

Business Forms

1. Sole Proprietorship

2. General Partnership

Right to dissolution, but still liable for breach of K, damages from dissolution

3. Limited Partnership

4. Limited Liability Co.'s and P's (LLC/P)

Protect members/partners from liability while offering pass through taxation and relatively flexible operational requirements. If such entities do not wish the tax pass through status, they merely check a box on a tax form and they are taxed as if they were corporate entities.

5. Joint Venture

Choice of Form Problem

Traditionally one of balancing the tax, liability, and administrative burden issues associated w/ the various forms.

Normally, one had to trade certain tax advantages and ease of organization and operation in exchange for limited liability and vice versa.

Tax

Administrative Burdens

Liability

Check the box

Principal-Agency Relationship

Agent

One who agrees to act on behalf of and under the control of another.

Principal-Agency Relationship (cont)

Actual Authority

Involves authority actually given by a principal to an agent. The authority may be express (there is an oral or written statement of what the agent is to do) or implied (inferred from the words or actions communicated by the principal to the agent).

Implied authority- often derived by determining what actions are reasonably included in the grant of particular express authority.

Apparent Authority

No real authority. It is created when action/inactions of a purported principal create in the mind of a 3rd party the rsbl belief that a purported agent has authority.

-This often arises when one gives authority to an agent and informs a 3rd party and then revokes the authority w/o informing the 3rd party. The former agent, in disregard of the revocation, transacts w/ the 3rd party per original grant.

Inherent Authority

Does not depend on interactions b/w the principal and a 3rd party but inheres in a position.

-A 3rd party can rely (unless it knows or should've known of a restriction) on the level of authority one in that position typically has.

-The difficulty arises when, unbeknownst to a 3rd party, the principal has restricted the agent's authority. If the agent exceeds actual authority, but acts w/in the authority a person in the position would normally have, the principal will be liable for those acts.

-No overlap in authority when there is an undisclosed agency relationship and the 3rd party believes he/she is dealing w/ a principal

Principal-Agency Relationship (cont)

Directors

Directors as directors are not agents of the corporation. Individual directors have no authority. As a board, they act for the corporation but not under its control. In fact, directors set the path for the corp. and have control of its actions

Liability for Principal

1. Principal sets the transaction in motion
2. Principal could have more easily and cheaply prevented and control agent's behavior
3. Transaction costs would be huge risk if it fell on unwitting vendor

Duties Owed

Fiduciary Duty

Trust, Efficiency, Giving social expectations legal affect

Duty of Loyalty

ex) Self-Dealing, Interlocking Directorate, Corporate Opportunity

Structural Hold- officers are often SHs and may have personal stakes of officer as individual

Structural bias- Concept applied to relationship among members of closely knit working groups. Directors of major corps. have the same class, educational, and social background. Similarities and repeat interactions result in an unconscious maintenance of collegial, non-confrontational relations. Directors won't criticize colleagues and often "go along" with the idea that they can count on others going along with their proposals even at the expense to the corporation.

Duties Owed (cont)

Duty of Due Care

Duty to inquire, examine, attend meetings (no duty to make it more profitable)

-Must object, resign, or sue

1. **Duty to monitor**- Directors have a duty of care to be well informed about the corporation's general operations.

-In CHCs, this is a relatively simple since directors are often the SHs and workers of the corp.

-In PTCs, this is more difficult so the rule has developed that bds must create:

RSBL monitoring devices, geared to the particular corp.'s business (maximizing)l that allows info to move downstream and upstream.

-If the board has developed such a system, the Cts. will give **BJR deference to the monitoring decision and directors will not be liable for wrongdoing of which they were not (nor should've been) aware.**

2. **Duty to investigate:**

Efficient Market Hypothesis-states that a market w/ complete accessible info will price sec's at their real value. The criticisms of the hypothesis in relation to the actual markets include:

-Lack of complete and accessible info.

-Ability of certain investors to manipulate the market

Issues of psychology such as rationality and the endowment effect that inhibit rational choice

-Differences in analytical outcomes concerning existing info among diff. investors, etc.

***Note: Exculpatory Clause**- limits or eliminates bd. members liability in damages for good faith breaches of duty of care, and can still be liable for conscious disregard.(statutory or corp's adopted provision)

Duty of Good Faith

Duties Owed (cont)

Duty of Utmost GF and Loyalty

Controlling Shareholder Duties

ex) 1. If SH actually controlled the actions of the board, 2. Transfers control of corp. to a looter, 3. In selling corp. asset.

