Monterey College of Law

Business Organizations II

Professor: D. Bean

General Instructions:

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

MCL
Business Organizations II
Spring 2024
Final Exam
Prof. D. Bean

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.

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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?

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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?

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Business Organizations - Corporations II – Spring 2024

Final Exam

Question 1

ANSWER 1 (OUTLINE)

20% Organization (Similar headings – boldfaced below)

20% Issue (Spot all issues)

20% Rules (Name all rules – <u>underlined</u> below)

20% Analysis (Apply law to facts – all non-underlined, non-italicized font below)

20% Conclusions (Provide correct conclusions – as italicized below)

Introduction

Nature of the transaction: corporate existence (filings, naming, content of bylaws) and status, personal versus corporate liability

When did the corporation exist?

- *<u>California law requires an incorporator to file the articles of incorporation with the secretary of state. The articles must contain the name, the address, the number of shares authorized, the names of the directors (if they have been designated), and the permitted activities, though California forms have a standard clause allowing any activity legal in the state of California.</u>*
- *<u>The name must include a corporate designation such as Inc., or Corporation.</u>*
- *<u>A de facto corporation is one in which there has been a colorable intent to incorporate, but there are some errors in the filings. Such a corporation cannot be invalidated by a third party, but can be invalidated by the state.</u>*
- *In this case, the name was not correct, and may have been too close to an existing corporate name, thus causing confusion. The did use their intended name when they opened for business and it contained "inc.".*
- *The shares were not listed, but all other information appears to be present based on the facts provided.*
- *Accordingly, the three appear to have formed a corporation at the time of filing, though the name needs to be update which can be done by filing an amendment to the articles, which could also include the authorized shares.*
- *If this is a defacto incorporation, a third party may not claim it was not a corporate form providing liability protection to the shareholders.*

Are the three shareholders/directors personally liable for the injuries of the customers?

- *<u>Shareholders are liable only for the amount of their investment in the event the corporation is dissolved.</u>*
- *<u>Directors are not liable so long as they carry out their duties with reasonable care.</u>*
- *<u>Directors' decisions are protected under the business judgment rule and are considered correct so long as there is no indication of gross mismanagement or negligence.</u>*
- *<u>In addition, the bylaws of the corporation may detail the roles and responsibilities of the directors, as well any indemnification provided by the corporation.</u>*

- *The three would not be held liable as shareholders except to the amount they invested in the corporation. It appears their investments were designated as part of the corporation when they were deposited into the corporate account, prior to the accidents. The facts do not indicate that the shares were actually issued, however, so the amount of each shareholder's investment may not be clear, and indeed may appear to be Suzanne's only, depending on how she opened the account.*
- *Directors may be held liable in the event of a failure to fulfill their duties using reasonable business judgement. The facts do not indicate that the accidents were due to an error in their decisions. If sued, they will likely need to show that they built and equipped the facility using reasonable and informed business judgment.*
- *In addition, the facts do not indicate the content of the bylaws (unread by the directors), so it is not clear whether the corporation will indemnify them for any personal liability should the injured parties prove liability.*
- *Accordingly, the facts indicate that the shareholders will not be liable beyond their investments as a de facto corporation was formed prior to the injuries.*
- *The directors may be liable depending on the level of care and judgment when planning, and whether the bylaws provide further protection.*
- *However, as the state has the ability to invalidate a de facto corporation, the risk exists that the directors and shareholders may be liable should the state remove the corporate form. A partnership would result in such a case, and the directors' liability would be determined under partnership law.*

ANSWER 2 (OUTLINE)

20% Organization (Similar headings – boldfaced below)

20% Issue (Spot all issues)

20% Rules (Name all rules – <u>underlined</u> below)

20% Analysis (Apply law to facts – all non-underlined, non-italicized font below)

20% Conclusions (Provide correct conclusions – as italicized below)

Introduction

Nature of the transaction: corporate opportunity doctrine, misuse of corporate assets

Did Albert misuse corporate funds by charging his honeymoon to the corporation?

