Monterey College of Law - HYBRID

Business Organizations II – Section 1

Professor: M. Egenthal

General Instructions:

Answer Three (3) Essay Questions.
Total Time Allotted: Three (3) Hours
Recommended Allocation of Time: Equal Time per Question

Hybrid
Business Organizations II – Sec. 1
Spring 2024
Final Exam
Prof. M. Egenthal

Question 1

Mike, Suzanne and Bruce decide to organize a corporation for their holistic health center in Cambria, CA, named Namaste. The center will offer yoga, spa services, saunas, a full gym, a pool and personal trainers. They each contribute $1 million. They use an online template for their articles and bylaws, but don't make any changes to them, or even read them. Mike signs and sends the articles to the secretary of state, but doesn't notice that the name is incorrect (it is listed as "GOLD's GYMyoga"). and there is no information about shares. They have a shareholders' meeting and elect themselves as directors and adopt the unread bylaws which someone told them they had to do. Suzanne says she will open their bank account, but becomes so busy the first week that she forgets, keeping all of the contributions in her account.

One month after the business has begun, the center is extremely busy and popular. There is a big sign saying NAMASTE, Inc. on the door. Suzanne finally remembers the bank account and sets it up under the name Namaste, Inc., and transfers the investments. The very next day everything goes pear shaped. One member hits her head in the pool and almost drowns, but is rescued just in time. Another member is burned in the sauna. And a third member has a stroke during a somatic breathwork session. All three incur large medical fees and sue both Namaste, Inc., and Mike, Suzanne and Bruce.

The three come to you to ask what they can do and if they are liable.

*****

Business Organizations II – Sec. 1
Spring 2024
Final Exam
Prof. M. Egenthal

Question 2

Albert is a director of IronMan Corporation, a private California corporation with 1,000 shareholders and a board of 9 directors. The corporation manufactures and sells vitamins and natural health supplements. It is averaging a yearly net profit of $65 million. Albert and the other directors all have travel credit cards which can be used only for travel costs to the board meetings as per the bylaws.

Albert gets married to Taylor Swift and they leave for their honeymoon in Bali. At the airport, Albert realizes he forgot his personal credit card so he uses the company travel card and charges the entire trip (total $1 million for the jet and the villa on the beach). He is so happy that he forgets to tell the company about this, and it is charged to company travel expenses.

While in Bali, Albert meets a farmer who grows Cambria berries on his 50-acre farm. These berries grow nowhere else in the world and, according to the farmer and the locals, extend longevity, cure cancer, and make regular vitamins unnecessary. It appears that no one outside that part of the island knows about the berries. Albert persuades the farmer to sell the farm to him and all the berries produced every year in exchange for the farmer living on the land, growing the berries for albert, and being paid $1 million per year. Albert pays the farmer from his personal funds. Albert calls three of the directors who are his friends and lets them in on the deal. They happily agree, but are inclined to think they should keep the opportunity for themselves.

When Albert returns, the entire board schedules a meeting to confront Albert and the other three directors about the travel costs and the Bali farm.

Albert has asked you to help him prepare. He wants to remain a director and does not want to resign. What must he do? What must the board do?

******

Business Organizations II – Sec. 1
Spring 2024
Final Exam
Prof. M. Egenthal

Question 3

Burrito Shell, Inc. (“Burrito”) is a large food service and supply corporation that owns 55% of Lettuce, Inc. (“Lettuce”), 70% of Tomato Corp. (Tomato), and 90% of Pico de Gallo, Inc. (“Pico”). Burrito has the power to select a majority of directors of Lettuce, a supermajority of directors of Tomato and all directors of Pico.

Burrito causes Lettuce to declare dividends distributing all profit from 2023 to shareholders. This dividend complies with all applicable statutory laws generally applicable to dividends, including approval by disinterested directors. Lettuce continues being able to operate at a modest profit based on its traditional business model. The dividend, however, leaves Lettuce unable to pursue a new growth opportunity wherein Lettuce would grow its own vegetables rather than merely source and repackage vegetables.

Burrito causes Tomato to declare dividends distributing all profit from 2023 to shareholders. This dividend complies with all applicable statutory laws generally applicable to dividends, including approval by disinterested directors. However, at the time dividends were declared, it was widely known that Tomato was expected to face competition from new startups in 2024 and would need additional cash flow. Due to the dividend, Tomato is unable to compete in 2024, and enters bankruptcy in 2024.