CHC SHs have been held to have duties similar to partnership-like, broad duties tempered by right of selfish ownership:

1. If wronged by a maj. (or min.), wrongdoer can show:

2. There was a **legitimate business purpose** for the action.

3. Once shown, injured party may show that the purpose might have been achieved by a **less harmful alternative.**

-Controlling SH selling shares at a premium is permissible, liquidation of corp is not by itself harmful to SH.

***K to replace the board**- sale of office is impermissible, but SH can replace directors if SH interest make it possible.

Contractual Duties

Corp. fiduciaries owe only contractual duties to creditors. There are no duties beyond what is in the K. "Other constituency" statutes permit (not require) creditors to be considered when fiduciaries make decisions.

Preferred Shareholders (PS) hold a place b/w SHs and creditors. Specific rights of PS are established in the articles of incorporation, and as to them, fiduciaries owe K-like duties. For all other issues, PS have the same rights as SHs and are owed the same duties. Charters often provide modifications for preferred SHs in areas such as dividend or liquidation preferences and reduced voting rights.

-A more subtle modification involves the callability of preferred shares (see Zahn).

Duties Owed (cont)

No Duty

Traditional rule was that controlling SHs had no duty to the corp or to the other SHs.

In CHCs, more recently the courts have held that SHs owe each a duty of utmost good faith and loyalty tempered by the rights of selfish ownership.

Lastly, new theory that even in PTCs, while they may act in their own self interests, controlling SHs may not take action designed to specifically injure the other SHs.

Serving Other Constituencies

Corps have been obligated to pursue wealth maximization.

Nevertheless, have been permitted rsbl charitable contributions and the provision of benefits for workers.

-These were justified by the goodwill and efficiency they generated leading to greater corp. profit.

-Charity was also justified b/c corporation are public citizens and the responsibility of much of the nation's wealth, replacing individual philanthropists.

-Many states passed statutes permitting charitable contributions. SEveral states have also adopted "other constituency" statutes which permit (not require) boards to consider the interests of works, suppliers, lenders, local communities, etc. without incurring liability for making such decisions.

-Critics say these statutes give boards even greater power to justify anything they decide to do.

Duties Owed (cont)

Corporate Waste

A concept that goes beyond merely fiduciary duties. It involves a Corp's decisions (or inactions) that are so egregious that no reasonable board could have taken (or failed to take) them. It entails the exchange of a corp asset for consideration so disproportionate that no rsbl person would make the exchange.

Usually involves disloyalty, gross negligence, or bad faith but does not require any of them in order to find waste.

Standard of Review (BJR/EF)

BJR

Goal is to allow fids. to act and take entrepreneurial risks w/o fear of the SHs or cts. second guessing them.

BJR Procedural

1. **Rebuttable presumption** that the bd. (or other fiduciary) has made a decision in good faith, in due care, and without conflict of interest.
2. **The burden is on the Pl. to show bd breached duty,**

BJR Substantive

If not rebutted, the rule substantively protects the action/decision unless it is one that no rsbl bd could have made, that is unless the decision is arbitrary or an abuse of discretion

In PTC's: Courts will not interfere in the absence of conflicts of interest, an attempt to freeze out a minority SH, or a situation where there is no rationale to support a decision to declare a dividend.

BJR Examples

Parent-Subsidiary transactions: Not enough to trigger EF, must show more to show that parent took a benefit at the expense of the minority.

Standard of Review (BJR/EF) (cont)

Entire Fairness Test

If FD presumption is rebutted and FDs are breached, the burden shifts to the fid. to justify action by showing that the action/decision was completely fair to the corp. at the time it was taken.

-This requires a showing of fair dealing and fair price (but this is only a subset of entire fairness).

1. Fair Dealing:

2. Fair Price:

-If the decision has been sanitized by a full disclosure of the conflict and the transaction and a maj of either the disinterested directors or SHs approved the transaction, the **burden of proving unfairness reverts to the SH**

Corporate Opportunity Doctrine

Duty of Loyalty

Requires a fiduciary to refrain from taking for him/herself an opportunity that ought to go to the corp.