- *<u>Under California law sec 309, directors are required to act only in the best interests of the corporation and with a duty of care.</u>*
- *<u>Misuse of corporate assets would be a violation of the fiduciary duty of care, particularly when the director is aware that the use of those assets was prohibited.</u>*
- *In this case, Albert was aware that the corporate card was to be used for directors' travel in relation to the corporation only as it was stated in the bylaws.*
- *Despite this knowledge, he used the card for a substantial sum charged to the corporation for his personal travel.*
- *Accordingly, Albert violated his fiduciary duty to the corporation by using corporate funds for personal purposes.*
- *Albert will be required to reimburse the corporation and may be removed from the board should the requisite number of directors agree.*

Did Albert usurp a corporate opportunity by purchasing the farm in Bali

- *California law requires directors to act in the best interests of the corporation and adhere to their fiduciary duties of care and loyalty and avoid self-dealing.*
- *Corporations have a prior claim to opportunities that are sufficiently connected to the corporation's business, or the acquisition of the opportunity is accomplished through disloyalty and unfairness to the corporation.*
- *Usurping a corporate opportunity is not permitted without following specific procedures such as disclosure to the board and allowing the board to determine whether to adopt the opportunity. The board may vote, but only disinterested directors' votes will be counted.*
- *Under California section 310, directors must not engage in an opportunity personally if that opportunity may have a material interest to the corporation.*
- *In this case, the farm produced berries that have medicinal qualities very similar to the products produced by the corporation. Hence, the corporation would have a material interest in acquiring the opportunity.*
- *Albert usurped the opportunity by purchasing the farm without allowing the corporation the chance to investigate and possibly pursue it.*
- *In addition, the berries may have a negative impact on the market for the corporation in that they would be in direct competition.*
- *Accordingly, Albert did violate his duties under Section 310 by not disclosing the opportunity and by not acting in the best interests of the corporation.*
- *While Albert may argue that he found the opportunity while in a personal situation (his honeymoon), this argument would fail in light of the close relation to the products of the corporation.*
- *In order to avoid liability, Albert must fully disclose all relevant information to the board and the board must vote whether to adopt the opportunity, or to forfeit it to Albert. In the vote, Albert's vote would not be counted as he is an interested party and only disinterested directors' votes will be counted.*

Did the other three directors usurp a corporate opportunity?

- *The other three directors will be held to the same standard as Albert under Section 310.*
- *If they agreed to partner with Albert, they will have acted outside of their fiduciary duties and usurped a corporate opportunity.*
- *If the directors fail to disclose, as the facts appear, they will be subject to the same treatment.*
- *In this case, the other three directors appear to want to keep the opportunity and not share it with the company. This is a clear violation of their fiduciary duties as explained above.*
- *The disinterested directors may pursue an action to disgorge any profits should they determine the opportunity should belong to the corporation.*
- *Accordingly, the three directors also usurped the corporate opportunity when they agreed to join Albert. The remaining board members may either bring an action against them or vote to determine whether to adopt the opportunity.*

What procedure must the board follow under California rules?

- *Under California law, the board may vote to adopt the corporate opportunity, or forfeit it to the interested directors.*
- *Under section 310, only those disinterested directors' votes will be counted, so long as the number of the disinterested directors constitutes a quorum and required by the by laws.*
- *In this case, the board must determine whether the opportunity should be adopted by the corporation. In taking the vote, only the five disinterested directors' votes will be counted. As there are nine directors, five would constitute a quorum if the corporation's bylaws define the necessary quorum for such votes as a simple majority.*
- *Accordingly the board must vote whether to adopt the opportunity, forfeit it, or possibly take action against the interested directors for a violation of their fiduciary duties to the corporation.*

ANSWER 3 (OUTLINE)

20% Organization (Similar headings – boldfaced below)

20% Issue (Spot all issues)

20% Rules (Name all rules – <u>underlined</u> below)

20% Analysis (Apply law to facts – all non-underlined, non-italicized font below)

20% Conclusions (Provide correct conclusions – as italicized below)

.Type of suit

A. A d<u>erivative suit is one on behalf of the corporation, where a shareholder suffered a loss due solely to their status as a shareholder, and recovery from such a suit is to the corporation.</u>

A. Here, the minority shareholders would be bringing a derivative suit because no facts suggest that they suffered special or unique damage beyond their status as shareholders.

