**Business Associations Outline**

**Basic forms of business organizations**

* Sole proprietorship: 1 owner, cannot contract with self, benefits/obligations flow to owner, liability, no formalities
* Partnership: 2+ persons, business for profit, joint and several liability, partners are agents of others, contractual relationship (orally or implied)
  + Limited partnership: limited liability – limited to investment
* Corporation: only formed by prescribed statutory manners, separate legal identity from owners, shareholders, limited liability, double taxation (company profits, dividends), preferred tax rate

**Agency**

* Principle (P), Agent (A), Third Party (3P)
* When someone is acting as A, creates liability for P
* R3 Agency §1.01: Agency is the fiduciary relationship that arises when one person (P) manifests assent to another person (A) that A shall act on P’s behalf and subject to P’s control, and A manifests assent or otherwise consents to act
  + 3 factor test for agency – manifestation of intent (acts on P’s behalf, subject to control); agent’s consent to so act
* Actual Authority, R3 §2.01: A acts with actual authority when, at time of taking action that has legal consequences for P, A reasonably believes, in accordance with P’s manifestations to A, that P wishes A to so act
  + Actual express (P tells A to do x, A does x to 3P, P bound to 3P); actual implied (A takes steps necessary to carry out P’s instructions, no explicit instructions, within scope of employment, P bound)
* Apparent Authority, R3 §2.03: Power held by A or other actor to affect P’s legal relations with 3Ps when 3P reasonable believes the actor has authority to act on behalf of P and that believe is traceable to P’s manifestations
  + Where P has discussion with 3P, A seems to have authority from P to deal with 3P, words or business custom that leads 3P to reasonably believe that A has authority, P bound
* Estoppel, R3 §2.05: Person who has not made manifestation that actor has authority as A and who is not otherwise liable as a party to a transaction purportedly done by action on that person’s account is subject to liability to 3P who justifiably is induced to make a detrimental change in position because the transactions is believed to be on that person’s account. Must show: P intentionally/carelessly caused 3P to believe the act was on P’s account; having notice of 3P belief and that 3P might change position because of belief, fail to notify 3P of facts
* Inherent agency power (A acts unauthorized, but close or incidental to things that P allows A to do)
* Ratification, R3 §4.01: is 1) affirmance of a prior act done by another that 2) may have been done without actual or apparent authority. However, 3) actor must have acted or purported to act as A, and 4) the person must have full knowledge or notice (should have known) to ratify
  + Ways to ratify: express acceptance; accepting benefits without disclaiming/repudiating; implied affirmation of agreement (3P is going to rely on how P is acting; silence, inaction); lawsuit to enforce agreement
  + Ratify all or nothing – if ratify, ratifying entire agreement
* To determine agency:
  + 9 Elements to indicate control (Cargill)
    - Constant recommendations
    - Right of first refusal to purchase product
    - Inability to enter into mortgages, buy stock, pay Div’s w/out P’s approval
    - Right of entry to premises to carry on checks/audits
    - Criticism of finances/officer salaries/inventory
    - P’s determination needed strong guidance
    - Business forms had P’s name printed on them
    - Financing purchase of inventory and operating expenses
    - Power to discontinue financing
      * Any single factor indicates debtor/creditor relation
      * Look at totality of factors – at some point becomes P/A relationship
* Fiduciary obligations of A
  + Duty of Loyalty, §8.01: must act for P’s benefit in all matters connected with agency relationship – continues after relationship terminates
  + Duty of Care, §8.08: A has duty to act with care, competence, and diligence normally exercised by As in similar circumstances
  + R3, §8.02: Duty to not acquire material benefit from 3P due to A’s position (no kickbacks, tips) (Reading: Soldier had to disgorge profits from steering trucks through checkpoints; position as soldier made him A and representative of Crown [P], so couldn’t keep good gotten b/c of his position) – continues after relationship terminates
  + R3, §8.05: Duty to not use P’s property for A’s or 3P’s purposes; duty to maintain confidentiality of P’s confidential information – continues after relationship terminates
* A’s liability on K (Atlantic Salmon)
  + A is personally liable if there is an undisclosed P; no duty for 3P to ask (however, actual knowledge nullifies)
    - A has duty to disclose P
* P’s liability to 3P
  + Respondeat superior: if servant relationship exists (agency), then P (master) is liable
    - Must be within scope
      * R3, §7.07: Within scope if performing work assigned by employer or engaging in conduct subject to employer’s control; without scope if incident occurs during independent course of conducted not intended by employer to serve employer’s interests (Bushey: drunk seaman broke dry dock, Ct said foreseeable because required him to stay aboard; Manning: pitcher threw ball at heckler; Arguello: Petrol clerk racism – franchises were not As, company owned store employees were As, Ct looked at time/place/purpose of act, similarity to acts which servant authorized to perform, whether act is commonly performed by servants, extent of departure from normal methods, whether master would reasonably expect such an act)
    - Independent Contractors (IK) may or may not be agents; comes down to control (Petrol Cases)
      * Non-A IK: IK agrees to carry out the task, but master cannot control
      * A: IK’s conduct is controlled (or subject to right of control) by master
      * Liability for IK: master generally not liable
        + Exceptions: Master has right to control physical means of task; IK is incompetent/indigent; inherently dangerous activity