If it came to one in his/her fiduciary capacity

The opportunity is deemed corporate

1. If it came in the fiduciary's private capacity

2. Corp. has a financial capacity

3. In corp's current line of business

4. Oppty is one which the corp has an interest or expectancy

Already having some claim on the oppty or has taken action indicating that it is or will be seeking such oppty.

Corporate Opportunity Doctrine (cont)

*Right of First Refusal

When presented w/ a corp. oppty, a fiduciary must offer it to the corp and fully disclose all pertinent info w/o attempting to influence the board to reject the oppty. so that he/she may personally profit from it. If a maj. of the disinterested directors (or SHs) reject the oppty. after full disclosure, the fiduciary may take it.

If the oppty is deemed corporate, the fid. must disclose it and allow the corp. to pursue it.

Sanitization

3 ways that self-dealing/interlocking directorate transactions may be sanitized

1. Disinterested Directors

Make full disclosure to the bd. material facts (the nature of the conflict)

-If a majority of the disinterested directors thereafter approve the transaction, it is sanitized to the extent that a complaining SH will have the burden of proving any defect in the transaction.

2. Majority of shareholders

Same disclosure, and now an approval of the majority of the SHs. While some states require a majority of the disinterested directors (and other states do not, thereby letting the conflicted SH vote his/her shares) judicial opinions seem to require the approval in GF by the SHs, therefore casting doubt on a transaction approved w/ the aid of the conflicted SH.

If Sanitized

-Burden shifts to Pl. to show transaction was not entirely fair.

-Does not insulate transactions from challenge

Sanitization (cont)

3. Burden of showing it was entirely fair

Traditional showing by fiduciary that the transaction he/she engaged in was completely fair to the corporation at the time it was entered. This may be proved even in the absence of full disclosure but the burden remains on the fiduciary.

Derivative Suit

Direct v. Derivative

Direct-Suit to recover for a specific harm to the PI.

Derivative-Suit to recover for harm to corp. (not including emply. suits)

By a SH(s) on behalf of the corp. to recover a judgment in its favor. The claim injury is to the corp. with the sh's injury being derivative (the SH's stake suffers a pro rata diminution by virtue of the injury to the corp.)The corp. is a nominal def. to give the court jxn over it. The rule is that a SH must make a demand on the bd to bring suit before bringing the suit.

1. SH at the time of the wrongdoing

2. Adequately represent interest of SHs

3. Demand Required

Where demand is made and refused, the plaintiff has conceded that the bd. was capable of making a valid business judgment, and BJR protects the decisions of the board. PI's only recourse is to sue claiming:

Wrongful Refusal-meaning that the rejection itself was the product of a lack of due care, interested directors, or domination of the board's decision.

Derivative Suit (cont)

3. Demand Futility/Excused

The only excuse for a demand is if it would be futile. Then, the SH must explicitly and in detail allege in the complaint why demand would be futile. Futility can be shown when a maj. of the directors are interested in the transaction or where they can not be relied upon to exercise due care where they are dominated by an interested director. -If excused, BJR dna and the pl. may proceed with the suit. However, a bd. may appoint a:

-**Special Litigation Committee (slc)** to determine whether the suit should continue.

Maj. rule: slc's decision is protected if the committee is disinterested and used appropriate procedures.

Min rule: Utilizes the same test as a first step, but the minority rule allows the court to determine whether in its judgment, the suit should continue. This position recognizes the possibility of structural bias influencing outcomes.

Strike Suitor- abuse the process to extract private settlements. Many states have addressed this by requiring settlements to be approved by the court and by instituting security for cost legislation.

Security for Cost- Requires SHs with less than a certain % of shares or less than a certain dollar value to post a bond for the cost of legislation in case it is not successful, thus creating both a new cost for SHs (cost of the bond) and a new liability (litigation costs). This is intended to discourage derivative suits by those with a minor stake in the company but it also discourages suits over legitimate concerns by small SHs.

Failure to meet threshold req's when motion for security is made by def, PI may aggregate the shares of other SHs to meet threshold.

Derivative Suit (cont)

Recovery goes to the corp. rather than the sh, except in rare instances where wrongdoers benefit by an award to the corp.

The real def. may be a fiduciary who has allegedly breached a duty to the corp. or a 3rd party who has allegedly caused it harm where the bd. will not sue.

