility requirements (usually own certain number of shares for certain period of time) and (b) Good Faith/Proper Purpose requirement).
   - MBCA §16.02: (a) Demand made; (b) Proper Purpose/Good Faith; (c) Describe w/ reasonable particularity purpose and records requested; (d) Records are directly connected w/ the proper purpose.
   - MBCA §16.04: Ct ordered inspection. Unless corp proves had good faith reason to doubt right of shareholder to inspect, ct orders corp to pay fees.

   Assessment of Interest is Proper Purpose: Right to inspect is property right flowing from ownership of assets in corp together w/ right to protect this investment. (Anaconda).

   Usually improper purpose of Competitor; BUT: Anaconda: Correction of misstatements mgmt made in course of tender offer battle is proper purpose Tender offer inimical to interests of mgmt but not owners.

   Ct takes requests for shareholder inspection rights much more seriously than shareholder proposals b/c right to inspect is right to destroy. So, mere political purpose not enough.
   - (a) Must have *bona fide investment interest* (not just got shares to be eligible to make demand) and (b) inspection must be *motivated by concern w/economic effect on corp*. (Pillsbury: wanted econ records to use to convince shareholders corp shd no longer produce munitions b/c opposed Vietnam).

3. **Shareholder Voting Control:**
   - *Stroh v. Blackhawk:* Under Ill law, can remove the ‘economic incidents’ of stock (right to earnings and assets); Just can’t remove management incident (right to vote). This is sufficient ‘proprietary right’ conferred by stock ownership.
   - *Peerless:* Where P established that the bd acted for primary purpose of thwarting exercise of shareholder vote (and did), Bd has burden to demonstrate compelling justification for its actions. If P doesn’t est such primary purpose, BJR applies to Bd’s actions; otherwise, violates duty of loyalty.

4. **Control in CHCs:**
   A. **Shareholder Agreements:**
   - CHCs, via agreement, turn corp norms on head. Cts reluctant to allow them to bind Bd as to future decision-making (neuters them).
Will enforce shareholder agreements concerning election of directors (a uniquely shareholder decision). *(Ringling Bros)*.

Will enforce shareholder agreements concerning non-shareholder decisions (election of officers/salary) only if they are (a) signed by all shareholders and (b) the agreement is unobjectionable/unthreatening (in office only so long as faithful, competent, efficient; guaranteed salary portion of net income). *(Clark v. Dodge)*.

- *(McQuade*: Where non-unanimous (even if no one complains), minority shareholders and creditors are harmed b/c deprived of Bd’s indep decision-making.)
- *(Galler v. Galler: Ct implies duration term so there is termination date.)*

- Cts retain wide equitable discretion as to enforceability of shareholder agreements concerning exit from CHC or remedies for fiduciary breaches. (See Below).

**B. Abuse of Control:**

Controlling shareholders owe minority same fiduciary duty owed by ptnrs in gen’l ptnshp (so standard is strict good faith). *(Donahue)*

- **Selective Redemption** Prohibited *(Equal Opportunity Doctrine)*: when repurchasing shares from one shareholder, must be willing to take up shares of any other shareholder who wants to at same price. *(Donahue v. Rod Electrotype)*.
  - Controlling shareholders violate fiduciary duty of loyalty in depriving min shareholder of both salary and dividends *(Wilkes)*.
  - Fiduciary duty doesn’t protect job-security in CHC. *(Glamore)*. But can’t fire even at-will EE for opportunistic reason in order to acquire benefit for self.
  - Even non-majority shareholders owe fiduciary duty to others in CHC if have veto pwr. *(Smith v. Atlantic*: Moves selective redemption cases beyond oppression context; wdn’t allow dividends b/c needed bargaining chip).

- **Freeze-out** of Minority is breach of fiduciary duty. Series of abuses w/ lowball buy-out offer at end may demonstrate intent to freeze-out. *(Sugarman)*.

**Shareholder Agreements unenforceable if they violate fiduc duty:**

- CHCs buying their own stock, like insiders buying from outsiders, under Rule 10b-5, have fiduciary duty to disclose material facts. Can’t waive via shareholder agreement. *(Jordan v. Duff and Phelps: EE wdn’t have resigned and sold stock back to corp if plans for merger had been disclosed).*

**Statutory Dissolution:** *(Exit Mechanism for those who’ve gone into CHC w/out one)*

- (Stat Dissolution may be provided for by State Statutes. Dissolution rarely granted; exist primarily to give corp incentive to be fair and make respectable buy-out offer.)

- **4 ways in which Shareholder can get forced buyout at FMV:** *(Alaska Plastics)*.
  - (1) Private Agreement
  - (2) Fundamental Corp Change (such as merger) shareholder dissented to
  - (3) Breach of Donahue Duty (Equal Opportunity Doctrine).
  - (4) **Statutory Dissolution:**
    - Is Extreme remedy. Cts have broad equitable pwrs to order less drastic remedy of forced buyout at FMV.
      - To be entitled to forced buyout, must prove acts of the other shareholders was “illegal, oppressive or fraudulent” or, alternatively, constituted waste or misapp of corp assets.”
• Statutory dissolution **appropriate only where it is impracticable for the corp to go on or there is evi of oppression of minority stockholder.** Minority not entitled to dissolution merely b/c have no control in corp. *(Suparich)*
  o (Now stuck w/ no exit mechanism. Shd’ve provided exit mechanism in agreement.)

Even where provide for exit mechanism via Agreement, Ct may not enforce it.
• Ct will ignore buyout agreement in favor of statutory dissolution if mechanism if agreement is unfair. *(Haley v. Talcott)*
  o Reflects cts more **modern view of dissolution** *(Doesn’t result in sale on cthouse steps: either results in negotiation or buyout by maj stockholder/EEs).*

• **Ct will ignore buy-out agreement and grant damages if fiduciary duty breached** *(Pedro v. Pedro: Grants damages at FMV though agreement provides for buy-out at 75% of book value).*

5. **Transfer of Control:** Who is entitled to premium from transfer of controlling block of stock?
• Absent bad faith, controlling stockholder free to sell controlling interest at premium and keep that premium. *(But wd be breach of fiduc duty to sell control in looting situation.)* *(Zetlin).*

• Illegal to sell control by itself unaccompanied by stock (b/c control isn’t ‘owned’ by indiv), but okay otherwise. *(Yate)*

• **Is legal for purchaser to receive immediate operating control when, by virtue of share control, wd eventually receive it anyway.** P, to show illegality of the K, must show inability of purchaser to elect maj of bd in due course. *(Yates: Yates was trying to reneg on the K; if someone else had complained, ct wd likely sustain).*