Burrito enters into a contract with Pico wherein Pico supplies all salsa to Burrito’s other businesses on an as-needed basis with no fixed price maximum. Unexpectedly, during the term of the contract, Pico’s costs increase due to supply chain issues and Burrito’s needs also increase to a point where the contract is no longer profitable for Burrito. Burrito pays only half the negotiated price, but Pico continues to supply Burrito with all needed salsa, and never seeks to enforce the contract price.

Minority shareholders of Lettuce, Tomato, and Pico seek to recover against Burrito. What must they show to qualify and prove their case, and what might the result be?

******

1)

Corporations

A corporation is a legal entity formed for the purpose of conducting any legal enterprise in the state. The primary benefit of a corporation is that it offers its shareholders limited liability, meaning they will generally only be liable to the extent of their investment in the corporation (i.e., their personal assets will not be accessible by creditors or lawsuits).

Close Corp

A close corp is a corporation that typically has few shareholders (less than 35) and where ownership and management of the corporation are mostly the same.

Here, Namaste is a close corp. There are only three shareholders and all three shareholders are on the board of directors who are responsible for managing and overseeing the corporation. Because the ownership and management are done by the same parties, and there are only three share holders, this is a close corp.

Thus, Namaste is a close Corp.

De Jure vs. De Facto Corporations

A de jure corporation is one that has been properly formed following all the appropriate rules, all of the corporate formalities, and is properly filed with the appropriate state office, typically the secretary of state. In order to be a de jure corporation, the articles of incorporation (AOI) must be filed with the secretary of state and must list the name and address for the agent for service of process, the entity name and type, and the number of shares to be issued. A de facto corporation is one that was formed with some sort of procedural defect. If the parties made a good faith attempt to follow the procedures, and operated as if the corporation was properly formed, but failed to properly adhere to the formation rules, the court may grant them de facto corporate status. This means that despite the defect, the corporation is treated as if it were properly formed.

Here, the parties most likely have a de facto corporation. The plaintiffs suing them will likely argue that the shareholders are not entitled to limited liability because the corporation has multiple flaws. First, the name on the AOI that was filed has the name "GOLD's GYMyoga", which is the incorrect name. Second, the plaintiffs will argue that they failed to list the number of shares to be issued when for filed with the secretary of state. Finally, the facts indicate that the shareholders failed to read the AOI, which was a template pulled from online, so they carelessly adopted the incorrect name and are unaware of what is actually in the AOI. Thus, because there are multiple defects in the way in which Mike, Suzanne, and Bruce (MSB) filed their corporation, the plaintiffs will assert that limited liability should not apply, as there is technically no entity. MSB will counter this by arguing that Namaste should be recognized as a de facto corporation. The facts are silent as to whether this is their first business venture, but it is clear that MSB did make a reasonable effort to file with the state office, they adequately funded the corporation, they held an appropriate shareholder meeting to elect the board members, and they operated the business as if it were a corporation. Thus, MSB will claim that they made a good faith effort, and it was mere negligence that they failed to follow the procedures properly. Here, both parties have a strong argument, but it is likely that MSB will succeed.

Yes

Thus, Namaste is a de facto corporation, because they failed to properly follow the procedures for forming a corporation.

Corporation by Estoppel

A corporation by estoppel is an equitable measure that prevents a plaintiff who treated and improperly formed corporation as a corp from later disavowing the corporations corporate status.

Here, even if the corporation was not properly formed, MSB will argue for a corporation by estoppel if they are not awarded de facto corporate status. MSB will argue that when the members signed up and used the facilities, they did so in recognition of Namaste as a corporate entity, and not a partnership or other form of business entity. The nature of a corporation is such that it grants the shareholders limited liability, which protects their personal assets from reach of a lawsuit. Thus, because the plaintiffs operated under the assumption that Namaste was a corporation, they should be estopped from seeking personal liability of the shareholders now that it might be more beneficial for them to do so. On the other hand, the plaintiffs will argue that they did not operate under the assumption that Namaste was a corporation. A corporation must have some kind of indication as to the entity type in its name. MSB will point to the sing on their door, which reads "NAMASTE, Inc.", as a clear indication that they were a corporation. The plaintiffs will argue that the AOI lists the wrong name and does not indicate the entity type. MSB will likely succeed in this argument, however, as it is clear in the sign that NAMASTE is intended to be a corporation, and it is highly improbable that the plaintiffs went to the secretary of state and reviewed the AOI prior to bringing this suit.