Shareholder Protective Mechanisms

Proxy

A ONE time transfer of a voting interest from a SH to an agent of the SH who must follow his/her wishes

Used to mean both the written authorization given by a SH to another to vote the SH's shares according to the instruction on the written instrument and to id the person holding the authorization. It is:

1. **Revocable unless it is coupled with an interest**
2. **Valid only for the meeting for which it was given and for no more than 11 months**
3. **Used to secure a quorum at SH meetings and to marshal votes of SHs for the purpose of passing resolutions**
4. **Used in PTCs and CHCs.**

Shareholder Protective Mechanisms (cont)

Shareholder's Agreement

K b/w 2 or more SHs.

It often involves voting arrangements (for each other as directors), buy/sell agreements (for min. to exit the corp. and req. that the corp other SHs purchase shares at pre-arranged price), share transfer restrictions, and dispute resolution mechanisms and are most prevalent in CHCs.

Some states require the existence of an agreement to be adjudicated on the share certificates, particularly if there is a share transfer restriction in place.

CHC SA Importance

-No rdy market for shares so a min. SH is subject to oppression from the maj.

-Despite ct. imposed FDs b/w SHs in CHCs, the oppty to oppress is omnipresent.

-An SA may remove from the maj the availability of several oppressive mechanisms.

-It can bind future boards by giving particular employment, salaries, pensions, and dividends to the SHs, -Appointing neglecting officer: fiduciary duty means K must be read to limit SH right to appt. officers to situations where appointee is faithful, effective, and competent if:

1. If it doesn't harm the public, SHs, or creditors AND
2. If it includes all SHs, OR
3. The min. does not object to it

Shareholder Protective Mechanisms (cont)

Voting Trust

Statutory device arranging SHs transfer of their shares to a trust.

-Trustee is independent from SHs and last for a long period of time and for a wide array of activities.

-The shares will be voted by a trustee who is guided by the terms of the trust agreement, not by the SHs themselves. -The SHs get trust certificates and retain the beneficial ownership of the shares. -Are used to consolidate voting power and to protect the interests of outsiders, typically lenders, who have some interest in the corp.

They are normally limited in duration (usually 10 yrs)

-Utilized in 3 primary situations:

- (1) Donor, often a parent, making a gift of stock to a minor while retaining voting control of the shares,
- (2) Creditor demanding voting control in the event of a default on the creditor's loan, and
- (3) Employers incentivizing employees by giving them a share of the co. w/o giving up voting control.

Cumulative Voting

Only involves voting for a directors

Closely Held Corporation

Piercing the Veil

Piercing the Veil (cont)

Standard Piercing (vertical piercing)

Pierces the barrier b/w a corp. and one or more of its owners, whether individual or corp.

-It permits creditors to access the personal assets of the owners to satisfy claims against the corp.

Enterprise Theory (horizontal piercing)

Involves the relationship b/w sibling corps, not a corp and its owner. The same alter ego theory applies.

-When several corps. are run as one enterprise, as a result of the disregard of corp. formalities, the barriers b/w the corps. in the enterprise will be pierced to treat them as if they were one corp.

-Thus, the assets of all the included would be available to a creditor of one of the corp.

Reverse Piercing

Operates on the same principles as standard piercing. The alter ego theory must be accompanied by some injustice to the injured party other than merely not being able to collect on an obligation.

-Allows an injured party who has pierced a corp. veil to pierce back from the principal to another corp in which the principal owns shares and which is operated as his/her alter ego (although it need have no relationship with the 1st corporation pierced).

-The advantage is that the injured party does not take the principal's shares in the 2nd corporation (which would make the injured party a shareholder of the 2nd corporation and with a lower priority than that of the corp's creditors) but becomes a creditor of the 2nd corp. on equal footing w/ its other creditors.

Piercing is a remedy for outsiders where courts behind the protective shell of corporate existence.

-Where the corp. is merely the alter ego of the SH(s), and no real distinction between the corp. and SH, and where injustice would result from the recognition of the corp. existence, the veil may be pierced.

-**Alter ego status** is shown by evidence of:

1. **Undercapitalization,**
2. **Disregard of corp. formalities** ex) failure to hold meetings, elections, keep records, minutes, resolutions, maintain separate accts, appropriate decision-making process, or
3. **Commingling of funds,** inappropriate withdrawals of funds and running the corp. for personal rather than corp. purposes are also indicia



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Oppression

1. Arises when controlling SH acts to defeat expectations of the minority SHs which formed the basis of participating in the venture.