B. A <u>plaintiff in a derivative suit must have held at least one share at the time of the wrongdoing, have clean hands (not have consented, acquiesced, or partaken in the wrong), and not delay</u>. Here, there are no facts to suggest that the minority shareholders lack standing or have personal defenses.

C. Typically, <u>a plaintiff in a derivative suit must also make a demand on the board, unless they can show that making such a demand would be futile.</u> Here, as Burrito controls the board, there is a reasonable argument that demand would be futile as the board has acquiesced in the actions in each suit.

D. Recovery: <u>Typically, recovery goes to the corporation, then is divided pro rata among shareholders. However, where a shareholder engaged in the wrong, the court may use equitable principles to redistribute</u> the recovery. Here, where Burrito is found to have engaged in wrongdoing, a court may therefore consider redistributing the recovery.

II. Duty generally

A. <u>Generally, shareholders owe no duty to the corporation or to each other.</u>

A. <u>However, a controlling shareholder (CS) may have some duties. A CS is one who owns an outright majority of shares or who has sufficient power, despite not owning a majority, to control managerial decisions</u>. Here, we are told Burrito has a majority share and controls a majority of the board of all three affected companies so Burrito is a CS.

B. <u>A CS has the following duties:</u>

1. *<u>Refrain from harming the minority (act in the best interest of the corporation as a whole)</u>*
2. *<u>Refrain from self-dealing (benefitting at the expense of the corp)</u>*

III. Procedure: <u>Burden will be on the minority to prove unfairness of a transaction. Examine procedure (uninterested directors, adequate information) and substance of transaction.</u> Here very few facts re: procedure except the fact that Burrito controls the BODs, but each fact pattern says a disinterested majority approved the transaction, so the transactions appear to be procedurally fair. Focus should be on substance.

.Lettuce: We are told that a dividend is properly declared that leaves Lettuce solvent. There does not appear to be a reason to set aside the BJR. The speculative opportunity of loss of a possible expansion is likely not sufficiently unfair to equate to a breach of duty by Burrito. The minority shareholders have no claim.

.Tomato: We are told that Burrito was on notice of competition that could necessitate additional cash flow for Tomato to remain competitive. Despite this info, Burrito declared a dividend, leaving insufficient cash for Tomato to continue to function. Close call (given dividend was fairly declared and competition can be speculative) but it seems likely that Burrito's dividend unfairly prejudiced Tomato and would not be declared by a disinterested holder. The minority shareholders likely have a claim.

.Pico: We are told that Pico never enforces its contract with Burrito despite suffering cost increases and only being paid half of what Pico is owed. This failure has no rational explanation; the only explanation is Burrito's conflicted self-dealing. The minority shareholders have a strong claim.

1)

Corporations

A corporation is an entity formed to conduct business. Ownership of the corporation is split into units called "shares". Each share carries with it an even amount of ownership in the corporations, and the owners of the corporation's shares collectively own the corporation and are called shareholders. A properly formed corporation shields individual shareholders from liability in lawsuits. Here, Mike (M), Suzanne (S) and Bruce (B) believe they created a corporation named NAMASTE, Inc. (N). N is the owner of a holistic health center and is operated by M, S, and B. Three members of this health center sustained injuries and all are suing N, M, S and B. To asses the potential individual liability of M, S, and B, it must first be determined whether N was a properly formed corporation.

Corporation Formation

To form a corporation, articles of incorporation must be drafted. Those articles must include the name of the corporation, the address of the corporation, the number of shares of the corporation and their par value, the purpose of the corporation, and an agent of the corporation who can be served. The articles must then by filed with a state.

