Business Enterprises Outline

I) Business Judgment Rule
  1) Definition: Where a director is independent and disinterested, there can be no liability for corporate loss, unless the actions are such that no rational person could have done it (Waste).
     a) *Gagliardi v. TriFoods*: Gagliardi claims that management was breaching there duty and committing waste when they brought an extra factory, hired a consultant, and hurt the quality of the product. Plaintiff lost because the court is not going to step in to second guess the board.
     b) No liability for stupidity.
     c) The presumption is that the board of directors are acting well informed with good faith and loyalty the best interest of the company.
        (i) Shareholders have the burden of proof.
        (ii) Strength of presumption will vary depending upon breach alleged.
  2) *Shlensky v. Wrigley*: Wrigley refused to install lights in field, alleged that it was to protect the neighborhood. Believed that baseball needs to be played during the day. Wrigley won, but would likely not fly in Delaware. However, there is a very high burden to prove waste. Essentially, has to be totally implausible.
     a) Either have to claim a breach of fiduciary duty, which would be hard to prove. That only leaves, waste with its high burden.

II) Self-Dealing
  1) *HMG v. Gray*, HMG and Fieber were negotiating a joint venture, Gray was the negotiator and was on HMG's board. He became a silent partner with Fieber's venture and did not disclose.
     a) Self-dealing occurred because the information was material and Gray was on both sides and received substantial financial benefit which he did not disclose.
     b) Safe harbor provision of Section 144 says that if a director discloses his financial interest and it is ratified by a majority of disinterested board members, then the self-dealing was okay.
     c) Gray's Defense:
        (i) Not yet an investor; but he knew that there was a significant chance beyond de minimus possibility.
        (ii) It was an immaterial amount; if that is so, why did he not disclose it.
  2) Self-dealing by its nature overcomes the BJP, unless it is ratified.
  3) There must be a transaction involved.
  4) *EBay v. Newmark* (Craigslist), Craigslist modified their procedure to stagger the board so that eBay would not be able to unilaterally appoint a board member and created a right of first refusal in which they granted the rights they had back to the company, which effectively granted the right back to themselves.
     a) The staggered board was not self-dealing because they were not on both sides of the transaction.
     b) However, as they were assigning rights back to themselves this was a self-dealing transaction.
  5) Entire fairness test:

a) Fair dealing-embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to directors, and how approval was obtained.
b) Fair Price- relates to the economic and financial considerations of the proposed transaction: assets, market value, earnings, future prospects, and other elements effecting value of company's stock.
  (i) Compare market value
  (ii) But-for causation; but for breach, what would company have received.
  (iii) Could they have possibly gotten a better deal?
c) Fair dealing not really going to win, not clear what it means. Everything turns on price.

III) Self-Interested
1) Self-dealing requires that the parties need to be on both sides.
2) Self-dealing is a per se rebuttal of BJR; whereas, self-interest requires the interest to be material to overcome the BJP.
  a) SI alone is not disqualifying factor, must be evidence of disloyalty.
  b) Director is independent only when his decision is based entirely upon the corporate merits of the transaction and is not influenced by personal or extraneous considerations. By contrast, a director who receives a substantial benefit from a transaction, cannot be objectively viewed as disinterested or independent.
  c) Example:
    (i) Personal benefit not received by SH's generally.
    (ii) Self-dealing.
3) *Cede v. Technicolor*, a director was hoping to keep his job by having his nemesis fired and another director was going to receive a $150,000 fee for a closed deal. Ryan abstained from the vote.
  a) Materiality: the interest must be such that it is sufficient to create a reasonable probability that the independence of judgement of a reasonable person in the director's position would be affected.
  b) Self-interest must be of the board collectively, not of a single director. It can be sufficient if it can be shown that the director has influenced the actions of the board.
4) *In Re: TCI*, TCI was seeking to merge with AT&T and the class B stock demanded a 10% premium over the A Class.
  a) Shareholders overcame the BJP, because there was a clear and significant benefit accrued primarily by the directors at the expense of another class of shareholders.
5) *Ryan v. Lyondell*, merger in which SH's got $48 per share and the directors got the same amount but accelerated vesting shares, which they were entitled to in their compensation plans. Not self-interested because the vesting was not a special benefit.
  a) A narrative of self-interested is not enough, there must be evidence disloyalty.

IV) Entrenchment
1) A way for directors to breach their duty of loyalty, might take actions to protect their jobs
  a) Making it hard for shareholders to remove them.
  b) Avoid transactions in which their jobs might be threatened.
2) Reason's for keeping:
  a) Directors are experts; that is why they have control.
  b) Shareholders have some ability to remove incompetent directors.