2. Min.'s reasonable expectation that was known or should've been known to the maj. at the time of entering the venture.

3. Balance b/w the protection of the min.'s interest and maj.'s right of selfish ownership

4. Did the corp. action have a legitimate business purpose that might have been achieved by a less harmful alternative.

If Oppression is found, Courts have many remedies available when SHs shows conditions that would justify a judicial dissolution.

-Risk that the majority would be in the best position to buy up the company's assets upon dissolution
Cts. are reluctant (termination = corporate death) to liquidate going concerns and may use any remedy short of dissolution to achieve a just result, including

REMEDIES

1. Requiring the oppressor to purchase at fair value the shares of the oppressed.
2. Since the maj may have siphoned off corporate value as part of the oppression, the ct. may also award damages for such losses
3. And may protect the rsbl expectations of the min. such as by giving the minority the value of long term employment.
4. The Ct. may also pressure the parties to negotiate a resolution by ordering dissolution unless they reach a settlement by a specified time.

Freeze Out and Deadlock

Ex) Pattern of behavior by the maj. that forms a coherent plan that puts the minority in an economic disadvantage by pushing min. to the margins. Inadequate Price (CAPSTONE)

- | | |
|--|----------------|
| 1. Legitimate business purpose | Burden on Def. |
| 2. Can be achieved with a less harmful alternative | Burden on Pl. |

Corporate Freeze-out (Leader v. Hycor)

- | | |
|---|----------------|
| 1. Legitimate Business Purpose | Burden on Def. |
| 2. Achieved by less harmful alternative | Burden on Pl. |

Hostile Takeovers

No Threat- BJR

Hostile Takeovers (cont)

Threat- Enhanced Scrutiny

-When a bidder makes a hostile offer to a target, it is clear that the bidder believes that the co. is worth more than its current stock price.

-This is either b/c the bidder believes the current mgmt. is not doing a good job or b/c the bidder thinks the co. is worth more broken up than as a going concern. In either case, it is likely that a successful hostile bidder will dismiss current mgmt.

Therefore, mgmt will have a personal incentive to oppose rsbl bids by hostile bidders.

-While this possibility does not rise to a level of conflict of interest, it does justify examining the boards actions in putting defenses in place to thwart a hostile bid.

Intermediate test-b/w BJR and EF requires that the ct. assure itself that:

1. The bd had a rsbl belief that the hostile action posed a threat to corp. policy and effectiveness.

-Proof of this prong is enhanced by the existence of a maj. of outside directors who has a good deal less to lose in a successful bid than the inside directors.

2. Requires that any defenses be proportionate to the perceived threat.

-Means that the defenses need not be unnecessary, but must be within a **range of reasonableness** in relation to the threat.

-Defenses may not be **draconian**--

Preclusive: if the defenses deprive the SHs from voting or receiving other offers or

Coercive: force SHs to accept the bds. position independent of its merits.



Publicly Traded Corporation

CEO v. Board

Technically, the bd sets the policy of the corp. and makes (at least initially) all of its important decisions.

-It hires and sets salaries for the top execs, including the CEO.

-Practically, however, the bd is made up of primarily outside directors who do not spend a great deal of time w/t the corp.

-Given the complexity of such businesses and the number of decisions that have to be made, they are not equipped to solve problems as effectively as the CEO.

-Moreover, outside directors don't have sources of corp. info other than through mgmt.

-These "**structural holes**" allow mgmt., led by the CEO to control the info flow and to characterize info.

Lastly, CEOs are typically the most visible member of the corp. and are in position to control the loyalty of mgmt. and SHs.

Registration

Initial public offering (IPO)

Letter of Intent and Registration Statement

Includes Prospectus, waits for SEC review and approval

Restriction during Waiting period

Can make offers but not sales until over, place ads road shows, no letters, can't give any written material

Corp Liability

Material Misstatement: Strict Liability

Signatory Liability

Attys, accountants, financial analyst: Due diligence defense, but if knowingly states without due diligence

Registration (cont)

Exemption Reg D

Private placement: creates a safe harbor from statutory req. if complies w/ reg D, can seek offers:

-**504**: Unlimited number of accredited investors and the amount of the offering is under \$5mil

-**506**: No more than 35 unaccredited investors and the amount of the offering is unlimited

-Subject to blue sky laws req., don't need to apply

-If private placement is not successful in satisfying Reg. D req's, then opens itself up to potential lawsuits.