Thus, if MSB are not given de fact corporate status, they will likely succeed on an argument for corporation by estoppel.

Should be a 1 line analysis. Not a contract action

Plaintiffs v. MSB

Piercing the Corporate Veil

Piercing the Corporate Veil is a doctrine that allows a plaintiff to pierce the corporate shield of limited liability to reach the personal assets of the shareholders. Generally, veil piercing is allowed under the alter ego theory, when a corporation is under capitalized, or when a shareholder commits fraud, and a failure to pierce the veil would result in an injustice to the injured party. The alter ego doctrine provides that when a shareholder or shareholders operate a corporation in such a way that it is essentially an alter ego for their personal ventures, their personal assets may be liable. The court will look at whether the corporation followed proper corporate formalities, whether there was commingling of personal and corporate funds, and whether there are other facts that indicate that the corporate structure was being used merely as a guise to shield them from liability to third parties. An under capitalized corporation is one in which the shareholders have not provided enough capital to reasonably cover foreseeable debts or damages for the business type.

Alter Ego

Here, the plaintiffs will argue that the corporate structure was merely an alter ego of MSB and they should be personally liable. First, the directors did not follow formation principles. Second, they adopted a generic AOI without actually reading them or modifying them for Namaste's specific purpose. And third, there was commingling of personal and corporate funds, because Suzanne was responsible for opening a bank account, but delayed in doing while holding the initial investment in her personal account. MSB will counter this by pointing to the fact that they made a good faith effort to follow corporate formalities, even if they made some mistakes. They filed the AOI with the state office, they held the proper shareholder meeting to elect the board, they adopted the AOI, and they operated the business as if it were a separate entity. There are some negligent acts that they made, but they did not use Namaste as a means to conduct personal business while shielding themselves from personal liability. MSB will also counter the plaintiffs argument regarding Suzanne commingling funds. Although she did hold the initial investment in her personal account for a short time, the corporation was newly formed, and she opened the corporate account within one month of the business operating. There are no facts which suggest that she was using her personal funds to conduct business affairs or that she was taking corporate money to use for her personal expenses. For all intents and purposes, her personal account was only used as a short term

Good.

holding account. MSB has the stronger argument here, because the facts do not show that Namaste was essentially indistinguishable from MSB in their business ventures.

Thus, the court is not likely to peirce the corporate veil under the alter ego theory.

Under Capitalization

Good.

Here, the facts indicate that the shareholders contributed $1 million each, and $3 million in total. The facts are silent as to whether an insurance policy was taken out on the facility, which would likely be required, as the potential risk of harm in a fitness facility is quite high. The plaintiffs will argue that the corp was under funded and uninsured, because $3 million is not likely to be enough to cover damages suffered by individuals, and there is no insurance policy to cover the difference. MSB will counter this by arguing that $3 million is a significant amount of capital and was a reasonable amount to cover the potential injuries that people might face. There is no good argument as to why they did not have an insurance policy, however. Both parties have a strong argument and this is a fact specific analysis regarding how much a fitness facility should actually expect to pay in case of injury. Because Namaste did not have an insurance policy, it is likely that the court may find it was under capitalized.

Thus, the court may pierce the corporate veil due to the lack of insurance policy if $3 million is not an adequate amount of capital as an industry standard.

<u>Plaintiffs v. Namaste</u>

Third party's may sue a corporation for damages suffered as a result of the corporations actions. Generally, the award will be limited to the corporate assets.

Here, the parties were injured at Namaste's facilities. Without addressing the merits of each parties' claims, Namaste will be liable to the extent of its corporate assets. This means that the $3 million dollars in capital, which is held in the corporate account, will be available to the plaintiffs if they succeed in court. While most places require a waiver of liability for injuries such as these, if Namaste did not require members to sign a waiver, then its assets will be available in the event that the plaintiffs are successful.

Thus, Namaste's corporate assets will be liable to cover any award to the plaintiffs.