3) *Benihana of Tokyo v. Benihana*, Benihana was seeking financing and they agreed to sell convertible preferred stock while the stepmother had controlling stake. By issuing the stock, all stock was lumped into a common pool, diluting stepmother's shares to less than 30%.
   a) There must be more than the mere possibility that they were entrenching. Entrenchment must be the sole or primary purpose behind the transaction.
   b) It is harder to prove an entrenchment claim than a self-interest claim, which is harder than a self-dealing claim.
   c) Corporate fiduciaries must not use the corporate machine to keep them within their jobs.
4) *Gantler v. Stephens*, directors refused to sell the company and were not providing due diligence materials to potential buyers. None of the potential buyers wanted to keep the current directors. Other directors had other businesses which benefited from the association with the bank.
   a) In order to rebut the BJR, the plaintiffs must supply fact showing that the motive of the action was entrenchment and state other facts sufficient to state a reasonable claim that the directors acted disloyally.
      (i) This could not have been stupidity.
      (ii) Stephens brought the board down because of his disloyal act because he provided the information and dominated the negotiation process.

V) Duty of Care/Oversight Liability
1) Corresponds to the duty to be informed. Roughly equal to gross negligence. Not the magnitude of the negligence but the motivation.
   a) Objective good faith (similar to duty of care)
      (i) Harder to breach and overcome BJR.
      (ii) Often lumped in with oversight.
2) Objective bad faith (*Caremark*):
   a) Where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties.
   b) A sustained or systematic failure of the board to exercise oversight such as an utter failure to attempt to assure a reasonable information and reporting system exists.
3) *Stone v. Ritter*, shareholders brought suit against director after the bank failed to detect and report the use of the bank to carry out an illegal Ponzi scheme and bank employees did not file the Suspicious Activity Reports.
   a) Court had a reasonable system of professional reporters.
   b) No lack of good faith, as there was not enough red flags and the board cannot be held responsible when other employees did not do their jobs.
   c) System was up to statutory standards.
4) *In re: Puda Coal*, The directors did not know if the company owned any assets and resigned when the issue came up. The directors did not care enough to make any effort to learn the basic information of the corporation (objective bad faith). Absentee board.
5) *In re: Massey Energy*, Massey had a history of receiving penalties and judgments against it for safety violations when an explosion occurred. He had made general statements about his antagonism towards government regulations and that he knew better about mine safety

a) A fiduciary cannot be loyal to a corporation by knowingly causing it to seek profit violating a law.
b) Blankenship was an unreliable, political, libertarian, zealot. His battle with regulators was his identity.
c) There is a presence of qualitative factors.
d) Plaintiffs won on oversight but lost to enjoin the merger because the claims survive the merger.

6) Summary
   a) Quantitative inadequacy (*Stone*) is insufficient to overcome BJR.
   b) SH must allege unreasonableness in kind, not just degree.
   c) Duty of good faith is equal to restoration of the original subjective component of the duty of care, freed from its negligence underpinnings.
7) *South v. Hecla Mining Co.*, an argument that the board "did not get the balance right" is not a winning argument.

VI) Corp. Opp.
   1) Actions by directors that don't specifically hurt the corporation directly, but does hurt indirectly by not allowing the corporation to exploit an opportunity.
   2) Types:
      a) Line of business opportunity or expectancy:
         (i) If it easy to substitute on the production side, the easier it is to argue it is the line of business.
         (ii) How easy or natural would it be for the corp. to take advantage of the opportunity?
         (iii) Marketing issue might have an effect.
      b) Opportunity director learned about from service.
         (i) Information not obtained independently but comes to him through the performance of his functions.
   3) Restatement
      a) Don't take it; or
      b) Disclose it
   4) Delaware Law
      a) Needs to be an actual conflict
      b) No requirement to disclose
         (i) Non-disclosure comes at your peril, because you would have to prove the corporation wouldn't have taken it.
   5) Remedy is disgorgement; director would have to return all of the profits and any benefit received. Remedy is harsh to discourage activity and because of the untruthfulness involved.
   6) Three things that can overcome opportunity:
      a) Have to disclose the opportunity to board.
      b) Disinterested directors/SH have to waive opportunity
      c) Directors would have to prove entire fairness.
   7) *AngioScore v. TriReme*, Konstantino was replaced as CEO but was still on the board. He obtained permission to make one device, but made a competing device. He continued to serve on the board during development and he never took the product. He also claimed he did not need to take it to the board because it was his intellectual property.

        a) A director takes a corporate opportunity when (1) the opportunity is within the corporation's line of business; (2) the corporation has an interest or expectancy (there must be some tie between the property and the nature of the business) in the opportunity; (3) the corporation is financially able to exploit the opportunity; and (4) by taking the opportunity, the director has placed his fiduciary duties below his own gain.
        b) AngiScore did not have an automatic claim, but had a duty to offer to AngioScore first.
        c) Could have cured the breach by offering the device to the board at any time.
    8) *EBay*, using a corporate opportunity to push a kickback like issue by giving Goldman Sachs business.
        a) Commandeered corporate profits and/or selling the office.