Investment Contract

Howie Test

A financial instrument not otherwise listed under the '33 Act is an investment contract and thus a security, when it meets a 3 part test:

1. Investment of Money

2. In a Common Enterprise where

Horizontal Commonality: when there is a pooling of funds from several investors

Vertical Commonality: There is an ongoing relationship in the enterprise b/w an investor and the promotor.

Investment Contract (cont)

3. Profits are to be derived solely from the efforts of others

Williamson test: "Solely" means that the efforts of others must be "undeniably significant"

Ct. looks for the ability of the investor, legally and practically, to control the enterprise by looking at a disjunctive set of 3 factors:

1. Do the org's docs and agreements b/w the parties leave the investor so little control that the investor appears similar in power to a **limited power**?

2. Even if the investor has legal authority, is he/she so inexperienced or unknowledgeable in business affairs (in general-not limited to the business in question) that he/she **cannot intelligently exercise** power, or

3. Even if he/she is experienced and knowledgeable in general, is the investor **so dependent** on some **unique entrepreneurial or managerial ability** of the promotor so that the promotor cannot be replaced?

If any of these factors is applicable, the 3rd prong of the basic test is met.

Insider Trading 10b, 10b-5

Insider Trading

Missappropriation Theory

When someone who has been given trust or confidence to material, non-public information, with a fiduciary or fiduciary-like duty to the source of information, breaches that duty if he/she does not disclose that he/she will trade on the market based on that info.

Insider Trading 10b, 10b-5 (cont)

Tippor/Tippee

The liability of tippees is a derivative of that of the tipper.

Tippees are liable when they derive their info from one with a duty to the corp(s) in whose securities they are trading (insider/temp.insider) or to the source of the information (fiduciary/fiduciary-like).

Tippor must have breached that duty and derived some benefit, pecuniary or non-pecuniary, for giving the tip.

The tippee must know or should've

known about the original tipper's breach.

The same set of rules apply down the chain of knowledge of sub-tippees.

Proxy Solicitation Reg. 14

Materiality

Any information that a reasonable person would consider important in deciding how to vote.

Opinion- To prove it was material, Pl. must prove opinion was based on false belief and false underlying facts that support Def's false belief

Proxy Solicitation Reg. 14 (cont)

Causality

Assuming a misleading, material misstatement or omission in a proxy solicitation, the Pl. must show causality. As this often involves millions of SHs, the evidentiary task would be overwhelming if not impossible. The court has developed a bright line test concerning causality:

1. Solicitation itself is an essential link in the outcome. If procured by fraud vote of the maj. is worthless.
 2. Where proponent did control sufficient shares for approval, VBI left open the possibility that something other than voting (by addressing Pl's arguments that there was some other benefit derived by the solicitor in seeking proxies not necessary to carry the vote) could be an essential link
- Such as loss of a state law right, but not bd. avoidance of SH ill will

Mergers

Merger

The combination of 2 corporations and the disappearance of at least 1 of them.

-Requires the votes of the boards and of the SHs of both corps.

-A certificate of the merger must be filed with local authorities to consummate the transaction.

-The resulting corp. has all of the assets and liabilities of each of its constituents.

Mergers (cont)

Sale of Assets

-A sale of assets doesn't affect the organic status of either the purchaser or the seller. Both continue to exist in their original form. The buyer might not want the seller's liabilities or its personnel.

Instead it purchases only the assets but may accept selected liabilities as part of the transaction. No vote of the buyer's SHs is required to approve a purchase.

-A seller may want to dissolve an dsell its assets prior to doing so. A vote of its SHs is necessary for both the sale and the dissolution. However, the seller need not dissolve and may use the consideration it received (often cash) for its assets and buy new assets or shares in other companies. Therefore, it might stay in business as an operating co. or holding co.

De Facto Merger

1. Assets of sales is the functional equivalent of a statutory merger, then the ct will impose the merger voting rights to the SHs (this is jurisdictional)

1. Did it change the essential nature of the business

2. Did the transaction alter the fundamental relationships between the SHs themselves and between the SHs and the corp?

If so, then SHs must be given chance to vote for the merger or get appraisal rights.