**Partnerships**

* Uniform Partnership Act
* All states have P’ship statutes
* Elements to determine existence:
  + Intention of parties (relevant, not dispositive)
  + Sharing of profits and losses
  + Joint administration and control of operation
  + Capital investment by each partner
  + Common ownership of property
  + See: Fenwick: beauty shop owner didn’t want to lose receptionist, called her Pnr, but no sharing of profits/losses/control; Southex: Ct looked at totality of circumstances, said no P’ship – agreement term (fixed, not indefinite) and title (not P’ship), profit sharing 55/45, control mostly vested in one party, no shared risk (indemnity), contributions (one party paid, other did not)
* Features of P’ship: assets belong to Pnrs (tenants in common); limited life; unlimited liability; taxed as individuals; non-transferrable (though can bring in more Pnrs); flexible and inexpensive (compared to Corps); multi-lateral agency, UPA §9 (all Pnrs are As of P’ship)
* P’ship by Estoppel, UPA §16
  + When represent self (or consent to another representing him), as Pnr, then liable to anyone who relied on that representation (Young v. Jones: Price-Waterhouse Bahamas case; failed to show reliance)
* Rules determining rights/duties of Pnrs
  + 1914 UPA §18
    - Pnrs can agree to almost anything between themselves
    - Default rules (when P’ship agreement silent)
      * Each Pnr repaid contributions and share equally in profits/surplus remaining after liabilities settled
      * Pnrs receive interest on moneys advanced beyond agreed capital, but only from date it should have been repaid
      * Equal rights in management; no new Pnrs without consent of all Pnrs
      * P’ship must indemnify Pnrs for personal liabilities reasonably incurred in ordinary conduct of business
      * No Pnr entitled to remuneration (except surviving Pnr entitled to reasonable compensation for winding up P’ship)
      * Ordinary matters need majority vote; extraordinary matters must have unanimous consent
  + 1997 UPA §103, non-waivable provisions (the agreement may not…)
    - Vary rights/duties under §105
    - Unreasonably restrict the right of access to books/records
    - Eliminate duty of loyalty
    - Unreasonably reduce duty of care
    - Eliminate obligation of good faith and fair dealing (but can prescribe standard of measure)
    - Vary power to disassociate as Pnr
    - Vary right of a court to expel Pnr
    - Vary law applicable to LLP
    - Restrict rights of 3Ps
  + 1997 UPA rules
    - Property and capital: Transfer is permissible, but – 1) Transferee only get rights to distributions; 2) transferee does not get other rights (right to participate in mgmt, access books, etc); 3) transferee may seek judicial determination that dissolution is equitable; and 4) transferor retains rights/duties except to distributions
    - Expulsion: usually governed by P’ship agreement
    - Dissolution
      * Cts of Equity may order dissolution where there are quarrels to such extent that confidence/cooperation between Pnrs destroyed or where one Pnr has materially hindered proper conduct of P’ship business with misbehavior (Owen v. Cohen, UPA §32)
      * UPA §801(5): P’ship dissolved on application by Pnr, by judicial decree that 1) economic purpose of P’ship likely to be reasonably frustrated; 2) another Pnr has engaged in conduct relation to P’ship that makes it not reasonably practicable to carry on business with that Pnr; or 3) not otherwise reasonably practicable to carry on P’ship business in conformity with P’ship agreement
      * UPA §701: if a Pnr withdraws from P’ship in contravention of the agreement, P’ship isn’t necessarily dissolved
      * Winding up requires appointment of receiver; remaining Pnrs may wind up in event of Pnr death; Pnrs may bid for assets, business as a going concern (Prentiss); Pnrs still owe fiduciary duty
      * Innocent Pnr can try to continue business (but will have to buy out bad Pnr) or may get out and sue for breach of K
* Fiduciary obligations of partners
  + Duty of Loyalty: can’t appropriate P’ship opportunity (mere disclosure not enough) (Meinhard)
    - Opting out: can’t harm other Pnrs (not all self-dealings violate DoL, only if other Pnrs harmed)
      * CA allows P’ship agreements to vary/permit ratification of violation of DoL if it’s not manifestly unreasonable (interested Pnrs cannot vote – is manifestly unreasonable; Prometheus)
    - Duty to fully disclose if intending to leave P’ship – must render on demand full and true info of all things affecting P’ship
      * May plan to compete if do not otherwise violate duty (making logistical arrangements okay – i.e. leasing office space, etc)
  + Duty of Care: refrain from engaging in grossly negligent/reckless conduct, or intentional misconduct; ordinary negligence is not enough