VII) Special Litigation Committees
    1) Reason: The board gets to decide whether the suit is in best interest of the company. Allows the board gain independence so that they can control the suit.
        a) SHs have to either go and make a demand or argue futility to the court.
        b) The standard for the board during demand is BJR.
    2) *Zapata v. Maldonado*, Maldonado initiated a derivative suit without demand claiming futility. Zapata brought in two new directors for an SLC, who dismissed the suit.
        a) Test
            (i) SLC has the burden of establishing good faith and independence when they choose to dismiss the suit. If not, then the motion is denied.
                (A) Showing domination and control.
            (ii) If yes, then the court applies its own business judgment.
                (A) Step two almost never done.
    3) *In re: Oracle*, created an SLC with two Stanford professors, in which several members had deep connections.
        a) Director must show that there is not substantial reason for which he is incapable of making a decision with only the best interests of the corporation in mind.
            (i) SLC could not establish independence.
            (ii) Not just looking for financial dependency, look at the whole context.
            (iii) Information was not disclosed.

VIII) Books and Records
    1) Two types of books and records
        a) Other books and records (220b); SH has burden.
        b) Stock ledger (220c); burden is on the board.
    2) Must show that you want them for a proper purpose
        a) A purpose reasonably related to such person's interest as a stockholder.
    3) Investigating fraud and mismanagement is the most common claim.
    4) Sufficiently detailed testimony, even if not available for cross examination should be given substantial, even if it can't be proved.
    5) *Seinfield v. Verizon*, SH wanted to show there was waste and mismanagement for executive compensation based off of his own BS analysis.
        a) A SH needs to show, by a preponderance of the evidence, a credible basis from which the court can infer there is possible mismanagement, waste, or wrongdoing. Mere

suspicion or curiosity is not sufficient as it would result in an indiscriminate fishing expedition.
(i) Claim has to be plausible or colorable
(ii) Testimony, insider or expert; inconsistent reports; SEC and misconduct.

6) *South v Hecla*, SH brought a derivative suit for Caremark oversight claim without doing a books and records.
   a) There is presumption that a plaintiff who hastily files a Caremark claim without doing a books and records claim is acting disloyally to the corporation. He is instead serving the interest of the law firm.
   b) The claim will be dismissed with prejudice only to those particular plaintiffs. Not a universal rule, CA dismisses with prejudice to all plaintiffs.
7) ***LAMPERS v. Lennar***, LAMPERS sought to compel disclosure based off of past lawsuit and news articles related to Dept. of Labor conducting nationwide investigation into labor practices.
   a) Might be some social or political interest behind this request, political harassment is not what this is designed for.
   b) Two types of uncertainty (Credible basis insufficiency)
      (i) Guilt (only being investigated)
      (ii) Identity (industry wide, not necessarily Lennar). This is the big one.
   c) Do not have something being pointed directly at this company, might not be able to survive.
8) *FAST v. Wal-Mart*, a union wanted Wal-Mart to provide a list of its SHs so they could do a proxy solicitation to avoid products made with forced labor.
   a) Soliciting proxies was a legitimate purpose and FAST agreed to limitation.
   b) Ensuring compliance with legal obligations is also consistent with the long term interests of the corporation.
   c) Wall-Mart failed to overcome 220(c) presumption.

IX) Bylaws
1) *CA v. AFSCME*
   a) Bylaws govern process not substance.
      (i) A subject proper for action by shareholders and cannot violate the law.
   b) In a dispute between a SH bylaw and a director bylaw, SH wins because they have a statutory bylaw right; board's right is in certificate.
2) Board bylaws are cheaper because board only needs to get together and vote.
   a) A problem can occur because they can forum shop in the bylaws.
3) *Boilermakers v. Chevron*, boards amended the bylaws to require derivative suits to be brought in DE courts.
   a) Under the law, boards have the ability to amend the bylaws related to the business of the corporation, the conduct of its affairs, and the rights or powers of stockholders, directors, officers, or employees. When the stockholders bought stock, they were on notice that the board could unilaterally amend the bylaws.
4) *Providence v. First Citizens*, Two holding companies were merging and set N.C. courts as the forum. During the merger, the target company became minority shareholders, meaning it would be more difficult with
   a) Case of hometowning.

b) The bylaws validity does not necessarily depend on whether it can actually be repealed, as long as it is a proper subject and doesn't violate the law.