Mergers (cont)

Short Form Merger (sfm)

- Statutory device where a parent who owns at least 90% of a sub can merge w/ the sub w/o the formalities of a traditional merger.
- Since the goal of sfm statutes is speed and cost efficiency, the bd of the parent merely needs to adopt a resolution approving of the merger and including the terms.
- No vote is required by the sub's board or minority SHs.
- After the merger, the parent must notify the sub's SHs who are entitled appraisal rights.
- B/c there is no interaction w/ the sub in negotiating the merger, entire fairness (fair dealing and fair price) is not applicable.
- The sub's SHs sole remedy is appraisal to set the fair price.

TAKEOVERS

Key Terms

Golden Parachute

- Provides mgmt. with a significant severance package, typically to protect mgmt. from loss of job due to hostile takeover.
- Advantages to SHs:**
- A GP is an inducement for talented execs to join the co.
- Importantly, it may mitigate mgmt's conflict in the face of an offer by a hostile acquirer that would cost managers their jobs
- Managers are more likely to accept a fair offer if they know they will receive the lucrative package if they are fired.
- Thus, SHs are more likely to get the benefit of a fair premium in a takeover.

Key Terms (cont)

Poison Pill Types

1. Defensive device used by a target to make hostile takeover less attractive
 2. Offer shareholders other than raider a dividend in form of a non-transferable right.
 3. If triggered, right entitles holder to purchase heavily discounted shares of target (flip in) or opt to sell shares back to target for a premium price.
 4. Trigger usually is a raider obtaining a percentage of target's stock.
 5. Alternatively, right could entitle the holder to purchase heavily discounted shares of the raider (flip over) in the event of a merger of target and raider.
 6. In both cases, the pill intends to dissuade the raider from proceeding due to the financial harm to itself or its SHs, either the dilution of its shares in the target or the dilution of its own shares in the raider or the depletion of net assets of target.
- PP's must be redeemable: no **dead hand** (bd at time of pill in place or bd-approved directors are only ones to redeem pill) or **no hand** (non-redeemable for a period of time after merger, reducing economic viability))

A's Strategy for Poison Pill Redemption

- Normally, the pills are redeemable at a low price by T's board prior to triggering.
- A's seek to avoid triggering the pill and buy T shares up to just below the triggering threshold.
- Then, at T's next annual meeting, A will institute a proxy fight to take control of T's board.
- A will solicit T's SHs by stating that, if successful, A will redeem the pill and effectuate the merger.
- If its terms are sufficiently enticing, enough SHs will vote for A's board for the pill to be redeemed and the merger consummated.

Revlon Triggers

1. Change of Control
3. Initiating a bidding war
2. Break up of a corp.
4. Abandoning long term strategy

Target's board must treat all acquirers equally

1. **Must take steps to increase consideration** given for that target's shares and
 2. **Must remove all defensive measures** except those that can be used to increase the bid
- Usually when the target's board reasonably believes that the bidding has reached an apex and using a protective device will coax one final higher bid.

Duty of Maximization

1. When consideration is cash, the target's bd is charged with obtaining the **highest price** for SHs
 2. When consideration is other than or in addition to cash, the bd is charged w/ obtaining the **highest value** per share.
- In deciding what is the highest value, the bd. may attempt to quantify the various aspects of consideration but may also consider long term value for SHs when the consideration includes shares in the merged co.
 - The bd's decision on these issues will be judged by **Unocal's Enhanced Scrutiny Std** and the bd. will be charged w/ reaching a rsbl, as opposed to perfect, decision
 - *Note: This applies when T has deal protection device

Reasonable Threats

1. Inadequate Price

Reasonable Threats (cont)

2. Structural coercion

Two-tiered, front loaded offer:

Tactic used by an acquirer in a hostile takeover attempt.

-In the 1st tier will offer the SHs of target a price in a tender offer that is somewhat above the market.

-Acq. seeks to obtain enough shares in the 1st tier to gain control of target.

-2nd tier is a merger in which the remaining SHs will be cashed out at a price somewhat lower than the 1st tier tender price (although even this price is likely to be at least at the market level.

Otherwise, it could be attacked as inadequate.

-2nd tier may be financed with junk bonds of dubious value and marketability.

-Concept is coercive b/c SHs who don't have enough shares to influence the outcome of the tender offer will fear that if they don't tender, others will and the offer will be successful even if they believe the first tier price, while above above market, is not the true value of the target.

-The shareholders who didn't tender will be left with the less appealing 2nd tier price.

3. Substantive Coercion

Timing of the offer, not reflective of actual price

4. Opportunity Costs

Proportional Threat: Unocal/Unitrin/Omnicare



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