Judicial Dissolution

When a third party is owed money by the corporation, but the corporation does not have adequate capital to cover the damages, the court may impose a judicial dissolution. A judicial dissolution is one in which the court mandates that the corporation be dissolved and all of its assets be liquidated to cover the creditor's claims.

Here, if the $3 million capital contribution is insufficient to cover the damage award to the plaintiffs, the court may require a judicial dissolution. This would require Namaste to cease its existence as an entity and liquidate all of its assets. In this case, MSB would be required to sell all of their equipment and facility, as well as any other assets, in order to cover the damages owed to the plaintiffs.

Thus, if Namaste does not have enough cash to cover the plaintiffs damages, Namaste may face a judicial dissolution to cover the money owed.

N.W.

2)

Can Albert remain on the board?

Generally, board members can be removed for any reason, with or without cause, by a shareholder vote. In order for the action to pass, there must be a quorum present and a majority of the votes cast must approve the proposed action. A quorum requires a majority of the shareholder to be present, unless specified otherwise in the bylaws, but can be no less than one third of the shareholders entitled to vote.

Here, Albert can remain on the board, unless there is a proper vote to remove him from the board. Given his various actions, it is likely that the shareholders would vote to remove him, but they are not required to. His actions alone are not sufficient for him to be removed without the appropriate procedures being followed. Unless the bylaws modify the terms and state that a breach of fiduciary duty is automatic grounds for dismissal, Albert can remain on the board if he is not voted out.

Thus, Albert can remain on the board subject to the vote of the shareholders.

Fiduciary Duties

When one person is acting on behalf of another in a position of trust, they owe fiduciary duties to those parties. Generally, the board members owe fiduciary duties to the corporation and are liable for acts which violate those duties and harm the corporation or its shareholders. Fiduciary duties include the Duty of Care, Duty of Loyalty, Duty of Disclosure, and Duty of Good Faith and Fair Dealing.

Duty of Care - Personal Expenses

The duty of care requires that board members conduct themselves as a reasonably prudent person and with the corporations best interests in mind.

Here, Albert violated the duty of care by using the company credit card for his own personal expenses. The bylaws state that board members can use the card for travel expenses to and from board meetings and no other purpose. When Albert got married and went on his honeymoon, he spent $1 million dollars on the company card. This is a significant expense, and likely exponentially higher than the costs of traveling to and from board meetings. While the corporation has annual profit of approximately $65 million, that does not excuse his use of corporate money to pay off the expenses. Albert could have sough unanimous approval from the other members of the board in writing or, at the very least, paid off the expenses before they were charged to the company. However, due to him being on personal vacation and relaxing, he failed to do either. No reasonably prudent person would fail to seek approval or forget to pay back their $1 million dollar personal vacation expenses that were charge on a company card. Further, this action is not with the corporations best interest in mind.

Thus, Albert Violated the Duty of Care

Business Judgement Rule (BJR)

The business judgement rule is a defense for duty of care violations, in order to encourage a certain degree of risk taking in business management. The BJR looks to the process used in the decision making process to determine if it was reasonable. The courts do not concern themselves with the result of those decisions, even in cases where the result is catastrophic, because the directors are in the best position to determine what risks are worth taking. Thus, when a director makes a good faith decision and follows a reasonable process, but that decision ends poorly, the BJR may protect them from liability.

Here, Albert may raise the BJR to defend his violation of the duty of care, however, he will likely fail. There are a number of steps he could have taken to make his decision to use the corporate card reasonable, such as requesting board approval, but instead, he chose to rack up a significant bill on the corporate card, for his personal gain. This is not the kind of business decision or risk taking that the BJR is intended to protect, as it does nothing to advance the corporations interests. Because of this, the BJR will not apply.

Thus, the BJR does not protect Albert for his personal travel expenses on the company card.

Duty of Loyalty

The duty of loyalty can be violated in a number of ways: Conflict of interest, Usurping Corporate Opportunity, Unfair Competition, and Fraud. A conflict of interest occurs when a director engages in a transaction with the corporation that places his own interest ahead of the corporation, or when a board member enters into a transaction with the corporation in which they stand to benefit personally or indirectly, without giving all material information to the board ahead of time. Usurping corporate opportunity occurs when a board member becomes aware of an opportunity that the corporation would have been able to take advantage of and would reasonable expected to have been presented with, but the board member seizes that opportunity for themselves. Unfair competition occurs when a board member sets on in direct competition with their corporation.