X) Shareholder Democracy

1) *Portnoy v. Cryo-Cell*, corporation is struggling and SHs made complaints, which the board ignored. SHs then ran a proxy contests. Improper agreement to buy Filipowski votes in return for appointing to board and a second seat after the contest, to allow self-dealing.
    a) Should the election be set aside because of the board's improper motivation?
        (i) RULE: Vote buying is okay in some situations. However, you cannot use company money to advance your own selfish interests, only personal money, and there cannot be inequitable motives or discreet agreements.
            (A) Watson extension was improper because she failed to state the real reasons for doing, makes it seem more improper.
            (B) After elections, appointing Filipowski's lackey was improper, because it essentially gave F two seats, which the SHs did not vote for.
            (C) Dividends have to be distributed equally.
        (ii) Providing boards seats before a proxy contests could be for proper purpose; but afterwards it is more likely disloyal and hurts investments if you can just add seats after contests.
2) *Kurz v. Holbrook*, vote buying with your own money is fine. Risk of buying votes is less than buying stock.

XI) LLC's and LP's

1) *Elf Atochem v. Jaffari*, after forming a joint venture, the agreement was finalized several days after LLC was formed and arbitration was in CA. Elf tried to sue in Delaware.
    a) All of the agreements related to the LLC are part of the operating agreement, i.e., distributing agreement, operating agreement.
    b) Maximum flexibility to enter into an agreement and the law favors the freedom to contract.
2) *McConnell v. Hunt*, McConnell and Hunt created an LLC to purchase a hockey franchise. After the agreement fell through, McConnell formed a competing LLC, Hunt claimed that he breached the contract and fiduciary duties, even though the agreement said that members were allowed to form any other business venture of any nature, including any venture which might be competitive.
    a) If contract is clear and unambiguous, it will be given its plain meaning and there is no genuine issue of material fact.
    b) In an LLC, can waive some fiduciary duties, including corporate opportunity.
3) *VGS v. Castiel*, Castiel took on two minority interest holders for the board. He retained control of the members. Actions by the LLC needed to be done by a majority of the board, not the majority of shares. The other two merged the LLC with VGS, taking majority control from Castiel.
    a) To operate covertly and not giving notice is a breach of good faith. Fiduciary duties can be waived but the implied covenant of good faith cannot be waived.
    b) Applied equity in this case, which is why it came out differently.
4) *In re: Carlisle*, Two companies formed an LLC after designing an operating agreement which they intended to elaborate later. WU assigned its interest to WU Sub. When the relationship soured, WU sought to dissolve the LLC, but under Delaware law, a member

assigning an interest ceases to be a member but the assignee does not become a member without the permitted admission of the other members.

   a) An assignee cannot become a member without (a) being provided for in the agreement, or (b) without the affirmative consent of the members, which can be implicit through action.
      (i) Membership is freely assignable and the economic benefits transfer, but this does not entitle an assignee to be a member.
   b) An equitable court can dissolve an LLC:
      (i) Oppression when a passive investor is under the domination and control of another.
      (ii) Deadlock
         (A) Chancery court is willing to protect members from their own mistakes. Equity looks to substance not form.

5) *Allen v. Encore Energy*
   a) Can waive the "reasonableness" for good faith. At which point the question then becomes whether the defendant subjectively believed they were acting against the LP's best interest. LP did define "good faith" as a belief that the determination or other actions is in the best interests of the Partnership.
      (i) Objective standards of reasonableness can be evidence relevant to defendant's creditability.
      (ii) Three options for the trial court.
         (A) You believed it was in the best interest.
         (B) You did not believe it was in the best interest.
         (C) You did not care (objective bad faith).

XII) Dominating and Controlling Shareholders

1) *Sinclair Oil v. Levien*, Sinclair created a subsidiary in Venezuela, which it owned 97% of, and Levien was a minority shareholder, who claimed that the subsidiary breached its fiduciary duties because it paid out excessive dividends to both the parent and minority SHs.
   a) In order for a parent to breach a fiduciary duty, it must have received something from the subsidiary to the exclusion of and detriment to the minority SHs.
2) Selfish-ownership
   a) A controlling SH is permitted to exercise selfish ownership to encourage the SH to pay more for the control premium.
   b) Obtaining a deal on purchasing products from controlling SH would be too selfish because it is a special benefit not conferred upon others.
3) *Williamson v. Cox Comm., Inc.*, AT&T, Comcast, and Cox were a controlling bloc (Comcast and Cox were constantly acting in concert) with 63% of the voting power (through Series B Stock). They changed the Articles to allow AT&T to appoint 5 directors, with Cox and Comcast able to appoint a director each.
   a) Control test:
      (i) Owning more than 50% of the voting power.
      (ii) If the SH exercises control over the business and affairs of the corporation.
         (A) A plaintiff can survive if they can allege actual control with regard to a specific transaction.

4) *In re: Primedia*, KKR owned the company through a number of subsidiaries and was listed to have control. They bought several series of stock at a discount rate and forced the company to redeem it at more than the liquidation preference earlier then they needed to be.
    a) As all SH did not benefit from the action, it was a breach of a fiduciary duty.
    b) KKR sold off all of the assets to redeem the preferred shares which deprived the company of the ability to improve its fortunes.
    c) If they had replaced the preferred stock with some other financing then they may not have been liable because they would have left the company in a position to improve its fortunes.