**Limited Partnerships**

* Limited Pnrs (LPnrs)
  + Risk limited to capital investment
  + If manage/control, may be classified as GPnrs (Holzman v. De Escamilla, the check-signing case)
    - Includes: control of finances, daily operations; does not include mere advice
* General Pnrs (GPnrs)
  + Full personal liability
  + Management/control of business
* RULPA (Revised Uniform Limited P’ship Act) §303
  + (a): LPnr is not liable for obligations of LLP unless LPnr is also a GPnr or, in addition to exercise of his rights and powers as a LPnr, he takes part in the control of the business. However, if LPnr takes part in control of business and is not a GPnr, LPnr is liable only to persons who transact business with the LLP and who reasonably believe, based upon his conduct, that the LPnr is a GPnr
  + (b): LPnr does not participate in control solely by consulting with and advising a GPnr on business matters

**Corporations**

* Triangle of Directors=Shareholders (SH)=Officers
* Default to DE law
* General rule: no individual SH is personally liable for the debts of the business

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|  | P’ship | Corp |
| Formation | Informal (can be verbal or otherwise) | Statutory formalities |
| Ltd. Liability | No (but can have LLP) | Yes! Is the reason to incorporate; Corp is separate entity |
| Transferrability | Restrictive; bringing in new Pnrs requires Pnr agreement | Yes. Can buy/sell shares without any real restrictions |
| Continuity | Generally no | Perpetual existence |
| Centralized Management | No; run by all Pnrs | Generally yes; Board of Directors, etc. |
| Cost | Nothing (unless invest in a lawyer’s advice) | Considerable cost |
| Default Rules | Extensive | More extensive |
| Client Perception | Usually low prestige (except law firms, etc.); often seen as “Mom’n’Pop Shop” | Usually considered a serious business |
| Flexibility | Very | Not much |
| Tax | Single or flow-through | Form of double taxation: Corporation taxed on profits, SH taxed on dividends after |