Articles of Incorporation

Here, M, S and B used an online articles of incorporation (articles) template to form N. Because the facts do not say otherwise, it can be assumed M, S and B correctly put the address of N, the purpose of N and an agent who can receive service of process on behalf of N on the articles. However, the articles were submitted with an incorrect name, GOLD's GYMyoga, rather than the intended name, NAMASTE, Inc. Additionally, the articles lacked any information about the shares of the corporation, be it number of shares or par value. The par value is the lowest dollar amount the shares of a corporation

A de jure corporation is one that properly filed articles of incorporation with a state, appointed directors, authorized and issued share, and adopted corporate bylaws. Here, M, S and B filed defective articles and never authorized or issued (or even discussed) shares. Because of the defective articles and unclear number of shares, N would not be considered a de jure corporation.

De Facto Corporation

A de facto corporation is one where people make a coloreable attempt at forming a corporation, but make an error or errors that make the formation defective and not legally valid. Here, M, S and B obtained templates for articles of incorporation and bylaws, filing the articles and adopting the bylaws. Additionally, M, S and B held a shareholders meeting and appointed themselves directors. However, M, S and B filed articles with the incorrect name, did not list the number of shares in the articles, did not attempt to authorize and issue shares, and did they note in the articles that this would be a closely held corporation. Plaintiffs will argue that because of all these defects, N should not be considered. M, S and B will argue that these flaws were mainly procedural, and substantively the 3 attempted to form N by contributing $3M in capital, attempting to file articles with the state, conducting a shareholders meeting, prominently displaying the intended name that notes N is a corporation and actively managing N. A court would likely find N is a de facto corporation.

Piercing the corporate veil

Corporation generally shield the assets of its shareholders from legal liability. However, shareholders assets can be reached under certain circumstances, which is known as piercing the corporate veil. To pierce a corporate veil, a court looks at whether a shareholder was using a corporation as an alter ego, whether the corporation follows corporate customs, whether the corporation is sufficiently capitalized at formation, and whether corporate funds are commingled.

M's liability

N as an alter ego

Here, M (along with S and B) prominently displayed the name NAMASTE, Inc. in front of the health center. Additionally, articles of incorporation were filed and M (along with S and B) contributed $1 million. No facts indicate that M was using N as an alter ego.

Corporate Customs

Here, M filed articles of incorporation for N. Additionally, M, S and B held an initial shareholder meeting and appointed themselves directors and adopted bylaws (though they did not read them). Because the incident happened so soon after N opened, this would be everything a corporation would be expected to do, with the exception of shares not being discussed, authorized, or issued. However, because M (and S and B) did everything else, a court would find M followed corporate customs.

Capitalization

M contributed $1M in addition to $1M contributed by S and B. $3 would likely be considered sufficient capitalization.

Co-mingling of corporate funds.

Here, S was in charge of the corporate money, and deposited it into her own bank account, which co-mingled corporate funds with personal funds. However, because this did not involve M, it would likely not factor into a court deciding whether M should be personally liable. B? Causation of injury?

Knowledge of defective articles

While an improperly formed corporation can be considered a de facto corporation and still shield its shareholders from liability, if a director has knowledge that the corporation was formed improperly then that director will not be protected from liability. Here, M appears to have taken the lead on drafting the articles, as he signed the articles and sent them to the secretary of state. M sent the articles despite the articles lacking information about the shares and containing an incorrect name. While M did not notice this, plaintiffs will argue that he should have known. M will argue that the whole point of the de facto corporation doctrine is to protect people from honest mistakes such as these, and that M conducted himself as if N was properly formed. Plaintiffs will argue that the errors (especially the name of the corporation) were so egregious, that M should have known the articles were defective.

It would be a close call whether a court would allow M to be held liable. A court may find that the error of the name is simply to egregious for a person to miss if exercising the slightest amount of care, and therefore allow the plaintiffs to hold M personally liable.

S's liability

Piercing the corporate veil

See above for analysis of alter ego, corporate customs, and capitalization.

Co-mingling

As stated above, S co-mingled corporate funds with her own funds. However, the day before the incident S set up a corporate bank account and transferred all corporate assets into it. Plaintiff's will argue that because the funds were co-mingled to begin with, this should allow them to pierce the corporate veil and reach S's assets. S will argue that she cured the co-mingling issue, and that the funds were only very briefly co-mingled to begin with. A court would likely find the initial co-mingling insufficient to hold S personally

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liable, as she completely fixed the problem and did nothing else that would make the court find her personally liable.

