

### Introduction

**Definition** a distinct legal entity that can conduct business in its own right by buying, selling, and holding property or by suing or being sued, and by lasting forever

**Why form a corporation** Limited liability and promoting investment

**Corporate Law** set of state laws governing structure of corporations and the rights and responsibilities of participants in corporations

### People Involved in Corporation

**Shareholders** Investors, ultimate owners of a residuary interest in a corporation

**Directors/ Board** Elected by shareholders, responsible for major corporate decisions, appoint officers

**Officers** Run the corporation on a daily basis

### Pre-Incorporation Transactions

**Promoters** Try to find investors, enter into contracts on behalf of corporation, fiduciary of corporation

**Liability** Corporation not liable but promoters personally liable

**Novation** Special agreement that alters the default rule; it shifts liability from the promoter to the corporation; An agreement between the promoter, the corporation, and the third party

### Incorporation

**Incorporators** must sign and file the articles of incorporation, pay fee; not liable for contracts formed by promoters

### Incorporation (cont)

**Articles of Incorporation** Must include name, agent, incorporator, duration, purpose, and authorized shares

**Ultra vires** Acts beyond the powers of the corporation; corporation acts outside of its stated purpose, the acts will be held unenforceable. Shareholders can sue to enjoin; corporations can take action against directors or officers; states can initiate proceedings to enjoin such actions

### Timing of Incorporation

**Moment of incorporation** Liability begins

Corporation existence begins when the Secretary of State accepts the fee and files the articles

### Bylaws

**File?** No obligation to file

**Why not in articles** easier to amend; Board can change (on shareholders can amend articles)

**article conflict** articles of incorporation always win

**de jure corporation** When all of the statutory requirements for incorporation have been satisfied

### De Facto Corporation

**Issue** What if the corporation is not properly formed, but nevertheless enters into obligations after it was supposedly formed

### De Facto Corporation (cont)

**Rule** Corporation will still be treated as a corporation, with limited liability, if the organizers made a good faith effort to comply with the incorporation process and have no actual knowledge of defect in corporate status

### Investing in the Corporation

**Stock** ownership is represented in shares of stock

**Creditors** hold debt of corporation; entitled ONLY to repayment of their loan plus interest

**Stockholders** Equity holders; entitled to ALL the value that remains in a corporation after the debts have been paid

**Preferred Stock** Preference over common stock with respect to dividends and liquidation

**Classes of stock** Can have as many as they choose with different voting and economic rights- most corporations have one stock

**Participating Preferred Shares** Collect as preferred share and then again with common shares

**Cumulative Preferred Shares** Accumulates if no dividend paid the year before

### Issuance of Stock

**Authorized shares** Maximum number of shares that the directors of a corporation can sell; set in articles of incorporation



### Issuance of Stock (cont)

Issue shares	Number of shares from the authorized pool that the directors have actually sold
Outstanding Shares	Shares that were once issued to shareholders and still remain in the possession of the shareholders
Treasury shares	Stock previously issued to shareholders, but then reacquired by the corporation
Par Value Stock	A corporation may, but is not required to, issue stock at a par value. Typically not required
Valuation of Consideration	Corporation can receive any valid consideration that the board of directors deems adequate
Watered Stock	The corporation sets a par value amount and sells the stock for less than the stated amount; shareholders who bought below par are liable to the creditors
Stock Subscriptions	Ask people to agree in advance to buy stock before the corporation is formed; agreements are irrevocable for up to 6 months before incorporation
Preemptive Rights	Right to acquire stock to maintain the percentage of ownership any time new shares are issued; Default: do NOT have preemptive rights

### Distribution

Two ways	Board can declare a dividend or buy back shares of corporation
Authority and Liability	Board has power to authorize dividends, shareholders have NO rights to dividends, directors who vote to authorize unlawful dividends are personally liable to the corporation
Unlawful dividends	corporation is insolvent or issuing dividend would make corporation insolvent

### Potential Illegality with Sale of Securities

Closely Held Corporations-Private Restriction on the Sale	prevents outsiders from becoming involved, initial shareholders retain control
Restriction must be	conspicuously noted, enforceable (must have knowledge of it)
Types of Restrictions	Outright prohibition on transfer, require company consent, company has option to buy company has right of first refusal
Challenge to Restrictions	Usually made on the basis of restraint on alienation, test is one of reasonability
Who is bound	Anyone who agrees: Almost any shareholder in a closely held corporation agrees to these restrictions.