Self Interested Transaction

Here, it is unlikely that Albert engaged in a self interested transaction. While he engaged in a transaction with the farmer, he did not engage in a transaction with the corporation.

Thus, Albert did not engage in a self interested transaction with the corporation.

Usurping Corporate Opportunity

Here, Albert will be liable for usurping a corporate opportunity. While on vacation in Bali, Albert became aware of a particular type of berry that allegedly was so healthy it could make regular vitamins necessary. Albert is on the board of IronMan Corp, which is in the business of making vitamins and natural health supplements. It would be reasonably expected that a company engaged in natural health supplements would take interests and likely take advantage of a new berry that could be added to their repertoire of products, and potentially make some of their products obsolete. This is even more so, because the facts indicate that no one outside of that part of the island was aware of the berries' existence. Because of this, Albert would have been expected to bring the opportunity to the corporation, giving them the opportunity to take advantage of it first or to pass it up. The corporation nets $65 million per year in profit, and Albert purchased the farm, with exclusive rights to the berries, and agreed to pay the farmer $1 million each year. Based on these facts, the corporation was capable of taking advantage of the opportunity and very likely would have, if it had been presented to them.

Thus, Albert is liable for violating the duty of loyalty and usurping a corporate opportunity.

Unfair Competition

Here, Albert engaged (or attempted to engage) in unfair competition with IronMan. In purchasing the farm and keeping it a secret, he sought to corner the market of a unique berry that was unavailable outside of a small region, and we generally undiscovered. According to the facts, the berry could "extend longevity, cure cancer, and make regular vitamins unnecessary." Since IronMan was in the business of making vitamins and naturual health supplements, Albert was looking to compete with the corporation by offering a product that would make one of IronMan's primary products potentially obsolete. This is a direct competition. Given that he took the opportunity in secret and did not disclose, it would likely be deemed an unfair competition with IronMan.

Thus, Albert violated the duty of loyalty by engaging in unfair competition with IronMan

Duty of Care - Purchasing the Farm

See rule above.

Here, Albert breached his duty of care to the corporation when he purchased the farm. Albert acted for his own personal gain and did not have the corporation's best interest in mind. A reasonably prudent director would not have acted in this way for purely personal gain. He further shared the opportunity with three other board members who were his personal friends, while excluding others.

Thus, Albert violated the duty of care regarding the farm purchase.

BJR

See rule above.

Here, Albert acted in his personal capacity when purchasing the farm and was not making a decision in his capacity as a director of IronMan. The BJR protects risky decisions made in furtherance of a business. Because his action was not in furtherance of IronMan, Albert will be liable for violating the Duty of Care.

Thus, the duty of care does no apply.

Duty to Disclose

Board member have a duty to disclose a material information that is relevant to a decision made by the board. This includes conflicts of interest, business opportunities, or other information material to the management of the corporation.

Here, Albert failed to disclose both his personal use of the company credit card and the business opportunity regarding the farm. The board of directors independently discovered both of these facts and addressed them with Albert after he returned from his vacation. Both of these are material to the management of the corporation as it impacts their future business prospects, their budget, and their decisions on how to move forward in the supplement industry. Albert's failure to disclose these facts to the board would breach his fiduciary obligation of disclosure.

Thus, Albert breached the duty of disclosure.

What must the board do?

The board of directors act as a body and on behalf of the corporation. When a board member breaches their fiduciary duties, the board should bring suit on behalf of the corporation against the violators.

Here, the board should bring a direct action against Albert. Generally, when a board member profits from a breach of fiduciary duty, the corporation can sue to have an profits realized from the transaction turned over to the corporation. Here, the corporation could have the sale of the farm rescinded and seize the opportunity for themselves. Additionally, any profits Albert has already realized would be turned over to the corporation. Additionally, Albert would be liable for the $1 million in travel expenses that were charged to the company. Finally, the board could hold a shareholder vote to have Albert removed from the board of directors.