XIII) Preferred Stock
1) *In re: Trados*, common SHs because the preferred stock board directors wanted a merger bonus.
    a) Where the rights are shared equally between preferred stock and common stock, than there is an equal fiduciary duty by the board.
        (i) Preferred SHs are protected by contract. Common SHs are protected by fiduciary duties.
    b) Where the rights are in conflict between the preferred stock and common stock, than the board owes a greater duty to the common stock.
        (i) Not likely to make a bright line rule, but the self-interest might help overcome the BJR.
2) *LC Capital Master Fund v. James*, preferred SHs claimed that they did not get enough money when the company was acquired. Directors owned common stock.
    a) We want the board members to be aligned with the common stock, because it benefits the company more to do so.

XIV) Close Corporations
1) Close corporation is shorthand for a closely held corporation meaning that the corporation has a small number of SHs.
2) Lemon problem
    a) Arises from asymmetries between buyer and seller.
        (i) Seller knows of problems that buyer doesn't.
    b) Hard to sell because people assume it's a lemon and if you attempt to discount, then you reinforce the ideal.
    c) Systems in place to remove the asymmetries, increase the value.
    d) Corp law general solves this problem by posing fiduciary duties on the shareholders of close corporations to other shareholders.
        (i) Do not freeze-in-equity is tied up, earning return, cannot be redeemed, and cannot be sold. (oppression)
3) *Wilkes v. Springfield Nursing Home*, Wilkes co-founded with three others, all took the same salary and fees, with no dividends. After a falling out, he was fired, kept his equity but was unable to get value for it.
    a) Duty of good faith was breached unless the other shareholders had a **legitimate business purpose** in firing him and there was **no less harmful option**.
    b) It is flawed because it is unpredictable and doesn't really address the main issue, which is the freeze-in.

4) *Brodie v. Jordan*, alternate approach, Mrs. Brodie did not work there, inherited shares, and she received fees until the others fired.
    a) Court order constructive dividends, money paid out like dividends, but paid out another way, and pro rata.
        (i) Lot of ways of pulling money out of a company close to dividends.
        (ii) Would have been paid out as a dividend if it had not been disguised.
    b) If SHs are structuring profit distribution in such a way as to avoiding providing the equity to the froze-in SHs, who has an expectation of pro rata treatment. Strongest case when other SHs are getting a benefit roughly equal to their equity interest (Ex. 60%, 20%, and 20%, and one SH receives a salary approximately 3x as high).
    c) Remedy is once the court determines what constitutes the dividend-like profits, pool them together and then distribute the money pro rata.
5) *In re: Kemp & Bentley*, six SHs who were also employees, profits had always been divided at the end of the year, proportionate to stock ownership, like dividends. Fires 2 SHs, changes to a productivity, like merit based system.
    a) Possible remedy is a court ordered buyout:
        (i) Hardest to implement, court has to make a valuation
    b) Court weed out
        (i) Court orders dissolution, put assets up for sale, and let the highest bidder win.
        (ii) Third party unlikely to bid. Thus, business stays intact and goes to who wants it more.
    c) Dissolution/Buyout hybrid
        (i) Dissolution must be conditioned on permitting any SH to purchase the complaining SH stock at fair value.
        (ii) Court orders dissolution and SH gives a "fair offer" complaining SH refuses requiring court to make a determination of fair value.
6) *Haley v. Talcott* (dissolution for deadlock), LLC specified an exit mechanism (a buyout) that was not equitable to one party. Talcott was owner and Haley was an employee, but they had equal profits and authority. Talcott fired Haley. The agreement provided for voluntary departure of one party where one partner would buy the other out a certain price.
    a) Exit mechanism defeats reasonable expectations.
    b) Court ordered dissolution of the LLC and either party can bid, higher bidder wins.

XV) Agency
1) 3 ways agency relationships can be established
    a) Express authority-given permission by principal.
    b) Implicit authority-implied by conduct
    c) Apparent authority-not actual agency; agent purports to have authority to do something outside principal's permission. Allows principal to take action against agent for compensation.
2) Implied Agency
    a) How
        (i) History between agent and principal.
        (ii) Custom and community standard.
        (iii) Implied in agency relationship.
    b) How do we know there is apparent authority?

(i) Third party reasonable expectations.
(ii) Custom and community standards.

c) In "apparent authority," the principal is bound but the agent is liable to him.

3) Duties of an agent
   a) Fiduciary duty to act in the principal's best interest.
   b) Agent's opportunities belong to the principal when in service to the principal.
      (i) It does not matter whether you were acting within the scope of employment, but whether you were acting as an agent at that time.