### Federal Causes of Action

Rule 10b-5	Fraudulent purchase or sale of stock or other securities
For private person to pursue 10b-5	Plaintiff has to have purchased or sold the security, transaction involves interstate commerce, defendant engaged in fraudulent or deceptive conduct, conduct related to material information, defendant acted with scienter (intentionally or recklessly)
Section 16(B)-Insider Trading	A corporate insider can be forced to return short-swing profits to the corporation;
Applicable Company	Corporations with securities traded on national securities exchange or corporation with assets of more than \$10 million and more than 500 shareholders
Corporate Insiders	Directors, officers, or shareholders who hold more than 10% of any class of stock
Transactions	made before someone becomes a corporate insider are generally not subject to short-swing issues; transactions made after a corporate insider leaves office may be
Short-swing profits	six months after corporate insider transactions



### Federal Causes of Action (cont)

**Reporting** Corporate insiders must report changes in stock ownership to the SEC

### Veil Piercing

**Rule** Shareholders are NOT personally liable for the debts of a corporation, but only liable for the amount invested into the corporation, except a court may "pierce the veil" of limited liability to avoid fraud or unfairness

**Three factors** Alter ego, under capitalization, fraud

**Alter ego** The investor or shareholder has failed to observe any corporate formalities between the person and the corporation—treated the company just like itself

**Under capitalization** Failure to maintain funds sufficient to cover foreseeable liabilities

**Fraud** The parties engaged in fraud or fraud-like behavior.

**When is piercing more likely** torts > contracts; small closely held corporations

### Shareholder Meetings

**Most important duty** elect board of directors, Vote on major decisions that affect fundamental changes in the corporation

**Annual meeting** Mandatory- elect directors and conduct other shareholder business

### Shareholder Meetings (cont)

**Special Meeting** Vote upon fundamental change

**Notice** No fewer than 10 days but no more than 60 days before the meeting. Must include time, date, location, and purpose for special meeting. Notice can be waived by attending meeting

**Record Date** Used to determine which shareholders are eligible to vote; no more than 70 days before the meeting.

**Meeting alternatives** Proxy- Authorizes others to vote shares in accordance with the wishes of the shareholder

**Proxy requirements** be in writing, signed by the shareholder as of record date, be sent to secretary of corporation, state that it authorizes another to vote shareholder's shares and cannot be valid for more than 11 months unless specified

### Voting

**Shareholders typically vote on** election of directors, mergers, share exchanges, amendments to the articles of incorporation, sales of all or substantially all of its assets, or dissolution

**Quorums** majority of the corporation's outstanding shares represented at the start of the meeting

### Voting (cont)

**Necessary Vote** If quorum is present, shareholder vote is effective if the vote cast in favor of the proposal exceed the votes cast against the proposal

**Cumulative Voting** Applies only to the election of directors, votes equal the number of shares multiplied by the number of director positions being voted on

**Shareholder inspection rights** A shareholder may inspect the corporation's records in person or through an agent as long as the shareholder states a proper purpose

### Shareholder Litigation

**Direct Lawsuit** Shareholder is suing in the shareholder's own name for damages and the damages go directly to the shareholder. Interference in voting rights or dividends, misinformation about important issues, and tort injury.

**Derivative Lawsuit** Shareholder is suing on behalf of the corporation- claim made in corporations name and recovery belongs to corporation

**Derivative Lawsuit Elements** standing (stock ownership), demand requirement (unless futile), recovery (if substantial benefit, corporation pays attorneys fees)



### Shareholder's Duties to Other Shareholders

generally Shareholders do NOT owe a duty to fellow shareholders in the corporation

Controlling shareh-olders sale of stock to an outsider/ looter; Controlling Shareholder Transacts with the Corporation  
duty to minority

Who is a contro-lling shareh-older case—those who own 50% plus one, or more OR Less than 50% plus one—look to the nature of the ownership of the c

### Board of Directors

Generally The board of directors manages and directs the management of a corporation's business and affairs; usually receive compensation

Number and Qualifica-tions at least one director, must be a natural person

Term and Selection Elected by shareholders for limited term (usually one year)

Removal and Replac-ement Shareholders may remove directors with or without cause unless Staggered Board

### Board of Directors (cont)

Staggered Board Classes of directors are elected at different times— e.g., nine directors: Three elected in year one, three elected in year two, and three elected in year three. May only be removed for cause, only if the articles provide

Vacancy or size of the board has increased chosen by shareholders at special meeting OR by the board

### Board Meetings

Boards relatively small and meet regularly

Notice only required for special meetings. Attendance waives notice unless director promptly objects at the meeting.