Breaches of the duty of loyalty may be cured when a majority of the disinterested board votes to approve the transaction after material disclosure; or a majority of the disinterested shareholders vote to approve the transaction after material disclosure and the transaction was objectively fair to the corporation. However, the transaction here was objectively unfair to the corporation because it sought to directly compete with the corp and cut them out of a potentially highly profitable business venture. Thus, the board will not be able to ratify Albert's actions

Thus, the Board can sue Albert to have the Farm and any profits turned over to the Corporation and for the $1 million in personal travel expenses for Albert's honeymoon.

Derivative Suit

If the board fails to bring an action against Albert, the shareholders may bring a derivative suit on behalf of the corporation. Generally, a derivative suit requires that the shareholders make a written demand for the board to bring an action against the director who violated their duties. If the board chooses not to bring the action, the shareholders may be precluded from bringing the suit. If a written demand would be futile, the shareholders may have the written notice waived.

Here, there are 5 uninterested board members. It is likely that the board would choose to bring the action, especially if the shareholders made a written demand, thus, it is not futile for them to make the demand. The shareholders should demand that Albert and the other three board members be sued in order to recover any lost profits and the business opportunity which was usurped.

Thus, a derivative action is appropriate here.

What must Albert do?

Albert will be responsible for repaying the $1 million in personal travel expense for his honeymoon. Failing to do so would be a form of fraud or embezzlement and could carry criminal penalties.

Additionally, Albert should turn over any profits received from the farm transaction. If he wishes to remain on the board, he should do so voluntarily, and not wait until an action is brought against him. Additionally, he must rescind the contract with the farmer and allow the corporation to take it over; or he should voluntarily offer a novation, which gives the corporation all of his rights under the contract.

As a final note, he would not be required, but would likely benefit from issuing a formal apology to the shareholders and corporation for his conduct. Because he is at the mercy of their vote to determine whether or not he remains on the board, it would benefit him to demonstrate that he accepts responsibility for his conduct, that he understands the severity of his decisions, and has genuine remorse.

32133

3)

Governing Law

Internal Affairs Doctrine

Laws of the State of Incorporation Govern

Parent Corporation

Here, Burrito is the Parent Corporation to Lettuce, Tomato, and Pico because Burrito owns the majority of the stock in each of these other corporations. That would make each of these other corporations subsidiary's of Burrito.

Majority Shareholders

Majority Shareholders have a fiduciary duty to minority shoareholds to make decisions that do not primarily benefit themselves at the expense of the Minority Shareholders.

Here, the Director's of Burrito will argue that they put the needs of the sharholders first when they instituted Dividends to be issued to the SH of Lettuce and Tomato. The minority sharholders of these two corporations all got paid Dividends from the profits of their respective corporations. However, this divedends left both Corporations undercapitalized and unable to to achieve growth they would have without the dividends. Burrito will argue they followed all statutory laws and achieved a mojority vote from all disinterestded directors. They didn't need Sh approval becasue Directors of the board decide whether dividends will be issued and Sh hold no right to the distribution of dividends.

Derivitave Lawsuit

A lawsuit brought by the SH on behalf of the corporation. The SH must file a demand with the Corporation and Wait 90 days before bringing the derivitave suit.

Here, the minority shareholders of Lettuce, Tomato, and Pico can bring a deriviative suit on behalf of their respective corporations for violation of the Duty of Care and the Duty of Loyalty. This suit can be against the Burrito Corporation and if they are able to pierce the corporate veil they can bring the suit against SH of the Corporation also.

Duty of Care

Directors ,Officers, and Parent Corps. must:

(1) take reasonable steps to monitor management; (2) ensure proposals are in the best interest of the Corp; (3) Disclose all material facts to the board of directors; (4) and make reasonably informed decisions.

Here, Lettuce will be arguing against burrito that the although the dividend paying the Shareholders from the profits of 2023 benefited SH, Burrito owns 55% of the shares, meaning its shareholders saw a very large dividend payout. So this was primarily in the interest of SH of the Parent company. Lettuce will argue that Burrito as the Parent Corp. did not ensure that this was in the best interest of Lettuce and as a Majority SH they owe Lettuce fiduciary duties. This proposal was in Burritos best interest. When making the determination Lettuce will argue that Burrito did not disclose to the disinterested Directors that this would leave Lettuce unable to pursue new growth opportunities. Luttuce will argue that Burrito did not make a reasonablyt informed decision becasue if it had done an investigation or due diligence they would have seen that utilizing all the profit would leave Lettuce undercapitalized and unable to seek new growth at the expense of its sharholders and to Burrito's benefit.