XVI) Piercing the corporate veil
1) It is not a corporate law question as it does not address the relationship between the board and the shareholders.
2) Applies when a third party is suing a corporation.
3) Classic veil piercing:
   a) Shareholder has acted inequitably and may be required to satisfy the judgment against the corporation.
   b) Creditor goes through the corporation; must show that the corporate form has been disrespected by the shareholder.
4) *Sea-Land v. The Pepper Source*, where PS did not pay for transit of products and had been dissolved before a final judgment. SL went after the sole shareholder and his other companies. Evidence had shown that he had constantly moved funds around his companies and took money for his personal benefit, all his companies were run from the same office, and he never held meetings.
   a) In order to pierce the corporate veil:
      (i) There must be such unity of interest and ownership that the separate personalities of the corporations and the individual no longer exist. This includes:
         (A) The failure to maintain adequate corporate records or to comply with corporate formalities;
         (B) Commingling funds or assets;
         (C) Undercapitalization;
         (D) One corporation treating the assets of another as its own.
      (ii) But the circumstances must be such that adherence to the fiction of separate corporate existence would sanction fraud or promote injustice.
         (A) Promoting injustice means some wrong beyond a creditor's inability to collect.
5) *Fletcher v. Atex*, plaintiff brought suit against Kodak, Atex's parent.
   a) In order to succeed on an alter ego claim:
      (i) The parent and subsidiary must have operated as a single economic entity
         (A) The failure to maintain adequate corporate records or to comply with corporate formalities;
         (B) Commingling funds or assets;
         (C) Undercapitalization;
         (D) One corporation treating the assets of another as its own.
      (ii) And that an overall element of injustice or unfairness is present.
   b) In order to succeed on the agent claim, there must be evidence that the parent granted actual authority or apparent authority by words or other acts by the <u>principal</u> which reasonably give an appearance of authority to conduct the transaction.

6) Reverse veil piercing
    a) If a person has acted in a certain kind of inequitable way, the creditor may recover against the corporation.
    b) Entity shielding against shareholder debt; but they could take the shareholder equity as an asset to satisfy the judgment.
7) Bidirectional piercing
    a) Creditor seeks to collect from shareholders and all sister corporations.
8) Agency Liability
    a) Claim goes around the corporation on the theory that the corporation is not the primary actor; merely an instrumentality of the principal.
    b) Creditor need not pierce the veil. Shareholder may not have disrespected the corporate form.
9) Enterprise Liability
    a) Shareholder has not disrespected the corporate form, so the shareholder need not answer for the corporate debt.
    b) However, if subsidiary process has been abused, creditor may collect against sister corporations.
        (i) Example: incorporating individual taxi cabs to distribute insurance; can go after all of the cab "corporations."

XVII) Executive compensation and waste
1) Compensation is the job of the board. Usually handed by a compensation committee, who will meet with a compensation consultant. Committee should be made up of independent directors.
2) Clawback is any provision that allows a company to recoup what it paid.
3) Deferred compensation are things like retirement benefits, special pension plans.
4) Perks-"corporate heroin theory"-perks are so addictive, it will induce them to work harder.
5) *Lewis v. Vogelstein*, a board and shareholder ratified a board compensations package providing shares to board members. Plaintiff claimed it was wasteful.
    a) Waste is an exchange of corporate assets for consideration so disproportionately small that no reasonable person might be willing to trade.
    b) Shareholders can only approve a wasteful transaction by a unanimous vote.
    c) Reasonable standard applies because compensation is different. Not a rationality test.
6) *Sienfeld v. Slager*, where a CEO was given additional retirement benefits, including a $1.8 million cash payment and plaintiff claimed it was wasteful. The CEO signed a release of claims and an assurance that his retirement was on mutually acceptable terms.
    a) There is no duty to minimize tax payments
    b) Despite shareholder approval of the board compensation, the court is protecting the shareholders from themselves when there is no meaningful limit as to the compensation a board can approve.
    c) Do not want to give directors an incentive to do something manifestly unfair.

XVIII) Defensive Measures
1) When one company (the "Bidder") wants to acquire another (the "Target"), it can proceed in one of two ways:
    a) A "friendly" deal, in which Target's board negotiates and supports the deal

b) A “hostile” deal, which Target’s board opposes and which Bidder tries to ram down Target board’s throat.