B's liability

B did not do anything that would cause the court to find him personally liable, so the corporate veil would not be pierced with regard to B's assets.

Duty of Care

In closely held corporations all shareholders owe a duty of care to each other. If the court found N a de facto closely held corporation, M may have breached that duty to S and B by not filing correct articles of incorporation. This would mean M may have to indemnify S and B if S and B are held personally liable.

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2)

Duties of a Director

Directors are responsible for the decisions a corporation makes in the ordinary course of business. If something is outside the regular course of business, then a meeting of the shareholders must be called. Here, the two claims, the travel expenses and the farm, are roughly a million dollars each (one recurring) which is a lot of money. However Ironman (I) makes a yearly profit of 65 million, and travel expenses and land purchases are likely fairly ordinary issues for such a large corporation ,and thus it is unlikely a Special meeting of the shareholders would have to be called to deal with this, though some of the issues mentioned below might be brought at the annual shareholder meeting.

Additionally, directors are voted into their roles by the shareholders, and it is likely that these violations would have to be reported to the shareholders,or that the shareholders can use there inspection rights to learn about it. Thus even if Albert (A) is not dismissed by the board of directors, he could be voted out at the next shareholder meeting if they so chose. In addition to this, the shareholders might be able to bring a derivative suit against him on behalf of the company, and hold him personally liable for the damages

Duty of Care/ Business Judgement Rule (BJR)

Directors owe the corporation a duty of care in the actions they take on behalf of the company, that they will take actions in the best interest of the company.

Here, the first violation of the duty of care is using the corporate card to pay for the honeymoon travel expenses. A has just married Taylor Swift (TS) these are two very rich and very well connected people. Upon finding out that that A had forgotten his personal credit card, TS could have paid, they could have waited to have a personal assistant or some such run back and get it from his home, or called someone to bring it. There were many other options to do before using a fairly restricted company card. On top of this, A clearly had some way to access his funds, as he was later able to use his personal funds to by the farm, so clearly there was no need to use the company card.

Even if there had been a proper emergency, which there was not, A did not disclose the use afterward. While disclosure does not necessary prevent A from being held liable for the funds (he would need to return those anyway.) it would have certainly made him look better and would have been much easier to resolve, especially since some of the other issues require a vote from the directors to keep him on, so appearances are important. It might also be a good idea to get in the board's and the shareholder's good graces by returning the money as soon as possible, which the facts do not state that he has.

Thus, by using the corporate funds improperly, he has violated his duty of care.

Duty of Loyalty/ Usurpation of Corporate Opportunity

A director owes his corporation a duty of loyalty to act in the best interest of the corporation. This includes a duty to fully communicate business opportunities that arise in his life. The director has a duty to disclose any business opportunity that is in the corporations line of business, disclose and potential conflicts of interest, and allow the corporation to refuse the opportunity before taking advantage of it for himself. That the corporation did not have the funds to take advantage of the opportunity is not a defense to not communicating it.

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Here, A buys a farm using the personal funds that he can now access on a farm in Bali and yet not at a commercial airport. This farm grows Cambria Berries, which are rumored to be able to replace regular vitamins, but are not popular off the island. To determine if this is a Usurpation of Corporate Opportunity, the usurped opportunity must be in the line of business of the corporation, since most modern business are in business "for any lawful purpose," the courts have defined the line of business to be quite broad. Here however, there is not much to debate, I is in the business of making and selling vitamins and supplements, and the Cambria berry is rumored to be able to eliminate the need for vitamins. Whether or not he rumors are true, the berries can either be a big boost in I's products if they have access to them first, or the berries can substantially undercut I's profits if controlled by someone else. This makes the berries very much in the line of business for I.