<u>Therefore, it is likely Lettuce can show Burrito violated the Duty of Care.</u>

Tomato will make a very identical argument as above.However, the Burrito's lack of reasobly informed decisions will lead tomato to be so undercapitalized that they could not even compete in 2024. This leaves them having to seek additional cash flow. This has resulted in the them entering bankrupcy in 2024. Ultimately Burrito did not ensure that the proposal was in the best interest of Tomota because as it's parent corporation and Majority share holder it owes them fiduciary duties and these were ignored at their expense for the benefit of Burrito and its SH.

<u>Therefore, it is likely Tomato can show Burrito violated the Duty of Care</u>

Here, Pico will make an almost identical argument, but in their case Pico was not given dividends but instead a contract was made that forced Pico to provide Burrito with all its salsa at no fixed price. This proposal was only at the expense of Pico and designed to soley benefit Burrito because they get salsa for all their companies and can change the price as they see fit. This is a one sided contract that really only benefits Burrito. Pico's cost increase and they will argue if Burrito and its Director's were making reasonably informed decisions they would not continue to take from Pico and then pay only half the contract price.

<u>Therefore, Burrito likely breached the duty of Care.</u>

Business Judgment Rule

A presumption that the Director acted:

(1) without negligence or recklessness; (2) in good faith; (3) with an honest belief that the actions were in the best interest of Corporation.

Here, Burrito will try to argue the BJR and that they made these decisions in good faith to provide dividends to the sh of Lettuce and tomato and then award a contract to Pico during a time of difficulty and increased costs of operation. However, it appears these decisions were in bad faith and with reckless disregard to the harm it would cause it subsidiaries. Burrito acted with its intersts in mind at the detrimit of the its subsidiaries. The BJR will not limit Burrito's liability for their Breaches of Duty of CAre.

Duty of Loyalty

Directors owe the Corporation a duty to avoid implicating their own conflicts of interest when making decisions on behalf of the corporation.

Here all 3 corporations will also argue Burrito breached the duty of loyalty. In all 3 circumstances burrito made decisions for its own behalf and not for its subsidiaries. These decisions are conflicts of interest that benefited the parent Corp.

They will argue they Had approval from the Disinterested board and SH for the dividends but they did not for the contracts with Pico.

They might be able to avoid this breach against 2 but will be in breach in regard to Pico.

Piercing the Corporate Veil

A shareholder has a shield of limited liability and can be held personally liable unless:

(1) the shareholder Dominated the corporation in a manner that the corporation appeared to be the shareholders alter ego; (2) they followed corporate formalities; (3) were undercapitalized; OR *(4) fraud or illegality was present.*

Here, Burrito has Not treated lettuce as an extension of itself under the ego theory. Lettuce can argue that Burrito used Lettuce as an instrument for its own personal gain becasue they are a majority share holder and the dividends benefited them heavily. But this wont make Lettuce look like the alter ego of burrito. THet did leave Lettuce severly undercapitalized after the dividends were issued. They did this with knoweldge it would leave luttuce unable to pursue growth opportunitteis.

Thus it is likely Lettuce could pierce the corporate veil.

Here, tomoato makes the same argument as Lettuce because they are left undercapitialized even worse than Lettuce. they had to claim bankrupcy.

Thus Tomato can pierce the corporate veil.

Pico will argue that Burrito owns 90% of their stock and then created a contract that was one sided providing them all Pico's salsa at Pico's expense. It would appear that Burrito dominated Pico in such a way that they were an alter ego of Burrito. These deals and contracts like the other two sunbsideiaries would leave Pico undercapitalized.

Thus they can pierce the corporate veil.

All three corporations can bring suit against Burrito the corporation and its SH.

Fundamental Corporate Change

Short Form Corporate Merger

Parent Corp. must own 90% of the stock in the subsidiary and then do not have to have SH approvah from either Corporation to merge and consolodate the corporations.

Here, this might be the best option for Burrito to deal at least with Pico. Burrito is the parent company and it owns 90% of Pico, its subsidiary's stock. As such the Directors of Burrito could merge with Pico and consolodate the two companies without getting SH approval from either corporation. This would leave Dissenter's right to the SH's of Pico and they could pursue fair market value for their shares before the two corporations merge.