2) Friendly and hostile are not moral terms. Friendly deals are not intrinsically better.
   a) Friendly Merger
      (i) To complete a merger, the bidder must sign a merger agreement with the target company’s board; then the agreement must be approved by the target’s shareholders; then a certificate of merger filed with the Sec. of State.
   b) Tender Offer
      (i) A tender offer is a public offer to buy a specified percentage of the shares of the target, or an “any and all” offer.
      (ii) Shareholder who want to sell to the bidder “tender” their shares into the offer. If the offer succeeds, Target becomes a subsidiary of bidder.
      (iii) The target board is not formally involved in the transaction, although it usually recommends a course of action to the shareholders. In a friendly transaction, the board recommends that shareholders tender into the offer
   c) Hostile Takeover
      (i) This hostile transaction looks exactly like a friendly tender offer. The difference is that here, the target board does not want the bidder’s tender offer to be successful. The target board recommends to shareholders that they reject the offer.
      (ii) Because the board’s approval is not required, the bidder can circumvent the board and take its case directly to the shareholders
3) In either case, Bidder must offer a merger premium. Size of premium varies greatly.
4) Defensive measures are policies adopted by the Target board to ward off hostile bids.
5) Few hostile deals finish hostile. Many become friendly, after the parties understand their bargaining positions
6) Reason to Oppose a Hostile Bid
   a) Good Reasons
      (i) Board believe the offer undervalues the firm.
      (ii) Trying to negotiate a higher price.
   b) Bad Reason
      (i) Entrenchment
7) Defensive measures
   a) A defensive measure prevents the bidder from having direct access to the shareholders. The tender offer will succeed only if the board approves of it.
   b) The defensive measure has to be “unlockable” at the board’s discretion. That way, the board can negotiate, blocking shareholder access until the bidder raises its price to an acceptable level. At that point, the board’s posture changes, and the hostile bid becomes a friendly transaction.
8) The Poison Pill
   a) Deployable at the board’s will; destroys any bidder’ cannot be defeated.
   b) How it works
      (i) Each stock contains an option.
      (ii) If someone exceeds x% of stock ownership.
      (iii) The option kicks in and allows the shareholders to buy y shares for the price of 1.
      (iv) Cannot apply to the person who trigger the pill.

        c) Dilutes the percentage of stock the bidder has and causes him to lose the control.
    9) The board can redeem the pill.
        a) A bidder can
            (i) Launch an offer upon a contingent that the pill is redeemed.
            (ii) Run a proxy contest to replace the board.
    10) If the board could block the shareholders from ever considering the bid, the pill might be invalidated under entrenchment.
    11) If the board is staggered, then the bidder must wait at least two election cycles before it can have control of the board.
        a) They often can't or don't want to wait that long.
        b) No hostile bid has ever succeeded against a combination of staggered board and poison pill.
        c) Poison pill can be written to grandfather certain people in/out.
    12) Enhanced Scrutiny
        a) Applies because of the omnipresent specter of entrenchment, which make BJR scrutiny inappropriate.
        b) Applies when an action of a board or executive "touches on corporate control."
            (i) Who has the authority to do the action?
                (A) Example: the board issues new stock.
        c) *Unocal* Review
            (i) <u>Reasonable grounds</u> for believing that a danger to corporate policy and effectiveness existed because of a person's stockholding.
                (A) Opportunity loss: the bid might have deprived shareholders of a better alternative offered by management.
                (B) Structural coercion: the bid is structured to disadvantage non-tending shareholders.
                (C) Substantive coercion: the risk that shareholders will mistakenly accept an underpriced offer.
            (ii) That the defensive measure was proportional to the threat posed.
                (A) Cannot be coercive or preclusive.
                    (i) Coercive means it forces the shareholders to accept alternate terms.
                    (ii) Preclusion:
                        1. Dead hand pill: only continuing directors can redeem pill. Newly elected directors cannot.
                        2. Slow had pill: only continuing directors can redeem the pill for a period of six months.
        d) Court says that the bidder's success must be realistically attainable, not just theoretically possible.
XIX) Mergers and Acquisitions
    1) Stalking horse problem, nobody wants to be the first bidder.
        a) Fiduciary duty of the director to take the highest bid.
    2) That is why we have deal protections measures.
        a) Termination fee: paying a percentage if the company chooses a different bid.
            (i) Creates an additional increment for other bidders.
            (ii) Subject to a reasonableness standard.

(iii) Acceptable because it incentives initial bids, even though it might discourage other bids.

b) Go-Shop: allows the company to go out and find other bidders after an initial agreement is made.
c) Matching rights
d) No-Shop: does not keep the board from considering unsolicited bids.
e) No-talk: presumptively invalid.