Because of this, A had a duty to disclose the opportunity to buy the farm before he could purchase it himself. A could argue that he could not reach the directors, but he was able to contact the directors that were his friends, so there were lines of communication. What he could not argue was that I could not take advantage of the opportunity due to funding, he bought the farm under contract for a million a year, 1/65 of the companies annual profit. if I wished to take advantage, the certainly would have been able to, but even if they had not be able to do so, this would not have been a defense.

While A might try to argue that he was buying it for the corporation, this would not have helped him even if he had used the corporate card, as the bylaws do not allow the use of the corporate card for anything other that travel expenses. However if he had used the corporate card to by the farm, that purchase would not have been a violation of the duty of loyalty, but a violation of the duty of care, and thus, since purchasing the farm is likely in the best interest of the corporation, would have been protected under the business judgement rule. The BJR does not protect against violations of the duty of loyalty, and thus, since A did uses his personal funds, He cannot use BJR as an defense.

If he had brought the opportunity to the corporation, and they decided against it, he then would have been able to purchase the farm with a worry about a conflict of interest.

Thus, when A bought the farm, he usurped a business opportunity without properly offering it, and thus has violated his duty of loyalty.

Committee of Disinterested Directors

A violation of the duty of loyalty can be repaired if a committee of disinterested directors votes (majority rules) that the director did not violate his duty.

In order to remedy A's violation of the duty of loyalty, the board must call a committee if disinterested shareholders to judge on the violation. Here, A has let 3 of the directors, his friends, know about the purchase, and they wished to keep it between themselves, thus these three directors cannot be on the committee, especially since the committee must also make a ruling regarding their actions to keep silent as well. Thus the committee will be made up of the remaining five directors. Unless it states otherwise in the bylaws, a majority if these five would be 1/2 +1, or 3. Thus three of these directors must vote that A and his friends have not violated their duties, which seems a bit unlikely.

However, boards are made of people, and people can be negotiated with. A Committee if Disinterested directors is not a judge in a court of law, and their uppermost goal is to protect the interest of the company, not see justice done. This means that even if A technically violated his duties, if he satisfies the committee that retaining him and his friends as directors is in the best interest of the company, they may decide to keep him (Baring any actions from the shareholders) A might be able to accomplish this by returning the misused funds, and transferring ownership of the farm to I, without charging a profit on the sale.

Thus is is in A's best interest to (legally) get in the good graces of the remaining board members, and it is likely in the best interest of the board to keep A around, if not only to make sure title of the berry farm is properly transferred to the corporation, but also to avoid the PR nightmare of angering Taylor Swift's fans by firing her new husband.

3)

Question #3

Shareholders

The owners of the corporation are called shareholders. Generally, shareholders (SHs) are not personally liable for the obligations and debts of the corporation (they risk their investment). Management is centralized in a board of directors and the shares of the corporation are freely transferable. A corporation is implied to be perpetual and changes in ownership do not affect the corporation. The corporation is established and governed by state law, but the internal affairs doctrine (spells out the duties and responsibilities of the Officers and Directors) is governed by the law of incorporation. Directors and Officers and not personally liable for what the corporation does.

Right of Appraisal

do we need this?

The right of appraisal is one where the shareholders force the sale of the corporation to obtain it's investment.

Here, the minority SHs carry a right to appraisal in order to be protected from the controlling SHs. If the corporation or board are taking decision that a minority SH would believe goes against the best interest of the corporation, then that SH has a right to appraisal.

As a result, Lettuce (L), Tomato (T), and Pico (P) can enforce the appraisal rights to their own corporations and force a sale.

Derivative Suit

A derivative suit is one where the SHs act as a P and bring a lawsuit for the corporation. A SH needs: standing, a demand, it must be plead with particularity, a bond?, and that no

= ownership

disinterested SH move to dismiss because they find the suit to be in the corporation's least interest.

In this case, L, T, and P can bring a elect to each bring a derivative suit. They each have standing because they own stock in their own corporations. Next, the minority SHs will need to make a written demand, wait 90 days and bring the suit. However, L, T, and P might be able to skip this step because the parent company is the main defendant and thus the demand would be futile. Thus, they might be able to skip making the demand.