* 3 Types (for tax purposes)
  + C Corp: taxed as an entity distinct from owners (double tax)
  + S Corp: taxed as a P’ship
  + Limited Liability Corporation (LLC)
    - Offers limited liability with flow through tax benefits of P’ship
* Corp Characteristics
  + Legal entity (treated as a person)
  + Is generally a resident in state in which incorporated, where doing business, or where qualified to do business (matters in terms of tax); most incorporate in DE
* Formation
  + Must comply with statutory provisions (often based on Revised Business Corporations Act)
  + Model BCA §2.02 (Page 183); §2.03 (begins when articles of incorporation are filed)
* Piercing the Corporate Veil
  + Alter Ego
    - Totality of the circumstances (Sheffield, Catholic dog case; Breast Implants case), consider:
      * Common directors or officers
      * Common business departments
      * Consolidated financial statements
      * Parent finances subsidiary
        + Commingling of funds/assets
        + Acceptance by parent of liability for debts of subsidiary (including salaries)
      * Parent caused incorporation of subsidiary
      * Subsidiary operates with grossly inadequate capital
      * Subsidiary receives no business but that given to it by parent
      * Parent uses subsidiary’s property as its own
      * Daily operations are not kept separate
      * Use of one as a mere shell/conduit for affairs of the other
  + 2 tests for determining whether corp is so controlled by another as to justify disregarding separate identities
    - 4 part test for unity of interest (Sea-Land v. Pepper Source):
      * Failure to maintain adequate corporate records
      * Commingling of funds/assets
      * Undercapitalization
      * One treats the assets of the other as its own
    - Van Dorn Test:
      * Unity of interest and ownership
      * Honoring the separate corp existences would sanction a fraud or promote injustice
* Corps are usually run by centralized management: Board of Directors
  + Directors are responsible for setting policy, appointing officers
  + Officers then implement the policies
  + SH vote on directors
* Directors’ fiduciary duties:
  + Duty of Loyalty: relates to conflict of interest; must act in best interest of corp
    - Corp Opportunity says breach of DoL when appropriates business opportunity from the corp
      * Can take advantage if discloses opportunity and corp decides to not pursue opportunity or does not have the resources to take advantage
        + Need full disclosure; ratification of directors or majority of SH; whether corp could take opportunity monetarily or is it in the normal line of business
    - Can’t self-deal
  + Duty of Care: relates to negligence
    - Must perform duties with care that ordinary, prudent person would in similar circumstances
      * have they gone out and done research; have they asked questions; have they deliberated
* BJR: If there is no conflict of interest (duty of loyalty) and they (the management) have not been negligent in decision-making (duty of care), then the court will not question their decisions (BJR)
  + Must be malfeasance or nonfeasance, gross negligence – misjudgment is not good enough
  + BJR only protects decisions; decisions not to act are also protected
  + Van Gorkum: DE says BJR is a presumption that the directors acted on an informed basis, in good faith, and with honest belief that the action taken was in the best interest of the corp; party bringing action must rebut this presumption
* Ratification
  + If Board’s process isn’t fair, then Ct may take ratification into account (Fliegler)
    - Ratification isn’t enough (Board often holds majority of shares)
    - Legislative override of traditional approach means interested transaction is not void if:
      * Full disclosure and the Board ratifies; or
      * Full disclosure and SH ratify; or
      * Fair