3) *Revlon* duties
   a) Board must act "reasonably" to obtain the best reasonable price.
   b) It is an objective standard, other duties look to motive.
   c) Classic breach is treating one party different from another.
   d) What to do to satisfy
      (i) Have to accept the highest bid.
      (ii) Don't exclude people from the auction.
      (iii) Don't exclude someone unreasonably (*In re: Novell*).
   e) Any time a bid is put into place regarding control, enhanced scrutiny rather than BJR.
   f) Apply in the "No Tomorrow" situation. Courts do not want to scare off strategic transactions.
      (i) So long as shareholders maintain equity interest, *Revlon* does not apply.
   g) *Revlon* duties apply to:
      (i) Cash consideration
      (ii) Going private transactions
      (iii) Being broken up.
      (iv) Bored seeking to sell itself.
   h) *Revlon* or enhanced scrutiny determined based off of the deal signed, not the deal offered.
   i) *In re: Novell*, where Novell had given more information to one party than others, accepted a lower offer, and allowed one party to work with other companies to finance the merger.
      (i) Directors have a duty to maximize the sale of price of the enterprise. A plaintiff can survive a motion to dismiss if he can allege facts which can lead to the reasonable conclusion that the directors favored one party over another. There is no duty to auction of assets.
   j) *In re: Lear*, seeking to sell itself to a shareholder, Icahn. Had a short go-shop but found no other buyers. Executives were going to keep their jobs and liquidate their retirement benefits, but did not mention it to the shareholders.
      (i) Something is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.
         (A) In order to determine if Revlon duties were breach, it must be determined if they acted reasonably in order to secure the highest price reasonably available.
      (ii) Exploding offer: accept by Sunday or I'm out.
      (iii) Go-shop satisfies the *Revlon* duties.
         (A) A cheaper transaction.
         (B) Sets a floor. Creates certainty but loses the opportunity for an upside.
      (iv) Termination fee is not usually reciprocal but a party can create a reverse termination fee.

k) *In re: Netsmart*, been look for a buyer for years, putting out feelers for a strategic buyer but never actively seeking one. Decided to sell to a private equity firm, board would have been retained and given stock options.
   (i) There was an inadequate, pre-sale auction and no Go-Shop provision.
   (ii) They were not interested in doing the sale in the proper way.

l) *In re: Smurfit*, There was a final deal for 50% cash and 50% stock. There was a "No-shop" clause, no pre-deal auction, no go-shop. They were able to talk the buyer up in price. NEW REVLON.
   (i) *Revlon* applies in a 50/50 cash/stock deal.
   (ii) Bankruptcy is like putting the market on notice.
   (iii) No evidence the directors were interested.*
   (iv) Courts using subjective intent to determine objective reasonableness.

m) Breaches
   (i) Favoritism
   (ii) Absent favoritism, intent is going to be a part of the analysis.
   (iii) If the board is unconflicted and does nothing crazy, then there is a presumption of validity.

n) *In re: Delphi*, Chairman and CEO wanted a merger premium for his Class B Shares, which violated the agreement when he went public and the board agreed to give in to him.
   (i) When a director waives his right to a control premium and holds the shareholders hostage as to a merger by not being willing to vote unless he is given that premium, it is reasonable to infer a breach.

o) *N.J. Carpenter's Pension Fund v. InfoGroup*, a director, who severally needed capital due to lost derivative suits, SEC fines, and starting a new business, harassed and threatened a board with law suits until they accepted a merger that was below the market price.
   (i) Liquidity is a special benefits conferred upon a director which can make him interested in a transaction. Through his behavior, he was exercising domination and control of the board actions.

4) *Blasius/Liquid Audio* Review
   a) The principle that the board of directors cannot act for the <u>primary purpose</u> of interfering with the effectiveness of a shareholder vote without a compelling justification.
   b) *Liquid Audio*, where a board attempted to increase the size of a staggered board after a proxy contest to keep a hostile buyer from controlling the board to redeem a pill
      (i) Dilutes the shareholders vote.
   c) *Mercier*, where a board rescheduled a vote to call out an "illusory bid."
      (i) Court it was the primary purpose of the board to interfere with the shareholder vote.
      (ii) Two alternate holdings
         (A) *Blasius* only applies to election votes, not to merger votes.
         (B) This was a compelling justification.

XX) Takeovers

1) *Airgas v. Air Products I*, AP attempted to take over Airgas, and after replacing three board members, attempted to move the annual meeting up to January from July.

a) When there is an ambiguous contract term as to the election and terms of board directors, a court can look to extrinsic evidence to determine the meaning.
b) It would fundamentally undermine the reason for a staggered board.

2) *Airgas v. Air Products II*, Air Products was making offers starting at $60 dollars. The Airgas board rejected the offer. The final offer was for $70, all cash and the board rejected it. Some of the shareholders and Air Products wanted to redeem the poison pill so that they could buy the shares and obtain control of the company. Despite placing members on the board, Airgas was still rejecting the offers and it would have been another year before they could have run a second proxy contest.
    a) In order to justify defensive measures, the target board must show
        (i) That it had reasonable grounds for believing a danger to corporate policy and effectiveness existed, and
        (ii) That any board action taken in response to that threat is reasonable in relation to the threat posed.
            (A) Actions which makes a corporation realistically unattainable is preclusive and unreasonable if it permanently does so.
            (B) Substantive coercion, the risk of shareholders mistakenly accepting an underpriced offer because they disbelieve management's value of the company is a reasonable threat to justify defensive measures.