The following step is that the suit needs to be pleaded with particularity. This means that the cause of action, the demand, and damages must be clearly stated. Next, the court might require all of the SHs bringing the suit to post a bond. Lastly, that the suit is accompanied by the approval of disinterested directors.

If the minority SHs can establish these elements, then they can move to recover for the damages incurred because of Burrito's actions. However, the SHs would not keep the gains of the suit. These damages would be for the corporations. If any fees or costs are kept by the minority SHs, then they can move to be indemnified by the corporation if the win.

In the end, they minority SHs must prove all of the elements of a derivative suit to recover for the corporations.

Distributions

A corporations has four methods of distributions: dividends, redemption of stock, redeemed stock, and liquidation upon dissolution.

Here, Burrito caused L, T, and P to declare dividends and distribute all of the profit to the SHs. Dividends can either be preferred or common. A preferred stock get paid first and common stock if paid last. If there is no mentioning of what type of stock it is, it will be considered common. As a result, this dividend is common.

told all laws followed!

However, there was no mention of the procedure that was followed to issue these dividends. No meeting was scheduled or held and no notice was given to any SH. SHs require no less than 10 days or no more than 60 days for the notice and yet there was no notice given here. The procedures followed by Burrito lack protocol and could leave an open door for L, T, and P to attack.

As a result, the dividends awarded here are common stock, but the process of declaring these dividends were not properly followed. YES IT WAS

CONTRA FACTUAL X

Business Judgement Rule

Generally, the courts will not interfere with a corporate action if it was made in good faith, informed, with rational basis, and with no conflicting interests.

In this case, Burrito acting the the parent company decided to break the bank of all three companies. But was this proper? In order to analyze this question the courts will look at whether the decision was made in good faith, was informed with rational basis and that there are no conflicts of interest. Here, the minority SHs can argue that distributing all of the profits was not made while being informed and did not carry rational basis.

Let me explain, if Burrito would have been informed of Pico's increase of costs it would have not entered into the agreement and yet it did causing Pico (not in fact) to go under. Being a parent company, Burrito should have taken the time and become informed of the financials of Pico and it did not do so. Moreover, distributing all of the profits is not a decision that carries rational basis because you are essentially eliminating all of the wiggle room that these corporations created by themselves. [illegible] p 1.20

As a result, L, T, and P could petition the courts to review this business decision.

Fundamental Corporate Changes

– [illegible]

Fundamental corporate changes require the approval of the SHs before the can be made effective.

In order for a fundamental change to be proper, the SHs meet, they vote, the articles are amended, and the board issues the change. In this case, there was never a meeting by the SHs or even a vote. Burrito unilaterally decided cause L, T, and P to declare dividends and incurred damages. Here, all three (L, T, and P) should argue that because of these fundamental changes that they have suffered. Tomato even entered into bankruptcy. When a parent company makes such drastic changes that would essentially destroy the company, then they can object (specially when procedures are not followed) and petition the courts for assistance. Burrito could have implemented an equity test and could have seen that making these distributions would have not been possible because Pico was no profitable and could not sustain itself. Similarly, Burrito could have also just checked the balance sheets and could have seen the red numbers.

To conclude, these fundamental corporate changes were not procedurally done correctly and as a result, L, T, and P should object.

In the End

[illegible] these all differ?

The actions taken by Burrito proved to be in the corporation's least interest. Lettuce was unable to pursue grow, Tomato was unable to compete in 2024 and entered into bankruptcy and Pico was left standing with unpaid invoices. Instead of acting like the parent company, Burrito acted like a leach that sucked the life out of corporations and rendered Lettuce, Tomato, and Pico stale and rotten. SHs don't hold the same duties as directors and officers, but these actions go against the duty or care of loyalty of an officer or director to the corporation. In the similar light, the SHs should reciprocate the respect because the SHs are the owners of the companies. Sure the other companies and run by other people but in the end, the owners are the ones being hurt. Lettuce, Tomato, and Pico have strong causes action to bring forward and obtain judicial relief from the improper SH action.

END OF EXAM