

Empire College of Law
Spring Semester 2012
Business Organizations
Final Examination
Issues Outline

Question 1

Pete's Liability to David and Mark

Shareholders Fiduciary Duties in Closely Held Corporation

1. Good Faith and Fair Dealing; not defeat reasonable expectations of other shareholders

Liability to David

1. Breached Duty by lying about potential sale

10b-5 Violation

- a. applies to all entities regardless of size
- b. prohibits intentional misrepresentation of a material fact in connection with sale or purchase of securities
- c. statement about no other buyers clearly was material
- d. intent
- e. sold as a result
- f. damages

Liability to Mark

- a. Duty not to sell controlling interest to a third party likely to loot the corporation.
- b. Premium for sale of control; generally okay except in certain circumstances.

Liability of Giant to Mark

- a. Self Dealing transactions; Parent Corporation must establish intrinsic fairness or deal if parent benefits and other shareholders do not.
- b. If treat all shareholders equally, the business judgment rule applies.
- c. Dividends
 - a. Evaluate under the BJR because both Mark and Giant received them;
- d. Sales to Subsidiaries:
 - a. Intrinsic Fairness applies because only Giant benefited.

Does Mark have a direct action against Giant, or must he bring a derivative claim?

- a. Usually derivative claim where damage is to corporation not individual shareholders.
- b. But cases such as *Perlman v. Feldman* have awarded damages to individual plaintiffs

Question 2.

Shareholders Ability to pursue derivative action against directors.

- a. Demand Excused: Complaint must include specific allegations that is true raise doubt that a majority of the directors are entitled to the protection of the BJR.
 - a. Specific allegation that a majority of the directors authorized the bribes.
 - b. Won't be entitled to BJR protection for illegal action
- b. Litigation Committee; If independent may recommend dismissal of the lawsuit.
 - a. First question: Was committee independent?
 - b. Second: Did it reasonably inform itself?
 - c. If yes, some courts stop there.
 - d. Others, like Delaware, see *Zapata*, make an independent determination if the case should go forward

Potential liability of Jim

- a. Does the BJR protection apply?
- b. Directors must act in good faith in manner they reasonably believe to be in best interests of the corporation.
- c. Directors must reasonably inform themselves before making decisions.
- d. Appear not to have done that
- e. May have breached duty of loyalty by disregarding duties to act properly

Exculpation Statute does not protect against illegal conduct or breach of duty of loyalty.

Indemnification.:

Not entitled to indemnity in criminal matter because he was not wholly successful
For discretionary indemnification to apply, he must not have knowingly violated the law and have acted in a manner he reasonable believed to be in the best interests of the corporation
Probably not entitled to permissive indemnity either
Will turn on whether he knowingly violated the law
May advance funds for defense if board believes he qualifies
Would be entitled to indemnity if he is exonerated in shareholder action

Question 3

Liability of Directors for breach of their fiduciary duty

- a. Duty of Care
- b. Duty of Loyalty

Duty of Care and the Business Judgment Rule

a. Court doesn't second guess director decisions if acted in good faith and reasonable informed themselves.

Higher Scrutiny applied in takeover cases due to concern about director entrenchment

Unocal; Action to repel a hostile takeover are protected by the BJR if they were taken in good faith and were reasonably proportionate to the risk posed.

- a. Good faith if independent and reasonably informed themselves.
 - i. Identified a threat
 - ii. Got expert advice
 - iii. No apparent conflicts of interest
- c. Initial response was probably proportionate to the risk posed.

Revlon: When it becomes obvious the breakup of the company is inevitable, the directors duty switches to obtaining the highest value for the shareholders: they become auctioneers.

- a. Break up inevitable when they locked up solar car division.
- b. Ended competition
- c. Breach of fiduciary duty
- d. Fast perhaps could have agreement voided.

Liability to Innovative and its shareholders:

Articles include statutory elimination to the fullest extent allowed by law.

Not allow exculpation for acts not taken in bad faith

Disney and Caremark: Director must have intentionally disregarded duties

So breach here may be no more than lack of care for which liability is eliminated.

Perhaps could do no more than enjoin sale to Lucky

Violation of Williams Act

Prohibits false statements in proxy solicitation materials

Materiality: Would an investor deem it important? Would it change the mix of information?

- a. Claiming the president of Fast is a felon probably is material.
- b. Shareholders may be able to invalidate the vote. Not use the proxies gained through the violation.

No liability to Fast under Williams Act: it does not protect contestants in takeover battle.

Maybe liability to Fast for state law claims such as intentional interference with contractual relationship.