Voting CANNOT vote by proxy. Need quorum, affirmative vote of those present OR unanimous written consent

Dissent If disagrees with board decision: enter dissent in meeting minutes, file written dissent before meeting is adjourned, provide written dissent by certified or registered mail to the corporation's secretary immediately following adjournment of meeting

### Officers

Officers Selected by the board, run corporation on daily basis

Duties duty of loyalty and care

### Officers (cont)

Duty of Care Business Judgment Rule, reasonable standard of care, reliance defense

Business Judgment Rule in the absence of fraud, illegality, or self-dealing, courts will not disturb a good-faith business decision

Standard of Care Act with the care that a person in a like position would reasonably believe appropriate under similar circumstances

Reliance Defense A director or officer is entitled to rely on the expertise of officers and other employees, outside experts, and committees of the board

Duty of Loyalty May not receive an unfair benefit to the detriment of the corporation without effective disclosure or ratification

Self-D-ealing Transactions A transaction in which the director, officer, or their relative receives a substantial benefit directly from the corporation

Corporate Opport-unity Doctrine Usurping or stealing a corporate opportunity



### Officers (cont)

**Insulation from Liability/Ratification** A self-interested transaction may be upheld if it is disclosed and ratified by majority of disinterested directors or a majority of disinterested shareholders

**Fairness** If a director or officer can demonstrate that the transaction was fair, then they will win.

### Indemnification

**Indemnification** The practice of corporations paying for the costs of a director's or officer's defense in litigation, usually by purchasing insurance

**Required/Mandatory** The corporation is ALWAYS required to pay the costs of defense if the director or officer successfully defends the case

**Prohibited** The corporation CANNOT indemnify a director or officer who is liable for receiving an improper benefit from the corporation or otherwise loses a lawsuit

**Permissive** The corporation may, but is NOT required, to indemnify a director or officer for the costs of a suit if the director or officer acted in good faith or had no reasonable cause to believe the conduct was illegal

### Fundamental Changes to a Corporation

**Required approval** BOTH the shareholders and directors must approve fundamental changes.

**Merger** The combination of two or more corporations where one corporation survives and assumes the assets and the liabilities of the other corporation

**Consolidation** The combination in which neither of the two corporations survives. New entity is created- assumes the assets and liabilities of both corporations

**Dissolution** The existence of a corporation is extinguished either voluntarily by the shareholders and the directors or involuntarily by disgruntled parties.

**Involuntary Dissolution** A corporation may be dissolved involuntarily by creditors if the creditors show the corporation is not paying its debts.

**Shareholder dissolution** corporate assets are being wasted, directors are acting fraudulently, or directors and shareholders are deadlocked

**Process of Changing** The board must adopt a resolution proposing the change; notice sent to shareholders of special meeting; majority of shareholders casting a vote must vote in favor of the fundamental change

### Dissenters' Rights (in merger)

**Generally** Entitled to have their shares purchased from them by the corporation at a fair market value determined by the court

**Procedural Requirements** Send written notice of intent to dissent, abstain/dissent at meeting, make prompt written demand for fair market value

**Fair Market Value Determination** Court can appoint expert appraiser to issue binding appraisal

### Close Corporation

**Closely Held** Corporation with a few shareholders

**Characteristics** Shareholders are often also directors and officers, Typically NOT publicly traded, Relaxation of rigid rules for corporations

**Voting Agreements** CAN form voting agreements (unlike corporation)

**Preemptive Rights** The default rule prohibiting preemptive rights may be relaxed

### S Corporation

**S Corp** a corporation for state corporate law purposes, but it gets special treatment for tax purposes

**Taxation** only taxed once, like a partnership; not taxed at entity level; allows "pass through" taxation

**Limitation** Limited in the number of shareholders it may have



### Limited Liability Corporation

Generally	LLC combines the limited liability of corporations with the tax treatment of a partnership; no limitation on number of shareholders; no residency requirement; no natural persons requirement
Key Characteristics	LLC files articles of organization and an operating agreement with the state; owners are called members not shareholders; LLC is presumed to be managed by ALL of its members
Comparison to Corporations	difference in terminology and taxing features, but otherwise, analyze LLCs under general corporate law principles



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