**10b-5**

* IPO: Initial Public Offering
* Options, stocks, etc. are all securities, and 10b-5 protects them
* 1933 act is disclosure statute
  + Must file form S-1 and Prospectus; idea is- going to document business model, expected growth
* 1934 act collects variety of disclosure provisions – 10b and 10b5
  + Company disclosure on a regular basis of what their profits are
  + Section 11a
    - If is materially misleading, anyone signing it or is a director is liable; being an inexperienced person gets you nothing in the way of defense (still need due diligence)
* Rule 10b-5: Prohibits fraud by anyone related to buying/selling security
  + Makes it unlawful for anyone, directly or indirectly, to give misleading information or not say something and it misleads (omission, commission)
* P suing needed to show:
  + Scienter: P must show that D acted with intent to deceive or defraud (negligence insufficient)
  + ProxCa/Causation: P must show that misstatement caused the damage
  + Materiality: P must show that a reasonable investor would likely consider misstatement important
  + Reliance
    - Traditionally was bifurcated (P had to prove relied on affirm. misrep; if failure to disclose, rebuttable presumption that P relied)
    - Basic Inc. extended rebuttable presumption to affirm. misrep; shifted burden of proof of reliance to D (if P proves first three)
* Fraud-on-the-market
  + Committed a fraud on the market, not necessarily on the individual
    - Unsophisticated investors follow what sophisticated investors do; sophisticated investors rely on company statements
      * Hence, relied on statements, even if didn’t know statements, because relied on sophisticated investors’ actions
* Puts and Calls
  + Rights to buy (Call) or sell (Put) shares at a later date (naked put: don’t own stock when give option)
  + Matters in terms of 10b because information will affect share price and also this trading
* Insider Trading
  + Who’s banned from trading on material nonpublic info?
    - Employees of company
    - Temporary insiders
    - Person who misappropriate information entrusted to them
    - Tippers and tippees
  + Main weapon today to combat is 10b-5 (not the case until 1960s)
  + TX Gulf Sulphur
    - Duty to disclose info or abstain from trading
      * Must have a fiduciary nexus to have this duty
    - Materiality: what reasonable investor might consider important if it might affect the value of the stock
    - 10b-5 prohibits: fraudulent statements in connection with the purchase or sale of a security
  + Chiarella
    - Duty to disclose/abstain arises when in a relationship of trust between individual who’s trading on information and those on the inside
    - No fraud absent a duty to speak
  + Dirks v. SEC
    - Trying to stop fraud is not breach of fiduciary duty
    - Absent breach of fiduciary duty, 10b-5 not applicable
      * Whether tippee violates will depend on whether tipper owes fiduciary duty
      * Breach of fiduciary duty occurs only where tipper earns benefit from fraud

**Derivative Suits**

* Direct v. Derivative
  + Direct: individual cause of action (recovery 🡪 SH)
  + Derivative: 1) individual SH who, 2) under normal circumstances wouldn’t have the right to sue, 3) steps into the shoes of the corp (thus any recovery from suit 🡪 corp)
* Requirements for action
  + SH must first sue in equity to bring suit against directors (i.e. SH sues corp for right to sue directors)
  + Actions must allege that P has made demand on board or why demand should be excused
    - Either Bd rejected demand and was wrong in rejection (Ct looks for a good faith rejection by independent Bd); OR SH didn’t make demand because futile
    - Demand futility: Bd could not have properly exercised independent/disinterested business judgment in responding to a demand; conflict of interest in that directors who breach duty have power to sue selves (probably won’t use that power)
      * Majority of Bd has interest in transaction; Majority of Bd is dominated or controlled by alleged wrongdoer; Or challenged transaction was not product of valid business judgment
* Special committee (S/C) of “untainted directors”
  + Cts say BJR when S/C of disinterested, fully informed, independent members makes a decision
  + Ct looks at process: is S/C following all the steps?
    - Ct inquires into independence and good faith of S/C and its bases for supporting conclusions
      * Requires detailed report of S/C’s findings, procedures

**Proxy Fights**

* Only shareholders who hold stock on the record date can vote
* Proxyholder (proxy): SH appointed agent who attends meeting and votes on SH’s behalf
* De facto control can be with much smaller percent; de jure control is 51% or more
* Levin v. MGM
  + Given virtues of informed voting, corporations can be charged for costs of informing
    - In uncontested year, corp must spend money for quorum (soliciting proxies), so controversial year shouldn’t change that
  + Proxy fight reimbursement
    - Corporation may not reimburse unless dispute concerns policy
    - May reimburse only reasonable or proper expenses
    - Firm may reimburse incumbents whether they win or lose
    - Firm may reimburse new Bd only if they win, and only if SH ratify
* 14a-(8)(i)(8), “the town meeting rule”: regulates SH proposals
  + Provides that corp may exclude SH proposal if proposal relates to election for membership on BoD
  + 5% rule
    - Issuer of securities may omit a proposal and any statement in support thereof from its proxy statement and form of proxy if the proposal relates to operations which account for less than 5% of the issuer’s total assets at the end of its most recent fiscal year, and for less than 5% of its net earnings and gross sales for its most recent fiscal year, and is not otherwise significantly related to the issuer’s business